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Some Basic Ways Good Law, Good Legal Institutions Good Legal Traditions, and Principles of The Rule of Law Can Augment Markets

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SOME BASIC WAYS GOOD LAW, GOOD LEGAL INSTITUTIONS, GOOD LEGAL TRADITIONS, AND PRINCIPLES OF THE RULE OF LAW CAN AUGMENT MARKETS

Robert S. Summers[1]

I. INTRODUCTION

One kind of good law is good contract law. Contract law and related law, good in form and good in content, can help augment markets in developing economies. In the first part of this paper, I will summarize the elementary rudiments of how this is so, with special focus on contracts of loan secured by interests in personal property. (I, of course, include advancement of credit as one kind of loan.) In this first part, I will, in simple terms, identify eight basic characteristics of a rational system whereby parties may create, through contract and related law, loans and personal property security interests to secure those loans, and thereby augment markets for loans. In the second part of this paper, I will merely identify the basic types of good institutions required to facilitate and enforce such contractual and related law. In the third part of the paper, I will turn to how a society may come to have such good contract and related law. There, I will single out legal traditions, but will concentrate on the extent to which the society generally subscribes to principles of the rule of law generally. Such a society is much more likely to have good contract and related law than a society that does not subscribe. This, of course, is not the only factor that can explain the existence of good contract and related law in a society.

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[1] McRoberts Research Professor of Law, Cornell Law School, and sometime advisor on the new civil codes of the Russian Federation and the government of Egypt. The author wishes to thank Mrs. Pam Finnigan for assistance, and also Ms. Shelley Detwiller, Cornell Law School Class of 1999, Mr. Steve Greenblatt, Cornell Law School Class of 1999, and Mr. Ian Johnson, Cornell Law School Class of 2000, for assistance. The types of laws discussed in this paper are treated intensively in White and Summers, 1995.

Yet, as I will argue, because of its fundamental and normative character, it is worthy of special emphasis.

II. THE RUDIMENTS OF GOOD CONTRACT AND RELATED LAW FOR SECURED LOANS

A society with good contract law with respect to loans of money would have several important types of good contract law, and several important types of related personal property law. Such a society would also have several important types of legal institutions and other basic legal constructs that facilitate and implement secured lending pursuant to contract. As the late Mancur Olson saw clearly, markets for loans also depend on the existence of what he called "third party enforcement" through appropriate action of courts and other agencies.

One of the most important types of contracts is that whereby a lender and a borrower enter into a contract in which the lender makes a loan secured by an interest in the debtor's personal property, i.e. the collateral. If the debtor fails to repay the loan as agreed, the creditor becomes entitled to "realize" on the collateral either by applying it directly in satisfaction of the debt or by making a public sale and applying the proceeds on the debt, with the debtor remaining liable for any deficiency. Such a security interest in the debtor's personal property is mainly a kind of "insurance" safeguard, and in the Western economies I am familiar with, creditors generally do not enter into contracts of loan with the expectation that the debtor is likely to default, so that it will be necessary to realize on the collateral. Rather, creditors generally expect repayment in the usual course, without default. The usual decision to lend is therefore very largely made on the basis of an independent assessment of the prospective debtor's likely ability to repay the loan without default, and so without the need to realize on any collateral.

Still, loans are not self enforcing trades. Creditors thus frequently lend to some degree against specific personal property security which they know they will have a right to realize on if the debtor defaults. Though this point is debated, it is I think, reasonably certain that even in advanced Western economies many loans still might not be made if it were not possible to take

security interests in collateral which can be realized upon in event of loan default. It is likely that this is all the more true in some less developed economies.[2]

I will now identify the main characteristics of good contract and related law with respect to contracts of loan to be secured by interests in personal property. I will dwell on the positive and the negative. That is, I will identify not only each of the major positive characteristics of such good law, but also the major corresponding deficiency for each characteristic. In many developing economies, it is the deficiencies that stand out.

A. RECOGNITION OF CONTRACTS FOR SECURED LOANS AS VALID AND ENFORCEABLE

At minimum, the law must grant and protect broad freedom of contract to enter into loan agreements. This type of freedom of contract is, in developed systems, merely one facet of much broader grants of freedom of contract. If the system already has a special body of law on contracts of this general type, legal recognition of their validity should be straightforward. The law governing contract formation with respect to loans ought to be relatively simple and contract formation ought to be relatively cheap. The relevant criteria of validity ought to require only that contracts of loan be in writing and that there be offer, acceptance, consideration or its equivalent, and due definiteness. The law ought also to include "off the rack" gap fillers providing standard terms in event of omissions in the contract itself.

The main possible deficiencies that such a body of law might have consist simply of negative correlates of the foregoing: undue restrictions on freedom of contract, costly formalities of contract formation, absence of gap fillers, and so on.

Another type of deficiency is that the system might fail to provide for the creation of security interests in property *acquired* by the debtor *after* the loan is made, for example, in inventory or equipment so acquired. That is, the system may fail to recognize "after-acquired property" clauses in security agreements, and therefore require parties to incur further costs at

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[2] This issue is discussed in Harris and Mooney, Jr., 1994. See also White, 1984.

periodic intervals to sign up further, new, security agreements covering such property. The recognition of such clauses at the outset saves these costs.

Similarly, the system might fail to recognize "future advance" clauses in security agreements. Such clauses allow one agreement to provide *now* for a security interest in property currently held by the debtor to secure not only loans *now* made, but loans to be made in the future. This saves costs, too.

The system might also fail to identify, define, and differentiate clearly between the various possible types of recognized collateral. Such binding legal definitions are essential. The lender needs to be able to describe the collateral in the security agreement, and in any further document that is to be publicly registered. The parties should be able to describe such collateral with legally effective accuracy free of confusion.

Also, if the various types of collateral do not, in the law, have authoritative defining descriptions, this may create some incentive for some lenders to become "collateral hogs" and insist on taking security interests in all of a debtor's property. If this occurs, this is likely to limit the flow of financing to the debtor.

The system of definitions should be clear enough, and related types of collateral sufficiently differentiated, so that several different lenders might be willing to share in the overall risk of lending to the same debtor, as where, for example, a real estate lender takes a security interest in the debtor's land, an equipment manufacturer takes a security interest in the debtor's equipment sold to the debtor by the manufacturer, a bank takes a security interest in the debtor's inventory (created by use of the equipment and materials), and so on.

The rules for determining ownership of types of personal property might also be deficient. The law might fail to include definitive rules for determining who has title to what. If it is difficult for a lender to determine with certainty whether a prospective borrower owns a given asset, the lender may be less willing to lend against such collateral.

The rules for integrating and co-ordinating personal property security interests *with* security interests in land and in fixtures on the land may also be deficient. Certainly, they require special attention.

B. ADEQUATE RECOGNITION OF TYPES OF PERSONAL PROPERTY INTERESTS WHICH MAY BE CREATED BY CONTRACT

The law should allow the creation of security interests in all appropriate types of personal property. This positive characteristic is perhaps best understood by considering what recognition would not be adequate. There might be valuable types of property that the law fails to recognize as possible types of collateral. For example, the system might fail to recognize inventory as potential collateral. Or the system might fail to recognize goods stored in a warehouse, or goods in process of manufacture, as potential collateral. Or the system might fail to recognize certain general intangibles such as intellectual property (copyrights, trademarks, or patents) as potential collateral.

C. SIMPLIFIED AND EFFECTIVE REQUIREMENTS FOR CREATING SECURITY INTERESTS THROUGH CONTRACT IN PERSONAL PROPERTY

The law should provide simple and effective means whereby two parties may contractually create security interests. This requirement, too, may be best understood by focusing on the ways in which it can fail to be satisfied. This requirement includes the subject of formalities for creation of a valid contract as such, and since I have already referred to this topic, I will confine myself here to the additional steps for creating a security interest in personal property.

The rules might simply fail to specify *clearly* what steps the contracting parties must take to create a valid security interest. Thus, the rules might fail to specify what type of language creates such an interest, and in what property. Further, these legal requirements for creation of a valid security interest might be excessive, unduly formal, too costly, or might unjustifiably limit the power to contract to a select class of prospective lenders (thereby inhibiting competition

among lenders). In addition, the rules might lack facilitative gap-fillers that importantly supplement the usual security agreement. For example, the rules might not provide that the creditor's security interest in inventory attaches to proceeds of its sale, in the absence of contrary agreement. The rules might also be deficient in a further major way. They might fail to provide, or fail to provide clearly, when a security interest becomes effective, how long it is to last, and how it may be terminated.

D. PROVISION FOR DUE NOTICE TO POSSIBLY INTERESTED THIRD PARTIES THAT THE CREDITOR AND THE DEBTOR ARE CREATING A SECURITY INTEREST BY CONTRACT IN PERSONAL PROPERTY OF THE DEBTOR

The creditor and the debtor do not enter their contract in a vacuum. There may be interested third parties, including other creditors of the debtor, buyers from the debtor, holders of liens on the debtor's property, and still others who have or wish to assert interests in the same property. All such persons need to be able to make informed decisions. A rational system for contractual creation and enforcement of security interests therefore must generally provide for public notice of the creation of security interests.

The rules might simply fail to give adequate public notice to possible lenders and other interested third parties that the creditor and the debtor are creating a security interest. Some systems require either that the lender take possession of the collateral (pledge), or give notice by filing in a public registry in order to "perfect" the security interest, and thereby achieve maximum protection against other possible third party creditors and other claimants. Both possession and formal filing in a registry give notice to third parties. Other devices may also be used, such as "field warehousing," or the posting of signs on the debtor's property, or the like.

Generally, priority of right as between competing lenders with security interests in the same collateral should date from the time of taking possession or filing, whichever is earlier. So should priority of a secured creditor over unsecured creditors of the same debtor.

To the extent that a system does not require creditor possession of the collateral or public filing in a registry, the system tolerates "secret liens." In general, this is likely to undermine

creditor confidence in the system as a whole. Of course, many systems do not require possession or filing for every single type of collateral. For example, neither may be required for security interests in certain consumer goods.

The most fundamental flaw here is simply the failure to provide any kind of public registry in which notice of the contractual creation of a security interest can be filed, with date of filing serving as a basis for determining priority as between competing security interests in the collateral, or other competing claims to the collateral. There may be many types of collateral, such as equipment, that cannot be efficiently possessed by the creditor. Hence, there is a basic need for some kind of public registry to put third parties on notice.

Another possible flaw is that the rules governing the operation of the registry might not inspire confidence among creditors as to the reliability of the registry. Also, the costs of filing in the registry may be unduly high. Or there may be several registries in different places, instead of merely one for personal property and one for land interests. This duplication may make search costs by prospective creditors unduly high, compared to a single centralized registry for personal property security interests.

E. PROVISION OF SOUND RULES FOR DETERMINING PRIORITY AS BETWEEN DIFFERENT PARTIES CLAIMING RIGHTS IN THE SAME PERSONAL PROPERTY

Because of the inevitability of some debtor defaults and because of the inevitability that different parties will, in event of such defaults, claim interests in the same personal property of the debtor, a system of contract and related law facilitating the use of personal property to secure loans must also include clear rules determining who wins in event of such priority conflicts. This, too, is a major characteristic of a rational system here. This general characteristic can also be understood best in light of possible deficiencies in such rules.

Thus, the system might not include clear and well defined priority rules granting priority to specified types of *secured creditors in competition with each other*, or in competition with

other third parties such as buyers. In most systems I know, such rules generally grant priority on the basis of who publicly perfected first, as by taking possession or by filing in a public registry.

The system might also fail to give sufficient priority status to a secured creditor over competing *unsecured* creditors, or over other third parties claiming against the collateral in the absence of bankruptcy. Or, in event of bankruptcy, the system might fail to give a secured creditor sufficient priority status against competing creditors or against other parties represented by a trustee in bankruptcy. If a security interest becomes valueless when the debtor takes bankruptcy, this will be a grievous legal flaw.

The priority rules of the system might themselves not be well justified. For example, they might generally disregard the basic justificatory principle of "first in time first in right," a principle that grants priority to the first creditor to file publicly or take possession. Or the rules might, for example, fail to provide exceptional priority for a "new-money" lender, a lender who helps keep the borrower's business going by making new loans regularly, even though second in time.

F. PROVISION OF RULES ENABLING THE SECURED CREDITOR TO ENFORCE THE LOAN AND THE SECURITY INTEREST ON DEBTOR DEFAULT

A further major characteristic of a system of contract and related law providing for the creation of security interests in personal property is that such a system includes sound rules enabling the secured creditor to enforce the loan and security interest on default. Again, the possible deficiencies in enforcement rules remind us of the importance of enforcement. A system must, at minimum, define the duties of a creditor seeking to exercise rights on default. What steps must a creditor take to get possession of the collateral or to require a third party owing the debtor to pay the creditor directly? What notice must a creditor give the debtor or others of intent to conduct a foreclosure sale? How must the creditor advertise such a sale of the collateral? The law must include definite rules here, yet we by no means always find such rules. Moreover, the rules should not be unduly cumbersome. For example, rules requiring judicial approval of any

and all foreclosure sales are indeed unduly cumbersome. Of course, the rules must also provide for rights of the creditor to collect any deficiency.

G. PROTECTIONS OF DEBTORS AGAINST CREDITOR OVER-REACHING AND THE LIKE

A sound body of law allowing the contractual creation and enforcement of personal property interests to secure loans must also provide specific protections to debtors. Fairness to debtors, too, is an important characteristic of a rational body of law in this context. Debtors should be protected against bad faith declarations of default, against creditor repossessions that are not peaceful, against failure of the creditor to take due care of property repossessed, against failure of the creditor to send notice of foreclosure sales, against failure of the creditor to publicly advertise and conduct such sales openly and fairly, and more.

H. ESTABLISHMENT OF A UNIFIED SYSTEM FOR CONTRACTUAL SECURITY INTERESTS FOR LOANS

A rational system for contractual security interests is also a unified system. Yet many countries lack such a system, e.g., England and France. Instead they have different bodies of law and sometimes even different registries for contractual security interests in equipment, in retail merchants assets, in ship and airplane financing, in fixtures on real estate, and on and on. All these separate bodies of law can, however, be efficiently drawn together under one unified system of rules and a single registry. Multiple systems within a single jurisdiction are, at the very least, far more costly to establish and operate.

III. THE RUDIMENTS OF GOOD INSTITUTIONS TO FACILITATE AND IMPLEMENT CONTRACTUAL ARRANGEMENTS FOR SECURED LOANS

It is not enough for a developing country to have good substantive law with respect to contracting for loans and with respect to personal property security. We must also have good institutions. I will confine myself merely to identifying the bare essentials.

A. NEED FOR WELL DESIGNED LEGISLATURE

There is plainly need for a well designed legislative body capable of installing a system of contract law and of personal property security for loans in the first place, and capable of amending statutes required to stay abreast of major economic changes. For example, new forms of personal property security collateral may come into use or potential use, and this may require changes in the existing law.

Moreover, an effective legislative body is required to provide material and other support to the court system, for the court system must play major roles in the authoritative interpretation and enforcement of private contracts for loans secured by personal property. Similarly, the legislature must provide requisite material and other support for an executive branch of government.

B. NEED FOR WELL DESIGNED EXECUTIVE BRANCH

There must, of course, also be an effective executive branch of government. Among other things, some such branch must have power to appoint judges. This branch, too, must be capable of restraining itself. It must allow judges to make decisions independently and impartially. Furthermore, the executive branch and the legislature will have specific roles to play in order for the contractual and related arrangements required for a system of personal property security law to function. A major example is simply that of setting up and administering the central registry for the filing of security interests in personal property. Another major example is that of providing an official agency capable of exercising state power, as ordered by a court, to enforce private contracts, and to enforce court judgments requiring a defendant to pay money.

Further, a central banking system will have an important role to play.

C. NEED FOR WELL DESIGNED COURT SYSTEM

We come more directly now to Mancur Olson's concept of "third party enforcement." A well designed court system is, of course, indispensable if contracts of loan secured by personal property collateral are to be at all viable, and thus are to augment markets for financing.

The courts should devise rational and consistent methodologies for the interpretation of contracts and for the filling of gaps in contracts, methodologies that can also be readily applied by contracting parties out of court to resolve contractual disputes so they do not require judicial resolution. This will contribute greatly to the certainty and predictability of contract rights generally, and more particularly to the efficacy, of a system of secured contractual lending against personalty.

Courts must also have efficient and reliable means of finding facts. When, in disputed cases, the courts accurately find facts and accurately resolve disputed issues of law, this not only secures the enforcement of contracts generally, it also, more particularly, secures enforcement of the language of contracts of loan against personal property collateral. Of major import, it also induces parties voluntarily to perform such contracts without any intervention by the courts.

Similarly, when courts devise a rational and consistent methodology for interpretation of statutes applying to aspects of loan contracts, this, too, contributes greatly to the general reliability and enforceability of contracts.

D. NEED FOR A WELL TRAINED AND ACCESSIBLE LEGAL PROFESSION

Still a further basic institutional need is for a well trained and accessible legal profession to draft contracts of loan, interpret and advise on the meaning of contract language, interpret statutes applicable to contracts of loan and to personal property security, conduct negotiations in event of disputes over contract rights and duties, and represent creditors and debtors in disputed cases before courts. Without well trained lawyers to do these things, the other legal institutions cannot function as they must.

IV. GOOD LEGAL TRADITION AS EXPLANATORY OF GOOD LAW AND GOOD LEGAL INSTITUTIONS

How is it that a society may come to have a good system of contractual and related law for lending, and a good basic set of institutions furthering such contractual lending? We can identify several general factors that make for good law and good institutions generally. I will first provide a general review of several basic factors. I will then concentrate on one of these, namely the extent to which the system generally subscribes to principles of the rule of law.

A. GENERAL FACTORS OF TRADITION THAT MAY MAKE FOR GOOD CONTRACT LAW AND GOOD LEGAL INSTITUTIONS

I am often asked, when abroad advising on law reform the following question: Just what is it that explains the fact that our legal system is as good as it is — more particularly, why do we generally have such a good body of contract and related law and such a good set of legal institutions, a set that works so well — or at least seems to? This question is an extremely difficult question to answer. I am not a legal historian, and I do not have a full or even anything like a final answer.

The first factor I would mention is simply our general inheritance. On the Mayflower and subsequent ships, there were law books, and also people with memories. We thus inherited much from English law, including the idea of contract, the idea of loans of money in return for interest, and the idea of lending money against security, with land being a prominent form of collateral. All these inheritances came to us early on in the 17th and 18th centuries and so have been with us for hundreds of years.

The second major factor is that, given this age old inheritance, we have had a long time to improve upon it.

A third major factor is that this inheritance and the disposition to develop and improve upon it readily took root in America. Why? One might mention that our inheritance coalesced with important values held dear by our ancestors, values which their successors also took on. An elementary such value is simply that a promisor should keep a promise — a debtor should repay a debt.

Freedom, however, is perhaps the most fundamental value here. Contract is a great instrument of freedom. It is no wonder that settlers rejecting restrictions on freedom in the old world would strive to improve contract as an instrument of freedom. This disposition to improve contract continues to thrive in many fields, including the field that is our subject today. Our Article Nine of the Uniform Commercial Code is now being revised in major ways for the third major time in fifty years.

A fourth factor is this. The economic, scientific, cultural and other basic development of a society requires facilitative law. When our country was first settled, it, of course, required development. Americans saw early the connection between economic development and law facilitative of that development. This continues to be seen and stressed at the end of the 20th century. It is not only that much still remains to be developed. Even without this, and without our major innovative economic developments, the complex needs of the levels of production and exchange in our society would alone continue to require an elaborate and sophisticated body of law and legal institutions. We would still be much in need of contracts for the loan of money and for collateral to secure them.

A fifth factor is this. Since the end of the 19th century, we have, in the United States, had a highly advanced and continuously improving system of legal education. Ours is also a society in which lawyers rank high. This, too, has provided the human and other resources required not merely to staff our legal institutions and to advise our citizens. It has also provided the resources for continuous efforts to improve our substantive and procedural law, including of course, our law of contract.

The final factor I will identify is one I will dwell on at some length. This is what I will call general respect for the rule of law and for the corresponding set of general principles of the rule of law.[3] This respect varies to some extent with the principle involved, but it generally

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[3] For one of the leading general accounts, see Fuller, 1969. See also Summers, 1984, chapter 3.

remains strong overall. Another way to put this, is to say that there is in our society, especially, but not only, among the law trained, a widely accepted set of formal standards of what constitutes law-like uses of law. Departures from these generally provoke criticism. It may be that we only gradually took these principles on board over time. But I suspect that our espousal of these, more than any other factor, is what sustains us most today in all matters of law, including general contract law and the institutions that facilitate it. Perhaps, then, the ultimate question is *why* do we espouse these principles? That I must leave for another day. For now, I turn to the principles themselves, and how good contract and personal property security law *instantiate* these principles.

B. GENERAL PRINCIPLES OF THE RULE OF LAW

Even though the principles of the rule of law are not, as such, derived from the idea of market augmentation, they are of fundamental importance for market augmentation. Indeed, many of the very rudiments of good contract law and good personal property security law I have identified here can be rationally construed as manifestations of the general commitment of society to principles of the rule of law. Certainly without general commitment to these principles, the general law of contract in a system could not flourish, nor could any of its special branches.

I now turn to the principles of the rule of law.

The principles of the rule of law differ conceptually from principles of ordinary "first order" law. Ordinary first order law includes principles and rules. Principles of ordinary first order law apply directly to determine legal relations between the immediate addressees of such law. In our own system, first order law also includes principles. Two examples are the moral principle that "no person shall profit from his own wrong," and the quite different commercial law principle that "a transferee of property takes no better title than the transferor had." The contractual and security interest rules I have already discussed are first order rules. Unlike "first order" principles and rules, the principles of the rule of law are what might be called "second order" principles. That is, they are *about* first order law. They are about principles and rules of first order law. Principles of the rule of law are about such first order law in the sense that they

are general norms that direct and constrain what counts as first order law and how first order law is created and implemented. They are also about first order law in the sense that they specify its general shape and configuration. When the creation and implementation of a first order principle or first order rule conforms to these second order norms, the requirements of the rule of law are met.

Individual principles of the rule of law have far wider scope of application than individual first order laws. Indeed, principles of the rule of law apply across all the basic operations of a legal system in their full "breadth," and also apply to these operations in their full "length," and so are truly systemic in scope. The second order principles of the rule of law indirectly serve the basic substantive policies and other values incorporated in first order principles, rules, decrees and other such law. At the same time, the principles of the rule of law, as applied, serve fundamental political values such as legitimacy, and general legal values such as certainty.

I will now identify what I consider to be the leading second order principles of the rule of law, all of which I also claim are recognized to some extent in developed Western systems of law. What follows is, I think, a relatively comprehensive inventory of the second order principles governing how first order law is to be made and implemented, and specifying what shape or configuration it is to take, if it is to conform to the rule of law. In my inventory, I do not include specific legal devices for implementing each such principle in the set. The principles of the rule of law consist of the following:

(1) That all forms of law be duly authorized, and thus conform to established criteria of validity;

(2) That the accepted criteria for determining the validity of law generally be clear and readily applicable, and include criteria for the resolution of any conflicts between otherwise valid forms of law;

(3) That state-made law on a given subject be uniform within state boundaries, and, so far as feasible and appropriate, take the preceptive form of general and definite rules applicable to classes of persons, acts, circumstances, etc., and also be applicable to officials and citizens alike, as appropriate;

(4) That all forms of law be appropriately clear and determinate in meaning;

(5) That state-made law, and other law as appropriate, be in some written form, and be promulgated, published, or otherwise be made accessible to its addressees;

(6) That law, and changes in law, generally be prospective rather than retroactive. (See also (13) and (14));

(7) That the behavioral requirements of a law be within the capacity of its addressees to comply;

(8) That the law on a subject, once made and put into effect, not be changed so frequently that its addressees cannot readily conform their conduct to it or cannot feasibly engage in long term planning;

(9) That purported changes in the law be made by duly authorized institutions, officials, or persons, and in accordance with known procedures, as appropriate;

(10) That a form of law be interpreted or otherwise applied in accord with an appropriate, uniform (for that type of law), and determinate interpretive or other relevant applicational methodology, itself a methodology duly respectful of the expressional form and content of that type of law;

(11) That any possible remedy, sanction, nullification, or other adverse consequence of failure to comply with a form of law be known or knowable in advance of the relevant occasions for action or decision under that law;

(12) That in cases of dispute, or occasions for enforcement, a politically independent and impartial system of courts and administrative tribunals exist and have power, [a] to determine the validity of the law in dispute, [b] to resolve issues of fact, all in accord with relevant procedural and substantive law, and [c] to apply the valid law in accord with an appropriate interpretive or other applicational methodology;

(13) That when an interpretive or other applicational methodology does not authorize an outcome under antecedent law, yet a court or a tribunal is urged (sometimes in the guise of such methodology) to modify or otherwise depart from law to achieve such an outcome, courts or tribunals shall have only quite limited and exceptional power thus to modify or otherwise depart from antecedent statute, precedent, or other law, in order that the legal conclusions and any reasons for action or decision on the part of the law's addressees which would otherwise arise under valid law, duly interpreted or applied, generally remain peremptory for the law's addressees, including courts and other tribunals;

(14) That any exceptional power of courts or other tribunals to modify or depart from antecedent law at point of application be a power that, so far as feasible, is itself explicitly specified and duly circumscribed in rules, so that this is a power the exercise of which is itself law-governed;

(15) That a party who is the victim of a crime, or of a regulatory violation, or of a tort, or of a breach of contract, or of wrongful denial of a public benefit, or of wrongful administrative action, or other alleged legal wrong, shall be entitled to instigate criminal prosecution insofar as appropriate (with any required official concurrence), or to seek other appropriate redress, before an independent and

impartial court or other tribunal with power to compel the alleged wrongdoer or other person responsible to answer for such wrong;

(16) That, except for minor matters, no significant sanction, remedy, or other adverse legal consequence shall be imposed on a party, against his or her will, for an alleged crime, regulatory violation, tort, breach of contract, administrative wrong, or any other alleged legal wrong, without that party having advance notice thereof and a fair opportunity to contest the legality and the factual basis of any such projected adverse effect before an independent and impartial court or other similar tribunal;

(17) That a private party who fails to prevail before such court or tribunal pursuant to (15) and (16) above, whether an alleged victim or an alleged wrongdoer, shall have the opportunity to seek at least one level of appellate review, in a court, as a check against legal error;

(18) That the system and its institutions and processes be generally accessible. That is, (1) that there be a recognized, organized, and independent legal profession legally empowered and willing to provide legal advice, and to advocate causes before courts, other tribunals, and other institutions as appropriate, and (2) that at least where a party is accused of a significant crime or similar violation, denies liability, and is without financial means to pay costs of defense, such party shall be entitled to have defense provided by the state.

The foregoing account does not include mere *devices* for implementation of such principles. Not everything that tends to secure the rule of law is itself a principle of the rule of law. For example, the constitutional separation and division of powers in many systems tends to

secure against official behavior contrary to the rule of law, but I do not here classify it as an affirmative principle of the rule of law. Provision for periodic transfer of power from one set of elected officials to a set of newly elected officials also tends to secure against lawless despotism, but this provision, again, is not itself a principle of the rule of law, even though whatever secures against despotism also tends strongly to secure the rule of law. A provision of a bill of rights entrenching freedom to criticize the government tends to secure against lawless rule, but this freedom is not itself a principle of the rule of law. Rather, all the foregoing are merely examples of what I call devices that, among other things, implement the rule of law. Of course, at the borderline, there is no sharp line between such devices and principles of the rule of law.

Do the second order principles of the rule of law apply only to the creation and implementation of first order law by the state, or do they also apply to first order law created by private parties? Such first order law includes contracts, including contracts of loan, certain property arrangements, and more. Most of the principles of the rule of law, as formulated here, also apply, with appropriate modifications, to privately created law.

Does just any particular departure from any of the foregoing principles always seriously threaten the rule of law? Not at all. Exceptional departures from some of the principles of the rule of law may even be justified. A particular retroactive statute may be justified, for example. Moreover, not all judicial departures even from the explicit text of a statute seriously threaten the rule of law. Thus, a judicial modification that makes a statute clearer in a fashion consistent with the text may even be justified. Also, sometimes a law cannot be made definite, and therefore must in some respect be left vague, given its subject matter.

Yet, at the same time, complete non compliance with any one major principle of the rule of law would signify that the system is not properly called a legal system. Thus, there is no scope for a balancing act that could rescue such a "system." For example, it would not be possible to rescue total abandonment of all rules by formal adoption of all the moral principles possibly relevant to any legal matter. Nor, for example, could we rescue total abandonment of a generally accepted interpretive methodology merely by substituting totally wise and judicious men and

women as judges acting ad hoc. And so on. This is not to say, however, that conformity to the principles of the rule of law is sharply on-off. Conformity is a matter of degree, and some systems conform less fully than others.

Not all of the foregoing principles of the rule of law are fully recognized in the positive law of all developed Western systems as binding second order principles of the rule of law. Of course, a principle may be recognized by different means in different systems. One system may embody a principle in a constitutional provision, while another leaves this matter entirely to judge-made law. Or one system may recognize a principle directly and explicitly, while another merely adopts a device that, in effect, tends to secure a principle and so recognizes it only indirectly and implicitly. Or one system may provide real "teeth" for enforcing a principle, while another does not. And there are other variations.

The second order principles of the rule of law, then, direct and constrain how the legal system is to operate, at all stages within each of its basic operational techniques. The directives and constraints of the principles of the rule of law are not, however, merely instrumental means to the ends and values to be served by first order law. That is, these principles do not merely secure efficacious use of first order law. If that were so, then a violation of one or more of these second order principles would *merely* signify that the legal system would then be less effective as a means to the ends and values that first order law is to serve.

The violation of principles of the rule of law, may, if significant enough, not only signify that the first order use of law in question is or will be ineffective or less effective. Of equal, if not of even greater import, such violation may also signify that a given first order use of law is not really law-like. A vague rule on who has priority as between competing creditors would not merely be ineffective. It would also be less law-like. A rule that is quite unclear in its meaning, for example, is not really law-like. In the absence of quite special circumstances, a retroactive statute is not really law-like. And so on. In all such instances, not only is the efficacy of law sacrificed. The very conceptual claim that this use of first order law is law-like is also at risk and may even have to be forfeited.

What should we say if violations of principles of the rules of law were to occur, not merely individually here and there, but on a major scale across all of the law's primary operational techniques, and were to extend to the full length of the linear progressions within each technique? Should we say that such a "system" is not really a system of law at all? Certainly any massive violation would strain our very *concept of a legal system*, for it would not be congruent with our very concept of the minimal essential form of a legal system. We would certainly say that the whole system is, at the least, less truly a system of law, and, at the most, we would say the system is not a system of law at all. It just is characteristic of a true system of law that, overall, it operates substantially in accord with principles of the rule of law. A system of law is not, conceptually, merely a system that includes first order rules and other first order law having the type of substantive content that purports to order human relations. A system of law is, conceptually, a system that actually operates in its breadth and length in law-like ways. That is, it generally operates in accord with second order principles of the rule of law. It follows that it is logically possible that a system of law could even have first order bodies of law the contents of which were in themselves just, right, and good in subject-matter, yet the system itself not be a true system of law because of its general failure to operate sufficiently in accord with second order principles of the rule of law. For example, the laws in question all might be indefinite, retrospective, secret, and generally inaccessible to the citizenry, yet still sprung on citizens at despotic whim. These examples show, too, that fundamental fairness, and so legitimacy, are at stake in departures from principles of the rule of law, even though these principles are all formal!

C. HOW GOOD LAW AND INSTITUTIONS AUGMENTING MARKETS INSTANTIATE PRINCIPLES OF THE RULE OF LAW

It is no difficult matter to set forth many examples illustrating how good law and good institutions that augment markets may be viewed as instantiations of principles of the rule of law. I will confine myself to four examples. Each of these is an example of good law and good institutions that plays a fundamental role in augmenting markets for secured lending. Each example also instantiates a major yet different principle of the rule of law.

First, it is a major principle of the rule of law that there be clear and readily applicable criteria for determining the validity of newly created first order law, whether created by state institutions or by private individuals or entities. Contracts of loan and the interests in personal property securing such loans constitute privately created law, when valid. We have seen that one important type of law applicable to such loan transactions just is the law specifying what is required for a valid contract of loan secured by an interest in personal property. This first order law qualifies as law specifying criteria of validity, and thus instantiates a leading principle of the rule of law, insofar as this law is clear and readily applicable to determine the validity of such contracts.

Secondly, it is a basic principle of the rule of law that all first order law, so far as feasible, take the shape of general and definite rules with clear and determinate meanings, rather than be a vague and open-ended formulation that affords little guidance to citizens on the front lines of human interaction and in effect confer on judges vast power to decide disputes however they wish. The eight main characteristics of good contract and related law with respect to loans secured by interests in personal property are all characteristics calling for the relevant law to take the form of highly determinate rules, including for example, rules defining and differentiating the various types of property in which security interests may be created. Without such determinate rules, this branch of the law, would lack the certainty required for general business confidence that loans will be duly repaid.

Third, it is a further leading principle of the rule of law that for each major variety of law such as statute, precedent, or contract, there be an appropriate, uniform (for that type of law), and determinate interpretive or other relevant applicational methodology, itself a methodology duly respectful of the special expressional form and content of the type of law to be applied. One of the requirements of good law and good institutions with respect to contracts of loan secured by personal property interests is precisely that there be a rational and consistent interpretive methodology for contracts, and also one for applicable statutes, and indeed further ones for other types of relevant law.

Fourth, it is a vital principle of the rule of law that there be independent and impartial courts with (a) power to determine the validity of law in dispute, (b) power to resolve issues of fact, (c) power to apply valid law in accord with appropriate interpretive or other applicational methodology, and (d) power to grant appropriate remedies. Both the legal and the institutional set up for recognizing and enforcing loan contracts and interests in personalty securing them likewise instantiate the foregoing vital principle of the rule of law. Indeed, credible courts are far more important for the influence that the threat of their use has on out of court compliance with law than for the specific contractual or other remedies that they grant to aggrieved lenders and others in actual judicial proceedings.

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