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Finance, Law, and the Courts

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# An Introduction to Courts' and Principles-Based Interpretivism

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## 1 Disputes in the law of finance and courts' principles-based interpretivism

This book focuses on financial disputes, courts, and the law of finance. In academic and policy-making circles, we speak of 'constitutional law', 'civil law', or 'administrative law', but of 'financial regulation' as if finance's rules and norms were something alien to, or distinct from, 'law'. This emphasizes finance's peculiarities, such as the presence of regulatory norms, the use of soft law, the norm-producing status of administrative authorities, and the relevance of global standard-setting bodies. As a matter of fact, in the law of finance there is, first, a (growing) emphasis on tools that do not fit squarely within traditional conceptions of law: policy statements, press releases, guidelines, memoranda of understanding (MoU), or no-action letters have no obvious legal standing, but to market participants they clearly indicate the official position on legally significant issues. Secondly, in the law of finance there is a prominent role for authorities like central banks or financial supervisors, which seem more norm-producing than norm-accepting, and are sometimes granted so much discretion as to raise the question whether they move within the 'legal' universe, or in a parallel one. Third, the growing importance of global and supranational bodies, which, without any electoral backing, dictate the standards that finance is supposed to abide by. Governmental bodies and agencies are judicially accountable; other, global bodies are not clearly so; and some, like ISDA (the International Swaps and Derivatives Association), are private bodies, which rely on market participants to disseminate their legal standards via private contracting. All these phenomena accelerated after the global financial crisis, raising one pertinent question: are we witnessing law's eclipse in finance? Our answer is a resounding 'no'. Finance presents unique problems for the law, but these need to be answered from inside legal practice. **1.01**

**1.02** This, in turn, raises several challenges. One, explaining why finance's peculiarities are important for law, and why a legal perspective is important for finance, and finding a conceptual framework that reconciles both sides. Two, to use this conceptual framework to explain how the substantive specialties of finance can be woven together with existing legal practice in concrete practical settings. Three, to explore how this goal could be furthered from a procedural perspective through the use of specialized courts not as a mechanism to replace generalist courts, but to complement them. With all these forces pushing towards specialization, finance's rules may drift away from the logic of law and courts. Is that desirable or inevitable? In our view, neither is inevitable, and, while specialization is desirable, the 'drift' is not. Law and courts provide finance with the certainty it needs to operate, and the elasticity it needs to evolve. This combination of strengths results from law's status as an interpretative construct formed by both rules and principles, which are malleable enough, but can also operate in predictable ways. Yet, these benefits are inextricably linked to the need for consistency across the *whole* legal system. Thus, there will be 'hard cases', where the solution is not preordained by the rules, and where principles collide. This can be a source of drift and instability, but also of evolution and strength. 'Weaving' finance's specificity into the fabric of law's more general questions is essential for both finance and law, and can only be accomplished by courts. We divide the book between Part I, where we explain the theoretical foundations of the role of law and courts; Parts II and III, where we explain how courts have shaped the public law and private law of finance, by combining finance's specific needs with law's broader general principles; and a Part IV, where we make the case for limited specialization of finance justice in the EU. With a note of caution: our scope is functional, and the term 'court' is used throughout this book to encompass also arbitral tribunals and 'quasi-judicial' bodies, to the extent that they render decisions pertaining to the law of finance.

**1.03** This book draws comparatively from case law which primarily originates from the European Union (EU), the United Kingdom (UK), and the United States (US), with some references to other jurisdictions, and proposes a taxonomy of cases, both in the public law and in the private law of finance, which highlight finance's specialties. This book also illustrates how the answer to the overwhelming complexity of finance has been a gradual increase in reliance on general principles of law and procedural specialization, and studies its significance.<sup>1</sup>

<sup>1</sup> There are excellent books which deal with aspects of regulation and adjudication in the law of finance which are also considered in this book. However, their focus and approach are different from ours and our book is to some extent unique in the existing literature. A recent and excellent book on judicial review in the Banking Union is Chiara Zilioli and Karl-Philipp Wojcik (eds), *Judicial Review in the European Banking Union* (Elgar Financial Law and Practice 2021). Compare also, for a discussion of the case law on the Banking Union, Raffaele D'Ambrosio (ed), *Law and Practice of the Banking Union and of Its Governing Institutions: Cases and Materials* (Quaderni di Ricerca Giuridica della Consulenza Legale No, Bank of Italy, No 88, April 2020); Raffaele D'Ambrosio and others (eds), *Pandectae: Digest of the Case-law on the Banking Union* (Quaderni di Ricerca Giuridica della Consulenza Legale, Bank of Italy, No 92, December 2022). Another excellent book is William Blair, Richard Brent, and Tom Grant, *Banks and Financial Crime: The International Law of Tainted Money* (2nd edn, OUP 2017), which shares with ours the focus on the importance of enforcement through the courts of financial law. Its focus is, however, criminal enforcement. This is also true for Giulia Lasagni, *Banking Supervision and Criminal Investigation, Comparing the EU and US Experiences* (Springer International Publishing 2019); and Silvia Allegrezza (ed), *The Enforcement Dimension of the Single Supervisory Mechanism* (Wolter Kluwer 2020). Thomas Cottier, Rosa M Lastra, and Christian Tietje (eds), *The Rule of Law in Monetary Affairs: World Trade Forum* (CUP 2014) shares with ours a message on the importance of accountability and the rule of law, but it focuses on 'monetary' issues and 'policy' more than on 'disputes' and 'courts'. Christopher Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance and Ethics* (Hart Publishing 2015) also deals, as our book does, with the role of 'law' in constraining financial behaviour, considering, however, corporate law and competition law. Justin O'Brien and George Gilligan, *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Hart Publishing 2013) and Gerald Nels Olson, *Money, Morality and Law: A Case for Financial Crisis Accountability* (Kluwer Law International 2019) share with ours a message on the importance of accountability and the rule of law. They do not focus on the fitness of the institutional design for financial disputes adjudication. Joanna

In a field characterized by fluidity and burgeoning activity, both among market practice and regulation, a focus on either gives the impression of a constantly moving target, and yet the big questions that emerge in financial disputes tend to be surprisingly stable. In the public law disputes, they concern, for example, the mandates of regulatory and supervisory authorities, their exercise of delegated competences, including enforcement and sanctioning powers and the level of discretion granted to them for assessing facts, or making complex technical assessments or entering the area of policy, which parties have standing to challenge their acts, what acts can be challenged, and how their powers are checked by the fundamental rights of the parties affected by their actions. In private law disputes, they concern an array of different issues concerning, eg, liability for misstatements or misbehaviour, violations of directors' (and other trustees') fiduciary duties, approaches to contract validity and interpretation, and collateral enforcement. **1.04**

Finance offers important twists when answering all those questions. The exercise of competences is not the same for financial regulators than for other public authorities, and even less so for central banks. In finance, who can challenge a supervisory action becomes a loaded question, for instance when a financial institution's board is replaced with special administrators or trustees appointed by the regulator; at the same time, private law doctrines of tort and contract liability are interspersed with regulatory standards in ways that are often hard to fathom. In turn, fiduciary duties can be decisively shaped by notions of 'financial risk' among others, and collateral enforcement can be extremely challenging when the 'asset' only exists in the imagination or expectations of the parties, and the extremely complex documentation devised by them. This shows that finance's peculiarities are important for law. In turn, however, a legal perspective is important for finance, and both sides need to be reconciled. **1.05**

This requires paying attention to the way financial disputes are handled on their merit in their respective *fora* and see how these decisions, *fora*, and their procedures make use of values, principles, and rules and of their interconnections to respond to the rule of law, and **1.06**

Jemielniak, Laura Nielsen, and Henrik Palmer Olsen, *Establishing Judicial Authority in International Economic Law* (CUP 2018) focuses on the role of 'law' and courts in economic activity, yet it considers WTO disputes, not financial disputes. On the growing number of international courts, a must-read is still Ruth Mackenzie and others (eds), *The Manual on International Courts and Tribunals* (2nd edn, OUP 2010) and, in an historical perspective, Hélène Ruiz Fabri, Michel Erpelding (eds), *The Mixed Arbitral Tribunal 1919-1939, An Experiment in the International Adjudication of Private Rights* (Nomos 2023) Several excellent contributions include Danny Busch, Guido Ferrarini, and Jan Paul Franx (eds), *Prospectus Regulation & Prospectus Liability* (OUP 2020); Danny Busch and Cees van Dam, *A Bank's Duty of Care* (Hart Publishing 2017); Danny Busch, Laura Macgregor, and Peter Watts (eds), *Agency Law in Commercial Practice* (OUP 2016); and more recently Danny Busch, 'The Influence of EU Prospectus Rules on Private Law' (2021) 16 CMLJ 3; 'Self-Placement, Dealing on Own Account and the Provision of Investment Services under MiFID I & II' (2019) 14 CMLJ 4; Danny Busch, 'The Private Law Effect of the EU Market Abuse Regulation' (2019) 14 CMLJ 296; and Danny Busch, 'The Private Law Effect of MiFID: The Genil Case and Beyond' (2017) 13 ERCL 70, as well as the books of Raffaele D'Ambrosio and Stefano Montemaggi (eds), *Private and Public Enforcement of EU Investor Protection Regulation* (Quaderni di Ricerca Giuridica della Consulenza Legale, Bank of Italy, No 90, October 2020), Federico della Negra, *MiFID II and Private Law: Enforcing EU Conduct of Business Rules* (Hart Publishing 2019); Shala F Ali, *Consumer Financial Dispute Resolution in a Comparative Context: Principles, Systems and Practice* (CUP 2013); and Stefan Grundmann and Yeşim M Atamer, *Financial Services, Financial Crisis and General European Contract Law* (Kluwer Law International 2011) analyse systems for financial disputes across the world, but they focus on consumer/investor disputes. Pierre Henry Conac and Martin Gelter (eds), *Global Securities Litigation and Enforcement* (CUP 2019) focuses on 'securities' disputes. On specialized justice, two books stand out in the literature, but with a generalist view see Stephen Legomsky, *Specialized Justice: Courts, Administrative Tribunals, and a Cross-National Theory of Specialization* (Clarendon Press 1990) (although because it was published in 1990, it does not focus on finance in particular, where the argument for specialization is more pressing, and it lacks a practical discussion of cases) and Lawrence Baum, *Specializing the Courts* (University of Chicago Press 2011), which offers a mostly US-based perspective, without a focus on finance.

to help the legal system evolve to adjust to finance's peculiarities. Financial rules' single-minded pursuance of one or more overarching values (investor protection, solvency, financial stability) needs to be reconciled with basic legal principles (the rule of law, separation of powers, fundamental rights, property, or contract freedom) and to dispel a wide array of collisions among rules. The symbiosis between law's and financial regulation's principles also applies when the goal at stake is 'stability', and it helps to limit biases and to foster legitimacy. In our view, financial crises provide less an argument for 'suspending' law's role in finance than for strengthening it. In fact, crisis situations are but one example of 'hard cases', ie legal problems that cannot be solved by reference to a single provision and require a deeper reflection over the underpinning legal principles, and the balance between them. For this reason, we claim in this book that courts must rely on principles-based interpretivism to determine the fitness of a certain decision within the law's overall scheme. This requires acknowledging that, in an important number of cases, it does not suffice to discuss the scope of application of a legal rule in isolation, but to understand the considerations of principle supporting that rule, and how they shape its scope and intensity also in relation to other rules and principles. In such exercise, there is a need for greater awareness of the fact that different sets of rules may be inspired by conflicting values and narratives, which need to be considered together, in order to determine whether a specific exercise of authority is legal. A case-by-case analysis can not only result in errors prompted by heuristic biases. It may undermine the integrity of the whole regulatory edifice. This, in turn, requires expert judgment, and thus courts' design has implications for the outcome of the decision-making process.

### 1.07 Courts are 'curious institutions':<sup>2</sup>

For some, courts are major decision-makers that function as principals on a par with legislators and executives in developing, monitoring and adapting public policies. Others take quite the opposite view, envisioning courts as more modest institutions whose functions involve arbitrating public and private disputes by doing little more than faithfully interpreting existing law.<sup>3</sup>

For legal realists in the United States, and formalists in civil law jurisdictions<sup>4</sup> courts are a fundamental component of the *trias politica*. For others, however, courts are 'under-funded, under-supported, under-trained and under-protected', and thus 'a neglected branch of government'.<sup>5</sup>

### 1.08 In this book, we claim that courts are an essential component of the law of finance and, whilst supreme courts at the apex of the judicial systems normally are well-equipped generalist courts which can cope with (mostly episodic, albeit often consequential) case law in financial matters without more,<sup>6</sup> lower courts need to address a wide range of difficult issues of

<sup>2</sup> Martin Shapiro, *Courts: A Comparative and Political Analysis* (University of Chicago Press 1981) 1.

<sup>3</sup> Kevin T McGuire, 'The Judicial Process and Public Policy' in RAW Rhodes, Sarah A Binder, and Bert A Rockman (eds), *The Oxford Handbook of Political Institutions* (OUP 2008) 535; Koen Lenaerts, 'The Court's Outer and Inner Selves: Exploring the External and Internal Legitimacy of the European Court of Justice' in Maurice Adams and others (eds), *Judging Europe's Judges* (Hart Publishing 2015) 13; and Joseph HH Weiler, 'Epilogue: Judging the Judges—Apology and Critique' in Maurice Adams and others (eds), *Judging Europe's Judges* (Hart Publishing 2015) 240–41.

<sup>4</sup> Mitchel de S-O-Ï'E Lasser, *Judicial Deliberations: A Comparative Analysis of Judicial Transparency and Legitimacy* (OUP 2004); Mitchel de S-O-Ï'E Lasser, 'Transforming Deliberations' in Nick Huls, Maurice Adams, and Jacco Bomhoff (eds), *The Legitimacy of Highest Courts' Rulings* (Asser Press 2009) 33–53.

<sup>5</sup> Hiram E Chodosh, *Global Justice Reform* (New York University Press 2005) 5.

<sup>6</sup> Supreme Courts often count, however, internally, on the specialisation of one or more members in the relevant area of law: compare Chris Hanretty, *A Court of Specialists: Judicial Behavior on the UK Supreme Court* (OUP 2020), in particular 38, 66, 114, 135, 143.

fact and of law and their specialization in the law of finance may hugely help to ‘take rights seriously’ in finance. We further argue that in Europe courts’ specialization may bode well for the new legal order established with the Banking Union,<sup>7</sup> and may decisively contribute to its consistent application, improvement, and expansion under the rule of law.<sup>8</sup> The same is true in the framework of the still developing Capital Markets Union. For this reason, for Europe we advance a proposal for a bespoke mechanism of enhanced judicial cooperation (which may possibly evolve into a dual-court system in the future),<sup>9</sup> which seems to us desirable both from an external and internal perspective<sup>10</sup> and also as a first European response to the ongoing process of ‘judicial globalization’.<sup>11</sup>

We argue in this book that in the law of finance courts need to ensure coherence through principled-based interpretivism,<sup>12</sup> one which can occasionally enter the territory of policy.<sup>13</sup> In a sense, we build on an intuition of Katharina Pistor<sup>14</sup> and we consider courts as one of the fundamental ‘safety valves of the financial system’. As ‘safety valves’, courts must then calibrate the interpretation and application of the law of finance ‘to adapt it to an inherently unstable financial system’ without undermining the credibility of legal certainty and without transforming law in a ‘weapon of mass destruction’.<sup>15</sup>

<sup>7</sup> For a discussion whether the European Banking Union is a potential boost to (and blueprint for) integration or a potential blow to democracy see Stefan Grundmann and Hans-W Micklitz (eds), *The European Banking Union and Constitution. Beacon for Advanced Integration or Death-Knell for Democracy?* (Hart Publishing 2019).

<sup>8</sup> Lady Arden of Heswall, ‘Foreword’ in Chiara Zilioli and Karl-Philipp Wojcik (eds), *Judicial Review in the European Banking Union* (Elgar Edward Publishing 2021) xxvi.

<sup>9</sup> For a seminal proposal dating back to 1990, noting that a new judicial architecture ‘should feature as an important item on the agenda’ see Jean Paul Jacqué and Joseph HH Weiler, ‘On the Road to European Union: A New Judicial Architecture: An Agenda for the Intergovernmental Conference’ (1990) 27 CMLR 185.

<sup>10</sup> We use the term ‘external’ to analyse legal decisions (and their institutional setting) in accordance with criteria external to legal practice, eg whether certain decisions are good for efficiency, expediency, etc. We use the term ‘internal’ to analyse decisions (and their institutional setting) in accordance with criteria internal to legal practice, eg whether a decision is ‘valid’ in light of its consistency with precedent and principles. For other authors, an ‘internal’ view looks not at the outputs of the courts (their decisions), but also at the way courts actually function and their inner working practices and relationships: Jeffrey L Dunoff and Mark A Pollack, ‘International Judicial Practices: Opening the ‘Black Box’ of International Courts’ (2018) 40 Michigan J Intl L 40 (comparing the practice of dissent between the ECtHR and the CJEU).

<sup>11</sup> Laurence R Helfer and Anne-Marie Slaughter, ‘Towards a Theory of Effective Supranational Adjudication’ (1997) 107(2) Yale LJ 273.

<sup>12</sup> Ronald Dworkin, *Taking Rights Seriously* (HUP 1977); compare also Ronald Dworkin, *Justice in Robes* (HUP 2006) 50 (advocating, in praise of theory, a ‘theory-embedded approach’, whereby ‘legal reasoning means bringing to bear on particular discrete legal problems a vast network of principles of legal derivation or of political morality’, noting that ‘in practice, you cannot think about the correct answer to questions of law unless you have thought through or are ready to think through a vast over-arching theoretical system of complex principles about the nature of tort law, for example’). See also Ronald Dworkin, *A Matter of Principle* (HUP 1995) 119–80.

<sup>13</sup> This is adamant in the policy role of the judiciary in the United States, Arthur R Miller, ‘The American Class Action: From Birth to Maturity’ (2018) 19 Theoretical Inquiries in Law 1, 9:

‘No one could be elected President and realistically no political party could secure control of the Congress based on promoting racial equality. That would be politically inexpedient, so it was not surprising that the Supreme Court undertook the task in 1954 in the Brown case. American lawyers understand this and are accustomed to resorting to the courts to press sensitive issues of public policy and to challenge governmental conduct even absent legislative or executive branch guidance. Thus, in many contexts the nation’s least democratic branch—in the sense that federal judges are not elected and have lifetime appointments—is asked to formulate policy on various emotional and contentious matters, often because the elected branches are politically paralyzed by a division of viewpoints or political expediency . . . It is an aspect of American exceptionalism . . . [A]nd many judges do not shy away from policy issues.’

<sup>14</sup> Katharina Pistor, ‘Towards a Legal Theory of Finance’ (2013) ECGI Law Working Paper no 196/2013, 48.

<sup>15</sup> *ibid* 47.



**1.10** We acknowledge that whilst in the US judge-made law has a long tradition in Supreme Court's decisions and this is also true for the Supreme Court in the United Kingdom,<sup>16</sup> in Europe courts, including the Court of Justice of the European Union (CJEU) at the apex of the system, are more prudent in openly asserting their role beyond that of 'saying what the law is':<sup>17</sup>

If courts go beyond their duty of saying 'what the law is' they lack the legitimacy as they intrude into the political process. By drawing the borderline between law and politics, courts in fact are drawing the contours of their own legitimacy. The imperative need for courts to stand behind that line is by no means a novel question, but it has accompanied them ever since the constitutionalism was born. As Chief Justice Marshall famously articulated more than two hundred years ago, in *Marbury v Madison* [5 U.S. 137 (1803)], whilst '[i]t is emphatically the province and duty of the Judicial Department to say what the law is', acts of a political nature 'can never be examinable by the Courts'.

In this vein, European courts refrain 'from rewriting secondary EU law, even if the latter is outdated or no longer fulfils the objectives it pursues'.<sup>18</sup> Yet, despite this self-perceived modest role, European courts interpret primary EU law 'as a living constitution capable of coping with societal change'<sup>19</sup> and go well beyond 'a formalistic understanding of the rule of law', quietly accepting a 'gap-filling function' meant to 'complete the constitutional lacunae left by the authors of the Treaties' by 'setting the founding principles of the EU legal order by having recourse to the general principles of law'.<sup>20</sup> As Lady Arden recently noted, in the Banking Union 'the case law will connect the dots, and what will appear will be the contours of a developed new legal order, and also opportunities for its application, improvement and expansion'.<sup>21</sup> Thus, courts also exert a maieutic function which helps developing and completing a new legal order in finance.

**1.11** In so doing, courts often provide solutions to problems that political institutions could not solve. The establishment of the internal market through the coexistence of positive and negative integration techniques, the former entrusted to the Union political bodies and the latter undertaken by the Court is a landmark example.<sup>22</sup> Thus, as Joseph Weiler noted,<sup>23</sup> 'at a minimum there is a tension' between the statements proclaiming court's self-restraint and its gap-filling function and 'that line between law and politics begs more questions that it resolves'. Indeed:<sup>24</sup>

[C]ourts can no longer confine themselves to applying the legal rules as established by the legislator. Rather they are increasingly expected to weigh and reconcile the relevant

<sup>16</sup> Chris Hanretty, *A Court of Specialists. Judicial Behavior on the UK Supreme Court* (OUP 2020) 17–25. Lord Justice Laws, 'Should Judges Make Law?' in Jeremy Cooper (ed), *Being a Judge in the Modern World* (OUP 2017) 199–212, 199 (in the 'common law world the interpretation and application of the law are interwoven with its creation, because the judges mediate Parliament's legislation to the people, so that, so far as possible, it conforms to civilized constitutional principles whose guardians are the courts').

<sup>17</sup> *Lenaerts* (n 3) 13.

<sup>18</sup> *ibid* 26.

<sup>19</sup> *ibid* 26.

<sup>20</sup> *ibid* 15. Reconciliatory interpretation, special attention to the objectives pursued by the legislation and the importance of consistency are described as three interpretative means of paramount importance to this end.

<sup>21</sup> Lady Arden of Heswall, 'Foreword' in Chiara Zilioli and Karl-Philipp Wojcik (eds), *Judicial Review in the European Banking Union* (Edward Elgar Publishing 2021) xxvi.

<sup>22</sup> *Lenaerts* (n 3) 16.

<sup>23</sup> Weiler (n 3) 238, 241.

<sup>24</sup> Adams and others (n 3) 2.

interests themselves. Also, on ever more frequent occasions, courts must derive appropriate standards from the available rules—i.e. principles of good administration and good governance, demarcations of responsibility, etc.—which may then serve as benchmarks for assessing the extent to which conflicting interests should be protected. For that reason, the process of adjudication will necessarily have to be dynamic—at least, if the law itself is to remain a valued means for channeling social developments.

Courts' fundamental mandate is to ensure the rule of law, so as to preserve the legitimacy of the legal order.<sup>25</sup> The European courts echoed this principle in finance recently in *Banco de Portugal v VR*.<sup>26</sup> The Court was confronted, in the context of the Banco Espírito Santo resolution, with the fact that the appellant had brought an action before the competent national judge in February 2015 against Novo Banco in connection with a liability which was originally transferred to Novo Banco under the original resolution arrangement adopted in Portugal in August 2014 but was subsequently retransferred to Banco Espírito Santo with a retroactive decision of December 2015. The Court held that, although a retransfer of liability from Novo Banco to Banco Espírito Santo was allowed under the original arrangement of 2014, it violated the principle of legal certainty in the first place. Yet, the Court also found that 'the imperative of legal certainty' may have a direct bearing also on the right to effective judicial protection guaranteed by Article 47 of the Charter. The Court concluded, in particular, that the reorganization measures adopted in December 2015 were 'aimed precisely to render inoperative' the judgment delivered in October 2015 by the competent court in the dispute brought by the appellant and that:

63 To accept that reorganisation measure taken by the competent authority of the home Member State subsequent to the bringing of such an action and such a judgment, which have the effect of modifying, with retroactive effect, the legal framework relevant to the resolution of the dispute which gave rise to that action, or even directly to the legal situation which is the subject matter of that dispute, might lead the court seized to reject that action, would constitute a restriction on the right to an effective remedy within the meaning of the first paragraph of Article 47 of the Charter.

Another telling example that legal certainty needs to be ensured in finance no matter the importance of the competing values at stake is offered, in the United Kingdom, by a landmark judgment of the Financial List in *Law Debenture v Ukraine*,<sup>27</sup> where the court concluded that it was compelled to allow for summary judgment in respect of non-payment of Eurobonds issued by the Republic of Ukraine and purchased by Russia, taking account of the tradable nature of such instruments, and irrespective the fact that Ukraine claimed that the non-fulfilment of the payment obligation was caused by Russia's invasion of Crimea, its fuelling and supporting separatist elements and its destabilisation of the political situation in Ukraine, causing huge destruction across eastern Ukraine. Justice Blair, endeavouring to sever the aspects of the human tragedy from those of legal certainty, wrote:

<sup>25</sup> One of the 'most underspecified concepts in political theory and social science' according to Weiler (n 3) 235; also compare Adams and others (n 3) 5. For the debate on the legitimacy of strong judicial review in a democracy, when judges can quash primary legislation (as is the case for the CJEU) compare Anthony Arnall, 'Judicial Review in the European Union' in Antony Arnall and Damian Chalmers (eds), *Oxford Handbook of European Union Law* (OUP 2015) 379ff (revisiting the Waldron/Kavanagh debate).

<sup>26</sup> Case C-504/19 *Banco de Portugal, Fundo de Resolucao, Novo Banco v VR* ECLI:EU:C:2021:335, para 51.

<sup>27</sup> Case No FL-2016-00002 *The Law Debenture Trust Corporation PLC v Ukraine* [2017] EWHC 655 reversed on appeal and then referred to the Supreme Court. The Supreme Court delivered its final judgment on 15 March 2023 [2023] UKSC 11 unanimously holding that no summary judgment should be granted.



Ukraine submits that there are compelling reasons to proceed to trial [instead of summary judgment] because the claim is in reality a tool of oppression which includes military occupation, destruction of property, the unlawful expropriation of assets, and terrible human cost. Ukraine submits that these matters should be the subject of the full rigours of a public trial, and that the summary judgment process is not something to which Russia should be entitled to benefit given its egregious conduct. This point was powerfully put by Finance Minister Danyliuk in his evidence, and the court has given it careful consideration. However, ultimately, this is a claim for repayment of debt instruments to which the court has held that there is no justiciable defence. It would not be right to order the case to go forward to a full trial in such circumstances.

**1.13** Naturally, courts' role is curtailed by the peculiar process of decision-making in the 'theatre' of justice:

[i]n any given case, two litigants are pitted against one another, each asking for some specific remedy. All else being equal, judges regard it as their responsibility to decide cases as narrowly as possible and develop limited, not expansive rulings'. [Moreover, due to the constraints of this 'theatre'] 'judges who might have particular policy goals must await an appropriate case in which to craft their policy'.<sup>28</sup>

This makes courts' role episodic ('ships passing in the night' in the metaphor of Henry Wodsworth Longfellow<sup>29</sup>), unless 'courts' are apt in constructing a network of supporting precedents. Our finding in this book is that this is what courts do in the law of finance, more than elsewhere. In this sector, caseload is significant and most of the litigants are repeat players who have an abundance of resources, expertise, and access to the best legal representation. This means that, in the law of finance, 'judges are not lacking for legal vehicles in which to develop policy'.<sup>30</sup> Moreover, when courts resort to principles in order to fill in gaps in the legal system or to check administrative discretion, this is an exercise which rarely remains confined to courts' practice and often lends to what has been conceptualized as a 'law-making partnership'. A clear example was the development of the principle of proportionality by the CJEU,<sup>31</sup> which was eventually codified in Article 5 TEU.<sup>32</sup> Another example is offered by US securities fraud litigation.<sup>33</sup> The general antifraud provision of the Securities Exchange Act of 1934, section 10(b), did not expressly provide for any private right of action, nor was this envisaged by Congress. It was the courts which delineated the scope of this judge-made cause of action, and which opened the gates to private securities fraud (class) actions under Rule 10b-5, thereby creating, in the words of the Supreme Court, 'a judicial oak which has grown from little more than a legislative acorn'.<sup>34</sup> Indeed, in its *Basic* judgment<sup>35</sup> the Court created the new 'fraud on the market doctrine' to enable plaintiffs in capital markets transactions to address the 'reliance' requirement in federal securities fraud class actions (reliance can be presumed for securities traded in an efficient market tainted by public misrepresentation), noting that this was necessary to adapt the common law 'reliance'

<sup>28</sup> McGuire (n 3) 540.

<sup>29</sup> Sabino Cassese, *A World Government?* (Global Law Press 2018) 252

<sup>30</sup> McGuire (n 3) 543.

<sup>31</sup> Case C-379/87 *Anita Groener v Minister for Education* ECLI:EU:C:1989:599, para 19.

<sup>32</sup> Cassese (n 29) 249.

<sup>33</sup> Jill E Fisch, 'The Development of Securities Litigation as a Law-making Partnership' in Sean Griffith and others (eds), *Research Handbook on Representative Shareholder Litigation* (Edward Elgar Publishing 2018) 12.

<sup>34</sup> *Blue Chip Stamps v Manor Drug Stores* 421 US 723, 737 (1975).

<sup>35</sup> *Basic Inc v Levinson* 485 US 224 (1988).

requirement to the realities of modern securities markets and for ‘considerations of fairness, public policy, and probability as well as judicial economy’.<sup>36</sup> However:

[t]he Court did not act alone in developing the parameters of securities fraud class actions. Congress responded to *Basics* through explicit statutory provisions that clarified and modified the scope of the class action. In 1995, Congress adopted the PSLRA, which reflected both congressional acceptance of the judicially created private right of action and a reassertion of congressional authority over the scope of that right of action.<sup>37</sup>

These examples also show distinctive features of the ‘law-making partnership’:

**1.14**

First the original statute must be open-textured so as to contemplate judicial lawmaking through the process of statutory interpretation. Second, Congress and the Court must engage in sequential adjustments, in each case cognizant of, and responding to concerns that are raised in the other forum. Third, Congress and the Court must make these adjustments to further a common objective.<sup>38</sup>

It is a dynamic exercise, and one which is inherently unstable. The Supreme Court was, for instance, presented on several occasions with the question of whether to overrule its prior decision in *Basic*, based upon new evidence on market efficiency, which questioned the assumptions on which *Basic* was grounded.<sup>39</sup> It did not, so far, overrule this doctrine, but it may still do in the future. To some extent, the same occurs in Europe.

Under the rule of law, courts are granted a margin of appreciation to balance conflicting principles, rights, and colliding rules. And, as Katharina Pistor noted:<sup>40</sup> ‘[l]aw tends to be relatively elastic at the system’s apex, but inelastic in its periphery’; therefore, at the apex ‘where the very survival of the system is at stake, the ‘ultimate backstops abrogate the discretionary power to do what it takes to rescue the system’. Courts may find themselves in the uneasy position to review such decisions as ultimate decision-makers, often to carefully balance values and principles’ flexibility with rules’ rigidity, preserving the certainty of law.

**1.15**

The question then arises on whether, when confronted with hard cases where the survival of the system is at stake, courts are given policy responsibilities of outright political nature and significance.<sup>41</sup> In Europe some have argued that ‘the Euro crisis and the legal and institutional responses to it have dramatically increased the powers of the judiciary vis-à-vis the political branches, making economic and monetary affairs in Europe more judicialized than even in a hyper-judicialized system like the US’.<sup>42</sup> Others have argued the opposite, finding that courts are restrained in their ability to adjudicate over ‘fiscal rules imposed to constrain policymakers in time of crisis’,<sup>43</sup> and that ‘have, for the most part, been quite deferential to

**1.16**

<sup>36</sup> Fisch (n 33) 245.

<sup>37</sup> *ibid* 15.

<sup>38</sup> *ibid* 19.

<sup>39</sup> In *Halliburton Co v Erica P John Fund Inc* 134 S Ct 2398, 2408 (2014) the Court reaffirmed *Basic*.

<sup>40</sup> Pistor (n 14) 18.

<sup>41</sup> Sabine Saurugger and Clément Fontan, ‘Courts as Political Actors: Resistance to the EU’s New Economic Governance Mechanisms at the Domestic Level’ (2017) EMU Choices Working Paper Series 5.

<sup>42</sup> Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes, Constitutional Challenges* (OUP 2016) 64.

<sup>43</sup> Mitu Gulati and Georg Vanberg, ‘Paper Tigers (or How Much Will Courts Protect Rights in a Financial Crisis?)’ in Franklin Allen, Elena Carletti, and Mitu Gulati (eds), *Institution and the Crisis* (European University Institute 2018) 113.

the political choices made by their governments and parliaments.<sup>44</sup> Yet others have contended, in a middle ground, that ‘the control exercised by the courts in the post-crisis period has played an important role in reassuring citizens that the fundamental principles stand and must be respected even when decisions need to be taken under pressure; and that the courts, beyond formal barriers, do not hesitate to analyse measures that have an impact on citizens, while exercising judicial restraint and remaining coherent with the fundamental principles of our legal framework and within the constitutional balance of power.’<sup>45</sup>

**1.17** The years 2007–2022 have been turbulent ones, and for finance more turbulent than most. The 2007–2009 financial crisis, and its aftermath, with the euro crisis 2010–2013 shaped the economic, political, and legal order like few other events. As if this were not enough, new trends, most notably technological change, and one further accelerated by the pandemic, promise to remake the face of finance yet again. In this fluid environment, legislatures and regulators have seized the opportunity with gusto, passing an overwhelming number of new laws, regulations, rulebooks, or guidelines, to limit future crises, enhance accountability, thoroughly reconsider existing institutions, or simply show that they can keep track with reality. Analyses provide new insights into finance and its legal underpinnings, from perspectives grounded in classical economic or financial theory, behavioural finance, law and economics, institutional economics, political economy, history, as well as the different combinations between them. This has greatly enriched the law of finance as a discipline, and made it more relevant, but it has also made its functioning more complex, in at least two respects. First, the number and complexity of old, new, and proposed rules has made it harder, not easier, to ensure that those rules are consistent. Secondly, the burgeoning supply of theories helps to study finance from more angles than ever before, but there is no instruction manual to use the explanatory theories to draw normative insights, let alone help adjudication to be more robust. This matters because when we add ‘law’ to a discipline, the stakes are automatically raised, because something ‘mistaken’ or ‘wrong’ is not the same as something ‘unlawful’. We argue in this book the need of an approach to the law of finance that pays sufficient attention to some intrinsically legal aspects of such law. We synthesize these legal aspects in the role of principles in the interpretation and application of law in the adjudicating financial disputes and in the importance of expert judgment in achieving this result. Some might prefer to call this law’s ‘open-texture’. However, this would look at law from the ‘external’ perspective of the economist, sociologist, or member of other disciplines. We think what is needed is an ‘internal’ perspective, which looks at law’s validity, consistency, and integrity, for two reasons. First, because it is only through legal principles that courts, but also agencies and bodies ‘make sense’ of the law of finance. They may attach some importance to whether their rulings, regulations and decisions are efficient or fair, but they put extra care in ensuring that they are lawful, ie that their sense and meaning is coherent with that of an established set of precedents and principles. Such ‘sense’ or ‘meaning’ entails an exercise that is partly linguistic, but also value-laden. Secondly, because legal principles are the gate through which new knowledge and insight from other disciplines, usually in the form of explanatory theories, can acquire normative force and play an effective role in the

<sup>44</sup> Bruno de Witte, ‘Judicialization of the Euro Crisis? A critical Evaluation’ in Franklin Allen, Elena Carletti, and Mitu Gulati (eds), *Institution and the Crisis* (European University Institute 2018) 107.

<sup>45</sup> Chiara Zilioli, ‘From Form to Substance: Judicial Control on Crisis Decisions of the EU Institutions (with a Focus on the Court of Justice of the European Union)’ in Franklin Allen, Elena Carletti, and Mitu Gulati (eds), *Institution and the Crisis* (European University Institute 2018) 135.

adjudication process, if, and to the extent that, such explanations satisfactorily reflect the balance of criteria for 'good', 'bad', 'right', 'wrong', 'fair', and 'unfair' also present in the law.

In light of this, this book makes a descriptive claim and a normative claim. The descriptive claim is that legal operators, and courts in the first place, use, and need, principles (and the values reflected in such principles) to adopt decisions and ensure their validity, in a way that is often overlooked by rules-based constructs. The normative claim is that such awareness of the role of principles helps to assess the 'rightness' or 'wrongness', the 'fairness' or 'unfairness' of the conduct of private players, of the content of authorities' and courts' decisions, or of new pieces of legislation, by examining whether they are consistent with the fundamental values underpinning our legal system and our society. **1.18**

The above explanation needs to be supplemented by a couple of disclaimers. First, this book does not propose a takeover of the law of finance by moral theory. Whilst we acknowledge the growing narrative emphasis on ethical and moral standards, in the words of a former Governor of the Bank of England, 'to deliver a more trustworthy, inclusive capitalism: one which embeds a sense of the systemic and in which individual virtue and collective prosperity can flourish',<sup>46</sup> we try to keep our analysis as based in norms and practice as possible and exemplify our views with concrete value-considerations. Yet we also think that, in legal terms, it is a mistake to think that the law of finance should be value-neutral (it cannot), that considerations of efficiency are not value-laden (they are), or that they should be the only relevant considerations (they should not and cannot). In our view, the adjudication of financial disputes offers strong evidence of it. Secondly, this book does not make a predictive claim. Being aware of the principles underpinning the rules helps to understand the law of finance better and should help in preventing decisions with a legal content form turning out into 'false positives' or 'false negatives'. That does not mean that courts will always share our views about the relative weight of considerations of principle, or value. But even where they do not, this approach will take them to better engage with fundamental principles and values and to account for them. To do that, this book takes 'hard cases' as the exemplary battlefield. Our view is that hard cases always involve a deep controversy over the principles, policies, and values at stake. We submit that only if this inner controversy is duly acknowledged as part of the legal process and the reasoning of the relevant decision duly substantiates the role that principles play in it, the legal process is made robust enough to effectively serve the public interest. **1.19**

Other authors who depart, like we do, from a criticism of excessive simplification, offer alternative theories, some compatible with ours, because they offer a different viewpoint. Katharina Pistor points out law's 'incomplete' character, and the role that 'culture' or 'enforcement' play for completion purposes.<sup>47</sup> We cannot but agree and this fits within a long tradition that sees 'institutions' as a broader concept, which encompasses all 'humanly devised constraints that structure political, economic and social interaction', constraints that 'consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)'.<sup>48</sup> Professor Pistor and others **1.20**

<sup>46</sup> Mark Carney, 'Inclusive Capitalism: Creating a Sense of the Systemic' (Bank of England, Speech given at the Conference on Inclusive Capitalism, London, 27 May 2014) 10 <https://www.bis.org/review/r140528b.htm>, cited by W Blair, 'Reconceptualizing the Role of Standards in Supporting Financial Regulation' in Ross P Buckley, Emiliós Avgouleas, and Douglas W Arner (eds), *Reconceptualising Global Finance and its Regulation* (CUP 2016) 443.

<sup>47</sup> Katharina Pistor and Chenggang Xu, 'Incomplete Law' (2003) 35 *NYU J Intl L & Policy* 931. See also Katharina Pistor, 'The Law and the Non-Law' (2006) 27 *Michigan J Intl L* 973.

<sup>48</sup> Douglass C North, 'Institutions' (1991) 5 *J Econ Perspectives* 97.

also focus their criticism on shortcomings of normative institutional analysis that highlight points similar to the ones we make here, such as the lack of discussion of law's indeterminacy of concepts,<sup>49</sup> the connection between legal rules and the system's 'core' features,<sup>50</sup> the role of law as a cognitive institution, and the related 'interdependence' or rules,<sup>51</sup> the 'endogenous' relation between an economic system and its legal system.<sup>52</sup> On this ground, Professor Pistor proposes her compelling *Legal Theory of Finance* (LTF), which emphasizes finance's legal construction, and how this explains its unique characteristics, such as its intrinsic instability, its hierarchy, or the system's varying degrees of 'elasticity' (apex and periphery<sup>53</sup>). This has offered significant progress in the literature's explanatory power. However, by adopting both a viewpoint that is both explanatory, or descriptive,<sup>54</sup> and 'external' to legal practice,<sup>55</sup> the approach runs the risk of offering less insights from a normative and internal perspective. To illustrate this point, if we analyse the role of legal institutions before the 2007–2008 financial crisis, the LTF and approaches based on institutional economics can help us understand better what role in the system was played by legal constructs (eg derivatives regulation, or central banks' policies) or the culture inside central banks and regulators, or why certain (apex) banks were treated differently from (peripheral) banks. However, it cannot help us conclude whether a central bank acted, or not, *lawfully*, whether some banks investors' *rights* were trampled over, or whether bank directors breached their *legal duties*. Institutional economics cannot provide an answer because their goal is to answer pertinent, but different questions. Thus, an 'internal' perspective that considers the arguments from inside legal practice to yield normative conclusions of 'validity' and 'consistency' is still necessary.

**1.21** In our view, as we will show throughout this book, this perspective needs to be principles-based in nature. None of the questions above, and similarly difficult ones, can be answered without properly interpreting and weighing the principles underpinning the law of central banks and their operations, supervisory or resolution practice, or investors' role in capital markets regulation, and interpreting what the law is in each case (descriptive claim). A proper interpretation and understanding of these principles, and the way they are inter-related, will establish the framework to assess which conduct is right, fair, and legal (normative claim). This requires, however, expert judgment on facts and complex economic assessments.

**1.22** Such principles-based interpretive perspective explains from inside legal practice, what for the external perspective is the 'interdependence' between rules, law's 'incompleteness', or the 'endogeneity' between legal and economic systems, or law's relationship with 'culture'. 'Hard cases' involve questions about what is legally 'right', or 'lawful' which are difficult to answer without appealing to the system's underpinning principles and values. These are inextricably linked to the system's 'cultural' constructs. However, the role and weight of these principles

<sup>49</sup> Tamara Lothian and Katharina Pistor, 'Local Institutions, Foreign Investment and Alternative Strategies of Development: Some Views from Practice' (2004) 42 CJTL 101.

<sup>50</sup> Katharina Pistor, 'Rethinking the "Law and Finance" Paradigm' (2009) 6 BYU L Rev 1647.

<sup>51</sup> Katharina Pistor, 'The Standardization of Law and Its Effect on Developing Economies' (2002) 50 AJCL 97.

<sup>52</sup> Pistor (n 50) 1647–70.

<sup>53</sup> Pistor (n 14) 315–30.

<sup>54</sup> *ibid* 317.

<sup>55</sup> The LTF itself claims to offer an 'explanatory', and not a 'normative' approach. Our classification of it as an 'external' perspective is due to its use by Pistor of concepts outside legal practice (eg 'culture' or 'social norms') or explanations that emphasize the non-legal (eg sociological or economic) logic of legal decisions. See, in particular, Pistor and Xu (n 47). See also Pistor (n 47) 973–83. Saying that culture and social norms influence law is (we believe) true and insightful, but does not help establish the validity of a legal act. Focusing on the legal principles resulting from such culture or norms, however, can do so, and thus offer a normative perspective.

and values in each case will be given by law itself. Thus, its proper recognition needs, in our view, expert judgment. This is not the same as saying that law is ‘incomplete’, but, rather, a testimony to its ‘plasticity’, ‘flexibility’, ‘fluidity’, or ‘adaptability’, although it is more accurate to talk about the centrality of principles and law’s ‘interpretive’ nature, which are the source of all these features.

## 2 Principles, financial stability, and interpretation

Some could argue that ‘technical’ goals, such as solvency, liquidity, transparency, safety, and soundness, or even financial stability, can be explained by appealing to technical arguments based on the text of the rules and their application, rather than those flaky-ish arguments about ‘principles’ and ‘values’. This would be a mistake. Such rejection of principles would assume a simplified reality that does not exist. Indeed, the general reference to goals such as ‘solvency’, ‘liquidity’, ‘transparency’, ‘safety and soundness’, or ‘stability’ obscures the fact that their meaning and inner workings are controversial. The first source of complexity, and controversy, is the ‘narrative based’ formulation of those goals. That is, any explanation of the pathologies that act as the antonyms for those goals (insolvency, illiquidity, opacity, unsafety and unsoundness or instability etc.) require certain cause-and-effect assumptions about the functioning of markets, which, in turn, illustrate the dynamic sequence of actions and reactions that cause the problems. Every causal connection, thus, needs to be established as a ‘story’ of sorts, about how different players will behave in the presence of certain constraints and incentives. Solvency rules for banks must assume the existence of some kind of market failure or externality, which explain banks’ incentive to accumulate capital cushions that are lower than what is individually or socially optimal;<sup>56</sup> transparency rules for primary and secondary markets must assume that trading platforms and intermediaries, left to their own devices, will produce a less than optimal level of transparency;<sup>57</sup> and so on. These are not ‘literary’ views of the markets; they are simply a necessity to make sense of facts. When causal explanations about how markets work, and how their forces must be unleashed or constrained, work their way into rules, law lends them its seriousness and validity, but does not regulate controversy away. Such controversy is an intrinsic part of the legal process, as it may affect the ‘moral’ of the law, ie whether a legal provision is necessary, the ‘narrative’ of the law, or its justification, and the interplay between the specific rule, and fundamental legal principles. **1.23**

The explanations or ‘stories’ underpinning the ‘moral of the law’, or the necessity of the rules, are also the first source of disagreement. In bank regulation, the narrative underpinning the need for intervention is hotly disputed by authors, who posit that transparency levels, or even capital cushions, will be optimal if only market forces are left to work properly,<sup>58</sup> that frictions and inefficiencies introduced by a prior legislative or government intervention, **1.24**

<sup>56</sup> See Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (Peterson Institute for International Economics 2008) 16–29 for a discussion of the various arguments.

<sup>57</sup> Joel Seligman, ‘The Historical Need for a Mandatory Corporate Disclosure System’ (1983) 9 J Corporate Law 1. Contrast with George J Benson, ‘Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934’ (1973) 63 A Econ Rev 132.

<sup>58</sup> Roberta Romano, ‘Empowering Investors: A Market Approach to Securities Regulation’ (1998) Yale LJ 2359.



which created the problem in the first place,<sup>59</sup> are removed or that instability cannot be prevented because it is caused by uncontrollable market forces, and that restrictive rules will simply hamper the economy's potential level of development.<sup>60</sup> The arguments used in the debate may be 'technical', but their *legal* consequence will be to sow controversy deep down the narrative underpinning the rules, i.e. the 'moral' of the story will, itself, be controversial.

- 1.25** A second source of complexity is that even if there is agreement about the 'moral' of the story, e.g. about the need for legislative/regulatory intervention, the narratives justifying such intervention may be different and partial, emphasizing different sequences, or the role of different players, ie there may be a disagreement about the decisive, or efficient, cause, and the level of importance that each factor can have in the (construct) of market dynamics. The 2007–2008 financial crisis, and the ensuing 2010–2012 euro zone sovereign debt crisis, have shown an extraordinary literary creativity.<sup>61</sup> Likewise, it is already clear that also the economic disruptions caused by the Covid-19 pandemic, first, and the Russian/Ukrainian war then, will have their toll on the narratives for future reflections of those events into finance.
- 1.26** Thus, the legal process needs narratives to understand the reality that the law is supposed to regulate and give normative meaning to that law, while it also needs to confront controversy. This is of paramount importance at the stage when courts are called to interpret and apply the law of finance. Indeed, different narratives may inspire a different set of rules, and the *policies* underpinning them.
- 1.27** Some may argue that the competing narratives or 'themes' are an issue limited to the political process leading to the adoption of the rules, and no further. We believe they are not, for the coexistence between multiple themes can create problems of consistency and interpretation both between each theme and the rules inspired by it, as well as between rules inspired by competing narratives. Part of the problem is in the open-textured nature of the rules, but also in the competing nature of the mandates given to the authorities (eg banks' safety versus investor protection), and the transposition of those mandates into specific rules which in some circumstances may collide. This raises difficult questions about the relative weight and importance of each theme's underpinning principles and values.<sup>62</sup> Problems can be countless, but the general idea is that many cases may require public authorities and the courts that review their acts to make trade-offs between themes and narratives and weigh their importance. The increase of long and detailed rules, rather than mitigating the problem, makes it worse. The sheer numbers of such rules means an increase in the number of interactions between rules, which also increases the probability of inconsistencies and collisions. Also, the need to distribute the entities' legal and compliance departments' attention among a greater

<sup>59</sup> Roberta Romano, 'For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture' (2014) 31 Yale J on Reg 1.

<sup>60</sup> *ibid* 52–57.

<sup>61</sup> For one of the best compilations there is about the different narratives see Andrew W Lo, 'Reading about the Financial Crisis: A Twenty Book Review' (2012) 50 J Econ Literature 151.

<sup>62</sup> Only a small portion of the measures originally envisaged by the specific theme may be implemented due to the availability of different options within a single theme, the lack of clarity about the options, the presence of opposing narratives, or sheer political reasons (lobbying, lack of public concern, weakness, or lack of political capital, new 'crises', or problems, etc.) Some authors incorporate an 'interest group' theory to limit the courts' ability to interpret statutes. See eg Frank Easterbrook, 'Statutes' Domains' (1983) 50 U of Chicago L Rev 533. However, using an interest group theory when it comes to statutory interpretation would limit the purpose of having a general law for all, and would be contrary to non-discrimination. Tribe emphasizes the point that even laws contemplating private interests must be susceptible of identifying a broader public interest in protecting the private parties. See Laurence H Tribe, 'Constitutional Calculus: Equal Justice or Economic Efficiency' (1985) 98 Harv LR 614.

number of provisions increases the likelihood of misunderstandings. Finally, the shortening of the rules' shelf life, often as a matter of design,<sup>63</sup> undermines the rules' role as guidance of expected behaviour and hampers the process of settlement that helps gauge the interpretive implications of the new rules.

A final source of controversy arises between the rules and the fundamental rights that protect the individuals and institutions affected by the rules. It is customary to view fundamental rights as hard bulwarks that 'trump' policies in their restricted area,<sup>64</sup> while policy considerations rule in the space left by fundamental rights. This stylized view, however, is simplistic. First, fundamental rights are seldom characterized as 'concrete' rights, but rather behave more like 'abstract' rights, whose content in individual cases needs further specification.<sup>65</sup> The EU fundamental rights texts, such as the EU Charter of Fundamental Rights, talk about rights *and principles*,<sup>66</sup> in order to accommodate legal propositions with varying degrees of generality. Yet even this distinction is not entirely correct, since some of the principles with the greater degree of generality and scope, can also encapsulate some of the hardest rights, such as non-discrimination.<sup>67</sup> Thus, fundamental rights enjoy the double dimension, of both abstract principles and concrete rights. Indeed, some influential views characterize *all* fundamental rights as 'optimization mandates', which are subject to 'balancing' and 'proportionality', when they clash with other rights, policies, or rules, as every open-ended maximization mandate is bound to do.<sup>68</sup> This methodology applies to the fundamental rights normally involved in the law of finance,<sup>69</sup> such as the right to property over tangible and intangible assets (herein included legal titles on shares and creditor status),<sup>70</sup> freedom to conduct a business,<sup>71</sup> privacy rights,<sup>72</sup> procedural rights, during the administrative, and the judicial review procedures,<sup>73</sup> or the right to non-discrimination.<sup>74</sup> Furthermore, in many cases, the rights' protection will be claimed by legal persons, which means that the scope and intensity of the right must be further calibrated.<sup>75</sup> Secondly, not only fundamental rights are

<sup>63</sup> This is the case of the automatic revision clause in many EU rules. These provide that the Commission, on a specified date shall present a report on the implementation of the relevant directive, accompanied, where appropriate, by a proposal for its revision. Very often, the Commission finds that such modification is appropriate.

<sup>64</sup> Ronald Dworkin, 'Rights as Trumps' in J Waldron (ed), *Theories of Rights* (OUP 1984) 153–67.

<sup>65</sup> Ronald Dworkin, 'Hard Cases' (1975) 88(6) Harv LR 1070.

<sup>66</sup> Charter of Fundamental Rights of the European Union [2012] OJ C326, art 51(1) (Charter) provides that the EU institutions, bodies, offices, and agencies, 'shall therefore respect the rights, observe the principles and promote the application thereof in accordance with their respective powers and respecting the limits of the powers of the Union as conferred on it in the Treaties'.

<sup>67</sup> See eg Charter, art 23 (equality between women and men). It is interesting to note that, in Case C-176/12 *Association de Médiation Sociale (AMS) v Union locale des Syndicats* ECLI:EU:C:2014:2 the Court held, with regard to the 'workers' right to information and consultation within the undertaking' that: 'It is therefore clear from the wording of Art 27 of the Charter that, for this article to be fully effective, it must be given more specific expression in European Union or national law', only immediately to hold that: '[t]he facts of the case may be distinguished from those which gave rise to *Kücükdeveci* in so far as the principle of non-discrimination on grounds of age at issue in that case, laid down in Article 21(1) of the Charter, is sufficient in itself to confer on individuals an individual right which they may invoke as such'. *ibid* paras 45–47.

<sup>68</sup> Robert Alexy, *Teoría de los derechos fundamentales* (2nd edn, CEPC 2002).

<sup>69</sup> See generally Marco Lamandini, David Ramos, and Javier Solana, 'The ECB Powers as a Catalyst for Change in EU Law (Part 2): SSM, SRM and Fundamental Rights' (2017) 23(2) Col J Eur L 199.

<sup>70</sup> European Convention on Human Rights (ECHR) art 1 of Protocol 1. See eg *Dennis Grainger and Others v the United Kingdom*, App no 34940/10 (10 July 2012).

<sup>71</sup> Charter, art 16.

<sup>72</sup> See Charter, arts 7–8, or ECHR, art 8.

<sup>73</sup> Charter, arts 41–42, 47, and ECHR, art 6.

<sup>74</sup> Charter, arts 20–21.

<sup>75</sup> Compare judgment of the Italian Constitutional Court No 84/2021 (13 April 2021), implementing CJEU judgment in Case C-481/19 *DB v Consob* ECLI:EU:C:2021:84 on the right (of natural persons) to be silent.

characterised as principles, or optimization mandates; some of the policies underpinning the law of finance, such as financial stability, tend to be portrayed as 'trumps' themselves. Pitted against such powerful reasons, which can automatically justify a measure's rationale, necessity, appropriateness or proportionality, fundamental rights can be easily trumped over, or, at best, resemble a weak right to make a court 'balance' competing considerations of policy. This may be more difficult to do if the rules applicable operate as an internally coherent whole, where, however, fundamental rights were not, or not sufficiently, taken into consideration, which means that introducing an exception or caveat to a rule via constitutional interpretation creates frictions in the rule's internal structure. Thus, an interpretation needs to be offered, where both the general principles and policy considerations underpinning the rules, and the fundamental rights that operate as their limits, make sense together, and 'fit' within the broader scheme of the legal values that conform the legal system.

### 3 Principles-based interpretivism, heuristics, and biases

1.29 The third advantage of a principles-based, interpretive perspective to the law of finance has to be formulated cautiously, and with a view deferential to science, but it is important nonetheless. If principles-based interpretivism is necessary, legally, to avoid inconsistent decisions, psychologically it can also help overcome cognitive and decision-making biases, which could deeply affect the adjudicatory process. The literature in the field is vast, but it was pioneered by Kahneman and Tversky, whose experiments alerted about the existence of biases in the way persons process information and make decisions under conditions of uncertainty.<sup>76</sup> These prompt individuals to focus on 'salient' or 'available', if improbable risks,<sup>77</sup> be loss averse,<sup>78</sup> and neglect the role of interventions in an already complex system.<sup>79</sup> Heuristics not only explain probability assessments, but also moral decisions,<sup>80</sup> and can bias them depending on their framing.<sup>81</sup> Given that metaphors and analogical thinking are key in moral, or political decision-making,<sup>82</sup> principles-based interpretation, by forcing courts and agencies to use different frames and openly to address the rules' fundamental questions can help them overcome the bias of a single frame. By superimposing different frames onto a single problem agencies and courts can calibrate the weight of the principles underpinning a specific set of rules, and thus assess their scope and intensity of application. If category-bound thinking is a major source of inconsistency and arbitrariness in judgments,<sup>83</sup> the simultaneous use of different categories can help mitigate those biases. Principles-based

<sup>76</sup> Amos Tversky and Daniel Kahneman, 'Judgment under Uncertainty: Heuristics and Biases' (1974) 185 *Science* 1124.

<sup>77</sup> See Amos Tversky and Daniel Kahneman, 'Judgment under Uncertainty' in Daniel Kahneman, Paul Slovic, and Amos Tversky (eds), *Judgment under Uncertainty: Heuristics and Biases* (CUP 1982) 3.

<sup>78</sup> Daniel Kahneman, Jack Knetsch, and Richard H Thaler, 'Experimental Tests of the Endowment Effect and the Coase Theorem' (1984) 98(6) *J Pol Econ* 1325; Richard Thaler and others, 'The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test' (1997) 112(2) *Q J Econ* 647.

<sup>79</sup> Richard Dornier, *The Logic of Failure: recognizing and Avoiding Error in Complex Situations* (Metropolitan Books 1996). Most of these were originally identified by Kahneman and Tversky and used by Sunstein as a basis for his criticism. See Cass R Sunstein, *Laws of Fear* (CUP 2005) 34.

<sup>80</sup> Daniel Kahneman and Cass Sunstein, 'Indignation: Psychology, Politics, Law' (2007) U Chicago L School John M Olin Law and Economics Working Paper 346.

<sup>81</sup> Cass Sunstein, 'Moral Heuristics and Moral Framing: Lecture' (2004) 88 *Minnesota L Rev* 1561.

<sup>82</sup> For a general approach see George Lakoff and M Johnson, *Metaphors We Live By* (University of Chicago Press 1980); George Lakoff, *Moral Politics: How Liberals and Conservatives Think* (University of Chicago Press 2002).

<sup>83</sup> Cass R Sunstein and others, 'Predictably Incoherent Judgments' (2002) 54 *Stanford L Rev* 1153.

interpretivism is not the antidote to biases, but it is surely a mechanism for limiting some of them.

The above puts forward a *descriptive*, or explanatory claim, and a *normative* argument for principles-based interpretivism in the law of finance. From a descriptive perspective, like Moliere's bourgeois Monsieur Jourdain, who discovered that he had been speaking in prose all his life,<sup>84</sup> principles-based interpretation and application of the law is what courts and other bodies already do or at least try to do (with margins for improvement) and legal theorists have been discussing ever since. We argue, however, that this should be made by courts engaged in financial disputes with more consciousness of the importance of principles-based interpretivism to reconcile law in action with the values inspiring and embedded in the law of finance. From an operational point of view, this should turn into a necessary adjunct to the statement of reasons that shows a straightforward engagement not only with the text of the provisions but also with the general principles inspiring their adoption, their finality and the values embedded in the legislative or regulatory choice. We argue that this also passes through the way the adjudication of financial disputes is organized. **1.30**

#### 4 Principles-based interpretivism and legitimacy

Another factor supporting the opportunity of a principles-based interpretivist approach is the need to bridge some logical gaps between issues of validity, and of legitimacy, which are of special importance in the law of finance. By using 'legitimacy' we do not wish to be bogged down in a conceptual quagmire,<sup>85</sup> since we are not trying to explain the concept,<sup>86</sup> but to discuss specific, pressing problems in the law of finance, related to the difficulty to fit the law of finance's decisions, practices, or governance structures within canons of acceptability or justifiability, which is how 'normative legitimacy' is often understood.<sup>87</sup> The problem is one of 'input' legitimacy, which measures the process, as well as of 'output' legitimacy, which measures the success in meeting desired outcomes, i.e. 'delivering the goods'. For institutional purposes, however, 'input/process legitimacy' is more relevant, as it is the parallel concept of 'accountability',<sup>88</sup> understood as a (political) actor's obligation to explain and justify her conduct in a forum, which may be followed by a judgment by the forum, and the ensuing consequences.<sup>89</sup> **1.31**

<sup>84</sup> Molière, *Le Bourgeois gentilhomme* (Louandre 1910) scène IV.

<sup>85</sup> In trying to prioritize the concrete legal-political problem over the conceptual problem we share Joseph Weiler's sentiment when he said 'Legitimacy is a notoriously elusive term, over-used and under-specified. So the first thing I will do is to explain the sense in which I plan to use 'Legitimacy' in this essay. Do not, please, argue with me and say: 'That is not legitimacy! It means something else!' See Joseph Weiler, 'In the Face of Crisis: Input Legitimacy, Output Legitimacy and the Political Messianism of European Integration' (2012) 34 *Eur Integration* 826 and in Joseph Weiler, 'Europe in Crisis: On 'Political Messianism', 'Legitimacy' and the 'Rule of Law' [2012] *Singapore J Legal Studies* 248, where he makes the exact same remark.

<sup>86</sup> An excellent summary is provided by Fabienne Peter, 'Political Legitimacy' in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* <http://plato.stanford.edu/entries/legitimacy/>.

<sup>87</sup> Therefore, we would leave aside descriptive accounts of legitimacy, such as Weber's (based on people's actual belief that lends prestige to persons exercising authority). See eg Max Weber, *The Theory of Social and Economic Organization* (Free Press 1964) 382, or accounts that some would classify as 'social', based on empirical assessment of social attitudes of acceptance. See also Weiler, 'In the Face of Crisis' (n 85).

<sup>88</sup> Allen Buchanan, 'Political Legitimacy and Democracy' (2002) 112(4) *Ethics* 689. See also Giandomenico Majone, 'Transaction-cost Efficiency and the Democratic Deficit' (2010) 17(2) *J Eur Pub Pol* 150.

<sup>89</sup> Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13(4) *Eur LJ* 450. Bovens also offers another distinction of 'accountability' as a 'virtue', which has a normative perspective, and as a

**1.32** The reasons why the law of finance poses a particularly acute problem are multiple, but generally stem from finance's complex causal chains, and the fact that, once enacted, the law has to accept such causal chains as a given aspect of its logical structure. This means that, first, when economic effects are far removed from their causes, they may be hard to grasp, and thus unacceptable to citizens, law-makers or judges (inaccessibility); secondly, the 'law of unintended consequences' may be accepted as a valid reason by technocrats or policy-makers for not focusing on the more visible aspects of a problem, but it is often less acceptable to citizens, law-makers, or judges as a way to justify a 'wrong' state of affairs only because other options could lead to worse consequences (complexity);<sup>90</sup> thirdly, when adopting new rules legal actors will overlook the tensions between the rationales underpinning these and other rules, and/or inadvertently sacrifice principles or values (dissonance);<sup>91</sup> fourthly, the saliency of a problem may appear to justify granting vast powers to administrative agencies, but the consequences of this may become evident only at a later moment, when the justification that initially seemed obvious is no longer so salient (time-inconsistency); and, fifthly, and as a corollary, the competing forces of the elusive yet ubiquitous 'markets', and the severe and judgmental presence of independent agencies can give the impression that 'people', or 'polities' have their work cut out for them, or, simply, have the decisions made for them (unaccountability). The problem can be particularly acute in the European Union, where a common perception is that the EU itself, and its institutions have a democratic legitimacy problem.<sup>92</sup> Thus, addressing finance's vagaries by transferring more powers to EU institutions can be seen as accumulating one illegitimacy with another, or as a naïve expectation that two illegitimacies, like two negatives, can cancel each other out.

**1.33** As a clarification, we are not focusing on 'justice' beyond law, and we limit our concern with legitimacy to the extent that it intersects with legality, because the two are intimately related.<sup>93</sup> If law is an interpretative process, a decision whose process is illegitimate, will tend to be found illegal eventually.<sup>94</sup> Thus, legality (based on principles-based interpretivism) and legitimacy must support each other. Principles-based interpretivism should delineate how to make the decision-making process in the law of finance more legitimate. Consider the role of independent regulatory and supervisory agencies. The legitimacy dimension helps to stress the importance of the *justification* of decisions, or the *reasons* for them, over the *discovery* process, or *motives* leading to that decision.<sup>95</sup> It follows that including justificatory reasons needs to be *institutionalized*, or codified into decision-making, and a lack of such

'mechanism', which has a descriptive component. See Mark Bovens, 'Two Concepts of Accountability: Accountability as a Virtue and as a Mechanism' (2010) 33 West Eur Politics 946.

<sup>90</sup> For example, a country's citizens, parliament, or government, may not accept imposing losses on a bank (retail) investors as a means to limit moral hazard or taxpayer losses, or the strict enforcement of defaulted mortgage loans over family homes, as a way to avoid a crisis of non-performing loans (NPLs).

<sup>91</sup> For example, a court enforcing transparency requirements for the marketing of financial instruments among retail investors may not be aware of the effect that his strict interpretation may have on the entities' ability to raise equity capital, and thus their solvency, and the sector's stability and concentration.

<sup>92</sup> Weiler, 'In the Face of Crisis' (n 85); Weiler, 'Europe in Crisis' (n 85) 248.

<sup>93</sup> We agree with Weiler's assertion that 'Legitimacy, normative or social, should not be conflated with legality'. Weiler, 'In the Face of Crisis' (n 85) 827.

<sup>94</sup> Contrast this with a situation where a decision may be found unjust for failing to duly uphold some specific standards of justice, but whose process is legitimate, and will tend to be considered legal. Rawls, for example, argues that, while legitimacy and justice draw on the same political values, legitimacy makes weaker demands for justice, which means that an institution may be unjust, but legitimate. See John Rawls, 'Political Liberalism: Reply to Habermas' (1995) 92(3) J Phil 148.

<sup>95</sup> Giandomenico Majone, *Evidence, Argument and Persuasion in the Policy Process* (YUP 1989) 29.

justification should be a strong prima facie evidence of illegality. Furthermore, not every reason will do. Even if agencies can resort to considerations of policy to make their decisions, considerations of principle, or value, will operate as external limits, and internal, logical constraints, eg requiring any appeal to those principles or values as a justification for agency action to be consistent with the way they are understood by the courts. Secondly, and conversely, the focus on legitimacy should inform a court's use of principles-based legality. On one level it may help courts reflect about their own role in the broader system of checks-and-balances, ie other branches or bodies can obtain a better result in terms of the justification of decisions,<sup>96</sup> courts can consider the availability of such other means, and the multi-faceted nature of 'accountability'<sup>97</sup> (political, administrative, legal) to shape their own standard of review.<sup>98</sup> Both courts, and their standard of review shall remain critical, not because of their intrusiveness, but of their status as the system's keystone, or closing piece and ultimate arbiter. Furthermore, the notion of legitimacy can help the courts to better contextualize the role of fundamental rights in the law of finance, not only as the means to protect the passive victims, but of giving voice to active constituencies who need to be part of the process,<sup>99</sup> a point too often missed when it comes to the law of finance. Thirdly, a principles-based and legitimacy-based view are necessary complements in contexts of polycentric authority, with multiple sources that are not related by hierarchy, or where trying to establish hierarchy may itself be controversial (eg, between the European Union and Member States). In such cases, the pull towards construing a single theory of how different sets of rules, and their unifying principles fit together needs to give way to a construction that acknowledges other systems, and the dialogue between them. Those familiar with EU law will automatically see the connection with 'legal pluralism',<sup>100</sup> grounded on 'discourse theory',<sup>101</sup> and the complex equilibria needed to mitigate the risks of plain 'primacy'.<sup>102</sup>

<sup>96</sup> If we put this more formally, it is common to use agency theory, originated in the corporate field, to analyse the action of public agencies. See Giandomenico Majone, 'The Regulatory State and Its Legitimacy Problems' (1999) 22(1) *West Eur Politics* 1, with reference to Murray Horn, *The Political Economy of Public Administration* (CUP 1995). In its original conception, agency theory can anticipate that under conditions of high monitoring costs, an agent will seek its own interests, rather than the principal's. Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *J Fin Econ* 305.

<sup>97</sup> Bovens 'Analysing and Assessing Accountability' (n 89) 447–68. See also Deirdre Curtin, *Mind the Gap: The Evolving European Union Executive and the Constitution* (Europa Law Publishing 2004).

<sup>98</sup> Such holistic view of accountability as the reference point to determine the court's standard of review of the legality of a decision, or structure, was at the core of the European Court of Justice's strict review in *Case 9/56 Meroni v High Authority* ECLI:EU:C:1958:7. The specific circumstances, with a semi-private agency, with no clear accountability, and the absence, at that time, of stronger mechanisms of political control did not ensure a robust process of justification, which, in our view, explains the Court's reference to the broader concept of 'institutional balance', as the vantage point to cast judgment.

<sup>99</sup> Some authors have pointed, for example, that the CJEU's case law on the internal market helped to open a direct channel of communication with citizens, by vesting them with individual rights, and thus giving them a stake, and a voice, in the process of European integration. See Miguel Poyares Maduro, *We, the Court: The European Court of Justice and the European Economic Constitution* (Hart Publishing 1998) 27.

<sup>100</sup> See Neil MacCormick, 'Beyond the Sovereign State' (1993) 56 *Modern L Rev* 1; Miguel Poyares Maduro, 'Interpreting European Law: Judicial Adjudication in a Context of Constitutional Pluralism' (2007) 1(2) *Eur J Legal Studies* 137. More recently see Klemen Jaklic, *Constitutional Pluralism* (OUP 2014). For some critical views see P Eleftheriadis, 'Pluralism and Integrity' (2010) 23(3) *Ratio Juris* 365; of Julio Baquero Cruz, 'Another Look at Constitutional Pluralism in the European Union' (2016) 22 *Eur LJ* 356. For a comprehensive view of the different interactions see Giuseppe Martinico and Oreste Pollicino, *The Interaction between Europe's Legal Systems Judicial Dialogue and the Creation of Supranational Laws* (Edward Elgar Publishing 2014).

<sup>101</sup> Jurgen Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (William Rehg tr, MIT Press 1996).

<sup>102</sup> Bruno de Witte, 'Direct Effect, Primacy, and the Nature of the Legal Order' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (OUP 2011) 323–62.



- 1.34** The relevance of this approach, however, transcends the European setting, for the law of finance requires increasing coordination on a transnational level, with actions that may result in an intrusion upon principles of the basic legal order. Consider the legal grounds and effects of Memoranda of Understanding (MoU) between authorities, the ‘contracts’ between central banks, or the use of coordinated supranational structures to decide on joint supervisory or resolution action, which may clash with privacy or property rights, or administrative safeguards. Imagine a resolution action which affects shareholders in third countries. Since different legal orders are mutually aware that each has no absolute power over the other, they are encouraged to engage in a dialogue.<sup>103</sup> Discourse theory provides normative value to what would otherwise be a mere descriptive sociological or political account of how courts interact, but such normative value legitimizes the vessel, and not the content. What renders the acknowledgement of different legal orders ‘right’, and not merely expedient, is an interpretative approach that can give weight to the principles and values of other legal orders.

## 5 Critical views: Rules-based positivism and pragmatism

- 1.35** After having formulated our view of court-based interpretivism, we offer some potential criticisms, and their corresponding replies.
- 1.36** ‘Hard cases make bad law’ is the catchphrase coined by Oliver Wendell Holmes<sup>104</sup> aimed at cases that enjoy unnecessary public, media, or political attention and stir feelings, in a way that makes the courts go astray from settled law.<sup>105</sup> Formulated this way, this criticism does not concern us, because our ‘hard cases’ are not hard because they enjoy public attention. They are hard because the problem at stake is a potential inconsistency between the goals and principles inspiring different rules. Some may enjoy public attention, and some not. For those that do, public attention is often a consequence, rather than a cause, of the underpinning clash of goals and principles. Holmes’ sentence, however, could be rephrased to make a different argument: hard cases are not a useful example of what ‘the law is’, because the law has no answer for an entirely new issue, or more mildly put, no clear answer. In our view, this objection would misconstrue the issue, no matter how it is put. In one sense, the objection could be formulated as saying that hard cases solved with an appeal to principles are ‘bad law’ because they fail the standard of certainty and predictability normally associated with the law. Put in this way, however, the objection barks at the wrong tree, for the ‘hardness’ of a hard case is not a problem of the method used to find a solution to it, but a problem of the case itself, which cannot be resolved with simpler tools, such as a textual interpretation of specific rules. It is hard because it forces a deeper reflection on the basic criteria lying beneath the rules, criteria that may be controversial, as reflective of competing considerations of principle, or values. Someone following this logic to its last consequences, however, would have to say that the only possible answer in hard cases is ‘sorry, but there is no law to solve

<sup>103</sup> Maduro (n 99) 31.

<sup>104</sup> The first dated use of the expression was in *Hodgens v Hodgens* [1837] 4 CI Fin 323, quoted by Fred R Shapiro, *The Yale Book of Quotations* (YUP 2006) 614 (Proverbs no 136). The more famous quotation, however, is by Justice OW Holmes’ dissenting opinion in *Northern Securities Co v United States* 193 US 197 (1904).

<sup>105</sup> In Justice Holmes’ own words: ‘Great cases, like hard cases, make bad law. For great cases are called great not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend.’

the problem.' This, however, would be sticking to a reductionist view of the law, which would render it unable to address new, hard cases. There is, however, a third sense of the objection with a deeper meaning. The sentence can also mean that reasonable, knowledgeable jurists can disagree over the *interpretation and application* of the law in concrete, marginal, cases, despite there is agreement as to 'the law' itself. This, in the view of positivists, may be due to discrepancies over the linguistic meaning of terms like 'monetary policy' or 'price stability', 'arbitrary and capricious', 'particular circumstances' and 'financial stability' and 'transparency' just to mention a few examples. Precisely because of this, hard cases are not the best example to illustrate what the 'law' is, something on which most jurists agree most of the time. Formulated in this way, the objection could be an expression of the ideas of Holmes, but also of H.L.A. Hart;<sup>106</sup> in whose view, for the drafter of a specific statute or precedent, it is impossible to anticipate all the *factual* situations that may be encountered in the future, which means that certain provisions need to be open textured,<sup>107</sup> thus leaving room for disagreement and interpretation.

Reframed in this way, however, this view, persuasive as it may appear at first glance, is also unsatisfactory. It would be wrong, and almost disingenuous, to argue that courts spend so much energy in a semantic disagreement over the meaning of 'monetary policy' or 'price stability', or devoting hundreds of pages to ascertain the meaning of 'client money' as a kind of sideshow. They disagreed about what 'the law' for the particular problem was, and what was the right solution, which ensured a construction of the interests at stake that fit within the existing scheme of legal practice, and parties' rights. Thus, hard cases can not only be 'marginal', ie illustrate instances where there is agreement over the *law*, but disagreement over the *application* of that law; they can also be *pivotal* cases, which illustrate deeper disagreements over the law.<sup>108</sup> In this light, the problem is that hard cases are a problem for the neat construction of 'pure' positivists, which is based on a certainty over what is law and what is not.<sup>109</sup> This certainty, in Hart's view, is represented by a 'rule of recognition', which helps to identify what is part of the law, and what is not.<sup>110</sup> The positivist edifice rests upon the *acceptance* of the rule of recognition, which then acts as the source of authoritative criteria for identifying rules of obligation. Disagreements over the law run contrary to the assumption of acceptance of a rule of recognition, which, for some, is a matter of 'convention'. Thus, 'hard cases' are an anomaly, and their role should be marginal. Yet, in our view, any sense of certainty grounded on an idea of 'convention' that overlooks legal principles and controversy is a false sense of certainty. Hart himself revised his position in a postscript, where he acknowledged the importance of principles, and expanded his analysis of the rule of recognition to explain how principles could fit into the overall scheme of the 'law';<sup>111</sup> more modern

<sup>106</sup> HLA Hart, *The Concept of Law* (Clarendon Press 1997) 124.

<sup>107</sup> *ibid* 128–30.

<sup>108</sup> Ronald Dworkin, *Law's Empire* (Bloomsbury 1998).

<sup>109</sup> In Kelsen's purest positivistic view, this is grounded on a clarity over the body that has promulgated the rules, and the procedure used to promulgate those rules. See Hans Kelsen, *The Pure Theory of Law* (University Presses of California, Columbia and Princeton, 1970).

<sup>110</sup> Hart's 'rule of recognition' is part of the 'secondary rules', which help bring certainty, and move beyond a system based on 'custom' towards a system based on 'law', and also include 'rules of change', and 'rules of adjudication'. See Hart (n 106) 91–100.

<sup>111</sup> In essence, Hart argued, first, that some principles were identified by a convention over the right sources of law, eg the principles that are included in the Constitution, or those that have been repeatedly cited by courts. Second, he also argued that a rule of recognition can be expanded to encompass principles that form part of the legal system not as a matter of their 'pedigree', but as a matter of their content, ie because they belong to a coherent scheme of principles which both fits the institutional history and practices of the system and best justify them, which Hart identifies with a 'soft' positivism. See Hart (n 106) 264–65. In addition to this, Hart also pointed out that Dworkin's discrete, or binary distinction between rules, as legal propositions that apply in an all-or-nothing

positivists follow similar approaches, which try to show that purported disagreements over 'law' are, in reality, disagreements over its 'application'.<sup>112</sup> Indeed, the main disagreements between Dworkinians and positivists are whether the 'law' implies moral judgments, and whether parties disagree over the 'contents' of the law, or over the 'application' of the law. We do not need to answer those questions here to claim a relevant role for principles in the legal system and the adjudication of financial disputes.

**1.38** 'Hard cases are solved by discretion, not principles.' A second objection postulates that in hard cases, with open textured concepts, where the law provides no clear answer, judges exercise their discretion to solve the problem. In some versions of this idea, like Holmes' legal realism (and rule-scepticism), discretion becomes the norm, and judges weigh considerations of social ends to decide individual cases; the law is not formed by logical deduction from principles or axioms, it is formed by 'predictions' over how the courts will decide on a certain issue.<sup>113</sup> Positivists like Hart argued instead that courts use discretion to decide hard cases;<sup>114</sup> but saw the risk of arbitrariness in this,<sup>115</sup> and also argued that the scope for such arbitrariness is limited by the consensus over the 'core' meaning of certain legal terms, and over the proper role of the courts.<sup>116</sup> This position, however, by relying on the same basic positivist ideas, is vulnerable to the same criticism discussed above: it is difficult to talk about 'convention' or 'consensus' in hard cases, and even more difficult to accept that the controversy is linguistic, rather than 'value based'. The real answer to the objection is that the discretion-based description of how courts solve hard cases is not descriptive at all. Courts do not decide on the basis of discretion, or personal preferences, because doing so would be seen as wrong and capricious. Courts, in hard cases, usually employ long and sophisticated reasoning in an attempt to establish what the law is for the specific problem at hand, a difficult exercise, requiring them to weigh competing objectives, values and propositions of general application, in a construction that makes sense of competing, conflicting, and often seemingly irreconcilable, reasons, a far cry from the massive deployment of discretion proposed by legal realism, or the milder version espoused by some positivists.<sup>117</sup> Furthermore, saying that hard cases are solved by discretion presupposes that discretion is vested in one

fashion and principles, which have a dimension of weight and importance, was not of kind, but of degree, since very often rules have also this dimension.

<sup>112</sup> According to Hart, examples of this 'soft' positivism would include EP Soper, 'Legal Theory and the Obligation of a Judge: The Hart/Dworkin Dispute' (1977) Michigan L Rev 473; J Coleman, 'Negative and Positive Positivism' (1982) 11(1) J Legal Studies 139; D Lyons, 'Principles, Positivism and Legal Theory' (1977) 87 Yale LJ 415. Professor Coleman re-elaborated his views in J Coleman, *The Practice of Principle: In Defense of a Pragmatist Approach to Legal Theory* (OUP 2001), to argue, in essence, that, in cases where interpreters of the law are called to cast seemingly moral judgments, such as whether a party has acted in 'good faith', or whether a party has behaved 'unreasonably', it is the 'convention' over a rule that includes such terms that makes such judgment 'law'. Dworkin replies that this strategy of 'abstraction' rather than making positivism more robust, signal its demise, and are a trick to recharacterize moral arguments over the content of the law as argument over the application of the law, which also eviscerate the idea of 'convention'. Dworkin, *Justice in Robes* (n 12) 188–94.

<sup>113</sup> OW Holmes, 'The Path of the Law' (1897) 1 The Boston L School Magazine 1. Holmes framed the more famous version of this 'predictive' theory of law, based on the perspective of the 'bad man', who sees no reason for action in moral arguments, but fears punishment.

<sup>114</sup> See Hart (n 106) 141–47.

<sup>115</sup> Hart illustrated this as the 'nightmare' scenario in HLA Hart, 'American Jurisprudence through English Eyes: The Nightmare and the Noble Dream' (1977) 11 Ga L Rev 972.

<sup>116</sup> Hart (n 106) 144–46.

<sup>117</sup> Advocates of the discretion-based view would reply that, in hard cases, courts only 'pretend to be' discussing the law, when they are truly applying their own considerations of justice and morality, in an exercise of discretion, ie having a debate over what the law 'should be'. For a critique see Dworkin (n 108) 37–41, who calls that the 'fingers crossed' defence of positivism.

single body. Yet, in finance there is the discretion of public authorities (central banks, regulators) and the discretion of the courts that review their actions, and then there may be more than one court, eg first instance and appeal, national and supranational etc. Thus, saying that hard cases are solved by discretion begs the question, does not answer it. Consider a case on monetary policy in the EU: the composition of 'discretions' would be impossible. In the EU, the ECB's discretionary monetary policy mandate would be subject to the discretionary interpretation of the CJEU to assess its conformity with EU law, which would, in turn, be subject to the discretionary assessment of national constitutional courts, seeking to establish whether the ECB's, and the CJEU respected the democratic principle of the national constitutions. Thus, the distribution of powers and competences is only admissible if its interpretation is considered a legal exercise, and the decisions where those are allocated are considered 'law', not discretion.<sup>118</sup>

'Principles-based interpretivism is backward looking'. One may claim at this point those philosophical reconstructions of the law are backward-looking and useless; courts should consider the effects of their individual decisions using a forward-looking approach. This objection, based on legal realism,<sup>119</sup> and also in Posner's 'pragmatism',<sup>120</sup> complements the previous criticism, which focused on what courts do, by focusing on what they should do. Admittedly, it is a catchy criticism, prone to sound bites like 'keep it simple', 'focus on the facts', 'decide incrementally and experimentally'. Yet, this provides an attitude, but little guidance. An appeal to deciding cases 'on their own facts', when carefully considered, says nothing about what those facts should say to us. Even if one accepts pragmatism's essentially consequentialist approach, ie the need to focus on the consequences of a legal decision, it is necessary to decide which consequences are 'good' or 'bad', and whether the 'good' consequences outweigh the 'bad' ones, in order to decide whether the decision is 'right'.<sup>121</sup> To do this, one needs to appeal to some kind of theory of value, be it utilitarianism, Rawlsian views, or another moral theory,<sup>122</sup> to rank the different outcomes, which is where the problem is, **1.39**

<sup>118</sup> A (cynical) realist could retort that, in such case, the CJEU did not use the law, but only the arguments it found sufficiently persuasive to be accepted by the German BVerfG. But then *why* would their argument (in this case validating the acts of the ECB) be persuasive at all, if not because it would rightly weigh the right principles and values enshrined in the EU Treaties, within the right boundaries of legitimacy conferred by national constitutions?

<sup>119</sup> The consequentialist side of this argument was well-expressed by Holmes when he said that: 'I think that the judges themselves have failed adequately to recognize their duty of weighing considerations of social advantage. The duty is inevitable, and the result of the often proclaimed judicial aversion to deal with such considerations is simply to leave the very ground and foundation of judgments inarticulate and often unconscious, as I have said'. Holmes (n 113) 9. The 'experimental' side of the argument would be synthesized by his '[t]he life of the law has not been logic; it has been experience' in OW Holmes, *The Common Law* (Paulo JS Pereira and Diego M Beltran eds, University of Toronto Law School Typographical Society 2011) 5.

<sup>120</sup> Posner criticized the use of theory as a sound basis for, and deciding cases, because it could be an open door for the judges' imposition of their own personal preferences and proposed a style of 'pragmatic adjudication'. He first did so as an alternative to existing approaches to statutory interpretation. See R Posner, 'Legislation and Its Interpretation: A Primer' (1989) 68 Neb L Rev 431, and then expanded this view as an alternative also to what he saw as an excessively theoretical approach, like Dworkin's. See R Posner, *Overcoming Law* (HUP 1996).

<sup>121</sup> According to Rawls, teleological theories, including utilitarianism, construe the relationship between the 'good', and the 'right', the two main concepts of ethical theories, by arguing that the 'good' can be defined independently from the 'right', eg as 'utility', or 'wealth', and the 'right' can be construed as that which maximizes the 'good'. This, in Rawls' view, has a great intuitive appeal, because it is natural for someone to think that rationality must mean to maximize something. See John Rawls, *A Theory of Justice* (HUP 1971) 21–22.

<sup>122</sup> Dworkin argues that 'pragmatism' at its best simply stood for 'consequentialism' based on utility, wealth maximization, or some other (unspecified) measure of 'good'. This is a theory, not an 'anti-theoretical' view. See Ronald Dworkin, 'In Praise of Theory' (1997) 29 Ariz St LJ 353. Posner objected to this characterization, which led to a thrilling exchange between the two professors. See Richard A Posner, 'Conceptions of Legal Theory: A Response to Ronald Dworkin' (1997) 29 Ariz St LJ 377; Ronald Dworkin, 'In Praise of Theory: Reply' (1997) 29

because this is where the controversy typically lies in the first place, and what makes hard cases hard. Thus, pragmatism so defined, like positivism, would take for granted a non-existent consensus over the hierarchy of values and their relative weight, and attempt to solve the problem by redefining it as a non-problem. This version of pragmatism fails by its own standards. Even if the argument that the positive consequences outweighed the bad ones could be a useful contribution, an engine of the courts' reasoning, this had to be within the path set out by the principles underpinning the relevant set of laws.

**1.40** Others claim that 'principles-based interpretivism is too ambitious and impracticable or leads to ossification.' This is another, softer version of pragmatism, espoused by authors like Sunstein and Vermeule, which provides a stronger criticism against a principles-based interpretative approach.<sup>123</sup> Their view is that, first, providing a full fledged theory for every case would be both impractical (since judges do not have the time or ability to do so) and counter-productive, by making consensus more difficult, ie different people may agree on a solution, yet disagree about the theoretical reconstruction that gives rise to it. Secondly, if judges could succeed, nonetheless, it could be even more dangerous, by ossifying existing theories into law, and making evolution more difficult.<sup>124</sup> At its extreme, it may turn legal interpretation into a gnostic exercise, by a court of chosen philosophers. It seems that this is also the core of Posner's objection to what he sees as arrogant theoretical constructs,<sup>125</sup> a concern that is also captured by Isaiah Berlin's qualms about 'hedgehog's views', which try to encompass everything to a single, universal, organizing principle.<sup>126</sup> The truth of these criticisms depends on how far one takes the interpretative exercise.<sup>127</sup>

Ariz St LJ 431; Richard A Posner, 'The Problematics of Moral and Legal Theory' (1998) 111 Harv LR 1637; R Dworkin, 'Darwin's New Bulldog' (1998) 111 Harv LR 1718.

<sup>123</sup> Cass Sunstein and Adrian Vermeule, 'Interpretation and Institutions' (2003) 101 Mich L Rev 885; Cass Sunstein, 'Incompletely Theorized Agreements' (1995) 110 Harv LR 1733.

<sup>124</sup> Sunstein agreed with Dworkin that judges should resolve new cases by relying on parallels from previous cases, and that the way to draw comparisons was by relying on the common principles. He just was more distrustful of the need to derive grand or comprehensive theories to solve every new case, because he considered this well beyond the possibilities of most judges, impracticable given the constraints of time and resources judges normally faced and could also ossify the legal system and render it impervious to change. See Cass R Sunstein, *Legal Reasoning and Political Conflict* (OUP 2000), a point that had been previously stated in Sunstein, 'Incompletely Theorized Agreements' (n 123), and was retaken to formulate a more comprehensive theory of the 'institutional' constraints on interpretation, eg why a generalist court could be compelled to a more formalist interpretation than a specialized agency as a matter of its institutional role. See Sunstein and Vermeule (n 123).

<sup>125</sup> Posner's view can be confusing due to his own personal view of pragmatism. In his view: 'the pragmatist judge regards precedent, statutes, and constitutional text both as sources of potentially valuable information about the likely best result in the present case and as signposts that he must be careful not to obliterate or obscure gratuitously, because people may be relying upon them. But because he sees these 'authorities' merely as sources of information and as limited constraints on his freedom of decision, he does not depend on them to supply the rule of decision for the truly novel case. He looks to sources that bear directly on the wisdom of the rule that he is being asked to adopt or modify.' Richard Posner, *The Problematics of Moral and Legal Theory* (HUP 1999) 242. Although his views collide with Dworkin's on a general level, his greater problem seems to be more with some of Dworkin's contributions, such as Ronald Dworkin, *Freedom's Law: A Moral Reading of the American Constitution* (HUP 1997). Posner also criticizes the position of positivism for ossifying the system through its rule of recognition and failing to acknowledge the essence of the common law system of decentralized experimentation.

<sup>126</sup> Isaiah Berlin, *The Hedgehog and the Fox: An Essay on Tolstoy's View of History* (Henry Hardy ed, 2nd edn, Weidenfeld & Nicolson 2014). Not by chance, Dworkin's main contribution to a theory of justice is called Ronald Dworkin, *Justice for Hedgehogs* (HUP 2011). For Dworkin's reply to Berlin's views on moral pluralism see his 'Moral Pluralism' in Dworkin, *Justice in Robes* (n 12) 105.

<sup>127</sup> True, judges or lawyers cannot be expected to have the philosophical training of Dworkin's judge Hercules. Yet, it is equally unrealistic for them to have the insights and experience of Richard Posner or Oliver Wendell Holmes, with the difference that Judge Hercules is an idealization of what 'real' judges do, while Holmes and Posner are real judges themselves.



Of course a new theory is not necessary for every new case, and a principles-based, or integrity-based view merely points the direction to follow, not how far to go. Textual interpretation or analogical reasoning will suffice in cases where the similitude between the facts of the case and the hypothesis envisaged in the rule, or decided by precedent, is uncontroversial; in other cases the discussion may focus on whether a different fact calls for the application of a different rule or precedent. As soon as such controversy arises, some criteria will be necessary to accept one analogy or construction and reject another, and these criteria of validity cannot rest on factual similitude alone, but on the correctness of the judgment resulting from such similitude. Legal practice bears this out. **1.41**

Once we accept the basic idea that, to evaluate conformity with past legal practice, one needs to adopt an evaluative perspective that takes into consideration the principles and objectives underpinning applicable precedents or statutes, it is possible to assume that the process of 'justificatory ascent' does not need to exhaust all the legal system every time a problem arises,<sup>128</sup> ie there is no need for a theory, let alone a grand theory for every case. However, there is otherwise no convincing method yet to determine where to stop on an ex ante basis.<sup>129</sup> This largely depends on the specific issue at stake, and the weighing of principles that it required. Indeed, Sunstein subsequently accepted that a principles-based approach does not require grand theories on each case,<sup>130</sup> and that judges who proceed 'one case at a time', are 'highly likely to produce a pattern of outcomes of which they themselves would disapprove'.<sup>131</sup> It seems that, as long as 'theorizing' means imposing different frames to check the solution's consistency with the system's principles and values, it produces more robust outcomes. This also addresses the criticism of ossification of the legal system, which, in any event, is more adequately directed at 'system's theories' that focus on law's self-referenced, or autopoietic, nature.<sup>132</sup> Principles-based interpretative views do not ossify the legal system. First, any new rules adopted by Parliaments or regulatory bodies will form part of the legal system, and thus provide new criteria for interpretation, which can, in turn, change the formulation of higher-level principles. Indeed, a focus on principles, and the need to seek consistency, can help to identify pieces of legislation that should be changed, or reinterpreted, for failing to fit the framework embodied by the new rules. Secondly, in construing certain **1.42**

<sup>128</sup> This could be the so-called 'local priority', by which a court would prioritize the rules or precedents of accepted 'departments' of law, over those from different parts of the legal system. See Dworkin (n 108) 250.

<sup>129</sup> Dworkin's reply to Sunstein and Vermeule clarified that his views did not require a 'grand theory' every time a new case arose, since ordinary lawyers and judges reasoned from the inside-out. See Dworkin, 'In Praise of Theory' (n 122) 370.

<sup>130</sup> See the subsequent exchange in Cass Sunstein, 'From Theory to Practice' (1997) 29 *Ariz St LJ* 389, 391; Dworkin, 'In Praise of Theory: Reply' (n 129) 445, where Dworkin clarifies that judges reason from the inside-out, and that the reasoning process he very visually defines as 'justificatory ascent', is applied as needed, and that both factors are perfectly compatible with his theory. In fact, Dworkin's own view emphasizes the so-called 'local priority', ie that judges, when looking for a theory that 'fits' a solution within existing legal practice should prioritize the examples of that practice that relate to the legal categories where the new issue belongs, eg 'contract', or 'tort', or, more specifically, 'liability for breach of contract', or 'causation in tort'. Yet he says that such local priority should be abandoned when the distinctions and categories have become mechanical and arbitrary. See Dworkin (n 108) 250 ff.

<sup>131</sup> It is a testimony of Sunstein's elegance, that he is ready to admit, in plain and simple terms, that one of his co-authored studies provides more ammunition for Dworkin than for his own initial approach, ie even if striving for global coherence (which he characterizes as Dworkin's view) may overload the cognitive capacities of judges, 'local coherence' will likely result in inconsistent judgments, which is a reason to promote global coherence as an approach. See Sunstein and others (n 83) 1201. Sunstein has not spared un-nuanced praise for Dworkin's approach, in particular Dworkin's idea of interpretation as a 'chain-novel' exercise, in one of his most recent works, an improbable place to find such reference, since it is an entertainment piece. See Cass Sunstein, *The World According to Star Wars* (Dey Street Books 2016).

<sup>132</sup> Gunther Teubner, *Law as an Autopoietic System* (European University Institute Press Series 1993).



indeterminate concepts the courts (and regulatory bodies) will often have to make considerations of value (dry, technical considerations, such as risk or efficiency would also be included therein), which may be a source of change, if the values underpinning the rules have themselves changed. To sum up, principles-based interpretivism is not an obstacle; it is a major agent of (smooth) change within the area of interaction of predetermined values and the best possible policeman for these values and of their relative consistency at the stage of their implementation by the legal system.

**1.43** ‘The alternative to a system of complex rules is a system of simple decision-making rules.’ A seemingly different reaction to current financial regulation, especially after the Great Financial Crisis (GFC) of 2007–2008, cluttered with an excess of legal rules, is to advocate simpler, intuitive, decision-making rules. Although not canonically ‘pragmatist’, these views embrace part of the pragmatic discourse, since they argue that simple, intuitive rules-of-thumb can best replace complex analysis in the presence of high costs of cognition, excessive complexity, uncertainty, and small samples of data available,<sup>133</sup> while they also posit that complex rules can cause defensive behaviour. Alas, these views also disappoint as soon as one tries to use them as guidance for legal construction. Haldane and Maduros’ argument based on the use of ‘heuristics’,<sup>134</sup> taking the views of Gigerenzer and others, who posit that these are adaptive mechanisms that lead to better decision-making (normative argument) under certain conditions of uncertainty.<sup>135</sup> This goes against the traditional association between ‘heuristics’ and systematic ‘biases’ by Tversky and Kahneman,<sup>136</sup> without evidence of why heuristics should work better in this environment.<sup>137</sup>

**1.44** Furthermore, it is unclear whether the problem that simple rules try to address is one of models ‘overfitting’ the data, ie a problem of *prediction*, or one of agencies falling back into ‘soft’ attitudes as the rules’ benefits seem far away on time, while the benefits of ignoring them appear close and certain, a problem of ‘time inconsistency’ of preferences, or ‘self-control’, or, in more modern formulations, the ‘this time is different’ syndrome.<sup>138</sup> This problem can be addressed by strategies of *commitment*,<sup>139</sup> for example, the 2 per cent inflation target of

<sup>133</sup> They use the example of a dog catching a Frisbee to illustrate that complex decision-making abilities are not needed to succeed at complex tasks. See Andrew Haldane and Vasileios Maduros, ‘The Dog and the Frisbee’ (The Changing Policy Landscape: A Symposium Sponsored by the Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming (30 August–12 September 2012)) 109–16.

<sup>134</sup> *ibid* 112.

<sup>135</sup> Gerd Gigerenzer and Henry Brighton, ‘Homo Heuristicus: Why Biased Minds Make Better Inferences’ (2009) 1 *Topics in Cognitive Science* 107.

<sup>136</sup> Their seminal article sought to illustrate that ‘that people rely on a limited number of heuristic principles which reduce the complex tasks of assessing probabilities and predicting values to simpler judgmental operations. In general, these heuristics are quite useful, but sometimes they lead to severe and systematic errors’. Tversky and Kahneman (n 76) 1124–31. For a more recent criticism of Gigerenzer and Brighton’s views see Benjamin E Hilbig and Tobias Richter, ‘Homo Heuristicus Outnumbered: Comment on Gigerenzer and Brighton (2009)’ (2011) 3 *Topics in Cognitive Science* 187.

<sup>137</sup> Gigerenzer and others are more nuanced in their conclusions, and do not claim that heuristics work better in all possible environments. See Daniel Goldstein and Gerd Gigerenzer, ‘Models of Ecological Rationality: The Recognition Heuristic’ (2002) 109 *Psych Rev* 75.

<sup>138</sup> Carmen M Reinhart and Kenneth S Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (PUP 2009).

<sup>139</sup> Richard Thaler and Hershey Shefrin, ‘An Economic Theory of Self-Control’ (1981) 89 *J Political Econ* 392. For a critical survey see also Shane Frederick, George Lowenstein, and Ted O’Donoghue, ‘Time Discounting and Time Preference: A Critical Review’ (2002) 40 *J Econ Literature* 351; Robert Henry Strotz, ‘Myopia and Inconsistency in Dynamic Utility Maximization’ (1956) 23 *Rev of Econ Studies* 165, for an early example. Thaler exemplifies this taking from Strotz the example of Odysseus in the *Odyssey*, who ordered his men to tie him up to the mast, while they put bee’s wax in their ears, so that he could enjoy the sirens’ songs without throwing himself overboard. See Richard Thaler, *Misbehaving: The Making of Behavioral Economics* (Norton 2015) 99. Coincidentally, it is exactly

central banks, which helps to overcome time inconsistency.<sup>140</sup> Why does this matter if the answer is still 'simple, clear-cut rules'? It matters because the different nature of the rules requires a different role for discretion. On the one hand, the *predictive* rules are *internal* decision-making rules, ie if we look at the agent from outside, the solution lies in *enhancing* its *discretion*. This seems the type of setting discussed by Haldane and Maduros, who advocate more discretion for public authorities.<sup>141</sup> *Commitment* rules, on the other hand, are generally *external* in nature, because they try to address a problem of self-control and time-inconsistency, and therefore they *curtail* the agent's *discretion*.

When we look at legal rules, it is clear that they resemble more the external kind. However, pre-commitment rules do not fully capture the peculiarities of legal rules, which are not (at least, not just) a way that the agent uses to commit itself to a certain goal or task. They are a standard of *validity* of its actions and carry with them a series of consequences. For example, the fact that a central bank sets a 2 per cent inflation target does not mean that a central bank decision will be rendered invalid, or that it, or its members, will be held liable, or that other consequences will be automatically triggered if the threshold is crossed. Therefore, predictive accuracy is an important part of the decision-making of a public body, such as a central bank, to judge when there is an ongoing inflationary process, an asset bubble, or when an entity is about to become insolvent or illiquid. A pre-commitment to keep inflation low ensures that the body will act upon its predictions. However, when it comes to implementing those decisions by, say, purchasing assets in the market, the problem becomes one of *validity*, which rests on the *legitimacy* of the decision. This will, in turn, heavily rely on the decision's *consistency* with existing rules and past practice, which will be used as *ex ante* guidance by parties subject to the decisions, and as *ex post* review criteria by courts. **1.45**

Once the distinction is made, the argument in favour of heuristic rules no longer works with legal rules: if the relevant thing is the decision's legitimacy, intuition is not a good justification for the decisions of public authorities or courts. Discretion can be necessary, and thus legally admissible in certain scenarios, but on a wholesale (and unchecked) basis (and oversimplistic rules of thumb only pretend to offer a reasonable check, which in reality they do not) it undermines the decision's legitimacy, and if the problem is one of inaction or defensive behaviour it offers no solution either. That does not mean that complex and lengthy rules are not a problem, especially in hard cases. They truly are. Yet the problem lies in complex rules' susceptibility to increase conflicts and inconsistencies between rules, which means that simple cases may be made hard, and hard cases harder, by piling up the tension between rules *on top of* the tension between principles or policies, typical of hard cases. Yet the superior answer is not to eliminate part of the information or rules for the sake of simplicity, but in seeking the best possible fit within existing rules and practice, and their underpinning policies and values. In this light, a 'simple-rules' approach can be complementary to a principles-based interpretive approach, but not a substitute that can operate on its own. **1.46**

the same example used to exemplify the decision-making rules of central banks when they commit themselves to an inflation target.

<sup>140</sup> Finn E Kydland and Edward C Prescott, 'Rules Rather than Discretion: The Inconsistency of Optimal Plans' (1977) 85 J Political Econ 473.

<sup>141</sup> Haldane and Maduros (n 133) 144. They seem to draw an analogy with doctors, who perform better when unencumbered by a complex rulebook.

## 6 Principles-based interpretivism versus plausibly similar alternatives in the adjudication of law of finance: the case of cost-benefit analysis and the discourse theory of justice

- 1.47** It is now time to compare our preferred approach to principles with alternatives that are ‘plausibly’ similar, in the sense that they may ‘sound’ similar, and/or try to achieve similar goals. We will show where those approaches are compatible with ours, but also that they are not really alternatives to a principles-based interpretation and application of the law of finance by expert courts, but rather complementary to it.
- 1.48** The clearest example is offered by the use of cost-benefit analysis (CBA), an approach with an important tradition in the United States,<sup>142</sup> which has also been adopted by the European Union as part of its policy-making toolkit.<sup>143</sup> Although CBA was originally related to health and safety or environmental regulation, the debate rapidly moved also to financial regulation, with similarly enthusiastic proponents<sup>144</sup> and critics,<sup>145</sup> engaged in insightful exchange.<sup>146</sup>
- 1.49** Indeed, the *Metlife v FSO* case in the United States<sup>147</sup> is a good example where the lack of a CBA was highlighted by the court as an indication that the decision to subject an insurance company to the purview of the Federal Reserve Board was ‘arbitrary and capricious’, a court decision in the wake of a (controversial) line of case law by D.C. courts that stroke down different SEC regulations for failing to undertake the corresponding CBA.<sup>148</sup> Advocates and critics of CBA have extensively debated the issue, and clarified its advantages, eg clarity

<sup>142</sup> Cabinet departments and executive agencies are often required to perform a CBA for major regulations, as a result of executive orders. Of special importance are executive orders (EOs), 12,291 in 1981 by President Ronald Reagan, instructing executive agencies to prepare regulatory impact analyses of their draft proposed and final major rules including a CBA, and to submit them to the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB); and 12,866 in 1993 by President Clinton, requiring executive agencies to assess costs and benefits of intended regulation. CBA is widely acknowledged as one of the primary tools to anticipate the consequences of rules. See Office of Management and Budget, ‘Circular A-4’ (17 September 2003) <https://www.regulationwriters.com/downloads/Circular-A-4.pdf> (accessed 9 September 2022). Although independent agencies have traditionally not been subject to the requirement to undertake a CBA, they were encouraged to do so by a variety of EOs (eg EO No 13,563, 76 Fed Reg 3821 (21 January 2011) (President Obama), and the Administrative Conference of the United States adopted Recommendations suggesting CBA should form part of independent regulatory agencies’ policymaking process. See Administrative Conference of the United States (ACUS), ‘Benefit-Cost Analysis at Independent Regulatory Agencies’ (13 June 2013) <https://www.acus.gov/rec-ommendation/benefit-cost-analysis-independent-regulatory-agencies> (accessed 9 September 2022).

<sup>143</sup> Interinstitutional Agreement between the European parliament, the Council and the European Commission on better Law-Making [2016] OJ L123/1, recital 5 and point 12; European Commission, ‘Better Regulation Guidelines’ (7 July 2017) SWD(2017) 350 <https://ec.europa.eu/info/sites/default/files/better-regulation-guidelines.pdf> (accessed 9 September 2022), Chapter III Guidelines on Impact Assessment, Question 5.

<sup>144</sup> Eric Posner and E Glen Weyl, ‘Benefit-Cost Analysis for Financial Regulation’ (2013) 103 *A Econ Rev* 1; Paul Rose and Christopher J Walker, ‘The Importance of Cost-Benefit Analysis in Financial Regulation’ (2013) Report for US Chamber of Commerce; Committee on Capital Markets Regulation, ‘A Balanced Approach to Cost-Benefit Analysis Reform’ (October 2013) <https://www.capmksreg.org/2013/10/01/a-balanced-approach-to-cost-benefit-analysis-reform/> (accessed 9 September 2022).

<sup>145</sup> See eg John Coates IV, ‘Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications’ (2015) 124 *Yale LJ* 882; Jeffrey N Gordon, ‘The Empty Call for Benefit-Cost Analysis in Financial Regulation’ (2014) 43 *J Legal Studies* S351.

<sup>146</sup> The *Yale Law Journal Forum* made it possible for proponents of CBA to reply to John Coates IV article. See Eric Posner and E Glen Weyl, ‘Cost-Benefit Analysis of Financial Regulations: A Response to Criticisms’ (2015) 124 *Yale LJ Rev* 246; Cass R Sunstein, ‘Financial Regulation and Cost-Benefit Analysis’ (2015) 124 *Yale LJ Forum* 263; Bruce Kraus, ‘Economists in the Room at the SEC’ (2015) 124 *Yale LJ Forum* 280. This was followed by the corresponding reply. See Coates IV (n 145) 305–15.

<sup>147</sup> *Metlife v FSO* [2016] 1:15-cv-00045-RMC 30, District Court, District of Columbia.

<sup>148</sup> *Business Roundtable v SEC* 647 F 3d 1144 (DC Cir 2011); *American Equity Investment Life Insurance Co v SEC* 613 F 3d 166 (DC Cir 2010); *Chamber of Commerce v SEC* 412 F 3d 133 (DC Cir 2005).

about the consequences of rules, and thus wiser, and more rational decision-making,<sup>149</sup> and disadvantages, eg little consideration for values that are hard to quantify, or benefits that are hard to monetize, overestimation of costs, underestimation of future benefits through discount.<sup>150</sup> The debate has moved along similar lines in the field of financial regulation, with critics arguing that CBA is especially implausible due to finance's special features, eg its centrality to the economy, social and political, and non-stationary character, according to Coates,<sup>151</sup> its artificiality and construction by the law, in Gordon's view,<sup>152</sup> while advocates insist that the obstacles are not insurmountable, or that CBA provides alternatives for cases of uncertainty.<sup>153</sup>

There seems to be margin for compromise in practice.<sup>154</sup> While an important part of the debate should focus on whether the conditions to perform CBA are adequate, or on the reforms that would be needed to carry on adequate CBAs.<sup>155</sup> Our point is more basic: regardless of its virtues (or vices) CBA is not an alternative to a principles-based interpretive approach. First, CBA is not a *necessary* part of the law. Recent cases may offer support to the idea that CBA has the status of a transversal principle, such as the US Supreme Court's decision in *Michigan v EPA*,<sup>156</sup> relied upon by *Metlife v FSO*,<sup>157</sup> where CBA was considered to be an inextricable part of 'rational' analysis, and 'reasonable' interpretation.<sup>158</sup> Yet, such a sweeping statement is misleading, because it was grounded on the purported acceptance by statutory *rules* and agency *practice* of the basic principle. Thus, CBA's scope and intensity must be determined against the backdrop of other legal sources, such as statutory rules or precedents; it is not a meta-principle, let alone *the* meta-principle of legal construction. Indeed, CBA is seen by its advocates as a way to improve the law,<sup>159</sup> not as an inextricable part of what law is, identifiable as such by its mere content.<sup>160</sup> Secondly, CBA is not *sufficient* for purposes of legal construction. Even its advocates accept that CBA works better in some scenarios than

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<sup>149</sup> ACUS, 'Recommendation 79-4, Public Disclosure Concerning the Use of Cost-Benefit and Similar Analyses in Regulation' (3 July 1979) 44 Fed Reg 38,826. See also Cass R Sunstein, 'The Office of Information & Regulatory Affairs: Myths and Realities' (2013) 126 Harv LR 1838, 1846.

<sup>150</sup> Frank Ackerman and Lisa Heinzerling, 'Pricing the Priceless: Cost-Benefit Analysis of Environmental Protection' (2001) 150 U Pa L Rev 1557, 1580-81.

<sup>151</sup> Coates IV (n 145) 998-1003.

<sup>152</sup> In Gordon's view, CBA in fields like environmental regulation is possible because it is undertaken over a stable system, which rests on natural constraints, whereas finance is an artificial, legally-constructed field, meaning that non-trivial rule modifications will change the system in ways that are hard to foresee, and thus undercut the value of cost and benefit evidence based on the previous situation. See Gordon (n 145) S351. This explanation could provide an explanation to Coates' claim that finance is non-stationary.

<sup>153</sup> This would be the case of 'breakeven analysis', ie when costs are certain and benefits are not, the analysis needs to determine the minimum benefit that the regulation needs to achieve. See Sunstein (n 146) 263-279; Cass R Sunstein, 'The Limits of Quantification' (2014) 103 Cal L Rev 1369.

<sup>154</sup> Compromise views can focus on CBA's usefulness as a procedural, rather than moral, instrument, which would yield information of moral importance. See eg Donald C Hubin, 'The Moral Justification of Benefit/Cost Analysis' (1994) 10 Econ & Philosophy 169; Coates argues in favour of a 'conceptual CBA' also in procedural terms. See Coates IV (n 145) 1008-1010. CBA's use as a procedural tool would make it possible to accommodate criteria such as deontological rights and other moral values. See Matthew Adler and Eric A Posner, 'Rethinking Cost-Benefit Analysis' (1999) 109 Yale LJ 165.

<sup>155</sup> Richard L Revesz, 'Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation' (2017) 34 YJR 545.

<sup>156</sup> *Michigan v EPA* 135 S Ct 2699 (2015).

<sup>157</sup> *Metlife v FSO* (n 147).

<sup>158</sup> *ibid* paras 5-7.

<sup>159</sup> See eg Sunstein (n 79).

<sup>160</sup> Strict positivist views failed to capture the fact that certain principles formed part of 'the law' by virtue of their content, something that has led more modern versions of positivism to construe a broader 'rule of recognition' for the elements of the law that does not only appeal to the 'procedure' by which norms were approved, or the 'convention' about their being part of the law, but also to their content.

others, and that it does not exhaust all the possible criteria to construe the law.<sup>161</sup> Focusing solely on CBA would require ignoring harms and benefits that are not quantifiable, eg if they have a moral dimension, despite the fact that they may be embodied in precedents and rules.

**1.51** A bank supervisor can use CBA to calibrate capital requirements for each institution, consolidate certain entities within a bank's balance sheet, or subject other entities to prudential rules for banks or funds if and to the extent that the rules, and their underpinning principles, allow so, but cannot ignore those rules and principles, even if it considers that they are not justified by CBA. Indeed, absent such precision, CBA would be *self-defeating*, because, if the conclusion of CBA were that 'an action will be required when justified by CBA, and an action will be invalid when not justified by CBA' this would impose an enormous cost in terms of unpredictability, and the resulting mistrust from the system's lack of legitimacy. This dichotomy is well captured by Rawls's 'two concepts of rules,' where he distinguishes between justifying a practice, and justifying a particular action falling under it.<sup>162</sup> Broad theories of justice, such as utilitarianism, or CBA, for that matter, may justify a practice, such as the combination of access to liquidity, deposit guarantee, and bank prudential rules, but a specific supervisory action (or, say, an action to refuse access to liquidity) needs to be justified under the rules themselves.

**1.52** This means that, in hard cases, where a question over the applicability of the rules, or the friction between competing sets of rules, also raises questions about the principles and rationale underpinning those rules, any CBA needs to be justified, and circumscribed, by its adoption by applicable rules, and their underpinning principles. It also means that, in cases where the legislature decided to obviate CBA concerns when passing a certain piece of legislation in favour of other considerations, public bodies and courts need to obviate CBA when interpreting and applying the rules, at least in the absence of an overarching mandate to uphold CBA when interpreting the rules, which, right or wrong, was the assumption of the D.C. Court in *Metlife v FSOC*.

**1.53** The principles-based interpretative process outlined here could be characterized by some as a theory about the communicative process in law, and more specifically, the law of finance. Our claim could be restated as a claim about what counts as a valid argument, and what does not. In this light, one could see the resemblance with discourse theories of justice, such as Habermas,<sup>163</sup> theories that see argumentation as part of the validation process, such as Rawls' 'reflective equilibrium,'<sup>164</sup> or even theories about the policy process that consider argument and persuasion essential in that process.<sup>165</sup> Thus, it is important to identify the parallels, and the differences. In terms of parallels, our argument about the use of principles-based

<sup>161</sup> See Sunstein (n 160) 149–74; Andrea Renda and others, 'Assessing the Costs and Benefits of Regulation. A CEPS–Economisti Associati Study for the European Commission' (March 2014) 157 [https://ec.europa.eu/smart-regulation/impact/commission\\_guidelines/docs/131210\\_cba\\_study\\_sg\\_final.pdf](https://ec.europa.eu/smart-regulation/impact/commission_guidelines/docs/131210_cba_study_sg_final.pdf) (accessed 9 September 2022).

<sup>162</sup> A 'practice' in Rawls' broader sense, includes any form of activity specified by a system of rules, which define offices, roles, moves, penalties, defences, which give the activity its structure. See John Rawls, 'Two Concepts of Rules' (1955) 64 *The Philosophical Rev* 3.

<sup>163</sup> Habermas (n 101).

<sup>164</sup> Rawls (n 121). Rawls describes reflective equilibrium as a process of mutual adjustment between considered judgments, which operate as the initial 'fixed points', and the principles that are selected as an explanation of those considered judgments. Sometimes the principles will alter our considered judgments, and other times the principles will be considered as an unsatisfactory explanation of our considered judgments and will have to be adjusted themselves. When the principles match our considered judgments, duly pruned and adjusted, we reach 'reflective equilibrium'. See *ibid* 18, 42–43.

<sup>165</sup> Giandomenico Majone, *Evidence, Argument and Persuasion in the Policy Process* (YUP 1989).

claims as valid claims can be rephrased as a claim about the validity of arguments, and the enabling procedural mechanisms that facilitate the identification of the relevant principles can be justified by a theory of discourse. Thus, a process that favours the exchange of views, where authorities and courts have to give reasons for their actions, and which is iterative, in the sense that it provides opportunities to review arguments, is better than a process without exchange, reasons, iteration or review. The latter will be illegitimate, which, in our view, provides a strong *prima facie* claim of illegality.

The differences stem from the scope and reach of each inquiry. Ours is not a theory as ambitious as Rawls' or Habermas'. We do not try to provide a holistic answer to the question of 'justice' in a political society, or for a top-down structuring of communication and discourse. Our goal is to illustrate the controversies that lie at the core of seemingly accepted concepts, and the tensions between vast pieces of financial legislation, and between these and basic fundamental rights, to stress the perils of an overly simplified 'one problem at a time' approach, and to examine the way courts approach the identified tensions and controversies in hard cases, and distil some criteria from that practice, which should be used to discuss problems of legality. Our principles-based interpretive approach fits well with some elements of a discourse theory of law and ethics but does not need to answer their broader questions to be operational. At the same time, all-encompassing theories of justice, or law, like Rawls' or Habermas', due to their level of generality, are inspirational, but not operational, in a field as concrete as the law of finance, at least not without an important process of specification, and are only useful to the extent that the concrete problem can be related back to their basic premises, but not when the problem lies elsewhere. A procedural decision, or rule, that curtails dialogue and exchange, will fall short of a discourse theory's normative standard. Yet if the controversy lies in making sense of a conflict between financial stability, and the avoidance of moral hazard, on one hand, and investor protection and property rights, on the other, all in a context where administrative discretion is in tension with judicial review, authorities and courts will find little comfort in discourse theories, and their indeterminacy. **1.54**

It is time for some stock-taking. In our view the role of principles for courts' interpretation and application of the law of finance is key. First, they are critical to understand both how positive legal 'institutions' are or can be connected with a society's broader 'values', and how these institutions are deployed by courts and public bodies, as well as to understand the potential frictions in both processes. Secondly, in the law of finance's increasingly complex landscape, principles are essential to arbitrate between the competing narratives, and themes, supporting the different sets of rules, as well as to calibrate the scope and intensity of rules, the degree of discretion left to public bodies to exercise their powers, and the role that fundamental rights play as limits to those powers. In this sense we make two claims. The first is that principles-based interpretivism is part of the process by which courts and public bodies apply the law of finance. The second is that this dimension needs to be properly acknowledged to provide better evaluative criteria about whether a decision is right or wrong. **1.55**

Principles-based interpretation is obviously a reality in the practice of courts that adjudicate financial disputes, which need to constantly appeal to the rules' rationale, purpose, objectives, fill in the open-textured concepts left by the legislature, or mediate between potentially inconsistent rules in order to establish the parties' *rights*. This can be seen in all kinds of hard cases, no matter whether present in the field of monetary policy and financial stability, supervision, or insolvency and bank resolution. Yet our claim is not merely descriptive, but normative. Being aware of the importance and role **1.56**



of principles-based interpretation provides courts and public bodies with guidance on how to determine what the law *is*. In relation to this, a principles-based, interpretivist approach also helps to understand the proper place of criteria such as the cost-benefit analysis (CBA), whose use, widespread as it is, needs a previous normative habilitation. That is, even if such principles inform the legislative process, and can also be useful interpretative tools, they are not all-encompassing, or self-sufficient, and their use is conditional upon their presence among the values that inform a specific legal practice (rule or precedent) and, as such, compete with other considerations of value. Principles-based interpretivism does not advocate complexity for its own sake, nor does it postulate ‘grand theories’ as the answer to every problem. It rather helps public bodies and courts to contextualize the problems they examine and use more than one framework to look at them. This does not require those bodies and courts to theorize ‘all the way to the top’ in each case, but to understand the precedential effect, and implications, that a specific decision could have beyond the immediate field where it applies, and thus understand, to a better extent, the demands of consistency, or integrity, and to see the impact that specific rulings or reasoning can have in the values underpinning the specific institutional framework.

**1.57** The above considerations have relevant implications for the role of judicial review, and more specifically for expert adjudication of financial disputes and accountability. The first, and more evident, is that courts have to rely on principles-based interpretivism to determine the fitness of a certain decision within the law’s overall scheme. This requires acknowledging that, in an important number of cases, it does not suffice to discuss the scope of application of a legal rule in isolation, but to understand the considerations of principle supporting that rule, and how they shape its scope and intensity. Such exercise needs to be aware that different sets of rules may be inspired by conflicting narratives, which need to be considered together, in order to determine whether a specific exercise of authority is legal. A case-by-case analysis can not only result in errors prompted by heuristic biases. It may undermine the integrity of the whole regulatory edifice. This, in turn, requires expert judgment. Secondly, the law of finance needs to integrate fundamental rights and values properly as part of its overall narrative. Imagine a legislative process where goals are set first, a certain narrative determining a specific cause-and-effect relationship is selected, which inspires a specific set of rules; fundamental rights and values are often examined at the end, as the inconvenient red lines that must not be crossed but are not conceived as principles inspiring the rules. If such shortcomings are present in the legislative process, they cannot be present in the interpretative process. As a matter of hierarchy and interpretative value, they are the more basic sources of legal authority, which means that a greater theoretical effort is needed to blend them within the narratives of monetary and financial stability, or investor protection.

**1.58** Thirdly, principles-based interpretivism allows a better understanding of the role of simple rules, as part of a better law-making process, but no substitute for principles-based interpretation (clarity and consensus as to meaning are convenient illusions, but illusions after all). It also helps to understand better the role of transversal interpretative criteria, such as cost-benefit analysis (CBA). A court confronted with a cost-benefit argument needs to consider, first, whether the relevant legal sources are conceived with such criterion in mind, or a different one, and whether other sources that are inspired by different considerations of justice clash with or trump over them. Even if a specific set of prudential rules is inspired

by CBA considerations and the supervisory authority is vested with discretionary power to make such CBA, the decision over whether the application of those rules interferes with other rules, say, investor protection rules, or with the fundamental right of privacy, is a legal decision, to be adopted by the court.

Fourthly, among the relevant legal principles, courts need to be more aware of their expert role within the system of governance, where they may be the ultimate arbiters of validity, but they are also accompanied by other parameters that set limits for their role and help put it in context. A court considering whether the act by a supervisory agency is legal or not cannot oscillate between the opposite poles of acknowledging the agency's 'discretion', as a blank check, or ascertaining whether it reached 'the' correct answer. It needs to examine, with expert judgment, first, what was the legal mandate with which it was vested by the relevant rules, and how that mandate has to be examined in light of its finality. Then, it has to examine that mandate in relation with other, potentially competing, mandates by the same agency, or other agencies whose activity may overlap with it. Then, it should analyse what are the legal reasons for vesting the agency with the ability to set goals, and interpret the corresponding provisions, and examine the specific scope of 'discretion' in light of those reasons. Even within the scope of discretion it should examine whether the mechanisms of accountability, consisting in transparency duties, duties to give reasons, or the parties' right to be heard, ensured the robustness of the decision-making process. If the conclusion is compliant, the court should simply declare the decision valid. In case of doubt, it could well ask the agency for more information, or examine the arguments of the parties that may be affected by the decision. Finally, deeper analysis is needed in order to establish the reasons why courts and public bodies in one country should treat soft law of supranational bodies, or legal practice from other countries, as a source of authority for decision-making, other than the fact that 'it works'.

'Works for now, until it does not' could be the answer. It is unclear whether the answer may be in states' duty to enhance the legitimacy of their acts, which leads them to incorporate international law as part of the law of the land, in the assumption of an internationally shared notion of human dignity that transcends national borders, at least in what concerns fundamental rights, in broader notions of 'political community', 'shared sovereignty', or 'legal pluralism', which go beyond the nation state and comity, or in a combination of them. Yet we cannot but see that the current system of polycentric exercise of authority in financial matters, by lacking a clear legal, principles-based foundation, is the proverbial giant with clay feet.

All this may sound more theoretical than it would be in reality. In the practice of the courts we constantly see interpretative exercises that closely resemble the one that we have just described. Not every hard case requires a full, all-encompassing theory, least of all in a polycentric system. Yet, even if we keep that in mind, the introductory analysis offered here is not trivial, because it stresses the need for greater awareness of the processes going on in courts' interpretation and application of the law of finance and helps to point out that the law's internal consistency, and, beyond that, its coherence with a set of shared values, is its major source of legitimacy. If, in the words of Lord Justice Laws, in the act of construing statutes, judges very often develop, refine, and apply constitutional [and other foundational] principles, interpretation is an autonomous creative process, and one which is 'not just a matter of filling in gaps the legislature would itself have filled, if the legislators had thought about it' but rather a purposively interpretation and application where statutory text is taken

to mean what it should in light of basic foundational principles.<sup>166</sup> However, to achieve this, as Lord Justice Ryder noted,<sup>167</sup> we need specialist skills and knowledge, because ‘judges will have to understand their caseload to a greater extent than in the past; be able to identify the features of cases that are out of the ordinary; and be able to predict, react to and actively direct cases in order to try and achieve the best-quality outcome in each case’.

<sup>166</sup> Lord Justice Laws (n 16) 201–203.

<sup>167</sup> Lord Justice Ryder, ‘Improving the Delivery of Justice in the Shadow of Magna Carta’ in Jeremy Cooper (ed), *Being a Judge in the Modern World* (OUP 2017) 133.