Regulatory Competition in Contract Law and Dispute Resolution

von
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of uniform interpretation of its provisions in all the different European national jurisdictions. Standard form contracts struggle to achieve such a demand for autonomous interpretation other than by ever-greater specificity and the use of boilerplate that has to some extent developed a standardized and accepted meaning in the international legal community.[40] But standard form contracts can rely upon specialized arbitration schemes in an attempt to realize the goal of autonomous and therefore uniform interpretation. In many respects, therefore, the proposed Common European Sales Law is not so much a Code as a standard form contract, and for this reason, despite its pretensions to be a Code, assuming that it can be enacted within the competences of the European Union,[41] the Regulation has a small chance of success. It must be questioned, however, whether this regulatory technique is appropriate for consumer transactions, where there is a greater risk of strategic choice of law decisions by businesses that are designed to circumvent protections established by national law.

This example of the proposed European regulation on consumer sales only goes to show how the rigid distinction so frequently drawn between law in the form of national legal systems and standard form contracts slowly disappears as you watch it, like the vanishing froth on the top of a tankard of beer. Because so much of contract law functions as default rules rather than mandatory rules, the crucial part of the law that governs contracts must be the normative system that supplies those default rules. Once framework agreements are perceived to function as the customary default rules that govern a particular sector of trade, they cannot be sharply distinguished in practice from the official national laws of contract. For businesses engaged in international trade, there is an evident pattern of preferring to write their own default rules, tailored to the particular kinds of transactions involved in their business affairs. To make these rules of the framework agreement legally effective within national legal orders, they have to be presented as terms that have been incorporated into particular agreements. But though national legal orders insist upon regarding such framework agreements as mere terms of contracts, for they are committed only to the mutual recognition of state power under the Westphalian system of international order, this rigid perspective should not disguise the fact that the framework agreement does provide the effective regulatory framework for transactions in a particular international business sector. If national law tries to supply its own default rules, they are unlikely to be used, as in the example of the German Marine Insurance Conditions.[42] The framework agreement is the effective governing norm, because it has been chosen in preference to the default rules of nation states and is accepted as binding and authoritative by the participants in the market.

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[40] For a fascinating examination of standard English boilerplate used in contracts governed by a different choice of law, see: *Cordero-Moss (ed.)* (2011).

[41] *Sensburg* (2012).

[42] *Basedow* (fn. 28), 716.

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Private Production of Transnational Regulation through Standard Form Contracts

Thomas Ackermann

In his paper, Hugh Collins puts forward an idea that can best be summarized by using his own words: "In international business transactions the process of regulatory competition has led to the rejection of state law in favor of private transnational law-making in the form of standardized contracts."[1] This idea breaks down into two elements which I will address separately in this comment. Firstly, it is acknowledged by Collins that a process of regulatory competition exists in international business transactions. Secondly, he claims that this process leads to a rejection of state law in favor of non-state law in the form of standardized contracts. In my comment, I will address both elements of his central idea in turn.

I. The Existence of Regulatory Competition in International Business Transactions

Whenever the existence or non-existence of regulatory competition is at stake, it is important to know what we are looking for. In a nutshell, advocates of regulatory competition take the view that the law is shaped by a process in which

- a demand side and a supply side can be identified,
- decisions on the demand side and decisions on the supply side mutually affect each other, and
- an efficient equilibrium results.

The empirical claim that such a process can not only be observed in markets for ordinary goods and services, but also in the area of legal rules is generally associated with a positive normative assessment of efficient outcomes. Leaving aside this normative aspect for a moment, the central question is whether and how such a competitive process can be identified at all.

Let me first strike a cautious note on this issue. In the field of competition law, it is part of the regular business of authorities and courts to examine whether a given market is in effect competitive or not. Even where ordinary products are involved, and where extensive information on the quantity and quality of goods, the prices paid, the market shares of participants, the existence of potential competitors etc. is available, it is often hard to tell whether competition prevails. A nice example that illustrates this point is the German fuel market. Presently, it is hotly debated whether there is competition in this market or whether the five leading suppliers

[1] *Collins*, *supra* II.

collectively enjoy a dominant position that allows them to extract monopoly rents from consumers. The German Federal Cartel Office (FCO) made a sector inquiry that covered all market levels of the oil sector from the production to the retail level.[2] In order to reconstruct price developments on the retail level, the FCO collected and evaluated more than 3 million data points. An econometric analysis of this database led economists to the conclusion that the price fluctuations on the retail level of the German fuel market consistently followed the pattern of a so-called Edgeworth cycle, which is in line with a model developed by Jean Tirole and Eric Maskin in 1988.[3] However, while the economists agreed on the existence of such an astonishingly stable pattern, they did not agree on the decisive question whether these fluctuating prices are on average monopoly prices or competitive prices. This example shows that even if we know a lot about the interaction of supply and demand in a given market, it can be very hard to tell if this interaction leads to the efficient outcome that is regarded as a characteristic of effective competition. Considering the interaction between supply and demand in the area of law, our empirical basis is nowhere near the level of our knowledge about markets for ordinary products such as the fuel market. Therefore, we should be very careful and not jump to conclusions about the existence or non-existence of law markets in which competitive forces shape legal rules towards efficiency. Despite recent surveys on choice of law in international business transactions,[4] it still seems rather doubtful whether we know enough about the behavior of private and public actors in this area in order to tell whether this amounts to a competitive process.

However, a glance at the way competition works in markets for ordinary products does not only remind us of the ubiquitous problem of identifying effective competition, but also allows us to reject two common objections against the paradigm of regulatory competition as such.

The first objection relates to the supply side of regulatory competition. It is based on the observation that states do not demand a price for the use of the legal rules they supply to private parties so that they apparently lack an incentive to respond to customer preferences. Enforcement before a state court may have to be paid for, but not the choice of the rules supplied by the state. While this observation is of course correct, the underlying assumption that competition always requires an exchange of goods for a price paid by the recipients of the goods is false. Markets work in a much more sophisticated manner if products are inter-related so that network effects have to be considered. This is dealt with in the theory of two-sided markets.[5] The characteristic feature of two-sided markets is a division between two products with separate, but inter-related demand. There is one group of customers to whom the supplier gives away product A for free. Due to the increased distribution of product A to this group of customers, demand for a related product B offered by the same supplier will increase. The supplier will then be able to demand higher prices for product B and thus maximize the joint profit from products A and B. Google or free TV are typical examples of two-sided markets: while consumers can use the

[2] For an English summary, see http://www.bundeskartellamt.de/wEnglisch/Publications/sector_inquiriesW3DnavidW2654.php (last visited 10 July 2012).

[3] *Maskin/Tirole* (1988).

[4] *Cf* the contribution by *Vogenauer* (in this volume, Ch. 9).

[5] *Cf* e. g. *Rochet/Tirole* (2003); *Weyl* (2010).

search engine or watch the program for free, advertisers are charged a price, and this price increases with the number of consumers who make use of the gratuitous service. If states provide parties of international business transactions with contract laws, their position is similar. The more successful a particular contract law is, the higher will be the demand for legal services with regard to this contract law. Even if these services are not offered by the state itself, the state benefits from them as they generally generate taxable income (and higher voter satisfaction). This is an incentive that can clearly influence the formation of contract law.

The second objection relates to the demand side of the law market. Regarding international business transactions, it is beyond dispute that parties often do not care very much about choice of law issues. Herbert Kronke aptly described this phenomenon as "champagne-hour syndrome": in contract negotiations, the insertion of a choice of law clause is regularly left to the "cleaning up" by lawyers in the back-office, while the businessmen are celebrating in the front-room.[6] If this is true and parties are ordinarily not very sensitive to the differences between contract laws offered to them by states worldwide, one may think that there is no sufficient pressure by the demand side on the supply side of the law market in order to make suppliers adapt to the preferences of customers. However, this conclusion is flawed. Again, it is helpful to look at competition in markets for ordinary products in order to clarify this point. If we take the price as an exemplary parameter set by a supplier, the success of a price increase depends on the question whether there is a group of marginal customers who will stop buying the product from the supplier in case of a price increase and who is big enough to make the price increase unprofitable. It is important to note that it does neither take all nor even the majority of customers in order to achieve this disciplinary effect. Even if marginal customers only form a rather small fraction of the customer base, their imminent exit as a reaction to a planned price increase is sufficient to prevent this measure if this reaction renders the price increase unprofitable. This can be translated to the world of regulatory competition in the sphere of international business transactions: whether the demand side exerts influence on the supply side in order to induce a market process does not depend on the (non-) sensitivity of the average or even most parties towards choice-of-law issues. Even if there is only a small group of sophisticated parties who make a deliberate choice-of-law decision depending on the quality of the contract law, they are sufficient to induce a market process if a state is ready to react to a non-choice of its contract law by adapting its provisions to the preferences of this group.

II. Regulatory Competition Between State Law and Non-State Law

Let us assume that a law market in international business transactions is not only feasible, but that it actually exists. Then the next issue is the definition of the product market: can it be said to include not only state law, but also non-state law? It seems plausible that the answer is yes. Contract law satisfies the demand for stabilization of individual market transactions by a normative order that prevents opportunism and provides for contingencies. If seen from this perspective, state orders and non-state orders are interchangeable if they provide the stability

[6] *Kronke* (2000), p. 390.

required by the parties. In other words, they can be said to belong to the same market in which they compete with each other. However, I am not sure whether state law has really lost this competition to non-state law. Regarding transnational law-making in the form of standardized contracts, there are surely impressive examples mentioned by Hugh Collins and also by Dan Wielsch.[7] But what is still lacking is a complete survey of contract practice in the sectors where standardized contracts are available. Can FIDIC contracts, for example, be said to have displaced state laws in international construction contracts? Or do private standard forms and state laws co-exist or even complement each other? In order to answer these questions, more evidence is needed, which, admittedly, is very hard to get. Moreover, it seems that private standardization is still far from being a universally applied technique in international business transactions. There are reasons to believe that private standardization can only succeed under specific conditions, such as a certain degree of homogeneity of interests on both sides of a market, which may not be met in all sectors of international trade. If this is true, state laws will always be able to defend a considerable share of the market for international business transactions against the onslaught of private law-making in the form of standardized contracts.

Apart from this empirical issue, the idea of private law-making gaining ground against state law has a normative ring that needs to be discussed. Private lawmakers appear to break a state monopoly in the production of contract law, and as in any David and Goliath narrative, it seems to be clear for which side we keep our fingers crossed. But I think it is far from evident whether the monopolization of the production of law by the modern state really deserves to be condemned. At least, quite the opposite was true when states took over the legislative power to regulate business transactions from guilds and similar organizations which used this power as a means of controlling trade and erecting barriers to entry.[8] This was a way to create free commerce and therefore not a bad thing at all. If the state monopoly is breaking up again after a relatively short period of history, this may be welcome if the problem it was meant to solve has gone away. On the other hand, privatized systems may again function as barriers to entry or, if they are controlled by one side of the market, as a means to exploit the other side of the market. If this is true (which cannot be explored in this comment), we should be glad about the state remaining in ultimate control of the legal regulation of business transactions.

The answer to this normative question is decisive for the assessment of possible reactions of the state to private law-making. On the one hand, if private law-making in the form of standardization has exclusionary or exploitative effects, a state intervention is called for (for which antitrust law provides the means). On the other hand, if standardization is just serving the interests of the parties involved without having pernicious side effects, states may just be content that they are spared the effort of producing rules that fit with the parties' preferences. Indeed, I agree with Hugh Collins that this insight is a welcome antidote against the obsession of many private law scholars with contract codes: as far as default rules are concerned, codes may not be as important as their drafters think. States may even lend their support to private law-making by sponsoring organizations performing this task or by

[7] *Wielsch* (in this volume, Ch. 5).
[8] See *Berman* (1983), pp. 333 et seq.

providing enforcement structures. Finally, states may try to imitate private standardization by offering optional standardized contracts if markets fail to produce these contracts.[9] However, exploring these options would go beyond the scope of this comment.

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[9] *Cf Ackermann* (2013).