REGULATING CONTRACTS

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UNIVERSITY PRESS

that the sharp distinction between private law reasoning and the reasoning linked with economic and social regulation becomes confused. Private law reasoning becomes less self-referential and closed as it seeks to grapple with the information about the effects of its regulation in different social contexts. The sharp limits on what was regarded as relevant information by the private law system become riddled with holes as private law reasoning seeks to ascertain the efficiency and efficacy of its regulation in particular contexts. We can speak of the relevance of former 'non-legal' reasons to the legal reasoning process. These 'non-legal' reasons are the empirical information about the impact of regulation, and how those subject to regulation, such as banks, have altered their conduct to adjust to regulation. These 'non-legal reasons' then provide the argument for fresh private law regulation by means of a reinterpretation of the principles of private law.

We should not conclude, however, that this instrumentalism in private law regulation reduces it to an exercise in economic or sociological reasoning. Legal doctrine retains both distinctive closure rules and procedural rules that restrict its acquisition and understanding of information. The insights available from other kinds of disciplines, such as political theory, economic analysis, empirical and sociological studies of market practices, will not easily be constructed as relevant facts for the doctrinal discourse. Legal doctrine must reconstruct its information about the effects of regulation by selecting the knowledge that can be translated into facts or principles which are relevant to the legal discourse. Economic arguments about efficiency, for instance, can normally be translated into legal discussions about whether consent to a transaction was given voluntarily on the basis of full information (the essential conditions for competitive markets and wealth enhancing transactions). Sociological observations about market conventions can be incorporated as implicit aspects of the agreement, known in legal discourse as implied terms or supplementary rules. General clauses in law, such as broad requirements of 'reasonableness' or 'good faith', can be used as gateways which permit social science perspectives to become relevant sources of information to legal doctrine. Contractual behaviour can be regarded as reasonable, if it contributes to a competitive market or conforms to an established market convention. Yet even with these methods available for private law reasoning, the discourse remains closed to much information about its impact. The information is often confined to the succession of factual instances that happen to be litigated before the courts. This information is in turn limited by the presentation of evidence that appears pertinent to the application of the legal regulation. Private law therefore remains a distinctive regulatory instrument with important structural weaknesses that impede its pursuit of instrumental objectives.

The Productive Disintegration of Private Law

In this chapter, we have been seeking to understand the dominant form of legal regulation of contracts, that is the private law of contract, as a type of discourse. Private law systems provide immensely sophisticated regulation due to the complexity of their normative orientation. But they can also provide gravely defective instruments for regulating contracts due to their self-referential character and closure rules. We noted in particular that the differentiation of the subsystem of contract law from other branches of private law, though serving to reduce complexity, impeded the possibility of productive learning across branches or classifications of private law regulation.

Yet my argument has been that private law is undergoing a transformation in its discourses. This change in the pattern of private law reasoning has resulted most immediately from an inevitable clash with the discourses of the economic and social regulation that were designed to address the inadequacies of private law as a form of distributive regulation caused by its lack of differentiation between the social contexts of contractual practices. The result of the collision between discourses has been the reconfiguration of private law reasoning, so that instrumental or policy concerns within its normative orientation become the dominant force of its evolutionary trajectory. Private law reasoning loses much of its special character as it seeks to incorporate social and economic reasoning within its normative orientation. Private law reasoning approximates much more to policy analysis and implementation.

Although I suggest that this transformation of private law reasoning is occurring in all advanced legal systems, it is interesting to observe some special factors that apply to Member States in the European Union. Here the project of harmonization of laws in order to create a Single Market has led to social and economic regulation of contractual practices at European level. This general regulation then has to be translated into more concrete rules that fit into the national private law and regulatory traditions. Since the European regulation may not be adequately implemented by national legislation, the national courts fall under an obligation to strive to achieve harmonization by the manipulation of all sources of national law, including private law. Reasoning in private law therefore has to be adjusted as far as possible to achieve harmonization with European regulatory goals. This internal logic of the constitutional arrangements of the European Union therefore poses two crucial challenges to the self-referential character of private law systems. In the first place, private law systems have to be adjusted so that they conform to the objectives of European social and economic regulation, which in turn requires the inclusion of consequentialist or instrumental reasoning as the dominant guide in private law. But since these objectives are often slightly opaque, national private law systems have to observe how these objectives are interpreted by other courts, that is the European Court of Justice and other national private law courts, in order to ensure harmonization of laws. The effect is that private law reasoning becomes in part an exercise in comparative law, in order to understand how the courts in different Member States have interpreted and implemented the objectives of European regulation.[24]

But I am not suggesting that private law can be reduced to some other discourse of economic or social regulation. The closure rules and self-referential concepts of private law remain the crucial elements in its construction of understanding of contractual practices for the purpose of regulation. In our example of family sureties, for instance, private law still thinks through its doctrinal categories such as the rule against undue influence or the rule against permitting family emotions to distort choices. What changes, however, is the extent to which this rule can be reinterpreted in the light of analogous policy and normative directions pursued in social and economic regulation. This search for reintegration of welfare regulation within private law reasoning compels private law to loosen its closure rules in order to ascertain the facts or events which permit an assessment of whether the effects of private law regulation achieve harmony with the objectives of social and economic regulation. Private law cannot remain oblivious to the demands of distributive policy and efficiency, but it has to harness them within its own discourse.

This account of the evolution of private law reasoning describes an uncertain outcome. The unresolved question is whether private law can integrate the discourses of social and economic regulation without collapsing into those discourses itself. Another way of presenting this question is to ask whether legal reasoning can avoid becoming just a branch of economic analysis or rational choice analysis. My view is that private law retains sufficient normative complexity to withstand such a reduction. It has the capacity to learn productively from the discourses of social and economic regulation, whilst at the same time preserving its other normative points of reference such as political conceptions of justice. In the context of private law, I do not favour the image of the law standing as neutral umpire above a host of competing discourses, which it seeks to regulate by developing rules of hierarchy, procedures for investigation and conflict resolution, and a search for internal legal coherence.[25] I prefer instead

[24] Collins, H., 'The Voice of the Community in Private Law', *European Law Journal* 3 (1997), 407–21; Joerges, C., 'The Impact of European Integration on Private Law: Reductionist Perceptions, True Conflicts and a New Constitutionalist Perspective', *European Law Journal* 3 (1997), 378.

[25] e.g. Habermas, J., *Between Facts and Norms* (Cambridge: Cambridge University Press, 1996), ch. 9.

the metaphor of harness: the private law system harnesses the reasoning of economic and social regulation and redirects it within its own operations. To this extent, I agree with Teubner's analysis in terms of systems theory:

> Legal operations, by their very operative closure and, as a matter of principle, cannot reach out into the domains of non-law. As a result, law can only reconstruct its environment internally through closed self-referential operations. This internal reconstruction of the external world is never identical with the events as they happen in the external world. Even if their substance appears to be identical, they are different because they are recontextualized. For instance, at the very moment that law reconstructs moral arguments internally, they lose their relation to the criterion of universality and to the moral code. They are now subjected to the mechanics of equal/unequal treatment, pressed into the programmes of law (rules, principles, doctrines) and ultimately linked to the binary legal code of legal/illegal. Calculations of costs and calculations of power, policy arguments and scientific constructs, they are all treated by the law in the same way. They all become strange hybrids which are now, however, the sole responsibility of the legal discourse.[26]

The problem with this formulation is to understand the qualities of these hybrid forms of legal discourse.

Our answer has been that in the context of private law regulation of contracts, the hybrids have not been so dissimilar to the traditional private law style of reasoning that we described in terms of self-reference and closure. The integration of economic and social regulation into private law discourse forces greater differentiation between the private law regulation of the variety of contractual practices. Private law has to reinvent itself in a more contextual way, so that it can differentiate its approach according to new categories such as consumer transactions and more significant old categories such as employment. At the same time private law incorporates the kinds of consequentialist considerations that lead to the creation of these categories in economic and social regulation, such as the protection of consumers against sharp trade practices and the protection of employees against abuse of managerial power. The former general rules of private law therefore begin to disintegrate and are replaced by more local regulation informed by a more purposive approach to regulation. Yet these developments enrich the legal discourse. They enable it to become more refined in its differentiation and normative orientation. Furthermore, private law in its application learns from its environment about the effects of its rules on the subjects of regulation. This observation then permits the recursive process of further refinement of the legal rules in order to modify their effects (as they are understood by the law). This new style of private law may indeed be described as its productive disintegration.

[26] Teubner, G., 'Altera pars Audiatur: Law in the Collision of Discourses', in R. Rawlings (ed.), *Law, Society and Economy* (Oxford: Clarendon Press, 1997), 149, 166.

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The Capacity of Private Law

How efficient and effective is the private law of contract as a technique for regulating markets and contracts? To pose this question at all compels us to make two controversial assumptions. In the first place, we assume that private law constitutes a regulatory technique, equivalent to other techniques of social and economic regulation of business, though it differs in its form, attributes, and capacities. Our second assumption is that private law pursues instrumental purposes like other types of legal regulation of markets, so that the comparative efficacy of private law in achieving its purposes can be measured, and the costs of this type of regulation can be compared to other techniques. These assumptions seem to conflict with the traditional understanding of private law as a mechanism for supporting the private ordering of civil society without seeking to organize or steer it.

In this chapter, we explore the implications of analysing private law as a regulatory technique. The special strength of private law regulation of contracts compared to other styles of regulation is analysed in terms of its 'reflexive' capacity. We then proceed to examine the structural weakness of private law as a regulatory instrument. Our special interest lies in detecting how these weaknesses in the capacity of private law can be overcome, and how private law itself is evolving mechanisms that enable it to address these weaknesses.

Private Law as Regulation

However private law regards itself within its own internal discourses, it can also be examined from an external point of view as one mechanism by which the state seeks to regulate markets. Private law certainly has similar effects in steering market behaviour to other types of social and economic regulation of business activity. Participants in markets may alter their behaviour in order to comply with private law rules. If the participants seek to make a legally binding contract, then they may put their contract into writing in order to comply with a legal requirement of formality, or they may create a token exchange such as a peppercorn in order to comply with the common law doctrine of consideration. My central question addresses the issue of how private law performs in terms of its effectiveness

and cost compared to other forms of business regulation.[1] It is consistent with this approach to concede that private law may contain other objectives, such as providing an articulate justification for the recognition of fundamental obligations owed between citizens in civil society. In so far as private law possesses instrumental purposes, however, it is fair to ask whether it proves a satisfactory technique for achieving those purposes. Furthermore, if my argument in the previous chapter that instrumental purposes increasingly steer private law discourses is accepted, then it becomes more pressing to assess the efficacy and efficiency of private law in meeting those objectives.

Even so, some lawyers may still remain dissatisfied with my approach. It may run against the grain of their understanding of private law as a pre-political system of support for private ordering in civil society. This traditional interpretation of private law imagines a separation of the realm of the state from civil society. Inside the latter, individuals arrange their affairs often by engaging in commitments towards others. These private agreements comprise the private ordering of society. The role of the state is merely to support this private ordering, at least to the extent that it is compatible with general conventional moral standards. This function is achieved primarily by granting legal enforcement to most of these private arrangements and to protect property rights. The purpose of legal enforcement of contracts is not to steer private ordering, but rather to encourage it by constructing the possibility of making binding commitments with the force of law. As part of this function, however, legal rules may be devised to protect private ordering from abusive practices such as fraud and violence.[2] The purpose of such rules is believed to be one of safeguarding private ordering against abuse, rather than one of the imposition of policy objectives upon the participants.

This traditional interpretation of private law fits closely into a liberal, or even a libertarian, conception of the role of the state and the requirements of justice. It emphasizes the importance of choice and freedom of private individuals. The role of the state is the minimal one of holding the parties to their private arrangements, without seeking to impose upon civil society a particular conception of what is good or right. The values of private law are merely the elementary moral ideals of holding people to promises which have been made seriously, or the protection of legitimate expectations raised by private undertakings.

To examine private law as a form of regulation therefore appears to misunderstand its nature, and, perhaps even worse, to pose a challenge

[1] See generally: Daintith, T., 'Law as a Policy Instrument: A Comparative Perspective', in T. Daintith (ed.), *Law as an Instrument of Economic Policy: Comparative and Critical Approaches* (Berlin/New York: Walter de Gruyter, 1988) 3.

[2] Raz, J., 'Promises in Morality and Law', *Harvard Law Review*, 95 (1982) 916.

to its liberal or libertarian premises. I can admit that this book as a whole contests traditional understandings of the private law of contract. It regards private law as an instrument of the state for controlling and shaping private ordering according to a variety of competing policy objectives. The book also assumes that it is impossible for the law to adopt a position of neutrality with respect to the distributive outcomes of private ordering. Yet in this context, the crux of the issue does not turn on these general perceptions of the nature of private law. The crucial point is rather whether private law contains the normative complexity that I described in the previous chapter. Once it is admitted that one strand in the normative discourses of private law concerns instrumental policy objectives, then it becomes fair to assess private law as an instrument or regulatory technique.

It is only possible to exclude such questions about private law as a regulatory technique, if it is denied absolutely that private law is influenced by policy objectives. There may be some legal scholars who remain attached to an idea of private law as a sealed, self-referential discourse linked only to basic moral ideals such as the idea that promises ought to be kept. For them, the observation of the social effects of private law must be a matter of sublime indifference; consequentialist considerations in the formulation of private law doctrines must be an anathema. Yet I do not believe that such legal scholars really exist. Even the most traditional accounts of the private law of contract introduce references to instrumental considerations in their pages, though they remain crudely formulated and empirically unverified. The pages are in fact peppered with such considerations as the need for 'certainty' in the law, so that businessmen can plan their affairs. Of course, hidden in this appeal to certainty (which is not the same as doctrinal integrity, for a clear rule can be inconsistent with the values of the doctrinal system), there is an implicit rejection of some other standard or policy such as fairness by which to measure the effects of private law. These breaches of the seal of self-reference in order to admit consequentialist considerations indicate that even in the most traditional accounts of private law, instrumental considerations are not excluded entirely.

At the same time as the assumptions behind my question about the effectiveness of private law as an instrument of regulation raise the hackles of traditional private lawyers, they also present a puzzle to a modern breed of lawyers who use economics in the study of business regulation. These lawyers understand that it is appropriate to ask whether business regulation is efficacious and cost-effective. But they have a difficulty in appreciating that the same question should be asked of private law.

One reason for this difficulty seems to be an assumption that private law permits more or less unbridled freedom of contract. This assumption appears frequently in the contrast drawn by economics between the market guided by the invisible hand of competition and the controlled zone of conduct guided by business regulation. This contrast between markets and regulation often appears in economics, without the appreciation that the category of markets is in fact also a regulated arena, though it is a field which is regulated primarily by private law. Given the false assumption that markets in their pure state are virtually unregulated, however, it becomes possible to draw a sharp contrast between private law and other forms of social and economic regulation. It is assumed that only the latter types of regulation have as their objective the placing of restraints upon freedom in the market place by increasing the costs of undesired activities. My contention is that, on the contrary, private law and business regulation may differ in the degree to which they control market activity, but that it is wrong to suppose that private law does not also seek to regulate business. Private law is the index finger of the invisible hand that guides market economies.

Private law rules can be presented as addressing the same kinds of issues as those dealt with by regulation. If some of the purposes of business regulation include the correction of market failures or the redistribution of wealth, we can point to private law rules which serve similar functions. For example, private law rules about the bargaining process such as misrepresentation, duress, and undue influence can be analysed as correcting market failure,[3] or redistributing wealth.[4] Moreover, this parallel in functions between private law and business regulation emerges clearly when we examine the sources of regulation of a particular market activity. In the case of misleading advertising, for instance, we discover a common pattern in most jurisdictions that the sources of regulation combine private law rules with specialized regulatory techniques.[5] The two sources of regulation operate in tandem.

Where private law regulation differs from other kinds of business regulation is simply in the generality of rules, which only become specific when applied by private ordering and adjudication. Daintith reaches a similar conclusion with respect to the private law of property:

> there seems to be no reason why we should not treat the security of enjoyment of land as an integral element of state management of the economy, distinguished from other policies by the degree of its generality, its importance and its antiquity rather than by any difference in kind.[6]

[3] Trebilcock, M. J., *The Limits of Freedom of Contract* (Cambridge, Mass.: Harvard University Press, 1993).
[4] Kronman, A. T., 'Contract Law and Distributive Justice', *Yale Law Journal* 89 (1980), 472.
[5] Trebilcock, M. J., 'Private Law Remedies for Misleading Advertising', *University of Toronto Law Journal* 22 (1972) 1.
[6] Daintith, T., 'Regulation', *International Encyclopedia of Comparative Law*, xvii (1995) ch. 10, 35.

The contrast drawn between private law and business regulation is also sustained by other false assumptions. The difference in kind between the two types of law is often thought to rest on the different sources of law. In Common Law jurisdictions, a frequent assumption is to equate the basic facilitative rules of private law ordering with judge-made law, and interventionist regulation with legislation. This contrast obviously breaks down in Civil Law jurisdictions where their private law Codes are the product of legislation.[7] But even in the context of the common law, this formal contrast collapses when we observe how legislation becomes integrated into the doctrinal fabric of the common law over the course of time. An example is the Statute of Frauds 1677, which began life as a regulatory measure, but over the centuries became the bedrock for the elaboration of the private law rules governing formalities in the formation of contracts. In the common law much legislation is also an attempt to codify and clarify the existing common law, as in the case of the Sale of Goods Act 1893 and the Bills of Exchange Act 1882. This legislation is interpreted as fitting into the doctrinal fabric of the common law, as creating and facilitating basic property rights and forms of transaction, with the effect that no distinction can be drawn between private law and business regulation.

The conventional contrast between private law and business regulation is also informed by an implicit contrast between, on the one hand, private law as an instrument that permits the promotion of private interests through contracts, and on the other, public law regulation as the embodiment of public interests. Here private law is separated from business regulation by describing the latter as having its source in public law, a formal distinction, which is then linked in an obscure way to a contrast between private and public interests. This view amounts to little more than a restatement of the unsupportable contention that private law lacks the normative complexity of including instrumental concerns for public policy. It also shares a rather naïve view of the content and operations of business regulation. Any close inspection of the practice of business regulation reveals that the regulatory standards applied are the product of bargaining between public officials and the regulated commercial interests, with little guarantee that the ill-defined public interest will prevail.[8]

A final misleading assumption that prises private law apart from business regulation focuses attention on the form of the regulation. As a matter of legal technique, private law differs substantially from those practices which lawyers normally describe as regulation of business and markets. Unlike modern forms of business regulation that employ specialized agencies and

[7] Daintith, T., 'Regulation', *International Encyclopedia of Comparative Law*, xvii (1995) ch. 10, 9.

[8] Stigler, G. 'The Economic Theory of Regulation', *Bell Journal of Economics and Management Science* 2 (1971) 1.

mandatory codes of practice, the law of contract forms part of the general law which is enforced by the ordinary courts. Unlike those modern forms of regulation, the law of contract lacks the power to promulgate detailed administrative rules and to police behaviour, but rather awaits a claim by a plaintiff and then applies the general rules of contract in order to settle the dispute. Lawyers therefore conventionally draw a contrast between, on the one hand, specialized mandatory regulation of particular business sectors such as utilities, and on the other hand, the general rules of private law that facilitate transactions and that form the backdrop against which instrumental regulation takes place.

But it is precisely this contrast in technique that interests me here. Instead of the contrast making comparison impossible, the differences in technique become the subject of inquiry. The question is whether private law viewed as a technique of business regulation has special advantages and disadvantages compared to other regulatory techniques. The major differences in the method of regulation pose a challenge for the analysis, but should not obstruct it altogether.

This examination of private law as an instrument of regulation has been attempted before. During the 1970s the work of consumer lawyers, particularly that of Leff and Cranston, presented a sustained attack on private law as an instrument of consumer protection on the ground that it was inefficient and ineffective.[9] For example, Leff observed in connection with private law regulation of 'unconscionable' clauses in standard form contracts:

> What is the function of an unconscionability concept or clause? Briefly, it appears to be one technique for controlling the quality of a transaction when free market control is considered ineffective. It is one method for substituting government regulation for regulation by the parties.[10]

The conclusion drawn by these critics of private law in a consumer context was that public regulation was required for any effective consumer protection measures. The conclusion could be generalized: private law has negligible social effects.[11] This critique of private law was countered by a Chicago style of law and economics pioneered by Richard Posner,[12] which contended that in fact private law achieved a more efficient form and content of regulation than public regulation. It was also challenged

[9] Leff, A. A., 'Unconscionability and the Crowd—Consumers and the Common Law Tradition', *University of Pittsburgh Law Review* 31 (1970), 349; id., 'Injury, Ignorance and Spite—The Dynamics of Coercive Collection', *Yale Law Journal* 80 (1970), 1; Cranston, R., *Consumers and the Law*, 2nd edn. (London: Weidenfeld and Nicholson, 1984).

[10] Leff, A. A., 'Unconscionability and the Crowd, n. 9 above, 350.

[11] Epstein, R. 'The Social Consequences of Common Law Rules', *Harvard Law Review* 95 (1982) 1717.

[12] Posner, R., *Economic Analysis of Law*, 4th edn. (Boston: Little Brown, 1992).

implicitly in the work of legal historians such as Morton Horwitz, who contended that the distributive effects of private law rules were profound.[13] Here it will be argued that both positions were exaggerated. Private law possesses some considerable advantages as a regulatory instrument over public law regulation by virtue of its efficiency and reflexivity, but, in any particular instance such as consumer protection, the optimal regulatory solution in terms of efficiency and efficacy will usually be discovered in a combination of regulatory forms.

Reflexive Regulation

Our first task is to establish an analytical framework for a comparison between private law and other forms of economic and social regulation. A simple model describes three principal ingredients of any regulatory system. We shall need to refine this model further, but it suffices at this stage to permit a comparison between regulatory techniques. In addition, the simple model enables us to understand a key feature of private law regulation, which I shall describe as reflexive regulation.

The core element of the simple model consists of rules or standards that define the conduct required or proscribed. These rules may be created by a variety of processes ranging from parliamentary determination to self-regulation by the participants in the market. The second element consists of an agency charged with the task of monitoring compliance with the standards and to detect breaches. The final element consists of an enforcement mechanism, which is empowered to impose sanctions against deviance from the standards. Often a court will be charged with this responsibility for determining whether a sanction is deserved, but other agencies may be awarded similar powers such as the jurisdiction to withdraw a licence to trade.

This model of the three elements of regulation fits easily onto modern institutional arrangements for the regulation of particular business sectors such as utilities. In these contexts, a democratic legislature sets the general standards and policy goals, and then an administrative agency or regulator provides detailed guidance in the form of rules, performance targets, and prohibitions. Usually the same agency is charged with monitoring compliance with these standards, for which purpose it conducts investigations and inspections. Any breach of the standards revealed by monitoring can be challenged by the agency. Compliance with the rules can normally be achieved by education and negotiation with the perpetrator, using the

[13] Horwitz, M. *The Transformation of American Law, 1780–1860* (Cambridge, Mass.: Harvard University Press, 1977).

bargaining weapon of the threat of instituting legal proceedings for the imposition of a punishment. This threat usually provides a sufficient incentive to negotiate practices compatible with the regulation, provided that the threatened fine for breach of regulations is set at a sufficient level of gravity and is routinely enforced, for then rational economic choice will cause businesses to desist from that practice. Business regulation often employs the ordinary courts for the purpose of imposing these sanctions, but it is also possible to create specialized tribunals which possess the expertise for understanding technical information and the complexities of the regulatory framework of rules.

The same headings of standards, monitoring, and sanctions can also be employed as the tools for analysing the institutions and practices of the private law of contract.

Standards

The standards set by private law comprise both mandatory standards and 'self-regulation'.

Mandatory standards are usually discovered in the Civil Code or the equivalent precedents in the common law, supplemented in some instances by legislation. These mandatory standards include the rules governing the validity of contracts, compulsory terms, and the rules governing the procedures through which enforceable contracts can be made. The principal function of these mandatory standards is to set basic conditions for the valid exercise of the power of making legally enforceable contracts. These conditions contain both substantive and procedural elements. With respect to substance, mandatory rules place limits on the types of subject matter of transactions, as in the examples of the invalidity of contracts of slavery, the sale of endangered species, and the sale of parts of the human body. The procedural element contains some rules regarding formalities, such as a requirement of written documents or special oaths, together with rules governing unfair practices during negotiations such as the use of fraud and violence.

Most of the detailed standards governing a particular transaction are set by the parties themselves, as a type of 'self-regulation'. These standards are described as the terms of the contract. In some instances these standards will be the result of negotiation, but more typically they will be set by one of the parties and contained in a standard form contract. The use of the term 'self-regulation' may appear strange in this context. In studies of business regulation, the concept of self-regulation is used to describe the practice of members of an industrial sector agreeing to comply with a particular set of standards, such as a Code of Practice or a particular standard form contract. This self-regulation may then receive endorsement by a regulator as the appropriate standard, which can be enforced by the regulator. This type of self-regulation is a collective mechanism for the setting of standards across an industrial sector. In contrast, private law supports individualized negotiation of standards that apply solely to an isolated transaction between the parties. Apart from this particularized feature of the standards negotiated as terms of a contract, the practice endorsed by private law has the same quality of binding self-regulation as the collective model in business regulation.

As a supplement to self-regulation, private law often provides a model set of rules to govern a particular type of transaction such as a sale of goods. This model set of rules provides the detail of the regulation in the absence of express self-regulation. These rules serve the purpose of reducing transaction costs, because they can save the parties the expense of devising their own regulatory regime. Examples of such rules include the implied terms regarding quality and title in sales of goods, the articles of association for a limited company, and the allocation of the risk of negligent damage on to the supplier of a service. The supply of these 'default rules' by private law distinguishes this system of self-regulation from the practice of collective self-regulation by an industrial sector.

Monitoring

Monitoring compliance with these regulatory standards of private law is delegated to the parties themselves. They have the discretion whether or not to enforce the rules or to negotiate a revision of the standards. There is no policing and enforcement agency, but rather the parties to the contract have the discretionary power to enforce the standards through an ordinary court procedure. At most, private law may require one party to notify the other that it has committed a breach of the standards prior to taking steps to enforce the standards.

Sanctions

The sanctions available in the ordinary courts for breach of standards vary according to the type of rule which has been broken. For some of the mandatory rules, such as the requirements for the formation of a valid contract, the sanction is the declaration of the invalidity or unenforceability of the contract. In other words, the legal system declines to recognize the transaction as having created any binding commitments, so that the self-regulation contained in the agreement is ineffective. In respect of the other mandatory rules and self-regulation, the sanction is usually a liability rule that requires the payment of compensation to the injured party. In respect of the breach of some rules, such as the prohibition on

fraud, both types of sanction will be available, so that the contract induced by fraud will be declared invalid and in addition the fraudulent party will be required to pay compensation for losses incurred under a liability rule. Unlike specialized tribunals often used by public regulatory systems for imposing sanctions, the private law system of regulation employs the ordinary courts. These courts possess considerable expertise in their knowledge of the rules of private law, but usually lack any specialized knowledge of the particular market which is being regulated.

Reflexivity

In scholarly examinations of regulatory techniques, a contrast is frequently drawn between 'command and control' styles of regulation and 'responsive' (or reflexive) regulation.[14] The former style of regulation approximates to criminal law. The rules are imposed by the regulator (or parliament); inspectors monitor compliance; and courts or specialist tribunals impose deterrent sanctions against breach of regulations. In contrast, responsive regulation seeks to achieve the collaboration and co-operation of those subject to regulation. In setting the standards, it favours the use of self-regulation, so that within a broad requirement fixed by legislation the participants can settle through negotiation the detailed rules to govern transactions. The advantages of seeking collaboration are expected to be that the participants will have better knowledge about the technical problems of regulating a particular market, that they will be in a better position than a regulator to tailor the rules precisely to this market sector, and that they will have a surer sense of what standards will prove practicable. With respect to monitoring and enforcement as well, responsive regulation promotes a strategy of securing co-operation from the participants in markets. Co-operation may be expected to achieve higher levels of compliance in general at the expense of strict enforcement of the rules in those few instances where monitoring detects a breach. Devices to secure co-operation are expected to reduce the costs of monitoring and enforcement, and to conserve the resources of the regulatory agency for the pursuit of particularly egregious cases. Although no single regulatory system probably corresponds to either of these paradigms, the policy

[14] Ayres, I., and Braithwaite, J., *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press, 1992). The term 'reflexive' is used within systems theory with a more technical meaning: Teubner, G., 'Substantive and Reflexive Elements in Modern Law', *Law and Society Review* 17 (1983), 239. I prefer the terminology of reflexivity, because it recognizes that the fundamental problem for regulation consists in the interaction between the operationally closed systems of legal regulation and contractual agreements. As a result, the theory of reflexive law is sensitive to the problem of the 'regulatory trilemma' discussed below. However, little turns on the distinction in terminology for my argument.

prescription is for an increase in the style of responsive regulation as a more efficient and effective way of achieving regulatory objectives.

The striking feature of private law as a system of regulation of markets is the extent to which it fits this model of responsive regulation. It achieves this approach to regulation both in the standard setting process and in the monitoring and enforcement mechanisms.

In the setting of standards, private law usually refrains from fixing in detail the obligations of the parties, but rather leaves these to be settled by negotiation and agreement through the express terms of the contract. There are some mandatory rules applicable to all legally enforceable transactions, and some further mandatory rules that govern particular types of transaction such as sales. Beyond these requirements, private law usually employs only default rules, which comprise regulations that apply only in the event of incomplete self-regulation by the parties. The principal advantage of this extensive power of self-regulation is that the parties can adjust the regulation to their particular business needs in the light of their information about the market. By use of this information, the regulation is better tailored to the particular circumstances of the transaction than general rules issued by a state agency, since the general rules will often prove under- or over-inclusive, and the agency may lack sufficient expertise to provide a practicable regulatory framework. The degree of self-regulation therefore permits adaptation to new kinds of business relations, which can be constructed by self-regulation. By subsequent agreement the parties can vary or modify the content of the rules as well, so that this regulatory technique provides considerable flexibility and potential for adaptation to changing circumstances. Another way of expressing this flexibility is to say that private law regulation confers alienable rights on the parties to the business transaction. This style of self-regulation is also likely to achieve an efficient level of regulation in the sense that the parties will only bargain for those rules which are vital to protect their interests. Due to the transaction costs involved, the parties to a contract will refrain from negotiation of every detail. The parties will rely in part on the assumption that the risk will not occur, and in part on the perception that the self-interest of the parties will lead them to further detailed negotiations in the event of the need to adjust the content of the rules in the light of changed circumstances.

The responsive quality of private law regulation is further enhanced by the devolution of the discretion to enforce the regulatory standards (both mandatory rules and self-regulation) to the parties themselves. This power can be used either to enforce the rules, or, more commonly, to provide the setting for the negotiation of an adaptation of the applicable standards in post-breach bargaining. The court only acts to enforce the agreement when one of the parties demands observance of the rules by the other. In this sense, the private law of contract uniquely among regulatory systems provides a species of self-enforced self-regulation. This constitutes an extreme example of responsive or reflexive regulation. It is this aspect of private law that is often used to draw the contrast with ordinary business regulation, for it is assumed that delegation of the discretion to enforce the standards to the parties themselves is inconsistent with regulation of markets in the public interest. But in fact the distinction cannot be drawn sharply, for economic and social regulation usually must rely upon reporting of breaches of standards by parties adversely affected such as consumers or workers. Without this supply of information, the regulatory agency usually lacks the capacity to monitor the effects of its regulation adequately. The decision to supply this information to the regulator is, however, a discretionary decision by the parties affected. The consumer may not bother to contact the relevant trading standards officer, and the worker may not wish to expose the unsafe working conditions for fear of reprisal or suffering economic loss. On closer inspection, therefore, the contrast between self-enforcement under the system of private law and public enforcement under business regulation is much less sharp than is commonly supposed.

The great strength of this private law regulation of contracts is plainly its responsive or reflexive quality. It devolves an extensive discretionary power of self-regulation to the parties. Subject to the requirement of a negotiated consensus, the rules produced will then be routinely enforced by the legal system through the agency of the ordinary courts. By conferring autonomy upon the parties to devise their own regulation, private law achieves considerable flexibility, which in turn achieves the advantage that the regulation permits experimentation with novel types of business transaction that might enhance productive efficiency. But the greatest potential advantage of reflexive law is the way in which it permits the subjects of regulation, in this instance the parties to a contract, to express their expectations of the relationship in their own language, so that their private regulation minimizes any distortion of communication that might be imposed by a regulatory framework.

This reflexive character of private law regulation works best when the parties negotiate the terms of the contract. The use of standard form contracts does not impede this process provided that the parties have the opportunity to negotiate variations from the model. When businesses impose standard form contracts upon consumers, however, the terms are likely to give expression solely to the expectations of the business. Adhesion contracts achieve only partial reflexivity. Consider, for instance, the following clause in a contract to supply a mobility aid to a consumer.

> The company reserves the right at any time and without notice to vary or alter any of the design specification and packaging of equipment described in its sales literature.[15]

At first sight this term produces a one-sided contract, for the manufacturer appears to be entitled to substitute a different product for that promised under the contract. From the point of view of the manufacturer, however, in order to remain competitive, it must institute a process of continuous improvement in its products, and if this strategy is successful, the sales literature will inevitably lag behind. Since the variations in design are intended to benefit the consumer, the manufacturer does not foresee any unfairness arising. The contract term is reflexive because it represents the commercial situation accurately. The problem is that the clause is too broadly stated, for the consumer may be concerned that the new product design will be inferior or less suitable for her needs. The standard form failed to reflect these competing expectations, though no real conflict of interest was present. As a result of an intervention by the Unfair Contract Terms Unit of the Office of Fair Trading, a public regulatory agency in the UK, the clause was revised to achieve a fully reflexive character.

> The company will use its best endeavours to supply the customer with the exact goods ordered but where this is not possible the company will notify the customer as soon as possible of any alterations to the design, specification and packaging of the equipment described in the sales literature and where the alteration is fundamental to the goods ordered the customer may terminate this contract and any deposit paid will be refunded.[16]

Partial reflexivity is a weakness of consumer adhesion contracts. The appropriate response is not a complete removal of the power to tailor contract terms to the precise market conditions of the transaction by the imposition of mandatory public standards on all sales contracts, but rather to renegotiate the clause so that it achieves a fully reflexive character that incorporates the expectations of consumers.

Private law thus addresses the problem of self-reference in its doctrinal discourse by seeking to maximize the opportunity for the parties to express the governing rules in their own terms. These terms of the contract still must be interpreted by the law, which reinserts the problem of self-reference, but the strategy of endorsing self-regulation tries to minimize the distortions of regulation. In other words, the private law of contract presents a distinctive approach to the problem of the 'regulatory trilemma'. As described by Teubner, this trilemma states that: either the legal rules may fail to have an impact on social practice, or they may subvert the

15 Office of Fair Trading, *Unfair Contract Terms*, Issue No. 3, (London: March 1997), 72.
16 Ibid.

desirable social practices by making impractical demands, or the law may lose the coherence of its own analytical framework by seeking to incorporate sociological and economic perspective in its reasoning.[17] Private law regulation minimizes the threat of the second limb of the trilemma by granting a wide scope for self-regulation. In so doing, however, it has to wrestle with the problem of retaining its own coherence (the third limb), and poses for itself major structural weaknesses in implementation (the first limb), to which we now turn our attention.

Standard Setting

It is well known that private law is a weak technique for implementing economic and social regulation. After all, it was the search for more effective regulatory techniques that led to the creation of modern styles of public regulation. The lesson was learned again in connection with measures of consumer protection, where it quickly became apparent that alterations in private law rights were insufficient to adjust market practices. Why exactly is private law an ineffective regulatory technique?

A simple answer points to the problem of access to justice: most people do not have the resources to vindicate their private law rights in the ordinary courts, so their rights remain unenforced and ignored. Although this answer contains an element of truth, in my view the problems for the efficacy and efficiency of private law as a regulatory technique run far deeper than this procedural obstacle of the expense of justice. The problem of access to justice is merely one aspect of the difficulties for private law in establishing an effective mechanism for the monitoring of compliance with standards and the enforcement of standards. Before we consider how that problem can be tackled by private law regulation, we need to consider the more complex problem of standard setting by private law. In the formulation of standards for guiding participants in markets, the private law of contract suffers from several structural weaknesses. These weaknesses include the difficulties of incorporating externalities in setting standards, the problems of setting standards with an adequate degree of specificity in order to provide effective guidance, and the lack of expertise in choosing between standards.

My interest in this discussion lies not so much in cataloguing this list of structural weaknesses in private law as a system of regulation, but rather to notice how private law is developing the capacity to remedy

17 Teubner, G., 'After Legal Instrumentalism? Strategic Models of Post-Regulatory Law', in G. Teubner (ed.), *Dilemmas of Law in the Welfare State* (New York/Berlin: Walter de Gruyter, 1988) 299, 309.

these weaknesses. As private law undergoes the process of what was described in the previous chapter as productive disintegration, it evolves new capacities for redressing its own regulatory failures. It learns these capacities through its interaction or 'interference' with public regulation.

Externalities

A fundamental weakness of the private law regulation of contracts consists in the subordinate role played by third parties whose interests may be affected by the self-regulated transaction. Unlike a regulatory regime imposed by an agency that is required to consider the interests of all affected parties and other externalities, under the rules of private law the self-regulation represented by the contractual agreement denies the need to consider any spill-over effects. Private law lacks a clear mechanism for the interests to be voiced. Indeed, it is this weakness of the private law system of regulation which often provides the justification for much more interventionist styles of regulation that are designed to compel the parties to a transaction to internalize the costs of spill-over effects such as environmental damage and increased risks to the safety and health of other persons.

One of the important insights of advocates of consumer protection regulation is that the weakness of private law as a remedial system is the atomization of disputes. Private law treats each consumer's grievance about a product or a service as a separate event, isolated from similar complaints about the same product or service. Each decision about a breach of a consumer's contract handles the problem by examining the conflicting interests of the manufacturer or retailer and the individual consumer, without considering the impact of legal regulation upon other consumers in a similar position. In order to address this problem of incorporating third party effects into the formulation of regulation, advocates of consumer protection seek to 'reconceptualise little injustices as collective harms'.[18]

The blindness to externalities of the traditional private law of contract serves an important function in the constitution of markets. Markets can deliver an efficient satisfaction of personal preferences by empowering individuals to act solely in their self-interest when entering transactions. If participants in markets always had to consider the interests of others before entering transactions, then this remarkable mechanism for preference satisfaction would be impeded. When I purchase a washing machine, for instance, if I had to give priority to consideration of externalities such as the pollution of water by its effluent and the damage to the environment

[18] Nader, L., 'Disputing Without the Force of Law', *Yale Law Journal* 88 (1979) 998, 1021.

caused by its consumption of energy, then I might end up by deciding not to purchase the machine. If this behaviour became generalized, then the consideration of externalities would block the operation of the market for the satisfaction of preferences. By excluding the consideration of externalities from its regulation, the private law of contract therefore contributes to the construction of an efficient market.

Modern regulation of business insists, however, that we can have it both ways. We can preserve most of the efficiency of the market mechanism for the satisfaction of preferences, whilst at the same time using public regulation for the purpose of avoiding the worst undesirable externalities. This strategy proposes a division of functions between private law, which supports self-interested action, and public law, which compels participants in markets to take externalities into account. In the example of the washing machine, for instance, the private law of contract supplies the regulation for the enforcement of the contract to supply the machine, and some specific public regulation determines standards which reduce effluent discharge and energy consumption. But how accurate is this analysis of private law that claims it lacks the capacity to take into account externalities in its regulation of markets?

My contention is that private law is evolving the capacity to incorporate considerations of externalities in its formulation of regulatory standards and the application of its remedies. The courts usually resist any ostentatious embarkation upon the unruly horse of public policy and general regulation of contracts, preferring instead to confine the argument to the competing interests of the litigants and their original intentions. The interests of third parties can be taken into account, however, in the interstices of private law doctrine.[19] When determining the detailed content of these rules, the courts can take externalities into account by regarding the parties to the transaction as representative members of a group such as consumers, tenants, and employees. This strategy in private law reasoning has been learned from public law regulation, which characteristically sets the boundaries of its regulatory standards by reference to classes of participants in the market.

A court can devise rules designed to protect the interests of the group as a whole at the same time as disposing of the particular case. For example, by exercising the discretion to imply a default rule as an implied term in favour of a tenant in a particular contract for a lease, the court can in effect provide supplementary regulation of all leases of a similar type. We illustrated this process in the previous chapter in the discussion of the case

[19] These arguments are developed further in Collins, H., 'The Voice of the Community in Private Law', *European Law Journal* 3 (1997), 407–21.

Liverpool City Council v Irwin.[20] In that decision the court implied a term into leases of apartments in high rise buildings that the landlord should take reasonable care that the common areas of access should be kept in a state of 'reasonable repair and useability'. We noted that the argument for such a default rule based upon the joint intentions of the parties was weak in the particular case, due to the evidence about the contrary intentions of the landlord in devising the terms of the standard form contract. Nor could the term be implied on the basis of 'business necessity', the legal test which seeks to ascertain what would have been agreed explicitly by the parties in the pursuit of their own self-interest. The self-interest of the landlords was opposed to the proposed implied term, and it was not clear that any particular tenant would prefer a higher rent combined with the implied term to the actual agreement which was signed. The justification for the default rule lies rather in a consideration of externalities, such as the interests of tenants in high rise blocks in general, and the public interest in improvements to the housing stock. In the private law reasoning in the case, this concern for externalities is disguised by the adoption of a legal test for the default rule of 'reasonable necessity'. This test looks simultaneously in both directions: it represents an endorsement of self-interested action, whilst at the same time the qualifier of reasonableness permits the court to insert a consideration of externalities into its reasoning process. The test provides the private law of contract with the capacity to escape the confines of supporting self-interested action exclusively.

The move from a consideration of the interests of the parties to the litigation to the interests of a class which they represent has become a standard technique in private law reasoning. This move then provides the capacity for private law to incorporate a consideration of externalities into its determining of standards and award of remedies. A typical example learned from public regulation involves the classification of a litigant as a 'consumer'. The court sets a standard appropriate for all members of the class, not simply the individual parties to the agreement. In *Smith v Eric S. Bush*,[21] for instance, the issue concerned the power of surveyors to limit their liability by contractual terms for negligent inspections of property that failed to alert a potential purchaser to structural defects in a house. The limitation of liability enabled the surveyors to provide a cheap service, though it created a risk for purchasers that the property acquired would be worth much less than the sale price. The Unfair Contract Terms Act 1977 empowered the court to determine the validity of the limitation clause on the basis of whether it was 'fair and reasonable', which provided the capacity for a consideration of externalities. In determining that the limita-

[20] [1977] AC 239, [1976] 2 All ER 39, HL.
[21] [1990] 1 AC 831, [1989] 2 All ER 514, HL.

tion clause was invalid, the court defines the class of contracts where such terms will be invalid by reference to the characteristics of the parties. On the one side is a professional with liability insurance, and on the other is a purchaser of modest means acquiring his or her most expensive asset. Lord Griffiths reveals the class of regulated contracts in his concluding remarks:

> It must, however, be remembered that this is a decision in respect of a dwelling house of modest value in which it is widely recognised by surveyors that purchasers are in fact relying on their care and skill. It will obviously be of general application in broadly similar circumstances. But I expressly reserve my position on valuations of quite different types of property for mortgage purposes, such as industrial property, large blocks of flats or very expensive houses.

This passage suggests that the private law regulation of terms purporting to limit the liability of surveyors will differentiate between classes of transactions according to the type of party receiving the advice and the property to be inspected. This differentiation by class is the hall-mark of the insertion of externalities into private law reasoning.

Once private law develops this capacity for considering externalities, then it poses many problems for assessment of the impact of regulation. One problem concerns the determination of the relevant class whose interests should guide the standards. The choice of class implicitly determines which externalities will be awarded priority in the legal reasoning. For example, the issue in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd*,[22] was whether the court should issue an injunction to require a supermarket in a shopping mall to remain open until other tenants could be found. The Court of Appeal issued the injunction in order to protect the interests of other tenants in the shopping mall, whose businesses would suffer if the supermarket closed for a period of time, and who had no possibility of redress for their reduction in income. But the House of Lords reversed this decision on the ground that the correct class to consider was the tenants of supermarkets, who would be reluctant to enter into these transactions, if they were compelled to keep their businesses open, even though they were trading at a loss. The selection of the relevant class determines the types of externalities that guide the legal reasoning. The Court of Appeal emphasized the interests of the business participants of the shopping mall as an interdependent business unit and sought to protect the operations of that market. The House of Lords, however, favoured the interests of supermarkets as a class of business entity, and therefore sought to protect the market for retail tenancies.

[22] [1996] Ch 286, [1996] 3 All ER 934, CA; revsd, [1997] 2 WLR 898, HL.

A more pervasive problem for the incorporation of externalities into private law reasoning consists in the lack of capacity of the ordinary courts to investigate the operation of markets and their inability to comprehend such information and transform it into practical regulation.[23] The court has no powers to conduct an empirical enquiry into the consequences of alternative rulings. This limitation is a consequence of the closure rules of private law reasoning. The court cannot know, for instance, whether an implied warranty of 'habitability' improves the position of tenants or has the undesirable effect of reducing the availability of rented accommodation, thereby driving up rents. Even if such information were available, it consists of statistical data, which has to be translated into the different discourse of private law regulation. Similarly, the court in *Smith v Eric S. Bush Ltd* could not be sure of the effects of its regulation of surveyors. Nevertheless, Lord Griffiths explained his assumption about the effect of regulation:

> The result of denying a surveyor, in the circumstances of this case, the right to exclude liability will result in distributing the risk of his negligence among all house purchasers through an increase in his fees to cover insurance, rather than allowing the whole of the risk to fall on the one unfortunate purchaser.

This argument assumes that the increase in fees will not be so substantial as to discourage the use of surveyors by the class of purchasers receiving protection. Lord Griffiths dismisses this risk, even though there was some evidence before the court that the price charged for surveys with unlimited liability was greatly in excess of the standard fee. Reasoning in private law lacks the capacity to examine this evidence by the standards of an empirical and systematic economic analysis to discover where the new equilibrium will be set. Instead, private law regulation fixes the standard by reference to an economic hypothesis about the effects of regulation, and then awaits further information from subsequent litigation to determine the validity of the hypothesis. The source of information is, of course, haphazard and unreliable.

Some critics may conclude that private law should revert to its earlier stance of refusing to contemplate externalities in its reasoning. It should leave regulation for distributive purposes to agencies equipped with the capacity to carry out a systematic inquiry into the effects of regulation. But my view is that the evolution of this capacity of private law to consider externalities cannot now be reversed, and that its enhanced capacity for productive regulation of markets needs to be nurtured by the further loosening of its closure rules rather than aborted.

[23] Henderson, J. 'Judicial Review of Manufacturers Conscious Design Choices: The Limits of Adjudication', *Columbia Law Review* 73 (1973), 1531.

Public Goods

A guiding assumption of private law regulation provides that the objective of state sanctions should be to redress harm to an individual. Without some identifiable loss to a particular individual, then no damages may be awarded. This requirement may not apply to the remedy of declaring the invalidity of the transaction, though often evidence of harm is needed to provide support for allegations of breach of equitable standards such as undue influence. This emphasis upon harm to the individual no doubt fits closely into a liberal political philosophy where the principal role of the state is to deter actions which cause harm to the interests of others.

As a limitation upon the scope for regulation, however, this emphasis upon the need for harm precludes private law from tackling certain kinds of sharp practice in dealings.[24] Consider, for instance, a sign in a shop window proclaiming a 'sale' of goods. This implies reductions of price, and is plainly designed to draw customers into the shop. Once inside, they may agree to purchase 'bargains' and feel pleased with their purchases, though in fact they have paid the normal market price. Where is the harm in such an example? The shopper has acquired desired goods at the ordinary market price; this cannot be described as harm. If there is harm to anyone, it is the rival traders who may have lost sales as a result of the misleading advertising, but as third parties these competitors have no redress either.[25] Another example of the inability of private law to detect harm concerns consumer credit transactions. Where an individual is persuaded to enter a loan arrangement that in the long run he or she has no realistic prospect of being able to repay, private law can detect no harm unless the rate of interest is 'extortionate'. The loan represents an ordinary market transaction agreed under competitive conditions. The harm of driving the individual and dependants into bankruptcy, homelessness, and social exclusion cannot be recognized by private law regulation. Private law regulation is therefore disabled from regulating many sharp practices in the market, even though the prevalence of such practices either undermines its competitiveness or leads to social disintegration.

Many private law rules do in fact protect the institutional arrangements of the market and its competitive properties. Rules against fraud and misrepresentation, for instance, serve to deter lying and the supply of misleading information, practices which would undermine the competitiveness of the market and reduce trust. But these rules evolve in private law because the court can identify a particular individual who has suffered economic loss. What private law cannot achieve within its discourse is the

[24] Rice, D. A., 'Remedies, Enforcement Procedures and the Duality of Consumer Transaction Problems', *Boston University Law Review* 48 (1968) 559.
[25] Trebilcock, M. J., n. 5 above.

protection of abstract or collective interests unless those public goods coincide with private harms.

Insufficient Particularity

Another systematic problem for the efficacy and efficiency of private law regulation is caused by its traditional commitment to generality in respect of both procedure and substance. With respect to the procedural aspect, private law tends to apply uniform procedural and evidential rules to govern litigation across the whole range of contractual disputes. These rules were primarily devised in order to handle the most complex commercial disputes, since these cases occupied most of the business of the private law courts. These rules are then applied equally to the simple claim brought by a consumer for compensation for an unsatisfactory product. In the latter context, the elaborate rules governing the procedural contest, such as the disclosure of evidence requirements, seem to impose costs out of all proportion to the sum of compensation in dispute.

This problem of inefficiency can be partially solved by the differentiation of the ordinary courts into specialized branches, such as a commercial court, a small claims court, or courts with special expertise in particular types of transaction such as employment and landlord and tenant. Yet the commitment to generality in private law tends to undermine this type of differentiation. The general principles of civil procedure will be imposed in all these courts in the absence of specific statutory derogation, and a failure to apply these general rules will result in a successful appeal against the decision of an inferior tribunal. As a consequence, the cheaper and more efficient tribunals are frequently criticized for the unnecessary legal formality and the expense of their procedures.

This assault on the legalism of inferior tribunals seems to me to present an unattractive sweeping criticism. Part of the purpose of these rules of procedure is to ensure that both parties have a fair opportunity to state their arguments, and any weakening of these elements would deprive adjudication of one of its principal sources of legitimacy. Where the concern about legalism may represent a fair criticism of procedural rules is when these rules prevent tribunals from acquiring information about the particular transaction and the context in which it took place. But I doubt whether the general procedural rules have this effect to any great extent, for there are many ways around the artificial restrictions on the presentation of evidence.

With respect to the substantive aspects of private law, the tendency towards generality in rules again presents problems for the efficacy of regulation. The desirable level of particularity of any regulatory regime of rules always raises problems of balancing such concerns as transparency

in formulation, their accessibility in the sense that the rules can easily be self-applied, and their congruence with policy objectives.[26] The clever solution to this problem produced by the private law of contract lies in the combination of general rules with extensive, particularistic self-regulation through agreement on the terms of the contract. Yet this strategy does not remove the difficulty for regulatory efficacy. In so far as regulatory objectives can only be achieved through general rules rather than self-regulation, then the commitment to generality in private law obstructs sufficient particularity in regulation.

We noticed this problem in the previous chapter in connection with exclusion clauses in standard form contracts. That problem of generality was that in commercial contexts exclusion clauses often represent an efficient exercise in self-regulation for the allocation of risk, but in consumer standard form contracts the practice of inserting exclusion clauses in the small print was interpreted rather as a sign of market failure. Private law reasoning was unable to produce legal reasoning that differentiated between these classes of contracts for the purpose of regulatory intervention. The general rule that favoured freedom of contract was applied to commercial transactions and standard form consumer contracts alike.

It is true that over a long period of time legal doctrine has developed specialized regulation for certain types of recurrent and familiar contracts such as the sale of goods. These nominate contracts often have special regulation, such as a standard set of default rules or implied terms or a particular style of remedy. But the list of nominate contracts remains short compared to the potential variety of business transactions. We therefore discover a wide range of modern commercial relationships such as franchises where no particularized regulation has yet developed. Another effect is that legal reasoning often seeks to classify these modern business relations within traditional categories in an inappropriate way, since the novel arrangements are hybrids and adaptations to new commercial objectives.

Modern legislation often introduces a decisive rupture with the traditional generality of the private law of contract by regulating for the discrete handling of particular types of contracts or contracts with parties with particular characteristics. In this vein, for instance, extensive regulation of the contract of employment distances it from traditional private law regulation. Similarly, consumer protection legislation introduces separate mandatory rules for consumer contracts. This legislation may be seen as responding to a regulatory failure of private law to differentiate its rules in

[26] Diver, C. S., 'The Optimal Precision of Administrative Rules', *Yale Law Journal* 93 (1983), 65; Baldwin, R., *Rules and Government* (Oxford: Clarendon Press, 1995) 175–85.

response to new policy objectives. Its effect is to narrow the sphere of transactions regulated principally by the private law of contract, and to subject the selected category to a heavily modified private law regime.

Modern private law responds to these challenges to its generality by developing the capacity to embrace greater differentiation in its regulation. This is part of the phenomenon we described as the productive disintegration of private law. We can now suggest that one reason why greater differentiation within private law rules governing contracts can be productive is that it facilitates more efficacious regulation of particular types of contract.

Although greater differentiation in the rules of private law permits more efficacious regulation of contracts, private law cannot proceed far down this road without presenting a crisis of legitimacy. Greater particularization of the rules renders the task of articulating the coherence of the legal doctrine much more formidable. If the rules differ according to the category of contract, then private law requires principles which can provide a rational explanation of the categorization and the reasons for differential regulation. The search for a coherent rationalization of private law doctrine also undermines the stability of rules that are presented as exceptions. We observed this problem before in connection with the principle of fairness in contracts. Once regulation permits the assessment of the fairness of terms in contracts in numerous particular instances such as consumer contracts, employment, and tenancies, then it becomes difficult to assert that the general principle of private law declines to assess the fairness of contracts. The question constantly arises whether some other category of contracts should also be subjected to a requirement of fairness. Yet if the private law principle is not a refusal to judge fairness, it is hard to say what it is. A particularistic, unprincipled private law regulation then can be attacked as lacking its basis of legitimacy in the rational articulation of fundamental principles of human association, that is the ideal of integrity in law. Private law regulation therefore puts up a stubborn resistance to the demand for increasing differentiation of its rules in order to preserve its own legitimacy. In other words, private law suppresses its potential regulatory efficacy in order to avoid the problem of the third aspect of the 'regulatory trilemma'.

This problem of insufficient specificity for the purposes of regulatory efficacy can be tackled most fruitfully by the development of default rules to supplement self-regulation. These supplementary rules or implied terms avoid the problem of generality by their presentation as default rules for a particular agreement. Yet at the same time, the rules can be developed to apply to a whole class of contracts, as we have noted, for instance, in the context of tenancies in high rise apartment buildings.

As supplementary rules, however, this regulation runs the risk of being

ineffective due to the systematic use of express contractual exclusions in standard form contracts. The solution at this point for private law is to develop the idea that some supplementary rules cannot be waived at all, or cannot be excluded without express and conscious agreement. The former idea of compulsory terms encounters a different problem of doctrinal integrity, namely that default regulation should in principle always give way to express self-regulation. In England, such compulsory terms have required legislative intervention so far in order to provide a justification for their exceptional treatment. In the United States, some default rules, such as the implied warranty of habitability in residential leases, have been declared to be non-waivable on the ground of public policy, namely the public interest in health and safety in housing.[27] A second method of placing procedural obstacles in the way of exclusion of default rules can be developed by private law without significant revision of doctrine. The requirement of taking reasonable steps to notify the other party of any 'unusual and onerous' terms in a standard form contract has been interpreted as part of the ordinary doctrinal requirements for establishing the content of the terms of a contract.[28] In the American Restatement of Contracts 2d, the rule is presented as a method for determining the applicability of terms contained in a standard form document to the content of the agreement.[29] The stronger the procedural requirement, that is, the more steps required before reasonable notification has been given, the harder it will be to exclude the default regulation.

Guidance

One objection to regarding private law as a system of regulation is provoked by the comparative absence of explicit policy justifications. In public regulation, the legislation usually states its objectives either as a preamble or as a direction to a regulatory agency. But in private law doctrines, the formulation of principles describes a deontic order rather than a set of instrumental goals. Of course, one can attribute to particular private law rules a policy objective and then consider their effectiveness in achieving that objective. But the objection can always be made that this is not the correct policy objective to attribute to the rule, or indeed that to

[27] *Fair v Negley*, 257 Pa. Super 478, 390 A. 2d 240 (1978).

[28] *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, [1988] 1 All ER 348, CA; in the USA, the term will not be binding if not brought to the buyer's attention and he was not made understandingly aware of it: *Henningsen v Bloomfield Motors, Inc*, 32 N.J. 358, 161 A. 2d 69 (1960).

[29] s. 211(3) 'Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.'

attribute a policy objective would be to misconceive the discourse of private law.

This vagueness and ambiguity with respect to policy objectives is both a strength and a weakness of private law regulation. The strength comes from the potential this leaves for each generation to reinterpret the rules of private law in accordance with contemporary policy objectives. The weakness for private law is that it persistently evades criticism about its efficiency and efficacy as a regulatory system over markets.

The strength which private law draws from the indeterminacy of its policy objectives can be illustrated by showing how its abstract concepts can be manipulated in order to favour rival policy objectives. The law of contract usually contains a general test for the legal enforceability of contracts, such as the requirement of 'consideration' in the common law and 'causa' in systems based closely on Roman law. This requirement is stated in sufficiently abstract terms that in its interpretation it can embrace either policies which favour an unrestricted free market or policies which favour controls over the fairness or justice of transactions. In the case of the common law doctrine of consideration, it requires that the parties should have agreed to an exchange, so that each party is expected to give up something of value in return for the reciprocal undertaking. The ambiguity here lies in whether the law regards what is being given up as something of value 'in the eyes of the law'. A policy that favours freedom of contract can simply assume that whatever has been requested amounts to something of value for these purposes, so that even if the request is for handing over a trivial item such as a peppercorn, this satisfies the requirement of consideration. But the identical legal principle can also justify controls over unfairness, as where the court may declare that a promise to perform a pre-existing legal duty does not amount to any detriment at all, and that therefore the requirement of consideration has not been satisfied. The same legal requirement can therefore be used for rather different instrumental policy objectives. This feature of the abstract and general rules of private law enables them to persist over long periods of time without ostensible change even though in their interpretation and application the policy objectives may fluctuate.[30] Private law regulation in the form of abstract rules and principles has the strength that it does not require reformulation in order to adjust to shifts in policy with respect to regulation of markets.

At the same time, of course, this regulatory style creates the weaknesses that it renders it more difficult to determine in advance the requirements of the legal regulation, and that it prevents challenges to the law based on

[30] Renner, K., *The Institutions of Private Law and their Social Functions*, O. Kahn-Freund (ed.) (London: Routledge, 1949).

criticism of the lack of effectiveness of the regulation. No-one can be sure in advance whether or not a court might decide to use the doctrine of consideration to police the unfairness of a transaction. If it fails to do so, the decision cannot be criticized on this ground, for the legal regulation has never explicitly claimed that its purpose includes the regulation of fairness.

Furthermore, the self-perception of private law adjudication that it concerns the resolution of a dispute rather than the regulation of a market by setting a standard tends to result in the production of standards which cannot guide market behaviour. As soon as private law departs from its abstract principle in order to determine the outcome of a particular case, the standard set by adjudication will often be tied closely to the facts of a particular transaction, so that it is difficult to generalize its application to other contracts. 'The implications for systematic policy development are serious: the most we can expect from the common law courts is sporadic, *ex post, ad hocery*.'[31]

This emphasis upon dispute resolution in individual cases also leads to the incapacity of private law to publicize its standards. The detailed regulatory standards produced by private law can only be gleaned from the reports of courts' decisions, which are seldom complete. These decisions are then only disseminated by uncoordinated private publicity in the form of books and articles about the law. Consider, for instance, the problem of discovering the appropriate standard of quality for a car. The general law informs the parties to the transaction that the car must be of 'satisfactory quality', but any further detail is almost impossible to obtain despite the fact that the purchase of a car almost certainly produces the major source of litigation in the area of consumer claims for product quality.[32] The decisions of the courts in the UK that deal with these issues are not published unless the case goes to appeal, and even then it requires the expensive advice of an expert lawyer to gather any useful guide about the requirements of the standard. Effective standard setting plainly requires the dissemination of information about the requirements, for otherwise exact compliance tends to be fortuitous. But the private law system can rarely achieve adequate dissemination of its standards to the regulated industry or market.

If we take the view that the merits of any form of regulation must always depend upon its relative success in achieving policy goals compared to other techniques of regulation, the vagueness of the policy objectives of private law regulation tends to defeat any intelligible assessment of the

[31] Belobaba, E. P., 'The Resolution of Common Law Contract Doctrinal Problems Through Legislative and Administrative Intervention', in B. J. Reiter and J. Swan (eds.), *Studies in Contract Law* (Toronto: Butterworths, 1980) 423, 444.

[32] For discussion of this example, see Ramsay, I., *Consumer Protection: Text and Materials* (London: Weidenfeld and Nicholson, 1989) 430–8.

efficacy of regulation. The secrecy of private law in respect of its detailed standards also obstructs such an assessment and places substantial obstacles in the way of compliance and enforcement. Public regulatory techniques usually have the relative advantage that their policies are usually articulated and their detailed standards publicized, so that we can assess their merits as interventions and their success in achieving compliance.

Private law can develop this capacity for setting standards that can guide participants in markets when it adopts a particular pattern of reasoning. It has to forgo the flexibility of abstract principle in favour of a more explicit rationalization of the policy behind the law. The policy statement combined with general principle can then produce more determinate guidance, which can be generalized across a series of transactions. We saw an example of this style of reasoning in *Smith v Eric S. Bush*,[33] the case concerned with the negligent valuation of a house by a surveyor. By stating the policy objective behind the creation of liability in negligence and the inability to exclude such liability in terms of consumer protection for major investments combined with loss distribution through the system of liability insurance, the court was able to provide an effective regulatory standard. For the vast majority of ordinary house purchases, the court makes it clear that surveyors must be subject to a standard of reasonable care and must also take out liability insurance against costs of breach of that standard. The clarity of the regulatory standard supplied by this private law reasoning depends upon the explicit articulation of the policy objectives of the rule imposed by the decision.

Expertise

The ordinary courts are the crucial agency in setting private law standards. In the Common Law jurisdictions the courts created private law through the system of precedent. In Civil Law systems, the ordinary courts provide the concrete regulation derived from the general, abstract provisions of the Civil Codes. The courts possess unrivalled expertise in the details of private law. At the same time, they lack all the necessary dimensions of expertise and information for the task of setting standards for regulating markets. We have already encountered some of these problems. Private law seeks to regulate all markets, which presents enormous difficulties in acquiring information about the operation of those markets and how contracts function within them. Since any business relation, from a trivial consumer purchase to a complex long-term international business transaction, falls within this jurisdiction, the judges will be unlikely to understand the

[33] [1990] 1 AC 831, [1989] 2 All ER 514, HL.

particular context of the self-regulation across the whole range of disputes brought before the court. To compound the problem, the principal source of information available to a court will come from litigation proceedings, which provide a distorted and unrepresentative sample of market practice because of the incidence of the taste for litigation.[34] Compared to a regulatory agency charged with the task of regulating a particular market, with the power to acquire systematic information about the operation of that market, private law courts are plainly disabled in their formulation of satisfactory standards.

Despite this lack of expertise, the Chicago school of law and economics tends to assert that private law regulation of business transactions is superior in terms of economic efficiency and sometimes even economic policy implementation to other forms of regulation.[35] The first step in this argument insists that many types of regulation of business tend to impair economic efficiency, since the regulation, by restricting market activity, reduces the opportunities for wealth-enhancing transactions. The second step demonstrates that many regulatory interventions have the potential to back-fire by actually harming the group which they are designed to protect.[36] An example of this problem might be the control of interest rates in consumer credit, which discourages lenders from making loans to high-risk groups such as the poor, with the ultimate effect of preventing the poor from obtaining credit at all. A third step in the argument points to the risk that regulatory intervention will be distorted away from its ostensible objectives by the political process, even creating the risk that the large businesses that are supposed to be controlled by the regulation may achieve the position of dictating the content of the rules. Although sometimes exaggerated, these steps in the argument do provide grounds for being suspicious of business regulation. It is the final step in the argument, however, which interests us most here. This conclusion asserts that the private law of contract usually provides the regulation best designed to promote efficiency, and that minor adjustments of private law rights and obligations will usually prove the superior regulatory strategy for setting standards.

This faith in the expertise of the ordinary courts to devise satisfactory regulation of business transactions seems to depend upon a perception that for the most part the courts maximize self-regulation or freedom of contract. Private law therefore avoids the objection to regulation in the first step of the argument by restricting opportunities for wealth-enhancing transactions in only a few rare instances. Minimizing mandatory regulation of business transactions is certainly a relatively straightforward task for

[34] See below Ch. 14. [35] Posner, R., n. 12 above.
[36] This argument is examined critically in Ch. 11 below.

ordinary courts, so it becomes plausible to suppose that they can carry it out as well as most regulatory agencies. Private law also meets the second step in the argument by rarely seeking to pursue an ostensible policy of protecting particular groups in markets or redistributing wealth. Its regulation therefore cannot back-fire, since it tends to support wealth maximization as the predominant policy objective. Indeed, where private law attempts to deviate from this path of freedom of contract, as for example in the control over exclusion clauses in sales to consumers, the Chicago law and economics school tends to criticize this private law regulation on precisely the same grounds that it tends both to impair efficiency in the sense of wealth-maximization and to back-fire by harming consumers. The final virtue of private law regulation from this perspective is that the ordinary courts are relatively immune from turbulent political pressures, so that powerful interest groups cannot obtain advantageous concessions. This perception of the autonomy of court processes from political influence is certainly unfounded, for pressure groups such as insurance companies plainly use litigation as a technique to obtain favourable regulation. Nevertheless, it is true that the ordinary courts are relatively immune from political pressures compared to the legislature and regulatory agencies.

The major objection to this presentation of the virtues of private law regulation is simply that the priority which it awards to wealth-maximization as a goal for regulation may not accord with the preferred policy objectives of the regulation of markets. As soon as one departs from wealth-maximization as the sole objective by introducing some other task for regulation such as consumer protection, then the problem of the lack of expertise of the ordinary courts becomes a structural weakness of private law regulation.

A second objection to the arguments of the Chicago school questions whether the task of determining the rules which maximize wealth through transactions is in fact so simple. As soon as it is observed that free markets are not always competitive, but contain various market failures such as those caused by lack of information and unreliable information, the task of regulation in order to reduce or eliminate market imperfections becomes complex. For example, how far should private law control misleading information? We might argue on the one hand that only false information as opposed to misleading information should lead to the sanction of invalidity in private law, since only when the information is false can we be sure that it distorted the market. On the other hand, we may consider that misleading information, such as advertising which suggests that products are being sold at a bargain price rather than their normal market price, does distort markets by discouraging price comparisons, so that it should provoke private law sanctions. The determination of where to fix the limits of regulation in order to remedy market failures cannot be reached by some simple private law reasoning process, but requires an investigation of the consequences of market distortions and the likely beneficial effects of regulation. In drawing such fine lines at the outer limits of regulation, even when the policy objective is merely one of wealth enhancement proves to be a task which goes beyond the expertise of ordinary courts.

This lack of expertise in the ordinary courts in regulating markets is the inevitable corollary of the self-referential quality of private law reasoning. As long as a sharp distinction is drawn between, on the one hand, legal reasoning, and, on the other, social and economic enquiry, then the courts will lack the capacity to integrate information about the effects of regulation into their reasoning process. The path of reducing the self-referential quality of legal reasoning by drawing economic and statistical information into the process of adjudication might relieve this problem, but only at the price of subverting the integrity of legal doctrine itself. This tension goes to the heart of the regulatory trilemma. As the courts venture towards the introduction and assessment of social and economic information in their reasoning processes, this move towards the 'materialization' of law comes under criticism for creating a problem of legitimacy for the authority of the courts.[37]

The process of regulation through adjudication also suffers from an acute shortage of information. An efficacious regulatory system requires a 'feed-back' loop, through which it can observe the effects of its regulation and then respond through re-regulation to shortfalls in compliance. The ordinary courts possess only an unreliable feedback mechanism. This mechanism consists of the litigated cases coming before the courts. The courts can observe the effects of their private law regulation in cases where the parties seek to contest the content of the regulation. In the example of the sale of cars, the courts can observe the consequences of their regulation that requires new cars to be free from any defects, and then adjust that standard in the light of any difficulties which it presents to car dealers. The defect of this feedback mechanism is that it provides highly selective information. Objections to the effects of private law regulation will only be voiced by those participants in markets who have a taste for litigation. In the context of consumer transactions, for instance, the courts are only likely to receive objections from businesses, for consumers will normally lack the resources and incentive to raise a point of law, that is, to challenge the existing regulation. This feedback mechanism is therefore likely to provide the

[37] The debate about the crisis of legitimacy provoked by the 'materialization' of private law has been pre-eminent in Germany: Weber, M., *Economy and Society* (G. Roth and C. Wittich eds.), (Berkeley: University of California Press, 1978), ii, ch. 8; Habermas, J., *Between Facts and Norms* (Cambridge: Cambridge University Press, 1996) ch. 9; Teubner, G. (ed.), *Dilemmas*, n. 17 above.

courts with a distorted source of information about the effects of regulation. As a consequence, even when the courts introduce into the legal reasoning a more contextual appreciation of the regulatory context, they are starved of reliable information about that context.

One conclusion that might be drawn from this problem of lack of expertise is that the courts should simply abandon any attempt to provide instrumental regulation through private law. Hayek even argues that the operations of the market are always too complex and unknown for regulation to become a precise science regardless of the expertise of the agency.[38] At best, regulatory agencies engage in a practice of trial and error, in which the regulation is constantly altered as it is observed to be ineffective or counter-productive with respect to its policy objectives. Hayek then contends that this constant process of change is in itself damaging to the economy, for it discourages long-term planning and investment in private transactions. It also creates the opportunity for the political process leading to regulation to be abused either by distortions by interest groups or simply the arbitrary use of power. He concludes that regulation of business should be discouraged because it threatens the rule of law, by which he means a respect for the freedom of the individual by controlling state power. Private law regulation of the economy, provided that it is stable, general, and not subject to political pressures, is the only desirable form of regulation on this view. Since no one has the requisite expertise to regulate business effectively, the second-best solution is to prefer simple, stable regulation of the kind provided by private law.

My disagreement with this view returns us to the point of commencement of this chapter. Although private law often presents itself as a type of pre-political support for private ordering without regulatory objectives, my contention has been that in the formulation of standards private law has always responded to instrumental concerns. The general rules of private law therefore contain implicit policy objectives that can be compared to the instrumental goals of business regulation. The question we have been considering here is whether the courts possess the expertise and information to devise general, stable regulations, which provide adequate support for a flourishing market economy. What is so worrying about the private law system is that it lacks the mechanisms to acquire information about the effects of regulation and the reasoning processes needed to incorporate this information within its discourses. Hayek is right to insist that the regulation of markets is an extremely complex task which stretches the capacity of human institutions to the limits. It is then astonishing, however, that he should seek to vest this task in the ordinary courts exclusively, when this

[38] Hayek, F., *The Constitution of Liberty* (London: Routledge, 1960).

institution has such deep flaws in its capacity to acquire and process information about its environment.

Yet private law can generate tools for the acquisition of expertise. The relevant information can be acquired in a more systematic way by permitting the parties to the litigation to present statistical information and other forms of expert evidence. This right to supply information could also be extended to interested pressure groups as 'amicus curiae', who might be permitted to submit written briefs to the court that address the problem of setting an effective standard. These practices of using a 'Brandeis brief' containing statistical information and admitting information from pressure groups have become widespread in the US in the context of litigation about constitutional rights and public law issues. My argument is that they should also be extended systematically to private law litigation in order to grant the ordinary courts the capacity to overcome their lack of expertise in setting standards.

Monitoring and Enforcement

The private law system leaves monitoring and enforcement of the self-regulation and the mandatory regulatory standards to the parties to the transaction. This mechanism fits into the strategy of maximizing the flexibility or reflexivity of the regulation by conceiving of the rules as conferring alienable rights. The question which concerns us here is whether by relying on the use of resources by participants in the market rather than supplying public support, the private law system provides inadequate resources for monitoring and enforcement of standards. The absence of public financial resources to support regulatory compliance tends to limit the ability to enforce the rules to those with considerable wealth. The costs of litigation will often deter the enforcement of standards where the damage caused by the violation imposes only a minor cost on the plaintiff. When consumers experience minor problems with goods or services, for instance, it is most unlikely that they will turn to private law mechanisms of enforcement, even to the extent of contacting a lawyer. They will rather try to deal with the problem by making a complaint and seeking redress by informal means.[39] But more litigation about private law rights is not necessarily an advantage, for it imposes costs on the participants in markets. How can we describe and achieve an optimum level of monitoring and enforcement?

[39] National Consumer Council, *Seeking Civil Justice—A Survey of People's Needs and Experiences* (London: National Consumer Council, 1995).

Efficient Level of Enforcement

The appropriate level of enforcement may be described by a cost and benefit analysis. The costs of enforcement should be weighed against the benefits achieved by increasing the levels of regulatory compliance. The problem of the lack of resources of private litigants can then be described as a failure to achieve an optimum level of compliance due to insufficient enforcement proceedings. In the case of consumer contracts, this argument suggests that the private law enforcement procedure of a law suit to claim compensation for shoddy goods and services fails to achieve an optimum level of compliance, because in individual cases the costs of litigation exceed the benefits to be achieved, even though at an aggregate level the benefits of compliance with the regulatory standard of satisfactory goods exceed the total cost of litigation required in order to provide a sufficient degree of incentive for manufacturers and retailers to comply with the standard. This analysis therefore describes a collective action problem at the heart of the regulation of consumer contracts by private law.

To resolve this problem for private law regulation, a public or a collective group (such as a consumer organization) is required in order to pool resources. Such a consumer organization with the power to initiate litigation can achieve an optimum level of enforcement by commencing a sufficient number of test cases to provide the correct incentives for regulatory compliance. Consumer groups enjoy such powers in some jurisdictions of the Member States of the European Union, such as Germany and Italy. The power seems likely to be extended throughout the Community in order to harmonize the levels of regulatory compliance with European Directives aimed at consumer protection.[40]

We must be careful, however, not to make the mistake of assuming that the lack of resources for the enforcement of private law regulation necessarily leads to a failure to achieve an optimum level of enforcement. This mistake occurs when we forget that the major incentives for regulatory compliance do not depend upon legal sanctions, but rather upon other kinds of non-legal sanctions such as damage to the business reputation of a trader. The enforcement mechanism provided by the law is usually a minor

[40] Commission Green Paper, 'Access of consumers to justice and the settlement of consumer disputes in the single market', Com (93) 576, concerning the proposed Directive on Injunctions for the Protection of Consumers' Interests, OJ C389, 22.12.97, p. 51. Under the proposed Directive, which is expected to be adopted by the end of 1998, Member States will be able to designate as 'qualified entities' one or more independent public consumer bodies as well as private consumer bodies which will be able to seek injunctions in the courts of other Member States to stop traders contravening consumer rights under nine EU consumer policy Directives, including that on unfair terms. Department Of Trade and Industry, *Widening the Scope for Action under the Unfair Contract Terms Regulations: A Consultation Paper* (London: DTI, January 1998). The Lord Chancellor has also announced plans to consider the possibility of allowing representative actions more widely throughout public and private law.

consideration in the incentives for regulatory compliance. Retailers of goods, for instance, will generally comply with the standard of providing goods of satisfactory quality for the sake of establishing a good business reputation so that consumers return to the shop. Thus the question of the optimum level of resources to be spent on the enforcement mechanism must be assessed in the light of information regarding actual levels of compliance with standards in the absence of legal enforcement. When compliance appears to fall below an optimum level, and the enforcement mechanism appears to provide weak additional incentives, then we need to address the problem of the lack of resources inherent in the design of the private law self-enforcement mechanism.

Detection

The resources provided for an enforcement mechanism also must be adjusted in order to cope with the difficulty of proving that a violation of a regulatory standard has occurred.[41] In many instances of breach of contractual regulation, the failure to comply may be easy to establish. If the goods are damaged or do not function properly, then this defect can be established by casual observation. Nevertheless, problems of proof do occur frequently in contractual contexts. When the issue is compliance with a negligence standard, that is, whether the provider of services took reasonable care, the matter may only be resolved after lengthy consideration of past conduct which is not directly observable. Similarly, when the dispute concerns the loyalty of an agent, the evidence of corruption or failure to put the best interests of the principal first may be ambiguous.

One solution to this problem of detection is to provide public resources to supplement private litigants. Some regulatory standards are simultaneously criminal offences, as in the case of fraud and deceptive trade practices, so that the state's resources are used to detect breaches of standards and to enforce compliance. But criminal enforcement mechanisms only apply to a small segment of those contractual disputes where the breach of standards is hard to detect and to prove.

Another solution to the problem of detection is to transfer the burden of proving compliance onto the alleged violator. This reversal of the burden of proof is common in public regulation, where the business can defend itself against a criminal prosecution by arguing that the default occurred despite the exercise of due diligence. The trader has to reveal its operational and management methods in order to prove this defence of due diligence, which in turn creates the opportunity for a court to discern

[41] Landes, W. M., and Posner, R. A., 'The Private Enforcement of Law', *Journal of Legal Studies* 4 (1975) 1.

failure to comply with the regulatory standard. Private law regulation has the capacity to achieve similar methods of detection, though it is hampered by a principle that requires those who allege fault to produce the initial evidence. But if the courts regard proof of an unsatisfactory product or an inadequate service as sufficient evidence of breach of the regulatory standard, then the legal process can imitate public regulation by in effect requiring the trader to demonstrate the absence of fault. In a case such as *Smith v Eric S. Bush*, for instance, once the purchaser has demonstrated that the survey and valuation was plainly wrong, then the court can switch the burden of proof onto the surveyor to demonstrate that the defects in the property were not discoverable even on careful inspection. The capacity of private law to detect failures of regulatory compliance turns crucially on such techniques for the reversal of the burden of proof.

Poverty of Sanctions

Another major weakness of the private law system of regulation consists in its impoverishment with respect to penalties for violations of the rules. In relation to contracts, the penalties for breach of private law regulation are usually confined either to a declaration of the invalidity of the transaction combined with restitutionary remedies, or to the award of compensatory damages for breach of the self-regulation represented by the terms of the contract and the default rules. This range of remedies compares unfavourably with alternatives provided by public regulation and non-legal sanctions. For instance, both of these latter systems of penalties have the potential to exclude a trader from a market. Public regulation also has the potential to impose compulsory standardized terms in market sectors, or to provide pre-contractual clearance of standard forms in a sector so that objectionable terms are never used.[42]

The private law remedy of invalidity of a contract is weak in securing policy objectives. The declaration of invalidity only applies to a particular transaction, so, unlike a sanction of the removal of a licence or exclusion from a market, the penalty provides little incentive to refrain from the conduct in breach of the mandatory rules. The force of the incentive is further diluted by the presence of effective non-legal sanctions. For example, an illegal transaction in drugs may be deterred by legal invalidity, since the supplier will be reluctant to deliver the goods without payment in advance, but equally the purchaser will be reluctant to hand over the money until the drugs are in his possession. As many criminals discover,

[42] Cranston, R., *Consumers and the Law*, 2nd edn. (London: Weidenfeld and Nicholson, 1984), 80–1.

however, the way around the problem is to create effective non-legal sanctions, such as credible threats of violence, in order to ensure contract compliance. Legal invalidity in this instance therefore plays an insignificant role in deterring these types of market transaction.

The other principal remedy consists of a liability to pay damages in order to compensate for losses caused by breach of mandatory rules and self-regulation. A liability rule imposes a cost on businesses for breach of the rules, and therefore provides an incentive for compliance. The strength of the incentive depends, of course, upon the measure of liability. Under the traditional perspective of private law, the measure of damages has almost invariably been restricted to one of restoration or compensation for provable losses. This corrective justice measure regards the purpose of the remedy as one of restoring the balance of the wealth of the parties, either as considered prior to the formation of the contract, or as it would have been after proper performance of the contract. This narrow policy objective excludes the possibility of setting the measure of liability at a level designed to achieve an optimum level of compliance with the regulatory standards.

The idea of an optimum level of compliance recognizes that at some point the costs of performance in order to achieve compliance will exceed any benefits from performance which might accrue to the other party or society as a whole. The objective of a liability rule might be to provide an incentive to perform up to the point when the additional costs of compliance are higher than the benefits of performance. The strength of the incentive represented by the liability rule would also have to take into account the probability of a successful claim for liability being brought. As private law is largely self-enforced, the risk of liability to a sanction can be quite small in some circumstances such as consumer transactions. In order to counteract this weakening of the incentive toward compliance, the measure of liability would have to be augmented in those cases where successful actions are brought in order to achieve the appropriate level of incentive across a series of transactions. This use of deterrent or 'punitive' damages, as these measures are sometimes called, in order to distinguish them from the compensatory purpose of corrective justice, is, however, generally eschewed in private law systems. Private law lacks a mechanism for the escalation of sanctions that is designed to provide a credible threat against systematic or persistent deviation from its standards.[43] Again this represents a substantial structural weakness in the remedies available in private law to provide incentive for regulatory compliance.

The poverty of legal sanctions forces injured parties back onto non-legal

[43] Ayres, I., and Braithwaite, J., n. 14 above.

sanctions. The best recourse is to refuse to pay for a service or goods, or to reject the defective goods and to demand one's money back. Private law regards these non-legal sanctions with suspicion, however, for this tactic can obviously be used opportunistically in order to evade contractual obligations and to become unjustly enriched at another's expense. As a general principle, the law will not permit this self-help remedy unless the breach of contract has been substantial, so that usually the injured party remains liable to pay for the goods or services. By withdrawing the non-legal sanction for minor defects, the injured party is left with the expensive and ineffective course of seeking compensation. As Reynolds observes, 'The difficulty in English law is then that if the goods are not bad enough to be rejected there is no remedy at all (unless special contract terms provide it).'[44]

These weaknesses in the sanctions offered by private law for breach of its regulations are defended on the ground that an essential feature of private law should be that it focuses entirely on the dispute between the parties to the litigation and not consider broader issues such as those we called earlier externalities and public goods. To the extent that private law is developing the capacity to incorporate such considerations into its standard setting, then the argument in favour of restricting its remedies in traditional ways is undermined. The question becomes rather whether the remedy provides sufficient incentives to comply with the regulatory standard so that the objective of the regulation may be achieved. If the liability to pay compensation for loss fails to supply this incentive, perhaps because the plaintiff cannot point to any harm suffered or because the profits from breach of standard exceed the risk of liability, then private law needs to adjust its levels of compensation. In some instances the courts have introduced suitable variations, such as a remedy for the partial disgorgement of profits in order to combat the problem of profitable breaches of standards.[45] Although private law has this capacity to alter its remedial sanctions, English courts have been reluctant to depart from the tradition of compensatory damages.[46] This reluctance derives in part from tradition, in part from the conception of private law as a system of principles of corrective justice rather than one of regulation, but also in part from a more justifiable concern that damages in excess of compensation might deter participants in markets from entering into contracts.[47] We

[44] Reynolds, F., 'The Applicability of General Rules of Private Law to Consumer Disputes', in S. Anderman *et al.* (eds.), *Law and the Weaker Party* (London: Professional Books, 1982), ii, 93, 100.

[45] *Wrotham Park Estate Co v Parkside Homes Ltd* [1974] 1 WLR 798, [1974] 2 All ER 321; *LAC Minerals Ltd v International Corona Resources Ltd* [1989] SCR 574, 61 DLR (4th) 14.

[46] *Surrey County Council v Bredero Homes Ltd* [1993] 1 WLR 1361, [1993] 3 All ER 705, CA.

[47] Smith, L., 'Disgorgement of the Profits of Breach of Contract: Property, Contract and "Efficient Breach"', *Canadian Business Law Journal*, 24 (1994–5) 121.

examine the validity of this concern in the next chapter, where it will be argued that it is invariably over-stated.

Conclusion

The preceding catalogue of the structural weaknesses of private law as a system for the efficient and efficacious regulation of markets provides ample room for doubts about its merits compared to other styles of regulation. No doubt we could add further to this list of weaknesses if we extended the enquiry beyond the criteria of efficiency and efficacy. For instance, the lack of democratic procedures in the formulation of private law standards could be a ground for questioning the legitimacy of the regulatory system. But at the same time, we should not lose sight of the great strength of private law regulation that we identified as its reflexive properties. Furthermore, it is wrong to suppose that other forms of regulation, such as public rules administered by a regulatory agency, are free from defects or do not contain their own structural weaknesses.

My argument has been that the private law of contract has the capacity to overcome or diminish many of these structural weaknesses in its system of regulation. This capacity can be realized by the evolution of many of the contemporary tendencies that were described earlier as the productive disintegration of private law. The development of some of these capacities require procedural adjustments, such as permitting *amicus curiae*, granting standing to collective groups, the admission of statistical evidence, and using the burden of proof for the purpose of detection of violations of regulatory standards. Other capacities of private law require the evolution of reasoning to incorporate references to externalities, public goods, and the articulation of policy objectives for the regulation. These developments can be engineered without diminishing the crucial advantage of private law regulation over public regulation that we have described as its reflexivity with respect to regulation of markets and contracts.

My argument should not be taken to suggest that public regulation of markets is unnecessary. In stressing the structural weaknesses of private law regulation of contracts, we have noted frequently how public regulation can overcome these difficulties with respect to setting standards, monitoring, and enforcement. My conclusion is rather that private law regulation is more sophisticated and has greater potential than is commonly thought by advocates of public regulation.