Global Law's Toolbox: Private Regulation by Standards

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Global Law's Toolbox: Private Regulation by Standards†

The idea to conceive of "law as a product" is usually linked to regulatory competition among states that strive to make their legal systems more responsive to the needs of private actors. From a societal perspective, however, the regulatory activities of the nation states themselves seem to be driven by the logics of globally operating social systems. If societal differentiation is regarded as the ultimate driving force of legal evolution, the distinction between public and private lawmaking loses its relevance. There is no reason then to exclude private regulation from an analysis of how well a normative order reflects the preferences of parties. Privately crafted legal regimes often build on models of standard contract terms (SCT) that are highly responsive to the specific rationality of whole sectors of business. The public dimension of such multifirm contract standardization is significant as it substitutes for either inflexible or parochial state law, regulates markets instead of being regulated by markets, and quite often affects third parties.

As these private normative orders continue to rely on linking to national legal systems, they face diverging national conditions for recognition. In consequence, we should develop a comparative law of the public rules of recognition for private regimes. Such an approach is specifically interested in the linking performance of different jurisdictions in relation to private regimes. It has to proceed stereoscopic, i.e., it has to take into account both the territorially and the functional differentiation of law. On one side, it has to look at different social sectors developing their specific functional rationalities and their specific normativities. On the other side, it has to analyze differences between national laws in their capacity and flexibility to recognize those private regimes. This Article exemplifies a "comparative law

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squared" by analyzing privately crafted regimes in the fields of construction law, financial law, and intellectual property (IP) law.

One of the main conclusions is that the legal order of the state itself becomes transformed in contact with collectively applied private rules, and vice versa. To the extent private legal regimes internally provide for diversity of perspectives and impartiality of rulemaking state law has reason to reconsider its own standards of recognition for such forms of private lawmaking. With a view to the issue of regulatory competition it follows that the attractiveness of a forum depends, inter alia, *on a state's flexibility to accommodate private regulation based on model SCT. From a broader perspective, the Article argues that the public side of private legal regimes has to be taken seriously.*

I. INTRODUCTION

Competition for law products is usually defined as regulatory competition among countries for a subset of national legal rules for the use of private parties to govern their relationships.[1] The focus, then, is on nation states as actors that manage the legal order within their respective territories to achieve comparative advantages *vis-à-vis* the economies of other states. Yet, explanatory power of this approach regarding legal evolution is limited by the combination of methodological individualism and methodological nationalism: individual private actors select from a public menu according to the logic of rational choice, but at the center of policy dynamics the states remain as sovereign units.[2]

From a perspective of functionality, which sees law as a social institution controlling cooperative behavior,[3] however, there is no reason to exclude phenomena of private regulation from an analysis of rule sets deliberately created to reflect the normative preferences of private business. If the idea of a market for "law as a product" is

1. Among the rapidly growing literature, see HORST EIDENMÜLLER, THE TRANSNATIONAL LAW MARKET, REGULATORY COMPETITION, AND TRANSNATIONAL CORPORATIONS (2010, *available at* http://ssrn.com/abstract=1681982); EVA-MARIA KIENINGER, WETTBEWERB DER PRIVATRECHTSORDNUNGEN IM EUROPÄISCHEN BINNENMARKT 105, 275 (2002); Klaus Heine & Wolfgang Kerber, *European Corporate Laws, Regulatory Competition and Path Dependence*, 13 EUROP. J. L. ECON. 47 (2002) and—pioneering—Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L., ECON., ORG. 225 (1985).

2. For a critique of methodological nationalism, *cf.* Diane L. Stone, *Transfer Agents and Global Networks in the 'Transnationalization' of Policy*, 11 J. EUR. PUBLIC POLICY 545, 549 (2004), and, for a more comprehensive account, *cf.* DANIEL CHERNILO, A SOCIAL THEORY OF THE NATION-STATE: THE POLITICAL FORMS OF MODERNITY BEYOND METHODOLOGICAL NATIONALISM 9 (2007). For a brief sketch of methodological individualism, see Kenneth J. Arrow, *Methodological Individualism and Social Knowledge*, 84 AMER. ECON. REV. 1 (1994).

3. On the merits as well as the shortcomings of such an approach, *cf.* Gralf-Peter Calliess & Moritz Renner, *Between Law and Social Norms: The Evolution of Global Governance*, 22 RATIO IURIS 260, 262 (2009).

viewed as a metaphor for setting up legal rules with the intention of prompting international private actors to have their transactions voluntarily governed by this legal regime (e.g., by means of choice of law clauses), then the international market should not only consider state-made law but should also include normative orders crafted by private entities. Key actors in processes of societal lawmaking are multinational corporations, non-governmental organizations, consulting firms, law firms, and financial institutions that take part in the creation of normative regimes highly sensitive to the operational logic of certain business sectors and industries.

This sector-specific lawmaking indicates a shift in the development of legal systems from territorial to global functional fragmentation. Whereas initially, transnational forms of private regulation were a response to local normative fragmentation (especially in the form of market regulation by states), today, multiple public and private regulators compete for business and legitimacy of sector-specific regulation in the transnational sphere,[4] changing the form of legal fragmentation.[5] Moreover, if analysis concentrates on the peculiarities of governance in the global sphere, national regulation that dresses up for the needs of international business may be viewed as a manifestation of law-production according to the imperatives of global functional systems. From this perspective, regulatory competition does not reinforce the coupling of law to the nation state but rather appears to move in the direction of de-nationalization of law. Regulatory activities of nation states can themselves be regarded as driven by the logics of globally operating social systems. Thus societal differentiation is at the heart of law production. If this is the ultimate driving force of legal evolution, the distinction between public and private lawmaking must be reconsidered.

Replacing a statist with a societal perspective does not imply a marginalization of the state. Instead, it draws attention to the fact that private normative orders face diverging conditions for recognition in different states. As a consequence, the success of states in the law market depends on how responsive a particular state law is to instances of private regulation. This also encompasses private orders that become binding on parties beyond those who formally make the agreement, and that thereby have a general effect at least on actors in the targeted sector.

Private regulation includes numerous sector-specific normative orders that are established with the help of a wide range of legal instruments. For present purposes, the focus will be on contractual

4. *Cf. also* Jacco Bomhoff & Anne Meuwese, *The Meta-Regulation of Transnational Private Regulation*, 38 J. L. & Soc. 138, 139 (2011).

5. Fabrizio Cafaggi, *New Foundations of Transnational Private Regulation*, 38 J. Law & Soc. 20, 26 (2011).

regimes built on models of standard contract terms (SCTs). Beyond situations in which SCTs are used by a single entity, a second layer of standards is added when multiple entities acting in the same sector all use the same SCTs. This "multifirm contract standardization" is effected by trade associations or other centralized standard-setting organizations through collective agreement on a standard contract, sometimes involving public agencies.[6] In light of the suggested two-pronged change of perspective on lawmaking—from statist to societal and from territorial to functional—these standards appear as powerful tools for legal regulation at the global level: they form contracts similar to public regulation. In a way they become substitute statutes in the transnational sphere.

Contractual regimes embodying sector-wide normativities have a significant public dimension, which states cannot afford to ignore. Mass contracting is a key factor in transferring sovereign functions to private actors. Standardization not only affects individual rights somewhat in a manner equivalent to legislation but also opens up new avenues for enforcement of contracts by private actors themselves.[7] The aggregation of bilateral normativity causes new risks and requires new forms of monitoring.[8] This is particularly true since the high social impact of this form of private order seems to stand in contrast with its seemingly low level of legitimation: although multifirm SCTs may have effects "as if" they were statutes, they lack the procedural and substantive legitimation of "real" statutes that become binding only by passing the democratic process and by complying with fundamental rights. As these requirements are absent in the case of self-ordering in a particular social sector, the legitimacy of the outcomes of such processes is in doubt, "because they are self-imposed by the relevant power holders and power brokers—and thus open to challenges from all those not participating in the process, but subject to their decisions."[9] This general legitimacy problem of private regulation—asymmetric representation that may favor the particular interests of rule-makers at the expense of third

6. *Cf.* Mark R. Patterson, *Standardization of Standard-Form Contracts*, 52 WM. & MARY L. REV 327, 332-33 (2010).

7. This is quite obvious in the digital environment: ICANN's UDRP proceedings are conducted before private arbitration panels whose decisions are immediately enforced through registrars that may delete, transfer or otherwise change a registered domain name, *cf.* sec. 3(c) UDRP. Another case in point is software for Digital Rights Management that allows copyright holders to enforce license terms against users irrespective of access granted to users by legislation. However, examples can also be drawn from other fields of law. In financial law, the technique of collateralization gives swap counterparties a self-help mechanism that allows to resolve disputes bypassing the priority systems of national bankruptcy law, *cf.* ANNELISE RILES, COLLATERAL KNOWLEDGE 41 (2011).

8. *E.g.*, in the market for credit derivatives, *cf. infra* II.*B*.

9. *Cf.* Andreas L. Paulus, *Comment: The Legitimacy of International Law and the Role of the State*, 25 MICH. J. INT'L. L. 1047, 1048-49 (2004).

parties and common interest—becomes especially virulent where the private regulatory regime in question allows by-passing a state's legal subsystem designed to protect the interests of such third parties.[10] Legitimacy concerns also emerge, however, under standards whose role it is to specialize in the justification of private action.

From the perspective of private law doctrine, the idea of viewing law-as-product was foreshadowed by the discussion of mass adhesion contracts. Under the prominent "contract-as-product" theory, contracts form part of the product, economically inseparable from the collection of functional components that comprise the product proper, and not a separate textual artifact constituting an agreement about the product.[11] To the extent that standardization reifies a contract, it becomes less convincing to frame it as a manifestation of will. With pressure bearing down on liberal will-theory, the traditional normative underpinning of private ordering is rendered problematic—not to mention that extensive third-party effects challenge the principle of privity of contract as well as the legitimation rule it contains for private action.

Viewed from the perspective of law and economics, the standard-setting contracts create network effects, that is to say they have a bearing on the value parties attribute to a particular product simply because more people use it. These network effects include, but are not limited to, information benefits and a higher degree of legal certainty in relation to the content and meaning of the contract.[12] As a result, the contract is then changed from a tool for internalizing costs and benefits to a catalyst of externalities.[13] The presence of network externalities thus puts strong limitations on what is commonly referred to as the *Coase Theorem*. The *Coase Theorem* presupposes a world with zero transaction costs and pertains to trade in externalities, that is to say, costs or benefits that are not transmitted through prices. Specifically, it states that in this particular context, bargaining will lead to an efficient outcome regardless of how property rights are initially allocated or divided. The mere presence of network advantages, however, can make any contract term self-enforcing even if it is so-

10. Again, see RILES, *supra* note 7, on the power of collateralization as part of transactions based on the ISDA Master Agreement. Another example is the creation of an alternative copyright regime through the proposed Google Book Settlement Agreement, see *infra* II.C.

11. *Cf.* Margaret J. Radin, *Form Contracts and the Problem of Consumer Information*, 167 J. INST. & THEORETICAL. ECON. 49, 51 (2011).

12. A comprehensive analysis of network externalities flowing from standardized contracts provides Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 774-89 (1995).

13. *Cf.* Michael Adams, *Norms, Standards, Rights*, 12 EUROPE J. POLIT. ECONOMY 363, 373 (1996).

cially suboptimal.[14] Contracts with network externalities therefore do not require that the terms be efficient since they will prevail over alternatives in any case once they are adopted as a standard. Welfare can only become optimal if the bargain manages to dispose of the standard; if instead the standard rules the bargain, then that rationality is no longer guaranteed.

From the perspective of competition policy, standardization exerts a strong market regulatory function.[15] Even if the agreed-upon terms of the contract are fair and reasonable in themselves, they may be undesirable because the standard contract can eliminate competition among reasonable terms.[16] In short: sector-wide standardization can regulate markets instead of being regulated by markets. This market regulatory effect and the way it is achieved by means of agreement among the relevant market players needs to be scrutinized especially under the aspect of competition law. Thus, the normative coercion of the standard not only compromises the efficiency of the individual bargain, it also encroaches on the regulatory power of the market.

Yet, the quasi-statutory effects of private regimes based on model SCTs may themselves be a reason that supports their legitimacy. Comprehensive private regimes can substitute state law where the latter is either inflexible, parochial, or (currently) non-existent.[17] Here, private regulation steps in with its quasi-public function. It takes up the challenge to regulate a vast array of business relations while it is, at the same time, highly responsive to the sector-specific rationality of interaction. Especially under conditions of globalization where legal relations have a variety of non-territorial affiliations (so that imposition of community norms on a dispute with links to other communities becomes pretentious) and where private actors may even be in the position to evade national regulation (so that sovereignty becomes simply ineffective), it can be in the very interest of the state that transnational private regulation gains traction. In a globalized world, nation states may find it useful to "consider a broader set of governmental interests in being part of an interlocking world system of transnational regulation and multiple community affiliation."[18]

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14. *Cf.* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 729-36 (1997), discussing the potential for the suboptimality of terms in contracts based on the effects of network externalities.

15. *Cf.* HUGH COLLINS, REGULATING CONTRACTS 56 (1999).

16. For details, *cf.* Patterson, *supra* note 6, at 334.

17. See examples *infra* II.*A* (VOB/B, FIDIC), II.*B* (ISDA Master Agreement), II.*C* (Google Books and "orphan works").

18. *Cf.* Paul S. Berman, *Towards a Cosmopolitan Vision of Conflict of Laws: Redefining Governmental Interests in a Global Era*, 153 U. PA. L. REV. 1819, 1852 (2005), (discussing an adequate vision of conflict of laws in a global world).

Moreover, private regulatory regimes may well be able to back up their extensive regulatory impact with a normativity richer than that of the usual standard contracts—with the consequence that state law has reason to take their claims to validity seriously. If the process of standardization is open and the resulting norms reflect public interests, private regulation becomes justifiable in the legal forum of the state.

Ultimately, the emergence of contractual regimes embodying sector-specific normativity does not leave state law unaffected. The main point of the following argument will be that state law needs to rearrange itself selectively and further elaborate its rules of recognition in order to accommodate the public function of private-born normative orders in a process of "horizontal accommodation."

It is in the matrix of those two aspects that the extensive social effects of private regulation will be analyzed: on the one hand, the collision with established national standards in the search for legitimacy of private action and, on the other, the richer normative claims of private regimes based on genuine forms of legitimacy.

II. Recognition of Sector-Specific Contractual Regimes

Using a societal rather than a statist perspective facilitates a comparison between legal systems that is not limited to statutory law. An analysis subject to such a limitation would neglect the reasons for parties to create legal regimes parallel to state law in the first place. For instance, even dispositive law may become dysfunctional because of the increasing demand for specificity in highly differentiated forms of interaction and new instances of uncertainty.[19] Private parties are not interested in a certain national legal order as such but in a legal regime that (a) reflects their specific rationality of transaction or cooperation, and (b) is immune to charges of lawlessness, i.e., that is legally valid. Parties take on what one might call a "drafting perspective."[20] This drafting perspective is primarily interested in the functioning of the regime and does not care about the public or private origin of norms—as long as the regime is ultimately enforceable in the state forum.

The focus must therefore be on the link between private normative orders and national legal systems. Ultimately, a comparative law of public rules of recognition for private regimes should envision the

19. For instance, the German Law on marine insurance had become devoid of practical importance and was ultimately abrogated by Parliament in 2007 because the whole industry, without exception, relied on private sets of insurance terms such as the German Marine Insurance Conditions, *cf.* Jürgen Basedow, *The State's Private Law and the Economy*, 56 Am. J. Comp. L. 703, 716 (2008).

20. In the sense of Erich Schanze, *in* International Standards and the Law, 83, 88 (Peter Nobel ed., 2005). Before *cf.* Ronald J. Gilson, *Value Creation by Business Lawyers*, 94 Yale L. J. 239 (1984).

"linking performance" of multiple jurisdictions. Such a comparative approach will have to proceed stereoscopically: it will have to take into account the territorial *as well as* the functional differentiations of law. On the one hand, it will have to look at different social sectors developing their specific functional rationalities and their specific normativities. For this reason, the case studies chosen below (*infra* II.*A-C*) have been taken from different fields. In order to assess the respective normativities at issue, they necessarily exhibit some attention to detail. In any case, it will become clear that they are subject to similar structures of justification. Yet, the study will also point out differences between national laws in their capacity and flexibility to recognize those private regimes. These more traditional comparative observations are scattered among the case studies. In sum, we need to achieve a kind of "comparative law squared," of which this essay can only provide a first sketch. A conclusion (*infra* IV) will try to recap these insights.

A. Construction Law: VOB/B and FIDIC

With regard to construction projects in Germany, and also with regard to international construction projects in which German contractors or employers are involved, parties regularly agree on the Construction Contract Procedures Part B (VOB/B, *Vergabe- und Vertragsordnung für Bauleistungen*), the general conditions of contract governing construction work. Although the VOB/B is not law and must be explicitly incorporated by the parties, thus qualifying as an instance of SCTs, it is privileged by firmly established case law in several ways. Most notably, as long as VOB/B is agreed upon as a whole, the German Federal Supreme Court does not subject single terms to the normal fairness test. Since 2009, this principle has even become codified law and is enacted in § 310(1)(3) of the German Civil Code.

The reason for this deference judicial is the way VOB/B is set up. The VOB/B was established by the *Deutscher Vergabe- und Vertragsausschuss für Bauleistungen* (DAV), an association within which public authorities and head organizations of the construction industry participate in order to develop and maintain rules for the proper procurement and execution of construction contracts (*cf.* § 2 DAV-statute).[21] According to the German Federal Supreme Court (*Bundesgerichtshof,* BGH), the VOB/B, on the whole, achieves a fair balance between the interests of employers and contractors that is well adapted to the peculiarities of construction contracts.[22] Terms

21. *Available at* http://www.bmvbs.de/cae/servlet/contentblob/65614/publicationFile/37038/dva-satzung.pdf.

22. BGHZ 86, 135 (142). It is still possible, however, for courts to check whether the overall set of rules in VOB/B complies with the criteria in § 307 of the German

that are perhaps disadvantageous to the contractor are compensated by advantageous terms thus providing an equilibrium. Unlike single-firm boilerplate contracts, the VOB/B is even-handed and does not express merely the preferences of the party introducing it. The process of negotiations among representatives of the parties operates as proxy for the absent bargaining of the specific contract ("second order bargaining").

The fact that the legislature has adopted this approach shows its willingness to recognize the self-contained normativity of this form of private regulation. It respects the particular standards developed solely within this distinct professional and economic sector. Deference to this private normative order, however, is not confined to mere accreditation. State law goes even further: courts sometimes make reference to the VOB/B when construing the meaning of statutory norms.[23] The relation between contract and statute is thus turned upside down. In fact, both are interdependent. The VOB/B must show flexibility towards the changes in contract law covering work performance and services,[24] whereas this specific part of the law piggybacks on the VOB/B to inform itself about the standards in the social sector.

Thus the VOB/B receives its legitimacy from procedure of standard setting and the resulting fund of rules that are highly responsive to the regulated sector and are seen as fair on the whole.[25] Notably, procedural legitimacy does not therefore hinge on the involvement of public authorities.

International construction projects are governed by SCTs authored by the *Fédération Internationale des Ingénieurs-Conseils* (FIDIC). They are a substitute for a uniform international law since equivalents to the Contracts for International Sale of Goods (CISG) do not exist for such projects. First released in 1957, FIDIC terms today are globally accepted in a way that suggests the status of a *lex mercatoria constructionis*.[26] The FIDIC standard conditions are drafted under the strong influence of common principles and are actually based upon the much older and widely used British form of the Institution of Civil Engineers. As FIDIC-rules are also generated by

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Civil Code (*cf.* BT-Drucks. 16/511, p. 32). This has to be assessed separately for each professional group of contractors. The test is necessary if the contractor is not represented in the DVA and therefore cannot influence the applicable version of the VOB/B (*cf.* BGHZ 178, 1 para. 27).

23. *Cf.* BGH NJW 2008, 511 (514); NJW 1987, 643.

24. Such as to the revisions of §§ 632a, 641a, 648a of the German Civil Code.

25. The fair balance of the VOB, however, can be questioned on the grounds of the unequal composition of the DVA members, (*cf.* Claus v. Rintelen, *Introduction, no. 3)*, in VOB (Klaus Kapellmann & Burkhard Messerschmidt eds., 2007). For instance, public authorities (acting as employers) make up the majority. Private employers are only represented by two out of eighty-one members.

26. *Cf.* Charles Molineaux, *Moving Toward a Lex Mercatoria—A Lex Constructionis*, 14 J. INT'L ARB. 55 (1997).

participation of community representatives, they qualify for certain normative privileges. For instance, English law does not apply the *contra proferentem* rule to FIDIC terms because they are developed by an institution in which representatives of both employer and contractor collaborate.[27] In a legal system that does not engage in general control of SCTs, this derogation from a rule of interpretation is another indicator by which national law can recognize the genuine normative quality of private regulation.

The attractiveness of FIDIC is rooted in its high responsiveness to the specific allocation of risk required by construction projects. At the heart of FIDIC are procedural and material rules that calibrate risks in a construction-specific way without any interference with the balancing of interests envisioned by a legislator (as, for example, in § 307(2), alt. 1 of the German Civil Code). These rules cover considerably more legal questions than the VOB/B. Though they do not constitute a self-contained regime and presuppose that the parties decide on a governing law of the contract (see Sub-Clause 1.4), FIDIC turned away from the judiciary and now refers disputes to arbitration (see Sub-Clause 20.6). Hence, FIDIC is able to develop a truly autonomous transnational normative order whose dependency on state law is limited to the enforcement of arbitration clauses and the exequatur of arbitral awards. International arbitration can dispose of its own rules of recognition. In relation to SCTs, arbitration is autonomous in deciding whether terms were individually negotiated; furthermore it can apply autonomous standards in controlling boilerplate clauses without having to resort to the general standards used in state law.[28]

Yet, the FIDIC terms high sensitivity to the needs of the contracting professionals has been criticized as relative blindness to public policy externalities. The significant ecological and human rights implications of large-scale construction projects (such as airports, major dams, mines or power plants) are barely addressed in FIDIC model contracts. Sub-Clause 4.18 on the protection of the environment succinctly provides that "[t]he Contractor shall take all reasonable steps to protect the environment (both on and off the Site) . . . and . . . shall ensure that emissions, surface discharges and effluent from the Contractor's activities shall not exceed the values stated in the Specification or prescribed by applicable Laws." Yet by this last reference, FIDIC terms seem to subscribe to the public/private dichotomy and to shift responsibility for environmental compliance of

27. Tersons Ltd. v. Stevenage Development Cor. [1963] 2 Lloyd's Rep 333 a. *Cf.* PHILIP ALLERY, OVERSEAS SUPPLY AND INSTALLATION CONTRACTS para. 9-04 (2002).

28. ICC case No. 10279, Interim/Partial Award of Jan. 29, 2001, 2005, 108, autonomously qualifying individually negotiated terms.

the project to the "extra-contractual" competence of state law.[29] At first glance, the private *lex constructionis* seems to refrain from developing appropriate legal tools for balancing conflicts between different rationalities (especially economic versus ecological considerations). Instead, it refers to the assessment of national legislation as the ultimate forum to safeguard the public interest. Nonetheless, the reliance of a sophisticated SCT regime on state law to assure its societal responsiveness suggests that transnational compliance clauses are not employed to circumvent mandatory law but constitute a legitimacy-providing nexus. Here again, the ordinary relation between statute and contract seems to be turned upside down. It is the autonomous contractual legal order of a *lex constructionis* that incorporates certain provisions from state law—in what may be an interesting step towards firmly embedding guarantees of transnational mandatory norms into private regimes.

B. Financial Law: ISDA Master Agreement

Multifirm contract standardization also dominates the many over-the-counter (OTC) global derivatives markets. OTC derivatives are traded internationally, occur in a variety of currencies, and link actors in a variety of national jurisdictions. The key to creating a reliable legal regime for transactions under these circumstances have been private standardization initiatives.[30]

1. Standardization in the Derivatives Market

Published by the International Swaps and Derivatives Association (ISDA), a private organization representing more than 750 OTC derivatives market players (mainly banks, pension and hedge funds, and insurance companies), the ISDA master documents spell out the terms of derivatives contracts and contain detailed definitions typical for common law contracts. In particular, contracts about credit default swaps (CDS) are not drafted from scratch but rely almost entirely on the ISDA standardized contract known as the ISDA Master Agreement, an umbrella agreement providing legal and credit protection and a close-out netting mechanism for credit default. It includes clauses dealing with default events, representation and warranties, jurisdictions, and other covenants. The Master Agreement is referenced by the Confirmation that specifies the economic terms of the trade and incorporates the Credit Derivatives Defini-

29. On the ecological reflexivity of FIDIC in general, *cf.* OREN PEREZ, ECOLOGICAL SENSITIVITY AND GLOBAL LEGAL PLURALISM: RETHINKING THE TRADE AND ENVIRONMENT CONFLICT 176 (2004).

30. On the development of the ISDA, *cf.* Glenn Morgan, *Market Formation and Governance in International Financial Markets: The Case of OTC Derivatives*, 61 HUMAN RELATIONS 637, 644-46 (2008).

tions (CDD) of ISDA.[31] Individual parties may choose to modify the Master Agreement but there are incentives against that. Doing so would forfeit the gains in reducing transaction costs associated with standardization, generate legal uncertainty, raise compliance issues, and would interfere with aftermarket trading in these financial instruments.[32]

Several developments have pushed standardization in CDS contracting even further. The first development concerns the "market share" of CDS under the Master Agreement. Parties using it submit either to the jurisdiction of English courts (if the contract stipulates English law) or to the non-exclusive jurisdiction of the courts of New York (if the contract is to be governed by the laws of the State of New York).[33] Parties that refuse to choose either jurisdiction can decide to use an alternative model contract and then agree to apply the CDD in order to avoid any incompatibility with CDS executed under the ISDA documentation ("bridge solution"). Confirmations under these other models often contain a "conflict of standards" rule by stipulating that in the event of inconsistency the CDD would prevail.[34] In Germany, an Annex for credit derivatives to the Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfte*) presenting its own definitions, was published in 2005 by the Central Credit Committee (*Zentraler Kreditausschuss*). Even the German market, however, did not accept it as a standard, so that it came as no surprise when the Central Credit Committee announced in 2010 that it would not develop the Annex any further.[35] Apart from the lack of acceptance within the community, it was also a reaction to the major revisions of the CDD in 2009 that in essence diverged from the definitions in the German model. In the long run, the conceptual gap between the Annex and the market-leading standard would have been too great.

2. Regulatory and Institutional Dimensions of the 2009 Supplement to the Master Agreement

The idea of the Supplement released in March 2009 by the ISDA—incorporated into existing trades by parties signing the so-called "Big Bang Protocol"[36]—was explicitly to achieve a greater extent of standardization and certainty in the CDS market sector. The

31. For the documentation architecture of an OTC derivatives transaction, *cf.* PAUL C. HARDING, MASTERING THE ISDA AGREEMENTS 19-22 (2010).

32. *Cf.* Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, 104 MICH. L. J. 1129, 1141 (2006).

33. *Cf.* Section 13(b)(i) 2002 ISDA Master Agreement.

34. *Cf.* JEAN-CLAUDE ZEREY, FINANZDERIVATIVE § 7.137 (2010).

35. *Cf.* Rüdiger Litten & Matthias Bell, *Kreditderivate—Neue Dokumentations-Standards als Reaktion auf die globale Finanzmarktkrise*, WM 1109, 1112 (2011).

36. 2009 ISDA Credit Derivatives Determinations and Auction Settlement CDS Protocol.

two main devices were the establishment of central committees to make contractual determinations that bind all parties to the standard corporate CDS contract, and the creation of a centralized auction methodology for pricing and settlement of CDS. Because of the formalized nature of the auction process and the increased number of participants, a more representative price is gained than would be the case under the normal bilateral cash settlement in the course of which the Final Price is usually determined through the protection seller.[37] The creation of Credit Derivatives Determinations Committees (Committees) was yet another step away from a system of bilateral CDS. The Committees operate as arbitral institutions and resolve uncertainty over issues such as whether a credit event has occurred, or a succession event, or whether an auction will be held, and what obligations are deliverable for purposes of the auction. A determination by a Committee is binding on all parties to CDS trades under the new Supplement, unless the parties have chosen to opt out of the jurisdiction of a Committee on all or some of these issues.[38] Because each Committee resolution has a market-wide impact, the rules include a complex dispute resolution procedure, encompassing voting thresholds, burden shifting and procedures for external arbitration.[39]

On the one hand, it may well be that state regulation has been preempted by this reform initiative of the market players' standard; on the other, the increase of standardization and the opening of bilateral contracts to intermediary institutions can function as appropriate docking sites for a sort of second-order public regulation. In the course of measures responding to the financial markets crisis, the European Commission has tabled the proposal COM(2010)485 for a Regulation on OTC derivatives that builds on previous standardization and wishes to further transform the OTC swaps markets from a bilateral to a multilateral and centrally-cleared structure in which a single transaction is replaced with two transactions each involving a third party, the Central Counterparty (CCP).[40] The idea is to prevent situations where a collapse of one market participant can cause the

37. *Cf.* Litten & Bell, *supra* note 35, at 1115. According to the Form of Credit Derivatives Auction Settlement Terms, the auction is administered by two financial information services (Markit Group Ltd and Creditex Securities Corp.), both appointed by ISDA.

38. *Cf.* Jacky Kelly & John Goldfinch, *Weapons of Less Destruction*, 28 INT. FIN. L. R. 36, 36 (2009).

39. John Williams & Vinod Aravind, *Credit Default Swaps: Lessons on the Role of Private Ordering in Mitigating Systemic Risk*, 5 CAPITAL MARKETS L. J. 267, 275 (2010).

40. A CCP becomes the seller to the buyer and the buyer to the seller. The CCP monitors the value of the underlying assets on which the derivative contracts are based and collects and releases collateral from the counterparties based on the value of the assets, thereby effectively reducing the level of activity and netting down the risk. *Cf.* House of Lords European Union Committee, The Future Regulation of Deriv-

collapse of others, thereby putting the entire financial system at risk.[41] Since CCPs are to take on additional risks, the proposal requires that they must possess robust governance arrangements and will be subject to organizational and prudential requirements to ensure their safety (such as internal governance rules, audit checks, greater requirements on capital). As it stands, with the focus of financial market regulation of intermediaries, the problem of good governance of contracts will partially translate into good governance of organizations.

All in all, the Master Agreement simulates the function of an exchange. Through standardization it makes visible (and publicly observable) a huge network of bilateral contracts that, due to the aggregate effect, bring about a high systemic risk. State legal ordering is then able to piggyback on this private standardization and, in fact, presupposes it in its own regulatory efforts. Yet, in this way state recognition is limited to instrumentalizing private regimes for the purpose of pursuing public policies such as the mitigation of systemic risk in derivatives markets. The reforms of the 2009 Supplements tried to cope with the interdependence of contracts and the vulnerability of previous settlement mechanisms. The key market participants were cognizant of the problems inherent in the system and proved capable of designing correctives. The ultimate test of public recognition of sector-specific self-regulation by the Master Agreement only takes place when third-party interests (outside the swap market) come into play. This test came with the collapse of Lehman Brothers and insolvency-driven litigation on swaps referencing collateralized debt obligations.

3. Conflicting "Touchdown" Points of the Master Agreement

Lehman Brothers Special Financing Inc. (LBSF) had been a counterparty to a number of swap agreements made with a series of special purpose vehicles (Issuers) that in turn issued notes to investors (Noteholders) and used the funds to buy securities (Collateral). The Issuers' obligations to investors were secured by the Collateral as were their obligations to LBSF. The priority of the security over the Collateral was set out in a trust deed between LBSF, the Issuers and a security trustee. Accordingly, the LBSF security had priority over the Noteholder security unless the swap counterparty (LBSF) itself was in default in which case it ranked below the Noteholders in the priority of payments (so-called "flip" clause). When LBSF applied for Chapter 11 bankruptcy protection in the United States in 2008, Per-

atives Markets, HL Paper 93 (10th Report of Session 2009-10, 31 Mar. 2010), para. 63.

41. *Cf.* Hans Diekmann & Dermot Fleischmann, *Der Verordnungsentwurf der Europäischen Kommission für den OTC-Derivatemarkt*, WM 1105, 1106 (2011).

petual Trustee Company Ltd. initiated proceedings against the security trustee to force it to realize the Collateral and apply the proceeds in favor of the Noteholders in priority over LBSF. The English courts affirmed the validity of the flip clause and held that its purpose was not to deprive LBSF's creditors of assets that they would otherwise have been entitled to at the onset of insolvency, but merely to change the order of priority.[42] The main rationale suggests that no offense to the anti-deprivation principle (under which a provision that a person's property shall be divested from him upon bankruptcy is contrary to public policy) occurs where contractual provisions are part of a complex commercial transaction entered into in good faith. This was obvious from the wide range of non-insolvency circumstances capable of constituting an event of default under the swap arrangements. Affirming the power of freedom of contract in English commercial law, the courts did not regard the flip clause an intention to evade insolvency law but rather to manage the relative balance of risk between LBSF and the Noteholders.[43]

A very different view was taken by a U.S. Bankruptcy Court before which LBSF had initiated parallel proceedings. The court ruled that the flip clause contravened the *ipso facto* provisions in sections 365(e) and 541 U.S. Bankruptcy Code, which render

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42. *Cf.* Belmont Park Investments Pty Limited v. BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc [2011] UKSC 38, *affirming* Perpetual Trustee Co Ltd, Belmont Park Investments PTY Ltd v. BNY Corporate Trustee Services Ltd, Lehman Brothers Special Financing Inc [2009] EWCA Civ 1160. It is important to note, as does Roy Goode, *Perpetual Trustee and Flip Clauses in Swap Transactions* 127 THE LAW QUARTERLY REVIEW 1, 9 (2011), in his comment on the decision of the Court of Appeal, that the court was not seeking to lay down the general principle that a change in priorities does not involve a deprivation. Rather, it says

> that because there was no deprivation—the asset having been financed by the Noteholders and the flip having been agreed from the outset as a condition of the security interest—the change in priorities would not give the Noteholders anything more than they were entitled to from the outset or deprive the company of the right it had enjoyed from the beginning, namely a priority qualified by reference to specified contractual contingencies.

Interpretation of the anti-deprivation principle then has to consider the inherent qualification of the entitlement in question, i.e., that the priority given to LBSF before the default was a form of determinable interest that would come to an end with the occurrence of a default event.

43. The UK Supreme Court emphasized two aspects: first, although, as a matter of law, the security was provided by the Issuer out of funds raised from the Noteholders, in commercial reality, the security was provided by the Noteholders and subject to a potential change in priorities. In the context of the threefold risk the Noteholders were exposed to in the complex transaction (occurrence of credit events under the Swap Agreement, decline of collateral in value, and LBSF not providing sufficient funds to the Issuer to pay the Noteholders' interest) the Noteholder Priority provisions, as part of the transaction's risk scheme, were specifically intended to deal with LBSF risk. The fact "that, in certain circumstances, the change in priority would lead to a (possibly unanticipated) benefit to the Noteholders and to the loss of LBSF's security rights in the Collateral in respect of Unwind Costs does not unravel this highly complex transaction." (Lord Collins, para. 108-13.)

unenforceable any provision that alters a party's rights as a consequence of filing a case under Chapter 11.[44] In the (debatable) opinion of the court, the clause did not form part of the swap agreement itself.[45] Thus it could not be protected by the safe-harbor provisions of the U.S. Bankruptcy Code that, for the sake of the non-defaulting party, permit the termination of swap contracts, notwithstanding the commencement of bankruptcy proceedings.[46] For a truly transnational normative order such as the Master Agreement, this glaring inconsistency in judgments on the validity of the flip clause is sobering, the more so as London and New York are the two national docking stations of the ISDA umbrella. This conflict of "touchdown" points could prompt forum shopping with future transactions eschewing a U.S. nexus.[47] As critics have pointed out, neither court contemplated the option that national rules of insolvency law may give way to, or at least accommodate, the authority of the Master Agreement and its purpose of regulating international financial transactions.[48]

The question of whether the private normative order in question appropriately considers public interest issues seems vital for the recognition of sector-specific normativity. When private regulation steps in it must be called upon to develop an explicit and sound public policy; the transnational regime (here the ISDA framework) would have to create a "transnational *ordre public*" internally. This may be less unlikely than expected. Case studies of three arbitral regimes (ICC, ICANN, ICSID) have shown that arbitration bodies rely on mandatory norms from different domestic laws but also on transnational public policy considerations, thus creating a multilayered system of mandatory law.[49] Although the use of arbitration in financial contracts has lagged behind its growth in other sectors, recent years have seen a surge in the frequency with which arbitration

44. Lehman Brothers Special Financing Inc. v. BNY Corporate Trustee Serv'cs Ltd. (In re Lehman Brothers Holdings Inc.), Adv. Pro. No. 09-01242 (JMP) (Bankr. S.D.N.Y. Jan. 25, 2010).

45. The Court found that "[a] review of the components of each Swap Agreement—the ISDA Master Agreement, schedules and written confirmation—reveals that there is no reference at all to the Supplemental Trust Deeds, the Noteholder Priority provision" and concluded that these provisions "do not comprise part of the Swap Agreements themselves," whereas the provisions of section 560 specifically refer to "swap agreements." (*Cf.* Opinion at 22.)

46. 11 U.S.C. § 560.

47. For the idea (and the necessity) of a juridical "touchdown" of transnational private regimes, *cf.* Robert Wai, *Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization*, 40 COLUMB. J. TRANSNAT'L L. 209, 265 (2002).

48. *Cf.* Hugh Collins, *Flipping Wreck: Lex Mercatoria on the Shoals of Ius Cogens*, *in* CONTRACT GOVERNANCE (Stefan Grundmann ed., 2012.), *available at* http://www.lse.ac.uk/collections/law/projects/tlp/Collins flips conference paper.doc, p. 18.

49. *Cf.* the results in Moritz Renner, *Towards a Hierarchy of Norms in Transnational Arbitration?*, 26 J. INT'L ARB. 533, 552 (2009).

clauses are taken into consideration, including derivatives transactions documented under ISDA Master Agreements.[50] Currently, the ISDA is contemplating the drafting and publishing of a model arbitration clause designed for use in conjunction with the ISDA Master Agreement.[51]

Still, the appropriate public policy to be pursued with regard to bankrupt swap counterparties is not clear. Since the anti-deprivation rule is a general principle of public policy, the UK Supreme Court's interpretation is a good example of the assumed accommodation of a private regime by the state. The Court did not override the private construction with a fixed policy but instead fine-tuned the general public policy principle in dialog with the logic of the transaction, fleshing out the limits of flip clauses. These dialectical processes between states and transnational entities are the forces that will determine public policy with respect to global market issues in the future, mapping the trajectories for regulatory competition.

C. *IP Law:* Google Book *Amended Settlement Agreement*

Another field in which private normative orders have evolved is IP law. Knowledge sharing regimes backed by open access licenses (such as the GNU General Public License or the Creative Commons licenses) rely on the consent of contributors. The focus here will be on the Amended Settlement Agreement (ASA) in the *Google Book* case since its approval by the court would have put in force the world's largest private licensing model, extending even to the works of third parties. If Google's activities of copying and distributing out-of-print orphan works digitally were to be legalized, a new market would emerge and Google would be first in line. Automatically, the provisions of the quasi-contractual license under the ASA would amount to a standard in this market. Authors of orphan works would be subject to the SCTs of the ASA.

Litigation over Google Book Search (GBS) concentrated on the class action brought by the Authors' Guild, the Association of American Publishers, and several individual plaintiffs before the U.S. District Court for the Southern District of New York, which originally focused on the copyright admissibility of Google's retrodigitalization and publishing of brief text excerpts ("snippets"). But the extent of the first proposal of settlement went far beyond the original issue of the dispute. The ASA allowed Google, among other things, to digitally reproduce and display out-of-print, analogue publications ("display uses"), unless the rights holders concerned were to object within a

50. *Cf.* ISDA Memorandum, The use of arbitration under an ISDA Master Agreement (Jan. 19, 2011), para. 3.2.

51. *Cf.* ISDA Memorandum, The use of arbitration under an ISDA Master Agreement: feedback to members and policy options (Nov. 10, 2011), para. 2.1.

specific period of time ("right to remove"). In return for the rights granted in the ASA, Google promised a one-time payment of at least $60 (USD) per digitalized work. In addition, 63% of the total income from the GBS Project was to be distributed to the rights holders.[52] But the court denied the parties' request for final settlement approval.[53]

The main argument is that the settlement creates an extensive system for the use of orphaned books beyond the original object of the dispute which should be reserved for regulation by the legislature because of the encroachment on the vested rights of authors; in particular, because it disregards the requirement of the authors' permission to use their work. It is true that the ASA construes user rights more broadly than U.S. copyright laws do. In short, the proposed settlement amounts to a shift from an opt-in to an opt-out regime. This does not imply, however, that private regulation affecting third parties cannot be legitimate. Yet, the justification for copyright access rules that are not authorized by the rights holders depends on the consideration of several legitimating factors.[54]

In terms of procedural legitimation, a representation of the authors of orphaned works is assured by the fact that the settlement was reached within the context of a class action suit. The court certified the action only under the condition that "the representative parties will fairly and adequately protect the interests of the class," the represented rights holders having the right to be excluded from the class.[55] Contrary to its provisional certification of the order granting preliminary approval of the ASA, the court finally held that a proper representation of absent members of the group by plaintiffs is not guaranteed with respect to specific subgroups, for instance scientific authors whose interest in maximizing access diverges from those of economically oriented groups of authors. However, this assumption is relativized by the settlement—granting Google only non-exclusive rights—since it leaves authors free to make their work equally accessible under an open-content license.

In substance, the parties' request for a class action settlement can only be approved when it is "fair, reasonable, and adequate" for all members of the class. The court's negative decision in this regard, was already foreshadowed by the restrictive fairness test applied. The ASA's granting of rights to Google, that go well beyond what had been available to the company under the Copyrights Act's "fair use"

52. The ASA is *available at* http://www.googlebooksettlement.com/r/view_settlement_agreement.

53. The Authors Guild et al v. Google, Inc, No. 05 Civ 8136 (S.D.N.Y. Mar. 22, 2011), *available at* http://thepublicindex.org/docs/amended_settlement/opinion.pdf.

54. For details, see Dan Wielsch, *Die Zugangsregeln der Intermediäre: Prozeduralisierung von Schutzrechten* GRUR 665 (2011).

55. *See* Fed. R. Civ. P. 23(a)(4), (c)(2)(B).

and contain future-oriented business arrangements, can hardly be justified under the "identical factual predicate" doctrine chosen by the District Court. Instead, the application of the three-pronged test that the Supreme Court had developed in "*Firefighters*" would seem appropriate because it allows settlements that provide broader relief than the court could have awarded after trial. It builds on the idea that it is the parties' consent, not the scope of the court's remedial power, which "animates the legal force of a consent decree."[56] Accordingly, a settlement must (1) "spring from and serve to resolve a dispute within the court's subject-matter jurisdiction," (2) "come within the general scope of the case made by the pleadings," and (3) "further the objectives of the law upon which the complaint was based."[57] With the help of these criteria the Supreme Court released the approvability of a settlement from the strict limits of statutory regimes. With respect to the ASA's far-reaching third-party effects and the society-wide impact of this restructuring of rules concerning digital use of works, the request for a "heightened Rule 23 scrutiny" seems plausible.[58] In cases of private regulation replacing state law, the third criterion deserves special attention. It calls for thinking beyond the "politics of the law"[59] in the spirit and in compliance with the Copyright Clause contained in the U.S. Constitution. In order for a contractually generated extension to be admissible, judges need to investigate whether the qualified use in question, promotes not only private, but also the public interest. *In casu*, the comprehensive digital library envisioned would be of simultaneous relevance for knowledge sharing in different social discourses. It would provide an important "infrastructure resource" (with "snippets" even provided as a public good) that possesses a large capacity for creating new knowledge in different sectors of society—rendered even more valuable due to the network effects arising from the large number of works possibly included.[60]

Google's continuing substantive commitment to the public interest could be ensured by the imposition and execution of fiduciary duties. Through collective bundling of rights for retro-digitalization, Google would move into the position of a project-bound fiduciary of the individual rights holders, similar to the fiduciary position of con-

56. International Association of Firefighters v. City of Cleveland, 478 U.S. 501 (1986), here at 525.

57. *Loc. cit.*

58. Ardently requested by Pamela Samuelson, *The Google Book Settlement as Copyright Reform*, WIS. L. REV. 477, 555 (2011).

59. Phrase from Ernst Steindorff, *Politik des Gesetzes als Auslegungsmaßstab im Wirtschaftsrecht*, *in* FESTSCHRIFT FÜR KARL LARENZ 217 (Gotthard Paulus, Uwe Diederichsen & Claus-Wilhelm Canaris eds., 1973).

60. A theory of intellectual infrastructure resources is developed in Brett M. Frischmann, *An Economic Theory of Infrastructure and Commons Management*, 89 MINN. L. REV. 917 (2004).

ventional collecting societies. In order to meet these fiduciary duties, the settlement provided for the establishment of a "Books Rights Registry" in the form of a non-profit collecting society, whose task is to find the affected rights holders and to distribute the proceeds generated to the authors, accompanied by an independent "Unclaimed Works Fiduciary."[61]

Of course, it would have been against the public interest if the designated privilege of use had harmed competition. To this extent, the court correctly objected that the settlement led to a broader strengthening of Google's position in online searches, because access to indexable repositories requires not only the consent of the registry, but also that of Google.[62] Yet, this dependence of potential competitors on Google's discretion could have been prevented if the court had conditioned its approval on additional requirements to ensure effective market entry of others.

A private copyright regime may only gain sufficient legitimacy, however, if it is not enforced against the explicit will of the individuals concerned. The individual must possess a veto right against the extra-legal extension of fair use. By means of the opting-out provisions in the ASA, individual rights holders can effectively turn the legal protection of the work back into an exclusive right.[63] As such, instead of curtailing authors' rights as in the case of compulsory licenses, the result is a "procedural restructuring" of intellectual property rights: authors can assert their right also against Google's qualified uses, but only on condition that they passed through the opt-out procedure in advance.[64] In other words, the extra-legal, quasi-contractual scope of users' rights applies only when the author does not restore the statutory situation.

On the whole, the privately crafted licensing regime of the ASA may well be justified. Having emerged from the representation of the group of authors concerned, the regime permits the digital intermediary a qualified use of out-of-print books in the public interest, while at the same time granting individuals a veto position against the restructuring of their intellectual property rights. Imminent dangers to competition could be prevented by a court approval subject to further conditions.

61. *Cf.* 6.1 and 6.2(b)(iii) ASA.

62. The Authors Guild et al. v. Google, Inc, No. 05 Civ 8136 (S.D.N.Y. Mar. 22, 2011), 37 (referring to 1.123, 3.9 and 7.2(d)(viii) ASA).

63. *Cf.* 3.5(a) and 3.5(b) ASA.

64. *Cf.* Joy Su, *Google Book Search and Opt-Out Procedures*, JOURNAL OF THE COPYRIGHT SOCIETY OF THE USA 56, 947, 965 (2009).

III. Developing Public "Rules of Recognition" for Private Regimes

Taking up the threads of these case studies, it is possible to distill a set of justificatory elements that make up "public rules of recognition" which SCTs-based normative orders have to follow. Most notably, these rules of recognition themselves are subject to a process of justification because they in turn may have to be accommodated within the augmented normativity originating in the private sphere, and fine-tuned with national legal systems differing in their capacity and flexibility to adjust and "*re*-state" when they are faced with these private normative claims. Thus, private regulatory regimes and national law engage in a form of dialectical interaction.[65] The dynamics of this interaction may be modeled in terms similar to conflict of laws: autonomous private regimes are not subordinate to domestic law, nor is domestic law ousted by private regimes; rather, there takes place a reciprocal reconstruction of state law in private regimes and vice versa.[66]

To be sure, this qualification of the relation between state law and private normative orders is much closer to the concept of law proposed by legal pluralism than it is to that of state-centered positivism. Whereas the latter channels all legal validity through the monopoly of state power and regards private normative orders either as non-legal or as subordinate to state law, i.e., "re-*stated*,"[67]—*tertium non datur*—legal pluralism insists on the autonomy of non-state legal orders and, in consequence, resists transforming them into state law.[68] This extension of the concept of law to certain private normative orders does not only explain the extended efficacy of such orders[69] but also aims at an extended control of private lawmaking.[70]

65. On "dialectical" interaction of legal orders, *cf.* also Paul S. Berman, *Global Legal Pluralism*, 80 S. Cal. L. Rev. 1155, 1176, 1199, 1201 (2007), but with a focus on formal state and international legal institutions (e.g., the engagement of domestic courts and the ECHR in a series of interpretive mutual accommodation strategies).

66. *Cf.* Gunther Teubner, *The Corporate Codes of Multinationals*, *in* Conflict of Laws and Laws of Conflict in Europe and Beyond: Patterns of Supranational and Transnational Juridification 261, 272 (Rainer Nickel ed., ARENA Report No. 1/09, RECON Report No. 7, 2009) on the interaction of corporate codes of conduct of multinational companies with national and international law.

67. *Cf.* Ralf Michaels, *The Re-State-ment of Non-state Law*, 51 Wayne L. Rev. 1209, 1228 (2005), (suggesting three different ways in which the state operationalizes other normative orders: incorporation, delegation, and deference).

68. *Cf.* Teubner, *supra* note 66, at 271, who states with respect to corporate codes of conduct: "it should be clear that their reception in national law is not a condition of the legal character or binding effect of the codes. Both are produced by the juridification and the constitutionalizing processes in the company, and also in interactions with actors external to it."

69. Sometimes, the extension of the influence of non-state legal orders is linked to the idea that the acknowledgement of genuine lawmaking power should take place through choice of law rules (*cf.* Gunther Teubner & Peter Korth, *Two Kinds of Legal Pluralism*, *in* Regime Interaction in International Law 23 (Margaret A. Young ed., 2010); Berman, *supra* note 65, at 1228.

It includes a strategic function that allows "influencing the development of private regimes by constitutionalizing them in a comparable way, as the Enlightenment's jurists did in subjecting the sovereign nation state to the rule of law," whereas denying alternative modes of global governance the status of law would risk their falling into irrelevance.[71] For these present purposes, however, the debate between traditionalists and transnationalists on private lawmaking is not the main focus. Here, we concentrate instead on the search for criteria that constitute the "publicness" of the rules of lawmaking.[72] In fact, public rules of recognition should not be limited to national legal systems. Especially private arbitral tribunals may also host the rule of law and provide the primary norms for a regulatory regime with reflexive second-order observation that would subject those norms to binding decisions about legality, thereby producing secondary norms for the regime in question. Irrespective of the forum of recognition, private regimes need to comply with some generic criteria in order to make their pervasive effects appear legitimate.

A. Representation of Affected Interests

First of all, recognition of private normative orders requires some form of representation of the interests affected. Insofar as the private regime encroaches upon vested rights, representation of rights holders appears indispensable. For the class action against Google to be certified, the litigants must "fairly and adequately" protect the interests of the absent class members. Still, the standard may be relaxed to a "rough and ready" representation if the rights holders are a highly dispersed group of participants in a network project, and if their copyrighted contributions appear collectively bound for the sake of the specific mission of a project from the outset.[73] In situations where the impact of the private regime can be traced back to a formal act of consent, the involvement of the rights holders' representatives in the process of generating the SCTs is not a precondition for the validity of the regime. Where there is such an involvement—as in the formulation of the German VOB/B—national law has good reason to attenuate its scrutiny of SCTs. For instance, German courts refrain

70. This is emphasized by DANIEL KLÖSEL, COMPLIANCE RICHTLINIEN (2012).

71. *Cf.* Gralf-Peter Calliess, *Transnational Civil Regimes: Economic Globalisation and the Evolution of Commercial Law*, *in* CONTRACTUAL CERTAINTY IN INTERNATIONAL TRADE 215, 217 (Volkmar Gessner ed., 2009).

72. In detail, *cf.* Dan Wielsch, *Relational Justice*, 76 L. & CONTEMP. PROBS. (forthcoming 2012).

73. This standard is suggested by Robert P. Merges, *Locke for the Masses: Property Rights and the Products of Collective Creativity*, 36 HOFSTRA L. REV. 1179, 1190 (2008). For a discussion with regard to the 2009 Wikipedia license migration, *cf.* Dan Wielsch, *Governance of Massive Multiauthor Collaboration—Linux, Wikipedia, and Other Networks: Governed by Bilateral Contracts, Partnerships, or Something in Between?*, 1 J. INTELL. PROP., INF. TECH. & ELEC. COMM. L. 96, para. 49 (2010).

from rigidly controlling even B2B-contracts when parties decide to incorporate the VOB/B *en bloc*.

Finally, if the private regime in question refers parties to arbitration—such as in international construction contracts based on the FIDIC terms—dependency on the standards of national law shrinks to a minimum. The contract then is administered under a transnational rule of recognition that decides autonomously on how proper representation of interests changes the standard of control.

B. Public Function of Sector-Specific Regimes

A second legitimizing element that makes national legal orders willing to recognize the normative claims of private orders is that of a public function. Again, this requirement appears as a *conditio sine qua non* for rules with pervasive third-party effects. As the discussion of the proceedings in the class action against Google has demonstrated, the new copyright regime proposed by the ASA is eligible for court approval only on the condition that its deviation from copyright law promotes the very aims of copyright, i.e., "the progress of science and useful arts." Because of the expected benefits for the intellectual infrastructure of society, it is suggested that the ASA meet this condition. To be sure, the criteria for testing the reasonableness and fairness of a settlement agreement have to be further developed in order to be responsive to the comprehensive arrangement vying for approval. Regulatory competition is concerned with exactly that: the readiness of a national legal system to engage in a process of opening up its rules of recognition to private legal regimes of rich normative claims.

Another example for the public function of private license models that comes to mind is the so-called "extended collective license" (ECL) in the copyright systems of Scandinavian countries (Denmark, Finland, Norway, Sweden, and Iceland).[74] The basic idea is to extend the binding effect of a collective agreement between an organization of copyright holders and a user of copyrightable works to rights holders who are not members of the organization.[75] What makes the ECL a unique form of collective rights management by private actors is that

74. *Cf.* Thomas Riis & Jens Schovsbo, *Extended Collective Licenses and the Nordic Experience - It's a Hybrid but is It a Volvo or a Lemon?*, 33 COLUM. J. L. & ARTS 1 (2010). Initially, the model was developed to deal with broadcasting rights in the Nordic countries but ECLs now cover a broad variety of situations where rights holders are numerous, dispersed, and difficult to find.

75. A precondition is that a substantial number of rights holders in a given category are represented by the collecting society. *Cf.* Stef van Gompel & P. Bernt Hugenholtz, *Popular Communication*, 8 INT'L J. MEDIA & CULT. 61 (2010). The contracting party on the users' side often is an organization that represents users in a certain area, acts on behalf of the individual users or at least recommends the collective agreement as a model contract to its members.

its function is equivalent to a compulsory license.[76] The licensing mechanism fulfills a crucial public function usually implemented by statutory copyright law: to provide legal certainty for users who want to engage in (privileged) activities without running the risk of committing a copyright infringement.

Since the agreement must relate to the exploitation of a work in a certain field of use (e.g., education, broadcasting, organization-internal press reviews, library distribution),[77] ECL can be tailored to such specific types of use. In part, this provides ECL legal systems with comparative advantages over different national models.

Last, but not least, the discussion about the revision of credit derivatives definitions in the ISDA framework suggests that national law should acknowledge the public function of collective risk management through private regime.[78]

C. *Right to Opt Out of the Private Legal Order*

A central building block of private normative orders with third-party effects that depend on recognition by national law is the right to opt out. This procedural mechanism substitutes for the requirement of consent that is considered to be the main element of establishing binding legal orders among private actors. It comes into play when the performance of the public function hinges on extending the regime to as many participants as possible. For instance, the value of the Google Books digital library heavily depends on the inventory of orphan works and their accessibility. If Google were forced to apply the usual opt-in default of copyright, the project would forfeit the benefits accruing from significant network externalities and efficiency gains. Requiring Google to conduct a reasonably diligent search for the rights holder of each individual work would be prohibitively expensive.[79] Similar considerations apply to extended collective licenses that partly replace statutory compulsory licenses. But since collective licensing is authorized by legislation here, it is a matter of national consideration whether the extension of license models can be vetoed.

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76. Therefore the instrument of extended collective license is in conflict with the InfoSoc-Directive and the enumeration of possible exceptions it contains in arts. 5(2) and 5(3). In order to ensure compatibility, recital 18 explicitly states that the directive "is without prejudice to the arrangements in the Member States concerning the management of rights such as extended collective licenses."

77. *Cf.* Henry Olsson, *The Extended Collective License as Applied in the Nordic Countries* (presentation available online at http://www.kopinor.no/en/copyright/extended-collective-license).

78. *Cf.* Litten & Bell, *supra* note 35, at 1117.

79. *Cf.* Katharina de la Durantaye, *Finding a Home for Orphans. Google Book Search and Orphan Works Law in the United States and Europe*, 21 FORDHAM INTELL. PROP. MEDIA & ENT. L. J. 229, 287 (2011).

At the same time, this highlights the fundamental political dimension of private regulation. While the right to opt out of the regime makes it possible for rights holders to return to their exclusive prerogatives, the legal presumption is nevertheless shifting: use of the copyrighted work is no longer prohibited unless the author gives permission; instead, use is allowed unless the author objects. The onus of cooperation is imposed on authors in the course of the private regime procedurally restructuring their intellectual property rights. This requires strong substantive rationale which may be found in the public function of the private regime.

Against this background, it seems reasonable for national legal systems to appreciate the existence of opt-out provisions in private regimes. They should favor the recognition of the regime since it allows individual rights holders to exit a regime that, from their perspective, is heteronomous. In a situation where it is reasonable to let social self-regulation go forward, despite effects on third parties who may reject their inclusion because they deem it paternalistic, the opt-out provisions respect at least the negative will.

Finally, when rights holders have originally agreed to access the regime (e.g., by contributing to Wikipedia, or by incorporating the ISDA Master Agreement), subsequent amendments of the SCTs can in principle be channeled through contractual instruments. But here as well, the use of opt-out is indicated when the regime innovation (such as the introduction of CDD as arbitral bodies) depends on maximal inclusion of participants.

D. Compliance with Ordre Public*: Competition Law*

In the best case, a private normative order would ultimately be recognized in the same way as foreign judgments or arbitral awards. The focus of the receiving legal order then is on safeguarding compliance of the foreign normativity with its own essential public policies. Competition law forms an important part of this. Indeed, private normative orders that build on standardization appear vulnerable to challenges by competition law.

Antitrust evaluation of the settlement agreement in the litigation on Google Book Search revealed some issues. In its present form, the ASA would give Google unfettered control over the search market with respect to orphan book searches. Competitors would have to rely on Google's consent for displaying snippets and for accessing the index repository.[80] Moreover, in the market for digital access to orphan works, Google would enjoy a *de facto* monopoly. This market position would not per se infringe upon Sec. 2 Sherman Act because that pro-

80. The Authors Guild et al. v. Google, Inc, No. 05 Civ 8136 (S.D.N.Y. Mar. 22, 2011), Slip Opinion, at 37.

vision prohibits only "monopolization," i.e., the willful acquisition or maintenance of monopoly power by anticompetitive means. As Google's activities created the preconditions for a new market, naturally Google is the first to enter it. What is crucial then is the contestability of that market. The essential question is how high are the barriers and risks for any competitor following Google who wants to license out-of-print books?

In consequence, from a substantive point of view, SCTs-based private regulation causes competition issues when a market participant is in control of the standard and this control is tantamount to control of a market. Realistically however, unilateral control of the standard will be rare. It is more likely that market participants cooperate in the process of standardization. Antitrust then is concerned with the openness of contract standardization. Multilateral standardization efforts seem designed to provide this openness.[81] In particular, the standardization processes concerning symmetric agreements are inconspicuous from an antitrust perspective because here a particular party could find itself on either side of the contract so that every participant has an incentive to strive for a balanced contract model.[82]

IV. Conclusion

Writing on the status of privately crafted legal regimes in the market for law products requires telling a tale of two stories. Comprehensive private regimes substitute for state law in functionally specialized social sectors. Quite often they are designed to transcend national borders with the aim to establish globally uniform rules; this is part of their appeal when compared to national legal systems. Except for regimes that share in the system of international arbitration, however, private orders have to rely on recognition by state legal orders to become recognized as valid and enforceable law. They need to "link" to a national system, whose responsiveness to private regulation in turn will increase the attractiveness of national systems in the eyes of private actors. Parties are unlikely to choose as their applicable law a legal system that is overly restrictive in recognizing private regulation.

Yet, state law is definitely not confined to a mere certification of any given private arrangement. Private normative orders must meet criteria set forth in public rules of recognition. These criteria vary with the extension of the normative claim of the private rules, in particular they need to consider third-party effects. At the same time, existing rules of recognition cannot remain unchanged; they need to

81. *Cf.* Patterson, *supra* note 6, at 382.
82. *Cf. id.*, at 384.

be innovated in order to do justice to private orders and their autonomous normative claims. On both sides, the private and the public, it is not just a question of exercising private autonomy and of granting it. Matters are more complex. Where the private lawmaking process is open and strives for balanced rules in a multitude of relationships, state law cannot just refer to the usual limitations of private autonomy and simply dismiss rules with third-party effects. The public rules of recognition should acknowledge these efforts by making concessions of autonomy subject to requirements and reserved review (especially with regard to standards, fora, and procedures).[83]

Obviously, this understanding of law—as capable of "learning"[84]—differs from the paradigm of formal law in the liberal state that sets out to reconcile, in accordance with a universal law, equal spheres of freedom that are taken as a given. Nor does it correspond to the paradigm of materialized law in the welfare state, which aims to guarantee actual freedom by providing the conditions for the generation of private autonomy, but which at the same time runs the risk of behaving paternalistically in defining that autonomy.[85] Both models tend to isolate public and private normativity rules from their application, authors and recipients of law. In contrast, the discussed dialectical relation between instances of private autonomy and public rules may best be understood in terms of the legal paradigm of proceduralization. It centers on conditions of "jurisgenerative" processes in society:[86] it acknowledges the potential of private actors for self-regulation (by opening up public normativity for realizing innovative new modes of social action) and at the same time sets out requirements that oblige private rulemaking to reflect public interests. The type of state that is committed to such a proceduralist

83. On this concept of admissability of freedoms, *cf.* Rudolf Wiethölter, *Justifications of a Law in Society*, *in* PARADOXES AND INCONSISTENCIES IN THE LAW 65, 71 (Oren Perez & Gunther Teubner eds., 2005).

84. On "normative" and "learning" models of law, *cf.* DAN WIELSCH, FREIHEIT UND FUNKTION 181 (2001).

85. On the liberal and the welfare-state model of law, *cf.* Jürgen Habermas, *Paradigms of Law* 17 CARDOZO L. REV. 771 (1995/1996). In the analysis of Wiethölter, the dilemma of these two models of law can be described as follows: "law as *formal category* (substantively) privileges specific 'freedom' . . . law as *substantive category* invokes . . . ideas against social reality and development, or plumps for specific particularity," *cf.* Rudolf Wiethölter, *Proceduralization of the Category of Law*, *in* CRITICAL LEGAL THOUGHT. AN AMERICAN-GERMAN DEBATE 501, 505 (Christian Joerges & David Trubek eds., 1989).

86. On the concept of "jurisgeneration" in society, *cf.* Robert M. Cover, *The Supreme Court, 1982 Term - Foreword: Nomos and Narrative*, 97 HARV. L. REV. 4, 11 (1983). For an expanded conception of jurisgenerative processes at the international and global level, *cf.* Berman, *supra* note 65.

paradigm of law is the "ensuring" or "cooperative" state that is able to consider the public interest in private regulation.[87]

Maybe the essential question for both kinds of normative orders—statist and private—is how to ensure that private actors, while autonomously pursuing their own interests, do so simultaneously in and for the general interest (i.e., of others).[88] The more a private regime diverges from the respective statutory law, the more ambitious the regime's internal dispositions must be to consider all legal positions in play. The requirements put on public rules of recognition would consequently be the higher the more the policy of the private regime touches upon cardinal policies of state law. A similar gradualism of responsiveness of a legal order to normativities of different origins is known from the doctrine of "*ordre public atténué de la reconnaissance*" in French conflict of laws and, similarly, from a modified application of the German *ordre public* depending on whether primary or secondary connecting factors are concerned.[89] The suggested set of justificatory elements that make up public rules of recognition (*supra* III) tries to reflect this nexus. It can be adaptable to the extent that the private policy depends on public recognition. For instance, parties stipulating the VOB/B just require the law to abstain from applying the usual fairness test for SCTs; they only want to have their specific regime of liability recognized. State law can then confine itself to controlling the integrity of the second-order bargaining by representatives. In contrast, the Google Book Search project amounts to nothing less than reversing the logic of copyright for a certain class of works. Accordingly, a rule of recognition needs to demand a strong commitment of the project to the public interest and even a right to opt out of the private regime, all of which can be accommodated within a heightened Rule 23 scrutiny.

All of the case studies underline that it is not just up to the legislator to develop appropriate linking institutions but also (if not primarily) to the judiciary. As judges can use their power to make law and spell out linking criteria, they play a significant role in the process of regulatory competition. This has already been demonstrated in the field of private international law facilitating the "liftoff" as well

87. On the correlation between the three mentioned legal paradigms and the types of states required for implementing the respective law-type, *cf.* KLÖSEL, *supra* note 70.

88. *Cf.* Rudolf Wiethölter, *Zum Fortbildungsrecht der (richterlichen) Rechtsfortbildung*, KRITISCHE VIERTELJAHRESSCHRIFT FÜR GESETZGEBUNG UND RECHTSWISSENSCHAFT 1, 22 (1988).

89. For French law, see the decision Rivière v. Roumaintzeff, Cour de Cassation, 17.4.1953, Rev. crit. Dr. int. privé 42 (1953), 412 (421); for German law, see Hans-Jürgen Sonnenberger, art. 6 EGBGB, *margin no. 22*, in MÜNCHENER KOMMENTAR, BGB (Franz Jürgen Säcker & Roland Rixecker eds., 5th ed. 2010) and GERHARD KEGEL & KLAUS SCHURIG, INTERNATIONALES PRIVATRECHT 527 (9th ed. 2004).

as the regulation of private transnational law.[90] Besides developing further substantive criteria for recognition, courts are also called upon to adapt legal method to instances of SCTs-based regimes. Courts should understand that the rationale for using boilerplate is to invoke the store of tested knowledge and of the learning that comes with it. Rather than relying on textual analysis and investigating the will of the parties before them, judges should elicit the historical context of drafting the SCTs in question and then move forward to the market's (not the parties') current understanding of the term, referring to expert sources of interpretive authority provided by the standard-setting organizations.[91] This proposal to interpret at least multifirm-SCTs as if they were a statute also invites consideration of the broader normative context of the contract as well as to gain an understanding for the sector-specific normativity of the regime.

Since the differing flexibilities of national legal regimes to host private normative orders contribute to regulatory competition, it should be recognized that in Europe, this competition is constitutionalized by supranational rules that prevail over national law. Member States are only free within the limits set by "European rules of recognition." For example, with regard to recognition of arbitral awards, the European Court of Justice has held that EU competition law constitutes such a fundamental mandatory law that national courts are, under domestic rules of procedure, required to grant an application for annulment based on failure to observe national rules of public policy.[92] In other words, Member States are not free in construing their *ordre public* when it comes to recognizing private regimes but have to observe the European *ordre public*. Harmonization may also extend to organizational requirements for contract intermediaries. If the proposed Regulation on OTC derivatives enters into force, the criteria for authorization of entities qualifying as CCP will be fixed. At the same time, the ISDA documentation framework will have to adapt to this new market environment. This is due to the fact that the terms of agreements between end-users and counterparties that are subject to the clearing obligation will need to be amended to include specific terms for cleared trades.

Finally, good governance of standardized contracts translates into a request for good governance of the organizations that issue and maintain the SCTs.[93] By controlling SCTs which in turn regulate whole markets or networks of creative developers, these entities per-

90. *Cf.* Wai, *supra* note 47, at 264.

91. For this "contract as statute" approach, *cf.* Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, *in* THE FOUNDATON OF MARKET CONTRACTS, 145, 157 (Omar Ben-Shahar ed., 2007).

92. *Cf.* ECJ, Case C-126/97, [1999] ECR I-3055 "Eco Swiss China Time Ltd v. Benetton International NV."

93. *See already supra* II.*B*.2 on the role of the ISDA.

form a public function.[94] Questions then arise as to how the internal governance of these norm entrepreneurs needs to be structured so that SCTs are not biased in favor of certain participants but can be justified in the light of impartial standards.[95] The public side of private legal orders needs to be taken seriously.

94. On the public function of the Free Software Foundation as a "license steward" to the GNU Free Documentation License and its role in the 2009 Wikipedia license migration, see Wielsch, *supra* note 73, at para. 61.

95. How "neutral" standardization of contracts can be achieved by different procedural and organizational models is the topic of Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 PACE L. REV. 179 (2008). Does it make a difference whether contractual terms are drafted by nonprofit or for-profit organizations, analyzed by Kevin E. Davis, *The Role of Nonprofits in the Production of Boilerplate*, *in* THE FOUNDATON OF MARKET CONTRACTS 120 (Omar Ben-Shahar ed., 2007).