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Governing Law Issues in International Financial Transactions

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Although in theory parties to a contract are free to choose any one of a number of systems of law as the law that is to govern their legal relationship, in practice the parties' choice is likely to be confined to either: the municipal law of the territory in which one of the parties is domiciled or operates; the system of law that is customarily chosen to govern contracts of a similar nature in accordance with trade or market usage; or the neutral system of law that the parties agree shall be the governing law.[1] In international financial transactions choices of governing law may depend on whether finance is being raised in a specific capital market or through bilateral negotiation between the lender or lending syndicate and the borrower.

Loans raised in specific capital markets will be evidenced by loan agreements and other debt instruments governed by the system of law that customarily governs transactions in the relevant market. In other cases normally the lender determines the choice of governing law, which is most frequently the law of the lender's domicile. The main exception to this rule is a loan made by a multilateral institution such as the International Bank for Reconstruction and Development (IBRD) or one of its regional offshoots, whose agreements may be governed not by a specifically

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1. For a good general review of the issue, see PHILLIP WOOD, THE LAW AND PRACTICE OF INTERNATIONAL FINANCE chs. 1-2 (1986).

chosen municipal law, but by what might be loosely termed "public international law." This type of agreement may be indicated by either a positive statement such as one confirming the applicability of "general principles of law," or a negative statement (as in the case of the IBRD) that the rights and obligations of the parties under the loan agreement shall be: "valid and enforceable in accordance with their terms notwithstanding the laws of any State or political subdivision thereof to the contrary."[2] This article focuses on financial transactions in which the express choice of a specific municipal governing law is customary. First, it examines current practice, both in capital markets and in other forms of lending. Second, it sets out arguments for and against current practice. Third, it analyzes the internationalization of municipal law and legal practices. Fourth, it evaluates the importance of legal opinions regarding the validity and enforceability of the provisions of a loan agreement. And finally, the article sets out the author's conclusions regarding the issues raised.

I. Current Practice

A. Capital Markets

The lending of Eurodollars, traditionally defined as dollars held in the form of deposits with commercial banks outside the United States (but which can now include deposits held within the United States) commenced around 1950, but the Eurodollar market really took off in the mid-1960s. The 1970s saw the emergence of different types of loans, such as stand-by facilities and revolving credits, and an increase in syndicated lending. The latter half of the decade also brought an increased emphasis on lending to public sector borrowers: states and state agencies and instrumentalities. Lenders felt lending to public sector borrowers constituted a low risk (and often high yield) investment. This feeling was based on the belief, which was of course later exposed as a myth, that sovereign states would not default on their debt service obligations to major international banks.

Eurocurrency lending has developed a number of features characteristic of the particular market in which Eurocurrency loans are made or traded. Two of the most important are: (a) the floating interest rate, calculated by reference to a specified deposit rate such as the London Interbank Offered Rate; and (b) the development of a secondary loans market in which loans are transferred or "sold down" from the original lenders or syndicate participants to other financial institutions, whether before, during, or after the drawdown of funds.

The evolution of Eurocurrency loan documentation has been much influenced by the need to ensure that such documentation allows lenders the maximum possible flexibility to trade their loans in the market. At the same time such documentation must afford the original lender and its successors in title the best

2. *See* the general Conditions applicable to Loan and Guarantee Agreements of the International Bank for Reconstruction and Development (Jan. 1985) § 10.01.

possible protection against all foreseeable risks associated with margins of profit, which can be perilously small at times.

In this environment technical competence, and above all, drafting skills, are at a premium. Most English and U.S. lawyers consider it a happy coincidence that virtually all documentation in the major financial markets is governed either by English law or by the laws of one U.S. state or another.

B. Project Financing

Other forms of lending are available that generally are unrelated to specific financial markets. Arguably the most important of these is project financing, some of which is raised on capital markets, but much of which is raised either from specialized funding institutions, such as bilateral and regional development banks, or directly from commercial banks either individually or in syndicates.

No theoretical reason explains why loan documentation evidencing project financing should not be susceptible to secondary market trading, but in practice specific features of project-related financings often make them unsuitable for subsequent assignment or transfer. Consequently, loan and facility agreements relating to project financing tend to be governed by the law of the lender's domicile. Nevertheless, some subsidiary documentation may be governed by other laws, for example, security documentation relating to immovable property, which will be governed by the place in which the property is situated (lex situs). As a general rule, however, regional financial centers will provide commercial loans for major international projects, documentation for which is likely to be in the English language and governed by one common law system or another. Therefore, the dominant legal systems of the international financial community are those of the United Kingdom and the United States, and the dominant legal influence is that of English and U.S. lawyers.

II. Arguments for and Against Current Practice

A. Arguments for Current Practice

Domination by one or two specific systems of municipal law leads to uniformity of documentation and practices. It also allows potential lenders and borrowers to readily identify the "magic circle" of practitioners skilled in the particular area of financial work in which they need assistance. The tendency of large firms with international reputations to dominate legal work in these areas also allows them to build ancillary skills and areas of knowledge, for example, environmental law or intellectual property rights, specifically designed to meet the needs of lenders and investors.

1. *Certainty*

The constant use of one particular governing law enables all participants to predict with a reasonable degree of certainty the likely terms and conditions

applicable to loan documentation. Additionally, a high degree of standardization inevitably results, which produces generally accepted solutions to problems arising in the normal course of investment activity and allows more negotiating time to be spent on those aspects that are peculiar to the specific transaction.

2. *Flexibility*

The lack of codification and the cultural bias towards freedom of contract, which are hallmarks of common law systems (though perhaps less so nowadays), allow agreements subject to those systems to be continually modified and improved as new legal problems are identified and new solutions found. The use of one or two basic systems that are continually developed by practitioners also allows the documentation to keep pace more easily with developments in the market (for example, the use of swaps and of financial derivatives such as futures and options). Additionally, the use of one or two basic systems allows practitioners to develop universal models for transactions, such as the standard terms and conditions of the International Swaps Dealers Association.[3]

3. *Uniformity of Law and Banking Practice*

Historically, since World War II banks and financial institutions from the United States and other English-speaking countries have dominated financial markets. Banks from other leading industrial nations have found it necessary to establish strong financial market operations in London and New York and to adopt local custom and usage. Logically, this same rationale should apply to the language of the legal documentation and the choice of governing law.

B. ARGUMENTS AGAINST CURRENT PRACTICE

1. *Documentation*

Although the core of the standard Eurocurrency-type loan or facility agreement is quite logical and comprehensible, most lawyers from civil law countries find the documentation extremely long and some of the provisions dealing with what appear to be peripheral matters overly complicated. The lack of a background of codified law encourages common law practitioners to identify and deal with every perceived threat to their clients' interests within the document itself. The result is that documents sometimes appear, in the words of one recent commentator, to "degenerate into an elaborate enumeration of worst case scenarios."[4]

One example of this type of provision is the "market disruption" clause that deals with the situation where the loan interest reference rate, for example, the

3. Agreement on Interest Rate and Currency Exchange, 1992.
4. PADAZIS KARAMANOLIS, THE LEGAL IMPLICATIONS OF SOVEREIGN SYNDICATED LENDING 279 (1992).

LIBOR rate, ceases to be quoted as a result of disruption in the money market. This clause usually stipulates at greater length how, in such a situation, the lender and the borrower will attempt to agree to a substitute interest rate. However, the crucial part of the clause is the one or two lines providing that in default of agreement the borrower must either pay the rate stipulated by the lender or prepay the loan. In this context the biggest issue—if the money markets are not functioning, how can the borrower obtain new financing with which to pay off the existing loan?—is not and cannot be covered.

2. *Self-Perpetuation*

The concentration of all legal activity around one specific system of law over a period of time results in the increasing entrenchment of that system. This tendency is exacerbated in a sophisticated and fast-moving environment where large numbers of highly skilled legal draftsmen are reducing ever more complex and intricate concepts to writing. Of course, advocates of the existing situation would reply that nothing is intrinsically undesirable in this situation if the chosen legal system is that which is the most suited to the relevant transactions.

3. *Cultural Ring-Fencing*

Lawyers trained in, for example, the London market have a natural tendency, and some would argue, even a need, to ensure that their approach to documenting and negotiating financial transactions in Hong Kong or Singapore, for instance, shall be consistent with the approach taken in London. This might be termed the "macrocultural imperative." Additionally, where those practitioners are in fact members of a law firm based in London and are seconded to a branch office of that law firm overseas, they further tend, and some would say need, to ensure that the drafting and conceptual approach, including style, adopted by the branch office, should be entirely consistent with that of the head office.

This might be termed the "microcultural imperative." The normal manifestations of this tendency would be a high concentration of lawyers from the home office spending two or three years in the overseas office and then returning home, and the use of virtually identical precedents in each of the offices for the drafting of documentation. From the viewpoint of consistency and the maintenance of uniformly high standards, this degree of standardization and cultural infiltration is extremely important. The cities used in the examples given, in any event, share a common legal heritage and culture. In addition, English law is the "mother law" of many financial centers. Thus, the case that can be made for English law as a universal law of the major Asian financial centers is, at least in the view of most English lawyers, much stronger than the case that can be made for U.S. law.

Nevertheless, a degree of intellectual and cultural rigidity inevitably results, as it does in any business structure in which the corporate culture is determined by the head office and applied throughout the various branch offices. Yet, this

rigidity is not essentially a legal problem. The lawyers are simply following the practice of the markets in which they operate. If market culture changes, the relevant legal culture will change with it.

III. Internationalization of Municipal Law and Legal Practice

As seen above, one of the claimed advantages of choosing a specific system of law as the governing law of an agreement is the degree of certainty it introduces to the application of the terms and conditions of the agreement. Another is the degree of predictability of the legal principles on the basis of which these terms and conditions will be construed and enforced. That certainty extends not only to the construction and interpretation of the agreement itself, but also to the enforcement by the parties of their respective rights and remedies. However, new extraterritorial elements have intruded into some key municipal legal systems in recent years. To illustrate that point, this part of the article focuses specifically on English law and examines briefly some recent developments.

A. Supranational Laws

Legislators have been obliged to make numerous changes to existing English law as a result of the requirement to enact European Community (EC) legislation. Two examples are discussed: the Contracts (Applicable Law) Act 1990 (1990 Act) and the Civil Jurisdiction and Judgments Act 1982 (1982 Act).

1. *The Contracts (Applicable Law) Act 1990*[5]

The 1990 Act brings into legal force the provisions of the Rome Convention of 1980,[6] which was intended to ensure that the courts of all EC countries would apply the same criteria in determining the applicable law of contracts. Some English commentators believe that the Rome Convention strikes at the heart of the English concept of proper law.[7]

In general terms, the Convention provided that a contract is to be governed by the law chosen by the parties. If no applicable law has been chosen, the law of the country with which the contract is "most closely connected" will govern the contract.[8]

The Rome Convention[9] (and therefore the 1990 Act) excludes a number of matters particularly relevant to financial transactions. These include: obligations

5. Contracts (Applicable Law) Act 1990 (1990 C 36) (available in 11 HALSBURY'S STATUTES 237 (1991)).

6. Convention on the Law Applicable to Contractual Obligations, June 19, 1980, 1980 O.J. (L 266) 1 [hereinafter Rome Convention of 1980].

7. *See, e.g.*, Brian Davenport, *Proper Law Now Not So Proper*, 6 BUTTERWORTHS J. OF INT'L BANKING FIN. L. 157 (1991).

8. *See* Rome Convention of 1980, *supra* note 6, arts. 3-4.

9. *See id.* art. 1.

arising under bills of exchange, checks, promissory notes, and other negotiable instruments to the extent that such obligations arise out of their negotiable character; matters relating to the constitution of trusts and the relationship between settlors, trustees, and beneficiaries; and matters governed by the law relating to companies and corporate bodies.

At first glance the provisions of the Convention appear rather similar to the applicable principles of English law before the 1990 Act came into force, but some commentators believe that the differences are significant. For example, article 3(1) of the Rome Convention provides that the choice of a specific governing law by the parties must be "expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case." The Giuliano-Lagarde Report,[10] on which the Convention was based and which is an officially sanctioned guide to the interpretation of the Convention, comments that the court may find that the parties have made a real choice of law "although this is not expressly stated in the contract." One commentator has suggested that this appears to require a civil law approach to interpretation rather than a common law approach.[11]

Again, the "close connection" test, used when the parties have not chosen an applicable law, appears very similar to the previous English law rules that the contract shall be governed by the legal system with which it has "the closest and most real connection."[12] However, article 4(2) states that the contract is presumed most closely connected "with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of the conclusion of the contract, his habitual residence or, in the case of a body corporate or unincorporate, its central administration."[13]

The Convention does not attempt to interpret the phrase "characteristic of the contract," and article 4(5) provides that article 4(2) "shall not apply if the characteristic performance cannot be determined" and shall be disregarded "if it appears from the circumstances as a whole that the contract is more closely connected with another country."[14] Consequently, previous English case law must be put back "in the melting pot" until new rules of interpretation emerge.

The provisions of the Act leave many unanswered questions. However, the salient points seem to include:

(a) the provisions of the Rome Convention, with regard to relevant contracts made after April 1, 1991, are now part of English law;

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10. Report on the Convention on the Law Applicable to Contractual Obligations by Mario Giuliano, Professor, University of Milan, & Paul Lagarde, Professor, University of Paris I, Oct. 31, 1980, 1980 O.J. (C 282) 1, 17.

11. Davenport, *supra* note 7, at 158.

12. *See* 2 DICEY & MORRIS, THE CONFLICT OF LAWS 1161, 1190 (11th ed. 1987) (rule 180 and, particularly, subrule 6).

13. Rome Convention of 1980, *supra* note 6, art. 4(2).

14. *Id.* art. 4(5).

(b) in the absence of any express choice of governing law, the provisions of the Convention must be applied to determine the law of any contract to which the Convention applies and not previous English case law; and
(c) for those contracts to which the Rome Convention applies, and subject to any practice developing in the English courts of using article 4(5) as an escape route back to pre-Convention law, an English statute will be at least partially interpreted not by reference to English case law, but to a report published by lawyers trained in other jurisdictions some ten years before the Act passed into English law.

The above reflections are intended as observations and not as howls of chauvinistic rage. No specific comment is made about the relative merits of the provisions of the Act and those of previous English law. However, the vehemence with which leading English commentators, including Lord Wilberforce, have criticized the provisions of the 1990 Act clearly indicates the significance that they see in its enactment.

2. *The Civil Jurisdiction and Judgments Act 1982*[15]

The 1982 Act incorporates into English law the provisions of the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters 1968.[16] The Convention (as subsequently amended by the Lugano Convention of 1988[17]) lays down rules governing the jurisdiction of the domestic courts of Member States and provides that recognition and enforcement of judgments of such courts are to be automatic.

The 1982 Act has introduced a new concept of domicile into English law. Traditionally, English law considers the person as being domiciled in the country in which he is considered to have his permanent home, and a corporation is domiciled in the country under whose law it is incorporated. Under the 1982 Act, an individual is domiciled in a particular jurisdiction if he is a resident and has a substantial connection with that jurisdiction. In the absence of proof to the contrary, residence for three months is presumably to be a substantial connection. A corporation is domiciled where it has its seat. Under the 1982 Act, a corporation has its seat in a particular jurisdiction if it was either incorporated or formed under the law of that jurisdiction and its registered offices or some other official address is there, or its central management or control is exercised in that jurisdiction.

This may or may not constitute a significant change to the previous English law. However, once again the old law has been changed by the direct enactment of a Convention that not only predated the Act by some fourteen years, but that

15. Civil Jurisdiction and Judgments Act 1982 (1982 C 27) (available in 22 HALSBURY'S STATUTES 379 (1991)).
16. 1969 E.C. BULL. SUPP. 2, at 17.
17. Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, authorized for signature at Lugano 9 Sept. 1988 and signed 18 Sept. 1989, 1988 O.J. L 319.

predated the United Kingdom's accession to the Treaty of Rome. Moreover, in interpreting the Convention the English courts must, by statute, "take account of any principles provided by any other Lugano Contracting State concerning the provisions of the Convention"[18]—in other words, principles of civil law.

B. Cross-Border Issues—Where the Law of the Contract Has to Take Account of Local Law

Although the parties to an agreement can expressly choose a specific system of law to govern their agreement, it cannot govern all aspects of that agreement. For example, a specific system of law cannot govern the legal validity aspects, that is, the legal capacity of the parties to enter into and perform their obligations under the agreement, the due authorization of the transaction, and the due execution and delivery of the documentation. Again, if the borrower goes into liquidation or becomes insolvent, or a receiver or administrator of the borrower or its assets is appointed by a court, legal issues arising as a result of that action will be subject to the laws of the borrower's country of incorporation.

In the case of English borrowers, therefore, the provisions of the Insolvency Act 1986[19] cut across the strict legal rights and remedies of lenders under a loan agreement. In the United States, the same can be said of title 11 of the Bankruptcy Reform Act of 1978,[20] which allows the debtor company to seek the protection of the court during a period of financial reorganization.

Under the Insolvency Act 1986, the debtor, its directors, or its creditors can seek an administration order resulting in the appointment of an administrator who effectively takes control of the company. Once an administration order is in force:

(a) a company may not be placed in liquidation;
(b) a secured lender to the company may not appoint an administrative receiver, notwithstanding that the lender will almost certainly have given itself the right to appoint such a receiver in the relevant charge document;
(c) no legal proceedings may be commenced or continued against the company without the administrator's consent or that of the court; and
(d) no charges over the company's assets may be enforced and no goods supplied to the company recovered except with the consent of the administrator or the court.

On the other hand, the administrator may sell assets subject to a charge in favor of a lender without the consent of that lender, although he must account to the chargee out of the proceeds of sale. Clearly, these powers directly cut across

18. Civil Jurisdiction and Judgments Act 1982 (1982 C 27) § 3B(1) (available in 22 HALSBURY'S STATUTES 384–85 (1991)), *amended by* Civil Jurisdiction & Judgments Act 1991 (1991 C 12) § 1(1) (available in 22 HALSBURY'S STATUTES 474 (1991)).

19. Insolvency Act 1986 (1986 C 45) (available in 4 HALSBURY'S STATUTES 717 (1991)).

20. Bankruptcy Reform Act of 1978 (codified at 11 U.S.C. §§ 101 to 151326).

those powers that lenders have taken to themselves under the provisions of loan agreements and security documentation.

C. Strict Liability Laws—A Look at Environmental Legislation

The parties to a contract cannot, except to a very limited degree, use contractual devices such as warranties, representations, and indemnities so as to avoid those local laws that contain elements of strict liability such as environmental laws. Lawyers acting on behalf of lenders will be particularly concerned with "lender liability." This phrase refers to the enactment of legislation that effectively places lenders in the shoes of the borrower for liability for breaches of environmental legislation. The concept of lender liability for the costs of cleaning up polluted sites and for damages arising from the escape of hazardous substances has been recognized in the United States for some years and enshrined in the Comprehensive Environment, Response, Compensation and Liability Act of 1980 (as amended).[21] This Act established both a Fund (the Superfund) and an Agency (the Environmental Protection Agency) to facilitate the cleanup of affected sites.

The legislation exempted from liability a person who without participating in the management of the site has acquired an ownership interest as a means of security (the so-called "secured lender exception"). However, lenders have still become liable as owners of facilities when acquiring legal title for the purposes of selling assets in the course of realizing their security. Lenders have also become liable as operators of facilities by reason of becoming necessarily involved in the borrower's operations, and consequently, its management.

In England, under the Environmental Protection Act 1990,[22] a lender may become liable for the costs of cleaning up a polluted site, or of waste disposal, on similar grounds, either as the owner of assets by virtue of having taken steps to realize the security or as the producer of waste. Additionally, in the United Kingdom and throughout the European Community the 1985 Single European Act includes a chapter on the environment (title VII).[23] In 1990, a Council Regulation established the European Environment Agency to gather data for future Pan-European legislation.[24]

A number of draft directives and directives have been or will be produced as a result. These directives will give rise to the usual problems of interpretations as between different Member States, particularly where civil law concepts are introduced into common law systems. Again, much will turn on the interpretation of words and phrases such as "ownership," "actual control," "occupier," and

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21. Comprehensive Environment, Responses, Compensation and Liability Act of 1980 (codified as amended at 42 U.S.C. §§ 9601-9657.

22. Environmental Protection Act 1990 (1990 C 43) (available in various sections of HALSBURY'S STATUTES (1991)).

23. Single European Act, tit. VII, 1987 O.J. L 169.

24. Council Regulation 1210/90, 1990 O.J. L 120.

"operator." A fundamental difference of approach between current English "fault-based" liability provisions[25] and the proposed European "no fault" liability approach[26] (which incidentally does not as yet incorporate any "secured lender exception") also appears to exist.

Thus, lenders will need to consider a number of due diligence issues irrespective of the governing law of the contract, under the law of the place where the potential hazardous facility is situated, including potential lender liability; whether such liability is strict; whether the borrower can insure against potential claims, and if so, whether the borrower has a suitable policy; whether the borrower is actively seeking to minimize its risks, for example, by having regular "eco-audits"; whether the borrower has entered into suitable warranties in relation to environmental matters; whether the lender has organized a visit to the borrower's premises by suitably qualified and experienced staff or consultants, and received a report of that visit; whether the records have been checked, for example, with the local health and environmental authorities and the local courts; and the potential adverse effect on the value of real property taken as security if it is contaminated or the risk of its becoming contaminated is legitimate. In fact, irrespective of the law of the contract, lenders will need to constantly monitor the effect of local legislation on the market value of every site included in the borrower's operations, particularly where such sites represent secured assets.

D. Alternative Dispute Resolution

Alternative Dispute Resolution (ADR) is an informal alternative to court proceedings and involves direct dealings between the parties and their respective lawyers with an independent neutral playing the role of moderator or mediator. The process is normally undertaken by the parties without prejudice to their respective legal rights. However, advocates of the ADR system point out that the likely outcome of the process is that either the parties will arrive at a negotiated settlement, with the help of the neutral advisor, or, alternatively, the likely outcome of legal proceedings will become clear in the course of the exchange of legal arguments, which might lead to a partial settlement or facilitate a subsequent settlement of the dispute.

ADR may initially seem more suited to disputes between, for instance, sellers and buyers of goods, where differences of opinion may arise over such matters as the quality of the goods, rather than investment disputes, which normally concern the failure of one party to honor payment obligations that are quite specific and unambiguous. However, advocates of ADR point out numerous situations in which ADR may be suitable.

25. *See, e.g.*, Environmental Protection Act 1990 (1990 C 43) §§ 33 and 34 (available in 35S Halsbury's Statutes 145 (1991)).

26. The proposed European "no fault" liability approach is still in draft form and is subject to change.

For example, disputes as to the apportionment of the loss may arise in the situation in which a bank and its customer are both victims of a fraud perpetrated by a third party, based, for example, on the interpretation of a mandate or questions of constructive trust. Such complex legal issues would be expensive to resolve in court proceedings and might be more easily resolved informally via the ADR system. Additionally, disputes or questions of interpretation arising between different banks involved in syndicates, which cannot be immediately settled, might be better negotiated through an ADR procedure rather than litigated in public court proceedings. ADR procedures have in fact been used in the United States in similar circumstances to those described above and have been found workable.

Of course, ADR procedures in no way replace the governing law of the contract, and parties to ADR will base their arguments on the true construction of the contract pursuant to the applicable law in the same way as parties to litigation proceedings. However, ADR is not an adversarial system, and, therefore, does not encourage parties to take extreme positions at the beginning of the dispute in order to make concessions at a later stage. The adversarial approach may be tactically correct, but it is by definition expensive. While the vast majority of litigation is settled before the trial commences, frequently at the door of the court, liability to pay counsel's fees for at least part of the court hearing has already been incurred.

Why does ADR effectively derogate from the governing law of the contract since it is accepted that parties to ADR will apply the law of a contract in the same way as parties to litigation? The answer is that because of the nature of ADR the tendency is to rely less on the strict application of the rights and remedies of the parties and more on the application of universal principles of justice and equity, which might involve one or both parties compromising these rights and remedies. Where the parties are domiciled in two different legal jurisdictions, and the mediator possibly in a third, the chances of the final settlement embodying elements foreign to the law of the contract must be far from remote.

IV. Legal Opinions

A financial transaction is as strong as its weakest link. From a legal point of view the weakest link is the legal opinion given by lawyers from jurisdictions other than that of the governing law as to the validity and enforceability of the provisions of the loan and security documentation in those jurisdictions. Legal opinions may be required not only from the borrower's lawyer, but also from that of the guarantor (who may be incorporated in a different country) and also from a lawyer in any jurisdiction in which assets are situated over which security is taken.

Legal opinions are vital to establish the proper authorization of the transaction by parties other than the lender; the due execution and delivery of documentation by those parties; the requirement for formal steps to be taken, such as registration,

in order to validate the agreement; and the necessity to pay any local taxes or stamp duties for the same purpose. Finally, the local legal opinion must confirm that the acceptance by the borrower or guarantor of the lender's choice of law, and its submission to the jurisdiction selected by the lender, are valid and enforceable in the jurisdiction of the borrower or, as the case may be, the guarantor.

All these matters should be capable of reasonably precise judgment. However, positive clearance in respect of such matters does not amount to a confirmation that the agreement constitutes valid and binding obligations of the borrower or, as the case may be, guarantor, or that the agreement is enforceable in accordance with its terms. Lawyers are frequently asked to opine on these matters, but frequently resist doing so on the understandable basis that the burden of care that this places upon them is unreasonably great. In any event, a positive statement made on the basis of no or insufficient inquiry is of no more practical benefit to a lender than no statement at all.

Moreover, the local lawyer's opinion prepared in this context is normally based on a number of assumptions such as the genuineness of signatures, the accuracy of documents of record (minutes of meetings, for example), and the conformity of copies with original documents. Accompanying these assumptions will also be qualifications, including important ones such as dominance of local bankruptcy or insolvency laws over the terms of the contract within a specific jurisdiction, or statements that the payment of default interest may be considered a penalty.

Finally, statements that the borrower or guarantor is not involved in material litigation, or that the provisions of the agreement do not infringe any laws, orders, or decrees applicable to the borrower or guarantor are often given in reliance on certificates from officials of the borrower or guarantor, and are, therefore, of little added value.

Consequently, this author believes that those arguments in favor of any specifically chosen system of governing law in international financial transactions must be heavily qualified by an acknowledgment of the reliance of lawyers in the lender's jurisdiction on the competence of lawyers in other jurisdictions. Such an acknowledgment should refer not only to their diligence in checking out and verifying local aspects of the transaction, but also to their capacity to understand the documentation and to determine whether that documentation is valid and enforceable in accordance with its terms.

V. Conclusion

The practice of choosing a governing law from an extremely narrow range of common law options has become a deeply ingrained practice among lawyers in the major financial centers, particularly where the borrower's financial obligations are evidenced by debt instruments in a form designed for potential trading on one or another capital market. Not only is the practice deeply ingrained, but the vast majority of lawyers who advise lenders are probably convinced of the

lack of any real alternative to the choice of English or U.S. law as the governing law of agreements, notes, bonds, and other debt instruments. Moreover, many lawyers who habitually act for lenders do not consider it a matter of embarrassment that the documentation is both voluminous and heavily biased in favor of the lender. They are well aware that once the lender has parted with its funds, it will be extremely vulnerable. They also know that the vast majority of all litigation involving loans is concerned not with esoteric issues arising from the construction of the agreement, but with straightforward default. For the same reason, those lawyers would probably not be embarrassed by accusations of forum shopping when selecting the jurisdiction to which the borrower is required to submit. Instead, they would likely point out that borrowers who intend to fulfill their obligations should not object to lenders requiring them to submit to the jurisdiction of a forum that maximizes the lender's opportunity to recover its funds and enforce its rights and remedies.

Pragmatically, those lawyers are probably correct, even though this author holds to the ideal of truly international loan agreements governed by bilaterally accepted legal principles rather than unilaterally imposed ones. However, a significant number of emerging nations, in Eastern Europe, Latin America, and Asia have legal systems based on civil law rather than on common law, and legal processes that are inquisitorial or consensual rather than adversarial. If the legal community is to aim towards a basis for construing and applying financial laws and legal concepts, it must essentially choose between freedom of contract as a paramount principle and the acceptance of some basic conceptual constraints such as those imposed by the doctrine of good faith. No one today can prophesy how that debate will end, but recognizing that it has begun is important. Consequently, the presumption that financial agreements are necessarily creatures of common law might henceforth be considered rebuttable.