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Legal Documents as Means of Financial Abstraction: How Bankers' Lawyers Constructed Swaps and Changed Finance

Abstract

Finance rests on a process of abstraction, based on various material devices that have been studied by economic sociologists in recent years. The fact that many of those devices are legal in nature has not attracted much attention, even though financial instruments are typically embodied in legal documents. This paper argues that interactions involving legal documents shape both financial markets and their regulation, by specifying the contextual elements that will be deemed relevant in interpreting financial commitments. It takes as a case study the emergence of swaps since the 1980s. Through their work in standardizing, commenting, and litigating swaps contracts, bankers' lawyers were able to recast obligations between banks and their clients in more abstract terms, discarding all references to specific business projects. Such abstraction simultaneously allowed the spectacular development of swaps markets, their positioning on the fringes of regulations, and the strengthening of bankers' prerogatives against their clients.

Keywords: Law and Finance; Financialization; Legal Work and Financial Innovation; Financial Derivatives' Legal History; Financial Regulation and Categorization.

Introduction

Debts, suggested David Graeber, are promises detached from their social context, which may circulate irrespective of their initial justifications. The anthropologist claimed that debts were promises corrupted by mathematics and by violence: once reduced to a sum of

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money, debts justify forcible actions against debtors that would otherwise seem morally condemnable [Graeber 2014]. Graeber's insight that the power of debt, money, and finance is rooted in their abstraction echoes a long tradition in the social sciences, spanning from early Marxist analyses of capitalism to contemporary works on the financialization of the economy [La Berge 2014; Hudson 2010]. Abstraction, for example, is a recurring theme in Marx's writings, where it refers to a social process in which human labor is stripped of its concrete qualities and made commensurable through the exchange of commodities, and where money at once embodies and mystifies this social process, by lending it an objective and natural appearance [Marx (1887) 2010]. Credit and financial assets, like stocks and bonds, further money's abstraction by creating claims for payments detached from tangible production—a form of "fictitious capital" that sustains the fantasy of money breeding money and earmarks for financiers part of the profits to be earned by the exploitation of labor [Vasudevan 2017]. Weber's work, pursuing a different line of inquiry, similarly ties financial abstraction to the rise of capitalism, though this time through the dissemination of various calculation methods, such as rational accounting, which promoted an ethos of systematic profit seeking [Weber (1981) 2017]. Such rational calculation, in Weber's account, objectified commercial endeavors, depersonalized business relationships, and contributed to the broader rationalization of modern Western societies—an evolution depicted, with the metaphor of the "iron cage," as both efficient and humanly dreadful [Weber (1930) 2001].

At a micro-level of analysis, these various processes of abstraction, intrinsic to finance, rest on a set of concrete instruments and local practices, many of which have been studied by economic sociologists in recent years. Social studies of finance, in particular, have examined the performativity of economic models: they have shown that the formulas employed to calculate and price financial risk, when incorporated into market devices, tend to dictate the conduct of their users and shape markets along the lines of financial economics [MacKenzie 2006; Callon, Millo and Muniesa 2007]. Stressing socio-technical agency in financial markets, they have documented the role of various calculative tools—from former charts and stock tickers to more recent software, indices, and formulas—in framing financial reality and decision-making [Preda 2006, 2007; Muniesa 2011; Millo 2007; Lépinay 2011]. This stream of research indicates that finance's abstract character, which gives its claims an aura of mathematical truth, is materially produced through a set of specialized knowledge, techniques, and instruments whose history may be traced, and whose controversies may be uncovered.

The fact that many of finance's calculative devices are legal in nature has not, however, attracted much attention.[1] Such omission constitutes a major gap in our knowledge of finance, considering that financial instruments are typically embodied in legal documents—contracts, stock certificates, notes, and other evidence of indebtedness—and that lawyers rank among the prominent professionals in the financial industry [Dezalay 1993; Hartmann 1995]. As some legal scholars have pointed out, financial assets are legal constructions in a deep sense: they are bundles of rights and obligations that coalesce into payable debts, which will, if necessary, be enforced by courts and bailiffs [Pistor 2013, 2019; Cornut St-Pierre 2016; Forray 2016]. Moreover, despite finance being a heavily regulated industry, creative legal work has the ability to bend the rules and circumvent regulation—so much so that an important part of the financial engineering witnessed in past decades would be better conceived as "legal engineering" [McBarnet 2010]. Law thus seems to be entwined with both the constitution of finance and its regulation, with both the calculability of debts and the violence of their collection. Yet we lack a precise understanding of how the relationship between law and finance unfolds in practice: how does the law contribute to contemporary practices of financial abstraction?

This paper addresses this question by studying the emergence of swaps, a kind of financial instrument invented in the 1980s that allows financial institutions, businesses, government entities, and institutional investors to manage, hedge, or speculate on a variety of financial risks. In early swaps markets, a few major investment and commercial banks joined their efforts and entrusted lawyers with the task of standardizing swaps contracts for their entire industry. Through their long-term work in drafting, commenting, and litigating their standard contracts, these lawyers were able to recast obligations between banks and their clients in more abstract terms, discarding all references to swaps' economic purposes or contribution to specific business projects. Such abstraction simultaneously allowed the spectacular development of swaps markets, their positioning on the fringes of existing regulations, and the strengthening of bankers' prerogatives against their clients.

Drawing from the case of swaps, this paper argues that the work around legal documents shapes both financial markets and their regulation, by specifying the contextual elements that will or will not be deemed relevant in interpreting and delimiting financial commitments. Legal documents are powerful framing devices that render promises more or

[1] One notable exception is Riles [2011], whose work I discuss below.

less responsive to changing circumstances, and debts' enforceability more or less questionable. A focus on legal documents may thus contribute to recent attempts to bridge the gap between social studies of finance's close examination of financial markets' socio-technical devices, and broader inquiries of political economy concerning the distribution of wealth and power in a financialized society [Christophers 2014; Braun 2016; Mabbett 2020].

Swaps and financialization, from a legal perspective

The last four decades witnessed the spectacular rise of derivatives, a kind of financial instrument whose value "derives" from the performance of an underlying asset or benchmark. Derivatives come in many forms and include futures contracts, forwards, options, and swaps[2]. They may trade on or off exchanges and relate to a broad variety of underlying assets, ranging from interest rates to currencies, commodities, and market indices.

The rise of derivatives is undoubtedly one of the hallmarks of financialization, albeit one that has yet to be fully theorized. While prevailing accounts of financialization often do mention financial innovation amidst the distinctive features of financialized economies, they rarely make it a centerpiece of their explanation [Krippner 2011; Lapavitsas 2011; Van der Zwan 2014]. Financialization has at times been attributed to changes in corporate governance and the increasing power of shareholders [Froud *et al*. 2006; Lazonick and O'Sullivan 2000], at times to class dynamics and the political domination of financial interests [Palley 2014], and at times to a cultural change that brought financial reasoning into everyday life [Martin 2002]. None of these accounts, however, properly captures the magnitude of what many observers have termed the "derivatives revolution" [Schapiro 1993; Ford and Liao 2010; Scalcione 2011], which far outweighs other trends frequently associated with financialization, such as the maximizing of shareholder value: derivatives reach more

[2] Futures and forwards are both contracts to buy or sell an asset at a predetermined price on a specified future date; futures contracts are standardized and negotiated on exchanges, while forwards are customized and traded over the counter. Options are contracts that give their buyers a right (but no obligation) to buy or sell an asset at a predetermined price on a future date. Swaps, by contrast, are contracts where two parties agree to exchange cash flows tied to two different underlying financial instruments; they are sometimes analogized to a series a forward contracts, where each party acts both as a seller and as a buyer [Nicholls 2013: 253]. The mechanics of swaps is explained in more detail below.

economic actors—including unlisted companies and governmental entities—and involve amounts of money that exceed the market capitalization of the world's principal stock exchanges [Bryan and Rafferty 2006: 32].

Among all derivatives, swaps have achieved the most phenomenal growth, evolving from an experimental technique of corporate finance in the early 1980s to a global multi-trillion-dollar market worth almost 6.5 times world GDP in 2018 [BIS 2020]. Swaps are bilateral contracts, traded over the counter (i.e. off exchange), in which two parties agree to exchange a series of payments over a period of time (usually a few years), following a fixed schedule and predetermined calculation formulas. Each term, each party to a swap is bound to pay the other a sum calculated on the basis of fluctuating prices or rates, for example the price of crude oil or a reference interest rate such as LIBOR. Since the sums due on both sides of the contract offset each other, a swap's overall value depends on the differential price movement of its underlying assets: as markets move, the party who is today the net debtor of a swap could well become, tomorrow, its net creditor. From this basic pattern, swaps have proven to be extremely versatile financial instruments, used for a variety of purposes, including corporate financing, debt and cashflow management, speculative investment, and insurance against a diversity of risks.

Swaps are emblematic of a new wave of financial instruments that support financialization and shape its characteristic relationships between banks, large corporations, institutional investors, and public powers. Swaps markets involve "dealers," which develop and trade a broad array of swaps, and "end-users," which enter swaps to serve their various business purposes. Swaps dealers are dominated by a group of 15 prominent banks[3], which together account for over 80% of the value of global swaps markets [Mengle 2010]. Swaps users, in contrast, are diverse and innumerable, as swaps have become fairly common management tools for all kinds of organizations, including multinationals and institutional investors, but also actors less conversant with financial markets, like local governments. According to both mainstream and critical accounts of finance, swaps achieve a commodification of risk [Mehrling 2005; Bryan and Rafferty 2006]: they allow their users, for a fee, to gain or dispose of an exposure to selected risks tied to interest rates, currencies, stock or commodity prices, etc. Swaps mark the

[3] These banks are well-known, "too big to fail" financial institutions: Bank of America, Barclays, BNP Paribas, Citi, Crédit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Morgan Stanley, Nomura, Royal Bank of Scotland, Société Générale, UBS, and Wells Fargo.

repositioning of banks towards their corporate clients, from direct lenders to financial service providers, as well as the entry of finance into the strategic management of businesses, beyond the sole purpose of raising capital [Lapavitsas 2011]. As they opened up new possibilities to financially manage risks that used to be handled by organizational or political strategies, swaps facilitated the offshoring of production and the reconfiguration of large firms into transnational networks of subcontractors and suppliers. They have expanded the scope of capitalist calculation, both within firms and across markets and regions, thereby increasing economic pressure on workers [Bryan and Rafferty 2006] and on populations from periphery countries [Lipuma and Lee 2004].

While most historical accounts of derivatives place their origins back to the futures contracts on rice, wheat, or tulip bulbs that were traded on commodity exchanges since at least the 17th century [e.g. Poitras 2009; Weber 2000], a legal genealogy of swaps leads the investigation into the much more recent development of contractual techniques allowing the creation of global markets for tailor-made financial instruments. Since the 1980s, swaps have been a concrete site for renegotiating the respective duties and prerogatives of global banks and their clients, and for legitimizing emerging models of financialized management. From a legal perspective, the advent of swaps was fraught with controversies, whose scrutiny sheds light on the socio-economic dynamics of financialization. As these controversies settled, swaps were freed from entire segments of financial regulation and became, for their users, gateways to a global legal space, subject to fewer constraints but affording fewer protections.

This article traces the legal history of these financial instruments by drawing on the analysis of professional and academic literature in the field of financial law, the swaps industry's legal documentation—its standard contracts, users guides, and legal opinions—, and litigation over swaps from the 1980s onwards. I compiled a corpus of over 30 law journal articles dealing centrally with the legal nature of swaps (mostly under American, British, and French law, with a few additional insights from Canada, Belgium, and Australia), 50 legal and policy documents published by the International Swaps and Derivatives Association (ISDA)—the swaps industry's leading trade association—, and 60 court decisions involving swaps contracts (rendered predominantly in England and the United States, with a few judgements emanating from France, Germany, Portugal, Australia, and Canada).

The article is organized as follows. The next part concentrates on the construction of a shared narrative on the legal nature of swaps. As Funk and Hirschman [2014] have shown, swaps' ambiguity with respect to

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regulatory categories was crucial to their success and paved the way, in the US, for banking deregulation. Such ambiguity, however, was not a given: it was carefully constructed and disseminated to a large audience of practitioners, courts, and regulators through the publication of numerous law journal articles, in which financial lawyers systematically argued swaps' *sui generis* character and the impossibility of bringing them under the scope of established categories of financial regulation. The article then turns to swaps' contractual standardization. It shows how lawyers, through an inventive combination of a few contractual techniques, have managed to bring an ever-increasing variety of financial transactions under the aegis of the ISDA Master Agreement, regardless of their context. Lastly, the article looks at the litigation triggered by swaps, and observes that the legal narrative and documents actually constrained the kind of arguments that could be voiced in trials as to why and when debts should *not* be paid. Swaps users have lost the ability to argue their own needs and circumstances convincingly, and swaps dealers have succeeded in securing their financial calculation, whatever the costs to their clients. All in all, such a development has resulted in a financial system especially unyielding for swaps users, in which the biggest financial institutions have gained the upper hand.

Unclassifiable, hence unregulated: neutralizing swaps' legal characterization

What are swaps, legally speaking? The smooth reception of such financial innovation into the legal system necessitated a considerable amount of legal analysis, so as to determine how swaps would be conceptualized in law and how they would fit into the established regulatory landscape. This analytical work was undertaken by a host of lawyers, working for law firms, banks, or universities, who have written about swaps and their legal framework[4]. The analyses they published in law journals have constructed a shared narrative about what these financial

[4] About two-thirds of the articles analyzed were authored by lawyers from global law firms, like Allen & Overy or Clifford Chance. Academics also contributed significantly to the debate, with law professors, researchers, and students accounting for approximately one-quarter of the authors. Boundaries between universities and law firms are porous, however, as law professors were often former practitioners, and students were often legal interns, soon to become lawyers. The remaining authors were either in-house lawyers for banks or non-financial firms, or did not claim any title.

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instruments were and were not, and gradually settled the question of swaps' legal characterization.

Far from being trivial or merely technical, the issue of swaps' legal characterization was of strategic importance: it would decide which legal regime these new financial products would be subject to. As a practitioner wrote in the 1990s, "the legal character of the product may have a significant impact on the rights and remedies customers will have in certain circumstances"—not to mention its sway on the powers exercised by different regulators—so it is "important for the efforts to address these issues to be made at the product development stage, at the same time as credit and other risk issues are being considered" [Kelly 1998: 25]. The doctrinal debate over the legal characterization of swaps is all the more interesting since it was, for decades, the main site for discussing swaps' legal framework, these financial instruments having been the target of relatively few legislative or judicial interventions before the financial crisis of the late 2000s.

A close study of this debate reveals that the authors who have published their legal analyses of swaps have systematically advocated the impossibility of bringing swap agreements under existing legal categories, using arguments that departed significantly from the canons of construction [Llewellyn 1950] that had hitherto prevailed in financial law. For most of the 20th century, financial law had revolved around three major institutions—banking, stock and commodity exchanges, and insurance—and adhered to a functionalist vision of the capitalist economy, based on corporatism [Moran 1987], economic efficiency, and the protection of finance's vulnerable users [Wang 2009]. Departing from the abstract individualism typical of classical private law [Kennedy 2006], financial law envisaged instead contrasted legal subjects serving complementary roles, with different rights and obligations: bankers and their clients, dealers and investors, insurers and insureds, etc. Its key legal concepts, such as banking operations, securities, futures, or insurance contracts, all give precedence to substance over form, thanks to their definitions that are more functional than analytical. By focusing on the purpose of financial instruments, functional definitions are deemed to provide the law with the flexibility to adapt to innovative financial practices. In the controversy around swaps' legal characterization, however, these categories were everywhere undermined by the novel analyses carried out by financial lawyers.

Virtually all authors who have expressed their views on the characterization of swaps have claimed that they *did not* qualify for one or another of financial law's key categories[5]. In most cases, they cited the versatility of these financial instruments—the fact that they can serve many purposes—as a ground for downplaying function as a defining feature of swaps and for introducing new distinguishing criteria, like the sophistication of their users. This reversal of financial law's functional approach occurred concurrently in the fields of banking, securities, futures, and insurance regulation.

In banking, for example, the authors studied have striven to avoid a double pitfall: swaps needed to be analogized to traditional banking activities, lest banks could be precluded from entering them [Henderson 1989], but they also had to be distinguished from credit operations, otherwise they could fall under the banking monopoly in force in countries like France and be forbidden to other businesses [Chabert 1989]. The challenge was especially acute for French lawyers, as French law defines credit operations quite broadly as the provision of funds for valuable consideration, thereby encompassing not only loans, but all kinds of guarantees and overdraft protections[6]. As swaps, in practice, often complement other credit arrangements, by allowing borrowers to improve their financing conditions through better interest rates, the characterization of swaps as credit operations was plausible and would have entailed additional obligations for banks regarding the calculation and disclosure of their fees to customers[7]. Against such characterization, the legal arguments French authors raised were hardly convincing on their own—for example that swaps would lack credit's temporal dimension, because they involve only simultaneous payments [Mattout 1987], when in fact swap payments are usually spread over several years—but drew strength from a more pragmatic consideration: equating swaps with credit operations "would lead to precarious consequences" [Chabert 1989: 194], by shutting all non-bank participants from their markets. In the years that followed, this difficulty was circumvented legislatively, by adding new derogations to the monopoly of credit institutions, in favor *inter alia* of investment funds [Constantin 2010].

A parallel controversy arose in the United States in connection with securities regulation. US law offers a broad definition of securities, by

[5] Of the 34 papers examined that specifically addressed the question of swaps' legal nature, only three came up with a positive characterization, declaring that swaps could qualify as securities [Kojima 1995] or as insurance contracts [Kimball-Stanley 2008; Juurikkala 2011].

[6] Loi n° 84-46 du 24 janvier 1984 relative aux établissements de crédit [Law n°84-46 of 24 January 1984 concerning credit institutions], Art. 3.

[7] In France, Art. L. 313-4 of the *Code monétaire et financier* sets out strict rules for computing and disclosing the overall effective interest rate, subject to penal and civil penalties.

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means of a long list of financial instruments capable of extending, by analogy, to virtually any product sold as an investment[8]. The list includes the "investment contract," which in case law has become the functional category *par excellence*: an investment contract comprises any investment of money in a common enterprise, where profits are expected from someone else's efforts[9]. In lawyers' writings, each element of this definition became a ground for distinguishing swaps from securities: swaps were not profit-generating investments, but mere commercial tools for managing risks and reducing funding costs [Gibson 1999: 394], whose success did not rely on a common enterprise or on swap dealers' efforts, but on price movements alone [Klett 1989: 376; Klein 1986]. Their arguments emphasized one function of swaps, the hedging of risk, while ignoring another, yet unanimously recognized in the literature: speculation, which inherently involves an expectation of profits. When considered in context, however, some swaps actually fit quite well with investment contract's open-ended definition and could thus fall under US securities regulation: this is true for most swaps entered into with a speculative intent, motivated by the hope of financial gains for their users. Such characterization would have meant an increased supervision of swap dealers by the Securities and Exchange Commission and additional protections for investors, including a civil remedy against issuers for misrepresentation.

The characterization of swaps as futures contracts was disputed on the basis of similar arguments. US law requires that futures contracts be traded on authorized commodity exchanges, whereas forward contracts, left unregulated, may be traded over the counter. Futures and forwards are not defined legislatively, but courts have differentiated them on a functional basis: the ultimate question for determining if a financial instrument qualifies as a futures is whether it serves substantially the same function as exchange-traded futures, that is, a function of hedging or shifting risks related to price movements, rather than of delaying the actual delivery of a commodity [Klett 1989: 93; Gibson 1999: 403]. Forced to recognize that swaps indeed perform a function of risk management reminiscent of futures contracts, authors who have examined this issue have nevertheless contended that the fact that swaps were traded off-exchange, and only by sophisticated parties, should suffice to characterize them as forward contracts [Klett 1989: 390; Gibson 1999: 406; Henderson 1989]. In an odd rhetorical twist, a reference to

[8] *Securities Act of 1933*, Pub. L. 73-22, 48 Stat. 74, s. 2 (1).

[9] *SEC v. Howey Co.*, 328 US 293, p. 298-299 (US Supreme Court, 1946).

swap participants' quality (their "sophistication") was enough to discard the long-established functional test for futures, and to turn the failure to comply with their regulatory requirements into an additional reason for distinguishing swaps. Assimilated to forward contracts, swaps would continue to trade over the counter, escaping the jurisdiction of the Commodity Futures Trading Commission (CFTC), as well as the provisions of the *Commodity Exchange Act of 1936* promoting transparency and investors' protection[10]. In the United States, this construction was eventually officialized by the *Commodity Futures Modernization Act of 2000*, which provided that as long as swaps were restricted to sophisticated parties, they would exceed the competence of *both* the SEC and the CFTC[11].

Across all jurisdictions, however, the risk that has worried lawyers up to the most recent date was that swaps be characterized as insurance contracts. Insurance embraces any contract whereby a party undertakes, against the payment of a premium, to deliver a performance upon the occurrence of a predefined uncertain event. Insurance contracts may only be offered by authorized insurers, which are subject to administrative scrutiny of their business practices and their solvency. Swaps in general, when marketed as tools for hedging risk, may resemble insurance, but credit default swaps in particular have raised the most challenging questions, as their payment structure nearly duplicates that of an insurance policy: in a typical credit default swap, indeed, a "protection buyer" periodically pays a premium to a "protection seller," whose payment obligations are triggered only upon the occurrence of a predefined "credit event". Against the characterization of swaps as insurance, most authors have stressed their non-compensatory nature, i.e. that contrary to insurance, payments due under a swap did not depend on the payee's loss. In the late 1990s, a more technical version of this argument circulated through an ISDA legal opinion on credit derivatives: that, unlike insurance, credit derivatives did not require protection buyers to have an "insurable interest" [Potts 1997]—which meant that credit default swaps could be used to speculate on someone else's loss. Soon echoed by several authors [e.g. Benton, Devine and Jarvis 1997; Ross and Davies 2001; Schwartz 2007: 189], this reasoning enabled the creation of markets for credit derivatives in Europe, by removing banks' hesitancy as to their

[10] *Commodity Exchange Act of 1936*, Pub. L. 74-675, 49 Stat. 1491, s. 2.

[11] *Commodity Futures Modernization Act of 2000*, Pub. L. 106-554, Appendix E, 114 Stat. 2763. Both agencies recovered some regulatory authority over swaps in 2010, after the financial crisis, with the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. 111-203, 124 Stat. 1376.

capacity to lawfully engage in them [Huault and Rainelli-Weiss 2012]. Yet the fortune of this argument is remarkable, considering that an insurable interest was never, in law, a defining feature of insurance contracts, but rather a public order requirement for their validity: under insurance law, a swap devoid of insurable interest would not be considered as a non-insurance contract, but rather as an insurance contract that is *void* [Kimball-Stanley 2008; Juurikkala 2011].

Through such rhetorical and methodological displacements, financial lawyers have managed to erect swaps as a new class of objects that are incommensurable [Huault and Rainelli-Weiss 2014], and therefore out of reach of prevailing regimes of financial law. By systematically negating the possibility of linking swaps to longer-standing legal institutions, their analyses have stalled the conceptualization needed to develop a sound understanding of this financial innovation in law. Unlike other types of derivatives, however, the unity of swaps as a class of financial products did not hinge on a centralizing institution, like a commodity exchange, nor on an unequivocal relationship to an underlying physical product, like cotton or coal [Huault and Rainelli-Weiss 2012]. It is rather their standard contractual documentation, to which the following section turns, that formed the bedrock of their identity as a distinct class of financial instruments.

The ISDA Master Agreement: abstracting debts from their context

The history of swaps is closely connected to one trade association, the International Swaps and Derivatives Association (ISDA), and its standard contract, the ISDA Master Agreement. The standardization of swaps' legal documentation is at the very root of ISDA as a trade association. Its history began in New York, in 1984, when a dozen investment and commercial banks decided to convene, together with their legal counsels[12], and establish a global standard for swaps [Stoakes

[12] Interestingly, most lawyers involved in these initial meetings later became leading figures in derivatives law: for example, Jeffrey Golden and Daniel Cunningham, from Cravath, Swaine & Moore (appointed special drafting counsel for the group), have been known as ISDA's main attorneys for almost 25 years; Schuyler Henderson, from Mayer, Brown & Platt, authored one of the leading textbooks on the law of financial derivatives [Henderson 2010], and over 50 articles and book chapters on the topic; Gregory Palm, from Sullivan & Cromwell, later joined Goldman Sachs' legal department and was the bank's general counsel (and one of the world's best-paid corporate lawyers) for two decades, until his retirement in 2019.

1985]. ISDA was incorporated at the end of this first round of negotiation, in order to be the official copyright holder of its first *Code of Standard Wording, Assumptions and Provisions for Swaps* (or *SWAPS Code*), published in 1985 [Flanagan 2001: 238]. This is not a trivial point, as it highlights the value that the industry placed on its standard legal documentation, as well as the collective control it intended to maintain over it. ISDA has then ensured the international recognition of its contractual techniques through the dissemination of legal opinions on its Master Agreement's enforceability in over 50 countries, its interventions before courts as *amicus curiae*, and its active lobbying of legislative and regulatory bodies likely to impact its members' interests [Biggins 2012].

Undertaken initially to ease the coordination between swap dealers—so as to reduce transaction costs, as economists would say [Kahan and Klausner 1997]—ISDA's work of contractual standardization soon proved to have a much more fundamental role to play in financial innovation: standardization turned to be the backbone of the commercialization of new financial instruments. To appreciate this, one has to look back to the early 1980s, when every single swap appeared as a unique deal, tailored to each client's specific needs. In the legal literature, the first descriptions of swaps invariably included a description of the client's associated borrowings, which the swap was intended to complement: swaps were not fungible, but firmly embedded in a commercial context. For the lawyers responsible for drafting their terms, these early swaps entailed a considerable amount of negotiation, where each component of the swap agreement had to be perfectly aligned with its underlying financial arrangements, and where both parties sought to cover their position in the event of their counterparty's default before the swap's maturity. According to the lawyers involved, this work was glamorous, exciting, but frustrating: agreements were complex and hard to finalize, deadlines were tight, and clients fought on every detail [Cunningham, Golden and Berry 2005].

The contractual complexity of swaps was depicted humorously in a vignette published in the *International Financial Law Review* in 1984, under the title "The Banker's Lawyer" [Wynne and Cuthbert 1984: 35]. It pictured an imaginary dialogue between a banker and his lawyer, in which the latter constantly had to explain to the former why the seemingly simple swap transaction he was trying to set up actually required a lengthy legal documentation, much more sophisticated than he could have imagined. "You need to cover the mechanics for all the payments." "Have you covered your position in the event of default?" "Yes, but an

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amicable solution may not be achievable…" As the lawyer's warnings went by, the one-page document initially envisioned turned into several dozen pages, much to the banker's dismay!

The sheer complexity of negotiating swap agreements was an obvious obstacle to the development of large markets, which major dealers first tried to overcome by creating their own in-house standard contract. While they simplified the dealings between each dealer bank and its clients, these templates further complicated the interactions between banks, each striving to impose its own model on the other. The resulting "battle of the forms," annoying and costly for all parties involved, impelled the standardization of swap contracts across the industry and the creation of ISDA [Flanagan 2001: 235]. Many observers actually believe that, more than anything else, it is ISDA's work on contractual standardization that enabled the phenomenal growth of swaps markets over the past few decades [Field 2005].

The ISDA Master Agreement, first published in 1992, is at the heart of Annelise Riles' anthropological inquiry into legal reasoning in global financial markets [Riles 2011]. It is one of the most extensive studies of this contract in the social sciences to date, and one of the few contributions to the social study of finance with a specific focus on law. Riles argues, quite rightly, that ISDA's standard contract does not really reflect a set of norms shared by a global financial community, but rather lays down a well-defined routine, thanks to a form that strictly delineates the behavior expected from its users. ISDA's contract is handled like a form to be filled in, rather than a text to be read: it directs contracting parties' attention to its blanks to be completed rather than to its standard terms, to which no one no longer pays any attention. By taking a close look at how ISDA's legal documentation structures the day-to-day work of lawyers in Japanese banks and government, Riles offers a rich insight into the inner workings of financial regulation, emphasizing the shared expertise of private practitioners and bureaucrats. Her depiction, however, leaves the long-term distributional effects of swaps in the shadows and ignores the broader picture of financialization.

I take a more genealogical approach to the ISDA Master Agreement, by uncovering the work, debates and strategies behind its standard contractual provisions. From this angle, the great success of ISDA's legal documentation has been to achieve the commensurability [Espeland and Stevens 1998] of a growing range of financial transactions, which could henceforth be managed on an aggregated basis, irrespective of their particular business context and purpose, and irrespective of the requirements of their local legal environment. Contractual standardization proved crucial for the liquidity of swap markets.

"The code doesn't contemplate fault or no-fault. It simply puts in the formula for the parties to use, which simply produces a number." This is how a bank executive described ISDA's first *SWAPS Code* in 1985 [Stoakes 1985: 14]. Although subsequent versions of ISDA model agreements implicitly reinstated a sense of fault in the swaps contractual regime, through their provisions on events of default, this early description evinces the spirit that has animated the drafters of ISDA's legal documentation ever since: to provide the legal basis for an unequivocal calculation, sparing all notions that could prompt a reasoned debate on the motivations, objectives, or strategies of the parties. A first necessary step to that end was to standardize not the obligational content of swaps, but their vocabulary. The first *SWAPS Code* thus offered a catalogue of definitions of key economic and contractual terms, such as the main reference interest rates or the designations of contracting parties. Normatively modest, it did not claim to govern swaps' entire contractual relationship, but it did intend to fix its main technical parameters.

The ISDA Master Agreement, by contrast, is normatively more ambitious, as it pretends to create a universal legal regime for swaps, applicable across countries and across types of derivative instruments. The Master Agreement is not a stand-alone document, but the centerpiece of a set of contractual pieces that can be assembled to meet the parties' needs. Its universality rests on a principled separation between the legal and economic terms of swaps. Only the former, in their very generality, are included in the Master Agreement, the latter being recorded in distinct documents: the confirmation documents and the definitional booklets, which specify the financial attributes of different types of products, e.g. currency, equity, or credit derivatives. As regards the legal terms of swaps, the Master Agreement distinguishes between terms that are standardized, and terms that are customizable (and thus negotiable), confining the latter to a schedule to the main document. Among the few choices the schedule invites the parties to make, the one with the farthest-reaching legal consequences is unquestionably the choice-of-law clause: the Master Agreement will be governed by either English law or the laws of New York—the schedule provides no other options—and from this choice flows the selection of the courts having jurisdiction to settle eventual disputes in connection with swaps. Considering that virtually all swaps worldwide are governed by an ISDA Master Agreement, it is no exaggeration to say that British and New York courts have actually established themselves as global jurisdictions for

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swaps contracts—as they have for other financial transactions covered by industry-wide standard master agreements, such as securities lending, repurchase agreements, or foreign exchange transactions.

The ISDA Master Agreement is a lengthy document, of about 30 pages, known for its complexity. This complexity stems from the extreme *abstraction* of the rights and obligations stipulated therein. All provisions specifying the nature, timing, and amounts of the monetary exchanges contemplated are indeed missing from this document, which nevertheless anticipates in detail all parameters that could potentially affect a party's ability or willingness to pay the sums expected. After reading a Master Agreement, one has no clue as to which contracting party is bound to pay what to the other, when, or, most importantly, why. Such information, crucial to understanding the nature of a swap, is instead to be found in the confirmation form specific to each transaction—a document that consists mainly in numbers, abbreviations, and calculation formulas, with relatively few words familiar to lawyers. The ISDA Master Agreement instead focuses on three core components, applicable regardless of the particulars of the swaps at hand: a payment obligation subject to a condition precedent, provisions on early termination, and a statement of single agreement.

First, the fundamental obligation of parties to a swap agreement is to make due payments on due dates, subject to a condition precedent that no event of default has occurred in respect of the other party. It follows that once an event of default has occurred, the non-defaulting party may rightfully suspend its own payments. Around this payment obligation, the Master Agreement determines the mechanics of the payments and provides, *inter alia*, for the automatic netting of payments due on the same date in the same currency. Second, on the occurrence of an event of default, the Master Agreement provides a right for the non-defaulting party to terminate the deal and to request the payment of a lump-sum as damages—a contractual technique known as "close-out netting". Definitions of the specific events that may trigger the other party's right of early termination are among the most significant provisions of the Master Agreement and include a party's default of payment, loss of credit support, or bankruptcy, but also changes in applicable law, including taxation, or *force majeure* events. Third, the principle of a master agreement is to serve as an umbrella for multiple transactions. In the ISDA agreement, this is achieved through a single agreement provision, that distinguishes between a derivative "agreement" and a derivative "transaction". While several derivative transactions may take place between the contracting parties and be documented under shorter confirmation forms, the ISDA Master Agreement stipulates that they all form a single agreement. Consequently, a bank and its client may well enter into several swaps over the years, those swaps shall nevertheless be considered, in law, as one indivisible contract.

In short, the ISDA Master Agreement allows the management of several swaps on an aggregated basis, by virtue of the twofold abstraction it imposes on singular swaps: by relying on this standard contract, the parties may overlook the specificities of both their local legal system and the commercial context proper to each transaction. Under a Master Agreement, the occurrence of an event of default for one swap may trigger the early termination of all transactions covered by the contract. The importance of this increases with the number of swaps entered into by the parties, and may become considerable when one party, for example a bank's corporate client, uses swaps for a range of business issues: a misstep on one single issue could jeopardize the firm's strategies on several fronts. By failing to record the concrete determinants of a given swap—such as the client's motives and objectives, or the swap's expected performance—, the ISDA Master Agreement de-singularizes swaps, stripping any single swap from a legal face of its own, and blending it with the bulk of the parties' financial operations. This, in turn, complicates the task of end-users, lawyers, and judges who might be inclined to demand more stringent obligations from swaps dealers.

Swaps in contested terrains: making debts undisputable

On paper, swaps boil down to a series of contractual mechanisms for calculating and securing payments between two parties, disconnected from their commercial context and purpose. Being a pure matter of calculation, swaps bear no discussion: their debts aspire to mathematical purity. The contrast with prior depictions of finance in law is startling: unlike credit operations, securities, futures, or insurance, financial lawyers have successfully crafted a regime for swaps in which the justification for the payments exchanged between two parties is deemed legally irrelevant. In other words, the reason why one has entered into a swap should influence neither their regulatory treatment, nor the content of their obligations.

In practice, however, debts resulting from swaps are sometimes disputed. A global look at swaps litigation since its inception in the 1980s reveals that the reasons underlying swap payments, although not recorded in their legal documentation, remain crucial to their understanding by swap users. Indeed, discord between swap dealers and their clients often arises following circumstances that have upset clients' expectations as to the meaning or usefulness of the monies exchanged under a swap. To take a few examples drawn from case law, a swap designed to complement a loan, so as to reduce its user's overall borrowing costs, may become pointless after the loan's unanticipated cancellation or early repayment; the bank may nonetheless refuse to renegotiate the agreement and insist that the swap be paid in full, despite having lost all utility for its client[13]. Swaps marketed as sophisticated debt management tools for local governments may, once they start generating losses disproportionate with reasonable borrowing fees, prove completely disconnected from the actual debts to be managed, and thus be unsuitable to the clients' needs: such was the case, for instance, in the "toxic loans" affair, which involved numerous public entities in France and in other European countries, sparking considerable public outcry in the wake of the late 2000s financial crisis [Wymeersch 2013; Lagna 2017; Pérignon and Vallée 2017]. Innovative derivative transactions that were touted as winning investment strategies may suddenly generate dramatic losses, turning out to be ruinous for investors[14]—a recurring story in the judicial annals of swaps especially among corporate end-users, which have oftentimes used swaps as a discreet vehicle for speculative investments, in the shadow of "the powerful sunlight that securities regulation shined on other financial instruments" [Partnoy 2009: 46].

When such disillusions arise, swap users naturally seek to reopen the debate regarding the justifications of the payments owed by virtue of the swap. In their disputes with their banks, they have endeavored to cast doubt on the validity of the claims brought against them by invoking various legal issues. Unfortunately for them, their contracts generally offered few resources to do so: thanks to its abstract terms, the ISDA Master Agreement has proven quite impervious to their vicissitudes and disappointments, and the characterization of swaps as *sui generis* financial instruments has precluded investors from pursuing more effective remedies under financial law. Compelled to express their grievances in the general language of contract law, swap users have often had no other choice than to plead the spirit of their contract against its very letter: since the written terms of swap agreements exclusively address the mechanics

[13] E.g. *St. Matthew's Baptist Church v. Wachovia Bank National Association*, n°04-C4540 (New Jersey District Court, 18 May 2005).

[14] E.g. *Proctor & Gamble v. Bankers Trust* [1996] 925 F. Supp. 1270 (District Court Ohio, 9 May 1996).

for calculating and securing payments, their arguments have tended to allege instead a variety of unwritten contextual elements, which might justify deviating from stipulated liabilities. By and large, such arguments have had little traction before the courts.

An analysis of court decisions rendered between 1985 and 2017 suggests a litigation pattern that undoubtedly favored swap dealers, which have won over two out of three cases. Beyond the diversity of the legal issues raised in these proceedings, the success of the arguments deployed depended on the parties' unequal ability to base their claims on the written provisions of their contracts. Overall, swap users that have managed to assert claims grounded on express contractual terms were about as likely to prevail in court as were swap dealers. Those unable to rely on the letter of their contracts, in contrast, were dismissed in over four cases out of five.

Until the mid-2000s, the vast majority of lawsuits brought against swap dealers were of the latter kind. Plaintiffs' allegations were manifold, but only exceptionally referred to a genuine breach of contract [Finnerty and Brown 2001: 151]. They rather pointed to a range of background considerations that underpinned their comprehension of their financial instruments or of their relationship with their bank. For instance, swap users have repeatedly reported that their banks supplied them with false or misleading information, by either lying about the attributes of their derivatives instruments, or by failing to disclose material information[15]. Private law claims of negligent or fraudulent misrepresentation were often made in conjunction with allegations of fraud under securities or futures legislation, which were almost systematically rejected by courts[16]. Substantiating claims of misrepresentation has proven arduous for swap users, since their contracts usually remained silent as to the features of their derivatives products besides their calculation formulas: parties have frequently found themselves embroiled in complex testimonial evidence as to what the banker actually said in his sales pitch and what the client could reasonably infer from it, a process in which banks' witnesses were often deemed more credible than their clients' counterparts[17].

[15] E.g. *Korea Life Insurance v. Morgan Guaranty Trust Company of New York* [2003] 269 F. Supp. 2nd 424 (Southern District of New York); *Cassa di Risparmio della Repubblica di San Marino SpA v. Barclays Bank* [2011] EWHC 484 (UK); Bundesgerichtshof (German federal court), 22 March 2011, BGH, XI ZR 33/10, Ille Papier Services GmbH c/ Deutsche Bank.

[16] E.g. *Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes v. Salomon Brothers* [1996] 928 F. Supp. 398 (Southern District of New York).

[17] E.g. *Bankers Trust v. Dharmala* [1996] CLC 518 (Queen's Bench Division, Commercial Court, UK: 35-36).

In another vein, swap users have recurrently alleged their inability to engage in the impugned swap agreements: those agreements were *ultra vires*, they argued, meaning that they exceeded their organization's power to bind itself contractually, or that they were signed by an individual lacking the authority to bind the organization. Variations of such arguments were raised, with some success, in disputes between banks and local authorities[18], but also, less convincingly, between banks and various enterprises, public[19] or private[20]. In such cases, swap users have sought to assert, against the express terms of their agreement, their specificity as contracting parties: rather than generic contractors, they were organizations accountable to a host of stakeholders, embedded in a web of rules designed to protect multiple interests, not limited to their banks'.

A third type of argument frequently advanced by swap users concerned the breach of their banks' fiduciary duties: clients trusted their banks to advise them on products suitable to their needs, free of conflicts of interests, and their banks took advantage of that trust[21]. Through these allegations, swap users pleaded the existence, beneath their swaps' legal documentation, of a long-term relationship with their bank, based on the expertise of the latter and their confidence in it. Courts have generally been reluctant to recognize such relationships in a business context, adhering to the old principle of *caveat emptor*—let the buyer beware—and leaving it up to swap users to check the appropriateness of their banks' commercial offers.

Last but not least, swap users have occasionally attempted to cite the reasons for entering their swap agreements as a ground for cancelling their commitments. Their swaps, they claimed, were concluded either for illegal or fraudulent reasons—for example, to circumvent the law[22] or to deceive a third party[23]—or for no reason at all, being a pure gamble, or having lost their *raison d'être* due to unforeseen events[24]. In all cases, they contended that the courts should refuse to enforce such contracts which

[18] E.g. *Hazell v. Hammersmith and Fulham London Borough Council* [1992] 2 AC 1 (House of Lords, UK).

[19] E.g. *Banco Santander Totta v. Companhia De Carris De Ferro De Lisboa SA & Ors* [2016] EWHC 465 (Queen's Bench Division, Commercial Court, UK).

[20] E.g. *Standard Chartered Bank v. Ceylon Petroleum Corporation* [2012] EWCA Civ 1049 (Court of Appeal, Civil Division, UK).

[21] E.g. *Republic National Bank v. Hale*, [2000] 75 F. Supp. 2d (Southern District of New York).

[22] E.g. *Lehman Brothers Commercial v. Minmetals International* [2000] 179 F. Supp. 2nd 118 (Southern District of New York).

[23] E.g. *Mohonia v. JP Morgan Chase* [2004] EWHC 1938 (Queen's Bench Division, Commercial Court, UK).

[24] E.g. *Banco Santander Totta v. Companhia De Carris De Ferro De Lisboa SA & Ors*, [2016] EWHC 465 (Queen's Bench Division, Commercial Court, UK).

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were devoid of legitimate cause. Courts have rarely granted these requests.

By the end of the 2000s, lawsuits filed against swap dealers had partly shifted strategy: claims based on the spirit of swap agreements, which had proven fairly ineffective, gradually gave way to arguments more firmly rooted in the letter of the ISDA Master Agreement. Swap users have been more successful when they relied on written contractual terms—they have won almost one out of two cases—although in rather unusual circumstances. Litigation that followed the 2007-2008 financial crisis indeed involved several cases of default by swap dealers, where swap users were suddenly in a position to put forward arguments typically advanced by their banks: that swaps' calculations are undisputable, that no circumstances warrant revising them, and that the contractual rights of non-defaulting parties must be respected[25]. In fact, between 2008 and 2017, nearly four out of five disputes based on swaps' contractual provisions were settled in favor of the non-defaulting party—a markedly pro-creditor jurisprudence that promises to benefit swap dealers on the long run.

This overview of swap users' attempts to challenge the debts they felt to be abusive or prejudicial confirms that swaps' contractual documentation has effectively removed from judicial scrutiny a number of considerations essential to a rich understanding of the socio-economic relationship between a swap dealer and its client. Long-term relationships of trust or occasional trading of risk, sophisticated dealings made at arm's length or asymmetrical interactions between experts and amateurs: such portrayals of swaps convey different senses of justice, likely to influence judicial outcomes. By discarding all contextual elements that would promote a rebalancing of the parties' obligations, legal documents reduce swaps to a one-dimensional relationship, where all that ultimately matters is that everyone properly pays their debts.

Before concluding, the reader may wonder how swap markets have evolved after the crash of 2007-2008. In the midst of the turmoil, indeed, swaps were quickly named among the culprits, and several measures were adopted to better regulate their markets: mandatory use of clearing houses for certain swaps, an increased role for new trading platforms, mandatory disclosure to trade repositories, etc. While an in-depth discussion of swaps' post-crisis regulatory framework is beyond the scope of

[25] E.g. *Lomas v. JFB Firth Rixson et al.*, [2012] EWCA Civ 419 (Court of Appeal, Civil Division, UK).

this article[26], suffice it to say here that those reforms were largely premised on the legal narrative, conceptualization, and documentation previously crafted by bankers' lawyers [Braithwaite 2011]. They have therefore not significantly altered the balance of power between swap dealers and end-users, which was the focus of this article.

Conclusion

By tracing the legal history of swap agreements and of their markets, this article has sought to investigate law's contribution to contemporary practices of financial abstraction. The law it observed turned out to be more decentralized and more subtle than in prevalent accounts of law: instead of an official body of rules promulgated by states and enforced by courts, it found dispersed knowledge practices aimed at setting terminology, standardizing contracts, characterizing products, and asserting claims, which together have shaped, incrementally, the global law of derivatives. "Law is less a tool than a raw material to be worked upon," wrote legal sociologist Doreen McBarnet [1984: 238] over 35 years ago. Lawyers innovate by creating new legal forms, and by putting old ones to new uses. Lawyers have long exercised their craft on behalf of the wealthy, by applying a variety of legal techniques to shield their land and other assets from reversals of fortunes—or, to borrow Katharina Pistor's words, by using the legal code to turn these assets into capital [Pistor 2019].

In the case of swaps, the bankers' lawyers' efforts were captured in standard legal documents, which acted as powerful framing devices for their financial commitments. Legal documents lie at the heart of financial lawyers' practices of categorization, as they record and disseminate the cognitive operations by which lawyers produce both similarities and distinctions among their clients' financial liabilities. As this research found, legal documents have served as a means of financial abstraction in three key respects. First, they have directly contributed to disembedding swaps from their regulatory environment. By forging a shared legal identity for swaps regardless of their various uses and purposes, innovative contractual techniques have undermined the functional approach

[26] For an overview of swaps' post-crisis regulation, see Murphy [2013] and Helleiner, Pagliari and Spagna [2018]. Overall, these reforms have received a mixed assessment, and their implementation has been marked by delays, inconsistencies, and fragmentation between countries.

hitherto relied upon in financial law. Lawyers were able to invoke the versatility of swaps to throw doubt on the relevance of established criteria for identifying banking operations, securities, futures, or insurance policies. As a result, swaps have eventually emerged as financial instruments of their own kind, escaping the principal regulatory regimes inherited from the financial crisis of the 1930s, along with the political compromises they embodied as to the distribution of risk and wealth in industrial society. In this sense, legal documents have shown themselves to be formidable tools of deregulation, at once discreet and effective.

Swaps' legal documents have also been a means of financial abstraction in a second sense: their standardization was the cornerstone of a process of commensuration that allowed swaps to stand as a unified category. In line with insights from the social studies of finance, legal documents were used to objectify swaps as a class of financial instruments, thanks to a contractual architecture geared to the clear-cut calculation of payable sums, extricated from a rich socio-economic reality inevitably open to competing interpretations. The ISDA Master Agreement has severed swap transactions from their meaning and context, while aggregating their debts into a single arrangement, comparable to other derivatives instruments on the market. Legal documents have thus made swaps calculable and fungible—in a word, they have made swaps financializable.

Lastly, legal documents have turned out to be a means of financial abstraction in a third way: they have fostered around swaps a judicial reasoning blind to the context of financial transactions, which has led to an adjudication process especially unforgiving for swap users. The latter have seen their ability to effectively advocate their own needs and expectations with respect to their swaps sharply reduced when compared to other kinds of financial arrangements. This violence against the particular may be seen as the dark side of commensuration: as Espeland and Stevens [1998: 317] pointed out, "[e]veryday experience, practical reasoning, and empathetic identification become increasingly irrelevant bases for judgment as context is stripped away and relationships become more abstractly represented by numbers." This finding is consistent with other studies on the contemporary politics of debt, which suggest a global strengthening of creditors' position vis-à-vis debtors over the past few decades [Graeber 2014; Lemoine 2017; Krippner 2011]. The indisputability of debts incurred under swaps' standard legal documents has allowed banks to harden their attitude towards their clients. Banks were able, on the one hand, to disengage from swap users' misfortunes, even when they had directly contributed to them; their own use of derivatives (especially credit derivatives), on the other hand, has partially insulated them from the adverse consequences of their borrowers' defaults, making banks less committed to supervising their borrowers' business projects and less inclined to renegotiate their terms when they face even minor difficulties [Tung 2009].

As Katharina Pistor noted, "law and finance stand in an uneasy, paradoxical relation to one another" [2013: 323]. Finance needs the legal certainty that law lends to its numerous instruments, but could not sustain the strict enforcement of all past commitments when circumstances change and crisis looms. The global financial system thus intertwines contractual commitments of differing textures, which tend to be distributed hierarchically: rigid at its base, obligations become more flexible as one gets closer to the top (i.e. the lender of last resort) [Mehrling 2013]. The analysis conducted in this article indicates that swap agreements figure among the means deployed by the world's largest financial institutions—with the help of their lawyers—to increase their share of legal certainty, at the expense of the market participants below them and, presumably, at the expense of the stability of the entire financial system. It suggests, against conventional wisdom, that an appropriate legal regime for finance should permit a reasoned distinction between circumstances in which debts must be honored, and circumstances in which debts may rightly be relaxed, restructured, or even cancelled.

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