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INTERNATIONAL TRANSACTIONS IN A COLD CLIMATE; OR WHATEVER BECAME OF THE LAW MERCHANT?

*Henry Harfield**

International trade can be conducted only under the rule of law. There is no rule of law that governs international trade. These statements form a paradox, and the beginning of two possible syllogisms. One construction is that since there is no rule of law governing international trade, and international trade is dependent upon the rule of law, international trade must perish. The other and more hopeful construction is that international trade does exist, it must exist, and because it is dependent upon the rule of law, a rule of law must be devised.

I believe in the latter formulation, but I recognize that there is a vital difference between a rule of law and a principle of law. Principles and rules both describe conduct; but a rule does more—it requires conformity to the described conduct, under penalty of consequences. These philosophical abstractions can be proved in the laboratory experiment of trade, and as the trade becomes more sophisticated, the proof of the abstraction becomes more concrete.

Bear with me for just a moment while I go back to first principles. Trade was initially an exchange of goods. One party had a surplus cow and the other had a surplus daughter. The exchange was fair, not because rule 10(b)(5) had been invented, but because the parties were dealing at arm's length and at the end of each arm there was a roughly comparable club. One can be fairly certain, however, that if this transaction had been articulated in philosophic terms, it would have been articulated as a rule and not as a principle. Fairness of the exchange did not grow out of regard for principle, but rather out of a concern for the consequences of dissatisfaction.

Very early in social development, however, the necessity for a somewhat more complex and comprehensive set of rules became apparent. Probably the prime reason was that credit entered the scene. Thus, there came a time when the trade transaction was not a completed physical exchange of tangible goods, but rather contemplated an exchange of immediate performance for a call on future performance. There are those who say that money lies at the root of this complication, as at the root of all evil, but I believe that credit

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came before money. Of course, I do not use the word "credit" as it is used today in a sophisticated sense, but rather in its very primitive sense of belief or reliance. The word is derived, I suppose, from the Latin *credo*—"I believe." A man was prepared to part with goods or services because he believed that his opposite party would perform by giving him goods or services in return at some future date. He acted on that belief because he relied on the certainty that society would enforce the promised performance.

In those early days a sense of formalism was more prevalent, at least in the United States, than it is today. The rules were rather narrowly stated and there had to be perfectly strict compliance in order to invoke the sanctions of society. The case of *Weeks v. Tybald*[1] is precisely in point. The facts were simple. The defendant was heard "to affirm and publish" that he would give 100 pounds "to him that should marry his daughter with his consent." The plaintiff forthwith married Miss Tybald and, whatever his gratifications may have been, they were not pecuniary in character: he was no richer. He therefore brought an action in *assumpsit* against the defendant, but the writ was dismissed. The court said, in effect, that words spoken in haste to excite suitors did not constitute a contract.

You may think that I am wandering, and perhaps I am, but only a few years ago, when a client was proposing to spend a very substantial amount of money in a North African country in reliance on its recently enacted investment guaranties law, I had occasion to ask the Minister of Finance of that country if he were aware of *Weeks v. Tybald*, and whether he proposed to rely upon that case. Perhaps as a consequence of my inquiry we entered into a very carefully and rather comprehensively drafted concession, which looked more to the *Dartmouth College* case than to *Weeks v. Tybald.*

This anecdote illustrates my first point. Trade requires a rule of law if it is to be anything more than a very simple swap. International trade has the same fundamental requirement as domestic trade; it can function only if there is a set of rules upon which sellers can rely when they ship their goods abroad and upon which buyers can rely when they pay for goods in transit to them. Generally speaking, however, the rule of law that regulates trade is necessarily a rule of municipal law, because no nation has the right to make laws for the regulation of conduct in other sovereignties.[2]

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1. 74 Eng. Rep. 982 (K.B. 1605).

2. That is not to say that the laws of one nation may not prescribe consequences for conduct occurring in another sovereignty. *See, e.g.,* United States v. Aluminum Co. of America, 148 F.2d 416, 443-44 (2d Cir. 1945).

Consequently, a realistic appraisal of our present structure reveals that there is no international law of sales; nor, indeed, is there any private international law of commercial transactions that is really worthy of the name. There is no set of precise and enforceable rules for the governance of particular transactions. Most of the body of private international law is, in effect, a body of conflicts law—rules for the choice of law that is to determine and resolve the particular controversy. This situation is almost inevitable, because even if there were a comprehensive body of private international commercial law, there is no international court that can undertake and enforce the adjudication. Under such a structure, which provides for the adjudication of commercial controversies in the courts of one nation or another, most nations are entitled to set their own rules of conflict or choice of law under the auspices of private international law. They therefore have an almost overwhelming temptation to apply the law with which they are most familiar, and in most cases that law is their own.

International commercial transactions are affected by political considerations as well as by divergent systems of municipal law. The expectations of the parties obviously may be frustrated by war or nationalization, but equally they may be frustrated by such less direct measures as currency controls, embargoes and discriminatory taxation. In such instances the ordinary choice of law rules frequently are put aside or considerably altered in their application. In the United States, at least, courts have been disposed to apply American rules of conduct without regard to the *locus* of the transaction where the rule reflects a fundamental national policy. The antitrust cases and *Schoenbaum v. Firstbrook*[3] generally are not regarded as being in the field of commercial transactions, but it is not difficult to imagine a commercial dispute to which the doctrine of those cases might be relevant.

Apparently, then, the increasing political and economic impact of divergent national policies on conventional mechanisms for resolving legal conflicts, as well as a concomitant increase in the volume of international transactions, emphasizes the need for some commonly accepted set of rules. Against this background I propose to examine the relative sufficiency in meeting that need of the Uniform Customs

3. 405 F.2d 200 (2d Cir.), *rev'd,* 405 F.2d 215 (2d Cir. 1968) (rehearing en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969). In *Schoenbaum,* a 10(b)(5) action to recover profits made on "insider" knowledge, the Securities Exchange Act was held to have extraterritorial effect "to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities." 405 F.2d at 206.

and Practice for Commercial Documentary Credits, Brochure No. 222 of the International Chamber of Commerce, and article 5 of the Uniform Commercial Code.

Both sets of rules are concerned with letters of credit, and it is useful to consider the nature of the transactions that are intended to be governed by these two sets of rules. Each set of rules makes clear that a letter of credit is quite distinct from a sales contract or any other related contract. The letter of credit is essentially a payment mechanism, but it also has a long history as a useful international instrument for carrying out the payment term of a trade transaction. For our purposes, then, ascertainment of a good governing system for letters of credit is an exercise that may be applied profitably to any other international commercial transaction.

The Code and Customs are identical in concept. It should be remembered that article 5 is one of eight, each dealing with defined areas of commercial activity. When the Code was adopted in New York in 1962, Governor Rockefeller said:

> This action is of far-reaching importance not merely because the Uniform Commercial Code constitutes a comprehensive and general revision and recodification of New York's commercial laws.
>
> The adoption of the Code in New York State . . . is a major step toward the enactment of a single uniform body of commercial law throughout the United States.[4]

Today, the Code has been adopted in all states except Louisiana. Section 1-102 of the Code describes its underlying purposes and policies as follows:

> (a) to simplify, clarify and modernize the law governing commercial transactions;
> (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
> (c) to make uniform the law among the various jurisdictions.

One of the primary objectives of the letter of credit article of the Code, then, was to achieve within the federal framework of the United States precisely the kind of interjurisdictional body of law that we have been discussing. In his commentary to section 1-101 of the New York Code, Lester Denonn said:

> While it is true that this is the *Uniform* Commercial Code, the ideal of uniformity has not been attained. It is, therefore, indispensable that the

4. *Governor's Memorandum of Approval,* 62½ (Part 1) McKINNEY'S CONSOLIDATED LAWS OF NEW YORK (ANNOTATED) *xiii.*

> Code of the particular state involved be consulted to be certain that the applicable sections are properly brought to bear upon the problem at hand.[5]

Nevertheless, the structure of the Code is uniform; the local deviations are not numerous and are readily ascertainable. An interstate transaction may be planned therefore with reasonable confidence concerning the terms and outcome of any dispute. In the light of this fact and in the recollection of Governor Rockefeller's laudatory statements, it is fair to ask why New York State has, in effect, adopted the Uniform Customs and Practices and relegated the Code to a secondary position. The 1963 Report of the New York Law Revision Commission provided a partial answer to that question in the following words:

> The primary objective of the Uniform Commercial Code is to expedite the conduct of commercial transactions. Although there may be room for argument, the furtherance of the objectives of the Code may require, for the present and as a practical international matter, maintenance of established routines of the New York international letters of credit business.[6]

To examine the reason behind that statement it is necessary to note the fundamental distinction between article 5 of the Code and the Uniform Customs and Practices. That distinction is one neither of content nor of the form of expression. There are differences of substance and content between the Uniform Customs and the Code, but they are surprisingly few in number. The respective forms of expressing the rules are significantly different, but each is reasonably understandable; I believe that a Frenchman would have no more difficulty in understanding a translation of article 5 than the average American has in understanding the English text of the Uniform Customs and Practices. The fundamental difference is that the Code is a law and the Customs are an agreement.

There is, therefore, a difference in the scope of coverage: law prescribes conduct in the area controlled or affected by the lawmaker; agreement prescribes conduct between parties. Thus one is essentially geographical; the other is essentially transactional. When a transaction occurs in more than one jurisdiction—*i.e.* when it is transnational in its character—the first problem is to find out not what the law prescribes but rather what law controls. This preliminary task is eliminated where the set of rules are transactional rather than geographical in their application. Putting the matter differently, the

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5. *Practice Commentary,* 62½ (Part 1) McKINNEY'S CONSOLIDATED LAWS OF NEW YORK (ANNOTATED) 2.

6. *New York Commission Comments,* 62½ (Part 2) McKINNEY'S CONSOLIDATED LAWS OF NEW YORK (ANNOTATED) 650.

international acceptance of the Uniform Customs and the habit of incorporating them by reference into every international letter of credit accomplishes two purposes: first, it makes the choice of law inquiry unnecessary; secondly, it facilitates the resolution of the controversy. The Uniform Customs, once incorporated, are in effect contract terms, which will be given full effect under almost any system of commercial law.

Section 1-103 of the Uniform Commercial Code provides:

> Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant... shall supplement its provisions.

The law merchant, of course, had its origins in the customs of merchants, and was particularly beneficial to those merchants who traded among nations at a time when municipal law was sparse, primitive and unpredictable. In our contemporary world, with its vastly increased volume of international transactions and its vastly more complex interplay of national, political and economic policies on private trade and transactions, municipal law is neither sparse nor primitive, but it has not become more predictable. In these circumstances, when the rule of law is not likely to be expressed and enforced by a supergovernment or by a unanimity of nations, the custom of merchants may be the best hope for that degree of predictability without which international transactions cannot survive.

Let me see if I can frame my thesis in the terms of an actual problem that is so contemporary that it has not yet been resolved. There is an area in Africa that was formerly a colony of one of the large trading nations of Europe. It is now an independent republic, and I shall refer to it as Middle Euphoria, although that is not its true name. A United States bank does business in Middle Euphoria. It does not conduct that business through a branch or agency; it has organized a local banking institution—its wholly-owned subsidiary—under the laws of Middle Euphoria. One of the major commercial houses in Middle Euphoria is an importer. At the request of that importer the subsidiary bank issued a letter of credit for his account covering an importation of merchandise. In due course, title documents were presented to and paid by the subsidiary bank. Prior to the arrival of the merchandise, however, the Government of Middle Euphoria had found the importer guilty of some horrid offense, and had imposed fines that exceeded the importer's total resources. Accordingly, when the subsidiary bank sought reimbursement from the importer for the amounts it had paid out under the letter of credit, the importer was unable to respond. When the merchandise itself arrived in Middle Euphoria shortly thereafter, the Government immediately seized it as a

means of collecting the fines it had imposed on the importer. As law school examination questions used to say: "What are the rights of the parties?"

There is no doubt under the law merchant, under any custom of trade, under the Uniform Customs and Practice, and even under the Uniform Commercial Code, that the subsidiary bank is the owner of the merchandise in question, or that at the very least it has a superior security title. At the same time, it is equally clear that the Government of Middle Euphoria is considerably larger than the subsidiary bank, has actual possession of that merchandise, and claims that it was seized in aid of the government levy on the debt owed by the importer to the Government. If you are representing the bank, what do you advise it to do? What authority do you cite?

It is a delict under international law for the Government of Middle Euphoria to seize property that belongs to the subsidiary bank. This is especially true that bank, although incorporated in Middle Euphoria, is in essence an alien doing business in that country. But where is there an international court that is prepared to adjudicate and implement the international law which I think I have accurately stated?

There is very little doubt that the seizure by the Government of Middle Euphoria is a clear violation of constitutional rights enjoyed by the American shareholder of the subsidiary bank. Does the protection of the United States Constitution extend to Middle Euphoria? I realize that our Constitution provides that Congress is entitled to define and punish offenses against the laws of nations, but do the other nations know and accept that? And if they do, what court has jurisdiction over this dispute?

It is very clear to me that the Uniform Commercial Code neither has any application nor provides any degree of comfort. The record is silent on whether there is a commercial code of Middle Euphoria and on whether that municipal law would either approve or denounce what the Government has done. Nor is there any indication of the means of exhausting legal remedies in Middle Euphoria. There is no possibility that I can see of finding a tribunal in which it can be asserted successfully that the hypothetical laws of Middle Euphoria, or the concrete acts of its Government, must in this case be subordinated to some international or supranational law or body of laws.[7]

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7. I do not suggest that if a municipal court, in the United States or elsewhere, had jurisdiction of the person of the Middle Euphorian Government in a proper case (*see, e.g.*,National City Bank v. Republic of China,348 U.S. 356 (1955)), it could not do justice. As in the preparation of rabbit stew, the first problem is to catch the rabbit.

In short, there is a vacuum: there are no dispositive rules of conduct. This problem, of course, is a function of the theme of this conference—changing circumstances—but also I must hasten to point out that in international trade and private international transactions circumstances have been changing since the days of the Phoenicians.

The problem, stated very succinctly, is this: our politics never seem to catch up to our economics. More appropriately stated for this learned gathering, our municipal laws and foggy concepts of international jurisprudence are, to put it most charitably, not adequate to meet the requirements of the circumstances of international trade that are changing today, and that have been changing virtually since trade began. But whether it is the ancient custom and usage that became known as the law merchant, or the more modern and more specialized arrangements found in such bodies of rules as the Uniform Customs and Practice, or Incoterms (defining trade terms) or the efforts by the International Chamber of Commerce to establish comparable rules for the collection of international negotiable instruments, the agreements of merchants are relatively effective within their limited areas. I cannot say whether the hypothetical problem that I have described to you in Middle Euphoria would be solved if that country or the bank had formally adhered to the Uniform Customs and Practice for Commercial Documentary Credits, but it is quite clear to me that if the rights of merchants and their bankers had been defined clearly by some international consensual agreement, there would be great reluctance on the part of any government, even that of Middle Euphoria, to step out of the line of practice in the community of trading nations.

I do not propose, even in jest, that article 5 of the Uniform Commercial Code should be repealed. Nor do I suggest that all of the problems brought about by changing circumstances would be solved by an extrapolation of the Uniform Customs and Practice to create a consensual international Uniform Commercial Code, so that the very cold climate for international trade would instantly become an economic Garden of Eden. But I do throw out the question whether an extrapolation and further development of rules among merchants, in the old tradition of the law merchant, may not be an extraordinarily useful stopgap, perhaps more useful than variegated municipal legislation, as we move so painfully slowly on our way to Utopia.