

LAWYER-MADE LAW, *LEX JURIS* AND CONFUSING THE MESSAGE WITH THE MESSENGER

A COMMENT ON FRANKEL

BRUCE A. MARKELL*

In *The Law of Cross-Border Securitization: Lex Juris*, Professor Frankel asserts that lawyers are central to the making of the laws, or “law-like” rules, that govern cross-border securitizations.¹ She lauds this development and hints that it might provide a useful model for other laws in a global context. I disagree. I think that lawyers and their work product, while important, are just agents in the system; or to put it another way, at best lawyers are no more than highly-trained facilitators of securitization. They are not, and likely cannot be, entities who make “law” in any consistent way or in any common sense meaning of the word. Put another way, a good lawyer ensures that the parties’ expectations conform to what the law provides or allows; he or she does not change the law or write new laws to satisfy those expectations.²

I wish to make three short points in this comment. First, I want to sketch further my argument that lawyers do not make law or law-like rules. Second, I want to question an implicit assumption in Professor Frankel’s article that lawyers are the primary agents for standardization and efficiency in securitization. Finally, I want to raise some questions about democracy and governance, if *lex Juris* is indeed a part of the “law.”

Copyright © 2002 by Bruce A. Markell

* Doris S. and Theodore B. Lee Professor of Law, University of Nevada Las Vegas; Of Counsel to the Los Angeles law firm of Stutman, Triester & Glatt.

1. Tamar Frankel, *The Law of Cross-Border Securitization: Lex Juris*, 12 DUKE J. COMP. & INT’L L. 475, 480 (2002).

2. I have set out my views on the proper role of lawyers. See generally Bruce A. Markell, *Digital Demons and Lost Lawyers*, 48 FED. COMM. L.J. 545 (1996) (reviewing ETHAN KATSH, *LAW IN A DIGITAL WORLD* (1995)).

I. IS WHAT LAWYERS DO THE “LAW”?

Professor Frankel identifies *lex Juris* as a possible “forerunner of a new type of lawmaking regulating global activities: law-like rules that escape tight control of domestic laws, but take them into account; rules that are highly flexible for a fast-changing environment, but quickly unified into standards and guidelines of sufficient predictability.”³ In short, she sees lawyers as bringing order out of potential chaos and being positive instruments of change by reducing variability of results through consistent and adroit drafting and planning.

I might agree with Professor Frankel’s conclusion that lawyers are such a positive force without accepting the notion that what they do constitutes rulemaking or the creation of “law-like” rules. My first point of departure, then, is in the definition of what we call “law,” and derivatively what it means to be “law-like.” In the quotation above, Professor Frankel uses “law” in an expansive and somewhat loose manner. As she elaborates, the opinions of legal scholars “have a respectable place as part of the law of the land.”⁴ Included within this place are the “legal documents that lawyers draft.”⁵ I disagree with this breadth; it represents a conflation between law and the texts that influence the shape of the law. While legislators and judges may consider academic writing in formulating policy or deciding issues, such consideration certainly is not compulsory. Similarly, while contracts set the “law of the parties,” contractual freedom is limited by notions of public policy.⁶

Another way to express this point of difference is to ask what special consequences flow from labeling something as “law” or “law-like.” One consequence is that a state legitimately may impose a sanction on anyone who acts contrary to the precepts or dictates of

3. Frankel, *supra* note 1, at 477.

4. *Id.* at 481–82.

5. *Id.* at 482.

6. Although freedom of contract is a norm of most modern legal systems, the parties’ ability to create effective and enforceable documents is limited by notions of public policy. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 110 (1981) (setting forth grounds upon which public policy may prevent enforcement of otherwise valid contracts); U.C.C. § 2-302 (2001) (allowing courts to refuse to enforce unconscionable contracts); U.C.C. § 9-109(a)(1) (2001) (stating that “this article applies to: [¶] (1) a transaction, *regardless of its form*, that creates a security interest in personal property or fixtures by contract . . .”) (emphasis added); U.C.C. § 2-401 (2001) (“Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest.”); U.C.C. § 1-201(37) (2001).

the “something” we are calling law.⁷ Another consequence of calling a particular text or activity law is that, at least under something like social contract theory or communitarian theory, the person subject to the law will have agreed to comply with it, or at least will have agreed to the process by which the law came about.⁸ Thus, it is difficult for me to accept lawyers’ work product as “law” or “law-like,” because I would feel perfectly free to act contrary to a contract to which I am a stranger and would find it surprising to be held to that law simply on the basis of knowledge of its existence.⁹

The practical effect of this difference in categorization already has surfaced in American securitizations. In the *LTV Steel* case,¹⁰ for example, LTV had securitized both its accounts and its inventory and had sold them to a special purpose vehicle (SPV), which was a subsidiary of LTV. This SPV subsidiary then borrowed \$270,000,000 from Abbey National Bank, a bank based in the United Kingdom, and gave the newly-acquired receivables as collateral. Under the documents as drafted, LTV sold absolutely its present and future receivables to the SPV. Under the documents, then, LTV had no residual interest in them other than through whatever residual interest its subsidiary held.

When LTV filed for bankruptcy, however, it took the position that bankruptcy law gave it the status of a representative of the bankruptcy estate,¹¹ and in the name of the estate, it sought to act contrary to the very documents it had signed.¹² Procedurally, LTV made this assertion in a motion for the right to use cash collateral under the

7. See, e.g., JOSEPH RAZ, *THE CONCEPT OF A LEGAL SYSTEM* 3 (1970); HANS KELSEN, *THE PURE THEORY OF LAW* 33 (Max Knight trans., Univ. of California Press 1967) (2d rev. ed. 1960); H.L.A. HART, *THE CONCEPT OF LAW* 20–25 (4th rev. ed. 1972).

8. See, e.g., RONALD DWORIN, *LAW’S EMPIRE* 190–216 (1986); see also HART, *supra* note 7, at 92–96.

9. Apparently, however, this may not be so strange to Professor Frankel. While she acknowledges that private contracts cannot bind non-parties, she creates an exception for “creditors . . . deemed to have agreed to the transfer by notice of the transfers . . . [In] the United States, if the parties follow certain procedures, such as perfection, the agreements are implicit.” Frankel, *supra* note 1, at 488. I think most lawyers who practice under Article 9 of the Uniform Commercial Code would find it odd to cast the structure of Article 9 in a consent (or more accurately, an estoppel) mode, instead of the more regularly accepted property mode.

10. *In re LTV Steel Co.*, 274 B.R. 278, 286 (Bankr. N.D. Ohio 2001).

11. Under United States bankruptcy law, an estate is created by the filing of a bankruptcy case consisting of all of the debtor’s interest in property, whether those interests are legal, equitable or contractual. 11 U.S.C. § 541(a) (1993).

12. As a debtor in possession under the U.S. Bankruptcy Code, LTV was a representative of its bankruptcy estate. 11 U.S.C. §§ 1107, 1108 (1993).

U.S. Bankruptcy Code.¹³ LTV's contention was that, despite the documentation drafted by its lawyers and Abbey's lawyers, LTV still held residual ownership of the securitized assets themselves, and that instead of the SPV being the owner of those assets, LTV was. Since the amount of Abbey's true interest—its loan amount to the SPV (or, as LTV saw it, Abbey's loan to LTV)—was significantly less than the amount of assets involved, LTV sought permission to use those assets contrary to Abbey's wishes.¹⁴

Ultimately, LTV settled. Abbey was paid its due through a debtor in possession financing.¹⁵ This scenario illustrates my basic notion of how laws function in a legal system: they enable one party to use the force of the state to compel actions contrary to the express wishes of another party. Here, LTV was able to use the law of disguised security interests to force Abbey National Bank to participate in its bankruptcy case. Had the documents drafted by the lawyers been considered the "law," or even the law between the parties, then the matter should have ended with a detailed reading of the documents. It did not. The documents were read against the received background of commercial financing, and the rights that such background gives to non-parties to the transaction.

The existence and recognition of third-party rights generally undercuts Professor Frankel's position. Professor Frankel seemingly acknowledges as much when she says, "Nonetheless, because third parties can resort to domestic courts and domestic laws, *lex Juris* does not afford full protection for the parties to these agreements."¹⁶ Yet, earlier in her article, Professor Frankel apparently thinks there is some benefit; she writes that *lex Juris* "affects, though does not determine, the rights of outside third parties."¹⁷ In light of my comments about third-party rights, I disagree.

The "law," or at least the law as developed by courts and legislators, always has been deeply concerned with the effect of transactions on third parties. Roman law acknowledged something akin to the

13. 11 U.S.C. § 363(c) (1993).

14. The bankruptcy court found that there was a 39% equity cushion providing adequate protection to Abbey. *In re LTV Steel Co.*, 274 B.R. at 286.

15. *In re LTV Steel Co.*, Case No. 00-43866, 2001 Bankr. LEXIS 635, *12 (Bankr. N.D. Ohio, Mar. 20, 2001) (discussing the results of LTV Steel Co.'s reorganization in bankruptcy, including its post-petition financing).

16. Frankel, *supra* note 1, at 488.

17. *Id.* at 487.

fraudulent transfer long before *Twyne's Case*.¹⁸ Additionally, both modern fraudulent transfer law¹⁹ and modern bankruptcy law²⁰ are replete with provisions that enable a neutral third party, such as an insolvency administrator, to revise or to avoid transactions that harm creditors.

The reason for these powers are simple: a debtor's transactions affect more than just the parties in privity. Furthermore, the debtor, especially if insolvent, often does not have sufficient incentive to look out for all of those interests. Unless these interests are forced to the parties' attention through the clumsy device of potential future avoidance, third parties stand to lose, and lose big. This situation may not be good for the polity.

As indicated above, Professor Frankel concedes that "*lex Juris* does not afford full protection[,]”²¹ because of the existence of such third party rights. This statement is also puzzling. If Professor Frankel's point is that freedom of contract in cross-border securitization leads to standardized forms and efficiency, then that is one thing upon which we probably can agree. But to make that point, one need not elevate lawyers' work product to the status of law. Lawyers may devise the structures, but the structures are useless unless they achieve the client's goals. The literature of path dependence and innovation are sufficient standing alone, without introducing further actors.

18. Roman law had recognized as a nominate tort an action *fraus creditorum* similar in purpose and effect to the modern intentional fraudulent conveyance. See 1 GARRARD GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 60 (rev. ed. 1940); Max Radin, *Fraudulent Conveyances in California and the Uniform Fraudulent Conveyance Act*, 27 CALIF. L. REV. 1, 1–2 nn.1, 2 (1938); Max Radin, *Fraudulent Conveyances at Roman Law*, 18 VA. L. REV. 109 (1931).

Twyne's Case, 3 Co. Rep. 80b, 76 Eng. Rep. 809 (Star Ch. 1601), is thought to be one of the first reported cases implementing the 1571 enactment of the Statute of Elizabeth, 13 Eliz., ch. 5 (1571) (Eng.), repealed by Law of Property Act, 15 Geo. 5, c. 20, § 172 (1925) (Eng.), but *Mannoche's Case*, 3 Dyer 295b, 73 Eng. Rep. 661 (Q.B. 1571) (Eng.), is actually earlier.

19. See UNIF. FRAUDULENT TRANSFER ACT, 7A U.L.A. 266 §§7, 8, at 339–59, Part II (1999 & Supp. 2000). This Act has been adopted in 39 states.

20. The fraudulent transfer provision of the U.S. Bankruptcy Code is found in Section 548 of the Code. 11 U.S.C. § 548 (1993). In addition, the estate representative succeeds to the status of any creditor who held a fraudulent transfer action as of the filing of the bankruptcy case. 11 U.S.C. § 544(b) (1993).

21. Frankel, *supra* note 1, at 488.

II. ARE LAWYERS THE INNOVATORS AND HARMONIZERS?

I also question whether lawyers innovate and standardize to the extent assumed by Professor Frankel. From my perspective, that function is being served by rating agencies such as Standard and Poor's, Moody's Investor Service, and Fitch. One need only visit the websites of these entities to see that they publish tremendous amounts of information on how to standardize deals.²² And with good reason: each of these agencies in turn issue ratings from which the parties then price their deals. As a consequence, one sees information on how different industries produce different deals,²³ how the domestic laws of various countries are or are not accommodated,²⁴ and even what the rating agency looks for in legal opinions.²⁵ My sense is that this is also an engine of standardization and perhaps the primary one.²⁶ When a market looks to relatively few players, such as rating agencies, for an essential component of a transaction (i.e., a rating), it is those agencies which take it upon themselves to standardize and to make efficient the transactions, since they have the most to gain, over time, from standardized transactions.

The relative status of lawyers and rating agencies can be seen from requirements that rating agencies impose upon securitization participants. These include extensive lists that detail those things upon which lawyers are required to opine.²⁷ I agree with Professor Frankel that the limitations on such opinions, such as liability for an incorrect opinion, in turn restrict the securitization structure, and

22. For Moody's Investor Service, see <http://www.moodys.com/cust/default.asp>; for Standard & Poor's, see <http://www.standardandpoors.com/>; for Fitch IBCA Duff & Phelps, see <http://www.fitchratings.com/> (last visited Feb. 26, 2002).

23. A good example is Fitch's research page on the web. See http://www.fitchratings.com/corporate/sectors/criteria_rpt.cfm?sector_flag=1&marketsector=2&detail= (last visited Feb. 26, 2002).

24. See, e.g., MOODY'S INVESTOR SERVICE, BANKRUPTCY & RATINGS: A LEVERAGED FINANCE APPROACH FOR EUROPE, PART IV: ITALY (May 2001), available at http://www.moodys.com/moodys/cust/research/venus/Publication/Special%20Comment/noncategorized_number/67414.pdf (last visited Feb. 26, 2002). Part I deals with Europe generally; Part II deals with France; Part III deals with Germany.

25. See, e.g., MOODY'S INVESTMENT SERVICE, MOODY'S APPROACH TO ANALYZING LEGAL OPINIONS IN RATING FULLY SUPPORTED DEBT (Mar. 19, 1999), available at http://www.moodys.com/moodys/cust/research/avalon/Publication/Rating%20Methodology/noncategorized_number/SF7356.pdf (last visited Feb. 26, 2002).

26. Especially since each of the rating agencies publish on their web sites many documents on the necessary criteria for obtaining a rating. See *supra* notes 22–25.

27. See, e.g., MOODY'S INVESTMENT SERVICE, MOODY'S APPROACH TO ANALYZING LEGAL OPINIONS IN RATING FULLY SUPPORTED DEBT, *supra* note 25.

promote standardization and efficiency. But, note who is asking for these opinions, not the parties, but an outside stranger to the contracts.

Transactions are done because they make money for the participants. That money is made only if the transaction closes as so devised. The transaction closes only if a suitable rating, or a price that reflects the risk of not obtaining a rating, is obtained. A suitable rating is obtained only if the deal comports with a structure that the rating agency has blessed, or can be convinced presents the same risk as existing transactions. The structures that have evolved, in turn, pay close attention to the pronouncements and words of statutes and judges. That a lawyer or an academic can connect a particular deal's structure to those words is not the same thing as saying that the words of law are surplusage; one can envision securitization without lawyers or academics, but not without courts or legislators.

III. IS THE VIEW THAT LAWYERS MAKE LAW OR LAW-LIKE RULES UNDEMOCRATIC?

There is another deeper objection. One hallmark of modern legal theory is that somehow the consent of the governed is sought, either by the text of the law itself, as in a public initiative, or to the process by which the law was adopted, the more normal legislative method.²⁸ Unless one adopts the estoppel theory of Professor Frankel,²⁹ her vision of *lex Juris* is notably lacking on this point. Indeed, lawyers, the source of *lex Juris*, are bound not to society but to the selfish interests of their clients. If a benefit of a particular deal structure comes at some cost to a non-party, and the non-party has no recourse under other law, then the lawyer is bound to achieve the benefit for her client, despite the consequences to third parties.³⁰

To institutionalize the marginalization of third parties, as a full theory of *lex Juris* would seem to do, appears to me to be the wrong way to go. And, its efficaciousness is belied by the actions of lawyers in the United States. If their opinions held the force of law, then pending legislation to change the U.S. Bankruptcy Code would not be necessary. This legislation, particularly Section 912 of the Bank-

28. See *supra* notes 7, 8.

29. See *supra* note 9, for my discussion of Professor Frankel's estoppel theory.

30. There are examples of the political process trying to limit these types of impositions. One example might be the federal Worker Adjustment and Retraining Notification Act (WARN Act), 102 Stat. 890, 29 U.S.C. § 2101 *et seq.* (1988), which obligates a business to notify local entities before closing certain plants or facilities. *Id.* § 2102.

ruptcy Reform Act of 2001, would codify a large chunk of current securitization practice.³¹ It would provide that no asset securitized in a transaction in which at least one tranche was rated investment grade could ever become subject to a bankruptcy filed by the transferor of that asset. This provision has drawn fire for being insufficiently protective of third party rights,³² but even so, if *lex Juris* has the status claimed, one wonders why it should even be necessary.

IV. CONCLUSION

The concept of *lex Juris* is subtly seductive. It leads us to view the work of lawyers in cross-border securitization as the work of public servants making everyone's lot in life better. While lawyers are important in the global legal system, I do not think that they necessarily serve that function. Rather, lawyers serve to articulate the needs and desires of their clients and strive to create crucibles in which those needs and desires can be combined with the lawyer's knowledge of the relevant law. That such crucibles are becoming standardized is a proposition with which I can easily agree. To say that it is *lex Juris* that is creating that standardization is, I think, conflating the crucible with its contents.

31. Bankruptcy Reform Act of 2001, H.R. 333, 107th Cong. § 912 (2001). This legislation is expected to be reintroduced in the second session of the 107th Congress.

32. I have reported on the opposition of the National Bankruptcy Conference and the National Association of Credit Managers. Bruce A. Markell, *What If Bankruptcy Reform Is Not Dead? Securitization Exclusions Could Pose Problems*, B.C.D. NEWS AND COMMENT, Oct. 10, 2001.