



THE ANNUAL GRAY'S INN READING



The Rule of Law: Good for the Economy?

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Overview

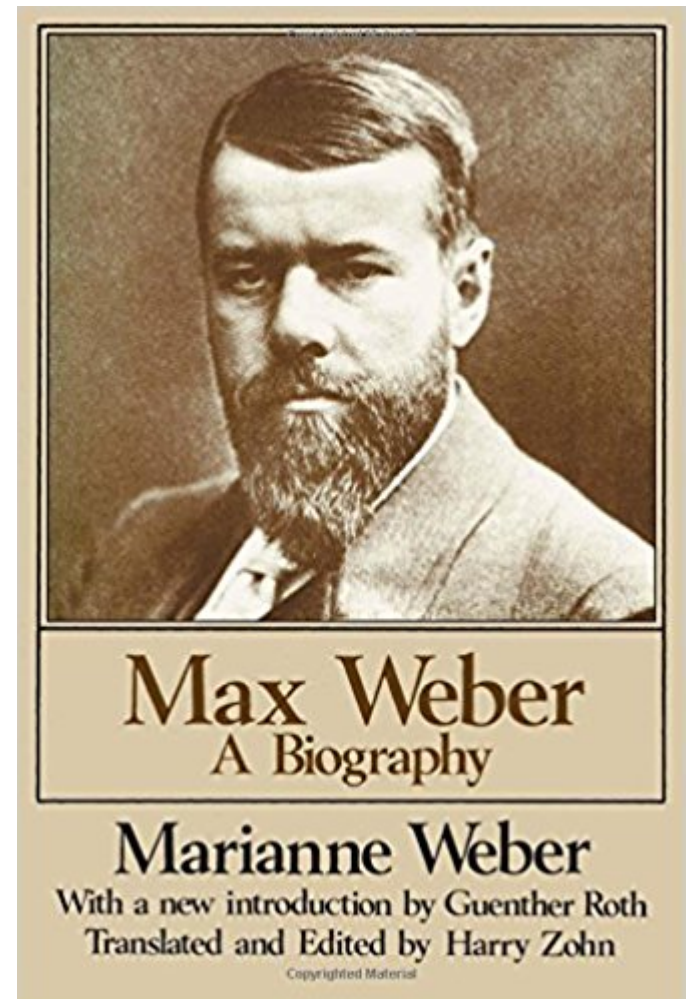
- Law and Economic Development
- English Commercial Law
- Five examples
- Analysis

Law and Economic Development (1)

Max Weber

“For the development of capitalism two features of Common Law have been relevant and both have helped to support the capitalistic system...[A] group [lawyers/judges] which is active in the service of propertied, and particularly capitalistic, private interests...

Furthermore...the concentration of the administration of justice at the central courts in London...We may thus conclude that capitalism has not been a decisive factor in the promotion of that form of rationalization of the law which has been peculiar to the continental West.”



Law and Economic Development (2)

‘Legal origin’ studies

- Legal origins (common law v civil law) have significant consequences for economic outcomes.
- Market supporting solutions of the common law system work better than the policy-implementing solutions of the civil law system.
- Measured differences in legal rules matter for economic and social outcomes.

La Porta, Lopez-de-Silanes, Shleifer, “Law and Finance after a Decade of Research”, in G. Constantinides, M. Harris, R. Stulz (eds), Handbook of the Economics of Finance (Elsevier, 2013), v.2

Law and Economic Development (3)

World Bank

- “Ultimately the rule of law...is needed for a country to realize its full social and economic potential.”
- “It is clear that a fully modern legal system is *not* a precondition for rapid economic growth.”
- “[T]he importance of law and legal institutions to...enhancing growth, promoting secure property rights, improving access to credit...”



English Commercial Law

Philosophical underpinnings

1. Freedom of Contract

“Despite statutory inroads, party autonomy is at the heart of English commercial law...it is desirable that, so far as possible, the courts give effect to contractual terms which parties have agreed. And there is a particularly strong case for autonomy in cases of complex financial instruments...” *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011].

**THE RISE AND
FALL OF FREEDOM
OF CONTRACT**

P.S. ATIYAH

2. Certainty in Commercial Transactions

“In all mercantile transactions the great object should be certainty: and therefore, it is of more consequence that a rule should be certain, than whether the rule is established one way or the other...” *Vallejo v Wheeler* [1774] (Lord Mansfield).

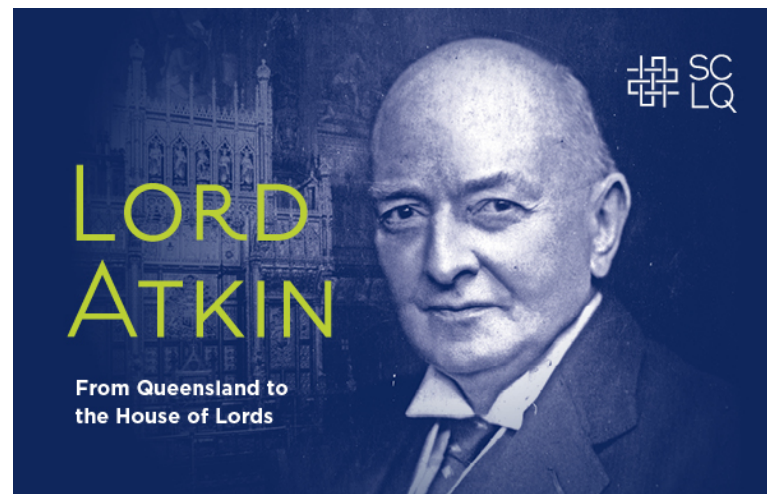


This observation is...particularly pertinent where the issue is one which...has been the subject of repeated litigation over the years...”

The Starsin [2003], per Lord Bingham.

3. Equitable Principles and Commercial Law

“It would have been futile in a code intended for commercial men [the Sale of Goods Act 1894]...[if] at the same time it was intended to leave, subsisting with the legal rights, equitable rights inconsistent with, more extensive, and coming into existence earlier than the rights so carefully set out in the various sections of the Code”: *In re Wait* [1927], per Lord Atkin.



Example 1 – Bankers' Clearing House

“The Clearing House is a large room fitted with drawers: each banker, using the house, has one of these, marked with his name or firm. In the morning, and at half-past three o'clock in the afternoon of each week day, a clerk from each banker, using the house, attends, bringing with him the cheques on other banks that have been paid into his bank since last clearing; these he deposits in the drawers of the respective banks on which they are drawn; he then credits their accounts separately, with the different amounts of the cheques they have placed in his drawer, as against his bank.

Balances are then struck from all the accounts... each clerk has only to settle, in cash, with two or three others, and thus, by means of comparatively small sums in money, the balances are immediately paid.” J. Grant, *The Law Relating to Bankers and Banking* (London, 1856).



Example 2 – Discount Houses and London Money Market

- 'Bill on London' - financed international trade
- Banks accepted bills but then discounted them: bill brokers became discount houses, funding themselves by short-term deposits from the banks (with whom they did not compete), and selling (rediscounting) bills on their own account, including to Bank England.

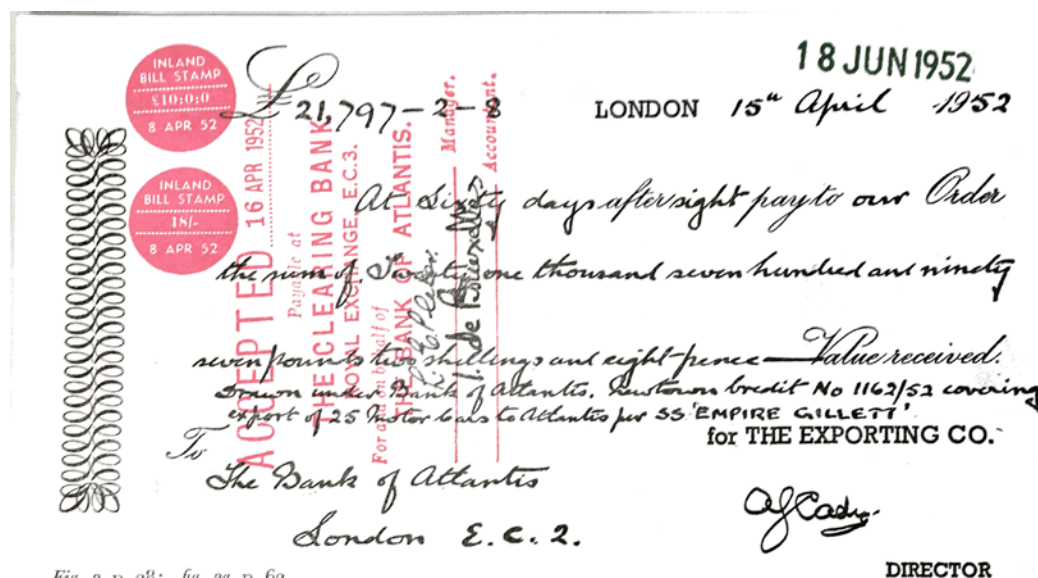
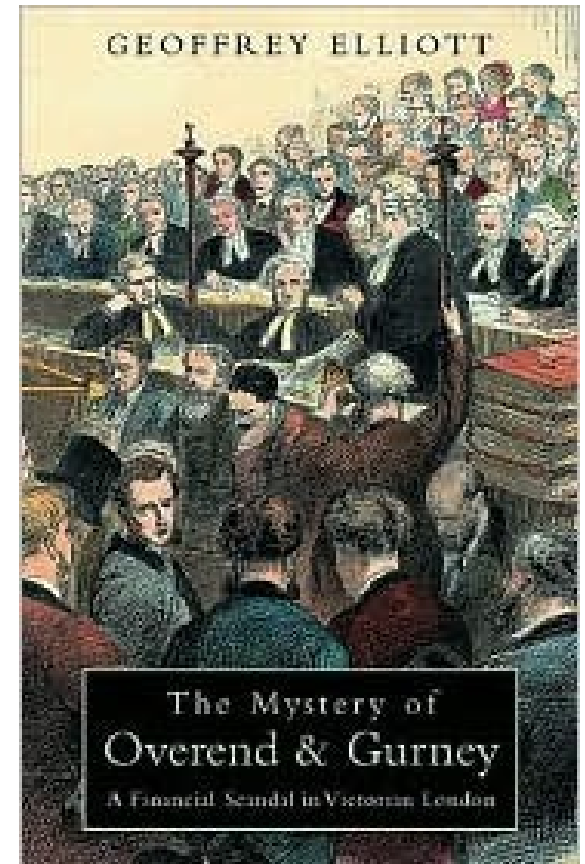


Fig. 2, p. 28; fig. 2a, p. 62

Example 2 – Discount Houses and London Money Market

- Collapse of largest discount house led to Walter Bagehot, *Lombard Street A Description of the Money Market* [1873] – central banks as lenders of last resort
- *In Re Fox, Walker, & Co* [1880] – despite collapse practice of discount houses indorsed



Example 3 – Futures Markets

- Arrivals contracts in Liverpool cotton
- Futures dealing recognized in contracts of the commodities associations
- Clearing houses: e.g., London Produce Clearing House (now LCH, “offering clearing services for a diverse range of asset classes, including rates, FX, repos and fixed income, commodities, cash equities, and equity derivatives”)
- Role of courts: futures dealing not gaming/broker able to close out on non-payment of margins: *Christoforides v Terry* [1924].

Example 4 – Asset Finance

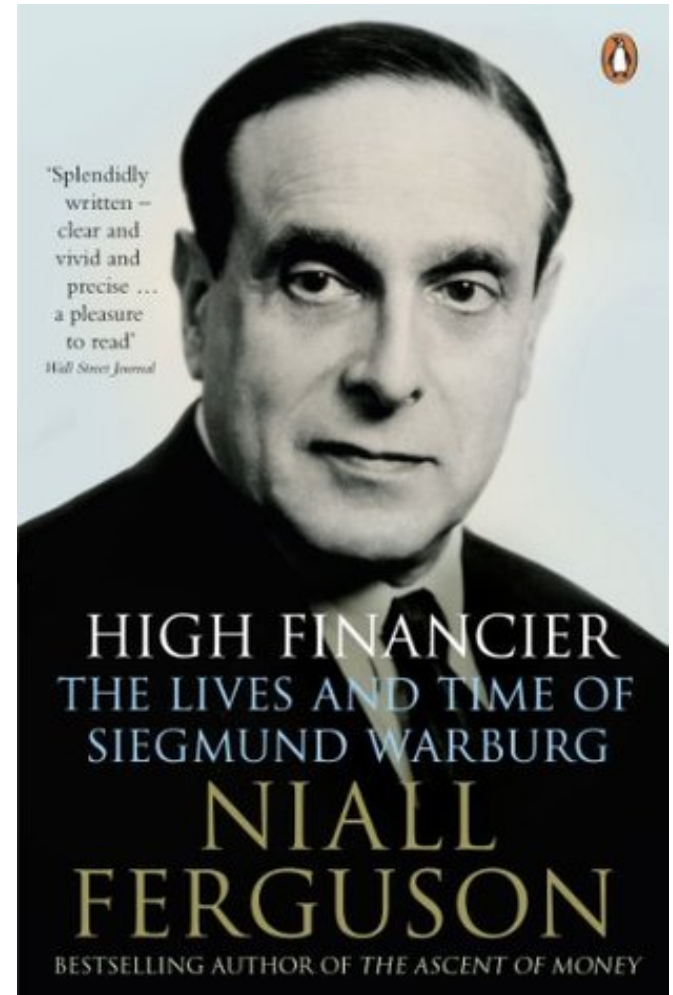
- Railway wagons – 1st finance lease 1857
- Caught by Bills of Sale Acts?
- Conditional sale?
- Railway wagon companies became finance houses e.g., Lombard
- Finance leasing/operating lease/hire purchase/ sale and leaseback today - photocopiers, fork-lift trucks, manufacturing plant, motor vehicles, aircraft



Grace's Guide to British Industrial History
<https://www.gracesguide.co.uk/File:lm189908Cass-North.jpg>

Example 5 - Euromarkets

- Eurodollars and the Eurodollar markets: the US restrictions
- Allen & Overy and the first Eurobond issue (the Italian Autostrade)
- Role of the courts: *Libyan Arab Foreign Bank v Bankers Trust* [1989]



Analysis (1)

Private Law-making

- London Corn Trade Association/GAFTA contracts and exclusion of ordinary rules of sales law
- Freedom of contract enabled trade associations to reverse unfavourable decisions

“[T]here was a celebrated case called *Cooke v Eshelby*... I brought it before our Association, and I told them that if the thing was going on, no man dare trade under those systems. The consequence was that a committee was formed, and a new contract was made out...” *Liverpool broker’s evidence to Royal Commission*, 1894.
- Merchant (and lawyer) creativity
- Arbitration by the trade

Analysis (2)

Normative Force of Commercial Practices



By William Hartley – VIA
image catalogue,
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- **Commercial custom** - (“mercantile usage”) if well known, certain and reasonable – to interpret contract and to add terms: *Chitty on Contracts*
- Examples: customs at ports and usage of markets (brokers liable as principals)
- **Commercial practice** – market practices able “to pull itself up by its own legal bootstraps”: Professor Sir Roy Goode.

Analysis (3)

English Judicial Approach

- “The Mareva injunction has proved most valuable in practice to the City of London and to those who operate in the shipping world and elsewhere.” *The Assios* [1979], per Lord Denning.
- “[I]t also began to be perceived, by arbitrators and lawyers practising in the City of London, that the effect of the breach date conversion rule [converting sterling into other currencies] was to render the English jurisdiction increasingly unattractive to businessmen... in the end, as is well known, in the Miliangos case [1976]...this House decided...to hold that it was open to an English Court to give judgment for a sum of money expressed in a foreign currency.” *The Texaco Melbourne* [1994], per Lord Goff.

Conclusions

- Banks, financial markets, Lloyd's insurance, Baltic Exchange, etc acted against backdrop of the law
- Commercial innovation generally given stamp of legal approval – freedom of contract as the balm
- Commercial court (Financial List) (established 1883), lawyers, arbitration as a longstop
- Rule of law, yes, but accounting, telegraph, steamship, electricity, computing...