Abstracts of European Financial Law Lectures

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Some Differences between Civil Law and Common Law

- In civil law, we start from the **concepts** to explain the **facts**, but common law develops by applying an **established rule** of law to **new circumstances**;
- Civil law is a top to down deductive view. By contrast, common law is the bottom to up inductive procedure.

The Countries with Common Law Legal System

- There are 2.3 billion people living under common law and equity legal systems.
- Some of the richest countries like:
- the United States (but not Louisiana),
- England,
- Canada (but not Quebec),
- Australia,
- Hong Kong,
- Israel,
- Commonwealth countries in Africa

are under common law legal system. In the **United Kingdom**, we do not have it, because Scotland has a mixture of common law and civil law as a legal system.

- Usually they use the law of **the New York State**, because the New York State has a very long traditional legal precedents and a bond market with transactions volumes about 97 trillion dollars. All this is in terms of equity law.

The Process of Development of the Common Law

 At the beginning of the common law there is the **judge**.

 In England, after the Normans invaded England, the new Norman king created his own legal system and gave to the judges the **real power**.

 Those judges would go to the countries with the **statutory law** (writs, called at that time) of the king, judge would apply and interpret this statutory law and make legal precedents in different situations.

 After a while to avoid a law that looks like a painting of Picasso, king decided against further strong interpretation. Status quo of interpretations should be frozen.

 A has a good friend ***B*** who will take care of his wealth as a **trustee**. ***B*** will not always act like ***A*** want. He may put a mortgage on the land, sell the goods and etc. At a certain moment the heirs complain that the trustee is selling the stuff. But according to all precedents in common law this is fully correct behavior

 The chancellor of the king in the 14th century does not want to change common law or compete with it, but as that one case is so **unfair** then in the name of equity, chancellor sets **parallel rules** and created a dual view: **common law and equity**.

 From 14th, 15th to late 19th century in England, there were both common law and equity courts. Sometimes, these two systems were mixed.

 Differences between Common Law and Equity:

 Common law is more **oral** than equity, equity was a **written** procedure.

 Criminal law was more part of common law and business more part of equity.

 So, for centuries with both equity and common law, common law is with capacity to **predict** what is going to happen to law, equity much more open to **interpretation**.

SPECIFIC vs GENERAL LAW

The first point of view we need to approach the law from is the distinction between specific and general
law:

 Specific law: it refers to the *convention* and to the *codes*. it answers to the question "What is the law” (deduction);

 General law: it deals with the *nature of the law*. It tells us why the law is applied and how it is applied. The law is applied taking into account the concept of tradition, which is made of the judge, the costumes and the doctrine;

 How are the general and specific law linked to each other? The link between the two of them is the *wording*: it tells us how the codes are really executed in practice.

RULE OF THE LAW

 The *rule of the law* (stato di diritto) is above everything.

 It involves all the aspects of the social relationships.

 It deals with how the judge can interpret the codes to issue a *sanction*, according to the nature of each case.

SANCTION

 It is the final goal.

 We address the litigation lawyer two kind of questions:

 What facts are relevant;

 How the court will consider these relevant facts;

 For a financial lawyer, the situation is much more complex.

 The lawyer will have the *reasoning/legal thinking* about it the legal thinking is not only about the norms, but it’s mostly linked to the *fictio iuris*.

SPECIFIC vs GENERAL LAW

RULE OF THE LAW

SANCTION

 Most of the times, legal thinking is about fiction

 The legal thinking must be coherent with the law, but at the same time, it could easily be opposite

to common sense

 Example of fictio iuris: the conventional value of bank notes as money opposite to common

sense: how could a piece of paper considered as money?

 We want the law to be:

 Public;

 Definite and clear;

 Binding it must lead to sanction if the law was broken;

 Limited retroactive;

 Protective of legitimate interests.

 The *certainty* of the law has to smooth the arbitrary of judges.

 When the law of the rule leads to an arbitrary decision of the judge on a specific case, we are talking about the "*uncertainty of the law*", which is linked to the nature of the law and not to the convention.

Two different approaches to the interpretation of contracts: they both want to find the Intention of the parties, but they are not looking for the same thing.

• Civil law (or French law): subjective approach, wants to find the real and initial intention of the parties, the so called "*volonté psychologique*".

• Common law (or English law): objective approach, since often intentions remain a riddle, is much better to observe the situation, trying to find the real nature of the contract.

It's an important distinction for several reasons:

Every legal system has to choose only one of the two methods
Every draftsman should keep in mind the location of the court who will judge and read the contract, since different approaches will lead to different conclusions
However, we know that reality is much more complex, we don't always have this clear cut, this distinction between the two approaches.
In particular, we have said that:
The common law interpretation is more flexible, so is much more consistent with what you find in contracts, since circumstances are going to change a lot, commercial facts will hardly be the same: that's why the chapter is focused on cases of common law.
In the common law system, the contract is not the only way to get to the solution, is one of the way: is considered as a secondary rule: judges are very active under this point of view, they can definitely rewrite contracts, especially nowadays.
In our discussion about the legal thinking is fundamental to understand the meaning of the words and the connection between them, in order to get to the "certainty" of the law.
The legal thinking is about words: and at the end of the day the important thing is not what the writer has in mind, but what the reader understand
Since we want to know what to do in practise, the best way to understand how things work is to analyse some very important judgments:
• "Investor's compensation scheme" (1997)
• "Re Sigma finance corporation" (2009)
• "Re New Bullas trading limited" (1994).

"Investor's compensation scheme" case (1997)
one of the most cited English law cases in the last 10 years
Lord Hoffmann made a summary of the most important to follow for a correct interpretation:
• Intention is what a reasonable person would understand reading the contract and having the same information of the parties.
• The background, or "matrix of facts", as called by Lord Wilberforce, includes

anything that would have affect the comprehension of the document by a reasonable man.

• The law excludes from the admissible background the previous negotiations between the parties: this concept is very well expressed by Lord Hoffmann in the “Chartbrook” case. (they are admissible only in the case of rectification)

• The meaning of words is not a literal meaning, but the one reasonably understood from the context.

• Words should be given their ‘natural and ordinary meaning’.

These are the principles, but we have a lot of different cases in which:

Principles are not totally fully applied by the court

What is written in the contract is not what the court says

“Re Sigma finance corporation” case (2009)1

• Deals with the correct interpretation of a clause, of a term in a security deed.

• When Sigma went to administrative receivership in 2008, there were number of parties to the security deeds, who had become parties at different times and in different circumstances.

• The question was to which extend the judges had to take in consideration the surrounding circumstances

• Lord Collins, one of the judges of the Supreme Court concluded that in this type of case the surrounding circumstances were not relevant, but was the wording of the instrument which was paramount.

• Keep in mind that the decisions of the High Court and of the Court of Appeal were different from the ones of the Supreme Court (same clause, different conclusions)

“ Re New Bullas trading limited” case (1994)2

• Deals with the legal characterization of fixed and flexible charges in the security of book debts.

• The important fact here is that what was written in the contract, and was upheld by the Supreme Court, was later totally contradicted by the Privy Council, who argued, in the “Agnew” case, that the question of the characterization of the legal effect of an agreement is not something that parties could freely decide, but is a matter of law for a court to decide.

Importance of Legal Drafting

 According to equity law, contracts can overrule all kinds of rules. Therefore, financial lawyers need to work on the contract to show to the judge what the nature of the case is, anticipate all the loopholes, possibilities of interpretation. So that because of the bottom up approach of common law and equity, **legal drafting** is highly important.

1.Theoretical Concepts

1.1 Are common law and civil law two different sciences?

At first glance, the two major legal systems of the world seem to be so distantthat we are tempting to say that they are two different sciences. Actually it is not true because both Common law and Civil Law lay on the same two fundamental pillars: FictioIuris and Evidence.

Even if the two systems adopt different conventions, the legal concept of FictioIuris, ie Legal Fiction, plays a primary role in both common law and civil law. As far as evidences are concerned, the way in which they are reaching the nature is certainly different but finally they need to reach it. In other words, both systems follow the same procedure : they collect evidences, they make “fictioiuris” and in the end they put them on a legal thinking. But they do this in a different way.

1.2 Important tools to analyze the case

In order to deeply understand the case –thatwe are going to discuss in the next section of this paper - we should analyze how the distinction between property and personal right is declined to debt. This security could be seen as a “chose in action” and as a form of property. A “chose in action” means that the repayment of a debt is a right that can be obtained or enforced through legal action while from a form of property derives that a debt could be transferred and that it is possible to charge a debt.The last one means that the creditor agrees to dedicate the property to a particular purpose. An example of that is the so-called arrangement “charge-back”. The paradigm case of a “charge-back” is when a company has deposited cash flows from operations with a bank which usually provides to it a long-term loan in order to acquire PP&E(ie property plant and equipment), securitized by the deposit. So in this particular case, the charge, ie the bank, has a proprietary interest in the debt.

In the next section, we are going to apply this concept to a slightly different case.

2. Charge Card Case

2.1 Overview of the company’s business

Charge Card Services Ltd. was a company whose main business was to issue cards to commercial organizations. These companies gave these kind of credit cards to their employees who used them in order to buy petrol from service stations. On one hand, the service stations were looking for the payment to Charge Card. On the other hand, Charge Card had trade receivables from commercial companies.

2.2 Course of events

Charge Card sold all of its receivables (ie Factoring) to another company:Commercial Credit which would had paidfor the receivables before Charge Card’s corporate clients would have settled their debts. For this reason, the purchase price of each debt was the face value of the debt minus a discounting charge and an administration fee. Moreover, the contract required that Charge Card was obliged to buy back the insolvent receivables. Finally, Commercial Credit had to maintain a running account in order to manage all these accruals.

There were no problems until Charge Card went to liquidation. At that moment, there was a considerable credit balance in its favor, consisting of sums that Commercial Credit had retained in case of insolvency of the corporate customers of Charge Card. After he had analyzed this situation, the liquidator, who is an external officer, decided to challenge the terms of the factoring agreement. In particular, he disputed the charge that was a charge over a book debt of the insolvent Charge Card. He believed that this charge was a void because it has not been registered as required by the Company Act.

2.3 Juridical Debate

The Court rejected the charge’s argument on the behalf of the liquidator. The Court established that there was no charge over the debt. In fact, the factoring agreement purported only an obligation to pay, nothing more. However, this was not the end of the story.

Three arguments arose from the Court’s decision. First, the counsel for Commercial Credit claimed that the Charge Card’s obligation to buy back insolvent receivables was not part of the running account mechanism. Although this concession is accepted, it would be irrelevant.Second, it was argued that the debts from bankers to corporate customers would have not fallen within the definition of “book debts”. However, according to the Court was obvious to consider the running account balance as a “book debt”. Last matter concerned the judge reasoning. The judge Millet stated that the debt cannot be charged in favor of Commercial Credit for two main reasons: first a debt cannot be assigned to a debtor and second a debt cannot be made subject of a mortgage in favor of the debtor.

2.4 Conclusion

The judge Millet decided that the security created, ie the debt, was personal and so the charge was a void for want of registration.

From that judgment, it followed an heated debate which have been lasted for almost ten years.

REMINDER ON THE IMPORTANCE OF COMMON LAW IN INTERNATIONAL FINANCE

- The dollar is often used for financial transfer even outside of the United States.
- Big international financial markets and contracts often refer to the law of the State of NY.
- Therefore, common law is extremely important in international finance.

A DEBT AS A CHOSE IN ACTION

- A debt is a chose in action.
- This implies that lenders may protect through legal action their right to have their money returned after the date of redemption.

BONDS AND SHARES

 Both bonds and shares
o are forms of debt.
o can be sold on the market.

Bonds	Shares
long term loan	investment in the capital of a company
interest rate mostly fixed	interest depends on company revenue

date of redemption: at this point in time the owner of the bond has the right to obtain back the money invested

“Multiple Ownership”

- **Common law and equity** system provides a more **flexible approach** for the structuring of complex arrangements in financial and commercial markets. That is so for two reasons: the **nature of the ownership**(separation between legal and equitable ownership) and the difference between **personal and property rights** (response of practical situations).
- This at the core level gave rise to the creation of the **trust**, allowing the House of Lords to implement the idea of proprietary interest to arrangements for which the only logical approach seemed to be only by personal rights.
  The separation of legal ownership from the equitable ownership:
- The **legal owner** has the right to possession, the privilege of use, the power to convey those rights and privileges (i.e. through a trust), thus the trustee appears to be the owner of the property to all but one person: the beneficiary of the trust. The trustee has in fact fiduciary duties to the beneficial owner to exercise his legal rights, privileges, power in order to benefit the beneficiary.
- The **equity owner** is thus the beneficiary of the trust agreement, namely He is the one considered to have rights/ obligations of an owner regardless a legal title on the ground of equity.

Practical cases of dealing with multiple ownership:

- Through **syndicated lending**, each of a number of banks in the syndicate makes available to the borrower a separate loan. The borrower repays the principal and the interest to an agent bank who acts on behalf of all the lenders. Issues arise if the loan is to be secured: Is the loan to be secured as a whole or do we secure each bank in the syndicate separately? This position will become very complex if the individual loans are capable of assignment or transfer in whole or in part. Thanks to the trust, a trustee can be appointed at the outset on behalf of all the banks, therefore the security is given to the trustee, so It is charged with a single proprietary interest in the asset concerned, holding its ownership interests as a charge on trust for the members of the syndicate.
- **Bond issuing** presents practical difficulties that due to the nature of the bond market, arise when bonds may be owned by hundreds or thousands bondholders. Bond usually lasts for many years, thus attempts to obtain the consensus of all bondholders to change the terms of agreement are unlikely to succeed. On the other hand, each bondholder each will face difficulties if he wishes to enforce the terms of the agreement on his own. There is no easy mechanism for collective actions.

  The ability to split ownership turns to be useful: a trustee is appointed (specialist trust corporation) to hold the contractual rights on behalf of the bondholders. The trustee holds the benefit of contractual promises as legal owner; meanwhile the equitable ownership is kept by the bondholders.
- **The entity of equitable and legal ownership is always remarked as different**: as a matter of law, only the trustee can enforce his rights (backed by calling meetings, provisions, negotiations). Legal and equitable ownership allows the drafting of consistent and sensible arrangements to deal with the administration of contractual arrangements.
- **Project financing** arrangements are typically very complicated. They provide to secure finance granted to the project both from outsiders and between participants themselves. The ability to use trust mechanism to deal with the holding of the benefit of security interests is critical for success.
- In **fund management** the assets of the collective funds are heldby the trustees, in fact they might be the managers of the fund, or simply hold the assets. The trustee hold the

assets on behalf of equitable owners (unit trust agreement).The beneficial investors hold in equity a share of the assets. The benefits consist of the separation between the assets of the trust from the assets of the trustees. In case of insolvency of the trustees, the assets of the fund will fall outside insolvency.

- The approach taken by common law systems facilitates the work of a financial lawyer to structure commercial and finantial transactions with flexibility, providing protections for the participants without affecting the transaction. This is the reason why common law system are preferred for international finantial transactions and trading.

Intangible property

- When dealing with financial law we almost entirely talk about intangible property such as rights & claims, debt, contract right, money etc.
- It is not necessarily the underlying itself, which constitutes the property, but may be and interest in equity but not in law.

Example: Consider the rights of bondholders, where the rights are vested in a trustee. The bondholder will then have an equitable interest in the rights owned by the trustee.

- This is familiar from what we learnt before about the *duality* of common law systems where the approach is to deal with legal relationships as they arise, rather than establish detailed rules as a matter of logic. Here we get back to the case where we start from the "bottom" with the evidence in C.L.

This has of course affected how intangible assets have been created under common law

- The chapter further distinguishes between a *choose in action* and a *choose in possession* where the more "*obvious*" way would be a division between *tangible* and *intangible* assets and a more clear cut view.

Since we know that C.L did not develop this way but was formed to the wording of writs and customs, the case is not that simple.

- The difference between a *choose in action* and *choose in possession* lies in the way the **owner** can establish his rights.

"where a man hath NOT ONLY the right to enjoy but hath the actual enjoyment of the thing"

"*only a bare right without any occupation or enjoyment"*

-William Blackstone

- If someone is denied a choose in action, the only way to enforce the rights is by action or suit where the problem often arises when one is about to decide **if** something is a choose in action or not,**and** if it is, is it property at all?
  "All things capable of being owned, and which are not real property, are either chooses in possession or chooses in action" – Fry LJ

- A choose in possession is often more obvious, something capable of physical transfer

- The problem lies not always in identifying which items fall under chooses in actions, but the analysis of the particular item itself.
  First, it needs to be something capable of being **owned**
  Second, a choose in action must not be real property (e.g. land)
  Third, it must not be a choose in possession.

  Here we have a quite clear view of the categories, however when focusing on the item itself, it may not be so obvious.

  Example where judge Fry LJ in his analysis more focuses on defining the nature of a share rather than if it is a choose in action or not.

- Further the chapter make a distinction between legal and equitable chooses in action which relates to the time BEFORE the fusion of the administration of equity and law in 1873, however we still keep this definition.
  - Legal choses in action where those which only could be enforced by action of law before 1873 **(Debts, bills of exchange)**
  - Equitable CiA were those which only could be enforced through courts of equity before 1873**(Shares in a partnership**

- There is no formal or systematic categorization for financial assets and practitioners have to look for earlier decisions by courts.

- Then we move on to characterizing the *nature of a choose in action* and how to deal with chooses in action.
  For example if CiA can be transferred, realized, mortgaged, or charged and what legal requirements need to be met to ensure the legitimacy.

- If we go back to the definition of *Blackstone* it does not refer to the property *itself*, but only the method which the property may be realized.

- A CiA differs from a CiP in the sense that it has no real objective existence where we have the example with the pen.
  aCiA is defined as *"a caim to have something to happen where the claim is capable of being realized through court action"*

- There is also a quite long discussion which separate the property which constitutes the CiA and the process by which is enforced where we can take the example of two obligators owing one person money. The owner of the debt can sure either of the two for the money but there exists still only one CiA

  "what is assignable is the debt or other personal right of property. It is recoverable by action, but what is assigned is the chose, the thing, the debt or damages to which the

assignor is entitled" – Blackstone

- Further, a CiA can often depend on the characteristics of the *owner*.
  An exampled of this is if the contract where to perform and illegal act the CiA would not come into existence at all.
  Another example is if we consider a bearer instrument where the holder of the instrument is entitled to a sum of money against the issuer. If the instrument is destroyed, then there can be no one person to own the claim. That depends on the bearer.

- Here we can go back to the Charge Card example in previous chapters where "*a debts cannot be assigned to the debtorsince an assignment operates as a release"*. So the question here depends on the characteristics of the first owner rather than the property itself.

- We move on the **assignability** of CiA where Lord Hoffman makes quite a clear statement about CiA"*CiA is property which can be turned into money"*

  But we still need to make a distinction between something that a person "has" and something, which he "owns"
  Example: A statute may give citizens in certain area rights to bring proceedings against an authority. This is seen as a "mere chose" and is NOT considered property.

- To link this to the assignability we can take the point of describing a debt as property. Why do we do this? The meaning of doing so is not only that the owner of the debt has the right to be paid by the debtor, but also to transfer the benefit in return for "money"
- The assignability of CiA has developed slowly and originally almost no CiA where capable of being transferred at Law, but only in equity.
- Some CiA were assignable in England by virtue of the Law Merchant in trading and here we have another example of how common law has developed from customs

"The customs of merchants is a part of the Law of England, and courts must take notice of it as such" – Lord Mansfield

- There still exists non-assignable CiA such as public policies and social security benefits but the contract itself may also prevent the CiA from being assigned to someone else.
- This does not necessarily prevent the owner of a CiA to deal with it in a certain way but defines the nature of the CiA itself, so it being incapable of transfer.

Here we return to the duality again in the common law system. Even if the CiA itself cannot be transferred, the benefit can, where someone can become entitled in equity to this benefit. In this case if the owner of the CiA makes a declaration of trust in benefit of the trustee.

- Further we distinguish between the CiA itself and the fruits of the property. Even if a contract made clear that a certain CiA is incapable of being assigned, courts may accept that the benefit can be assigned. Here again return to the duality.

The uses of the Money

Nature of Money

The nature of money is something rather conceptual and differs accordingly the people to whom is concerned. With simply the word money one could refer to:
_ Notes and coins
_ Bank accounts
_ Supply of money (under a political point of view)
_ Debts (chose in actions) created either from the central bank or among individuals
On the other hand economists define money looking at the uses it could have:
_ Medium of change
_ Store of wealth
_ Unit of account
_ Mesaure of value

At a conceptual level, instead, money can be seen as the total value of the assets owned by a sovereign entity, measured by units of currency.
Under a legal point of view what it is important is to understand that money is a theoretical and broad concept that is difficult to grasp in its completeness but has several particular emanations in the real world. From time to time the crucial point is to recognise which emanation we are in front of.

Conventions and Statutes

If one looks at the conventions, that have been built in order to handle this extensive notion, it is possible to notice that the situation is far from being exhaustive.
A proper legal discipline about money -i.e. the monetary law - historically, has been provided only by civil law systems, due to the necessity to set clear rules after the cases of hyperinflation witnessed in France, first, and then in Germany.
On the other hand, the common law, given its inductive and pragmatic structure, in absence of major monetary crises, has not developed precise statutory provisions that can be accounted for a definition of money.
At a statutory level, one of the few provisions tha can be found is the definition of legal tender as those money tokens that if tendered to pay a debt must be accepts as a discharge.
At a first sight one might think that, legally speaking, the bank notes and the coins have to be legal tender in order to have the status of money.
Nevertheless, when dealing with commercial transactions, such definition as a little meaning and the significant point is whether the tokens are “currency of circulation”, concept that Darling J has defined as:
". . . that which passes freely from hand to hand throughout the community in final discharge of debt and full payment of commodities, being accepted equally without reference to the character or credit of the person who offers it.."
As a clear example of the little implication of the legal tender definition, we could consider the fact that Scotland and Northern Ireland present no such provision in their statutes: no bank notes have the status of legal tender.

This can be seen as the first example of how hard it is to give a legal status to something like money, whose nature is complex.

The Euro Currency

The birth of a new currency did not shine a light on the nature of money, in fact the process toward EMU raised two types of issues:

1. short-time practical issues for financial markets and lawyers in oder to deal with the transitional period, that have been handle in a rather smooth way (the notice was provided years in advance and the market are adaptable)
2. general and theoretical questions that arose from the vague and uncertain legislation about the nature of money.

This second type of issues remain unresolved and survived to the transaction toward the Euro.

These issues are the result of a broader uncertainty also due to a vague and incomplete legislation of the EMU. Both these characteristics are result of a complex and hesitating political environment. In fact, not only the EU did not exploit this change to clarify its status and its legislation, but also avoided to clearly define the nature of its currency.

The status of the euro has been described in a way that seemed too simple and the mechanism of issuing the notes was vague and cryptic.

“As from 1 January 1999 the currency of the participating Member States shall be the euro.

The currency unit shall be 1 euro. 1 euro shall be divided in 100 cents.” 1998 Regulation

“The ECB shall have the exclusive right to authorize the issue of bank notes within the Community.

The ECB and the national banks may issue such notes. . . ” Treaty of Rome, art.105

The vagueness of these articles can be easily connected to the fear of each Member State of losing (or even simply sharing) sovereignty of their central bank.

The art.105, written in this way, allowed the governments to reassure the population on that matter : there was nothing to worry about since the national central bank would still be the issuer of the bank notes.

As a matter of a fact, the ECB is the only bank liable on the promise in the euro notes and the national banks are only in charge of the the printing and the distribution.
In the end the biggest question, that has had big consequences in the recent debt crisis, is :
‘whose currency is this?’.
This question may have different answers according to the theory about the nature of money the we are referring to.
_ The Social Theory identifies money with the purpose it is used for, if an item is used as money then, it is money. In this case we don’t need further explanations (except for the case of the coins).
_ The State Theory requires instead that to call something ‘money’ there must be a sovereign State that controls and issues it.
If accepted the latter theory, then we must identify this entity: in the case of EMU, who is the Sovereign State? Who is liable for the issued euros?
_ Since the Euro is a single currency, each State can not be the sovereign issuer, otherwise the euro would be different among countries.
_ The Europen Union could not be either since not every Member State has adopted the euro.
_ The ECB has no more power than any other central bank and it is just an administrator on behalf of the sovereign State.
_ The only solution may be that the euro is a collective obligation of all the Member States.
In 2010, in occasion of the Greek crisis, the UME had to answer to this very question and, in order to do so, it created the European Financial Stability Facility, a special purpose vehicle with the objective of providing financial assistance to each member State. The effect was the same of a mutual guarantee among the States (as suggested by the last hypothesis).
For a single State the euro is in fact a foreign currency (since it has not the power of printing it anymore) and when the risk of default on domestic debt occurs the necessity of the liable Soveregin Entity arises.

The problem is that the creation of this fund has been a remedy to a problem, it was not part of the legal structure of the Community that failed to cover all the monetary legal issues.

The case of the European Union is a further example of how difficult it is to legally define the concept of money and the nature of currencies, most of the time one must accept that money is a broad and extremely theoretical approach and try to deal with each different emanation and each particular problem once at the time.

To understand the role of the money is important not only a theoretical analysis but also a consideration of its scopes in the real word, in the social reality where we live in.

PREDDY CASE (1996)

The first case shows that a debt can be created thanks to an electrical transfer of money, even if procured by fraud.

The payer's bank transferred money electronically to the payee's bank, fulfilling the instructions of the clients, and in this way it:

• became a debtor for the payee's bank for the amount concerned;

• ceased to owe a corresponding amount to its costumer.

At the same time, the fraudulent payee received the acknowledgment that:

• its own bank had become a creditor of the payer's bank;

• and a debtor of the payee (who was its own customer).

The fraudulent payee made statements which he knew to be false since he was charged dishonestly, obtaining in this way an advance given by the '*property belonging to another*' as established by the Theft Act (1968).

Actually, when his bank account was credited, he did not obtain a lender's chose in action nor the '*property belonging to another*' because, before the money transfer, the debt does not really exist.

The debt was a new creation that he has acquired as a result of the transfer itself.! !

Therefore, he has been found not guilty.

MOSS v HANCOCK (1899)

This case illustrates that money can mean many different things in different contexts.! !

A butler stole from his employer a five-pound gold coin. The coin was issued by the Royal Mint (according to the Coniage Act that gives the monopoly of issue coins by the Crown) and would have been legal tender for its face value, also if its value was largely greater as a collector's item.
The thief sold the coin to a dealer who, when the facts were uncovered, claimed to have bought the gold piece in good faith and therefore the order to return the stolen property to its true owner, as established by the Larency Act (1861), could not be made. Indeed, since the gold coin was legal tender, and so was regarded as money, title to this particular physical item passed to him thanks to the '*bona fide*' purchasing (with the money there is an exception to the brocard '*nemo dat quod non habet*').
The judge held that the purchasing coin dealer did not acquire title in this case because, making adistinction between 'money as currency' and 'money as medal', he noticed that in that specific case
that money had not used in the sense of currency, but as a chattel and therefore had to be applied the principle '*nemo dat quod non habet*': the dealer could not receive an indefeasible title.
We can notice at the end that the scope of the dealer was the central point of his charge.
ROBINSON (1974)
This case looks at the principles of the previous case, with different conclusion.! !
A coin dealer was caught in possession of a number of United States dimes, marked 1941/1942, with lawful currency usage but, because of production errors, the coins had a numismatic value far in excess of their face value. For this reason, the dimes were counterfeit and the dealer was charged because of his possession of that coins, as established by the Canadian Criminal Code.
In a first moment, the trial judge acquitted the defendant, relying on the *Moss v Hancock* debate: the dealer was not guilty because he held the money for their numismatic value and not to use them as currency.
The supreme Court reverse the decision since, although the dealer may have been holding the coins as 'medals', they could be used as current currency in the USA.
In this case, we can observe the fact that it did not matter whether the holder intended to use the coins as currency or not. This is a sign that in the Common Law is not important

the subjective intention, what matter is the objective evidence that a reasonable man could deduce: the holder was guilty because of his possession of counterfeit money, irrespective of his intentions with the dimes.

BANCO DE PORTUGAL v. WATERLOW & SONS (1932)

This well known case arose from one of the largest frauds in history perpetrated against Banco de Portugal in 1925 by a 25 years old, Alves dos Reis.

Banco de Portugal, a private company which acted as the issuer of bank notes for its government, decided to print 600,000 notes of new 500 escudo (for a issue worth of 300,000,000 escudos) and gave the assignment to Waterlow & Sons, Limited, a famous security printers company in London.

The notes were printed, delivered to Banco de Portugal and put in circulation.

At this point the fraudster intervened, persuading the London society that they were acting for the Portugal and arranged to print a further 600,000 escudo notes.

Obviously these fraudsters's note were indistinguishable from the genuine notes and, by the timethe plot was uncovered, 290,000,000 escudos had been placed in circulation.

Banco de Portugal, in order to preserve public confidence in the currency, called in all the notes (300,000,000 by its own issue more 290,000,000 by the fraudsters issue).

It was evident that Waterlow company had been negligent and Banco de Portugal calling-in had been a reasonable way to react, but the question was the amount of the loss suffered by Banco do Portugal issuing new notes to replace the false ones.

On this point, the problem was that there were no principles since there were no similar proceedings.

Moreover, of the judge who sat on the case, some of them held that the Bank suffered no loss (the assets of 300,000,000 was perfectly balanced by the liabilities of 300,000,000), while others found that the Bank did suffer a loss of 290,000,000 (given by its obligations on notes issued to replace the 'spurious' notes).! !

In the first group, we have Lord Warrington of the House of Lords, who addresses the question considering that the Bank cannot be treated as the other institutions because the obligation incurred by the Bank is merely to pay in other currency which it has the power to create for the purpose.

Lord Russell strengthened this theory, arguing that a bank note, before it is handed over to a recipient by the issuing bank, is simply a piece of paper containing a promise to pay bearer.

When the newly-issued note is presented to the bank for repayment, the bank's obligation is simply to replace the existing bank note with a fresh note: this transaction does not change the bank's position at all (at most it costs the new paper, the ink and the printing).

Actually, the bank does not fulfill its liability to pay by the simple replacing each note with the new one. The central bank pays its liability through the banking system, namely by crediting the account of the commercial bank which makes the presentation. Therefore Banco de Portugal would ultimately paid out the value of the replaced notes by making credits in its own books in favor of its commercial bank customers, which maintain accounts with the central bank.

Among the judges in favor of this second point of view, there was Lord Atkin whose judgement is considered the most meaningful.

His central point is that the bank, issuing its note, is in the same position as any other trader who issue a promissory note or a cheque: it has an obligation to pay on presentation. !

Like the trader, it is liable on default to judgment for the face value exigible out of its assets and, if it is compelled by the wrong of another to incur that liability, its damages are measured by the liability it has incurred, exactly like a trader.

Therefore we can observe that there was not a unique point of view in the court and the debate shows, still today, the conceptual difficulty involved in understanding the nature of money.

Property Concepts

The Legal nature of the International Bond Market-

The Property concept could be referred in two ways: ***Absolute element*** or ***Relative element*** . The former way to refer to the property according to the civil law is a myth and therefore the latter is the only way to address the property as we live in a Society. The single individual is the main actor and he or she needs to be protected by the law as the only one who can really take care of his or her property better than anyone else. The individual needs to exchange goods within our society and that is described as an anthropological evidence which needs to be taken in consideration all the time. The exchange needs to be either asymmetrical or balanced and for this reason the judge/the law is fundamental in assessing the exchange considered. All goods are going to be exchanged by nature and therefore we should go beyond the concept of absolute property and refer to it as a concept of division instead.

Moreover another feature able to highlight the relative element of property is ***Taxation*.** The main actor lives in the society (also known as Civil Society) and he or she has social responsibilities towards that. As a consequence of this he or she needs to pay taxes on the wealth produced in order to sustain the entire community or society which in turn is the only structure able to allow the creation of wealth. In a political perspective Taxation is also referred as a Representation, a way to contribute to the good of our society.

The Legal nature of the International Bond Market

The estimated debt outstanding nowadays on world bond market is about $100 trillion, which makes it the first market to exchange money. The word Bond has no technical meaning, it is used to include all obligations and instruments which constitute long-term indebtedness. The *International Bond Market* is not only vast but also growing and changing as well. However the legal issues concerning the International Bond Market are complex matters for two reasons:

1. First of all not all bonds are the same legal nature and they involve more than a simple purchase of a chose in action. As a matter of fact a bond is typically defined as a "web" of relationships between the issuer, investors and other parties.

2. Secondly, the complexity is due to the fact that the market is International and this in turn makes the bond market even more complicated from a legal point of view.

There is a special link between the trading activity and the nature of the commodity which is traded and this creates constraints (i.e. the Iron market) due to the fact that the demand for it relays on the circumstances of the companies which need it (for steel-making). Whereas in the International Bond Market we don’t find such constraints since the issuers are only interested in raising long-term funds. 2

When we look at history of the Bond we have to take into account that is was born from the growth of the joint-stock. A stock was considered a chose in action, similar to a debt, however then it was realised that it is more than a simple debt. Shares were transferable or more accurately the ownership of the share was transferable. Shares were not the only way to raise funds, companies could have also borrowed money in a form of loans. Despite that, if they wished to borrow money for long-term, that would have been a problem. Banks were reluctant in lending money for long-period of time since it would have exposed them to a possibility of liquidity squeeze. It's from the need of borrowing money for long time horizon that the first prototype of bond was born. It was basically similar to the share capital, therefore the lender would have been issued with a certificate that entitled him to be paid an amount of money at a specified date in the future and receiving also an interest rate paid periodically.
Going further in the history of the Bond Market, the Post-World War II and thus the Marshal Plan under which the US financed the rebuilding of Europe was vital for the creation of the Eurodollar market. As matter of fact thanks to the large amount of dollars pouring in Europe that it was possible to have such a market. Nevertheless, concerning about the massive outflow of dollars going to Europe that there were introduced some restrictions regarding to the lending of dollars: In 1963 a tax on the interest rate received by US lenders from an non US borrowers and in 1965 a limitation of the amount of credit available to the non US residents.
It was in the twentieth that we had the first negotiable instrument: *The Bill of Exchange*. It was a document under which the banker accepted at the request of the customer who wished to transfer value, that he would pay a sum of money to a named transferee. The recognition of the Bill of exchange was subordinated to the *"Law Merchant"*. Therefore no matter whether the person was a merchant or not, in the case of even a single purchase, it would have been regulated under the Law Merchant. The legal concept behind the negotiable instruments is the concept of *Negotiability*, that first was used in connection with money in the form of coins whose ownership like any other chattel passes by delivery.
As the Eurobond Market developed a form of documentation was needed. That documentation would be a form of evidence which proves that there exists a contract

between the issuer and the subscribers each one entitled to receive a coupon: an amount of interest paid periodically and the final capital called the redemption capital at maturity.
Another aspect to take in consideration regarding to the International Bond Market is what followed the financial crash occurred in 1929. As a consequence of that in 1933 the US provided a new regulation called *The Security Act*. It was a way to protect the US investor, making compulsory for the issuer to register with the SEC (Security Exchange Commission) once the company decided to issue bonds. This procedure was either expensive or time consuming and therefore companies outside the US wanted to avoid it as much as possible. A limitation to that protection called “Safe Harbour” was implemented. However this exemption worked only if the subscriber declared not to be an US-person. In the case that declaration was not made, then the subscription of the bond wouldn’t be accepted.
During the years the International Bond Market became even more dominant and developed and that arose the problem to constitute a system able to process and settle market trades. The system in charge to accomplish that task is the ICSD (International Central Securities Depositories) which has the function of settling trades on international bonds and other securities. 3

Basically the buyer and the seller must maintain an account with the ICSD which shows the ownership of the security (an evidence) and it serves as a platform for the settlement of the trades. The participants therefore maintain cash balances with the ICSD and once the bond issue is launched, the issuer signs a document (note) which will be kept and placed with a Depository bank (Commercial Bank).

This kind of structure and relationships among the actors who are involved into the bond's transfer is what constitutes the frame of *Immobilization*. Therefore in this system, the idea of negotiability that was the main driver of the development of the Bond market in the first place, is seen as a danger. In fact none of the actors involved in the bond's transfer wants the notes (the documentation) which are held in the Depository bank, are merchandized. The transfer must be completed only via bank accounts and no longer physically.

In the European system, the ECB faces the issue of lack of clarity regarding to who is eligible to be the Depository bank. To address this problem the ECB proposed 2 changes:

1. The Depository bank must be a bank outside the Euro zone.
2. The Depository bank must be a nominee of one the ICSD and appointed as the "Common Safe Keeper of the note".

Finally we have the concept of *Dematerialization* under which the trades are made electronically and no longer physically. This in turn helps to improve the simplicity, the clarity and the legal certainty of the complex structure which characterises the International Bond Market and therefore is without any doubt greatly welcomed.

The "Bank of Credit and Commerce International" case

The case of BCCI

The **BCCI** is a bank that made loans to a number of companies and had in its contract purported to take as security a charge over the money in the bank accounts these companies held with BCCI.

Figure 1 - Contract made by BCCI with the companies

When the bank became insolvent, the liquidators demanded that the companies repay their loans to the bank, without addressing the fact that the deposits had been held as security for the debts of the companies. The depositors retorted that the bank must set off the amount of the deposit, owed to him, against the debts due to the bank from the companies, although the depositors would receive nothing back from the bank and their companies would be relieved of their debts to the extent of the unpaid deposits (The Insolvency Rules).

Figure 2 – The "Set-off" of the debts owed by both BCCI and depositors

The Millett's point

The judge **Millett J** said that it's conceptually impossible that the bank could take a proprietary interest and, thus a charge, over a deposit, because the money deposited with the bank was a debt owed by the bank to its customer.

However because the security could not be proprietary in nature, it must have the effect of creating a personal liability:

- from the depositor to the bank (to pay an amount up to the value of the deposit)
- from the bank to the depositor (in respect of the amount of the deposit).

Because the arrangement created only personal right, rather than property right, the bank did not have the option of claiming repayment from the company.

Millett J point was that, in a common law, in contrast to the Roman Law, the question, whether a right is personal or proprietary, depends on the nature of the remedy available for its enforcement.

Because in this case no equitable remedy is needed to enforce the right of the security taker, his interest is not proprietary in nature, but consists of a personal right, inherent in nature of the debt itself.

The **Court of Appeal** accepted the Millett's point, but did not accept the argument that the effect of the lien was to create a personal liability from the depositor to the bank. They held that the Insolvency Rules has no effect: after the loan was repaid, the depositor would be entitled to ask for his deposit back.

Lord Hoffmann, House of Lords

Lord Hoffmann accepted the Court of Appeal reason, but he went on and tried to give an explanation on what equitable charge is:

"It's a property interest granted by way of security. Proprietary interests confer rights in rem which will be binding upon third parties and unaffected by the insolvency of the owner of the property charged. It entitles the holder to resort to the property only for the purpose of satisfying some liability due to him and the owner of the property retains an equity of redemption to have the property restored to him when the liability has been discharged."

For Hoffmann the effect of debtor being able to have a proprietary interest in his own debt by way of charge is no different in substance from the effect of any other security-taker having a proprietary interest in the same asset. Therefore there is no reason why the law should not allow the definition of a charge to include such an arrangement. So the charges were valid and not conceptually impossible and the right to claim a payment of a deposit with a bank is a chose in action - a proprietary right. So a charge could be created over a deposit in favour of BCCI.

Lord Hoffmann agreed with Millett's point but the difference is that he would go one step further by adding that the method of enforcement in this case was not important. The fact that the enforcement method was not based on ownership was not a bar to describing the right itself as "proprietary"; it was a label that did not affect the substance of the right itself.

Conclusions

The House of Lords decision in BCCI has been welcomed generally by financial lawyers. It has been the practice for some years, because of the legal uncertainties surrounding the question of security over book debts, for institutions to draft security documents to include the so called “triple cocktail”, the bank who wishes to take security over a deposit:

- First, expresses its security interest as being a charge over deposit;
- Second, it takes a specific right of set-off of the deposit against debts owed to it;
- Third, it is agreed with the depositor that the deposit will not be repayable so long as any indebtness is outstanding.

The thinking is that one of these arrangements must be effective, whatever the uncertainties in the law surrounding the area.

CHATTEL

The term “chattel” comes from the feudal era when “cattle” was the most valuable property besides land. The word then entered the common law vocabulary where it is a synonym of personal property. It refers to moveable items of property, which are neither land nor permanently attached to land or a building, either directly or indirectly. For instance, a piano is a chattel but an apartment building, a tree or a concrete building foundation are not. In civil law jargon, a chattel is a *res mobilis.* The opposite of chattel is **real property**, which includes lands or buildings.

Until some years ago a common juridical aphorism was *res mobilis, res vilis,* to mean that moveable things were void of value, or just less valuable than immoveable properties. However, nowadays such a point of view has been completely turned around, as the financial market is mainly international and based upon bond and stock exchange.

Mario Draghi, the president of the ECB, on 2^{nd} October 2014 announced the operational details of a covered bond purchase program, starting during the second half of October and lasting at least two years. Such a measure belongs to a wider program to provide new stimulus to the eurozone's weak economy. The aim of the new purchase program is to bolster the money supply and convince financial markets and the public that inflation would go back to the ECB's goal of just under 2% despite being at 0.3% last month.

What are COVERED BONDS?

Roughly speaking covered bonds are long term, low risk, collateralized bank bonds that carry extra-protection. Due to these features, they are usually really safe and attractive to highly risk-averseinvestors. More precisely, the characteristics that a debt security must satisfy to be considered a covered bond are:

- **Double recourse:** investors in covered bonds have two different claims that secure their investment. First, they have a claim on the issuer of the bond, who must satisfy the payment of principal and interest. Secondly, in case of the issuer's default, bondholders have a preference claim over the pool of assets that serve as collateral.
- **Cover-pool assets**: a guarantee for the buyer of the bond to be paid back. The peculiarity is that these assets remain on the balance sheet of the issuer, which can still use them as a source of liquidity. However, it is important to stress that usually covered bond holders have a priority claim over them compared to the other creditors. In this way, the investors' incentives are aligned to those of the issuer.
- Covered bonds are **over-collateralized:** assets in the cover pool exceed the notional value of the bond, assuring the timely payments of the interests and principal even if the issuer fails

  The cover pool is **dynamic:** the quality of the covered pool must be maintained over time. Thus, in case some assets deteriorate they must be replaced by assets of the same quality as the original ones. Obviously, in case of default of the issuer, the pool becomes static

Dealings with Choses in Action

In order to deal with Choses in Action we have to keep in mind some fundamental
characteristics:

 a chose in action is an item of property (not a real property nor a chose in
possession);

 it can be enforced only by a court action;

 the owner of the chose in action can transfer it to someone else, since it has a
monetary
value (being a property): the owner can turn it into money.

Therefore, a Chose in Action can be treated by the owner as the subject-matter of
transactions
with third parties.

The first distinction to be made is between *legal* and *equitable* assignments:

a) *Legal assignment* - some statutory forms of transfer, related to different types of legal
choses in
action. We have specific **requirements** (see s136 – Law of Property Act 1925):

 The assignment must be absolute, that is, a complete transfer of
ownership (the debtor has to be sure about the identity of the
person to whom he must pay);

 The object of the legal assignment is any debt or other legal thing in
action;

 the effect is that the transferee becomes the owner of the chose in
action at law (so that the transferor is deprived of the legal rights);

 it is requested a notice in written form to the debtor: the transfer is
effectual in law from the date of the notice.

b) *Equitable assignment* – in the case of equitable choses in action or legal choses in
action that
cannot be transferred with a statutory assignment, we can have a transfer of the benefit
of the
chose in action in the eyes of equity. It is important to remind that:

 the effect is that one person becomes entitled (in the eyes of equity)
to the property rights in the chose in action;
 the assignment needs not to be absolute, since it may be effective
also if made by way of charge only or if it is only of a part of a debt;
 moreover, the equitable assignment is complete, between the
assignor and the assignee, when made, without the requirement of
any notice.

Usually when we have a *syndicated lending1* (many banks which make separate loans under the
same agreement), each bank becomes the owner of a chose in action. It may well be the case that
one bank may wish to dispose of all or part of the debt owned, creating a so-called *Sub-participation*. The most commonly used **procedures** are:

i. *Funded participation;*

ii. *Participation by guarantee;*

iii. *Sale of part of the debt*.

Sometimes these syndicated lending agreements comprise explicit provisions for the transfer of the benefit of the debt. Typically, in such cases, we're dealing with a form of *Novation*. It can bedefined as a form of transfer by replacement of one party by a new one.

Novation has a strong limitation, because for the transfer under this regime is required the consent of all the parties before the transfer is effective. Going back to the example of thesyndicated lending, this implies that in this case the agreement must contain an explicit provision in which the parties consent in advance the transfer of the debt.

We could define the *Chattelization* as the "materialization" of a chose in action. A *chattel* is a physical object, a movable good. It follows that these chattels can be transferred more easily than a chose in action. Of course, we must keep in mind that a chattel is quite distinct from a chose in action (an *incorporeal* right).

But we can find some examples in which an incorporeal claim had been attached to a physical object:

 Coins - represent monetary obligations of a sovereign issuer: the claim is incorporated into a piece of metal, and therefore the ownership of the claim passes with the ownership of the coin itself (by currency or delivery);
 Banknotes ;
 Bills of exchange, *promissory notes* and other similar instruments.
It is important to note that all these instruments, since they are representatives of money, follow the nature of the money itself: so they may pass and the right to them may arise, as for money, by currency or delivery.
The reason is simply that these instruments give a property right over money.

Hans **Kelsen** (1881-1973)

jurist, legal and political philosopher.
He can be defined as one of the main contributors in the field of Law during the 20th century.
Before his period, the idea of Law was still permeated by elements from religion, theology, metaphysics, philosophy and politics.
In one of his most important works, "The Pure Theory of Law" (1934), he contributes to the development of legal positivism by giving a very strict and scientifically view on what should be the approach of legal thinking.
It's difficult to summarize positivism thinking but a generally accepted definition is: "*In any legal system, whether a given norm is legally valid, and hence whether it forms part of the law of that system, depends on its sources, not its merits.*"[1]
Kelsen defined a legal science based on *normative reasoning* different from the *causal reasoning* of modern sciences.
Morality should kept separated from the application of the law in order to protect the latter from moral and political influence. "*Justice*" is not the concept where jurisprudence should start from because it's just an "*irrational ideal*" and therefore "*not subject to cognition*". Only in this way objective nature of the science of law can

[1] Gardner, John (2001) "Legal Positivism: 5 ½ Myths," :

be ensured, by attributing to law a descriptive task , and not to produce values or standards or to make value judgments. According to the theory of Kelsen, in fact, law is made only by the positive norms and valid in the legal system, despite any precept they contain .

Kelsen didn't denied the importance of public discussion about philosophy, sociology, religion and morality but he sustained that culture and society should be regulated by the State according to legislative and constitutional norms.

Law should derive it's authority from a hypothetical basic norm, *Grundnorm*, from which all the subsequent level of a legal systems are born, beginning with constitutional law. [2] In this way the abidingness of legal norms can be understood without tracing it to superhuman source as God, personified Nature or State.

This hierarchical view of the legal system should be put there to prevent possible conflict between concurrent rules and successive norms.

The hierarchical model is part of a dual vision of the law. A static nature, because norms are related as being either superior or inferior the one to the other. A dynamic nature, at same time, from the need of writing new laws. Law is a product of political and ethical debate which is the product of the activity of the legislature before it becomes part of the domain of the static theory of law.

Kelsen believes that the state is necessary because there is no order without any coercion of man on his neighbor and that the state institution is a social technique indispensable for every society. The state constitutes an organized system of norms, whose recipients are the various subjects. Hence an identification between state and law for which there is a dependence of the state with respect to the law.

Always from The Pure Theory of Law, comes Kelsen's definition of sovereignty. The sovereignty of the state defines the domain of jurisdiction for the laws which govern the state and its related society. A clear definition of sovereignty was required in those years after WWI to facilitate the development and effectiveness of international law. International law was seen by Kelsen as a still primitive kind of law in respect of national law, often lacking of effective coercive sanctions. The problem was to

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[2] An important part of Kelsen's main practical legacy is the model of constitutional review what set up a separate constitutional court which was to have sole responsibility over constitutional disputes within the judicial system.

recognize international law as supremely valid while at the same time national law were supremely valid too.

These are the main topics in “The pure Theory of law”. Kelsen also published six major works in the areas of government, public law, and international law. He was a profuse scholar, in the 21st century, Kelsen’s influence continues to be supported, debated and criticized in books and conferences concentrating on his contemporary and historical influence.