

THANK-OFFERING TO BRITAIN LECTURE

The Law: an Engine for Trade

THE RIGHT HONOURABLE
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I. Introduction

MY SUBJECT IS COMMERCIAL LAW and its role as an engine for trade. English law is practically unique among the legal systems of the world because its commercial rules are entirely integrated into the general practice of the law, with business disputes heard in the same courts, using the same principles, as other litigation. This sets commercial principles in context. It avoids stark distinctions between commercial contracts, private contracts and consumer contracts and stands in the way of overclassification. The explanation for separate commercial systems elsewhere is that they should reduce legal burdens on business, whilst an integrated system may not provide the fast and sensitive procedures traders require.¹ English law, however, is highly regarded in the international commercial community. Out of seventy-two trials heard in the Commercial List in the High Court during the last year, forty-four involved foreign parties.

Let us consider the four principal ways in which commercial law serves our free market economy. First, commercial law is clear and predictable, providing a firm body of rules on which traders can depend.

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¹ In France, for example, commercial contracts are an exception to the strict rule, contained in Civil Code, Art. 1341, that contracts must be proved by signed documents. Art. 109 of the Commercial Code allows commercial contracts to be evidenced *par tous moyens*. The limitation period is also shorter (being 10 years) than the 30-year period applicable to general contractual transactions: Commercial Code, Art. 189.

Proceedings of the British Academy, 111, 275–96.

Secondly, it contains a strong and positive law of contract to uphold trading agreements. Thirdly, the law has been shaped by the needs and expectations of merchants, and much business practice has been incorporated into law. Fourthly, Parliament and the courts have made genuine innovations to lead the market economy forward, building on business practice to provide strong frameworks for industry.

II. Legal predictability

The very first need of the business community is legal predictability. An unpredictable legal climate is unacceptable to business, forcing traders into unnecessary legal advice and insurance cover to secure against the risk of their deals being defeated. In 1774, Lord Mansfield said:

In all mercantile transactions the great object should be certainty; and therefore, it is of more consequence that a rule should be certain, than whether the rule is established one way or the other. Because speculators in trade then know what ground to go upon.

The commercialisation of the common law

Before 1750, commerce was hindered by a division between the law merchant and the common law.² Common law was the unified law of the land,³ yet it was slow to innovate in commerce, since it had become preoccupied with its own technicalities and procedures rather than the requirements of business.⁴ A misplaced word in a property transfer would often defeat entire transactions.⁵ Businessmen had to have some reprieve from these stern rules, and the solution was to let merchants rely on their own customs as exceptions to the common law. If a transaction accorded with a practice recognised in the mercantile community, its validity could be assessed by reference to that practice rather than the insensitive common law.⁶ The

² Maitland, 'Select Pleas in Manorial Courts' (1889) 2 *Selden Soc.* 132.

³ J. Holden, *The History of Negotiable Instruments in English Law* (1955), pp. 27–36, M. Postan, *Medieval Trade and Finance* (1973), ch. II. For a different perspective on the nature of *lex mercatoria* (but a similar conclusion on the question of incorporation) see J. Baker, 'The Law Merchant and the Common Law Before 1700' [1979] *CLJ* 295.

⁴ P. Atiyah, *The Rise and Fall of Freedom of Contract* (1979), ch. 12.

⁵ J. Powell, *Essay upon the Law of Contracts and Agreements* (1790) I, 152–60.

⁶ If he did not adduce such evidence, the merchant would be 'stuck' in the common law doctrine of *assumpsit*, and the custom would only be relevant to 'explain the *assumpsit*', that is to justify the implication of a liability: *Oaste v. Taylor* (1612) Cro.Jac. 306.

solution was an obvious compromise, the price of which was legal certainty.⁷ Litigating businessmen invariably put evidence of local customs before their judge,⁸ and the success or failure of commercial transactions then came to depend on the judge's acceptance of this factual evidence.⁹

It was not until Lord Mansfield became Lord Chief Justice in 1756 that positive measures were taken to combat the uncertainty permeating commercial litigation. Mansfield's approach was to incorporate mercantile customs directly into the common law. When a merchant led evidence of a local custom, Mansfield evaluated its content by consulting businessmen¹⁰ and applying his renowned expertise in foreign systems.¹¹ If the custom was accepted, it would become binding law,¹² and no subsequent court could admit further evidence on the point.¹³ Through this process, Lord Mansfield laid the foundation of the modern commercial system. Commercial law was transformed from propositions of fact into a rational corpus of law, accessible to businessmen, lawyers, and judges alike.¹⁴

Late nineteenth-century codification projects

In the nineteenth century the exponential growth in commerce from the Industrial Revolution fuelled the demand for clear and accessible commercial rules. Digests of cases on core commercial subjects were perceived as inadequate when traders looked to the commercial codes of Continental Europe and India,¹⁵ and the Associated Chambers of Commerce seized

⁷ See the complaints of Buller J in *Lickbarrow v. Mason* (1793) 2 TR 73.

⁸ This in fact appears to be what the majority of business litigants did: *Death v. Serwonters* (1685) Lutw 885.

⁹ It was eventually settled that merchants wishing to rely on trade customs were obliged to meet two heavy burdens of proof: that the custom had immemorial antiquity and limited geographical application: *Brown v. London* (1669) 1 Lev 298.

¹⁰ See, for example, his evaluation of the rules of contract in *Loveacres d Mudge v. Blight* (1775) 1 Cowp 352.

¹¹ In the leading case of *Lewis v. Rucker* (1761) 2 Burr 1167, Lord Mansfield determined the method of quantifying an insurer's liability for partial loss by first 'conversing with some gentlemen of experience in adjustments'.

¹² *Edie v. East India Co* (1761) 2 Burr 1216.

¹³ Evidence in future would thus be admissible only on matters which had not yet been resolved: *Long v. Allen* (1785), detailed in J. Park, *Marine Insurance*, 1st edn., p. 446.

¹⁴ Commentaries were soon produced to rationalise particular areas. Among the earliest commentators were Paley, *Principles of Moral and Political Philosophy* (1785), and J. J. Powell, *Essay upon the Law of Contracts and Agreements* (1790). These were soon followed by famous works on more specific subjects, such as Chitty's *Treatise on the Law of Bills of Exchange* (1799) and Byles' *Treatise on the Law of Bills of Exchange* (1829).

¹⁵ M. Chalmers, 'An Experiment in Codification' (1886) 2 *LQR* 125; J. Dove-Wilson, 'Concerning a Code of Commercial Law' (1884) 28 *Journal of Jurisprudence* 337.

the initiative.¹⁶ During the 1880s, leading commercial minds of the day¹⁷ were commissioned to collate the case law into a cluster of codifying legislation in the four key areas of commercial activity: bills of exchange, factoring, partnerships, and sale of goods.¹⁸

The codes were a huge advance in the quest for legal clarity. Adopted throughout the Commonwealth, they condensed a hundred years of common law understanding into individual statutory statements. Their format relieved traders of the need to refer to the vast body of case law when ascertaining commercial rules. In *Bank of England v. Vagliano Brothers*,¹⁹ concerning the Bills of Exchange Act 1882, Lord Herschell said:²⁰

The purpose of [a codifying] statute surely was that on any point specifically dealt with by it, the law should be ascertained by interpreting the language used instead of, as before, by roaming over a vast number of authorities in order to discover what the law was, extracting it by a minute critical examination of the prior decisions.

The statutes were a triumph, described by one judge as ‘the best-drafted Acts of Parliament ever passed’.²¹ Not only did they make the law accessible,²² but they yielded such effective principles that the law has required little reform since.²³ This is not to say that the law has stood still. Many details have required modification to reflect changing commercial and social values, but this modification has taken place well within the original framework. In sales law for example, demand from consumers has tightened the legal duties imposed on sellers,²⁴ and demand from business has necessi-

¹⁶ For the role of business in instigating the codification process, see Rodger, ‘The Codification of Commercial Law in Victorian Britain’ (1992) 108 *LQR* 570.

¹⁷ Sir Frederick Pollock, author of a highly influential digest on the law of partnership, drafted the Partnership Bill. The rest were entrusted in large part to Sir Mackenzie Chalmers.

¹⁸ The cost of the draft Bills was ultimately shared between the Chambers of Commerce and the Institute of Bankers: Executive Council of the Associated Chambers of Commerce, 11 Mar. 1881.

¹⁹ [1891] AC 107.

²⁰ At 144–5.

²¹ MacKinnon, LJ in *Bank Polski v. Mulder & Co* [1942] 1 All ER 396.

²² Another argument in favour of codification was that it would offer a single coherent statement of English business law at a time when numerous international conventions were being held to undertake the global harmonisation of trade laws: T. Barclay, ‘Assimilation of Mercantile Law’ (1886) 2 *LQR* 66.

²³ The codes also gave the opportunity for the assimilation of laws in England and Scotland. These laws remained very different even following the investigation of a Royal Commission in June 1853. The Commission published a first Report in 1854, and legislation followed in 1856. However, it was unpopular and widely criticised at the time for making unsatisfactory and superfluous changes to the law: ‘English Amendments of Scotch Law’, 1 *Scottish LJ* 1 (1858).

²⁴ The most significant amendments were made by the Supply of Goods (Implied Terms) Act 1973, which introduced a distinction between consumer and non-consumer transactions and

tated the legal recognition of co-ownership in mixed goods.²⁵ Parliament has introduced these changes without compromising the clarity of the original code, by passing consolidating legislation. The Sale of Goods Act 1979 brings together the disparate Sales Acts passed since 1893, reproducing the original Act and its subsequent reforms in a single instrument. This consolidation does not serve the same function as codification, since earlier materials are not replaced, merely republished. However, the combination of both measures—codification and consolidation—has ensured that our commercial laws remain both relevant and accessible.

Parliament has even added entire branches of law without disturbing the integrity of the original legislation. This summer Parliament passed the most important partnerships legislation since the original Act of 1890 in the shape of the Limited Liability Partnerships Act.²⁶ The Act will add another form of business entity to the existing armoury, providing an attractive means of incorporation for multinational accountancy and legal firms.

Nineteenth-century codification was therefore a great success, which has led some to question why the process should not be expanded across a broader ambit of commercial transactions.²⁷ The reason for this lies in the law's inherent pragmatism. During the nineteenth century full codification was considered to be too difficult within the British parliamentary system, and lawyers concluded that the complexity of formulating and enacting a large commercial code would not be justified by compensating benefits.²⁸ Experience from France and Germany has added little momentum to the campaign, as the commercial codes in these countries have yielded only equivocal benefits. No code can be entirely comprehensive,²⁹

introduced an implied term of merchantable (now *satisfactory*) quality where the seller is in the course of a business. It also took measures to prevent sellers from restricting their liability and consolidated the terms implied into contracts of sale with those implied into contracts of hire purchase. For details, see Carr, 'The Supply of Goods (Implied Terms) Act 1973' (1973) 36 *MLR* 519.

²⁵ See the Sale of Goods (Amendment) Act 1995.

²⁶ See N. Beresford 149 (1999) *NLJ* 1647.

²⁷ See, e.g. R. Goode, *Commercial Law in the Next Millennium* (1998), ch. 4.

²⁸ It was said by no less a reformer than Lord Selborne LC, chief proponent of the Judicature Acts, that a wholesale commercial code would create enormous difficulties in Parliament, and would be unlikely to pass through both Houses without so much scrutiny as to destroy the utility of the project: 'Codification of Commercial Law' (1885) 78 *Law Times* 321.

²⁹ The German commentator Köndgen writes of the 1897 *Handelsgesetzbuch* (Commercial Code) 'Its choice of transaction types seems selective at best, arbitrary at worst; and its provisions are often fragmentary. While we find adequate provisions relating to the carriage and storage of goods, or commercial agency, the Code is silent on banking, secured transactions or commercial leases; the provisions on commercial sales cover merely ten sections.' ('Commercial Law', in Ebke and Finkin (eds.), *Introduction to German Law* (Kluwer, 1996).

and in Germany a trader now refers to the commercial code for the content of his agreements, to the civil code for the existence of his agreements, and to judicial precedent for the validity of his agreements.³⁰

In Britain, the absence of full-scale codification has brought a significant advantage: legal flexibility. Since it is founded on general principles, commercial law has evolved in tandem with wider legal values. For example, in the Victorian era from which the Sale of Goods legislation dates, a contract formed under the influence of illegitimate pressure would only be set aside if this pressure took the form of a physical threat.³¹ Today we recognise a subtle body of rules that regards all illegitimate threats as capable of amounting to duress.³² By a process of steady evolution, the law has moved far from its unforgiving Victorian roots.

III. Laying the foundations for a free market economy: the law of contract³³

The second keystone of commercial law is its recognition of private agreements. Today it goes without saying that most types of business contract may be freely made and enforced in the courts, with the obvious exception of contracts which have unlawful or immoral purposes.³⁴ In any free market system, a large proportion of wealth is concentrated in speculative interests held on share and futures exchanges. For this market to operate, it is essential that traders be kept to their promises.

The absence of any law of contract at the turn of the nineteenth century

Yet the modern law of agreements is a surprisingly recent phenomenon. In the wake of the Glorious Revolution, secure property rights assumed supreme political importance³⁵ and legal policy was focused on the

³⁰ Under the principle of good faith, devised by German courts in response to hyperinflation during the 1920s and 1930s and based upon §242 BGB.

³¹ *Skeate v. Beale* (1841) 11 A & E 983.

³² *The Dimski Shipping Corporation SA v. International Transport Federation (The Evia Luck)* [1992] 2 AC 152. The law is, of course, commercially sensitive. Careful distinctions are drawn between those threats which are illegitimate and those which are legitimate business practices: *CTN Cash & Carry v. Gallagher Ltd* [1994] 4 All ER 714.

³³ See generally P. Atiyah, *The Rise and Fall of Freedom of Contract* (1979), A. Simpson, 'Innovation in 19th Century Contract Law' (1975) 91 *LQR* 247.

³⁴ See *Lipkin-Gorman v. Karpnale* [1991] 2 AC 548.

³⁵ J. Plumb, *The Growth of Political Stability in England 1675–1725* (1967).

protection of ownership.³⁶ Any financial speculation undermining this security was frowned upon, and even criminalised. As late as 1800, traders were being prosecuted for offences such as *regrating*, that is buying goods for resale at the same market.³⁷

This economic climate had no need for an autonomous law of contract. Agreements did little more than facilitate property transfer,³⁸ and the law gave no support to market speculation. Agreements to purchase goods were unenforceable until the goods had in fact been delivered,³⁹ so parties could simply escape from a bargain if a change in the market price made it unprofitable. Even when goods had been delivered, a supplier could not insist on the agreed contract price, but damages in any court proceedings would be confined to the objective value of the goods provided.⁴⁰

Nineteenth-century revolutions—the age of freedom of contract

A developed law of contract did not really emerge until the 1820s, led on by the pressures of railway capitalism.⁴¹ Steam railways demanded an unprecedented financial outlay which could only be met through public subscription, and they offered healthy profits in return. Speculation took off on an unprecedented scale,⁴² but the framework for this speculation was simply not in place. With no adequate legal backing, the market experienced three devastating crashes in the space of twenty years.⁴³

In response to the vast increase in trade during the Industrial

³⁶ As Thompson points out: ‘Millers and—to a greater degree—bakers were considered as servants of the community, working not for a profit but for a fair allowance’: E. Thompson, ‘The Moral Economy of the English Crowd in the Eighteenth Century’, (1971) 50 *Past & Present*, 76: 83.

³⁷ *R v. Ruby* (1800) Peake Add Cas 189.

³⁸ It is of particular interest that in Blackstone’s *Commentaries*, contract is dealt with under *Volume ii* (‘*Rights of Things*’).

³⁹ In *Walker v. Moore* (1829) 10 B & C 416, Littledale J went so far as to say: ‘It is contrary to the policy of the law that a man should offer an estate for sale before he has obtained possession of it.’

⁴⁰ *Flureau v. Thornhill* (1775) 2 W BL 1078. The reason for this is that promises were enforced not for the subjective reason that the parties had reached agreement, but only in so far as the transaction had a binding moral force.

⁴¹ See generally R. Kostal, *Law & English Railway Capitalism 1825–1875* (Oxford, 1994).

⁴² N. McKendrick, J. Brewer, & J. Plumb, *The Birth of a Consumer Society: The Commercialisation of Eighteenth-Century England* (1982).

⁴³ The crashes took place in 1826, 1836, and 1845. Contemporary businessmen pilloried the legal system for its shortcomings. The harsh verdict of the *Railway Gazette* (26 May 1849) was that ‘the public have waited in vain for three years for some speedy means of bringing to justice those who robbed them. . . . They have hitherto been helplessly and hopelessly without redress.’

Revolution, a new and principled law of agreements emerged.⁴⁴ Its rules were focused on the original intentions of the parties to the agreement, so bringing three crucial advantages to business. First, technical and artificial constructs gave way to new simple rules for the interpretation of agreements.⁴⁵ Secondly, the law began to enforce speculative bargains without requiring prior performance by either party, preventing recalcitrant traders from evading unprofitable transactions.⁴⁶ Thirdly, damages began to be assessed on a realistic basis, the court looking to the terms of the original agreement to calculate a party's loss.⁴⁷

In this way the law has evolved into a fine engine for financial speculation. By 1877, less than eighty years after Kenyon LC had condemned regrating as contrary to the common law,⁴⁸ Bacon VC said in the case of *Noble v. Edwards*,⁴⁹

A man who speculates in land means always to get as much profit from it as he can. If, by his superior skill, he foresees that he can make an advantageous profit by working, cultivating and improving a farm, certainly if it is worth his while he can do that, and it would be quite worth the while of anybody buying from him to pay him whatever in their respective judgments, the land is worth, without considering what the then vendor gave for it himself. What is more common? It is everyday practice in this court.

IV. Upholding the expectations of merchants— legalising mercantile practice

The law of contract gives traders the flexibility to establish business arrangements tailored to their own requirements. But a business agreement will rarely make express provision for every detail of the bargain, and so the law must fill the gaps, giving effect to the presumptions and expectations of the traders entering the agreement. English law achieves this objective in two ways: by creating legal rules based on realistic trade customs, and by recognising that traders often wish to incorporate standard terms and practices into their agreements.

⁴⁴ Such work was founded on the work of Lord Mansfield, who half a century earlier had championed the intentions of the parties as a means of contractual interpretation in cases such as *Pillans & Rose v. Van Mierop & Hopkins* (1765) 3 Burr 1663.

⁴⁵ See *Kingston v. Preston* (1773) 2 Doug 691.

⁴⁶ Simpson, 'Innovation in 19th Century Contract Law' (1975) 91 *LQR* 247.

⁴⁷ This was achieved by the time of *Hadley v. Baxendale* (1854) 9 Ex 341.

⁴⁸ *R v. Ruby* (1800) Peake Add Cas 189.

⁴⁹ (1877) 5 ChD 378.

Conferring positive legal status on mercantile institutions

Let me turn to three specific illustrations of how the law has facilitated trade by creating bodies of law based on trade custom.

Bills of exchange

First, bills of exchange. A debtor wishing to make a payment may approach his bank for a bill of exchange, to be drawn in favour of the creditor. The bill is sent to the creditor, who has two options: either he may present the bill to the bank or its local agent for payment, or he may transfer the bill to a third party, who then receives the right to payment from the bank. The mechanism holds many advantages for business, and has been operated by merchants since the thirteenth century. Its greatest attraction is the attribute of free transfer, or *negotiability*. The creditor receives a promise of payment that can readily be transferred to third parties with the minimum of formality.

Bills of exchange were not easy to integrate into the law. Their negotiability sits in stark contrast to the inflexible common law rule that contractual rights may not be transferred to third parties.⁵⁰ For this reason, early decisions set bills of exchange outside the common law, in the law merchant.⁵¹ By the late seventeenth century, however, bills of exchange had become such a central feature of commercial transactions that they were finally recognised by the common law,⁵² and a full set of rules was swift to develop. These rules were modelled firmly upon the practice of traders. For example, in a case of 1695⁵³ the court was asked to rule upon the appropriate rule for the settlement of foreign bills. Evidence was led, proving that universal practice in the business world was to allow three days' grace for payment. This practice was accepted as law. Much further development and consolidation took place during the eighteenth and nineteenth centuries—the numerous digests on the law⁵⁴ culminating in Sir Mackenzie Chalmers' Bills of Exchange Act 1882. Its principles derive directly from the practice of businessmen and that is the reason for its enduring success.

⁵⁰ In *Three Rivers v. Bank of England* [1996] QB 92, the court summed up the common law's refusal to countenance the assignability of contractual rights. Assignment is only recognised in equity or in exceptional cases by statute. See Law of Property Act 1925, s. 136.

⁵¹ See *Burton v. Davy* (1437) SS 49, 117.

⁵² This achievement is credited to *Woodward v. Rowe* (1666) 2 Keb 105, 132.

⁵³ *Tassell and Lee v. Lewis* (1695) 1 Ld Raym 743.

⁵⁴ e.g. Chitty's *Treatise on the Law of Bills of Exchange* (1799), Byles's *Treatise on the Law of Bills of Exchange* (1829).

Bills of lading

The innovation of the international shipping community provided another fertile source of inspiration. Of particular importance to modern shipping is the bill of lading, a document issued by the carrier both to evidence the shipping contract and to prove the shipper's title to the cargo. Yet bills of lading are another legal oddity. Once issued by the carrier they may be freely conveyed to third parties, and this conveyance operates to transfer not only title to the cargo, but also the rights of the shipper under the contract of carriage.⁵⁵ Given the conflict between bills of lading and the common law's refusal to sanction transferable contracts, these bills were slow to be recognised. It took the decision of a special jury in the historic decision of *Lickbarrow v. Mason*⁵⁶ in 1793 to establish that transfer of title to the cargo accompanied transfer of the bill and that became the common law. However, it took the Bills of Lading Act, 1855, to provide that the rights of the shipper under the contract of carriage also accompanied transfer of the bill.

Two unusual features highlight the unique commercial origins of the law governing bills of lading. First, legal intervention has been kept to a bare minimum, to the extent that many central doctrines remain as presumptions, rather than rules of law. Indeed, the first principle of shipping law—that carriers may always be compelled to issue a bill of lading—stands entirely unsupported by legal authority.⁵⁷ The law has intervened only as required, as for example in 1992, when the Carriage of Goods by Sea Act was passed to close a serious gap identified in a case before the House of Lords when a carrier escaped all liability for negligently damaging a cargo sold in transit.⁵⁸

The second unique feature of shipping law is the extent of international harmonisation. At the turn of the twentieth century, international practice began to grow disparate. Individual states had introduced legislation regulating the rights and duties of parties to shipping agreements,⁵⁹ but this piecemeal approach could not be sustained in an increasingly

⁵⁵ Since the Carriage of Goods by Sea Act 1992.

⁵⁶ (1793) 2 TR 73.

⁵⁷ D'Arcy, *Ridley's Law of the Carriage of Goods by Land, Sea and Air*, 7th edn. (1992), p. 82.

⁵⁸ See *Leigh & Silavan v. The Aliakmon Shipping Company Ltd, The Aliakmon* [1986] AC 785, where the buyer of steel coils was left without a remedy when the goods were negligently damaged in transit at a time when they still belonged to the sellers. The sellers had no remedy as they had suffered no loss, and the contractual rights under the agreement had not passed to the buyers until a point in time after the damage had already occurred.

⁵⁹ The first legislation of the modern age was the Harter Act, enacted in the United States in 1893. This was followed by the Australian Sea Carriage of Goods Act 1904 and the 1910 Water Carriage of Goods Act in Canada.

global marketplace. The international trading community moved for standardisation, and a body of international rules was introduced at The Hague on 25 August 1924.⁶⁰ The Hague Rules (as amended in 1968)⁶¹ have been highly successful in establishing a worldwide framework for contracts of carriage by sea. The rules stand as testament to the role of the law as an engine for trade. By harmonising conditions of carriage across the globe, they have lowered the costs of negotiating international contracts and established minimum standards to set a level playing field for traders.

Letters of credit

My third example of business-led development in commercial law comes from international finance. Letters of credit are financing mechanisms operated between parties to an international sale. The buyer opens at his bank a credit in favour of the seller subject to specific instructions, usually that the bank withholds payment until it receives valid shipping documents. The buyer's bank then sends a letter of credit to the seller, either through its own offices or through another bank in the seller's country. Once the goods have been dispatched, the seller must present the requisite documents to the bank, and payment will be made.

Letters of credit provide traders in the international market with a guaranteed means of payment, which oils the flow of international trade. Yet letters of credit contain two legal surprises. First, they are anomalous within the common law. By mercantile usage, the bank's payment undertaking is considered binding by virtue of its issue alone without the need for consideration or reliance by the beneficiary. A second surprise is the complete absence of statutory intervention in this area. Both these features are understandable, however, since letters of credit have developed almost entirely through the initiative of businessmen.

In 1933, the International Chamber of Commerce published a set of Uniform Customs and Practice for Documentary Credits to establish an international standard for letters of credit. Revised on a regular basis,⁶² the

⁶⁰ The International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 25 Aug. 1924. The Convention was implemented into English law by the Carriage of Goods by Sea Act 1924, which came into force on 1 Jan. 1925.

⁶¹ This amendment was necessary to take account of the container revolution. It was signed at Brussels on 23 Feb. 1968, and implemented into English law by the Carriage of Goods by Sea Act 1971.

⁶² Revisions occurred in 1951, 1962, 1974, 1983, and 1993.

Uniform Customs and Practice are incorporated into letters of credit world-wide.⁶³ They are a prime example of commercial development taking place outside the legal arena, but recognised by the law. Of course, letters of credit have come before the courts and judges have upheld their legality as an aspect of mercantile practice, but these judgments owe their content largely to the terms of the Uniform Customs and Practice. In 1983, the House of Lords was asked to determine a point on which there was no prior authority in English law: whether, when the seller had unwittingly tendered to the confirming bank documents containing a false statement, the bank was obliged to pay.⁶⁴ The House of Lords found that the bank *was* obliged to pay, after evaluating the possible solutions to the problem with one eye to the Uniform Customs and Practice and another to the demands of commerce. Lord Diplock dismissed the proposition, that the bank was not obliged to pay if the documents, although conforming on their face with the terms of the credit, contained some inaccurate statement of material fact, thus:⁶⁵

The more closely this bold proposition is subjected to legal analysis, the more implausible it becomes; to assent to it would, in my view, undermine the whole system of financing international trade by means of documentary credits.

Letters of credit are thus another prime example of the law responding to change by adapting its rules with keen commercial sensitivity to the customs and expectations of traders.

Soft law—incorporating the understandings of merchants into commercial agreements

The second way in which the law has acted to uphold the expectations of traders is by giving effect to standard business practices in commercial agreements. Widely accepted practices are of great value to business, as they provide ready-made bodies of rules that adapt to change and avoid the need for direct legislation. This is particularly true in international trade, where the commercial pressure for legal harmonisation is great but the potential for agreement among governments is low. The legal vacuum remains to be filled by the initiative of businessmen.

At an international level, much positive work has been carried out by

⁶³ See the comments of Mustill LJ in *Royal Bank of Scotland v. Cassa di Riparmio delle Provincie Lombard* [1992] 1 Bank LR 251 at 256, and for a full discussion, see B. Kozolchyk, 'Letters of Credit', 9 *International Encyclopaedia of Comparative Law*.

⁶⁴ *United City Merchants v. Royal Bank of Canada* [1983] 1 AC 168.

⁶⁵ at 184.

the International Chamber of Commerce, (the ICC), an organisation run by businessmen from over 130 member states. We have already seen the value of the Uniform Customs and Practice for Documentary Credits. The ICC has also been active in international shipping, by drawing up a set of standard terms for international shipping contracts. INCOTERMS are drafted by lawyers and businessmen and updated regularly.⁶⁶ They are so widely accepted throughout the world that INCOTERMS are likely to be implied into shipping contracts even if the parties make no direct election themselves.

Such permissive forms of regulation are also evident in domestic trade law. The Companies Act 1985 contains a model constitution for limited liability companies, whose provisions may be adopted or excluded at will. These measures are a highly efficient way of supervising business, as they give entrepreneurs commercial freedom to select the most appropriate rules for their individual needs.⁶⁷ So, we have seen various means in which the law has facilitated trade by giving full effect to business customs. In some instances the law has followed the initiative of business by turning commercial practice into law. In others it has maintained a deliberately low profile, allowing businessmen to make their own rules and giving legal effect to these rules only when required.

V. Sensitive regulation of trade

Next, let me turn to instances where lawyers have led the way.

Early political economists declared that the sole objective of business law was to follow the lead of merchants. In his *Wealth of Nations*, Adam Smith concluded that man's pursuit of his own self-interest provided the key to prosperity, and that legal intervention was unwelcome in the free market process.⁶⁸ Of course, the idea has much truth. Healthy market freedom is an important interest, and modern economists continue to stress the importance of minimum commercial regulation.⁶⁹

⁶⁶ The latest version is INCOTERMS 2000.

⁶⁷ B. Cheffins, *Company Law: Theory, Structure and Operation* (1997), ch. 5.

⁶⁸ G. Brennan & J. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (1980).

⁶⁹ As Professor Cheffins writes in his economic analysis of company regulation, 'The enactment and amendment of legal standards can be a process plagued by delays. . . . The individuals who promulgate and administer laws governing market behaviour may not have sufficient expertise concerning the conduct being regulated to judge accurately the impact of the decisions they are taking. . . . Government regulation can suffer from problems which can undermine the case for intervention': Cheffins, *Company Law*, p. 364

However, at some point regulation becomes inevitable. At the time of the first railway company flotations in the 1820s, there was an entirely unregulated share market.⁷⁰ Prevented from forming public companies by the notorious Bubble Act of 1721,⁷¹ entrepreneurs offered shares to the public unlawfully by trading under 'deed of settlement' associations. Disreputable enterprises flourished. Of the 624 associations floated in 1824, only one fifth survived until 1827.⁷² When the practice of public subscription was legalised in 1825, businessmen were able to operate within the law but little overall benefit was achieved. In the absence of any regulatory framework, commercial standards remained reprehensibly low. Dishonest businessmen floated thinly-capitalised companies,⁷³ and devastating stock market crashes occurred in 1826, 1836, and 1846.⁷⁴

This experience highlights the first danger of an unregulated market: the inevitable temptation to perpetrate fraud. The second danger is the so-called externalities problem.⁷⁵ Businessmen are likely to operate to maximise their own profits, although this may prejudice society as a whole. Thus, law must regulate to ensure that the driving force of commerce does not undermine wider public interests. Self-regulation is one possible solution to these two dangers, allowing business to take collective notice of public policy. For this reason, self-regulation is an essential feature of the English business system, and is directly encouraged by law. The Financial Services Act 1986 established a comprehensive scheme of self-regulation in the supervision of equity markets,⁷⁶ with daily operations overseen by Recognised Investment Exchanges, run by market practitioners, with ultimate authority in the Securities and Investment Board, itself a private company. The most recent Statute is the Financial Services and Markets Act 2000, which establishes the Financial Services Authority.⁷⁷

⁷⁰ DuBois, *The English Business Company After the Bubble Act* (1938).

⁷¹ See generally, Gower, *Principles of Modern Company Law* (1997), chs. 2–3.

⁷² H. English, *A Complete View of Joint Stock Companies Formed in 1824 and 1825* (1827).

⁷³ Hunt, *The Development of the Business Corporation in England 1800–1867* (1936).

⁷⁴ M. Reed, *Investment in Railways in Britain 1820–1844: A Study in the Development of the Capital Market* (1975), 14–16; Pollins, 'The Marketing of Railway Shares in the First Half of the Nineteenth Century', *Economic History Review*, 2nd ser. VII (1954–5), 233.

⁷⁵ As identified in the ground-breaking article by Professor Ronald Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law & Economics* 1.

⁷⁶ R. Bagott, 'Regulatory Reform in Britain: The Changing Face of Self-Regulation' (1989) 67 *Public Administration* 435.

⁷⁷ The regulation of markets and financial services is now supervised by the Financial Services Authority under a new statutory framework created by the Financial Services and Markets Act 2000. The Act lays down four central objectives to be respected in the regulation of financial markets: market confidence, public awareness, the protection of consumers, and the reduction of financial crime.

However, self-regulation is not always adequate, and the law must often take a positive lead in prescribing commercial standards. In taking this lead, the law recognises three key principles. First, the principle of minimum regulation: the regulator must avoid tying the hands of business with an excessive number of rules. Secondly, the principle of appropriate regulation: selecting the correct type of rule for the context. Broad mandatory rules are rarely required, and it is often possible to regulate in less intrusive ways by providing standard practices in which industry is strongly encouraged to participate. Thirdly, there is the principle of continuing relevance: the regulator must ensure that the rules passed are capable of frequent and effective updating to take account of commercial developments. By respecting these principles in all forms of regulation, English law has been consistently sensitive to commercial needs.

Company law—sensitivity in Parliament and the courts

The boom-and-bust experience of railway capitalism illustrated the need for state intervention in the companies' market. Yet, at the same time, a middle course was required between total deregulation and the stifling administrative requirements formerly imposed by the Bubble Act.⁷⁸ In the aftermath of the appalling market crashes came the modern corpus of company law.

The answer to companies regulation was devised by Gladstone in 1844.⁷⁹ Since that time, the company as a business vehicle has taken off as an unequivocal success. In 1885, there were 60 listed companies. Today, the total number of companies registered at Companies House is around 1.14 million,⁸⁰ and 2,450 of these are listed on the London Stock Exchange.

The modern system rests on three key principles: free incorporation, limited liability, and minimum external interference. The first principle is that businessmen must have freedom to seek access to public money by incorporating as companies. There is of course the danger that incorporated companies will be used as a sham to swindle investors, but this danger cannot be addressed by burdensome regulation, or else promoters

⁷⁸ As the *Railway Gazette* recorded in 1859: 'Each separate railway company which has been under the necessity of applying to Parliament for powers . . . has been mulcted in an enormous amount of money for no earthly purpose but to fill the pockets of parliamentary lawyers': *Railway Gazette*, 5 Mar. 1859.

⁷⁹ *Parliamentary Papers*, Commons (1844) VII Q 2054. See also F. Hyde, *Mr Gladstone at the Board of Trade* (1934).

⁸⁰ Figures taken from DTI Consultation Paper: *Modern Company Law for a Competitive Economy* (1998).

will operate outside the law as they did in the 1820s. The solution is a model of free market theory, a system of public company registration which is convenient for businessmen, yet informative for potential investors. Individuals now have the right to incorporate as companies, but the price of this right is the publication of details including the company's constitutional documents and annual accounts at Companies House.

The second principle is that the public must be actively encouraged to subscribe in business ventures, which generally requires that they be protected from the risk of business failure. In 1855, the Companies Act was amended to allow the liability of members to be limited to the value of their shareholdings. Again, however, there must be a price for this broad right, and Parliament has evolved protective mechanisms to ensure that limited liability is not abused at the expense of company creditors. For example, it is a rule of fundamental importance that the share capital of a company—that proportion of assets which has been contributed by shareholders—must be kept intact for the benefit of creditors. The Companies Act strictly controls the circumstances in which a company can reduce its share capital, and court approval must be sought before making a formal reduction of the capital fund.⁸¹ The common law has also evolved doctrines to prevent fraud, and shareholders will be personally liable for a company's debts if they have formed the company to perpetrate a fraud.⁸²

Thirdly, there is the principle of minimum interference in company management. Informed market freedom underlies the operation of English companies legislation, and supervision of company management is generally left to the shareholders acting through the general meeting. Of course, there has been some legislative intervention to provide for cases where the principle of informed market freedom has failed. Under the Company Directors Disqualification Act 1986, dishonest or incompetent company directors can be disqualified from company management. The Insolvency Act 1986 contains provisions to hold directors criminally liable for fraudulent trading,⁸³ and liable at civil law for trading in the knowledge that the company cannot pay its debts.⁸⁴ The Law Commission has recently recommended that the law impose a strict objective standard of care on company directors to ensure the better pro-

⁸¹ This was achieved by a legislative reform of 1928. See Company Law Committee, *Section 151 Companies Act 1985* (Law Society Legal Practice Directorate, 1990) pp. 21–32.

⁸² *Williams v. Natural Life Health Foods Ltd* [1997] 1 BCLC 131.

⁸³ Insolvency Act 1986, s. 213.

⁸⁴ Insolvency Act 1986, s. 214.

tection of those dealing with companies.⁸⁵ This would be a considerable development from the position at the turn of the twentieth century, which merely required a company director to exercise diligence in the conduct of his duties.⁸⁶

Companies regulation should not only be effective, but it must also be clear. The original Companies Act 1844 has now been amended on many separate occasions, and while these amendments are presently consolidated in the Companies Act 1985, the profusion of company law sources remains a cause for some concern. A major review of company law is currently underway at the Department of Trade and Industry in order to streamline the regulation of companies, to eliminate unnecessary bureaucracy and to ensure the greatest respect for the principle of minimum regulation. The consultation document proposes:

To strip out obsolescent and over-complex provisions and repair defective ones. . . . We need clear and simplified arrangements which, starting from first principles, better capture the balance of obligations, protections and responsibilities which are required to underpin the modern marketplace so as to ensure that the participants can be confident about fair dealing.⁸⁷

The Review is also considering a reformulation of the duties imposed upon directors. In the manner of a nineteenth-century code, these duties would be taken from the common law and laid out in a single statutory statement to make the principles clear and accessible. All stages of the Review will enjoy full public consultation, through representative Working Groups and the regular publication of key findings for comment. All proposals will undergo economic analysis to ensure that the new law strikes an appropriate balance between regulation and facilitation.

Patents—sensitivity in legislation

Another example of successful legislative intervention in the free market has been the patent system, originating in the 1624 Statute of Monopolies. Patents are a clear compromise of free market principles, as they prohibit businessmen from taking the obvious and profitable step of copying other people's ideas. However, the compromise is entirely necessary. Without

⁸⁵ Law Commission Report No. 261, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*. This development may already have been pre-empted by the common law. See *Re D'Jan of London Ltd* [1994] 1 BCLC 561; (1994) 110 LQR 390.

⁸⁶ *Re City Equitable Fire Insurance Co* [1925] Ch 407.

⁸⁷ DTI Consultation Paper: *Modern Company Law for a Competitive Economy* (1998) para. 3.8.

patents, inventors would have little incentive to innovate and technological advance would be substantially impaired.

The modern patent system is again a product of the Industrial Revolution. Before the formation of the Patent Office in 1852, the administrative burden of obtaining patents was overwhelming. Applications demanded attendance at 10 different offices, and the process had to be carried out separately in Scotland, Ireland, and England and Wales.⁸⁸ The reforms of 1852 have transformed the patent system into an outstanding engine for commercial innovation. Last year alone almost 29,000 applications were made. Four features in particular have been instrumental in achieving appropriate regulation.

First, patents do not create wholly controlled monopolies. They confer on their owners the narrower benefit of exclusive commercial exploitation for a duration limited to twenty years. Even during the currency of the patent, members of the public⁸⁹ are free to conduct experiments on the patented invention.⁹⁰ The law only intervenes if the copier derives commercial advantage.

Secondly, the patent application procedure ensures that full technical details of inventions are disclosed to the public.⁹¹ Not only does this requirement ensure that patent applications are genuine, but crucially it facilitates technological advance. As Grove J said in a case of 1884:

[The applicant] is bound so to describe it in his specification as that any workman acquainted with the subject . . . would know how to make it; and the reason of that is this, that if he did not do so, when the patent expired he might have some trade mystery which people would not be able actually to use in accordance with his invention (although they had a right to use it after his patent had expired), because they would not know how to make it.⁹²

Thirdly, patents protect only novel and non-obvious inventions.⁹³ Applications are subject to intensive review, by the Patent Office before grant, and by judicial scrutiny after grant in any infringement proceedings.⁹⁴ This confines the rights of commercial exploitation to meritorious

⁸⁸ H. Dutton, *The Patent System and Inventive Activity During the Industrial Revolution* (1984), ch. 5. Charles Dickens portrayed the arduous process and its expense in his *Tale of a Poor Man's Patent*.

⁸⁹ Patents Act 1977, s. 60(5)(a).

⁹⁰ Patents Act 1977, s. 60(5)(b).

⁹¹ This has been the case since the great reforms of 1883.

⁹² *Young v. Rosenthal* (1884) 1 RPC 29.

⁹³ Patents Act 1977, s. 1.

⁹⁴ Patents Act 1977, s. 74.

cases, and prevents abuse by those seeking monopoly rights on the basis of no real innovation.

Fourthly, patents have been applied in a manner that is friendly to commerce. In particular, the judge-made rules of construing patent specifications display commercial sense and subtlety. Judges do not read patent documents literally, but search for their *pith and marrow*. In the leading case,⁹⁵ Lord Reid said:

Claims are not addressed to conveyancers: they are addressed to practical men skilled in the prior art, and I do not think that they ought to be construed with that meticulousness which was once thought appropriate for conveyancing documents.

That was under previous legislation but is still the modern approach of the judges.

The patent system is strongly marked by commercial sensitivity at all levels, both in its legislative infrastructure and in its judicial application.

Equity: sensitivity in judicial rule-making

In addition to these major legislative schemes, the continuing role of the judiciary in commercial regulation must not be overlooked. There is strong international confidence in our specialised Commercial judges.⁹⁶ Of particular interest is the way in which the courts have developed principles of Equity—an institution originally conceived to mitigate unfairness in the common law—in the commercial context. In the *Romalpa* case, in 1976,⁹⁷ the Court of Appeal was asked to adjudicate on the ownership of aluminium foil which had been sold to a company on the following terms:

The ownership of the material to be delivered will only be transferred to purchaser when he has met all that is owing to seller. . . . Until the moment of full payment of what purchaser owes seller purchaser shall keep the objects in question for seller in his capacity of fiduciary owner.

These terms were intended to prevent ownership from passing to the buyer until the price had been paid. This turned out to be important

⁹⁵ *Rodi & Wienberger AG v. Henry Showell Ltd* [1969] RPC 367.

⁹⁶ For a positive appraisal of the sensitivity of the specialised commercial judiciary in England, see R. Austin, 'Commerce and Equity—Fiduciary Duty and Constructive Trust' (1986) 6 *OJLS* 444. A very different system of judicial specialisation operates in North American jurisdictions, and this has been criticised: see, for example, H. Butler and L. Ribstein, 'Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians' (1990) 65 *Wash LR* 1.

⁹⁷ *Aluminium Industrie Vaassen BV v. Romalpa Aluminium Ltd* [1976] 1 *WLR* 676.

security, as the buyer went into receivership before making payment. The seller's only effective means of recovery was to rely on these terms and claim ownership of the foil it had supplied. The court accepted that the seller could claim the aluminium remaining in the buyer's yard. This proved a milestone in the law of secured credit, giving suppliers the opportunity to protect themselves against the insolvency of their buyers without the need for formal security in the shape of a mortgage or a charge. Since the original *Romalpa* decision in 1976, there has been a flourishing case law in this field.⁹⁸

The court also accepted that the seller was entitled to claim ownership of £35,000 in the buyer's bank account representing the proceeds of foil that had been sold on to third parties. The claim was revolutionary, as orthodoxy suggested that the seller's claim to ownership of the foil had lapsed in favour of a bare contractual claim to the proceeds of sale. Yet the court looked to principles of Equity to uphold the seller's claim. It has long been established that when a party is appointed to serve the interests of a principal, whether as a trustee or an agent, he must not take unauthorised profits from the transaction. If he does, the profits belong in equity to the principal. In *Romalpa*, the court took this rule and set it in a commercial context, holding that the terms of the sale contract created a fiduciary relationship, and that any profits obtained by the buyer would belong in equity to the seller.

This is not the only example of judicial creativity in the commercial world. In company law, judges have relied on the law of fiduciaries to regulate company management, prescribing minimum standards of honesty and loyalty with which directors must comply. In these ways, the judiciary has played an important and creative role in commercial regulation even during the twentieth century.

VI. Conclusion—commercial law into the future

In this brief review, we have seen that the unique English system, without any distinct corpus of commercial rules, has proved an outstanding success. In particular, three features have marked the law's approach since it began the process of commercialisation in the eighteenth century: facilitation, integration, and regulation. The law has *facilitated* trade by

⁹⁸ Key cases have been *Re Bond Worth Ltd* [1980] Ch 228, *Re Peachdart Ltd* [1984] Ch 131, *Armour v. Thyssen Edelstahlwerke AG* [1991] 2 AC 339, and *Compaq Computer Ltd v. Abercorn Group Ltd* [1993] BCLC 602.

recognising the effect of commercial agreements and practices, giving effect to the intentions of contracting parties to support the free market economy. The law has *integrated* key mercantile customs into its structure, establishing coherent and predictable legal frameworks in a number of areas important to business, from bills of exchange to sales of goods. The law has also *regulated*, particularly in recent times, prescribing rules to ensure that the free market operates with the greatest internal efficiency and without detriment to the community at large.

Each of these features has assumed its greatest importance at different stages of legal development. Facilitation and integration were early objectives, as the common law courts had to reform their rules and procedures to accommodate a body of mercantile custom which had for centuries been regarded as a separate institution. Regulation is a more recent phenomenon, as increasingly sophisticated economic theories of markets have called for measures of state intervention, and governments have become more eager to act in the interests of market openness and fairness. Yet all three processes remain relevant to the law-making process as we begin the twenty-first century.

The law continues to facilitate, by encouraging flexible frameworks that give traders the freedom to set their own standards of conduct. In the last five years, the approach to dispute resolution has been undergoing radical change to reduce the burden of litigation on business. Court procedures have been streamlined to enhance the speed and effectiveness of litigation, and in a broader context, other procedures such as strengthened arbitration,⁹⁹ and mediation,¹⁰⁰ and alternative dispute resolution, are being actively promoted.

The law continues to integrate, particularly in the international arena. Legal cooperation within the European Union has been considerable, and Community Directives have now harmonised large areas of commercial practice, from public company mergers¹⁰¹ to the use of unfair terms in

⁹⁹ As a result of the Arbitration Act 1996, the arbitration mechanism has been substantially expedited, parties have been given greater freedoms to fix their own procedures, and arbitration has been asserted as a true source of dispute resolution independent of the courts.

¹⁰⁰ In June 1996 the Commercial Court issued a practice statement encouraging judges to adjourn proceedings at an early stage if alternative dispute resolution, particularly mediation, would be appropriate.

¹⁰¹ The 1st Company Law Directive of 1968 (Directive 68/151) made provision for compulsory disclosure of company information, registration, pre-incorporation contracts and *ultra vires* and exhaustive grounds of nullity. To date, a further four Company Law Directives have been adopted and implemented, two are awaiting implementation and five remain under negotiation.

consumer contracts¹⁰² and the mutual recognition of professional qualifications.¹⁰³ In the field of intellectual property, the European Patent Office in Munich has provided an invaluable service to business since its inception in 1973. It allows inventors to secure patents in every Member State with just a single application, and the Office now receives over 100,000 applications every year. Global cooperation is also an increasing reality. I have emphasised the valuable work of the International Chamber of Commerce in formulating standard practices, and the importance of the Hague Rules in setting standards for international shipping. International instruments for the harmonisation of trade are a striking feature of the modern legal scene. In July 2000, the International Law Association met in London to discuss proposals for international conflict of laws rules, and in December in Geneva the World Intellectual Property Organisation will consider an international instrument for the protection of audiovisual performances. The law also continues to innovate through regulation. The limited liability partnership and the current Company Law Review are prime examples of an increasingly sophisticated law reform process led by government in consultation with the Law Commission and business.

Thus the law has been and is an essential engine for trade. By devising a principled reconciliation of *laissez-faire* and excessive regulation, giving scope for market freedoms while prescribing firm rules when required, English law has been the creative mediator to resolve diverse interests into a congruent whole.

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¹⁰² Directive 93/13 (Unfair Terms in Consumer Contracts).

¹⁰³ See especially Directive 89/48 on the mutual recognition of diplomas, and Directives 77/249 and 98/5 on legal qualifications.