

**The Resilience of the Law of Performance Bonds:
An Emphasis on Colombia**

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ABSTRACT

This thesis proposes a new idea about the so-called “resilience of laws”, which was designed to protect the effectiveness of laws within civil law or common law jurisdictions against any change, i.e. social, legal, political, or economic, amongst others. Laws may initially be effective but become ineffective afterwards, and one possible cause may be such changes. Thus, the author states that any of the aforementioned changes may shock a non-resistant legal regime, turning it into an ineffective legal regime to the detriment of society. As a result, the thesis imposes new expectations of legislators and judges whereby they are expected, not only to provide society with effective laws, but with resilient laws. Resilience of laws, within the context of this research, comprises two features: i) static resilience, i.e. the ability of the law to resist the shock caused by a previous change; and ii) dynamic resilience, i.e. the capacity to recover the effectiveness of the law once it has been shocked, and the capacity to prevent a future scenario of ineffectiveness. To achieve the resilience of laws, the author explains how legislators and judges have to take into consideration previous challenging changes and shocks in order to later recover successfully the level of effectiveness, and to prevent ineffectiveness as a result of a similar future shock; this is aimed at having resistant laws, if possible. The thesis places emphasis on the evaluation of the level of static and dynamic resilience of the Colombian laws of performance bonds as an illustration of the notion of resilience of laws, based on the politico-economic changes that were implemented in that country in 1990 and 2002.

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THE RESILIENCE OF THE LAW OF PERFORMANCE BONDS:

AN EMPHASIS ON COLOMBIA

GENERAL INTRODUCTION

The financial legal regime of performance bonds is a transverse area of expertise composed of a number of instruments that are expected to achieve a specific purpose, i.e. the economic protection of the creditor of a contract. In Colombia such creditors are not, and never have been, soundly protected by the laws that were designed to achieve the aforementioned purpose. Those laws were sufficiently effective at some point, but were later left to drift and their level of effectiveness was always at risk, in spite of over 20 legislative reforms and many judicial decisions.

The effectiveness of those laws was at risk not only because they were already vulnerable, but because they were shocked as a result of previous economic and political changes that have been taking place in Colombia for more than two decades. Those changes will continue to occur not only in Colombia, but also in further developing countries, as they do in developed countries. In that sense, we need to create a “new expectation” of legislators and judges whereby, from now on, they are required to make laws that can resist the effects of those changes. In other words, they should now be expected to make resistant laws, so that society can benefit from having resilient legal norms. Thus, it is society that needs to create a new expectation in order to stimulate legislators and judges both from developing and developed countries to move forward, and to do more than simply verifying the effectiveness of laws. They are herein requested to leave behind, if possible and if needed in every particular case, those old, traditional and modern expectations that impede society from having resistant (which involves the notion of effectiveness), and durable laws.

“Resilience” is a term that is not commonly used in legal literature, and has never been used in the same way that it is used in this research. Thus, this study is not only aiming at giving another use to the term resilience within a legal framework, but at setting forth the first steps for the adoption of a new way of seeing the effectiveness of laws in contemporary times. To that end, in this research the author is trying to develop this new notion of resilience of laws by using the Colombian legal regime of performance bonds.

It is important to clarify in advance that the label “performance bond” will not be treated as a specific financial instrument. In the author’s opinion,

performance bond is a generic term similar to the labels “tender bond”, “advance payment bond”, “maintenance bond”, or “off-site material bond”. Therefore, the label “performance bond” refers to the object of the contractual promise – cover –, something that is not directly related to whether it is a conditional or unconditional bond. Hence, it is believed a performance bond may be agreed in the form of a contract of guarantee –in the strict sense – a contract of indemnity, or an “independent guarantee”, among others.

In that sense, it is important to offer at the outset a brief explanation of these three English instruments – irrespective of the specific cover (tender bond, advance payment bond or performance bond, among many others).¹ The contract of guarantee – in the strict sense – is the dependent security *par excellence* as it is substantially dependent before and after the claim. Under this specific financial instrument the liability of the guarantor is ancillary to that of the principal, and, as a consequence, the liability of the latter will follow the same fate, based on the principle of co-extensiveness.² This principle means that any material variation of the terms of the underlying contract that is made after the giving of the guarantee without the consent of the guarantor will discharge his liability.³ Similarly, if the underlying obligation becomes void, unenforceable or ceases to exist, the guarantor will

¹ *Trafalgar House Construction (Regions) Ltd. v General Surety & Guarantee Co. Ltd.* [1995] 3 W.L.R. 204; *Marubeni Hong Kong v Government of Mongolia* [2005] 2 Lloyd’s Rep. 231; *WS Tankship II BV v Kwangju Bank Ltd* [2011] EWHC 3103

² The principle of co-extensiveness means that, as a general rule, the guarantor’s liability is not greater and no less than that of the principal, who will have equal defences, and will equal in terms of amount time for payment and the conditions under which the principal is liable: *Direct Acceptance Finance Ltd v Cumberland Furnishing Pty Ltd* [1965] N.S.W.R.; *Canadian Permanent Trust Co v King Art Developments Ltd* [1984] 4 W.W.R. 587, CA; *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *Hampton v Minns* [2002] 1. W.L.R.

³ The scope of this general rule was described by Cotton L.J. in *Holme v Brunskill* (1877-78) L.R. 3 Q.B.D. 495, as he stated: “The true rule, in my opinion, is that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court [...] will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if he has not so consented he will be discharged”. Similarly in *Rees v Barrington* (1795) 2 Ves. 540, 30 E.R. 765.

be discharged, even before the relevant claim, as his obligation is secondary to the underlying obligation.⁴

The second instrument in English law, according to *Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd*,⁵ is the contract of indemnity, understood as a promise to “indemnify” the creditor against “loss arising out of the principal contract”,⁶ where the promisor is primarily liable; the promisor then has a right of recourse against the principal. Under this contract, unlike a contract of guarantee, the liability of the indemnifier is not co-extensive to the liability of the principal. Therefore, the indemnifier (security issuer) shall be required to indemnify the aforementioned losses, and not only the one caused by default of the principal debtor, as it occurs under a contract of guarantee. In other words, the clear distinction between indemnities and guarantees is that the former relate to protection against loss or liability, and the latter relate to protection against default in performance of another.⁷

The third instrument is the “independent on-demand bond”,⁸ also known as *demand guarantees*, according to the latest revision of the ICC Uniform Rules for Demand Guarantees (URDG 758). This independent on-demand undertaking is conceived to pay a specified amount to a named beneficiary⁹ when the latter affirms (no need to justify, establish or prove) the nature of the applicant’s breach in the performance of the underlying contract relationship. This security bond will be usually be given by a bank, although it may also be provided by some other financial institution such as an insurance company, and is normally used to secure construction projects and

⁴ *Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch)

⁵ [2010] EWHC 2443 (Ch).

⁶ *Argo Caribbean Group v. Lewis* [1976] 2 Lloyd’s Rep. 289; *Birkmyr v. Darnell* (1704) 1 Salk. 27; O’Donovan, James; Phillips, John: *The Modern Contract of Guarantee*, p. 8, English Edition, Sweet & Maxwell, London, 2003; Andrews, Geraldine; Millett, Richard: *Law of Guarantees*, p. 11, Fifth Edition, Sweet & Maxwell, London, 2008.

⁷ McGuinness, Kevin: *The Law of Guarantee*, p.621, 2nd Ed., Carswell, 1996.

⁸ *Caja de Ahorros del Mediterraneo v Gold Coast Ltd* [2001 EWCA Civ 1806, [2002] 1 All E.R. (Comm) 142; *Carey Value Added SL v Grupo Urbasco SA* [2010] EWHC 1905 (Comm); *Wood Hall Ltd v Pipeline Authorities* [1979] 53 A.L.J.R. 487;

⁹ *Franz Maas (UK) Ltd v Habib Bank AG. Zurich* [2001] Lloyd’s Rep. Bank; *Clydebank & District water Trustees v Fidelity & Deposit Co of Maryland* [1916] S.C. (HL) 69; *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 W.L.R. 392; *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 A.C. 168.

international trade, substituting the traditional guarantees and indemnities. This instrument is more akin to a promissory note payable on demand, or even to letters of credit,¹⁰ and, in practical terms, the former instruments are treated as substitutes for cash,¹¹ being considered as the “lifeblood of international commerce”.¹² Indeed, Lord Denning said in *Edward Owen Engineering Ltd v Barclays Bank International Ltd*:¹³

“[It] is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit.”

In addition, the concepts of a “Colombian legal regime of performance bonds” or a “Colombian market of performance bonds” also deserve some clarification before moving to the body of the research. It is clear and agreed that insurance contracts are not bonds, as it is repeatedly mentioned within this research. However, to facilitate the comprehension of this research, included within the latter concepts is the financial instrument that is most commonly used in Colombia, i.e. the “performance insurance”. This Colombian instrument, although not a bond, is considered as such in Colombia; indeed, English insurance companies located in Colombia understand this atypical instrument as a regular bond when they are financially reporting to their headquarters; English insurance companies cannot, and should not, catalogue those Colombian instruments as first-party insurances.

¹⁰ *Edward Owen Engineering Ltd v. Barclays Bank International Ltd* [1978] 1 Q.B. 159; *Solo Industries UK Ltd v. Canada Bank* [2001] 1 W.L.R. 1800.

¹¹ Andrews and Millett, Op.Cit, p.575-576

¹² Ibid, p.605. As these bonds are considered in such way, consequently the courts will not intervene and disturb the mercantile practice of treating the rights of the beneficiary as the equivalent of cash in hand. *Harbottle (Mercantile) Ltd v. National Westminster Bank* [1978] Q.B. 146.

¹³ [1978] 1 Q.B. 159.

In that sense, the Colombian legal regime of performance bonds nowadays comprises different instrument that could be provided or administrated by the financial sector: 1) the performance insurance¹⁴ issued by insurance companies; 2) the *fianza*,¹⁵ 3) the banking guarantee in strict sense (so-called “independent on-demand bond”)¹⁶, 4) the stand-by letters of credit¹⁷ and 5) stand-alone trust funds.¹⁸ However, only the first three instruments will be treated in this research for two main reasons.

Firstly, given that this research is mainly based on assessing the level of resilience of the Colombian laws of performance bonds, the author needs to focus his analysis on the instruments that have were susceptible of being shocked by the politico-economic changes that could have challenged the effectiveness of those instruments between 1992 and 1995, and between 2005 and 2010: those instruments are the *fianza* and the “performance insurance”. However, since the old *fianza* was substituted by the banking guarantee in Act 80 of 1993¹⁹, it is necessary to include the banking guarantee that could have played an active role within the domestic market of performance bonds: this is the independent on-demand bond, which is particularly important to establish if legislators could have caused a legal detriment to society by not recovering the effectiveness of *fianza* given that the replacing instrument does not seem to be competitive enough.

Secondly, the remainig instruments listed above do not have an internal legal regime and are not frequently used in domestic transactions. The stand-by letter of credit, like the rest of guarantees, has different covers; it may be used, among other options,²⁰ as an *Advance Payment Standby*, a *Bid Bond/Tender Bond Standby*, a *Performance Standby*²¹ or a *Commercial*

¹⁴ Colombian Decree 1510 of 2013, Articles 111, 129-139

¹⁵ Colombian Civil Code, Article 2361

¹⁶ Colombian Decree 1510 of 2013, Article 111, 146

¹⁷ Colombian Decree 1510 of 2013, Article 111, 146

¹⁸ Colombian Decree 1510 of 2013, Article 111, 140

¹⁹ Article 15.19

²⁰ Neilsen, J., and Nicolai Nielsen: *Standby Letters of Credit and the ISP 98: A European Perspective*, p.188-189, Banking and Finance Law Review 16.2, 2001; Maximilano Rodríguez Fernández and Ligia Catherine Arias Barrera: *Aspectos Introductorios al crédito documentario*, p.24-25, Revista e-Mercatoria, Vol. 8, No. 1, 2009

²¹ A *Performance Standby* supports an obligation to perform other than to pay money for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions: in Neilsen, J., and Nicolai Nielsen, Op.Cit, p. 188

Standby.²² In Colombia, stand-by letter of credits are only used to secure imports and exports of goods and services (this is the *Commercial Standby*), whereas the type on stand-by letter of credit that could be part of this research (the *Performance Standby*) is not used in this country.²³ Besides, they do not have an internal legal regime that could be shocked during 1992-1995 and 2005-2010, as they are regulated by the rules of the International Chamber of Commerce of Paris, known as International Standby Practices – ISP98-;²⁴ these are reasons for which this instrument was not included in this research.²⁵

Finally, in regards to the stand-alone trust fund, it seems that this specific instrument has never been used in Colombia to secure public law or private law contracts, given that society has always had a more protective, inexpensive and regulated instrument in the market (the price that needs to be deposited by the debtor to constitute a trust of this kind would be equal to the amount that serves as basis to calculate the premium). Besides, the structure of this instrument is more akin to a large cash deposit made by the debtor in favour of the creditor where the financial institution acts an administrator of the deposit, and not as a real guarantor unlike in the rest of

²² Maximilano Rodríguez Fernández and Ligia Catherine Arias Barrera, Op.Cit, p.24-25; Neilsen, J., and Nicolai Nielsen, Op.Cit, p.188

²³ In Colombia, the stand-by letters of credit is seen as a generic instrument that could take the form of *Advance Payment Standby*, a *Bid Bond/Tender Bond Standby*, a *Performance Standby* or the *Commercial Standby*, amongst others; however, in practical terms, only the *Commercial Standby* is used pursuant to international legal rules of voluntary compliance such as IPS 98. *Commercial Standby* supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods: Neilsen, J., and Nicolai Nielsen, Op.Cit, p.189

²⁴ Traditional letters of credit are regulated by the Colombian Commercial Code, Articles 1408-1415, but these legal rules do not expressly refer to the Stand-by letter of credit and do not refer to the operability of this modern instrument since it was created after the enactment of these rules. To use the latter securing instrument, these general legal rules must be specifically complemented by the international commercial practice, which is compiled by the International Chamber of Commerce, known as UCP 600 and by ISP 98, in Maximilano Rodríguez Fernández and Ligia Catherine Arias Barrera, Op.Cit, p.8

²⁵ Thus, not having the previous rules as part of the Colombian legal framework is another reason not to include them within this research given that their effectiveness could not be challenged by the domestic shocks occurring between 1992-1995 and 2005-2010, and their effectiveness could not be treated by Colombian legislators or judges. Besides, it is to mention that the Uniform Rules for Demand Guarantees -URDG 758- are not commonly used by Colombian banks not even to secure imports or exports of goods and services; and, in addition, the URDG 758 could not be part of this research as they are not part of a domestic legal framework and their effectiveness could not be challenged, recover or prevented by Colombian legislators or judges, just like ISP 98.

the guarantees that were mentioned above; therefore this instrument will not be included in this research either.

This research, therefore, was designed to answer one main question: what is the level of resilience of the laws of performance bonds in Colombia when shocked by politico-economic policies? The question aims to establish the capacity of the laws of those financial instruments to resist, recover from, and prevent the effects of certain macro politico-economic changes that occurred in said country in the past three decades.

Accordingly, this research is divided into five parts. The first chapter has the appearance of the common historical chapter; however, the objective of this chapter is far from serving as a simple historical introduction. Indeed, the ways in which both the English and Colombian markets of performance bonds were not simply created upon the whim of their legislative institutions are analysed; it is suggested that they were created as a result of the convergence of political, legal, social and economic factors, in order to demonstrate an historical relation between those factors or changes and the aforementioned markets. The second chapter will suggest that the previous historical relation is not coincidental; this part, on the other hand, will propose that there is a marked tendency whereby certain changes – macro politico-economic policies – are capable of influencing the behaviour of markets of performance bonds both in developing and developed countries, and not only in Colombia. Then, in the third part, since English scholars are not necessarily familiar with the Colombian financial instruments mentioned in this research, it is important to describe their legal nature, and some issues related to the effectiveness of the laws of those financial instruments. Therefore, the following will be mentioned: 1) the “*contrato de fianza*”, which seems to be the equivalent of the English contract of guarantee, properly called; 2) the Colombian “banking guarantee”, which seems to be the equivalent of the English “true independent on-demand bond”; and 3) the Colombian “performance insurance”, which, for being an indemnity contract in general terms, appears to be the equivalent of the English “contract of indemnity”. The next chapter is the first original contribution and the axis of this research as it will present the first steps for the notion of the so-called

“resilience of laws”. This idea suggests that laws should be resistant against the shocks caused by social, economic, political and even environmental changes. The concept of resistance is based upon the concept of effectiveness, meaning that no law can be resistant if it is not effective. Resilience of laws is divided into two elements: a) static resilience –resistance; and b) dynamic resilience, which is the capacity to recover effectiveness when lost as the result of a shock, and to prevent ineffectiveness before a future shock. In the end, such dynamic intervention should lead to having resistant laws. The nature of the proposed notion of resilience of laws, necessarily leads to certain philosophical debates that are mentioned therein, but cannot be deeply discussed for their extensiveness would change the course of this research; yet, they should be addressed in future researches – as it is considered that the words provided in chapter four are only the first steps with regard to the notion of the resilience of laws. The final chapter is, therefore, the conjunction of the preceding chapters. It aims to confront “the resilience of laws” with the “changes”, the resulting “shocks”, and the legal natures described in chapter three, with the emphasis on Colombian instruments.

Thus, this research has three main objectives that represent an original contribution to knowledge. The first is to present the notion of resilience of laws, as mentioned above; although the author is aware that much needs to be said in relation to this matter, herein are introduced the first steps of a new concept that has been developed to protect the effectiveness of the laws in a modern way. This is relevant, given that the contemporary ideas carried out in developed countries to have effective laws, in practical terms, are still precarious and not always useful; the situation is much worse in developing countries such as Colombia. The second objective is another innovative matter referring to the creation of a “new expectation” that should fall upon legislators and judges: societies are constantly becoming more demanding with regard to the effectiveness of laws, and the aforementioned need to move forward accordingly. Thus, this study proposes for the first time that the latter characters, within the context of the “resilience of laws”, should now also safeguard the level of effectiveness of laws by revising any potential *change* that could later produce a *shock* against laws, and then by taking all

the recovery and preventative measures that are needed to maintain specific laws above the line of “sufficient effectiveness” (which is another notion introduced by this research). The third original contribution of this research is the result of assessing, based on the previous notions, the levels of static and dynamic resilience of the Colombian laws of performance bonds. This result may be particularly useful for Colombian scholars in the legal field of expertise as it will suggest that the laws of performance bonds, from the first moment they are shocked, are being taken along the wrong legal road. In the author’s opinion, taking the proper legal road to have resilient laws of performance bonds, in terms of Robert Frost, which involves going back to the yellow wood to take the road not taken before – considering now the strong relation between those laws and politico-economic changes in Colombia.

CHAPTER 1: THE STATE, THE ECONOMY, THE PEOPLE AND PERFORMANCE BONDS

INTRODUCTION

Firstly, the legislative organs, the courts and the governments should enquire of themselves, what is less harmful for their society and for a specific industry, such as the performance bonds industry: having an obsolete legal regime in a particular subject or not having a legal regime at all? An updated, harmonious, consistent, meticulous and correct legal regime is ideal for the addressees of the law; nevertheless, this is not the general rule. An obsolete regime is conceptually far from a wrong regime: the former was once pertinent whereas the latter is updated but the effect of its provisions does not meet the requirements demanded by society in order to safeguard its rights. In addition, the binding aptitude of an obsolete legal regime may suggest that the parties to a contract will coactively perform their obligations in a manner that is no longer in conformity to the current reality, and will restrain the natural evolution of the market.

The appearance of an obsolete legal regime is hardly conspicuous, given that it is caused not by defective laws, but by the development of performance bonds industries which is ultimately propelled by macro politico-economic policies, based on various factors²⁶ within a wide period of time; these developing industries are, in return, governed by rules that are no longer pertinent, creating a vicious circle. The evolution of the performance bonds market, thus, is normally faster than the legal and jurisdictional updating ability, or than the initiatives in regulation. As a consequence of the silent, progressive and perpetual tendency of deterioration of the legal regime, the law and reality begin lose their harmony, causing a forced lack of protection of both the guarantor and the obligee, and a subsequent flight of financial customers. Similarly to an obsolete legal regime, a flawed regime is also caused by the evolution of the industry because otherwise the legislative organs and courts would not try to intervene; it would be senseless to create a legal regime that is not needed. This flawed legal regime is, therefore, causing comparable consequences.

Thus, in this chapter, the strong relation between the macro politico-economic policies and the development of the performance bonds industry,

²⁶ The convergent factors that can motivate those policies refer to discoveries, revolutions, schools of thought, guerrilla movements, globalisation, financial crises, and wars, amongst many other influences around the world.

that would be the first link in the chain, will be demonstrated. Indeed, the first part of this chapter will suggest that many politico-economic changes provoked by the State and further external changes occurring in Colombian before the 1930 led to the creation of the Colombian legal regime of performance bond in hands of the insurance sector, for which the latter sector was the one that created the market of performance bonds as a line of business within insurance companies. In the second part of this chapter, it will be suggested that similar changes as those of Colombia, but these occurring a century earlier led to the creation of the market of performance bonds, and afterwards, unlike in Colombia, the law started to play a role in this context. Thus, in the UK, it was the market pulling its relevant regulation to the future, unlike Colombia, where it was the regulation the one in charge of creating an untested and improvised market to secure the due performance of contracts. Yet, this chapter suggest that in any of the latter jurisdictions (developed or developing country) there is a pattern of dependence in the evolution of performance bonds.

1. THE CONCEPTION OF THE COLOMBIAN PERFORMANCE BONDS MARKET UNDER COLOMBIAN INTERVENTIONISM

1.1. ORIGINAL LEGAL STRUCTURE OF PERFORMANCE BONDS

First, it is of paramount importance to establish that financial industries, such as insurance, banking or stock markets, have two groups of legal regimes. On one side would rest the provisions directed to structure the private discipline of contracts; on the other side is the set of rules that governs the control and supervision of financial companies. However, behind these groups of rules, there are other factors that have never been taken into consideration to protect the legal regime governing performance bonds.

It is well known that regulatory and supervisory authorities or the legislative organ in several jurisdictions²⁷ enact rules regarding technical requirements

²⁷ The most popular are: Colombia, Financial System Organic Statute; United Kingdom: The Financial Services and Markets Act 2000 (Although it may be superseded in the near future); Mexico: Federal Act of Surety Institutions of 1950 (This country has several Acts, one for each sector of the financial industry); France: Loi de la regulation bancaire et financière of 2010.

for financial companies in order to safeguard the public's wealth and to avoid financial failures or contagions. A precautionary legislation will always tend to prevent these sorts of risks, and will also enact laws enhancing the protection of both the obligee and the guarantor, but these ways are not the only ones in which the state directs the performance bonds industry; this is also unconsciously done based on the type of state and economic model that is implemented at some point,²⁸ based on a social reality.

Thus, it is fundamental to demonstrate that the aforementioned factors have been connected to the performance bonds market since its origins, and that the state is therefore the organ that is ultimately conducting the behaviour of the market, and causing the legal and technical deficiencies that will be mentioned later; once the status quo is lost, the legal regimes begin to be obsolete. Nonetheless, it is important to mention beforehand, that the forthcoming paragraphs are not an historical development, but the process of linking the performance bonds market with these factors, beyond the curtain of the law.

In Colombia, Act 45 of 1923 was the first regime that conceived the general framework of national interventionism in the banking and financial sectors; this Act followed the model of other countries²⁹ that had initiated a period of stronger intervention of the financial sector after the announced end of economic liberalism. Later, Act 105 of 1927 established a particular regime to govern the public aspects of the insurance industry whereby the Act was meant to include this industry under the regulatory and supervisory framework of the Colombian Financial Superintendence. This interventionism into the insurance industry was based on the essential protection that the people's wealth should be officially supervised, given that the technical design of premiums shows that, despite the fact that premiums can be demanded just after the validation of the insurance, they do not entirely belong to the insurer; premiums become a part of the insurer's assets progressively and proportionally as long as there are no claims. In the

²⁸ V.gr: Gendarme State, Interventionist State, Regulatory State, etc.

²⁹ Countries such as Spain, Brazil and Argentina in 1921 and 1922 were denoting a strong tendency towards a strict regime of regulation, supervision and sanction actions in the financial sector; on the other hand, other countries such as France or even Switzerland had no strong legislation regarding this, and were still mostly under the philosophy of free markets.

meantime, a proportion of total premiums belong to the public because they have the vocation to return to these customers, for which the State is under the obligation to intervene and safeguard resources that can be catalogued as capital raised from the public or even as customers' savings³⁰.

1.2. POLITICO-ECONOMIC CHANGES

Nevertheless, the aforementioned intervention was not a coincidence or an isolated idea; it was just a demonstration of the massive interventionist process that was going to start due to the Great Depression, the Soviet Revolution, the class struggle, the Marxist Theory, the Weimar Constitution, the Mexican Constitution, the economic scheme provided by John Maynard Keynes, the theory of the public service admitted by the French Council of State, the constitution of the “*École du service public*” represented by Léon Duguit, Gaston Jèze, Roger Bonnard and Louis Rolland,³¹ and finally, two World Wars.³² The cult of trade and free exchange led to the re-evaluation of the obligations of the Gendarme State, which was originally focused on three main functions – security, taxation and justice – where occasional public contracts were subscribed in order to provide the State with military supplies, and a very limited legal regime for construction contracts existed.³³ The Gendarme State, as the economic dimension of the Liberal State, was based on the idea of *laissez faire, laissez passer*, in which the latter did not intervene actively or positively. Thus, unlike the residual role of the above-mentioned type of State, the Interventionist State was given a primary function of satisfying the required basic needs of the marginal population;³⁴ especially given the lack of interest of private investors, due to the poor profitability or excessive amounts of money required to set the proper infrastructure to supply these public services.³⁵ This generated a massive

³⁰ Ordoñez Ordoñez, Andres E.: *Elementos Esenciales, Partes y Carácter Indemnizatorio del Contrato*, p. 44-45, Universidad Externado de Colombia, 2001; Colombian Civil Code, Article 1069-1070.

³¹ Montaña Plata, Alberto: *El concepto de servicio público en el derecho administrativo*, p. 17, 134, 136, 141, 146-147, Bogotá, Universidad Externado de Colombia, 2005.

³² Fandiño Gallo, Jorge Eliecer: *Impact of the regulatory State in state contracts: The Colombian Case*, p.48. Justicia Juris, ISSN 1692-8571, Vol. 6. No. 12, October 2009 – March 2010.

³³ *Ibid*, p.48.

³⁴ Durán, Victor Manuel: *Estado Social de Derecho, Democracia y Participación*, Par.3.3., VII Latino American Conference of Civil Servants. Valle de Bravo, Mexico, 2001.

³⁵ Fandiño Gallo, Op.Cit., p.49.

enlargement of the public structure and the monopolistic supply of public services to its associates.

Then, the “Liberal State subject to the rule of law” finally became the “Social And Democratic State subject to the rule of law”, where the authorities, amongst other functions, had to direct their activity towards a progressive line of equality of all the social sectors and improvement of their living conditions;³⁶ the State should generate the corresponding effects within the social, political and economic field, with human dignity as its foundation.³⁷ Therefore, the latter type of State is based on the intimate interconnection that exists between the Social and the State spheres.³⁸

This social upgrade was constitutionally ratified under the reform presented in 1936 where the pillars of the Social State subject to the rule of law were established, although these were later enhanced with future constitutional reforms;³⁹ finally in 1968, through another constitutional reform, the State was given the power of directing the economy.⁴⁰ Consequently, the implementation of the social policies offered by the new type of State was always meant to be carried out through its administrative arm that had already been created. However, the public administration was therefore facing a major problem: the directors of the public entities were ultimately liable for the public funds, placing the nation in a weak position, given the colossal amounts of public contracts in comparison to the assets of the civil servants that could have mismanaged those funds.

Moreover, another phenomenon occurred at the beginning of the 1920s. The already mentioned enlargement of the Colombian public structure in that

³⁶ Santamaría, Pastor J.: *Principios del derecho administrativo*, V II,-Ceura, Madrid, 2000. Cited by Fandiño Gallo: Op.Cit, p.49

³⁷ Hernández Galindo, José Gregorio: *Los servicios públicos en la Constitución Política, Los servicios públicos como instrumento de solidaridad y cohesión social del Estado*, p.27, Bogotá, Ediciones Jurídicas Gustavo Ibáñez. C. Ltda., 2005.

³⁸ Colombian Constitutional Court: *Decision C-566 of 1995*. Speaker Magistrate: Eduardo Cifuentes Muñoz.

³⁹ Jaime Vidal Perdomo, *El renacer de la noción de servicio público*, p.8-9, Los servicios públicos como instrumento de solidaridad y cohesión social del estado, Bogotá, Ediciones Jurídicas Gustavo Ibáñez. C. Ltda., 2005; Fandiño Gallo, Op.Cit, p.49

⁴⁰ Fandiño Gallo, Op.Cit, p.49

period⁴¹ led to one of the first major crises of the classic notion of public services⁴² that had been brought from France.⁴³ The crisis arose as a consequence of the expansion of the State as a public services supplier, since the Administration, for the purpose of satisfying public interest, began to carry out economic activities based on private law; as a result, the classical theory of public services that was being applied in certain countries such as Colombia entered into the mentioned crisis.⁴⁴

The aforementioned crisis demonstrated that public resources were insufficient to cover the total amount of basic needs of the people under the new type of State.⁴⁵ The above mentioned increase in the public structure and the limited resources led to the failure of the ambitious plan of the Nation, for which it subsequently had to permit and attract a large number of private resources to carry out the civil service successfully. The inclusion of private funds was particularly regarding the construction industry, which also led to the creation of the public concession contract which was aimed at improving the national infrastructure, and was gradually but reluctantly widespread to other services, such as the gas and the telegraph.⁴⁶ The civil service functions were still the direct responsibility of the State, due to its interventionist character; yet, private collaboration was achieved through the use of public contracts assigned by the civil servants in their capacity as directors of public entities.

⁴¹ This massive increase in the public structure and public expenditure due to the implementation of an interventionist model occurred not only in Colombia; this growth was also seen in countries such as the U.S., where a very substantial growth of their government expenditures took place between 1929 and 1949. This can be explained by the depression of the 1930s and the Second World War: Total public expenditures during these two decades increased from 9.9% to 23% of GNP. Rothenberg Pack, Janet: Privatization of Public-Sector Services in Theory and Practice, Journal of Policy Analysis and Management, Vol. 6, No. 4, Privatization: Theory and Practice (Summer, 1987).

⁴² Fandiño Gallo: Op.Cit, p.50

⁴³ This crisis of public services also took place in France, where the concept had been originally created by the Council of State. Zegarra Valdivia, Diego: *El Servicio Público, Fundamentos*, p.69, 1st Edition, Palestra Editores, Peru, 2005. The concept of "public service" was officially used for the first time in history in 1873 by the French Council of State in the so-called "Blanco" Decision, (Conseil d'État, Tribunal des conflits - 8 février 1873 - Blanco - 1er supplt - Rec. Lebon p. 61).

⁴⁴ Zegarra Valdivia, Diego: *El Servicio Público, Fundamentos*, p.69, 1st Edition, Palestra Editores, Peru, 2005.

⁴⁵ Fandiño Gallo: Op.Cit p.50

⁴⁶ Ibid, p.50

1.3. LEGAL CREATION OF THE MARKET OF PERFORMANCE BONDS

Until 1938 a significant number of political changes had taken place in Colombia caused by the external factors mentioned above, but none of them had a relation with the performance bonds industry for one simple reason: these bonds did not exist in Colombia at that time. Nevertheless, the factors and the government policies previously emphasized, ultimately conceived the creation of the Colombian performance bond. The nation's wealth needed to be protected in the middle of the establishment of the interventionist model, under the social and democratic state, and subject to the rule of law, where the civil service was mainly under the responsibility of the directors of public entities and occasionally under the collaboration of the private sector.

Consequently, because of the increasing volume of public contracts that was implied and the growing amount of public funds involved, another element was required: an undertaking in favour of the nation to guarantee public funds. It was then thought and was suggested that these hazards had to be covered not by the State, but by the insurance market⁴⁷.

Thus, the legislative power heard the call and enacted Act 225 of 1938 whereby it established the provisions for performance bond issued by insurance companies.⁴⁸ Accordingly, Article 2 of this Act stated that this sort of insurance⁴⁹ was included to guarantee the correct management of funds or values of any class, that are trusted to civil servants or private persons in favour of the public entities or persons to whom they are liable; this could be extended to the payment of taxes, tariffs and rights, and to the performance of obligations that emanate from acts and contracts. The aforementioned undertakings were therefore aimed at protecting the nation from the mismanagement of public funds in the charge of the civil servant in his

⁴⁷ Colombian Financial Superintendence: Performance bond contracts, Article No. 2003046122-2, *Doctrinas y Conceptos Financieros*, February 4th 2004.

⁴⁸ Colombian Act 225 of 1938, Article 1.

⁴⁹ As it will be stated later in this research, this is neither a typical contract of guarantee nor an insurance policy.

capacity as director of the public entity, and from the non-performance of the obligations in charge of the occasional private contractors.⁵⁰

In conclusion, the interventionist state and the gradual implementation of the Social State subject to the Rule of Law ultimately led to the legal birth of the Colombian performance bond (in the form of insurance) and to the regulation of the insurance market in order to safeguard those public funds; this would not have been necessary under the “Gendarme State”, given its characteristics.

Therefore, under the interventionist state, the nation’s wealth needed to be secured against all the new perils that arose as a result of those politico-economic changes, and the best way to do it was by transferring such risks to somebody else with sufficient legal and financial capacity. The question is, Why did the Colombian State choose the insurance market and the insurance contract to achieve such an end in the first half of the 20th century?

1.4. THE INSURANCE MARKET: THE LEADER OF COLOMBIAN BONDS

Firstly, the Colombian Act 225 of 1938 established that those risks had to be covered by “insurance companies” if possible. Indeed, the first article states: “The Government will endeavour that some or at least one of the insurance companies in the country have to establish the fidelity and performance bond treated in this Act, and under the conditions set herein; in case this is not possible, the government will carry out the appropriate actions for the foundation of a public limited company of performance or fidelity bonds”.

According to Willis D. Morgan, a few writers consider performance bonds companies to be insurers,⁵¹ while other authors view them as something unique, a hybrid as it were, devoted neither to insurance nor banking but

⁵⁰ Ordoñez Ordoñez, Andrés: *Efectividad de la garantía única de cumplimiento de contratos estatales, Constituida a través de póliza de seguro de cumplimiento*, p.136-137, Private Law Journal, No. 19, Universidad Externado de Colombia, 2010.

⁵¹ Blanchard and Moore, *Corporate Bonding*, Proceedings of the Casualty Actuarial and Statistical Society of America, Vol. VIII, Par. 1; Towner, Premiums and Rates, Insurance Society of New York, Lecture XI. Cited by Morgan, Willis D: *The History and Economics of Suretyship*, p.495, 12 Cornell Law Quarterly 487, 1926-1927.

related perhaps to both;⁵² nevertheless, U.S. Courts held them to be insurers.⁵³ *Tebbets v. Mercantile Credit Guarantee Co.*,⁵⁴ established that: “Corporations entering into contracts like the one at bar may call themselves ‘guarantee’ or ‘surety’ companies, but their business is in all essential particulars that of insurers, [...] Their contracts are, in fact, policies of insurance, and should be treated as such”.

Morgan pointed out that the preceding statement had been justified from an economic standpoint, since insurance has been defined as “[...]a social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of the risks of many individuals to one person or to a group of persons”.⁵⁵ However, technical insurance presupposes that the risks that are going to be transferred have to satisfy certain conditions: a) as to the beneficiary, the happening of the event, upon which the policy is to be conditioned, must be an accident; b) that this event must be of such a nature that it is not likely to happen in every instance in which a policy is issued, or in any great number of instances at the same time; and c) that the extent of the loss, in a given number of cases and for a given time, be scientifically ascertainable, to some degree of accuracy, upon the basis of past experience. Therefore, Morgan said, a risk of this nature, commonly known as a static risk, may be made the subject of insurance.⁵⁶ These risks with which performance bonds companies are concerned come directly within this class and the transfer of these risks by persons or corporations would seem to constitute insurance.⁵⁷

⁵² Mason: *Origin and History of Suretyship* 7; Mason, Jarvis W.: *Radio Talks, American Surety Company of New York, 1924*; Roulston: *Fidelity Bonds, Surety Bonds, Casualty Policies*; Joyce: *Proper Reserves for Fidelity and Surety Claims*, all cited by Morgan: 12 *Cornell Law Quarterly* 487, Op.Cit. p.496

⁵³ Arnold, *The Compensated Surety (1926)* 26 *Col. L. Rev.* 177 and cases cited; 60 *Bankers' Magazine* 216; R.R. Brown: *Corporate Suretyship* 2; MC Rae: *A new View of Suretyship (1891)* 15 *Va. L. Jour.* 181, all cited by Morgan: 12 *Cornell Law Quarterly* 487, Op.Cit, p.496

⁵⁴ (C. C. A.) 73 F. 95, 97, decided in 1896, cited by Morgan, 12 *Cornell Law Quarterly* 487, Op.Cit. p.496.

⁵⁵ Willett: *The Economic Theory of Risk and Insurance* 106, cited by Morgan, 12 *Cornell Law Quarterly* 487, Op.Cit. p.496

⁵⁶ Haynes: *Risk as an Economic Factor*, 9 *Quarterly Journal of Economics*, cited by Morgan: 12 *Cornell Law Quarterly* 487, Op. Cit. p.497

⁵⁷ Morgan, 12 *Cornell Law Quarterly* 487, Op. Cit. 497-498.

In addition, the Colombian confusion between performance bonds and insurance was also caused by a foreign, historical reason. Lord Mansfield incorporated the principles of insurance law from Law Merchant to the Common Law,⁵⁸ but from his perspective there was still a clear distinction⁵⁹ between a three-party performance bond and the two-party insurance policy.⁶⁰ It was said then that if the performance bond company were required to indemnify the obligee for loss due to the default of the human principal, the latter had a duty to indemnify the performance bond company; therefore, in theory, the company should not suffer a loss from the risk assumed. Nevertheless, the simple ability to avoid a loss could not provide any incentive for a person to undertake the well known dangers inherent in performance bonds, whilst the financial stability of the insurer depended upon the pooling of risks and the actuarial principle of averages.⁶¹ Thus, it was established that a commercial performance bonds was to charge a premium including: a) operating expenses; b) losses caused by the inability of some principals to provide indemnity; and c) a profit.⁶² However, insurers, given the forces of nature and the losses that could not be recovered, were charging a premium that consisted of: a) operating expenses; b) unavoidable losses caused by the risks of nature assumed; and c) a profit. Nevertheless, as stated by Edward G. Gallagher: “Over time [...] this historical distinction between insurance and suretyship became less clear. The types of risks assumed by insurers broadened to include loss from human conduct, both intentional and unintentional. Two parties blanket fidelity insurance policies issued by incorporated insurers began to replace three party individual fidelity bonds written by individuals. Scientific knowledge increased to

⁵⁸ In England, Lord Mansfield, who was Chief Justice of the King’s Bench from 1756 to 1778, began the process of incorporating Equity, and the Law Merchant into the Common Law, in the period of American Independence, and while Colombia was still part of the Viceroyalty of New Granada. The Viceroyalty of New Granada was a Spanish colonial jurisdiction in South America that included what today is Colombia, Venezuela, Ecuador, Northern Peru, Panama, and other small territories, where the capital was Santa Fe de Bogotá, the principal administrative centre in the New World. In other words, Colombia was not still able to govern itself, until Independence which started in 1810.

⁵⁹ These are only historical differences; at the present time the number of differences is much larger, despite some jurisdictions disregarding them. (These differences will be treated in greater depth later in this research).

⁶⁰ Gallagher, Edward G.: *The Law of Suretyship*, p.18, Second Edition, American Bar Association, KF1223. L39, 2000.

⁶¹ Gallagher Op.Cit. p.18

⁶² Ibid, p.18

provide greater insights into causes of losses. Once human responsibility for insured losses could be fixed, the courts applied the equitable principle of subrogation to insurers, as well as to sureties”.⁶³

Consequently, the clear intention of the Colombian Act 225 of 1938 was that insurance companies, in accordance with their corporate purpose, should issue insurance contracts under the legal form expressly given in this law (performance bond) and fidelity bond. Likewise, these forms of contracts were not to be treated as an exception to the general legal regime for insurance contracts;⁶⁴ in other words, it was wrongly believed that a performance bond was an insurance contract, when, in fact, there are several differences between these two notions.⁶⁵ Therefore, within this context, as was expected, all the issues that could arise from turning this exotic “performance insurance” into a more usual undertaking in the public contracting field were not foreseen.⁶⁶ Thus, Colombian insurance companies, based on their state-regulated solvency soundness and its corporate purpose, were designated to assume the payment for the eventual damages that could harm the State by reason of the breach of public contracts or the dishonesty of public officers, given its position of trust.⁶⁷

Despite all these factors and the interventionist state policies ultimately leading to the creation of a “performance bonds market” in Colombia, this market was brought to life without technical, corporate or legal structures, even worse, without commercial and professional experimentation; the only similar figures that Colombia had before the enactment of Act 225 of 1938 were the private sureties. Conclusively, due to the way the market was initially conceived and the reasons for its conception, it started by being a

⁶³ Ibid, 18.

⁶⁴ Ordoñez Ordoñez, Andrés: *Efectividad de la garantía única de cumplimiento de contratos estatales, Contituida a través de póliza de seguro de cumplimiento*, Op.Cit, p.136.

⁶⁵ These differences are mentioned in: Cushman, Edward: *Surety Bonds on Public and Private Construction Projects*, p.649-650, 46 A.B.A. J. 649, 1960; Cross, J. Harry: *Suretyship is not Insurance*, p.235-237, 30 Ins, Counsel J. 235, 1963.

⁶⁶ This is the one representation of the legal issues caused by the improvisation of the legislative organ. This was weakly fixed by the Colombian Supreme Court of Justice and by the Council of State in the following years. It was later amended by further Acts and Decrees that suffered from the same problems. Nevertheless, this will be looked at in greater depth later in this research, together with other legal and technical deficiencies of performance bonds.

⁶⁷ Ordoñez Ordoñez: *Efectividad de la garantía única de cumplimiento de contratos estatales, Contituida a través de póliza de seguro de cumplimiento*, Op.Cit. 136.

fragile and artificial market made by the legislative organ, devoid of any natural process.

However, in defence of the latter emerging economy, it is vital to point out in this research that since all developed economies were once less developed, some people have not shown sufficient awareness of the similarity of their issues to those of the current developing nations;⁶⁸ nonetheless, the nature of the legal regimes currently enacted are designed depending on the reality of the nation where these are going to govern and for the moment of the enactment, and not for other circumstances. To reinforce this statement it is suggested that Colombia is currently living in a sort of Industrial Revolution in its second stage, but is legally treated as a developed economy.

The subsequent question, then, is whether there is another precedent of a particular type of state that could ultimately determine the birth and future behaviour of the performance bonds market, through its social and politico-economic policies.

2. THE CONCEPTION OF THE ENGLISH PERFORMANCE BONDS MARKET, THE RULE OF LAW AND LIBERALISM

2.1. NATURAL DEVELOPMENT OF THE ENGLISH MARKET OF BONDS

Unlike the Colombian case, the English performance bonds market was progressively created as a requirement of trading life, and not due to a sudden and improvised law without a previous process of experimentation. It was then the performance bonds market urging the law to protect the legal parties, and not a law, full of legal loopholes, urging the financial industry to create a performance bonds market. However, the English performance bonds industry was also a consequence of a chain of factors that occurred in Western Europe, in which the state and the economy both had an essential role.

⁶⁸ This statement is backed by authors such as: Iniroki, Joseph E.: *Slavery and the Development of Industrial Capitalism in England*, p.772, *The Journal of Interdisciplinary History*, Vol. 17, No.4, Caribbean Slavery and British Capitalism, The MIT Press, 1987.

Since the time of Queen Elizabeth I the evils of the system of private performance bonds⁶⁹ were beginning to be felt.⁷⁰ The private guarantor used to assume the risks mainly based on the qualities of the undertaken person, and until the amount they subjectively considered was payable before risking his business.

Therefore, the first precedent of corporate performance bonds within this era is recorded in an advertisement appearing in the *London Daily Post* of June 10 of 1720, which stated:

*“Whereas notwithstanding the many excellent Laws now in force for punishing hired servants⁷¹ for Robbing their masters, or mistresses, yet noblemen as well as commoners are daily sufferers; and seldom a Sessions but great numbers are convicted, to the utter ruin of many families, as also a scandal to the Christian religion. This is to give notice that at the request of several house-keepers, Books will be open’d next Saturday at the Devil Tavern, Charing Cross, a 10 a clock, wherein any person may Subscribe, paying 6d. p.c. for a share call’d a £1000 stock; no more shares than 3000, and the call for a stock not to exceed 10s. p.c. the first year by quarterly payments. This So. Will ins. To all masters and mistresses whatever loss they shall sustain by Theft from any servant that is Tick’d and Register’d in this So.[...]”*⁷²

⁶⁹ For a detailed explanation of the evolution of this type of performance bond, see: Hawxhurst, Ralph R.: *Dawn and Evolution of Suretyship*, p.76-81, *The Insurance Counsel Journal*, Vol. 3, Issue 4, 1936; Morgan, Willis D.: *History and Economics of Suretyship*, 12 *Cornell Law Quarterly* 153, p.153-171, 1926-1927; Jones, Philip K. Jr.: *Roman Law Bases of Suretyship in Some Modern Civil Codes*, 52 *Tul. Law. Rev.* 129, 1977-1978; Lloyd, *The Surety*, 66 *U. Pa. L. Rev.* 40, 67, 1916; Weichelt, George M: *Corporate Suretyship*, p.39, 1 *Ins. Counsel J.* 40, 1934; Hazeltine: *The Formal Contract of Early English Law*, p.608, 609, 612, *Selected Readings on the Law of Contracts* 1, 1931; Gallagher, *Op.Cit.*, p.18.

⁷⁰ Morgan, 12 *Cornell Law Quarterly* 153, *Op.Cit.* p.162

⁷¹ It is of paramount importance to highlight that: “ [...] the word “servant”, as then used, included not only those whom we now so designate but also “clerks” and “all other persons holding positions of trust and not themselves principals.”: Morgan, 12 *Cornell Law Quarterly* 153, *Op.Cit.* p.163

⁷² *Ibid.*, p.163-164

Nevertheless, the fate of this first commercial enterprise that intended to replace private performance bonds is unknown, and more than a hundred years passed before corporate performance bonds was developed further.⁷³

Accordingly, professional and corporate performance bonds initiated its conception process by the middle of the 19th century, albeit it was created under a scenario of quotidian trade and fixed customs, freedom of commerce, increasing necessities of merchants and employers, and not due to a legislative imposition. The aforesaid situation is worthy of analysis since it is a precedent on how a type of state has a fundamental influence on the performance bonds market and its legal regime, without intervening in the latter.

Thus, the antidemocratic or irrational capitalism prevailing in Western Europe by the seventeenth and 18th centuries, so-called mercantilism, came to an end.⁷⁴ This economic model had expressed a comprehensive intervention of the Absolutist State in the economic life of the European societies, conceiving a truly commercial capitalism of state. It signified, in global terms, the defence of domestic production, the development of the fiscal system, the control of monetary and credit systems, the establishment of privileges and subsidies to spur commerce and industry, and the regulation of the production of specific goods,⁷⁵ under the umbrella of the state.

In effect, the mercantilist economy was subject to the king power's discretion, and not to the stability of the legal rules. It could be said that there was a governing rule, although it was unconnected with reality in such a manner that, instead of having a "state subject to the rule of law", there was a "state of legality".⁷⁶ The latter state existed under mercantilism because it conceived formal legal rules that were produced by the current or prevailing state authority in a certain period; and these rules were imposed on society by

⁷³ Gallagher, Op.Cit. p.26

⁷⁴ Weber, Max: Ed by: Graciela Inda and Celia Duek: *"Historia económica general"*, p.398, Fondo de Cultura Económica: México. 1997.

⁷⁵ Anderson, P.: *Linhagens do Estado Absolutista*. De. Brasiliense, San Pablo, 1985; Ardant G.: *Nations*", cited by Tilly C. *The Formation on National States in Western Europe*, Princeton University Press, New Jersey, 1975.

⁷⁶ Gherzi, Enrique: *Las Consecuencias Jurídicas del Mercantilismo*, p.1, Cato Institute, Washington D.C., 2009.

force.⁷⁷ Also, unlike the forthcoming state subject to the rule of law, under the state of legality the law did not restrict power; it stressed the latter. The law was therefore an instrument of social control, of dominance,⁷⁸ easily governable through the state nations.

Notwithstanding the massive extension of mercantilism under the absolutist states, this economic system fell into a crisis principally caused by convergent factors such as: the English Civil War; the English Glorious Revolution; the American Independence; the Age of Enlightenment; the Bourgeois Revolution; the French Revolution; the first stage of the Industrial Revolution, the discovery of America, amongst others. This led to the conception of the “State subject to the Rule of Law”, where classical liberalism was implemented, lasting until the interwar period. This new form of state brought to modern life a comprehensive philosophy containing illustrious, constitutional, legal and economic reforms in order to thwart the policies of the Monarchist State, which, in the end, set the perfect environment for the natural creation of the English performance bonds market, the corporate performance bonds.

2.2. POLITICO-ECONOMIC CHANGES AND THEIR RELATION WITH PERFORMANCE BONDS

The most important economic reform was the implementation of economic liberalism⁷⁹ that was considered to be the organizing principle of a society aiming at creating a free market system;⁸⁰ nonetheless, this economic reform was possible for reasons of the constitutional protection given to society and

⁷⁷ Ibid, p.2

⁷⁸ Ibid, p.2

⁷⁹ Like any other political theory, there are different versions of liberalism, ranging from the social welfare liberalism of John Rawls, to the libertarian liberalism of Robert Nozick, to the conservative liberalism of Friedrich Hayek, to the pluralistic liberalism of Isaiah Berlin, to the egalitarian liberalism of Amy Gutman: Tamanaha, Brian Z.: *On the Rule of Law, History, Politics, Theory*, p.32, University Press, Cambridge, 2004; Mill, John Stuart: *On Liberty 1860*, p.3-4, Harvard Classics 1909, P.F. Collier and Son. In: http://people.emich.edu/jtodd/mill_on_liberty.pdf. Last Revised: 3 August 2011; Kurland, Philip B.: *The Rise and Fall of the Doctrine of Separation of Powers*, p.596, 85 Mich. L. Rev. 592 (1986-1987); Merryman, John Henry: *Comparative Law and Social Change: On the Origins, Style, Decline & Revival of the Law and Development Movement*, p.458, The American Journal of Comparative Law, Vol. 25, No. 3, Summer, 1977.

⁸⁰ Polanyi, Karl: *The Great Transformation, the political and economic origins of our time*, p.77, Beacon Press, Boston, 1944.

the legal reforms.⁸¹ In effect, Polanyi stated, with regard to the establishment of the economic model:

“To antedate the policy of laissez-faire, as is often done, to the time when this catchword was first used in France in the middle of the eighteenth century would be entirely unhistorical; it can be safely said that not until two generations later was economic liberalism more than a spasmodic tendency. Only by the 1820's did it stand for the three classical tenets: that labor should find its price on the market; that the creation of money should be subject to an automatic mechanism; that goods should be free to flow from country to country without hindrance or preference; in short, for a labor market, the gold standard, and free trade. [...] In England, [...] laissez-faire was interpreted narrowly; it meant freedom from regulations in production; trade was not comprised”.

The aforementioned production, due to the first Industrial Revolution and the power of the bourgeoisie,⁸² showed massive growth at its level. Most industries increased their output by between 40% and 200% from 1770 to 1815, and by 33% and 150% from 1815 to 1841.⁸³ In addition, it has been written that “whoever says Industrial Revolution says cotton”,⁸⁴ although iron may be added.⁸⁵ The proof is that the production of cotton increased by 2200% in the first period and by 400% in the second; and iron production by 350% and by 250% respectively, amongst many others, albeit not as significant.⁸⁶

Given the abrupt augmenting of the domestic production in Britain during the dates mentioned above, trade markets felt a consequent expansion; in other words, the number of conducts to be guaranteed increased. The

⁸¹ Perhaps the most important law regarding the implementation of economic liberalism, in social terms, was the New Poor Law or Poor Law Amendment Act 1834.

⁸² The bourgeoisie means the class of Modern Capitalists, owners of the means of social production [...]. In: Marx, Karl and Engels, Friedrich: *The Communist Manifesto*, p.79, Bourgeois and Proletarians, Penguin Books, 1967.

⁸³ Harley, C. Knick: *British Industrialization Before 1841: Evidence of Slower Growth During the industrial Revolution*, p.268-269, *The Journal of Economic History*, Volume 42, Issue 2, June 1982.

⁸⁴ Hobsbawn, E. J.: *Industry and Empire*, London, 1969 in Harley, Op.Cit. p.268

⁸⁵ Harley, Op.Cit. p.269

⁸⁶ *Ibid*, p.269

demand for goods and services was higher for some factors, such as foreign demand, the demographic transition lived in Britain in the preceding years, and the economic and legal reforms implemented during those dates.

The external sector stimulated the growth of incomes and employment in different ways that were crucial to the structural transformation of the English economy and society in the 18th century; the commodity production for exports directly accelerated the growth through trade and its transportation.⁸⁷ Inikori states that: “Because of the relatively large volume of English overseas trade in the 18th century, and the long distances involved, the external sector of trade and transport regularly generated more income than the domestic sector. [...] Taking industry, trade, and transport together, the contribution of foreign trade to the combined incomes of the sector rose from £7.2 million in 1700, or 29.9% of the total, to £54.2 million in 1811, or 48.1%.⁸⁸

Accordingly,⁸⁹ the growth of England’s population from 4.9 million in 1680 to 11.5 million in 1820 was a major factor in the expansion of the domestic market. This demographic growth and its concentration on important trading and manufacturing centres reinforced the stimulating impact of foreign trade in providing a final push that propelled the economy.⁹⁰ This demographic transition, where the domestic demand increased due to the larger number of claimed needs, was vital for the natural consumption of the vast production. This was later explained in conformity with the liberal economic principles where the total production was going to be spontaneously demanded by society, paying no attention to the overwhelming production, and without the intervention of the State. Thus, with regard to this cause of growth, by the 19th century the domestic demand was three times higher and therefore the quantity of contracts was progressively higher.

Great Britain was then becoming an industrial centre, and the legal, economic and demographic factors described above also generated social

⁸⁷ Iniroki, Op.Cit. p.783

⁸⁸ Ibid, p.783

⁸⁹ The relation between foreign trade and the motives for the population growth can be deeply studied in: Iniroki, Op.Cit. p.783

⁹⁰ Inikori, Op.Cit. p.783

implications in this period, which were recognized worldwide in the forthcoming years. The birth of a new social class, the so-called proletariat, marked an important moment within the natural process of corporate performance bonds. Proletarians had no wealth other than their labour power, and therefore no capacity for production.⁹¹ Thus, given the liberal conception of rights implemented by the British state at that time, this working class had to sell its labour to the other social class, the bourgeoisie, generating a multiplication of the existing “employer-employee” relationships,⁹² amongst further innumerable consequences. The colossal growth of these labour relationships was going to be another raw material of the corporate performance bonds and cause of its creation, due to a specific line of business proposed in this industry by the middle of the 19th century (fidelity bond).

The expansion of the market system in the aforementioned century was synonymous with the simultaneous spreading of international free trade, competitive labour markets,⁹³ an immense development in commerce, navigation and communication over land. This development had, in turn, reacted to the extension of industry; and as industry, commerce, navigation, and railways extended, in the same proportion the bourgeoisie developed and increased its capital. Economic liberalism, led by Adam Smith⁹⁴ and other

⁹¹ By Proletariat is meant the class of modern wage-labourers who, having no means of production of their own, are reduced to selling their labour power in order to live: Marx, Karl and Engels, Friedrich: *The Communist Manifesto*, p.79, Bourgeois and Proletarians, Penguin Books, 1967.

⁹² Although it has been stated by some authors that this period stimulated the growth of employment (Inikori, Op.Cit.p.782-785), the exact rates are not given since the British Government only started collecting the figures in 1851: To revise the estimates see: Lindert, Peter, H. and Williamson, Jeffrey G.: *English Workers' Living Standards During the Industrial Revolution: A New Look. p.3-18*, Second Series, Volume XXXVI, No.1, February 1983

⁹³ Polanyi, Op.Cit. p.19

⁹⁴ Smith, Adam: *An Inquiry into the Nature and Causes of the Wealth of Nations*. Edwin Cannan, ed. London: Methuen & Co., Ltd. 1904. Library of Economics and Liberty [Online] available from <http://www.econlib.org/library/Smith/smWN19.html>; Last Revised 16 August 2011.

economists,⁹⁵ then turned into a secular religion once the great perils of this venture were evident.⁹⁶

Nonetheless, as Polanyi argues in his classic study of the Industrial Revolution in Britain, the initial extension of the market was very much an act of the state;⁹⁷ indeed, every step in the development was accompanied by a corresponding political advance. Accordingly, Polanyi stated⁹⁸: “[...] the leading free trade industry— were created by the help of protective tariffs, export bounties, and indirect wage subsidies, *laissez-faire* itself was enforced by the state. The 30s and 40s [of the 19th century] saw not only an outburst of legislation repealing restrictive regulations, but also an enormous increase in the administrative functions of the state, which was now being endowed with a central bureaucracy able to fulfill the tasks set by the adherents of liberalism. To the typical utilitarian, economic liberalism was a social project which should be put into effect for the greatest happiness of the greatest number; *laissez-faire* was not a method to achieve a thing, it was the thing to be achieved. True, legislation could do nothing directly, except by repealing harmful restrictions. But that did not mean that *government* could do nothing, especially indirectly. On the contrary, the utilitarian liberal saw in government the great agency for achieving happiness [...] through administrative organs”.

Thus, the implementation of a number of government policies in order to consolidate the “liberal state” demonstrated that there was nothing natural about *laissez-faire*; free markets could never be turned into what was proposed by allowing things to take their natural course.⁹⁹ It was the influence of the state that co-supported the massive English expansion of the market, particularly by the middle of the 19th century. In other words, these factors led to an augmenting of the number of commercial contracts, of

⁹⁵ David Ricardo, Jean Baptiste Say, Thomas-Robert Malthus (together with Adam Smith, they formed the “École Classique”); J.S. Mill, S. Sismondi, F. List, C.H. de Saint Simon (Reformist current); On the other hand, C. Fourier, K. Marx, P.J. Proudhon, R. Owen (Socialist current); and others such as Augustine Cournot, Friedrich Hayek, John Rawls, Robert Nozick, Isaiah Berlin, Amy Gutman.

⁹⁶ Polanyi. Op.Cit.p.19

⁹⁷ Hodgson, Geoffrey, M: *Varieties of Capitalism and Varieties of Economic Theory*, p.393, Review of International Political Economy, Vol. 3, No, 3, 1996

⁹⁸ Polanyi, Op.Cit. p.19

⁹⁹ Ibid, p.19

underlying agreements; more clearly they generated an increase in the raw material required by a potential performance bonds market.

The creation of the performance bonds market was not a consequence of the deficiencies of the private sureties, as has been suggested;¹⁰⁰ it was part of an involving economic, legal and constitutional philosophy (classical liberalism) that could only take place under the reality lived within that period of modernisation. Even if private sureties had been effective, the modernisation of the performance bonds industry had occurred; therefore, it cannot be seen as the relevant cause. In addition, with regard to the static element of this process, it worth mentioning that after the mercantilist economic model came to an end, where corporations were no longer affiliated to the state and under its arbitrary protection, the official implementation of liberalism¹⁰¹ turned these corporations into entities free of government direction. The economic part of the theory was then reinforced by modern company law as a subsequent factor of economic liberalism that influenced the creation of the performance bonds market, due to the progressive lifting of government restrictions. For more than a century, beginning with the enactment of the Bubble Act in 1720, the formation of joint-stock companies in England was prohibited. The only legal possibility was to obtain specific state authorization, in the form of a Charter or Act. This induced entrepreneurs to organize into family firms, closed partnerships, or unincorporated companies of doubtful legality.¹⁰² Perhaps this is another explanation for the unsuccessful fate of the performance bonds enterprise that was proposed in 1720.¹⁰³

The functional limitations experienced by these forms of association became more critical as these organizations grew larger, as risks increased and as managerial responsibilities became more complex. But in 1825, unexpectedly, the Act was repealed, marking a turning point in the attitude of

¹⁰⁰ For a different opinion, see: Morgan: 12 Cornell Law Quarterly 153, Op.Cit, p.162-163; Gallagher, Op.Cit., p.26.

¹⁰¹ Smith, Adam: *An Inquiry into the Nature and Causes of the Wealth of Nations*. Edwin Cannan, ed. London: Methuen & Co., Ltd. 1904. Library of Economics and Liberty, Available from <http://www.econlib.org/library/Smith/smWN19.html>, Last revised 5 September 2011.

¹⁰² Harris, Ron: *Political economy, interest groups, legal institutions, and the repeal of the Bubble Act in 1825*, p.675, *Economic History Review*, L, 4, 1997

¹⁰³ Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.164

Parliament¹⁰⁴ to these companies, and starting a process that led to the enactment of the Joint Stock Companies Acts 1844 and 1856, the Limited Liability Acts 1855 and 1856, the Companies Act 1862,¹⁰⁵ and eventually to the rise of big business managerial capitalism and corporate economy.¹⁰⁶ This reinforced the idea thought up by entrepreneurs of creating a sound and experimental company that could fulfil professionally the requirements of modern performance bonds, in a standardized manner.

Therefore, it is conceivable that by the middle of the 19th century, the economic liberalism had infiltrated every aspect of both the modern government and the national economy; thus, all the factors were set in order to create, “naturally”, a professional, commercial and experimental performance bonds market to secure the performance of contracts, as seen today.

Consequently, once all the conditions for the proper initiation of a professional and structural model that could offer guarantees (in the broadest sense) to modern life were set, the experimentation era for performance bonds began.

2.3. THE EXPERIMENTATION AND IMPLEMENTATION ERA OF PERFORMANCE BONDS

In the August issue of the *Dublin Review* of 1840, an article by Professor Willis D. Morgan of London University was published, in which he stated that in 1837, the American, William L. Haskins, published a pamphlet¹⁰⁷ entitled “Considerations on the Project and Institution of a Guarantee Company, on a New Plan: with some general views on credit, Confidence and Currency,” in which the organization of company, named The New York Guarantee Co. was proposed.¹⁰⁸ Foreseeing the financial requirements of the proposed company,

¹⁰⁴ It is important to highlight that the Parliament was then the responsible organ to regulate, and no longer a restricted government as a consequence of the legislation.

¹⁰⁵ The General Incorporation Act 1844 was also fundamental in this process. The Companies Act 1862 was later fortified by the House of Lords in the case: *Salomon v. A Salomon and Co Ltd. AC22, 1897.*

¹⁰⁶ Harris, Op.Cit. p.675.

¹⁰⁷ A copy of this pamphlet is to be found in the Library of Congress, Washington, D.C. It was published by D. Felt and Co., 245 Pearls St., New York City, in 1837: In Morgan, 12 Cornell Law Quarterly 487, Op.Cit. p.492

¹⁰⁸ Gallagher, Op.Cit, p26; Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.164-165

this American said that it was to have a capital of ten million dollars “secured to be paid by the several persons composing the Company, on Real Estate of undoubted value, *** the Trustees.” [...] “The object and business of the Association will be to *guarantee* the payment of noted and *other written obligations or contracts*, whether of individuals, corporations, or private associations; to undertake the strict fulfillment and execution of trusts, escrows, wills, and endowments; to exercise other duties of Financial Mediation and Agency, and to do other things relative thereto.” [...] “Whenever this system may be adopted, there would be an end to the system, and the necessity, of individual endorsement; a species of accommodation ever dangerous – always to be avoided – laying the parties who yield to it under mutual obligations that, in their interchange, often lead to serious mutual injury”. Therefore, Morgan states that, according to these provisions of the plan as well as from the name of the company, it is clear that an institution, whose main function would be to act as a guarantor, was contemplated.¹⁰⁹ As a consequence, and despite this company never being formed, Morgan pointed out that “To this American, Haskins, is thus to go all credit for having first conceived of the corporate performance bonds, in its broader and more significant aspects”.¹¹⁰

Therefore, three years later, in the aforementioned article, Willis D Morgan proposed applying the principle of averages to the writing of fidelity insurance.¹¹¹ Through the article, the author explained the technical aspects of the proposed company and said that the operations should be in accordance with the established mathematical principle used in insurance. Nevertheless, it is essential to stress that this article only mentioned fidelity business, the least important of modern bonds lines,¹¹² although it was the starting point for corporate performance bonds. Subsequently, during this experimentation process, in 1840 two companies were organized, but only the Guarantee Society of London operated and it was an immediate success.¹¹³ This company, based on the vast amount of employer-employee

¹⁰⁹ Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.165

¹¹⁰ Ibid, p.165

¹¹¹ Gallagher, Op.Cit. p.26; Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.165

¹¹² Morgan: 12 Cornell Law Quarterly 153, Op.Cit., p.165-166; Gallagher, Op.Cit, p.26

¹¹³ Ibid, p.26

relationships, followed the structure and objectives given by Morgan in the *Dublin Review*.

Thus, as Hodgson says, even in “*laissez-faire*” Victorian Britain, the State was necessarily intimately involved in the formation and subsequent regulation of the market,¹¹⁴ given its liberal character. On June 18 1842, less than two years after the above-mentioned company was incorporated, an Act was passed by Parliament entitled “An Act for regulating Legal Proceedings by or against ‘The Guarantee Society’ and for granting certain powers thereto.”¹¹⁵ In addition to the regulation of the business of this company, the Act established, “Be it therefore enacted, That from and after the passing of this Act it shall and may be lawful to and for the Lord High Treasurer and Commissioners of the Treasury, or any three or more of them, or the principal officer or officers of *any other public office or department* in which any person or persons shall be required to give security by bond or otherwise,^{***} to take and accept ^{***} the guarantee or security of the said Guarantee Society ^{***}.” As Willis Morgan affirms, this Act was a decided stimulus to the business of the company since it had received the stamp of government approval¹¹⁶.

Further models of corporate performance bonds, including the combination of life and fidelity insurance and the creation of the British Surety Co. were experimented with. But it was not until 1852 and 1853 that corporate performance bond contract was proposed in England, as mentioned before, once the pre-conditions were given by liberalism in the middle of the 19th century. In the first year, the prospectus for the Contract Guarantee Co. stated: “The object for which this company is incorporated, is to supersede the necessity of individual security under commercial or trading contracts by providing that of an associated body”; unfortunately, this company was never formed. In 1853, another prospectus of the Achilles, for the Contract Guarantee Co. stated: “The success of those companies which have been established to provide a substitute for personal guarantees for fidelity is well known; but no company at present exists securing the performance of

¹¹⁴ Hodgson Op.Cit, p.403

¹¹⁵ Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.166

¹¹⁶ Ibid, p.166

contracts, *** One of the objects of this Society, therefore, will be to take the place of the surety in those instances, so that any contractor of known respectability and ascertained credit may be able immediately to offer to his principal an undoubted and unquestionable security of the due performance of this contract".¹¹⁷ However, once again, this company was never incorporated and the Achilles did not enter into this class of business.¹¹⁸

The performance bonds business had assumed real proportions in Great Britain, and between 1860 and 1875 ten new companies entered the performance bonds field. By the latter year the corporate performance bonds industry had thus become an established institution where the fidelity business was extensive and was being written on sound underwriting principles, including the modern *floating policy*;¹¹⁹ the companies had also ventured into the field of contract bonds.¹²⁰ The date on which the practice of insuring the performance of contracts of public contractors was initiated is uncertain, but these sorts of undertakings were effective by 1875, as an extension of the fidelity insurance business. Conclusively, due to all the State reforms, the corporate performance bonds acquired such a structure that the government had to reinforce its regulation and control immediately by enacting, in 1867, an Act of Parliament establishing that the heads of departments in the public service were authorized to accept the security only of companies which satisfied certain financial requirements.¹²¹

Since modern times, regulation and supervision of the performance bonds market have been a consequence of the power given to the State by the people, in accordance with what is expected from the type of State, the economic model and social reality, carried out through the enactment of certain laws in order to protect the public's wealth and the market from contagion. The laws that direct the private discipline of performance bonds

¹¹⁷ Gallagher, Op.Cit, p.26.; Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.169

¹¹⁸ Morgan: 12 Cornell Law Quarterly 153, Op.Cit. p.169-170

¹¹⁹ The floating policy is an undertaking under which the fidelity of a staff or clerks exceeding five in number is insured, obviating the necessity for long lists of questions and personal inquiries. Morgan: 12 Cornell Law Quarterly 153, Op.Cit, p.170

¹²⁰ Ibid, p.170

¹²¹ Ibid, p.170

are no more than previous commercial customs¹²² reinforced by the same power attributed to the State. However, the power of the State even goes beyond the umbrella of the law, and is capable of conducting the performance bonds market without altering the performance bonds law, causing the legal and technical deficiencies that will be considered herein. Indeed, the market behaves in the way it is unconsciously directed by the State by virtue of its policies, and not simply by manipulating its regime or by external economic variations. The performance bonds market was born in England according to the established political, economic and social models, as well as it did later in an emerging economy such as Colombia; therefore, this would suggest that the latter market has to respond in a similar manner at the present time in both developed and developing economies.

¹²² Dworkin, Ronald M.: *The Model of Rules*, The University of Chicago Law Review, Vol. 35, No. 1. Autumn, 1967 and Cooley, T. *Blackstone's Commentaries on the Laws of England* 2, 2nd Edition, 1872, in Gallagher. Op.Cit. p.19; Fonseca, Marco Antonio: *Las Fuentes formales del derecho colombiano a partir de la nueva Constitución*, p.33-34, Law Journal No. 1, Universidad del Norte, Barranquilla, 1992; (As an example: the practice of English insurers, on agreeing upon a risk, to subscribe a "slip" or short memorandum of the proposed insurance, which has been considered to be binding on parties.)

CHAPTER 2: CAN THE BEHAVIOUR OF THE PERFORMANCE BONDS MARKET IN DEVELOPED AND DEVELOPING ECONOMIES BE CHALLENGED BY MACRO POLITICO-ECONOMIC POLICIES?

INTRODUCTION

In the previous chapter it was suggested that there was a relation between certain social, political and economic changes, the market of performance bonds, and the laws of performance bonds. Therefore, it is important to analyse whether the market of performance bonds may be challenged by some public policies. To establish if those policies objectively have an effect over the latter market, it is necessary to study further jurisdictions. If the Colombian jurisdiction were the only studied market of performance bonds, then the conclusions would still be subjective as such a country probably has a number of particularities that may not exist in other countries. For example, the type of social conflict within Colombia at the present time is a factor that, since it does not exist in other countries, may affect the analysis that suggests a direct relation between certain public policies and the said market. For that reason the market of bonds in another developing country that has a similar social, political and economic reality to Colombia will be studied to see how such a market has been influenced by state policies. In addition, any relation between public policies and the market of performance bonds in some developed countries such as the United States of America and Germany will be sought, in order to discard factors that can only have an effect in developing countries. Then, once all those single studies are analysed, they will be compared in a global way to extract from developed and developing countries all those similarities that could be challenging their market of performance bonds in contemporary times.

Therefore, first of all, this chapter will mention the transition towards neoliberalism and to the modern notion of regulatory state that occurred in the last quarter of the past century. Afterwards this chapter will explain the relationship between the later changes, in particular the implementation of supply-side economics and the market of performance bonds. Finally, the

author will explain the effect of the implementation of the latter politico-economic changes in Colombia, the United States of America and Mexico for their markets of performance bonds. However, the chapter will also refer to the German case given that the latter policies were not implemented in said country.

For the previous cases the research has been narrowed to the 1980s onwards, and will be analysed for the most common financial instrument (bond) in every country. Analysing only the commonest instrument is not going to provide precise data about the influence of public policies in those markets, but should set a marked tendency, i.e. enough to suggest the relation between those state policies and the aforementioned markets. Thus, after having analysed the market data in those countries and a number of public policies, three main aspects were noted: 1) in three out of four countries the market skyrocketed at some point (Colombia, Mexico and the United States); 2) in those three countries the market of bonds only skyrocketed just after the implementation of one specific macro politico-economic policy; and 3) the fourth country (Germany) never implemented those politico-economic policies and never witnessed its market of bonds skyrocketing. In other words, it seems that those specific policies have a unique capacity to reach the market of bonds in developed and developing countries.

1. TOWARDS NEOLIBERALISM AND THE REGULATOR STATE

1.1. CRISIS OF DEMAND-SIDE ECONOMICS UNDER AN INTERVENTIONIST STRUCTURE

It has been generally established that the amount of written premiums issued by the performance bonds market depends on economic variations. In fact, the annual GDP has been one of the favourite justifications to excuse the State from the lows and highs suffered by the aforementioned market.¹²³ The previous chapter did not confirm, although it stressed the correlation between the macro politico-economic policies implemented by a specific type

¹²³ Junguito, Roberto: *Economía y seguros de cumplimiento*, p.2-5 Fasesolda, Panama, 2008; Monroy Uribe, Hernán Dario: *El Seguro de Cumplimiento de cara al 2019*, p. 9, Fasesolda Journal 45, 2006, Latinoinsure, in the PASA Convention, Argentina, 2007.

of state and performance bonds. Thereby, within this chapter it will be demonstrated that what is truly influencing that market refers to those policies that are implemented due to various factors, and is not due to the economic growth itself; similarly to the manner in which this market was born.

Landes and Posner¹²⁴ stated that “Influence, like cause in history, is exceedingly difficult to determine because of its severely counterfactual quality. To say that *X* influenced *Y* is to say that, had *X* never existed, *Y* would be different in some particular way or, at least, that more time would have been required for the particular difference to occur (that is, *X* may merely have accelerated changes in *Y* that would in time have occurred anyway). But *X* did come into existence, so how is one to figure out how things would have stood if it had not?” Therefore, the following chapters will explain how *X* or politico-economic policies have influenced *Y* or performance bonds.

Thus, by the decade of 1970, arises the second cyclical crisis of capitalism in the 20th century.¹²⁵ The exhaustion of the previous expansion of capitalism was beginning to show its effects in an abrupt way and on a worldwide scale, and the period of economic stability¹²⁶ was over.¹²⁷

The interventionist state that developed out of the Second World War attempted to manage the whole economy (through Keynesian policies) and

¹²⁴ Landes, William M. and Posner Richard A.: *The Influence of Economics on Law: A Quantitative Study*, 36 Journal of Law and Economics, p. 385-386, 1993.

¹²⁵ Bowles, Samuel and Gintis, Herbert: *The Crisis of Liberal Democratic Capitalism: The Case of the United States*, p.69, Politics and Society, Vol 11, March 1982; Heap, S.H.: *World Profitability Crisis in the 1970s: Some Empirical Evidence*, Capital & Class, p.68-71, Vol 4, Winter, 1980; Bejarano, Jesus A.: La Intervención del Estado en la Economía Colombiana, p.19-21, Nueva Sociedad, No. 46, Enero-Febrero, 1980; Durán, Op.Cit, Par.2.1.

¹²⁶ The economic stability was mainly a consequence of fixed exchange rates and fixed interests rates that offered a level of security to both international finance and economic or business planning between countries. Huerta Moreno, Maria Guadalupe: *EL Neoliberalismo y la Conformación del Estado Subsidiario*, p.129, Política y Cultura, Autumn, No. 24, Mexico, 2005.

¹²⁷ In this context, the two largest financial multilateral organizations were the International Monetary Fund and the World Bank. Those institutions were the pillars of international economic stability and development. The former, by guaranteeing the convertibility of the currencies not only favoured world trade but, at the same time, prevented the rising of monetary fluctuations that could affect the domestic and foreign finances of other countries; the latter, by providing technical advice and credits in order to carry out projects for the formation of capitals and infrastructure to support economic growth. Correa, Eugenia: *Liberalization and financial crises*, Foreign Trade Journal, Mexico, 2002, in Huerta, Op.Cit, p.129

pursued the redistribution of resources¹²⁸ which legitimated this sort of interventionism.¹²⁹ Rhodes called it “command-and-control” bureaucracy.¹³⁰ After the postwar period, some western governments played a major role in the stabilization of the whole economy: they used public investment, publicly owned industries and tax policies to try to steer the entire economy on a path of economic growth.¹³¹ These policies were the essence of the expansionist state model derived from Keynesian economics¹³² that had defeated the *laissez-faire* philosophy in the past in order to materialize the concept of the Welfare State.

However, the crisis of capitalism and world recession in the 1970s marked the return of liberalism to economic and political scenarios, and led to the creation of the regulatory state.¹³³ Neoliberals argued that the body ultimately responsible for the subsequent social and economic consequences of the crisis was the State. They affirmed that the causes of this crisis were: a) excessive public spending by the State, b) the overwhelming power of unions, and c) the exaggerated interventionism of the State in the economy¹³⁴. But the interventionist State was also criticized for its corruption, the permanent fiscal deficit, techno-administrative inefficiency, and the gigantism of the administrative system. Accordingly, the size of States and their approach regarding the civil service were the structural motives of the crisis of capitalism, which then turned into the crisis of both the State and public administration. Given that these crises were interconnected, the latter crises

¹²⁸ Moran, Michael: *The Rise of the Regulatory State in Britain*, p.20, Parliamentary Affairs, N. 54, Oxford Journals, 2001.

¹²⁹ Fishlow, Albert: *Some Reflections on Comparative Latin American Economic Performance and Policy*, p.17-19, World Institute for Development Economics Research Of the United Nations University, August 1987; Huerta, Op.Cit. p.141

¹³⁰ Rhodes, R.A.W: *Understanding Governance*, Open UP, 1997, in Moran, Op.Cit. p.20.

¹³¹ Moran, 2001. Op.Cit. p.19

¹³² Huerta. Op.Cit. p.129; For a deeper explanation of those policies, see: Hicks, John Richard: *The Crisis in Keynesian Economics*, Blackwell, 1974; Larner, Wendy: *Neo-liberalism: Policy, Ideology and Governmentality*, Studies in Political Economy 63, Autumn 2000

¹³³ Majone, Giandomenico: *The Rise of the Regulatory State in Europe*, p.79-82, Volume 17, Issue 3, Western European Politics, 1994; Huerta. Op.Cit. 131-132; Moran, Michael: *Review Article: Understanding the Regulatory State*, p.395-397, British Journal of Political Science, Vol 32, N. 2, Cambridge University Press, 2002; Moran. 2001. Op.Cit. p.26; Baldwin, R. and Cave, M.: *Understanding Regulation: Theory, Strategy and Practice*, Oxford UP, 1999; Hood C., Scott C. James O., Jones G. and Travers T.: *Regulation inside Government: Waste-Watchers, Quality Police and Sleaze-Busters*, Oxford UP, 1999 in Moran, Op.Cit, p.395,397

¹³⁴ Montes, Pablo: *El Desorden Neoliberal*, Trotta, Madrid, 1996 in Durán. Op.Cit, Par 4.

reached a universal scale, and were therefore treated similarly in a large number of western countries due to their homogeneous characteristics.¹³⁵

For these reasons these States were again in a position where they were not capable of providing comprehensively the basic needs required by their societies.¹³⁶ Thus, due to the increasing risk of sustainability of the public resources (caused by the excessive, but unsuccessful indebtedness that was used to offer an effective civil service) and the market pressure for liberalization, some politico-economic reforms were proposed by the conservative political sectors by the 1980s.¹³⁷

1.2. SUPPLY-SIDE ECONOMICS AND PERFORMANCE BONDS

Those reforms were the pillars of the neoliberal movement that was politically reappearing, particularly in the United Kingdom and the United States of America. The implementation of those policies in the aforementioned countries was known as the “Conservative Revolution”,¹³⁸ headed by the then Conservative Prime Minister Margaret Thatcher and the Republican President Ronald Reagan, respectively.

The structural adjustment reforms could be mainly divided into two groups: firstly, those reforms that were strongly related to the reforms of the State; secondly, those reforms that were indirectly related to the structure of the State. 1) The reform of the structure of the State, reflecting the thesis of the reduction of the administrative apparatus (the minimalist state); the privatization of both public-owned companies and public services; the deregulation or liberalization of the economies; abolition or diminution of social policies and the privatization of social health; flexibilization of the

¹³⁵ Huerta. Op.Cit. p.132.

¹³⁶ Fandiño Gallo, Op.Cit, p-49-50.

¹³⁷ Moran, 2001. Op.Cit, p.20-21; Fandiño Gallo. Op.Cit, p.50; Larner. Op.Cit. Huerta. Op.Cit. p.134, 136-138

¹³⁸ The Reagan and Thatcher Governments came to office expressing similarly strong commitments to market-oriented economic policies. Policy at the macroeconomic level was to be explicitly monetarist. At the microeconomic level the emphasis was to be on reducing the role of government and especially the burden of regulation and taxation on individuals and companies, with a view to improving the performance of the ‘supply-side’ of the economy. O’Shaughnessy, Terry: *Economic policy, A Conservative Revolution? The Thatcher-Reagan decade in perspective*, Manchester University Press, 1994; Harvey, David: *Neo-liberalism as creative destruction*, p.4, *Annals of the American Academy of Political and Social Science* 610, 22-44, 2007.

labour and social laws and the reinforcement of outsourcing; a new fiscal philosophy and new financial and monetary policies. 2) Economic openness (insertion to the globalization process); modernisation (reconversion) of the domestic productive assets; economic integration based on Free Trade Agreements, and a new educational system based on the “code of modernity”.¹³⁹

The majority of the reforms mentioned above began to be implemented by the end of the 1970s in North, Central and South America, a process that was boosted by the Mexican external debt crisis in 1982.¹⁴⁰ By then, in the Latin American political scenarios there was a legitimate discussion: whether those policies had been voluntarily established or if they were imposed by multilateral institutions such as the IMF and the World Bank. It is currently clear that despite the fact that some governments had applied those policies as a consequence of the educational background of their leaders, in other nations those policies were constituted as impositions of those international institutions.¹⁴¹ In the following years, the aforementioned western governments¹⁴² had to incorporate and carry out those new guidelines for the efficiency of the market laws.¹⁴³ The fundamental differences amongst countries were the gradualness or rapidness with which those policies were implemented.¹⁴⁴

¹³⁹ Harvey, Op.Cit., p.4; Durán, Op.Cit. Par.4; Huerta, Op.Cit, p.135. For a detailed explanation of SAPs and their influence in some countries, see: Dollar, David; Svensson, Jakob: *What explains the success or failure of structural adjustment programmes?* The Economic Journal N. 100, Blackwell, Publishers, 2000.

¹⁴⁰ Cline, William R.: *Mexico's crisis, the world's peril*, p.108, 110-112, Foreign Policy, N. 49, Winter 1982-1983; Fishlow, Op.Cit p.18-19; Huerta, Op.Cit. p.144

¹⁴¹ Durán, Op.Cit. Par. 4; Fishlow, Op.Cit p.19-20

¹⁴² Despite the research being mainly concerned in those countries mentioned above, a similar process was taking place in Asia, Africa, and Eastern Europe. For instance, India applied similar reforms during the same years, and was subject to the above-mentioned social and economic counter-reformation. Ahluwalia, Montek S.: *Economic Reforms in India since 1991: Has Gradualism worked?* p.70, Journal of Economic perspectives, Summer 2002. Curiously, in those Asian countries where the neoliberal model was not strongly applied in relation to the role of the State as an economic agent or as a regulator of the economy, were the countries that have shown the largest economic growth in the past two decades: Durán, Op.Cit, Par. 4.. Fishlow, Op.Cit p.21-22

¹⁴³ Huerta, Op.Cit.p.141; Fishlow, Op.Cit.p.20; Harvey, Op.Cit p.4, 23

¹⁴⁴ Durán, Op.Cit, Par.4

Those neoliberal policies or, in particular supply-side economics, began to be implemented in the United States, the United Kingdom and Latin America¹⁴⁵ within a period of ten years (1980-1990), except in Chile (1973).¹⁴⁶

Consequently, as those nations implemented those neoliberal policies and Structural Adjustment Programmes (SAPs) the latter States started their transformation from Interventionist or Welfare States to Regulator State.¹⁴⁷ This was also considered to be a constitutional counter-reformation, affecting the aims of the “social democratic rule of law”, and subsequently the concept *per se*.¹⁴⁸ Therefore, the State changed its role, transferring its direct responsibility but retaining regulation and control over the economy in general, and both the civil service and public contracts in particular,¹⁴⁹ as far as this research is concerned.

In Colombia, as in Mexico (countries with very similar political, economic and social realities), the imposition of these politico-economic policies had a

¹⁴⁵ Some authors remember that the chaos, unemployment, poverty and the wild utilitarianism of “each person for himself” that was noticeable in Latin America by 1989 was not different from the situation in New York in 1890, and in London or Paris in 1750. For a deeper sociological approach, see Touraine, Alan: *La centralidad de los marginales*, Propositiones, Num. 14, Santiago, SUR Ediciones, 1989; Tironi, Eugenio: *Para una sociología de la decadencia*, Propositiones, Num. 12, Santiago, SUR Ediciones, 1989; Jelin, E. and Calderón F.: *Clases y movimientos sociales en America Latina*, Buenos Aires, Estudios Cedes, 1987, Cited by Zermeño, Sergio: *El Regreso del Lider: Crisis, Neoliberalismo y Desorden*, Mexican Sociology Journal, Vol. 51. N. 4, Oct-Dec 1989.

¹⁴⁶ In Chile those policies were imported earlier as it was the experimenting State for the neoliberal project directed by Nobel prizewinner Milton Friedman. As for the other countries mentioned within this section, the process occurred later: a) Bolivia in 1985 under the government of Víctor Paz Stenssoro; b) Mexico in 1988 under the government of Carlos Salinas de Gortari, who, given the radical manner in which he applied the model, was even publicly awarded by Prime Minister Thatcher; c) Argentina in 1989 under the government of Carlos Menem, and his famous Finance Minister Domingo Cavallo; d) Venezuela in 1989 under the government of Carlos Pérez; e) Perú in 1989 under the government of Alberto Fujimori; f) Brazil in 1989 under the government of Fernando Collor, and later on under the Government of José Sarney, and g) Colombia in 1990 under the government of President Cesar Gaviria.

¹⁴⁷ Huerta Op.Cit. p.121, 145-146; Moran, 2001, Op.Cit. p.26; Fandiño Gallo, Op.Cit., p.51-53; Durán, Op.Cit. Par.4. The simplest difference between the Interventionist State and the Welfare State is, according to Huerta, that the former took place in developing countries, and the latter in developed nations. However, according to Jeannot, the former occurred in countries where the bourgeoisie had been incapable of conducting strategies for development; as for the latter, it was a support in the process of valorisation of the capital of the nations with a mature capitalism. In these nations, the State, through the government and public spending policies, favoured the upward mobility of the social scale, from the idea of improving the access of society to the economic satisfiers, and permitting the incidence of the social requirements in the execution of the public programmes: Jeannot, Fernando: *Empresas paraestatales y sistemas económicos: hacia un concepto integrador del Estado empresario*, Análisis Económico, Vol. 2, Num. 1, UAM, Mexico, 1983, in Huerta Op.Cit p.131

¹⁴⁸ Durán. Op.Cit, Par.4

¹⁴⁹ Fandiño Gallo, Op.Cit, p.52-53

massive effect within the performance bonds market. The effect is, then, extensive to insurance law and banking law (in Colombia ¹⁵⁰) and to performance bonds law (in those countries where this financial instrument is not considered to be an insurance policy) according to their individual levels of legal resilience that those policies are challenging.

In the aforementioned developing countries those neoliberal policies are not only correlated to the performance bonds market, in fact, they are also directing the behaviour of that market. In other words, these governments are manipulating, perhaps unconsciously, the destiny of both the performance bonds market and its laws. The results of this manipulation are legally and economically harmful for the public and private interests that the market attempts to protect. First, some particular and contrasting examples will demonstrate how these policies are challenging the latter markets.

2. THE COLOMBIAN CASE

Despite the performance bonds market having been alive for almost a century in Colombia and for more than two centuries in the world, the Colombian performance bonds market grew 880% between 1980 and 2010;¹⁵¹ this growth may only be comparable with the development of new technologies. This would signify that this market had an annual average growth of 42%. But, the reality is that the market had periods of slow but consistent growth such as between 1980 and 1990, and 1995 and 2004;¹⁵² and even had an important period of contraction in 1991.¹⁵³ However, these periods are not relevant to this research, and will be excluded, for the performance bonds

¹⁵⁰ Other countries such as Spain still consider these financial instruments to be insurance policies: Bercovitz, Rodríguez-Cano Rodrigo: *Contrato de Seguros*, epigrafe 26, 2003; Camacho de los Ríos, Francisco Javier: *Seguro de Caución*, Revista española de seguros, N.º. 143-144, 2010; Spaniard Supreme Tribunal, Civil Chamber, Decision 1237 of 20th of December 2004, Speaker: Pedro Gonzalez Poveda. These insurance policies have also been treated as demand guarantees: Spaniard Supreme Tribunal, Civil Chamber, Decision 378 of 29th April 2002, Speaker: Antonio Romero Lorenzo.

¹⁵¹ Colombian Federation of Insurers – Fasecolda – Performance Bonds Chamber: *Historical indicators between 1975 and 2010*. All the figures provided by Fasecolda were originally in nominal prices, but were later inflation-adjusted on a 1995 basis, and are therefore presented in constant prices within this research, based on the inflation rates provided by the World Bank: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?page=1>. Revised: 15/06/2011

¹⁵² Ibid

¹⁵³ Ibid.

market is not challenged during these times by the massive demand of these financial instruments.

On the other hand, the political, economic and social scenarios, and the behaviour of the Colombian performance bonds market were different in the remaining periods; i.e. between 1992 and 1994 and between 2005 and 2010. This is an important statement, given that in each of the latter periods the market bizarrely skyrocketed,¹⁵⁴ significantly increasing the average.¹⁵⁵ It is, then, during these periods that it is possible to affirm that certain State policies directed the fate of the aforementioned market. Therefore, these periods were those that caused the performance bonds market, its legal rules, the addressees of these laws, and public and private funds to suffer the consequences of both the aggressive increase of the demand of bonds and of the avalanche of legal reforms.¹⁵⁶ Indeed, more than 17 legal reforms, regarding bonds, were enacted within these nine years (not including the large number of jurisprudences interpreting the latter Acts or creating new duties upon the parties), destabilizing the legal regime that governs performance bonds. In other words, those are the periods that challenged the resilience of performance bonds in Colombia.

2.1. COLOMBIAN MARKET BETWEEN 1992 AND 1994

Thus, as mentioned above, in 1990 Colombia moved firmly towards a regulator State under a neoliberal economic model with its respective implications and a security programme, given the current situation and the impositions of the IMF and the World Bank. This occurred during the

¹⁵⁴ Between 1992 and 1994 the surety market increased from \$34.561.360.000 Colombian Pesos –COP– in written premiums in 1992 to \$60.187.760.000 COP in 1994. And, between 2005 and 2010 it increased from \$87.961.690.000 COP in written premiums to \$166.087.000.000 COP in 2010. Colombian Federation of Insurers –Fasecolda– Performance Bonds Chamber: *Historical indicators between 1975 and 2010*. These figures were inflation-adjusted on a 1995 basis, and are therefore presented in constant prices within this research, based on the inflation rates provided by the World Bank: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?page=1>. Revised: 15/06/2011

¹⁵⁵ The performance bonds market growth should be calculated and based on the total of written premiums after the inflation-adjustment process, and not on further elements such as net or gross market's profits, or on the ratio-experience. These latter elements cannot be taken into consideration as a factor of growth of the market because they do not explain how often contracts to be guaranteed are given to underwriters, nor the value of the guarantees.

¹⁵⁶ These legal reforms and jurisprudence will be treated later on in this research, as a part of the deficiencies caused by the politico-economic shock suffered by the performance bonds market.

administration of President Cesar Gaviria¹⁵⁷ when Colombia was facing two major problems: significant socio-economic afflictions and an uncontrolled violence in its society.

President Cesar Gaviria (1990-1994), started out with a very aggressive and controversial¹⁵⁸ economic openness that unlocked Colombian markets to the world and reloaded its economy. Therefore, Colombia needed to change the structure of the State and its economic model in order to be suitable for the internationalization of the economies. The transition to Regulator State was stimulated by the neoliberal model that was implementing that administration. The reformation of the State (into a Minimalist State) started with 62 decrees enacted in 1992 that affected more than 80 State entities, by abolishing or merging them.¹⁵⁹ The aim of these reforms was to reduce the institutional size of the State and its scope over the economy and the social public policies.¹⁶⁰

President Cesar Gaviria, the architect of Colombian neoliberalism, also carried out another set of structural reforms that marked an historical change over the Colombian economic model. The aforementioned government privatized a large number of national entities,¹⁶¹ to face part of the endemic fiscal deficit, and to consolidate the model of the economic markets. That administration also liberalized imports (1991), and set the grounds for exchange market liberalization (1991); liberalization of capital account (indebtedness and direct foreign investment) (1991); Central Bank independence (1991-1992); fiscal decentralization (1991-1993); tax reforms

¹⁵⁷ Valencia Sarria, Luis Carlos: *Neoliberalism and Democratic Governability in Latin America*, p.475, 477, 480-482, Pap. Político, Vol. 11. N. 1, 475-487, Colombia, January-June 2006. It is surprising to have these sorts of reforms during a liberal government, given that neoliberalism was normally implemented in conservative administrations, as happened in the UK, the United States and Mexico, amongst many others. Some of these neoliberal policies were originally thought of by Gaviria's predecessor, former president Virgilio Barco, whose Finance Minister was Cesar Gaviria; nonetheless, President Barco (1986-1990) mostly tried to implement a sound interventionist model, refusing the idea of supply-side economics.

¹⁵⁸ The social and micro economic implications of this openness were extremely criticized given the rapidity of its implementation since it signified affecting social conditions in the poorest sectors, and bankruptcy for micro-entrepreneurs.

¹⁵⁹ Nieto, Emmanuel: *La reforma del Estado Colombiano*, ENS journal N. 28, March-April, Colombia, 1993.

¹⁶⁰ Nieto Lopez, Jaime Rafael: *Guerra, Neoliberalismo y resistencia civil en Colombia*, Unaula N. 24, 2004

¹⁶¹ Colombian Act 1 of 1990 and Colombian Decrees 2156 to 2171 of 1992.

(1990-1991, 1995); labour (1990), health and pensions reforms (1993), and privatizations and concessions (1991-1994).¹⁶²

These economic reforms not only marked the transition to a Regulator State, which signified more public contracts, but subsequently, a higher demand for sureties. This new economic model also generated, between 1990 and 1994, a significant economic growth of the GDP,¹⁶³ diminished external debt, caused an increase in foreign direct investments,¹⁶⁴ and lowered the inflation rate,¹⁶⁵ after a harmful period of “stagflation”.¹⁶⁶ The inflation rate has had an important role, as a cause, in the transition process towards a neoliberal state in further developing and developed countries, and a massive influence over the demand of performance bonds for its correlation with all sorts of investments (raw material of performance bonds). For instance, due to the excessive inflation in 1990, the government presented a stabilization programme –monetary squeeze– that promoted measures such as public expenditure cuts, 100% marginal reserves for credit institutions, maintaining high interest rates despite the reduction on the rhythm of devaluation, all of them with the intention of diminishing the inflation rate.¹⁶⁷ These reforms benefited investments in general and subsequently the market of performance bonds in the medium and long term, starting two years later. As a particular example, these reforms stimulated the investment in infrastructure which had been extremely low in the preceding decade, seriously affecting the performance bonds market.¹⁶⁸

¹⁶² For a detailed explanation of these reforms, see: Ramirez, Juan M.; Nuñez, Liliana: *Reformas Estructurales, Inversión y Crecimiento: Colombia Durante los Años Noventa, Serie Reformas Económicas* 45, 1999.

¹⁶³ The GDP growth was consulted in: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 26/07/2011.

¹⁶⁴ Garay, Luis Jorge: *Apertura Económica 1990-1996, Colombia: Estructura Industrial e Internacionalización 1967-1996*, p.1, Edición del Banco de la República (Colombian Central Bank Edition), URL: <http://www.banrepcultural.org/blaavirtual/economia/industriatina/204.htm>. Last Revised: 11/07/2011.

¹⁶⁵ The inflation rate was consulted in: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 26/07/2011

¹⁶⁶ At the end of the first semester in Office (December 1990), the government achieved a GDP growth of 4.3%, but the inflation rate reached 32.4%, and the investment rate in infrastructure was 3.03%: Archivo Banco de la Republica (Colombian Central Bank Archive).

¹⁶⁷ The idea was to diminish the inflation rate to 22% in 1991: Garay, Op.Cit, p.1

¹⁶⁸ The investment in infrastructure rate suffered a declining period between 1983 and 1991, affecting the performance bonds market: Ramirez, Juan M.; Nuñez, Liliana: *Reformas*

However, these reforms were not as immediately efficient as was expected, but this may be explained by the fact that the Colombian Central Bank confirmed that the implementation of monetary policies do not take effect immediately in Colombia nor in many other countries. In fact, it has been calculated that it takes between six and twelve months for interest rates to generate an effect, and between 18 and 24 months to cause an effect over the inflation rate.¹⁶⁹ Conclusively, the effects of these neoliberal policies during Gaviria's first year in Office (August 1990 to August 1991) were not seen, and, therefore, the performance bonds market did not grow in 1991. The performance bonds market had to wait until 1992, this is the two years later mentioned above, when the economic policies effectively caused the expected effects.

However, the mentioned economic situation and the monetary squeeze negatively affected investors and public contractors (the principals in performance bonds) in the short term because there is a need to control inflation in order to promote investment in general, and investment in infrastructure in particular (infrastructure and bonds are extremely high correlated).¹⁷⁰ Proof of this is that in 1991 the performance bonds market suffered a massive decrease due to the aforementioned monetary squeeze implemented to reduce the inflation¹⁷¹.

Nevertheless, once the squeeze was in the past, i.e. by 1992, investments in general and infrastructure in particular, and the performance bonds market started a period of prosperity. For these types of investments to be viable, the long-term interest rate has to be reasonable, and this requires that the medium/long term inflation rate has to be moderate. This has to be mentioned since these bonds are totally dependent on infrastructure,

Estructurales, Inversión y Crecimiento: Colombia Durante los Años Noventa, Serie Reformas Económicas 45, 1999; Junguito, Roberto, Op.Cit, p.5-6

¹⁶⁹ Uribe, Jose Dario: *Tasas de Interés y Crecimiento Económico Sostenido*, p.1-2, Director of the Colombian Central Bank, Macro-economic and Sectorial Seminar, ANIF-FEDESARROLLO, Medellín-Colombia, 2007.

¹⁷⁰ Junguito, Op.Cit, p.6-7

¹⁷¹ The bond's market dropped from \$46.792.760.000 COP in December 1990, to \$31.421.440.000 COP in December 1991: Colombian Federation of Insurers –Fasecolda– Performance bonds Chamber: Historical indicators between 1975 and 2010. These figures were inflation-adjusted on a 1995 basis.

particularly in developing countries, where the percentage for bonds guaranteeing international contracts is scant.¹⁷²

Additionally, the Colombian Nation, under this administration also entered into other international agreements that consolidated foreign investments, such as The Andean Group for the formation of a Free Trade Agreement in the region, or integration agreements with Central America countries. These agreements also encouraged investments causing the opposite effect to the one mentioned above; this increased the amounts of commercial and legal relations, some of which, by law, needed to be undertaken by performance bonds.

Thus, Gaviria's government, the first administration implementing strongly neoliberal economics,¹⁷³ left behind some reforms that did not cause an effect in Gaviria's first year in Office. However, it was during the rest of his neoliberal government (1992-1994), and given its successful economic results,¹⁷⁴ that the performance bonds market overwhelmingly skyrocketed for the first time in Colombian contemporary history. As mentioned before, the amount of written premiums in the performance bonds market dramatically rose from \$34.561.360.000 COP in 1992, to \$60.187.760.000 COP in 1994.

2.2. COLOMBIAN MARKET BETWEEN 2005 AND 2010

The second time in history that Colombia was under a neoliberal government was exactly the same time that the Colombian performance bonds market skyrocketed. Between 2005 and 2010, under the administration of President Alvaro Uribe (2002-2010), the performance bonds market increased from \$87.961.690.000 COP in written premiums, to \$166.087.000.000 COP in 2010.¹⁷⁵

¹⁷² Tarapore, S.S.: Building From the Bottom: Infrastructure and Poverty alleviation, Par.4, Sameer Kochhar, M. Ramachandran (Editors) New Delhi 2010.

¹⁷³ Nevertheless, it has also been stated that the Gaviria's government did not apply neoliberal reforms. Kalmanovitz, Salomon: *Neoliberalismo e Intervencionismo: sus Fuentes y razones*, p.1-5, Revista de Estudios Sociales, Universidad de los Andes, 1998.

¹⁷⁴ Cesar Gaviria, throughout his presidency, implemented supply-side economics.

¹⁷⁵ Colombian Federation of Insurers -Fasecolda- Performance bonds Chamber: Historical indicators between 1975 and 2010. These figures were inflation-adjusted upon a 1995 basis.

In 1999 Colombia suffered its worst crisis since the Great Depression in the 1930s, which obliged the government to enter into further agreements with the IMF in order to recover the confidence of international markets. Due to these agreements the government continued with an expansive public expenditure and the indebtedness sharply increased until 2003. Afterwards, the recuperation was slow under a pessimist atmosphere regarding the economy and the security. The Colombian GDP only grew 0.57% in 1998, decreased 4.2% in 1999, and rose by 2.92% in 2000, 1.47% in 2001, and 1.53% in 2002; the current account deficit reached 8% of the GDP. However, the crisis at least helped to diminish the two digit inflation rate to 7% in 2002, so the Central Bank was able to maintain low interest rates¹⁷⁶ with the respective implications for the performance bonds market, mentioned above.

Colombian President Alvaro Uribe established three main policies when entering Office, although the third one is not related to this research: a) to confront insurgent groups under his democratic security policy; b) returning into economic growth, based in his investment confidence policy, and c) social equality. During his term in Office, Uribe modified fiscal and monetary policies, privatized national entities, attempted to reduce the size of the State, promoted economic openness and Free Trade Agreements, amongst other policies predisposed to a neoliberal State.

In addition, given that the economic model must be economically harmonious to avoid an increase of the external debt or a deeper fiscal deficit, the security policies that were implemented led to an increase in the defence expenditure which could be compensated by a reduction in public spending in further areas. However, the cuts in public spending do not signify that those services are no longer going to be provided, it means that the State has transferred those obligations to the private sector, and will reaffirm its condition of being a mere regulator within the neoliberal model. However, as mentioned above, the transfer of those obligations into private hands implies that the private sector will then require more financial sureties to undertake the performance of those contracts that have been transferred by the State.

¹⁷⁶ Kalmanovitz, *Salomon: Recesión y Recuperación de la Economía Colombiana*, p.1-2, Nueva Sociedad, N. 192, Colombia, 2004

On the other hand, regarding the economic concerns existing in Colombia at that time, that government strongly re-established a number of economic policies based on supply-side economics under a neoliberal model in order to stimulate economic growth. According to the desired economic model, the State carried out all the proper steps to be catalogued as a neoliberal government but not including those mentioned above. Firstly, to mention a few, it signed free trade treaties with the United States of America and many other countries or economic groups.¹⁷⁷ These treaties were part of the plan to maximize the process of globalization by enhancing international competitiveness and phasing out State protectionism.

Likewise, besides the security policy to attract Foreign Direct Investment (FDI), Uribe's administration materialized the legislative grounds to reduce taxes in the form of tax exemptions or tax discounts in compensation to investments from foreign investors.¹⁷⁸ The aforementioned administration also created tax-free areas which, together with legal stability contracts for 20 years between government and companies, and other incentives for investors who reinvest their profits in Colombia, have been essential in the promotion of the national investment; thus, the FDI grew four-fold under Uribe's government. As a consequence, the investment rate in infrastructure (the most important sector for the performance bonds market in a developing country) reached a rate equal to 10.6% of the Colombian GDP in 2009, where 6.3% referred to private investments, and only 4.3% to a reduced public investment.¹⁷⁹ Nonetheless, this was also supported by the large number of trade treaties that were signed during this period of liberalization generating substantial challenges in terms of infrastructure; in other words, more contracts to be guaranteed.

In addition to these economic policies, Uribe's government also carried out structural reforms by privatizing important Colombian entities such as "Telecom" or "Ecopetrol", public services and part of the educational system.

¹⁷⁷ China, Canada, the Eurozone, the G3, Chile, Brazil, and Panama, amongst others.

¹⁷⁸ Uribe Velez, Alvaro: Report to the Congress, Colombia, 2009.

¹⁷⁹ Departamento Nacional de Planeación (DNP) (Colombian National Department of Planning). Since 2002 the private investment rate in infrastructure rate grew more than 25% per year until 2008, as a consequence of the FDI growth. Archivo del Banco de la República (Colombian Central Bank Archive).

Other reforms or adjustments, i.e. SAPs, such as cuts to the Health and Pension System and cuts to the territorial entities transferences, were implemented. In accordance with the plan of minimizing the administrative apparatus (minimalist state), the aforementioned administration also merged several national entities such as the Justice and the Interior Department and some supervisory and regulatory authorities.

It is then undeniable that Uribe's administration established a neoliberal model¹⁸⁰ of supply-side economics, and that the performance bonds market had responded to that economic model, proving a non-casual relation between them; within this period the performance bonds market almost doubled its amount of written premiums. This can be explained by the simple fact that millions of new public and private contracts permeated the economy and the performance bonds market had to undertake an incalculable and unexpected number of contracts. Despite the precise cause of the augment being controversial, the strong influence of neoliberalism over the behaviour of the performance bonds market is not.

3. INFLUENCE OF THE ECONOMIC MODEL ON THE PERFORMANCE BONDS MARKET IN FURTHER DEVELOPING AND DEVELOPED ECONOMIES

Economic neoliberalism has also been conducting a performance bonds market in Mexico, another developing country, under similar economic and social conditions. Nonetheless, given that this influence is not coincidental and exclusive to Colombia or to further developing countries, it has been noticed that the same influence exists in a developed country such as the United States of America, where the performance bonds market also skyrocketed when neoliberal policies were implemented. Unlike these countries, Germany, a country that has implemented a different State model, shows no influence at all.

3.1. THE MEXICAN CASE

¹⁸⁰ Although it has been admitted that Uribe re-established a strong neoliberal model, it also has been accepted that the architect of those economic policies in Colombia was Cesar Gaviria. Nieto Lopez, Jaime Rafael: *Guerra, Neoliberalismo y resistencia civil en Colombia*, Unaula N. 24, 2004.

Mexico has a mature and strictly regulated performance bonds market, and was the fourth-largest in the world with 4% of the world market in 1998 and 2004.¹⁸¹ However, before 1989 the Mexican performance bonds market remained steady for several years; and only from 1989 has the market consistently grown. Yet, between 1989 and 1994 the latter market suffered its rapidest augment, almost doubling the amount of written premiums.¹⁸² Within this period of time is precisely when the neoliberal model was strongly implemented by Mexico's President Carlos Salinas de Gortari.

This Central American country had massive recessions in 1982 and 1986,¹⁸³ particularly caused by the dramatic fall in oil prices, high interest rates, a catastrophic inflation rate, the overvaluation of the Mexican peso, and a flight of capitals to other markets.¹⁸⁴ In addition, the national debt drowned the possibilities of economic growth during the administration of President Miguel de Madrid,¹⁸⁵ therefore causing a period of economic stagflation. In 1988, the Mexican GDP growth was 1.2%,¹⁸⁶ the inflation rate was 114.2%,¹⁸⁷ the gross public debt reached 64.7% of the GDP,¹⁸⁸ and the public deficit was 11.3% of the GDP.¹⁸⁹

President de Gortari, in order to overcome the latter economic affliction, strongly implemented the neoliberal model during his presidency (1988-

¹⁸¹ SIGMA, Credit Insurance and Surety: Solidifying Commitments, No. 6/2006, Economic Research and Consulting, Swiss Reinsurance Company.

¹⁸² The Mexican performance bonds market went from \$648.1185 MXN of written premiums in 1989, to \$849.626.000 MXN in 1990, to \$974.283.900 in 1991, to \$1.095.820.000 MXN in 1992, to \$1.131.415.000 MXN in 1993, reaching \$1.180.255.000 MXN in 1994. The National Commission of Sureties and Insurances –CNSF– provided the figures of the Mexican performance bonds market between 1981 and 2010. The figures were inflation-adjusted upon a 1995 basis, based on the inflation rates provided by the World Bank: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?page=1>. Revised: 15/06/2011

¹⁸³ Gilly, Adolfo: Mexico: *Crisis y Modernización del Capitalismo*, p.14, Nueva Sociedad, No. 82, March-April, 1986

¹⁸⁴ Gelos, Gastón: *La Inversión Fija en México desde 1982*, p.98, Una Revisión Selectiva, Gaceta de Economía, Año 5 Num. 9, 1998; Huerta, Op.Cit, p.144

¹⁸⁵ Gilly, Op.Cit, p.14, 16-17.

¹⁸⁶ Figures from: URL: <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>. Revised: 27/07/2011.

¹⁸⁷ Figures from: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 26/07/2011.

¹⁸⁸ H. Congreso de la Unión, Cámara de Diputados, Centro de Estudios de las Finanzas Públicas: *Estadísticas Históricas de la Deuda Pública en México, 1980-2001*, CEFP/029/2002. URL: <http://www.cefp.gob.mx/intr/edocumentos/pdf/cefp/cefp0292002.pdf>. Revised: 29/07/2011.

¹⁸⁹ Bolivar Carolina: "Mexico: Economic Development and Tax Reform", Conference at a meeting of The Heritage Foundation Mexico Working Group on July 19, 1990, The Heritage Foundation, 1990.

1994), through the structural adjustment programmes designed by the IMF and the World Bank.¹⁹⁰ These policies mainly aimed at reducing the size of the State and cutting public spending; these cuts referred to the sectors of health, housing, education and infrastructure. The reforms were materialized through Free Trade Agreements,¹⁹¹ trade liberalization, financial deregulation,¹⁹² and the privatization of 85% of companies owned by the nation, and firmly promoted private investments to stimulate the economy.¹⁹³

Thus, Mexico, given the implementation of these policies, had an important economic recovery between 1989 and 1994. Not only the public deficit decreased,¹⁹⁴ the total public debt went down,¹⁹⁵ the GDP showed a massive growth¹⁹⁶ and the inflation rate dropped¹⁹⁷; in fact, the FDI growth was also extremely encouraging. The FDI grew from 3% in 1989 to almost 11% in 1994, particularly due to the Act of May 1989, given that it phased out regulations designed to protect the Mexican domestic industry from unfair competition.¹⁹⁸ In conclusion, President de Gortari, during his administration, set the economic platform through those neoliberal reforms for the transition from an Interventionist State to a Regulator State. This transition and imposition of neoliberal policies occurred between 1989 and 1994, exactly the same period in which the performance bonds market had a surpassing growth for the first time, just as happened in Colombia.

3.2. THE AMERICAN CASE

¹⁹⁰ Durán, Op.Cit, Par.4

¹⁹¹ De Matos, Carlos A.; Hiernaux Nicolás, Daniel; Restrepo Botero, Darío: *Globalización y Territorio: Impactos y Perspectivas*, p.99-100, Pontificia Universidad Católica de Chile, Fondo de Cultura Económica, 1998. Cooney, Paul: *Dos Décadas de Neoliberalismo en México, Resultados y Desafíos*, p.1,3,4,6, Socio-Economic Centre, Economics Department, Federal University of Para, Brazil, 2007.

¹⁹² Gelos, Op.Cit. p.98; Cooney, Op.Cit, p.4-5

¹⁹³ Minzoni Consorti, Antonio: *Crónica de Dos Siglos de Seguro en México, Comisión Nacional de Seguros y Fianzas*, p.122,124, Mexico, 2005.

¹⁹⁴ Huerta, Op.Cit. p.147

¹⁹⁵ It decreased from 64.7% to 39.8% during the Administration of Salinas de Gortari. H. Congreso de la Unión, Cámara de Diputados, Centro de Estudios de las Finanzas Públicas: *Estadísticas Históricas de la Deuda Pública en México, 1980-2001*, CEFP/029/2002. URL: <http://www.cefp.gob.mx/intr/edocumentos/pdf/cefp/cefp0292002.pdf>. Revised: 29/07/2011.

¹⁹⁶ The GDP averaged almost 4%, during the aforementioned government. Figures from: URL: <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>. Revised: 27/07/2011.

¹⁹⁷ The inflation rate dropped from 114.4% to 7% during the aforementioned government. Figures from: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 26/07/2011.

¹⁹⁸ Minzoni, Op.Cit.p.122; Cooney, Op.Cit, p.5

Likewise, in the United States of America, a developed country with the largest performance bonds market of the world, the implementation of neoliberal policies has had the same effect on its performance bonds market. Those policies were strongly established during the administrations of conservatives Ronald Reagan and George W. Bush. During these governments, the American performance bonds market suffered its most important increases in the past 40 years, just as happened in Mexico and Colombia.

3.2.1 THE INFLUENCE BETWEEN 1983 AND 1985

In the past 40 years, the first time the performance bonds market had a massive increase was between 1983 and 1985,¹⁹⁹ almost doubling the amount of bonds. During the latter period President Reagan (1981-1989) struggled with some economic woes left from the preceding government, where the inflation²⁰⁰ and interest rates were at near record highs, and the economy, given the recession, was still falling down to 1.9% in 1982. This economic malaise was mainly caused by and associated with the period of stagflation under an interventionist model applying demand-side economics.

Nevertheless, President Reagan was elected as he presented legislation to stimulate the stagnated economic growth, to curb inflation, to increase the employment rate and to strengthen national defence; this was partially achieved through the neoliberal model he implemented, based on supply-side economics, although they were not effective immediately, as normally occurs. Thus, it was affirmed that the Administration sought to a) lower the cost of labour, b) shrink the welfare state, c) limit the role of the federal government, and d) weaken the influence of social movements. Those tactics included 1) tax cuts, 2) retrenchment of social programmes, 3) devolution, or the shift of social welfare responsibility from the Federal Government to the States, and

¹⁹⁹ The market grew from \$1.788.382.000 USD in written premiums by 1982, to 3.250.166.000 in 1985. The figures were kindly provided by the Surety and Fidelity Association of America. The figures are given in billion dollars. The original figures were later deflated under a 2005 basis, based on inflation rates provided by the World Bank: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?page=1>. Revised: 15/06/2011.

²⁰⁰ The inflation rate in 1980 was 13.5%. Figures from: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 25/07/2011.

4) privatisation or the transfer of public responsibility to the private sector.²⁰¹ In fact, some of these policies were so aggressive that Reagan was accused of implementing trickle-down economics. For instance, the top marginal tax was lowered from 70% to 50% during these first years, and later to 28%.²⁰² Nonetheless, these tax reductions tended to attract capital because the after-tax rate of return on capital investment rises as the tax rate falls.²⁰³ This caused net foreign investments in the United States to increase from \$31 billion in 1980 to a high of \$115 billion in 1987, according to the Department of Commerce's Bureau of Economic Analysis;²⁰⁴ the idea, then, was to partially substitute public spending with private investments. And, as mentioned above, federal contributions for investment in infrastructure were massively reduced since 1981,²⁰⁵ being, to some extent, replaced by private investment in infrastructure during the expansionary period of Reagan's economic policies, which stimulated a global shift in ideology: a renewed emphasis on free markets and private coordination of production,²⁰⁶ such as occurred later in Mexico and Colombia.

3.2.2. THE INFLUENCE BETWEEN 2005 AND 2008

Coincidentally, the second time within the past 40 years that the performance bonds market had a massive increase was between 2005 and 2008, under the presidency of George W. Bush. This administration was known for re-implementing Reagan's policies, in particular with regard to defence and economics, where his economic model was also based on supply-side economics, although Reagan's ideas suffered a sudden shift due to the world crisis in 2008.

Between 2005 and 2008 the American performance bonds market suffered the second largest increase. In 2005, it grew to \$3.692.074.000 USD in

²⁰¹ Abramovitz, Mimi: Saving Capitalism From Itself, Whither the Welfare State? p.25, New England Journal of Public Policy, Fall 2004/Winter2005, Vol. 20 Issue 1.

²⁰² "Effective Federal Tax Rates: 1979-2001". Bureau of Economic Analysis, 2007

²⁰³ Niskanen, William A. and Moore, Stephen "Cato Institute Policy Analysis: Supply Side Tax Cuts and the Truth about the Reagan Economic Record." 1996. URL: <http://www.cato.org/pubs/pas/pa-261.html> p. 10. Revised: 07/07/2011.

²⁰⁴ Ibid, p.10

²⁰⁵ The Associated General Contractors of America: The Pivotal Role of Federal Infrastructure Investment in Our Economy, 2007.

²⁰⁶ Orr, Ryan J.: Investment in Foreign Infrastructure: The Legacy and Lessons of Legal-Contractual Failure, the Collaboratory for Research on Global Projects, Stanford University, 2006.

written premiums, which increased to \$3.981.440.000 USD in 2006.²⁰⁷ It later went up to \$4.187.804.000 USD in 2007, and then it had a total of \$4.141.545.000 USD in 2008; finally, the market went down in 2009.²⁰⁸

During the aforementioned years, neoliberalism and particularly supply-side economics made a comeback with President W. Bush given the economic indicators he received from the previous administration²⁰⁹. This President argued for tax cuts²¹⁰, increased the defence spending and cut social spending, and finally re-enhanced the free-market philosophy to strengthen the contribution of the private sector to the economy. It has been said by Freeman that those Bush policies²¹¹ were the classic re-enactment of the original supply-side tax cuts of the early 1980s.²¹² In addition, the figures of the American FDI between 2005 and 2008 confirm the relation between these policies and the performance bonds market. In spite of the decrease of the FDI rate after 2008 as a consequence of the world crisis, in 2009 the FDI rate was higher than the rates in 2002, 2003 and 2004 and 2005. The massive augment of the FDI occurred, not coincidentally, between 2005 and 2008,²¹³ two years after the implementation of Bush's policies and at the same time as the dramatic growth of the performance bonds market. This FDI increase was, in addition, backed by the Federal Reserve as it slashed interest rates even further which, together with tax cuts, encouraged even

²⁰⁷ The figures were kindly provided by the Surety and Fidelity Association of America. The figures are given in billion dollars. The original figures were later deflated under a 2005 basis, based on inflation rates provided by the World Bank: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?page=1>. Revised: 15/06/2011.

²⁰⁸ Ibid

²⁰⁹ In 2001, the United States plunged into a small recession, as the GDP dropped from 4.2% in 2000 to 1.1% in 2001. However, during the early years, the inflation rate fell from 3.4% in 2000 to 2.8% and 1.6% in 2001 and 2002, respectively. Figures from: URL: <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>. Revised: 13/07/2011; and, Figures from: URL: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. Revised: 25/07/2011.

²¹⁰ Freeman, Robert: *The Rise, Fall and Re-Rise of Supply Side Economics*, p.11, C. 2005.

²¹¹ These policies were mainly carried out through the Economic Growth and Tax Relief Reconciliation Act of 2001, the Job Creation and Worker Assistance Act of 2002, the Jobs and Growth Tax Relief Reconciliation Act of 2003 reducing marginal taxes; as mentioned above, these policies did not have an immediate effect.

²¹² Freeman, Op.Cit. p.11

²¹³ Figures from: <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD> Revised: 13/08/2011.

greater levels of and more risky borrowing than before, pushing investment (and sureties subsequently), despite it later leading to the housing bubble.²¹⁴

On the other hand, the performance bonds market suffered no relevant increases whilst the Democratic Party was in the White House implementing demand-side economics. This was a similar situation to the one that occurred in Colombia; as long as neoliberalism was not being firmly implemented, the Colombian performance bonds market was growing at a firm but controlled pace.

It is then undeniable that performance bonds markets in both developed and developing economies are under the conclusive influence of economic policies such as supply-side economics. Every time the latter sorts of policies were implemented in The United States of America, Mexico and Colombia, the performance bonds market suffered massive and sudden increases in the demand of bonds being researched in this study. For this reason it is possible to affirm that the aforementioned State policies are directing the behaviour of the performance bonds market.

3.3. THE GERMAN CASE

On the other hand, a developed economy such as that of Germany, which has never implemented the aforementioned class of economics, has had a different experience in its performance bonds market where no unexpected and abrupt increases have occurred.²¹⁵ In Germany, supply-side economics were never used, instead, they implemented a model called the “social market economy” designed for the reconstruction of the Federal Republic of Germany after the Second World War; this model was an alternative to an intervened economy,²¹⁶ leading to the economic wonder (Wirtschaftswunder). The concept of social market economy gathers legal, political and social aspects since it sees economic growth as the

²¹⁴ Kurtbag, Omer: The Crisis of Neoliberalism and its Implications For the World Politics: The End of Western Dominance and a New Power Distribution in the Emerging International Order? URL: <http://web.inonu.edu.tr/~ozal.congress/pdf/6.pdf>. Revised: 10/07/2011

²¹⁵ Statistical Yearbook of German Insurance 2010, Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV) German Insurance Association.

²¹⁶ Ernste, Dominik H.: Una perspectiva Ordoliberal de la Economía Social de Mercado, p.45 (p.1), Serie No. 2, Economía Social de Derecho, Fundación Konrad Adenauer, 2009.

interdependence of “orders” whereby, for instance, without a free political system it is not possible to conceive economic freedom, and vice versa; a social connotation was later added to the idea, thus creating the mentioned notion.²¹⁷ This concept was originally based on “ordoliberalism” which was an economic theory formulated in the decade of 1930 against the savage capitalism of the *laissez-faire* (Friedrich Hayek) on one side, and the socialist ideology of planning and economic intervention of the State, on the other.²¹⁸ Therefore, the German case with regard to corporate sureties under this research is unique for two reasons that are closely related: a) during the past 50 years the German performance bonds market has grown at a very consistent pace, but has never suddenly skyrocketed as a consequence of economic policies; b) the economic model used in Germany is substantially different from those implemented in the other analysed countries. Thus, these points confirm that as long as supply-side economics and extreme security policies are implemented the performance bonds market will suffer uncontrolled and unforeseen increases, whilst further models do not create the same effect.

²¹⁷ Rösner, Hans Jürgen: Crisis financiera: Redescubrimiento de la Economía Social de Mercado, p7-8, Serie No. 2, Economía Social de Derecho, Fundación Konrad Adenauer, 2009.

²¹⁸ Ibid, p.9

CHAPTER 3: THE LEGAL NATURE OF COLOMBIAN SECURITY BONDS

INTRODUCTION

The current Colombian regime of financial security bonds²¹⁹ is the result of a thorny and curvy legal evolution, and the (wrong) mixture of legal frameworks. The former regime has been evolving within the idea that a massive reform, going back to the starting point, is not necessary or commercially appropriate; therefore, the culture of legal patches has prevailed. Thus, as mentioned before, these financial instruments started out having the legal nature of insurance (when it was considered as such around the world), later became a performance bond, and ended up having the legal nature of insurance again, or the legal nature of a bond, depending more on the issuer than on the real legal nature. Therefore, if an insurance company issues the bond it will be necessarily considered as an insurance policy (and shall have the respective legal nature), but if a banking entity issues the bond it will be considered to be a banking bond, and the same applies to trust undertakings, and to other sorts of securities not studied herein. In that sense, the legal nature of the Colombian financial “guarantee” is based upon an organic factor, hence the nature of the issuer is the one that involuntarily assigns the applicable regulation of the relevant undertaking.

The reason for this is that, as mentioned before, the Colombian Act 225 of 1938 (the first one regulating these instruments in Colombia), specified that “insurances” were the proper instruments to guarantee the correct management of public funds or further values of any kind, that are trusted to civil servants or private persons in favour of the public entities or persons to whom they are liable, and they could be extended to the payment of taxes, tariffs and rights, and to the performance of obligations that emanate from acts and contracts including the performance of contracts. However, years

²¹⁹ The current Colombian regime of financial performance bonds is constituted by Title 4, Third Book of the Civil Code; Title 5, Fourth Book of the Commercial Code; the Public Contracting Regime (Act 1150 of 2007, Article 7, and Decree 1510 of 2013, Articles 110-147); and the Organic Statute of the Financial Sector (Decree 2555 of 2010), amongst further concordant norms.

later, the Colombian Decrees 1670 of 1975(Art.58), 150 of 1976(Art.58) and 222 of 1983(Art.70) established that the pertinent contractual instrument for those purposes was the “*fianza*” or “guarantee bond” (ancillary liability), as seen below. The latter decrees stated: “*Securities may consist of guarantee bonds from insurance companies or banks [...]*”.

Then, besides all the issues caused by the apparent similarities between these contractual instruments (most of them already solved in other jurisdictions), another massive conflict arose as a result of these decrees. Insurance companies, in Colombia, have never been authorized by the relevant financial authority²²⁰ to issue “bonds” of any kind; they can only issue insurance policies.²²¹ Yet, given that the insurance sector was predominant in regard to these instruments and that they wanted to remain in the business, insurance companies continued offering “performance insurances”, in spite of the mandate of the law. Consequently, the guarantee (*sensu lato*) mentioned by the aforesaid decrees turned, in practical terms only, into two different types of guarantee: a) “performance insurances”; and b) “banking guarantee bonds” –*fianza bancaria*– (similar to the English contract of guarantee, strictly so called).

Thus, with the politico-economic changes that shocked the Public Contracting Regime and the regime of performance bonds in 1992,²²² law designers realised that another reform was needed to overcome the incoherence between the legislation and commercial reality. In that sense, instead of solving the confusion from its roots, Colombian law designers put a major patch over the legislation and simply made law out of the practical but wrong division of these two guarantees. Act 80 of 1993, therefore, entered into force ratifying the existence of two different types of guarantee (and two different legal natures). It stated: “*Guarantees will consist of insurance policies from insurance companies legally authorised to operate in Colombia or of banking guarantees*”.²²³ After the second major shock in

²²⁰ The Colombian financial authority is the so-called: “*Superintendencia Financiera*” (Financial Superintendence).

²²¹ Colombian Decree 2555 of 2010 (Article 2.31.1.1.1 - Article 2.32.1.1.8)

²²² As mentioned in Chapter 2 of this research.

²²³ Given that the C.C.C. in 1971 abolished Act 225 of 1938, Decree 663 of 1993 (the former Organic Statute for the Financial System) in Article 203 brought back the provisions relating to

2005,²²⁴ another reform was enacted in 2007,²²⁵ leaving these provisions unamended, and later regulated by Decree 4828 of 2008 which introduced the term “Unique Performance Guarantee”. The latter may take the form of: a) insurance policies, and b) on-demand banking guarantees (banking guarantee or stand-by credit), amongst a few others.²²⁶ This “comprehensive performance guarantee” must include several covers, as mentioned later. The previous Decree was later amended by Decree 734 of 2012, and then by Decree 1510 of 2013, but they did not alter the list or legal nature of the aforementioned financial instruments.

As a result, besides the old and traditional “contract of guarantee” (ancillary liability), and those that are not part of our research, two more legal natures²²⁷ could be now involved within the Colombian legal regime of “guarantees” (*sensu lato*): 1) the one for insurances, 2) the one for on-demand “guarantees”.²²⁸ Yet, it is important to highlight that although in public contracting the banking sector, apparently, is not allowed to issue “conditional”²²⁹ bonds (not under an ancillary or primary liability), in private matters banks are allowed to do so,²³⁰ with certain restrictions.²³¹ And still, despite the Colombian Supreme Court of Justice²³², the Constitutional

“performance insurances” contained in Act 225, and then reconfirmed the existence of these instrument.

²²⁴ As mentioned in Chapter 2 of this research.

²²⁵ Colombian Act 1150 of 2007, Article 7

²²⁶ Besides the aforementioned financial instruments, that decree admits mercantile trust guarantees, endorsement of securities or cash deposits.

²²⁷ Later on it will be demonstrated that the legal nature of these “performance bonds” (insurances are not security bonds) could not be determined based on the fact that the bonds are conditional or on-demand; therefore the statement given above is false, but is the one creating confusion.

²²⁸ Stand-by credits will be studied tangentially, as they are not part of our research; however, they will be compared with the financial instruments that demand our attention.

²²⁹ The term “conditional” when referring to bonds will be discussed later on in this chapter.

²³⁰ In Colombian law, the directing regulation for these financial instruments is provided by the Colombian Civil Code (for ancillary bonds) and by the Commercial Code (for insurance policies), including the applicable jurisprudence. The Public Contracting Regime, therefore, determines the manner in which these financial instruments should be used with regard to such contracts, and is also responsible for the aforementioned confusion related to their legal nature. The Organic Statute of the Financial Sector (Decree 2555 of 2010, Article, 2.1.12) regulates the “guarantees” issued by banking institutions and is also responsible for the confusion. Unfortunately, but coherently, the same confusion related to the legal nature of these instruments was transmitted to private contracting, as the legal nature of these instruments regarding private contracts has historically followed the fortunes of the of public law contracts.

²³¹ The restrictions are given by Article 2.1.12.1.1 of Colombian Decree 2555 of 2010.

²³² Colombian Supreme Court of Justice, Civil Section: Decision of September 21st 2000, Settlement number: 6140, Speaker: Silvio Fernando Trejos Bueno; Decision of August 15th 2008,

Court²³³ and the Council of State²³⁴ having confirmed the existence of these two legal natures, a number of doubts and criticisms are unveiling the hidden ineffectiveness or lack of regulation of these financial instruments.

Colombia has historically borrowed from the English system a number of provisions and terms related to the financial system, particularly from insurance law and the banking sector. And, together with those provisions and terms, Colombia imported the confusions that English law had (apparently solved by now) between insurances and the aforementioned instruments. Nowadays, England lives a calm moment with regard to these financial instruments, whereas Colombian scholars and legislators are timidly prolonging their discussion.²³⁵ Hence, in England it has been stated for a number of years that the appropriate financial instruments to guarantee the performance of obligations arising from either contracts or other legal duties are security bonds²³⁶ (issued by either insurance companies or banks, generally), and not insurances. Therefore, the latter position includes three legal natures:²³⁷ 1) applicable to contracts of guarantee; 2) applicable to contracts of indemnity; and 3) applicable to the so-called independent “performance bond”,²³⁸ akin to the stand-by letter of credit.²³⁹ Nevertheless,

Settlement number: 11001-31-03-016-1994-003216-01, Speaker: Pedro Octavio Munar Cadena; Decision of April 5th 2010, Settlement number: 50001-31-03-002-2001-14548-01, Speaker: Cesar Julio Valencia Copete.

²³³ Colombian Constitutional Court: Decision C-449 of July 9th 1992, Speaker: Alejandro Martinez Caballero; Decision of November 22nd 2011, C-877, Settlement number: D-8571, Speaker: Humberto Antonio Sierra Porto.

²³⁴ Colombian State Council, Third Section: Decision of December 13th 2001, Settlement number: 25000-23-26-000-1999-2225-01 (18506), Counsellor Speaker: German Rodriguez Villamizar; Decision of November 29th 2006, Settlement number: 25000-23-26-000-02043-01 (24414), Counsellor Speaker: Fredy Ibarra Martinez; Decision of January 30th 2008, Settlement number: 52001-23-31-000-2005-00512-01 (32867), Counsellor Speaker: Mauricio Fajardo Gomez.

²³⁵ This discussion has also taken place in further scenarios apart from Colombia and the United Kingdom: In Venezuela: Morles Hernandez, Alfredo: *Nuevo Desarrollo del Régimen de las Garantías de las Obligaciones Mercantiles*, p.211-219, Boletín de la Academia de Ciencias Políticas y Sociales, Academia de Ciencias Políticas y Sociales, Caracas, No. 143, 2005. In Germany: Swacker, Frank W.: *Accommodation under German Law*, p.516-519, 18 Bus. Law. 515, 1963. In the United States of America: Hawxhurst, Ralph R.: *Op.Cit.*, p.76-81; Cross, J. Harry: *Suretyship is not Insurance*, *Op.Cit.*, p.235-237; Barru, David J.: *How to guarantee contractor performance on international construction projects: comparing surety bonds with bank guarantee and standby letters of credit*, p.55-56, 37 Geo. Wash. Int'l L. Rev. 51, 2005.

²³⁶ Securities are offered in the form of either a contract of guarantee or a contract of indemnity.

²³⁷ Not including the legal nature of stand-by credit, comfort letters or co-debtorship with security function, real securities, etc...

²³⁸ *GKN Contractors v Lloyd's Bank plc* [1985] 30 B.L.R 48; *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd* [1994] 4 All E.R. 181; *Western Credit v Alberry* [1964] 1 W.L.R.945; *Goulston Discount Co Ltd v Clark* [1967] 2 Q.B. 493; *Gulf Bank KSC v Mitsubishi Heavy Industries*

in the end, the choice of any of these financial instruments, or any other financial option, depends either on law requirements or upon the bargaining power of the parties. Accordingly, since English scholars are not necessarily familiar with these Colombian financial instruments, it is essential to provide them with this descriptive chapter; and within this chapter, some issues related to the effectiveness of the laws of these instruments are given.

In that sense, this chapter will describe the main notions of both the contract of *fianza* and the banking guarantee in the Colombian context, and it will later show legal nature of the Colombian “performance insurance”. Finally, this chapter will set forth the major problematic issues of this instrument, and the decisions adopted by Colombian Courts to solve those issues; solutions that are not shared by the author, for which some alternative solutions are provided at the end of the chapter.

1. THE SOURCE-CONTRACT OF THE OBLIGATIONS OF THE PARTIES: COLOMBIAN BANKING GUARANTEE V. “CONTRATO DE FIANZA”

English security bonds, in spite of their different possible legal natures,²⁴⁰ and in regard to contractual liability, are considered to be a promise to pay the debt or obligation of another if he fails to pay²⁴¹ (guarantee); or as a promise to indemnify the creditor against loss arising out of the principal contract²⁴² (indemnity). Yet, the obligation of the bond-issuer needs to be created by a particular type of contract,²⁴³ which may be either the contract of

Ltd [1994] 2 Lloyd’s Rep. 145; *Standard Bank London Ltd v Canara Bank* (unreported) May 22, 2002

²³⁹ *Hongkong and Shanghai Banking Corporation v Kloeckner* [1986] 2 Lloyd’s Rep. 146; *Offshore International SA v Banco Central SA* [1977] 1 W.L.R. 399.

²⁴⁰ One may be considered as a contract of guarantee (on-demand or conditional bond under ancillary liability), and the other as a contract of indemnity (on-demand or conditional bond under primary liability).

²⁴¹ *Lep Air Services v. Rolloswin Investment Ltd* [1973] A.C. 331.

²⁴² *Birkmyr v. Darnell* (1704) 1 Salk. 27; *Argo Caribbean Group v. Lewis* [1976] 2 Lloyd’s Rep. 289; O’Donovan, James; Phillips, John: *The Modern Contract of Guarantee*, p. 8, English Edition, Sweet & Maxwell, London, 2003; Andrews, Geraldine; Millett, Richard: *Law of Guarantees*, p. 11, Fifth Edition, Sweet & Maxwell, London, 2008.

²⁴³ In Colombia it has been said that those obligations can also be created legally or judicially (Article 2362 of the Colombian Civil Code). Nevertheless, the author believes that they are not created legally or judicially; instead, it seems the law or judge gives an order to constitute those obligations, which are truly created through a posterior contract.

guarantee or the contract of indemnity,²⁴⁴ or by a legal duty. In other words, the source of those obligations seems to be clear in English law, unlike the Colombian case. In the latter jurisdiction, there are still a massive number of issues regarding the source-contract of the obligations of these financial guarantors; some are related to lack of law or to the harmful culture of legal patches mentioned before.

Henceforth, when referring to the source-contract the author means the precise legal precept with a specific legal nature that creates characteristic contractual obligations that differentiate it from others. This has a special relevancy by the time these contracts need to be interpreted and integrated by the judge,²⁴⁵ particularly with regard to terms implied in law.²⁴⁶

1.1. THE CONTRACT OF “FIANZA”

Firstly, Colombian contracts of guarantees (ancillary liability), in spite of the common belief, apparently are not contracts *per se*. According to the Colombian Civil Code (C.C.), these guarantees are accessory “obligations” by virtue of which one or more persons are answerable, in part or in whole, for the obligation of another if that other (the principal) defaults.²⁴⁷ The latter obligations need to be created by a contract; however, the required contractual model is not expressly specified by the applicable legislation; and little has been stated by Courts²⁴⁸ or scholars²⁴⁹ about the source-contract of this guarantor’s obligations. Thus, the source-contract of the guarantor’s

²⁴⁴ *Citicorp Australia Ltd v Hendry* (1985) 4 N.S.W.L.R.; *Trafalgar House Construction (Regions) Ltd. v General Surety & Guarantee Co. Ltd.* [1995] 3 W.L.R. 204

²⁴⁵ Partisani, Renato: *L'integrazione del Contratto come correttivo delle disfunzioni sinallagmatiche prodotte dall'inosservanza della clausola di buona fede*, Danno e responsabilità, fasc. 2,174, 2003; *Corte Suprema Di Cassazione, Ufficio del Massimario e del Ruolo, Rel n.116, 10 Settembre 2010.*

²⁴⁶ Austen-Baker, Richard: *Implied Terms in English Contract Law*, p.31-33, 40-45, Edward Elgar Publishing Ltd, 2011; *Eyre v. Measday* [1986] 1 All E.R. 488; *Thake v. Maurice* [1986] Q.B. 644; *Gregory v. Ford* [1951] 1 All E.R. 121.

²⁴⁷ Colombian Civil Code, Article 2361.

²⁴⁸ Colombian Supreme Court of Justice, Civil Section: Decision of September 21st 2000, Settlement number: 6140, Speaker: Silvio Fernando Trejos Bueno: This decision is an example on how the “*fianza*” is mentioned to be a contract, although the decision omits mentioning its elements. Likewise, the Colombian Financial Authority, in Directive 2006004784-002 of February 23rd 2006, has not explained such elements.

²⁴⁹ The doctrine has gone a little further but is not quite conclusive: Muñoz Obando, Camilo: *La Fianza*, Imprenta Nacional, Bogotá, 1967; Ordoñez Ordoñez, Andres E.: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, p.11-26, Universidad Externado de Colombia, Bogotá, 2011.

obligation may be, if agreed, the same underlying contract (provided that the guarantor is included). Alternatively, it could be a parallel, innominate, and multilateral agreement, which “could” be entered into between the guarantor, the creditor and the debtor of the underlying contract.²⁵⁰ Yet, although the name conferred to this agreement is not as relevant as its construction, it should be differentiated from all other sorts of security bonds, and labelled accordingly. In Colombia, the source-contract of this ancillary obligation could be known as “*contrato de fianza*”, which would be, in essence, the equivalent of the English contract of guarantee (strictly so called), given the ancillary nature of the guarantor’s obligation.²⁵¹

1.2. BANKING GUARANTEE

In addition, according to Colombian Decree 1510 of 2013 (Article 146), another possible “guarantee” (*sensu lato*) could be the “banking guarantee”, with its specific legal nature and its own particular obligations. This guarantee falls into the Colombian classification of on-demand bonds, together with the stand-by letter of credit.²⁵² Nevertheless, the first question that needs to be asked is: Why did the Colombian legislator change the term “banking guarantee bond” (“*fianza bancaria*”)²⁵³ contemplated in Decree 222 of 1983, for the term “banking guarantee” (“*garantía bancaria*”) contemplated in Act 80 of 1993? However, in Colombia, nothing has been formally said about this point in particular, and neither the law nor the courts have provided a precise definition of the term “banking guarantee” that, at least, could be used as a hint to understand the will of law designers.

²⁵⁰ *Tweddle v Atkinson* (1861) 1 B. & S. 393; *Gandy v Gandy* (1884) 30 Ch. D. 57; *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*, A.C. 847 [1915]

²⁵¹ *Wardens and Commonalty of the Mystery of Mercers of the City of London v New Hampshire Insurance Company* (1991) 2 J.I.B.F.L. 144; *Swire v Redman* (1876) 1 Q.B.D; *Rouse v Bradford Banking Co* (1894); *Clough Engineering Ltd v Oil & Natural Gas Corp Ltd* [2007] FCA 881 (Fed Ct (Aus) (Sgl judge)); *Brooks Wharf & Bull Wharf Ltd v Goodman Bros* [1937] 1 K.Bb; *Lipkin Gorman (a firm) v Karpnale Ltd* [1991] 2 AC 548; *Kleinwort Benson Ltd. v Lincoln CC* [1999] 2 AC 349; *Mills v The Guardians of the Poor of the Alderbury Union* (1849) 154 E.R. 980; *United States Fidelity & Guaranty Co. v R.J.L.*, (1917) 39 O.L.R. 388.

²⁵² This financial instrument (stand-by letter of credit) will not be studied in this research, as it is not formally catalogued as a bond, and has its own rules. Yet, some authors consider that these two terms are synonymous: McGuinness, Kevin: *The Law of Guarantee*, p.832, 2nd Ed., Carswell, 1996.

²⁵³ The contract of “*fianza*” is, in essence, the equivalent of the English contract of guarantee (strictly so called).

Therefore, the source-contract(s) of the “banking guarantee” and the relevant obligations resultant from that contract(s) are still unclear.

1.2.1. BANKING GUARANTEE AS A SPECIFIC CONTRACT

The first option could be that the Colombian legislator, in the early 90s, realised that in other jurisdictions a modern instrument called “banking guarantee” was commercially being substituted for the old and dependent “contract of guarantee”, strictly so called;²⁵⁴ and, subsequently, the legislator felt the need to protect public funds through this new and more reliable contract subject to primary liability. This would imply that a “banking guarantee” should be considered as a specific contract of personal security, akin to a stand-by credit. Although it seems a reasonable interpretation if it is seen exclusively within the scope of Decree 1510 of 2013 (Article 146), the author cannot admit it, *ab initio*, as it disregards the rest of the Colombian banking legislation, hence paralysing part of the banking business²⁵⁵. Colombian Decrees 663 of 1993 and 2555 of 2010 (Organic Statute of the Financial Sector) establish that banks are permitted to issue only two kinds of guarantee (*sensu latiore*): 1) “*avales*”²⁵⁶ and 2) “banking guarantees”. Therefore, if the latter term is considered to be a specific contract, and not a generic term, banks would not be allowed to issue any other security, neither personal nor real. In other words, banks would be permitted to issue “banking guarantees” only, but could not issue “*fianzas*” or contracts of guarantee (strictly so called), nor stand-by credits, nor pledge agreements, etc.

1.2.2. BANKING GUARANTEE AS A GENERIC TERM

However, another interpretation is that the legislator noticed the existence of new financial instruments that could be issued by banks, and, therefore, wanted to widen the scope of available “guarantees”. Thereby, the former would have used the term “banking guarantee” as a generic term for all sorts

²⁵⁴ Andrews and Millett, Op.Cit, p.579.

²⁵⁵ Serrano Escribano, Selina. *Garantía a Primera Demanda*, Cuaderno de Estudios Empresariales No 9, s.l., 1999, p. 282. This commentator also highlights the inappropriateness of the term “banking guarantee. She states that: “In further cases, the name “banking guarantee” is used, but we don’t believe it is an appropriate term provided that Banks issue different types of guarantees, ancillary or independent”..

²⁵⁶ The term “*aval*” refers to a guarantee (*sensu lato*) issued by a bank, exclusively related to the payment of negotiable instruments.

of “guarantees” (*sensu lato*) that could be issued by banks; as opposed to precise terms (“*contrato de fianza*” or contract of guarantee, strictly so called, pledge agreements, etc.). In short, a “*contrato de fianza*” is a banking guarantee, if issued by a bank. Thus, if we accept this interpretation, and we should, the “banking guarantee” could not be the source-contract of any obligation, simply because it is not a contract itself; this term only explains who the issuer of the security is.

In admitting this interpretation, all sorts (precise term) of banking guarantees (generic term) could be used in private contracting, including the “*contrato de fianza*” (secondary liability) or the stand-by credit (primary liability). However, based on the Public Contracting Regime, the use of the term “banking guarantee” is not equally clear. Inappropriately, Decree 1510 of 2013 (Article 146) uses the aforementioned term in both senses, i.e. as a generic term and as a precise term (banking guarantee as a source-contract),²⁵⁷ hence opening up the way to a huge world of misinterpretations. As a result, a stand-by credit is a banking guarantee (generic term), but it is also the rival instrument of the “banking guarantee” (precise term); and only the latter two instruments can be admissible to secure a public contract. Therefore, the “*contrato de fianza*” which is another “banking guarantee” (generic term), even if issued by a bank, is not admissible by law as a source-contract in matters of public contracting, not even if enforceable on demand.²⁵⁸ In other words, “banking guarantee” can be the genus and the species at the same time.

The “*contrato de fianza*” (equivalent to the English contract of guarantee, strictly so called) is not admissible in public contracting for one vital reason: the liability of the guarantor under this agreement is essentially ancillary (dependent security). This means that if the parties agree that the liability will be primary, the latter contract will become a different contract, such as the stand-by credit or the “contract of banking guarantee”, for instance. On the other hand, Decree 1510 of 2013 (Articles 146) mandates that for a

²⁵⁷ Decree 1510 of 2013 (Article 146) establishes the “banking guarantee” as one of the options considered to be a specific contract whereby a banking institution promises to indemnify the Public Entity for the loss caused by the principal’s default.

²⁵⁸ The manner in which the obligation is enforceable has no relation at all to the agreed liability, as seen later on.

banking guarantee (generic term) to be admissible it needs to be independent, autonomous,²⁵⁹ and under primary liability, such as the “contract of banking guarantee”. This explains the most important difference between the “*contrato de fianza*” and the “contract of banking guarantee”,²⁶⁰ and how they can both be different source-contracts, but only the second one can be used in public contracting matters.

Therefore, in comparison to English law, the author could state, *ab initio*, that what the Colombian legislator really meant by “banking guarantee” (as a contract), according to the provisions of the latter decree, is what the English law knows as a “contract of indemnity”.²⁶¹ And, consequently, Colombia would have the same two source-contracts provided by English law: 1) contract of guarantee (strictly so called), equivalent to the “*contrato de fianza*”, and 2) English contract of indemnity,²⁶² more similar to the Colombian banking guarantee

With regard to the “banking guarantee”, as a contract, the author believes it has been unfortunately labelled by the Colombian legislator, as it is repeatedly confused with the generic term; or, in particular, with the “*contrato de fianza*” entered into by a bank. When implementing new legal instruments, jurisdictions cannot simply translate literally the term used

²⁵⁹ Colombian Decree 1510 of 2013, Articles 110-147

²⁶⁰ However, the same decree, without providing a definition, offers further differences between these two contracts, by specifying certain legal requirements for the security to be valid in public contracting matters. It establishes that the guarantor will not be discharged if there is any material variation to the underlying contract, which goes against the nature of the “*contrato de fianza*” or English contract of guarantee, strictly so called. On the other hand, this decree also limits the defences of the guarantor against the underlying creditor, which is a characteristic of the “contract of banking guarantee”, based on its autonomy.

²⁶¹ *Moshi v Lep Air Services* [1973] A.C. 331; *Board of Trade v Employers' Liability Assurance Corp'n* [1910] 2 K.B. 649; *Pattison v Guardians of the Belford Union* (1856) 1 H. & N. 523; *Oastler v Pound* (1863) 11 W.R. 518; *Canadian General Insurance Co. v Dube Ready Mix Ltd* (1984) 52 N.B.R.; *Zurich Insurance Co v Modern Marine Industries Ltd* (1993) 111 Nfld. & P.E.I.R. 181; *Ruxley Electronics and Construction Co Ltd v Forsyth* [1996] A.C. 344; *Staniforth v. Lyall* (1830) 7 Bing.169; *Sutherland v. Webster* (1894) 21 O.A.R. 229 (C.A.); *Leeming v Smith* (1877) 25 Gr. 256.

²⁶² It is of paramount importance to reaffirm that, although the difference may be subtle, the contract of indemnity is aimed at “indemnifying” the creditor against loss arising out of the principal contract, under a primary liability; and, not aimed at “paying” the debt or obligation of another if he fails to pay, under an ancillary liability. Yet, the term “indemnity” should be understood in a strict sense, where a person giving the indemnity does so by way of security for the performance of an obligation of another; and not “indemnity”, in its widest sense, which comprises an obligation by law or by contract on one person to make good a loss suffered by another (most contracts of insurance and all contracts of guarantee also fall within the broad definition): Andrews and Millett, *Op.Cit.*, p.11

outside such jurisdiction, disregarding its own legal harmony and its resulting terminology. Otherwise, this is likely to undermine the essence of the agreed instruments, and their effectiveness,²⁶³ hence possibly causing the consequences mentioned in the previous paragraph. In international banking the “guarantee”²⁶⁴ is a primary obligation, meaning that the bank’s liability turns only on whether the beneficiary presents the specified documents, and is unrelated to the facts in underlying contract.²⁶⁵ However, in the United States²⁶⁶ and in England, for instance, the term “guarantee” is used as a secondary obligation, whereas in Colombia it is more typically used as a generic term for all sorts of securities (personal or real). However, disregarding the Colombian terminology, and the subsequent effects, Decree 4828 of 2008 (amended by Decree 734 of 2012, and later by Decree 1510 of 2013) imported the international meaning, and also uses this term as a specific contract whose essential obligation is primary.²⁶⁷ For that reason, the author believes that the first step to differentiate the “*contrato de fianza*” from the Colombian banking guarantee, and from further dependent securities, is to provide another label to the latter contract, according to its function and the Colombian terminology, i.e. simply the “*contrato de garantía independiente*”.

As seen below in more detail, the manner in which any of these contracts (guarantee or indemnity) is enforceable (upon previous and objective verification of the condition or on demand) is not likely to alter the essence of

²⁶³ This does not mean that using the wrong label in a contract will alter the nature of the security. What really needs to be taken into consideration is the content of the contract (construction), and not the name provided to the instrument. However, one party may use the wrong financial instrument to secure a contract, which is likely have material consequences for the parties, the underlying contract, and the relevant instrument.

²⁶⁴ They are also known in international matters as: independent guarantees, bank independent guarantees, demand guarantees, international demand guarantees, simple demand guarantees, first demand guarantees, or performance guarantees: Barru, Op.Cit., p.62.

²⁶⁵ Ibid, p.62

²⁶⁶ Guttman, Egon: *Bank Guarantees and Standby Letters of Credit: Moving Toward a Uniform Approach*, 56 Brook L. Rev. 167, 1990, in McLaughlin, Gerald: *Standby letters of Credit and guaranties: an exercise in Cartography*, p.1139, Vol, 39, Issue, 4, William and Mary Law Review.

²⁶⁷ In addition, the use of the word “banking” (in the term banking guarantee) has been a common mistake that has its origins in the American regime of performance bonds. In this jurisdiction, as in Colombia, insurance companies are not allowed to issue these sorts of financial instruments for which the banking sector took possession of the business, and provided the aforementioned label. However, the word “banking”, in the same context, is not used in other jurisdictions where further financial institutions are also allowed to issue these instruments, such as England.

these source-contracts. The parties can indistinctively agree an on-demand clause in a security contract, based on the autonomy of the parties and upon their bargaining power, without affecting the relevant legal nature; although, in certain cases this clause is mandatory due to specific legal requirements. This means that there is no relation between the “on-demand” clause and the type of liability (primary or ancillary) of the security. Moreover, that clause needs to be agreed, as it is essential in those securities where the underlying relation is totally irrelevant for the guarantor; this is an independent security, in the strict sense. However, it does not mean that every security with an on-demand clause becomes an independent security. In that sense, the author considers that a useful way to explain this point is by studying it from the perspective of English securities, given the wider and clearer classification they have within their regime.

2. “PERFORMANCE INSURANCES”: HIDING THEIR INEFFECTIVENESS

At the beginning of this chapter it was mentioned that insurances may also secure the due performance of contracts.²⁶⁸ As the historical confusion between insurance policies and security bonds was finally solved in England and Colombia,²⁶⁹ it is important to highlight that the author is referring to an actual insurance against contractual perils and not to any kind of security bond. First of all, it is worth mentioning that the legal nature of any of these instruments has no relation with the fact that some of them may be sufficiently effective, i.e. achieving its purpose which is to protect the underlying creditor. Secondly, within the Colombian context, to safeguard both that the “performance insurance” is catalogued as insurance, and to hide its inoperability, it had to disregard certain rules that are applicable to traditional insurance contracts.²⁷⁰ Thirdly, it is of paramount importance to state in advance that this section is not aimed at providing another arbitrary solution, such as those given periodically by Colombian courts and legislators, to enhance the effectiveness of the “performance insurance”; the

²⁶⁸ In fact, “performance insurances” are, by far, the most commonly used instrument by public and private contractors in Colombia.

²⁶⁹ Ordoñez Ordoñez, Andres E.: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, p.15, Universidad Externado de Colombia, 2011.

²⁷⁰ These provisions will be mentioned throughout this section.

objective is simply to show how problematic and ineffective it is, and propose its abolition rather than its perpetual modification, to allow the creation of a new system.

2.1. LEGAL NATURE OF COLOMBIAN “PERFORMANCE INSURANCES”

Performance insurances against contractual perils have been classified as first-party insurance, which can no longer be regarded as a guarantee bond,²⁷¹ nor as a liability insurance.²⁷² The function of performance insurance, according to the Colombian Supreme Court, is to serve as a “guarantee” in favour of the creditor for the due performance of the underlying obligation.²⁷³ Therefore, if the insured risk occurs (this is, the breach of the underlying contract by the debtor), the insurer is obliged to indemnify the creditor up to the amount of the insured sum.²⁷⁴ Although it has been said that the aforementioned instrument does not perfectly fit into what the public entities really require or what the law requires for protecting private and public funds,²⁷⁵ it is still the most common instrument for those contractual purposes.

The Colombian insurance industry has always been inclined to offer these “guarantees” (performance insurance of contracts) providing them with the appearance of insurance policies, to avoid possible legal prohibitions if any, until they finally but irregularly acquire the legal nature of an insurance. That

²⁷¹ Colombian Supreme Court of Justice: Decision 6140, 21st September 2000, Speaker: Silvio Fernando Trejos Bueno. This was reaffirmed with the subsequent acts and decrees that catalogued this instrument as insurance, as stated before.

²⁷² It is not a liability insurance for three main reasons: a) under the liability insurance the assured is the person whose damaging conduct is insured, whereas under a performance bond the assured is the victim of the other’s conduct; b) in the former the insurance protects the equity of the liable person, whereas under the latter it protects the equity of the creditor, which explains that: c) under liability insurance subrogation is not possible, with a few exceptions, whereas under a performance insurance, subrogation must be possible against the debtor who was in default. Ordoñez Ordoñez, Op.Cit. p.37, 2011.

²⁷³ This type of insurance is different from “credit insurance” that was designed to protect the creditor against the absence of payment of an amount of money. These insurances are equally questionable as they are considered as sub-species of the one being analysed herein. It has no regulation apart from the provision that allows its use; this is Decree 1516 of 1998.

²⁷⁴ Colombian Supreme Court of Justice, Civil Section (Decision of March 15th 1983); (Decision of September 21st 2000); Decision of February 2nd 2001); Decision of December 12th 2006); (Decision of August 15th 2008, Settlement number: 11001- 31- 03 016 -1994 -03216 - 01) Speaker: Pedro Octavio Munar Cadena.

²⁷⁵ Ordoñez Ordoñez, Op.Cit, p.15, 2011.

occurred in Colombia thanks to the legal confusion between the insurance and bonds,²⁷⁶ to the prohibition to issue any instrument apart from insurances, and to all the legal modifications set forth below; as a consequence, local insurers were finally able to keep issuing “guarantees” against contractual risks in the form of insurance. On the other hand, as English insurers were allowed to issue both insurances and bonds, it was not necessary for them to design the exotic instrument that was progressively created in further jurisdictions, such as France²⁷⁷ and Colombia.

Therefore, it has to be mentioned that if this Colombian instrument were to be a contract only between creditor and insurer, to indemnify the losses derived exclusively from the debtor’s default, there would not be any problem regarding its legal nature.²⁷⁸ However, this insurance is currently regarded as a service provided to the principal debtor (as under a performance bond), and not as a service provided by the insurer to the insured (creditor in this case) as in any insurance.²⁷⁹ Then, the problem with its legal nature relies on the essential elements that are required to consider this instrument as insurance. To contemplate it as such in Colombia, there must validly exist: a) *the conditional obligation* of the insurer, b) an *insurable risk*, c) a *premium*, and d) an *insurable interest*.²⁸⁰ If any of these essential elements is lacking, the contract will be legally inexistent.

First of all, under these particular insurances, although they secure the potential loss resulting from the breach of an underlying contract, the liability of the insurer is not ancillary. Their liability, however, as in an English

²⁷⁶ This is due to the historical confusion between insurance policies and contracts of guarantees.

²⁷⁷ In France, after a judgement that did not satisfied any of the parties, banks and insurance companies made an agreement whereby it was considered that, although it should be called guarantee insurance (*assurance caution*), it was a banking operation instead of an insurance policy, but the latter operation could be issued by insurers; this position was legally confirmed in 1953, with the clarity that those issued by insurers could only be in favour of public entities. Ordoñez Ordoñez, Op.Cit, p.32, 2011.

²⁷⁸ Indeed, a similar instrument is issued by insurance companies in England, known as “credit insurance”. Therein, the parties must be the insurer and the principal creditor.

²⁷⁹ The way this Colombian instrument works today is similar to the English Mortgage Insurance, where the purchaser of the insurance policy is the debtor or mortgagor, and the insured and beneficiary is the creditor or mortgagee. But, unlike the Colombian performance insurance, the insured risk is non-payment due to the mortgagee’s death, disability or incapacity to pay for a certain reason, based on the construction that does not depend exclusively upon him.

²⁸⁰ C.C.C., Article 1045.

contract of indemnity (in the strict sense), is primary which does not necessarily mean that it stops being *conditional upon the creditor's default*.²⁸¹ In other words, although the insurer's liability depends on the status of the principal contract, its obligation is not the same debtor's obligation (as under a guarantee bond), but is one of his own created by the insurance contract; yet, it is, simultaneously, an alternative obligation.²⁸² These insurances, as any other non-life insurance, are subject to the principle of compensation²⁸³ and therefore cannot be treated as substitutes for cash or as any other payment method. The insurer is then due to "indemnify" the insured (creditor) once the latter has proven the occurrence of the loss (debtor's default) and the amount of the compensable damage,²⁸⁴ which at the time of the formation of the contract are future and uncertain factors for the insured. The aforementioned factors constitute the "*insurable risk*" that is finally transmitted from the policy-buyer (principal debtor), on behalf of the insured (principal creditor), to the insurer, which is therefore the element that links the performance insurance contract and the underlying contract, making the former dependent on the latter.

2.2. JUDICIAL AND LEGISLATIVE PATCHES TO "SOLVE" PROBLEMATIC FEATURES OF THE INSTRUMENT

2.2.1. INSURABLE RISK: THE ESSENTIAL AND PROBLEMATIC ELEMENT OF THIS INSTRUMENT

This Colombian instrument may not seem problematic at the outset. However, within the Colombian scenario, the legal nature of this instrument is challenged by certain imperative rules that apply to every single insurance contract; rules that do not exist in England. Firstly, it should be remembered that this Colombian instrument is seen as a service provided to, and paid by, the debtor (policy-buyer). Then, the definition of "insurable risk",²⁸⁵ given by Article 1054 of the Commercial Code, establishes that: risk is the uncertain event which does not depend exclusively on the power of the policy-buyer, the insured or the beneficiary, and whose occurrence is the origin of the

²⁸¹ Nevertheless, the condition may vary depending on the construction of the policy.

²⁸² Colombian Supreme Court of Justice, Civil Section (Decision of August 15th 2008, Settlement number: 11001- 31- 03 016 -1994 -03216 - 01) Speaker: Pedro Octavio Munar Cadena.

²⁸³ C.C.C.: Articles 1088, 1089 and related.

²⁸⁴ C.C.C.: Article 1077

²⁸⁵ C.C.C., Article 1054

insurer's obligation. In addition, the first part of Article 1055 thereof, which refers to perils that are never insured, affirms that: deliberate acts, gross negligence,²⁸⁶ or exclusively facultative acts, from the policy-buyer, the insured or the beneficiary cannot be insured. Therefore, these two imperative provisions are extremely problematic, regarding their legal nature, as per the function of the instrument where the conditional event always depends exclusively on the debtor. This means there would never be an *insurable risk*, and subsequently the contract would always be legally inexistent. In other words, it could not be an insurance contract.

In order to keep considering these instruments as insurances and justify their issuance by insurance companies, Colombian Courts offered a questionable solution. They stated that, due to the socio-economical function of performance insurances and the protection of the public interest, the aforementioned imperative provisions should not be equally applied to this particular instrument.²⁸⁷ Therefore, since the notion of "*insurable risk*" was arbitrarily saved from imminent violation, and can be used over performance insurance due to the latter judicial interpretation, it can be still considered as insurance. Nevertheless, another possible solution could have been to confirm that only the principal creditor can be a party to the performance insurance contract (buyer, insured and beneficiary), leaving behind the wrong belief that this is a service provided to the debtor. In that case, it should also be considered as an insurance contract, given that the concept of *risk* would not be affected with the participation of the principal debtor (then a *penitus extranei*), who would not be involved in the insurance contract.

As a partial conclusion, to consider this particular instrument as a proper insurance contract, according to Colombian legislation, there are two main options: a) accepting that the principal debtor is still the policy-buyer (party to the insurance contract), but disregarding the application of the

²⁸⁶ Gross negligence can be insured in some cases, such as in liability insurance, but subject to legal and contractual restrictions (articles 1127 and 1055 of the C.C.C.); however, as explained before, performance insurances are not liability insurances.

²⁸⁷ Colombian Supreme Court of Justice, Civil Section (Decision of August 15th 2008, Settlement number: 11001- 31- 03 016 -1994 -03216 - 01) Speaker: Pedro Octavio Munar Cadena; Colombian Supreme Court of Justice, Civil Section (Decision of December 18th 2009, Settlement number: 68001-3103-001-2001-00389-01) Speaker: Pedro Octavio Munar Cadena.

aforementioned Colombian imperative norms referring to “*insurable risk*”; or b) accepting that the underlying debtor is a *penitus extranei*, and that only the underlying creditor can be the policy-buyer.²⁸⁸

2.2.2. SECONDARY INSURANCE PROVISIONS CHALLENGING THE OPERABILITY OF THE INSTRUMENT

This financial instrument also has some provisions that originally affected its effective operation (not its legal nature) since it took the form of insurance. The most visible are: Article 1071 of the Colombian Commercial Code (C.C.C.) that permits the parties to the non-life insurance contract to revoke it unilaterally, which, due to the function of this “performance insurance”, would leave the creditor unprotected. The same consequence would occur, as the result of the principle of utmost good faith, when the proposer (debtor) does not disclose certain material facts; or, even if he induces the insurer to enter into the contract by fraud or misrepresentation (Article 1058 of the C.C.C.). Another problematic provision, although there are many more,²⁸⁹ refers to the automatic termination of the insurance contract when the policy-buyer is in arrears with the payment of the premium (Article 1068 C.C.C.), which would also end the creditor’s protection.

As a consequence, Colombian Courts chose to hide, or at least attempted to hide, the original ineffectiveness of this instrument given that in practice it was not completely achieving its purpose, i.e. securing the creditor.²⁹⁰ To do so, they have decided that, due to its socio-economical function and for the protection of public interest, the latter Colombian provisions should not be applied to the performance insurance.²⁹¹ It is clear that this instrument, once

²⁸⁸ The problem mainly refers to who the policy-buyer is, because it is clear, at least, that the insured and the beneficiary is normally the principal creditor.

²⁸⁹ Many other provisions, besides those mentioned herein, are not applied within this context. For example, the one that refers to the infra-insurance or to the proportional rule of compensation.

²⁹⁰ By “original ineffectiveness of this instrument” (performance insurance) the author is referring to the fact that those legal rules that were originally enacted (those of two-party insurance contracts) were not properly designed to protect the creditor against the default of debtor, which is the main purpose of the Colombian “performance insurance”. In that sense, if Colombian Courts had not excluded some of those rules, the instrument could not be used by society because they would be void given the absence of an essential element: risk, according to Articles 1045, 1054 of the Colombian Commercial Code, and 1501 of the Colombian Civil Code.

²⁹¹ Colombian Supreme Court of Justice, Civil Section (Decision of August 15th 2008, Settlement number: 11001- 31- 03 016 -1994 -03216 - 01) Speaker: Pedro Octavio Munar Cadena; Colombian

it took the form of insurance, was not properly designed to achieve that objective as can be seen from the amount of incompatibilities between its effective function and its legal regime; yet, those courts have insisted over several years on the operability of the performance insurance.

Unlike the English case, Colombia has a legal regime for certain “guarantee”, depending on the contract that is secured, which undeniably extends the problem. As mentioned above, some rules are for when the guarantee secures private contracts, and others govern the guarantees of private law contracts. Therefore, refusing the applicability of these provisions to avoid the inoperability of this instrument was also the solution given with regard to the performance insurance for public law contracts. However, regarding this case, besides the latter exclusions, more provisions were excluded or altered through the progressive issuance of certain laws, in order to avoid inoperability when considering the protection of public funds, which, due to their public nature, require a particular treatment.

The current Public Contracting Regime and its related jurisprudence, therefore, has limited the applicability of Articles 1036 and 1037 of the C.C.C. which refer to the formation of the contract. In this case, it has been stated by the Colombian State Council that the performance insurance for public law contracts is formed only when the creditor (insured) has approved the guarantee, turning it into a three-party contract;²⁹² thus, the consensus between policy-buyer and insurer is not sufficient (although only they are the legal parties), and if not approved by the creditor, the guarantee is inexistent.²⁹³ Accordingly, the contractual freedom that is normally part of non-life insurances, where the insurer can include or exclude particular covers discretionally (Article 1056 of the C.C.C.), or at least negotiate them

Supreme Court of Justice, Civil Section (Decision of December 18th 2009, Settlement number: 68001-3103-001-2001-00389-01) Speaker: Pedro Octavio Munar Cadena.

²⁹² It has been said by the Colombian State Council that the jurisdictional competence falls upon the Administrative judge and not upon the Civil judge, given that the State is a party to the insurance contract as its consent is required for the legal formation of the instrument. Colombian State Council, Third Section (dissenting opinion to the Decision of February 19th of 2008, Settlement number: 24609). However, although preceding decisions have had a different approach, the jurisdictional competence is not part of this research.

²⁹³ Colombian State Council, Third Section (Decisions of September 24th and November 27th 1998, Settlement number: 144471) Counsellor Speaker: Ricardo Hoyos Duque; and (Decision of October 12th 2000, Settlement number: 18604) Counsellor Speaker: Maria Helena Giraldo.

with the policy-buyer, was also limited in order to protect the beneficiary, and thus public funds. Some terms and conditions²⁹⁴ were previously imposed by the aforementioned regime ²⁹⁵ and, consequently, by the plans and specifications sheet the entity should have previously provided in the process of letting the public contract.²⁹⁶ If this is omitted, the entity is entitled to reject the guarantee ²⁹⁷ which brings about the mentioned inexistence. Additionally, the second part of Article 1055 of the C.C.C., referring to the prohibitions to insuring fines, and Articles 1088 and 1089 *ibidem* referring to the compensatory principle, are also excluded or limited by the Public Contracting Regime,²⁹⁸ to avoid the partial inoperability of the instrument. Then, these fines (which have a punitive function and not a compensatory nature) are agreeable within the public law contract²⁹⁹ and, if so, they must be guaranteed by the performance insurance, as imposed by the law; otherwise the relevant public entity would be partially unprotected for the misconduct of the debtor.

Another essential element was excluded from the General Insurance Regime in order not to affect the operability of this instrument. Article 1044 of the C.C.C. establishes the principle of “communicability of the defences” whereby the insurer is entitled to propose to the beneficiary or insured the same defences that the former could have proposed to the policy-buyer. This would leave the creditor in a really unprotected position because his claim would depend on the conduct of the debtor, who is his contractual counterparty. Therefore, to avoid this consequence, the Public Contracting Regime established that only certain limited defences may be agreed in the

²⁹⁴ For instance: the risk that must be covered, the period of the validity, the types of cover required, the sum to be covered for every cover in order to be sufficient, and any other essential terms or conditions required by the entity for the particular contract; none of them will be subject to negotiation: Colombian State Council, Third Section (Decision of January 30th 2008, Settlement number: 52001-23-31-000-2005-00512-01(32867), Counsellor Speaker: Mauricio Fajardo Gomez. Colombian State Council, Third Section (Decision of March 4th 2008, Settlement number: 25000-23-26-000-1999-02724-01(31120), Counsellor Speaker: Ramiro Saavedra Becerra.

²⁹⁵ In particular by Act 1150 of 2007 (Article 7) and Decree 1510 of 2013 (Articles 110-147)

²⁹⁶ Colombian State Council, Third Section (Decision of January 30th 2008, Settlement number: 52001-23-31-000-2005-00512-01(32867), Counsellor Speaker: Mauricio Fajardo Gomez.

²⁹⁷ Decree 1510 of 2013, Articles 110-147

²⁹⁸ Act 1150 of 2007 (Article 7) and Decree 1510 of 2013, Articles 110-147

²⁹⁹ Colombian State Council, Third Section (Decision of July 30th 2008, Settlement number: (21574), Counsellor Speaker: Enrique Gil Botero.

performance insurance.³⁰⁰ Exclusions³⁰¹ to the insurance policy are: Strange Cause (this is an Act of God, Force Majeure, the act of a third party, the exclusive fault of the victim); damages caused by the debtor to the creditor's goods not related to the performance of the contract; the misuse or improper use or lack of preventive maintenance to which the creditor is obliged; the regular deterioration of goods. Again, the operability of this instrument was safeguarded by denying the application of the aforementioned principle.

The Public Contracting Regime has set more modifications to the General Insurance Regime for non-life insurances. However, the author believes that they are no longer conceived to avoid the inoperability of the instrument, as those mentioned before, but to provide an enhanced protection of public funds.

2.2.3. ALTERNATIVE METHODS TO IMPROVE THE OPERABILITY OF THE INSTRUMENT

Conclusively, the author shares the opinion of Professor Ordoñez as he states that the original idea was that insurers were allowed to issue these performance insurance policies as another line of business, but without setting any exception to the general insurance regime. However, as expected, he says, the problems that could rise from turning this instrument into the most common “guarantee” were not foreseen,³⁰² given the necessity of making them efficient enough to protect public and private interests. Later he says, all those legal and jurisprudential patches resulted in being useless and, on the other hand, maintained all the traditional problems thus creating even more; this is something that will continue as long as this “guarantee system” based on performance insurance policies is maintained in the same way.³⁰³ In fact, the current problem is so serious that, according to the latter commentator, the only three possible solutions are: 1) abolishing the

³⁰⁰ Decree 1510 of 2013, Articles 110-147

³⁰¹ Although they are presented as exclusions to the risk, in fact they are not. They are events that do not correspond to the occurrence of the risk: the absence of risk. A real exclusion would be, for instance, a breach of contract by the debtor due to specific causes that the insurer does not cover, as occurred in the case of a breach derived from a computer anomaly or other technical malfunctions, which were normally excluded, when the year 2000 was approaching. Ordoñez Ordoñez, Op.Cit p.94-95, 2011. In other words, exclusion is a specific event that is normally covered by such a policy, but for which the insurer will not pay in certain cases.

³⁰² Ordoñez Ordoñez, Op.Cit. p.54, 2011

³⁰³ Ordoñez Ordoñez, Op.Cit. p.111-112, 2011

performance insurance as a type of “guarantee”, implementing then an actual system of bonds with the creation of companies dedicated to the issuance of those new instruments, but also regulated and supervised by the pertinent authority; 2) the same abolition, but authorising insurance companies to create separate departments to issue bonds, as it is in England; and 3) exceptionally, only with regard to public law contract, maintaining the current guarantee system but abolishing the administrative decision as the act that makes the guarantee effective, and, instead, leaving it to traditional commercial regulation,³⁰⁴ although this author believes this would not be more than another partial and useless solution.

Nevertheless, it cannot be forgotten that in no more than ten non-consecutive years (1992-1994 and 2005-2010), almost 20 legal reforms and tens of judiciary decisions from all the Colombian courts have tried to protect the underlying creditor by “protecting” the existence and effectiveness of this instrument. However, as it may be inferred from the possible, but harmful, solutions given above, the true victims of these unsuccessful and continuous attempts to enhance protection have been the legal certainty which tends to decrease,³⁰⁵ and the effectiveness of the law because the norms are not reaching society, hence not providing a service that facilitates the interaction or interdependence of that society. For instance, within this context, beneficiaries are now demanding from their debtors to provide them with “on-demand performance insurances” to avoid the consequences of such an unstable regime; and some insurers, without any legal foundation, have designed, and are issuing, these exotic types of “guarantees”. This is a clear example of how desperate Colombian creditors are in obtaining a different and efficient instrument that could secure their interest in a comprehensive manner.

Thus, in Colombia this instrument has been forcibly moulded to have the legal nature of an insurance contract, but, even as such, these instruments were not designed to achieve the purposes that society is now demanding from them. England, however, given that insurance companies were allowed

³⁰⁴ Ordoñez Ordoñez, *Op.Cit.*, p.114, 2011

³⁰⁵ D’Amato, Antony: *Legal Uncertainty, Num.1 (January)*, p.1,2,8,18, Vol. 71, California Law Review, 1983.

to issue certain “guarantees”, did not have to induce that legal moulding process. In the latter country, creditors and “guarantors” were not exposed to all those constant legal changes; they have been using instruments that were designed for the required purpose. And, those instruments might not be as highly effective as a diligent law-maker or creditor would like them to be, but they were originally effective. In Colombia, however, even if it is accepted that all those past or forthcoming modifications and interpretations turning this instrument into an insurance or hiding its ineffectiveness jeopardise legal certainty seriously, it could be healthier if a different instrument were to be provided to the insurance sector that is, at least initially and comprehensively effective; and even better if such an effectiveness were to be perpetuated in spite of changes in the socio-economic context.

CHAPTER 4: THE RESILIENCE OF LAW*

INTRODUCTION

The considerable increase in the amount of legal norms and the corresponding decrease in their value is acknowledged as an essential problem in law; some authors have called it the “inflation of the laws”.³⁰⁶ Accordingly, it seems that the remedy for every social ill, or the mechanism for achieving every social goal, is to make a law; yet, sometimes, the ills continue and the goals are not attained.³⁰⁷ The reason, whichever it is in every particular case, refers in general to the very usual ineffectiveness of those norms. As a result, the enhanced importance that has been given to the effectiveness of the law³⁰⁸ in modern times, where it has been incorporated in international and domestic scenarios in the form of a new³⁰⁹ “general principle”³¹⁰, is to safeguard legal certainty and guarantee normal functioning of the legal system.³¹¹ Antony Allott stated that: “the biblical aphorism that “without vision the people perish” can be paralleled by the conclusion that “without a generally respected and effective legal system, a society will tend to its own disintegration”.³¹²

* This chapter in particular, and the thesis in general, is identified by the author with the famous phrase of Georg Wilhelm Friedrich Hegel: “We learn from history that we do not learn from history”.

³⁰⁶ Ssulmane, Dace: *The Principle of Effectiveness – The Guarantee of Rule of Law in Europe?* European Integration and Baltic Sea Region: Diversity and Perspectives, p.237-238-239, European Regional Development Fund, 2011.

³⁰⁷ Allott, Anthony, *The Effectiveness of Laws*, p.230, 15 Val. U. L. Rev., N.2, 1981.

³⁰⁸ The notion of “effectiveness” that is largely used in this research cannot be confused in any case with “efficiency” as the key concept of “law and economics”.

³⁰⁹ However, Professor René-Jean Dupuy stated that “effectiveness does not form a new principle of law; it is more ancient than law. It is a condition and justification of the norm’s existence, which originates from the implementation or adoption of the law. (Ssulmane Op.Cit., p.236.)

³¹⁰ Effectiveness of the law as a principle has been theoretically developed since “Allgemeine Staatslehre” in 1900 by G. Jellinek, although by then the German scholar had not developed a theoretical terminology (Milano, 2005, p.25). The development of the principle of effectiveness of the law was first developed as an international principle, and then, later, started becoming an essential characteristic of domestic legislatures and judicial competences: in Ssulmane, Op.Cit, p.234.

³¹¹ A small number of scholars have shared the idea that, although effectiveness is certainly an important characteristic of legal rules, it should not be regarded as a “general principle”, especially considering that only ideas (moral, ideological, philosophical and human) and values can be called principles. Ssulmane, Op.Cit. p.237.

³¹² Allott, Op.Cit. p.229

Within the context of the “general principle of law-effectiveness”³¹³ it would be ideal that *perfect effectiveness* could be reached and proved for every legal norm. However, this is not likely to occur, especially since it would imply that the whole of society would have to accept the law and to comply with it. Hence, only one divergent individual within the entire society is enough to jeopardise the perfect scenario when he does not respect the norm, no matter whether he is aware of its existence or not.³¹⁴

Besides, society tends to expect that all laws produced by the relevant authority are designed in such way that they will all achieve, at least in theory, the expected purpose. However, a law (or Act) is generally composed of a set of legal rules, and there may be the case where one or more of those rules are not properly designed to achieve the expected purpose of the law, despite the others doing so. In the latter case, accordingly, the effectiveness of the law could be jeopardised by those non-pertinent legal rules. Therefore, it would be important to separate that ideal and absolute concept of *perfect effectiveness* from the notion of *sufficient effectiveness*, which seems more appropriate and, above all, achievable. The concept of “*sufficient effectiveness*” is one tangential but original contribution offered by this research.

“Effectiveness of the law” is not an absolute. To reach and prove *sufficient effectiveness* of the law, it would be vital to carry out a test to see how far a law realises its objectives, i.e. fulfils its purposes.³¹⁵ The latter would represent the objective element of the notion of “effectiveness”, where the

³¹³ Which is deeply explained by J. Touscoz in: *Le Principe d'effectivité dans l'ordre international*. Dupuy R-J. Preface, p. I-II, Paris, LGDJ, 1964; by Francis Snyder in *The effectiveness of European Community law: Institutions, processes, tools and techniques*, *The Modern Law Review* 56.1, 1993; and by Matej Accetto and Stefan Zleptnig: *The Principle of Effectiveness Rethinking Its Role in Community Law*. *European Public Law* 11.3, 2005

³¹⁴ The “inflation of the laws” reduces the possibility of the addressees of the law being aware of all the norms that are promulgated. In France, for example, they are supposed to know more than 10,000 statutes, 120,000 decrees, 7,400 treaties, and approximately 17,000 EU texts. (Ssulmane, *Op.Cit.*, p.238.). In Colombia, in 2007, Congress enacted 56 statutes; in 2008, 88 statutes; in 2009, 102 statutes; in 2010, 47 statutes; and this, including further years, leads to an average of between 80 and 100 statutes per year. (URL: <http://www.secretariasenado.gov.co/senado/basedoc/arvol/10786.html>; Last revised: 17-05-2013).

³¹⁵ There is one important difficulty with this, i.e. the purpose of a particular law may not be clearly stated by its maker; and, besides, as the law acquires a history those who apply it, follow it, or disregard it, re-shape both the law and its purposes. Allott, *Op.Cit.* p.233

fundamental analysis is not with regard to the addressees of the law, although they are part of the study, but in relation to the design and objectives of the law. Thus, the author believes that for a law to accomplish the “objective element” of “effectiveness” it is not necessary that all its rules are properly designed. Otherwise, this would challenge the effectiveness of a large number of existing and future laws. Yet, it is not easy to determine whether or not a law is effective when some of its particular legal rules are properly designed, and some others are not. In those situations the method to establish whether or not a law has the objective element of the notion of “effectiveness” should vary widely, depending on the specific case. For instance, as seen later in this research, in the case of a law that regulates a specific contract it could be said that the essential elements, based on their function and not on hierarchy, are more relevant than the accidental elements. Therefore, under the same example, if well-designed rules are more “relevant” than those that are not, it could be said that such law is *sufficiently effective* in spite of those deficient rules, provided that the subject element is also present.

Nonetheless, succeeding with the objective element of the notion of “effectiveness of the law” is not enough by itself to catalogue a law as an effective law; it needs to be accompanied by an equally important test that assesses what proportion of the intended addressees of that law were persuaded to accept it and complied with it.³¹⁶ This would represent the subjective element of the notion of “effectiveness of the law”, where a pertinent analysis must refer to the relationship between said law and the addressees of the law. However, only two law-abiding individuals out of an entire society do not prove the effectiveness of such law; on the contrary, they evidence its ineffectiveness. The “required percentage or number of people” to qualify a law to have *sufficient effectiveness* is unknown, and it seems incorrect to propose an arbitrary formula without any comprehensive method to qualify this.³¹⁷ Is the law effective if 50%+1 of society respect the law?

³¹⁶ Tyler, Tom R: *Compliance with the Intellectual Property Laws: A Psychological Perspective*, p.219, 224-226, NYUJ Int'l L. & Pol. 29, 1996; Stout, Lynn. *Cultivating conscience: How good laws make good people*, p.5-6, Princeton University Press, 2010; Fell, James C: *The relationship of underage drinking laws to reductions in drinking drivers in fatal crashes in the United States*, Accident Analysis & Prevention 40.4, 2008; Manning, Bayless: *Hyperlexis: Our national disease*, Nw. UL Rev. 71, 1976

³¹⁷ However, this is not part of the author's research.

Should it reach at least 2/3 of the addressees of such law? Can this be numerically calculated? Therefore, it can never be “confirmed” with absolute certainty that a particular law is *sufficiently effective*. Yet, both society and law-makers may “estimate” the latter is efficient in a large proportion, as in the case of the rules of the road; or they may also “estimate” that a certain norm is vastly disregarded, as in the case of the prohibition of alcoholic beverages in the United States of America between 1920 and 1933.³¹⁸

Consequently, when a comprehensive test about the sufficient effectiveness of a new law is made,³¹⁹ it is normally grounded on “estimations”: *estimated sufficient effectiveness* sounds more appropriate; but, still, far from any precise analysis that is needed in modern times. Yet, estimating the level of effectiveness has been admitted and carried out by scholars and legal observatories to analyse whether or not laws are achieving their purpose. A clear example was provided in spring 1999 when the effectiveness of a 1997 Florida law was evaluated; the said law took effect mandating that all bicycle riders younger than 16 wear a helmet while riding; 64 counties in Florida had enacted this law, while the other three had opted out. Under that evaluation and prior studies, “*it was estimated*”³²⁰ that such a law was sufficiently meeting its objectives, given that in such counties children riders where the law was in place were twice as likely to wear helmets as children in counties without the law, to prevent fatal accidents.

Furthermore, there has been a tendency to put the blame for the law’s estimated ineffectiveness on the wrong segment of society; it is those who make the laws, rather than those who should keep them or actually break

³¹⁸ Report on the Enforcement of the Prohibition Laws of the United States, National Commission on Law Observance and Enforcement, (The Wickersham Commission Report on Alcohol Prohibition, Par. IX and X), January 7, 1931.

³¹⁹ Nevertheless, the number of reports and strategies seeking to test the ESF is almost insignificant in relation to the total amount of enacted rules.

³²⁰ Kanny, Dafna; Schieber, Richard A.; Pryor, Vickie, and Kresnow, Marcie-jo: *Effectiveness of a State Law Mandating Use of Bicycle Helmets among Children: An Observational Evaluation*, p.1072, 1074-1075, Oxford Journals, American Journal of Epidemiology, Vol. 154, Issue 11, 2001. Similarly in: Foldvary, L. A., and J. C. Lane: *The effectiveness of compulsory wearing of seat-belts in casualty reduction (with an appendix on chi-square partitioning-tests of complex contingency tables)*, p.63,67, Accident Analysis & Prevention 6.1, 1974, and; De Waard, Dick, and Ton Rooijers: *An experimental study to evaluate the effectiveness of different methods and intensities of law enforcement on driving speed on motorways*, p.753-756 Accident Analysis & Prevention 26.6, 1994

them,³²¹ who are largely responsible for the failures.³²² And the examination of the quality of certain laws is rarely performed. Antony Allott stated that:

“[...] legislators fail to realize that it is not enough to make a law, and even to communicate it effectively to its subjects, if there is no monitoring of its reception and implementation: no feedback, in other words. Iceland I believe is one of the few countries in the world which has institutionalized such monitoring of new laws”.³²³

Unfortunately, nowadays this kind of examination is not institutionalised in every country,³²⁴ though it is a more frequent process for new laws in order to test its quality. For instance, in Europe a “Better regulation strategy” was implemented, which deals with the contemporary problems of “inflation of legislation” which is strongly related to effectiveness as a principle, since the latter is falling due to such “inflation”. Thus, impact assessment, consultation, evaluation, and recasting are just some of the methods used to analyse whether or not the legislative efforts have met their objectives. Accordingly, the Communication “Smart Regulation in the EU” in October 2010 set forth the European Commission’s plan to ensure the quality of regulation,³²⁵ which was similarly tackled in England, as seen below.

Therefore, from the past paragraph, it could be possible to highlight that: first, the law must be designed to achieve the expected purpose; secondly, if it does so, it must be properly communicated to its addressees, and finally, if it does both, it must be accepted and complied with by society.³²⁶ Thus, effectiveness of the law, according to Allott, should be measured by the

³²¹ A law is, despite its imperative form, essentially a kind of persuasion, and society will accept it and comply with it in exchange for a certain cost that is normally seen as the benefit of the law. Allott, Op.Cit., p.235

³²² Allott, Op.Cit., p.229

³²³ Allott. Op.Cit, p.236-237. England, as seen below, has follow the European directives in this respect, and has created a number of policies such as the “Good Law Initiative 2013” set forth by the Parliamentary Counsel Office, or “Reducing the Impact of Regulation on Business” by the Better Regulation Executive in the Department of Business, Innovations and Skills.

³²⁴ Feng Lu, Susan, and Yang Yao: *The effectiveness of law, financial development, and economic growth in an economy of financial repression: evidence from China*, p.6,13, World Development 37.4, 2009

³²⁵ Ssulmane, Op.Cit, p.238. European Commission, *Better Regulation — simply explained*, Luxembourg: Office for Official Publications of the European Communities, 2006.

³²⁶ It is important to recall that legal norms may be complied with even if the addressee is unaware of their existence and, consequently, has not accepted them.

degree of compliance; a) in so far as a law is preventive i.e. designed to discourage behaviour which is disapproved of, one can see if that behaviour is indeed diminished or absent; b) in so far as a law is curative i.e. operation *ex post facto* to rectify some failing or dispute, we can see how far it serves to achieve these ends; c) in so far as a law is facultative i.e. providing formal recognition, regulation and protection for an institution of the law, such as marriage or contracts. Hence, presumably, the measurement of its effectiveness is both the extent to which the facilities are in fact taken up by those eligible to do so, and the extent to which the institution so regulated is in fact insulated against attack, says Allott.³²⁷

Nevertheless, the problem with the effectiveness of the law goes even beyond the reception, implementation or voluntary compliance of new laws – which are some of the traditional expectations. Laws may become ineffective, even if they were initially effective, due to changes in the social, political, legal or economic context.³²⁸ So, here is where the “*resilience of the law*” arises with similar, albeit larger, functions, creating therefore “new expectations” over legislators and judges in favour of the addressees of the law.³²⁹ The author’s notion of “resilience of the law”, and its relation to the notion of the “effectiveness of the law,” is one of the main original contributions presented in this research. As seen below, the latter notion has been used in preceding academic articles, though it was only considered as a desired feature of the law, without any relation to the effectiveness of the law; the author’s notion of “resilience of the law”, nevertheless, goes far beyond such a simplistic approach and even includes a subjective part that proposes that the roles of judges and legislators need to be modernised to satisfy the current expectations of a contemporary and demanding society.

In this chapter the author will explain the notion of resilience of the law based on the principle of effectiveness of the law, and the differences from

³²⁷ Allott, *Op.Cit*, p.235

³²⁸ “Professor T. Alexander Aleinikoff [...] compares the “archeological metaphor” [referring to statutory interpretation] with a “nautical metaphor,” in which Congress turns the statute out to sea and leaves it to drift unpredictably”, says: Eskridge, Jr., William N.: *Dynamic Statutory Interpretation*, p.1482, Univ. Penn. L.R., Vol.135, N.6, 1987

³²⁹ The words of Alexander Pope: “Blessed is he who expects nothing, for he shall never be disappointed” seems unacceptable in a modern legal context.

similar notions, such as “legal resilience”. This chapter will later explain the so-called shock that may challenge legal regimes, and the concepts of static and dynamic resilience within the context of resilience and the conjunction between them to provide society with resilient laws. Afterwards the author will describe the legal tools available for legislators and judges in a civil law and a common law jurisdiction to achieve the later purpose, given that until now there is no constitutional foundation to demand the use of those tools (“vehicles”) from these characters. Finally, the chapter will mention all further characters that should support judges and legislators in providing resilient laws, and how all those characters do not depend exclusively on domestic shock, but how they can also use foreign and previous shocks, which is completely different from importing the law itself.

1. THE REASON FOR RESILIENCE OF THE LAW: THE STATIC AND DYNAMIC RESILIENCE

1.1. RESILIENCE OF THE LAW AND SIMILAR CONCEPTS

This concept of *resilience* has been described as “the ability of a substance or object to spring back into shape; elasticity...” or as “the capacity to recover quickly from difficulties; toughness...”.³³⁰ Therefore, putting this concept into a legal context would signify, so far, “the ability of the law to maintain in function when shocked” or “the capacity of the law to recover when shocked”. But, which one of these two concepts would be more accurate in the legal context? In fact, both notions should be considered as equally accurate, and could be the explanation of two variables that are part of the same concept: *the resilience of law*. In order to differentiate these two variables, we will refer to them as *static resilience* and *dynamic resilience*, respectively.

The *resilience of law*, first of all, seems to have been used synonymously with “legal resilience”, albeit the marked linguistic difference between them. In the former notion, the subject of the resilience is the law, whereas in the latter case the subject of the resilience is unknown. Thus, “legal resilience” could refer to society, to the individual, to a particular system, or to any other subject, and that would measure the level of “legal resilience of such subject,

³³⁰ Definitions from the Oxford Dictionary of English, Oxford University Press, 2010.

and not the “level of resilience of law”.³³¹ In other words, admitting they are synonymous would signify, for instance, that the “behaviour of the economy” is equal to the “economic behaviour of...”; and this might lead the analysis along the wrong path. Hence, this research will be referring to the *resilience of law*, as a related notion to the effectiveness of the law.

Although the *resilience of law* and “legal resilience” have not been often used, the latter was adopted to test the flexibility or strength of the law in order to become suitable so it can reach the addressees of the law integrally. For instance, Neil MacCormick’s idea was that when the law settles an issue in one way, it is never inappropriate for a person to form a contrary moral view – to the effect that the issue ought to have been settled in a different way. However, he says, it may be wrong for a person to act on his reserved moral judgement; it may be necessary or right for him to follow the law, but he cannot surely be required to abandon his own moral judgement. But, according to Jeremy Waldron, law is robust enough in this area so that the particular legal orders can command general respect, and be complied with, even in the face of significant criticism.³³² Therefore, the law must be sufficiently strong to reach the addressee with all its effects, to penetrate the individual scope of moral reservations. Thus, Waldron affirms that “law has made itself resilient so that it can withstand the mischievousness and self-indulgence of our vaunted moral autonomy”.³³³ According to the distinction given above, the author believes that “neither the resilience of law” nor “legal resilience” should be used in this context. First of all, the legal system has not been shocked by moral autonomy, and, secondly, it was not measuring the level of legal resilience of the person. In the author’s opinion people’s ideas simply refer to the operability of the general principle of law effectiveness that was briefly mentioned above, as the law is only trying to reach society in spite of said moral reservations.

A legal system that was originally effective may become at some point partially or totally ineffective, but that is different from the fact that, due to

³³¹ As regarded by Hornstein, Donald T.: *Resiliency, Adaptation, and the Upsides of Ex Post Lawmaking*, p.1552-1556, NCL Rev. 89, 2010

³³² Waldron, Jeremy: *Legal Judgement and Moral Reservation*, p.22, Law and Democracy, EUI, 2010.

³³³ Waldron, Jeremy: *Legal Judgement and Moral Reservation*, p.24.

certain reservations (moral, for instance), the law is not reaching society. In the latter case, effectiveness was never achieved, as in the previous paragraph. The problem then refers to the scenario where the law was initially and sufficiently effective, but due to changes in certain conditions (herein those relevant changes are referred to as “the origin of the shock”) the law becomes ineffective.

Therefore it is possible to think of two options, so far, to prevent the appearance of ineffectiveness of the law due to certain shocks. The first and the more obvious, would be avoiding the occurrence of those changes. In that case, law-makers could just keep designing effective laws, and in doing so, disregarding the resilience or vulnerability of the law, which is what they have been doing for centuries, because nothing could possibly affect the *status quo*. However, in real life those changes can hardly be avoided, and, indeed, most of the time changes are vital for the development of society. Those changes not always are endogenous,³³⁴ voluntary or expected;³³⁵ they may be also exogenous,³³⁶ involuntary³³⁷ and unexpected, as seen later on; and no person would have control over them. That means that non-avoided changes would always be challenging said vulnerability, if any; hence, the amount of ineffective laws would keep increasing constantly which, as stated before, could lead to the disintegration of a disciplined society. It is of paramount importance, however, to establish that some changes (given their remoteness, nature, pettiness, or similar reasons) will never produce a shock.

³³⁴ An “endogenous change” is considered to be the one that finds its origin, or occurs, inside the same system or framework that is finally shocked, such as the rise of a monopoly.

³³⁵ The author believes that “voluntary change” ought to be understood as those that are provoked by law-makers. For instance, the signature of a Free Trade Agreement, and its due legislative approbation, can be considered a “voluntary change”; this example may also be useful to illustrate an “expected change”, also referred to as an “anticipated change”, where the shock should be foreseen even before the change. However, another difference has been highlighted by Maria Savasta-Kennedy (in *Adaptation and Resiliency in Legal Systems, Introduction to the North Carolina Law Review Symposium*, p.1365, 89 N.C L. REV. 1365, 1365 (2011) where she recalls that the latter symposium opened with a brief of description of how the evolution of “earthquake ready” building designs in the San Francisco Bay area might serve as an example of creating a resilient system in response to “anticipated but unpredictable” events.

³³⁶ “Exogenous change” is understood to be that which finds its origin, or occurs, outside the system or framework that is finally shocked, such as political, economic or social factors, for example.

³³⁷ In the presence of “involuntary change” law-makers do not provoke the change; for example, in the case of a coup, a revolution, or a liberalization process.

But there is another option to prevent the appearance of ineffectiveness, which is situated on the other side of the problem, i.e. not upon those changes, but upon the law itself. The second option is then to provide the law with certain “tools” that allow it to resist the effect of those uncontrollable changes, or to recover if it could not resist it; in short, to make the law resilient against those shocks.³³⁸ But then, how can the notions of *resistance* and *recovery*, the two features of resilience, so far, be defined in a legal context?

1.2. RESILIENCE IS MORE THAN A PROPERTY OF THE LAW

A group of scholars,³³⁹ particularly in the field of climate change³⁴⁰ and environmental law, have worked in the past on the notion of “resilience of legal systems”. For instance, J.B. Ruhl, perhaps the scholar that went farthest in this matter, says that climate change will soon begin to disrupt the settled expectations of humans, and this will give rise to the need to formulate new policies and resolve new kinds of disputes.³⁴¹ Therefore, he argues, if the law is up to the task, it is in part because the law proves to be *resilient* and *adaptive*.³⁴² J.B. Ruhl therefore, going beyond previous scholars, outlines

³³⁸ Indeed, in October 2010, a group of scholars from diverse legal fields gathered at the University of North Carolina School of Law in Chapel Hill, North Carolina to talk about the shock waves of recent events hitting the environment, financial markets, and the criminal justice system, and to consider how the law can make these systems better able to deal with unanticipated challenges; see Savasta-Kennedy, Op.Cit, p.1365

³³⁹ Karl N. Llewellyn: *The Common Law Tradition: Deciding Appeal*, 513, 1960; Joni S. Charne: *The Interim Obligation of Article 18 of the Vienna Convention on the Law of Treaties: Making sense of an Enigma*, 25 Geo. Wash. J. Int'l L. 5 Econ. 71, 104, 1992; Janet C. Neuman: *Drought Proofing Water Law*, 7 U. Denv. Water L. Rev. 92, 106, 2003, and; Oren Perez: *Purity Lost: The Paradoxical Face of the New Transnational Legal Body*, 33 Brook. J. Int'l L. 1, 48, 2007, in Ruhl, J.B.: *General Design Principles for Resilience and Adaptive Capacity in Legal Systems – with applications to Climate Change Adaptation*, p.1378, 89 NCL Rev. 1373, 2011. Or, Joseph Vining, from the field of law and economics explains why law is not, and cannot be, a social science, which has no relation at all to the context proposed herein (The Resilience of Law, Law and Democracy in the Empire of Force, Jefferson Powell, James B. White, eds, Univ. of Michigan Press, 2009.

³⁴⁰ Driessen, Peter P.J. and Van Rijswick, Helena F.M.W.: *Normative Aspects of Climate Adaptation Policies*, p.561, Climate Law 2, DOI 10.3233/CL-2011-51, IOS Press, 2011; Ebbesson, Jonas: The rule of law in the governance of complex socio-ecological changes, Global Environmental Change 20, 2010; Van Rijswick, Helena: Moving water and the law, the distribution of water rights and water duties within river basins in European and Dutch water law, 2008.

³⁴¹ Ruhl, J.B, Op.Cit, p.1374

³⁴² Ibid, p.1374

some foundational principles of what he calls the “resilience theory” and then tries to apply them in the legal system context.³⁴³

In that sense, J.B. Ruhl starts out by structuring his idea, stating that *resilience* is “the capacity of a system to experience shocks while retaining essentially the same function, structure, feedbacks, and therefore identity”.³⁴⁴ Therefore, based on the ideas of Walker³⁴⁵ and Holling,³⁴⁶ Ruhl mentions two features of resilience that are similar to what the author of this thesis has previously called *static resilience* and *dynamic resilience*. According to Holling’s model, he says that the first feature of resilience is “recovery” – the time required for a system to return to an equilibrium or steady state following a disturbance. He calls this feature “engineering resilience” given that it would be based on reliability, efficiency, quality, control and similar strategies to pursue a single objective: returning to the equilibrium state. His “engineering resilience” could be paralleled to the author’s notion of *dynamic resilience* as it will be treated later on in this work. On the other side of Holling’s model, there is the “ecological resilience” (that could be paralleled to what is called *static resilience* in this thesis). The latter is measured by the amount or magnitude of disturbance a system can absorb without having its fundamental behavioural structure redefined – a property known as resistance.³⁴⁷

Hence, in a legal context, says Ruhl, scholars have used the terms “resilient” and “resilience” to describe positive qualities of a legal system.³⁴⁸ And those scholars seem to believe that a resilient legal system enjoys consistency in overall behavioural structure “*notwithstanding continuous change of external and internal conditions*”.³⁴⁹ In other words, the legal system must be resistant to, and recover easily after, those shocks. Nevertheless, at some point, the argument given by Ruhl takes a route that is not shared by the

³⁴³ Ibid, p.1375

³⁴⁴ Ibid, p.1375

³⁴⁵ Walker, Brian: *A handful of Heuristics and Some Propositions for Understanding Resilience in Socio-Ecological Systems*, Ecology and Soc, in Ruhl, Op.cit. p.1375

³⁴⁶ Holling, Crawford S.: *Resilience and Stability of Ecological Systems*, 4 Ann. Rev. Ecology and Systematics 1, 1973, in Ruhl, Op.Cit, p.1376

³⁴⁷ Ruhl, Op.Cit. p.1376

³⁴⁸ Ruhl, Op.Cit. p.1376

³⁴⁹ Also described herein as endogenous and exogenous changes

author; Ruhl is aiming at a different target. He believes that the resilience theory does provide a coherent set of questions and analytics for stepping back to assess how to coordinate and apply those strategies to design a legal system that is *durable* in the face of change. On the contrary, the author believes the objective is to design a legal system that is *sufficiently effective* even in the face of change. By doing that, Ruhl states that the resilience is no more than a property of the law, which is against the author's idea, where the resilience is a larger notion that comprises the principle of law-effectiveness. But, since the author disagrees with the way Ruhl incorporated those two features (resistance and recovery) into the legal scenario, a different road needs to be set to analyse whether or not a legal system is resilient.

It has also been suggested by scholars cited in this section that the term "resilience" refers to the "adaptability" of laws to new political, social, environmental, economic conditions, amongst others. The author departs from that belief however, given that it seems clear that norms cannot adapt themselves to anything; and it is as a result of that that sometimes those norms become obsolete very easily, particularly when they are enacted and left to drift. Those norms need an external propeller to evolve and recover from those new situations or "changes", and that is precisely what legislators and judges do, as seen below, when they use the elements of dynamic resilience.

2. THE SHOCKS AND THE STATIC RESILIENCE

2.1. "CHANGES" AND THE SUBSEQUENT SHOCK

In that sense, the first point that needs to be clear in order to discuss these concepts is that there must be a "change" and a consequent *shock*, as mentioned above. The *shock* is therefore, the *conditio sine qua non* of the *resilience of law*. Without the *shock*, it would be senseless to discuss resistance or recovery – resistance to what? – Recovery from what? Thus, in the absence of the *shock* this thesis would be discussing no more than the known effectiveness of the law, which is done under motionless conditions along a certain period of time. But, the effectiveness of the law herein is

mentioned from another scenario that includes the “changes” mentioned above, and their resulting *shocks*.

The *shock* is then the action resulting from one or more “changes” whereby, by themselves or together, the standard situation is altered and challenged, and is thus the essential element of the *resilience of law*. This, perhaps, can be better illustrated in a different scenario with the use of heuristics. Imagine one typical and commercialised “aluminium can” fulfilled with Coca-Cola, at a standard temperature, and at normal location. In this case, whether the “can” is or is not able to maintain that liquid inside under these standard conditions is simply a matter of effectiveness or ineffectiveness of the “can”; but that is not the issue in this research. In the case of the initial effectiveness of the “can”, and if the *status quo* is maintained, the said gaseous liquid will remain inside the “can” for a long time, because the latter was designed with that purpose; and, a similar conclusion should be given if there is such an irrelevant “change” that by itself is not capable of producing a *shock* over that “can”. Nonetheless, what would happen if that same “can” full of Coca-Cola is taken progressively outside the atmosphere? Or, simpler, what would be the result if it is put in the freezer or the oven for a long time? Or, what would happen if the “can” were shaken without being opened? Firstly, the *status quo* would have disappeared, and those “changes” would cause a severe pressure within the flimsy structure of that “can of Coca-Cola”; and that pressure is the *shock*. Secondly, it is only then, in doing so, that the resistance capacity and the recovery ability of that “can of coke” can be tested against that particular “change” and its subsequent *shock*.

2.2. STATIC RESILIENCE – MAINTAINING THE LAW IN FUNCTION

2.2.1. RESISTANCE IS NOT DURABILITY

Accordingly, the aforesaid “resistance or static resilience” is the ability to maintain in function in spite of a shock. But, as the first feature of *the resilience of law* it is important to consider how the words “maintain in function” should be understood in this legal context? Ruhl stated that the idea that “*a legal system is or is not resilient implies nothing about the system normatively. Resilience is a quality of a social system, but it does not*

make the system “good” or “bad”, and then he said that “[w]hat Americans might consider a contemptible legal system – feudalism, for example – might nonetheless be resilient (as it [lasted] for centuries)”.³⁵⁰ Hence, he seems to be putting resilience on an equal footing with durability³⁵¹ disregarding whether or not the system achieves its aims. According to this interpretation a law that is completely disobeyed by an entire society could be resilient as well.

However, the words “maintain in function” may be interpreted in another sense which seems more compatible with the legal context. The author believes that resilience should not be confused with durability, and therefore it cannot be understood as “maintaining the law valid or unamended” for long periods, because that could never be the function of a law. In general, the law has a facultative, curative or preventive function that does not depend upon a temporal factor.³⁵² To repeat a previous example, the compulsory use of helmets for children under 16 years old when cycling to prevent fatal accidents is the function of that law; the said function is not to have such a rule lasting as long as possible. Thus, unlike Ruhl, the author believes that “maintain in function” refers to keeping that particular law valid and, above all, achieving the purposes for which it was designed, i.e. being an effective law. “Maintaining in function” from the author’s perspective is equal to maintaining effectiveness. And this is the important link between the principle of law-effectiveness and the resilience of law, with the difference that the latter includes the aforementioned “changes” and “shocks”. In the example of the compulsory use of hands-free devices while driving, Ruhl could say that such a norm is resilient (durable), though ineffective. However, the author would say that the same norm is simply not resilient against “technological changes” because it lost its effectiveness when it was shocked.

Accordingly, a legal system can be considered as “resistant” if it keeps being sufficiently effective in spite of a shock. And, as mentioned above, “resistance” is a feature of the static *resilience of law*. For that reason, it

³⁵⁰ Ruhl, Op.Cit. p.1381

³⁵¹ Ruhl, Op.Cit, p.140.

³⁵² Law-makers will try to make any law durable, but that has nothing to do with its specific function

could be better believed that what measures the level of static resilience is not the amount of time the law exists; it is more the amount of shock the legal system can resist before losing its sufficient effectiveness.

2.2.2. RESISTANCE IS NOT JUSTICE

A statically resilient norm has no direct relation with the notion of justice. Resilience of law is based upon the effectiveness of the law; not upon its justice, which is not the function of the law, and may vary depending on whether it is explained from a perspective of liberty, of welfare or of virtue.³⁵³ If, hypothetically, we were to accept that justice or injustice could determine the resiliency of the law, we would have to accept that certain laws, from the same moment they are enacted, could be resilient to some people and not resilient to others, depending on their understanding of justice. And, then it would be subjective and harder, if not impossible, to determine whether the law were statically resilient or not, and whether it needs to be fixed or not. In the author's opinion, a resistant legal system is such that it is able to resist a shock without losing its effectiveness, even if the latter were unjust.³⁵⁴ It may occur that society, or a significant part of it, starts considering a law to be unjust, and as a consequence they may stop accepting it and complying with it. In this case, the social opposition to such injustice would be the origin of the shock that could cause the ineffectiveness of the law; but, static resilience of law is not measured by the justice that is lost. In short, injustice could be the cause but not the effect of the poor resistance of the legal system. Then, if the problem concerning the resilience of law is not about durability or justice, but about the effectiveness of the law, what should happen when the legal system cannot resist the shock? It is here, as a consequence, when the second concept arises: recovery, as the first element of dynamic resilience.

3. DYNAMIC RESILIENCE AND ITS CONJUNCTION

3.1. STRUCTURE OF RESILIENCE

³⁵³ A clear explanation of these three perspectives of justice can be seen in: Sandel, Michael J.: *Justice, What's the Right Thing to Do?* Chapter 1, Penguin Books, 2009

³⁵⁴ And this may be confirmed by Bobbio as he stated that: the fact that a norm is universally respected or used does not demonstrate its justice, in the same manner that not respecting does not imply its injustice. Bobbio, Norberto: *Teoría General de Derecho*, p.35, Debate, 1993.

Framing the notion of recovery in this legal context may simplify this section. Thus, resilience of law has two features: 1) static resilience and 2) dynamic resilience. Static resilience has only one element: resistance. However, dynamic resilience has two elements: a) recovery and b) prevention. This also sums up society's "new expectations"³⁵⁵ of those in charge of making the law resilient; or, from another perspective, what is "expected" from parliamentarians and judges in the context of this thesis.

3.2. RECOVERY AND PREVENTION

3.2.1. RECOVERY AS THE FIRST ELEMENT OF DYNAMIC RESILIENCE

Therefore, recovery should be understood as the capacity of the law to recover when it has been shocked. Nevertheless, the level of recovery should not be measured only by the rapidity or amount of times in which a law can be reformed, revalidated or reinterpreted. In accordance with what was mentioned before, the author believes that legal recovery should be measured by the level of "effectiveness of the law" that is recuperated after the shock.³⁵⁶ V.gr: A jurisdiction may have 20 reforms in one area of law in a short period of time, but if none of them, or all together, is capable of re-establishing effectively the purpose for which the law was created, the level of legal recovery will be equally low.

Accordingly, successful recovery in those terms is different from "attempting to recover". "Amending or rationalising the law" belongs to the scope of the

³⁵⁵ By "new expectation" the author is, and will be, referring not to a "duty", "obligation" "responsibility" of either legislators or judges, but to the "ought to do something" or "the aspirational conducts or results", if preferred, that are desirable when the aforementioned personages are using what has been called: the vehicles for resilience. The author is using the term "new expectations", and not simply "expectations", because there are many other desirable conducts or results that are expected from parliamentarians and judges, which, however, are outside the scope of this research. For example, having effective norms is a modern expectation, but herein the author refers to resilient norms (new expectations), which are different. In addition, further modern expectations could be, for example, having coherent and fair, and avoiding anti-technical laws.

³⁵⁶ The result of the measure should not conclude that the system is resilient or not resilient, in absolute terms; resiliency should have levels, perhaps catalogued as low, medium or high, or under any further classification. But it would seem extremely rigid to affirm that because a regime resists the first shock but not the second, for example, it is not statically resilient.

dynamic resilience, not to the static one. But, the activity of “amending or rationalising” is only a possible vehicle to acquire a certain level of dynamic resilience,³⁵⁷ and subsequently the required effectiveness of the law. In addition, there is another important vehicle to obtain the desired level of dynamic resilience which is the sole “interpretative process” carried out by the courts. Yet, amendability³⁵⁸ and interpretation³⁵⁹ do not signify, by themselves, successful recovering or prevention (elements of dynamic resilience) because they depend on the level of effectiveness of the law that is achieved; hence, unsuccessful amendment or interpretations of the law only demonstrate the low level of its dynamic resilience.

Having a high level of legal recovery, even reaching more than the sufficient effectiveness of the law expected by law designers, does not mean that such law will remain effective afterwards. In other words, recovering said effectiveness does not signify that such law will become resistant to future shocks. For example, a legal system may recover its effectiveness very easily, but can lose it in the same way after a slight shock. That would show that laws can have a poor level of static resilience, but at the same time a high level of recovery. Therefore, if resistance is a static or immobile element, and the recovery ability does not guarantee future resistance, the question would be: through which instrument is it possible to achieve static resilience for a legal system?

3.2.2. PREVENTION AS THE SECOND ELEMENT OF DYNAMIC RESILIENCE

Static resilience is not achieved by itself; it needs a dynamic element – different from recovery – that makes the law resistant to future shocks. Hence, the second element of dynamic resilience is “prevention” where the aforementioned legal amendments or interpretations are not performed after the shock. Indeed, the ineffectiveness of the law as a consequence of a future shock is what law designers should “prevent” with those vehicles. Therefore the level of static legal resilience always depends on the preceding level of

³⁵⁷ With regard to the resilience of law, there is no difference between “textual amendment” and “non-textual amendment”.

³⁵⁸ This right is given to the Colombian Congress by the Colombia Constitution in Art. 150, No. 2 and 3; With regard to the English case, this faculty is better explained below.

³⁵⁹ As seen below, this may refer to either legislative or judicial interpretation.

“prevention” achieved by law designers. Imagine the case of a massive *shock* originated by a Free Trade Agreement for example, which causes the total ineffectiveness of a legal system. Firstly, that would provide the level of legal “resistance” of that legal system. But, secondly, “legal recovery” would be needed to re-establish the effectiveness that was lost, and, above all, “legal prevention” would be needed to make the legal system “legally resistant” against future shocks, and that level of “legal resistance” achieved would remain unalterable by itself. Any alteration would imply the presence of dynamic resilience.

However, “prevention” can, and sometimes must, be carried out independently, particularly against two situations: a) unprecedented or pioneer Acts,³⁶⁰ and b) simple prevention, as seen below. Therefore, “preventive resilience” can be performed either before or after the shock, but its function is to make the legal system resistant to future shock, no matter if there was, or was not, a previous shock. And the vehicles to achieve “prevention” are those available to recover effectiveness of the law, with one small difference: when a new law is created it is not through an amendment (or any other type of modification of the law) or an interpretation; it is done through another vehicle which is the “production of law”. Thus, the process of producing unprecedented Acts, as there is no previous shock, is similar to the cases of “exclusive legal prevention” over an existing provision, where non-recovery is needed³⁶¹, although the aforementioned vehicles are different. Indeed, unprecedented Acts should be considered as having the first preventive legal process to benefit those addressees of the law that are requiring the intervention of the State against a situation of lawlessness.

³⁶⁰ An unprecedented or pioneer Act refers to those Acts of Parliament (or Congress, in the Colombian case) that cover new areas of activity previously not governed by legal rules.

³⁶¹ By pioneer (unprecedented) law it is important to differentiate between two possible meanings. Firstly, a pioneer law in a domestic scenario (V.gr. the first law that regulates intellectual property in Colombia). These laws are, most of the time, based on comparative law, and the experience of previous and non-domestic *shocks* can be borrowed; therefore, the analysis of non-domestic *shocks* can be performed. Secondly, a pioneer law on a worldwide level (V.gr. the first law that regulated performance bonds in the United Kingdom). This law, on the other hand, was the first law ever to explicitly regulate such types of contract, by which it was impossible for law designers to base their analysis on preceding experiences, domestic or non-domestic.

Accordingly, “exclusive resilient prevention” refers to one part of these “new expectations”; this one is related to the strengthening of the level of static resilience against future shocks, in those cases where there is no preceding shock against a valid legal system that is already in force. Anticipating those shocks is never an easy task for law-makers, as seen below. However, in some cases, the shock is voluntarily provoked by the same law-maker, even where the “change” is not directly related to the legal system that could be shocked. This provocation should imply a heavier weight over a diligent law-maker whereby if he is provoking a “change”, he is therefore required to protect that legal system against the shock. He is also required to foresee the consequences that the said “change” is going to generate, and as a result has to increase the level of static resilience in advance, through the aforementioned preventive vehicles. A clear illustration of this is the signature and legislative approval of Free Trade Agreements by developing countries where previous legal amendments are commonly carried out in order to *resist* the forthcoming shocks.³⁶²

3.2.3. LEGAL PREVENTION OF “UNANTICIPATED CHANGES”³⁶³

Legal modification, then, can attempt to achieve recovery or prevention, or both at the same time. Yet, the preventive element of dynamic resilience, from the author’s point of view, is the most important element within this study because it seeks to strengthen the level of static resilience for the future. The latter element can refer to two different challenges amongst others, regardless of whether they are voluntarily or involuntarily provoked or not provoked at all by the State: a) anticipated challenges, or b) unanticipated challenges. Anticipated challenges demand the presence of preventive measures (Free Trade Agreements in developing countries, for instance), but these challenges are not the most difficult problem regarding

³⁶² One recent example occurred regarding the Free Trade Agreement between Colombia and the United States of America. The agreement went into effect on May 15th 2012, and several legal reforms were implemented in Colombia before that date in order to prepare its normativeness to the new economic reality; therefore, avoiding the lack of legal protection in most of the Colombian commercial sectors.

³⁶³ Prevention under the context of this section does not refer to the “preventive purpose of a norm”, but to prevention against a scenario of ineffectiveness of the law. In the former case, prevention is aimed at controlling the conduct of society such as would desired in criminal law (Husak, Douglas: *The Criminal Law as Last Resort*, Oxford Journal of Legal Studies, Vol.24 N.2, 2004); in the latter case, prevention is aimed at avoiding that the *sufficient effectiveness* of laws is lost as a result of “changes and their resulting shocks”.

prevention, as they are foreseeable.³⁶⁴ Not preventing the effects of foreseen challenges is more a lack of diligence of law designers than a difficulty.

Preventing unanticipated challenges,³⁶⁵ on the other hand, is the Achilles' heel of law designers with regard to static resilience. Frequently, legal modifications, or further vehicles, contain the recovery element but not the preventive one of dynamic resilience, therefore the legal system remains fragile. For instance, Douglas Arner, a scholar relating financial markets and resilience, stated with regard to the financial crisis:³⁶⁶ “...efforts to create a resilient global financial system have far to go, and in their current iteration could not prevent or effectively address future global financial crisis”³⁶⁷. In other words, the current financial legal framework is effective so far, but still weak against the next unanticipated challenge, so it is not statically resilient in the end.

Nevertheless, it may be thought that legal prevention of unexpected challenges is not achievable in practical terms, or that it cannot be demonstrated until the shock hits the legal system. But, it could also be argued, that preventive actions can also be compared to excessive protectionism; for example, from a scenario of economic liberalism, for which legal prevention, along with recovery, would be likely to be criticised.

First of all, it is suggested that legal prevention against unanticipated challenges is viable and, indeed, has been successful in several cases. Yet, the proof that those preventive measures (leading to a resistant system) were effective relies on the posterior analysis of the shock. This would imply that the quality of those preventive components cannot be assessed *ex ante*, which causes a massive level of uncertainty about their possible efficacy against future shocks; a possible criticism of the preventive element of dynamic

³⁶⁴ Not preventing the effects of foreseen challenges is more an extreme lack of diligence of law designers than a difficulty.

³⁶⁵ The term “unanticipated” does not make reference to a totally unknown challenge, or to any kind of challenge; it means the lack of knowledge of the “approximate period” in which the system will be hit by determined components (shock). This is given that prevention and recovery, as mentioned herein, are designed to deal with a particular shock.

³⁶⁶ This quotation is also a clear example of legal modifications that contain the recovery element but not the preventive one of dynamic resilience.

³⁶⁷ Arner, Douglas W.: *Adaptation and Resilience in Global Financial Regulation*, 89 N.C., L. Rev. 1579, 2011, in Savasta-Kennedy, Op.Cit, p.1368

resilience. To maintain the same recent example, in April 2011 the Federal Deposit Insurance Corporation (FDIC)³⁶⁸ published the results of a report by experts³⁶⁹ that retrospectively analysed the way whereby it would have been able to handle the crisis of Lehman Brothers³⁷⁰ if the Dodd-Franck Act had existed. But, again, this is an *ex post* analysis that probably would have been catalogued as an unproven conclusion if it had been given before the crisis. Therefore, to evaluate the level of the preventive element of resilience, i.e. if in the end the legal system is truly resistant or not against unexpected challenges, it is necessary to wait until the shock hits the system; no one can assess an exam that has not been taken. The recovery element, on the other hand, can certainly be analysed as soon as the reforms come into force.

Additionally, there is another aspect that seems to have been forgotten by the FDIC, which is also frequently overlooked when attempting to incorporate the preventive element into legal reforms. As mentioned above, the cause of the ineffectiveness of the law is not the specific weakness of the system, but the “challenge” perpetrated by the components of the shock against a system that is not highly resilient. Thus, in terms of legal prevention, analysing the particular weakness of the legal system (systemic risk, under the same example) is not, in the author’s opinion, the best approach to strengthen the system for future occasions; although it should be used for recovery purposes. The analysis to design prevention should be based mostly on the components of the shock and their respective influence over the legal system. Yet, under the same example, the Dodd-Franck Act was based mainly on the weakness, in order to recover the effectiveness and to prevent future challenges; a

³⁶⁸ The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the federal government responsible for insuring deposits made by individuals and companies in banks and other thrift institutions. The agency also identifies and monitors risks to its deposit insurance funds and tries to limit the effects on the U.S. economy if a bank of thrift institution should fail. The FDIC is funded through premiums paid by banks and thrift institutions to pay for deposit coverage and from interest the agency earns on U.S. Treasury securities.

³⁶⁹ Federal Deposit Insurance Commission: *The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Franck Act*, April 18, 2011. http://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf. Last Revised, 29/05/2012

³⁷⁰ The bankruptcy filing of Lehman Brothers Holdings Inc. (LBHI) on September 15, 2008, was one of the signal events of the financial crisis. The disorderly and costly nature of the LBHI bankruptcy—the largest financial bankruptcy in U.S. history—contributed to the massive financial disruption of late 2008.

similar situation occurred with Basel II³⁷¹, just to mention another clear example.

On the other hand, prevention can also be compared to excessive protectionism under the perspective of economic liberalism, which is so common these days. However, two points need to be mentioned about this. Firstly, the concept of effectiveness of the law and the notion of legal resilience in general, are independent of the notion of justice, or of the idea that public policy is better. The law needs to be effective – whatever the social, political or economic tendency. Thus, whether prevention is, or is not, considered as excessive protectionism should, *ab initio*, be ignored from the point of view of resilience of law. Nevertheless, if the latter protectionism provokes by itself a scenario of ineffectiveness of the legal regime, the problem is not related to the *preventive* element, but to a poor *recovery* process. This is because the preventive element should protect the system from future challenges, and hypothetical excessive protectionism is not a future event; on the contrary, it is intrinsic from the beginning of the modified regime. Thereby, the cause of the ineffectiveness in this case, would not be an anticipated or an unanticipated challenge; the cause would be the poor recovery after a previous shock. Conclusively, it seems hard to catalogue prevention as an impossible task, or as synonymous with excessive protectionism.

Thus, the preventive element is essential in two senses within this context. Firstly, because social, financial, political or economic realities, among others, are in constant evolution, law always suffers from a tendency to become obsolete.³⁷² As a consequence, legal regimes, and ultimately the addressees of the law, are exposed to the massive effects of a potential shock, unless effective prevention is developed. As an example, Brett McDonnell and

³⁷¹ Basel II is an agreement between the financial authorities of the major developed countries referring to prudential regulation in order to develop a framework to strengthen the soundness and stability of the international banking system, based on three pillars: 1) Regulatory Capital (Credit, Risk, Operational Risk, and Market Risk), 2) Supervisory Review Process, and 3) Market Discipline.

³⁷² Particularly in civil law jurisdictions or with regard to statutes in common law jurisdictions: Posner, Eric Op.Cit, p.1699-1702, 1995-1996; Tetley, William: *Mixed Jurisdictions: Common Law v. Civil Law (codified and uncodified)*, 600 Louisiana Law Review 677, 2000

Daniel Schwarcz, who explored the role of “regulatory contrarians”³⁷³ in enhancing the ability of financial regulators to adapt to emerging challenges in the financial sector, affirm that: “*the crisis was also a product of the failure of regulators to carry through on their mandates in the face of evolving market risk*”. In that way, prevention is vital as it avoids the weakness of the legal regime and subsequent ineffectiveness of the law, caused by an evolutionary tendency, that most of time is imperceptible. Nonetheless, it should be remembered that the real cause of a potential case of ineffectiveness, within the context of this thesis, is the *shock*, and not the weakness of the legal system.³⁷⁴

Secondly, legal prevention is to be highlighted as it also avoids one of the most frequent problems within a legal system. This problem refers to the haste to recover effectiveness after a particular shock, occasionally accompanied by certain degree of improvisation, in order to catch up with the new reality as quickly as possible.³⁷⁵ Then, the obligation and the anxiety of law designers to provide effectiveness to that system may have three main negative effects: a) not analysing properly the “change” and its subsequent “shock”; b) as a consequence, directing the legal modifications in the wrong directions, away from sufficient effectiveness; and c) omitting the preventive element once again. As a result, there will be a poor level of dynamic resilience that will lead, above all, to a poor level of static resilience once

³⁷³ A regulatory contrarian is an entity that is affiliated with, but independent of, a financial regulator charged with the task of monitoring regulators and the regulated marketplace, and publicly suggesting new initiatives or potential structural or personnel changes” McDonnell, Brett, and Schwarcz, Daniel: *Regulatory Contrarians*, 89 N.C.L. Rev. 1629, 2011, Savasta-Kennedy, Op.Cit, p.1368

³⁷⁴ Weak or defective legal regimes may be nonetheless completely effective for long periods of time until there is a shock, as in the case of the financial market laws before the 2008 crisis.

³⁷⁵ “The first duty of the drafters must be to give effect to the intention of the department instructing them, and to do so in as clear and precise a manner as possible. These aims, however, have to be achieved under pressure, and sometimes extreme pressure, of time”: Slapper, Gary and Kelly, David: *The English Legal System*, p.88, 13th edition, Routledge, 2012. In addition, it is not, and never will be, a simple task for “law-protectors” (notion described below) to recover the effectiveness of a legal regime after a particular shock; and improvisation may be the general rule while trying anxiously to achieve effectiveness. The author believes that this is likely to occur with more intensity with regard to statutes or in civil law jurisdictions, and with less intensity in “case law”, due to the more frequent contact between judges and “case law”.

again. In other words, the lack of legal prevention tends to cause a harmful cycle of perpetual ineffectiveness of the law.³⁷⁶

3.3. CONJUNCTION OF THE FEATURES OF RESILIENCE

When *prevention* is not previously performed, the legal system “may” not resist the shock, due to its low static resilience. The author uses the word “may” because, as mentioned before, the legal system, possibly, can be involuntarily resistant already. Nonetheless, if any ineffectiveness of the law appears, then urgent and subsequent modifications or amendments are required to avoid a legal crisis (total ineffectiveness of the particular law); the massive problem is not only the ineffectiveness of the law, but believing that it has been solved. Normally these hasty or rushed posterior amendments do not consider the required analysis and time to achieve sufficient effectiveness for the law under examination; this leads to qualifying them with a very low level of legal recovery, and to overlooking the required legal prevention once again against further shocks. Furthermore, those amendments, even when recovery is unsuccessful, create the belief that the problem has been solved, and therefore the legal system is left to drift, i.e. ineffectiveness of the law is perpetuated. In terms of the resilience of law, it could be affirmed that the low level of legal *prevention* (element of dynamic resilience) may lead to a low level of future *resistance* (static resilience); whereas, after the shock, a low level of *recovery* (dynamic resilience) condemns from the beginning a future analysis over the level of resistance of the law, and makes the analysis senseless. It condemns a future assessment about the resistance of the law because if the effectiveness of the law is not achieved with the *recovery*, there is nothing to protect later on the grounds of static resilience; no resistance is needed to avoid the loss of a non-existent effectiveness. And, besides, even if recovery is voluntarily or involuntarily achieved, prevention can be omitted

³⁷⁶ For those in charge of making the law resilient, resistance, as the element of static resilience, is as important as the elements of dynamic resilience. On the other hand, for the addressees of the law, static resilience is more important than dynamic resilience, because they are the ones suffering from the ineffectiveness caused by the low levels of resistance of the law; or, hopefully, they are the ones benefiting from the high levels of resistance. However, this does not mean that dynamic resilience should be a total stranger to the addressees of the law because they, through the associations mentioned below, have the duty of being “resilience-provokers” (notions that are also explained below).

once again, turning the life of such a legal system into a cycle of ineffectiveness.

Consequently, it is important to highlight the interdependence between static and dynamic resilience, based on the effectiveness of the law. In other areas, for example in psychology, the notions of resistance and recovery are studied under a similar theory, but are not strongly interrelated. A particular child, for instance, can have a low level of resistance but a high level of recovery from affective shocks; yet, not having a good level of recovery does not mean that that child will have a future bad level of resistance.³⁷⁷ In legal terms, as argued above, those concepts are closely related, and a poor level of dynamic resilience normally will affect future static resilience because there is no recovered effectiveness to be protected, or the effectiveness can be lost at an early stage as there was no prevention. It could be affirmed, therefore, that the elements of dynamic resilience of law are the means, whereas the static resilience is the end.³⁷⁸

It is of paramount importance to anticipate that seeking static resilience, which refers to the effectiveness of the law over time, should not be regarded in any case as the stagnation of the law, as shown later. A modern, general, legal system needs to evolve permanently in the light of changing social, economic and cultural developments.³⁷⁹ The resilience of law is not against such evolution; on the contrary, it fights against the stagnation that causes the ineffectiveness of the law, and against the reforms that do not protect the effectiveness of the law.

³⁷⁷ Masten, Ann S., and Obradovic, Jelena: *Competence and Resilience in Development*, p. 15-16, NY. Acad. Sci. 1094, 13-27, 2006; Puerta, M.: *Resiliencia: la estimulación del niño para enfrenar desafíos*, Lumen, Mexico, 2002; Cyrulnik, B.: *Los Patitos Feos. La resiliencia: Una infancia infeliz no determina la vida*, Gedisa, Barcelona, 2006. Kalawski, Juan Pablo, and; Haz, Ana Maria: *Y... ¿Dónde está la Resiliencia? Una Reflexión Conceptual*, p.367-369, *Interamerican Journal of Psychology*, Vol. 37, Num.2, 2003.

³⁷⁸ Manciaux emphasises that [static] resilience is a capacity that results from a dynamic process: Manciaux, M., *La resiliencia: resistir y rehacerse*, Gedisa, Barcelona, 2005

³⁷⁹ R v R (Marital Exemption) [1992] 1 AC 599

4. THE “VEHICLES” OF THE RESILIENCE OF LAW IN A CIVIL LAW JURISDICTION – COLOMBIA – AND A COMMON LAW JURISDICTION – ENGLAND –³⁸⁰

4.1. VEHICLES AVAILABLE FOR LEGISLATORS

4.1.1. COLOMBIAN (CIVIL LAW) VS. ENGLAND (COMMON LAW)

The process of “producing legislation”, as stated in the introduction, has included an expectation of legislators to verify the sufficient effectiveness of the law. However, the author believes that there are “new expectations” of law-makers whereby they are also expected to make legislation resilient when they are producing it. And, those “new expectations” should also be widened to further cases where there is already an existing legislation in need of protection. Then, those “vehicles” to achieve resilience will be more than the traditional “production of legislation” and may vary, depending on the jurisdiction.

In Colombia, Congress is the principal law-maker,³⁸¹ though it is constitutionally allowed to delegate this faculty.³⁸² But even in such cases, Congress must delegate this legislative function under a particular statute (called a “Frame Act”),³⁸³ or must demand from the government the regulation of a general Act. In a common law jurisdiction such as England, the situation, *ab initio*, is not dissimilar. The term “common law” can have up to five different meanings: one of them is used to describe those legal systems

³⁸⁰ It is necessary to mention that this section is not intending to solve the conflicts between theories or approaches cited herein, although ideas have been borrowed from some of them to include them within the context of the “resilience of law”. In this section, first, aims to highlight the different “vehicles” to seek the resilience of law, which in this section is strongly related to the sources of law, in order to extract the resulting differences between Colombia and England, as a civil law and common law jurisdiction, respectively. However, the relation between the resilience of law and certain philosophical debates, or the former’s inclusion amongst some of them, has captivated the author’s mind for future research. In addition, in this research the influence of supra-national organisations such as the European Union (EU) or the Organization of American States (OAS) for England and Colombia, respectively, has not been expressly included, nor further international treaties, because these would also extend the discussion beyond the limits imposed by this research.

³⁸¹ Colombian Constitution, Art. 150

³⁸² The details for this delegation are given in the Colombian Constitution, Art. 150, No.10.

³⁸³ Colombian “Frame Acts” are conceived in the Colombian Constitution, Art. 150, No. 19. Besides, the Colombian Constitution permits the government to produce exceptional decrees without the previous enactment of the Frame Act; nevertheless, the produced decree in those exceptional cases must be subsequently controlled and confirmed or repealed by Congress: Colombian Constitution, chapter 6.

that developed from the English system; in this sense, a common law system is distinguished from a civil law system that is developed from the Romano-Germanic legal system. In the English system, Parliament is the principal law-maker, though it can also delegate the legislative function to other authorities under a statute called the “Parent Act” or “Enabling Act”, within the respective legislative and judicial controls.³⁸⁴ Yet, the Colombian Congress and English Parliament have a similar facultative authority to “produce law”, to “amend, reform, rationalise, or repeal an existing law”. Hence, in modern times they are also expected to safeguard the effectiveness of the law. And here appears the first difference between the Colombian and the English frameworks. Within the Colombian scenario, legislators are only expected to verify the initial effectiveness of the law, whereas as in England they are now expected to offer society fair and effective laws at all times.³⁸⁵ Although this clearly represents an English advantage in terms of having effective norms, it does not mean that, as a result, they are resilient, particularly because considering “changes” and subsequent “shocks”, prevention, and resistance to future shocks, among other elements of resilience, has not been analysed in either of these two countries.

It is of paramount importance to recall that seeking effectiveness of the law is different from seeking resilience of the law, which is a much wider notion although based on the former. Insofar as it concerns the *resilience of law*, legislators in both jurisdictions have a similar right to “produce law”, to “amend, reform, or rationalise” an existing law, or to “repeal and produce new law”; and through these vehicles, or others, they should generate dynamic and static resilience for either unprecedented or existing Acts.³⁸⁶

³⁸⁴ Huxley-Binns, Rebecca and Martin, Jacqueline: *Unlocking the English Legal System*, p.59, 3rd Edition, Hodder Education, 2013

³⁸⁵ The better Regulation Executive in The Department for Business, Innovations and Skills attempts to ensure that regulations in the UK are fair and effective at all times, as seen below.

³⁸⁶ It is important to highlight that attempting to make a law effective is different from attempting to make a law resistant. The English Parliament enacted the Legislative and Regulatory Reform Act 2006 which has created the idea that it is an “Enabling Act” whereby ministers could take certain measures to reform over-complicated, outdated or unnecessary legislation. In that sense, although the latter Act was related to the effectiveness of laws, it could be suggested that English ministers, through secondary legislation, could generate dynamic and static resilience for existing Acts, taking into account the restrictions given in the Act. Yet, as this is an English Act that has been severely criticised, it will not be a part of this research as it should be repealed from our point of view and never implemented in further jurisdictions.

The latter are the “new expectations” within the context of this research that fall to legislators in both jurisdictions, and the vehicles are, in general terms, identical. But we cannot forget that in England the distinction between government and the legislative power is not as marked as in presidential regimes such as Colombia. Yet, we cannot forget either that the government, as the issuer of secondary legislation, is also expected to safeguard the effectiveness of laws, and will be expected to seek the resilience of laws.

In the latter jurisdictions, in addition to the legislative connection to the resilience of law, there are the courts and the need for statutory interpretation; and, as mentioned before, this “interpretation” is another vehicle to make the law resilient. Legislation gives rise to a number of problems in terms of communication. One of the essential attributes of language is that words can have more than one meaning, and this meaning can vary depending on the context, causing uncertainty. One of the fundamental requirements of legislation is “generality of application” in order to ensure that it can be effectively applied in different circumstances. However, the need for “generality” can only be achieved at the expense of clarity and precision of language, causing uncertainty, and thus problems of interpretation. Besides, legislation may be obscure, ambiguous, meaningless, or may even fail to achieve the end at which it is aimed, simply through being badly drafted³⁸⁷ or because there was little legislative deliberation,³⁸⁸ hence causing severe cases of ineffectiveness. Moreover, there may be new developments, such as technology, where the old legislation does not cover present-day situations,³⁸⁹ leading to a scenario of progressive ineffectiveness. As societies change, adapt to the statute, and generate new variations of the problem that gave rise to the statute, the unanticipated gaps and ambiguities proliferate.³⁹⁰ The duty of the judge is then to provide the legislation with a

³⁸⁷ Slapper and Kelly, Op.Cit, p.91-92

³⁸⁸ Eskridge, Jr., William N.: *Dynamic Statutory Interpretation*, p.1480, Univ. Penn. L.R., Vol.135, N.6, 1987.

³⁸⁹ See: *Royal College of Nursing v DHSS* [1991] 1 ALL ER 545; *R (Quintavalle) v Secretary of State for Health* [2003] UKHL 13. In a similar sense, statutory interpretation may be needed due to changes in the use of language, such as occurred with the word “passenger”, in *Chesseman v DDP*, *The Times*, 2nd of November 1990, cited in Huxley-Binns and Martin, Op.Cit.p.59. However, the interpretation of statutes may vary depending on whether or not the statute is old or recent and whether the statute specifically addresses the issue or not. Eskridge Jr. Op.Cit., p.1497.

³⁹⁰ Eskridge, Jr. Op.Cit, p.1480.

concrete meaning and purpose to sort out certain situations in this modern time. Yet, in this regard the approach whereby the judge is a thinking-being, and not a simple machinist that applies the law, is accepted.³⁹¹ Therefore, within the context of the resilience of law, the “new expectation” regarding judges would be that they should recover sufficient effectiveness of the law in general if lost, and/or prevent future scenarios of ineffectiveness by means of interpretation, to make such legislation resistant to future “changes”.³⁹²

Nevertheless, firstly, it cannot be forgotten that legislators are also expected to interpret their own statutes,³⁹³ and to help judges with their interpretations. They may enact an interpretative statute of a preceding statute,³⁹⁴ or they can add sections in the same statute, defining certain words used therein.³⁹⁵ Legislators can also help judges by enacting interpretative acts that set down some general rules for interpretation.³⁹⁶ By doing this, legislators are indeed using that vehicle to achieve the

³⁹¹ In this regard, contrary to the positivistic approaches of Kelsen and Hart, it is likely to be accepted that a judge is a thinking-being, and therefore, “[...] the judge must be aware of the historical background of the law, and take into consideration the interests known to the resolution of each case. The judge must be able to understand the axiological system located in the legal system, enabling him to solve justly each case. By doing so, it is seen the clear transit from the jurisprudence of interests to a jurisprudence of values. Judicial decisions enter increasingly deeper into sociological and axiological aspects, having the judge a broad discretionary scope to decide, leaving aside the simple syllogistic and mechanical application of the law. The judge takes the role of active creator of rules, which generates a huge responsibility before society.” in: Lopez Daza, Germán Alonso: Colombian Constitutional Judge as the Positive Legislator: A Government of the Judges? *Revista Mexicana de Derecho Constitucional*, Núm.24, enero-junio 2011. It is important to highlight that, in particular within the context of the resilience of law, this must be extended to cases where the judge is acting as a law developer, and not only as an interpreter as seen in civil law jurisdictions.

³⁹² This may be extended to situations where the judge is not acting as an interpreter, but also as a common law developer. Those “changes” are the same as mentioned above, which may be political, economic, legal, social, etc... Thus, it is due to the possible consequences (ineffectiveness of the law) of those “changes”, and the subsequent “shock” that the law must be resistant, this being a responsibility of legislators and judges. Such “extra-duty”, when referring to judges, is far away from Lambert’s “government of the judges”, in which he suggests that the possibility that the judiciary could control economic, social, and political growth without recourse would be threatening to any free society: (Davis, Michael H.: *A Government of Judges: An Historical Re-View*, p.562, *The American Journal of Comparative Law*, Vol. 35, No. 3, Summer, 1987). Indeed, there is no relation, despite the similarities, between Lambert’s notion and the resilience of law, and the latter is not aimed at doing what is suggested by the former.

³⁹³ Colombian Constitution, Article. 150, No.1

³⁹⁴ Colombian Constitutional Court offers the fundamental rules that regulate interpretative legislation in Colombia: C-076 of 2007, settlement number: D-6383, Speaker: Rodrigo Escobar Gil

³⁹⁵ For instance, in the Theft Act 1968 the definition of “theft” is in Section 1, and Sections 2-6 define the key words in said definition.

³⁹⁶ For example: the “Lord Brougham’s Act” (1850), the Interpretation Act 1889, or the Interpretation Act 1978.

aforementioned purpose, but that does not necessarily mean that they are making the law resilient; the latter depends on the successful result, not on the simple use of such legal vehicles.

4.1.2. LAW COMMISSIONS

However, the Colombian system should envy the existence of certain agencies established in England that, besides helping with the effectiveness of law, would be very likely to enhance the level of resilience of law through the aforementioned reforms.³⁹⁷ Without these agencies, both political tendencies and the excessive amount of required reforms could affect the capacity of having laws that are updated, modernised and resilient. Those agencies are the “Royal Commission”; the “Law Reform Committee” created in 1952; the “Criminal Law Revision Committee”, created in 1959, and, especially, the “Law Commission” created in 1965. In the latter year, the White Paper Proposals for English and Scottish Law Commissions proposed the creation of a full-time body that could assist the reforming process,³⁹⁸ stating: “One of the hallmarks of an advanced society is that its laws should [...] be kept up to date and be readily accessible to all who are affected by them”.

Accordingly, the Law Commissions Act 1965³⁹⁹ confirms in its Section 3, that: “It shall be a duty of [...] the Commissions [...] to keep under review all the law [...] with a view of its systemic development and reform, including in particular the codification of such law, the elimination of anomalies, the repeal of obsolete and unnecessary enactments, the reduction of the number of separate enactments and generally the simplification and modernisation of the law [...].”

The Law Commission has, amongst its aims, to ensure that the law is fair, simple, modern and as cost-effective as possible. Since it never refers expressly to the effectiveness of the law, it could be said that it could not be involved in seeking resilience of law either. Notwithstanding, the author believes that such commission, by reviewing all the law, and proposing

³⁹⁷ In Colombia there are no Permanent Commissions; however, the executive power occasionally creates *ad hoc commissions through an administrative decision* in order to gather experts to draft a bill, so the government can later present it to Congress.

³⁹⁸ Huxley-Binns and Martin, *Op.Cit*, p.33

³⁹⁹ Such Act was complemented by the Law Commission Act 2009.

systemic reform, and provoking the use of all the “vehicles” stated in the this Section,⁴⁰⁰ is indeed attempting to maintain the sufficient effectiveness of the law at all times. Therefore, in accordance with this, it is possible to say that this Law Commission could also have an important role in helping to make the law statically resilient, if it was instructed to do so. Approximately a quarter to a third of Law Commission proposals for legislation are eventually enacted,⁴⁰¹ which in itself demonstrates the range in which they could participate in having resilient law, but not as a principal character – only as a sort of assistant in seeking static resilience. Therefore, parliaments in both countries, as principal law-makers, are ultimately accountable for the condition or status of all the Acts.⁴⁰² Thus, they should be the main protector of all those Acts, as they should ensure not only the laws’ effectiveness but also their static and dynamic resilience through the “vehicles” mentioned

⁴⁰⁰ The vehicles to achieve resilience of law, as mentioned above, are not part of a restricted list, they can also vary. In this case, Section 3 of the Law Commission Act 1965, mentioned different vehicles such as codification (for example, the Partnership Act of 1890, and the Sale of Goods Acts of 1893 and 1979), (duty imposed to the Colombian Congress in the Colombian Constitution, Art.150, No.2), simplification, elimination of anomalies, reduction of separate enactments, but does not mention “consolidation of legislation” which is another useful vehicle (for example, The New Companies Act 2006). Section 3 of the Law Commissions Act 1965 mentions “the repeal of obsolete and unnecessary enactments” (faculty also given to the Colombian Congress by its Constitution in Article 150, No.1). Thus, repealing ineffective acts, however, should not be considered by itself as another “vehicle” to achieve static resilience, simply because there would be no law at all in the future under a Kelsenian or Hartian approach. This is an important tool mainly for two reasons: 1) some laws impose legal consequences that can never be avoided by the addressees of the law (for example: Art.1055 of the Colombian Commercial Code, referring to “uninsurable perils” states that: any stipulation to the contrary will not produce any effect); 2) it will therefore permit those addressees of the law to use customs as a “source of law”, which will bring more benefits (to the contractual parties, for example) than the former ineffective and binding law. Indeed, within the European framework, the European Commission (in Better Regulation — simply explained, Luxembourg: Office for Official Publications of the European Communities, 2006) has highlighted the fact of “repealing” not only as a faculty, but as a responsibility saying that: “Naturally, over time, some legislation can become outdated or obsolete. The existing body of law needs to be examined on an ongoing basis so that such cases can be repealed. The Commission is making use of either sunset or review clauses so that this type of review becomes standard practice.”

⁴⁰¹ Zander, Michael: *The Law-Making Process*, p.2 and followings, Sixth Edition, Cambridge University Press, 2004.

⁴⁰² However, as Lord Steyn suggested “[...] the ‘pure and absolute’ conception of legislative supremacy is no longer part of the UK constitution. It is difficult to disagree. Parliament may continue to be the pre-eminent legal and political institution in the UK but decisions and judicial commentaries in cases concerning ouster clauses, European Community (now Union) law and fundamental rights suggest that the courts will impose limits on Parliament’s absolute powers” (McGarry, John: *The Principle of Parliamentary Sovereignty*, p.577, Legal Studies, Vol. 32 No. 4, December 2012). In addition, in Colombia it has been accepted for a long time that constitutional judges can “legislate negatively” (and even positively), by rejecting lower norms enacted by Congress that are entered into contradiction with the Constitution (Lopez Daza, Germán Alonso: Colombian Constitutional Judge as the Positive Legislator: A Government of the Judges?, *Revista Mexicana de Derecho Constitucional*, Núm.24, enero-junio 2011).

before; albeit in England, unlike Colombia, they could be assisted by some existing agencies or departments.⁴⁰³

4.2. “VEHICLES” AVAILABLE FOR JUDGES

4.2.1. INTERPRETATION AS THE MAIN “VEHICLE” OF RESILIENCE

Secondly, courts should also be expected to make the legislation resilient by means of statutory interpretation.⁴⁰⁴ Nevertheless, it is important to recall first that there is a difference between “making law” (mainly a legislative prerogative) and “making the law resilient”. The latter may be achieved through “making law” or through more vehicles; whereas the former may “make the law resilient”, but not every time law is made, is it resilient. This difference is important herein because it has been accepted in Colombia and England that by interpreting statutes judges are indeed “making law” when applying the law in an active manner.⁴⁰⁵ Therefore, within the context of the resilience of law, judges could “make the law resilient” by “making law” while interpreting. However, the author does not want to confuse this with the legislative process of “making law”, and they should be treated as two different “*vehicles*”.

Then, this section accepts the traditional assumption that a legislature is the primary law-making body, and that in many cases statutory language will be sufficiently determinate to resolve a given case. But even under these conventional assumptions, original legislative expectations should not always control statutory meaning. This is especially true when the statute is old and generally phrased and the societal or legal context of the statute has changed in material ways.⁴⁰⁶

⁴⁰³ For example, it could be assisted by the Department for Business, Innovations and Skills, or Department for Business, Enterprise and Regulatory Reform.

⁴⁰⁴ Nevertheless, given the Parliamentary Sovereignty, the laws that have been enacted by Parliament can never be “overruled” by Courts.

⁴⁰⁵ Lopez Daza, Germán Alonso: *Colombian Constitutional Judge as the Positive Legislator: A Government of the Judges?*, Revista Mexicana de Derecho Constitucional, Núm.24, enero-junio 2011; Colombian Constitutional Court: Decision SU-047 of 1999, Settlement number: T-180.650, Speakers: Alejandro Martínez Caballero and Carlos Gaviria Díaz; and, [partially created law in] Decision C-577 of 2011, Settlement number D/8367, Speaker: Gabriel Eduardo Mendoza Martelo. And, in England, see: *Mendoza v Ghaidan* [2002] EWCA Civ 1533.

⁴⁰⁶ Eskridge, Op.Cit, p.1481.

Thus, seeking to make the law resilient through statutory interpretation by judges is vital in both jurisdictions, but in England there is an issue that is no longer present in Colombia: the conflict between the literal approach versus a dynamic⁴⁰⁷ and purposive approach. This conflict is one of the major issues in statutory interpretation because it would determine how far judges can move from the words given by legislators. The fact is that assuming one or another position would restrict or extend the capacity of the judge to make a law resilient. In that sense, although we believe that the correct decision should be allowing the purposive approach⁴⁰⁸ because it enlarges the judge's discretion to seek resilience of law, the author is not aiming herein at solving the aforementioned conflict between these approaches.⁴⁰⁹ Thus, he sides with a more dynamic and purposive approach, not within the context of the rivalry between these two approaches, but in favour of seeking resilience for those laws. Hence, for the sake of the resilience of law, recovering effectiveness of the law and preventing ineffectiveness, to make it resilient, may be achieved simply by interpreting,⁴¹⁰ though it may be better done from an "evolutive perspective" when changes have challenged the statute.⁴¹¹ Nonetheless, one of the aims of this interpretative process, in the author's context, is to recover the effectiveness of the norm; and, what the interpreter "believes to be the more accurate"⁴¹² or modern interpretation,⁴¹³ may not be the same as that

⁴⁰⁷ Interpretation, says Eskridge Jr., is not static, but dynamic. And, then he says, Interpretation is not an archaeological discovery, but a dialectic creation.

⁴⁰⁸ English statutory interpretation is moving in that direction, as stated by Lord Griffiths in *Pepper v Hart* [1993] 1All ER 42: "The days have long passed when the Courts adopted a strict constructionist view of interpretation which required them to adopt the literal meaning of the language. The Courts now adopt a purposive approach which seeks to give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears on the background against which the legislation was enacted". Similar opinion in: *R (Quintavalle) v Secretary of State for Health* [2003] 2All ER 113.

⁴⁰⁹ This section admits that interpretation, either under the purposive approach or the literal approach, serves as a fundamental vehicle to achieve resilience of law, though to a greater or lesser extent depending on the approach.

⁴¹⁰ "Should not an interpreter "ask [her]self not only what the legislation means abstractly, or even on the basis of legislative history, but also what it ought to mean in terms of the needs and goals of our present days [?]" is stated by Phelps in *Factors Influencing Judges in Interpreting Statutes*, 3 Vand L. Rev. 456,468, (1950), cited by: Eskridge Jr. Op.Cit., p.1480.

⁴¹¹ Eskridge Jr., Op.Cit., p.1483, 1496.

⁴¹² Indeed, Karl N. Llewelyn states that: "One does not progress far into legal life without learning that there is no single right and accurate way of reading one case, or of reading a bunch of cases, in: *Remarks on the Theory of Appellate Decision and The Rules or Canons about how Statutes are to be Construed*, p.395, 3 Vand. L. Rev. 395, 1949-1950.

⁴¹³ An example of what could be considered an accurate interpretation is given by Hart and Sacks where judges: "1. Decide what purpose ought to be attributed to the statute and to any

which recovers effectiveness. Interpreters have options, and they should choose,⁴¹⁴ – based on the interaction of the text, historical context, evolutive context,⁴¹⁵ and, the author adds, the need for making such statute *sufficiently effective* – to create a meaning that: a) in accordance with the purpose resolves the case under examination for modern times, and; b) recovers the effectiveness that never existed, or that was lost during the life of the statute as a result of the preceding “changes” (*and their subsequent shock*).

However, the dialectic construction of a meaning that also recovers the effectiveness of the law is not enough either. As explained before, sole recovery without the preventive element is likely to cause an “up and down” with regard to the effectiveness of the law, not ending the vicious circle. Therefore, such construction should be made in the sense that it prevents, to a certain extent, future scenarios of ineffectiveness due to the aforementioned *shocks* (resistant law). Then, once a comprehensive interpretation⁴¹⁶ seeking static resilience has been laid down, it may, at that point, form a precedent for future cases under the normal rules of judicial precedent.⁴¹⁷

4.2.2. DEVELOPING THE COMMON LAW AS ANOTHER “VEHICLE” OF RESILIENCE

And, finally, as stated above, the term “common law” has different meanings, depending on the context. Another possibility is to use this term when

subordinate provision of it which may be involved; and then 2. Interpret the words of the statute immediately in question so as to carry out the purpose as best as it can [...], in H. Hart & A. Sacks: *The Legal Process: Basic Problems in the Making and Application of Law 1201* (tend. Ed. 1958) (unpublished manuscript), p.1411, cited by Eskridge, Op.Cit, p.1545

⁴¹⁴ To affirm this, the author is using the definition and scope of “interpretation” given by Ludwig Wittgenstein as it offers to the judge a serious possibility of choosing. (Wittgenstein, L., “*Investigaciones Jurídicas*”, cited by Maritza Iglesias Vila in “*El problema de la discreción judicial. Una aproximación al conocimiento jurídico*”, p.162, Centro de Estudios Políticos y Constitucionales, 1999, Madrid. In a similar sense, the author favours Eskridge’s position, where he affirms, unlike Hart and Sacks, that judges make choices in hard cases of statutory interpretation. However, as mentioned repeatedly in this chapter, the author is not taking part in a philosophical discussion about whether there may be only one correct answer (Dworkin’s approach), but this should be treated in a future research process to include all its components.

⁴¹⁵ Eskridge Jr. Op.Cit p.1498

⁴¹⁶ The specific rules and secondary aids (including the use of Hansard) of interpretations available for a judge depend exclusively on their own jurisdiction, but through all of them, it is believed the resilience of law may be sought (though not necessarily achieved)

⁴¹⁷ Colombian Constitutional Court: Decision SU-047 of 1999, Settlement number: T-180.650, Speakers: Alejandro Martínez Caballero and Carlos Gaviria Díaz. (In Colombia, the three main rationales to implement the Precedent are a) the right to equality, b) legal certainty, and c) legitimate expectations.). See, also Huxley-Binns and Martin, Op.Cit p.63

referring to case law, i.e. the law developed by judges through cases.⁴¹⁸ In civil law jurisdictions, as is well known, judges are only expected to apply and interpret the law (in Colombia it has been accepted that they create law by doing so), not to develop it as with case law. And this difference may be the greatest disadvantage for a civil law jurisdiction in terms of the resilience of law. The Colombian jurisdiction could achieve the aforementioned resilience only through its legislators or the interpretations made by judges, whereas the English jurisdiction has an extended range of actions for seeking resilience: English judges can also seek the resilience of law by developing the common law. However, although English judges have at their disposal the latter two different “vehicles”, the general basis of their modern discretionary powers is the same, as stated above,⁴¹⁹ and in particular should be the same to make the law resilient.

Therefore: 1) since the resilience of law can be achieved by different means (such as interpretation or development of the common law) apart from the pure legislative process whereby parliamentarians enact or reform statutes; and 2) since the author is not aiming herein at agreeing whether or not the English judge is a law-maker (in the Benthamite approach) or a law-discoverer (in the Blackstonian approach),⁴²⁰ it is believed that an alternative name should be given to group together and identify those who should seek said resilience. In that sense, and based on the fact that they should be protecting laws from ineffectiveness, the author considers that they should be generalised as “law-protectors”.

Retaking, despite being an over-simplification, it could be said, *ab initio*, that the constitutional role of judges is to decide disputes and grant remedies,⁴²¹

⁴¹⁸ Huxley-Binns and Martin, Op.Cit p.5; and, the following example is provided to refer to this possible meaning: “*The common law principle that a manufacturer is liable in negligence to the ultimate consumer of its products derives from the case of Donoghue v Stevenson [1932] AC 562*”.

⁴¹⁹ J.A.G. Griffith: *The Politics of the Judiciary*, p.281, Fifth Edition, Fontana Press, 1997

⁴²⁰ Blackstone, William, *Commentaries on the Law of England*, (1765), repr. with introduction by Stanley N. Katz (Chicago, 1979), 66, and; Jeremy Bentham ‘Truth versus Ashhurst; or, law as it is, contrasted with what it ought to be’ in John Bowring (ed), *The Works of Jeremy Bentham*, (Edinburgh/London:1843), vol. V., at 235, cited in Muhammad Munir: *Are Judges the Makers or Discoverers of the Law? Theories of Adjudication and Stare Decisis with Special Reference to Case Law in Pakistan*, March 22, 2011, 2011.

⁴²¹ *R v Governor of Brockhill Prison*, [2001] 2 A.C. 19

by applying the doctrine of precedent.⁴²² Yet, that doctrine does not mean that judicial decisions are immutable, as the principle of “*stare decisis et non quieta movere*”⁴²³ was originally thought. “[...] too rigid adherence to precedent may lead to injustice in a particular case and also unduly restrict the proper development of the law”.⁴²⁴ The latter doctrine and principle,⁴²⁵ are, however, no longer static notions searching for security; indeed, security can only be achieved through constant change, through the wise discarding of old ideas that have outlived their usefulness, and through the adapting of others to current facts.⁴²⁶ Judges, therefore, are not only supposed to decide a dispute, they are in charge of developing the common law in order to bring it forward constantly to modern times. In *R v Governor of Brockhill Prison*, it was stated that:

“The common law develops as circumstances change and the balance of legal, social and economic needs changes. New concepts come into play; new statutes influence the non-statutory law. The strength of the common law is its ability to develop and evolve”.⁴²⁷

Such constant modernisation, though it is a slow process, implies that judges are expected to evaluate all those new legal, social, political and economic realities. The principle of *stare decisis* cannot lead to judicial laziness as it could be suggested.⁴²⁸ Judges are demanded to provide decisions for their own times,⁴²⁹ and that seems, in general, the purpose of the Practice Statement [1966]⁴³⁰ when arguing that in some cases it is right to depart from a precedent when the earlier decision was influenced by the existence of

⁴²² Indeed, we use the term over-simplification because the constitutional role of judges is much larger not only regarding judicial creativity, but because they are also achieving a political role, as explained by J.A.G. Griffith: *The Politics of the Judiciary*, Fifth Edition, Fontana Press, 1997.

⁴²³ The Latin phrase “*stare decisis et non quieta movere*” may be translated as “to stand by decisions and not to disturb settled matters”.

⁴²⁴ *Practice Statement* [1966] 3 All ER 77

⁴²⁵ The doctrine of Precedent and the Principle of *Stare Decisis* are interchangeable concepts.

⁴²⁶ Douglas, William O.: *Stare Decisis*, p.735, Columbia L.R., Vol.49, N.6, 1949.

⁴²⁷ [2001] 2 A.C. 19

⁴²⁸ Huxley-Binns and Martin, Op.Cit, p.70

⁴²⁹ As an example: *Miliangos v George Frank* [1975] Q.B. 487, overruled *R v United Railways of the Havana and Regla Warehouse Ltd* (1961). In *British Railways Board v Herrington* [1972] A.C. 877, the House of Lords overruled *Addy and Sons v Dumbreck* (1929).

⁴³⁰ 3 All ER 77. And this is not an exclusive job of the House of Lords; it may be extended to lower courts based mainly on the rules given in *Young v Bristol Aeroplane Co Ltd* [1944] 2 All ER 293, and *Williams v Fawcett* [1985] 1 All ER 787.

conditions which no longer prevail⁴³¹, and that in modern conditions the law ought to be different.⁴³² A great example is given in *R v R*⁴³³ after the Court of Appeal stated that a husband cannot be convicted of raping, or attempting to rape, his wife based on Hale's text, *History of the Pleas of the Crown*, published in 1736. The House of Lords stated that:

“It may be taken that the proposition was generally regarded as an accurate statement of the common law of England [at that time]. The common law is, however, capable of evolving in the light of changing social, economic and cultural developments. Hale's proposition reflected the state of affairs in these respects at the time it was enunciated. Since then the status of the women, and particularly of married women, has changed out of all recognition in various ways which are very familiar and upon which it is unnecessary to go into detail. Apart from property matters and the availability of matrimonial remedies, one of the most important changes is that marriage is in modern times regarded as a partnership of equals, and no longer one in which the wife must be the subservient chattel of the husband. [...] In modern times any reasonable person must regard that conception as quite unacceptable.”

In that sense, if the Supreme Court – by then the House of Lords – in the latter case, by the end of the 20th century, had decided otherwise, it could have affected, amongst other vital aspects, the present and future role of women in society, and the type of society. The decisions of the courts in one sense or another have future and general effects. The work of a court, said Douglas, may send a whole economy in one direction or help shape the manifest destiny of an era.⁴³⁴ Thus, in the latter case, the author believes that the House of Lords not only developed the common law, but, perhaps, it also prevented the end of the institution of legal marriage, given that a contemporary society would not be likely to accept those obsolete legal rules.

⁴³¹ However, it is important to highlight, particularly within the context of the “resilience of law”, that there is a technique used on occasion in the United States called “prospective overruling” whereby the court announces that it will change the relevant rule but only for future cases. To find a deeper explanation see: Zander, Michael: *The Law-Making Process*, p.397 and followings, Sixth Edition, Cambridge University Press, 2004.

⁴³² Huxley-Binns and Martin, Op.Cit, p.44

⁴³³ (*Marital Exemption*) [1992] 1 A.C. 599

⁴³⁴ Douglas, Op.Cit, p.737

And such social rejection could have caused a progressive increase of ineffectiveness of those norms.

Therefore, when judges are analysing all the social, legal, political or economic “changes” that surround the case *sub-judice*,⁴³⁵ they are expected not only to solve the dispute, but, subsequently, to drive the vehicle towards a modern and updated common law, if it is both needed and possible. In those cases, they are simply acting as common law developers. In addition, people believe that once judges have analysed all those “changes”, “new expectations” fall upon them, on certain occasions, based on public interest, related to the effectiveness and resilience of laws, since their judgements have the potential to cause an effect in the future. In those circumstances, they should act not only as judges, but as what were previously called “law-protectors” to seek the resilience of law through their comprehensive judgements.

It would be very open to criticism if judges – after having analysed the aforementioned “changes” and being able to avoid possible consequences as those given in the previous example – did not act proactively in order to introduce “legal prevention”, for example. In fact, that could mean that they would be consenting with what Bentham named “dog-law” when criticising common law; in that sense Bentham said:

“Do you know how they make it? Just as man makes law for his dog. When your dog does anything you want to break him of, you wait till he does it and then beat him for it. This is the way you make laws for your dog, and this is the way the judges make law for you and me. They won’t tell a man beforehand what it is he should not do- they won’t so much as allow of his being told: they lie by till he has done something which they say he should not have done, and then they hang him for it”.⁴³⁶

⁴³⁵ Although the author said that this section was not aimed at solving rivalries between approaches or theories, people are not likely to accept the traditional view where it is said that the judge “must act like a political, economic, and social eunuch, and have no interest in the world outside his court when he comes to judgement”, in J.A.G. Griffith, *Op.Cit.*, p.290.

⁴³⁶ Jeremy Bentham “*Truth versus Ashhurst*; or, law as it is, contrasted with what it ought to be’ in John Bowring (ed), *The Works of Jeremy Bentham*, (Edinburgh/London:1843) vol. V., at 235, cited in Muhammad Munir: *Are Judges the Makers or Discoverers of the Law? Theories of Adjudication and Stare Decisis with Special Reference to Case Law in Pakistan*, March 22, 2011.

It is important to recall, however, that herein the author is not discussing whether the judges can create or discover law, or whether they have options to choose or if there is only one correct answer when deciding, as mentioned before. Neither is this part based on those philosophical debates, though the relation between “resilience of law” and those “theories” may be looked at in the future. This part is brought about to suggest that judges, as “law-protectors”, generate a “new expectation”: making the law resilient through their discretionary decisions. Both Colombian and English judges can seek static resilience by interpreting, but the latter country should also exploit its “faculty” of developing common law as another vehicle to generate resilience of law. Indeed, as mentioned above, those “new expectations” refer to “all the law”, and there is no better personage to analyse “all laws” and make them resilient than a member of the judiciary. Thus, the author strongly believes that English judges have such capacity for the reasons given above, and does not consider that it could be regarded as usurping the functions of legislators;⁴³⁷ yet, if someone thinks otherwise, then he would have to admit, at least, that judges should be obliged to exhort legislators to produce such result through statutes.⁴³⁸ Nonetheless, it is important to reaffirm that, as with the other vehicles, it is clear that developing the common law, and having a modern and updated common law does not signify, *per se*, that it will be resilient; this is just another scenario to attempt doing so – inexistent in Colombia. Again, testing if such judgement made the law resilient against certain shocks is something that could only be concluded *ex post*; however, the accountability of judges, like that of legislators, should be based only on the idea that they had to take “all the best reasonable endeavours” to make the law resilient.

5. IS THERE ANY CONSTITUTIONAL EXPRESS FOUNDATION TO SUSTAIN “THE RESILIENCE OF LAW” IN COLOMBIA AND ENGLAND?

⁴³⁷ For a different opinion, see: Lacharri re, Ren  D.: *Opinion dissidente*, Pouvoirs n 13 - Le Conseil constitutionnel - p.141-159, avril 1980 (juillet 1991).

⁴³⁸ Nevertheless, judges in that case will not be acting as “law-protectors”, but as “resilience-provokers”, which will be described below. To find some examples within the Colombian jurisdiction see the following Decision of the Colombian Constitutional Court: Decision C-473 of 1994, Decision C-700 of 1999 or Decision C-577 of 2011.

5.1. A LEGISLATIVE RIGHT WITH LIMITATIONS AND EXPECTATIONS AND ASPIRATIONAL CONSTITUTIONALISM

As mentioned within this chapter, legislators and judges, the latter acting either as interpreters or as developers of the common law, now should have “new expectations” falling upon them, different from those that have historically been expected of them. Those “new expectations” then refer to the search of “static resilience”, i.e. making the law resistant against certain shocks, through the elements of dynamic resilience. However, the reader may, and should, be asking himself by now, where do those “new expectations” over legislators and judges come from? Or, better, do those “new expectations” have an express constitutional source?

With regard to the aforementioned questions, allow the author to start at the end by saying that nowadays there is no constitutional foundation, neither in the Colombian nor English legal frameworks, to sustain this theory, particularly from a positivistic perspective; yet, it should exist. The traditional views are that legislators have, under the constitution, the right (faculty) to create, reform, or repeal laws,⁴³⁹ irrespective of whether they are anti-technical, ineffective, inefficient, or unfair; and, that the function of the judiciary is to decide disputes in accordance with the law and with impartiality and neutrality, where the judge is not to take into account any consequences which might flow from his decision and which are wider than the direct interest of the parties.⁴⁴⁰ Fortunately, from the author’s perspective, and from the context of “the resilience of law”, the days of these traditional and obsolete views are being phased out, albeit slowly.

The modern legislative power of parliaments has been moving forward towards being considered as a right with limitations and expectations;⁴⁴¹ and

⁴³⁹ Dicey, Albert Venn: *An Introduction to the Study of the Law of the Constitution*, p.3, Macmillan 8th edition, 1996.

⁴⁴⁰ Under the traditional view the judge was supposed to act as a political, social and economic eunuch, and have no interest in the world outside his court when he comes to judgement. J.A.G. Griffith, *Op.Cit*, p.290

⁴⁴¹ Although herein the author is not referring to the modern restrictions to an absolute parliamentary power [but to the responsibilities that such relative right implies] it may be important, as it is indirectly related to the resilience of the Constitution and the modernisation of such traditional views, to highlight that “the doctrine of parliamentary sovereignty, in its traditional form, is increasingly under pressure. The phenomenon is demonstrated most clearly by Britain’s membership in the European Union. In that context, as we have seen, EU law now

this evolutive process must keep progressing in order to meet the present day needs of a country.⁴⁴² Currently, “law-making” can more sensibly be seen, as it was by Stuart Walkland in his perceptive study (*The Legislative Process in Britain*⁴⁴³), as much wider process encompassing the formulation and transformation of policy proposals into legislative form, their enactment into law and the review of their operation and effectiveness.⁴⁴⁴ These modern expectations have been seen clearly in the recommendations given by the Hansard Society Commission in 1992,⁴⁴⁵ or in the “Good Law Initiative in 2013.”⁴⁴⁶ Yet, legislative reforms and further legislative privileges of Parliament, if not included within the notion of law-making, should be seen equally;⁴⁴⁷ for that reason the author would rather use the words “better legislation”, which is the approach originally taken by the European Commission and includes certain modern expectations. It states:

enjoys *de facto* supremacy in the U.K., and the judiciary is joining the academy in contemplating re-evaluation of the doctrine of parliamentary sovereignty itself. [...] These collisions between traditional theory and contemporary political reality are not, however, confined to the implications of EU membership. Parliamentary sovereignty cannot consist as an island, untouched by the radical changes [...]. It is to be hoped that theory will ultimately catch up these changes, although the history of the British Constitution suggests that the process will be a slow and gradual” (Elliot, Mark: *United Kingdom: Parliamentary sovereignty under pressure*, p.554, 2 Int’l J. Const. L. 545, 2004.

⁴⁴² “There have been profound changes in the nature and impact of legislation in the last few decades, not least the growing volume and importance of European Community law. These changes, amounting in the view of some people to a legislative overload, have affected the working of Parliament and other aspects of law making in this country. Changing circumstances require new responses. It has therefore been our objective to consider to what extent and in what ways the legislative process for the making of statute law for the United Kingdom should be changed to meet the needs of the country today. Based on evidence of widespread anxiety on the part of those most directly affected about the way things are working at present [1992], we make a large number of proposals. These should act as a catalyst for change. We believe that action is needed in many areas, but what is most needed is the will to accept change and the momentum to carry it through. There may be doubts and disagreements [...], but above all we hope that our conclusions and recommendations may stimulate further debate, open up the argument, and get the thinking moving”: The Report of The Hansard Society Commission on Legislative Process: *Making the Law*, p.5, The Hansard Society 1993.

⁴⁴³ Allen & Unwin, London, 1968, cited in Rush, Michael: *Making Better Law: A Review of the Hansard Society Commission on the Legislative Process*, p.75, 14 Statute L. Rev. 75, 1993.

⁴⁴⁴ M. Rush, Op.Cit, p.75-76

⁴⁴⁵ The Report of The Hansard Society Commission on Legislative Process: *Making the Law*, p.5, The Hansard Society 1993.

⁴⁴⁶ The challenges of the “Good Law Initiative 2013” set forth by the Parliamentary Counsel Office can be better seen in: (URL: <https://www.gov.uk/good-law#good-law-the-challenge>; Last revised: 03/06/2013.

⁴⁴⁷ This clarification becomes important, particularly from the perspective of “resilience of law”, where “producing law” is a “vehicle” (to seek resilience) different from “reforming law”, and even different from the “legislative interpretation through statutes”, as explained before.

*“Today’s Europe moves quickly. To face up to the challenges we face inside and outside Europe, policies, laws and regulations need to adapt to the fast pace of technological change, to foster innovation, to protect the welfare and safety of Europeans. Public administrations need to be effective, flexible and focused. This is the standard which the European Commission has set itself, and this is why we have made Better Regulation one of our core priorities.”*⁴⁴⁸

*[...] poorly conceived and ill-considered regulation can prove to be excessive and go beyond what is strictly necessary. Some regulation can be overly prescriptive, unjustifiably expensive or counterproductive. Layers of overlapping regulation can develop over time, affecting businesses, the voluntary sector, public authorities and the general public. Regulation can also become quickly outdated. Rapid technological developments, open and expanding global markets and ever-increasing access to information mean that regulation has to be kept under constant review and adapted to keep pace with the fast moving world”.*⁴⁴⁹

Unlike Colombia which has yet not adopted any of these modern doctrinal or supra-national recommendations, the UK “Good Law Initiative 2013, in the Office of the Parliamentary Counsel, and the UK Better Regulation Executive (BRE) located in the Department of Business, Innovations and Skills are domestic examples of the governmental implementation of these modern expectations. The first is more related to the pre-enactment stage, and the second to the post-enactment stage as it only refers to reducing the impact of regulation on business. Yet, it is important to bring about both of them to indicate that the traditional view has been left behind. The BRE states:

“Some regulations are ineffective and unnecessary. Complying with them costs businesses time and money, and can restrict growth. Red tape can also make running charities and community groups more difficult than it needs to be.

⁴⁴⁸ European Commission, (Comment by José Manuel Barroso, President of the European Commission), *Better Regulation — simply explained*, Luxembourg: Office for Official Publications of the European Communities, 2006.

⁴⁴⁹ European Commission, *Better Regulation — simply explained*, p.4, Luxembourg: Office for Official Publications of the European Communities, 2006.

The government wants to ensure all regulations are fair and effective. We want to strike the right balance between protecting people's rights, health and safety and freeing them from unnecessary bureaucracy.

To ensure regulations in the UK are fair and effective, we are: controlling the number of new regulations by operating a 'one in, two out' rule for business regulation; assessing the impact of each regulation; reviewing the effectiveness of government regulations; reducing regulation for small businesses; improving enforcement of government regulations; using alternatives to regulation; reducing the cost of EU regulation on UK business.

We publish guidance for all government policymakers to help design better regulations or find other options instead of regulation.

Effective, well-designed regulation plays a vital role in protecting consumers, businesses, employees and the environment. But many regulations are unnecessary, overcomplicated or out of date. These regulations waste time and money, and damage economic growth. Unnecessary regulations also harm our society. For example, people don't want to volunteer in their community if they have to comply with overly complicated regulations. In many cases alternatives to regulation are more effective, such as simplifying existing regulation, giving clearer information to consumers or developing voluntary codes of practice. We are committed to getting rid of ineffective regulation that places unnecessary burdens on business and the public.”⁴⁵⁰

In that sense, it could be said that the legislative standard is being raised and seems to be moving towards a more demanding level for parliamentarians, in terms of the effectiveness of laws.⁴⁵¹ This means that expectations of legislators in these matters are now generally higher, and even higher for

⁴⁵⁰ Better Regulation Executive: Reducing the impact of regulation on business; Department for Business, Innovation & Skills; Minister: The Rt Hon Michael Fallon MP; Updated: 19 December 2012

⁴⁵¹ Although the ineffectiveness of laws has been tackled in the English scenario, it seems that the only option that has been taken into account when laws become ineffective is to get rid of them, as is expressed by the policy of "Reducing the Impact of Regulation on Business" set out by the Better Regulation Executive.

English legislators than for Colombian legislators,⁴⁵² as the former not only verifies the initial effectiveness of norms once they are enacted, but also during the entire life of those norms. Indeed, in the English case for instance, the expectation is even higher because it was agreed in the UK Coalition Agreement published in 2010,⁴⁵³ although there is no supreme constitutional provision in this regard.⁴⁵⁴ As mentioned before, the “effectiveness of law” is different from “resilience of law”, albeit the latter is based on the former. Accordingly, it could be stated that since the issues related to “effectiveness of law” are currently being taken into consideration by Parliament as a result of governmental policies, then the “resilience of law” could equally be incorporated in order to have a better legislation. Thus, these “new expectations” would also depend on the political climate or priorities, and not on constitutional grounds, which does not seem the ideal path for the aforementioned evolutive process. Therefore, the author strongly believes that there should be a superior and independent guide that could take this evolutive process out of the discretionary public policies of one or another government, and that could outlive modern – but sometimes fragile – supra-national authorities.

In modern times, legislative privileges are more likely to be seen as a faculty based on certain expectations, i.e. making⁴⁵⁵ and having⁴⁵⁶ fair, coherent and effective law, for example, and should now include “new expectations” related to the resilience of law. Nevertheless, it could be said that nowadays it seems more akin to a persuasive doctrinal or governmental recommendation to

⁴⁵² In Colombia, there are only doctrinal recommendations to legislate better, which have led nowhere in the past decades, as legislators are only verifying the initial effectiveness of law, and then they simply leave them to drift.

⁴⁵³ Before this, England had the Better Regulation Task Force created in 1997, which was later replaced by the Better Regulation Commission in 2006. However, none of them was supported by a constitutional provision.

⁴⁵⁴ However, England and other European countries have another advantage over Colombia, since they have to comply with the European Laws and Regulations, which are directed in a similar sense. Nevertheless, depending exclusively on a supra-national authority to stimulate a domestic evolutive process should not be permitted since said authority can at any time disappear, or exclude the country from the Union, which is not far from happening according to the current circumstances regarding the relation between England and the European Union. In this regard, Colombia has no influence from the Organization of American States, or any other supra-national authority.

⁴⁵⁵ This is the challenge of the “Good Law Initiative 2013” set forth by the Parliamentary Counsel Office.

⁴⁵⁶ This is more related to the challenges of the English Better Regulation Executive in the Department of Business, Innovations and Skills.

have a better legislation, than to the constitutional aspiration whereby they “ought to legislate based on certain expectations”, or than the “constitutional duty to legislate based on certain expectations”.⁴⁵⁷

A “duty” typically has more force than “ought to”, and the former is never used just to talk about what ideally ought to be, or even about what ideally someone ought to do.⁴⁵⁸ However, when someone has a “duty” to do something, and fails to do it without a suitable excuse or justification, this reflects on him as a person, and normally he is then properly subject to sanctions.⁴⁵⁹ For that reason, accepting an approach whereby legislators could be sanctioned for not performing such duty of making the law effective or not making it resilient, which is an even wider notion, could be too rigid, and could generate serious issues in terms of democracy and accountability. On the other hand, accepting the current approach – whereby having better legislation or making the law resilient could be seen as mere persuasive doctrinal recommendations or as a political discretionary public policy interconnected with supra-national authorities – could be too “floppy”; this would not secure the independence of the aforementioned evolutive process, and could lead nowhere as has been seen in the past decades in Colombia. As a result, it is believed that there should be a place in the middle of the latter two approaches where there would be some sort of constitutional stimulation to pursue those goals, though avoiding any type of legal sanction. At the present time, and since it should evolve, it is likely to be accepted that the adequate “middle-point” to locate modern expectations or these “new expectations” is within the *aspirational constitutionalism*. This refers to a process of constitutional building in which constitutional decision makers understand what they are doing in terms of goals that they want to achieve and aspirations that they want to live up to; it is a fundamentally forward-

⁴⁵⁷ To go deeper into a comparison between “ought to”, “wrong not to”, and “duty”, see: Brandt, R. B.: *The Concepts of Obligation and Duty*, Mind. New Series, Vol. 73, No. 291, July 1964. However, it is important to highlight that, according to Brandt, “wrong not to” could not be used to study these responsibilities because it does not involve a positive goal, and “wrong” is normally used to label certain kinds of behaviour as justifiably prohibited.

⁴⁵⁸ Brandt, Op.Cit, p.391-392. However, “duty” is used in this, and the next paragraph instead of “obligation”, but taking into account that in order to compare them with “ought to” they could be interchangeable but, in general, the author is not treating them as synonymous.

⁴⁵⁹ As stated by Brandt, the criticism and disapproval need not be “moral” since obligations are not always “moral”: Brandt, Op.Cit, p.391

looking viewpoint.⁴⁶⁰ Thus, as an aspiration, the goals of the authors of the relevant constitutional text often will not have been realised at the time of its adoption,⁴⁶¹ which would be the case of the “new expectations”, as already mentioned.

Accordingly, “having resistant legislation” should be an evolutive process where, although there should be an express constitutional aspiration, those potential aspirational constitutional provisions do not bind *a posteriori* generation⁴⁶², who should then decide, by means of interpretation, the adoption, meaning and scope of such provision. Yet, once this aspiration has been originally set out, all related conducts should be directed in a sense pursuant to said aspirational provisions, more akin to the “ought to”. Therefore, under this study’s approach, it is believed that parliamentarians have a “right to legislate”, but such right involves certain expectations; and the latter refer, among others things, to not making or having anti-technical, unfair, or ineffective laws. Within the context of the resilience of law, these “new expectations” refer to having these norms protected against the shocks caused by future changes by recovering effectiveness, and preventing future ineffectiveness. However, to stimulate this behaviour from parliamentarians in that direction, there should be an express constitutional provision, at least in the form of aspirational provision, imposing them such burden.

5.2. A JUDICIAL DUTY WITH RIGHTS AND EXPECTATIONS AND ASPIRATIONAL CONSTITUTIONALISM

On the other hand, the circumstances within the judiciary context are slightly different. Judges do not have a right (or permission) to decide cases; they have a duty (or obligation).⁴⁶³ The modern judicial duty of judges,⁴⁶⁴

⁴⁶⁰ Scheppele, Kim L.: *Aspirational and adversive constitutionalism: The case for studying cross-constitutional influence through negative models*, p.299, 1 Int’l J. Const. L. 296, 2003.

⁴⁶¹ Dorf, Michael C.: *The Aspirational Constitution*, p.1634-1635, Cornell Legal Research Paper No. 09-024, 2009.

⁴⁶² West, Robin L: *The Aspirational Constitution*, Northwestern University Law Review 88.1, 1993; Cook, Anthony E: *Comment on Professor Robin West's Aspirational Constitution*, Nw. UL Rev. 88, 1993

⁴⁶³ “Obligation” is brought forward to contrast it with the “permission” in the sense given by deontic logic, and not in the sense given by Brandt, Op.Cit. 375-393

⁴⁶⁴ This clarification is made because it could also be said that judges have moral duties when deciding. In that sense, the author is trying to exclude all moral aspects from this research, though they should be included in the future when studying the relation between “resilience of law” and some philosophical debates alluded to before.

however, has been moving forward towards being a duty to decide on certain (much narrower than Parliament) “negative⁴⁶⁵ and positive legislative rights”,⁴⁶⁶ in conjunction with a political role, as mentioned before. In other words, if the words in deontic logic are borrowed for a moment, it could be said that the judge has an “obligation” to decide the case that involves “permission” if he is creating law, which seems completely different from the legislature’s right (permission) that involves certain expectations. That evolutive process⁴⁶⁷ must keep progressing, particularly in terms of the effectiveness and resilience of laws, when judges are constitutionally reviewing law, interpreting it, or developing the common law, depending on the jurisdiction.

Therefore, for the sake of legal coherence, if it is accepted that judges have a limited “right” to legislate (positively or negatively), it would not seem rational that they could acquire said modern faculties without having certain similar expectations over them. Judges should also have over them those expectations related, at least, to the effectiveness of those laws, when either developing the common law, or interpreting statutes. The author would like to emphasise here that those expectations should also fall upon judges in the sense that there a large number (decreasing though) of matters that do not

⁴⁶⁵ As explained before, judges have been attributed the role of “negative legislators”, making special reference to constitutional matters. To study the global growth of judicial powers, see: Dick Howard, A.E., *A Traveler from an Antique Land: The Modern Renaissance of Comparative Constitutionalism*, p.21 and followings, 50 Va. J. Int’l L. 3, 2009-2010.

⁴⁶⁶ “By the 1970s it had become respectable In England to recognise that that judges made law – even conservative judges affirmed as much. Lord Edmund-Davies said in 1975: “The simple and certain fact is that judges inevitably act as legislators...” [...]. (Zander, Michael: *The Law-Making Process*, p.392, sixth edition, Cambridge University Press, 2004. Similarly, Benjamin Cardozo stated: “The choice of methods, the appraisal of values, must in the end be guided by like considerations for the one as for the other. Each indeed is legislating within the limits of his competence. No doubts the limits for the judge are narrower. He legislates only between gaps. He fills the open spaces in the law. [...] None the less, within the confines of these open spaces and those of precedent and tradition, choice moves with a freedom which stamps its action as creative. [...] The process, being legislative, demands the legislator’s wisdom” (Cardozo, Benjamin: *The Nature of the Judicial Process, The Judge as a Legislator*, p.113-115, 1921). Indeed, to separate the duty of the judge to decide from his discretionary legislative right, the author accepts the point of view given by Kent Greenwalt who states that: “[...] it does not make good sense to say that a judge is under a duty [obligation] to reach one result rather than another [although he has an obligation to decide]; as far as the law is concerned, he has discretion to decide between them [permission]” (Greenwalt, Kent: *Discretion and Judicial Decision: The Elusive Quest for the Fetters that Bind Judges*, p.378, 75 Colum. L. Rev. 359, 1975.

⁴⁶⁷ “There is [...] in the House of Lords, especially among judges such as Lords Hoffmann and Steyn, an evolving sense of the jurisprudential and political role of the judiciary. As the power of the judiciary becomes more obvious, a literature and understanding of the judicial role will become essential”. (Stevens, Robert: *The English Judge*, p.148, Hart Publishing, 2005.

have statutory regulation, where the effectiveness of law cannot be analysed by parliamentarians, or their legislative delegates. Moreover, within the context that concerns this research, those expectations should be extended, if necessary and possible, into “new expectations” to make the law resilient. In short, it could be said that judges have a “duty” that involves a “right” that should involve “new expectations”. However, currently, these “new expectations” do not count as an express constitutional provision or a subsequent sanction in Colombia or England. Nowadays, there is a sanction for failing to perform the former duty (deciding a case), but no sanction of any sort (neither political nor legal, etc.) for failing to comply with those traditional and new expectations derived from the latter “right”. In this sense, those “new expectations” also look more like an “ought to” than a “duty to”, although both pursue a positive goal.⁴⁶⁸ On the other hand, unlike the legislature, the judiciary has not been subject to persuasive doctrinal recommendations, or governmental or supra-national policies related to making effective, and resilient, norms, as those mentioned above.

As a result, it is believed that caring for both the effectiveness and resilience of laws is also expected from judges. But, it should not be imposed in the form of a “duty” given by a constitutional mandate, not even with a proportional political, disciplinary, economic, or legal sanction for failing to perform, at least not currently. This would be too rigid, and would present comparable accountability issues to those referring to the legislature. On the other hand, those expectations should not take the form of persuasive doctrinal recommendations or governmental policies either, for the similar reasons mentioned above when referring to Parliament. As part of an evolutive process, and similarly to the middle-stand approach stated with regard to legislators, the author strongly believes that the latter expectations and, particularly the “new expectations” of judges, should take the form of aspirational constitutional provisions.

In that sense, those “new expectations” related to the resilience of law should be considered as an “ought to”, both for legislators and judges, at least for

⁴⁶⁸ Brandt, *Op.Cit.*, p.391-392

now, stimulating those respective “conducts or results”.⁴⁶⁹ Accordingly, although currently a constitutional foundation to support this does not exist either in Colombia or England, it is believed that it should be incorporated in the constitutional framework in both jurisdictions, but in the form of aspirational constitutional provisions. This would permit attributing additional weights in an express manner over the legislature and the judiciary, and would set a non-binding path to future generations related to those “new expectations”, and even future expectations. Additionally it will liberate the aforementioned evolutive process from political or supra-national matters or priorities, and could start materialising all those goals that people believe should be achieved and aspirations that they would want to live up to.

6. “AGENTS OF RESILIENCE” UNDER SPECIFIC AND COMPARATIVE SHOCKS

6.1. AGENTS OF RESILIENCE

Having resilient norms may be even harder than simply having effective norms. Some of the characters mentioned within this chapter – referred to as law-protectors herein – have the main charge of seeking the resilience of law; and as a result they are responsible⁴⁷⁰ for the level of resilience of all laws during their validity. Nevertheless, the entire burden of reviewing and protecting the effectiveness of all laws against certain shocks is exceedingly heavy for legislators, particularly in civil law jurisdictions, such as Colombia, where judges are strangers to the process of originating⁴⁷¹ the law. Therefore, these law-protectors require the support of others to alleviate that weight. In this study they are referred to as “resilience-provokers”, but that does not

⁴⁶⁹ As mentioned before, it is called “new expectations” to differentiate it from those already existing – especially in the legislature context – and from the traditional constitutional role of judges and parliamentarians; but it is of paramount importance to recall that seeking the resilience of laws, although it should be a permanent expectation, is not always necessary, and for that reason judges and legislators will not always be acting as law-protectors.

⁴⁷⁰ It is important to clarify that they are not responsible, in a strict legal sense; they are just expected to behave in a determined manner according to the set of traditional and new expectations that fall upon them. Thus, when the term “responsible” or “responsibility (ies)” is used in this chapter it should be understood not from a strict legal perspective.

⁴⁷¹ Again, the term “origin” is used to avoid debate between “creative theory” and “declaratory theory” and their relation with the resilience of the law (not referring either to the “originalism” as a principle of law); although it is not part of this research, the author suggests that such a relation should be studied in the near future.

mean that they are invented; this name, just like “law-protectors” is given mainly to group them together according to their function, hence highlighting and relating the new responsibility of those existing personages to the resilience of law. In that sense, “resilience-provokers” are those that assist “law-protectors” in making the law resilient; they just help in reviewing the entire legal system to alert law-protectors to a potential or existing case of ineffectiveness of the law. Subsequently these provokers may suggest a way to overcome or prevent cases of ineffectiveness, to ultimately make such law legally resistant.

Accordingly, Law Commissions were previously mentioned – although inexistent in Colombia –, as being the best example of resilience-provokers in England, but only if they seek resilience in their suggestions to Parliament. In other words, if a Law Commission suggests a law reform which is not aimed at making such a law resilient, then it would not be acting as a “resilience-provoker”. In addition to these Law Commissions, there are similar characters indirectly related to law reforms that could also assist in making the law resilient in both countries. These are: academics,⁴⁷² judges when exhorting Parliament to produce law,⁴⁷³ pressure groups,⁴⁷⁴ or even the media.⁴⁷⁵ Hence, all the characters that have been mentioned above (i.e. law-protectors and resilience provokers) that are then in charge, directly or indirectly, of making all laws resilient through the aforementioned “vehicles”, should be known as “agents of resilience”.

⁴⁷² “Legal academics can [and should] be very persuasive in arguing for changes to the law. [...] it used to be that an academic had to be deceased in order to be regarded as an authority (that way, he could not change his mind), but nowadays it is recognised that certain academics’ views have authority weight, irrespective of their living status”: (Huxley-Binns and Martin, Op.Cit., p.26).

⁴⁷³ In *Mendoza v Ghaidan* ([2002] EWCA Civ 1533) the Court of Appeal could also have declared that the Rent Act 1977 was incompatible with human rights and so left it to Parliament to amend the Act (instead they made it law). In Colombia, Decision C-577 of 2011 (Settlement number D/8367, Speaker: Gabriel Eduardo Mendoza Martelo) of the Constitutional Court [albeit it made law in some partial issues] declared a deficit of protection of a minority with regard to same-sex marriage, and exhorted Congress to legislate within a specific period.

⁴⁷⁴ “Pressure with widely differing aims also contributes to law reform” (Huxley-Binns and Martin, Op.Cit p.26.); examples include: trade unions (bankers, insurers, miners, etc.) Greenpeace, NSPCC, The National Consumer Council, The Howard League for Penal Reform, The Legal Action Group, amongst others.

⁴⁷⁵ “The influence of the media must not be forgotten. The increase in law-based TV programmes such as *Rough Justice* and *Panorama* have raised the profile of errors or gaps in the law. Media influence on the public, and therefore also politicians, may have resulted in the recent changes to the law of ‘double jeopardy’ [...]”: Huxley-Binns and Martin, Op.Cit, p.27

6.2. SPECIFIC AND COMPARATIVE SHOCKS

Therefore, a high level of static resilience is the main objective of the *resilience of law*, but, even if it is achieved, that does not mean that the legal regime should be resistant to any kind of shock. Law-protectors should base the particular recovery and preventive processes on the “specific shock” that the legal regime suffered. Otherwise, modifying the legal regime may not be supported by the analysis of the causes that led to the scenario of ineffectiveness of the law, and therefore legal modifications are likely to be sent off course. For that reason, the author believes that it is not possible to speak about factors that promote resilience, but about factors that promote resilience against a specific risk⁴⁷⁶ (risks such as the implementation of economic policies or a financial crisis). Therefore, the legal system can be properly recovered, and preventive elements should be implemented, but only based upon an analysed, specific and related shock; the latter is one of the most important differences between seeking the effectiveness of laws and seeking the resilience of laws.

Nevertheless, does the dynamic resilience need to be exclusively based on particular domestic shocks? Or, is it possible to make use of foreign or international shocks as well? First it is worth mentioning that the use of a non-domestic shock for resilience’s purposes is far different from studying or importing foreign or international norms. On the one hand, comparative law has been as flattered⁴⁷⁷ as it has been criticised,⁴⁷⁸ but studying further regimes is different from copying foreign or international norms and disregarding the “realities of the importing country”.⁴⁷⁹ The latter is one of

⁴⁷⁶ Kalawski and Haz, Op.Cit., p.370

⁴⁷⁷ Schadbach, Kai: *The benefits of comparative law: a continental European view*, 16 B.U. Int’l L.J. 331.1998.

⁴⁷⁸ Mattei, Hugo and Arbor, Ann: *Gulliver’s troubled travels or the Conundrum of Comparative Law*, 67 Geo. Wash. L. Rev. 149, 1998-1999.

⁴⁷⁹ The bad habit of copying laws disregarding the reality of the importing country occurs in a large number of jurisdictions, but a significant example is given by Paul Cowling. He states with regard to administrative law: “...the vast majority of the commissions were dismantled [...] due to [a] failure that reflected the “deep cultural difference” between the legal traditions of Japan and the United States. The Occupation Forces tried introducing the “independent regulatory commission system”... because American administrative law had been developed by this method by its common law/equity styled “precedent”-building. But this system was utterly and wholly without success because of Japan’s belonging to the antipodal legal culture of building law from “written” or literal materials, i.e. by mainly copying foreign laws. Cowling, Paul: *The Kanagawan Wave of Change: Pressures for Fundamental Reform of Japanese telecommunications*, p.126, 59 U. Toronto

the misuses (perhaps the most frequent) of the comparative law when law-protectors are attempting to recover effectiveness under a scenario of urgency, leading to poor dynamic and static resilience. On the other hand, unlike the copy of the norm, the use of non-domestic shocks could never disregard the realities of the importing country; on the contrary, the shock is the basis of the analysis that needs to be later harmonized with those realities to produce effective and resistant norms within a specific society. As a consequence, it needs to be possible to use non-domestic shocks to improve the static resilience of the domestic legal regime (through the preventive element).

Conclusively, law-protectors in every particular case have three options with regard to the resilience of law. Firstly, they can just attempt to present a legal change of the law to recover effectiveness; secondly, they can attempt to present a legal change of the law to recover the lost effectiveness and, in addition, to strengthen the regime to face a similar future shock without losing effectiveness; and thirdly, they can attempt to simply strengthen the legal regime in order to face similar future shocks (which also includes *unprecedented* laws). Thus, the modified legal regime, if possible and if needed, will be effective, and will be composed of: a) a resistance element; b) a recovery element; and c) a preventive element, although the latter two may seem imperceptible for the standard addressee of the law. These factors should also avoid entering into a harmful cycle of perpetual ineffectiveness of the law, with short episodes of temporary effectiveness. It is then, when the level of the past (the one that received the shock) and current static resilience, and the developed dynamic resilience, can again be entirely assessed; this will facilitate further preventive processes in order to avoid all the aforementioned risks that come with a recovery process.

Furthermore, it is worth commenting, in advance, that most of the potential situations that were presented in, or that may be deducted from, this chapter are from the history of the Colombian legal regimes of performance bonds (*sensu lato*) in the past 20 years. As a consequence, it will be argued that the

Fac. L. Rev.117 2001. See also: Jordan III, William S.: *Legislative History and Statutory Interpretation: The Relevance of English Practice*, p.18 and followings, 29, U.S.F. L.Rev. 1. 1994-1995.

said legal regimes have a low level both of dynamic and static resilience, as will be demonstrated in the following chapter. On the other hand, it seems that England law-protectors have achieved better levels of resilience for said bonds. Therefore, it is the author's duty to collate this chapter with the legal natures given in the previous chapter, based on the "changes" and "shocks" given in the first and second chapters.

CHAPTER 5: THE SPECIFIC LEVEL OF STATIC AND DYNAMIC RESILIENCE OF COLOMBIAN PERFORMANCE BONDS

INTRODUCTION

As explained in the first two chapters, the type of state and the economic model that are implemented in the developing or developed jurisdictions are not strangers to the law in general, or to the legal regime of performance bonds in particular. In 1923 the Colombian performance bonds market witnessed the beginning of an interventionist era and Colombia then moved from a “Liberal State subject to the Rule of Law” to a “Social and Democratic State subject to the Rule of Law”, and economic liberalism was left behind.

Public resources were insufficient to cover the basic needs of the people under this new type of state, and as a result private resources had to be attracted in order to collaborate with the public service. Thus, the Nation’s wealth needed to be secured in the middle of the implementation of the interventionist model, where the Civil Service was mainly under the responsibility of the directors of public entities and occasionally under the collaboration of the private sector. The legislative power understood that the perils referring to public funds had to be assumed by the performance bonds market,⁴⁸⁰ and not by the Nation. Hence, it was in 1938 that certain politico-economic aspects led to the conception of the first Colombian regime of performance bonds.

However, changing the type of state and the economic model from one to another not only led to the conception of said markets in developed and developing states, such as England and Colombia; those changes were, and still are, likely to have an effect on the market of performance bonds (as demonstrated in chapter two), and on its legal regime.⁴⁸¹ By the decade of

⁴⁸⁰ In Colombia, at that time, the performance market was exclusively within the scope of the insurance market, as explained in Chapter One.

⁴⁸¹ It is important to remember from the main introduction that in those cases where the author is referring to the “market of performance bonds” or to the “legal regime of performance bonds” he is including the Colombian Performance Insurance for the reasons mentioned therein, although it is clear to the author that the latter instrument is not a bond.

1970, arose the second cyclical crisis of capitalism in the 20th century, and the period of economic stability was over. This marked the return of liberalism to economic and political scenarios, and led to the transformation towards a regulatory state. In Colombia those neoliberal policies, or in particular supply-side economics, were implemented firstly in 1990, and later in 2002, which made the level of demand for bonds skyrocket without control during those years, causing an avalanche of legal reforms within the context of the Colombian instruments mentioned in the third chapter.

Based on what has been called “the resilience of law” which is grounded in the notion of the effectiveness of laws, it is then the author’s duty to seek the level of static and dynamic resilience of the Colombian norms of performance bonds since the implementation of both the regulatory state and the neoliberal policies.

Establishing the level of resilience of the aforementioned laws, with regard to this study’s original contributions to knowledge, is fundamental for two reasons: Firstly, it serves as a practical illustration of the notions provided in the previous chapter (it complements, by using a real situation as an example, the theoretical notion of resilience of the law). Secondly, which is particularly relevant for Colombian scholars, this chapter demonstrates the poor level of resilience of the Colombian laws of performance bonds, and how, in the author’s opinion, legislators and judges disregarded, not once but twice, politico-economic changes that later had a disastrous outcome on the effectiveness of those laws.

In that sense, this final chapter narrates the specific changes and subsequent shock that hit the Colombian regime in 1992, and how the lack of prevention against this shock affected the amount of effective instrument available to society, in particular the so-called “*fianza*, equivalent to English contract of guarantee. This chapter will later describe the unsuccessful attempts to recover the effectiveness of the general regime of performance bonds, and how this led to a legal detriment because the amount of available instrument to secure contracts was diminishing given that the *fianza* was not as accepted as before, and the modern on-demand banking guarantee was not a competitive against the reigning but imperfect instrument: the “Colombian

performance insurance”. Besides, it will be mention that the legal rules referring to Colombian performance are still fragile against another forthcoming shock, and have never been the object of static and dynamic resilience for which those rules are not resilient. For that reason, this chapter will finally affirm that society counts with only one imperfect instrument provided by the financial sector, for which in practical terms Colombian underlying creditors (including the Nation’s wealth) are in risk, but not totally unprotected against the contractual default of debtors.

1. THE SPECIFIC “CHANGES”, THE “SHOCK” AND THE ABSENCE OF “EXCLUSIVE RESILIENT PREVENTION” BEFORE THE SUBSEQUENT SHOCKS OVER PERFORMANCE BONDS

1.1. “CHANGES” IN THE CONTEXT OF RESILIENCE OF LAWS

Firstly, a change within the context of resilience is not different from a change in another context. The difference truly depends on the fact that the former changes are likely to have a relation with the effectiveness of laws. By those changes the author is not referring to an alteration of the law, as the latter variation cannot be considered as an endogenous change. It is clear, and very visible in common law systems, that social reality is what influences future legal decisions; indeed, within this study’s framework of performance bonds, it was suggested in Chapter 1 that these financial instruments and their laws were the result of many preceding political, economic and social changes. Yet, in this regard, there was a further difference between England and Colombia because, unlike in Colombia, the English performance bonds market was progressively created as a requirement of trading life, and not due to a sudden and improvised law without a previous process of experimentation. It was then the performance bonds market expected the law to protect legal parties, and not a law full of legal loopholes expecting the financial industry to create a performance bonds market.

Secondly, it is of paramount importance to remember from the previous chapter that not every change generates a shock,⁴⁸² and not every shock

⁴⁸² As stated in Chapter 4 Section 1, some “changes”, given their remoteness, nature, pettiness, or similar reasons, may not produce a subsequent shock.

produces the ineffectiveness of the laws challenged by the latter.⁴⁸³ However, once a norm is effective, it seems that it can only become ineffective due to a previous change of any sort that affects the relation between the norm and its addressees (subjective aspect). The other reason for which a norm could be ineffective, is related to the objective aspect of ineffectiveness, so once the norm is effective the design of the norm could only be altered by a human intervention which means there has also been a previous human change.

Thus, the basis of the resilience of the law is the existence of a shock, and its conjunction with some changes and the ineffectiveness of certain norms. The implementation of supply-side economics, together with the progressive transition towards the regulator state caused strong economic effects in the Colombian performance insurance market – the largest market in terms of securing financially the due performance of contracts. These changes in the Colombian politico-economic structure – by 1990 and 2002 – certainly were not unprovoked; they did not occur spontaneously. Those changes could have been avoided since Colombia could have remained as an interventionist state and applied demand-side economics as it had done in the past; or it could have moved to another type of state, and applied another type of economic policy.⁴⁸⁴ There were also more options. Yet, the Colombian State in a proactive attitude generated those changes believing that they were essential in the public interest, vital for the development of the Colombian economy and needed for fiscal sustainability. Additionally, it seems clear that those changes did not find their origin, or did not occur, inside the generic regime of performance bond (that includes the so-called “performance insurance”). For that reason, the aforementioned changes could be catalogued as voluntary and exogenous in relation to the latter regime.

Since the latter were voluntary changes, they could have been avoided, hence maintaining the *status quo*. Therefore, in the previous hypothetical case, a resulting shock would not have occurred either, and ineffectiveness of such laws, if any, could not be based on the existence of a shock, since the latter

⁴⁸³ As explained in Chapter 4 Section 2, this depends on both the severity of the shock and the resistance of the structure that is tested by that shock.

⁴⁸⁴ With regard to these options, the author is not criticising or favouring one or another type of state or economic policy, just confirming that there were options by then which depended on the will of the respective government.

never occurred. Within the context that concerns this study, i.e. performance bonds, those changes were not avoided, as seen in detail in chapter two, and the shock did exist. However, as mentioned in the previous chapter, there is another option to deter the ineffectiveness of laws when they are shocked by certain changes, though this second option is located not on the side of those changes, but on the side of the law itself, and is the one referring to the resilience of laws. The laws of performance bonds needed, and still need, to be provided with certain tools that allow them to resist the effects of those non-avoided changes, or to recover effectiveness and prevent future scenarios of ineffectiveness if those laws could not resist such effects, as seen later.

In that sense, given that those changes were directly provoked, the potential subsequent occurrence of a possible shock should be foreseen and expected. Yet, that does not necessarily mean that the location of the shocks should always be known beforehand, as it may affect an innumerable number of markets and their legal regimes.⁴⁸⁵ This seems more common when the change is exogenous, as the effects of these sorts of changes may spread in many directions. But even if the location of a shock is known, its magnitude is not likely to be measured in advance. Indeed, before those voluntary and exogenous changes were provoked, the Colombian government – through delegated legislation – and Congress developed in advance a number of measures to try to protect certain markets against potential subsequent shocks, but the generic market of financial performance bonds was not included, nor its norms, as seen below.

1.2. THE SHOCK

Although the aforementioned changes started in 1990 and later in 2002, their effects on the Colombian market of performance insurances were between 1992 and 1994, and between 2005 and 2010, respectively. Hence, during those periods there occurred uncontrolled and sudden increases in the demand of the most used performance securities ⁴⁸⁶ in Colombia –

⁴⁸⁵ However, law-protectors should always attempt to foresee the location of the shock, particularly in cases where “exclusive prevention” is sought.

⁴⁸⁶ Fandiño Gallo, Op.Cit p.52: This author suggests that in Colombia the influence of private law over the Public Contracting Regime, and subsequently over the performance insurance legal

performance insurances – which were shown in detail within the second chapter. Unlike performance insurances, with regard to the other instruments that are part of the regime of performance bonds in Colombia, there is no direct empiric evidence to suggest that those changes and a subsequent shock reached them in any sense. However, that does not mean that they should be excluded from this study because, as has already been explained,⁴⁸⁷ similar or non-domestic shocks cannot be disregarded, and may be used to seek static resilience within any legal instrument, such as guarantee bonds – in the strict sense –, or truly independent bonds. Those same changes massively influenced the demand on the most common instrument to secure contracts (the performance insurance) in Colombia, and also skyrocketed the demand on “*fianzas*” (contracts of guarantees) in the United States and Mexico. As a result, the author strongly believes that the latter instrument, and truly independent bonds, should have been affected as well within the Colombian scenario by those changes, following the pattern suggested in chapter two.

Nevertheless, the shock cannot be understood as an abstract and undefined notion when it is used to seek the resilience of certain laws. Firstly, suggesting that the shock is the action resulting from one or more previous changes is not equal to suggesting that the shock is the resulting ineffectiveness of certain laws caused by changes. Within the general context of the resilience of the law, the latter interpretation should not be acceptable, given that assuming that the shock has the same ineffectiveness would signify we are skipping one stage. Shock and ineffectiveness are different notions at different stages, and the former may be the cause of the latter, therefore they could not be comparable. The shock may be an effect of those changes, but at the same time may be the cause of ineffectiveness. Moreover, it is important to recall that not every shock, even if it has great magnitude, causes ineffectiveness since that also depends on whether those laws are highly resistant, or not, to such shocks.

regime, is generated as a consequence of the political and economic reforms that started in the late 1980s.

⁴⁸⁷ Chapter 4, Section 6.

Secondly, within the context of Colombian performance bonds, the specific shock that concerns the author does not refer to all the possible aspects that involve the massive, sudden and uncontrolled increase in the demand of those securities, mentioned in chapter two. Indeed, he believes that the actual shock refers only to a concrete part of such increase, i.e. the *pressure* over the law of performance bonds. But, what exactly is this *pressure*? By legal culture, Friedman means the ideas, values, attitudes, and expectations that people have with regard to law and the legal system.⁴⁸⁸ In that sense, he says, everybody has a legal culture, but probably no two people have exactly the same legal culture; yet, undoubtedly, there are patterns and tendencies that vary systematically. Then, an event occurs, for example the attack on the World Trade Center, the United States Civil war, the AIDS epidemic, a stock market crash, or, conversely, a steep rise in the stock market; or, in this case, an event such as the dramatic rise in the demand of securities during certain periods. None of these events automatically brings about changes in laws,⁴⁸⁹ but they enhance the *pressure* over those laws, given that they have an impact on the legal culture. They bring about a change in the way people think, what they expect, how they look at the world; and, those changes in attitude in turn lead to changes in the pattern of demands on the legal system.⁴⁹⁰ In that sense, both a change in the legal culture and the resulting *pressure* have a direct relation with the “subjective element” of the notion of “effectiveness of the law”, given that people may no longer accept, tolerate or comply with certain existing legal rules.

The legal culture started to change with regard to the laws of performance bonds in 1992 and 2005. From the example of the aluminium can, the vulnerabilities of such laws became perceptible due to the enhanced *pressure* caused by an exogenous “change”. Thus, what was tolerated before the politico-economic changes that concern this research, was then challenged in

⁴⁸⁸ Friedman, Lawrence M.: *Legal Culture and Social Development*, 4 L. & Socy. Rev. 29, 1969, cited in Friedman, Lawrence M.: *The Eye that Never Sleeps: Privacy and Law in the Internet Era*, p.561, Legal Scholarship Symposium: The Scholarship of Lawrence M. Friedman, 40 Tulsa L. Rev. 561, 2004-2005.

⁴⁸⁹ Friedman, Lawrence M.: *The Eye that Never Sleeps: Privacy and Law in the Internet Era*, p.562, Legal Scholarship Symposium: The Scholarship of Lawrence M. Friedman, 40 Tulsa L. Rev. 561, 2004-2005.

⁴⁹⁰ *Ibid*, p.562

1992 and 2005 due to the dramatic increase in demands of securities set forth in Chapter Two. Enhancement of the aforementioned *pressure* has also occurred in further scenarios. For example, with regard to the automotive American society: the automobile came into use in around 1900; in 1910, dealers sold 181,000 cars; in 1920, almost two million; by 1970, there were 89,000,000 cars registered, and by 1990, 123,000,000.⁴⁹¹ America then had an automotive society, with all its benefits and burdens; these turned into wishes and demands and interests, which in turn led to a whole new field of law: traffic law.⁴⁹² Before this, the rules of the road were few, simple and pretty unimportant, whereas the modern traffic code is huge, and has an impact on almost every one of us, almost every day.⁴⁹³ As the world changes, the law tends to be changed as part of that world due to the aforementioned *pressure* or variation in the respective legal cultures.

Therefore, given that the level of *pressure* over these securities has risen dramatically, the legal regime that was apparently resistant – in terms of resilience – before the changes, then, was no longer resistant to the new reality. Hence, if ineffectiveness appeared as a consequence of said *pressure*, it was due to the low level of static resilience, and therefore dynamic resilience would be required to solve the harmful effect of such *pressure*. Consequently, all the legal natures involved, could have become the first, though not the ultimate,⁴⁹⁴ victims of these unforeseen shocks, for several

⁴⁹¹ Friedman, Lawrence M.: *American Law in the Twentieth Century*, 549-555, Yale U. Press. 2002., cited in Friedman, Lawrence M.: *The Eye that Never Sleeps: Privacy and Law in the Internet Era*, p.562, Legal Scholarship Symposium: The Scholarship of Lawrence M. Friedman, 40 Tulsa L. Rev. 561, 2004-2005.

⁴⁹² Ibid, p.562

⁴⁹³ Ibid, p.562-563. Besides, as said by Friedman, “the automobile also revolutionized and in a sense even created interstate crime. [...] The automobile was also a tremendous boost to organized crime; bank robberies and other heists would be difficult or impossible without ‘getaway cars’. The epidemic of bank robberies led, indirectly, to the creation of the FBI, and nationalization of law enforcement. [...] Consider, as well, the thousands of car salesman, mechanics, and gas station operators. The millions of cars, trucks, and buses have an insatiable thirst for gasoline. Oil companies constitute, if anything, an even mightier industry than the auto industry. I hardly need mention the worldwide importance of oil, politically and economically. [...] Tort law feeds on the auto incident, its main source of claims and lawsuits –tens of thousands of claims every year, and a significant number of court cases as well.”

⁴⁹⁴ The ultimate victims will be detailed later, but it is possible to affirm in advance that the addressees of those laws are the ultimate victims mainly for two reasons: 1) principal creditors (including public bodies, hence the entire society) are not completely protected against the default of their counterparties; 2) principal creditors, principal debtors and guarantors are obliged to use the available financial instruments in spite of their known issues.

reasons – that that will be treated within this chapter – strongly related to the lack of resilience of those norms.

It is important to clarify that the demand for performance bonds skyrocketed not because the consumers of the market of performance bonds had believed that it was an infallible instrument. Such increase was not a voluntary act of those consumers; they were obliged. The growth or contraction in the demand for those bonds directly depended on the conditions of the underlying market, such as construction projects or international transactions. The latter conditions vary based on different factors, such as the implementation of one or another politico-economic policy. It is because of this that the increase in the demand for those bonds does not signify that there was a larger acceptance of the instrument by society, nor that, as a result, it was considered to be a more efficient instrument. In this case, on the contrary, it shows that such growth was the consequence of the implementation of certain policies and the impossibility to use other instruments with a similar purpose. In conclusion, the debtors of those contracts that were supposed to be secured were obliged to adapt themselves to the increase of those underlying markets, and they could only use the instruments that were available in the market of performance bonds. In other words, the increase in the demand for those bonds was an indirect imposition of the Colombian State on the consumers of the aforementioned market, and not the proof of the sufficient effectiveness of the laws regarding those financial instruments.

1.3. LACK OF EXCLUSIVE PREVENTION PRIOR TO THE FIRST “SHOCK”

Firstly, by 1990 and 2002, the valid laws of performance bonds were not the subject of any kind of “exclusive resilient prevention” against forthcoming shocks, which represents the absence of, chronologically, the first expected element of dynamic resilience. The Colombian government and Congress did not foresee that those changes in the latter years were going to produce shocks within both the market and laws of performance bonds; therefore, none of these public powers, in neither of these two occasions, carried out actions to deter beforehand the harmful effects of not having a statically

resilient legal regime. This brings about an aggravating factor: as per its nature and objectives, the market of performance securities, such as the automobile market, is not an isolated market. Indeed the market of performance bonds and its normativeness are strongly related to, and may also be altered by, the construction market, domestic and international commerce, and all sorts of matters involved in public contracting due to legal requirements, etc.

1.3.1. GENERAL ASPECTS OF COLOMBIAN PERFORMANCE BONDS BEFORE THE FIRST SHOCK

1.3.1.1. COLOMBIAN LEGAL REALITY BEFORE THE FIRST SHOCK

Before the first aforementioned changes and their subsequent shock (this is before 1990 and 1992), the Colombian legal regime of financial performance securities was much simpler and smaller than it is now. Colombia, unlike England, and in spite of the common belief, was never a scenario for the debate about the legal nature of those financial instruments, i.e. whether the instruments issued by banks and insurers to secure due performance of contracts were bonds or insurances.⁴⁹⁵ Yet, Colombia received the shards of such international debate.⁴⁹⁶ Within the Colombian private context, the contract of guarantee – in the strict sense –,⁴⁹⁷ has legally existed since 1887 when the Civil Code was enacted; however, the moment it started to be used at a financial level by the banking sector is not clear. On the other hand, the Colombian insurance sector, as stated before, entered into the world of securing contracts in 1938 with the enactment of Act 225.⁴⁹⁸ This Act

⁴⁹⁵ The debate is mentioned in Chapter 1. In Colombia the debate was, and still is slightly different. The question in Colombia was whether or not the instrument (performance insurance) issued by insurance companies was a pure insurance – and what type of insurance – rather than a “*fianza*” (English contract of guarantee), given that it was already clear that *fianzas* could only be issued by banks as a result of the legal prohibition over insurers whereby they can only issue insurance policies. However, the Colombian debate remained mainly in an academic atmosphere before the first implementation of the aforesaid macro politico-economic policies, as it was never addressed in depth by courts. See: Ordoñez Ordoñez, Andrés E.: *El Seguro de Cumplimiento Contratos Estatales*, p. 11-29, Universidad Externado de Colombia, 2011; Galindo Cubides, Hernando: *Seguro de Fianza en Colombia*, p. 1-10, Skandia, Bogotá, 1977.

⁴⁹⁶ Said international debate took place in different western countries such as England, France, Spain and the United States: See Ordoñez: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, Op.Cit. p.31

⁴⁹⁷ The “*contrato de fianza*” is established in Title 35 of the Colombian Civil Code. As mentioned in Chapter 3, this instrument is a conditional bond with ancillary liability, which is the Colombian equivalent of the English “contract of guarantee”, in the strict sense.

⁴⁹⁸ These rules were finally abolished in 1993 by Article 203 of Decree 663 of 1993.

established, among other things, that public law contracts needed to be secured by insurance policies.⁴⁹⁹ Therefore, there were two available legal natures to secure contracts by the mid-20th century: one for securing private contracts, and the other for securing public law contracts. By the mid-20th century, the aforementioned debate was coming to an end, and it was then clear that bonds were not insurances, and that the instrument securing due performance, issued by banks or insurers, was not in fact an insurance.⁵⁰⁰ Thus, it was stated by Colombian Decree 1670 of 1975, later by Decree 150 of 1976,⁵⁰¹ and finally by Decree 222 of 1983,⁵⁰² that: “*Securities may consist of [conditional] guarantee bonds from insurance companies or banks [...]*”.

Nevertheless, banks did not become massively involved in the issuance of these guarantee bonds,⁵⁰³ and the insurance sector took over the vast majority of the market of performance bonds. Since insurance companies were not legally authorised to issue guarantee bonds, as stated earlier, they kept issuing the formerly mentioned “performance insurances”, based on the rules of the insurance contract established in the C.C.C., historically backed by Act 225 of 1938. Indeed, although the aforementioned decrees referred to bonds, instead of insurances, issued by insurance companies, Directive 08660 of 1981 provided by the Financial Authority established the wording of the Master Insurance Policy to secure these types of perils, which applied when securing private or public contracts. It is important to mention all this because, by then, these performance insurances were subject to all the provisions – *essentialia negotii* and *naturalia negotii* – of the insurance

⁴⁹⁹ The enactment of this Act was also needed given that the C.C.C. of 1887 (abolished in 1971) only referred to the insurance of goods, and forbade the insurance companies from covering “personal facts of the insured” (Art. 676), and, in addition, used to define the “risk” as the eventuality of any *casus fortuitous* that could cause the loss or deterioration of the insured objects.

⁵⁰⁰ Cross, J. Harry, Op.Cit. p.235-237; Cushman, Op.Cit, p.649-650

⁵⁰¹ Decrees 1670 of 1975 and 150 of 1976 are based on extraordinary faculties given by Congress to the Government, in Act 28 of 1974.

⁵⁰² Decree 222 of 1983 is based on extraordinary faculties given by Congress to the Government, in Act 19 of 1982.

⁵⁰³ The banking sector was reluctant to enter into a field -securing public law contracts- that was mainly dominated by the insurance sector, for historical reasons. This, given that between 1938 (Act 225 of 1938) and 1975 (Decree 1670 of 1975), it was established that the proper instrument to secure public law contracts was the insurance policy, a reality that was theoretically abolished with the latter decree. The private sector later followed the public sector in the belief of demanding insurances to secure the due performance of contracts, which left the banking sector partially out of the market of performance bonds.

contract, with only a few exceptions;⁵⁰⁴ it was not until later that the Colombian legislation, and the Supreme Court and the Council of State by means of interpretation, affirmed that certain provisions were not applicable to these instruments because they were affecting their correct applicability.⁵⁰⁵ Consequently by the end of the 1980s there were two different legal natures available and each of them, unlike before, could secure either private or public law contracts. These instruments, according to the aforementioned legislation, the Colombian Supreme Court and the Council of State,⁵⁰⁶ were: 1) the “*fianza*” or “contract of guarantee” – in the strict sense –, and 2) the “performance insurance”.⁵⁰⁷ In addition, the valid Public Contracting Regime at that time set a few additional rules for those performance bonds when they were securing public law contracts.⁵⁰⁸ All the aforementioned legal rules, together, used to form the generic Colombian regime of performance bonds.

In that sense, according to the prevailing Colombian legal culture before the enhanced *pressure* in 1992, these two financial instruments seemed to be protective enough, in spite of their notorious legal and practical issues. Thus, the poverty of the regime of performance bonds was tolerated, mainly for four reasons: a) the legal rules that had legal or practical issues were not as relevant as those that were not problematic, as seen later; b) the lower frequency in the demand for these bonds, in comparison to the following years (1992-1994);⁵⁰⁹ c) because there was a strange tacit consensus within the relevant markets to avoid the exclusion of these instruments from the legal and commercial traffic, due to certain legal issues that will be

⁵⁰⁴ For instance, according to the Colombian Council of State: (Fourth Section, Decision of November 4th 1988, ref:1565, Speaker: Consuelo Sarria Oleos), the occurrence of the loss and the enforceability of the insurer’s obligation that was established for traditional insurances was irrelevant for these performance insurances when securing public law contracts, based on the Administrative Act 08660 of 1981.

⁵⁰⁵ Chapter 3, Section 3.

⁵⁰⁶ Colombian Supreme Court of Justice: (Civil Section, Decision of March 15th 1983), and the Colombian Council of State: (Fourth Section, Decision of November 4th 1988, ref:1565, Speaker: Consuelo Sarria Oleos).

⁵⁰⁷ Therefore, in practice, an organic factor has prevailed whereby if the instrument were issued by an insurance company it was considered to be a “performance insurance”, whereas if issued by a bank it was a “contract of guarantee”, and the applicable rules depended also on such factors.

⁵⁰⁸ For instance, Decree 222 of 1983, with regard to performance bonds for public law contracts, also regulated the sufficiency of the securities, the minimum secured values, the minimum validity, and the admittance of securities by the public entity.

⁵⁰⁹ Chapter 2, Section 2 of this research shows the increasing demand of these financial instruments between 1992 and 1994.

mentioned below; and d) the lack of further securing options, and the confidence of principal creditors and principal debtors in the soundness of financial companies. Those issues were not even faced by the legislature or the judiciary before 1992, in spite of the dominant doctrinal literature that was warning about the commercial precariousness of those two instruments, and clamouring for reforms.⁵¹⁰ Yet, those doctrinal suggestions were only thought to fix current legal issues, and not to avert the effects of the forthcoming shock.

1.3.1.2. GENERAL EXPECTATIONS AND CRITICISMS

If we go back in time, and place ourselves in Colombia in the 1980s, it would be possible to criticise the legislature and judiciary for not fixing certain legal deficiencies, provided that they had had the opportunity and the mechanisms to do so. Yet, this potential reproach, to be valid, should be based, among other elements, on the proactive behaviour⁵¹¹ that was expected from the passive subject of the critique. These expectations, in general, were grounded upon rational belief, where a person is expecting that something will, or will not, happen. However, there is no substantial relation between such rational belief and the real capacity and/or real interest of the active person with the expectation, even if aware of it, to finally achieve it. One may rationally expect that the best mathematician in the world could solve the hardest mathematical problem, but that does not mean he is aware that the passive subject of the expectation is in fact expecting such results from him; does not necessarily mean that he has an interest in solving it – unless there is a previous binding agreement –; and does not mean that he has the capacity to solve it.

⁵¹⁰ Within the 9th National Symposium of the Colombian Association of Insurance Law (ACOLDESE) (Pereira-Colombia, 1983, Skandia) the main subject was “Performance Insurance”. The memories of this national symposium denote the dominant position of the unsolved issues concerning such a financial instrument.

⁵¹¹ In this Colombian case, the author refers to “proactive behaviour” where the judiciary and legislature are expected to alter the current situation – to break the *status quo*. On the other hand, by “neutral behaviour” he means to maintain the *status quo*, i.e. doing nothing and leaving it in the same situation. None of them (proactive or neutral behaviours) is reproachable by themselves; the reproach depends on the particular expectations. Thus if the expectations were to do something, the reproach would arise when nothing is done (neutral behaviour), and if the expectations were not to do anything, the reproach would arise if the *status quo* is broken.

The expectation does not necessarily contain a previous, general, social, or particular, agreement between the subject that is expected to do something and the subject that is expecting such a thing from the former; though there may be a previous covenant, as in the case of a moral or legal contract.⁵¹² A previous agreement would not only create the expectation, but would also inform a person expressly that there is an expectation on his shoulders. Nevertheless, it is also possible to have expectations over a subject that we have not even met; and, in addition, the latter may not even know of our existence, by which it is clear that he would not be aware of what is expected of him. In the latter case, the expectation would be valid as well because it is not grounded in an agreement or on the weight he has on his shoulders, but on the rational belief of the expecting party; therefore if the active subject of the expectation does not fulfil it, given that he was not aware of it, he may equally be the object of grounded criticisms.

Furthermore, assuming that the active subject of the expectation is aware of such weight, he still may not have a real interest in satisfying the expectation, or, perhaps, he lost interest; yet, the expectation will exist and reproaches will be valid as well, if he does not fulfil the former. What creates a valid expectation is normally outside the scope of the aforementioned subject because he may not have agreed to satisfy something, and therefore he cannot be compelled to. Expectations are part of human and natural relations, and arise in any scenario: for example, in legal, political, or economic situations, but also in ecological, familiar, or sports matters, amongst many others. In the case of the best physicist of the world, society may be expecting from him that he discovers the time machine, or that he proves in a level of certainty the existence or inexistence of God, mathematically. However, he may prefer to research about other matters, such as telecommunications in times of war; still the expectations of him would be valid. What the author is trying to say is that the interests of the active subject of the expectation are not relevant to determine the existence and validity of an expectation.

⁵¹² Expectations arise even in cases of illegal or merely immoral agreements: for example, the mastermind of crime has a valid expectation of the perpetrator who was expected to commit the crime, and the latter may have an expectation related to payment.

Nevertheless, expectations produce either satisfaction when they are fulfilled or frustration when they are not. The former feeling is one possible end for that particular expectation although it could lead to praise, or, at a maximum, to the creation of further expectations. The latter feeling, however, may be the other end of the expectation, which can also lead to resignation and criticism, both being purely subjective; but frustration can also be the departing line to seek satisfaction by persuading or compelling the active party of the expectation, trying to achieve satisfaction in the end. For example, if the aforementioned physicist causes frustration, society may criticise him for not fulfilling such expectation, and may try to persuade him, but society cannot force him; yet, reproaches may fall upon him in spite, as mentioned before, of expectations being outside the scope of the physicist, as he, or what he represents, did nothing to create the expectation.

Conversely, if there is a previous, particular or general, legal agreement, the expectation will not be alien to the active subject of the expectation, given that his will played an active role in the creation of the expectation. Yet, in both cases, with or without an agreement, the expectation will be valid, the lack of interest of the active subject will be irrelevant with regard to the creation of the expectation, and reproaches may arise if the expectation is not satisfied. The difference is that in the second case, the lack of interest can be neutralised, not only by means of persuasion, but also by the compelling mechanism that comes with the relevant type of agreement; besides, the reproach may also take the form of sanctions, according to the relevant general or particular agreement. Provided that it is pursuant to constitutional rights,⁵¹³ the aforementioned mechanism may force the performance of such expectation, even if he is not interested, avoiding resignation and total frustration⁵¹⁴ since the expectation will have entered into the particular world of obligations and duties. Obligations and duties are upgraded expectations,

⁵¹³ “Forcing another” to do something to satisfy the expectation should be understood in this study’s context as the capacity to obtain such a result by constitutional, legal, or even moral, means. In this context the author is not referring to those scenarios where undue force (in legal or moral terms) or deceit, among other reproachable means, are used to obtain said result.

⁵¹⁴ This is just an ideal and theoretical scenario because, as an example, the legal right to compel the other contractual party to perform his obligation does not necessarily mean that he will effectively do so, i.e. in real life, the debtor may not have the money to pay, in spite of his honest intention to satisfy said obligation.

and they only represent a minute part of the general world of expectations that includes every single expectation that arises within human or natural relations.

Even if the active subject is aware of the expectation, and has an interest in satisfying it, it may be later demonstrated that he did not have the real capacity⁵¹⁵ to satisfy it, or that he lost it. The rational belief of the passive subject could have indicated himself that the active party had the capacity to fulfil said expectation at the moment of its creation based on certain information (e.g. he is known to be the best mathematician in the world); otherwise there would not be a valid expectation based on the said rational belief. However, that does not mean that the active subject has the real capacity to satisfy the expectation; he may only have an apparent capacity. By “apparent” the author means that the passive part of the expectation may rationally believe that the active part of the expectation had such a capacity, in spite of the latter being aware that he did not have such an ability. It also means that the passive part may believe that the active part did have such a capacity, and the latter may also believe he has the capacity to satisfy the other’s expectation, but at the end both realise that the active part did not have a real capacity given that he was not able to satisfy such expectation. Such a scenario, not having real capacity, does not affect the creation of a valid expectation, although it may lead to frustration and therefore to a reproach. Notwithstanding the feeling of frustration, the respective reproach, if any, which is a subjective judgement, may be less severe in this case, given the continuing interest in satisfying such expectation, or given a non-imputable impossibility to do so; this may also occur when he is not aware he has an expectation on his shoulders. Yet, not the same concession should be made when the active subject has had an active role in the creation of the expectation, as in the case of a previous, particular or general, agreement.

Additionally, it could be said that the expectation was fulfilled in so far as the hypothetical mathematician tried to solve a mathematical problem. That,

⁵¹⁵ “Capacity”, in this context, implies, among others, economic, legal, intellectual, technological, natural or physical capacity – which includes freedom to perform such expectation, as there are people that are sent to war, or are arrested or abducted, and therefore they cannot satisfy what the other subject is expecting from them.

however, would refer to a different expectation; in this case the mathematician had satisfied it if the expectations were “attempting to solve it”, and not to “solve it” effectively, which has a similarity to what the French scholar R. Demogue called “*obligation de moyen et obligation de résultat*”. Thus, if the expectation is to solve the problem, and he diligently tries but fails, the expectation would not be satisfied. The list of types of expectation could be endless. For instance, there could also be an expectation about the way something should be done, and not only over the result. A clear example of this last expectation is commonly seen with regard to the way a political party creates jobs, or the way it diminishes poverty, or the way it stimulates the economy’s growth (assuming all parties want the same result), i.e. if it is better to use demand-side economics, supply-side economics, “the third way”, or perhaps the way of a “social market economy”.

1.3.1.3. THE COLOMBIAN EXPECTATION OF PERFORMANCE BONDS

Then, criticising both the Colombian legislature and judiciary for the existing issues of these financial instruments by the end of the 1980s deserves two different analyses. Thus, before studying those particular legal issues, it is necessary to evaluate what the relevant part of society was expecting from legislators and judges.

By the end of the 1980s the Colombian legislature had the facultative authority to make, interpret, reform, and abolish the laws of the Republic when needed, according to the former Colombian Constitution.⁵¹⁶ Those were the traditional expectations falling on the shoulders of legislators, and they had satisfied such expectations, at least with regard to these financial instruments. As explained in the first chapter, legislators (primary and delegated) noticed the surpassing importance of “producing new legislation” to regulate this new market of commercial “bonds”, and then the need to “reform” it once it is produced. They had produced the Civil Code, Act 45 of 1923; then they produced Act 105 of 1927, and later Act 225 of 1938, and so on until the Commercial Code, Act 19 of 1982, and Decree 222 of 1983.

⁵¹⁶ Article 76 of the former Colombian Constitution of 1886, substituted by the current Political Constitution of 1991.

However, by that time there was no national or supra-national legal mandate implying an expectation related to the effectiveness or resilience of all laws produced by primary or delegated legislators. That does not mean that the notion and importance of the “effectiveness of the law” would not be known by the aforementioned characters, as scholars in law had treated such notions for more than a century; it means that they were not constitutionally or statutorily expected to achieve sufficient effectiveness. In that sense, there was a “modern expectation” without any agreement expected only from a small but representative part of society (scholars), but with regard to the initial effectiveness, and not regarding the effectiveness of laws at all times. Additionally, since this “expectation” was not part of the world of duties and obligations, legislators could not be legally forced to satisfy it, nor be subject to legal sanctions.

As mentioned in the introduction of the fourth chapter, the notion of effectiveness of the law contains two elements: a) the objective element that analyses whether or not the law is designed to achieve the specific purpose, depending also on whether they have a preventive, curative, or facultative function; and b) the subjective element that studies whether or not the law was properly communicated to its addressees and if they accepted and complied with it. Thus, to admit that a law is effective it must have both elements. In that sense, partial effectiveness means partial satisfaction of such expectation due to the absence of one of these elements. Also, partial satisfaction is no less than a breach of the comprehensive expectation which may lead to frustration, and the consequent reproach.

In addition, a law is normally a set of several legal rules, and some of those rules may, and probably will, have more relevancy than others of the same law with regard to the purpose for which the latter was designed. For example, when referring to a certain contract, *essentialia negotii*, and even *naturalia negotii*, play a more important role than *accidentalia negotii*.⁵¹⁷ It should not be expected that all the rules within a law were properly designed and then admit that such law is properly designed to achieve a purpose. If

⁵¹⁷ The author believes that “*essentialia*” is more important than “*accidentalia*”, not in the sense that the former outranks the latter, but within the idea that, if the parties want to use a specific contract, “*essentialia*” must be used whereas “*accidentalia*” can be used.

one or more legal rules in a law were designed in such a way that they do not help to achieve, or affect, the projected purpose, and the rest of legal rules are properly designed, it is not so easy to ask whether or not the objective element of effectiveness is present. Thus, unlike in the previous paragraph, in this case obtaining only a partial result could not be understood, necessarily, as a failure, i.e. it depends on the relevancy of the norms that are properly designed, and the relevancy of those that are not. If the former seems more relevant than the latter, it could lead to a partial reform of the law or re-interpretation of the particular rule, but admitting that the law is effective, provided that the subjective element of effectiveness is also present.

Thus, in the Colombian case, scholars, as representatives of society, created the expectation of producing effective laws over legislators. However, despite Colombian legislators not being legally bound by a general agreement, the laws of performance bonds they produced before 1992 – the time of the first shock – were initially effective, producing satisfaction and avoiding reproaches in this sense. Firstly, those laws were effective because, as seen below, the rules that were not properly designed were not as many, or as relevant as those that were correctly designed to provide sufficient protection to the addressees of these bonds (objective element). Secondly, they were considered effective because society, after being communicated with about the existence of those laws, accepted and complied with them (subjective element).⁵¹⁸

As indicated above, the effectiveness of the Colombian laws of “performance bonds” could be jeopardised by legal and practical issues existing within the scope of the two available securities that existed before 1990: a) the “performance insurance”, and b) the contract of guarantee, in the strict sense – *la fianza*.

1.3.2. EFFECTIVENESS OF PERFORMANCE BONDS BEFORE THE 1992

⁵¹⁸ With regard to those Colombian Financial instruments, the proof of the presence of the subjective element of the notion of effectiveness is that, even when the market was not skyrocketing, the demand of those “bonds” was always growing, as shown in Chapter Two of this research.

1.3.2.1. “PERFORMANCE INSURANCE”: THE LEADING COLOMBIAN INSTRUMENT

On the one hand, the notion of “performance insurance” was, by then, in the middle of the discussion regarding its legal nature, i.e. whether it was an insurance policy or a “*fianza*” (equivalent to the contract of guarantee in the strict sense). A similar discussion to the one England had gone on for many years. The Colombian Supreme Court had stated since 1983,⁵¹⁹ in spite of the wording of Decree 222 of 1983, that they were two different instruments, where “performance insurances” were insurances and not bonds, but had never solved the consequential issues of such affirmation. Based on the latter judicial statement, applicable rules were those related to the insurance contract.

Some authors at the IX National Conference of Acoldece (Colombian Association of Insurances) believed that the majority of the legislative issues concerning “performance insurances”, if seen individually, do not constitute an insurmountable obstacle for the operability of this instrument; yet, in conjunction, the nature of this instrument can be distorted.⁵²⁰ As mentioned throughout this research, the notion of effectiveness of the law is not absolute in any sense, where the law is perfect and accepted by everyone, or vice versa. For that reason the author believes that:

Regarding the aforementioned “modern expectation” of legislators to produce laws that were initially effective, and despite the fact that they could neither be forced to do so nor sanctioned in case of failure, legislators, consciously or unconsciously, satisfied such expectation in relation to “performance insurances”. Thus, before 1992 the laws regulating the latter financial instrument were sufficiently effective, but not perfect. Indeed, this sufficient effectiveness lasted for several years, although it was progressively diminishing as a result not of the objective element of effectiveness, but as a consequence of the subjective element as seen below.

In addition, as seen in this section, Colombian judges have had the capacity, by interpretative means, to guide the legal operability of this financial

⁵¹⁹ Colombian Supreme Court of Justice: (Civil Section, Decision of March 15th 1983).

⁵²⁰ Intervention by Bernardo Botero and Carlos Dario Borrero, Capitulo de Bogotá, *Memoria del IX Encuentro Nacional: El Seguro de Cumplimiento*, p.170-185, Acoldece, Skandia, 1983.

instrument by affirming that the aforementioned financial instrument was not a contract of guarantee, but an insurance policy. Although it will be treated in depth later on, given that it occurred after the shock, judges have had, also by interpretative means, the capacity to curb the applicability of some of the aforementioned problematic legal rules, but only with regard to such instrument. The latter judicial intervention, to some extent, improved the operability of the “performance bonds”, because the instrument was achieving its purpose in a better sense without those norms. Thus, what the author is trying to affirm is that the technical and legal operability of said instrument is strongly related to the “objective element of the notion of effectiveness of the law”. Therefore, in addition to what was stated in the previous chapter,⁵²¹ it seems clear that there is a link between “judges” and “effectiveness of the law” with regard to this instrument.

Before 1992, the laws of “performance insurances”, in terms of effectiveness, were not perfect laws, despite being sufficiently effective. However, judges could have increased their level of effectiveness, based on the aforementioned link. They had the capacity, to some extent, to satisfy a hypothetical expectation related to the quality of the objective element of the notion of effectiveness, as they did after 1992 by means of statutory interpretation. The capacity of judges to satisfy such hypothetical expectation was not full, given that, as mentioned before, it was the same insurance industry, as an addressee of those laws, the one that obstructed for commercial convenience the interpretative role of judges. Practically, in all “performance insurance” issued before 1992 insurance companies could have alleged that such financial instrument was legally inexistent to be discharged because one essential element of the insurance contract was missing – risk –, as one of the issues mentioned above. Yet, there was a tacit consensus within this industry to avoid such argument⁵²² given that a judicial analysis could have led to Courts deciding that this instrument was not an insurance policy. That conclusion would have marked the end of the insurance industry in securing

⁵²¹ Chapter 4, Section 5.

⁵²² There was another tacit consensus within the insurance industry about not alleging to use the defensive argument that economic penalty clauses could not be agreed by law, as mentioned above, because if the contract did require such a clause, the only option for the principal parties was to secure the contract with a “*fianza*” issued by banks, and not with a “performance insurance”.

the due performance of contracts because, unlike in England, Colombian insurance companies were not, and still are not, allowed to issue anything but insurance policies. Nonetheless, Courts were not totally tied to the arguments provided by the lawyers representing the insurance companies. In certain cases, such as the inexistence of a contract for the absence of an essential element, the judge, does not depend on the arguments exposed by the parties to grant a solution; therefore his decision would never be *extra petita* or *ultra petita*. Thus, following the same example of “risk” as an essential element, Colombian judges had the capacity to work, by interpretative means, on those legal rules to attempt to provide a more effective instrument.

In spite of the aforementioned capacity of Courts to satisfy a hypothetical expectation related to the effectiveness of the laws that reached them, the reality is that such expectation was never created. There was no constitutional or legal expectation falling upon judges requiring them to deal with the effectiveness of those laws. Besides, representatives of society were not only not expecting judges to deal with the effectiveness of the norms that regulate the “performance bond”, but, in some cases as those given above, they were curbing the idea of improving the objective element of effectiveness, for commercial convenience. Accordingly, courts did almost nothing before 1992 to protect the effectiveness of the aforesaid laws.⁵²³ The only relevant decisions they provided to deal with the objective element of the effectiveness of the laws of performance insurances were the Decision of March 15th 1983,⁵²⁴ and the Decision of November 4th 1988.⁵²⁵ The former Decision, as mentioned above, stated that “performance insurances” were insurances and not “*fianzas*” (equivalent to the English contract of guarantee, in the strict sense); and, therefore, confirmed that the set of legal rules applicable to this financial instrument was the one established in Title V of the Commercial Code, referring to the Insurance Contract; however, it did

⁵²³ Apart from the judicial decision cited below (which did nothing very substantial to protect the effectiveness of the laws on performance bonds), in Colombia there was no further decision protecting, directly or indirectly, the level of effectiveness of those laws. See: *Jurisprudencia de Seguros, Corte Suprema de Justicia 1971-2000*, Tomo I, and; *Jurisprudencia de Seguros, Tomo II, Consejo de Estado 1971-2001 Corte Suprema de Justicia 2000-2001*, 1st Ed., Acoldece, Fasecolda, 2002.

⁵²⁴ Colombian Supreme Court of Justice: (Civil Section, Decision of March 15th 1983).

⁵²⁵ Colombian Council of State: (Fourth Section, Decision of November 4th 1988, ref:1565, Speaker: Consuelo Sarria Oleos).

not solve the resulting issues of such affirmation which were mentioned previously. The latter Decision, despite accepting that said instrument had the legal nature of an insurance contract, excluded, only with regard to this instrument, the application of certain legal rules that were designed specifically for the insurance contract. Firstly, it affirmed that whenever there is a public law contract involved, the occurrence of the loss is not the one that applies to the rest of insurances, but the moment of the executability of the administrative decision that declares both the insured loss and the demandability of the guarantee. Secondly, it also stated that, with regard to public law contracts, Article 1053 of the Commercial Code⁵²⁶ – referring to the enforceability of the insurer's obligations – was not applicable either because the enforceability depended on administrative decisions, not on the general requirements for the rest of the insurances provided in said article.

Despite the latter Decision only referring to the inapplicability of two legal rules that were not very relevant or essential for the operability of this instrument, it was fundamental in terms of the effectiveness of this financial instrument. This decision marked the start of a judicial tendency to declare, while interpreting, the inapplicability of certain general legal rules that were affecting the correct operability of the instrument. In other words, it was the first step to legislate negatively in order to make this instrument more effective, but the Decision, by itself, did not increase significantly the level of effectiveness of the norms related to “performance insurances”. In that sense, and based on the apparent lack of interest of judges, it was fortunate for the addressees of such laws that those norms were already sufficiently effective and did not depend on the activity of judges to attain results.

In England, however, all the issues already described related to the Colombian performance insurance could not have existed by the last quarter

⁵²⁶ Article 1053 of the C.C.C. states: “The insurance policy, by itself, will be enforceable against the insurer in the following cases: [...] 3. Once one month has elapsed after the day in which the insured or the beneficiary, or their representative, claims against the insurer with the supportive documents that, based on the relevant policy, are indispensable to prove the requirements set in Article 1077 [of the same code], when such claim is rejected without a serious justification. If the claim is not rejected the plaintiff should state such circumstance in the lawsuit.” (Article 1077, burden of proof, states: “the insured will have to prove both the occurrence of the loss and the amount of the loss, if needed. The insurer will have to prove the facts and circumstances that discharge its liability.)

of the 20th century. In English law, as in American law,⁵²⁷ it was already clear by then that performance bonds was not insurance, something that Colombian legislators and judges have never believed.⁵²⁸ Given that “performance insurance” is a contract of indemnity (*sensu lato*),⁵²⁹ and that the English “contract of indemnity” is also a “contract of indemnity” (*sensu lato*), it could be said that they both operated similarly, and could possibly have some of the same issues; therefore, they would be equally effective or ineffective. Nevertheless, such assumption is too simplistic and cannot be accepted, given that the issues with the Colombian “performance insurance”, with regard to the objective element of the notion of effectiveness, referred to the particular legal rules that governed the Colombian contract, and not to the purpose the instrument pursues. The purpose of the “contract of indemnity” is similar to the one of “performance insurances”, but the rules and consequent operability are a different matter.

The general purpose of the English contract of indemnity, like the general purpose for any other securing bond in any of the jurisdictions cited herein,⁵³⁰ is to protect the underlying creditor, which is completely different from the legal rules that are designed to achieve such a purpose. The purpose of the latter instruments could be accepted or rejected by the relevant society, as in the case of the prohibition of alcoholic beverages in the United States of America between 1920 and 1933,⁵³¹ meaning that the purpose is related to the subjective element rather than to the objective element of the effectiveness of the law. However, the legal rules that try to achieve such a purpose, which

⁵²⁷ Cross, J. Harry: *Suretyship is not Insurance*, 30 Ins. Counsel J. 235, 1963.

⁵²⁸ As said earlier, Colombian legislators and judges differentiated bonds from insurance before 1992, but have always believed that the instrument that can be issued by insurance companies to secure the due performance of a contract is an insurance policy and not a contract of guarantee; whereas the instrument issued by banks with the same purpose is a contract of guarantee. In other words, they have differentiated these two instruments based on an organic factor.

⁵²⁹ It is important to remember the term “contract of indemnity” has two meanings that tend to be confused: 1) contract of indemnity as a generic classification of contracts for the indemnification of the beneficiary by the indemnifier as a result of a loss; the contract of insurance is one of several species that can be understood as a contract of indemnity (*sensu lato*). 2) “Contract of indemnity” can also be regarded as a specific contract designed to secure the due performance of contracts, as mentioned in the General Introduction of this Research.

⁵³⁰ Such affirmation includes those securing bonds that were created after 1992.

⁵³¹ Report on the Enforcement of the Prohibition Laws of the United States, National Commission on Law Observance and Enforcement, (The Wickersham Commission Report on Alcohol Prohibition), January 7, 1931.

normally vary from one jurisdiction to another, are related both to the objective and subjective elements of the aforementioned notion. The rules may not achieve such a purpose (issues within the objective element) and/or the rules may not be accepted and complied with by society (issues related to the subjective element).

As mentioned in Chapter 1, it was the same English society, and the changes within it, that created the necessity for a financial instrument that could protect the underlying creditor whenever he had to enter into a contract; and the legislative power met those demands.⁵³² Therefore, the purpose of the laws of securing bonds not only was accepted, it was required, given its socio-economic importance.⁵³³ However, for having an accepted function does not mean that the English contract of indemnity, or the rest of the instruments with a similar function, will have legal rules properly designed and accepted by society.

Yet, as occurs with the Colombian “performance insurance”, the English contract of indemnity may have some issues within its particular legal rules,⁵³⁴ but those misguided legal rules⁵³⁵ may not be as relevant as those that are properly designed, and as result the operability of the instrument should not be seriously affected, hence protecting the creditor. Both types of legal rules (misguided and proper legal rules) within a particular contract can be rejected by society even without justification. However, as explained before, if society rejects one simple legal rule within a whole Act, for example, it is unlikely that the latter could be considered as ineffective through such a small rejection; but it could happen depending on the relevancy of such a particular legal rule. Weighting the importance of the misguided legal rules, and balancing the misguided legal rules against the legal rules that are

⁵³² Chapter 1, Section 2.

⁵³³ In the Colombian case the function was also accepted, but not required: the events occurred in a different order: Act 225 of 1938 was enacted and communicated to society, and then the function was accepted. See Chapter 1, Section 1.

⁵³⁴ Gallagher, Edward: *Remedies Available Under Indemnity Agreements*, p.61, Ins. Counsel J., Vol. 28, No. 1, January, 1961; Condon, James M.: *Practice and Procedure Under the Indemnity Agreement – What are available remedies and how and when should they be exercised? Part 1: The Collateral Provision and Other Improvements in the Indemnity Agreement*, p.177-182, 1971, A.B.A. Sec. Ins. Negl. & Comp. L. Proc. 177, 1971.

⁵³⁵ By “misguided legal rules” the author is referring to those that are not properly designed to achieve the expected purpose of the law.

properly designed for the purpose of the law is a human analysis not grounded in mathematical formulae. Thus, establishing at the end whether or not the law is ineffective, based on the objective element of the notion of effectiveness, is also a subjective matter.

In accordance with the previous paragraphs and the irrelevancy of its own legal issues with regard to adequate operability of the instrument, the author strongly believes that the law of the English contract of indemnity, seen as a union of all those rules, was properly designed to achieve the purpose that was intended.⁵³⁶ Apart from this, the only thing that could have affected the level of effectiveness of such a contract before 1992 would be related to the subjective element of effectiveness, i.e. whether that law is accepted and complied with by society. However, it seems undeniable that, at least by 1992, the law regulating the latter contract was massively accepted⁵³⁷ by English society,⁵³⁸ in spite of some merchants, or companies, that used to demand a “contract of guarantee”. Consequently, the author is convinced that the legal regime regulating the English contract of indemnity was more than sufficiently effective by that year. If Colombia had followed the English route, differentiating bonds from insurances, the Colombian “performance insurance” would have disappeared before 1992. Therefore, the laws of a substituting instrument that could protect the underlying creditor would not be as exposed as those of “performance insurances” against the politico-economic changes mentioned herein.

Colombian legislators and judges not only disregarded the differentiation between bonds and insurances made in many Western countries during the second half of the 20th century. They also overlooked that the politico-economic changes that were going to be provoked in the 1990s by the

⁵³⁶ This conclusion can be extended to the English contract of guarantee.

⁵³⁷ The level of acceptance of this instrument has been progressively diminished in recent years as a result of the creation of new financial instruments, as mentioned later in this chapter.

⁵³⁸ Lloyd, William H.; *Surety*, p.58, 66 U. Pa. L. Rev. 40, 1917-1918; Haas, Theodore H: *The Corporate Surety and Public Construction Bonds*, 25 Geo. Wash. L. Rev. 206, 1956-1957; Newman, Paul: *Bonds, Guarantees and Performance Security in the Construction Industry*, p.108-109-110, Jordans, 1999; O'Donovan and Phillips: *Op.Cit.*, p.799. See Chapter 1, Section 2, referring to corporate sureties.

government had already occurred by the 1980s in England.⁵³⁹ But not only legislators and judges did not notice a potential forthcoming shock; what have been called in this research “resilience-provokers”⁵⁴⁰ did not realise that those changes would have an effect on the laws of a financial instrument that was already weak in terms of effectiveness, given the existing issues within its normativeness.

It could be assumed⁵⁴¹ that the English change in the 1980s could have caused a general effect within the English market of performance bonds, and that the laws of performance bonds suffered a shock as result of that change.⁵⁴² It could also be assumed that as a result of such provoked changes no legal prevention was undertaken by English judges who were, and still are, mainly responsible for the laws of performance bonds, given that the latter have evolved when developing the common law. Now, even considering all these assumptions, the author believes that the laws of both the English contract of indemnity and the English contract of guarantee were not as exposed to a progressive ineffectiveness as the laws of the Colombian instruments. This can be inferred based on the idea that, although those English instruments had certain legal issues, those issues were not as many, as relevant, and as reproached by scholars, as those related to the Colombian “performance insurance”. In other words, the author is suggesting that the latter instrument is weaker than the English contract of indemnity, and even than the English contract of guarantee, in terms of resilience.

1.3.2.2. “FIANZA” (CONTRACT OF GUARANTEE)

As mentioned above, the other available financial instrument in Colombia before 1992 was the “*fianza*” (contract of guarantee, in the strict sense). This Colombian ancillary security has been questioned for several reasons;⁵⁴³

⁵³⁹ As mentioned in Chapter 2, Section 1, with the so-called “conservative revolution” that took place in the United Kingdom.

⁵⁴⁰ See Chapter 4, Section 6.

⁵⁴¹ The lack of figures with regard to English bonds during those years prevented the author from establishing whether those changes caused a resulting shock.

⁵⁴² This would have to be assumed because, within the context of resilience, without the shock it would be irrelevant to study the rest as the notion of “shock” is the *condition sine qua non* of the resilience of the law.

⁵⁴³ Perhaps the best known problem with *fianza* refers to the inner relation between guarantor and principal debtors once the former has assumed the debtor’s obligation. See: Vitale, Maria Elena: *Contratos de Garantía: Fianza*, p.76-77, Trabajos del Centro N.3, 1998. Some of the issues

however, from the author's point of view, none of them truly challenges the correct operability of this instrument. The author strongly believes that, despite this Colombian version of the contract of guarantee having certain problems with some of its particular legal rules, those rules were far from being as relevant as those that allow the proper functioning of the instrument. For example, treating the commercial contract of *fianza* not as a multilateral agreement that includes the principal debtor, but as a bilateral contract only between the principal creditor and the guarantor, could be reproachable. As mentioned in chapter three, in order to sustain the latter argument, some authors have argued that the principal debtor is not part of this contract of *fianza* because the relation between him and the guarantor is rather based upon a contract of mandate.⁵⁴⁴ As in the case of the English contract of guarantee – properly called – which is the *fianza*'s English legal equivalent, the debtor should be a party to this ancillary guarantee forming a multilateral agreement that not only protects the creditor, but an agreement that at the same time regulates the relationship between debtor and guarantor. Otherwise, either the effects of the *fianza* could not positively or negatively affect the debtor, or the doctrine of privity of contracts would be openly ignored.

Although serious issues such as the one above needs to be legislatively or judicially clarified, from the author's point of view and within the context of this research, the most important matter is how the problems that could arise from the rules that establish the structure of the parties to the contract of *fianza* would not affect the purpose of the instrument, given that the beneficiary would still be protected by the instrument. Therefore, the issues referring to the objective element of the effectiveness of the laws that regulate the *fianza* do not have the potential to disturb its effectiveness when seen as a whole.

caused within the inner relation after the payment are based on the lack of clarity of the legal nature since the link between guarantor and debtor may derive from the rules of the contract of *fianza*, but also from the rules of the contract of mandate, as explained in Chapter 3, Section 1A. To analyse more problems with regard to the *fianza*, see: Ramirez Valderrama, Ricardo and McAllister Harker, Thomas: *Contrato de Fianza*, Universidad de la Sabana, 2013.

⁵⁴⁴ Ordoñez, op.Cit.: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, p. 21 and 78.

The contract of *fianza* or the English contract of guarantee – in the strict sense – unlike “performance insurance”, are ancient instruments that have been legally polished throughout many centuries as a result of the private legal traffic. Indeed, in the Colombian case its regulation is provided by the Civil Code whereas the one for performance insurances is mainly given by the Commercial Code which is much younger than the former. The *fianza* started to be implemented by the financial system in the 20th century, but not as a different instrument; the reason for this is that the development of the legal nature of this financial instrument is the same as for the private *fianza*. Thus, the regulation that establishes the operability of the financial *fianza* was properly designed to achieve its main purpose which is securing another's obligation in an ancillary manner.

Nevertheless, regarding the laws that discipline the latter instrument – *fianza*- the problems were apparently raised in relation to the subjective element of the notion of effectiveness of the law, and not with regard to its objective element. The contract of *fianza* even before 1992 has been a misunderstood instrument, given the issues in its legal rules, i.e. whether it was a bilateral, multilateral or unilateral agreement, or whether there was a mandate involved, or, given its ancillary condition,⁵⁴⁵ any other reasons.⁵⁴⁶ Therefore, despite the fact that these issues should not affect, at least in theory, the proper nature and operability of this instrument, society, particularly within a banking context, does not strongly believe in its soundness or in the effective protection it could offer.⁵⁴⁷ Besides, as the financial *fianza* was issued by banks it was also confused by creditors and debtors with another bank “guarantee” (*sensu lato*) called “*aval bancario*”, which was legally designed to only guarantee the due payment of security

⁵⁴⁵ Colombian Supreme Court of Justice, S.N.G. 25 de septiembre 1935, G.J. N. 1901, p.580; Gomez-Blanes, Pablo: *El Principio de Accesoriedad de la Fianza*, p.991-993, Ed. Thonsom-Aranzadi, Pamplona, 2008, AFDUDC, 13, 2009

⁵⁴⁶ There are more reasons why the *fianza* is misunderstood, such as the insecure relation between the guarantor and the principal debtor, and in particular the way subrogation operates. To analyse deeper this situation, see: Colombian Supreme Court of Justice, Casación, 26 de noviembre 1935, G.J. N. 1,907, p.393, or; Colombian Supreme Court of Justice, Casación, 27 de septiembre 1943, G. J. N. 2.001, p.163.

⁵⁴⁷ Ramirez Valderrama, Ricardo and, McAllister Harker, Thomas: *Contrato de Fianza*, p. 63-64, Universidad De La Sabana, 2013.

certificates. The *aval* has had a regulation⁵⁴⁸ that for obvious structural reasons – it is aimed at another purpose – does not protect the underlying creditor properly, which aggravated the lack of confidence in the banking guarantees that existed before 1992.

In the financial practice, principal debtors and principal creditors have always preferred other available instruments, although before 1992 the only remaining option was the performance insurance. In fact, despite the legal faculty given to principal debtors to choose between one instrument and another, before 1992,⁵⁴⁹ even public entities, in their role of creditor, tended, and still tend, to request only performance insurances from the principal debtor within the plan and specifications sheet; hence, it may be inferred that public bodies also believed that the latter provides a better financial protection than the *fianza*.

Although banks have never publicised the *fianza* within the financial context and society did not have a deep trust in it for several reasons, it could be said that the ones that should be blamed for the poor use of the instrument were those who created the instrument, rather than those who marginalised it. Accordingly, in relation to the subjective element of the effectiveness of the law, it could also be said that Colombian law-makers were expected to persuade society about the benefits of such a financial instrument in order to avoid its ineffectiveness.

Nevertheless, the author believes that this lack of persuasion or poor use of *fianza* as a financial instrument has no direct relation to the notion of effectiveness of the law. What could be ineffective was the law that regulated the instrument, and not the use that was made of the instrument; in other words, the law that disciplined the *fianza* is the one that needed to be effective. The fact that the *fianza* – which was originally a civil instrument – was not largely used within the financial market is irrelevant for the notion of

⁵⁴⁸ C.C.C., Article 633 and followings.

⁵⁴⁹ Colombian Decree 222 of 1983, Article 70. In the author's opinion, the idea that public bodies predetermined the "bond" that will secure the due performance of the public law contract is based on a restrictive interpretation of the latter decree, and even of those decrees that modified it. The reason is that the legal articles that have listed the admissible instruments are addressed to the principal debtor (providing him with the facility to choose), not to the principal creditor.

effectiveness of the law because within a civil context it was the most common instrument before 1992, if not the only one. Therefore, it is possible to estimate that before the latter year the laws regulating the *fianza*, provided by the Colombian Civil Code, were sufficiently effective.

Acceptance and rejection of certain laws also vary as a result of changes. As seen later on, i.e. during the last decade, the English contract of guarantee – the equivalent of the *fianza* – has not been used as frequently as it was in the last quarter of the 20th century. By then, the contract of guarantee – in the strict sense – was, perhaps, the most common instrument within the English market of performance bonds; its laws were openly accepted not only at a domestic level, but also accepted and used to secure international contracts,⁵⁵⁰ and in both the civil and the financial practices. The law of the contract of guarantee, from the perspective of the subjective element of the notion of effectiveness, was not in danger during the 1990s.

It was not in danger, in spite of some issues that could have jeopardised the effectiveness of its laws, from the view of the subjective element of such notion. The English contract of guarantee, in the strict sense, has been a victim of the constant confusion between said instrument and the contract of indemnity.⁵⁵¹ This frequent confusion between those financial instruments could have affected the regularity in which it was demanded. This is based on the fact that the underlying counterparties may have doubted the legal nature of the instrument they were actually agreeing. This may be more relevant as a result of the type of liability that was agreed under the contract of guarantee, versus the type of liability that could be agreed under the other instrument that was part of the latter confusion. The first one was an ancillary liability, because for the contract of indemnity the liability was primary. Therefore, for an underlying creditor, and even for his underlying debtor, the contract of guarantee, given its ancillary liability, was not as trustworthy as expected. Besides, the undertaking could be framed, perhaps unconsciously, in such a

⁵⁵⁰ Barru, David J. "How to Guarantee Contractor Performance on International Construction Projects: Comparing Surety Bonds with Bank Guarantees and Standby Letters of Credit." *Geo. Wash. Int'l L. Rev.* 37 (2005);

⁵⁵¹ *Yeoman Credit Ltd. v. Latter* [1961] 1 W.L.R. 828 (C.A.); *Unity Finance Ltd. v. Woodstock* [1963] 2 All E.R. 270; *Western Credit Ltd v. Alberry*, [1964] 2 All E.R. 938 (C.A.); *Stadium Finance Co. v. Helen*, (1965), 109 Sol. Jo. 471 (C.A.).

way that it ceased to possess the characteristics of a guarantee,⁵⁵² turning, therefore, into another instrument. However, by the last quarter of the 20th century, the number of available financial instruments in the English market was not as extensive as it is today, it is unlikely that the contract of guarantee could have been marginalised by other instruments, hence guaranteeing its effectiveness.

Retaking the expectations mentioned for the first instrument, i.e. the performance insurance, it is clear that they were exactly the same for legislators and judges in relation to this second instrument, the *fianza*, in spite of the different issues related to the effectiveness of the laws of those instruments.

1.3.3. NO PREVENTION WITHIN THE NOTION OF RESILIENCE: AN ACCEPTED EXCUSE

After stating that the two available instruments had effective laws before the politico-economic shock that occurred in 1992, we need to ask ourselves if legislators and judges were expected to make those laws resilient against such shock. At that time not even a small part of society had created an expectation of legislators and judges to make resistant laws – within our context – against specific shocks. Therefore, it could be affirmed, *ab initio*, that society should not reproach them for not taking the expected measures to achieve resistance as the static element of the resilience of the law. It should be remembered that in order to have a resistant legal regime, legislators and judges (law-protectors) need to use the two dynamic elements of resilience, i.e. legal prevention to avoid future ineffectiveness as a result of a forthcoming shock, and recovery to recuperate from the ineffectiveness already caused by a shock. Since the Colombian laws regulating the two aforementioned instruments were effective before the shock of 1992 as already explained above, recovery would not be needed. As recovery, i.e. the first element of dynamic resilience, was not expected by then, it would not be logical to reproach legislators and judges if nobody created such a particular expectation in the first place.

⁵⁵² McGuinness, Op.cit, p.39. That author, however, made no difference between a conscious act and unconscious act.

On the other side, i.e. with regard to the second element of dynamic resilience (legal prevention against a future shock), it is difficult to establish whether or not this particular expectation was created by legislators and judges before 1992. It could be said that judges, in particular, were not expected to implement “legal prevention” through their decisions in order to make a law effective. It could also be said that the ethics of responsibility, legal consequentialism or legal finalism⁵⁵³ could have created an expectation of judges to produce decision which are not only based upon the legal rule, taking into consideration the effects that may arise from such decision. However, even if we accept that, and admit that there may be convergent points between those philosophical beliefs and “legal prevention” within the context of resilience, it does not mean that the judge will direct his decision towards having a “resistant” legal regime based on the aforementioned beliefs. Therefore, in our opinion, ethics of responsibility, consequentialism, or finalism do not create an expectation of judges in such a sense, and therefore we could not criticise them for not having “prevented” the potential ineffectiveness that could resulted as a consequence of the shock that occurred in 1992. And, so far, we have not found another possible argument that could have created the aforesaid expectation before 1992. At the end, the reality is that judges, in general, did not take any action to avoid the potential future ineffectiveness of any legal regime, and, in particular, they did nothing to prevent the forthcoming progressive ineffectiveness of the laws of performance bonds.

On the other hand, with regard to legislators, the expectation referring to “legal prevention” seems to have been created before 1992 based on social and economic matters, but not on legal arguments; thus, apparently, principal and delegated legislators attempted to satisfy such expectation. Before the implementation of the economic policies (supply-side economics)

⁵⁵³ Anscombe, Gertrude: *Modern moral philosophy. Philosophy*, p.1-16, Vol. 33, No. 124, 1958; Inciarte, F.: *Liberalismo y republicanismo: Reflexiones sobre la ética de la responsabilidad y la ética de la convicción*. Ensayos de filosofía política, p.162-167, Eunsa, Pamplona, 2001 Santiago Nino, Carlos: *Consecuencislmo: Debate Ético y Jurídico*, p.91, Revista Iberoamericana de Estudios Utilitaristas, Vol. 1, No 1. 1992; MacCormick, Neil: *On legal decisions and their consequences: From Dewey to Dworkin*. NYUL Rev. 58, 1983.

that were going to be imposed in Colombia since 1989⁵⁵⁴, it was understood that some preventative measures should be taken to mitigate the social and economic effects caused by those policies. For instance, in February of 1990 the “CONPES” Document⁵⁵⁵ No. 2465 was issued containing the chronogram, criteria and instruments needed to carry out the implementation of those macro-economic policies that put an end to a period of severe protectionism. Based on this document, certain measures were taken to maintain the philosophy of a gradual abolishment of the protection to the industry in order to permit the productive sector to adapt to the forthcoming changes and be able to guarantee both the sustainability of the process and conservation of a proper balance of payments.⁵⁵⁶ Accordingly, Decree 3095 of 1990, amongst many other decrees, established the year in which all upcoming tariff deductions were supposed to enter into force in order to make out of such neoliberal policies a progressive process that would avoid an industrial and economic crisis.⁵⁵⁷

It is possible to conclude that there was some sort of prevention by Colombian legislators, but that the prevention was not aimed at making resistant laws within the context of resilience; indeed, such prevention was not even related to the effectiveness of laws. Those preventive measures were designed to avoid economic traumas, and not to make the laws of performance bonds, or any other law, resistant to the shock that was going to start in 1992. However, it should be remembered that society did not impose such expectation of legislators before the latter year, and therefore it would be incoherent to bring about a reproach against them.

In that sense it may now be affirmed that, despite the Colombian laws of performance bonds being sufficiently effective before the moment of the first

⁵⁵⁴ Chapter 2, Section 2.1.

⁵⁵⁵ “CONPES” is the Spanish abbreviation for National Council for Economic and Social Policies (Consejo Nacional de Política Económica y Social), which is the National Planning Highest Authority, and works as a government consultant organisation in all matters related to economic and social development.

⁵⁵⁶ Londoño Rendón, Carlos Enrique: *La Apertura Económica en Colombia*, Rev. Pensamiento Humanista, N.4, Universidad Pontificia Bolivariana, 1998; Garay, Op.Cit, p.1

⁵⁵⁷ Ibid, p.1

shock in 1992, neither legislators nor judges used any “vehicle”⁵⁵⁸ to protect the laws of performance bonds from becoming ineffective as a result of such provoked politico-economic change. Yet, ineffectiveness as an effect of the shock, as mentioned repeatedly herein, is just a contingent or potential effect, given that not every shock will necessarily generate the ineffectiveness of a legal rule; but, if the expectation of legislators or judges had been created, the fact that this is a contingency would not have excused them from not preventing it.

Consequently, it seems that legal prevention against a forthcoming shock, as the second element of dynamic resilience, was not taken in Colombia with regard to the laws of performance bonds before 1992. Hence, it could also be concluded that legislators and judges, though not expected to do so, did not take any measures to make those laws statically resilient against the future, but anticipated, shock that was going to start in 1992 as a result of the aforementioned politico-economic changes. However, as mentioned in chapter four, the effectiveness of the law can be involuntarily reached, and the same could happen with regard to the resistance of those laws. Therefore, it should now be established whether or not those laws were involuntarily resistant against the shock that started in 1992, and if not, whether or not legislators and judges used the other element of dynamic resilience, i.e. recovery, in order to recuperate a minimum level of sufficient effectiveness.

2. THE ATTEMPTS TO RECOVER THE EFFECTIVENESS OF THE LAWS OF PERFORMANCE BONDS AFTER THE FIRST SHOCK

2.1. LEGAL REACTION TO A NEW POLITICO-ECONOMIC REALITY AFTER 1992

Under the interventionist state that existed before 1990, the volume of public law contracts was already high – and so was the demand for bonds, given that in developing countries they are mainly used to secure public law contracts,⁵⁵⁹ in particular those related to infrastructure.⁵⁶⁰ However, with

⁵⁵⁸ “Vehicle” within the context of the resilience of laws is explained throughout Chapter 4 of this research.

⁵⁵⁹ Public contracting has been turning into a more frequent economic activity in Colombia. For example in 2002 it reached an equivalent of 16% of GDP: See, Colombian Contracting Mission of

the implementation of the Colombian regulatory state in 1990, for the reasons mentioned in chapter two, the market of performance bonds was going to witness its first massive and uncontrolled increase in the demand for those bonds.⁵⁶¹ This dramatic growth in demand for performance bonds started in 1992 and lasted until 1994.

Thus, every securing contract that was executed by the time the aforementioned increase started was based on the laws that were mentioned above. The increase in the demand for bonds, as a result of the aforesaid politico-economic changes, enhanced the *pressure* on the laws of performance bonds, given that they had an impact on legal culture. With this growth in the demand for bonds, many legal issues that were completely tolerated before were no longer accepted in the same way by the addressees of the laws of performance bonds – not only with regard to performance bonds, but also the laws of public contracting which are, as stated earlier, the main raw materials of performance bonds in Colombia. In other words, the “subjective element” of the notion of the “effectiveness of the law” was progressively diminishing at the same time as the demand for bonds was progressively increasing. The economic and political realities changed and those laws were not up to the expected level within the new legal traffic, i.e. they were becoming obsolete in a rigid legal system – civil law – where the modernisation of laws is far more complicated than it is for common law systems.⁵⁶²

In spite of the stringency of the Colombian legal system, legislators realised that the laws for public contracting were in need of reform to update them as a consequence of the increase of public law contracts that resulted from the

2002, *Transparency for Colombia*. The latter is the Domestic Chapter of Transparency International which is the global civil society organisation leading the fight against corruption, founded in 1993.

⁵⁶⁰ Chapter 2, Section 2.1. See: Tarapore, S.S.: *Building From the Bottom: Infrastructure and Poverty alleviation*, Par.4, Sameer Kochhar, M. Ramachandran (Editors) New Delhi 2010.

⁵⁶¹ Chapter 2, Sections 1 and 2.

⁵⁶² This discussion should be treated in the future from the perspective of law and economics. See: Posner, Richard A.: *Economic Analysis of Law*, 1st ed, Little, Brown, 1973; Tullock, Gordon: *Two Kinds of Legal Efficiency*, p. 669, 8 Hofstra L. Rev. 659, 1979-1980; Posner, Eric: *Law, Economics and Inefficient Norms*, p.1699, 144 U. Pa. L. Rev. 1697 1995-1996 ; Rubin, Paul H.: *Micro and Macro Legal Efficiency: Supply and Demand*, Supreme Court Economic Review, Vol 13, p.15, The University of Chicago Press, 2005; Rubin, Paul H. *Common Law and Statute Law*, p. 207, 11 J. Legal Stud. 205, 1982.

implementation of the regulatory state.⁵⁶³ Therefore, they designed Act 80 of 1993⁵⁶⁴ to modernise the Public Contracting Regime.⁵⁶⁵ Amongst the provisions of this Act, legislators included a section referring to performance bonds for public law contracts,⁵⁶⁶ in order to modernise this related matter. Article 15.19 of the aforementioned Act stated:

“The contractor shall provide a comprehensive guarantee to secure the performance of the obligations of the contract [...].

The guarantees shall consist of insurance policies issued by insurance companies legally authorised to operate in Colombia, or banking guarantees. [...]”.

It is important not to forget that the predecessor of that Act, in terms of performance bonds for public law contracts, was Decree 222 of 1983 that stated: “Securities may consist of [conditional] guarantee bonds from insurance companies or banks [...]”.

2.1.1. INSURANCE POLICY TO SECURE CONTRACTS

With such a legal reform, the Colombian legislator made the first reference to “insurances” within a statute related to these securities; before this, the term “insurances” was only used in judicial decisions, such as those listed above.

That new Act tried to resolve the old Colombian discussion about the legal nature of those instruments issued by insurance companies, which, under Decree 222 of 1983, were considered to be guarantee bonds. This has special relevancy, given that insurance companies have never been able to issue anything different from an insurance policy.⁵⁶⁷ However, the result was

⁵⁶³ Chapter 2, Sections 1-2.

⁵⁶⁴ Official Diary No. 41.094, from the 28th of October 1993, whereby the General Statute for Public Administrative Contracting was issued.

⁵⁶⁵ Act 80 of 1993 was complemented by Decree 679 of 1994. Articles 17, 18 and 19 of the latter decree regulated the sufficiency, approval and enforceability of those instruments that could secure public law contracts.

⁵⁶⁶ Colombian Act 80 of 1993, Article 25.19.

⁵⁶⁷ The Organic Statute of the Financial Sector imposes a restriction on insurance companies, and they are only authorised to issue insurance policies. This restriction, from the author’s point of view, is senseless and generates a much larger problem than the one it tries to solve. The government, through the Banking Superintendence (now, the Financial Superintendence) was trying to protect the financial consumer by limiting the instruments issued by these companies, and making a previous revision of standardised policies. However, that restriction, in part, forced the market and influenced judicial decisions to turn those “guarantee bonds” –mentioned

completely the opposite and indeed that Act, in conjunction with the latter legal prohibition, guided all the posterior acts and decrees to use the word “insurance”. It was then clear that the instrument issued by Colombian insurance companies to secure the performance of contracts, in theory, was not a bond, but an insurance policy subjected to the general legal rules of insurances provided by the Commercial Code.

Countries, such as England, France or Spain,⁵⁶⁸ were always trying to enlarge the difference between bonds and insurances by excluding insurances from this form of business, although insurance companies were allowed to issue bonds, as well. In Colombia, however, the difference was marked by the financial company allowed to issue a specific instrument, i.e. banks could issue bonds whereas insurance companies could issue insurance policies; this difference also influenced the applicable legal regime. In other words, if this legislative position is compared with the English evolution of these instruments, it could be said that Colombian legislators were heading backwards. Thus, Colombian bonds and Colombian performance insurance had the same purpose: the protection of the contractual creditor; the only two differences were the type of company that could issue them, and the legal regime that governed them.

As mentioned before, the legal rules that govern performance bonds when securing public law contracts are slightly different from those that govern them when securing private agreements. For instance, with regard to the Colombian performance insurance, this instrument is mainly governed by the Commercial Code in public and private scenarios; nonetheless, there are some dissimilar legal rules. In public matters, for example, the will of the parties is more restricted; the insurer cannot be discharged in circumstances that would be useful if the underlying contract were private, covers cannot be freely decided by the parties, and there are some other comparable limitations.⁵⁶⁹ Besides, when securing a public law contract some other rules

in Decree 222 of 1983 – into “insurances”. Otherwise, insurance companies would have been excluded from this market since the promulgation of the preceding Organic Statute of the Financial Sector.

⁵⁶⁸ Ordoñez, Op.Cit.: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, p. 31

⁵⁶⁹ Some of those further limitations refer to the period of validity, the sum for every cover in order so it can be sufficient: Colombian State Council, Third Section (Decision of January 30th

are also applicable, such as the Public Contracting Regime – Act 80 of 1993, and the Administrative Code.⁵⁷⁰ Given the particularity of this instrument, there are some legal rules from the Commercial Code that were going to be excluded by judicial decisions provided by administrative judges when a public law contract was involved. As seen later, civil judges, with a few years delay, followed those judicial decisions set forth before. This is important because Act 80 of 1993 (which was a consequence of the implementation of the aforementioned politico-economic policies) by trying to modernise the laws of performance bonds for public law contracts, was also going to set the path for the laws of performance bonds for private contracts.

This legislative reform successfully modernised the laws for public contracting, but the tangential attempt to modernise the laws of the instruments that could secure those public law contract was not as prosperous. As mentioned in the previous section of this chapter, Colombian legislators were not expected to use legal reforms in order to make resilient laws. Therefore, they cannot be criticised for not structuring the reform in such a way that it could seek the latter end. However, it is clear that the aforementioned reform did not resolve the issues that were affecting the objective element of the effectiveness of the laws of performance bonds. The instrument issued by insurance companies was considered to be an insurance policy and, subsequently, all the legal issues stated above were not modified; indeed, they were confirmed by the legal affirmation that such instrument was an insurance contract. Before such affirmation, given by the Act 80 of 1993, the judges had a wider option to decide whether the instrument issued by insurance companies to secure contracts was an insurance policy or a bond. The only limitation to this was the aforementioned prohibition whereby these companies were not allowed to issue anything different from bonds. Decree 222 of 1983 used the expression “guarantee bonds”, and the judges were responsible for turning this into an insurance contract, as seen before; but they had the option to differentiate between bonds and

2008, Settlement number: 52001-23-31-000-2005-00512-01(32867), Counsellor Speaker: Mauricio Fajardo Gomez. Colombian State Council, Third Section (Decision of March 4th 2008, Settlement number: 25000-23-26-000-1999-02724-01(31120), Counsellor Speaker: Ramiro Saavedra Becerra.

⁵⁷⁰ Colombian Decree 1 of 1984, reformed by Act 1437 of 2011.

insurances in order to establish that such instruments were bonds and not insurances, as had occurred in England. Once the latter decree was modified by Act 80 of 1993, judges lost that faculty. Then, it seems as if legislators, through that Act and Decree 679 of 1994, decided the future of such instruments, and, therefore, judges had to adapt to that legislative decision. However, what really happened was completely the opposite: Colombian legislators in the 90s followed the judicial belief of the 80s.

Thus, with regard to “performance insurances” in that period, a reproach could not have been produced over Colombian legislators (even less so over judges) for not having analysed the past shocks, nor having verified that the reforms were not designed to make those laws statically resilient. Such a “new expectation” had not been created yet; therefore, they could not have generated a feeling of frustration in this sense. On the contrary, traditional expectations were already in the atmosphere and ineffectiveness could have led to a serious reproach. Nevertheless, such an instrument was still sufficiently effective in spite of its issues within the objective aspect of the notion of effectiveness for which they satisfied said expectation.

2.1.2. FIANZA: JOURNEY TO A LOWER LEVEL

On the other hand, Act 80 of 1993 replaced the term “*fianza*” (i.e. the banking guarantee bond) with the term “*garantía bancaria*” (banking guarantee). The term “banking guarantee”, since the latter Act was enacted, was considered to be a generic term for all sorts of guarantees (*sensu lato*) that could be issued by banks. As a result, it could be said that Act 80 of 1993 wanted to widen the scope of available “guarantees”, as explained earlier; however, in practical terms, nothing changed. The on-demand banking guarantee and stand-by credits, were not recognised by the Colombian legal system, and the *fianza* was, therefore, the only security permitted to secure public law contracts, at that time.

The effectiveness of the financial *fianza* (equivalent to the English contract of guarantee) was not threatened by the legal intrinsic elements. As said earlier, the main reason to question this instrument, within the context of effectiveness of the law, was that society was no longer using it as before; society was no longer accepting this instrument with the same frequency. It

was becoming an obsolete security. No measure was taken by legislators or judges to modernise it, and the new economic reality was extremely demanding for this ancient instrument. Thus, the *pressure* over such an instrument was progressively higher due to the aforementioned politico-economic changes, which, together with the legal inactivity with regard to this instrument, left most of the market of bonds open for the remaining Colombian instrument (performance insurances).

The fortune of this instrument grounded in ancillary liability and the principle of co-extensiveness is not exclusive to Colombia. The English contract of guarantee – in the strict sense – has a very similar story, given that it has been gradually substituted for similar reasons by further instruments that were available in the English market of bonds. Since the late 19th century, new instruments such as on-demand (independent) guarantees were commercially substituting the traditional forms of bonds which were in the nature of a normal “guarantee” – in the strict sense –;⁵⁷¹ therefore, that modern instrument became prevalent in commerce, especially in international sales contract and in construction industry.⁵⁷²

As seen in chapter three,⁵⁷³ that modern, on-demand instrument provided a stronger protection for the underlying creditor, given its legal structure. A clear example of the weaker structure of guarantee bonds in comparison with on-demand bonds, from the perspective of the principal creditor, could be seen in public construction projects. There, public entities, in order to protect public funds, required the successful bidder to provide a guarantee. These guarantees frequently took the form of a “conditional bond”⁵⁷⁴, which differed from the on-demand bond in one critical respect: the former required a default to be proved on the part of the contractor before the value of the bond could be paid out.⁵⁷⁵ Besides, as per the legal nature of the guarantee bond, it allows the bond issuer to be discharged by a variation of the underlying

⁵⁷¹ O’Donovan, Phillips, Op.Cit., p. 799

⁵⁷² Andrews and Millett, Op.Cit., p. 579

⁵⁷³ Chapter 3, Section 2, Subsection C.

⁵⁷⁴ Andrews and Millett, Op.Cit, p. 508

⁵⁷⁵ Newman, Paul, Op.Cit., p. 109; *Direct Acceptance Finance Ltd v Cumberland Furnishing Pty Ltd* [1965] N.S.W.R.; *Canadian Permanent Trust Co v King Art Developments Ltd* [1984] 4 W.W.R. 587, CA; *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *Hampton v Minns* [2002] 1. W.L.R.

construction contract,⁵⁷⁶ and the guarantor would also have all the defences and rights that the principal would be given under the principal contract.⁵⁷⁷ If the same underlying creditor were to be secured through a truly independent bond, he would not be thinking about all those aspects, but about the requirements to claim that were set out in chapter 3 for these types of instrument.⁵⁷⁸

The contract of guarantee has not been totally replaced, but, since then, it was no longer the reigning instrument within the English market of performance bonds. Society, in particular professional creditors, has understood that, given its legal structure, it is not as reliable as it should be in modern times in order to protect the creditor's interests. Thus, the addressees of those laws have accepted the normativeness and applicability of the so-called "truly independent bonds" rather than those old instruments (contract of guarantee and contract of indemnity), and the main cause may be the inactivity of legislators and judges to revive an obsolete instrument.

2.2. INEFFECTIVENESS WITHOUT A LEGAL DETRIMENT

2.2.1. A WELL-DESIGNED INSTRUMENTS (*FIANZA*) VS. AN ACCEPTED INSTRUMENT (PERFORMANCE INSURANCE)

In that sense, did legislators and judges fail in protecting the effectiveness of the laws of guarantee bonds in England and Colombia? It seems clear, as noted above, that they were expected to protect the effectiveness of those laws. Nevertheless, the next question would be whether legislators and judges can be criticised for not protecting the effectiveness of the laws of guarantee bonds, even though they introduced to the legal system a replacement and modern instrument that seeks the same purpose?

From a restrictive point of view, it should be admitted that, in Colombia and England, legislators and judges failed in protecting the effectiveness of those laws of guarantee bonds. They failed because, being aware that those laws

⁵⁷⁶ O'Donovan, Phillips, Op.Cit., p. 799; *Holme v Brunskill* (1877-78) L.R. 3 Q.B.D. 495

⁵⁷⁷ *Trafalgar House Constructions Ltd v. General Surety and Guarantee Company Ltd* (1996) 1 A.C. 199; *Wood Hall Ltd v Pipeline Authority* [1979] 141 C.L.R. 443; *IE Contractors v Lloyd's Bank Plc and Rafidain Bank* [1990] 2 Lloyd's Rep. 496.

⁵⁷⁸ Chapter 3, Section 2, Subsection C.

were to some extent effective but not resistant in terms of resilience,⁵⁷⁹ they did not take any measures to safeguard the effectiveness of those laws, either by preventing the continuing decrease of the level of effectiveness, based on the subjective element of this notion, or by recovering the expected level of effectiveness by using the “vehicles” mentioned in chapter 4. Legislators and judges had a larger responsibility with English society, given that by the 1990s there already existed expectation to maintain effective laws at all times. However, during the same period of time, in Colombia there was only talk of the initial effectiveness of the laws. At the end of the day, the fact is that none of them fulfilled the respective expectations that were created within their jurisdictions, and it is important to highlight that the author did not take into consideration the notion of shock to present this partial conclusion, meaning this that the expectation they did not satisfy is not the one related to the resilience of the laws; otherwise, they would have failed twice. However, is this reproachable just by taking this feeling of resignation into account? Can legislators and judges be criticised, knowing that society is omitting another circumstance different from the simple loss of the effectiveness of such law?

It is hard to deny that legislators and judges failed in maintaining the effectiveness of the laws of those specific conditional instruments. Yet, the main reason to criticise them is because the effects of such failure seriously compromise the purpose that the endangered instrument was performing. If this instrument were to be the only form to achieve such a particular purpose, the conclusion probably would be that they failed, leaving potential creditors less protected, and therefore causing the aforementioned feeling of resignation within the addressees of the law. Nevertheless, with regard to performance bonds, at least since the 1980s there was not one unique manner to pursue such a purpose in Colombia or England; indeed, nowadays choosing one or another instrument depends most of the time on the bargaining power of the parties, the nature of the underlying contract, the

⁵⁷⁹ As seen in the preceding paragraphs, since the 90s the contract of guarantee (or *fianza*) was being substituted by a modern instrument that was achieving the same purpose in a similar way. The legal culture changed and the people were not openly accepting guarantee bonds as they had done before. The level of effectiveness, if measurable, was going below the minimum limit of sufficient effectiveness.

jurisdiction in which the security is requested, or the admitted commercial practice, amongst others.

As mentioned before, in Colombia, by the time the laws of *fianza* (equivalent to the English contract of guarantee, in the strict sense) started to lose effectiveness, there was another instrument, i.e. performance insurances. They were both seeking a similar purpose, but the hypothetical extinction of one of them would affect the list of available options legally offered to society, and would oblige society to use the remaining instrument in spite of all the possible legal issues it could have. And, this would give the wrong impression that the remaining instrument would be more than sufficiently effective because society would be demanding it more than before. In this case, the reproach against legislators or judges should not only be for not protecting the effectiveness of those laws, but also for being an accomplice in obliging the addressees of those laws to use one instrument that, perhaps, has several legal issues, or that may not be voluntarily accepted by society. However, in spite of all the issues of this imposed instrument, at least there is still an available instrument to protect the creditors of underlying contracts.

If the instrument that is on the way to extinction is the only option in such a market, the reproach against legislators and judges needs to be stricter, unless such extinction is taken as a positive ending. The first thought is that it seems as if the disappearance of that solitary instrument would leave society without the possibility of protecting the underlying creditor through a financial instrument. For that reason, the responsibility would be attributed to legislators and judges for undervaluing or neglecting the purpose that was pursued by that unique instrument. The purpose is an abstract necessity that becomes a concrete expectation of society – or some of its representatives – and it may be achieved by one or more mechanisms, and each mechanism may be regulated by its own set of legal rules. However, when there is only one mechanism and it disappears, the concrete expectation does not consequently retake the form of an abstract necessity,⁵⁸⁰ and society then

⁵⁸⁰ This does not mean that a concrete expectation – purpose of a particular law – can never retake the form of an abstract desire. The latter becomes a concrete expectation because society expresses that it is requiring something from another (the passive subject of the expectation). Accordingly, the concrete expectation retakes the form of an abstract desire in the moment

expresses the aforementioned feeling of frustration for not having an active mechanism to achieve the specific purpose.

Nonetheless, the latter feeling may also become a feeling of satisfaction under the same situation set forth above. A solitary instrument that is not properly designed to achieve the purpose, and is not likely to disappear, may be obliging society to use it, and hence to use a flawed set of rules, which may be counter-productive for the relevant parties. Under those scenarios it may be much better for the consumers of such an instrument to promote or accept with satisfaction the extinction of the latter mechanism, together with its rules, because this would give them the freedom to create a new commercial practice in order to achieve by other means the expected purpose; and, perhaps, legislators or judges will later create a resilient law regulating such practice. It is important to remember, as seen in chapter one, that the laws of performance bonds in England were created to follow the preceding non-legal practices of the performance bonds market.

In the Colombian case, it could be said that, although *fianza* has never disappeared since it remains in codes and is lightly used, in commercial practice the only reliable⁵⁸¹ instrument to secure large transactions in the 1990s was the performance insurance. Therefore, the scenario that was explained in the previous paragraph was not far from the Colombian reality, given that the members of society, if in need of an accepted security bond, were practically obliged to obtain a performance insurance; hence, suffering the legal issues of such an instrument. In that sense, during the negotiation of the contract, the parties were not truly free to negotiate all the clauses of the contract because the one referring to guarantees was pre-imposed by commercial reality, and finally imposed by the creditor. The parties could negotiate the inclusion of a guarantee, but not the type of guarantee; in other

society stops requiring such a thing. These conversions become thorny when they need to be proved. Becoming a concrete expectation is a positive visible expression that needs to be found to serve as the proof, whereas retaking the form of an abstract desire can only be proved when someone affirms such a transformation, and there is no express or tacit denial. By tacit denial the author refers to a posterior and unconnected statement that affirms that society is expecting such thing.

⁵⁸¹ The Colombian performance was not truly reliable, but society when comparing the latter instrument with the other available instrument considered that the performance bond was the most reliable instrument to secure an underlying contract, and, therefore, it was normally the one demanded by all potential creditors.

words, the “guarantee clause” was, to some extent, an adhesion clause. In England, however, the previous situations were never considered because there were at least two available instruments that were commonly used at all times by the last decade of the 20th century: the contract of guarantee, the contract of indemnity, and the substituting independent bond (wrongly known, in the author’s opinion, as a “performance bond”). By the time the English contract of guarantee was starting to become obsolete, the modern “independent bond” was rising, therefore, English creditors and debtors were not commercially obliged to have the remaining instrument (contract of indemnity), which, by the way, does not have as many legal issues as the Colombian performance insurance.

Neither in the Colombian nor English case, was the “purpose” that concerns the author in this research at risk because there was always, at least, one other available instrument. Therefore, it would not be appropriate to criticise legislators or judges for not providing a juridical instrument able to seek said purpose. Nevertheless, it would be possible to criticise them for not preventing the situations mentioned in the previous paragraphs, i.e. society being compelled to use a defective law and therefore a defective instrument.

Although no sanctions could have been imposed,⁵⁸² in Colombia, as explained above, legislators and judges practically left society depending exclusively on the faulty performance insurances for many years. In theory, the latter harmful dependency lasted until the legislative implementation⁵⁸³ of the Colombian “on-demand banking guarantee” in 2008;⁵⁸⁴ yet, in practical terms, little has changed.

2.2.2. THE NON-COMPETITIVE ON-DEMAND BANKING GUARANTEE

The Colombian “banking guarantee” (equivalent to the English on-demand bond) is a legal instrument with fewer legal issues than the performance insurance, and far more accepted than both the performance insurance or the old *fianza*, as a result of its reliable legal structure in favour of the creditor.

⁵⁸² Chapter 4, Section 5.

⁵⁸³ Decree 4828 of 2008, regulating the Act 1150 of 2007 (Article 7).

⁵⁸⁴ The Colombian banking guarantee was occasionally used before 2008 in Colombia, but with regard to international transactions.

However, there is another factor that also needs to be valued: competitiveness within a market. The economic structure of the performance insurance, as with any other insurance, turns the latter into a low-priced instrument, in comparison with the on-demand banking guarantee. As has been repeatedly mentioned herein, in developing countries such as Colombia, the market of performance bonds mostly depends upon public law contracts. And, in those cases the contractor has the option to choose the instrument he prefers to secure the due performance of the underlying contract, as long as the instrument is accepted by the relevant law for public contracting.⁵⁸⁵ In private matters it is not particularly common to negotiate the instrument that will be required to protect the principal creditor. When the debtor is free to pick any of the available instruments, he will normally opt for obtaining the cheapest; this is so, particularly if the difference is as big as the existing one between performance insurances and banking guarantees, where the price of the former may be half the latter. Thus, the price of the bond is a determining factor for the buying-debtor, who tends to disregard the rest of the advantages or disadvantages of the acquired instrument, particularly because the debtor does not normally believe that he will not be able to duly perform the principal contract. The same logic is used by the potential debtor in the middle of a pre-contractual negotiation, if there is one. In that sense, it could be stated that the debtor only buys a “piece of paper” to comply with a contractual requirement, for which he prefers to buy the cheapest “piece of paper” on the market.⁵⁸⁶

The large difference in price between the Colombian banking guarantee and the Colombian performance insurance takes us back to the scenario where, in practice, society is only using one instrument, with all its legal issues. In some cases, the buying-debtor prefer to take the cheapest bond, but in others the debtor cannot afford the value of the banking guarantee, meaning that obtaining a “performance insurance, in practical terms, may not be a voluntary decision.

⁵⁸⁵ Currently, the list of admitted instrument to secure public law contracts is provided by Decree 1510 of 2013, Article 111

⁵⁸⁶ In some cases, the Colombian “banking guarantee” is also discarded because its price does not make it accessible to certain debtors, who need to offer a counter-guarantee that is above their financial capacity, as in the case of small developing businesses which depend on an advance payment to start performing the principal contract.

2.3. UNSUCCESSFUL RECOVERY IN TERMS OF RESILIENCE

As mentioned before, Colombian legislators and judges have only been expected to safeguard the effectiveness of a law during its initial stage. Therefore, it would be inappropriate to set a reproach based on an inexistent expectation, given that all the problems suffered by the *fianza* did not occur during its initial stage, but many decades later. Moreover, society was not expecting from the legislature or the judiciary to make resilient laws, and, as a result, no reproach could be attributed either. Yet, not being able to reproach them does not signify that their actions or omissions, which will remain “unpunished”, did not occur or are irrelevant. The facts mentioned in the preceding paragraphs with regard to the *fianza* unfortunately occurred and were relevant for Colombian society, in particular for financial consumers who had to suffer the effects of the progressive ineffectiveness of the laws of the latter instrument. However, a reproach without a previous expectation seems to be as unacceptable as disregarding the maxim “*nullum crimen, nulla poena sine praevia lege*”.

In that sense, although the “purpose” that concerned the author was not imperilled, Colombian legislators and judges cannot (but should, if “new expectations” had been previously created) be criticised because: a) they did not satisfactorily recover the sufficient effectiveness of the laws of *fianza* after a shock; b) they did not progressively substitute the *fianza* with a modern and sufficiently effective instrument; c) by the time they implemented a substituting instrument – banking on-demand guarantee –, it could not economically compete against the rooted performance insurance; and d) Colombian society, and in particular financial consumers, felt, suffered and condemned the consequences of the preceding facts; and those feelings are in the end what is truly concerning.

For that reason, if the substituting instrument improves, or at least equals in every aspect, the instrument that is practically disappearing, the ineffectiveness of the laws of the replaced instrument would be irrelevant. In that sense, society should not present a reproach because there would not be a real legal detriment. Unfortunately, that was not the Colombian case given that, in commercial practice, the banking guarantee was implemented late

and it could not even equal the *fianza* in every aspect. Therefore, there was, indeed, a legal detriment with consequences for Colombian society, and in this case the ineffectiveness of the *fianza* was no longer irrelevant.

If the “new expectations” explained in chapter 4 had existed at that time in Colombia, legislators and judges should be reproached for such legal detriment. It is important to highlight that they should be reproached for not achieving the expected result that was to successfully recover the effectiveness of those laws, or to provide substituting laws, in order to avoid a legal detriment. They attempted to recover it by reforming laws and also by offering a replacing instrument through new laws; however, attempting is not enough, as mentioned in chapter 4.

In England, the so-called new expectations did not exist either before 2002, but the weight upon legislators and judges was heavier, given that English “modern expectations” had already imposed on them the job of safeguarding the effectiveness of laws at all times. The financial contract of guarantee (equivalent to *fianza*) was not, and is not, as accepted by society as it was before, challenging the subjective element of the notion of effectiveness of laws. Consequently, as in the Colombian case, it could be said that English legislators and judges should be criticised for not preventing the progressive ineffectiveness of the laws of the contract of guarantee.

Nevertheless, in the English scenario, it is possible to start at the end, by stating that there is no legal detriment and no feeling of frustration as a result of the progressive ineffectiveness of the “contract of guarantee”. Thus, the aforementioned ineffectiveness would be irrelevant because its harming effects, if any, were never felt by English society. It is also irrelevant because society was legally provided with a substituting instrument that achieves the same purpose and in a better way, i.e. the on-demand bond. However, it is important to highlight that in England, the addressees of the laws of the contract of guarantee were not forced to move to another instrument; indeed, one of the reasons for the gradual ineffectiveness of the contract of guarantee was that the addressees of those laws voluntarily replaced the traditional instrument with a new option they were given. Conclusively, a simplistic analysis of the progressive ineffectiveness of the English contract of

guarantee would lead to a number of reproaches against the English judiciary and legislature. However, even if the “new expectations” had existed, no reproach should be made at all by English society because, as seen from the previous paragraphs, the ineffectiveness of the law by itself means nothing. Ineffectiveness of the law becomes relevant to a legal system only as long as there is a legal detriment perceived by society, as happened in Colombia.

Thus, by 1995, in Colombia, the only instrument that was sufficiently effective was the “performance insurance” in spite of its legal issues. It is also possible to suggest that such an instrument was effective mainly because society was obliged to use it for the reasons explained above. However, within the context of resilience, it is not possible to affirm *ex ante* if the legal reforms that were implemented actually achieved the objective of making those laws resilient against future shocks (besides, it is clear that by then legislators and judges were not expected to do so). Under a notion of resilience, those reforms should have not only recovered their lost ineffectiveness, but prevented future ineffectiveness as a result of a shock. Therefore, it is with the shock that occurred in 2002 that those reforms were going to be truly tested in order to establish whether or not the laws of performance bonds were resistant.

3. THE RESISTANCE OF THE LAWS OF PERFORMANCE BONDS, AND A SECOND FORESEEN SHOCK

Preventing the ineffectiveness of laws and recovering the effectiveness of laws are not capricious expectations. Not doing so may lead to harmful consequences such as those described in the preceding section, or towards many others, depending on the topic. Thus, having effective laws is an ideal scenario for the addressees of those laws, but that scenario can change at any time for incalculable causes. For that reason, within the context of resilience, the ideal scenario should now be having resistant laws. Resistant laws, as explained within chapter 4, mean effective laws that are able to resist a future shock caused by a change. Nevertheless, “resistance” is the main expected objective, and as it is a static factor, as a result such an objective can only be achieved through the dynamic intervention of judges or legislators.

3.1. DISSIMILAR MEASURES TO HAVE RESISTANT LAWS OF PERFORMANCE BONDS

As seen above, the legislative reforms and judicial decisions mentioned in the previous section did not recover the effectiveness of the laws of performance bonds affected by the first shock. If recovery actions are not taken or are unsuccessful, and the laws are not sufficiently effective again, it seems clear that taking preventive measures to protect the sufficient effectiveness of those laws against future shocks would be a contradiction – they would be unnecessary. In spite of the first shock and the unsuccessful legal reforms to improve its operability and to heighten its level of effectiveness, the laws of “performance insurances” were still effective; however, although needed, none of the aforesaid reforms or others had a preventive component. In the case of financial *fianzas*, the minor premise was different as its laws were no longer sufficiently effective after the first shock. Thus, fortunately preventive measures were not needed since they were not taken by Colombian legislators or judges. In other words, after the first shock nothing was done in advance to make resistant laws.

3.1.1. NON-RESISTANT LAWS TO FACE THE SECOND SHOCK

By 2005 the Colombian “performance insurance” was still the dominant financial instrument to secure contracts (the *fianza* was being set aside). Accordingly, after all the legal reforms (dynamic interventions) that were implemented in Colombia before the latter date, the question would then be: Were the laws of performance bonds resistant against the shock that was going to occur in 2005?⁵⁸⁷ The answer is negative. Why? – for one main reason: the same legal consequences of the first shock (1992-1994) explained in the previous section, occurred in Colombia as a result of this second identical shock. Indeed, changes, the subsequent shocks, and their consequences, are so similar that it could be said that the second shock (2005-2008) was no more than a continuation of the first shock. The only reason the latter statement is not valid, is that between 1995 and 2002 the politico-economic policies that led to the aforementioned shocks were not implemented. Hence, the shock occurring between 2005 and 2008 is not the

⁵⁸⁷ Chapter 2, Section 2.

result of the changes provoked in 1990, but the result of the state policies that started to be implemented in 2002 under the neoliberal government of President Alvaro Uribe.⁵⁸⁸

Accordingly, it seems clear that, within the context of this research, legislators and judges (and, even the so-called resilience-provokers) learned nothing from the first shock. If “new expectations” (resilience of laws) had existed then, a massive reproach would also have existed; and the reproach should have been as big as the damage caused by the inactivity of judges and legislators. Besides, it could be easier to excuse those legislators and judges who did nothing during against the first shock because previous shocks were not as visible, and were not in Colombia, as seen in Chapter 2. However, those that should have sought resilience with regard to the second shock, if the aforementioned expectation had existed, had to be aware of the first Colombian shock, and of all those similar and previous foreign shocks. To some extent, the responsibility of legislators and judges could be attenuated, for in practical terms they can hardly analyse every aspect of every legal regime within a whole national system. Yet, resilience-provokers for this specific legal regime should have noticed the results of the first shock and foreseen the effects of a forthcoming one, in order to aid the former characters to seek resilience; Colombian scholars (excepting Ordoñez⁵⁸⁹) did nothing to protect the resilience, or at least the effectiveness, of the laws of performance bonds as they all remained critical of legal those rules but never proposed a solution.

Thus, given that those laws were not statically resilient (resistant) by the time of the second change, and were consequentially shocked and identically affected once again, legislative or judicial intervention was expected. However, since performance insurances and *fianzas* were under different circumstances within the context of resilience, the latter intervention should have been dissimilar, but always aimed at making resistant laws. In the case of the first instrument, preventive actions were essential to make those laws resistant, whereas recovery measures were not indispensable as those laws

⁵⁸⁸ Chapter 2, Section 2.

⁵⁸⁹ Ordoñez, Op.Cit.: *El Seguro de Cumplimiento de Contratos Estatales en Colombia*, p.54

were still sufficiently effective, in spite of their legal issues. However, this does not mean that those laws were not in need of an intervention to improve their level of effectiveness and the operability of the instrument. Conversely, in the case of the second instrument, recovery actions were essential, given that its laws were, and still are, far below the abstract line of sufficient effectiveness; accordingly, as mentioned earlier, without successful recovery any preventive action would be useless in terms of effectiveness.

3.1.2. “FIANZA” IN NEED OF RECOVERY ACTIONS

With regard to the *fianza* (equivalent to the English contract of guarantee) legislators and judges not only did not attempt to recover the minimum level of sufficient effectiveness, but also discouraged its utilisation by legislative means. This is related to something the author has repeatedly stated: public contracting (and its legal regime) is the main raw material for all types of performance bonds in developing countries. Act 1150 of 2007 restructured the Colombian Public Contracting Regime, including the available instruments to secure those public law contracts. This Act reaffirmed “performance insurances” as an option to the latter end, and also referred once again to the generic term “banking guarantee” as another abstract option.⁵⁹⁰ Such writing created the belief that *fianza* was staying within this pack of securities, and that the forthcoming regulatory decree was going to strengthen such an instrument. Nevertheless, Decree 4828 of 2008 – complementing the aforementioned Act – abolished *fianza*, and, for the first time, incorporated into the Colombian system the so-called “on-demand banking guarantee” as a substitute for the convalescent *fianza*; this decree determined the exclusion of the latter instrument from the Public Contracting Regime and, given the importance of this regime, such exclusion marked the practical death of said instrument. This circumstance was relevant because society, in the end, suffered a legal detriment, given that a delayed replacing instrument (on-demand guarantee) had certain structural issues that prevented it from being an appropriate substitute.

⁵⁹⁰ As explained before in Chapter 3, Section 1, Subsection B, the term “banking guarantee” may have different interpretations under Colombian law: a) it may be understood as a generic term that includes any security issued by a bank; and b) it may also be understood as a specific term, a particular contract, i.e. the on-demand banking guarantee.

3.1.3. “PERFORMANCE INSURANCE”: IN NEED OF PREVENTIVE ACTIONS

On the other hand, the “performance insurance” for both public law contracts and private contracts was still the dominant instrument within the Colombian system. With regard to this instrument, the judicial and legislative intervention to overcome legal issues from 2005 onwards cannot be ignored. Besides, Act 1150 of 2007 (Article 7) and Decree 4828 of 2008, and within the context of performance insurance, almost 20 legislative actions were implemented after 2005;⁵⁹¹ and more than 20 judicial decisions have faced this matter.⁵⁹² Those decisions did change, to some extent, the legal structure of the performance insurance, and, thus, it could be thought that such decisions were attempting to increase the level of effectiveness of the laws of performance insurances, pursuant to the objective element of the notion of effectiveness. Nevertheless, in the author’s opinion, those decisions were not attempting to increase the latter level; they were actually trying to hide the original ineffectiveness of the laws of performance bonds because those laws were not initially designed to achieve the purpose for which they were assigned, as extensively explained in Chapter 3,⁵⁹³ although in practice it still is effective for external reasons.

⁵⁹¹ Decrees 66 of 2008; 4444 of 2008; 2450 of 2008; 490 of 2009; 836 of 2009; 931 of 2009; 2025 of 2009; 2493 of 2009; 3576 of 2009; 2473 of 2010; 2555 of 2010; 4266 of 2010, 734 of 2012, and 1510 of 2013.

⁵⁹² Colombian Council of State: Third Section, Decision of March 10th 2005, ref:14245, Speaker: Ruth Stella Correa Palacio; Third Section, Decision of July 27th 2005, ref:23565, Speaker: Ruth Stella Correa Palacio; Third Section, Decision of November 29th 2006, ref:24414, Speaker: Freddy Ibarra Martinez; Third Section, Decision of January 30th 2008, ref:32867, Speaker: Mauricio Fajardo Gomez; Third Section, Decision of March 4th 2008, ref:31120, Speaker: Ramiro Saavedra Becerra; Third Section, Decision of February 11th 2009, ref:16653, Speaker: Ruth Stella Correa Palacio; Third Section, Decision of February 25th 2009, ref:15797, Speaker: Myriam Guerrero de Escobar; Third Section, Decision of June 23rd 2010, ref:16367, Speaker: Enrique Gil Botero; Third Section, Decision of February 4th 2010, ref:15665, Speaker: Enrique Gil Botero; Third Section, Decision of July 23rd 2010, ref:16494, Speaker: Enrique Gil Botero.

Colombian Supreme Court of Justice: Civil Section, Decision of June 30th 2005, Speaker: Edgardo Villamil Portilla; Decision of September 16th 2005, Speaker: Jaime Alberto Arrubla Paucar; Civil Section, Decision of November 15th 2005, Speaker: Cesar Julio Valencia Copete; Civil Section, Decision of November 16th 2005, Speaker: Silvio Fernando Trejos Bueno; Civil Section, Decision of July 24th 2006, Speaker: Carlos Ignacio Jaramillo Jaramillo; Civil Section, Decision of December 12th 2006, Speaker: Edgardo Villamil Portilla; Civil Section, Decision of February 28th 2007, Speaker: Carlos Ignacio Jaramillo Jaramillo; Civil Section, Decision of August 15th 2008, Speaker: Pedro Octavio Munar Cadena; Civil Section, Decision of December 18th 2009, Speaker: Pedro Octavio Munar Cadena; Civil Section, Decision of April 5th 2010, Speaker: Cesar Julio Valencia Copete; Civil Section.

⁵⁹³ Chapter 3, Section 2.

3.2. THE CURRENT VULNERABILITY OF THE COLOMBIAN LAWS OF PERFORMANCE BONDS DUE TO MISGUIDED INTERVENTIONS

In spite of all those legislative and judicial interventions, it seems that in Colombia there has never been dynamic resilience in relation to the laws of performance bonds. No recovery actions were implemented in favour of the *fianza* (equivalent to the English contract of guarantee), despite being required. Although recovery actions were not needed with regard to the performance insurance, the interventions to increase the level of effectiveness of those laws were not successful; they did not resolve the essential issues of the laws of performance insurances.⁵⁹⁴ Indeed, from the author's perspective, since the legal issues were structural because those laws were not originally designed to achieve the expected purpose, those issues cannot be solved. Indeed, the author partially endorses Ordoñez's proposal in which he states that the principal solutions at the present moment are: a) to abolish the performance insurance contract as a form of guarantee (*sensu lato*), implementing then a true system of bonds, with the creation of financial companies dedicated to provide such instruments; or b) to abolish the performance insurance contract as a form of guarantee (*sensu lato*), implementing then a true system of bonds, but authorising insurance companies to create separate administrative units to operate in such a line of business.

Besides, with regard to the same instrument, zero preventive actions have been designed or implemented after the second shock. Therefore, it seems that the laws of performance bonds (*fianza* and *performance insurance*) are not statically resilient at the present time. Legislators, judges and the relevant resilience-provokers, again, learned nothing from previous domestic and foreign shocks. Moreover, the Colombian laws of truly independent guarantees (are not as accepted as they are in other countries), in spite of their legal and commercial potential; thus it would not be possible to admit that this instrument is sufficiently effective; hence it is not resistant in terms of resilience. However, as mentioned before, no one was expecting from those

⁵⁹⁴ With regard to "performance insurances" all those fundamental legal issues that affect the objective element of the notion of effectiveness are described in Chapter 3, Section 2.

characters that they would take into consideration the shocks, and they were not aware of such a “new expectation” (to avoid the term “duty” or “obligation” for the reasons explained in Chapter 4). Conclusively, no reproach against them should be made by Colombian society.

In 1980 the existing laws of performance bonds were not statically resilient (which is the objective of dynamic resilience) due to the lack of legislative or judicial preventive measures that could protect the level of effectiveness of their laws. The existing financial instruments by then were normally criticised for not being protective enough in favour of the principal creditor. Some of those laws (*fianza*) started to progressively lose their levels of effectiveness, and there were no recovery actions in place either; thus they are hardly going to survive as a common instrument that secures the due performance of contracts. Also, the laws of performance insurances could never overcome all those legal issues that were asphyxiating the instrument. The latter instrument was saved by the gradual exclusion of the *fianza* and the late inclusion of the banking guarantee. This instrument was never below the level of sufficient effectiveness, but it never benefited from preventive actions; equally, this instrument is never going to be improved because its issues are structural, as mentioned above. Finally, banking guarantees were never sufficiently effective for subjective matters (as a result of their economic structure) that cannot be solved only by changing their norms; thus, they are not resilient either. In other words, since the creation of the market of performance bonds, and, in particular since 1980, the Colombian laws of performance bonds have never been statically resilient. Furthermore, nowadays, 30 years later, all the laws of performance bonds remain in an almost identical situation, i.e. none of those laws are statically resilient (resistant). In that sense, if in the future there is another similar shock, the respective laws will not be prepared to resist it, and the effectiveness of the laws of performance bonds will probably be affected again.

If legal systems, such as the English one, keep depending on modern legislative and judicial expectations, they will hardly be able to succeed in having effective, durable and resistant legal norms, with all the political, social, economic, legal, and even environmental, benefits that normally come

along with them. Changes, such as those set forth in chapters 1, 2 and 4, will always occur in real life, and the resulting shocks can no longer be ignored by so-called law-protectors (legislators and judges). England, fortunately, is one step ahead since they are, in theory, reviewing the effectiveness of all their laws at all times; yet, that is not enough in these times. Besides, English judges should also be expected to look after the effectiveness of the laws that pass through their hands, and, especially, to safeguard the effectiveness of legal norms that are exclusively developed by case law; yet, this would not be enough either. Even if judges and legislators were to satisfy the latter expectations, the majority of English laws would be effective but not resistant in terms of resilience.

In Colombia the situation is more dramatic in terms of resilience since it is one step behind English expectations; nowadays, legislators are only expected to review the initial effectiveness of laws; afterwards, those legal norms are left to drift. Colombian society needs to escalate its expectations; they need to be more demanding, to the extent of, at least, moving towards those “modern expectations”; and still, that would not be enough. If legislators and judges, from any jurisdiction, continue depending on obsolete expectations, the entire legal system will not become obsolete, but it is probably never going to be a sound legal system because every shock will always jeopardise the level of effectiveness of the relevant laws.

Both the English and Colombian legal systems will always have at least one ineffective law as long as there is a subjective element within the notion of effectiveness; even if it is assumed those countries will always have infallible legislators and judges. Laws may become ineffective, even if they were initially effective, as happened with certain Colombian and English laws of performance bonds, in the same way a boat can sink long after it has sailed. Thus, when legislators and judges realised the boat of performance bonds was sinking, they did nothing on some occasions, they replaced the boat on others, or they tried to fix the boat. However, they never analysed the reason that caused the sinking in order to direct the solution in the proper way. Thus, if the problem of the boat is that there is a plague of xilophagous insects that are eating the wooden hull, attempting to fix the problem by re-

patching the hull with wood would not be adequate. This is exactly what Colombian legislators and judges did with regard to performance bonds; they attempted to fix all the problems of the laws disregarding the real cause of ineffectiveness, which was not the pre-existing legal fragility of those instruments, but the shocks caused by politico-economic changes. Hence, 20 years after the first shock, the Colombian boat of performance bonds is still sinking, and this tragedy is the consequence of non-legal and unconnected decisions taken by the Colombian State – i.e. the change.

Besides, the Colombian regime of performance bonds has another large disadvantage in comparison to the English regime of bonds, in terms of resilience. Although these English corporate instruments were first regulated by an Act of Parliament⁵⁹⁵ (that is no longer in force), they have been later developed by the common law. Those English judicial decisions have always followed commercial practices, and are constantly adapting to the market of bonds, without being restricted by a sovereign legislative Act. In other words, their laws are the ones that are constantly adapting to the current reality. Indeed, even the latter Act, enacted in 1867, was the result of certain changes that took place in the 19th century.⁵⁹⁶ In that sense, the legal regime of performance bonds has always been sufficiently effective for two main reasons. Firstly, the laws that govern the different types of financial instruments have no major intrinsic legal issues, as they understood the difference between insurances and bonds. Secondly, it could even be stated that society does not need to accept the laws of those instruments because it was the same society that created or replaced those financial instruments. Conclusively, the English regime of performance bonds is not an invented, improvised or imported set of legal rules, but a legal regime (composed of several effective instruments) that has responded to the expectations of society. Thus, English judges are constantly fixing the boat of performance bonds so it can smoothly navigate, but, as in Colombia, they are not identifying the causes that challenge the effectiveness of the performance bonds; they only identify the fragility of the laws that are shocked.

⁵⁹⁵ Chapter 1, Section 2.

⁵⁹⁶ Chapter 1, Section 2.

In that sense, it could be suggested that the Colombian society was given different instrument by legislators and judges in order to secure the performance of contracts, such as the *fianza*, the on-demand banking guarantee and the performance bonds, amongst others that are not part of this research. Yet, society does not trust in *fianza* as mentioned above for it seems an obsolete and not very protective instrument, which, in addition, was excluded from the list of available instrument to secure public law contracts. Besides, society does not buy on-demand guarantees for they are, by far more expensive than “performance insurances” and in terms of competitiveness is useless for the debtor to pay a higher price if he believes, as they all normally do, that he will perform the contract properly. But *fianza* and on-demand guarantees are instrument that were originally designed to achieve the purpose of securing the creditor of a contract, and they have never had serious issues with their legal rules. In that sense, in practical terms, the demand of performance bonds is mainly relying on “performance insurance” as an instrument that is not expensive (for the premium is calculated upon the actuarial principle of averages) and protective for creditors until now. Firstly, so far it is protective since it can only be issued by insurance companies (normally more reliable than a private guarantee not issued by a financial company). Secondly, it is protective because, in spite its legal rules were not originally created to achieve the purpose of securing creditors against default, certain legal decision made that possible, and therefore, in practical terms, the instrument is useful for the parties of the underlying contract, and for that reasons it is the most common instrument in Colombia.

Nevertheless, there are also certain risks for creditors in practical terms. Firstly, society has only one competitive instrument to achieve the expected purpose i.e. “performance insurance”,⁵⁹⁷ and therefore insurance companies have a larger bargaining power than the policy-buyer (excluding creditors in public law contracts since the law prohibits insurance companies to modify the covers and exclusions of these sorts of policies). Secondly, if in the future there is one judicial decision stating that Article 1054 and 1055 of the Commercial Code, referring to the *insurable risk* as one of the essential

⁵⁹⁷ However, in the banking sector in order to guarantee obligations where the creditor and the guarantor is the same bank, demand from its consumers to execute a banking guarantee that

elements of any insurance contract, is also applicable to “performance insurances” the consequence in practical terms would be that every underlying contract secured by a “performance insurances” would be then unprotected for all those instruments would be legally inexistent for the lack of one of its essential elements,⁵⁹⁸ not to mention all further issues regarding this improvised instrument.⁵⁹⁹

For that reason, this research is aimed at three main objectives. Firstly, these words represent the first steps in developing the so-called resilience of laws as a new way of thinking the legislative and judicial process in which “planning” is essential. Laws can no longer be regarded as cheap electrical fuses that can be replaced when they do not work properly, or every time they stop working after a while, or every time there is an electric shock. Nevertheless, the author cannot be radical by saying that every enacted law or judicial decision should be valid for ever if it is truly resistant. Durability does not mean that the law will be valid for ever, but that the law will not be constantly modified as a result of the lack of planning, such as has been happening in Colombia with the improvised laws for performance bonds for decades.

Secondly, it is important to write this thesis for it is the creation of a “new expectation” that falls upon legislators and judges, and although they are not aware at this moment, and perhaps will not be for a while, they will be expected to satisfy that expectation by a part of society. In that sense, we will be able to produce a social reproach in case they generate a feeling of frustration among us for not taking all possible measures to avoid the ineffectiveness of certain laws. The aforementioned “post-modern or new expectation” is, to some extent, the sum of several factors that already exist within the English and Colombian systems (albeit separately), with a fresh element known as the shock. The latter element is *condition sine qua non* of the resilience of laws, and for that reason the author has mentioned the possibility of judges and legislators considering preceding foreign shocks to carry out the legislative or judicial design, which is completely different from

⁵⁹⁸ See chapter 3, Section 2.2.1

⁵⁹⁹ See chapter 3, Section 2.2.2

the fact of importing foreign legal rules. To develop such a task in order to seek resistant laws, law-protectors (judges and legislators) need the assistance of the so-called resilience-provokers⁶⁰⁰ who are also expected to stimulate the resilience of laws within their respective areas of expertise; nevertheless, reproaches against them for not provoking resilience is not being considered herein for they do not have the capacity to seek static resilience, and this lack of capacity is normally reflected in environmental matters.

Finally, this research has tried to equate the Colombian legal regime of performance bonds within the context of the resilience of laws, to suggest that such a regime has a poor level of static and dynamic resilience. In fact, for the local market of performance bonds, it would be more useful not to have a legal regime of bonds rather than having an obsolete restrictive legal regime that compels the parties to use undesirable legal rules. Therefore, it is important to rethink this legal regime (including its different instruments) in order to have, not only effective laws for financial instruments designed to secure the due performance of principal contracts, but also resistant laws against the possible ineffectiveness caused by shocks, as a result of further politico-economic changes. Colombian legislators and judges, therefore, now have an expectation to make the laws of performance bonds statically resilient, through the dynamic elements of resilience by using all the available “vehicles for resilience” that were mentioned in the previous chapter.

⁶⁰⁰ Chapter 4, Section 6.

CONCLUSIONS

1. The Colombian politico-economic reality in the late 19th century changed as a result of several factors; those external factors led to the rise of both the “social and democratic state subject to the rule of law” and the “interventionist state” in the early 20th century.
2. The implementation of the latter two types of state was considered to be the most relevant “*change*” in Colombia by then, and those changes also had an effect on the creation of the Colombian performance bonds market. Further politico-economic changes also had an effect on the creation of the English performance bonds market, which demonstrated that the Colombian case was not a coincidence, and showed the strong relation between those macro politico-economic changes and the performance bonds markets since their origins.
3. The first legal rules that were enacted in the UK, with reference to the performance bonds market, were the result of a commercial practice that needed to be regulated, whereas in Colombia the legal rules preceded the commercial practice.
4. Therefore, to obtain such legal regulation for an unborn Colombian performance bonds market, Colombian legislators had to import European legal rules, but disregarded that the particular circumstances were not the same, although macro politico-economic policies were involved in both Colombia and England.
5. The aforementioned importation produced one direct and harmful effect: Colombian legislators and judges brought those performance bonds in the form of an insurance contract. Nevertheless, English judges later understood that those undertakings were not insurances, but the Colombian legislators and judges persisted, since then and until now, in stating that they are insurances, and that the only

financial firm authorised to issue those securities was an insurance company.

6. In that sense, the market of performance bonds (understood as explained in the Introduction of this research) in Colombia is a class of business within the Colombian insurance market. Yet, Colombian insurers, when trading with foreign – particularly English – financial entities, have to treat those exotic insurance policies (known as performance insurance) as bonds, for financial, legal and accounting reasons. However, in the interest of clarity, in this research the author has made reference to the Colombian market of performance bonds, and not to a class of business within the insurance market.
7. The Colombian market in performance bonds maintained after its creation an unknown but strong relation with politico-economic changes.
8. The implementation of neoliberalism – in particular supply-side economics – and the provoked transformation towards a regulator state that has taken place in Colombia over the past 30 years represented those new *changes* that had an effect on the Colombian market of performance bonds; this effect was seen in two different moments: i) between 1992 and 1994, and ii) between 2005 and 2010.
9. During the last two periods, moments in which those politico-economic changes were severely implemented in Colombia by the respective governments, the behaviour of the market in performance bonds was completely different: it skyrocketed. There was an uncontrolled and unexpected increase in the demand for those bonds, possibly motivated by the fact that an incalculable number of new public laws and private contracts permeated the Colombian economy, and the market of bonds had to undertake many of those principal contracts. Thus, it does not seem a coincidence that outside those two

periods, the aforementioned market always had a normal, controlled and expected behaviour.

- 10.** Colombia, however, has some relevant particularities, such as an internal armed conflict, which may distort the direct relation between politico-economic changes and the Colombian market of performance bonds. For that reason, the author studied further jurisdictions, such as Mexico (a developing country with a very similar social, political and economic reality), the United States of America (a developed country that also implemented those policies), and Germany (to contrast, because it never implemented those policies). Those countries were analysed in order to establish if their economic policies also had an effect over the respective market in bonds. It was concluded that the aforesaid relation was seen in Mexico and in the United States, as they also implemented neoliberal policies; yet, in Germany, where the latter economic policies were not applied, no relation between economic policies (which are not supply-side economics) and the market in bonds was found. In that sense, the author suggests that there is an objective and direct relation between supply-side economics and the market in performance bonds, as seen in Colombia in the two periods mentioned above. The latter relation had never been explained in such terms, so the author considers it to be the first original contribution to the Colombian law of performance bonds.
- 11.** The politico-economic changes have never been taken into consideration by Colombian legislators or judges when creating the law (or jurisprudence) that regulates performance bonds, despite there being more than 20 years in those two periods.
- 12.** By performance bonds the author is not referring to a specific financial instrument, but a generic term similar to “tender bonds”, “advance payment bond”, “maintenance bond” or “off-site material bond”. By performance bonds he is referring to the object of the contractual

promise – cover –, which is not directly related to whether it is a conditional or unconditional bond. Thus, in his opinion, a performance bond may be agreed in the form of a contract of guarantee (in the strict sense), a contract of indemnity, or an independent guarantee.

- 13.**In Colombia, as a result of the importation of legal rules that occurred in the early 20th century, the aforementioned “performance insurance” was created, and is the most frequent instrument to secure public law and private contracts. As a result, the Colombian regime of performance bonds is comprised of the performance insurance, the *fianza* which is the Colombian equivalent of the English contract of guarantee (in the strict sense), and the *garantía bancaria* which is the equivalent to the English independent guarantee (also known as the performance bond, although the author disagrees with such a label for that particular legal instrument). The English contract of indemnity has no equivalent within the Colombian legal system.
- 14.**The Colombian performance insurance is a legal instrument that is still (wrongly, in the author’s opinion) considered and regulated as a first-party insurance contract. The function of this instrument is to serve as a guarantee in favour of the creditor for the due performance of the underlying obligation, and it is governed by the C.C.C., in the same way as any other insurance policy.
- 15.**There are several issues recognised by scholars and courts between the legal rules that govern insurance contracts and the nature of the performance bond, which may affect the effectiveness of those laws.
- 16.**Nonetheless, Colombian judges have been “hiding” those legal issues by producing exceptions to the legal rules in order to avoid the inoperability of the mentioned instrument.

- 17.** In Colombia, before the implementation of neoliberal policies and the transformation to the regulator state, the demand for performance bonds (including the performance insurance) was normal, and although financial consumers were aware of the legal deficiencies, they always tacitly tolerated them.
- 18.** By the time the demand for bonds skyrocketed as a result of politico-economic changes, between 1992 and 1995, and 2005 and 2010, such legal issues became more relevant as a result of the frequency and the large amounts that needed to be secured; hence, the level of tolerance was not as high as before. This increasing intolerance of those legal issues challenged even more the effectiveness of the legal rules governing Colombian performance bonds.
- 19.** The “effectiveness of the law” comprises two elements: i) *the objective element* related to the design and purposes of the law, whereby it is vital to assess whether or not the law was properly designed to achieve its objectives, i.e. fulfilling its purpose, and; ii) *the subjective element* related to the addressees of those laws, where a pertinent analysis should fall upon the relationship between said law and its addressees; i.e. what proportion of the intended addressees of that law were persuaded to accept it and then complied with it.
- 20.** Within the context of the *subjective element* it is concluded that the effectiveness of the law is not an absolute; it would be unrealistic to state that a law is effective if everyone complies with it, and ineffective if no one does. Therefore, people have to use the notion of *sufficient effectiveness*, where it is believed by society and law-makers that the law is effective in a large proportion. Thus, since the effectiveness of laws must be grounded in “estimations”, therefore, the author offers the new idea of “*estimated sufficient effectiveness*”, which is an estimation that, in practice, has already been used to assess the effectiveness of laws.

- 21.** Nevertheless, the problem with effectiveness goes beyond the reception and implementation of, or voluntary compliance with new laws which are some of the traditional expectations of society. Laws may become ineffective, even if they were initially effective, due to changes in the social, political, legal, environmental or economic contexts.
- 22.** For that reason the author has provided the first step for the creation of a theory that needs to take into consideration the aforementioned changes in order to safeguard the sufficient effectiveness of laws, and has named it: the *resilience of the law*.
- 23.** The latter notion has already been used but in a different sense where it was argued that resilience is no more than a property of the law.
- 24.** The author's idea of resilience of the law is based upon the notion of the effectiveness of the law, and how the sufficient effectiveness of the law can be challenged, and in some cases lost, as a result of *shock* (pressure) that is caused as a consequence of any change (social, political, economic, etc.).
- 25.** The shock is therefore the *condition sine qua non* of the resilience of the law. Yet, not every change produces a shock, and not every shock leads to a scenario of ineffectiveness of a particular law.
- 26.** When a particular effective law is shocked, it may be resistant and can therefore resist the shock; in other words, the law will not lose its sufficient effectiveness as a result of the shock. This resistance is the only element of *static resilience*, and is the ability of the law to maintain functional in spite of a shock. Thus, static resilience is the first feature of the resilience of the law.

- 27.** The second feature of the resilience of the law is its *dynamic resilience*, which comprises two elements: i) recovery and ii) prevention. If the law is shocked but not resistant, it will start the process of becoming ineffective. It is there that a dynamic aspect enters into the process of re-achieving a level of sufficient effectiveness, and since it is dynamic it needs the intervention of society (particularly judges and legislators) to *recover* the expected effectiveness. It is worth mentioning that “recovering effectiveness” is far beyond “attempting to recover effectiveness” (legislators, for example, may modify an Act a hundred times and may still not recover the sufficient effectiveness. Yet, recovering the effectiveness of the law is not enough because that would imply a vicious circle of effectiveness and ineffectiveness. Therefore, a second element within the dynamic resilience was needed, and such an element is legal *prevention* in order to prevent the future ineffectiveness of that law as a result of future shocks.
- 28.** *Recovery* and *prevention*, i.e. dynamic resilience, must be used in order to make such law resistant, i.e. static resilience, thereby safeguarding the effectiveness of laws in favour of societies. However, to achieve such an end, it is mandatory to analyse the “changes” that caused the “shock”, and the relation between them and the legal regime that was challenged.
- 29.** Recovering and preventing should be done in part by legislators, but at the present time legislators are not expected to do that. In Colombia, legislators are only expected to produce, reform, rationalise and repeal laws, to interpret their laws on some occasions, and to verify the initial effectiveness of laws (these are known as legal vehicles for resilience). English legislators, for example, are also expected to verify the effectiveness of laws at all times. The author has named this as: *modern expectations of legislators*.

- 30.** Dynamic resilience should also be carried out by judges, but judges today are not expected to do it, and therefore there cannot be a resulting reproach if they do not do it. Colombian judges, since they are in a civil law jurisdiction are only expected to interpret statutes to provide the legislation with a concrete meaning and purpose in order to solve certain situations in contemporary times. English judges, for example, since they are in a common law jurisdiction, are also expected to create (discover) law by developing the case law (interpreting and developing case law are the legal vehicles for resilience available for judges). The author has named these expectations as: *modern expectations of judges*.
- 31.** “*New expectations*”, in civil and common law jurisdictions, involve legislators and judges, who in addition, are expected to recover the effectiveness of a law after a shock, and then prevent ineffectiveness as a result of potential future shocks, by using the “legal vehicles that are available for judges and legislators, and taking into consideration changes and the resulting shock. When legislators and judges are mentioned as having to analyse the shock that does not signify that it must be a previous and domestic shock. Certainly it needs to take place before the analysis, but the shock may have occurred in a foreign jurisdiction: in other words, it is possible to import a shock, which is completely different from importing a law.
- 32.** It is believed that at the present time, at least in Colombia and England, there is no express constitutional foundation to sustain the resilience of the law, especially from a positivistic perspective. And, such expectations over legislators and judges cannot be understood as obligations or duties, and should not stay as a mere faculty, as a doctrinal recommendation or a political discretionary public policy.
- 33.** Therefore, the author believes that the resilience of the law, and the expectations it imposes over legislators and judges should be based on an approach that can be located in the middle of the world of duties

and obligations and the world of recommendations. He states that the resilience of the law, and the new expectations it creates, should be located within the *aspirational constitutionalism*. This refers to a process of constitutional building in which decision-makers understand what they are doing in terms of goals that they want to achieve and aspirations that they want to live up to. Accordingly, “having resilient laws” should be an evolutive process and, once an aspiration is set out, all related conducts should be directed in a sense pursuant to said aspirational provision.

- 34.** It is important to highlight that judges and legislators are not alone in attempting to make resilient laws, although they are the ones who are expected to do so, and, therefore, the ones who can fulfil the expectation of having resilient laws. The latter characters (law-protectors) must be assisted by what the author has called “resilience provokers”; these are: i) Law Commissions, ii) academics, iii) judges when exhorting Parliament to produce law, iv) pressure groups, or v) even the Media.
- 35.** When merging all the previous conclusions, it is then possible to assess the level of static and dynamic resilience of the laws of performance bonds, taking into consideration the specific changes and the subsequent shock. Despite the aforementioned macro politico-economic changes that took place in 1990 and later in 2002, the shocks arose in 1992 and 2005 since, as per the nature of those changes, the effects only arise after certain time. This assessment and its subsequent results, which are described below, are further original contributions provided by this thesis.
- 36.** The shock, within this study’s context, was the *pressure* on the Colombian laws of performance bonds.
- 37.** Such *pressure* falls within the legal culture (i.e. the ideas, values, attitudes, and expectations that people have with regard to law

and the legal system). Thus, changes, such as the one described in Colombia, or any other change, do not automatically bring about changes in the law, but they enhance the *pressure* over those laws, given that they have an impact on legal culture. They mean a variation in the way people think, what they expect, how they look at the world; and those variations in attitude in turn lead to changes in the pattern of demands on the legal system. In that sense, both the change and *pressure* have a direct relation with the “subjective element” of the notion of “effectiveness of the law”, given that people may no longer accept, tolerate or comply with certain existing legal rules. In the particular case, Colombian bond consumers and Colombian insurers no longer tolerated, as they did before, all the legal issues present within the regime of performance bonds.

- 38.** After having examined all enacted statutes and judicial decisions in Colombia referring to the performance bonds since the last quarter of the 20th century, it is possible to conclude that:
- a.** Before the two shocks to the Colombian regime of performance bonds there was some sort of prevention by Colombian legislators, but that prevention was not aimed at making resistant laws in the context of the resilience of the law; indeed, such prevention was not even related to the effectiveness of laws. Yet, society was not expecting that, and therefore a reproach should not fall upon legislators or judges.
 - b.** After the shocks (1992 and 2005) to the Colombian regime of performance bonds, the only legal instrument that was sufficiently effective was the “performance insurance” in spite of its legal issues. And it may be suggested that it was still effective only because society was obliged to use it since the others had become totally obsolete.

- c.** Although in practical terms the “performance insurance” is currently useful for society, underlying creditors are always in risk given that one judicial decision stating that Article 1054 and 1055 of the C.C.C (*insurable risk*) should also apply for “performance insurance” as it applies for any other insurance, would cause that all these instruments issued until now would become legally inexistent and, therefore, creditors would be unprotected from now on. Thus, the society has one competitive instrument in the market i.e. “performance insurance” which is not the best scenario for financial consumers, and, besides, this instrument is walking the tightrope.

- d.** In spite of more than 20 legal modifications and a larger number of judicial decisions, Colombian legislators and judges have never recovered the expected level of effectiveness of all those instruments; they only attempted to do so, unsatisfactorily. Nevertheless, once again, there cannot a reproach over them for not recovering the effectiveness of those instruments, taking into consideration changes and shocks, for they were not expected to do so.

- e.** Thus, the Colombian laws of performance have never been resistant according to the notion of the resilience of laws. For that reason, another contribution to knowledge is that the author strongly believes that if there is a future shock within this grade of vulnerability, the consequences with regard to the effectiveness of those laws may be catastrophic for the Colombian consumers of those legal instruments, and for Colombian insurers. Yet, as said before, it was not possible to make a reproach against Colombian legislators and judges because they were not expected to behave in such a manner. From now on, which is another main original contribution provided by this research, the author has created an expectation, that falls upon legislators and judges, whereby they

are expected to prevent a scenario of ineffectiveness, to recover effectiveness if it is lost, and to provide society with resistant laws under the context of the resilience of laws, taking into consideration previous changes and shocks.

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ANNEX

COLOMBIAN JURISPRUDENCE

Constitutional Court:

Decision C-449 of 1992, Speaker: Alejandro Martinez Caballero Decision C-473 of 1994

A question had been raised as to the constitutionality of article 33 of the 9th Act of 1991, which states that contracts subscribed by the National Fund of Coffee Growers are subject to the Congress' review. The Constitutional Court declared this provision unconstitutional due to the fact that the Congress was interfering with the powers of other authorities. As a matter of fact, Congress is empowered by the Constitution to authorize and approve contracts, but not to review them.

Decision C-566 of 1995, Speaker Magistrate: Eduardo Cifuentes Muñoz

A question had been raised as to the constitutionality of article 89, numeral 9 and article 99, numeral 6 of the 142 Act of 1994, which determine solidarity and income redistribution criteria and ways of subsidize public services. The Constitutional Court declared the provisions constitutionality, since in a Social Rule of Law, the Congress has the power to determine social policies aimed to subsidize public services to people with no or low income, as a form of an affirmative action.

Decision SU-047 of 1999, Settlement number: T-180.650, Speakers: Alejandro Martinez Caballero and Carlos Gaviria Diaz

XX, a congressman, requests the tutelage of the due process of law as a fundamental right, since the Supreme Court of Justice did not have the competence to examine opinions and votes issued as a parliamentary. After examining a great variety of subjects, such as parliamentary inviolability,

unlawful conduct, *ratio decidendi* and *obiter dicta*, *res iudicata* and distinguishing, the Constitutional Court decided to grant the request and protect the fundamental right, since the Supreme Court is not empowered to investigate parliamentary votes as crimes.

Decision C-700 of 1999, Settlement number: D-2374, Speaker: Jose Gregorio Hernandez Galindo

A question had been raised as to the constitutionality of a series of Decrees, including 1730 of 1991 and 663 of 1993 (Financial System Statute), regarding private savings systems regulations. The Constitutional Court declared itself reluctant to the rule on these decrees, since they were not producing legal effects, except for the Financial System Statute. The Constitutional Court declared the unconstitutionality of articles 18, 19, 20, 21, 22, 23, 134, 135, 136, 138, 139 and 140 of the Financial System Statute, due to the fact the Statute exceeded his powers, because savings systems regulations should be stated by law and not by decree.

Decision C-076 of 2007, settlement number: D-6383, Speaker: Rodrigo Escobar Gil

A question had been raised as to the constitutionality of article 53 of 383th Act of 1997, which states that discounts product of disposal of securities are not considered as tax deductions. The Constitutional Court declared this provision unconstitutional due to the fact that the Congress disregarded the constitutional requirements regarding its interpretative functions, since the provision established a new prohibition and not a interpretative rule.

Decision C-577 of 2011, Settlement number D/8367, Speaker: Gabriel Eduardo Mendoza Martelo

A question had been raised as to the constitutionality of article 113 of the Civil Code, article 2 of 294th Act of 1996 and article 2 of 1361th Act of 2009, which regulate civil marriage and the concept of family. The Constitutional Court

declared itself reluctant to the rule on these provisions, except for article 113 of the Civil Code, which declared constitutional, since the concept of family brought by the Constitution is flexible and allows its creation by couples of the same sex. Besides, the Court ordered instructed the Congress to legislate on rights of same sex couples.

Decision C-877 of 2011, Settlement number: D-8571, Speaker: Humberto Antonio Sierra Porto

A question had been raised as to the constitutionality of article 860 of the Tax Code, which states that when the taxpayer applies for a tax return, he must secure the amount of the return, as well as its interests and sanctions. The Constitutional Court declared this provision unconstitutional due to the fact that the Administration cannot assume that taxpayers will always act in bad faith while requesting tax returns.

Supreme Court of Justice:

Civil Section:

Decision of September 25th 1935, S.N.G., G.J. N. 1901

XX, a public authority confiscated a series of goods property of YY, for not having the proper required by law stamps. The goods were ordered to be auctioned, since they were considered to be product of smuggling. ZZ gave a security and kept the goods in his power as a depositary. XX initiated an executive process against YY and ZZ. The Supreme Court Of Justice acknowledged that ZZ could not be pursued since he was not the debtor, but had just given a security and stated that the depositary had not breached the contract, thus ordering the executive process to stop.

Decision of November 26th 1935, G.J. N. 1,907

XX and YY were joint debtors of ZZ, and created a non-possessory pledge on his favor. ZZ initiated an executive process against the joint debtors. The

Supreme Court of Justice stated that a contract may cease to produce effects by will of one, many or all of the parties; as well as by a judicial order. Besides, declared that a third party may subrogate, by law or agreement, in the rights of the creditor when he pays for the debtor. The Court acknowledged that in this case there was no subrogation and continued the executive process.

Decision of September 27th 1943, G.J. N. 2,001

XX and YY were joint debtors of ZZ, obligation which was laid down in a promissory note. ZZ endorsed the promissory note to AA, who collected it to XX and YY. XX stated that he had already paid. The joint debtor who pays the creditor the entire joint obligation, in addition to subrogation or exchange action, has in his favor the personal action that comes from legal link connecting it to the debtor, actions that can promote by his election, thus considering that the collected obligation was not paid.

Decision of March 15th 1983, G.J.N. N.2411

XX promised to stablish a mortgage and secured his promise with an extra performance insurance. XX failed to deliver, thus the event of loss occurred. The Supreme Court of Justice stated that a performance insurance is not the same as a guarantee or bail, since in the first the insurance company takes the place of the debtor and replaces him, while on the others the creditor may collect from the debtor or the guarantor. The Court ordered the insurance company to pay for damages caused bay XX's failure to deliver.

Decision of September 21st 2000, Settlement number: 6140, Speaker: Silvio Fernando Trejos Bueno

XX claims his rights resulting from the performance insurance created in his favour. YY, the insurance company, refused to pay for considering that there was no contract, since the policies had not been subscribed; that the action had expired; and that damages were not proven. The Supreme Court of

Justice acknowledged that in this case, XX, did not fulfilled his obligations, and therefore could not request ZZ, the insured party, the fulfilment of his obligations. The Court did not grant the requests.

Decision of February 2nd 2001, Settlement number: 5670

The Superior Court declared that a supply contract between XX and YY had been breached and ordered its rescindment. The obligations of the supplier had been insured by ZZ, an insurance company, who has required by both XX and YY to pay. ZZ stated that XX had been compensated with the rescindment of the contract, and, besides, damages were not proven. The Supreme Court of Justice acknowledged that the purpose of the performance insurance is to guarantee the fulfilment of an obligation, and indicated that damages were proven, therefore granted de requests. The Court ordered ZZ to pay default interests after considering that an exemption clause of the contract was abusive and null, due its dominant position.

Decision of June 30th 2005, Speaker: Edgardo Villamil Portilla

XX requested YY, an insurance company, to enforce the management and enforcement insurance policy. YY claimed that the action had prescribed, and that the event of loss and damages were not proven. The Supreme Court of Justice acknowledged that the action had prescribed based on the disregarded duty of the claimant to duly notify within 120 days after the presentation of the claim.

Decision of September 16th 2005, Speaker: Jaime Alberto Arrubla Paucar

XX was ordered by a Sentence to pay a specific amount, which was insured by YY, an insurance company. XX paid and requested YY for the reimbursement, but refused arguing that the action to claim the insurance had already expired, since more than two years had passed since the event of loss. The Supreme Court of Justice stated the action had not prescribed due

to the fact that the event of loss was the Sentence, and there were not two years between the Sentence and the claim.

Decision of November 15th 2005, Speaker: Cesar Julio Valencia Copete

XX claims his rights resulting from the performance insurance created in his favour. YY, the insurance company, refused to pay for considering that there was no event of loss, that XX had not fulfilled his obligations and that the contract was null. The Supreme Court of Justice stated that damage insurances are purely compensatory, their purpose is to repair the insured or beneficiary from damages received as a result of the occurrence of an uncertain event determined in the respective contract as the insured risk. XX did not prove the amount of damages, therefore the Court exonerated the insurance company.

Decision of November 16th 2005, Speaker: Silvio Fernando Trejos Bueno

XX appealed the decision of the Superior Court that declared that the insurance contract subscribed with YY did not produce any legal effects due to the extent of the covered risk. The Supreme Court of Justice confirmed the decision stating that the insurance contract between the parties had the the cancellation of the mortgage on the property as a covered risk and not the performance or payment of the secured debt with it.

Decision of July 24th 2006, Speaker: Carlos Ignacio Jaramillo Jaramillo

XX requested the Supreme Court of Justice to declare the partial nullity of an insurance contract held with YY, an insurance company, as well as his breach of contract. The Supreme Court of Justice restated the reflections made in Decision of February 2nd 2001, by stating that damage insurances are purely compensatory. The Court established that the damaged was proven by XX and granted the requests.

Decision of December 12th 2006, Speaker: Edgardo Villamil Portilla

XX established a performance insurance in favour of YY for the constitution of a trust. XX failed to deliver, and YY is collecting the insurance. The Supreme Court of Justice restated the reflections made in Decision of July 24th 2006, by stating that that damage insurances are purely compensatory. In this regard, as damages were not proven, the Court did not grant the request.

Decision of February 28th 2007, Speaker: Carlos Ignacio Jaramillo Jaramillo

A contract subscribed by XX and ZZ was insured by YY, insurance company, in favour of ZZ. XX failed to deliver and increased the risk, and did not give notice to YY, by modifying the insured contract and concluding a settlement with ZZ. XX sued YY, claiming that they had to pay for there was a performance insurance. The Supreme Court of Justice, stated that an increase of the risk by XX allows YY to end the contract, based on article 1060 of the Commercial Code, and therefor did not grant the requests.

Decision of August 15th 2008, Settlement number: 11001- 31- 03 016 -1994 - 03216 – 01, Speaker: Pedro Octavio Munar Cadena

XX demands YY, an insurance company, to pay a sum of money, considering that the event of loss took place. YY argues that he had already paid. The Supreme Court of Justice stated that, due to the socio-economical function of performance insurances and the protection of the public interest, they are not subject to certain provisions of the insurance contract, such as articles 1054 and 1055 of the Commercial Code, which indicate that the risk is an essential element of the contract. The Court acknowledged that YY had already paid and did not grant the requests made by XX.

Decision of December 18th 2009, Settlement number: 68001-3103-001-2001-00389-01, Speaker: Pedro Octavio Munar Cadena

XX claims that he is a beneficiary of a performance insurance issued by YY, and requests payment since the event of loss took place. YY argues that the event of loss did not take place and there is no damage to be compensated. The Supreme Court of Justice restated that performance insurances are not subject to certain provisions of the insurance contract, such as articles 1054 and 1055 of the Commercial Code, which indicate that the risk is an essential element of the contract.

Decision of April 5th 2010, Settlement number: 50001-31-03-002-2001-14548-01, Speaker: Cesar Julio Valencia Copete

XX demands YY, an insurance company, to pay a sum of money, considering that the event of loss took place. YY argues that the insurance contract does not exist since there is no risk involved, that the occurrence of the event of loss was not proven and that the action had already expired. The Supreme Court of Justice acknowledged that the contract was a performance insurance and that the risk consisted in the compliance of a contract, and confirmed the decision by which the claim was admitted.

State Council:

Third Section:

Decision of July 10th 1997, Settlement number: (9286), Counsellor Speaker: Carlos Betancur Jaramillo

XX requested the nullity of a Resolution issued by a public entity, YY, by which it was declared that a risk had occurred, thus ordering ZZ, an insurance company, to pay, considering that it was wrongly motivated. The State Council indicated that the administrative act was not null, since the due process of law was not breached, due to the fact that the administrative act

didn't need to have previous acts, for it was a prerogative of the Administration.

Decision of September 24th 1998, Settlement number: (14821), Counsellor Speaker: Ricardo Hoyos Duque

XX requested the nullity of two resolutions issued by YY, a public institution, by virtue of which a guarantee policy was enforced, considering that the due process of law was violated, since he was not given the opportunity to contradict the decisions of the Administration. Admitted the claim, XX requested the provisional suspension of the Resolution, request that was denied, therefore XX appealed the decision before the State Council. The State Council granted the provisional suspension due to the fact that the due process of law was disregarded.

Decision of November 27th 1998, Counsellor Speaker: Ricardo Hoyos Duque

YY was drunk and held resistance from a police requisition and tried to disarm a police officer XX, who shot and tried to hide the body of YY. The State Council indicated that the conduct of YY created a risk to which he exposed and caused the damage. The State Council exonerated XX for there was sole negligence of the victim.

Decision of August 24th 2000, Settlement number: (11318), Counsellor Speaker: Jesus Maria Carrillo

A question had been raised as to the nullity of article 19 of the 679th Decree of 1994, which states that when not paid voluntarily the unique guarantees will continue being effective through the summary jurisdiction subject to the law. The State Council declared this provision's nullity because it infringes article 75 of the 80th Act of 1993 and exceeded the regulatory powers. The State Council also indicated that while the insurance contract has the nature of a civil contract; the warranty clause incorporated in public contracts is of public order, since its purpose is the protection of public property.

Decision of October 12th 2000, Settlement number: 18604 Counsellor Speaker: Maria Helena Giraldo

XX started an executive process to enforce a contractual guarantee against YY, an insurance company. The payment order was appealed at the State Council, who confirmed it, indicating that the obligation to compensate shall become due when the administrative act declaring the accident is enforceable.

Decision of December 13th 2001, Settlement number: 25000-23-26-000-1999-2225-01 (18506), Counsellor Speaker: German Rodriguez Villamizar

XX, a public institution, requested the State Council to issue a payment order to YY, an insurance company, for the event of loss had occurred and the risk was covered. The State Council stated that collecting obligations for the contracting entity is confirmed by the public contract, an enforceable administrative act and warranty policy. Besides, when the event of loss occurs, it must be made effective by executive proceedings at the contentious jurisdiction.

Decision of May 27th 2004, Settlement number: (24371), Counsellor Speaker: Alier Eduardo Hernandez Enriquez

XX appealed a rejection of claim before the State Council, who revoked the decision and admitted the claim. The insurance contracts were subscribed on 1997, under the application of the 80th Act of 1993, for which the action had 20 years to be filed; but the event of loss took place on 1998, after the 446 Act of 1998 had been enacted, for which the action had 2 years to be filed. The State Council considered that the expiration provision to be applied is the existing one by the time of the subscription of the contract, therefore, the claim should be admitted.

Decision of March 10th 2005, ref:14245, Speaker: Ruth Stella Correa Palacio

XX requests the compensation for moral damages caused by the negligence of the Administration, because YY, a public institution, left a sewer opened and XX's sibling fell in the hole. A public insurance Company, ZZ, was linked to the process since it had insured the contract by which YY left the sewer opened. The State Council acknowledged that the basic contractual warranty must include civil liability to third parties, as additional security, imperative in contracts regarding public works, but, non-material harm was not included in the insurance policy, thus ZZ is not obliged to pay for this concept.

Decision of April 14th 2005, Settlement number: (13599), Counsellor Speaker: Alier Eduardo Hernandez Enriquez

XX requested the nullity of two resolutions enacted by YY, a public institution, by virtue of which a guarantee policy was enforced, considering that the Administration does not have the power to declare, ponder and establish contractual liability resulting from a guarantee. The State Council did not declare the nullity of the resolutions, due to the fact that YY's director had the competence to declare the event of loss referred to the instability of the contracted work, through an administrative act properly motivated.

Decision of July 27th 2005, ref:23565, Speaker: Ruth Stella Correa Palacio

YY, an insurance company, requested the State Council to declare that there was no executive title inside a process initiated by XX, against ZZ and himself. The State Council declared the inexistence of the executive title against YY, after stating that the original insurance policy, as part of the executive title, should be presented to the process and not its copy, as happened in the present case.

Decision of November 29th 2006, Settlement number: 25000-23-26-000-02043-01 (24414), Counsellor Speaker: Fredy Ibarra Martinez

XX, a public institution, requests the State Council to declare that YY, a public insurance company, is obliged to enforce the coverage contract. The State Council acknowledged the existence of two administrative, principal and confirmatory decisions of XX, through which declared the occurrence of the event of loss and ordered the guarantee to be enforceable. It was also proven that the administrative act was enforceable and executive, and therefore, it contains clear, express and claimable obligations, thus granting XX's requests.

Decision of March 21st 2007, Settlement number: (29102), Counsellor Speaker: Alier Eduardo Hernandez Enriquez

XX requested the State Council to declare that a risk had occurred and therefore an insurance company, YY, was obliged to pay a sum of money. In this case, the State Council acknowledged that the declaration of an event of loss in insurance policies is not an inordinate power of the Administration according to article 14 of the 80th Act of 1993. The Administration can declare that an event of loss occurred to enforce an insurance policy. The State Council granted the request.

Decision of June 6th 2007, Settlement number: (30565), Counsellor Speaker: Ramiro Saavedra Becerra

XX, an insurance company, appealed a decision by which it was ordered to continue the executive process against him, considering that the action had already expired, since more than two years had passed since the Resolution that declared the event of loss was enforceable before the claim was made. The State Council confirmed the decision, after indicating that the action has an expiration term of five years since the occurrence of the event of loss.

Decision of January 30th 2008, Settlement number: 52001-23-31-000-2005-00512-01(32867), Counsellor Speaker: Mauricio Fajardo Gomez

XX appealed a decision before the State Council, in which an executive claim had been refused against YY, an insurance company. The claim was not admitted due to the fact that the judge considered that he did not have the competence. The State Council admitted the claim after stating that it was competent in this case, since the insurance contract is a public contract when one of the parties is a public institution and must not be governed by civil law.

Decision of March 4th 2008, Settlement number: 25000-23-26-000-1999-02724-01(31120), Counsellor Speaker: Ramiro Saavedra Becerra

XX claims that YY, an insurance company, is obliged to pay him a sum of money by virtue of an insurance contract, whose event of loss took place. The State Council granted the request after stating that there was an executive title in the administrative act by which the Administration liquidates a contract, since it demonstrates the party's default and therefore the event of loss, and proves the amount of damages that the insurance company should compensate.

Decision of July 30th 2008, Settlement number: (21574), Counsellor Speaker: Enrique Gil Botero

XX requested the nullity of a Resolution in which a penalty was imposed, based on a public work contract, since YY, the public institution who issued the Resolution, had no competence to enforce a penalty; disregarded the economic balance of the contract and; has a falsely motivation. The State Council granted the request, due to the fact that the public entity that is a party in the contract does not have the power to impose unilaterally a penalty.

Decision of February 11th 2009, ref:16653, Speaker: Ruth Stella Correa Palacio

XX requested the nullity of a Resolution enacted by a public entity, YY, by which a contract between both XX and YY was liquidated, considering that it was issued out of time based on the 80th Act of 1993, which XX considers governs the contract even though it was signed before, due to an extension made in 1994. The State Council stated that because of the principle of non-retroactivity, the 80th Act of 1993 is not applicable in this case. Thus, the State Council declares the validity of the Resolution.

Decision of February 19th 2009, Settlement number: (16080), Counsellor Speaker: Mauricio Fajardo Gómez

XX claims a compensation for damages caused for negligent medical attention by YY, a public institution. The State Council did not grant the claim due to YY's absence of legitimacy, since it did not have to fulfil the obligation that was breached, since XX had been examined previously in a negligent manner by ZZ, a private doctor.

Dissenting opinion to the Decision of February 19th of 2009, Settlement number: 24609

XX, an insurance company, appealed a decision by which the Superior Court ordered him to pay a sum of money to YY, by virtue of an insurance company. XX considers that the action had already expired. The State Council confirmed the decision for considering that the action had not expired, because 5 years had not passed since the moment in which the obligation became enforceable. The dissenting opinion indicates that the provision to apply in this case should have been another one, due to the fact that the expiration should be determined by the governing law of the moment of the presentation of the claim.

Decision of February 25th 2009, ref:15797, Speaker: Myriam Guerrero de Escobar

XX requested the State Council to declare the nullity of a Resolution decreed by a public entity, YY, by which YY declared the termination of a contract, considering that there was no nullity cause in it and that it was falsely motivated. The State Council declared the nullity, because it was found to be falsely motivated in facts that do not correspond to reality, and stated that the Administration has the power to end a contract when considering that it is null, based on article 44 of the 80th Act of 1993.

Decision of April 22nd 2009, Settlement number: (14667), Counsellor Speaker: Myriam Guerrero de Escobar

XX requested the State Council to declare the nullity of a Resolution decreed by a public entity, YY, by which YY declared the occurrence of an event of loss, considering that it was falsely motivated and violates articles 1602 and 1603 of the Civil Code. The State Council did not declare the nullity and indicated that the administrative acts that declare the occurrence of an event of loss are contractual acts and must be done within two years from the date on which the Administration was aware of the factual occurrence of the event of loss.

Decision of August 19th 2009, Settlement number: (21432), Counsellor Speaker: Mauricio Fajardo Gómez

XX requested the State Council to declare the nullity of a Resolution decreed by a public entity, YY, by which YY declared the occurrence of default risk, considering that it was issued out of time since the contract had already expired and its expiration was not declared. The State Council did not grant XX's requests due to the fact that the risk occurred within the period of validity of the guarantee and the Resolution was issued within two years from the date on which YY was aware of the factual occurrence of risk.

Decision of February 4th 2010, ref:15665, Speaker: Enrique Gil Botero

XX requested the State Council to declare that the financial and economic balance in a contract between XX and YY, a public institution, was breached because of new tax legislation. XX also requests that YY is obliged to re-establish the contract's balance. The State Council acknowledged that XX was aware of the new tax legislation when he signed the contract, therefore, it was not an unforeseen event. In this regard, the State Council refuses the requests made by XX.

Decision of April 14th 2010, Settlement number: (16432), Counsellor Speaker: Mauricio Fajardo Gomez

XX requested the State Council to declare the nullity of a Resolution decreed by a public entity, YY, by which YY declared a public bidding vacant, considering that there was a lack of motivation. The State Council declared the nullity of the Resolution and indicated that due to a lack of harm, there is no need for the claimant to prove its amount and underlined the need to support the decisions made in Resolutions.

Decision of June 23rd 2010, Settlement number: (16494), Counsellor Speaker: Enrique Gil Botero

XX requested the nullity of a Resolution enacted by a public entity, YY, by which YY declared that XX had breached the contract subscribed between both of them and made use of the penalty clause. XX considers that YY did not have the competence to activate the penalty clause because the contract had already expired. Besides, he states that the due process of law was violated, since he was not given the opportunity to contradict evidence. The State Council acknowledged that the due process of law was disregarded, and declared the nullity of the Resolution, without a declaration on the competence of the public entity.

Fourth Section:

Decision of November 4th 1988, ref:1565, Speaker: Consuelo Sarria Oleos

XX appealed a payment order, considering that there was no enforceable right, since the Resolutions that declared the expiration of contract were not duly notified, and because the event of loss was not caused. The State Council stated that the Resolutions were notified in the right way, and acknowledged that the provisions of the insurance contract under private law and related to the timing of the requirement and occurrence of the event of loss are not applicable to public guarantees contracts because in these, the administrative act duly notified, enforceable and firmly closing the administrative stage, can make it enforceable.