CHALLENGES AND PERSPECTIVES OF COMMERCIAL LAW WITHIN GLOBALIZATION: THE ISRAELI CASE

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SUMMARY: I. *Introduction*. II. *Commercial Law –General*. III. *Israeli Commercial Law – General*. IV. *Security Interests.*

I. INTRODUCTION

The development of modern means of communication has spurred the process of globalization. Transactions between parties from different countries are more prevalent now than ever before, and the Internet has blurred the borders between nations, transforming the world into a global village. As jurists, we are concerned with the impact that technology and globalization should have on the law.

The influence of globalization can be seen in all areas of the law. For example, censorship and restrictions on the freedom of speech have become less effective, and the imposition of legal restrictions that cannot in reality be enforced is never wise. The possibility of direct communication between artists and the end users, could change copyright law. In this talk, I discuss the influence of globalization on commercial law, with a particular focus on Israeli law.

The law defines rules of behavior, and sanctions in case these rules are violated. In order for these rules to be applicable and for people to uphold them, the legislator must tailor the law to the cultural characteristics of the population. This is true not only of criminal law, but also of civil law, namely, the law of obligations, property law and commercial law. For example, under English law, satisfaction of an obligation by a third party does not cause the obligation to expire. This is because English culture does not approve of third party intervention. English law perceived a contract as

existing only between the two parties that executed it, and until recently did not recognize third-party-beneficiary rights. Under Israeli law, on the other hand, an obligation can be satisfied by a third party, unless the obligation is intrinsically personal. Also, the law of obligations in Israel provides that where the implied intention of a contract is to grant rights to a third party, that party is entitled to sue the obligor and demand satisfaction of the obligation.

Globalization exposes people to different cultures and narrows the cultural gaps, but does not erase them altogether. It is therefore unadvisable, I believe, to impose the same commercial code in different countries. The inevitable result of such uniformity would be that strong countries would dominate small ones that do not have as much political strength. This could undermine the local culture and injure national pride, and consequently, cause people to feel alienated from the law.

I believe that a distinction should be made between areas of the law in which most of the trade is between parties from different countries, and areas of the law where most of the transactions involve parties from the same country. This is why it would make sense to have uniformity in the area of international trade, which, to the best of my knowledge, is indeed the case: the Uniform Customs and Practice for Documentary Credits (UCP500), which regulates documentary credit, its independence from the underlying transaction and the exception for fraud on the part of the beneficiary, has been adopted by many legal systems.

My focus is on the influence that globalization has had on Israeli law. Israel is a small country with a large immigrant population, and the influence of other cultures has been immense. In this talk, I describe the origins of Israel's commercial law and the influence that different legal systems have had on it.

II. Commercial Law-General

The term 'commercial law' does not carry an unequivocal meaning in legal theory, nor does it have a uniform sense throughout the various legal systems. In Israel, the term is, in practice, rarely used to denote a special branch of law. For example, in contrast to most Western countries, there is no independent course entitled 'commercial law' offered in the Israeli law faculties. In England, for example, various topics are taught under this

heading, such as sale, agency, carriage of goods, negotiable instruments, guarantees, insurance, as well as companies and partnerships.

Concerning the question of whether to consider commercial law as a separate branch of law, there is a distinction between countries with a tradition of continental law and those influenced by the English common law. Commercial law in Continental legal systems is regarded as a distinct branch of law, covering special enactments applying to businessmen and commercial transactions. In various European countries, there exists, in addition to a civil code, a comprehensive commercial code dealing with common transactions on the commercial level, such as agency, carriage of goods by sea or land, etcetera. These topics are also handled by separate court systems. This method creates a dual system of laws, so that in German law, for example, there are separate systems of civil and commercial agency, and so on. Criteria must therefore be established for distinguishing commercial transactions from civil transactions, and then the appropriate law must be applied to each. In common law countries, commercial law is no longer a separate branch of law. Actually, until the seventeenth century, the Law Merchant existed outside the scope of English common law, and was also dealt with before special tribunals. From the beginning of the eighteenth century, it gradually ceased to exist as an independent entity and was merged with the common law.

In the United States, there is a comprehensive enactment known as the Uniform Commercial Code (U.C.C.), which deals with a number of fundamental transactions, such as sale, bills and checks, bills of lading, securities and secured transactions. The U.C.C. has been an outstanding success, having been adopted by the legislatures of the different states of the United States. It includes the most detailed provisions, its aim being the reduction of uncertainties that derive from general provisions, thereby reinforcing legal certainty. The American code differs from the European commercial codes in that it does not relate to commercial law as a separate branch of law. The American code does not distinguish between civil and commercial transactions, nor does it lay down different standards for businessmen and others, nor, needless to say, does it establish a separate court structure for commercial transactions.

III. Israeli Commercial Law – General

My talk deals with commercial law in Israel in general, and will concentrate on the law of secured transactions as a main example. At first, I will give a general survey of the Israeli commercial law.

Israeli law has been influenced by twentieth century English law, and thus does not have a distinct branch of commercial law. In principle, Israeli commercial law is derived from two sources: English law and European continental law. Before Israel independence it was under British Mandatory rule between 1917 and 1948. During that period a number of enactments were passed regulating wide areas of commercial law, such as companies, partnerships, bankruptcy, banking, and bills of exchange. These enactments were copied from the corresponding English statutes. After the State of Israel was established, these enactments remained in force. It is interesting to note that while far-reaching reforms have been carried out in England in various fields, such as bankruptcy, Israeli law in this field has remained rather static and is thus based on English statutes that are today obsolete in England.

From 1965 until 1980, the Israeli legislature passed various statutes covering the principal areas of civil law. For various reasons, a single, comprehensive code was not adopted. Instead, the legislature enacted various statutes one at a time. These statutes include, *inter alia,* the following: the Agency Law, 1965; the Security Interests Law, 1967; the Sale Law, 1968; the Hire and Loan Law 1971; the Contracts (Remedies for Breach of Contract) Law, 1970; the Contract (General Part) Law, 1973, etcetera. These statutes, influenced mainly by European Continental law. Although they deal with the fundamentals of civil law, they actually form a considerable part of Israeli commercial law because there are no special laws relating to commercial transactions. The new civil legislation was enacted in stages, and was influenced by more than one legal source. There was no overall harmonization among the various statutes.

About a year ago, the Israeli Ministry of Justice published a proposal for a comprehensive civil code that contains more than 1,000 sections. The proposed code addresses a wide range of civil and commercial aspects of the law, such as torts, unjust enrichment, contracts, sale, lease, gifts, guarantees and bailment. This code is meant to replace all of Israel's civil laws, which were not enacted as an integral system but one at a time. The new

code would synchronize the various fields of law, as opposed to the existing body of law, which contains conflicting provisions between legislative acts that were adopted at different times. No specific legal system dominates either the current body of law or the proposed code.

To conclude, Israeli commercial law is influenced mainly by English law, and to a lesser extent by the laws of various European countries, especially Germany. American law has not served as a source for any complete piece of legislation, but did inspire some sporadic provisions. In practice, namely, in case law, however, American law has had notable influence over Israeli law.

Israel's laws are short and laconic, and do not determine detailed arrangements for routine commercial affairs. Since, by and large, Israeli laws define standards rather than rules, case law plays a central role. In this sense, the Israeli system resembles common law more than the Continental systems, where codes and statutes are more decisive than case law.

Israeli case law uses comparative law more than other legal systems. Since Israel is a small country, the courts often encounter issues that have not yet been addressed and for which no Israeli precedent exists. When a legal issue first arises or when the Supreme Court considers setting aside an existing precedent, the court often considers the way in which the same issue was resolved by other legal systems. Reference to comparative law is not obligatory, but serves as an inspiration for the interpretation of Israeli law or for creating a precedent where the law is silent. It is in this respect that American law plays a key role. The courts review the law on such issues in the various states, even though American law may not have been the basis for the Israeli legal provision under debate.

The US legal system is more frequently cited than European systems or even English law, which was a substantial source of Israeli legislation. There are several reasons for this:

First, Israel is heavily influenced by the US in many fields. This influence is enhanced by the strong diplomatic relations between the two countries and by the close commercial ties created by the hi-tech sector, which is Israel's leading industry. American influence is also visible in the consumer culture and in the way Israelis spend their free time. While Israel is geographically part of the Middle East, bordering Arab countries, it is the West, primarily the US, that has been a dominant influence.

Second, many of Israel's leading jurists received their legal training in the States. Most law professors in Israel completed their LL.M.s or doctor-

ates in the US. Their writings, which are cited in case law, are heavily influenced by US law.

Third, the Uniform Commercial Code, which governs commercial affairs in the American states is very detailed. The UCC is designed to enhance certainty, which is critical in commerce. Thanks to the high level of detail, the UCC often provides solutions to questions that come up in Israeli case law.

Fourth, in the 1950s and 1960s, following Israel's establishment, most of the leading Israeli jurists had emigrated from Europe and were thus familiar with the European languages and legal systems. Nowadays, English is the only foreign language that most judges, academics and leading attorneys can read. Most of them learn about the Continental legal systems through English texts. Understandably, most comparative studies refer to the US and England. Paradoxically, legal provisions that originated from German law, for example, are now interpreted according to the Anglo-American system.

Fifth, about twenty years ago, Israeli case law was revolutionized. Formality was abandoned, and judgments are now often based on value-system reasoning. For example, in the interpretation of the law, the language of the law is secondary to its purpose. The same expression can be interpreted differently in different contexts, as required by the purpose of the law. The values of Israeli society play an important role in identifying the purpose of any given piece of legislation. This approach brought Israeli law closer to American law; while English law seems to lean toward a more formal interpretive approach, American courts are less formal, and can therefore more readily inspire Israeli law.

I started by saying that the law is closely linked to local culture, and proceeded to explain the influence that American law has had on Israeli law. This begs the question of whether the adoption of American legal norms is consistent with Israeli culture. Before examining this question, I must explain that there is continual tension in many ways in Israel, between two cultures: traditional Jewish culture and Western culture, represented primarily by American culture.

The Jewish people, which constitute a majority of 80% in Israel, has a longstanding religious and legal tradition. This tradition is rooted in the Torah, the Old Testament, and is extended in various legal chronicles, most notably the Talmud, which was compiled around 500 B.C.E. However, the

secularization that many nations experienced, beginning in the 19th. century, has left its mark on the Jewish people too. Today, most Israelis are secular, and their links with Jewish culture are rather loose. This population gives Western culture more weight than Jewish tradition. The secular majority does not feel a deep bond with its historical roots, and is open to adopting legal norms that originated in Western civilization. Therefore, US law does not encounter a significant cultural barrier in Israel, which facilitates the integration of American norms.

VI. Security Interests

The principal statute on security interests in Israel is the Security Interests Law, 1967. In addition, there are certain provisions in the Companies Ordinance that apply to charges on company assets. Under the influence of English law, company law in Israel recognizes a type of charge that does not exist with respect to an individual's assets, namely, the floating charge. This is a charge on company assets that crystallizes into a specific charge on the occurrence of certain events, usually the issue of an order for winding up or for receivership of the company.

The Security Interests Law deals with a wide range of subjects, such as the replacement of charged property, securing the obligations of another, termination of a security interest, realization of the collateral, and so on. The most important provision concerning security interests is found in section 4 of the Law. Section 4 prescribes that security is effective against other creditors of the debtor only when the collateral has been deposited with the creditor or with a bailee on his behalf, or when the security interest is registered. In present day practice, the registered security interest occupies a central position in the law of modern legal systems. The main advantage of this kind of security interest lies in the fact that the collateral remains in the hands of the debtor, who presumably will make the most effective use of it.

In this limited survey, another principal provision will be dealt with more extensively. Section 2(b) of the Law states that the provisions of this Law shall apply to every transaction, however designated, the intention of which is to charge an asset as security for an obligation. The legislature was, in fact, concerned about the possibility of parties succeeding in avoiding the application of the Law by indirect methods, such as by dressing se-

curity agreements as a sale or lease. In order to restrict such possibilities, the substance of a transaction, rather than its form, determines the applicability of the statute. In other words, the Security Interests Law applies to all transactions that are in substance security interests, i.e., whenever a transaction gives priority to a creditor over another creditor, even though it may not objectively appear to have the form of a security interest. This provision is taken from the American Uniform Commercial Code.

Let's analyze the implications of Section 2(b) through the common example of retention of title in sale transactions. In most sale transactions in Israel, especially when the buyer is a retailer rather than the end consumer, a credit arrangement is used. The supplier gives the buyer short-term credit, allowing him to pay for what he bought a few months after delivery. The supplier in such transactions wears two hats: he both supplies the asset, and provides the financing. As the financer, the supplier is concerned that the buyer might become insolvent before he has paid the price, whereupon the supplier becomes an unsecured creditor, just like all the buyer's other creditors. To protect themselves, suppliers stipulate that ownership of the sold asset transfers to the buyer only after payment of the final installment. This provision means that if the buyer becomes insolvent before full payment has been made, the asset still belongs to the seller, who is then entitled to demand its return, and no other creditors will have rights to this asset.

To the best of my knowledge, in the Continental legal systems and in England, stipulations of this kind give the supplier priority over the buyer's other creditors. The supplier may repossess his asset, which does not become part of the pool of assets for liquidation. On the other hand, US law views the retention of title provision as a security interest agreement, which must be registered in the registry of security interests. A retention of title agreement that is not registered is not enforceable against the buyer's other creditors.

I have already mentioned that the Uniform Commercial Code is very detailed. In this context too, the Code goes further than simply stating that any agreement whose purpose is to create a security interest, regardless of the form the parties have given it, is governed by the laws governing security interests. The Code specifically addresses title retention and states that it is governed by the provisions of article 9 with regard to security interests. Canadian law follows US law, and other countries have also considered

taking the same approach. Israeli law, by contrast, is not detailed. The Legislature has made do with a general provision, that classification of agreements as security interests depends on the substance of the agreement rather than on its form.

I believe this is one area of the law that should be homogenized. For example, Israel trades with both Europe and the US. European exporters that ship goods to Israel and extend their buyers credit, stipulate a title retention clause in their sale agreement, believing that this protects them if the Israeli importer becomes insolvent. At the same time, American exporters that ship goods to Israel do not rely on title retention provisions, and demand various securities instead.

Israeli law on this issue has seen changes. In 1991, the Supreme Court held that retention of title would be deemed a security interest arrangement, and that the supplier would have priority over other creditors for the purpose of collecting his debt from the asset, only if his right were registered. This decision effectively meant adoption of the American perspective on this issue. But in 2003 this case law was set aside, when the Court held that the result of a title retention provision was to grant the supplier priority over other creditors of the buyer, regardless of whether the arrangement was registered or not.

What brought about this change? One explanation offered by the Court was that in most countries, retention of title clauses give the supplier priority over the buyer's other creditors, and this priority does not depend on registration. The Court disregarded the fact that in countries in which the law stipulates that classification of an agreement as creating a security interest depends on substance rather than form, as does Section 2(b) of the Israeli Security Interests Law, the system is different, and the title retention clause is treated as a security interest. But the change in the Court's position was also influenced by other factors. The previous decision, which only recognized the supplier's priority if he registered his right, was designed to promote publicity: any preference given to any creditor must be reflected in a registry. According to this approach, a property right, in other words, enforceability against third parties, may not be validated unless it is made public. But in recent years, the importance assigned to registration in the various areas of law in Israel has decreased. This can be seen first and foremost in real estate. Israeli courts have in recent years leaned toward a less formal approach. This new way of thinking reduces certainty in trade,

but also grants the court flexibility and enables it to see justice served in cases where a strictly formal approach would have caused an injustice.

This takes us back to the tension between the local culture and the homogeneity needed in this era of globalization. The evolution of Israeli case law on this issue is consistent, I believe, with the cultural norms of the Israeli population, which does not advocate a strict interpretation of the rules of Law. Certainty as to the outcome of the law and foreseeability are not supreme values. The public prefers value-based rulings that would take the special circumstances of each case into account. This is the same mindset that has led to a significant expansion of the principle of good faith in the performance of contracts and other obligations, to a greater extent than in many legal systems.

To conclude, globalization and the tight link between entities in different countries promote legislative homogeneity, especially in the field of commercial law. There is no doubt that such homogeneity would streamline trade. But homogeneity is not all. We must be sensitive to the fact that sometimes, laws that originate in one culture are not suited to a population with an entirely different cultural background.