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FROM THE GLOBAL ISDA MASTER AGREEMENT TO THE CHINESE VERSION OF NAFMII: A STANDARD FORM CONTRACT AS THE SOURCE OF LEGAL TRANSPLANT, IRRITATION, AND INTEGRATION.

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The legal transplant is frequently used to justify a legal change in the recipient's jurisdiction. Close examination of a global standard form contract, such as the ISDA Master Agreement 2002 and its Chinese version, the NAFMII Agreement 2009, shows that judicial divergences over the boilerplate terms offer a mechanism for an intensified process of integration between the recipient's policies and international private law or transnational law.

I. INTRODUCTION

Standard form contracts (SFCs) have ancient origins where boilerplate terms were modified, adapted, and adopted by an enclosed group of merchants through years of experience engaging in frequent transactions.[1] The standard terms tend to affect a small enclosure of participants who subscribe to it in a particular market. As the markets have expanded, this group of participants has either grown or diminished. However, regardless of whichever influenced others, the market, or the number of groups, the boundary of standardized terms and legal effects certainly followed suit with complexities. From the outset, the normalization of the usage of the SFC invited a curious quest for a global private law order without states.[2] In general, states play a critical role in backing treaties as signature members or directly implementing treaties as part of national law, but SFCs developed through negotiations among market participants and private actors without the involvement of states. Hence, the concern that the interpretative methods applicable to these boilerplate terms often remains unsettled is equally a concern for

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[1] A Schroeder Music Publishing Co Ltd v Macaulay [1974] 3 All ER 616 (HL) 625 (Diplock L).

[2] GUNTHER TEUBNER, GLOBAL LAW WITHOUT A STATE, 3–28 (Dartmouth 1997).

transnational law.[3] There are residual legal uncertainties that contractual terms cannot insulate. Insolvency is an example of such uncertainty.[4] This involves the distribution of assets to creditors, and assets are subject to the lex situs.[5] This begs the question: to what extent the contractual terms, if not a securities' interest agreement, can protect the transacted parties? To summarize, if the terms can deprive third-party creditors of their rights in the event of insolvency, this is reasoned to contravene the insolvency policy of *pari passu*.[6] The regulatory intervention of an insolvency policy will void such contract terms to allow the insolvency proceeding to run smoothly. Conversely, the policy of party autonomy may avail an innocent party by reinforcing the contract's initial terms, hence avoiding the insolvency regulatory intervention.[7] This policy "effectively pits one public policy principle against another."[8]
Does the courts' divergence in their interpretation of the terms of the SFC become a source of anguish and persistent uncertainty? This is unlikely for the following reasons. First, on close examination of cases involving SFC in the event of insolvency, the practical concerns brought by the insolvency administrator sought confirmation on the obligations and rights under the SFC to avoid further litigation against his or her duties in the administration of the bankrupted estate.[9] Second, the outcome of both policies will practically be the same under economic-wide circumstances, except that the latter (party autonomy) might allow an innocent party to suspend payment obligation, enabling them to inevitably settle the final payment obligation with the bankrupted administrator in a timely fashion.[10]

Instead of examining the insightful literature on the interpretative techniques of the SFC, this article argues that once the SFC has been adopted, it becomes a source of legal transplant that can intensify the

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[3] *See* Louise Gullifer, *Interpretation of Market Standard Form Contracts*, J. OF BUS. L. 227 (2021)
[4] *Id*; *See* Steven Edwards, *Legal Principles of Derivatives*, J. OF BUS. L. 1 (2002).
[5] Foskett v McKeown [2001] 1 AC 102 (HL) 126-127 (Millett L) 'Property rights are determined by fixed rules and settled principles. They are not discretionary. They do not depend upon ideas of what is fair, just and reasonable. Such concepts, which in reality mask decision of legal policy, have no place in the law of property.'
[6] *See* Re Harrison Ex p. Jay (1880) 14 LR Ch D 19; *See* Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd [2009] EWCA Civ 1160, [2010] Ch 347 (CA) [73] (Perpetual Trustee*).*
[7] *See* Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc [2011] UKSC 38 (Belmont).
[8] Sarah Worthington & Grainne Mellon, *Statutory Rules, Common Law Rules, and Public Policy in the Global Financial Crisis*, 29(3) PENN. ST. INT'L L. REV. 613, 624 (2011)
[9] Perpetual Trustee, *supra* note 6.
[10] *Id.*

process of integration in two ways: inward integration into the host state's market and outward alignment with its needs. These judicial standpoints, however divergent, offer not only a deferential choice on the policies to be adopted by the host state's court(s), but a manifested reflexive integration into the host state's economic policy. This process has several names, such as irritation,[11] transposition,[12] or a simple transplant in ignorance of other factors.[13] These names, nevertheless, are ascribed to the process; referred to in this paper as a reflexive exercise by the recipient that is outward-looking with respect to judicial guidance and deferential principles and inward-looking for analogous coherency. This sets the view for an industry organization for standard implementation where the private law develops into a transnational or international law without states' involvement or, in simpler terms, *lex mercatoria,* albeit in the international private-law order. [14]

II. FOUNDATIONS – BORROWED LAW, NAFMII.

The first part of this paper clarifies and distinguishes the metaphoric legal transplant from those that are socio-legal comparativist and explicates an alternative dimension through which to perceive legal transplants in the context of an SFC. The second part demystifies the specific features of the SFC and how a standard can be an international setter for principles and rules to be transplanted via adaptation of the SFC by the Chinese market sector. Part 3 illustrates how judicial divergences on the SFC as persistent uncertainties with divergent responses pave the way for further integration in the process of legal alignment.[15] Finally, Part 4 presents concluding remarks on evolving integration.

A. Borrowed Law

According to legal scholar Alan Watson, a frugal way to develop and improve a particular legal system is to borrow rules from another developed legal system and apply them to the recipient

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[11] Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 MOD. L. REV. 11, 12 (1998).

[12] *See* Esin Orucu, *Law as Transposition*, INT'L & COMP. L. QUARTERLY 205 (2002)

[13] *See* ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (Scottish Academic Press, Edinburgh 1974); Alan Watson, *Legal Change, Sources of Law and Legal Culture*, 131 U. PENN. L. R. 1121, 1125 (1983).

[14] Teubner, *Global Law Without a State, supra* note 2, at 3-4; Joanne P. Braithwaite, *Standard Form Contracts and Transnational Law: Evidence From the Derivatives Markets* 75(5) MOD. L. REV. 781-82 (2012).

[15] National Association of Financial Market Institutional Investors (NAFMII) was founded in 3 September 2007 under the approval of the State Council of China (https://www.nafmii.org.cn/englishnew/aboutus/aboutnafmii/).

jurisdiction.[16] He espoused the metaphorical idea that legal change in a third state or jurisdiction occurs through borrowed law and that the latter will grow and become an integrated part of that recipient jurisdiction.[17] This paints an emphatic image for comparative lawyers who tend to categorize legal systems into either common law or civil law and inspires the thought that law has no boundary but is possibly an "autopoietic system."[18] At present, most, if not all, legal jurisdictions do not readily fit into this simple classification. Furthermore, the terminology no longer easily suits a well-developed legal system. For example, prior to Brexit, the United Kingdom (UK) witnessed numerous European Union (EU) regulations and directives being adopted into the legal systems of the four UK nations and interacted with pre-existing legal principles.[19] It is equally true to say that it is not easy to categorize the Chinese legal system as a simple civil law system.

Here, the borrowed law is a thrifty way to modernize domestic law; the socialist planned market economy has taken a selective approach to borrowing laws from Western jurisdictions or international practices through accession to international organizations.[20] The accompanying benefits are twofold: internally, it improves domestic rules by allowing the extraneous law to fill the gap in the market infrastructure, and externally, the rules allow market participants (corporates or financial institutions) in the recipient jurisdiction to be placed on the same level playing field as international practices.
Watson's legal transplant also applied to the legal development of the socialist market economy in the early millennium. The banking regulator at the time, the China Banking Regulatory Commission (CBRC), issued

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[16] WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW, *supra* note 13; *See* Alan Watson, *Legal Transplants and Law Reform*, 92 L. QUARTERLY REV. 79 (1976); Alan Watson, *The Birth of Legal Transplant*, 41 GA. J. INT'L & COMP. LAW 605, 607 (2012-13); ALAN WATSON, THE EVOLUTION OF WESTERN PRIVATE LAW (The Johns Hopkins University Press, Baltimore and London 2001).
[17] WATSON, *LEGAL TRANSPLANTS:* AN APPROACH TO COMPARATIVE LAW, *supra* note 13, at 27.
[18] *See* GUNTHER TEUBNER, *LAW AS AUTOPOIETIC SYSTEM*, Blackwell Oxford, (1993); *See* Anthony Beck, *Is Law as Autopoietic System?*, 14(3) OXFORD J. OF LEGAL STUDIES 405 (1994); *See* Katarzyna Gracz and Primavera De Filippi, *Regulatory Failure of Copyright Law Through the Lenses of Autopoietic Systems Theory*, INT'L J. OF L. & INFO. TECH. 46 (2014); *See* Kenneth Kang, *Making Paradoxes Invisible: International Law as An Autopoietic System*, 14(3) INT'L J. OF L. IN CONTEXT 332 (2018).
[19] Teubner, *supra* note 11, at 11.
[20] China's compliance with the Basel Committee's Recommendations on Banking Capital Adequacy Ratios and Liquidity Ratio (Basel I, II, and III); *see also* Klaus Peter Berger, *Harmonisation of the European Contract Law: The Influence of Comparative Law*, 50 INT'L & COMP. L. QUARTERLY, 877, 878–79 (2001).

the Provisional Administrative Rules Governing Derivatives of Financial Institutions 2004, with revisions in 2006 and 2011, respectively.[21] This Provisional Administrative Rule set an overarching parameter in recognizing the use of derivatives for hedge purposes, but predominately for micro-prudential policy for the supervisory authority.[22] There was no SFC for over-the-counter (OTC) derivatives transactions, nor was there a designated type of contract for the derivatives being explicitly inserted into the Chinese Contract Law 1999.[23] Until 2007, China had a regulatory and supervisory framework without a standard form of contract for real transactions.[24]

The substance of the contractual rights in OTC derivatives trading was heavily dependent on foreign contracts and deference to practice in Western markets. This was manifested in the case of *the Bankruptcy of Guangdong International Trust Investment Co., Ltd* 2003 (Guangdong International), where the Higher People's Court of Guangdong Province decided that the validity of swap contracts was a legitimate part of the authorization or license issued by the State Administration of Foreign Exchange (SAFE) to trade and deal in foreign exchanges. [25] The judgment also acknowledged the legitimate purpose of swap derivatives by referring to a generally accepted purpose, namely, to hedge to the financial position across the world outside China.[26]

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[21] *See* Interim Measures for the Management of the Dealings of Derivative Products of Financial Institutions Order of the China Banking Regulatory Commission (No. 1 2004), http://www.lawinfochina.com/display.aspx?lib=law&id=3378&EncodingName=big5 (last visited May 3, 2023); Mark Hsiao, *OTC Derivatives Regulation in China: how far across the river?*, 25(1) J. OF BANKING & FIN. L. & PRAC. 14, 15-25 (2014); MARK HSIAO, FINANCIAL REGULATION OF BANKING AND DERIVATIVES, SECURITISATION AND TRUSTS IN CHINA 3 (Carswell 2009).

[22] *See* Hsiao, *supra* note 21, at preface and 15; *see also* Trade Policy Review (China), WTO Doc. (WT/TPR/S/199); *see also* Duncan Alford, *The Influence of Hong Kong Banking Law on Banking Reform in the PRC*" 3 U. PA. E. ASIA L. REV. 35, 54 (2008).

[23] *See generally* Contract Law of China (adopted by the Second Session of the Ninth Nat'l. People's Cong., Mar. 15, 1999, promulgated by Order No. 15 of the President of China, Mar. 15, 1999) (indicating the lack of derivative contracts in Chinese law before 1999); *see* Hsiao, *supra* note 21, at 2.

[24] *See* Kingsley T. W. Ong and Mark W. H. Hsiao, *From ISDA to NAFMII: Insolvency Stalemate and PRC Bankruptcy Jurisdiction*, 8 CAP. MKTS. LAW J. 77, 77 (2013).

[25] *See* Guangdong Guoji Xintuo Touzi Gongsi Pochan An (廣東國際信託投資公司破產案) [Case on the Bankruptcy of Guangdong International Trust & Investment Co., Ltd], 2003 Sup. People's Ct. Gaz. 3 (High People's Ct. of Guangdong Province 2003) (China).

[26] *See id.*

Therefore, Watson's transplant suits such an early stage of Chinese development in the derivatives market as *sui generic* – there was no interaction with other internal branches of law such as Contract Law 1999 or General Principle of Civil Law 1986.

B. NAFMII and Legal Transplants

Although Watson later acknowledged the effect and importance of the cultural values affecting the legal transplant, the borrowed law does not reside in the socialist system as a mere regulatory repository; rather, it was adopted and adapted along with the pre-existing legal culture.[27] With the regulatory parameter being set for the purpose of derivatives, the State Council of the People's Republic of China endorsed and approved the establishment of the National Association of Financial Market Institutional Investors (NAFMII) in 2007, creating the standard setters for derivative transactions known as the NAFMII Master Agreement 2007.[28] The NAFMII Master Agreement is a wholesale importation of the International Swap and Derivatives Association (ISDA) Master Agreement (2002), and was created for derivative transactions within China and cross-border transactions.[29] This legal transplant of the standard set by the ISDA Master Agreement in the form of Chinese version NAFMII Master Agreement 2007 and 2022 cross-border transactions presents observable evidence of foreign judicial views being an important and deferential factor to Chinese courts in the process of "irritation."[30] This has theoretical and practical implications for the comparative development of transnational law. Regarding the former, the notion of transplant guides the metaphysic on the development of private law and shaping of the borrowed law with the recipient state.[31] In terms of practical implications, the standard-terms setter intensifies the integration of the Chinese economy, especially in currency trading, with global economies.

The ancillary benefit for market participants is the legal certainty of the rights and obligations under an agreement or contract. The SFC can benefit markets with respect to three broad aspects.

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[27] *See* Meryll Dean, *Legal Transplants and Jury Trial in Japan*, 31 LEGAL STUD. 570, 570–71, 573, 589 (2011).

[28] *See* Ong & Hsiao, *supra* note 24.

[29] *See* 中國銀行間市场金融衍生產品交易主協議 (輻噫悖掛求 2022年版, *translated in* NAFMII Master Agreement (Cross Border 2022 Version) (NAT'L. ASS'N. OF FIN. MKT. INSTITUTIONAL INVS. 2022).

[30] Teubner, *supra* note 11, at 12, 28, 31.

[31] *See id.* at 16, 28.

According to Lord Diplock, in the case of *A Schroeder Music Publishing Co Ltd v Macaulay*,[32] ("Macaulay"), the SFC can be broadly categorized into two different kinds. The first is an SFC that has an ancient origin. The characteristic of this type of SFC is that firstly, those terms were established according to mercantile transactions of common occurrence to be conducted.[33] Examples include bills of lading, charter parties, policies of insurance contracts of sale in the commodity markets, and the derivative markets. Secondly, the standard clauses or terms in these contracts also have settled over the years by negotiation of representatives of the commercial interests involved.[34] Additionally, they have been widely adopted because experience has shown that they facilitate the conduct of trade.[35] Contracts of these kind affect not only the actual parties but also others who may have a commercial interest in the transactions to which they relate, such as buyers or sellers, charters or shipowners, insurers, or bankers. Finally, SFCs are widely used by parties whose bargaining power is fairly matched, raising a strong presumption that their terms are fair and reasonable.[36] The second type of SFC is not the focus of this paper but can be summarized as a contract with terms that are neither subject to negotiation between the parties involved nor approved by any organisation representing the interests of the weaker party. This type of SFC is dictated by the party whose bargaining power enables it to impose terms on its counterparties that are sometimes colloquially referred to as "take it or leave it."[37]

This paper focuses on the first type of contract with particular reference to those produced by industry organizations. The exemplar is the ISDA Master Agreement,[38] excluding other standardized documents, such as collateral agreements, which have been the subject of judicial interpretations in various jurisdictions over the past three decades. In particular, the global financial crisis that occurred in 2008-2009 led to litigation concerning the contractual terms within the ISDA Master Agreement (2002).[39] Judicial interpretations of the terms of the contract in England and Wales, Hong Kong, Australia, and the United States illustrate the process of irritation or integration between the international

[32] Macaulay v. Schroeder Music Publishing Co Ltd, 1 WLR 1308 (1974).
[33] *Id.* at 1316.
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] International Swaps and Derivatives Association and ISDA Master Agreement (ISDA).
[39] *See* Kingsley T.W. Ong, *The ISDA Master Agreement: Insolvency Stalemate and Endgame Solution for Hong Kong Liquidators*, 40 HONG KONG L.J. 337 (2010).

standard setters, the ISDA, and the recipient jurisdictions that use the ISDA Master Agreement as the SFC.

C. Legal Transplant

The phrase "transplant," borrowed from the surgical domain and applied in law, vexes some comparative law scholars who consider it a platitude and an impossibility. [40] The initial idea of the legal transplant undoubtedly is a powerful way to explain why borrowing law occurs, however metaphorically.[41] Watson's idea serves as a narrative of the effort made by several jurisdictions to seek change and improvement to their own legal system.[42] Social-legal comparatists view the term as a platitude by illustrating that the transplant of an organ to a body and a mechanical transplant of a carburettor to another car do nothing more than show a purpose.[43] One would not ask if the carburettor is being rejected by the recipient car. Thus, the critical issue for the social-legal comparativist is the environmental factors surrounding the recipient jurisdiction that affect integration and assimilation.[44] Pierre Legrand, a comparative law scholar, considered Watson's idea to be impossible as each system has its respective complexity and uncertain factors that could lead to a change in meaning, indicating that the transplant fails to yield its initial idea.[45] Other legal scholars, like Gunther Teubner and Otto Kahn-Freund, share the same view that the legal transplant is a misleading metaphor, as it fails to take account of the context and, from

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[40] Otto Kahn-Freund, *On Uses and Misuses of Comparative Law*, Vol. 37, No. MOD. L. REV. 1, 5 (1974); Pierre Legrand, *The Impossibility of Legal Transplants,* MAASTRICHT J. EUR. & COMP. L., 111, 114 (1997).

[41] ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW, 13 (1974).

[42] *Id.*

[43] Kahn-Freund, *supra* note 40.

[44] *Id.* at 9 (industrialisation, urbanisation, and the development of communications have greatly reduced the environmental obstacles to legal transplantation, and nothing has contributed more to this than the greater ease with which people move from place to place. If anyone doubts that this flattening out of economic and cultural diversity is reflected in the law, let him consider the role played in society by the law of tort.'; *See* REINHARD ZIMMERMAN, DANIEL VISSER AND KENNETH REID (ED)S, MIXED LEGAL SYSTEMS IN COMPARATIVE PERSPECTIVE (OUP Oxford 2004); *See also* VERNON PALMER (ED), MIXED JURISDICTIONS WORLDWIDE: THE THIRD LEGAL FAMILY (CUP Cambridge 2001); *See also* Jacque du Plessis '*Comparative Law and the Study of Mixed Legal Systems'*, THE OXFORD HANDBOOK OF COMPARATIVE LAW (OUP Oxford 2006).

[45] Legrand, *supra* note 40; *See* Pierre Legrand, *Comparative Legal Studies and Commitment to* Theory, 58 MOD. L. REV. 262 (1995).

a legal sociological standpoint, suggests examining the process of assimilation or integration, which is referred to as irritation.[46]

i. Dichotomy in Perspectives

The dichotomy between Watson's metaphorical idea of legal transplant and those who attack the metaphor provide various interpretations of utilizing the same concept. Watson postulates the concept of legal transplant as a narrative of comparative law in an academic discipline or a historical account of legal development.[47] By contrast, the sociological approach to the law is concerned with comparative law as the tool of legal reform, taking into account environmental factors.[48] It is possible to describe the dichotomy in legal transplant using both narrow and broad versions. The narrow version is that a legal system is unique and transplanted for its inherent quality, while the broad version treats the transplant of a legal system as an instrument for triggering the process of irritation through environmental factors and is considered a representation of the integration process.

There is also a third way to consider the legal transplant, which is to combine the narrow and broad versions to conclude that the transplant results in transposition.[49] In Watson's later work, he accepted that cultural values played a role in determining what would happen to the transplanted rules.[50] The fashionable trends that comparative scholars strive to align with "law as rules, the law as a system, the law as culture, the law as social facts, the law in context, law and history and law and economic" are nothing more than descriptions of the process of transposition, tuning, and fitting the law reform.[51]

In the Chinese socialist market economy, where the socialist culture and policy are alleged to be fundamentally different from those of other countries, such a context cannot be ignored when examining the relative success of a transplanted system, rule, or commercial SFC within its residual rules.[52] The study of a mixed, hybrid, or pluralist legal system, such as that in China, benefits from the continuing discourse among legal

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[46] Teubner, *supra* note 11.
[47] *Legal Transplants and Law Reform*, *supra* note 16.
[48] Kahn-Freund, *supra* note 40, at 5; Watson, *supra* note 16 at 79.
[49] Orucu, *supra* note 12, at 205.
[50] Watson, *supra* note 13, at 1121. Alan Watson, *From Legal Transplants to Legal* Formants, AMERICAN J. OF COMP. L., Vol. 43 No. 3, 469–476 (1995).
[51] Orucu, *supra* note 12.
[52] Jaakko Husa, *Developing Legal System, Legal Transplants, and Path Dependence: Reflections on the Rule of Law*, CHINESE J. OF COMP. L., Vol. 6 No. 2, 129–150 (2018).

comparativists and generates new interest among those who view it as offering a paradigm for the evolving harmonization of a private law system. However, much of China's borrowed law is an instrument in facilitating the pursuit of economic policy.

ii. Addressing the Dichotomy from an Economic Dimension

Upon closer examination, Watson's legal transplant theory is not restricted to legal rules.[53] His conception of the transplant of Roman law also concerned both legal institutions and structures, despite there being little to no connection to any particular group of people, period of time, or place that such a transplant can sustain.[54] Since Watson's contributions, the objectives of the legal transplant have diversified.[55] These modern objectives range from statutes to foreign judgments used in court decisions.[56] Many decisions explained the various reasons for legal transplants to take effect, including voluntary, involuntary, deliberate, or common legal cultures.[57]

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[53] Watson *supra* note 13, at 81.

[54] *Id*.

[55] Mathias Siems, *Malicious Legal Transplants*, 38 LEGAL STUD. 103-119 (2018); Li-Wen Lin, *Legal Transplants Through Private Contracting: Codes of Vendor Conduct in Global Supply Chains as an Example*, 57(3) AM. J. OF COMP. LAW 711-744 (2009); Elisabetta Grande, *Legal Transplants and the Inoculation Effect: How American Criminal Procedure has Affected Continental Europe*, 64(3) AM. J. OF COMP. LAW 583-618 (2016); Hideki Kanda and Curtis Milhaupt, *Re-examining Leal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law*, 51(4) AM. J. OF COMP. LAW 887-902 (2003); Victoria Barnes and Emily Whewell, *English Contract Law Moves East: Legal Transplants and the Doctrine of Misrepresentation in British Consular Courts*, 7(1) CHINESE J. OF COMP L. 26-48 (2019); Randall Peerenboom, *Toward a Methodology For Successful Legal Transplants*, 1(1) CHINESE J. OF COMP L., 4-20 (2013).

[56] WILLIAM TWINING, GENERAL JURISPRUDENCE: UNDERSTANDING LAW FROM A GLOBAL PERSPECTIVE, 279 (CUP Cambridge 2009); Siems, *supra* note 55.

[57] Siems, *supra* note 55, at 105; Jonathan Miller, *A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process*, 51(4) AM. J. OF COMP. LAW 839-886 (2003); Louis F Del Duca and Alain Levasseur, *Impact of Legal Culture and Legal Transplants on the Evolution of the U.S. Legal System*, 58 (1) AM. J. OF COMP. LAW 1-30 (2010); David Schorr, *Horizontal and Vertical Influences in Colonial Legal Transplantation: water by-laws in British Palestine*, 61(3) AM. J. OF COMP. LAW (2021); Mathias W Reimann, *A Bottom-up View of Legal Transplants*, 68 (3) AM. J. OF COMP. L. 689-694 (2020)

However, there is little discussion of the common markets among particular trades that lead to the adoption of SFCs by states to achieve a level playing field for their financial institutions.[58]
As a test center for operative comparative law, the Chinese legal system in the socialist market economy provides an arena in which old and new transplant theories can be tested but also adds to the literature on the transplanting of rules and systems for economic efficiency.[59] There is merit in the theory that the transplant can improve economic performance through the adoption of more efficient legal institutions.[60] The tendency is that the pursuit of economic growth is designed without paying much inward attention to the institutional setting.[61] The creation of the NAFMII Agreement, mostly assisted by major law firms[62] and the International Swap and Derivative Association Inc.,[63] provides not only an example of this economic pursuance, but also a reflection of the influence of market actors in shaping a transnational law for derivative markets.

III. STANDARD FORM CONTRACTS IN THE CHINESE SOCIALIST MARKET ECONOMY

The SFC was not novel to the Chinese markets and their counterparties. The PRC foreign trade organizations have used SFCs to transact with global trading partners.[64] In recent years, we witnessed the growth of the level playing field that Chinese market participants have achieved against Western market players. For example, the

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[58] Michele Graziadei, *Comparative Law as the Study of Transplants and Receptions*, in MATHIAS REIMANN AND REINHARD ZIMMERMANN (eds) THE OXFORD HANDBOOK OF COMPARATIVE LAW (OUP Oxford 2008) 442, at 459; Katherina Pistor, Martin Raiser and Stanislaw Gelfer, *Law and Finance in Transition Economies*, 8 (2) ECON. OF TRANSITION, 325-368 (2000).
[59] Graziadei, *supra* note 58, at 459.
[60] *Id.* at 459.
[61] *Id*. at 460.
[62] *See* Statement of English Translation for drafting members, https://www.asifma.org/wp-content/uploads/2018/05/nafmii_master_agreement_2009.pdf (last accessed on Feb. 5, 2024).
[63] IBOR Fallback Documents, ISDA (July 30, 2021), https://www.isda.org/a/LhMgE/ISDA-NAFMII-Publish-Chinese-Language-IBOR-Fallbacks-Documents.pdf accessed 4th Jan 2023; *see* Liu Zhigang & Lv Yinghao, *Inter-Bank Market Financial Derivatives Master Agreement Promulgated*, CHINA LAWINSIGHT (Jan. 13, 2008), https://www.chinalawinsight.com/2008/01/articles/finance/interbank-market-financial-derivatives-master-agreement-promulgated/.
[64] *See* Alan Smith, *Standard Form Contracts in the International Commercial Transactions of the People's Republic of China*, 21:1 INT'L & COMP. L. QUARTERLY 133 (1972).

encouragement by the state for state-owned or controlled enterprises to undertake dual listing outside China, the aim being to utilize foreign rules (listing rules) to strengthen the corporate governance of Chinese corporations, and the establishment of Chinese International Commercial Courts in Shenzhen and Xi'an, respectively, are all the result of the piecemeal progression of legal integration.[65] All are exemplars of some form of legal transplant in private law. The early example of the SFC used to trade with foreign counterparts was a process in which Chinese traders would reflect upon their cultural value against the terms of the foreign counterparty under the SFC.[66] Such a process is often reflected in Gunther Teubner's notion of legal irritation.[67]

The modern Chinese financial market has developed or evolved piecemeal with caution through its mixture of socialist rules and codified law. Although Watson makes no distinction between borrowing private law and international standardisation in the context of recipient jurisdiction, he compares legal transplants with comparative jurisprudence as juxtaposing "like with like."[68] Comparative jurisprudence "represents the effort to define the common trunk on which represent national doctrines of law are destined to graft themselves as a result of both of the development of the study of law as social science and of the awakening of an international legal consciousness."[69]

The hallmark of comparative law is the study of the relationship between one legal system and its rules with another.[70] International standardized terms serve as the medium for bridging a legal relationship where no pre-existing relationship exists.[71] They have thus become important in establishing the nature of a possible relationship, whereby the Western legal terms or concepts are transported into the Chinese financial and legal systems. This is where plausible exploration occurs of the mechanism of Watson's legal transplant when the economic policy detects the integration. The mechanism did not occur without some form of self-reflexive exercise. The process of the legal transplant reflects the

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[65] *See* Wei Cai and Andrew Godwin, *Challenges and Opportunities for the China International Commercial Court*, 60 INT'L & COMP. L. QUARTERLY 869, 872 (2019)
[66] Smith, *supra* note 64, at 133.
[67] Teubner, *supra* note 11, at 11.
[68] Watson, *supra* note 13 at 3. "We shall be here concerned with an approach similar to that of Lambert and Wigmore but it is not proposed to look for an all-embracing definition or an enumeration of parts."
[69] *Id.*
[70] *Id*. at 6.
[71] Teubner, *supra* note 2; Braithwaite, *supra* note 14, at 779-780.

prior reflexive approach from the recipient jurisdiction to exercise some form of self-assessment through the market or governmental actors, first on the needs or weaknesses in the legal system, that involves self-identification of the recipient jurisdiction as to its necessity.[72] This process should focus from top to bottom as part of the political economy where governmental policy dictates.[73] In this instance, the state has a role in fostering the process of national legal change by encouraging the domestic business community to participate in the international SFC, and adopting the terms verbatim, if not identically.

A. A Transplant of a Standard Form Contract

The market SFC has been extensively discussed on various fronts.[74] A well-established consensus exists that a contractual regime has a sector-wide normativity that could result in a significant part of the public dimension, which states cannot ignore, primarily when a large volume of contracts on a specific type of market reflects a critical factor in transferring sovereign functions to private actors.[75] When an agreement is standardized, it affects not only individual rights but also opens new avenues for enforcing contracts by private actors themselves.[76] Some academics view this effect on individual rights as the equivalent of legislation.[77] Examples of such markets are bond and

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[72] Teubner, *supra* note 18.

[73] Aditi Bagchi, *The Political Economy of Regulating Contract*, 62 AM. J. COMP. L. 687, 687 (2014).

[74] Smith, *supra* note 64; George Gluck, *Standard Form Contract: The Contract Theory Reconsidered*, 28(1) INT'L & COMP. L. QUARTERLY 72-90 (1979); Edward Jacobs, *The Battle of the Forms: Standard Term Contracts in Comparative Perspective*, 34(2) INT'L & COMP. L. QUARTERLY 297, 297-316 (1985); Eyal Zamir and Yuval Farkash, *Standard Form Contracts: Empirical Studies, Normative Implications, and the Fragmentation of Legal Scholarship: Comments on Florencia Marotta-Wurgler's Studies*, 12(1) JRSLM REV. OF LEGAL STUD. 137, 137-170 (2015); Gino Gorla, *Standard Conditions and Form Contracts in Italian Law*, 11(1) AM. J COMP. L. 1, 1-20 (1962); Stephen J Choi, *Variation in Boilerplate: Rational Design or Random Mutation?* 20(1) AM. L. & ECON. REV.1, 1-45 (2018); Simon Deakin and Jonathan Michie, *Contracts and Competition: An Introduction*, 21(2) CAMBRIDGE J. ECON. 121, 121-125 (1997); John JA Burke, *Contract as Commodity: A Non-Fiction Statutory Approach*, 21(1) STAT. L. REV. 12,12-42 (2000).

[75] Regulation (EU) 648/2012 of 4 July 2012 on OTC derivative, central counterparties and trade repositories [2012] OJ L201/1 (the EMIR Regulation 648/2012 is a classic example).

[76] Dan Wielsch, *Global Law's Toolbox: Private Regulation by Standards*, (2012) 60 AM. J. COMPAR. L. 1075, 1078; George Gluck, *Standard Form Contract: The Contract Theory Reconsidered*, (1979) 28(1) INT'L & COMP. L. QUARTERLY 72, 73-74.

[77] Wielsch, *supra* note 76, at 1078.

derivative markets.[78] The interpretation of these SFCs has become important and is seen as being equivalent to a statute – 'Contract as Statute.'[79]

Intriguingly, this is highly similar to Lord Diplock's first category of the SFC in *Macaulay*.[80] The notion that there is little to no power imbalance among the parties is largely because the SFC has been drafted by a third-party organization whose members consist of participants in a specific market that subscribes to the SFC.[81] This is not only an example of neutrality in the SFC, but a fundamental psychological reflection akin to Rawls' original position.[82] He postulates that, hypothetically, if no one knows what the future entails, it is plausible that everyone will choose terms or rules that are less favourable to themselves in case they fall within this category as events unfold.[83] This presupposition means that parties autonomously choose these terms because they are valuable to them.[84] Rawls argues that everyone lies behind an imaginary veil of ignorance; not knowing the exact circumstances before them means they will be rationally and psychologically influenced by future uncertainty to choose less favourable terms in case they fall within that less favourable category.[85] For Rawls, when people are placed in this hypothetical position, the natural and rational approach by everyone to the choice of governing rules is that those rules benefit the least advantageous group.[86] This reflects Lord Diplock's statement in *Macaulay* that there is less likely to be a principle of reasonableness or fairness at play in this sort of SFC.[87]

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[78] *See id.*

[79] Stephen Choi & G. Mitu Gulati, *Contract as Statute*, MICH. L. REV. 1129, 1130 (2006).

[80] Macaulay, *supra* note 1, at 1136.

[81] *See* About ISDA, ISDA, https://www.isda.org/about-isda/, (last visited Dec. 21, 2023); *see also*, About NAFMII, NAT'L ASS'N OF FIN. MARKET INSTITUTIONAL INVESTS., https://www.nafmii.org.cn/englishnew/aboutus/aboutnafmii/ (last visited Dec. 21, 2023).

[82] JOHN RAWLS, A THEORY OF JUSTICE, 11–12, Harvard University Press revised ed.

[83] *Id.*

[84] *Id.* at 12.

[85] *Id.* at 11, 17.

[86] *Id.*

[87] Macaulay, *supra* note 1, at 1316. "Contracts of these kinds affect not only the actual parties to them but also others who may have a commercial interest in the transactions to which they relate, as buyers or sellers, charterers or shipowners, insurers or bankers. If fairness or reasonableness were relevant to their enforceability the fact that they are widely used by parties whose bargaining power is fairly matched would raise a strong presumption that their terms are fair and reasonable."

The standardization of the SFC also affects legal certainties and predictability. Although these characteristics relate to the choice of law and forum clauses, there are aspects of law or legal risk the contract cannot actually insulate or protect the parties. For example, insolvency law is largely the residual law for the state.[88] However, the judicial interpretations of these standard terms by various developed legal systems are useful as part of the ancillary benefit to the wholesale importation of SFCs.[89] This benefit could be said to fall under what Khan and Klausner described as "learning benefits," even if no one else in the market uses them, and "network benefits" arising from the use of standard terms by other market actors.[90] Following the global financial crisis, the standard terms in the SFC (ISDA Master Agreement 2002) attracted attention for their diverse and various judicial interpretations. Some academics see this as paving the way for the rise of transnational law.[91]

B. ISDA Master Agreement 2002 and NAFMII 2009

The International Swaps and Derivatives Association Inc. ("ISDA") is a not-for-profit corporation based in the state of New York that was formed in 1985 shortly after the emergence of a recognised derivatives market.[92] It has over 1,000 member institutions from 77 countries.[93] These members include corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks that are participants in OTC derivatives.[94] It was established to encourage efficiency and the prudent development of privately negotiated derivative contracts.[95] This need occurred in relation to swaps, and since 1992, standardized terms have been used for numerous types of OTC

[88] Edwards, *supra* note 4; Gullifer, *supra* note 3.
[89] Marcel Kahan and Michael Klausner, *Standardization and Innovation in Corporate Contracting (or Economics of Boilerplate*, 83 VIRGINIA L. REV. 713, 713 (1997).
[90] *See id*.; Gullifer, *supra* note 3.
[91] *See* Braithwaite, *supra* note 14, at 784; Aaron Taylor, *Interpretation of Industry-Standard Contracts*, LLOYDS MAR. COMM. QUARTERLY 261, 261 (2017); Dan Wielsch, *Contract Interpretation Regimes*, 81 MOD L. REV. 958, 958 (2018); *See* Jemeja Penca, *Transnational Legal Transplants and Legitimacy: The Example of Clean and Green Development Mechanisms,* 36 (4) LEGAL STUD. 706, (2016).
[92] About ISDA, ISDA (detail on the brief history and current memberships of the ISDA Inc), http://www2.isda.org/about-isda/; Lomas and others v JFB Firth Rixson, Inc and others, [2010] EWHC 3372 (Ch) [7] (Brigg J) (Lomas)
[93] ISDA Membership, ISDA, https://membership.isda.org/ (last visited Oct. 18, 2023).
[94] About ISDA, *supra* note 92.
[95] ISDA Membership, *supra* note 93.

derivatives.[96] Since then, the ISDA's standardized forms and the Master Agreement have been routinely applied.[97] They were revised in 2002.[98] The successful and widespread use of the ISDA Master Agreement is attributed to the active role of the ISDA.[99] It not only publishes standardized documents but also provides various forms of training for participants, as well as the continuing publication of legal opinion in various jurisdictions.[100] In addition, an effort has been made to lobby with the regulator.[101] A letter was addressed to the Peoples Bank of China (PBOC) regarding the disharmony on a parallel use of the ISDA Master Agreement and the NAFMII Master Agreement over a single agreement concept.[102]

Over-the-counter derivatives are governed by the ISDA Master Agreement, which is supplemented by a schedule as a means for traders to elect and add while negotiating with counterparties that are referenced *inter alia* in the Master Agreement.[103] The foundation of the contractual relationship is that all trades are entered into on the basis that the Master Agreement and schedule combine with all confirmations to form a single agreement.[104] This is structured to avoid cherry-picking by the insolvency practitioner in an attempt to disclaim unprofitable contracts while taking contracts that are beneficial to the insolvent party.[105] Accordingly, this means that in practice, the creditor would have to make full payment in respect of its loss-making contracts and would only receive a portion, if any, of the positive-value contracts. This is no longer the case with the ISDA Master Agreement, where the insolvent party has no right to designate close-outs.[106] Thus, the argument that those

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[96] *See* Lomas and others v JFB Firth Rixson, Inc and others [2010] EWHC 3372 (Ch) [7] (these OTC derivatives includes pure contracts for differences, caps and floors).
[97] Lomas, *supra* note 92, at 7.
[98] ISDA Membership, *supra* note 93; Edwards, *supra* note 4.
[99] Stephen J. Choi & G. Mitu Gulati, *supra* note 79, at 1141.
[100] *Opinions*, ISDA, https://www.isda.org/category/opinions/.
[101] Scott O'Malia, *Steps on the Way to China Netting*, ISDA (Mar. 31, 2017), https://isda.derivativiews.org/2017/03/31/steps-on-the-way-to-china-netting/.
[102] *Letter to Mr. Yi*, ISDA (Aug. 2008) *https://www.isda.org/a/tADDE/submission201aug08-english.pdf.*
[103] Edwards, *supra* note 4, at 4.
[104] *Id*. at 5; ISDA Master Agreement, §1(c) (2002).
[105] *Id*. at § 2(c), 5(vii); *International Insolvency and Restructuring Guide*, THE LAW FIRM NETWORK (Dec. 2014) at 344, https://www.lfnglobal.com/wp-content/uploads/2021/07/International_Insolvency_and_Restructuring_Guide_-_Author__The_Law_Firm_Network.pdf.
[106] Edwards, *supra* note 4; Ong, *supra* note 39, at 337.

derivative contracts are a series of executory contracts,[107] for which the payment obligations remain to be performed on both sides and the mutual promises for performance constitute executory consideration, differs from the operational clause.[108] Edwards, a practitioner, was correct in claiming that, notwithstanding the foundation of a proper concept to support the single agreement, the ability of the insolvency practitioner to bring the case forward depends on the enforceability of the close-out provision.[109] The single agreement concept aims to protect the netting rights that function to reduce the administrative costs associated with cash or securities transfers and minimize mutual counterparty credit risk exposure.[110] Therefore, from the outset of the single agreement concept, the operational terms aim to provide a mechanism to protect the non-fault party in the contract. This means that only a non-fault party can designate the notice of termination with close-out netting.

C. NAFMII Master Agreement

In August 2007, the National Association of Financial Market Institutional Investors (NAFMII), a self-regulated body, was formed by Chinese inter-bank market players working under the direction of the PBOC. A standardized set of documents for derivative transactions was presented in the following October.[111] The NAFMII documents were created to provide uniform documentation for inter-bank market participants in financial derivative transactions in the PRC.[112] They are

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[107] Alastair Hudson, Presentation of One Day Course at UCD, DEALING WITH DERIVATIVES (2005), http://www.alastairhudson.com/financelaw/derivativeslawcourse.pdf; ALASTAIR HUDSON, MODERN FINANCIAL TECHNIQUES, DERIVATIVES AND LAW 105-108 (Kluwer Law International 2000); RASIAH GENGATHAREN, DERIVATIVES LAW AND REGULATION 1*, 3* (Kluwer Law International 2002) (covering derivatives law and regulation in Australia, New Zealand, Singapore, Malaysia, and Hong Kong); Hsiao, *supra* note 21, at 2.

[108] Edwards, *supra* note 4, at 5 (arguing against this concept as being flawed on the single agreement. He opt for the view that counterparties would continue to trade derivatives in the pursuit of profit notwithstanding any defective foundations of the Single Agreement concept).

[109] *Id.*

[110] Kingsley T.W. Ong & Mark W.H. Hsiao, *From ISDA to NAFMII: Insolvency Stalemate and PRC Bankruptcy Jurisprudence,* 8(1) CAP. MARKETS L. J. 77, 77-89 (2012); The Law Firm Network, *supra* note 105, at 344.

[111] *Id.*

[112] David Olsson, Kennies Fung, Maggie Shen et al., *China: New Master Agreement for Financial Derivatives in China*, MONDAQ (Mar. 23, 2009), https://www.mondaq.com/china/commoditiesderivativesstock-exchanges/76684/new-master-agreement-for-financial-derivatives-in-china---18-march-

comparable with the ISDA documents on a like-with-like basis, except for those used for domestic derivative transactions, and have recently expanded for cross-border usage.[113] Accordingly, the NAFMII 2007 was drafted.[114] However, before the internalization of external rules such as ISDA documents, the Renminbi-foreign exchange forwards, swaps, and cross-currency swaps, the foreign exchange market was subject to the strict control of the State Administration of Foreign Exchange (SAFE).[115] These financial derivative transactions are conducted on the China Foreign Exchange Trading System (CFETS).[116] This implies that Renminbi forwards were subject to the CFETS and the NAFMII agreements.[117] These dual agreements created a discrepancy in their respective contractual terms. This conflict was addressed later in 2009 with the amended single documentation of the NAFMII Documents governing these CFETS transactions.[118] The NAFMII undeniably produced results in relation to similar legal difficulties that arose in the operational terms of the ISDA Master Agreement.[119] Take analogous examples on the representation clause on undertaking that there is no continuing occurrence of default was found in section 3(6),[120] the party's

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2009#:~:text=The%20NAFMII%20Master%20Agreement%20(2009,involved%20in%20financial%20derivatives%20transactions; NAFMII 2009 stands for National Association of Financial Market Institution which drafts the OTC derivative contract and approved by the People Bank of China in 2009. The standardized contract duplicates mechanism ISDA Master Agreement 2002. The NAFMII is a self-regulatory body, was newly formed in 2007 by Chinese inter-bank market players working under the direction of the People's Bank of China ("PBOC"). In 2007, it was authorised by PBOC to put forward a standardised set of documents for derivatives, which includes the Master Agreement, the Supplement (or Schedule), the Security Agreement and the Definitions (collectively the "NAFMII Documents"). The NAFMII Documents provide a uniform documentation platform for the inter-bank market participants in financial derivatives transactions in the PRC.

[113] About NAFMII, NAT'L ASS'N OF FIN. MARKET INSTITUTIONAL INVESTS., (Dec. 2023) https://www.nafmii.org.cn/englishnew/aboutus/aboutnafmii/.

[114] *Id.*

[115] *Major Functions*, STATE ADMINISTRATION OF FOREIGN EXCHANGE (SAFE), http://www.safe.gov.cn/wps/portal/english/Home (last visited Dec. 18, 2023).

[116] *See Measures of the Foreign Exchange Trade System and National Interbank Funding Center for the Administration of Information Disclosure on RMB Market*, CHINA FOREIGN BANKING EXCH. TRADE SYS. NAT'L INTERBANK FUNDING CTR. (Feb. 25, 2007), https://www.chinamoney.com.cn/english/svcfopgudrmkBM/20170225/2095.html.

[117] *See Letter addressed to the People's Bank of China* (PBOF), ISDA (Aug, 1, 2008) https://www.isda.org/a/tADDE/submission201aug08-english.pdf.

[118] *See* NAFMII, *supra* note 113.

[119] *See* Ong, *supra* note 110, at 77.

[120] NAFMII Master Agreement, §3(6) (stating "no Event of Default or Potential Event of Default with respect to its continuing and to its knowledge, no Termination Event with respect to it has occurred and is continuing . . .").

right to suspend payment obligation was found in section 4(III),[121] and only the non-defaulting party's right to give notice was found in section 9(I)(1)[122] of the NAFMII Master Agreement (2022).

The NAFMII protects the non-defaulting counterparty's close-out netting position by suspending the performance of its payment and delivery obligation if an event of default or potential event of default has occurred and is continuing in respect of its counterparty.[123] If no automatic early termination occurs, the insolvent counterparty has no power to terminate the NAFMII contract.[124] Only the non-defaulted party can designate a notice to terminate.[125] It is feasible upon a close-out calculation that the non-defaulting party will be out of money and, therefore, obliged to pay monies to the defaulting party.[126] Thus, the non-defaulted party may suspend and wait for the in-the-money alert before assigning a notice to terminate with close-out netting. The combined effect of the operational terms in the NAFMII and ISDA Master Agreement is that the non-defaulting party can take time to designate the termination notice, allowing them alone to choose a particular time that favours their speculative position in the contract.[127] At the same time, pending the designation of a notice of termination, the non-defaulting party does not have to pay a defaulting party even if they are favoured by the speculative position of the contract.[128] In practical terms, the policy of the party autonomy creates an "insolvency stalemate."[129]

When a transacted party is deemed insolvent, the contract becomes a centre of subject matter, whether it is a debt or asset. In common law, the anti-deprivation rule is that "no contract can be valid if a man's property shall remain his until his bankruptcy and on the happening of that event shall go over to someone else and be taken away

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[121] *Id.* at §4(III). "A party's performance of its payment or delivery obligations in accordance with the terms of the effective transaction agreement shall be subject to the satisfaction of all the following conditions precedent: (1) no Event of Default or Potential Event of Default with respect to other party has occurred and is continuing . . .".

[122] *Id.* at §9(I)(1) (stating that the Determination of Early Termination Date is (1) when an event of default specified in §6 of the Master Agreement occurs and is continuing, the non-defaulting party shall give the defaulting party a notice in writing).

[123] *Id.* at §4(III).

[124] *Id.* at §9(I)(1).

[125] Edwards, *supra* note 4 at 16□17.

[126] *Id.* at 16.

[127] *See* ISDA Master Agreement §6 (2002).

[128] *Id.* at §2.

[129] Ong, *supra* note 39, at 341.

from his creditor."[130] In other words, parties could not, on bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors.[131] It was argued that these provisions in the NAFMII and ISDA Master Agreement together affect the third-party creditors of the bankrupted party.[132]

D. Judicial Interpretations in Hong Kong, the UK, and the United States on operative terms in the ISDA Master Agreement

The financial and credit market has changed since 2007 because of the near-collapse of Citigroup, Lloyds, and the Royal Bank of Scotland due to the governmental sovereign debt crisis.[133] Some have blamed derivatives for the crisis by pointing to the change of law on this aspect,[134] as the globalized trading on derivatives in the 1980s[135] also led to the standardized contract being developed by derivative market counterparties to document OTC transactions.[136] The catastrophic events exposed certain weaknesses in the ISDA Master Agreements,[137] and the fact that the litigated cases arose from the liquidator's power to close out ISDA contracts in numerous jurisdictions,[138] including Hong Kong, which in view of the collapse of the Lehman Brothers, exemplifies the choice of policies.

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[130] "There cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else and be taken away from his creditors", Perpetual Trustee, *supra* note 6 at ¶ 26, (citing Lord Neuberger MR on Money Markets International Stockbrokers Ltd v. London Stock Exchange Ltd, 1 WLR 1150, (2002)).

[131] *Belmont*, *supra* note 7, at ¶ 104, (stating that "The policy behind the anti-deprivation rule is clear, that the parties cannot, on bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors. It is possible to give that policy a common-sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.").

[132] *Id.*

[133] *See* Ong, *supra* note 39, at 337 (examples for Sovereign debts are Greece, Spain, & Ireland).

[134] L. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1, at 3 (2011); D. Lynn, *Enforceability of Over-the-counter Financial Derivatives*, 50 BUS. L. 291, at 337 (1994); L. Stout, *Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives*, 48 DUKE L.J. 701, 704□05, (1999).

[135] Ong, *supra* note 39, at 338.

[136] *Id.*

[137] *Id.*

[138] Mark Hsiao, *Finality Orders in the Clearing System and OTC derivatives regulation in Hong Kong*, 43 H.K. L. J. 139, 141 (2013).

Section 5(a)(vii) of the ISDA Master Agreement (2002) provides that if a contracting party goes bankrupt, any credit support provided to such party or any applicable specified entity under the contract would be a default.[139] If automatic early termination does not apply, the existing mechanism under the ISDA Master Agreement does not allow the defaulting entity to close out trades where its counterparty has not triggered a termination (even if the defaulting entity has funds).[140] Furthermore, the condition precedent in section 2(a)(iii) permits a party to suspend the performance of its payment and delivery obligation if an event of default or potential default has occurred and is continuing in respect of its counterpart.[141] The combination of section 6 and section 2 led to a peculiar situation in the market.[142] This meant that while the Lehman Brothers were a bankrupted party (at fault), section 6 gave the counterparty the ultimate right to designate a specific termination date.[143] Until that designated termination date was set, the Lehman Brothers' bankruptcy administrator could not terminate the ISDA Master Agreement. Furthermore, the counterparty could, according to section 2 of the ISDA Master Agreement, stopping payment to the Lehman Brothers.[144] This meant that the Lehman Brothers' administrator could neither terminate the ISDA Master Agreement nor receive payment from the counterparty.

According to Ong, a legal practitioner and scholar, the resolution to such an insolvency stalemate under the Hong Kong insolvency regime was to use section 268 of the Companies Ordinance, in which the court is given the discretion to grant leave to a liquidator to disclaim 'onerous property within a twelve-month time limit.[145]

> Where any part of the property of a company which is being wound up consists of unprofitable contracts, or of any other property, by reason of its binding the possessor thereof to the performance of any onerous act, or to the payment of any sum of money, the liquidator of the company, notwithstanding that he has endeavoured to sell or has taken possession of the property, or exercised any act of ownership in relation thereto, may, with the leave of the court and subject to the provisions of this section.[146]

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[139] Ong, *supra* note 39, at 339.
[140] *Id.* at 341.
[141] *Id.* at 342.
[142] *Id.* at 341; *see* also ISDA Master Agreement §§ 2, 5 (2002).
[143] *Id.*
[144] *Id.*
[145] *See generally* Hong Kong Companies Ordinance, 32 O.H.K., § 268 (1933).
[146] *Id.* at § 268(1).

Before granting leave to disclaim, the court may require such notices to be given to interested persons as it finds just.[147] The unprofitable contract as part of the onerous property will follow the principles set down in the case *Transmetro Corporation Ltd*:[148]
A contract is unprofitable if it imposes on the company continuing financial obligations which may be regarded as detrimental to the creditors, which presumably means that the contract confers no sufficient reciprocal benefit. Before a contract may be unprofitable for the purposes of the section, it must give rise to prospective liabilities. Contracts that will delay the winding-up of the company's affairs because they are to be performed over a substantial period of time and will involve expenditures that may not be recovered are unprofitable. No case has decided that a contract is unprofitable merely because it is financially disadvantageous. The cases focus on the nature and cause of the disadvantage. A contract is not unprofitable merely because the company could have made or could make a better bargain.[149]

The Hong Kong court adopted such an approach in relation to the Lehman Brothers' contractual obligation under the ISDA Master Agreement and treated the latter as an unprofitable contract.[150] Although Hong Kong mirrored the section 268 unprofitable contract of the Hong Kong Ordinance from section 178 of the Insolvency Act 1986 (UK), this approach to the contractual obligation of the Lehman Brothers under the ISDA Master Agreement was never discussed in the courts in England or Wales.[151]

Courts in the United States view the suspension of payment obligation as a contravention of the Bankruptcy Code, under which section 365(e)(1)[152] provides that parties are prohibited from suspending their performance obligations solely on account of the bankruptcy filings

[147] *Id.* at § 268(3).
[148] *See Transmetro Corp. Ltd. v. Real Inv. Pty Ltd.,* (1999) 17 ACLC 1314 ¶ 21 (Austl.) (extracting five principles from the consolidated cases in *Transmetro Corp. Ltd. v. Real Inv. Pty Ltd*).
[149] Ong, *supra* note 39, at 343□44.
[150] *Id.* at 34.
[151] Insolvency Act 1986, c. 45, §§ 178, 178(3)(a) (Eng.).
[152] 11 U.S.C. § 365(e)(1).

of its counterparties.[153] Thus, the unilateral cessation of its payment obligation following the bankruptcy of the Lehman Brothers violated section 365(e)(1).[154] The *Lehman Brothers* case was concurrently litigated on both sides of the Atlantic.[155] To limit potential conflict between decisions in the two jurisdictions, the English High Court and the Bankruptcy Court in New York agreed that relief would be limited to declaratory relief.[156] This approach meant section 2 of the ISDA Master Agreement would be void, which put the counterparty in a position to consider exercising earlier on the notice of termination.[157] The administrators of the Lehman Brothers International in Europe (LBIE) filed an application to the High Court in England to seek the Court's directions as to the meaning and effect of section 2(a)(iii) of the ISDA Agreement. The Court was asked to consider whether section 2(a)(iii) ceased to be valid after the occurrence of a Bankruptcy Event of Default and, if so, in what circumstances.[158]

Furthermore, the administrators challenged the validity of section 2(a)(iii), arguing that it was inconsistent with the insolvency policy under the *pari passu* principle, where unsecured creditors, without preference, share the assets on pro rata basis.[159] As such, it violated the

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[153] Ong, *supra* note 39, at 347; *see also* Andrea Pincus, *The Metavante Ruling - in a Case of First Impression, US Bankruptcy Court Limits ISDA Counterparty Rights Upon a Bankruptcy Event of Default*, REED SMITH LLP, (last updated Dec. 3, 2009), at 1, http://www.lexology.com/library/detail.aspx?g=bb5c0a1b-4c88-43fb-8b80-f4299542e975 (discussing *In Re Lehman Bros. Holdings, Inc.,* Case No. 08-13555 *et seq*., where the Court deemed eleven (11) months after the filing for bankruptcy to be too late for Metavante to invoke early termination and instead imposed a sunset on a non-defaulting counterparty's right to early termination upon a bankruptcy event of default despite no such sunset provision in either the derivatives contract or the U.S. Bankruptcy Code itself).

[154] Ong, *supra* note 39, at 347; 11 U.S.C. § 365(e)(1); *see also* Pincus, *supra* note 153.

[155] *Belmont*, supra note 7, at ¶ 33.

[156] *Id.*

[157] *See The Metavante Ruling - in a Case of First Impression, US Bankruptcy Court Limits ISDA Counterparty Rights Upon a Bankruptcy Event of Default*, REED SMITH LLP, (last updated Dec. 3, 2009), http://www.lexology.com/library/detail.aspx?g=bb5c0a1b-4c88-43fb-8b80-f4299542e975.

[158] *See Perpetual Trustee, supra note 6, at ¶ 6; see also Re In the Matter of Lehman Brothers International (Europe) (in administration), Case No. 7942 of 2008, Ordinary Application filed on 25th May 2010, ¶¶ 1, 3, 118, 425, European High Court of Justice Chancery Div. Co. Court (Nov. 19, 2010).*

[159] *Id.*

anti-deprivation rule[160] and was contrary to public policy.[161] Both the anti-deprivation rule and the rule that it is contrary to public policy to contract out of *pari passu* distribution are two sub-rules of the general principle that parties cannot contract out of insolvency legislation.[162] However, the anti-deprivation rule only applies in the event of bankruptcy.[163] The *British Eagle* case applied *pari passu* throughout, irrespective of whether the airlines involved had gone into liquidation.[164] However, the anti-deprivation argument was dismissed and disapplied on the basis that there is good faith or a commercial sense of the transaction.[165] With regard to the contracting out *pari passu* principle argument, [166] the court held that the transaction was a sensible commercial arrangement that did not intend to circumvent insolvency law.[167]

The approach by the English courts and its divergence from the U.S. statutory approach seems to create legal uncertainty in the operative terms of the ISDA and NAFMII Master Agreement.[168] Moreover, uncertainty in commercial law can often persist over a long period.[169] The reason or cause of such persistency in uncertainty is suggested to be attributed to the existence of the very mechanism. This means that if such uncertainty can be resolved by whichever mechanisms are being

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[160] Belmont, *supra* note 7, at ¶ 75 ("Earliest days of the rule, it has been based on the notion of a fraud, or a direct fraud per Lord Eldon LC in Higinbotham v Holme (1812) 19 Ves Jun 88 at 92 on bankruptcy law, and that decision was taken to be authority for the proposition that where a person settles property in such a way that his interest determines on his bankruptcy that is evidence of an intention to defraud his creditors…"); *see also* Re Stephenson, Ex parte Brown [1897] 1 QB 638 at 640 (Williams J. holding that "The policy behind the anti-deprivation rule was clear: that the parties could not on bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors. It was possible to give that policy a common-sense application which prevented its application to *bona fide* commercial transactions which did not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.").

[161] Belmont, *supra* note 7, at ¶ 7.

[162] *Id.* at ¶ 1.

[163] *Id.* at ¶ 80.

[164] *Id.* at ¶75.

[165] *See id.*

[166] British Eagle International Airlines Ltd v Compagnie Nationale Air France, 1 WLR. 175 (1975).

[167] Belmont, *supra* note 7, at ¶ 76.

[168] Sarah Worthington, *Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule*, 75 MOD. L. REV. 112, 114 (2012); Sarah Worthington, *Testing the Anti-Deprivation rule: A response to 'Lehman Brothers and the Anti-Deprivation Principle: Current Uncertainties and Proposals for Reform*', 4 CAP. MARKETS L. J. 450, 453 (2011).

[169] Iain MacNeil, *Uncertainty in Commercial Law*, 13 EDINBURGH L. REV. 68, 84 (2009).

adopted, then the need to resolve uncertainty is reduced or eliminated.[170] Therefore, the more successful the responses to uncertainty, the longer the uncertainty is likely to survive. The reliance on non-legal measures can be associated with an ability to tolerate uncertainty within the law governing commercial transactions. Provided that responses to the uncertainty can remove damaging effects such as insolvency stalemate-temporary freeze in the market – and irrespective of the policies to be adopted in response to resolving the operative terms of the ISDA and NAFMII or the mechanism – there will be little pressure for uncertainty to be eliminated.

If such persistent legal uncertainty with divergent approaches or mechanisms holds true, one could categorize the divergences into two aspects of uncertainty. The first relates to the mandatory rule that the effect of uncertainty is greatest because it is not possible to contract around such rules. This mandatory rule is exemplified in the U.S. approach to voiding the provisions of the ISDA and NAFMII.[171] The second refers to the default rules in contract law. For instance, supporting a non-defaulting party's right to suspend all its obligations under the ISDA contract and indefinitely refraining from calling an early termination when faced with an insolvent counterparty would uphold the principle of freedom of contract.[172] Indeed, by protecting the non-defaulting party's contractual right, the English courts affirmed the policy that the courts should not interfere with commercial SFC entered between parties acting in good faith. [173] While academics doubt whether the notion of good faith really sets the anchor in reducing the effect of the anti-deprivation rule in the event of insolvency,[174] the presumption of good faith rests in the fact that these terms are established according to mercantile transactions of common occurrence to be conducted across years of negotiation by representatives.[175] It is this consistency of interpretation of the SFC that provides certainty. Conversely, it is submitted that that in insolvency, it is important to balance the interests and rights of general creditors of the insolvent estate.[176] Assuming the insolvent counterparty is "in the money" under the derivative contract, allowing a non-defaulting party to suspend its obligations and indefinitely delaying any call for early termination will deny the general

[170] *Id.*
[171] ISDA Master Agreement §§ 2, 6 (2002); NAFMII §§ 3, 9.
[172] Belmont, *supra* note 7, at ¶ 33.
[173] *Id.*
[174] *Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule*, *supra* note 168; *Testing the Anti-Deprivation Rule*, *supra* note 168, at 143.
[175] Macaulay, *supra* note 1, at 1316.
[176] Ong, *supra* note 110, at 105.

creditors valuable assets. It was based on this policy consideration that the U.S. court held that the relevant terms of the ISDA contract violated U.S. bankruptcy law.[177]

E. Transplant of the Judicial Responses and the Integration Dimension

This section examines how the divergence in the judicial responses to the ISDA affects the change of law in the adoption of the entire ISDA Master Agreement by the NAFMII, as the NAFMII Master Agreement also manifested wholesale importation.[178] If one approaches the divergence above in a brief two categories, mandatory rules and default rule of contract law, we see an observable reflexive process in the integration. This places the metaphorical term "legal transplant"[179] within an identifiable process of integration or repulsion with the existing law, political economy, and cultural values of the recipient jurisdiction before being entirely absorbed or adopted. In subsequent work, Watson acknowledges that culture plays a role in the settlement of transplanted rules.[180] The question is not so much whether the Chinese legal system will reject or integrate external rules; rather, it is how these judicial divergences can be constructed with an internal context without reconstruction for the fundamental change.

The importation of the SFC has since advanced to integrate with other Chinese laws, while additionally triggering more borrowed laws that could align with international practice. Indeed, social value plays a role in the interpretation of a specific article of the PRC Enterprise Bankruptcy Law 2006 when applied to the terms in NAFMII documents.[181] The notion of individual bankruptcy does not exist in traditional Chinese thinking.[182] In Chinese culture, it is believed that the debt incurred by a father ought to be assumed by the son.[183] Although this has been the case in Chinese law, this concept was short-lived

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[177] In re Lehman Brothers Holdings, Inc., Case No. 08-13555 et seq. (JMP) (jointly administered) ("Bankruptcy Case") for Metavane case filing. *See also The Metavante ruling - in a case of first impression, US bankruptcy court limits ISDA counterparty rights upon a bankruptcy event of default*, REED SMITH LLP (Dec. 3, 2009), http://www.lexology.com/library/detail.aspx?g=bb5c0a1b-4c88-43fb-8b80-f4299542e975.

[178] Ong, *supra* note 110, at 77-89.

[179] Teubner, *supra* note 11.

[180] *See* ALAN WATSON, SOCIETY & LEGAL CHANGE (Scottish Academic Press, Edinburgh (1977).

[181] Ong, *supra* note 110.

[182] S Li, *Bankruptcy Law in China: Lessons of the Past Twelve Years*, 5 HARV. ASIA QUARTERLY 1 (2001).

[183] *Id.*

because of the change of regime to the Communist Party and the subsequent adoption of Marxism in China.[184] The state bore all the losses incurred by state-owned enterprises until the enactment of the PRC Enterprise Bankruptcy Law (EBL) 1986, and when the subsequent EBL 2006 shifted the supremacy rights of creditors piecemeal towards a self-help approach.[185] During this period, creditors' rights were answerable by the state.[186] Although employees' debts from a bankrupted company are settled ahead of other creditors, this is comparable with Western society in its priority ranking of creditors like-with-like.[187] The law is an instrument designed to facilitate their political and economic plan, albeit not every rule is in the exact same paste. It is submitted that the EBL 2006 has a greater policy objective that is comparable with the U.S. Chapter 11, rendering the terms of the NAFMII void in the event of a financial institution triggering the event of default by bankruptcy.[188]

The comparison between Chinese law and the operational terms of the international SFC reveals how law and political economy are interrelated in more subtle ways.[189] Unlike normative integration without reference to social, political or economic factors,[190] the ISDA and NAFMII seems to occur on a mechanical rather than an organic level.[191] The binding arrangement of the law and social-economic policy depends on their interlocking with the specific power structure of the societies involved. The distinction of this mechanical transfer is that it has an impact at the level of financial institutions rather than individuals, as the design of the EBL 2006 and the NAFMII are aim at financial institution.[192] The national culture and union of law are not inadequate for the formulated technique. The economic policy is a more appropriate pitch for integration where little irritation or interaction occurs with the cultural aspects or environment.

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[184] Ong, *supra* note 110.
[185] *Id.*; S Li, *supra* note 182.
[186] S Li, *supra* note 182.
[187] Ong, *supra* note 110.
[188] *Id.*
[189] Teubner, *supra* note 11, at 22.
[190] ALAN WATSON, THE MAKING OF THE CIVIL LAW, 38 (Harvard University Press, Cambridge (1981)).
[191] Teubner, *supra* note 11, at 17.
[192] *See NAFMII Master Agreement (Cross-Border)*, NAT'L ASS'N OF FIN. MARKET INSTITUTIONAL INVESTS., https://www.nafmii.org.cn/ggtz/gg/202208/P020220831632138066172.pdf (last visited Dec. 26, 2023); Enterprise Bankruptcy Law of the People's Republic of China, art. 1 (China); Ong, *supra* note 110.

The policy that dictates the choice of relevant foreign rules dates back to basic general principles of civil law. Where there is a lack of relevant law regulating the contractual terms or SFC, the General Principles of Civil Law 1986 (GPCL) provides that state policies shall dictate.[193] The state policy that governs the issue interplays with the SFC and the EBL 2006 and is relatively easy to contextualize under the state policy to maintain the socialist market economy. Such a policy, manifested in the EBL 2006, is to settle claims and debts fairly so as to maintain the socialist market economy.[194] Due to the supremacy of this objective, the construction of the NAFMII operational terms for self-help in the context of the EBL 2006 is likely to incline towards the U.S. approach – bankruptcy procedural efficacy.[195] The practice is supported by the administration process in which the EBL follows the model of the United States.[196] In the case of a financial institution becoming insolvent, the EBL offers a degree of predictable outcome. Article 18 of the EBL recognises the executory contract to which the bankrupt is a party.[197]

After the people's court accepts an application for bankruptcy, the administrator shall have the right to decide to rescind or continue to perform a contract that is concluded before the acceptance yet remains to be fulfilled by both the debtor and the other party and shall notify the other party of his decision. Where the administrator fails to notify the other party within two months from the date when the bankruptcy application is accepted or to give any reply to the exhortation made by the other party within 30 days from the date the exhortation is made, the contract shall be deemed to be rescinded. Where the administrator decides that the performance of the contract be continued, the other party shall comply; however, the other party shall have the right to request the administrator to provide a guarantee. Where the administrator refuses to do so, the contract shall be deemed to be rescinded.[198]

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[193] General Principles of Civil Law of the People's Republic of China (hereinafter Civil Code), adopted by the Fourth Session of the Sixth National People's Congress on 12 April 1986, art. 6 (China) (civil activities must be in compliance with the law; where there are no relevant provisions in the law, they shall be in compliance with State policies).

[194] Ong, *supra* note 110.

[195] *Id.*

[196] Enterprise Bankruptcy Law (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 27, 2006, effective June 1, 2007), Lawinfochina (北大法律英文网), ch. 8 [hereinafter 2006 EBL], art. 18.

[197] *Id.*

[198] *Id.*

Article 18 contains a few additional clauses, appearing to reconcile the issue of an executory contract in the event of bankruptcy.[199] The contract becomes executed after the court accepts the bankruptcy application.[200] Under the EBL, the bankruptcy court treats the contract as completed upon accepting the application.[201] The right of the non-faulted party is shifted to the power of the administrator.[202] However, there is a balance in the creditor and debtor relationship where the administrator has two options. Administrators could continue to perform the obligation under the contract by serving notice. By doing so, the non-fault party could ask for collateral or a guarantee of performance. If the administrator opts to rescind the contract, damages may be awarded. This can be seen in the subsequent procedure of the EBL, where the administrator can dissolve or accept a contract following a normal bankruptcy petition or reorganization.[203] The latter was drafted on the basis of the protective mechanism from the U.S. Chapter 11.[204] The section 3 of the NAFMII will be treated as violating the procedure of the article 18 of the EBL and policy purpose of the EBL, regardless of an application for bankruptcy petition or reorganisation. This is a similar approach to the Lehman Brothers, which sought to enforce the payment obligation against the Metavante Corporation under the swap agreement between Metavante and Lehman Brothers Special Financing Inc (LBSF) guaranteed by LBHI. [205] The U.S. Bankruptcy Court held in favor of LBHI and LBSF and ordered Metavante to perform its obligation. The Court reasoned that Metavante's unilateral cessation of its payment obligation following Lehman's Bankruptcy filing violated U.S. bankruptcy law.[206] U.S. Bankruptcy Code, section 365(e)(1)[207] prohibits

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[199] Mark W.H. Hsiao, *OTC Derivatives Regulation in China: how far across the river?*, 25 J. BANKING AND FIN. L. AND PRAC. 1, 10 (2017).
[200] 2006 EBL, *supra* note 196.
[201] *Id.*
[202] *Id.*
[203] Haizheng Zhang, Rebecca Parry, et. al, *The Balance of Power in Insolvency Proceedings: The Case of China* 8 (1) INT. CORP. RESCUE 10, 14 (2011).
[204] *Id.* at 17; Lijie Qi, *The Corporate Reorganization Regime Under China's New Enterprise Bankruptcy Law* 17 INT'L. INSOLV. REV. 13, 13 (2008).
[205] Michael H. Torkin, Solomon J, Noh et. al., *Metavante decision: Dispute under section 2(a)(iii) of ISDA,* THOMAS REUTERS (Sep. 13, 2013), https://uk.practicallaw.thomsonreuters.com/7-500-4990?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1; *see also Belmont supra* note 7, at 33.
[206] Ong, *supra* note 129, at 347.
[207] 11 U.S. Code § 365(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease

parties from suspending their performance obligations solely on account of the bankruptcy filings of their counterparties.[208] This reveals that political economy dictates the law as an instrument for the pursuit of economic policy.

F. Integration of the ISDA/NAFMII via Chinese Courts

Other than the interaction of the EBL with the relevant provisions of the NAFMII, there is consistent recognition of the practice of the ISDA and NAFMII Master Agreement by the Chinese courts when adjudicating the disputes: termination and payment arose out of

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that is conditioned on— (A) the insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under this title; or (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—(A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (ii) such party does not consent to such assumption or assignment; or (B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

[208] Ong, *supra* note 39, at 347.

derivative products based on NAFMII Master Agreement 2009.[209] These cases represent the default rules of contract law as another mechanism responding to the persistent uncertainty in the operative terms of NAFMII and ISDA. In the dispute over early termination of a derivative product offered by Citibank, the Chinese court consistently defers to the international practice of the ISDA and the operational term of the NAFMII being mirrored on the same, such as commercial sense in this sort of complex transaction.[210] The judgment also referred to Article 94 of the Contract Law as the basis of authority and alignment.[211] Although

[209] The Supreme Court released the ninth of the top ten outstanding cases in the national courts for practising the concept of active justice: Bank of Tokyo-Mitsubishi UFJ (China) Co., Ltd. Shanghai Branch v. Shanghai Shengfeng Software Co., Ltd. (三菱东京日联银行（中国）有限公司上海分行诉上海晟峰软件有限公司金融衍生品种交易纠纷案) (2010) Pumin Six (Shang) Chu Zi No. 4077 Shanghai Pudong New Area People's Court; Citibank (China) Co., Ltd. v. Yingda Life Appliances (Zhongshan) Co., Ltd. Contract Dispute Case - Judicial Review Path for Liability for Breach of Exchange Rate Swap Transactions 花旗银行（中国）有限公司诉樱达生活电器（中山）有限公司合同纠纷案——汇率掉期交易违约责任的司法审查路径 (NAFMII) (2014) Pumin Six (Shang) Chu Zi No. S3800 Shanghai Municipal People's Court of Pudong New Area (Citibank China 2014); The Shanghai High Court released one of the typical cases of foreign-related financial disputes in Shanghai courts, and the Shanghai Financial Court released the third of eight typical cases of foreign-related, Hong Kong, Macao and Taiwan-related financial disputes: Standard Chartered Bank (China) Co., Ltd. v. Zhangjiakou United Petrochemical Co., Ltd. Financial derivatives transactions Dispute Case - Breach of Contract and Liability for Breach of Contract in Crude Oil Swap Transactions Should Be Determined According to International Practices (ISDA) (2020) Hu 74 Min Zhong No. 533 Shanghai Financial Court; Industrial and Commercial Bank of China (Asia) Co., Ltd., Kangzheng (Tianjin) Financial Leasing Co., Ltd. Financial Loan Contract Dispute Civil Judgment of Second Instance (ISDA) (2020) (中国工商银行（亚洲）有限公司, 康正（天津）融资租赁有限责任公司金融借款合同纠纷二审民事判决书) Supreme Court Minzhong No. 947 *Supreme People's Court of the People's Republic of China; Wu Zhengjun, Shenzhen Branch of DBS Bank (China) Co., Ltd.* (伍正军、星展银行（中国）有限公司深圳分行保证合同纠纷二审民事判决书) (NAFMII) (2019 Shenzhen Branch Civil Judgment of Second Instance on Guarantee Contract Dispute (NAFMII) (2019) Yue 03 Min Zhong No. 29568 Shenzhen Intermediate People's Court of Guangdong Province.

[210] Citibank (China) Co., Ltd. v. Yingda Life Electric (Zhongshan) Co., Ltd., Shanghai Pudong New Area People's Ct. No. S3800, Dec. 15, 2014 (China).

[211] *Id.* (referring to Contract Law 199, art. 94. " The parties to a contract may terminate the contract under any of the following circumstances: (1) it is rendered impossible to achieve the purpose of the contract due to an event of force majure; (2) prior to the expiration of the period of performance, the other party expressly states, or indicates through its conduct, that it will not perform its main obligation;

none of the cases involves an insolvent counterparty, all judgments consider principle on termination under the Chinese contract law is consistent with the standard terms in the ISDA/NAFMII Master Agreement.[212]

This process demonstrates how foreign judicial interpretations may be integrated as part of the legal transplant that occurred via the medium of the SFC, the ISDA Master Agreement, where Chinese policymakers, judges, or practitioners could be guided to pursue either the U.S. economic policy approach or the UK policy approach on party autonomy. Whichever method is adopted, the SFC, as the source of legal transplant, has an evolving role to play in the process of integration through foreign judicial interpretations of the ISDA Master Agreement. This evokes the notion of the learning benefits that SFC can entail, such as drafting efficiency, legal certainties on the terms, and allowing participants to be familiar with them. While these terms were designed to provide legal certainty or precisely on cost efficiency, the divergences in response to these terms lead to uncertainty. In this respect, it is not truly a legal uncertainty. It is possible to see how the judicial interpretations by various jurisdictions of the ISDA Master Agreement become useful responses with which to analyse the process of integration. The learning benefits are not mutually exclusive to the network benefit, which is associated with the derivative products or ancillary products that the network offers. In this sense, it covers the judicial interpretations arising from the use of common terms, as well as other aspects of the law with which such an SFC is associated. This can be illustrated by the market response of using the clearing and settlement system to resolve the 'stalemate' situation that, previously, might have been caused by the terms of the ISDA Master Agreement.[213]

A global political consensus after the Pittsburgh Summit (2009) was to enact a pan-regulation to clear the OTC derivatives,[214] which

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(3) the other party delayed performance of its main obligation after such performance has been demand, and fails to perform within a reasonable period; (4) the other party delays performance of its obligations, or breaches the contract in some other manner, rendering it impossible to achieve the purpose of the contract; (5) other circumstance provided by law").

[212] *Id.*

[213] Mark Hsiao, *Finality Orders in the Clearing System and OTC Derivatives Regulation in Hong Kong*, UNIV. OF LEICESTER SCH. OF L. (Rsch. Paper No-14-08) (2013).

[214] MARK HSIAO, REGULATING OTC DERIVATIVES: THE CCP'S ROLE AND THE EMIR IN RESEARCH HANDBOOK ON SHADOW BANKING: LEGAL AND REGULATORY ASPECTS 205, 210 (Iris Chiue and Ian MacNiel eds, 2018); DAVID MURPHY, OTC

predominately traded with the use of the ISDA Master Agreement. The clearing and settlement process is undertaken by the central counterparty (CCP) system, which is part of the payment system that adopts the finality order concept. The finality order means that any payment order being granted by the system shall, regardless of an insolvency order by the court or relevant authority, be processed and settled.[215] This helped to resolve the contractual stalemate in the Lehman Brothers case. Both CCP and Payment Finality practices have long been adopted by China.[216] A recent joint arrangement with Hong Kong on a Swap Connect to be initiated in 2023 provides another example of further legal integration of Chinese systems with Western practices.[217] This Swap Connect will allow investors from China to access foreign currency derivatives while at the same time allowing foreign investors to access Chinese RMB currency derivatives via Hong Kong as the hub.[218]

IV. CONCLUSION

The modern Chinese financial market has departed from its mixture of socialist rules and traditional Prussian codified law with a substantial number of borrowed laws and rules, achieved through accession to international organisations or with the assistance of market practitioners. Watson's observable idea of legal transplant to the recipient's jurisdiction to enhance their legal system with comparative jurisprudence 'like with like' offers useful insights into the legal development in China.[219] Some borrowed laws have a greater integration, while some have less, and some have none.

DERIVATIVES: BILATERAL TRADING AND CENTRAL CLEARING: AN INTRODUCTION TO REGULATING POLICY, MARKET IMPACT, AND SYSTEM RISK 281 (2013).

[215] MARK HSIAO, REGULATING OTC DERIVATIVES: THE CCP'S ROLE AND THE EMIR IN RESEARCH HANDBOOK ON SHADOW BANKING: LEGAL AND REGULATORY ASPECTS 205, 210 (Iris Chiue and Ian MacNiel eds., 2018).

[216] Payment, clearing and settlement systems in the CPSS countries, BANK FOR INT'L SETTLEMENTS, Vol. 2, Report No. 105 (2012), https://www.bis.org/cpmi/publ/d105.htm; *see also* Progress Report on the CCP Workplan, BANK FOR INT'L SETTLEMENTS (Sept. 2015), https://www.bis.org/cpmi/publ/d134a.pdf.

[217] Press Release, *HKMA Welcomes Swap Connect, Hong Kong Monetary Authority* (Jul. 4, 2022), https://www.hkma.gov.hk/eng/news-and-media/press-releases/2022/07/20220704-4/; *see* also Press Release, HKSAR Government welcomes establishment of Swap Connect, The Government of the Hong Kong Special Administrative Region, (Jul. 4, 2022) https://www.info.gov.hk/gia/general/202207/04/P2022070300806.htm.

[218] *See* About Swap Connect, HONG KONG EXCHANGES AND CLEARING LIMITED https://www.hkex.com.hk/Services/Clearing/OTC-Clear/Special-Topics/About-Swap-Connect?sc_lang=en (last visited Jan. 4, 2024).

[219] Watson, *supra* note 13, at 3.

There is little 'irritation' in financial derivatives markets in the integration process. From China's first adaptation of the capital adequacy ratio from Basel Committee's recommendation,[220] which was the first step towards the legal framework establishing the supervisory and regulatory foundation on derivatives trading, to the formation of the NAFMII, all of the processes involved borrowed laws to facilitate integration with international practices.[221] The comparative jurisprudence "represents the effort to define the common trunk on which represent national doctrines of law are destined to graft themselves as a result of both the development of the study of law as a social science and of the awakening of an international legal conscienceless."[222] The hallmark of comparative law is the study of the relationship between one legal system and its rules with another.[223] It follows that where international standardized terms serve as the medium for bridging a legal relationship where no previous relationship exists, the foreign judicial interpretation of the legal issues arising from the common standard terms also offers an option for recipient jurisdictions to consider. The international standardized terms thus became important in establishing the nature of a possible relationship, whereby Western legal terms or concepts are transported into the Chinese legal system as an integration or internationalization of national systems. Sociological studies on the law explored the mechanism of Watson's legal transplant that observes some form of self-assessment exercise, first on the needs or weaknesses in the legal system, which involves self-identification of recipient jurisdiction as to the necessity.[224] This process could be an exercise from top to bottom as the political economy where governmental policy dictates. In this instance, the state needs to nurture the process of national legal change by encouraging the domestic business community to participate in SFCs as well as adopting the terms verbatim.

Standardization is a common term in daily life. The standard price of a traveling ticket, standardized terms, and standards of practice

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[220] *See* Progress Report on Adoption of the Basel Regulatory Framework, BANK FOR INT'L SETTLEMENTS at 14-16 (Oct. 2021), https://www.bis.org/bcbs/publ/d525.pdf.
[221] *See* Hsiao, *supra* note 21.
[222] Watson, *supra* note 13, at 3.
[223] *Id.* at 6.
[224] *See* GUNTHER TEUBNER, LAW AS AN AUTOPOIETIC SYSTEM (Anne Bankowska & Ruth Adler trans., Zenon Bankowski ed., Blackwell Publishers 1993) (Where professor Teubner developed the idea of law as a kind of self-regulating, which he referred to as an organic system of 'autopoietic' system); *see also* NIKLAS LUHMAN, A SOCIOLOGICAL THEORY OF LAW (Elizabeth King-Utz & Martin Albrow trans., Martin Albrow ed., 2nd ed. 2014).

are examples of standardizing norms, goals, objectives, or rules that a sector of community or community at large reasonably accepts.[225] A standard could even indicate some fairness in terms of value for money. A standard form of contract offers an effective avenue for self-help and transparency regarding the operation of the terms. The efficiency of an SFC lies in the underlying national contract law theories. The change or affirmation of theories underpinning an SFC in a domestic context occurs in the judicial reconstruction in relevant social contexts. Social value plays a key role in shaping national legal change. However, the influence of this can extend beyond the boundaries of national jurisdiction. The simple characteristics of national contract law, once accepted in the wider international community, extend beyond national boundaries. The privately negotiated terms that become an SFC assert the influence of one national contract law over another when global players adopt the SFC by participation such that it becomes the 'global law without a state'.[226]

However, this is a qualified statement. The international SFC represents the collective efforts of a few national courts as the testing ground in the reinforcement of the terms.[227] When an emerging economic state adopts the international SFC, the recipient state effectively engages in the process of legal change in its national law. Although borrowing law from one national system is the most effective way to achieve a legal change, participation in the international SFC also enables legal transplants to occur. This paper illustrates that legal transplants are observable in China's legal system at two different levels when the Chinese financial community adopts, with the support of the state, the International Swap and Derivatives Association Master Agreement into its Chinese version. At the first level are Chinese financial institutions that enter into financial agreements with foreign institutions under the ISDA Master Agreement, which has affected and caused the Chinese judicial practice on jurisdictional clauses to be in alignment with international norms. Secondly, by adopting the NAFMII[228] Master Agreement, the legal transplant of foreign judicial interpretations offers enduring optional responses that are consistently reflected in Chinese national laws.

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[225] COLIN SCOTT, *Standard-Setting in Regulatory Regimes in* THE OXFORD HANDBOOK OF REG. 104 (R Baldwin, et. al. eds., 2010).

[226] GUNTHER TEUBNER, *Global Bukowina: Legal Pluralism in the World Society*, *in* GLOBAL LAW WITHOUT A STATE 3 (Gunther Teubner ed. 1997).

[227] *See* Braithwaite, *supra* note 14.

[228] About NAFMII, NAT'L ASS'N OF FIN. MARKET INSTITUTIONAL INVESTS., https://www.nafmii.org.cn/englishnew/aboutus/aboutnafmii/ (last visited Jan. 2, 2024).