Mark Fenwick · Steven Van Uytsel
Stefan Wrbka *Editors*

Networked Governance, Transnational Business and the Law

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Preface

A distinctive feature of contemporary globalization in business regulation has been the emergence, across the diverse fields of economic and business law, of regulatory "networks" involving routinized transnational cooperation—both formal and informal—between institutional actors. The resulting global web of regulatory networks has transformed the legal environment in which business enterprises now operate. The classic liberal system of nation states coordinating activities at the government level has been displaced by a more fragmented system of multi-level networked governance in which new institutional and normative forms have proliferated, and which state sovereignty is increasingly disaggregated. As a consequence of the emergence of regulatory networks, the contemporary global legal order is more uncertain, de-centred and interconnected as the multiplicity of regulatory networks creates unprecedented coordination problems and increasingly complex interactions between legal orders.

The intention of this book is to bring together scholars from different fields of economic and business law in order to map this emerging order of transnational regulatory networks. The book seeks to identify the main actors within a range of different networks and to identify and evaluate the diverse functions performed by such networks. Moreover, since networks raise a number of normative concerns (e.g. domination by experts, lack of transparency and circumvention of traditional democratic procedures/sources of legitimacy), networked governance requires a new normative foundation. Finally, the book will examine the meaning, value and limits of the "network concept" as an analytical tool for understanding and critically evaluating the emergent transnational regulatory order.

This book has its origins in a conference organized on this issue by the Faculty of Law, Kyushu University in Fukuoka, Japan in February 2013. We are particularly grateful to Professor Toshiyuki Kono and the Faculty of Law for providing the financial support to have made this event possible, and to the students of the LL.M. and LL.D. programs in International Economic and Business Law, Kyushu University for their logistical help and participation.

August 2013 Mark Fenwick, Steven Van Uytsel, Stefan Wrbka

Abbreviations

AIM	Alternative Investment Market
AMAII (by its initials in Spanish)	Mexican Association of Independent Investment Advisers ("Asociación Mexicana de Asesores Independientes de Inversiones")
AMB (by its initials in Spanish)	Mexican Association of Banks ("Asociación de Bancos de México")
AMERI (by its initials in Spanish)	Mexican Association of Investor Relations ("Asociación Mexicana de Relación con Inversionistas")
AMIB (by its initials in Spanish)	Mexican Securities Industry Association ("Asociación Mexicana de Intermediarios Bursátiles")
AMIS (by its initials in Spanish)	Mexican Association of Insurance Companies ("Asociación Mexicana de Instituciones de Seguros")
ATM	Air Traffic Management
BEUC	Bureau Européen des Unions de Consommateurs or European Consumers' Organisation
BIAC	OECD's Business and Industry Advisory Committee
BIS	Bank for International Settlements
BSE	Bovine Spongiform Encephalopathy (also known as Mad Cow Disease)
CAC	Codex Alimentarius Commission
CANACINTRA (by its initials in Spanish)	National Chamber of Industry ("Cámara Nacional de la Industria de Transformación")
CESL	Common European Sales Law
CONCAMIN (by its initials in Spanish)	Confederation of Industrial Chambers ("Confederación Nacional de Cámaras Industriales")

CONCANACO (by its initials in Spanish)	Confederation of Chambers of Commerce, Services and Tourism ("Confederación de Cámaras Nacionales de Comercio, Servicios y Turismo")
COPARMEX (by its initials in Spanish)	Confederation of Mexican Employers ("Confederación Patronal de la República Mexicana")
CSR	Corporate Social Responsibility
DCFR	Draft Common Frame of Reference on the Principles, Definitions and Model Rules of European Private Law
DOJ	Department of Justice
DPOC	Due Process Oversight Committee
EASA	European Aviation Safety Agency
EBR	European Business Register
EC	European Community
ECAA	European Common Aviation Area
ECAC	European Civil Aviation Conference
ECJ	European Court of Justice
EEC	European Economic Community
EEIG	European Economic Interest Group
EFSA	European Food Safety Authority
ENCASIA	European Network of Civil Aviation Safety Investigation Authorities
EPO	European Patent Office
EU	European Union
FDA	Food and Drug Administration
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSF	Financial Stability Forum
GCGF	Global Corporate Governance Forum
GCI	Global Competition Initiative
G.i.e.	Groupement d'intérêt économique
GLF	General Food Law
GM	Genetically Modified
GMO	Genetically Modified Organism
GRI	Global Reporting Initiative
IAIS	International Association of Insurance Supervisors
IALPA	Irish Airline Pilots Association
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAO	International Civil Aviation Organisation
ICB	Industry Consultation Body
ICGN	International Corporate Governance Network
ICJ	International Court of Justice

ICN	International Competition Network
ICPAC	International Competition Policy Advisory Committee
IFRS	International Financial Reporting Standards
IFRS Foundation	International Financial Reporting Standards Foundation
ILO	International Labour Organisation
IMF	International Monetary Fund
INECE	International Network of Environmental Compliance and Enforcement
IOSC	International Organization of Securities Commissions
IPO	Initial Public Offering
JAA	Joint Aviation Authorities
JAR	Joint Aviation Requirements
JPA	Japanese Patent Office
KIPO	Korean Intellectual Property Office
LSE	London Stock Exchange
MNC	Multinational Corporation
MOU	Memorandum of Understanding
MSE	Mexican Stock Exchange
NCASC	National Civil Aviation Security Committee
NGO	Non-Governmental Organization
NFR	Novel Food Regulation
NYSE	New York Stock Exchange
OECD	Organisation of Economic Cooperation and Development
OFF	Office of First Filing
OSF	Office of Second Filing
PCT	Patent Cooperation Treaty
PPH	Patent Prosecution Highway
PSOs	Public Service Obligations
RASFF	Rapid Alert System for Food and Feed
R&D	Research and Development
ROSCs	Reports on the Observance of Standards and Codes
SEC	Securities and Exchange Commission
SES	Single European Sky
SIPO	State Intellectual Property Office
SMEs	Small and Medium Sized Enterprises
SML	Securities Market Law
SPS Agreement	Agreement on Sanitary and Phytosanitary Measures
SSB	Standard Setting Bodies
TCE	Treaty Establishing a Constitution for Europe
TEU	Treaty on the European Union

TFEU	Treaty on the Functioning of the European Union
TGRN	Trans-Governmental Regulatory Networks
TUAC	Trade Union Advisory Committee
UDHR	Universal Declaration of Human Rights
UN	United Nations
USPTO	US Patent Office
WTO	World Trade Organization

Contents

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Part I
Introduction

Introduction: Networks and Networked Governance

Mark Fenwick, Steven Van Uytsel, and Stefan Wrbka

A much-discussed feature of the emerging global legal order has been the proliferation of so-called transnational regulatory networks. These new institutional forms consist of routinized, purposive interaction between diverse actors that share a common sphere of expertise. Such networks are of different types, some involving cooperation between public bodies, others entailing interaction between public, private and quasi-public institutional actors. These networks perform diverse functions: e.g. 'enforcement networks', designed to make enforcement more efficient across international borders; 'information networks' aimed at promoting information exchange; and, 'harmonization networks' setting standards and seeking uniformity in substantive and procedural normative standards.

The resulting global web of regulatory networks has transformed the legal environment in which business enterprises now operate. And yet, these polycentric structures occupy an ambiguous space between traditional forms of legality and market-oriented regulatory mechanisms. The classic liberal system of nation states coordinating activities at the government level has thus been displaced by a more fragmented system of "multi-layered" networked governance in which new institutional and normative forms have proliferated, and which state sovereignty is increasingly disaggregated. In particular, transnational regulatory networks need to be distinguished, on the one hand, from predominantly hierarchically organized legal mechanisms operating at a domestic level and, on the other hand, from international governmental organizations with their formal institutional structures and restricted (state-only) membership. As such, transnational regulatory networks represent an innovative institutional adaptation to the specific conditions of late modernity and address some of the limitations in extant forms of legality in responding effectively to these conditions.

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In spite of the ambiguous status of transnational regulatory networks—at least from the perspective of traditional distinction between domestic-international laws—such networks perform a number of crucial functions and these regulatory structures exert a powerful influence over legal developments at a national level. The notion that transnational networks are performing a merely advisory role with no "real" governance powers ignores the global reach of these networks. Across multiple fields of regulation, transnational networks exert a powerful influence over the general direction and substantive content of domestic legislation. Deepening our understanding of how these networks operate (the empirical question) and how they should operate (the normative question) thus represents a key site of contemporary legal debate.

In characterizing these new institutional forms, it has become customary to employ the network concept. One can find this in the earliest works discussing this issue (e.g. Keohane and Nye), as well as in more influential recent discussions (e.g. Castells or Slaughter). The power of the network concept is that it highlights a number of key features of these institutional forms. Firstly, cooperation is based on loosely structured, *horizontal* relationships developed over time through iterative practice, rather than *ex ante*, centrally coordinated, *hierarchical*, agreement. The network metaphor is thus used to highlight that the relationships between the various actors interacting in order to produce public purpose are best viewed in *heterarchical* rather than *hierarchical* terms. Secondly, regulatory cooperation within networks is most commonly structured by informal or, at least, non-legally binding agreements, and entails routinized peer-to-peer modes of coordination and cooperation between interdependent actors that is "trust-based". Compliance with any norms established by the network is primarily achieved through political rather than legalistic forms of obligation. Thirdly, the network metaphor is designed to capture the linkage of both public and private actors from different institutional "levels"—national, regional and international—in a system in which action is coordinated through voluntary agreement and routinized practice. In fact, such networks often function to blur the distinction between the public and private realms. The concept of a network thus highlights the shift from hierarchical legal forms to the more flexible, responsive, multi-layered structures of "networked governance".

Nevertheless, there are some doubts about the efficacy of the network concept, at least in its current form. In particular, there are concerns that the network metaphor may obscure structural considerations, and that networks are only intelligible if you look "behind" the network at the structural factors that explain what gives particular actors power in a particular institutional setting. At the very least, there are suggestions that more need to be done in theorizing networks and in elaborating our understanding of actual networks.

Another set of themes structuring the discussion on transnational networks concerns the issue of the origins of such networks and the question of how do we account for the emergence of transnational networks at this particular historical juncture? From a sociological perspective, networks should be thought of as a

functional adaptation to the particular conditions of accelerated functional differentiation that has occurred under conditions of late modernity.

The context and primary impetus for the emergence of transnational networks is the liberalization of trade that has occurred over recent decades. In this regard, transnational networks clearly represent an adaptation to economic liberalization. Transnational networks are a functional adaptation to this predicament, specifically the failure of existing legal forms to respond effectively to the particular challenges of economic globalization. Transnational regulatory networks typically arise as a result of policy failure and other structural deficits with traditional legal forms. In particular, the prohibitive transaction costs of achieving agreement between state actors at the international level, has led interested stakeholders to seek alternative institutional means to achieve their regulatory objectives.

Networks are a form of non-hierarchical structural coupling between various interested actors in which repeat communication and interaction are crucial. Organizing themselves in this way permits an expert-oriented, flexible approach to problem solving which can contribute to stabilization of expectations between interdependent actors. Networks can therefore reduce the cognitive capacities that an organization needs to deploy in order to continue operating and are efficient and responsive, at least in comparison with alternative regulatory forms.

One of the aims of this volume, therefore, is to seek to elaborate the advantages and limitations of the network concept as a means of understanding contemporary developments in global regulation. This is done in some cases via theoretical elaboration on the network concept and in others via a detailed discussion of a particular network. Part II of this volume, 'Networked Governance, Network Actors and the Limits of the Law', consists of contributions that seek to address these issues.

Ewa Komorek's contribution describes how from the late 1980s the European air transport sector was transformed by the creation of the common EU aviation policy leading to the emergence of new airlines, the opening of new routes and airports, and to lower airfares. This pan-European aviation sector required governance models to evolve accordingly. Not only did regulation to a large extent transfer from national governments to the supra-national EU level, but there has also been a noticeably greater involvement of all interested parties, from both public and private sectors, in policy formulation and decision making processes.

Mikael Rask Madsen, adopting a more sociological approach to the network concept explores how focusing on the properties of legal expert power may provide a necessary supplement to the more descriptive approaches prevalent in studies of transnational regulatory networks. He argues that although notions of regulatory networks clearly have descriptive force and help identify new patterns of transnational law-making, deploying such notions also entail a real risk of leaving out of the analysis those precise social conditions and forces that make networks powerful in the first place. According to this chapter, to make regulatory network power intelligible, one needs to establish the linkage between legal networks and power, including state power, and thus the structured social spaces that networked power is exercised in.

Anna Szajkowska and Bernd van der Meulen analyse the scope of application of risk analysis and the precautionary principle in the context of EU food safety regulation, focusing, in particular, on the degree to which a technocratic, science-based methodology sets limitations on the legislator in deciding on food safety measures that have an impact on trade.

Mark Fenwick explores the question of whether we might push the network metaphor further and examine whether regulatory networks exhibit 'network dynamics'. The study of networks dynamics is an inter-disciplinary field that has emerged at the intersection between sociology, social psychology and economics. The chapter suggests that one form of network dynamic, namely a threshold model of collective action, can be helpful in providing a new conceptual vocabulary for describing various features of regulatory networks. In particular, it allows us to move away from accounts that regard regulatory networks as expressing the collective normative preferences of participants and ideas of contractual consent.

Shinto Teramoto and Paulius Jurčys, in their contribution, explain how social network analysis might contribute to our understanding of legal networks and discuss some key concepts used by proponents of this methodology. In particular, they discuss how the establishment of trust-based relationships facilitates the transfer of values and resources within the context of regulatory networks.

Kirsteen Shields considers why voluntary regulatory efforts channelled by social movements, in particular 'Fairtrade', may achieve compliance in areas beyond the reach of traditional regulatory methods of international law. She argues that insights from network theory can help cast light on how ethical trading networks may serve as catalysts for corporate compliance.

Part III of the volume—'Networked Governance: From Democratic Deficit to Substantive Legitimacy'—consists of contributions that are primarily concerned with the normative challenge posed by transnational networks, particularly the challenge that such networks pose for justifications of traditional forms of legality and democratic accountability. These new structures are clearly controversial. Most obviously, they have been challenged by a number of high profile NGOs who regard them as a neo-liberal assault on democracy, but such normative concerns have risen elsewhere both amongst academic commentators and practitioners.

The normative basis of this critique seems clear: transnational regulations are neither (public or private) international law, nor so they comprise of self-executing rules in the classical sense. Transnational regulatory networks lack the authority to establish binding law, and they are often under-formalized. Moreover, the conditions and rules of membership are unclear, procedures and due process are often under-developed, and there are no internal means to challenge the decisions of networks. In other words, transnational networks function, on the one hand, beyond the constraints and strictures of the rule of law, but, on the other hand, their "output"—such as decisions or standards—can be extremely influential and have a major influence in domestic lawmaking.

According to this line of reasoning, the efficiency gains of transnational regulatory networks (i.e. their adaptability, flexibility and informality) are offset by the normative compromise that such efficiency inevitably entails. Transnational

networks are engaged in law-making functions that were traditionally performed by democratically elected representatives (i.e. national parliaments). To assert that transnational networks are not generating law, but merely generating recommendations, and that the decision to incorporate these recommendations into domestic law still remains a question for the domestic legislature, ignores the complex interplay and elaborate mutual inter-dependency that now exists between transnational regulatory networks and nation states. And yet, exposing the limits of contractual consent merely begs the question of whether it is possible to construct an alternative justification for transnational networks that is both plausible and persuasive.

Responses to this normative challenge seem to have focused on two issues. On the one hand, there are those accounts that focus on 'input-oriented' legitimizing strategies in order to develop transnational concepts of democracy. On the other hand are those that argue for entirely 'output-oriented' models of transnational legitimacy. The majority of commentators who are advocating some sort of conceptual change in our understanding of legitimacy in order to accommodate transnational regulatory networks, seek to incorporate both 'input-oriented' as well as 'output-oriented' elements. According to this approach, it is necessary to determine with regard to every individual regulatory regime whether a sufficient number of legitimizing factors exist that substitute or mutually reinforce each other.

Stefan Wrbka analyses the Proposal for a Regulation on a Common European Sales Law presented by the European Commission in late 2011 from the perspective of the role that consumer interest representation played in the drafting of the text. In particular, it focuses on the impact the European Consumers' Organisation (BEUC) had (and was allowed to have) in this context. The chapter covers key points of interest in this regard, notably the perceived 'democratic deficit' in European law making, the question of transparency of policy-making, *ad hoc* transnational networks installed by the Commission to craft new legislation and the role of lobbying groups and interests representatives in relation to EU consumer protection.

Thomas Ratka examines how within the EU, commercial register law remains—in spite of two EU directives—very much a national matter. Although there have been several attempts, an EU-wide unified commercial register—or even an official network between national registers arranged by EU initiative and governed by EU officials—is still pending. The chapter examines whether private networks provide sufficient democratic legitimation to the any European commercial register that enables citizens to enter other countries' registers.

In his contribution, Steven Van Uytsel argues that the International Competition Network, as an example of a transnational regulatory network, should set up a review system of its best practices. Best practices of transnational regulatory networks, are seen as a legitimate tool for influencing the regulatory behaviour of their members. These best practices are, at the end, developed by experts in the field based upon the experiences of these experts with their respective legislation or practices. Nevertheless, this chapter shows that this may be problematic if the legislation or the practice with which these experts work exhibits flaws. This is

an argument that can be made in the framework of the leniency program and its best practice under the Competition Network. Van Uytsel shows that the best practice finds its origin in the leniency program of two major jurisdictions, the United States and the European Union. The leniency programs of these two jurisdictions have recently been negatively scrutinized by several scholars. Therefore, the question arises on whether best practice is really reflecting a legitimate end-result for convergence. Suggesting that it is not, Van Uytsel argues that a review process could overcome the potential threat to legitimacy in this kind of transnational regulatory network and he also offers some ideas on how this review process could be institutionalized.

Transnational networks clearly represent an adaptation to economic liberalization. A distinctive feature of contemporary globalization in business regulation has been the emergence, across diverse fields of economic and business law, of regulatory "networks" involving routinized transnational cooperation—both formal and informal—between institutional actors. In Part IV, 'Networked Governance, Investment and Finance', the specific challenges are examined in further detail.

Karsten Nowrot focuses on the interrelationships between a number of influential transnational steering networks in one notable segment of the international financial architecture, namely the international standard-setting activities in the realm of financial reporting. This is an area of economic and business law that is frequently and rightly considered to be of central importance for transnational business. Following an introductory discussion of the functions as well as limits of the network concept as an analytical tool for the description and conceptualization of transnational steering regimes in the international economic system, the main part of the contribution is devoted to an analysis of the recently emerging hierarchical relationships between three trans-boundary steering networks, the private International Accounting Standards Board (IASB), the intermediate Financial Stability Board (FSB) as well as the intergovernmental Group of Twenty (G-20). On the basis of the findings made in this section, the final part is devoted to an evaluation of the underlying reasons for and motives behind the evolution of these hierarchical structures, prominently among them the efforts by state actors to establish—or rather re-establish—governmental steering capacity vis-à-vis the activities of private international standard-setting bodies, thereby providing, on the basis of mechanisms of public accountability, for a certain remedy to the legitimacy challenges these non-governmental networks are frequently confronted with.

In their contribution, Mathias Siems and Oscar Alvarez-Macotela discuss whether the approach of the OECD Principles of Corporate Governance, predominantly aimed at the lawmakers and firms of emerging markets, can be regarded as a success. While features of networked governance are clearly visible in the drafting and operation of the Principles, the practical effectiveness may be hindered by the lack of well-functioning local institutions. Moreover, while appreciating that the OECD has engaged in activities such as regional roundtables in order to take account of the local context, the Principles themselves are based on the corporate governance model of the OECD member countries not perfectly suitable for

emerging markets. Recent events also point towards scepticism of whether adoption of the Principles can be seen as an effective way to prevent future financial crises.

Finally, Charlotte Villiers focuses on the role of shareholders in transnational governance, particularly through institutional mechanisms such as the UN Principles for Responsible Investment. Shareholders enjoy particular salience in corporate governance but their role is limited by problems such as confusion over their fiduciary position, resource and information deficits, regulatory uncertainty, and a persistently short-term, profit oriented perspective. Networking has the potential to overcome some of these problems and the UN PRI has had a positive influence, but a fully transformative contribution requires engagement with and active participation of citizens and non-shareholder experts. Such involvement is necessary for a genuinely democratic and legitimate international governance system.

Part II
Networked Governance, Network Actors and the Limits of the Law

From Protected National Markets to Networked Governance? Regulatory Revolution in the EU Aviation Sector

Ewa Komorek

Contents

1 Introduction

For the majority of its existence—until the mid-1990s—the commercial aviation industry in Europe operated in a heavily restricted market. The strategic importance of airspace meant that airlines were set up as monopolies subject to government ownership and regulation. The national airlines, or 'flag carriers', operated in protected, non-competitive markets and were treated as part of national identity. Internationally, Chicago Convention signed in 1944, established a framework of rules and best practices for airspace, aircraft registration and safety, and created the International Civil Aviation Organisation (hereinafter, *ICAO*). However, as long as the aviation market in Europe was fragmented into national segments, there was no incentive for the European states to cooperate and harmonise the rules affecting the

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industry. The existence of restrictions on market entry, route structures, frequencies and fares hampered the development of the aviation sector. This all started to change in the late 1980s when the deregulation movement reached Europe. At the meeting of the Council of Ministers in 1986, the Heads of State and Government agreed that the internal market in air transport should be completed by 1992. This aim was achieved by the adoption of three "packages" of legal measures (1987, 1990 and 1992) and 'competition became a driving force in the dynamics of the airline industry'.[1]

The European aviation sector was transformed by the emergence of the common European Union (hereinafter, *EU*) aviation policy which has contributed to the emergence of new EU airlines, airports and routes, increased competitiveness, greater efficiency and lower fares. This new pan-European aviation sector required the governance models to evolve. Not only did regulation to a large extent transfer from the national governments to the supra-national EU level, but also there has been a noticeable shift to greater involvement of interested parties, from both public and private sectors, in policy shaping and decision making processes. The question is whether this shift resulted in the development of the EU level network governance of the aviation sector.

The analysis of academic contributions to the debate on network governance allows to identify five key features of network governance. First, the existence of a large number of interdependent actors who interact in order to produce public purpose.[2] Second, the linkage of public and private actors from different institutional levels (national, EU and international) in a negotiation system in which they "coordinate their actions through negotiating voluntary agreements".[3] Third, a shift of power from hierarchy to 'institutionalised modes of coordination'.[4] Fourth, a change in the mode of governance away from hierarchy to a system based on negotiation,[5] where the voluntary agreements are collectively biding[6] and the network plays a role in steering, setting directions and influencing behaviour.[7] The fifth and final feature is that compliance with the norms established by the network is ensured 'through trust and political obligation'.[8]

This chapter's aim is to analyse whether there is evidence of thus defined network governance in the EU aviation sector. The discussion forms part of a wider academic debate on the fairly recent phenomenon of the growing number of networks in the policy-shaping of the European Union as a whole.[9] It seems that

[1] Lijesen et al. (2005).

[2] Sorensen and Torfing (2005), pp. 195–218.

[3] Coen and Thatcher (2008), p. 50; Börzel and Heard-Lauréote (2009), p. 138.

[4] Coen and Thatcher (2008), p. 50; Börzel and Heard-Lauréote (2009), p. 137.

[5] Coen and Thatcher (2008), p. 50.

[6] Börzel and Heard-Lauréote (2009), p. 138.

[7] Parker (2007), p. 114.

[8] Nielsen and Pedersen (1998).

[9] See Coen and Thatcher (2008); Börzel and Heard-Lauréote (2009).

creating, mandating, legitimising or supporting networks is an attempt to answer and alleviate the concerns about the 'democratic deficit' of the Union.[10] These allegations centre around the lack of democratic accountability and legitimacy on the part of the institutions of the European Union on the one hand and on the feeling of alienation of European citizens from the Union's work on the other. In a 2001 White Paper on European Governance[11] the European Commission undertook to address these concerns by combining in a more effective way the various policy tools available to it, such as legislation, social dialogue, structural funding and action programmes. The White Paper marked the beginning of the reform of European governance with the European Commission promising better involvement of stakeholders in policy shaping.

Since the 2001 White Paper, 'network excitement'[12] seems to have overtaken European policy-making. Networks have been established in majority of policies, but mainly in the so called 'network sectors'.[13] Thus, since transport in general, and air transport in particular, is a 'network sector' it has recently witnessed the widespread introduction of networks into its regulatory regime, similar to railways, telecommunications or postal services. Aviation, however, is a specific area in this context, since it particularly, and one may risk a statement that even more than other sectors, requires the participation of all the market actors in decision-making processes. The situation which existed before the liberalisation in the 1980s, which saw strict government regulation with little to no input from other stakeholders, resulted in the inefficiency and serious underperformance of the industry.

This article provides and examines examples of the existing networks in the EU aviation sector, beginning with the analysis of the *EU level networks* operating in the fields of

- Aviation Safety Policy—(1) binding EU safety rules derive from a voluntary harmonisation effort undertaken by the network of national regulatory authorities; (2) the work of the European Network of Civil Aviation Safety Investigation Authorities; and
- Air Traffic Management (hereinafter, *ATM*)—the role of the Industry Consultation Body (hereinafter, *ICB*) under the Single European Sky (hereinafter, *SES*) ATM reform project.

It then moves to examine the *EU law mandated national networks* in the fields of

- Aviation Security Policy—the work of the Irish National Civil Aviation Security Committee (hereinafter, *NCASC*) established under the requirements of Regulation 300/2008; and

[10] See for instance Featherstone (1994); Majone (1998); Follesdal and Hix (2006).

[11] European Commision (2001).

[12] See Coen and Thatcher (2008), p. 50.

[13] Ibid., p. 66.

– Regulation of airports—(1) Airport charges: consultation on charges between airports and airlines mandated by Directive 2009/12/EC; (2) Slots: the role of the Coordination Committee introduced by Regulation 95/93.

Despite a widespread belief that globalisation of economic activity is necessarily linked with a rescaling and reframing of economic governance, a distinction must be drawn between networks and networked governance,[14] or in other words governance *in* networks and governance *by* networks.[15] Thus, the article finishes with a discussion on whether and to what extent the existing networks in the EU aviation sector fulfil the components of the definition of governance networks or whether they are simply forums of dialogue and information exchange playing advisory roles with no real governance powers.

2 History of Regulation of the European Aviation Sector

The economic integration in Europe begun in 1957 with the signing of the Treaty of Rome[16] by six western European countries[17] which created the European Economic Community (hereinafter, *EEC*). In 1993, by which time the membership of the European Economic Community had increased to 12 countries,[18] the Treaty of Maastricht[19] created the EU and marked the beginning of increased political integration between the member states. The EU was initially composed of three pillars. The first pillar consisted of the common policies of the EEC, which the Treaty of Maastricht renamed the European Community (hereinafter, *EC*). The second and third pillars dealt with common foreign and security policy and police and judicial cooperation in criminal matters respectively. The main difference between the pillars was varying degree of competence of the European institutions to enact binding legislation. While in the first pillar all of the European institutions (Commission, Parliament and Council) had a high degree of competence and legislation in the increasing number of first pillar policies was adopted as a result of majority voting in the Council, in the second and third pillar decisions were made as a result of intergovernmental co-operation between the member states in the Council. In 2009, with the membership of the EU increased to 27 states,[20] the

[14] Parker (2007), p. 114.

[15] Börzel and Heard-Lauréote (2009), p. 140.

[16] Treaty establishing the European Economic Community (EEC), OJ 25 March 1957.

[17] Belgium, France, Germany, Italy, Luxembourg and Netherlands.

[18] Denmark, Ireland and the UK joined in 1973; Greece in 1981 and Portugal and Spain in 1986.

[19] Treaty on European Union, OJ C 191, 29 July 1992.

[20] Austria, Finland and Sweden joined in 1995; Cyprus, Malta, Latvia, Lithuania, Estonia, Poland, Hungary, Czech Republic, Slovakia and Slovenia joined in 2004, and Bulgaria and Rumania—in 2007. As of July 2013 the EU consists of 28 Member States. Croatia joined on 1 July 2013.

Treaty of Lisbon abolished the pillar structure and all references to European Community were replaced by the European Union. However, the Treaty of Lisbon retained the varying degrees of EU competence to adopt legislation depending on the area.

The Treaty of Rome from the very beginning included rules intended to promote competition in various economic sectors, including transport. Article 3 of the Treaty provided that the activities of the Community shall include the adoption of a common policy in the sphere of transport. Title IV (Articles 74–84) (now Title VI, Articles 90–100 of the Treaty on the Functioning of the European Union—hereinafter, *TFEU*[21]) provided for more detailed rules of a common transport policy. However, Article 84 (now Article 100 TFEU) stated that the provisions of this Title apply only to transport by rail, road and inland waterway. With regard to air (and sea) transport the Article provided that it is up to the Council to decide, acting unanimously, whether, to what extent and by what procedure appropriate provisions may be laid down.[22] The reason behind this provision was the impossibility of adopting a common aviation policy without violating the existing multilateral and bilateral agreements which the member states concluded with non-EU countries.[23] The European Court of Justice clarified that Article 84 of the Treaty of Rome (now Article 100 TFEU) did not exclude the applicability of other provisions of the Treaty (e.g. rules on competition) to sea and air transport.[24] Nevertheless, the Council, which represents the interests of national governments in the EU, for a long time proved reluctant to use the power granted by Article 84 of the Treaty of Rome (now Article 100 TFEU) and start laying the foundations for a common air transport policy.[25] The result was that until the three liberalisation packages were adopted between 1987 and 1992, 'for nearly three decades the EC/EU left aviation outside the mainstream of European integration'.[26]

2.1 Before 1987: Fragmented and Nationally Regulated Market

International air transport is based on rights of access, which states grant to one another by bilateral service agreements.[27] The rights of access are described by

[21] Treaty on the Functioning of the European Union, consolidated version, OJ C 83, 30 March 2010.

[22] In the current wording of this Article (Article 100 TFEU) it is up to the European Parliament and the Council acting in accordance with the ordinary legislative procedure (thus not unanimously anymore), to lay down appropriate provisions for sea and air transport.

[23] Giemulla et al. (2011), p. 137.

[24] Case C-167/73, *Commission v. France*, ECR (1974) 359.

[25] Giemulla et al. (2011), p. 139.

[26] Dempsey (2004), p. 6.

[27] Giemulla et al. (2011), p. 130.

reference to the five basic freedoms of the air. The 1944 international Convention on International Civil Aviation, known as the Chicago Convention, drew up a multilateral agreement, known as the International Air Services Transit Agreement or 'Two Freedoms Agreement'.[28] The Agreement provides that each contracting state grants to the other contracting states the first two of the five freedoms of the air, i.e., (1) the privilege to fly across its territory without landing, and (2) the privilege to land for non-traffic purposes. The Agreement currently has 129 signatories.[29] At the same time, the broader Agreement encompassing all of the five basic freedoms and known as the International Air Transport Agreement or 'Five Freedoms Agreement', was also opened for signatures. Thus, in addition to the first two 'technical' freedoms, the signatory states granted each other the following three 'commercial' freedoms of the air: (3) the privilege to put down passengers, mail and cargo taken on in the territory of the State whose nationality the aircraft possesses, (4) the privilege to take on passengers, mail and cargo destined for the territory of the State whose nationality the aircraft possesses, and (5) the privilege to take on passengers, mail and cargo destined for the territory of any other contracting State and the privilege to put down passengers, mail and cargo coming from any such territory. To this date, however, only 11 states have signed it.[30] Therefore, for the large majority of states the third to fifth freedoms have to be negotiated bilaterally between the two countries concerned.

Despite the progress of market integration in other areas within the European Union, before the liberalisation process begun in the late 1980s the European air transport sector operated on the basis described in the previous paragraph—as if there was no European integration whatsoever. The industry was shaped by 'a web of bilateral air service agreements…, with specified routes and airports, agreed aircraft types, fares and frequencies, and designated carriers'.[31] To operate outside of its home market an airline needed to obtain multiple national licences. The product of this highly regulated and fragmented market "based on national sovereignty and non-competing national airlines"[32] was a restriction of capacity on the majority of routes, very high fares and a practical impossibility of non-flag carrier airlines to enter markets.[33]

[28] International Air Services Transit Agreement, signed at Chicago, on 7 December 1944 (Transit Agreement).

[29] http://www.icao.int/secretariat/legal/List%20of%20Parties/Transit_EN.pdf. Accessed 30 July 2013.

[30] http://www.icao.int/secretariat/legal/List%20of%20Parties/Transport_EN.pdf. Accessed 30 July 2013.

[31] European Low Fares Airlines Association (ELFAA) (2004), p. 3.

[32] Barrett (2009), p. 6.

[33] European Low Fares Airlines Association (ELFAA) (2004), p. 3.

2.2 *Three "Liberalisation Packages"*

2.2.1 1987: First "Package"

In 1987, under the first package of liberalisation measures, two important instruments were adopted (1) Council Directive 87/601 on fares for scheduled air services between Member States,[34] and (2) Council Decision 87/602 on the sharing of passenger capacity between air carriers on scheduled air services between Member States and on access for air carriers to scheduled air service routes between Member States.[35] The measures in the 'first package' limited the right of governments to object to the introduction of new fares for intra-EU traffic and gave airlines some flexibility with regard to seat capacity sharing. They also provided for a more open access to the market (limited third, fourth and fifth freedoms).

2.2.2 1990: Second "Package"

The 'second package' of liberalisation rules consisted of two regulations (1) Council Regulation 2342/90 on fares for scheduled air services,[36] and (2) Council Regulation 2343/90 on access for air carriers to scheduled intra-Community air service routes and on the sharing of passenger capacity between air carriers on scheduled air services between Member States.[37] The "second package" opened up the market further by granting unlimited right of EU carriers to operate services between their home country and another EU country (i.e., almost unlimited third and fourth freedom rights). It also allowed for greater flexibility over the setting of fares and capacity-sharing. Following the adoption of the 'second package', the member states of the EU committed themselves to full liberalisation of the aviation sector by 1 January 1993.

2.2.3 1992: Third "Package"—Full Liberalisation

The first two packages, while revolutionary in terms of the change in approach to the regulation of air transport in Europe, did in fact little in practice to increase competitiveness of the market.[38] This changed significantly with the adoption of the

[34] OJ L 374, 31 December 1987, pp. 12–18.

[35] Ibid., p. 19.

[36] OJ L 217, 11 August 1990, p. 1.

[37] Ibid., p. 8.

[38] Dempsey (2004), p. 55; see also Duchene (1995), pp. 131 and 137.

'third package' of liberalising measures,[39] which entered into force on 1 January 1993 and resulted in full liberalisation and market opening.[40] The third package harmonised requirements for an operating licence for EU airlines and introduced a concept of recognition by all member states of an operating licence granted by one member state. It also provided for fully open access for all EU airlines with an EU operating licence to all routes within the EU with no capacity restrictions. The only exception to the open access principle is the possibility of national governments to impose public service obligations (hereinafter, *PSOs*) on routes which are essential for regional development. Finally, full freedom with regard to fares and rates was introduced—fares were no longer required to be submitted for national authorities' approval. In 2006, with the creation of European Common Aviation Area (hereinafter, *ECAA*), thus created single market in aviation services in Europe was extended to Norway, Iceland, Croatia, Macedonia, Albania, Bosnia and Herzegovina, Kosovo, Serbia and Montenegro.

In 2008, Council Regulation 1008/2008 on common rules for the operation of air services in the Community (the 'Air Service Regulation')[41] updated, simplified and consolidated the three Regulations of the 'third package' into a single text. It provides the single point of reference for the economic framework for air transport in the European Union and regulates licensing of EU air carriers, access to routes, aircraft registration and leasing, conditions for imposing public service obligations, traffic distribution between airports and pricing.

The liberalisation of the EU aviation market has profoundly transformed the air transport industry and resulted in the unprecedented development of the sector. Prices have fallen and passenger numbers, as well as the quantity of routes offered increased dramatically. For instance, the UK Civil Aviation Authority reported that in the 10 years since full liberalisation international passenger traffic between the UK and the EU increased from 69.1 to 123.7 million.[42] However, it is worth emphasising that the aim of the European policy towards the aviation sector has since the beginning been twofold: first of all to open the market and create the conditions for competitiveness, and secondly to ensure both quality of service and the highest level of safety.[43] The second aim has been achieved by the adoption of common rules in the following areas: safety, security, consumer protection (passenger rights), airport charges, slot allocation, environment protection and air traffic

[39] Council Regulation 2407/92 on licensing of air carriers; Council Regulation 2408/92 on access for Community air carriers to intra-Community air routes; and Council Regulation 2409/92 on fares and rates for air services.

[40] Except for 'stand alone cabotage rights', i.e. the right to carry passengers within a foreign country without continuing service to or from one's own country (9. freedom of the air), which came into force in 1997.

[41] OJ L 293, 31 October 2008, p. 3.

[42] UK Civil Aviation Authority report 'No Frills Carriers: Revolution of Evolution?' (2006); see also Barrett (2009), p. xiv.

[43] See European Commission at: http://ec.europa.eu/transport/modes/air/internal_market/index_en.htm. Accessed 30 July 2013.

control. Evolution of governance models took place during the development of common rules in these fields. Not only did regulation to a large extent transfer from the national governments to the supra-national EU level, but also there has been a noticeable shift to network governance with greater involvement of interested parties, from both public and private sectors, in policy shaping and decision making processes.

3 Examples of Networks in the EU Aviation Sector

Having briefly outlined the historical development of the European regulation of the aviation sector, I now turn to consider whether there is any evidence of networked governance in this industry. I will first analyse the EU level networks in the fields of safety and air traffic management. Secondly, I will examine the networks which operate at national level, but the existence of which is mandated by EU legislation.

3.1 EU Level Networks

3.1.1 The EU Aviation Safety Policy

The European Commission predicts, that despite the current economic crisis, global air transport will to grow by around 5 % annually until 2030.[44] With the growth of traffic, concerns about safety become a priority. The EU aviation safety system is based on a close collaboration between all participants in the single aviation market, ranging from regulators at both national and EU levels (European Commission and national civil aviation authorities and safety investigation bodies), independent agencies [European Aviation Safety Agency (hereinafter, *EASA*)] and international organisations (Eurocontrol), through to manufacturers of aircraft and parts, airlines and other undertakings.

The backbone of the EU aviation safety system is constituted by a set of common rules which concentrate on four main aspects of safety. Firstly, *airworthiness* of aircraft, that is its ability to fly safely, must be ensured. In this respect, there are common rules on design, production, maintenance and operation of aircraft, parts and appliances. In addition, any aircraft, European or not, may be subject to 'ramp checks', i.e., safety inspections at the European airports. Secondly, common safety rules make sure that *personnel* and organisations involved in the operation of aircraft comply with the highest safety standards—to this end EU law regulates pilot

[44] See European Commission at: http://ec.europa.eu/transport/modes/air/index_en.htm. Accessed 30 July 2013.

licensing, cabin crew training, medical requirements and flight time limitations. Thirdly, EU law provides for constant improvement of safety standards by requiring *occurrence* monitoring and reporting, which involves cooperation between states and airlines. Fourthly, as it is impossible to avoid aviation incidents and accidents completely even with ever increasing standards of safety, there are common EU rules on *accident investigations* aimed at learning safety lessons for the future.

Within this legislative framework there are two interesting examples of network participation. First of all, binding EU safety rules are a result of the work of a network of national regulatory authorities which steered, set directions and ultimately influenced legislative behaviour of the EU. Secondly, the European Network of Civil Aviation Safety Investigation Authorities established by Regulation 996/2010 on the investigation and prevention of accidents and incidents in civil aviation is responsible for, *inter alia*, development of training activities, promoting best safety investigation practices, and developing a mechanism for sharing investigating resources.[45] The European Commission must cooperate with the Network on all aspects related to the development of the EU civil aviation accident investigation and prevention.

(i) Common Safety Rules as a Result of Early Network Governance

The first common safety standards in Europe were developed long before binding legislation was adopted and they were a result of rulemaking cooperation within the framework of the no longer existing Joint Aviation Authorities (hereinafter, *JAA*)—an associated body of the European Civil Aviation Conference (hereinafter, *ECAC*). ECAC is an intergovernmental organization established in 1955 by the ICAO and the Council of Europe whose strategic priorities are safety, security and the environment. The JAA framework consisted of the civil aviation regulatory authorities of a number of European states who voluntarily undertook to develop and implement on their territories common safety requirements, known as Joint Aviation Requirements (hereinafter, *JARs*), and related procedures. The cooperation was initially limited to aircraft manufacturing and design, and later developed to encompass also flight operations, maintenance and crew licensing. In 1991 the work of JAA became the basis for Council Regulation 3922/91 which provided for the first mandatory set of directly applicable safety rules based on JARs. Currently, by virtue of the Regulation 216/2008, known as the 'Basic Safety Regulation', there are binding common rules which apply to practically all aspects of aviation safety—from airworthiness, training and the licensing of aeronautical mechanics, technicians and engineers, through to aircraft operations, crew licensing and training, aerodrome operations and provision of air navigation services and air traffic management.

[45] European Commission at: http://ec.europa.eu/transport/air/safety/accident_investigation/authorities_en.htm. Accessed 30 July 2013.

JAA have to be praised for providing a first major effort in implementing common safety standards in Europe. Despite voluntary nature of the framework and lack of necessary powers to ensure uniform implementation of JARs across Europe, the work of JAA provided necessary stimulus for legislative harmonisation by the European Union, and in fact laid foundations for common binding rules. The framework can thus serve as an example of an early attempt at network governance in the European aviation sector. If we accept that 'governance networks involve a large number of interdependent actors who interact in order to produce public purpose',[46] and that 'compliance is ensured through trust and political obligation which, over time, becomes sustained by self-constituted rules and norms',[47] then JAA clearly was on the right path to become a form of network governance. However, the initial voluntary cooperation did not over time become 'sustained by self-constituted rules and norms', but instead was dissolved and the norms established as a result of the cooperation were sanctioned by binding legislation adopted by the traditional regulatory mechanism of the EU.

(ii) European Network of Civil Aviation Safety Investigation Authorities

Accident investigation is of paramount importance for civil aviation as it allows for drawing conclusions on safety shortcomings as possible causes of an accident, which in turn make it less likely for similar accidents to take place in the future. In this regard it is vital that the conclusions and recommendations resulting from accident investigation are shared with as many participants of the aviation market as possible. Recognising this important role of accident investigation for the overall safety of aviation industry, the European Community introduced first harmonised rules in the field of air accident investigation as early as 1980, that is before liberalisation of the sector and the introduction of harmonised rules in any other aspect of aviation.[48] In 1994, the harmonisation was taken even further when Directive 94/56 transposed into the Community legislation a number of fundamental principles contained in Annex 13 to the Chicago Convention.[49] In 2010 a comprehensive review by the European Commission of EU legislation on air accident investigations concluded that the framework requires modernisation for two main reasons. First of all, nowadays investigation of air accidents requires more diversified expertise and resources than in 1994 when the Directive 94/56[50] was

[46] Sorensen and Torfing (2005).

[47] Nielsen and Pedersen (1998).

[48] Directive 80/1266/EEC on cooperation and mutual assistance between the Member States in the field of air accident investigation.

[49] Annex 13 to the Convention on International Civil Aviation—Aircraft Accident and Incident Investigation.

[50] Council Directive 94/56/EC of 21 November 1994 establishing the fundamental principles governing the investigation of civil aviation accidents and incidents, OJ L 319, 12 December 1994, pp. 14–19.

adopted. Secondly, the EU institutional and legal framework in the field of aviation safety changed substantially, in particular with the adoption of binding common safety rules and making the EASA responsible for certification of aircraft in the EU. The result of the Commission's review was the adoption of Regulation 996/2010,[51] which is currently the main piece of EU legislation on the conduct of air accident investigations in the EU.

The Regulation declares in Recital 36 that the establishment of common rules in the field of civil aviation safety investigation cannot be sufficiently achieved by the Member States and can therefore, by reason of its Europe-wide scale and effects, be better achieved at Union level. Indeed, given the fact that almost all areas of aviation safety are regulated at the EU level, so too should be accident investigation as one of the pillars of any framework of aviation safety rules. The EU believed that there should be more recognition of the "European dimension" in the accident investigations conducted by national authorities and that the existing forms of voluntary cooperation and information exchange between the authorities should be formalised and, in fact, mandated.[52]

Interestingly, the solution chosen was not to establish a formal EU-level 'Air Accident Investigation Agency' similar to EASA, but rather to require the member states to ensure that their safety investigation authorities establish between them a European Network of Civil Aviation Safety Investigation Authorities (Article 7 Regulation 996/2010). As clarified by Recital 17 of Regulation 996/2010:

> The coordination role of safety investigation authorities should be recognised and reinforced in a European context, in order to generate real added value in aviation safety, by building upon the already existing cooperation between such authorities and the investigation resources available in the Member States which should be used in the most efficient manner. That recognition and reinforcement could be best achieved by the European Network of Civil Aviation Safety Investigation Authorities.

Article 7 of the Regulation provides that the Network is to be composed of the heads of the safety investigation authorities in each of the Member States and/or, in the case of a multimodal authority, the head of its aviation branch, or their representatives. It is to have a chairman chosen for a period of 3 years. In fulfilment of the obligation set out in Article 7, the heads of national air accident investigation bodies gathered in Brussels on 19 January 2011 and formally established the Network between them. Ulf Kramer, head of the air safety investigation authority of Germany, was elected Chairman.

The main stated objectives of the Network are to further improve the quality of investigations conducted by safety investigation authorities and to strengthen their independence, as well as to develop common approaches to air accident investigation in the EU, and advise EU institutions on air accident investigation and

[51] Regulation 996/2010 of the European Parliament and of the Council of 20 October 2010 on the investigation and prevention of accidents and incidents in civil aviation OJ L 295, 12 November 2010, pp. 35–50.

[52] European Commission (2009).

prevention matters. It should encourage high standards in investigation methods and investigator training.[53] The detailed activities of the Network are to be defined in its annual work programme. The Regulation provides examples of such activities which the Network should undertake in order to achieve its main stated objectives. These include i.a. (1) promoting the sharing of information useful for the improvement of aviation safety and actively promoting structured cooperation between safety investigation authorities, the Commission, EASA and national civil aviation authorities; (2) coordinating and organising 'peer reviews', relevant training activities and skills development programmes for investigators; (3) promoting best safety investigation practices with a view to developing a common Union safety investigation methodology and drawing up an inventory of such practices; (4) strengthening the investigating capacities of the safety investigation authorities, in particular by developing and managing a framework for sharing resources; (5) analysing safety recommendations recorded in the Central Repository of information on civil aviation occurrences with a view to identifying important safety recommendations of Union-wide relevance.

There is an important question as to the relationship between the Network and the institutions of the EU on the one hand, and EASA on the other. The Regulation provides that the Network should pursue its coordination activities in a transparent and *independent* manner, but it should also be actively supported by the Union. This support comes, for instance, in the form of assistance by the European Commission for the preparation and organisation of the Network's meetings, as well as for the publication of its annual report. The Council or the Commission may also submit requests to the Network. EASA, on the other hand, should be invited as an observer to the meetings of the Network, as well as an advisor in the accident investigations, provided that the requirement of no conflict of interest is satisfied. Other than that, the cooperation within the Network is purely voluntary and it is entirely up to the national accident investigation authorities to set the agenda and decide on the level of cooperation. There are no EU-level sanctions for not fulfilling the main stated objectives or not undertaking the specified activities. There will, therefore be no consequences should the member states decide in a particular instance not to share resources, information or data. Thus, despite the declaration in Regulation 996/2010 that the establishment of common rules in the field of civil aviation safety can be better achieved at the EU level, accident investigation largely remains in the competence of the member states.

The Network of Civil Aviation Safety Investigation Authorities as currently shaped by Regulation 996/2010 may thus be summarised as a forum for dialogue, information exchange and sharing of resources, rather than a governance network *sensu stricto*. The example may be the enforcement of one of the most important provisions in the Regulation—Article 17. It envisages an obligation for a member state in charge of an accident investigation to recommend to other member states any preventive action that it considers necessary to be taken promptly to enhance

[53] Regulation 996/2010, Article 7(2).

aviation safety. The recipient states are required to acknowledge the receipt of the recommendation and inform the sender of actions taken or under consideration, or where no action is taken—the reasons therefore. Both the safety recommendations issued as well as the responses thereto are to be recorded in the central repository of information on civil aviation occurrences established by the European Commission.[54] While the procedure provides in theory a powerful tool for quick and uniform response to the findings of aviation accident investigations, there are in fact no legal sanctions for the refusal by the addressee member states to abide by the safety recommendations issued by the national authorities in charge of the investigation. The only possibility of the sender member state if it disagrees with the response received is to issue a reply informing that it considers the actions taken inadequate and, when the addressee member state decided to take no action—to give justification as to why it disagrees with such decision. There is no other consequence or penalty envisaged by the Regulation even for situations when the addressee member states fail to present their responses in the timeframes provided. The successful operation of the procedure in Article 17 relies, therefore, solely on trust, peer pressure and a sense of political obligation among the members of the Network.

Bearing in mind the European Commission's belief that aviation accidents investigation must without further delay be brought to the European level, the question necessarily arises as to why the solution chosen was to establish a relatively weak network of national authorities with very little governance powers. Why not establish an independent European agency responsible for aviation accident investigations, equivalent and complementing the EASA? The simple answer, as with many "soft" legislative solutions in the European Union, is possibly the lack of legal basis for more binding measures. National 'technical' aviation accident investigations are in many instances tightly linked with criminal investigations, and thus with national judiciary systems, over which the EU has little to no jurisdiction. However, it would be possible to separate the two types of investigation of aviation accidents. A 'technical' investigation aimed at the search of the safety recommendations which could help avoid similar accidents in the future could be performed by the EU level agency, whereas a criminal investigation into the liability for the accident could remain in the competence of the member state. Thus, the easiest and simplest argument of "no legal basis" which is often given to explain the adoption of "soft" EU law does not really provide a complete answer for the decision to establish a network of national accident investigation authorities with very little concrete powers. The more complex, and likely correct, answer is threefold. First of all, member states have recently proved reluctant to establish and fund additional Euro-regulators to which they would be obliged to transfer a substantial proportion of their powers.[55] Secondly, the Network offers the advantage of flexibility and

[54] Established by the Commission Regulation 1321/2007 of 12 November 2007 laying down implementing rules for the integration into a central repository of information on civil aviation occurrences exchanged in accordance with Directive 2003/42/EC.

[55] Coen and Thatcher (2008), p. 61.

speed of action. There are almost no set procedures to follow, so the informal nature of cooperation allows for holding *ad hoc* meetings, establishing sub-groups for specific issues and speedy information exchange. And thirdly, it is possible that the establishment of an EU level agency responsible for aviation accidents investigation would require making a decision on common procedure and methodology. It is likely that the creation of the Network was a way to find what the best practice for such common procedure and methodology should be. Through cooperation within the Network, the member authorities may reach a consensus on what they all consider to be the best practice, which can in turn be sanctioned by EU legislation as binding for all member states. Thus, the Network may be seen as an intermediate step towards either turning European Network of Civil Aviation Safety Investigation Authorities (hereinafter, *ENCASIA*) into a governance network *sensu stricte* with binding enforcement powers or establishing an EU level authority responsible for aviation accident investigation.

3.1.2 Reform of Air Traffic Management (ATM) in Europe: Single European Sky (SES)

The SES is an initiative intended to move the organisation of European airspace and air navigation from national to the European level. In 2004 a package of four regulations, known as SES I, was adopted addressing the provision of air navigation services, the organisation and use of airspace and the interoperability of the European Air Traffic Management Network.[56] The Regulations were updated and extended in 2009 by Regulation 1070/2009 with a main aim of increasing the overall performance of the air traffic management system in Europe (the SES II package). The basic framework is supplemented by implementing rules and specifications intended to bring about interoperability of technologies and systems.

The Commission emphasises that this gradual transformation of the air traffic management in Europe has been made possible in a large part due to the extensive involvement of the stakeholders from the ATM community: airlines, air navigation service providers, national supervisory authorities, staff unions, airport authorities, the military and the certification authorities.[57] This cooperation was sanctioned by Regulation 549/2004 laying down the framework for the creation of the Single European Sky. The Regulation tasked the European Commission to establish the Industry Consultation Body (hereinafter, *ICB*) to provide technical advice to the European Commission on the implementation of the future ATM strategy. The ICB consists of representatives of all major ATM stakeholders, i.e., air traffic service providers, communication, navigation, surveillance service providers, meteorological service providers, airspace users, manufacturing industry, airports, and

[56] Regulations 549/2004, 550/2004, 551/2004 and 552/2004.

[57] European Commission at: http://ec.europa.eu/transport/modes/air/single_european_sky/index_en.htm. Accessed 30 July 2013.

professional staff representative bodies. The membership of ICB is limited to 30 and organised through the stakeholder representative bodies, rather than individual companies—both limitations were intended to ensure efficiency of operation.

The analysis of the ICB reveals that it acts as a platform for discussion, consultation and advice rather than a governance network in the area of air traffic management in Europe. It is true that the Commission officially emphasises that its intention is to use the advice of the ICB to *steer* not only the legislative initiatives in the area of ATM, but also the standardisation, research and infrastructure investments of the Commission.[58] However, according to the Terms of Reference of the ICB,[59] its main strategic and policy input is to complement the regulatory role of the Single Sky Committee (composed of representatives of the member states) and to advise the Commission on the development and implementation of the future ATM system and its components. The ICB is to act as a forum for presentation and discussion of views of the major stakeholder interests and a platform to develop joint guidance from the European industry about strategic and key developments in Air Traffic Management. Importantly, which only strengthens the view that ICB is simply a forum for discussion acting in an advisory role, the Terms of Reference envisage that the ICB shall not vote and in giving its opinion should endeavour to reach consensus. In the event that a consensus is not possible, the Commission will take the differing views into account.

3.2 EU Law Mandated National Networks

3.2.1 The European Aviation Security Policy

Regulation 300/2008 requires member states to designate a single authority responsible for the coordination and the monitoring of the implementation of aviation security law. For instance, in Ireland such a designated authority is the NCASC comprised of representatives of Government Departments, airlines, airports, the police, the Defence Forces, post, customs, Irish Aviation Authority, and IALPA (the Irish Airline Pilots Association). A recent example of the NCASC's activity is its involvement in addressing the security issues identified at Dublin Airport as a result of the European Commission's audit in May 2012. Following the audit, NCASC held a meeting and recommended that "additional security procedures" be applied to aircraft leaving Dublin for other EU destinations.[60]

[58] European Commission at: http://ec.europa.eu/transport/modes/air/single_european_sky/consultation_body_en.htm. Accessed 30 July 2013.

[59] Industry Consultation Body—Terms of Reference, 25 October 2007.

[60] 'Some passengers face extra security checks flying from Dublin Airport', www.thejournal.ie, 16 May 2012. Accessed 30 July 2013.

The purpose of NCASC is to advise the Government and the civil aviation industry of security policy for civil aviation, to recommend and review the effectiveness of security measures and to provide for co-ordination of the various interests involved. Thus, as it has no formal powers, it is not a governance network *sensu stricto*.

3.2.2 Regulation of Airports

There are two examples of EU law mandated network participation at national level with regard to airports (1) Directive 2009/12/EC on airport charges mandated the consultation on charges between airports and airlines at all airports covered by the Directive; and (2) Regulation 95/93 on common rules for the allocation of slots at Community airports introduced a Coordination Committee which makes proposals and advises the slots coordinator on all questions relating to the capacity of the airport. Membership in the Committee is open to: air carriers using the airport; the managing body of the airport; air traffic control authorities; and general aviation representatives.

(i) Mandatory Consultation with Stakeholders on Airport Charges

Airport charges are paid by airport users for the use of airport infrastructure. They include aircraft landing charges and charges for the processing of passengers and freight. The European Union became involved in the regulation of charges when it considered that the creation of the single European aviation market triggered the need for fair competition among all carriers using EU airports to be ensured through regulation. Thus, Directive 2009/12 on airport charges[61] sets minimum common standards on the setting of airport charges. Article 6 of the Directive obliges member states to ensure that a compulsory procedure for regular consultation between the airport managing body and airport users or their representatives is established with respect to the operation of the system of airport charges, the level of airport charges and the quality of service provided. To the extent that these matters can be considered governance as opposed to pure commercial issues, it is helpful to analyse whether the participation of a network in the consultation process fits the definition of networked governance.

The consultation shall take place at least once a year. Article 6 further envisages that changes to the system or the level of airport charges should be made in agreement between the airport managing body and the airport users. To that end, the airport managing body shall submit any proposal to modify the system or the level of airport charges to the airport users, together with the reasons for the proposed changes.

[61] Directive 2009/12/EC on airport charges, OJ L 70, 14 March 2009, p. 11.

Mandating that consultation on airport charges be held between the airport managing body and the airport users is arguably one of the most important changes introduced by Directive 2009/12 and is a further example of the regulatory revolution which has taken place in the aviation sector since its full liberalisation in the mid-1990s. Participation of stakeholders in decision-making processes has become a norm and is recognised as necessary in order to ensure proper functioning of the single European aviation market. However, as with most of the networks discussed above, the role of airport users in setting the charges is in fact limited. Consultations are a mandatory element of the regulatory process, but they play an advisory role only and their outcome is not legally binding on airport management.[62] Article 6 of Directive 2009/12 clarifies that when taking a final decision on airport charges the airport managing body is obliged only to take the users' views into account. If no agreement on the proposed changes in the charges is reached—the airport managing body shall justify its decision with regard to the diverging views. If the justification proves unsatisfactory to any of the airport users, they can bring the matter before the independent supervisory authority. The involvement of the authority suspends the entry into force of the airport managing body's decision. Importantly, however, Directive 2009/12 envisages a derogation from the obligation to provide for an appeals procedure which significantly weakens the influence of the consultation in the member states where it applies. Article 6(5) provides that a member state may decide not to provide an appeals procedure in a situation where there is a mandatory procedure under national law whereby airport charges, or their maximum level (known as a "price cap") are determined or approved by the independent supervisory authority. Such a situation exists at Dublin airport, where a "cap" has been imposed on charges by the Commission of Aviation Regulation—the Irish designated independent supervisory authority. Therefore, as long as the charges remain within the "cap" imposed, the users of Dublin airport have no possibility to challenge the decision on charges. In a situation of such a decisive involvement of a regulator in establishing the charges, the whole process of consultation under the Directive becomes questionable as to its effectiveness, leading some of the airport users to even describe it as "pointless".[63] This strengthens the argument that, as with previously discussed networks, participation of the network of stakeholders in setting the airport charges does not amount to network governance.

(ii) Slots Coordination Committee

The liberalisation of the aviation market in the EU has lead to a dramatic increase in traffic, leading to a continuously growing demand for capacity at congested

[62] Wolszczak (2009).

[63] 'Ryanair to boycott 'pointless' airport charges consultation', Irish Examiner, 12 December 2010.

airports. The response of the EU came in the form of Regulation 95/93 on common rules for the allocation of slots at Community airports (amended by Regulation 793/2004). The Regulation provides that airports with a serious shortfall in capacity should be designated as 'coordinated airports' and defines a 'coordinated airport' as any airport where, in order to land or take off, it is necessary for an air carrier or any other aircraft operator to have been allocated a slot by a coordinator.[64] Examples of coordinated airports in the EU include Munich, Rome (both Fiumicino and Ciampino airports), Amsterdam Schiphol, Dublin, Warsaw, Lisbon or London Heathrow.

Article 5 of Regulation 95/93 (as amended by Regulation 793/2004) requires member states to ensure that at coordinated airports a coordination committee is set up. Membership of this committee shall be open at least to the air carriers using the airport in question regularly, the managing body of the airport, the relevant air traffic control authorities and the representatives of general aviation using the airport regularly. Initially, the main tasks of the coordination committee were limited to making proposals or advising the coordinator and/or the member state on (1) the possibilities for increasing the capacity of the airport, (2) the coordination parameters, (3) the methods of monitoring the use of allocated slots, (4) local guidelines for the allocation of slots or the monitoring of the use of allocated slots, (5) improvements to traffic conditions prevailing at the airport in question, (6) serious problems encountered by new entrants, and (7) all questions relating to the capacity of the airport.

Importantly, Regulation 793/2004 significantly extended this list. The most important change was the addition of a second main task, apart from making proposals or advising—mediating between all parties concerned on complaints on the allocation of slots. Before the amendment, the role of the committee was limited to advising on complaints. A new Article 11 provides that without prejudice to rights of appeal under national law, complaints regarding the allocation of slots shall be submitted to the coordination committee. The committee shall, if possible, make proposals to the coordinator in an attempt to resolve the problem. If the complaint cannot be settled, the member state responsible may provide for mediation by an air carriers' or airports' representative organisation or other third party. The amendment obviously strengthened the role of the coordination committee. However Recital 7 remained unchanged and provides that it is important to ensure that the coordination committee has no power to take decisions that would be binding on the coordinator. Thus, as the role of the committee continues to be limited to consultation and advice, it cannot be considered networked governance.

[64] For instance, in Ireland the Commission of Aviation Regulation has appointed Airport Coordination Ltd, a UK company based at Heathrow, to act as coordinator at Dublin airport until March 2016.

4 Proliferation of Networks or Network Governance?

Having examined the networks participating in the regulation of the EU aviation industry, it is now necessary to analyse whether these networks do in fact exercise the governance function, in a sense of influencing or shaping decision making processes, or simply play advisory roles and provide forums of dialogue and information exchange.

Parker submits that there has been a tendency in the academic literature to 'conflate networks with networked governance'[65] in that it is often accepted that 'evidence of ... networking is evidence of ... governance'.[66] Coen and Thatcher add that networks existing in the context of decision-making in the EU 'have created much excitement, with claims that they form part of moves towards "network governance" in regulation'.[67] Meanwhile, Teisman and Klijn clarify that in reality 'while there is an intensified interaction between public and private partners, there is little joint decision making and continuity in cooperation'.[68] Superimposing the analysis of the networks existing in the regulatory system of the EU aviation sector on the five key features of network governance allows drawing a similar conclusion—there is an intensive governance *in* networks, but very little genuine network governance, i.e., governance *by* networks.[69]

The first identified feature of network governance—the existence of a large number of interdependent actors who interact in order to produce public purpose—seems to be fulfilled by the six networks identified above.[70] In the context of networks operating at the EU level (1) JAA was a voluntary grouping of national aviation safety authorities cooperating to produce the first common safety standards; (2) the European Network of Civil Aviation Safety Investigation Authorities (ENCASIA) evolved from voluntary cooperation to an EU law mandated forum working together to achieve the best outcome of air accident investigations; and (3) the Industry Consultation Body (ICB) within the SES initiative is again an EU law mandated platform characterised by extensive involvement of the stakeholders from the ATM community aiming to provide technical advice to the European Commission in order develop and implement the best possible future ATM system in Europe. With regard to the EU law mandated national networks, (4) in the area of aviation security, the Irish National Civil Aviation Security Committee (NCASC) has markedly wide membership and cooperates with the government in order to provide for the most effective aviation security system possible; (5) in the area of airport regulation, mandatory consultation on airport charges between the airport

[65] Parker (2007), p. 117.

[66] Davies (2000), p. 416.

[67] Coen and Thatcher (2008), p. 50.

[68] Teisman and Klijn (2002), p. 198.

[69] Börzel and Heard-Lauréote (2009), p. 140.

[70] Arguably with the exception of mandatory consultation with stakeholders on airport charges in case the subject of the consultation is not considered to be related to public purpose.

and the airport users aims at deciding on the system and the level of airport charges, and on service quality levels; and finally (6) the existence of Slots Coordination Committees at all coordinated airports in the EU is directed towards producing public purpose in the form of the most efficient slot allocation at congested airports.

The second key feature of network governance is the linkage of public and private actors from different institutional levels (national, EU and international) in a negotiation system in which they "coordinate their actions through negotiating voluntary agreements". It appears that all six of the identified networks in the EU aviation regulation lack this characteristic. The networks either bind together national regulatory authorities with no participation of sectoral actors (JAA, ENCASIA) or involving sectoral stakeholders acting in advisory role with regulatory authorities not being full members (ICB, NCASC, charges consultation, Slots Coordination Committee). ENCASIA is to be 'supported' by the Union, but the involvement of the European institutions is minimal. At the national level, networks such as the Irish NCASC seem to come the closest to having this characteristic as they link together representatives of government departments, aviation authorities, police, the defence forces and post on the one hand and the airports, airlines and pilot associations on the other. However, NASC does not negotiate voluntary agreements.

The third key element of network governance, i.e., a shift of power from hierarchy to 'institutionalised modes of coordination', is again not present in any of the networks existing in the regulatory environment of the EU aviation sector. European Commission remains the most powerful regulator and almost no formal regulatory powers have been shifted to the networks. The role of the existing networks is to serve as forums for dialogue, information exchange, sharing of resources and standard setting (ENCASIA), or as platforms for consultation, recommendation and advice for traditional regulators (ICB, NCASC and Slots Coordination Committee). In general, as Coen and Thatcher observe, the networks 'face ambitious aims and are asked to consult widely and cover broad fields; [y]et they lack formal powers'.[71] None of the networks has powers to impose its decisions on regulators or on members of the network. It is worth noting, that in some cases amendments to legislation have strengthened the role of a network. For instance, Regulation 793/2004 added a second main task of the Slots Coordination Committee, apart from making proposals or advising—mediating between all parties concerned on complaints on the allocation of slots. Before the amendment, the role of the committee was limited to advising on complaints. However, the Regulation continues to state that it is important to ensure that the coordination committee has no power to take decisions that would be binding on the coordinator. The closest any network came to fulfilling this element was the coming together of national safety authorities in order to form JAA and coordinate among themselves in an institutionalised manner the application of first common safety standards. The network, however, never grew to encompass all the remaining features of a

[71] Coen and Thatcher (2008), p. 64.

governance network. It was, instead dissolved and its achievements codified by traditional EU-law making processes.

The fourth characteristic of network governance is a change in the mode of governance away from hierarchy to a system based on negotiation, where the voluntary agreements are collectively biding and the network plays a role in steering, setting directions and influencing behaviour. Again, none of the networks existing in the regulatory framework of the EU aviation industry possesses this characteristic. Hierarchy continues to constrain the networks with the European Commission and national regulators maintaining control over decision-making and the continuing existence of EU committees (such as the SES committee constraining the power of ICB). Coen and Thatcher observe that 'such shadows of government potentially limit the innovative scope of the 'networks' and raise important questions about their ability to evolve into strong regulatory bodies'.[72] In addition, many of the networks identified operate in an intergovernmental manner and work through consensus. For instance, according to its Terms of Reference, ICB shall not vote and in giving its opinion should endeavour to reach consensus. In the event that a consensus is not possible, the Commission will take the differing views into account.

The fifth and final element of network governance—compliance ensured through trust and political obligation which, over time, becomes sustained by self-constituted rules and norms—seems to feature, at least in a partial form, in two of the networks identified. The first one was the now defunct JAA which serves as an example of an early attempt at network governance in the European aviation sector and was on the right path to become a form of network governance. However, the initial voluntary cooperation did not over time become 'sustained by self-constituted rules and norms', but instead was dissolved and the norms established as a result of the cooperation were sanctioned by binding legislation adopted by the traditional regulatory mechanism of the EU. The second network displaying some elements of the fifth key characteristic of network governance is ENCASIA which works to develop common methodology for air accident investigations in the EU. As already discussed in earlier, Regulation 996/2010 envisages an obligation for a member state in charge of an accident investigation to recommend to other member states any preventive action that it considers necessary to be taken promptly to enhance aviation safety. The recipient states are required to acknowledge the receipt of the recommendation and inform the sender of actions taken or under consideration, or where no action is taken—the reasons therefor. Both the safety recommendations issued as well as the responses thereto are to be recorded in the central repository of information on civil aviation occurrences established by the European Commission.[73] With no legal sanctions for the refusal by the addressee member states to abide by the safety recommendations issued by

[72] Ibid., p. 50.

[73] Established by the Commission Regulation 1321/2007 of 12 November 2007 laying down implementing rules for the integration into a central repository of information on civil aviation occurrences exchanged in accordance with Directive 2003/42/EC.

the national authorities in charge of the investigation. The successful operation of the procedure in Article 17 relies on trust, peer pressure and a sense of political obligation among the members of the Network. At present, this trust and political obligation has not yet become sustained by self-constituted binding rules and norms. Cooperation within the Network is purely voluntary and accident investigation largely remains in the competence of the member states. However, it is also possible that over time through cooperation within the Network, the member authorities will reach a consensus on what they all consider to be the best practice for air accidents investigation. This best practice can in turn be sanctioned by EU legislation as binding for all member states and enforced by ENCASIA. ENCASIA may thus be seen as an intermediate step towards becoming a form of a governance network.

Table 1 below summarises the discussion on whether the regulatory networks in the EU aviation sector demonstrate the features of governance networks identified in the academic literature.

Overall, the above analysis of the existing networks in the EU aviation sector allows the conclusion that there is little evidence of network governance or governance *by* networks, but there is rather an abundance of governance *in* networks.[74] The analysed networks have been given a variety of tasks, but very limited powers. They are forums of dialogue and information exchange, platforms for consultation and standard setting and sources of advice. However, as Coen and Thatcher observe, even though the networks lack formal powers, they 'may be able to develop informal resources and linkages' in the form of information, expertise, reputation and trust.[75] Börzel and Heard-Lauréote add that networks can 'facilitate the development of shared meanings and values which evolve via the use of common language to deliberate on particular problems or issue areas'.[76] This could allow them to go beyond their formal institutional framework and lead to a *de facto* governance by networks.

Moreover, even if the networks do not wield formal powers, their existence undoubtedly brings benefits for both effectiveness and legitimacy of decision-making process in the EU. With regard to legitimacy, Börzel and Heard-Lauréote note that 'by including affected actors at the input stage, networks may produce more widely accepted outcomes'.[77] They also provide for effectiveness gains due to their highly flexible nature which allows them to adjust to 'complex contemporary policy problems that cannot be tackled at all or as well by existing formal institutional arrangements'.[78]

Thus, although the regulatory environment of the EU aviation industry is characterised by a proliferation of networks rather than actual network governance, the creation and support for networks is a valuable development which transformed

[74] Börzel and Heard-Lauréote (2009), p. 140.

[75] Coen and Thatcher (2008), p. 68.

[76] Börzel and Heard-Lauréote (2009), pp. 140–141.

[77] Ibid., p. 144.

[78] Ibid., p. 144.

Table 1 Networks in the EU aviation regulatory system

		EU-level networks			EU law-mandated national networks		
		Safety		ATM (SES)	Security	Regulation of airports	
		Joint Aviation Authorities - JAA (historic)	European Network of Civil Aviation Safety Investigation Authorities	Industry Consultation Body (ICB)	National Civil Aviation Security Committee (Ireland)	Consultation on charges	Slots coordination committee
Governance network feature	A large number of interdependent actors who interact in order to produce public purpose.a	+	+	+	+	+	+
	Linkage of public and private actors from different institutional levels (national, EU and international) in a negotiation system in which they coordinate their actions through negotiating voluntary agreements.b	-	-	-	+/-	-	-
	Shift of power from hierarchy to institutionalised modes of coordination b	-	-	-	-	-	-
	A change in the mode of governance away from hierarchy to a system based on negotiation, where the voluntary agreements are collectively biding b and the network plays a role in steering, directions and influencing behaviour.c	-	-	-	-	-	-
	Compliance is ensured through trust and political obligation which, over time, becomes sustained by self-constituted rules and norms. d	+/-	+/-	-	-	-	-
	Governance network?	**No**	**Not yet (may develop)**	**No**	**No**	**No**	**No**

[a]Sorensen and Torfing (2005)
[b]Coen and Thatcher (2008) and Börzel and Heard-Lauréote (2009)
[c]Parker (2007)
[d]Nielsen and Pedersen (1998)

the decision-making process in the sector. For an industry which had for decades been subject to strict regulation by national governments, such a widespread involvement of stakeholders in the shaping of its regulatory framework has to be seen as nothing short of a revolution.

5 Conclusion

There is no doubt that the regulatory environment in the European Union has undergone a significant transformation in the last decade. The continuing claims about the 'democratic deficit' in the EU resulted in the widespread involvement of stakeholders in the law-making process. The White Paper on European Governance initiated the focus on networks in the EU as 'elements of substitute democratic legitimacy'.[79] In a number of European policies new networks have been created at the EU level, EU law mandated the creation of networks at the national level and in many cases the already existing informal networks received legislative recognition and sanction in the EU law.

Transport in general, and air transport in particular, is only one of many EU policies which has witnessed this 'network excitement'. However, as has already been submitted earlier, aviation is a specific area in this context, since it particularly requires the participation of all the actors in the market in decision-making processes. The European aviation sector was transformed by the emergence of the common EU aviation policy which has contributed to the emergence of new EU airlines, airports and routes, increased competitiveness, greater efficiency and lower fares. This new pan-European aviation sector meant that governance models needed to evolve as well. Not only did regulation to a large extent transfer from the national governments to the supra-national EU level, but also there has been a noticeable shift to greater involvement of all interested parties, from both public and private sectors, in policy shaping and decision making processes. The pre-liberalisation model of strict government regulation with little to no input from other stakeholders resulted in the inefficiency and underperformance of the industry. Therefore, the creation of new networks in the sector or legitimisation of the existing ones is a welcome development.

However, as the discussion in this article has shown, the fact that a number of networks exist does not necessarily mean that the regulation of the sector has moved towards network governance. Superimposing the analysis of the networks existing in the regulatory system of the EU aviation sector on the five key features of network governance identified in this article, led to a conclusion that there is an intensive governance *in* networks, but very little genuine network governance, i.e., governance *by* networks.[80] The networks discussed have been given a variety of tasks, but very limited powers. They are mainly forums of dialogue and information

[79] Ibid., p. 146.

[80] Ibid., p. 140.

exchange, platforms for consultation and standard setting and sources of advice. Nonetheless, at least some of networks, such as ENCASIA, are potentially intermediate steps between being a simple network of cooperation and an actual governance network. Moreover, most of the networks discussed can develop informal powers through socialisation, information, expertise, reputation and trust an thus become *de facto* governance networks. Finally, even if the networks do not wield formal powers, their existence undoubtedly brings both efficiency and legitimacy gains to decision-making processes in the EU aviation sector.

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Unpacking Legal Network Power: The Structural Construction of Transnational Legal Expert Networks

Mikael Rask Madsen

Contents

Regulatory networks and other forms of networked governance have come to play an increasingly important role in what is now often referred to as global governance. Generally, most theories of global governance involve some kind of claim of a decline of the role of nation-states in international affairs and a corresponding growing power of experts.[1] And, according to mainstream theory, it is this relative absence of the state that has provided a space for a rule by transnational experts. In lieu of the state and its legitimacy, transnational expert governance has then sought to legitimise its undertakings in notions of progress, effectiveness, (economic) rationality and other forms of non-democratic legitimacy. While this can be observed across a series of fields, it does not necessarily entail that the state has been side-lined quite as dramatically as what is often assumed.[2] A case in point is the European Union (hereinafter, *EU*) and its many and often complex decision-making processes. Since its genesis in the aftermath of the Second World War, the EU has been defined by both political and expert-driven decision-making processes. In fact, the very construction of the original Coal and Steel Community was essentially marked by a clash between those seeking to make European integration

[1] For an overview, see for example Slaughter and Zaring (2006), pp. 211–229.

[2] Cf. Sassen (2006).

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a new democratic political project, using templates from the state, and those arguing for making it essentially expert-driven, often using a logic of the market.[3]

Interestingly, while this competition for authority opposed economic and political elites of Europe during the 1940s and 1950s, one finds legal experts in both camps. Lawyers, more than any other actors at the early decisive moments of European integration, exhibited a unique professional skill in simultaneously professing their commitment to growth and economic innovation *and* arguing for a stabilising order of law and politics using templates derived mainly from federal state models. They basically played a double game of both defending law and order and joining the 'revolutionary' movement just like they had done previously in history—a notable example being the role of lawyers in the French Revolution. What is equally interesting about the role of lawyers in both state-building and Europeanisation and globalisation is that they since day one have operated as partly public experts, partly private experts. This double construction of the profession has provided lawyers with a unique symbolic power in terms of an ability of ordering politics without necessarily doing politics. Understanding the professional 'double game' of lawyers is however not just interesting for historical purposes. It is my claim that it is in fact pivotal for understanding contemporary network governance and regulatory networks. As I will argue below, at a deeper sociological level, it is indeed revelatory of how lawyers construct norms and regulations, as well as institutions, by using their unique position with regard to (state) power which they have acquired over a prolonged historical period.

A few additional historical notes might clarify the argument. My argument is basically that lawyers, and more generally the legal profession, are intrinsically linked to power and particularly state power.[4] From thirteenth century Europe, where jurists and jurisconsults first emerged as brokers between Church and early State, to the launch of international law in the late nineteenth century, they have been central to state power in a broad sense.[5] In fact, as noted by renowned Norwegian sociologist of law, Wilhelm Aubert, by the end of the nineteenth century jurists had constructed for themselves a unique position as the 'jacks of all trades'.[6] The twentieth century however saw an increased competition among professionals, but this did by no means imply a farewell to legal arms.[7] Although losing their monopoly on state expertise to other new professional forms of knowledge—economy, political science, etc.—they nevertheless remained highly central in numerous ways. Among the various professional groups now claiming a leading role as 'globalisers', legal entrepreneurs do in fact more than most exhibit the properties of what might be termed a 'transnational power elite'[8]: They are clearly one of the interrelated (and competing)

[3] Cohen (2007), pp. 109–135. See also Petersen et al. (2008).

[4] For example Kantorowitz (1961); Brundage (2008).

[5] Dezalay and Madsen (2012), pp. 433–452.

[6] Aubert (1976).

[7] For example Dezalay and Sugerman (1995).

[8] As defined in Kauppi and Madsen (2013).

groups of actors more or less permanently at the helm of global affairs. It is from this vantage position they help define the world order in the image of their own particular expertises—and with considerable consequences for society at large.[9]

I emphasise these sociological properties of legal expert power as such an analysis in my opinion provides a necessary supplement to some of the more descriptive approaches to transnational regulatory networks. According to the perspective I will propose in this chapter, although notions of regulatory networks clearly have descriptive force and help us identify new patterns of transnational law-making, deploying such notions also entail a real risk of leaving out of the analysis those precise social conditions and forces that make networks powerful in the first place. In a nutshell, the problem is that the very notion of networks is inherently vague which in itself calls for a complementary sociological analysis of the social structures that enable legal networks to contribute to the emerging world order. This inevitably involves establishing the linkage between legal networks and power, including state power, and thus the structured social spaces in which networked power is exercised.

To conduct this analysis, the chapter opens with an outline of what are probably the most sophisticated theories of networks so far developed: Manuel Castells' magnum opus on the network society,[10] Ernst Haas' notion of epistemic communities,[11] and Kathryn Sikkink and Margaret Keck's work on transnational issue and advocacy networks.[12] To highlight the problem of understanding power and social structure in network analysis, I contrast these works on networks with empirical studies of the role of lawyers in terms of transnational entrepreneurs and global power brokers in two key transnational fields of legal practice before international commercial arbitration and international human rights law. In both cases, the empirical studies go beyond the notion of networks and instead analyse these constellations as *fields* by drawing on Pierre Bourdieu's sociology. The chapter concludes by briefly recapturing the core arguments for supplementing—even substituting—the descriptive notion of networks with sociologically richer theories for better understanding lawyers and the workings of contemporary networked governance.

[9] A number of sociologists have analyzed the societal consequences of this forms of elite globalization, for example Bauman (1998).

[10] Castells (2000a, c, d).

[11] Haas (1992), pp. 1–35.

[12] Keck and Sikkink (1998).

1 Networks as Global Society: Manuel Castells and the Globalisation of the Web

Manuel Castells' trilogy on the information age is, to quote the author, 'not a book about books'.[13] It is indeed a grandiose conceptualisation based on extensive empirical research, whereby it grounds a few broadly defined concepts and research tools.[14] Castells' project is however marked by one empirical narrative that echoes throughout his oeuvre: information technology is the engine of the grand transformation towards the network society and the corresponding *technological paradigm*. Castells is seriously talking post-industrial society—indeed as noted by Swedish sociologist, Håkan Hydén: 'Silicon Valley is for Castells what Manchester was for Karl Marx'[.].[15] Comprised as an open field of computer and software engineers and their institutions and businesses around San José, hooked up to the intellectual power and capital of particularly the universities of Stanford and Berkeley, and sparked by the creative energy of San Francisco and its 'web' designers, the 'new Manchester' is undeniably a potent player in the continuous process of global restructuring, as well as the network society par excellence. Questioning this seems futile.

Castells, however, seeks to go beyond the original alleys and central valleys of California. His analysis of the network society is indeed more than a case-study of global 'Californication': in addition to the IT revolution, he links the emergence of the network society to broader social processes, including the exodus of Cold War bipolarity in international politics, the alleged crisis of capitalism and étatism and the power of social movements advocating cultural, ecological and other concerns.[16] However, at the core of the argument, as well as the empirical construction of the notion of network society, we find a focus on the merger of the provisions provided by information technology and the type of identity and cultural politics that, if anything, have characterised (Northern) California over the last 30 years. The globalisation of this blend of grassroots-organising, research networks, alumni networks and issue-networks has taken place interdependently with the development of information technology and to the extent that, on the one hand, it has infiltrated IT corporations' notions of management and organisation, and, on the other hand, it has made technology an integrated part of most networks.[17] Moreover, the decentralisation and denationalisation of the corporation and the state—something greatly enabled by IT as well as the globalisation of Western-style liberal market economy and the attributed decline of the nation-state—have

[13] Castells (2000d), p. 25.

[14] Castells does, however, provide a few more general outlines of his theory in the trilogy and in a few additional articles. See particularly Castells (2000b), pp. 5–24.

[15] Hydén (2001), p. 9.

[16] Castells (2000d).

[17] This dimension to contemporary capitalism is however much better captured by sociologists such as Luc Boltanski and Richard Sennett. See for example Boltanski and Chiapello (2007).

helped to spread and/or widen the networks in an outsourced, subcontracted or simply interconnected form of social organisation: the network society.

As we can see, the network organisation is simultaneously a metaphor and a concept encapsulating a dramatic change in the structures of advanced capitalist societies and how they are increasingly linked in a grand, transnational web. Technology is seen as a particular new layer of the society of the information age, however, not implying that other productive forces have ceased to impact the structuring of contemporary society and, thus, also the way we organise and claim our lives; capitalism is still the dominant way of production, but the emerging technological 'layer' redefines its determinative effect on social categories. As indicated by this, Castells might take a mundane Marxist starting point,[18] but his project is not primarily concerned with the negative consequences of globalisation.[19] His focus is instead on the new flows of information of the 'network society'. This he analyses around three central concepts: *production* (in regard to consumption), *experience* (the action of humans on themselves, determined biologically, culturally and socially) and *power* (both physical and symbolic). The notion of network is rather value-neutral, even if it is manifest in the new informational capitalism organised in such network formations, all together implying that a significant portion of (global) society is outside—literally off-line—of the dominant networks.

The *information age* does not equal the *information society* if this implies that knowledge and/or information have become the critical capitals—they have to some extent always been so throughout the history of mankind, Castells argues. The core change is the one towards *the technological paradigm*, which is characterised by 'the use of knowledge-based, information technologies to enhance and accelerate the production of knowledge and information in a self-expanding, virtuous circle'.[20] And, Castells adds: 'Because information processing is at the source of life, and of social action, every domain of our eco-social system is thereby transformed'.[21] Further, the emergence of the technological paradigm corresponds to the *new economy* we, according to Castells, live in. It has three fundamental features: (1) it is *informational*, 'the capacity of generating knowledge and processing/managing information determine[s] the productivity and competitiveness of all kinds of economic units, be they firms, regions or countries'[22]; (2) it is *global* in the sense 'that its core, strategic activities, have the capacity to work as a

[18] Actually, in a later work Manuel Castells pulls away from what appears to be clear-cut Marxist position in regard to the relationship between production/technology and social transformation. See Castells (2000b), p. 9.

[19] Castells analyses the relationship between the self and the web: those who are able to construct their lives within the new framework and those who fail to enter the new networks and flows, which are social groups and divisions of labour that cannot be captured in a traditional Marxist framework. See Castells (1996), pp. 9–38.

[20] Castells (2000b), p. 10.

[21] Ibid.

[22] Ibid.

unit on a planetary scale in real time or chosen time'[23]; (3) it is *networked* referring to a new organisational structure at the core of the connectivity of the global economy and the flexibility of informational production. Hence, the new (network) economy is 'not a network of enterprises, but a network made from either firms or segments of firms, and/or internal segmentation of firms. Large corporations are internally de-centralised as networks. Small and medium businesses are connected in networks'.[24]

The *structure* of the information age is the one of the network, which is defined as a set of interconnected 'nodes', where a 'node' is 'the point where the curve intersects itself'.[25] Generally speaking, there is nothing new about networks as a form of social organisation with the important exception that they in the information age have been powered by new technology making them *information networks*. Historically, the modern state and attributed bureaucracy originally outplayed networks as social organisations (for example guilds) by their capability to 'master resources around centrally defined goals, through the implementation of tasks in rationalised, vertical chains of command and control'.[26] The paradoxical resurrection of networks in the information age is due to the fact that they, in ways contrary to the hierarchical structure of étatism and its bureaucracy, allow co-ordination and management in a more interactive way by being more de-centred regarding execution, performance and decision-making, as well as by using the provisions offered by information technology being continuously flexible and adaptive to the evolutionary nature of the new paradigm. All together, this provides a 'superior social morphology for all human action' according to Castells.[27]

Attempting nothing but a paradigmatic shift, this is a serious challenge to most conventional understandings of society and calls for further explanation of the logics of networks and networking. Castells writes:

> By definition, a network has no centre. It works on a binary logic: inclusion/exclusion. All there is in the network is useful and necessary for the existence of the network. What is not in the network does not exist from the network's perspective, and thus must be either ignored (if it is not relevant to the network's task), or eliminated (if it is competing in goals or in performance). If a node in the network ceases to perform a useful function it is phased out from the network, and the network rearranges itself – as cells do in biological processes. Some nodes are more important than others, but they all need each other as long as they are within the network. And no nodal domination is systemic. Nodes increase their importance by absorbing more information and processing it more efficiently. If they decline in their performance, other nodes take over their tasks. Thus, the relevance, and relative weight of nodes does not come from their specific features, but from their ability to be trusted by the network with an extra-share of information.[28]

[23] Ibid.

[24] Ibid., pp. 10–11.

[25] Ibid., p. 15.

[26] Ibid.

[27] Ibid.

[28] Ibid., pp. 15–16.

This conceptualisation allows Castells to effectively decentralise and interrelate the whole structure of society into a network logic. He goes as far as stating: '[T]he main nodes are not centres, but switchers following a networking logic rather than a command logic, in their function vis-à-vis the overall structure'.[29]

In the light of these rather technical-inspired conceptualisations, Castells' theory includes an almost paradoxical high degree of belief in the role of actors. However, putting the actor in play in the network society consists of more than letting him or her go 'networking'. His general understanding of society has an in-built element of conflict. He writes: 'Human societies are made from the conflictive interaction between humans organised in and around a given social structure. This social structure is formed by the interplay between relationships of production/consumption; relationships of experience; and relationships of power'.[30] Thus, Castells' solution to the micro–macro puzzle, e.g. the concrete relationship between structuring structures and the structuring effect of actors, seems fairly mundane. It is only when adding the substantive element of the network society and its flows of information facilitated by information technology that the real framework appears for understanding what kind of action (collective and individual) is possible and when. It is in volume two of his trilogy under the header 'the power of identity', that he sets sail for explaining the role and life of individuals in the information age.[31] The key argument is related to the decline of the importance of *time* and *space*, thereby emphasising the deterioration of the core material foundations of the life under the 'ancien régime': the industrial society. Castells suggests two new categories: *timeless time* and *space of flows*, both defined clearly in correspondence with the above conceptualisations of a more fluid, de-centralised social structure.[32]

The relationship between the *self* and the *web*—practically meaning the ones able and willing to construct their lives within the network logic, and the ones who on the contrary seem to reject or even try to launch a counterattack on the evolving new logic of society—classifies and defines what type of social action or mobilising is 'new history making' or which rests as 'fragmented communalism'.[33] The distinction between what is inside and outside the web can however not be made clearly just as people of the network society obviously are members of both networks and communes simultaneously. As already noted, the networks as a structure are in principle value-free. However, this does not mean that all available networks are not programmed by the users (actors)—otherwise they would simply not exist. Hence, actors have to play their strategies *within* the networks or, alternatively from the *outside*, constructing new networks around alternative values and thereby seeking to destroy existing networks. Because of the importance of *values* in regard to networks, communication becomes central. Castells writes:

[29] Ibid., p. 16.

[30] Ibid., p. 7.

[31] Castells (2000c).

[32] Castells (2000b), pp. 13–14.

[33] Ibid. p. 23.

> Networks may communicate, if they are compatible in their goals. But for this they need actors who possess compatible access codes to operate the switches. They are the switchers or power-holders in our society (as in the connections between media and politics, financial markets and technology, science and the military, and drug traffic and global finance through money laundering).[34]

Among the 'switchers' we clearly find the key entrepreneurs of globalisation, including legal entrepreneurs: those who can pass the gate-keepers to several establishments and networks and, thus, have the privilege in terms of power and information to combine and thereby also construct new networks.

As it appears from this brief outline, Castells' theory more or less directly draws on notions of power, or by the Castellsian term, *relationships of power*. Power-sharing as a matter of fact (and a matter of need) characterises according to Castells the new network framework of the information age. The state is being bypassed on many levels by the new networks, as well as former traditional power holders in forms of organisations: the Church, the school, bureaucracies of various kinds and national-oriented corporations.[35] The forms of information and power that trespass or even bypass these former power-holders are found at the core of the new global economy, including information networks of capital, production, trade, science, communication, as well as human rights and crime.[36] As a matter of adapting to the new social reality, states react by transforming themselves in the image of networks and power-sharing, causing the importance of centres (and associated hierarchies) to diminish and become nodes in a large network construction of institutions. Castells concludes: '[W]hile there are still power relationships in society, the bypassing of centres by flows of information circulating in networks creates a new, fundamental hierarchy: the power of flows takes precedence over the flows of power'.[37] This is a rather dramatic conclusion, which seriously challenges standard conceptions of law, state and power. Above all, it provides a constitutive theory of networked governance.

2 Zooming In: Networks as Middle-Range Sociological Phenomenon

The work of Manuel Castells might very well be regarded as one of the most ambitious attempts of providing a *Zeitdiagnose* of contemporary globalisation and the rise of transnational flows and communications. The main take-away from his extensive studies is however more a problematisation of current exchanges than an exact terminology and methodology for analysing them. It is self-evident that the

[34] Ibid., p. 16.
[35] Ibid., p. 19.
[36] Ibid.
[37] Ibid., p. 20.

sort of macro analysis of the new transnational world which is found in Castells' œuvre cannot provide detailed analysis of the actual processes and have to limit themselves to an exposé of the infrastructures created and creating these changes. What is also striking across the three volumes on the network society is that he tends to draw on examples where the place of the state is not of key importance for exercising network power. There is in fact a striking absence of analysis of for example international law in his work—even human rights are only briefly touched upon and in general terms. His studies have however influenced a vast body of literature that has studied transnational knowledge-making, including law, in more detail; Peter M. Haas' article, *Epistemic Communities and International Policy Coordination*, is a seminal contribution in this respect.[38] Although it addresses some of the same issues as Castells, the article was originally written mainly as a reaction to the dominance of systemic approaches in IR, as well as an attempt to (re-)introduce actors in the 'international system'. Haas' basic idea is to analyse how actors—and particularly constellations of expert actors—influence international policy and policy coordination. In other words, it is an attempt at defining more precisely networked governance.

Haas defines an epistemic community as 'a network of professionals with recognised expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area'.[39] What makes the group particular is its episteme, that is, its adherence to a certain set of values and modes of validity. The notion is in fact loosely building on the observations of scientific communities, where adherence to specific methodologies as a way of generating truth is a prerequisite for its workings. Yet, as Haas points out, the notion is in fact more narrow that what is assumed in communities of scientists, where very divergent views often co-exist within the same group.[40] To more precisely describe the concept, Haas instead evokes Ludwig Fleck's notion of 'thought collectives' and particularly Kuhn's standard definition of a paradigm as 'an entire constellation of beliefs, values, techniques, and so on shared by members of a given community', which 'governs not a subject-matter but a group of practitioners'.[41]

Within the network framework of Castells, epistemic communities might at first glance be viewed as 'nodes' of a network. This is a however mistaken. According to Haas, epistemic communities are '[. . .] channels through which new ideas circulate from societies to governments as well as from country to country'.[42] As Haas further points out, these communities are not simply value-neutral networks, transmitting ideas from one place to another:

[38] Haas (1992), pp. 1–35.

[39] Ibid., p. 3.

[40] Ibid., p. 3, note 4.

[41] Ibid.

[42] Ibid., p. 27.

> [. . .A]n epistemic community cannot be reduced to the ideas it embodies or purveys, since these ideas are transmitted in tandem with a set of causal and principled beliefs and reflect a particular political vision. The ideas would be sterile without carriers, who function more or less as cognitive baggage handlers as well as gatekeepers governing the entry of new ideas into institutions.[43]

This comes back to the way in which the basic notion is defined, namely as a collective of like-minded experts, that is, there are not only shared ideas of validity and internal criteria for 'truth', but also collective policy interests and normative allegiances. Basically, the epistemic community is a group of actors who have a particular and collective expertise within a certain subject-area, which they assume is of importance for more generally furthering the subject-area. Following this definition, the legal profession can for example not be seen as an epistemic community, yet segments of the legal profession can be characterised as such in their pursuit of more specific goals using their collective knowledge and belief structures, for example human rights lawyers or international arbitrators, as I will discuss below.

As already noted, the notion of epistemic communities was developed as a reaction to mainstream realist and systemic theories in international relations which tended to offer very little in respect to explaining the way in which information and expert advice influence the manufacturing of international policy and regulation. According to Haas, the impact of such communities has gradually increased due to the new forms of communication and networking that current globalisations have facilitated. The rise and growth of these communities are moreover an example of the proliferation of international actors that Anne-Marie Slaughter describes in her work.[44] Further, they are the outcome of a more general proliferation of experts within public governance over the last some 50 years. This development has basically been a 'transfer of wider and wider areas of public policy from politics to expertise' as Harvey Brooks noted already in 1965.[45] A result of this development is the growing density of regulation over the same period, a phenomenon that has been transplanted to the international level and only accelerated by current globalisations. This process is not only a self-fulfilling prophecy in the sense that ever-increased regulation of national and international society necessitates more and more experts, it is also an outcome of the mere fact that globalisation produces new forms of complexity and uncertainty. While traditional international interaction has been framed as the interplay of State diplomacies pursuing State interests, the new scenario increasingly requires the expertise of other actors than State diplomacies in order to solve a whole array of new issue. There is basically not only a structure of opportunities for these new actors, but also a structural demand for their services.

[43] Ibid.

[44] For example Slaughter (2004).

[45] Cited Haas (1992), p. 8.

This is clearly a challenge to neo-realist accounts emphasising war and shifts in power resources and technologies as drivers of change. Different from the 'the Marines' who are still *occasionally* called upon to 'reduce international complexity', the experts—and new forms of expert communities with normative interests—are *permanent* actors of the governance of globalisation in subject-areas as different and complex as finance, the environment and human rights. Hass' argument is basically that epistemic communities are somehow the 'missing link' if international policy coordination and its connections to national, international and transnational levels of law and policy have to be more fully explained. Although certainly among the most influential contribution over the last decade, Haas' focus on experts and expert communities has however far from convinced the whole community of social scientists interested in transnational politics and law. According to some authors, the importance of the power-holders of globalisation in transnational policy-making is in fact unsurprising and an object of only limited scientific interest.[46] In their view, experts are not simply playing a role because they create epistemic communities and provide information to the formal decision-makers, they are in fact themselves being influenced—even orchestrated—by hegemonic forces of the real decision-makers.[47] What these more critical studies are interested in are the new forms of advocacy and policy coalitions facilitated by the new infrastructures of globalisation and technology in terms of alternatives and counter-hegemonic political practices. As I will come back to below, they thereby tend to overlook how certain expert communities have become a real force in themselves—which they in fact claim themselves when analysing subaltern movements. But perhaps most importantly, they overlook how networks are dynamic and adversarial. This can be explained by a quick look at so-called transnational advocacy networks.

In her pioneer study of the rise, consolidation and transition of the Latin America human rights network, Kathryn Sikkink has analysed the various stages of the politics of human rights in respect to Latin American since the late 1960s.[48] She demonstrates how human rights in the 1970s was created as an issue, a shared category of concern between the South and the North, by a number of pioneering human rights non-governmental organizations (hereinafter, *NGO*), including, in particular, Amnesty International. In the second stage, 1981–1990, she argues that an expanding 'network' between these groups increasingly, and more effectively, used the symbolic power of human rights in their common struggle. This period was symbolised by the launch of Americas Watch, which took human rights to a new level by professionalising and 'mediatising' the subject. Influenced by the beginning of the democratisation of Latin America, as well as more generally post-Cold War diplomatic practices, the third stage, 1990 to present, forced this network to reorganise and aim at a set of new issues related to the consolidation of

[46] See for example Sousa Santos and Rodríguez-Garavito (2005).
[47] Ibid.
[48] Sikkink (1996).

democracy and human rights. Together with Margaret Keck, Sikkink has more generally theorised this variation of 'epistemic communities' in terms of 'transnational advocacy networks'.[49] This analysis, which very cleverly situates itself somewhere between network analysis and social movements' studies, poses a set of key questions regarding the way in which advocacy networks form essential infrastructures for transnational symbolic politics such as human rights activism. Yet, as I will argue below, like most network literature it fails when it comes to explaining how symbolic politics is turned into real politics and ultimately law.

3 A Bourdieusian Critique of Networks as Social Scientific Object

Even if the Bourdiesian approach I will introduce in the following shares important scientific interest with both the macro-theory of Castells and the middle-range theories of Haas and Keck and Sikkink, it differs substantially in its basic framework. While networks invariably are defined as connections and have elements of shared understandings, Bourdieu introduced the notion of field as a research tool for understanding not simply how the actions of certain groups (and networks) of agents structure the social world, but also how they themselves are structured by the social world. In other words, the approach provides a double view of social practice that helps situate practice in structure and analyse the effects of practice on social structure. Conceptually, a field is a place for struggle between different agents where different positions are held based on the amount and forms of capital. In Bourdieu's own words:

> [I]t is a network, or a configuration, of objective relations between positions. These positions are objectively defined, in their existence and in the determinations they impose upon their occupants, agents or institutions, by their present and potential situation (*situs*) in the structure of the distribution of species of power (or capital) whose possession commands access to the specific profits that are at stake in the field, as well as by their objective relation to other positions (domination, subordination, homology, etc.).[50]

In more operative terms, the emergence of a field implies a degree of structural consistency and autonomy, meaning a set of objective and symbolic relations between agents and institutions around increasingly specific issues. Through this process, a field constructs its own particular symbolic economy in terms of the valorisation of specific combinations and forms of capital (social, economic, political, legal, etc.). The process of capitalization results from the struggle between the agents over gaining dominant positions in this social space, a process fuelled by interest, dedication, belief, etc., in the issues at stake. But above all, it is a struggle concerning the dominant visions and divisions of the field itself, which conversely

[49] Keck and Sikkink (1998).

[50] Bourdieu and Wacquant (1992).

help create not only the field's logic and taken for granted limits (*doxa*), but also its consecration mechanisms, enabling the translation of the external world into the specific code and issues of the field. Thus, a field is a social space composed of competing positions. It has a more structured centre of gravity where the effects of the field are most strongly felt, while the effects eventually diminish at its outskirts. Consequently, and essentially different from a systems theoretical conception of law, there are no fixed boundaries of fields. This conversely allows for studying the crossroads of fields—for example how neighbouring fields are mutually influential or how the evolution of transnational legal fields is taking place interdependently with national legal transformations.

The relatively open-ended definition of a field as a network of objective relations provides a broad conceptual ground for analysing both the social continuities and the construction of new practices.[51] Moreover, this approach clearly emphasizes what is often downplayed in the context of weakly institutionalized international legal practices, namely, social interests and ultimately class. The field approach also underscores the generally adversarial nature of social practices and the political and institutional effects of sociolegal struggles over domination. Drawing on my own work on the emergence and transformation of human rights since World War II, the difference in using a field-approach to a network approach can be illustrated.[52] Both approaches concur with the observation that NGOs and other civil society mobilisations have a significant impact on the area of human rights, as well as a human rights movement emerged benefiting from a transnational communicative network. One key disagreement concerns whether this development somehow represents the whole area and idea of modern human rights or rather a set of important yet specific producers of human rights. More precisely, should these civil society engagements in human rights be seen as an all-encompassing social movement and as somehow independent from concurrent state strategies or other competing strategies?

Compared to the Bourdieusian approach outlined above, the network model highlights an important communication structure yet downplays the internal conflicts and skirmishes that the notion of 'field' takes as its starting point. This can be exemplified further by highlighting another key feature of Keck and Sikkink's analyses, namely how a set of actors of institutions came to subscribe to a more or less common ideology and utopia—an idea that is also prevalent in the works of Castells and Haas. The critique raised by the field approach is that such accounts do not sufficiently accentuate the actual competition going on concerning the forming of this common utopia: how competitive and conflicting ideals and practices are in fact at the core of the definition and transformation of the concept. Even within the 'NGO network' the competition, for example, between Amnesty International, Human Rights Watch, and La Fédération internationale des droits de l'homme

[51] For further introduction to Bourdieusian sociology of law see Dezalay and Madsen (2012); Madsen (2011), pp. 259–275.

[52] See for example Madsen (2010); Christoffersen and Madsen (2011).

(FIDH) has not only been central to the transformation of the idea of human rights, but it has also—over time—differentiated the positioning of these (co-)producers of the field. The latter, I would argue, provides a crucial dimension for understanding the pervasiveness of contemporary human rights activism as not only the product of the political success of human rights activism in general but also the increased differentiation of this area of politics in terms of law and institutions.

When studying international human rights in terms of a relational field, that is as a network of objective relations as opposed to a set of subjective relations as in Haas and Keck and Sikkink's networks, the positioning of the actors vis-à-vis the other main positions of the field (the state, international institutions, academia, civil society, and so on) becomes is a very central issue. It is the basic claim that the game of positioning reflects different social histories and ultimately different social and political outlooks. Besides outlining these parallel and competitive engagements, the model therefore seeks to understand these different positions of the field from the point of view of the social history of each of these relational positions rather than only their attachment to a specific cause. As concerns the positioning of civil society actors, this does not downplay the impact of various NGOs and social movements, but it underscores their individual specifics and how these are linked to both the on-going competitions in the field and its more general history. Hence, rather than taking the self-presentations of these organisations and their advocacy strategies as the main object of study, what is interesting in this view are the actors who formed them and installed specific conceptions and visions in them. Mapping the field by the input of these relationally positioned agents and institutions, the analytical starting point becomes the structural dimensions of the progressive and competitive development of the field, including, obviously, the construction and reconstruction of the idea and ideal of human rights. To sum up, contrary to a network approach, the field approach basically adds a structural dimension to the study of human rights by positioning the producers of human rights in the broader social context of the field, that is as the space made up by the totality of agents of human rights. The approach does therefore not necessarily exclude the idea of network analysis, but it does suggest that the analysis should be carried out as part of a more structural description of the field, that is, within the structural matrix of the field of human rights practices and its many agents.

Yves Dezalay and Bryant Garth have deployed a similar approach in their seminal study of international commercial arbitration and the corresponding emergence of a transnational legal order.[53] Using both legal and sociological insights, they demonstrated how the battle over the form and the law of international commercial arbitration could be explained as battle between not only different forms of expertise (European academic law *v*. American-style Wall Street law), but also as a clash between different global elites. Similar to the cited human rights study, the work is based on two different research traditions which are brought together via a set of broader conceptual frameworks provided by Pierre Bourdieu:

[53] Dezalay and Garth (1996).

first, a sociology of professions with a view to analyzing how professions increasingly compete with one another in the construction of new transnational markets and arenas[54]; secondly, it builds on a sociology of elites with the aim of exploring how a set of distinct social groups of (legal) agents hold the power to define new areas of legal practice, with consequences not only for the profession at large, but also for international politics and society.[55] Drawing on Pierre Bourdieu, they frame these battles as social fields, that is, as spaces of contestation over defining the law in which different agents occupy positions relative to the portfolio of capitals they can muster and which are 'capitalized' according to the logic of the specific field in question.[56]

Dezalay and Garth's work also has a methodological feature that has turned out to be especially interesting in relation to the understanding of transnational legal networks. Although legal institutions are clearly important to their studies, they are not taking center stage in the original study on international commercial arbitration and even less so in their subsequent studies of the role of professional battles in the transformation of states in Latin America and Asia.[57] What they instead provide is a sociological alternative to the assumption of many studies in both law and political science that institutions in themselves can explain the emergence of new transnational legal fields. Much closer to neo-institutionalist scholarship on organizational fields, yet different, they claim that individual agents, and particularly the agents' personal and professional trajectories into the fields and institutions in question provide unique data for understanding how institutions and law come about and transform. Using a methodology they call 'collective biographies', a form of prosopography, they map out the social characteristics of the social spaces of institutions in terms of the combined and accumulated trajectories of the main agents.[58] Like in the above cited study of human rights, this is also precisely where they deploy Bourdieusian notions of capitals—social, educational, political, legal, etc.—to explore the specific legal elite formations of these socio-legal spaces and how their practices come matter in the definition of law and other regulations.

4 Unpacking Legal Network Power: From Network to Field?

As illustrated by these two brief examples of the usage of Bourdieusian sociology in the areas of international human rights and international commercial arbitration, the essential difference between a field approach and a network approach is how

[54] Dezalay and Sugerman (1995).

[55] Dezalay (2004), pp. 5–34.

[56] Bourdieu (1987), pp. 805–853. See also Dezalay and Madsen (2012), pp. 433–452.

[57] Dezalay and Garth (2002, 2010).

[58] The approach is detailed in Dezalay and Madsen (2012), pp. 433–452.

interrelations between agents are understood. As demonstrated, theories as different as those of Castells, Haas and Keck and Sikkink all tend to explain change by the flows from networks of convergent interests. Bourdieu, in contrast, suggests that the dynamic of change of any given social space—from human rights to international commercial arbitration—has to be located in the struggle over the very issue at stake in the area. For example, the legal field itself is marked by a struggle over defining what the law is.[59] The Bourdieusian analysis moreover significantly differs when it comes to defining social groups. All three network theories cited employ fairly broad professional categories of identity for explaining the interest of specific groups. In contrast, in the cited *field* studies the differences between the at first glance very similar agents are emphasized as a way of explaining the dynamics of change. In the case of Dezalay and Garth, the domination of the field by a traditional European internationalist elite of grand law professors was challenged by the arrival of a Wall Street law firm–based practice of arbitration. However, the outcome was not a complete collapse of the European business but a general restructuring of the field, integrating this new line of opposition. Similar examples can be drawn from the human rights study between the differences in outlook of legal advisors of different governments when negotiating key human rights documents to the structurally different role of private practicing lawyers from different legal cultures in the fabrication of international human rights.[60] In both cases, the outcome was influenced by the struggles between these different views, conceptualisations and interests.

All this brings us back to the central question raised by this chapter, namely how to unpack legal network power. More precisely, what is it that explains the collective power of legal actors at the transnational level? As suggested by this critical reading of advanced network theories, the notion of networks seems not to offer much for answering this crucial question besides some standard ideas of collective action and the power of knowledge. It is my claim that legal power is different than say the power of the ideas of an anthropologist. And this is due to the ways in which the legal profession over time has acquired a particular symbolic capital enabling it to act partly private, partly semi-public—also when it leaves the confines of the national state. As suggested in the introduction, this is of course the product of a very long historical process in which jurists not only changed camp between church and early state but also eventually turned the church against the church to construct the state in Europe.[61] In this process jurists relied on their symbolic resources of 'words and concepts',[62] which in combination with their unique ability to blend public interest and private interest helped them gradually conquer an increasingly autonomous space in state and society and, thereby, rationalize the state in their own image.

[59] Bourdieu (1987), pp. 805–853.

[60] See for example Madsen (2004).

[61] Bourdieu (2012).

[62] Ibid.

My claim is that when lawyers act transnationally—and thus theoretically outside the state—they still to an extent act in the shadow of the state as they embody both private and public interest. The legal capital of the legal profession is however only half of the explanation. The other has to do with broadly speaking social capital and international elite formations. Conducting in-depth empirical studies of transnational legal entrepreneurs in a number of new areas of global governance and regulation, it has repeatedly been noticeable that the decisive actors have been able to bring to the fore much more than legal capital and skills, namely social capital in terms of connections and access. A striking but less surprising example is international commercial arbitration, which for long existed as an exclusive club of European elite lawyers with a taste for academic discourse (in Latin) and grand hotels with lake view. It is perhaps more surprising that one finds similar attributes when one analyses the pioneers of international human rights. When we move beyond such less structured fields of legal practice and into for example certain subfields of European law, we do find that there is less space for entrepreneurs, as the fields operate with more differentiated legal knowledge and professional career patterns than what was the case at their initial stages. Yet, most forms of network governance do not concern highly structured legal spaces—those are indeed governed by normal legal and political logics. My claim is instead that in those social settings where network power is in practice exercised, the power of the network and the networkers is neither simply due to new technological advances nor to the network as such. Legal network power, like all other exercises of power in society, is due to underlying social structures that allow for the projection of symbolic power.

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Science Based Governance? EU Food Regulation Submitted to Risk Analysis

Anna Szajkowska and Bernd M.J. van der Meulen

Contents

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1 Introduction

Risk regulation, by its very nature, interferes with market processes to protect fundamental welfare of citizens, such as health or safety. The challenge national and regional politics face to balance free trade and health protection in this highly technological area consists in balancing choices made in an ideally deliberative environment of experts and technocrats with popular will and laypeople's risk perception. To be able to include in risk management a broad array of factors other than hard-core scientific facts, decision makers need to be entrusted with a certain amount of discretion. From a trade perspective, however, such discretion is suspect as it could be used for protectionist purposes. Therefore, the system of trade rules aims to limit discretion as much as possible, by making 'scientific risk assessment' the one criterion deciding which measures are justified.

One of the most visible areas of risk regulation where conflicts between popular choices and scientific evidence arise is food safety, where a system of multi-level governance has been established connecting international, regional (EU) and national levels. At international level, the World Trade Organization (hereinafter, *WTO*) Agreement on Sanitary and Phytosanitary Measures (hereinafter, *SPS Agreement*) introduces the requirement that national measures aimed at the protection of human and animal (sanitary) or plant (phytosanitary) life or health be based on risk assessment and not maintained without sufficient scientific evidence. At the EU level, risk analysis has also become a general principle of food law, codified by Regulation 178/2002 laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety[1] (the so-called General Food Law—hereinafter, *GFL*).

Obviously, the institutional context of risk regulation is predominantly public administration.[2] The growing demand for market regulation in modern welfare states and a corresponding need for the adoption of detailed rules referring to technical or scientific knowledge have led to the rise of government as law-maker, followed, in many countries, by the rise of regulatory agencies. Regulatory agencies, being either a part of the executive branch or performing their functions with oversight from the legislature, exercise autonomous regulatory and supervisory tasks in areas which require complex scientific expertise and rapid implementation. Their raison d'être is also a need for a regulatory environment operating without undue political interference.

The Food and Drug Administration (hereinafter, *FDA*) in the US is an example of a regulatory agency in the area of food safety. It has a broad mandate to protect public health through the regulation of not only foods and drugs, but also, e.g., medical devices, electronic products, cosmetics, veterinary products, and tobacco. Like in the EU, the US food safety system also uses risk analysis to ensure that the decision making process about foods is science-based and transparent. Unlike the

[1] OJ 2002, L 31/1.

[2] Fisher (2007).

EU, however, scientific evaluation and risk management take place within the same institution, which assumes a tight linkage between science and decision-making.

Food safety legislation enacted by the US Congress is confined to providing the FDA with authority and setting general objectives to be achieved.[3] Based on these objectives, the FDA develops specific measures and standards to achieve these objectives and has flexibility to amend regulations when new technologies or new food safety risks emerge. Here again, the EU has developed a different model for food safety regulation. Although the vast majority of legal acts in the EU and at a national level, ranging from the adoption of standards and market authorisations to the amendment of basic acts, are delegated,[4] the primary law-maker is actively involved in shaping food safety regulation of an often very detailed nature.

EU law-making in the area of food safety is thus diffused horizontally and characterised by a non-hierarchical interaction between different governmental actors. The Commission has the exclusive right to propose legislation. The European Food Safety Authority (hereinafter, *EFSA*) provides scientific advice. The Council of Ministers and the European Parliament are co-legislators. This diffused authority gives the possibility for various interests to influence the process of formulating risk regulation. Finally, although EU policies are developed and implemented by public actors, private actors abound in policy making process through a dense network providing resources such as expertise and consultations.[5]

The new reformed EU regulatory regime for foodstuffs established in 2002 as a reaction to the BSE scandal was set up with an important involvement of the European Parliament and with the aim to put consumers' interests in the centre. As a result, 'input' legitimacy is high in this area of regulation and the regime remains much politicised. This, however, may affect 'output' or performance-based legitimacy of food policy, which has traditionally relied upon scientific knowledge and where regulation is largely perceived as a technical exercise. Input legitimacy produces the 'aggregative' result of strategic bargaining and coalition building rather than 'integrative' consensus by deliberation in a technocratic style of policy making dominated by expertise and knowledge.[6]

In view of the above, the fact that the same regime establishes the risk analysis methodology as a general principle of food safety policy may sound paradoxical. According to this core principle, food regulation in the EU is not only dependent on scientific expertise, but even—as this chapter will argue—is bound by this expertise. Missing, in this context, is the analysis of how this could take place in the current EU institutional setting. In other words, it is important to analyse the impact of the legal principle of risk analysis on the EU decision-making process in the area of food safety. Does risk analysis apply only to authorization decisions and other

[3] Most important statutes include, e.g., the Federal Food, Drug, and Cosmetic Act; Food Quality Protection Act; or the Federal Meat Inspection Act.

[4] Türk (2006).

[5] Börzel and Heard-Lauréote (2009).

[6] March and Olsen (1989).

administrative activities 'under legislation', or should it also bind the legislature? The EU internal market straitjacket clearly imposes limitations on legislators in the Member States, by requiring scientific proof for national food safety measures restrictive of intra-EU trade. Does risk analysis, however, set limitations on the EU legislator as well, either through WTO or EU law making rules? Are EU food safety measures compliant with international trade obligations?

This chapter analyses the scope of application of risk analysis and the precautionary principle in EU food safety regulation on the example of prior authorisation schemes. Prior authorisation schemes are legislative measures which consider certain categories of products a priori hazardous—until the party (manufacturer, importer or exporter) interested in marketing these products proves otherwise. To gain approval, the proponent must provide adequate scientific evidence to ensure that a product (or technology) is safe. Thus, prior authorisation schemes are a *legislative* 'framework' (passed by the European Parliament and the Council), under which *regulatory or implementing* (subject to so-called comitology committees where the Commission submits draft acts for discussion and vote) decisions concerning the placing on the market of foodstuffs belonging to certain categories are being issued. These individual decisions are based on risk assessment. But do the prior authorisation schemes themselves—i.e. the *legislative* framework—require scientific justification? In other words, what is the scope of application of risk analysis and its impact on the discretion of the EU legislator?

As a precursor to this discussion, we will first explain the structure of the EU food law. Then, the principle of risk analysis and the precautionary principle in both EU food law and in international trade regime will be presented in outline, with a focus on the precautionary principle as prior authorisation schemes are often referred to as precaution-inspired. Next, we will put the EU prior authorisation schemes to two tests. Firstly, we will refer to the recent case-law of the Court of Justice of the European Union on the legality of a French prior authorisation scheme where the principle of risk analysis was referred to. We will analyse whether the Court's interpretation can also be applied to legislation at EU level. Secondly, the EU food safety legislation will be examined in the context of the obligations imposed by the WTO SPS Agreement.

2 EU Food Safety Regulation

2.1 EU General Food Law

The entry into force of Regulation No. 178/2002 is often characterised as the birth of a new comprehensive EU policy.[7] The Regulation established, i.a., an EU definition of food, an overarching requirement that food shall not be placed on

[7] Lafond (2001); Szajkowska (2009); Ugland and Veggeland (2006).

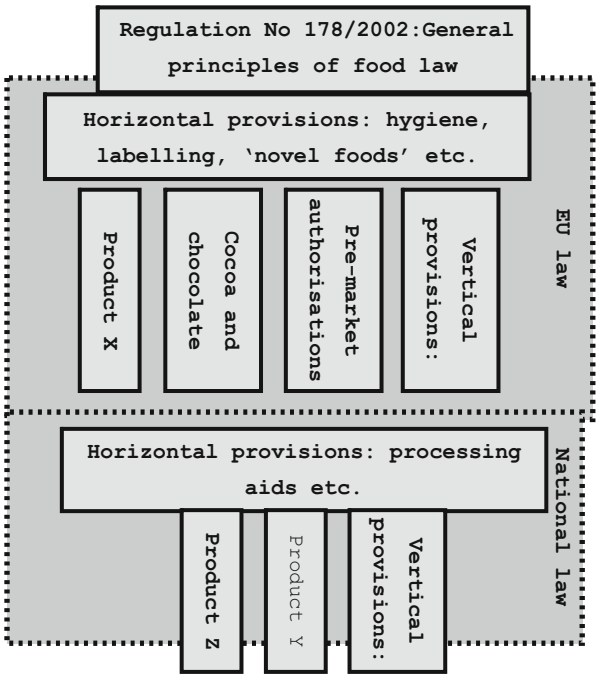

Fig. 1 Structure of EU food law

the market if it is unsafe, a traceability system, a Rapid Alert System for Food and Feed (hereinafter, *RASFF*), emergency procedures, and defined public and private responsibilities for assuring food safety. Articles 5–10 GFL set out the general principles of food law. Two of these are related to its scientific basis. Article 6 stipulates that food law shall be based on risk analysis. Article 7 says that, in specific circumstances, the precautionary principle may be applied.

These general principles apply to all stages of production, processing and distribution of food and feed for food-producing animals, leaving outside their scope only primary production for private domestic use and the domestic preparation, handling or storage of food for private domestic consumption (Article 1(3) GFL). Given that the GFL sets norms for 'food law', which is defined as 'laws, regulations and administrative provisions governing food in general, and food safety in particular, whether at Union or national level' (Article 3(1) GFL), the Regulation forms a truly general framework of a horizontal nature covering all fundamental aspects of the food safety policy, both at EU and national levels.

Figure 1 shows the structure of EU food law. Regulation 178/2002 applies to all measures taken in the EU multi-level food safety governance. 'Horizontal' provisions of food law, existing under the umbrella of the General Food Law, refer to legislation that covers as broad a category of foodstuffs as possible. An example of horizontal legislation is the Labelling Directive (which is currently being replaced by Regulation 1169/2011 on food information to consumers). Its rules of a general

nature are applicable to all foodstuffs put on the market.[8] Another example of horizontal legislation are premarket approvals for certain broad categories of foods.

'Vertical' provisions are specific measures concerning certain foodstuffs. These are a mix of legislative and regulatory measures, as some of these acts are delegated to public administration. An example of a vertical legislative act is the Directive relating to cocoa and chocolate products,[9] setting the cocoa percentage for chocolate, milk chocolate, white chocolate, pralines, etc. Chocolate marketed in the EU territory not only has to comply with the Labelling Directive (soon Regulation) and other horizontal provisions, but—additionally—with specific 'recipe' provisions relating to its compositional standard.

To further clarify the concept of 'horizontal' and 'vertical' regulation, consider Regulation 1829/2003 on genetically modified food and feed,[10] which is an example of a *horizontal* act applying to all products containing, consisting of or produced from genetically modified organisms (hereinafter, *GMOs*). Every GM food must undergo a safety assessment through an EU procedure before being placed on the EU market. Hence, within this 'framework', regulatory decisions concerning individual GM products, such as GM maize or soybean, are being issued (*vertical* decisions under *horizontal* legislation). A similar prior authorisation procedure for novel foods will be discussed in more detail later in this chapter.

Finally, the principles and requirements established in the General Food Law also apply to the food laws of the 28 Member States. At a national level, the same distinction between horizontal and vertical provisions can be made. However, these national legal systems additionally have to be filtered through the Treaty provisions relating to free movement of goods. In light of Articles 34–36 of the Treaty on the Functioning of the European Union (hereinafter, *TFEU*), national measures prohibiting or restricting imports, exports or goods in transit on grounds of the protection of health and life of humans, animals or plants are legitimate exceptions to the rule of free movement of goods within the EU, which is one of the fundamental principles of the internal market.

Because national measures aimed at the protection of human life and health are allowed by the Treaty provisions on the free movement of goods, food safety provisions are to a large extent harmonised at EU level to avoid trade barriers. Through harmonisation (Article 114 TFEU), the EU legislator is gradually taking over Member States' competences in the field of food safety. In relation to Spain, for example, Palau estimates that, in some years after the completion of the internal market, when positive integration in the field of food safety increased significantly, the percentage of food safety legislation totally or partially defined by EU acts reached 90 %.[11]

[8] OJ 2000, L 109/29.

[9] OJ 2000, L 197/19.

[10] OJ 2003, L 268/1.

[11] Palau (2009).

Apart from national measures aimed at health, consumer or environmental protection, a number of compositional or technical standards relating to foodstuffs exist in national laws. As these standards fall outside the scope of the exceptions allowed by the Treaty, they cannot constitute a barrier to intra-EU trade. The mutual recognition principle guarantees free movement of foodstuffs within the EU without the need to harmonise all compositional standards.[12] Because these standards are not aimed at the protection of human life or health, the principle of risk analysis does not apply to them either.

2.2 *International Food Law: A Meta-Framework*

The technocratic character of decision-making processes increases as policy areas become subject to globalisation processes.[13] The WTO SPS Agreement, introducing a science-based regime governing international trade in agricultural products and foodstuffs, illustrates this tendency. Article 2(2) of the Agreement states that WTO members shall ensure that any SPS measure is 'based on scientific principles and not maintained without sufficient scientific evidence'. Article 5 SPS introduces risk assessment carried out according to the internationally developed techniques as a method for determining appropriate measures to protect human health.

All standards concerning food safety that serve as a benchmark are developed outside the WTO, mainly by the Codex Alimentarius Commission. Although these standards are intended to be voluntary and not legally binding on member countries, the SPS Agreement creates a strong incentive to follow them. National or EU measures that conform to *Codex* standards enjoy a presumption of compliance with the WTO regime and are by definition considered necessary.[14] If legislators want to depart from international standards to maintain a higher level of protection, they must provide scientific justification for the stricter measures.

The SPS Agreement is therefore confined to a purely procedural requirement that sanitary or phytosanitary measures be based on scientific evidence (or international standards). It sets out a framework of requirements that apply to national legal systems and therefore it can be considered a meta-framework.[15]

[12] See Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein ('Cassis de Dijon'), [1979] ECR 649; or Case 178/84, Commission v. Germany ('Reinheitsgebot'), [1987] ECR 1227.

[13] UNRISD (2004).

[14] Art. 3.2 SPS stipulates: 'Sanitary or phytosanitary measures which conform to international standards, guidelines or recommendations shall be deemed to be necessary to protect human, animal or plant life or health, and presumed to be consistent with the relevant provisions of this Agreement and of GATT 1994'.

[15] van der Meulen (2010a).

Table 1 Risk analysis methodology in EU and WTO

Elements of risk analysis	WTO requirements	EU requirements
Risk assessment	✓	✓
Factors other than science	✖	✓
Precaution	**Art. 5.7 SPS: temporary measures in case of scientific uncertainty**	**Art. 7 GFL 'Precautionary principle': temporary measures in case of scientific uncertainty**

2.3 The Risk Analysis Principle

The requirement that food safety measures be science-based and the risk analysis methodology are also set out in Regulation 178/2002 (Table 1). The precautionary principle, which allows taking provisional food safety measures where a risk to life or health is likely but scientific uncertainty persists, is codified in the same Regulation and linked to the framework of risk analysis.[16]

Similarly to the widely accepted definition elaborated by the Codex Alimentarius Commission, risk analysis established by the General Food Law consists of three components: risk assessment, risk management and risk communication.[17] Science-based regulatory actions require a scientific risk assessment. Its aim is to identify and characterize a hazard, to assess exposure and to characterise risk. Risk assessment must be based on the available scientific evidence, and carried out in an independent, objective and transparent manner.

Based on the outcomes of risk assessment, a process of weighing policy alternatives leads to the selection of appropriate prevention and control options, which are designed to keep risk at a level acceptable to society. This step—risk management—takes into account risk assessment, but also other legitimate factors, such as societal, traditional, ethical or environmental concerns, although, as we will discuss later on in this chapter, the extent to which these 'other legitimate factors' can be considered varies considerably in different legal regimes.[18]

Strictly speaking—contrary to *Codex Alimentarius* and the EU General Food Law—the SPS Agreement mentions only risk assessment and remains silent about the other components of risk analysis. It is recognized, however, that risk

[16] Szajkowska (2010).

[17] Although not discussed in much detail here, risk communication is also an important element of risk analysis, which consists in the interactive exchange of information and opinions throughout the risk analysis process as regards hazards and risks, risk related factors and risk perceptions, among scientists, risk managers, consumers, businesses, and all other interested parties.

[18] Cf. van der Meulen (2010b).

assessment referred to in the SPS Agreement corresponds to the risk analysis methodology and its three steps.[19] Risk management, although not defined per se in the Agreement, is reflected in the concept of 'sanitary and phytosanitary measures', which are the result of decisions on actions to reduce or eliminate risks presenting more danger than society is willing to accept.

Skogstad analysed how the EU network governance functioning as aggregative institutions affect the institutional capacity to ensure policy effectiveness on the example of the EU regulation on GMOs.[20] The structure attributes of network governance affect its potential as an integrative institution. Translating these institutional aspects into substantive provisions of EU food law, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, often considerably 'dilute' scientific inputs on which the Commission's proposals are usually based.

Consider the following example. In 2010, the European Parliament blocked the Commission's proposal for adding bovine and porcine thrombin as food additives. These enzymes are used as 'meat glue'—they can bind separate pieces of meat together and create a product of a desirable form. Despite EFSA's positive scientific risk assessment of 'meat glue', the Parliament estimated that this method could be misleading to consumers and that there were no clear benefits for them. The proposal was rejected and the rejection was based on 'other legitimate factors'.

Another example of 'other legitimate factors' taking precedence over scientific risk assessment can be found in the process of updating the Regulation on novel foods and novel food ingredients (Novel Food Regulation—NFR).[21] The proposal aimed at introducing, i.a., provisions on food from cloned animals. In its scientific risk assessment of the safety of animal clones and their offspring used for food production purposes underpinning the proposal, the European Food Safety Authority concluded that no indications of differences between cloned and conventionally bred animals existed, although it recognised that one of the cloning technologies, namely Somatic Cell Nuclear Transfer, raises animal welfare issues, related to the increased animal deaths at different stages of development and mortality through abortion.[22]

During the revision process the European Parliament initially called for a ban on food from cloned animals and their offspring, and later changed it—as a compromise—into the obligatory labelling requirement for all animal products coming from cloned offspring. The compromise was rejected by the Council (co-legislator) and the process broke down in 2011. The reason why the Parliament opted for the ban/labelling of cloned animals was a negative public opinion. The Parliament justified its position as follows:

[19] Belvèze (2003).

[20] Skogstad (2011).

[21] OJ 1997, L 43/1.

[22] EFSA (2008).

> Parliament had overwhelmingly called for a ban on food from cloned animals and their descendants. We made a huge effort to compromise but we were not willing to betray consumers on their right to know whether food comes from animals bred using clones. Since European public opinion is overwhelmingly against cloning for food . . . a commitment to label all food products from cloned offspring is a bare minimum.[23]

These examples prove that the concept of 'other legitimate factors' in the EU institutional setting opens the door to considerations other than science and allows stakeholders and political actors, dependent on citizens' support, influencing decision making with diverging interests. The problem is, however, that—contrary to the EU and *Codex Alimentarius* standards—the SPS Agreement does not refer to 'other legitimate factors' on which risk management decisions could be based. This leads us to the second, rather controversial, element of the risk analysis framework: the precautionary principle. If science is the only criterion in judging the legality of food safety measures under the SPS Agreement, the concept of 'scientific uncertainty', or a 'broad' interpretation of the precautionary principle, may become a tool towards measures which lack scientific underpinning, but have political support.

2.4 The Precautionary Principle

The precautionary principle is considered a key tenet of the EU food safety governance. The General Food Law contains a definition of the principle applicable to all food legislation at EU and national levels. In accordance with Article 7 GFL, the precautionary principle allows taking provisional measures where the possibility of harmful effects on health has been identified but scientific uncertainty persists. The General Food Law sets out the following conditions for its application:

1. Available scientific data has to be assessed before a decision is made;
2. Potentially dangerous effects deriving from a phenomenon, product or process, have to be identified;
3. The scientific evidence is inconsistent or inconclusive and does not allow the risk to be determined with sufficient certainty.

Measures based on the precautionary principle are provisional and have to be reviewed within a reasonable period of time. They also have to be proportional and no more restrictive of trade than is required to achieve the high level of health protection.

The SPS Agreement contains one, indirect reference to a precautionary approach, as an exception to the requirement that SPS measures are based on risk assessment and not maintained without sufficient scientific evidence. The exception is contained in Article 5.7 SPS Agreement and applies to cases where:

[23] European Parliament (2011).

1. Relevant scientific evidence is insufficient;
2. Measures are adopted on the basis of available pertinent information.

Such measures have to be reviewed within a reasonable period of time and member states must seek to obtain additional information necessary for a more objective assessment of risk. All these elements are cumulative: whenever one of them is not met, the measure is inconsistent with Article 5.7 SPS.[24]

Although the elements of the precautionary principle in the General Food Law and precautionary measures allowed under Article 5.7 SPS Agreement look very similar (if not the same), the EU policy makers seem to bestow upon the principle a broader scope of application (and, in consequence, create much controversy in the international arena).

2.5 Stretching Out the Precautionary Principle

The discussion on the precautionary principle has often been raised within the WTO and the Codex Alimentarius Commission, leading to disagreements between the EU—strongly advocating the application of the precautionary principle—and other countries, fearing that the EU would use the principle to justify regulatory decisions based on factors other than scientific evidence.[25]

The controversy largely comes down to the place and role of scientific uncertainty in the risk analysis process, and—more precisely—whether the precautionary principle is linked to risk assessment or risk management. In this regard, the European Commission in its Communication on the Precautionary Principle distinguishes between a *prudential approach* applied by scientists and the application of the *precautionary principle* pertaining to the realm of politics and explains the distinction as follows:

> These two aspects are complementary and should not be confounded. The prudential approach is part of risk assessment policy which is determined before any risk assessment takes place . . . it is therefore an integral part of the scientific opinion delivered by the risk evaluators. On the other hand, application of the precautionary principle is part of risk management, when scientific uncertainty precludes a full assessment of the risk and when decision makers consider that the chosen level of environmental protection or of human, animal or plant health may be in jeopardy.[26]

The General Food Law follows this approach. The wording of Article 6(3) confirms that the precautionary principle in the EU is clearly considered as a risk management tool, and not as uncertainties built in the risk assessment and dealt with in the scientific conclusions.

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[24] WTO Appellate Body Report, Japan—Measures Affecting Agricultural Products, WT/DS76/AB/R, adopted 19 March 1999 (Japan—Agricultural Products II), para. 89.

[25] Allio et al. (2006); CAC (1999); Wiener and Rogers (2002).

[26] EC (2000), p. 13.

Although the *Working Principles for Risk Analysis for Food Safety for Application for Governments*—a guidance to national governments for food safety measures, negotiated within the Codex Alimentarius Commission and adopted in 2007—entrusts the responsibility for resolving the impact of uncertainty on the risk management decision on the risk managers, and not on the risk assessors,[27] the *Codex* also states that the assumptions used for the risk assessment and the risk management measures selected should reflect the degree of uncertainty. In the same way, it highlights that the decisions should be based on risk assessment, and should be proportionate to its results.[28]

Thus, although the *Codex* guidelines consider precaution an inherent element of risk analysis and even confirm that uncertainty exists during both risk assessment and risk management,[29] they link the principle as much as possible with scientific evidence, reiterating the importance to present explicitly, in a transparent manner, all constraints, uncertainties and assumptions that have an impact on risk assessment.

Conversely, the efforts of the EU legislator seem to be directed at detaching the precautionary principle from risk assessment. As a risk management tool, the principle allows decision makers to overrule the findings of risk assessment, and thus broadens their discretion. This is a logical outcome of the networks in which food safety policy is being shaped. Under the head of the precautionary principle, the EU legislator can still take measures contrary to the overall conclusion of the technical and scientific assessment showing that risks are acceptable. We will now turn to the case of prior authorisation schemes as one of the EU applications of the precautionary principle.

3 Pre-Market Approvals

3.1 Pre-Market Approvals in the EU

The 1962 Directive concerning colours for use in foodstuffs,[30] which marked the beginning of European food law, was also the first European pre-market approval scheme. The directive harmonised Member States' legislation by establishing a single list of colouring matters whose use was authorised for colouring foodstuffs and laying down purity criteria for these colours. Positive lists are part of the law (usually as an annex). To include subsequently a product on the list (or delete it), the law must be changed by the applicable procedure.

[27] CAC (2007), para. 28.
[28] CAC (2011).
[29] CAC (2007), para. 12.
[30] OJ 1962, 115/2645.

While the details may differ, the system of positive lists and prior authorisation procedures for certain products plays an important role in the EU food safety policy. The pre-market approvals exist in European as well as in national food laws. Apart from novel foods, examples at EU level include food additives (incl. sweeteners, colourants, etc.), flavourings, extraction solvents, infant formulae and follow-on formulae, foodstuffs intended for particular nutritional uses, food supplements, genetically modified food and feed, food contact materials, and nutrition and health claims made on foods.

3.2 Prior Authorisation Procedure for Novel Foods

The already mentioned Novel Food Regulation (hereinafter, *NFR*) applies to food that was not consumed to a significant degree in the EU before 15 May 1997, which is the date of entry into force of the Novel Food Regulation, and which falls under one of the categories listed in Article 1(2) NFR. In practice, the Novel Food Regulation concerns innovative foods (e.g. DHA-rich oil, phytosterols), foods produced by new technologies (e.g. high-pressure processing), as well as exotic traditional foods (e.g. noni fruit or *Stevia rebaudiana*), which may have a history of safe use in other parts of the world, but which were not known in the EU prior to 1997.

A manufacturer who wishes to place a novel food on the EU market must undergo a complicated authorisation procedure. This procedure takes 35 months on average, but—in extreme cases—almost 10 years, for the Commission to decide on an application for authorisation. This wide time span results from the lack of time preset in the Novel Food Regulation and is of course not conducive to innovation. Brookes estimates that the costs of bringing a novel food to market are between €4 million and €15.4 million, including R&D costs and the costs of meeting regulatory requirements, which vary between €0.3 million and €4 million.[31] Costs related to the considerable additional time needed to obtain authorisation in the EU compared to other countries (similar legislation exists, i.a., in Canada, Australia and New Zealand; in the US a substance that will be added to food is subject to a pre-market safety assessment, unless its use is generally recognized as safe by qualified experts) add an extra €0.3–0.75 million per application.

Around 7–10 applications are submitted per year under the Novel Food Regulation.[32] It seems impossible to assess the real size of the novel food market because of its diversity (covering many different products), as well as confidentiality policies and intellectual property rights issues. However, given the market potential in Europe for novel foods and the high level of innovation in the food industry, this

[31] Brookes (2007).

[32] EC (2008).

number has to be considered very low.[33] These observations beg the question whether the considerable obstacles the prior authorisation scheme places on businesses bringing novel foods to the market are justified under the general principles of EU food law.

4 Prior Authorisation Schemes in Light of Risk Analysis and the Precautionary Principle

4.1 Reversal of Burden of Scientific Proof

Although a decided advantage of prior authorisation schemes is a case-by-case safety assessment of food products, the food safety legislator faces the challenge to strike a fair balance between the requirements of the protection of human health and the interests of the business sector and of the internal market. Prior authorisation procedures constitute an exception to the general rule that food enters the market without prior approval. These exceptions are introduced for categories of food that are considered *a priori* hazardous—until competent authorities accept that scientific evidence proves that a foodstuff is safe.

Prior authorisation schemes thus reverse the burden of providing scientific evidence. While, as a general rule, it is for society (public authorities, consumer organisations, citizens) to prove, on the basis of risk assessment, that a certain substance, product or technology is unsafe and has to be banned or restricted on the market, in the case of pre-market approvals the burden of proof is shifted onto businesses. Measures based on prior authorisation schemes are 'temporary' in the sense that certain products are not allowed, pending scientific data that would confirm their safety, and giving the opportunity to finance research necessary to carry out a risk assessment to those who have an economic interest in placing the products on the market.

A product is presumed to be hazardous until the proponent of placing it on the market provides scientific evidence proving otherwise to the satisfaction of the competent authorities. The applicants have a commercial interest in placing the product on the market and—therefore—in actively contributing to risk assessment procedures. Hence, the burden lies with the applicant to prove safety and not with others to prove harm.[34]

The already mentioned EC Communication on the Precautionary Principle clearly refers to prior authorisation schemes (positive lists) as one of the possible expressions of the precautionary principle. According to this interpretation, the precautionary principle requires that responsibility for carrying out scientific work

[33] van der Meulen (2009).

[34] Levidow et al. (2005).

needed to assess the risk is shifted onto the business community. As long as there is no sufficient certainty that a product (or production method) is safe to human health, authorisation to place it on the market is refused.[35] Thus, a clause shifting the burden of proof by categorising certain substances as unsafe until proven otherwise is considered an example of the application of the precautionary principle.

4.2 Precaution: From Policy Guidelines to Legal Definition

The precautionary principle, as well as preventive and polluter pays principles, are not defined in the Treaty. The purpose of these principles is to set out general policy directions and to guide policy makers.[36] It is for policy makers to flesh them out and make them operative though specific policy instruments.

The purpose of the Communication on the Precautionary Principle was to inform all interested parties of the manner in which the principle was interpreted and applied.[37] The document was adopted in 2000, 2 years before the General Food Law entered into force. At that time, the only explicit reference to the precautionary principle was in the environmental title of the EC Treaty (now Article 191 (2) TFEU). The scope of application of the principle in EU law, however, was not limited to the environment, but also extended to human, animal and plant health.

The Communication on the Precautionary Principle belongs to the category of 'atypical acts'. Atypical acts are not provided for by Article 288 of the Treaty on the Functioning of the European Union which sets out the secondary legislation of the EU. These not legally binding 'soft law' instruments, such as communications or guidelines, produce, however, important practical effects. According to settled case-law, EU institutions may lay down for themselves guidelines to exercise their discretionary powers by way of measures not provided in the Treaty (such as communications), provided that they contain directions on the approach to be followed by the EU institutions and do not depart from the rules of the Treaty. Courts verify whether a disputed measure is consistent with the guidelines laid down in such communications.[38] The European judiciary states, 'where the Commission adopts measures which are designed to specify the criteria which it intends to apply in the exercise of its discretion, it itself limits that discretion in that it must comply with the indicative rules . . . imposed upon itself'.[39]

[35] EC (2000), p. 21.

[36] de Sadeleer (2002); de Sadeleer (2010).

[37] EC (2000), p. 8.

[38] Case T-13/99, Pfizer Animal Health SA v. Council, [2002] ECR II-3305, para. 119 and case-law referred to therein.

[39] Joint Cases T-254/00, T-270/00 and T-277/00, Hotel Cipriani SpA and Others v. Commission, [2008] ECR II-3269, para. 292.

Based on the Treaty and—since 2000—the Commission's Communication, which established further guidelines for the application of the precautionary principle, the principle has become normative in secondary legislation in a number of measures of a precautionary character aimed at ensuring a high level of the protection of human health. Not only measures taken in the field of food safety, such as the Novel Foods Regulation, but also other measures to protect human health under the common agricultural policy, e.g. legislation on plant protection products, provide examples of prior authorisation procedures based on the precautionary principle.

The principle also became gradually concretised in case-law, where, with regard to EU measures, the European judiciary followed the flexible, precaution-oriented approach outlined in the 2000 Communication, granting the EU institutions a wide discretion in decision-making and—as shown above—allowing them to stretch the precautionary principle to justify risk management measures departing from the findings of scientific risk assessments.[40]

If we accept that the European approach of placing the precautionary principle at the risk management stage allows the EU institutions more discretion, this discretion in the field of food safety has been crucially shaped by the EU risk analysis methodology and the definition of the precautionary principle introduced by the 2002 General Food Law. According to Article 4(3) GFL, all food law principles and procedures existing prior to the Regulation had to be adapted to the general principles of food law established in Articles 5–10 GFL by 2007. Moreover, existing legislation had to be implemented taking into account the new risk analysis framework and the definition of the precautionary principle from the beginning (Art. 4(4) GFL).

Although prior authorisation schemes are commonly considered to be the application of the precautionary principle, shifting the burden of producing scientific evidence is not enough to call such procedures based on the precautionary principle. The definition of the precautionary principle in Article 7 GFL does not mention reversal of the burden of proof. Instead, it sets out pre-requisites for the application of the precautionary principle: measures must be preceded by scientific risk assessment which—although inconclusive—has identified some potentially dangerous effects of a product or process.

The relevance of the regulatory framework for risk analysis introduced by the General Food Law to food safety legislation and prior authorisation schemes was addressed for the first time by the European judiciary in 2010 in a judgement concerning national food safety measures. The judgment, which places prior authorisation schemes strictly within the context of the risk analysis methodology, will be discussed below.

[40] See e.g. for prior authorisation schemes for plant protection products, Case C-77/09, Gowan Comércio Internacional e Serviços Lda, [2010] ECR I-13533.

4.3 National Prior Authorisation Schemes Put to the Test

Prior authorisation requirements do not only exist at the EU, but also at Member State level. Before the General Food Law entered into force, the European Court of Justice had the opportunity to address practices related to national pre-market approvals of fortified foods, i.e. foods to which vitamins or minerals have been added, in a number of rulings.[41] These judgements, however, did not touch upon national regulatory schemes as such, but referred to their implementation, relating to an administrative practice entailing that foodstuffs enriched with vitamins or minerals could be marketed in that Member State only if it was shown that such enrichment with nutrients met a need of the population.[42]

In the *Commission* v. *France* judgement, the European Court of Justice had the opportunity—for the first time—to apply the precautionary principle and the risk analysis methodology set out in the 2002 General Food Law to food safety legislation as such.[43] The ruling concerned French measures laying down a prior authorisation requirement for processing aids and foodstuffs whose preparation involved processing aids. This time, however, the action was directed at the prior authorisation scheme itself, not only the way it was applied in the case at issue.

The Commission argued that recourse to a prior authorisation scheme, although not excluded in principle, should be targeted and precisely justified on a scientific basis.[44] The Court agreed with the Commission's opinion and confirmed that, in exercising their discretion relating to the protection of human health, the measures chosen by the Member States must be confined to what is necessary to attain this objective. More importantly, the Court stated in this regard:

> A Member State cannot justify a systematic and untargeted prior authorisation scheme . . . by pleading the impossibility of carrying out more exhaustive prior examinations by reason of the considerable quantity of processing aids which may be used or by reason of the fact that manufacturing processes are constantly changing. As is apparent from Articles 6 and 7 of Regulation No 178/2002, concerning the analysis of risks and the application of the precautionary principle, such an approach does not correspond to the requirements laid down in the Community legislature as regards both Community and national food legislation . . .[45]

The French measure was judged disproportionate in relation to the possible risks which processing aids may pose for human health. For the first time in this context, however, the Court referred to the requirements of the risk analysis methodology

[41] See Case 174/82, Sandoz, [1983] ECR 2445; Case 192/01, Commission v. Denmark, [2003] ECR I-9693; Case 95/01, John Greeham and Léonard Abel, [2004] ECR I-1333; Case C-24/00, Commission v. France, [2004] ECR I-1277; Case 41/02, Commission v. Netherlands, [2004] ECR I-11373; Case 270/02, Commission v. Italy, [2004] ECR I-1559.

[42] Case 41/02, Commission v. Netherlands, supra note 41, paras 22–23.

[43] Case 333/08, Commission v. France, [2010] ECR I-757.

[44] Ibid., para. 59.

[45] Ibid., para. 103.

established by the General Food Law, according to which food safety legislation normally has to be underpinned by an assessment of risks posed by a product or process.

The prior authorisation scheme for processing aids is an example of horizontal provisions (see above). The scheme sets out a framework requiring all processing aids to undergo an authorisation procedure before they can be marketed on the French territory. Individual decisions concerning processing aids are the result of the implementation of this measure.

As a result of this analysis, the Court of Justice applied the risk analysis framework to all food safety measures, regardless of whether they are legislative or regulatory acts. As mentioned above, the General Food Law applies to both EU and national levels. So let us now turn to EU level and to the main question of this chapter: does the Court's interpretation of the General Food Law principles have any implications on the EU decision-making paradigm in this area of risk regulation?

4.4 Some Are More Equal Than Others?

Not only in national food safety laws does the absence of a scientific justification to consider certain foods a priori hazardous raise questions. It is also far from self-evident that this approach fits well with the underlying principles of food law when applied to EU legislation. But while national measures are ultimately put to the test of the free movement of goods principle, the internal market straitjacket does not seem to restrict the EU legislator to the same extent.

As illustrated above in the structure of EU food law, in light of the Treaty provisions, to national food safety laws, which constitute a barrier to intra-EU trade, exceptions from the fundamental principle of free movement of goods within the EU apply. These exceptions have to be interpreted strictly and cannot constitute a means of arbitrary discrimination or a disguised restriction of trade between Member States.[46] In practice, it means that Member States wanting to maintain or introduce their national food safety provisions which hinder EU trade have to show that a substance or product poses a genuine threat to public health.[47] In the context of the general principles of food law, they will need to provide scientific evidence (risk assessment) to justify their exceptions to free movement of goods.

Bound by the Treaty rules relating to the functioning of the internal market in the same way as the Member States, the EU institutions enjoy, however, a much broader discretion in taking measures. Case law shows that, unlike national food safety provisions, which—as exceptions to the free movement of goods principle—

[46] Case 174/82, Sandoz, supra note 41, at 22; see also Case C-333/08, Commission v. France, supra note 43.

[47] See Case C-192/01, Commission v. Denmark, supra note 41.

have to be interpreted strictly, EU measures hindering trade do not require the legislator to justify why they are necessary to protect human health. An example of the discretion the Courts grant to the EU legislature can be found in the *Fedesa* case, where the applicants argued that the EU directive banning the use of hormones in meat was not supported by scientific evidence and hence unlawfully hindered free movement of goods within the EU.[48] The Court did not uphold this claim, referring to the discretion conferred on the EU institutions, and stating that the Council was free to decide on adopting a solution that responded to the concerns expressed by society.[49]

Because the general principles of food law set out in Regulation 178/2002 form a framework of a horizontal nature applicable to all measures, the way the risk analysis methodology is applied to national legislation should—in principle—apply to EU food safety legislation as well. The launch of the EU model of risk analysis for the whole EU multi-level food safety governance and the 2007 deadline for adapting food safety legislation to the new principles did not result in profound reforms of the existing legislation at national or EU levels.[50] However, whereas Member States' food safety laws are submitted to the Treaty regime concerning free movement of goods, ensuring consistency of EU food safety legislation with the principles contained in the General Food Law would require some regulatory discipline, at least in relation to giving reasons for the regulatory choices of the EU legislator.

Let us now refer again to the 2008 Proposal revising and updating the Novel Foods Regulation,[51] which eventually failed after the Council and European Parliament were unable to reach agreement on cloning in food production (discussed above). Nevertheless, the proposal is an example of a measure that was designed after the General Food Law entered into force. No steps were taken, however, to review the Novel Foods Regulation to adapt it to the General Food Law. The draft report on impact assessment for the proposal[52] mentions Regulation 178/2002 among the EU legislation that had been taken into account in revising the Novel Food Regulation merely stating that the General Food Law lays down only general principles and requirements regarding food safety and thus "does not address specific issues such as the pre-market safety assessment of food which is covered by sectoral legislation."[53]

What makes the Novel Foods Regulation an interesting example is that the risk analysis methodology has unquestionably been applied within this framework: regulatory decisions concerning individual products are underpinned by a scientific risk assessment, and EFSA not only plays an active role in these procedures, but it

[48] Case C-331/88, Fedesa, [1990] ECR I-4023.

[49] Ibid., para. 9.

[50] van der Meulen (2006a, b).

[51] COM (2007) 872 final.

[52] SEC (2008), p. 12.

[53] Ibid.

also organises meetings to discuss scientific information needed for such applications.[54] Never in this context, however, has the rationale behind the framework itself been discussed. The Novel Foods Regulation applies to a wide range of different foods considered dangerous until proven safe, but no risk assessment underlies this presumption of lack of safety. No indication is available that EFSA's opinion had been asked prior to submitting the proposal or that it was based in some other way on risk assessment.

In the explanatory memorandum on the Proposal for a novel food regulation the Commission concluded that 'there was no need for external expertise'.[55] The fact that scientific expertise was not considered to be an important element in the design of the new novel food regulation confirms that the risk analysis methodology is not among the principles the European legislator feels guided (limited) by in adopting food safety measures.

The broad discretion the legislature here claims, however, ultimately leads to the last issue discussed in this chapter: the conformity of EU legislation with international trade rules defined by the WTO agreements.

4.5 WTO Regime: External Yardstick

Although the choice of an appropriate level of protection is perceived as a democratic choice of each WTO member, measures applied to protect human, animal or plant health must meet rather strict risk assessment requirements to be considered justified barriers to trade. Because marketing approval for novel foods is conditional and depends, i.a., on a satisfactory demonstration that the product does not present a danger to human health, the Novel Foods Regulation falls under the scope of the definition of an 'SPS measure',[56] which means that it is governed by the SPS Agreement.[57]

In general, prior authorisation schemes are not forbidden under WTO law, provided that certain conditions are met. Article 8 SPS acknowledges the existence of procedures aimed at 'checking and ensuring the fulfilment of SPS measures' and undertaken in the context of 'control, inspection, or approval'.[58] Annex C sets out requirements for these procedures. They have to be, i.a., undertaken and completed without undue delay and in no less favourable manner for imported than for like domestic products, the applicant has to be duly informed by the competent

[54] EFSA (2010).

[55] SEC (2008), p. 4.

[56] Annex A(1) SPS Agreement.

[57] This conclusion was reached in WTO Reports of the Panels, European Communities—Measures Affecting the Approval and Marketing of Biotech Products, WT/DS291/R; WT/DS292/R; WT/DS293/R, adopted 29 September 2006, para. 7.427.

[58] Ibid., para. 7.424.

authorities about the progress of the application at all stages of the procedure, and any requirements for control, inspection and approval of individual specimens of a product must be limited to what is reasonable and necessary.

Hence, within the meaning of these provisions, approvals are part of the procedures applied to implement an SPS measure.[59] The SPS measure is in this case the regulatory framework establishing prior authorisation requirements. In the *Biotech products* case, the WTO panel had the opportunity to consider the risk assessment requirement in the context of individual authorisation decisions taken within the framework of the Novel Foods Regulation, but did not consider the regulatory framework itself.[60] However, subsequent complaints against the Novel Foods Regulation raised by some developing countries, including Peru, Ecuador and Colombia, refer to the prior authorisation scheme as such. Therefore, it is not excluded that the prior authorisation scheme itself will also be brought to the WTO Dispute Settlement Mechanism.[61]

The concerns were first raised in 2006 by Peru, which highlighted in its communication that, as a consequence of the implementation of the Novel Foods Regulation, exports of exotic traditional plants to the EU had been stopped.[62] The main objection was the lack of distinction between strictly novel foods, i.e. those that have not been consumed anywhere in the world, and those that are novel only in the EU, e.g., exotic traditional products with a history of safe use outside the EU. Such products are submitted to the same prior authorization procedure, in which the applicant has to prove that a product is safe to consumers. These safety considerations refer to a category of products determined solely on the basis of an arbitrary date (15 May 1997), despite the fact that some of them have been used safely for human consumption for centuries in the country of origin and elsewhere in the world.

The complaint against the EU Novel Foods Regulation refers to the same arguments as those raised against the French prior authorisation schemes for processing aids. The Novel Foods Regulation, by applying a prior authorisation scheme to a wide range of products without scientific justification, can be considered an untargeted and arbitrary measure, disproportionate in relation to possible risks which products falling under the scope of this legislation may pose to human health. In consequence, as the intervening countries claim, the Regulation creates an unnecessary and unjustified barrier to international trade because of the very

[59] Ibid., para. 7.1491.

[60] Ibid., paras 1525–1526. Until April 2004, the scope of the NFR included GM foods.

[61] See Communication from Peru to the SPS Committee on the implementation of Regulation No. 258/97 concerning novel foods. G/SPS/GEN/1218 (7 March 2013). Peru upholds that '[t]he Regulation and its implementation constitute an unwarranted barrier to international trade in traditional Peruvian products deriving from country's biodiversity, owing to the high cost of preparing the request dossier for a particular form of a specific product (due to the scientific studies required) and the amount of time needed to approve a product's entry into the European market'.

[62] G/SPS/GEN/681 (5 April 2006).

high costs of producing the scientific studies required and a lengthy authorisation procedure.[63]

According to the SPS Agreement, WTO members have the right to adopt sanitary or phytosanitary measures necessary for the protection of human, animal or plant life or health, provided that such measures are based on scientific principles and not maintained without sufficient scientific evidence. Hence, when a WTO member invokes the precautionary principle to justify its measures, the exception set out in Article 5.7 SPS is the standard by which the measures will be judged whether it is justified and necessary. Because the Appellate Body declines to recognize the precautionary principle as a general principle of international law which could override obligations under the SPS Agreement,[64] Article 5.7 SPS considerably limits the inclinations of the EU legislator to dress up measures based on 'factors other than science' in the clothing of 'precaution-oriented' legislation.

Finally, although a detailed discussion on the effects of WTO law and DSB rulings in the EU legal order is outside the scope of this chapter, it has to be noted that—generally—unlike other agreements concluded by the European Union, the EU Courts do not consider the WTO Agreements among the rules in light of which the legality of measures adopted by the EU is reviewed.[65] This stance has triggered much criticism in the literature.[66]

Two important exceptions to this line of jurisprudence, however, have been recognised by EU Courts. GATT/WTO provisions have the effect of binding the EU where the EU implements a particular obligation (*Nakajima* exception),[67] or where an EU measure refers expressly to specific GATT/WTO provisions (*Fediol* exception).[68] Although the way the EU Courts have so far interpreted these exceptions is considered to be rather narrow and rarely applied,[69] the *Nakajima*/*Fediol* doctrine might still have important implications for food safety regulation. EU measures in this field often explicitly refer to the SPS Agreement, so they should, in principle, meet this standard. An example of the WTO 'consciousness' is reflected, e.g., in the EU Regulation on the hygiene of foodstuffs—Recital 18 states

[63] G/SPS/GEN/713 (12 July 2006). The trade concerns regarding Reg. 258/97 were raised again in 2011, after the EU institutions failed to agree on the revision of the Regulation. See G/SPS/GEN/1087 (7 June 2011).

[64] WTO Appellate Body Report, EC—Measures Concerning Meat and Meat Products, WT/DS26/AB/R; WT/DS48/AB/R, adopted 13 February 1998 (EC-Hormones), para. 123.

[65] The final recital of Dec. 94/800/EC concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986–1994) explicitly denies the direct applicability of WTO rules (OJ 2004, L 336/1).

[66] Griller (2000); Mendez (2004); Snyder (2003); Zonnekeyn (2004).

[67] Case C-69/89, Nakajima All Precision Co. Ltd v. Council, [1991] ECR-2069, para. 31.

[68] Case 70/87, Fédération de l'industrie de l'huilerie de la CEE (Fediol) v. Commission, [1989] ECR 1781, paras 19–22.

[69] Zonnekeyn (2001).

that the Regulation takes account of international obligations laid down in the SPS Agreement and the international food safety standards contained in the *Codex Alimentarius*.[70]

5 Conclusion

This chapter illustrated the tensions between the discretion of the EU legislator and the demand for science-based risk regulation. Food safety is the only area of risk regulation where a comprehensive risk analysis model has been introduced not only by international trade agreements, but also by EU legislation, as one of the general principles governing the food safety policy, applied to both EU and national measures. At the same time, policy making at EU level remains much politicized.

The ECJ ruling on the French measures concerning processing aids and the analysis of the EU Novel Foods Regulation in light of the WTO SPS Agreement show that the risk analysis methodology does not only relate to product authorisations and other technical 'decisions under legislation', but also to the choice and design of horizontal, framework legislation itself.

Under both WTO and EU laws, all food safety measures that restrict trade must be science-based and recourse to the widely interpreted and flexible concept of precaution by the EU legislator risks non-compliance with the decision-making paradigm in this field, if precautionary measures are based on considerations other than science.

In this sense, risk analysis also defines the boundaries of EU food safety legislation and limits democratic choices for stricter regulations. The chapter showed that the current EU food safety system, built on an enhanced input legitimacy, does not fit the multi-level governance system based on the legal principle of risk analysis and designed to rely on a strong output provided by technocracy. This might lead to tensions within the system that in the long run may create problems, either before the Court of Justice of the EU or the WTO dispute settlement mechanism.

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[70] Reg. 852/2004, OJ 2004, L 226/3.

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Regulatory Networks, Population Level Effects and Threshold Models of Collective Action

Mark Fenwick

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> If at the beginning of a rain shower a number of people on the street put up their umbrellas at the same time, this would not ordinarily be a case of action mutually oriented to that of each other, but rather of all reacting, in the same way, to the need of protection from the rain.[1]

1 Trans-Governmental Regulation and the Network Metaphor

Recent decades have seen a rapid expansion in routinized interaction between public officials from government agencies of different countries that share a common sphere of authority and expertise (such as banking, competition, securities, public health, anti-terrorism, policing, fisheries or the environment), a phenomenon that I shall refer to as trans-governmental regulatory networks

[1] Weber (1968), p. 23.

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(hereinafter, *TGRNs*).[2] In the context of economic and business law, for example, relatively developed examples of *TGRNs*, include cooperation between (1) securities regulators (the International Organization of Securities Commissions (hereinafter, *IOSCO*); (2) competition regulators [the International Competition Network (hereinafter, *ICN*)]; and, (3) environmental agencies [the International Network for Environmental Compliance and Enforcement (hereinafter, *INECE*)]. Cooperation of this kind has facilitated cross-border investigations and enforcement; policy development and standard setting; as well as information exchange and capacity building.

Over the last decade, "networked governance" has emerged as a central theme in contemporary debates on transnational regulation.[3] In this literature, a network metaphor has often been used. TGRNs are regarded as networks in the sense that this type of cooperation is usually based on loosely structured, *horizontal* ties developed over time through repeat interaction amongst multiple players rather than via centrally coordinated, *hierarchical*, *ex ante* formal agreement. The network metaphor is adopted to suggest that the relationships between the various stakeholders are best viewed in *heterarchical* rather than *hierarchical* terms, i.e. there has been a "flattening" of relationships. The "hub" organizations that have developed in the context of relatively developed TGRNs—e.g. the IOSCO, ICN, and INECE—are characterized by small secretariats that perform a coordinative function and possess few substantive powers. Moreover, regulatory cooperation within TGRNs is most commonly structured—when it is formally structured at all—by informal or non-legally binding agreements (e.g. "MOU"s), and primarily involves regular peer-to-peer cooperation between participating agencies that is principally "trust-based"—often originating in personal connections—and forged over time in the absence of direct control by the executive of the respective governments. The metaphor of a network is thus used in the context of a narrative of "de-juridification" that describes a shift from hierarchical legal forms ("government") to more flexible, responsive, "post-legal" institutional forms ("governance").

Nevertheless, it is often unclear why these new regulatory structures are characterized as networks, other than that they lack the authority to establish binding law, and the decision-making, information sharing, and norm-creation that they engage in eludes the formal structures of traditional international law. In much of the extant discussion, the network concept remains under-developed and under-theorized.

[2] By way of a preliminary caveat, it is worth noting that TGRNs often entail the participation of quasi-public and non-state actors, such as NGOs, trade associations etc., and, as such, are not the exclusive preserve of public authorities, although this is not an issue I shall explore in here. Moreover, such networks often blur the public–private structure.

[3] See, in particular, Raustiala (2002); Slaughter (2004); Braithwaite and Drahos (2000).

This chapter therefore explores the question of whether we might push the network metaphor further and examine whether TGRNs exhibit "network dynamics". The study of network dynamics is an inter-disciplinary field that has emerged at the intersection between sociology, social psychology and economics.[4] It attempts to understand the different ways that actors connected via a network mutually influence each other's behavior, as well as influencing the behavior of actors currently "outside" that network. It will be suggested that in examining whether TGRNs exhibit network dynamics we might develop an alternative conceptual vocabulary and framework for understanding the underlying mechanisms that drive TGRN formation and development.[5] More specifically, this chapter examines whether one particular form of network dynamic, namely a *threshold model of collective action*, can be of relevance for our understanding of TGRNs.[6] Section 2 of the chapter reviews existing accounts of TGRN formation in order to identify various assumptions of the conventional narrative that might be challenged with a threshold-based account.

The distinctive feature of a threshold model of collective action is that it focuses on those decisions where the number or proportion of other actors who have made a particular choice effects a given actor's decision make the same choice. The "threshold" is simply that point where the perceived benefits of engaging in the action exceed the perceived costs. Simple examples of such decisions are the decision to join a riot, where the perceived costs of joining the riot decline as the size of riot increases due to the decreased probability of being arrested or the decision to buy a phone, where the benefits increase relative to the number of other users already in the network. My decision to join a riot or buy a phone is directly effected by the number of other people opting for the same choice.

This is referred to as a *population level effect* in the sense that the utility of a product or activity is directly connected to the proportion of other users within a given population who have already made that choice.[7] Such effects are positive externalities in that they involve a situation in which the welfare of an individual is affected by the actions of other individuals without mutually agreed upon compensation. If another person joins a social networking site, for instance, they increase the benefit for other users, although no compensation is paid. The contrast is with an *individual level effect*, where the value that a particular product or activity has for an actor on its own (i.e. independently of whether anyone else is using or doing it). For example, my decision to purchase a particular type of cake is a decision that is based on individual effects and—subject to certain exceptions—is not contingent on other actors making a similar choice. This is the issue raised in the Weber quote at the beginning of this chapter, namely whether the decision to raise an umbrella in a rain shower is mutually oriented action (i.e. a decision subject to population level

[4] For an excellent introduction to this field, see Easley and Kleinberg (2010).

[5] See Raustiala (2002).

[6] This chapter will draw on the work of Marc Granovetter, in particular Granovetter (1978).

[7] See Katz and Shapiro (1985).

effects) or—as Weber seems to be implying—simply everyone reacting in the same way to the need from protection from the rain (i.e. a decision subject to individual level effects only).

Accounts based on threshold effects are interesting because they allow us to move away from explanations of collective action based on shared preferences or values; i.e. the idea that collective outcomes reflect or are consistent with the commonly held preferences of most of the participants. Threshold models of collective action instead proceed from the *heterogeneity* of individual preferences within a given population and offer an account of how a relatively stable collective order might nevertheless emerge from this diversity.

This chapter will therefore suggest that we frame the decision of any one particular agency or organization to participate in a TGRN as a decision where the costs and benefits to the agency of making that choice depend, at least in part, on how many others have made the prior choice to participate, i.e. a decision that exhibits population level effects.[8] Section 3 will defend this claim. Section 4 will then introduce some features of threshold models of collective action and examine some of the implications of this type of account for our understanding of TGRNs.

In looking for "law" at the transnational regulatory level, we often find diverse institutions engaged in norm generation and steering practices, rather than conventional models of legal unity and hierarchy, the rule of law, and the separation of powers. Such legal pluralism raises complicated questions about when—if ever—these social practices *become* law. More generally, it highlights the crucial significance that social conventions and routinized practice have in the context of the late modern legal order. There seems to be a broad consensus that a transnational infrastructure of implicit social rules has evolved in the shadow of the traditional legal order and which is indispensable for the continued existence of the legal system as a whole. The classic pillars of modern law—statutes and judgments, at a domestic level, and treaties at the international level—are increasingly performing a supportive role to these novel normative forms. *TGRNs* are an important part of this new legal order. My intention here is to suggest that in seeking to understand this new legal order it is important to think about the various processes and mechanisms that might structure the development of these new institutional forms. As such, my aim here is merely to suggest that we might gain a better understanding of the underlying processes that drive *TGRN* formation by using concepts that have been used to understand networks in other contexts.

[8] Moreover, since in the context of a lot of contemporary regulation the objects of regulation—companies or individuals—"voluntarily" submit to that regulation their decisions to "join" a network might also be usefully understood via threshold models.

2 Assumptions of Shared Preferences and Consistency in Conventional Accounts of TGRN Formation

The contemporary Anglo-American academic debate on TGRNs is usually dated to 1974 and the publication of Keohane and Nye's influential article on this issue.[9] Since then, an extensive literature has been generated on topics of TGRNs. Broadly speaking, this discussion has focused on five issues: the formation of TGRNs; the form and substance of TGRNs; the effectiveness of TGRNS; the accountability of TGRNs; and, the relationship between TGRNs and traditional international norms and institutions.[10] This section will focus on the first of these issues—namely the emergence of TGRNs in order to introduce some assumptions of this literature that a threshold effects model might challenge.

Existing narratives of TGRN formation identify two interlocked "logics" that drive network formation, namely the "logic of calculation" and the "logic of socialization".[11] The "*logic of calculation*" refers to the idea that economic, social and political interdependence associated with globalization has prompted an increased awareness amongst domestic regulatory agencies of the practical necessity of structured transnational cooperation between sub-units of government. This is a familiar narrative of the impact of globalization; law and politics have become overburdened both at the national and international levels and "traditional" instruments and institutions are unable to grasp and deal with the complex global dynamics of the economic system and other social systems.[12] The prohibitive transaction costs associated with treaty formation and the limited reach of domestic measures in the context of complex global problems has resulted in a search for alternatives, and institutional designs that involve cooperation between experts at the administrative level.

Facilitating this process is the "logic of socialization"; the fact that the relevant actors in each network comprise a group of professionals with a pre-existing, shared, and mutually recognized expertise. In Keohane and Nyes's original account, for example, they identify as a "necessary condition" of TGRNs that 'a sub-unit of one government must perceive a greater common interest with another government or sub-units of another government than with at least one pertinent agency in its own country'.[13] Particularly important in this context is the concept of the "epistemic community".[14] An epistemic community describes a community of experts who are united by four characteristics: (a) a "shared set of normative and principled beliefs" that provides them with a "value-base rationale" for undertaking

[9] Keohane and Nye (1974), p. 39.

[10] See Slaughter (1997).

[11] Slaughter and Zaring (2006), p. 1.

[12] See Verdier (2009).

[13] Katz and Shapiro (1985), p. 43.

[14] See Haas (1992). For a more recent review, see Cross (2012).

socially relevant action; (b) "shared causal beliefs" illuminating the underlying relationship between the available policies and the preferred outcomes; (c) "shared notions of validity" that are employed to identify admissible knowledge in the subject area of concern; and (d) "a common policy enterprise" that comprises particular sets of social issues and the policy instruments ordinarily used to manage them within the domain at issue.

Combining these two "logics" results in an account of the emergence of TGRNs that emphasizes a process of routinized purposive interaction occurring between actors who have a shared expertise as the crucial factor driving network formation. As such, the fact of existence, as well as the structural form and content (i.e. substantive and procedural "content") of any particular TGRN reflects the commonly identified shared norms, values and interests of participating agencies, i.e. the members of that particular "epistemic community". An *assumption of shared preferences* amongst network participants thus tends to characterize such accounts. Shared norms—deriving from a shared experience and a field of common expertise—are seen as a necessary, though not always sufficient, condition of collective action in this context and what holds these communities together is the fact of globalization and the limitations it exposes in existing regulatory forms. In other accounts, shared preferences are not presented as a premise but as an outcome of TGRNs. A process of persuasion—the effects of "soft power"—contributes to a convergence over time around shared preferences.

This kind of argument has a certain intuitive appeal: when we observe a collective outcome (such as the emergence of a TGRN) we tend to assume that individual preferences are consistent with that outcome. However, such a response entails a second assumption, an *assumption of consistency*, i.e. that the normative commitments of any particular actor and resulting actions are presumed to be consistent.

There is a long tradition within empirical sociology questioning the assumption of consistency, i.e. highlighting how behavior can run counter to the professed normative commitments of participants. Writing in a different context, the American sociologist David Matza, for example, observed, in the context of his work on youth crime gangs—i.e. crime networks, if you like—that most gang members do not actually have a strong commitment to counter-cultural values.[15] On the contrary, most of them did not think it is "right" to break the law, and most actually did not want to do so. However, the nature of group dynamics meant that gang members could not admit this without a significant loss of status. The threshold for law breaking is thus low because "daring acts" provided an effective means of guaranteeing and maintaining social status within a particular social milieu whereas expressing a reluctance to join criminal activities carried high reputational costs and a corresponding loss of status. Matza's takeaway from this is that it may be hazardous to infer individual dispositions from aggregate outcomes or to assume that behavior is directed by ultimately agreed-upon norms. Shared preferences and consistency should not be assumed and, as is explained below, one advantage of a

[15] Matza (1964).

threshold model is that it excludes both assumptions and proceeds from the heterogeneity of preferences.

Considerations of shared preferences and consistency are presented within much of the existing literature on TGRNs as the principle reasons for the limited range of cooperation within such networks, as well as their slow and often painful development. The assumptions of shared preferences and consistency establish a relatively high threshold for the emergence of TGRNs, not least since mutual identification and acknowledgment of shared preferences are still associated with high transaction costs (albeit lower than treaty negotiation). TGRNs are improbable, contingent and only like to emerge when there are compelling reasons for actors to cooperate. Moreover, the assumptions of shared preferences and consistency account for the limited scale of cooperation that is often characteristic of TGRNs, e.g. they often restrict themselves to procedural rather than substantive "rules", preferring information exchange, and are prone to cease functioning when there is a clash of either domestic interests or between agencies from different countries.

In doing so, much of the discussion in this area seems to negate the potential of the network concept. The value of the network concept in describing contemporary patterns of global regulation resides in that fact that it can provide a powerful narrative of the process of how order emerges "a-centrially" in the absence of value consensus. The complementarity and interdependence of the various nodes within a network and the synergy effects that occur between them generate new options that are only available in and through the network itself, and are not the result of actors negotiating with one another. A network is constructed not based on the implementation of a pre-formulated plan or value set, but continually invents itself over time by the innovative iterative recombination of individual elements.

In the following I will suggest that a focus on population level effects and thresholds encourages us to shift our focus away from shared preferences or epistemic communities. Networks might be interesting because they facilitate the mutual coordination of behavior and stabilization of behavioral expectations in the absence of shared normative commitments. Threshold models and population effects can provide us with a framework for thinking about this type of process. Actors within a particular population will have a threshold or "tipping point" where the benefits of joining and continuing to participate in a network may exceed the costs, irrespective of normative preferences. This is not to suggest that "shared worlds" are unimportant. Rather, they should not be taken as a premise of networks or assumed as an outcome. At the very least, their existence should be treated as being in need of empirical verification.

3 TGRNs and "Population Level Effects"

Can the decision of any one particular agency to participate in a TGRN be thought of as a decision that might exhibit population level effects? i.e. do the costs and benefits to the agency of making a decision to participate in a TGRN depend, at least in part, on how many others have made the prior choice to join?

In answering this question we need to think about the function of TGRNs, in particular the costs and benefits of membership. In this regard, I will make three suggestions; firstly, a key function of TGRNs is absorbing uncertainty via an iterative and recursive practice of making decisions to cooperate with partner agencies; secondly, the successful operation of TGRNs is contingent upon, and productive, of trust between participants: and thirdly, that both these features of TGRNs exhibit population level effects.

What then do TGRNs actually do? Transnational regulatory networks are flexible and adaptable and can perform diverse functions, in part as a result of the relative autonomy that they are able to maintain from external interference. At a minimum, they can contribute to the reduction in the potential for conflicts (jurisdictional or otherwise) by providing a forum for dialogue. Networks can also function as information hubs, gathering information from different legal or other social systems, repackaging that information and then disseminating it throughout the network.

More actively, they can facilitate inter-agency cooperation in investigation and enforcement of specific cases. The administrative costs associated with investigation and enforcement in cases involving a cross-border dimension can be greatly reduced by tapping into the local knowledge, expertise and fact-finding powers of partner agencies in other jurisdictions. Moreover, they can provide consultation and capacity building opportunities and coordination (e.g. procedures such as mutual recognition and simultaneous examination). Finally, networks can enhance the power and effectiveness of regulators by developing and promoting a degree of regulatory uniformity (i.e. common understandings, practices, knowledge and standards) from the "bottom up" without the delays and inefficiencies associated with centralized or negotiated harmonization.

All of the above types of activities are exposed to population level effects; the "systematization" of such cooperation clearly reduces costs in repeat situations. The more regulatory agencies that participate in coordinating and reciprocating enforcement efforts, for example, the "better off' are all other agencies within that network. The same logic applies to information-sharing: the more jurisdictions that share information about securities markets, for instance, the better off any one jurisdiction is at enforcing its law and deterring fraud or other forms of wrongdoing. Moreover, cooperation in specific cases can be more easily facilitated among countries that have relatively similar legal systems. Consequently, the greater the number of jurisdictions that share a common set of standards and practices, the more valuable cooperation among them ought to be and the greater the incentive for those on the outside of the network to join. TGRNs can reduce the complexity of the regulatory environment, stabilize expectations and activate resources produced by other agencies elsewhere within the network.

TGRNs perpetuate themselves through an iterative practice that connects one decision to cooperate with other subsequent decisions. As such, TGRNs can be thought of as "decision machines" in which every decision to cooperate is made possible by earlier decisions and gives rise to ensuing decisions. For a decision to cooperate to be made, information is needed on the basis of which one alternative

can be chosen over the others. The important point is that no decision can rely on complete information; some informational uncertainty inevitably remains. All this uncertainty, however, is absorbed by the decision: all given information and all remaining uncertainty is transformed into the selection of one alternative over the others. As decisions do not inform about the uncertainties involved in making the decision—they merely inform about selected and excluded alternatives—ensuing decisions connecting to them cannot "see" the uncertainties. That is to say, from the perspective of the connecting decisions orienting themselves toward the first decision the uncertainty of the first decision is absorbed. The crucial point in this context is that a decision can provide a premise that is not only binding for immediately succeeding decisions, but for a multitude of latter decisions. The capacity of a TGRN to absorb uncertainty thus increases as the number of participants in a network increases and the number of decisions to cooperate increases.

A second key feature of TGRNs that is relevant in this context is the centrality of trust. Many commentators have identified trust as particularly important in the context of legal networks; it is mutual trust that facilitates decisions within TGRNs. Again I would suggest that the decision to trust is a decision that exhibits population level effects.

There is a tradition within sociology that has conceptualized trust as a feeling that can be activated only between the members of a collective group who share the same preferences, values and norms. One finds this idea in Parsons, for example.[16] More recent work in sociology, however, has suggested that trust does not derive from shared values, but rather that trusting is a strategic game for coping with an uncertain and uncontrollable future.[17] Trust involves choosing one option in preference to others aware of the risk of disappointment as a result of the actions of others. Trust entails positive expectations about interdependent behavior that may not be met by the partner to the transaction. Trust is a condition of action in that it allows risk-taking decisions to be made but it always opens up the possibility of disappointment and regret.

Trust entails a particular kind of learning from experience and the function of trust is the reduction of complexity in the face of the autonomy of other actors. In consequence, trust is something that must be built over time, i.e. there has to be some cause for displaying trust. The building up of trust therefore depends on easily interpretable situations and, therefore, on the possibility of communication. Interactions with those who we endow with trust are liberated from anxiety, suspicion, and watchfulness, and allow for more spontaneity and openness. We are released from the necessity of monitoring and controlling every move made by others.

[16] For example, "[s]haring values makes agreement on common goals easier, and 'confidence' in competence and integrity makes commitment to mutual involvement in such goals easier ... All these considerations focus mutual trust in the conception or 'feeling' of the solidarity of collective groups". Parsons (1978), pp. 46–47.

[17] See e.g. Sztompka (1999).

In the context of a discussion of TGRNs the positive consequences of trust do not influence only the givers of trust, but the recipients as well, and—perhaps more significantly—any third parties who witness such interaction. A concept of observed trust can be useful here. It may be important to trust, but it may be equally important to be trusted and to be seen to be trusted by other participants within a network. Being visibly trusted by somebody may be an argument for others to grant trust too. Thus receiving trust raises one's trustworthiness in other subsequent transactions.

In networks, such as TGRNs, which are functioning based on routinized trust based practice, the routine of trusting and reciprocating trust gradually turns into a normative rule for both the "trusters" and the "trustees". A positive experience of confirmed trust or observed confirmed trust will generate a "culture of trust"; negative experiences of breached trust will generate a culture of distrust. In this way the normative climate for future acts of trust will be created; the tradition of trust or distrust will be passed on, and the process will continue interminably. A decision to reciprocate trust is thus influenced by the observed reciprocity of others. The number of other users thus determines my willingness to trust in the system. And at a certain point in the emergence of a network, trust in the network—in the system—generates automatic trust in other actors within that system.

Payoffs within a TGRN depend on the number of other users and on the particular details of network connectivity. Approaching TGRNs in terms of population level effects avoids an atomistic approach and suggests that we examine how attempts at purposive action are embedded in concrete, ongoing systems of social relations. Social and trust relationships enable the paths along which information will travel. However, information context determines which paths will be taken and when. Furthermore, the sharing of information leads to changes in social trust relationships, as individuals providing more valuable or high quality information, may be trusted more. Understanding the relationship between social and information network dynamics of trust is a crucial step in studying trust in this type of composite network.

Threshold models of collective action involve decisions where the costs and benefits to the actor of making one or other choice—in this case, the decision to participate in a network or not—depends, at least in part, on how many others make each choice. This section has suggested that the decision of a particular agency to join a TGRN can be thought of in this way. As the number of participants in a TGRN increases and as the number of decisions to cooperate increases, we can expect an increase in both direct trust and observed trust. This has two effects; on the one hand, the direct benefits of participating in a TGRN increases as the number of participants' increases and the network expands (more decisions to cooperate means more uncertainty is absorbed and expectations are stabilized to greater degree). On the other hand, the costs of non-participation also increase relative to the number of participating agencies. For existing participants, the risk of disappointment decreases as the TGRN develops and defection becomes more costly. For non-participants in the TGRN, there may well be negative effects that increase due to non-participation as the network increases in size, most obviously private

actors may opt to avoid those jurisdictions that are not participating in a particular TGRN on the grounds of risk. The existence of population effects suggest that by adopting a particular standard or practice within a TGRN, regulators can maximize the degree and depth of their interaction with other regulators and, in consequence, the "reach" of their own regulatory efforts. The existence of a TGRN increases the number of jurisdictions with which a state can usefully cooperate.

4 TGRNs and Threshold Models of Collective Action

Having established the claim that the decision to participate in a TGRN is a decision that exhibits population level effects, I will now consider threshold models of collective action and their implications for our understanding of TGRNs.

A simple model of a riot can illustrate some of the main features of threshold models of collective action.[18] A person's threshold for joining a riot can be defined as the proportion of the group he would have to see join before he would do so. A "radical" will have a low threshold: the benefits of rioting are high to him or her, the costs of arrest, low. Some people would be sufficiently radical to riot even when no one else does, i.e. a threshold of 0 %. These are the instigators. Conservatives will have a high threshold; the benefits of rioting are small or negative and the consequences of arrest are high. The key point: the threshold is simply that point where the perceived benefits to an individual of doing the thing in question and exceed the costs, and this is directly connected to the number of others already doing it. Moreover, the threshold is purely behavioral and does not entail any necessary assumptions about an individual's normative commitments.

Threshold models take as the most important causal influence on collective outcomes the variation of preferences within an interacting group. It will be clear even in the simplest versions of these models that collective outcomes can seem paradoxical—that is they may seem intuitively inconsistent with the intentions of the individuals who generate them. This possibility is foreclosed if we insist that collective outcomes reflect shared norms, whether pre-existing or negotiated, of most of the participants.

A threshold model aims to predict from an initial distribution of thresholds within a population, the ultimate number making each of two decisions. Mathematically, the question is simply one of finding the equilibrium point over time. Again a simple example will make the procedure clear. Imagine 100 people in a potential riot situation. Suppose their riot thresholds are distributed as follows: there is one individual with a threshold 0, one with threshold 1, one with threshold 2, and so on to the last individual with threshold 99. This is a uniform distribution of thresholds. The outcome is simple and would usually be described as a "domino" effect: the person with threshold 0, the "instigator", engages in riot behavior. This

[18] The following discussion draws, in particular, on the work of Granovetter (1978).

activates the person with threshold 1; the activity of these two people then activates the third person. This process continues until all 100 people have joined the riot. That is the equilibrium point.

Now change this distribution as follows. Remove the individual with threshold 1 and replace them by one with a second individual with threshold 2. By all of our usual ways of describing these groups of people, the two crowds are essentially identical. But the outcome in the second case is totally different—the "instigator" riots, let's say he or she breaks a window, but there is now no one with a threshold of 1, and so the riot ends at that point, with only one rioter.

This simple example makes clear a key point suggested by threshold models: it is very dangerous to infer individual dispositions from aggregate outcomes. The first situation would be described as "A crowd of radicals joined a riot"; in the second, "A single criminal smashed a window as horrified onlookers looked on". We know, however—since we constructed the parameters of the model—that the two crowds are almost identical in composition; the difference in outcome results only from the process of aggregation, and in particular from the "gap" in the frequency distribution in the second case.

These, and other more complex examples, can be modeled mathematically illustrating the two cases discussed, and a key task of threshold models is to develop mathematical procedures for assessing the stability characteristics of any given distribution equilibrium under a variety of possible combination of thresholds.

A second important feature of threshold models concerns the effect of social structure or "social capital". Social structure means that the influence any given actor has on another actors behavior will depend upon the relationship between the two actors. Take a simple case, where the influence of friends is double that of strangers, and assume that thresholds are given in terms of reactions to strangers. Consider an individual with threshold 50 % in a crowd of 100, where 48 individuals have rioted and 52 have not. In the absence of social structure, such an individual would not be activated. But if he knows 20 people in this crowd of whom 15 have already joined the riot, then each friend might be counted twice. Instead of "seeing" 48 rioters and 52 non-rioters, our subject "sees" more rioters, leading him to form a ratio not of 48/100 but 63/120. What we may then think of the perceived proportion of rioters now exceeds his threshold, and he will join. Recognizing the effects of social structure allows asymmetries in power to be incorporated into threshold models; in fact, considerations of social structure become a key factor in determining whether a particular collective outcome occurs.

What then are the implications of suggesting that threshold models and population level effects might be relevant for understanding TGRNs? There is not space for a comprehensive account, moreover, this type of approach is empirical and we need to look at a range of actual networks before making any generalizations. Nevertheless, a couple of preliminary suggestions can be made as to the kind of factors that might impact upon the distribution of thresholds within a given population of actors contemplating participating in a TGRN.

Firstly, threshold models imply that in the development of TGRNs, certain conditions would have to be met in order for the network to emerge and for a

process of policy standardization[19] to occur, and that there may be a very fine line separating a "successful" network and an "unsuccessful" one. The core intuition is that the organizational form of networks—a series of interconnected but decentralized nodes—might provide incentives for convergence and cooperation, but only under certain conditions. This is not to argue that convergence is "caused" by population level effects, but rather that population level effects might create incentives to participate in a network and to standardize and converge behavioral expectations.

A threshold model would seem to suggest that in situations where regulatory power is highly imbalanced the actor possessing the greatest leverage can propose a regulatory policy that other actors may feel compelled to adopt in order to enjoy the benefits of population level effects. Often market forces will drive this process. U.S. accounting standards, for example, have been adopted globally because of the importance of entering U.S. markets, and complying with their accounting standards thus becomes crucial. As the number of firms participating grows, the incentives for other states to adopt the U.S. standard also grow, i.e. thresholds are lowered.

A similar kind of dynamic seems to characterize the emergence of the network of securities regulators. The US Securities and Exchange Commission (hereinafter, *SEC*) has played the role of "institutional orchestrator" within the global network of securities agencies. The US is the world's leading capital market, and developed a system of regulation based around an independent regulatory agency in the 1930s (i.e. much earlier than other comparable jurisdictions). Moreover, key principles of the US approach were established relatively early, namely a preference for a mandatory disclosure based regulatory model; broad anti-fraud provisions with strict insider trading rules; mandatory registration with a governmental agency of public securities issues; and administrative oversight of brokers, dealers, and exchanges. Given this combination of economic clout, long history and institutional capacity, it is therefore perhaps not surprising that the SEC has been the dominant player in the development of this network.

While this process of convergence does not depend on the existence of networks to occur, population level effects strengthen this tendency toward convergence in asymmetric situations by lowering the threshold of a greater proportion of actors. When many agencies are regulating a field in a similar manner, and cooperating with one another through a TGRN, population level effects can then push agencies to adopt the dominant regulatory standard, leading to or accelerating a "tipping process" that results in a high degree of regulatory convergence. Regulatory asymmetry and population level effects complement each other; a marked asymmetry in regulatory power, can be reinforced by the presence of population level effects that encourage states to adopt the dominant mode of regulation.

[19] In the following, I am using "standard" in a broad sense to refer to any routinized rules, policies, or practices.

Another implication of the existence of population level effects is the creation of "first-mover advantage". In markets with population effects, being first in a market and setting the dominant standard or practice—taking the role of an "instigator"—provides important advantages over "late arrival" standard-setters. In the context of TGRNs, first-mover advantage suggests that those regulators who engage in networks and seek to export their regulatory models first will be well placed to set the international regulatory standards, i.e. they may reap distributional gains coming from being a standard-setter. This process is accelerated when a "networks of networks" start to develop, e.g. as part of the Financial Sector Assessment Program evaluating national regulatory frameworks, the IMF and World Bank have adopted IOSCO principles as the standard by which a state's securities laws will be evaluated. Regulatory competition becomes a race to set the global regulatory agenda.

This suggests that agencies in other states that subsequently converge on the dominant standard do not do so because those models are the most efficient or desirable or because the instigators "persuade" or "coerce, via "hard" or "soft" power, other agencies to join. Rather, they join because their threshold for participation is lowered and they make a strategic decision to do so. This raises difficult normative questions about whether such a decision to participate constitutes "contractual consent" or not.

Population level effects thus create incentives for "powerful" jurisdictions to try to export their standards and for relatively "weak" jurisdictions to import regulatory models in line with the emerging international "standards" in regulation. For weak states the import of regulation can be thought of as "the cost of entry" to the benefits provided by the network. When regulatory bodies are fairly new—in the case of emerging markets, for example—that price may be marginal. If so, the benefits of sub-optimal harmonization with others in the network may outweigh the costs.

The dominance of one regulatory perspective, or an asymmetry in regulatory power, might in the presence of population level effects, encourage states to adopt the dominant mode of regulation in order to make the efficiency gains associated with being a member of that network. Issues of institutional capacity may be pertinent here; the lack of cognitive resources to make an independent evaluation of what constitutes the most appropriate standards may provide an additional reason why the threshold for an agency to choose to participate is reduced.

Convergence may—in the context of TGRNs—create a perception that participation in the network and the adoption of the dominant standard might allow regulators to achieve more effectively their domestic objectives and to give them greater leverage in domestic political struggles. Moreover, a convergence of standard may benefits those companies that are operating transnationally. Divergent regulatory standards clearly impose costs that distort competition, particularly in the context of a globalizing economy. If they contribute to making the regulatory landscape more similar and providing regularity and certainty in cross-border transactions then convergence would be perceived as advantageous for business.

Once actors in a TGRN adopt a particular standard, changing to a new standard requires extensive and costly collective action. Population level effects therefore

tend to create "lock-in" effects within networks and the threshold necessary for implementing change consequently increases. This means that even if the adoption of a new more desirable standard is beneficial for a given state, threshold processes may occur in which a globally less efficient standard dominates the more efficient one. Population level effects may result in inferior standards defeating "better" standards because the costs of change raise the threshold for participating agencies. Population level effects might produce a resistance to change or "stickiness" that, in aggregate welfare terms, is sub-optimal.

Moreover, these kinds of "lock-in" effects raise the risks associated with "deviation" from the dominant standard for individual agencies. Actors have few incentives to defect in a network context in which a dominant standard has been established. If population level effects exist, cooperation in networks may resemble a self-policing coordination game since the threshold of defection may be rendered prohibitively high. Agencies may be more likely to permit themselves to engage in "deviant" behavior when they see others engaging in deviant acts and in the absence of collective deviance, the threshold for individual defection is raised as the costs of defection may be catastrophic.

In sum, the existence of a TGRN may, particularly given asymmetries in regulatory power, create incentives for jurisdictions to seek greater convergence because convergence allows for deeper and broader cooperation. The analysis here suggests that powerful jurisdictions will compete to set standards and weak jurisdictions will often "chose" to import these standards, irrespective of their normative preferences. This type of account can help explain why networks emerge and flourish, while it also helps explain why convergence occurs among members.

Nevertheless, a key point of threshold models is that the line between "success" and "failure" is marginal (as illustrated by the case of the riot) and crucially depends on a particular distribution of thresholds within a given population. In the absence of the asymmetries discussed here TGRNs may struggle to take hold. In this respect, it is hardly surprising that some of the most developed networks have emerged in the fields of economic and business law where market forces contribute to high levels of asymmetries.

One final point; it is important to stress—and this is something that Weber is insufficiently attentive to in the quote at the beginning of this chapter—that the influence of population level effects does not need to be decisive in any situation. The relevance of population and threshold models of action does not depend on the idea that the actions of others are the decisive influence on behavior. As long as there are some population level effects then the threshold concept is relevant. Where a threshold model is of little interest is where all or most people's behavior is not contingent in any way on that of others. But that would seem a difficult and somewhat curious claim to make in the discussion of any social phenomenon—such as TGRNs—that one is describing with a network metaphor.

5 Conclusion

The term transnational governance is often used to describe the emergence of new forms of legal and/or political collaboration of public and private actors at international and regional levels. TGRNs are an important element of this new regulatory landscape and so understanding the mechanisms and processes that structure the formation and development of this kind of network seems an important task in the context of understanding the new global legal order. This chapter has suggested that one potentially fruitful line of inquiry might be to adopt a stronger version of the network metaphor and examine whether new institutional forms, such as TGRNs, might exhibit network dynamics. Only a couple of examples have been briefly discussed here—population effects and threshold models—but other mechanisms may be at work, for example "herding" or "information cascades". Understanding the mechanisms of network formation seems important, not least because it might allow the important normative questions that are raised by these new institutional forms to be grounded on a better understanding of the social phenomenon under discussion.

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Intermediaries, Trust and Efficiency of Communication: A Social Network Perspective

Shinto Teramoto and Paulius Jurčys

Contents

> Trust is a passion proceeding from the belief of him who we expect or hope for good, so free from doubt that upon the same we pursue no other way.[1]

1 uCopy, iSue

The emergence of digital communication technologies, such as the Internet, has had a tremendous impact on the global economic, social and cultural landscape. The interconnectedness of computers and other digital devices has significantly reduced the costs of communication and the transfer of information.[2] Such technological

[1] Hobbes (2004), p. 29.

[2] Basedow (2000), pp. 2–4; Rodin-Hardy (2013), Chaps. 1 and 6; Easley and Kleinberg (2010), Chap. 1.

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development has spurred the rise of actors that facilitate the transfer of data between originators of information to its recipients. This, in turn, has accelerated the rise of multinational organizations as well as the proliferation of global business models.[3] In fact, most of the social interactions (including global business models) involve multiple parties some of which act as intermediaries (e.g., online search engines, social networking sites or perplexed chains of distribution of commercial goods).

The regulation of intermediary activities has been one of the most heated issues in the global agenda. The Global Financial Crisis that led to a collapse of large financial institutions showed the need for national governments to adjust their fiscal policies.[4] Illegal distribution of the copyrighted content online has been another area in which states have been striving to find some sort of decent regulatory solution.[5] The dissemination of information through intermediaries has been also brought to the public attention by court decisions in cases concerning Google Books, abuse of dominant position by Microsoft and, most recently, on-going patent saga between Apple and Samsung. Although intermediaries play an important role in furthering the dissemination of information and alleviating information asymmetries, the involvement of intermediaries could also be seen as conferring additional transaction costs. At the same time, intermediaries also could be considered as facilitators of social interface.

We start this chapter by explaining how social network analysis could contribute to legal scholarship and briefly discuss some key concepts used by proponents of this methodology. Having introduced a number of cases previously explored by other social scientists, we submit that the establishment of trust-based relationships facilitates the transfer of values and resources. Hence, we argue that networks and (mutual) trust should be viewed as a form of social capital. In the subsequent part of this chapter a further distinction between actual and deemed trust is introduced. This actual/deemed trust distinction helps explain the creation as well as functioning of social networks and focus on the role of intermediaries in considering how they could contribute to the dissemination of information and economic resources. To do that, we provide two case studies illustrating how the role of intermediaries can help build trust between remote actors and facilitate cooperation.

2 Social Network Analysis as a Methodology

Social organizations usually consist of a number of individuals or groups of individuals who are bound by mutual relationships, division of labour and spatio-temporal cohesion. The functioning of social organizations is often supported by

[3] Gilroy (1993), pp. 41–99; Kobrin (2001); Wilkins (2001).

[4] Kjaer et al. (2011).

[5] A number of interdisciplinary studies have been carried out in order to explore the role of intermediaries OECD (2010); Seng (2012).

certain norms: religious, social or legal.[6] Norms in general, and legal norms in particular, could be seen as possible means of social intervention and directing of individuals' behaviour. Scholars from different academic disciplines have conducted studies on such means of social intervention and applied various normative criterions or methodologies to evaluate their appropriateness or efficiency. We begin this article by introducing social network analysis as a promising methodology to be applied in assessing what legal framework best contributes to the transfer of such economic values as information and knowledge. In the following sections we briefly explain key concepts used in social network analysis and demonstrate how this approach could complement currently widely applied methodologies of law and economics or comparative institutional approach.

One the most often applied methodologies is the so-called "law and economics" approach[7] or economic analysis of law. This methodology is based on the premise that individuals act rationally[8] and consider legal sanctions such as fines, monetary damages, or imprisonment as costs of certain behaviour. As the famous US judge O. W. Holmes put it, a "bad man" does not aim to break the law; he rather wants to know what the law is and what consequences he would have to face if he broke legal rules.[9] Hence, economic approach suggests that law should be viewed as an incentive to guide (incentivize or prevent) certain behaviour. The proponents of law and economics approach consider the notions of "fairness" and "justice" as vague or ambiguous.[10] Therefore, a more telling "efficiency" criterion is utilised in order to evaluate certain legal rules and making normative suggestions how the general welfare could be increased.[11] The philosophical foundations of law and economics approach could be traced back to the writings of such thinkers as Jeremy Bentham or John Stuart Mill who espoused utilitarian ideas.[12] Yet, the foundations for empirical studies had been laid by Nobel Prize laureate Ronald Coase at the beginning of the twentieth century. In his seminal article Coase introduced the notion of transaction costs and bargaining as determining factors in dealing with the allocation of resources.[13] Since then transaction costs have been used by academics to analyse a broad range of legal issues starting from the economics of antitrust to family law matters.[14]

[6] Gambetta (1993, 2009).

[7] Posner (2012); Cooter and Ulen (2012); Landes and Posner (2003).

[8] Although recent studies in the field of behavioural economics have shown the shortcomings of the assumption that humans behave rationally. See e.g. Sunstein (2000).

[9] Holmes (1897), p. 459.

[10] Cf. Miceli (2009), p. 3.

[11] See e.g. Friedman (2000), Chap. 2; and Polinsky (2011).

[12] See Bentham (1988) and Bentham (1996) where he refers to the "principle of utility" as well as "the greatest happiness principle"; see also Mill (1907).

[13] See Coase (1937) and Coase (1960).

[14] See Buccirossi (2008) or Dnes and Rowthorn (2005).

Besides law and economics, comparative institutional analysis has been applied as a possible method to assess the appropriateness of legal norms and regulation. Institutional analysis goes beyond transaction costs and efficiency considerations and focuses on how formal and informal institutions affect the behaviour of actors. The notion of "institution" has often been used as an umbrella term in order to refer to wide range of values, conventions, norms, rules or standards.[15] Such institutions exist in each and every society; they are either self-regulating (i.e., institutions are followed by sanctions) or self-enforcing (i.e., actors comply spontaneously).[16] The institutional approach has been shaped by economists and political scientists who undertook parallel studies on governance-related issues. While scholars working in economic field focused more on the conceptual questions concerning economic governance (market vs. non-market governance),[17] political scientists carried out numerous empirical studies related to the governance of common pool resources.[18] Comparative institutional analysis calls for a broader view towards institutions within their surrounding socio-economic environment. Differently from law and economics, only few law scholars seem to have attempted to employ comparative institutional analysis in legal studies so far.[19]

Both institutional as well as law and economics approaches had significantly contributed to a better understanding of economic, political and social governance structures. Acknowledging the catalyst function in spurring the normative analysis of these two lines of thought, in this chapter we would like to advocate for the introduction of the so-called social network analysis in order to address legal matters. Social network approach has been widely applied in other fields of social sciences (especially, sociology, psychology).[20] It nevertheless remains a Higgs Boson in legal scholarship.[21]

The advantages of the application of a social networks approach in legal studies are manifold. Instead of placing an emphasis on black letter rules, social networks analysis provides a set of "tools" for fact-finding. In other words, rather than trying to squeeze in a given factual situation to a particular legal rule, social network analysis calls for a more subtle observation of the situation at hand and the surrounding society in general. For instance, in handling negotiations between a venture capitalist and a start-up company regarding the new issuance of shares, attorneys often tend to focus only on conflicting interests of the investor and company overlooking the interests of third parties (e.g., future investors). This could be partly explained by the fact that positive laws tend to formalize the human relationships as dyads (i.e., an

[15] See e.g. a path-breaking contribution by North (1990).

[16] Groenewegen et al. (2010), pp. 24–38.

[17] See Williamson (1981); Williamson (1996); Williamson (2002) and Williamson (2010).

[18] See Ostrom (2005) and Ostrom (2010).

[19] Komesar (2001) and Komesar (1994).

[20] Scott (2000); Watts (2004).

[21] But see e.g. Teramoto (2010, 2012a, 2012b, 2012c).

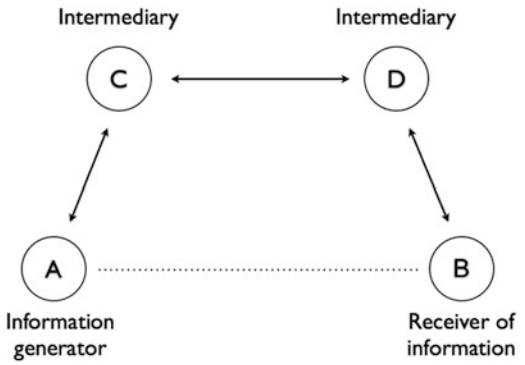

Fig. 1 Ties between four actors

interaction of two individuals). Nevertheless, in reality, most social interactions also involve a third party (for example, a bank or lawyers who mediate the negotiations).

Social network analysis provides for concepts and tools to identify the actors and their mutual relations by offering a special terminology. One of the key prerequisites of social network analysis is that legally super-imposed attributes of actors such as "seller", "buyer", "weaker party" should not be given prevalence. Instead, each participant is identified by using abstract terms ("vertex", "node", or "actor"). In social network analysis, the decisive factor is the *relationship* between the actors. Moreover, social network analysis offers a dynamic perspective by offering tools to visualize the relationship between several actors and showing how these relationships evolve over time. In the previous example of a start-up company, social network analysis could be used to explain its development from early stage to growth and IPO or exit through M&A. By analyzing the interaction of individuals and the change of their positions over time, the social network analysis offers some helpful concepts to investigate how the flow of resources between actors could be facilitated.[22]

Social network analysis begins with the notion of a dyad that demonstrates the relationship between two actors. These two actors might not know each other at all (like a relationship between A and B in Fig. 1). There may be one-sided relationships (e.g., A → C and D → B), it may well be the case that both two actors know each other (e.g., the relationship between D and C). One-sided, or directional, relationships are very frequent in reality and could be explained by "liking": A likes C, but C does not respond in the same way. For example, fans of a famous Hollywood diva may well know about their idol, but the idol may know only few of her fans in person. The relationship between C and D is mutual (or, bi-directional) which means that both C and D know or perhaps even "like" each other. Differently from one-sided relations, mutual relationships are not easy to achieve and tend to be quite limited in reality.

[22] For a more elaborate explanation see Easley and Kleinberg (2010), Chap. 1 who explain that game theory could be applied as a helpful mean in examining the relationship between actors.

In order to explain why people come together, two main reasons have been proposed. The first one is close geographical location of individuals. For example, children who live in the certain part of the city, students studying at the same college, or persons who are the members of the board of directors of particular corporation.[23] The notion of geographical propinquity has been modified due to the emergence of digital means of communication, mainly the Internet, which helps to curtail the territorial and temporal differences between individuals. The second factor which helps explain why people get connected is "homophily" or the famous adage "birds of a feather flock together".[24] At the individual level, people may become friends with those who have similar interests, hobbies or are engaged in similar activities. Homophily could be based on social status (e.g., ethnicity, race, nationality), or acquired attributes (e.g., education, religious or cultural values). Similar explanation could be extended to more complex forms of societal organizations: close ties may exist between the corporations established or competing in the same economic area (car manufacturers in Detroit or Samsung and Apple selling their gadgets in certain countries) as well as Silicon Valley R&D companies who engage in cross-licensing schemes allowing to use technologies owned by their competitors.[25] What matters for social network analysis is the mutuality of the relationship which involves "give and take". Moreover, it is remarkable that the power/asymmetry of the parties are of little significance.[26]

Although it is important to understand that the smallest unit of social interaction is represented by a dyad, the social network analysis puts more weight on the study of societies with three or more members. In fact, triads are considered as the simplest model of a "society".[27] In the case of interaction between three actors, the third actor is often considered as an intruder, and, compared to dyads, the level of complexity becomes considerably higher.[28] The homophily as we already know from the brief presentation of dyads evolves into more sophisticated balance hypothesis: "a friend of a friend is a friend of mine" and "an enemy of my friend is an enemy of mine". In other words, triads may consist of multiple dyadic ties (e.g., the triad of A, B, and C could consist of the following combination of ties: A–B, B–C and A–C that may be one-sided or mutual).

In social network theory, the ties between different actors are visualized by drawing a sociograph which illustrates existing actors and the relationship between them. These ties depicted by lines or arrows are not static demonstrations of connectedness; they could also reveal the dynamics among the members of the network. In fact, establishment of a tie between actor A and actor B leads to the transfer of certain tangible or intangible assets. In our example depicted above, if A is an information generator and

[23] Kadushin (2012), p. 18.

[24] Lazarsfeld and Merton (1978).

[25] For a recent exposition see Mattioli (2012), p. 103 et seq.; Branscomb (2004); Meurer (2008).

[26] Kadushin (2012), p. 21.

[27] Kadushin (2012), p. 22; Easley and Kleinberg (2010), Chap. 3.

[28] Kadushin (2012), pp. 22–23.

B is a receiver of information, the ties between actors A and B mean that there is a transfer of certain information. The transfer may be one-sided or mutual (if B agrees to pay for what B is bestowed). In addition, arrows play an important role for they represent the dependency relationship between the actors.

One of the main questions that we would like to address in this article is related to the transfer of resources from A to B. Figure 1 helps to clarify the point: since there is no direct tie between A and B, the transfer of resources between A and B is not possible. Accordingly, if A is an author of a novel and wants to expose himself/herself to a broader readership, the only available possibility to share his creative products with B is through intermediaries C and D. C in this context could be considered as a publisher and D as a distributor or a bookseller. The arrows in the graph already demonstrate the existing ties between A and C. Such ties may exist because C had already published A's previous novel. If B is a regular visitor at D's shop the ties between them also exist. Finally, the graph also shows that there is a mutual relationship between the two intermediaries C and D and that A can reach B via intermediaries C and D. Since author A does not have direct relationship with B, it appears that one of the possibilities to reach his readers is to act through intermediaries D and C. The same is true if we consider the B's access to reading materials: since there is no direct tie between the reader B and the Author A, the only possibility to access (namely, notice and read) the novels of A through intermediaries D and C.

In most cases acting through intermediaries is associated with additional transaction costs and begs for a further investigation into more efficient dissemination schemes. Accordingly, the next section proposes some factors that explain why individual actors enter into mutually beneficial transactions. We will focus on the notion of trust and then use this notion in further developing our argument concerning the role of intermediaries.

3 Networks and Trust as Social Capital

The above-mentioned example of a creator and a user of information rests upon two assumptions: first, there is no direct tie between them, and, second, this is a society without the Internet. One of the possible alternatives for author A is to turn to the intermediary C who has physical equipment necessary for publishing creative works and disseminating them through various distributors. For the information generator A this comes at a cost because A might need to engage in lengthy negotiations with the publisher regarding terms and conditions as well as remuneration fees. On the other hand, it may also happen that A decides not to act through intermediary publisher C. In such a case, A may incur even higher "installation costs" in order to publish the creative work and create a new chain of distributors in order to disseminate the work to the broader audience.[29]

[29] The notion of "installation costs" was used by Bala and Goyal (2000).

A number of theories have been proposed in order to explain why individuals engage in mutually beneficial transactions. Some of the theories have referred to self-interest of individuals; others suggested that behaviour on individual and organizational level was governed by social norms, rules or obligations.[30] The proponents of rational choice theory argue that in making decisions individuals try to maximize benefits and reduce costs. Rational action presupposes that every actor has control over certain resources and exploits them to pursue his/her personal interests.[31] In the earlier literature much attention had been devoted to discuss the defining features of various forms of resources that are possessed by individuals (physical, financial, human, cultural, social capital etc.).[32]

In finance and accounting, the notion of capital typically refers to physical capital (i.e., technology or assets that can be used in producing goods or services) and financial capital (i.e., funds available to buy real capital). This clear-cut definition does not include human capital which is less tangible and refers to the skills and knowledge acquired by individuals. Nor does finance and accounting take into consideration even less tangible forms of capital such as relationship between individuals (e.g., the fact that the manager of a start-up company is also member of the board of a multi-national corporation). Remarkably, one of the defining features of Japanese economy during the age of its high economic growth had been cross-shareholding and membership in the board of multiple SMEs and larger corporations. Since such inter-personal networks are not reflected in the balance sheets, the reality is that many of Japanese start-up companies easily meet the requirements to start bankruptcy proceedings. More generally, there has been an increasing acknowledgement in economic and sociology literature that such interpersonal networks should be also considered as a form of social capital.[33] The utility of social networks stems from anticipated economic or collective benefits that may be brought by the cooperation between individuals or groups of individuals.[34]

The first endeavours to investigate social ties within the community could be traced back to the writings of Alexis de Tocqueville and James Madison in the early nineteenth century who analyzed social cohesion in the US politics.[35] However, a more rigorous study of social capital attracted greater attention only in the second half of the twentieth century. The foundational works were conducted by social scientists who tried to explain what factors affect community and economic development. A wide range of definitions of social capital has been proposed in the literature. For instance, Putnam refers to '. . . features of social organization, such as

[30] Coleman (1988), pp. 95–97.

[31] Ibid., p. 98.

[32] See e.g. Coleman (1990); Dasgupta and Serageldin (2000); Dasgupta (2005); Bourdieu (1983); Bourdieu (1986).

[33] See Coleman (1990); Dasgupta and Serageldin (2000); Dasgupta (2005); Williamson (1993).

[34] See e.g. Gilroy (1993), pp. 138–161; Fink (2006) and Fairfax (2010).

[35] See de Tocqueville (2004); Madison (1961). It is often indicated that the term "social capital" was firstly used in 1916 by Hanifan (1916).

norms, trust and networks that can improve the efficiency of society by facilitating coordinated actions'.[36] Bowles and Gintis adopt even broader notion: '[s]ocial capital refers generally refers to trust, concern for one's associates, a willingness to live by the norms of one's community and to punish those who do not'.[37] Other scholars have criticized such over-inclusive attempts and instead referred to a much tighter label of "trust" in order to explain the credibility of joint course of actions between individuals.[38]

James S. Coleman distinguished three forms of social relations that could be viewed as social capital.[39] One possible situation maybe where a person A expects that B will do something for A; and B is actually obliged do something for A. For example, A may lend some money to his friend B hoping that B will not only repay, but also that B will help A in the future. Second possible example of social relations as a form of social capital is related to information gathering and information channels. In the case of venture capital such sharing of information may be crucial factor in finding the next generation start-up company that has a huge potential for growth. The identification of such a start-up business which may be a target for less-risky are more profitable investment in many cases depends on the network between the venture capitalists. Social norms accompanied with effective sanctions could be considered as the third form of social capital. One most telling example of this kind is a social norm which calls for action in the community interest and is followed by a set of rewards in the form of recognition, rewards or honour within the community.

Both Coleman and other distinguished sociologists have shown that trust plays an important underlying role in social interaction. In fact, the existence of networks hinge upon the existence of trust between the members of the group. Accordingly, in this article we assume that (mutual) trust should be perceived as social capital. Trust as social capital can be best understood through its function in facilitating certain actions without which such actions would not be possible. Social capital may exist in relatively small circles such as families or in larger forms of social organization. Just as the technological improvement of physical capital can lead to new products, the improvement of interpersonal relations may facilitate mutually beneficial interaction on micro as well as macro levels. Social capital helps generate trust, establish expectations, create and enforce certain rules of behaviour.

The elusive notion of trust has been in the focus of numerous economic or sociological studies. Some of the most prominent inquiries of the function of trust were pursued by Niklas Luhmann. Luhmann became famous mainly because of his theory of social systems which aims to untangle the problem of "unmanageable complexity".[40] Luhmann uses the notion of social system to contrast it with the world in which such social system exists. Social system is defined in most open

[36] Putnam et al. (1993), p. 167.

[37] Bowles and Gintis (2002), p. F419.

[38] Dasgupta (2005), p. 3.

[39] Coleman (1988), pp. 101–105.

[40] See three works of Niklas Luhmann: Luhmann (1979, 2000a, b).

terms in order to show that there are many more possibilities in the world that can be realized and that the world is constantly threatened by instability and uncertainty.[41] Systems are viewed as embedded in the surrounding environment; and a man who has the capacity to comprehend the world is also able to see alternatives and possibilities. Since social complexity in the world is growing, a man can and should be able to seek for more effective ways to reduce complexity.

Luhmann argues that trust could be an effective form to reduce complexity. Building trust is a relational process which involves at least one individual who interacts with another person. Hence, trust exists in every social relation. This is true for a broad range of social interactions: personal relations among family members or friends; professional dependency of patients to their physicians; social relations of members who belong to the same organization; economic interaction concerning the transfer of certain goods; or epistemic relations between laymen and experts.[42] It is also possible to consider trust as present between more complex layers of the societies (e.g., firms, agencies or states). Luhmann also emphasizes that one of the main issues of trust is time: to bestow trust is to anticipate future and behave as if the future is certain. In other words, the future contains far more possibilities that could ever be conceived. In increasingly complex societies, there is a growing need for assurances, and trust could be viewed as one of them. However, since the anticipation of future events is not feasible, trust is only possible at present and thus can only be achieved at present.[43]

Many scholars have been analyzing trust from the perspective of its relationship to such notions as affection, emotions,[44] reliance on the other parties' goodwill,[45] or simply reliance.[46] Luhmann focused on the juxtaposition between trust and familiarity. According to Luhmann, "familiarity is unavoidable fact of life" while trust is a solution for specific problems of risk.[47] This dichotomy helps demonstrating that familiarity represents experience based on past/historical events whereas trust implies the projection to the future events that is unavoidably obscure. Nevertheless, trust is only possible in the familiar world; therefore, familiarity is a necessary precondition for trust or distrust.[48] Luhmann's study showed that familiarity and trust are not identical, yet complementary ways to absorb complexity and build more stable systems that could reduce the complexity of the world.[49]

[41] Luhmann (1979), p. 6.

[42] Jones (2001), p. 15917.

[43] Luhmann (1979), p. 11–12.

[44] Jones (1996).

[45] Baier (1986).

[46] Hardin (1998).

[47] Luhmann (2000b), p. 95.

[48] Luhmann (1979), pp. 19–21.

[49] It could be noted that Luhmann did not place much emphasis on various possible forms of trust in his discussion; we aim to contribute to the discussion be introducing two forms of deemed and actual trust in Sect. 4 *Building Actual Trust in Transnational Setting* below and Sect. 5 *The Role of Intermediaries* below.

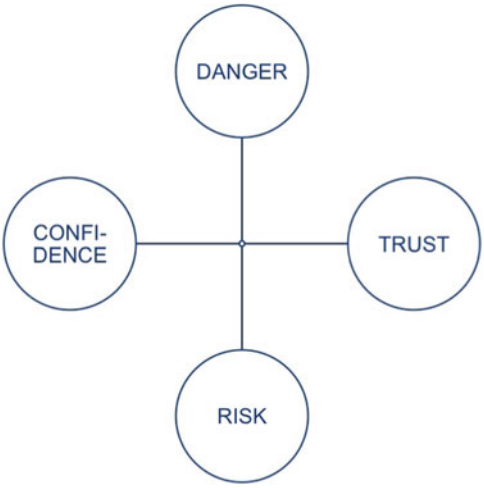

Fig. 2 Luhmann's conceptualization of trust

The distinction between trust and confidence has been one of the central elements in Luhmann's inquiry. Both of these notions are related to the expectations which may or may not result in disappointments. Confidence means that general expectations will not end in disappointment: e.g., that the car will not run over you, that there is no need to carry the gun every day, or that the banking system will not collapse. In other words, confidence is associated to surrounding dangers and contingent events that individuals cannot influence. In most cases individuals do not even have their own opinion about surrounding dangers and therefore simply ignore them (Fig. 2).

In order to draw the line between confidence and trust, Luhmann highlights the ability to distinguish dangers and risks.[50] This is not a matter of probabilities, but individual's previous behaviour. Dangers exist naturally and are independent one's choice (e.g., traffic accidents cannot be reasonably anticipated). On the other hand, risk underlies situations in which individuals have to make choices. Often such situations are indeed complex and put a high value at stake. Babysitter is a classical example that illustrates how risk is connected to trust. Parents may invite a babysitter to take care of their cute kids while enjoying themselves in a concert or at the pub. The decision of leaving kids with a babysitter without supervision is mainly based on trust: parents bestow trust on the person they rely and do so in their own risk often not considering the possibility that the babysitter may be a serial killer.

The babysitter example brings about one more distinctive feature between confidence and trust. This is related to the personal attitude of an individual to a given situation. By taking part in the elections a person may be confident that the government will act in the best interests of the taxpayers and will not squander state revenues. Risky behaviour, however, is related to the wilful decision-making and

[50] Luhmann (2000b), pp. 97–98.

previous engagement. This could be illustrated by another example of purchasing used cars whereby the buyer trusts the retailer and his assurance that the second-hand car will run smoothly. However, the risk to be harmed or betrayed is always there; and not buying the car will create no risk. In this regard, trust is the key concept which helps explaining why people enter into dependency relationships.

Several empirical studies conducted by Robert Putnam revealed that in regions with greater endowment of social capital, the convergence of per capita income is faster than in the regions where less social capital and greater hierarchy.[51] Putnam compared the economic development of Southern and Northern parts of Italy over four decades of the nineteenth century (1960–1990s). He identified that social composition was much more hierarchical in the South while the Northern part of Italy showed more signs of horizontal structures. In order to draw trajectories of economic development in Southern and Northern Italy, Putnam conducted numerous studies to effectiveness of local governments before and after the decentralization of government. In these studies, three variables (civic community, institutional performance and citizen satisfaction) were examined and showed that social capital creates possibilities of "civil engagement" and that regions with social capital are more developed.

Putnam is better known for his study of social capital and civic engagement in the United States.[52] An overview of statistical data showed that Americans' engagement in politics and government has dramatically decreased in the second half of the twentieth century. The most whimsical piece of evidence put forward by Putnam is the fact that the number of people playing bowling had increased by 10 % during the period of 1980 and 1993; however, the league bowling decreased by 40 %. Such a change in bowling habits had significant ramifications to the bowling businesses because league bowling usually would lead to the three times higher consumption of pizzas and beer.[53] One of the main thesis of Putnam was that the associational membership is closely connected to social trust: members of a group are more likely to participate than non-members. Community networks with social capital foster reciprocity and facilitate the emergence of trust. These networks further coordination and communication and reduce opportunistic behaviour.

Two different aspects of social capital have been distinguished in economic literature. From the viewpoint of the society in general, social capital may have positive or negative side. Positive social capital usually refers to interpersonal ties/networks that are valuable both to individuals as well as the society as a whole.[54] Nevertheless, social capital may also have a negative side to the society. A typical example is street gangs and criminal organisations that utilize their relationships to conduct illegal activities such as drug or human trafficking.[55]

[51] Helliwell and Putnam (2000), pp. 253–268; and Putnam et al. (1993).

[52] Putnam (2001); Putnam (2003).

[53] Putnam (1995), p. 70.

[54] Ostrom (1990).

[55] See Gambetta (1993). Some scholars also have argued that in some cases the existing social capital may lead to social inequality and stratification; see Bourdieu (2010).

Such smaller-scale interpersonal networks are *embedded* in any social system.[56] This leads to the observation that the patters of communication at a micro-level may depend on socio-economic environment in which such networks are embedded. Fashion could be used as an example here. In one country, elite classes aim to distinguish themselves by wearing clothes from the latest collection of a famous designer. In other countries, the social elite may stick to the traditional clothes that are worn by most of the population, but seek to distinguish themselves by more sophisticated patterns or accessories. Yet, in both societies, the perception of what distinguishes from the rest is based on shared belief concerning the necessity of attributes.

Just like in the elite fashion case, trust is the pivotal element in establishing and maintaining other sorts of interpersonal relationships as well. A friend may agree to lend a small amount of money because he is sure that the borrower will repay the amount. However, in the case of repetitive refusal to repay the loan, the expectations and trust in the borrower vanishes. If the borrower places more weight upon his reputation and trustworthiness than the amount borrowed, he is very likely to try to repay the loan. However, if the borrower does not care much about the reputation, he may not consider it necessary to repay the loan.

Closeness of an interpersonal relationship is a prerequisite for the generation of social capital. The trust can be bestowed upon a borrower who repays his loans. Conversely, in the case of default, the confidence bestowed upon the borrower is not reciprocated and the relationship between the borrower and the lender cannot be considered as a closed structure. Therefore effective norms can be generated in closed structures. For instance, parents may establish certain norms about the education of their children and make sure that the education is conducted according to the agreed norms. This common education endeavour may continue as long as parents are living together with their children (family as a closed structure). However, once parents separate and stop communicating with each other, it is very likely that earlier agreed norms about the education of children cannot be maintained for long. Similarly, closure is an important precondition for the functioning of larger-scale social structures. Trustworthiness in the system generates expectations and obligations (trust) among the members of the system. Financial institutions may share data about individual customers and their performance: the failure to timely repay for the credit, may be used as a signal for other financial institutions not to issue new credit cards for that customer. Also, the example of diamonds market illustrates that effective sanctions and reputation can be generated only on closed structures.

The preservation of trust among the members of the social structure also has important efficiency-related implications. The creditor will lend money knowing that the debtor will repay his debts in order to maintain his reputation. This point is even more obvious in communities of a larger scale. In the case of family, trust among parents means that their mutually shared norms about the education of children can be enforced by either of them. Yet, if parents divorce and have

[56] See Granovetter (1985).

different views about the future of their children, they will no longer be able to rely on each other and take actions separately. The same is true for the credit-card institutions that would otherwise have to bear increased risks of non-performing cardholders if the terms for sharing data about the credit-card holders cannot be agreed upon. In other words, the existence of trust in interpersonal networks has "closing" effects which help maintain the system without recourse to any external enforcer (e.g., courts).

4 Building Actual Trust in a Transnational Setting

In the previous chapters we explained the central notions used in the social networks analysis and tried to show that the relationships between two and three actors could be identified in larger scale groups. Having identified that the existence of ties between actors is a precondition for transfer of resources, we argued that social capital in the form of trust is embedded in these interconnected ties between individuals. Further references to the studies conducted by economists and sociologists showed the distinction between trust and other neighbouring concepts as well as the observation that the closeness of social structure is critical for the generation of trust. In the following sections we aim to contribute to the academic debate by introducing a distinction between deemed and actual trust. This dichotomy of deemed/actual trust is unfolded by an example of (international) transaction as well as building of a transnational regulatory framework in the field of intellectual property.

Assume that two persons (Ac and Ba in the graph below) would like to establish a business relationship. Since the future transaction is likely to involve huge risks, each of the parties may find it inevitable to consult legal experts. Each of the parties may approach attorneys with whom they had previous contacts. In order to negotiate the details of the future deal, attorneys will have enter into negotiations on behalf of the parties. In the graph below, the relationships between each of the parties and their attorneys are represented in direct and unbroken arrows. These unbroken arrows also represent the existence of actual trust between the actors involved: the clients actually trust their attorneys; moreover, both attorneys actually trust each other. At the same time it should be noted that mutual trust said trust does not mean no or little conflict of interest between them. On the contrary, each of them can assume that his/her counter party will understand what he/she contends and duly agree with, disagree with, or make counter proposal to it; and that the counter party can also clearly express his/her contention and explain it. Assume that actual trust between these actors has been established over time by conducting previous activities. The clients may have conducted previous transactions with the assistance of the two attorneys; while the attorneys themselves might have also been engaged in transactions with other clients. It may also happen that the attorneys have been good friends since the times when they were attending the law school. In the case of commercial success, the on-going business activities between Ac and Ba may lead to the establishment of actual trust.

In our example, Ac and Ba are parties from different countries (Country A and Country B). Both of these countries have their own social and legal systems; their national laws and regulations establish an institutional structure necessary for governance, collection of taxes or maintaining public order. These national legal systems function on a premise that citizens will abide the laws of the respective countries of residence. We call this paradigm as a situation of deemed trust. In the graph below deemed trust is illustrated by dashed lines. Some relationships between individuals may be based on deemed trust; others, as in the case of an attorney and a client, may be based on actual trust. In the same vein, it is assumed that citizens bestow deemed trust on their government.

The deemed/actual trust dichotomy is apparent in a transnational setting. States are members of international community. Accordingly, the relationships between them may be non-existent, or based on deemed or actual trust. The principles of public international law such as comity or sovereignty could be viewed as a mirroring deemed trust between the nations and national governments. Moreover, governments of states could be seen as trustees of the nation they represent; i.e., it is deemed that citizens trust their governments. International treaties are thus negotiated by governments of states based on the deemed assumption that they have legitimate powers to enter into internationally binding agreements. Once an agreement is reached the operation of international treaties also rests upon the deemed assumption that member states will implement necessary regulations on the domestic law level (Fig. 3).

Following this line of reasoning, it appears that most of the regulatory systems are founded on the assumption of deemed trust. This begs the question of how deemed trust could be transformed into actual trust. Although there is no clear-cut answer to this phenomenon, international patent system offers an illuminating case study. The seeds of international patent system were sown in 1893 by the adoption of Paris Convention.[57] The major principles of national treatment and priority right entrenched in Paris Convention catalyzed the process towards the harmonization of patent law. Paris Convention was amended several times; and several more international agreements in area of patent law were adopted.[58] Besides some of the substantive law provisions, these international instruments also form the basic pillars of institutional structure that is necessary for implementing the treaty provisions. Such institutional provisions are also entrenched with the deemed trust assumption that states will comply and take appropriate measures in aligning their domestic legal frameworks to meet the newly established international regulations.

[57] See Paris Convention for the Protection of Industrial Property, as revised by the Stockholm Revision Conference, 14 July 1967, 828 UNTS 303.

[58] Patent Cooperation Treaty ("PCT"), 9 *International Law Materials* 978 (1970); Agreement on Trade-Related Aspects of Intellectual Property Rights, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C (1994) 33 *International Law Materials* 1197 as well as a number of regional instruments such as the Convention on the Grant of European Patents (European Patent Convention) of 5 October 1973 as revised by the Act revising Article 63 EPC of 17 December 1991 and the Act revising the EPC of 29 November 2000.

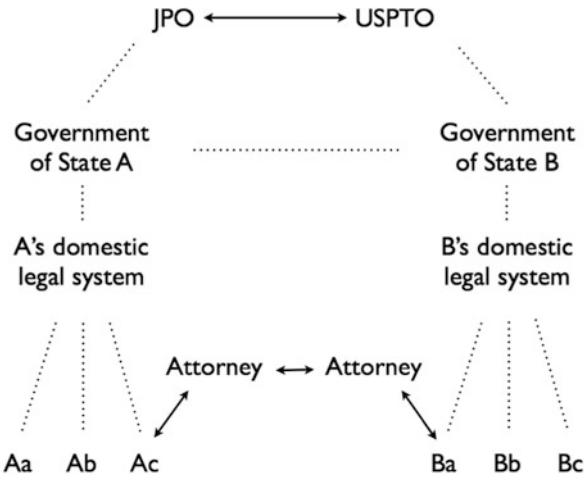

Fig. 3 Deemed/actual trust in a transnational setting

Rapid development of various fields of technology during the twentieth century had astounding effects to the functioning of the international patent system. The growth of multinational companies and implementation of global business models resulted in sky-rocketing number of patent applications worldwide. In 2010 a total number of 1,625,511 patent applications were filed worldwide using national and international (Patent Cooperation Treaty—hereinafter, *PCT*) application routes. Around 90 % of these applications were filed in the so-called IP5 bloc (US, Japan, EPC, Korea and China).[59] Such an immense number of patent applications has obviously been a hefty burden on patent administration agencies since the postwar period. The business community has been raising concerns about the lengthy examinations of patent applications and unwanted uncertainty. However, pursuit of an efficient solution was not that simple. Hiring more patent examiners did not actually solve the problem for the issue was not only the shortage of experienced patent examiners.[60] Moreover, on a global scale, substantial differences about patent examination existed (in the US patent applications were examined in secret while in Japan applications were published after 18 months).[61]

The problem of patent application backlog has been on the table for decades. First changes started to happen with the adoption of the PCT which opened the gates for global patent strategy at a significantly lower costs by establishing a set of procedural rules that allowed applicants to designate states that are members of the PCT for national applications in those states. Further significant steps in enhancing the spirit of cooperation were taken by establishing direct ties among the patent offices. In 1983, the so-called Trilateral Cooperation was set up between three major world's

[59] From 1,625,511 patent applications in 2010, only 166,456 come from blocs other than IP5; see IP5 Offices 2012.

[60] Drahos (2010), pp. 153–154.

[61] Ibid., p. 165.

patent offices (EPO, USPTO and JPO).[62] From the outset, the general objective of the Trilateral Cooperation was to reduce the duplication of work, enhance patent examination efficiency and quality and bring the patent system in line with demands of economic globalization.[63] Since then various mechanisms were developed to facilitate the sharing of information and computerization of patents. The cooperation between the three patent offices further matured in the establishment of the so-called Patent Prosecution Highways (hereinafter, PPHs) initially between the JPO and USPTO (in 2006)[64] which later embraced EPO, KIPO, SIPO and patent offices in other states.[65] PPHs allow one office to use the search and examination results conducted by the other office. Possible conceptual controversies are overcome by the principles of reciprocity and mutual recognition. The success of such cooperation is evidenced by the proliferation of the number of patent offices of great variety of states that join the PPH network.

The establishment of such transnational networks of patent administration would not have been possible without a considerable degree of actual trust between the agencies involved.[66] The international treaties in patent law area provided an initial institutional architecture based on deemed trust. Yet, the repetitive interaction over time between the major patent offices made it possible for deemed trust to grow into actual trust. This has been facilitated by horizontal coordination of behaviour as well as the alignment of mutual behavioural expectations.[67] For example, the spirit of actual trust among the offices could be best observed in capabilities of the patent examiners of the Office of Second Filing to find out prior arts and scrutinize the inventive-step of the invention to which patent is applied for by looking into the outcomes of searches and examinations conducted by their colleagues in Office of First Filing. The efficiency of search and examination proceedings is also increased by harmonizing necessary patent application requirements among the institutions that join the PPH network.

Trilateral Offices have similar, if not identical, institutional preferences, spheres of authority and expertise. More important than the international treaties in this field were memorandums of understanding and informal administrative cooperation between the patent offices. Deemed trust evolved into actual trust by way of long-term exchange programs which allowed examiners from one patent office get trained in the other patent office and thus get to know the inside patent administration practices. Besides direct interaction of the heads of leading patent offices,

[62] See ibid., p. 177 and Chap. 6 for a more detailed exposition.

[63] See 'The 30th Anniversary: A Brief History of the Trilateral Cooperation'. http://trilateral.net/index/30anniversarybrochure.pdf. Accessed 30 July 2013.

[64] See e.g. Arts. 184-3–184-20 of the Japanese Patent Act and Section 35 U.S.C. 371 which deal with applications under the PCT as well as provide for a starting legal basis for closed cooperation among the patent offices.

[65] Drahos (2010), p. 160.

[66] Ibid., pp. 172–173.

[67] For a more thorough overview of so-called trans-governmental regulatory networks see Fenwick (2013).

another significant aspect of building actual trust was training programs and seminars organized or supported by the leading world patent offices for the officials from emerging economies.[68] This sort of direct interaction between patent offices at a peer-to-peer level has played a catalyst role in overcoming sovereignty considerations and extended horizontal patent administration activities to include outsourcing of each others work in patent search and examination. Building of actual trust on a technocratic level has also benefited patent applicants a general public (tax savings).[69]

5 The Role of Intermediaries

The previous section aimed to illustrate how strengthening the relationship could lead to enhanced trust and new forms of actions. Repetitive interaction between the patent offices in examining patent applications and sharing of experience between patent examiners fosters actual trust and cooperation. Mutual trust increases expectations in the future and makes parties aware of the disadvantages of withdrawing from the social network. In this section we would like to introduce two case studies that explain how intermediaries could contribute to building trust among members of the community as well as trust in the system. The first example concerns the dissemination of information in the cloud computing environment and the need of economic incentives in order to attract intermediaries. The second example concerns the intermediaries in financial markets and illustrates how loss of trust amongst (some of) the actors may lead to the distrust in the whole system.

5.1 Case 1: Innovation, Short-Cuts, Incentives

Our first example concerns dissemination of information in a closed community of 16 actors. Such a "regular" network is based on five main assumptions:

(a) We assume that each actor is an originator as well as a user of information. This assumption is represented by bi-directional arrows;
(b) We assume that each actor can modify the acquired information;
(c) We also assume that each actor could become a transmitter of information: i.e., the acquired information could be further transmitted to other actors;
(d) We assume that all actors have four direct connections with actors that are located in the vicinity;

[68] Drahos (2010), pp. 160–161 and 174–175.
[69] Fenwick (2013).

(e) Moreover, we assume that this network is *closed*, i.e., each actor could reach any other actor in the network directly or indirectly. The fact that each actor has only four incoming and four outgoing ties means that the transmission of information could become a lengthy process (depending on the number of intermediary actors the information has to cross). Graphically this is again illustrated in a form of arrows connecting multiple actors with one another.

The second assumption that each actor is able to modify the information might have significant ramifications. Namely, since each actor has only four direct incoming/outgoing ties means that the flow of information in the network is associated to some risk. The risk is minimal when the information is shared among the actors which are directly connected because the information is not altered during the transmission process. However, the risk that the quality of information is affected depends on how many intermediaries are involved. This is so because each actor is able to modify the information. Accordingly, the main question regarding the dissemination of information is related to the reduction of the distance between the actors. One of the possible ways to reduce the distance among the actors is to create shortcuts. Hence the challenge for a lawmaker is to design a legal framework that would promote the generation of shortcuts in a person-to-person network. Moreover, such legal framework should also make sure that the quality of information is maintained as much as possible.

In the ideal world, the quality of information is maintained if each actor has a direct tie to other actors in the network. In such a constellation, the distance between all actors is one. This situation is depicted in the so-called "complete graph".[70] The complete graph is based on the following assumptions:

(a) Each actor is an originator as well as a user of information;
(b) Each actor can modify the acquired information;
(c) Each actor could become a transmitter of information;
(d) Each actor has a direct tie to all other actors in the network;
(e) The network is closed.

The advantages of having direct ties with each actor is that not only the quality of information is maintained, but also the costs of communication are reduced to minimum. However, the establishment of such a complete network might be a lengthy endeavour. In fact, such networks where all actors maintain direct ties to all other actors are very rare. Therefore, one has to look for other alternatives that could facilitate the dissemination of information among the actors in a "regular" network.

One of the possible solutions is to consider a "hub and spokes" network. Besides the assumptions which were posited with regard to a "regular" network, it is assumed that in a "hub" network there is an additional actor who has direct ties to all sixteen actors in the network and acts as an intermediary. In addition, it is also

[70] Wilson (2010).

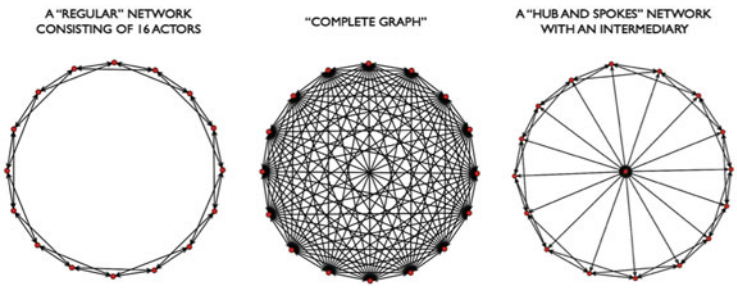

Fig. 4 Possible models of a network with 16 actors

assumed that this new actor is capable of modifying the information which it receives and transmits to other actors. Such a "hub" network could be considered as the second-best solution because it reduces the distance between sixteen actors to 2 steps. Curtailing the distance means reduction of costs of communication between the actors as well as the significantly minimizing the risk associated to the transmission of information within the network. Such a model of a "hub and spokes" network with sixteen actors and one intermediary is depicted in Fig. 4.

The introduction of an additional actor who acts as an intermediary to a "regular" network definitely contributes to the efficiency of communication: not only the costs of communication among the actors are cut, but also the average risk that would otherwise exist with regard to the quality of transmitted information is reduced. Yet, the presence of intermediary highlights the neutrality problem. This is so because the intermediary as any other actor could be distorting the quality of information. In more economic terms, creation of shortcuts by establishing an intermediary implies a necessary portion of investments. Creation of shortcuts is closely related to neutrality is related to meeting certain expectations regarding the shortcuts offered by an intermediary (so-called "capacity building"). In competitive market conditions, an intermediary's decision to enter the market in principle depends of the possibility to recoup the costs and receive benefits.

A number of possible incentives come into consideration. One possible form of incentives could be intellectual property rights.[71] Intellectual property rights could become a huge incentive for intermediaries in our example as well. Since intermediaries have to make substantial investment in order to enter the market (e.g., establishing a infrastructure connecting all actors in the network), intellectual property rights could serve as an incentive for intermediaries. This is so because intellectual property rights confer the monopoly rights and hence the ability to preclude potential competitors from entering the market (e.g., exclusive rights to distribute protected goods).

[71] According to the conventional understanding, intellectual property rights make sure that creators get compensated for their creative endeavours. In this regard, intellectual property rights facilitate creativity in the society and make sure that society can access the creative products. See Fisher (2001).

As it was stated above, economic incentives conferred to intermediaries are necessary for the establishment of a neutral and transparent communication network. It is worth noting that intellectual property rights could create additional incentives facilitating the operation of intermediaries, yet economic incentives can be found even without intellectual property rights. These investments necessary for establishing direct ties between the actors have to be born by intermediaries; accordingly, the costs for maintenance of the network are contingent on the number of actors. On the other hand, the common characteristic of successful systems with intermediaries is that the actors/users of the system incur no or very little additional costs due to the expansion of the network. For example, the users of Facebook or LinkedIn reap the benefits of increasing network; however, the costs of operating such a growing network should be born by the intermediary otherwise the users may simply leave the network.

The neutrality of the intermediary as well as the transparency of the functioning of the network is also related to the success of the network. The establishment of a technical infrastructure does not per se generate trust in the intermediary and in the system. In other words, the users of the network must be sure that the information disseminated in the network is not changed by the intermediary. The fact that users are present in the network could be considered as sign of deemed trust in the intermediary. This could be illustrated by the continuous modifications of the privacy policies by the operators of social networking sites; by doing so they wish to maintain the deemed trust of the users in the intermediaries. The loss of deemed trust in the intermediaries could lead to the "implosion of the system"[72] whereby the users of withdraw from the network.

5.2 *Case 2: Market, Intermediaries, Trust*

The second case study concerns the operation of intermediaries in financial services market. In particular we would like to investigate possible implications of the deemed/actual trust dichotomy in the financing of venture companies. A corporate life cycle of a firm could be roughly divided in to several stages (early, growth, initial public offering, expansion, exit); each of these stages is associated to specific economic activities of the firm and necessary capital. Moreover, regulation requirements vary according to the corporate form as well as on which stage of the corporate life cycle the firm is. One of the crucial points at the growth stage is initial public offering (hereinafter, *IPO*) during which a closed company becomes public. In this section we focus on a rather specific case of Alternative Investment Market (hereinafter, *AIM*) which helps illustrate the role of trust in operation of financial markets.

[72] We would like to thank Mark Fenwick who suggested this notion.

The global financial crisis has been one of the widely discussed problems in recent years. It brought about the collapse of large financial institutions, downturns in stock markets and prolonged unemployment. Economies worldwide slowed for several years since 2007 and governments of many states had to bailout banks and implement other sorts of austerity and stimulus measures.[73] Financial turmoil and market crashes usually lead to more regulation and more stringent rules that aim to increase transparency in the market, facilitate disclosure and investor protection. National regulators try to discern the cases of market flaws and adopt ex post regulatory measures. Such emergencies in the market offer a possibility for policy-makers not only to fix problems but also to engage in global regulatory competition in order to revitalize national economies.

One of the remarkable instances of the global regulatory competition was the opening of the AIM in London. AIM was developed by the London Stock Exchange in order to create a platform for cash-hungry small and mid-cap firms. A handful of factors contributed to the creation of the AIM. During the last decade of the twentieth century, the US suffered from several great corporate governance and accounting scandals involving major corporations such as WorldCom and Enron. In 2002 a new Sarbanes-Oxley Act was adopted in the US. This piece of legislation added additional layer of regulatory stringency which further increased costs associated with equity capital financing. In fact, the effects of the Sarbanes-Oxley Act were that firms had to spend more for professional consultancy services as well as face extra direct and indirect costs in order to meet transparency requirements, maintain incentive structures for managers etc. This mostly affected small-cap companies that were forced to operate below profit margins and seek for more cost-efficient alternatives of fund raising or even delist.[74]

At the same time London happened to be one of the leading financial services centers with sophisticated corporate governance and efficient regulator.[75] Having identified existing liquidity constrains in venture financing cycle, London Stock Exchange (hereinafter, *LSE*) opened a lightly regulated AIM. Strict regulation imposed by Section 404 of the Sarbanes-Oxley Act was criticized on the ground that "what investors really care about is the future and that's not in the financial statement".[76] AIM tries to solve this issue by the principles-based approach for publicly held companies. Lower regulatory thresholds at AIM significantly curtail the listing costs. This could be illustrated by the financial data. In 2006 the total market capitalization of AIM was about 75 billion Pounds with more than 300 companies out of 1,600 listed in Aim were.[77] For a comparison, the average market capitalisation of NASDAQ companies is 1.1 billion US Dollars, the average on AIM is 65 million US Dollars; the annual costs of listing on NASDAQ are about 2.3

[73] Stiglitz (2010).

[74] Mendoza (2009), pp. 286–287.

[75] Ibid.

[76] Grant (2007).

[77] Kelleher (2007).

million US Dollars including auditing and compliance fees while the costs for listing on AIM are about 900,000 US Dollars.[78] This reduction of regulatory compliance requirements led to the speedy growth of the AIM in which the number of IPOs as higher than NYSE or NASDAQ.

Flexibility and self-regulation are the pivotal principles based on which the AIM is operating. Differently from LSE or NYSE, companies listed in AIM do not have to abide myriads of mandatory rules. However, in practice most of the companies listed in AIM voluntarily comply with the corporate governance and disclosure regulations. This could be could be explained by two reasons. First, the flexibility of regulation of AIM lies in the "comply-or-explain" approach. Second, companies must have "nominated advisors" (so-called "nomads"). Nomads are usually investment banks and function as gatekeepers, advisors as well as regulators and guide companies during and after the IPO.

Since the establishment of AIM in 1995, nomads have been instrumental in preventing market abuse and disclosing bad news.[79] Nomads have to operate diligently and be wary of any misconduct by the company which they are in charge. It is actually nomads who put quite a bit of pressure upon the companies to perform due diligence, disclose relevant information and meet higher standards than are actually required. Besides financial benefits for their services, reputation and trust in nomads plays a weighty role in incentivizing nomads to perform as well as keeping the AIM functioning. AIM could be visualized as a closed system consisting of nomads, admitted companies and potential investors. Nomads have direct ties with their client companies, and also act as intermediaries in creating ties between potential equity investors and growing companies. Moreover, close ties exist also among nomads themselves. There is a huge amount of social capital in these ties among the participants in the AIM system.

The graph below illustrates bonding and bridging among the actors operating in the AIM. Green colour nodes represent start-up companies, blue—nomads, and red—potential investors. The arrows depict the existing ties between different actors in the AIM network as well as social capital generated among the participants of the system (Fig. 5).

As it was noted above, the LSE also relies on nomads as gatekeepers to police new entrants to the alternative investment market in keeping up to the requirements on financial reporting, disclosure and corporate governance. However, some things may go wrong and this is exactly what happened with AIM. In 2005 The Serious Fraud Office started an investigation because of a missing 350 million Pounds in one of the companies floating on AIM.[80] As other corporate scandals, this incident also facilitated some regulatory adjustments in 2007: new rules for companies[81] as

[78] Nuttall (2006).

[79] Blackwell (2009).

[80] Bowers (2005).

[81] http://londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aim-rules-for-companies-2007.pdf. Accessed 30 July 2013.

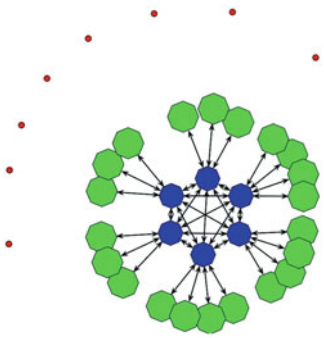

Fig. 5 A sociograph of the structure of alternative investment market

well as Nomads laying down eligibility criteria for Nomads and their core responsibilities were adopted.[82] However, it seems that the overall trust both in the system as in nomads has been fading. The number of nomads was around 80 in 2008 but had shrunk to little more than 50 in 2013.

6 Concluding Considerations

This chapter builds upon on the social reality and the notion of trust which underlies most, if not every, human interaction. Law is a tool of social intervention. Yet, it appears that legal norms tend to focus on ex post situations concerning conflicting rights or claims; legal regulation seems to turn a blind eye on bonding and bridging the interests of various individuals.[83] Therefore, the notion of trust helps explain the individual decision making in situations involving dangers and risk. We borrowed the babysitter example to show that the importance of actual trust in situations where a possible harm resulting from the breach of trust is greater than the possible benefits. Although trust does not eliminate existing risks, it nevertheless facilitates new forms of action. This chapter also proposes the idea that trust should be deemed as a form of social capital which is embedded in the ties and relationships between different actors.

This chapter also introduces a distinction between actual and deemed trust. Since actual trust exists only in relatively smaller scale social environments, the main question is related to the building of actual trust. We used an example involving several parties acting through intermediaries to illustrate the argument that building deemed and actual trust is a lengthy process which requires repetitive interaction between individuals in similar kinds of transactions. This argument was further

[82] londonstockexchange.com/companies-and-advisors/aim/publications/aim-rules-for-nominated-advisers.pdf. Accessed 30 July 2013.

[83] Luhmann (1979), p. 43 who similarly wonders how it is possible to make the processes of trust generation the object of norms.

elaborated by showing the interface of major patent offices that led to the gradual development of a system of cooperation and coordination. Such close ties would not have been possible without a considerable degree of actual trust on a person-to-person level. The experience of patent offices proves that consensus building is contingent on the ability to cooperate and that trust is not only an individual but also a community resource.

Social network analysis proved to be instrumental in developing further considerations about the building of actual trust and facilitating efficient modes of communication. By drawing a sociograph of 16 actors we identified that communication between remote actors could be promoted by connecting them directly or establishing an intermediary who has direct symmetric ties with other actors in the system. This example was also used to emphasize that building trust on a micro-level between one actor and intermediary facilitates confidence in the system and thus build new shortcuts between remote members of the network. Furthermore, we argue that the legal system must provide for an open and dynamic framework which facilitates the creation of new ties. This could be achieved by providing incentives for intermediaries. Trustworthiness contains two elements: (a) the intermediary must act in the interests of the users of the network, and (b) the intermediary must be neutral and transparent.[84] To put it differently, a neutral and transparent intermediary could function as a symbol of trust connecting familiar with unfamiliar and reducing the surrounding uncertainty.

As any other form of capital, the maintenance of trust needs constant adjustment and mending. Without continuous upgrading, trust-based relations evaporate over time. The contraction of trust on a person-to-person scale brings the feeling of alienation which in turn may curb willingness to interact or socialise. On a macro scale, the withdrawal of trust may lead to the collapse of the system. Such a precarious nature of trust was illustrated by the experience of AIM. Accordingly, building trust is a risky endeavour. Trust involves cognitive expectations and is something that has to be learned. Multiple steps are necessary to build strong ties and deepening personal acquaintanceships. A process of testing is associated with risks which may either lead to disappointment or actual trust. We conclude by noting that the idea of trust together with the social network analysis offer many insights and could lead to thought-provoking debates in various areas of social studies and should therefore deserve more attention in the future.

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[84] Cf. Sztompka (2001), pp. 15922–15923.

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Ethical Trade Networks as a Catalyst for Corporate Compliance with Human Rights

Kirsteen Shields

Contents

1 Introduction

The difficulties of attaching responsibility for human rights and environmental obligations to corporations have been well-documented. This chapter contrasts international institutional efforts at attaching social norms to corporations with voluntary regulatory efforts to the same end. The chapter asks why voluntary regulatory efforts channeled by social movements have been able to achieve compliance in areas typically beyond the reach of traditional international law. In exploring this question, insights from network theory are drawn upon. In so doing, the chapter explores what the development of transnational voluntary regulation reveals about the democratic nature of traditional methods of international law.

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2 Institutional Efforts at Attaching Human Rights Obligations to Corporations

Due to the apparent powerlessness of the state to regulate corporations in respect of human rights obligations, the Global Governance mandate saw international institutions adopt the role of states in telling corporations how to behave. In the 1970s, under the first wave of the New International Economic Order, the United Nations (hereinafter, *UN*),[1] the Organisation of Economic Cooperation and Development (hereinafter, *OECD*)[2] and the International Labour Organisation (hereinafter, *ILO*)[3] each attempted to respond to this imbalance by establishing their own principles on the conduct of Multinational Corporations (hereinafter, *MNC*) in relation to human rights. However the inability of these mechanisms to establish effective regulation of multinational corporations led to their redundancy and a general perception of these mechanisms as 'weak' instruments of international law.[4] In the 1990s, many of the original codes of conducts were revised. The ILO and OECD codes share similarities in that they are voluntary, envisage the primacy of national law and are addressed to both MNCs and national enterprises.[5]

The UN's attempts to regulate corporations directly throughout this period include; the creation of the Commission on Transnational Corporations in 1973[6]; Kofi Annan's Global Compact initiative in 1999[7]; and the subsequent drafting of the UN norms on the human rights obligations of MNCs and other business entities

[1] The UN constituted a Commission on Transnational Corporations [E.S.C. RES. 1913, U.N. ESCOR, 57TH Sess., Supp. No. 21, U.N. Doc. E/5570/ADD. 1 (1975)] but failed to establish draft norms on the code of Transnational Corporations due to disagreements between industrialized and developing countries. See generally Muchlinski (2007).

[2] OECD, 21 June 1976 adopted the Guidelines for Multinational Enterprises.

[3] ILO, November 1977 (revised November 2000), Tripartite Declaration of Principles concerning MNEs and Social Policy. The aim of the Tripartite Declaration of Principles, then, is to 'encourage the positive contribution which multinational enterprises can make to economic and social progress and to minimize and resolve the difficulties to which their various operations may give rise, taking into account the UN resolutions advocating the Establishment of a New International Economic Order' (para 2). Apart from specific references to fundamental worker's rights as guaranteed under conventions and recommendations adopted within the ILO—including the ILO Declaration on Fundamental Principles and Rights at Work, adopted in June1998 by the International Labour—Conference—such as references to the principles of freedom of association and the right to collective bargaining, the prohibition of arbitrary dismissals or the protection of health and safety at work, the Tripartite Declaration contains a general provision relating to the obligations to respect human rights—Para 8 on General Policies.

[4] See generally De Schutter (2006), pp. 1–41.

[5] Ibid., pp. 474–476.

[6] UN Doc. E.S.C. RES. 1913, U.N. ESCOR, 57TH Sess., Supp. No. 21, U.N. Doc. E/5570/ADD. 1 (1975).

[7] Creation of the UN Global Compact, the UN Sub-Commission for the Promotion and Protection of Human Rights approved in Resolution 2003/16 of 14 August 2003.

in 2003.[8] Both the Global Compact and the UN Norms demand that MNCs are not complicit[9] in human rights abuses but do not impose any legally binding obligations on corporations. Following Ruggie's admission that the UN Norms on the Responsibilities of TNCs and Other Business Entities with regard to Human Rights 2003 did not create any binding obligations for corporations, questions were raised as to autonomy and meaning of this norm-drafting activity.[10] Yet these efforts continued and gathered momentum as Ruggie's "Protect, Respect, and Remedy" Framework.[11]

Most recently, the UN's position on MNCs has evolved to support evolving quasi-legal human rights obligations for corporations in the shape of the 'Guiding Principles on Business and Human Rights'.[12] In 2011, the United Nations Human Rights Council endorsed the "Protect, Respect and Remedy" Framework submitted by John Ruggie as Special Representative of the Secretary General of the United Nations. According to Ruggie's framework, states remain the principle duty-bearer for human rights but corporations bear a '*responsibility to respect*' human rights. This marked the first time the United Nations Human Rights Council or its predecessor, the United Nations Commission on Human Rights, had endorsed such an instrument. Yet the endorsement does not lead to the generation of binding legal obligations, instead it established the norms as a '*global reference point*'.[13]

The final product was met with mixed reactions; human rights NGOs have been particularly critical over weaknesses within the Guidelines as the right to an effective remedy and the need for States' measures to prevent abuses committed by their companies overseas.[14] Human Rights Watch has lamented the Guidelines as a lost opportunity on the basis that the Guidelines essentially maintain the status quo.[15] It would seem that whilst pioneering standards the UN acquiesced on its inability to 'enforce'. A lack of enforcement mechanisms remains the greatest obstacle for social areas of public international law such as human rights and environmental law. Within international human rights law, monitoring and 'state-reporting' are the typical enforcement mechanisms for these frameworks and are often inadequate ones at that. The self-regulation encouraged by the UN Guidelines may have shifted the administration of monitoring but it has not solved the problem of enforcement.[16]

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[8] UN 'Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights' adopted 30 May 2003, Un Doc. E/CN.4/Sub.2/2003/12/Rev.1.

[9] See International Commission of Jurists (2008).

[10] Human Rights Council (2007).

[11] Ruggie (2008).

[12] Ruggie (2011). The sub-group refers to MNEs as TNCs for an account of the terminological influences of the terms see the introduction to Muchlinski (2007).

[13] UNOG News Report (2011).

[14] See for example International Federation for Human Rights Press Release (2011).

[15] Human Rights Watch Press Release (2011).

[16] Although some might argue that it bolsters competence to regulate corporations through municipal courts. See Muchlinski (2012), pp. 145–177.

The main contention with the UN Guiding Principles is that they comply with the notion of primacy of the state. Yet, this is not a realistic representation of the power relations between states and corporations. State power has been hollowed out by corporate power and states often do not have the strength to refuse the will of corporate interests. Not only do the Guiding Principles rely on an out-dated faith in state sovereignty but they also negate any progress towards the evolution of third generation extraterritorial human rights responsibilities. The UN Guiding Principles explicitly entrench the status quo of human rights obligations as exclusively State-held duties to protect against human rights abuses by non-State actors, including by business, affecting persons within their territory or jurisdiction. Another weakness of the principles is that they do not fully stipulate what is inferred by human rights and instead select certain international instruments as representing the '*core internationally recognised human rights*.'[17] The coming years will reveal the import of the responsibility to respect, a lot will depend on the extent to which domestic courts decide to engage in the '*responsibility to respect*' discourse.[18]

3 Understanding Compliance and Non-Compliance with Soft Norms

There has been much criticism of institutional efforts at corporate regulation,[19] yet little analysis of *why* exactly these efforts failed to impact. In order to begin to unpack that, it is necessary to assess the nature of soft law. Soft law is a relatively recent feature of international law and not exactly a flawless one. What soft law consists of is open to debate, as is, vice versa, what constitutes soft law. A useful point of definition is to consider that even treaty law can be considered soft law if there is no means to enforce its implementation, for example human rights and environmental norms may be considered within this category.[20] Guzman and Meyer identify language included in the Universal Declaration of Human Rights, the Helsinki Final Act, the Basel Accord on Capital Adequacy, decisions of the UN

[17] The instruments listed are 'the International Bill of Human Rights (consisting of the Universal Declaration of Human Rights and the main instruments through which it has been codified: the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural rights), coupled with the principles concerning fundamental rights in the eight ILO core conventions, as set out in the Declaration on Fundamental Principles and Rights at Work.' Ruggie (2011), Commentary to Principle 12.

[18] Indeed they may have already begun to do so through litigation under the US Alien Torts Claim Act and some developments in common law jurisdictions. See Muchlinski (2009), pp. 148–170.

[19] See for example Kinley et al. (2007), p. 25; Human Rights Watch Press Release (2011). See also Jerbi (2009), pp. 299–320; Jerbi (2011).

[20] Boyle (1999), pp. 901–913.

Human Rights Committee, and rulings of the International Court of Justice (hereinafter, *ICJ*) as examples of soft law.[21]

Soft law is generally considered to apply to states but in lieu of attaching international law personality to corporations, soft law has become a dominant feature of the grey world of 'transnational law'.[22] Although soft law bears little binding legal consequences, this regulation may nonetheless impact global normative behaviour. This flexibility, which encourages the participation of all interested parties, is the key advantage of soft law regulation. Soft law recognises the role of non-state actors in a way that is rarely found in traditional law-making processes. What's more, soft law compliance mechanisms provide a substitute for legally binding obligations for transnational corporations.

Soft law is often proposed as a substitution where legally binding obligations are not available or unimaginable. Yet as Christine Chinkin has pointed out, this grey area of law is in fact a rather poor substitute for hard law.[23] Nonetheless, as Chinkin also acknowledges,[24] the process of negotiating and drafting soft law may foster compliance and international stability through regulatory norms. This is substantiated by Schaffer in his study on the influence of public–private partnerships on WTO litigation. There Schaffer found that the growing interaction between private enterprises, their lawyers, and US and European public officials in the bringing of most trade claims reflects a trend from predominantly inter-governmental decision-making towards multi-level private litigation strategies involving direct public–private exchange at the national and international levels.[25] The problem which Chinkin alludes to is that when law lacks the rule of law, as is the case with soft law, it is open to capture.

Research by Oxfam describes the capture of law that occurs when transnational corporations use powerful states to promote their interests and 'enforce their claims for stringent protection of intellectual property and to prise open key markets'. In particular they note that '[t]he European Union and the US have used the WTO to

[21] Guzman and Meyer (2010), p. 171.

[22] Jessup, Philip C., is generally accredited with introducing the concept of transnational law in 1956. See Jessup (1956), p. 2, wherein Jessup introduces the term transnational law on the grounds that international law is 'misleading since it suggests that one is concerned only with the relations of one nation (or state) to other nations (or states). [. . .] [I]nstead of "international law," the term "transnational law" [is used,] to include all law which regulates actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories.' The term has subsequently been developed. See for example Friedmann et al. (1972); Tietje et al. (2006); Zumbansen (2006); Zumbansen proposes the concept of "transnational legal pluralism" central to which is "a shift in perspective, which leads to a focus on *actors*, *norms* and *processes* as the building blocks of a methodology of transnational law." Zumbansen (2012b), p. 6.

[23] Chinkin (1989), p. 850.

[24] Id.

[25] Shaffer (2003). Shaffer focuses mainly on how private firms collaborate with relevant government institutions in the US and the EU to challenge various trade barriers before the WTO dispute settlement system.

extend the investment rights of transnational companies.' Concluding that '[t]he great corporations of the early twenty-first century are every bit as effective in projecting their commercial interests through powerful governments as the East India Company was in the nineteenth century'. What results are agreements which have been reached through undemocratic processes and bearing unfair consequences. More democratic processes involve broader public consultation about proposed agreements and more prior assessment of the likely impacts of new rules. Such processes represent current practice of the UN specialised human rights bodies, in particular the Committee on the Rights of the Child.

Mosoti advocates that similar processes should apply to economic agreements: 'Some might complain that this might slow down the speed of trade negotiations, but it would increase the robustness, the fairness, and the legitimacy of any new agreements entered into'.[26] According to Mosoti economic and social institutions diverge through at least three processes, and this may impact the likelihood of compliance with the final norms. The first of these is '*mutual observation in the decision-making organs*'.[27] It is noted that civil society does not generally have observer status in economic forums but do in social forums. Secondly, formal agreements requesting cooperation between bodies,[28] which require that the relevant organisations submit recommendations and feedback reports on the implementation of norms. The third process, which Mosoti identifies, is 'Memoranda of Understanding (hereinafter, *MoU*)'[29] which may take various forms but foster inter-institutional collaboration and engender cooperation.

Another approach to understanding the drivers behind normative compliance is that taken by Gavin Anderson. According to Anderson, the non-contractual nature of the Universal Declaration of Human Rights 1948 (hereinafter, *UDHR*) becomes quasi-contractual when both citizens and states place legitimate expectations on states to uphold its standards.[30] Consequently State compliance with the UDHR is driven primarily by reputation and recognition.[31] A similar process may occur in relation to a consumer's expectation of a corporation's behaviour. Paddy Ireland has described this as a corporation's 'implicit social contract'.[32] A survey by Lewis

[26] Dommen (2005), p. 201.

[27] Mosoti (2005), p. 171.

[28] Agreement between the UN and the ILO Art IV, 115 UN Treaty Series 194 (1948).

[29] Mosoti (2005), p. 172.

[30] See Anderson (2006).

[31] As Shelton points out that '[f]urther, compliance may result not from the possibility of sanctions but from recognition of the need to ensure sustainability of the common good. Public goods theory may be more appropriate, in fact to the subjects of environment and human rights than game theory, which may apply to arms control and trade.' Shelton (2000), p. 14. See also Brown Weiss and Jacobson (1998).

[32] See Ireland (2003a). See also Ireland (2003b), pp. 453–509; Armour et al. (2009), p. 57.

in 2002 found that 80 % of people thought '*large companies have a moral responsibility to society*'.[33] The existence of an implicit social contract gives grounds for a moral obligation but the legal one is still missing. In 2004, Christian Aid made a convincing case that despite corporate claims, voluntary regimes have failed to stop major human rights violations in several countries.[34]

4 Voluntary Regulatory Initiatives

Human rights awareness and civil society pressures are often cited as the driving force behind MNC's voluntary corporate social responsibility (hereinafter, *CSR*) codes of conduct. Whilst human rights language is generally used in CSR documents there is often little clarity on the conditions of implementation and the voluntary basis of these commitments has led to strong criticism and dissatisfaction at the absence of a robust regulation within international law.[35] Organisations such as the Max Havelaar Foundation and Café Direct re-embodied and reintroduced the cooperative development principles which predate capitalism and have developed on the basis of equitable trade. On the back of a growing 'ethical demand', initiatives such as Fairtrade and Kimberley Diamonds took the initiative in generating 'binding' obligations for their members. Distributive justice social movements hold the potential to restructure international relations by aligning themselves with the demands of the under-represented,—most commonly, developing states and the poor in general.

Like corporations, from the outset it would appear that social movements may generate normative impact in both tangible and intangible ways, i.e. through generating a change in the letter of the law (generating rules) or by influencing social norms (embodying principles).[36] This impact bears considerable significance in areas which appear to be beyond the reach of law or at least regulation, such as the fields of human rights and the environment. Given that, within these fields, the

[33] Lewis (2003).

[34] Christian Aid (2004). Christian Aid is not alone in this criticism. See Addo (1999); Sullivan (2003); Sullivan (2008); Henderson (2001); International Council on Human Rights Policy (2002).

[35] See for example International Council on Human Rights Report Policy (2002), p. 8: 'By definition, voluntary initiatives apply only to those who accept them. A company might accept a code of conduct because of genuine commitment to the principles or because its reputation is at stake. Even where there is genuine commitment, voluntary codes may not be respected if their principles clash with other, more powerful commercial interests. People sometimes argue that, if it makes good commercial sense to respect human rights, then market forces will ensure compliance. It is not self-evident however, that human rights norms are always "good for business". Many companies have prospered under authoritarian regimes. In any case, the issues are often too complex for markets to understand and respond to. It would be difficult, for example, to insert into market mechanisms incentives and disincentives which would give competitive advantage to those companies that behave ethically.'

[36] For examples see Cohen and Rai (2000).

issue of enforcement remains a major obstacle, social movements can play an essential role in generating compliance with human rights and environmental norms.

To this end, it is useful to examine the extent to which the ethical trade initiatives have fostered compliance through soft law built through public/private partnerships. The Kimberley Process,[37] Rainforest Alliance,[38] and Fairtrade Labelling Organisation[39] serve as examples whereby public/private drafting processes were followed by a certification system. This independent certification system then acts as an additional enforcement mechanisms to the point that the norms could be considered contractual.[40] The following section will focus on the Fairtrade movement.

5 The Fairtrade Labelling Movement

Earlier research recognised that Fairtrade may offer a more effective means of monitoring than human rights bodies monitoring mechanisms.[41] It was found that this may in part be due to the additional features of the incentive of certification and through 'peer monitoring' whereby farms are willing to report on certified farms in the same region if they suspect non-compliance in order to maintain the integrity of the label. It is thought that peer monitoring may contribute to Fairtrade's high attainment of labour standards and is an important factor in understanding Fairtrade's attainment of compliance with labour standards. Yet, gaps in the governance of certification, for example through the rarity of application of penalties, would suggest that compliance cannot be due to enhanced monitoring alone. Looking beyond monitoring and enforcement to consider structural arrangements surrounding the norms may contribute to better understanding of why compliance with labour standards occurs on Fairtrade farms.

There are several aspects of Fairtrade governance that might be amenable to better scale and scope economies which may have a direct bearing on labour conditions. The argument is frequently made that through the Fairtrade Labelling initiative farmers have access to scale and scope economies at the cooperative level which are not available at the individual small-holder farmer level.[42] In particular,

[37] The Kimberley Process Certification Scheme. http://www.kimberleyprocess.com. Accessed 30 July 2013.

[38] The Rainforest Alliance Certification Scheme. http://www.rainforest-alliance.org/. Accessed 30 July 2013.

[39] The Fairtrade Labelling Organisation International. http://www.fairtrade.net/. Accessed 30 July 2013.

[40] Jones and Hartlieb (2009), pp. 583–600; Castaldo et al. (2009), pp. 1–15.

[41] See Shields (2011, 2012).

[42] Prevezer (2012).

risk management and investment are easier to achieve through a cooperative structure. Martha Prevezer identifies at least four ways in which a cooperatitve governance structure may influence conditions on Fairtrade farms as; ownership and control; agency issues; value chain management; and capacity building.[43] This study focuses only on ownership and control.

One of the most fundamental structural factors surrounding corporate norm setting is the distance between the owners and the workers within any enterprise. The evolution towards redistribution of ownership within the corporation finds a halfway house in social enterprises. Although definitions vary, Maria Granado defines social enterprises as occupying a unique space within the economy where, as businesses, they are driven by the need to be financially sustainable but, compared with a normal, for-profit organisation, they use economic surpluses to drive social and environmental growth. Additionally, SEs are distinguishable from other non-profit or charity organisations because they trade in the competitive marketplace.[44] Recognition of the social and environmental value of social enterprises is reflected in the United Nations General Assembly Resolution declaring the year 2012 as the International Year or Cooperatives 2012.[45] The endorsement of cooperatives as a mechanism for development highlights the value of networks in this context.

By operating through a network of social enterprises with smaller hierarchies, Fairtrade can be seen to be deconstructing the corporation from within. Fairtrade has successfully fostered and linked several social enterprises together under the umbrella of Fairtrade certification. Collective decision–making processes replicating ownership in Fairtrade and collective ownership in forestry movements demonstrate the value of co-ownership as a mechanism for human rights in areas where the state, for whatever reason, does not provide. The successes of these movements in delivering labour standards whilst investing in communities serve to highlight the limits of the traditional human rights framework, constrained as it is by the state as enforcer. Although Fairtrade operates two-models of direct trade, one for cooperatives (producers) and the other for organisations of farm workers (hired labourers) both groups may benefit from the scale and scope economies of access to a cooperative governance structure.

Steps in the direction of collective ownership in Fairtrade farms are found in requirements under the Fairtrade codes of conducts. For instance two fundamental components that apply to Fairtrade hired labour farms are (1) a Fairtrade minimum price designed to cover the costs of sustainable production (including ensuring fair wages and decent working conditions for farm workers) and (2) a social ‘Premium’

[43] Ibid., p. 23.

[44] Granados et al. (2011), pp. 198–218. Horst (2008), pp. 171–185; Kogut and Zander (1992), pp. 383–397; Drucker (1991), pp. 69–79.

[45] UN General Assembly Resolution [*on the report of the Third Committee* (*A/64/432*)] (11 February 2010) Cooperatives in Social Development. http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/64/136. Accessed 30 July 2013.

to be spent on development projects.[46] The 'Premium' is paid directly from the importer to a worker controlled group called the 'Joint Body', rather than to the plantation owner. The Joint Body is elected by the labourers and the labourers have a leading role in the decision-making of the Joint Body. According to the FLO, plantation management sit on the board of the Joint Body but the farm workers must have the majority of the votes. The Joint Body controls the distribution of the social premium which must be spent on 'community development'.[47]

Reports of the Kuapap Kokoo, Ghana case study show further evidence of producer ownership.[48] This regulatory structure goes beyond improvements in wage labour to offer tangible worker empowerment. Distribution of power is also integral to the element of cooperation between key economic actors. Cooperation between consumers and producers is integral in the Fairtrade supply chain. The drawbridge between the two sets of economic actors is lowered and each is able to communicate with each other, lending to greater concern for and responsibility towards the other. This is exemplified by Fairtrade's practice of inviting representative farmers to come to the UK to meet consumers as a culture and knowledge sharing activity.[49] This cooperation is also manifest when Fairtrade farmers communicate to consumers information relating to social premium spending on community projects—often on crèches and housing and IT, which is published often on product packaging and also on the Fairtrade Labeling Organisation website.[50]

Recent trends towards distribution of ownership within the forestry movement substantiate further that social movements are driving regulatory methods based on worker–ownership and consumer–producer networks. Forestry movements provide an example of where social and economic rights are secured by tenure rights rather than by human rights mechanisms such as monitoring. Over recent decades, distribution of ownership of forests has begun to diversify. Large-scale state ownership has been eroded by new methods of ownership. In their report for the Washington DC-based Rights and Resources Initiative entitled '*Who Owns the World's Forests*?: *Forest Tenure and Public Forests in Transition*',[51] Alejandro Martin and Andy White chart three new trends in forest tenure transition: Firstly, state recognition of community ownership, including territories owned by

[46] As set out in the *Generic Fairtrade Standards for Hired Labour*, Fairtrade Labelling Organisation Docs (updated May 2011).

[47] Ibid. For further discussion see Nicholls and Opal (2005).

[48] See Jones et al. (2011); Ronchi (2002), pp. 1–42; Barrientos and Smith (2007).

[49] See for example Fair Trade Foundation Press Release (2002), where we can read that "the Fairtrade Foundation is enabling farmers to meet with shoppers in UK supermarkets setting up internet links and running a competition so winners can visit coffee growers in Costa Rica."

[50] See for example Tea Growers Build School in Vietnam, 11 January 2012. http://www.fairtrade.net/967.html?&cHash=161b9e464989697b5493a6776ce47a5b&tx_ttnews[tt_news]=279. Accessed 30 July 2013. Many other examples are available at http://www.fairtrade.net/meet_the_producers.html. Accessed 30 July 2013.

[51] Martin and White (2002).

indigenous populations; Secondly, state designation of management responsibility to communities; Thirdly, reform of public forest concessions by states in order to support greater community access.

6 Implications for Democracy

The reduction of the state through alliances with corporations inevitably bears implications for democracy. In a climate of corporate unaccountability, electoral politics appears as a façade rather than offering any real means of self-governance. It could be said that democracy has undergone a metamorphosis simultaneous to the state. Once consisting of socio-economic and institutional components,[52] post-Schumpeter[53] it has become confined to the institutional, or even, simply the electoral.[54] Democratic decline has been explained as a result of 'willing capture' of the state,[55] sometimes as a result of 'Washington Consensus',[56] other times, simply a result of 'globalisation'.[57] Democratic decline is compounded by the fact that when state authorities deviate from subservience to corporate interests, companies are able to evade regulation or leave.[58] This has led not only to the 'market state' but also to the fragmentation of power away from the traditional monolithic state structures. It has also led to the blurring of the boundaries between the public and private realms, including public and private law,[59] and between the national and international.

Democracy within states pales into insignificance when power is international and multi-centric.[60] In today's globalised context, the UN's reliance on the state as the bearer of democracy strikes an awkward irony. The demise of sovereignty is widely recognised as a symptom of globalisation and with it our context for both

[52] Traditional writers such as Locke, Rousseau and Jefferson insisted that the 'essence' of democracy is to be found in complete political, social and economic equality. See Rejai (1967). This shift is detailed in my paper Dine and Shields (2008), pp. 163–186.

[53] Schumpeter (1962). Similar thinkers of the same period include Friedrich (1950); Dahl (1956); Schattschneider (1960); Lipset (1963); Rejai (1967).

[54] According to Schumpeter's definition, the democratic method is that institutional arrangements for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote. Schumpeter (1962), p. 269.

[55] Dine (2005).

[56] Chomsky (1999). See also George (2011). See also generally Klein (2007).

[57] Ochoa (2007).

[58] Just one example is the extensive use of offshore tax havens. See Alldridge and Mumford (2005), p. 253.

[59] Teubner argues that private law has become simply 'juridification of economic action' in Teubner (2007).

[60] Scholte (2004).

governance and democracy has changed.[61] As the growth of ethical trade initiatives would suggest, there is a need to re-envisage democracy as between individuals and centres of power. In the early twenty-first century those centres of power are more likely to be found within corporations and public/private partnerships than within states or state-centric institutions.[62]

At the international level, regional and international economic agreements have weakened state power[63] to the extent that even should states be capable of 'democracy' at the domestic level, 'democracy' within international forums is obstructed. Competition for foreign direct investment leads states agreeing to international economic agreements that may demand those states to strip down their regulatory environment. Therefore any policy and law-making undertaken via democratically elected governments may be trumped in the name of trade. What is more, these agreements often include provisions which impose higher costs on one party than on another for breaking the relationship. The most vulnerable parties in trade negotiations are usually those with a heavy concentration of exports in a few countries.[64] The emergence of avenues of global democracy becomes a necessary expression of civil society unrest as a result. Modern democracy needs to be global in nature and that requires mediation between civil society and corporations.

The Fairtrade movement and other ethical trade initiatives have offered some structure to these democratic processes by generating trust networks between consumers and producers and enabling mediation between individuals and corporations. These networks are built upon a series of labour movements which embodied democracy.[65] Yet the risk that some of this raw democratic quality is lost in the professionalization of these networks as many slip the net in the transition, is a real one that must be addressed although space does not permit that here.[66]

7 Conclusion

Fluid interpretation of democracy such as that advocated by Tilly portrays societies as always in a state of dynamic movement with constant pressures towards democratisation and de-democratisation.[67] Arguably this process must occur between peoples and powers—whether that power be wrested in states,

[61] On the demise of sovereignty, see generally: Brown (2002); Keene (2002); James (1999); Cox et al. (2001); Jacobsen et al. (2008); Lyons and Mastanduno (1995); Philpott (2001).

[62] In 2001 it was claimed that corporations constituted 51 of the world's top 100 powers, Anderson and Cavanagh (2000). Although subsequently contested on the basis that corporate economies cannot be subtracted from states economies (see for example Martin (2002)).

[63] Bernard (2002); Joerges (2007).

[64] See Beitz (1999), p. 148.

[65] Kaufmann, for example, grounds her support for centralised labour standards (as opposed to standards varying between states) on the basis of democracy, see Kaufman (2007).

[66] See for example Haight (2011).

[67] Tilly (2007). But see Elkins (2000), pp. 293–300.

corporations, institutions or elsewhere. Conversely, by virtue of its state-centric foundation, the UN human rights framework offers little in the way of mediation between individuals and corporations. Ethical trade networks may offer mechanisms of mediation between civil society and corporations that may foster regulatory compliance in this area but they also suffer from their own democratic deficits. Global democracy requires a bridge between civil society and corporations. Ethical trade network may offer a rope-bridge between the two, it may be a toll bridge and one that is full of holes, but a bridge nonetheless. Ultimately however global democracy will always be a Shangri-La in a world tethered to the endless pursuit of corporate growth.

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Part III
Networked Governance: From Democratic Deficit to Substantive Legitimacy

The Dilemma of European Consumer Representation in Deliberative Networks: The Democratic Deficit in the Context of the Drafting of the Common European Sales Law

Stefan Wrbka

Contents

1 Introduction

When writing about the European Union (hereinafter, *EU*) and its Internal Market one might be tempted to focus on businesses acting beyond borders. While it is true that the EU aims at (also) serving economic interests, the number of consumers

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potentially affected by the supranational European lawmaking, however, outweighs the number of businesses by far: more than 500 million people, potential consumers, live in the EU,[1] and many more shop in the EU when visiting as tourists or consummating goods or services from abroad.

In times of rapid internationalization and globalization, the supranational character of the EU is supplemented by a more vivid term: 'transnational networking'. When it comes to lawmaking, transnational networks are of increasing importance due to the expertise of the network members and their diverse geographic backgrounds. In addition, in many cases network members represent interests of groups potentially affected by new legislation and by the means of lobbying can thus further 'democratize' the drafting process of legal texts.

Transnational networks also play an important role in the field of consumer law, as European policy-making has shifted towards a broader regulation of consumer related issues over the last few decades.[2] The European Commission (hereinafter, *Commission*) also began to make its policy-making more 'transparent' and 'interactive' by installing networks composed of external experts and interest representatives. One of the most recent examples of consumer interest representation in transnational networks is closely linked to the drafting of the Proposal for a Regulation on a Common European Sales Law[3] (hereinafter, *Proposal*).

The aim of this chapter is to briefly analyze the role of consumer interest representation in this drafting process, putting the focus on the role of the European Consumers' Organisation, Bureau Européen des Unions de Consommateurs or European Consumers' Organisation (hereinafter, *BEUC*). The chapter will start by taking a look at the perceived 'democratic deficit' in the EU in general, the role of interest groups and their lobbying activities, before analyzing these issues in the context of European consumer law. The chapter will continue with a brief introduction of the Proposal. It concludes with an analysis of the role consumer representation and transnational networks played in the drafting process of the Common European Sales Law (hereinafter, *CESL*).

[1] For the exact data see e.g. http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tps00001. Accessed 30 July 2013. Note that the data refers to the total population as of 1 January 2013. Croatia joined the EU on 1 July 2013. In the table one can find both, the population excluding Croatia ['EU (27 countries)'] and including Croatia ['European Union (28 countries)'].

[2] For a brief summary of the development of EU consumer policy see Wrbka (2011), pp. 89–90. For more details see e.g. Micklitz et al. (2009), pp. 1–60; Weatherill (2005), pp. 1–33 or Weatherill (2011), pp. 837–876.

[3] Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, 11 October 2011, COM(2011) 635 final. For an analysis of the Proposal itself see e.g. Wrbka (2011) or Wrbka (2012), pp. 3–21.

2 The General Democratic Deficit Debate

2.1 The EU and Democratization

How democratic is the decision-making process of the EU? This question is interconnected with the composition of the EU institutions and the supranational character of the legal acts created by the European legislature. In order to visualise this, it is helpful to take a brief look at the legal framework of the EU. Article 1 TEU[4] starts with '[b]y this Treaty, the HIGH CONTRACTING PARTIES establish among themselves a EUROPEAN UNION ... on which the Member States confer competences to attain objectives they have in common'. In other words: the EU was founded and is composed by its Member States, directly representing them and not their citizens.[5]

Still, this does not mean that the EU is detached from the people living therein. Articles 10 and 11 TEU are the two central provisions to deal with democracy in its literal meaning, i.e. with the rule of the people. Article 10 (1) TEU reads: '[t]he functioning of the Union shall be founded on representative democracy', and Article 10 (2) TEU continues by stating that '[c]itizens are directly represented at Union level in the European Parliament. Member States are represented in the European Council by their Heads of State or Government and in the Council by their governments, themselves democratically accountable either to their national Parliaments, or to their citizens.' The literature refers to this statement of democratic legitimacy as dual democratic legitimacy, meaning that the citizens' interests are to be represented in the European Parliament (hereinafter, *Parliament*) via directly elected political parties, whereas the Member States as founders of the EU are represented by the European Council and the Council of the European Union (hereinafter, *Council*), with an indirect democratic control through the accountability of national representatives.[6]

Article 10 (3) TEU calls for a 'right to participate in the democratic life of the Union' for its citizens, bridging over to Article 11 TEU, which introduces several basic mechanisms of enhanced citizens' involvement in the European decision-

[4] In this chapter TEU refers to the consolidated version of the Treaty on European Union, OJ 2008 No. C115.

[5] See e.g. Isak (2009), p. 167.

[6] See e.g. Lienbacher and Kröll (2012), EUV Artikel 10, recital 13; Thun-Hohenstein et al. (2008), p. 130; Lenaerts and van Nuffel (2011), pp. 743–744. Lenaerts and van Nuffel also refer to important decisions of the German Constitutional Court and the European Court of Human Rights on the question of democratic legitimacy of European policy- and lawmaking; see ibid., p. 743, referring to *judgment of 12 October 1993*, BVerfG 2 BvR 2134/92, 2159/92 ('Maastricht judgment'), *judgment of 30 June 2009*, BVerfG 2 BvE 2/08 ('Lisbon judgment') linking the democratic legitimacy to the national accountability of national representatives at EU level and the direct elections of Members of the European Parliament and *Matthews v United Kingdom* (1999), Eur.Ct. H.R. 24833/94 dealing inter alia with the issue of direct elections of Members of the European Parliament and a (thereby) strengthened democracy.

making process, adding participatory elements to the democratic regime of the EU. According to Article 11 TEU the work of the European institutions shall be 'transparent' [Article 11 (2) and (3) TEU] and involve both 'citizens and representative associations' [Article 11 (1) TEU].

The wording of Articles 10 and 11 TEU can be traced back to Articles I-46 and I-47 of the non-ratified 2004 Treaty establishing a Constitution for Europe (hereinafter, *TCE*) titled 'The principle of representative democracy' and 'The Principle of participatory democracy' respectively. Although the terms representative and participatory democracy were first explicitly used by the TCE and the TEU, the democratic principle was already mentioned in the 1992 Maastricht treaty, however, in a slightly different context: Article F (1) of the Maastricht Treaty stated that '[t]he Union shall respect the national identities of its Member States, whose systems of government are founded on the principles of democracy', and thus put the focus on the democratic legitimacy of the Member States themselves. In 1998 the Amsterdam Treaty changed the wording and linked democracy to the EU itself. The newly introduced wording read as follows: 'The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.'[7] The 2001 Nice Treaty left this wording unchanged, but yet at the same time the Nice Treaty Conference adopted the 'Declaration on the future of the Union'.[8] Paragraph 6 of said declaration identified 'the need to improve and to monitor the democratic legitimacy and transparency of the Union and its institutions, in order to bring them closer to the citizens of the Member States'. The issue of the democratic legitimacy was further addressed in the subsequent meeting of the European Council in Laeken in December 2001. The Laeken Declaration on the Future of the European Union[9] asked for '[m]ore democracy, transparency and efficiency in the European Union'[10] and, via the European Convention, finally led to the adoption of the before-mentioned TCE with its Articles I-46 and I-47.

Various attempts have been made to bring the EU and its policy-making closer to the people *in practice*. They include inter alia a Commission Communication regarding the inclusion of representative associations into the 'social dialogue' in 1993,[11] the 2001 White Paper on European Governance[12] discussing new modes of governance based on the parameters of openness, participation, accountability,

[7] Article F (1) as amended by the Amsterdam Treaty and renumbered as Article 6.

[8] See declaration 23 of the Nice Treaty.

[9] The text of the Laeken Declaration on the Future of the European Union is available at http://european-convention.eu.int/pdf/lknen.pdf. Accessed 30 July 2013.

[10] Laeken Declaration, p. 4.

[11] Communication concerning the application of the Agreement on social policy presented by the Commission to the Council and to the European Parliament, 14 December 1993, COM(1993) 600 final.

[12] European governance—A white paper, 25 July 2001, COM(2001) 428 final.

effectiveness and coherence[13] or the Commission's European Transparency Initiative[14] launched in 2006 to facilitate the interaction with interest groups at the EU level. We will come back to some of these initiatives later.

The political debate concerning the democratic legitimacy of the European institutions and their actions stretching from Maastricht over Amsterdam, Nice, Laeken towards Lisbon, has been accompanied by protracted discussions also at the academic level. Leading scholars have extensively dealt with the question of democratic legitimacy, or to put it in more critical terms: the issue of the perceived democratic deficit.

2.2 *Multiple Layers of Democratic Deficit*

The democratic deficit discussion regarding European policy-making is well-known. Nevertheless, in order to fully understand the background of the issues discussed in this analysis, it is worth taking a brief look at some key points. This will help us understand why the Commission invited consumer representative groups to the CESL drafting process.

With regard to the academic debate we can understand the term democratic deficit in a multidimensional way. Based on Joseph Weiler's observations,[15] Paul Craig and *Gráinne de Búrca identify* seven layers of non-democracy: (1) 'unresponsive[ness] to democratic pressures' as an expression for the lack of political change by direct elections; (2) 'executive dominance' of EU institutions which are not set up by directly elected members; (3) 'by-passing of democracy' also known as comitology,[16] standing for the strong involvement of various non-directly elected interest and expert groups into the decision-making process; (4) 'distance issue' standing for moving the decision-making-powers (geographically) further away from the citizens; (5) 'transparency and complexity issue' of a decision-making process characterized by non-public decision-making; (6) 'substantive imbalance issue' encompassing the balance tension between capital and labour; and (7) 'weakening of judicial control issue' relating to the decrease of judicial powers of national courts when it comes to the question of constitutional compatibility of legal acts.[17]

[13] See ibid. or http://europa.eu/legislation_summaries/institutional_affairs/decisionmaking_process/l10109_en.htm for details.

[14] See Green Paper—European transparency initiative, 3 May 2006, COM(2006) 194 final, or http://ec.europa.eu/transparency/eti/index_en.htm for details. Accessed 30 July 2013.

[15] For Weiler's more general observations see e.g. Weiler (1998), ch 1; Weiler et al. (1995, 2002), pp. 563–580.

[16] On comitology see in general e.g. Craig (2012), pp. 109–139; Chalmers et al. (2010), pp. 117–125.

[17] See Craig and de Búrca (2011), p. 150 for more details.

One of the central issues in this debate is the question of the legitimacy of European policy-making, i.e. whether European policy-making is sufficiently legitimized from a democratic point of view. To briefly summarize the complex debate, one can refer to the antipode approaches of 'input aspects' as represented by e.g. Weiler[18] or Andreas *Føllesdal* and Simon Hix,[19] vs. 'output legitimacy', the preferred model by e.g. Anand Menon and Stephen Weatherill.[20] Representatives of the first approach make recourse to at least one of the above-mentioned layers of non-democracy and note that the typical legitimizing chain of democratic policy-making between citizens, directly elected political representatives and their decision-making is more complicated and longer at the EU level than at the national level. This school of thought focuses on the input mechanism or law-creating process, affirming the existence of a democratic deficit. Supporters of the output legitimacy approach, on the other hand, argue that it is rather the ultimate goal of the EU and its concrete actions/decision, i.e. the output, which should be looked at when analyzing the democratic character of the EU. This argumentation emphasizes the desired (and actual) outcome of European decision making and argues that one cannot compare national and European policy-making without distinguishing between their aims.[21] According to this view, a possible shortcoming of the democratic *input* should not be automatically understood as creating a democratic deficit. Neither of these two conceptions takes a fully holistic approach; instead both put the emphasis on different layers of democracy, the input for decisions in the first case and the impact of decisions on the citizens and other legal actors in the latter.

As can be concluded from this discussion, the concept of democracy can have various layers, which, to some extent, have one thing in common: the question of to what extent people and their concerns are involved in and represented by the decision-making process. The fulfilment of this criterion can be analyzed at different stages: the pre-decision-making stage, referring to the period prior to the adoption of legal acts, the decision-making stage in a narrow sense, i.e. the actual voting process—both putting the focus on the input—and the post-decision-making stage, embodying the output of the process. Ideally, people would—by whatever means—contribute (or benefit) at all three stages or to use Abraham Lincoln's words, the ideal state of government would be reflected by a 'government of the people, by the people [i.e. input], for the people [i.e. output]'.[22]

[18] See e.g. Weiler (1998) or Weiler et al. (1995).

[19] Follesdal and Hix (2006), pp. 534–537; Hix and Høyland (2011), pp. 131–137.

[20] See e.g. Menon and Weatherill (2007).

[21] For a more detailed summary of the positions see e.g. Craig and de Búrca (2011), pp. 152–155. They also mention a third, time-wise slightly preceding approach taken by *Andrew Moravcsik*, referring to it as the approach of *checks and balances*; see ibid., p. 152 and the literature listed there.

[22] Lincoln (1863). See also the library of congress information at http://myloc.gov/Exhibitions/gettysburgaddress/Pages/default.aspx (accessed 30 July 2013) for details. For an analysis of democratic governance based on the Lincoln model see e.g. Karr (2007), pp. 18–24.

2.3 Input Deficiencies in European Lawmaking

In the context of European decision making, one should especially take a brief look at the legislative process of the EU.[23] In the beginning, the Parliament had only very restricted legislative competences. The most it could ask for was to be consulted between the proposal of legal acts by the Commission and the adoption by the Council. When direct elections of Members of the European Parliament were introduced in June 1979, several voices criticized the legislative system for not lending enough substance to the citizens' only direct representative body, the Parliament.[24] Over the years amendments of the founding treaties had tried to enhance the role of the Parliament which finally led to a change of the ordinary legislative procedure from a Commission/Council dominated mechanism to an interplay of three main institutions: the Commission as the primary initiator and drafter of legal acts, the Council as the voice of the Member States, and the Parliament, representing the citizens directly. The dominating consultation process was replaced by co-decision making of the Council and the Parliament in most of the cases.[25] However, the Parliament, i.e. the only direct citizen's representative among the three core institutions, still does not possess direct law-initiating competences. Ian Ward quite bluntly criticizes this fact by saying that '[a] Parliament without the power to initiate legislation . . . is an absurdity.'[26]

With regard to the question of input democracy one can see that the European representative democratic model, though not as well-marked as at the national level, has been strengthened step by step and that the direct elections of the Parliament might be sufficient to legitimate legal acts co-decided by it together with the Council from a democratic point of view. Taking further into consideration that Member States transfer part of their legislative competences to the European institutions when joining the EU and that representatives of national governments are accountable at the national level for their decisions made in the Council, one could indeed be tempted to say that the question whether or not a democratic deficit exists is not of actual importance anymore. Walter van Gerven thus argues that:

> From a viewpoint of democratic legitimacy . . . the peoples – as represented by their universally elected parliaments and appointed executives, and reassured as to the legality of the transfer [of legislative competences] by their courts – are acting as ultimate decision makers and beneficiaries, at the national and the European level.[27]

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[23] On the democratic deficit and the lawmaking process in general see e.g. Chalmers et al. (2010), pp. 125–136.

[24] See e.g. Ward (2009), pp. 20–25.

[25] Article 289 (1) TFEU.

[26] Ward (2009), p. 19.

[27] van Gerven (2011), p. 341. See also Tatham (2012), pp. 135–136, arguing that '. . . the role of the European Parliament in the Union decision-making process has been increased while the information provided to and interaction with national parliaments – as a way to reduce the Union's democratic deficit – have improved.'

However, not everybody shares this view. Matthias E. Storme, for example, notes that '[n]ot only the legitimacy but also the accountability of the legislator . . . is . . . much lower at the European level',[28] criticising, inter alia, that the Parliament still is not vested with initiative legislative powers.[29]

As an interim result one can conclude that while the competences of the Parliament have been expanded over the years, they still fall behind the parliamentary competences at the national level; or in other words: the potential democratic input is still deficient, when one narrows the discussion down to a comparison of parliamentary powers at EU and national level. And although this alone does not tell us anything about the democratic *output*, one might nevertheless have to think of alternative ways to increase the citizens' involvement in the process and to guarantee that the legislative output satisfies the citizens' actual needs.

3 The Democratic Deficit and Alternative Interest Representation

3.1 Deliberative Democracy

Democracy can be achieved by various means. Elections are the most obvious example of how to vest people with power. Political parties legitimized by elections shall guarantee that the citizens' interests are represented and heard during the legislative process. However, as we just saw, direct representation via the European Parliament exhibit various deficiencies when compared to national parliaments. We can also say that representative democracy via directly elected political parties (hereinafter, *electoral democracy*), is not as well-developed at the EU level as it is at the Member State level.

However, electoral democracy is not the only form of a possible citizens' involvement in the legislative process at the EU level. Citizens might also participate more actively. The concept of deliberative democracy, as first named by Joseph M. Bessette[30] and based on ideas of inter alia John Dewey,[31] John Rawls[32] and Jürgen Habermas[33] can be seen as a mechanism to correct or support

[28] Storme (2011), p. 388.

[29] Ibid.

[30] Bessette (1980), pp. 102–116.

[31] Dewey (1927). For a short summary of his ideas see e.g. Eriksen and Weigard (2003), p. 112 or Rogers (2010), pp. 1–7 with further references in note 10.

[32] Rawls explicitly refers to the term deliberative democracy e.g. in Rawls (1997), pp. 772, 773 and 806.

[33] See e.g. Habermas (1992), pp. 11–24. For a critical analysis of Habermas's deliberative democratic model see e.g. Scheyli (2000), pp. 101–109.

electoral democracy. Jon Elster tries to summarize the rationale behind deliberative democracy as follows:

> All agree, I think, that the notion includes collective decision making with the participation of all who will be affected by the decision or their representatives: this is the democratic part. Also, all agree that it includes decision making by means of arguments offered *by* and *to* participants who are committed to the values of rationality and impartiality: this is the deliberative part.[34]

One could also say that one of the basic ideas of the deliberative democratic concept is that laws should not only be democratically legitimized by the rather technical means of parliamentary decision-making, but that it also requires that the public will is more directly reflected, i.e. that citizens are given the chance to interact with the legislative decision-makers before and during the decision-making process. Or to put it in other words: in order to legitimize policy decisions from a deliberative democratic point of view, it is desirable that a balanced communication process with the participation of the public, i.e. the citizens, supplements the actual decision-making of elected representatives. What is therefore needed is some form of interaction between the decision makers and affected groups.

3.2 The Democratic Deficit and Interest Groups

As we just saw, the question of democratic decision-making is not only related to the elections (or appointment) of members of the pivotal decision-making European institutions, i.e. the Commission, the Council and the Parliament. Supplementary as well as substituting democratic tools are currently discussed or, in other cases, have already been introduced.

One of the most relevant instruments is the involvement of representative interest groups (hereinafter, *interest groups*).[35] Interest groups are an important example of alternative interest representation, i.e. the representation of interests not by elected political parties, but by private or public intermediary actors, and enjoy growing popularity and support from various sides. Not only businesses make use of them, but also traditionally weaker or underrepresented groups such as environmentalists, workers or consumers. Interest groups can be an effective tool, as they

[34] Elster (1998), p. 8. See also the (mainly American) contributions in Fishkin and Laslett (2003).

[35] Interest groups are not the only tool debated in this context. R. Daniel Kelemen, for example, asks for (and tries to already identify) a stronger adversarial legalism, which he calls 'Eurolegalism', to strengthen the citizens' role in the European decision making. See Kelemen (2011), pp. 7–8. This approach would, however, only work ex post and not ex ante, at least if it does not show any 'deterrent' effect for the enactment of future acts. Another manifestation of (partial) democracy can be found in codes of conduct used by businesses as a form of a self-regulatory mechanism. They are, however, comparatively single-sided as codes of conducts are usually drafted by business groups for businesses. They usually do not reflect the voices and needs of the transactional counterpart—the consumers.

usually can rely on well experienced expert staff with strong networking skills. Activities of interest groups include (pre-)decision making tasks, such as lobbying, as well as supportive actions in the post-decision making stage, e.g. information dissemination or legal enforcement support.

In order to ensure the credibility of interest groups, the EU aims at ensuring the transparency of their composition, tasks and actions. By November 2012 more than 5,000 interest groups were registered in the European Transparency Register (hereinafter, *Transparency Register*).[36] Registration shall guarantee a transparent link from the represented interests to the interest groups and further to the European institutions, or as the Transparency Register Joint Secretariat frames it:

> European institutions interaction with citizen's associations, NGO's, businesses, trade and professional organizations, trade unions, think tanks, etc. is constant, legitimate and necessary for the quality of democracy, for their capacity to deliver adequate policies, matching needs and reality. Citizens have a right to expect this process to be transparent and to take place in compliance with the law as well as in due respect of ethical principles, avoiding undue pressure, illegitimate or privileged access to information or to decision makers.[37]

One can also say that the Transparency Register is an attempt to democratize the work of interest groups: people with a wish of being heard or represented at the EU level can identify a suitable interest group and consult it. Citizens thus have the chance to interact with the EU more easily, either by being informed about decisions concerning their personal interests or by having their interests represented at the European level.

3.3 The Democratic Deficit, Interest Groups and Lobbying

Lobbying to be understood as 'interest intermediation by the means of exchange of opinion to shape legal acts between associations, businesses, other private actors and politicians'[38] is undeniably one of the most often used, if not the most often used form of trying to influence decision-makers and also an important expression of deliberative democracy. At the same time, one can say that lobbying is not only beneficial for the represented people and entities, but that the existence of a well-functioning lobbying network is also in the interest of the European decision-makers. The Commission, the number one target of interest groups involved in the lobbying process,[39] first realized the importance of interest involvement in the

[36] For details on the Transparency Register see http://europa.eu/transparency-register/index_en.htm. Accessed 30 July 2013. Data taken from http://ec.europa.eu/transparencyregister/public/consultation/statistics.do?locale=en&action=prepareView. Accessed 30 July 2013.

[37] http://europa.eu/transparency-register/about-register/transparency-register/index_en.htm. Accessed 30 July 2013.

[38] Michalowitz (2007), p. 19 (own translation).

[39] See e.g. Tanasescu (2009), p. 55; Karr (2007), p. 155.

negotiation and drafting of legal projects in the early 1990s and has increased its efforts to open its doors to lobbyists ever since.[40] One of the main reasons for this development must be seen in the above-discussed democratic deficit issue and concerns that policy-making might occur too far away from the citizens.

In the aftermath of the Maastricht Treaty drafting, the Commission carried out some research on the possible need to interact more closely with interest groups. This resulted in several Commission communications which all stressed the importance of getting more closely in touch with the people and increasing the transparency of European decision making.[41] European lobbying codes of conduct followed soon and set the frame for a 'distinct European lobbying style'.[42] The significance and impact of interest groups have concurrently grown as well. Over the years lobbying has become a business of its own and the total number of lobbyists acting on behalf of interest groups has exceeded the number of Commission and Parliament officials already more than 10 years ago.[43] Enhancing the lobbying process has been on the agenda for the last 20 years and important intermediary steps such as the 2001 White Paper on Governance[44] or the 2006 Green Paper on the European Transparency Initiative[45] eventually led to the installation of a joint Parliament—Commission transparency register, the beforementioned Transparency Register.[46]

While the Commission itself would not use the term 'democratic deficit' to explain its interest in closer cooperation with interest groups, the increased reliance on and inclusion of such groups in its policy-making, via consultations or more broadly speaking: via lobbying,[47] is closely linked to democratic concerns. Karolina Karr for example argues that '[t]he existence and meaningful participation of interest groups in decision-making processes is seen as a sign of a functioning

[40] For a summary of the historical development of, what *Irina Tanasescu* calls 'Commission consultation processes', see Tanasescu (2009), pp. 57–80.

[41] See e.g. Commission Communication of 5 March 1993, on an open and structured dialogue between the Commission and special interest groups, OJ 1993 No. C63, pp. 2–7 or Commission Communication of 5 March 1993, on increased transparency in the work of the Commission, OJ 1993 No. C63, pp. 8–10.

[42] DG Internal policies of the Union (2007), p. 8.

[43] Ibid., p. 3.

[44] White Paper on European Governance, 12 October 2001, COM(2001) 428 final.

[45] See supra note 14.

[46] The Transparency Register replaced the 2008 Commission's Register for Interest Representatives; for more detail see http://europa.eu/transparency-register/pdf/key_events_en.pdf for more details.

[47] In the context of this chapter the term lobbying shall refer to any form of interest representation of interest groups at the EU level, which also includes public consultations, which refer to situations where the Commission takes the initiative and gives the public and/or interest groups the chance to comment on Commission plans.

democracy'[48] and, with reference to Joshua Cohen and Joel Rogers adds that 'interest groups can help set the political agenda and formulate policies by providing information both to citizens and to government officials, by facilitating deliberations and shaping opinions, and by acting as an interface between the citizens and representative government'.[49] Also Irina Tanasescu explains the interaction between the Commission and interest groups with democratic needs and thoroughly examines the added-value from a deliberative democratic point of view.[50] She comes to the conclusion that 'the institutionalization of stakeholder participation in policy-making at the level of the Commission has many (and increasingly more) deliberative qualities, without being fully deliberative and consistent across the board'.[51] In their studies, both Karr and Tanasescu identify a general shift of European policy-making towards more democratization due to the involvement of interest groups, but at the same time also argue that there is ample room for improvement, pointing to issues of an overload of EU institutions with requests from interest groups or agency capture by financially powerful of interest groups, thus leading to an imbalanced representation of interests.[52]

Still, we can note that lobbying activities of interest groups can be of importance from a democratic point of view in the European policy- and decision-making processes as they give un- and underrepresented the opportunity to be heard. The question for consumers, however, is whether this necessarily means that their interests are always sufficiently heard and reflected in the legislative outcome. Before answering this question in the context of the drafting of the CESL, we should first take a brief look at the work of consumer interest groups at the European level.

4 Interest Groups, Lobbying and Consumers

4.1 Consumer Interest Groups in General

When it comes to consumers and their interests, we can distinguish between several stages of consumers' involvement. The most visible stage is the post-decision making stage, which refers to situations occurring once laws are enacted. This can be experienced by anybody who purchases a good or pays for a service,

[48] Karr (2007), p. 73.

[49] Ibid., pp. 73–74 referring to Cohen and Rogers (1992), pp. 393–472. Karr further notes that interest groups are also important for strengthening the democratic element with regard to the output (not only input) of the decision-makers as 'providers of information, experts, and public support'—see Karr (2007), p. 75.

[50] Tanasescu (2009).

[51] Ibid., p. 230.

[52] For some deficiencies see especially Karr (2007), pp. 169–184 and Tanasescu (2009), pp. 233–235.

as consumer-related laws set the framework for the consumer cycle starting with the designing and production process or advertising and ending either with consummating the good or service or—if something goes wrong—with consumer complaints or redress mechanisms. Consumer interests are, however, not only affected once laws are enacted. Also in the field of consumer law private interests, in this case consumers' interests, are touched upon much earlier, at the time of lawmaking and even before legislative decisions are made. Although it is theoretically possible for consumers to interact with European institutions at those stages, e.g. by submitting comments in a public consultation process, consumers usually do not get involved, be it for a lack of time, knowledge, information or concrete interest. And even if consumers tried to raise their voices, in most cases the number of consumers who become active, might be too small to show any effect. In this respect it is of utmost importance that consumer concerns are represented in a different way—by the lobbying of consumer interest groups.

Various consumer interest groups and networks are involved in consumer-related processes. Compared to the number of business interest groups, the number of consumer interest groups is, however, relatively small: the total number of representative groups mainly driven by business interests registered in the Transparency Register currently ranges somewhere between 70 %[53] and 80 %[54] of all registered interest groups; in-house (business) lobbyists and trade/professional associations alone compose ca. 50 % of the registered interest groups.[55] The number of registered interest groups representing consumer interests, on the other hand, is lower than 100 or less than 2 % overall.[56] The reasons for this imbalance might be manifold, but very likely include the business-driven policies of the EU and the lack of funding of interest groups. Another reason can be seen in the focus of business interest groups, which, unlike consumer interest groups, in most cases pursue rather narrow, scattered goals and not the 'public spirit'[57] as Damian Chalmers, Gareth Davies and Giorgio Monti characterize it.

[53] Hix and Høyland (2011), p. 165 with reference to Coen and Richardson (2009), p. 6.

[54] Karr (2007), p. 148, Table 22.

[55] Data drawn from the Transparency Register available at http://ec.europa.eu/transparencyregister/public/consultation/statistics.do?locale=en&action=prepareView. Accessed 30 July 2013.

[56] Ibid. One could of course argue that not all networks representing consumer interests at the EU level are registered. The European Consumer Law Group (ECLG), a network of legal experts from national consumer organizations and scholars, for example, was not been registered in the Transparency Register by the time of writing this chapter, but nevertheless is one of the bigger consumer-related bodies and actively comments on consumer-related matters (for more information on the ECLG see e.g. the ECLG website at http://www.europeanconsumerlawgroup.org/Content/Default.asp? Accessed 30 July 2013). The same could, however, be also said with regard to business interest groups. Not every interest group which acts at the EU level is registered. Also the number of business interest groups present at the EU level can thus be estimated to be higher.

[57] Chalmers et al. (2010), p. 135.

4.2 BEUC as the Leading Consumer Representative in the Law-Making Process

Consumer interest groups registered in the Transparency Register all show a great interest in consumer representation. Most of them, however, do not possess a high enough capacity to perform this task effectively. Some groups might lack the financial strength, others expertise or size. One group which is regarded as influential—arguably it is the most influential of all consumer interest groups—is the Bureau Européen des Unions de Consommateurs or European Consumers' Organisation, a pan-European organization composed of more than 40 independent national consumer organizations.[58] BEUC can rely on relatively strong financial contributions from its member bodies, which contribute for more than half of its operational budget.[59] BEUC also repeatedly qualifies for EU project funding due to its highly appreciated expertise in the field of consumer protection. This allows BEUC to engage in various fields, inter alia in European consumer lobbying both at a very early stage before concrete measures are discussed and also directly at the stage of elaborating legal drafts.[60]

Not only is BEUC one of the leading lobbying bodies in the consumer field, but it is also one of the oldest lobbying associations in the EU. It dates back to 1962 and was thus created long way before consumer policy was given express reference at the European level in the late 1970s and early 1980s. Having celebrated its 50th anniversary in 2012 BEUC can look back at big achievements in various consumer law related fields, ranging from health policy to product liability issues, advertising practices to telecommunication and data protection.[61] Undeniably consumers in Europe have widely benefitted from BEUC's lobbying activities.

BEUC represents consumers by various means when new laws are drafted or already existing ones are amended. For example, BEUC regularly attends public hearings, presentations or other EU-hosted events and submits position papers in consultation processes, usually critically commenting on business-driven EU initiatives. The most direct method of influencing EU policy-making, at least in theory, is, however, the participation as a network member in the concrete negotiation and elaboration process. Transnational, EU-initiated networks have become an important part of today's lawmaking. Whenever bigger projects are discussed,

[58] The BEUC can be accessed online at http://www.beuc.org/Content/Default.asp?PageID=591. Accessed 30 July 2013.

[59] For details on BEUC's budget see http://www.beuc.org/Content/Default.asp?PageID=2144. Accessed 30 July 2013.

[60] According to its statutes, one of the main tasks of the BEUC is to 'seek by all legitimate means at its disposal to influence the evolution of European Union policies in the interest of consumers' (Article 2.2 a. BEUC Statutes).

[61] For these issues and some other important success stories see http://beuc50years.eu/achievements.

the Commission tends to install groups of experts[62] and interest representatives which shall serve primarily two functions: first, transnational expert networks shall guarantee that the Commission can rely on a broad international expertise when drafting new legislation. Networks shall, however, also serve a democratic function, as participating interest groups can table the voices of possibly affected people and entities more effectively.

5 The Democratic Deficit and the Common European Sales Law

5.1 The Proposal for a Common European Sales Law or: From DCFR to CESL

The drafting of the recent Proposal for a Common European Sales Law is a good example for the involvement of consumer interest groups in transnational law-drafting networks.

The Proposal was presented by the Commission on October 11, 2011.[63] If and once adopted, the CESL would introduce an innovative pan-European sales regime that would be available as a voluntary, alternative national sales law inter alia[64] in cross-border B2C sales relationships.[65] Already existing national sales law rules would remain in place though, and would be applicable if the parties did not agree on the applicability of the CESL.

Although the eventual drafting of the CESL was completed in less than one and a half years, concrete elaborations and preparations for the CESL date back to the late 1990s and early 2000s, when especially[66] two academic study groups, the Study Group on a European Civil Code[67] and the European Research Group on Existing

[62] For a list of expert groups installed by DG Justice (including groups related to consumer issues) see http://expertgroups.govtrace.com/justice-dg. Accessed 30 July 2013.

[63] Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, 11 October 2011, COM(2011) 635 final. The Common European Sales Law itself is attached as Annex I to the Proposal.

[64] Pursuant to Art. 7 Sales Law Regulation the regulation would also be applicable to B2B relationships, if at least one of the parties is an SME.

[65] For the question of its legal nature, i.e. whether it should be considered as 2nd, 28th or whatever regime, see e.g. Wrbka (2012), pp. 9–12 with further references at note 38.

[66] For more details of the interplay of various research groups see e.g. Twigg-Flesner (2008), pp. 151–156; von Bar et al. (2009), pp. 47–56; or Cámara Lapuente and Terryn (2010), pp. 161–163.

[67] For more details see e.g. von Bar (1999), pp. 133–135 or the website of the Study Group http://www.sgecc.net. Accessed 30 July 2013.

EC Private Law, better known as the Acquis Group,[68] began with research activities in 1998 and 2002 respectively.[69] Both groups were built by a network of legal scholars from all across Europe with financial contributions from various national sources and the Commission itself under its Sixth Framework Programme.[70]

The fruit of the groups' research was the Draft Common Frame of Reference on the Principles, Definitions and Model Rules of European Private Law (hereinafter, *DCFR*). For some time, the fate of the DCFR was not entirely clear. External commentators as well as scholars directly involved in the drafting of the DCFR were not sure about the Commission's final intention.[71] Was the DCFR to remain merely as an academic research result or was it to be practically used for further steps? And if the latter one was true, what was the direction that the Commission was heading to?

5.2 CESL and the Expert Group on a Common Frame of Reference in the Area of European Contract Law

The first partial answer was given in April 2010 when the Commission decided to install the Expert Group on a Common Frame of Reference in the area of European contract law (hereinafter, *Expert Group*).[72] The underlying Commission decision (hereinafter, *Expert Group Commission decision*) formulated the main task of the Expert Group as follows:

> The group's task shall be to assist the Commission in the preparation of a proposal for a Common Frame of Reference in the area of European contract law, including consumer and business contract law, and in particular in:
>
> (a) selecting those parts of the Draft Common Frame of Reference which are of direct or indirect relevance to contract law; and
> (b) restructuring, revising and supplementing the selected contents of the Draft Common Frame of Reference, taking also into consideration other research work conducted in this area as well as the Union *acquis*.[73]

[68] For more details see the website of the Acquis Group www.acquis-group.org. Accessed 30 July 2013.

[69] For details see Wrbka (2011), pp. 94–97.

[70] See e.g. von Bar et al. (2009), p. 55; or Twigg-Flesner (2008), p. 152.

[71] See for example Cámara Lapuente and Terryn (2010), p. 163, noting that the "[i]nterest in this instrument [note: the optional instrument], resulting from an idea to encode private law that was on the agenda in 2001 and 2003, has gradually diminished in recent years and is no longer a priority." Evelyn Terryn was a member of the Acquis Group.

[72] See Commission Decision of 26 April 2010 setting up the Expert Group on a Common Frame of Reference in the area of European contract law, OJ 2010 No. L105.

[73] Ibid., Article 2.

The Expert Group consisted of initially 18,[74] later 17[75] members. In addition to originally 14, later 13 law professors, the Commission also invited one lawyer, one notary, one business representative from the European Multi-channel and Online Trade Association (EMOTA), and one consumer representative from the Consumer Union of Luxembourg.

With the composition of the Expert Group the Commission obviously wanted to achieve mainly two things: it wanted to ensure that the Expert Group could proceed with its tasks smoothly; this was guaranteed by the fact that more than half of the Expert Group members appointed by the Commission had already been members of either the Study Group on a European Civil Code or the Acquis Group.[76] In addition, the Commission tried to balance the representation of interests, or to put it in other words: the Commission wanted to strengthen the democratic composition of the ad hoc network. The Commission's decision to enrich the Expert Group with interest group contributors mirrors ideas of the above-mentioned 2001 White Paper on European Governance[77] (hereinafter, *2001 White Paper*). The 2001 White Paper listed the five principles of 'openness', 'participation', 'accountability', 'effectiveness' and 'coherence' which were believed to be of importance 'for establishing more democratic governance'.[78] Especially the first two principles, openness and participation, had an impact on the actual composition of the Expert Group.

The Commission itself (of course) did not use the term 'democratic deficit' for explaining how it chose the members of the Expert Group. The wording of Article 4 (2) and (4) of the Expert Group Commission decision saying that '[t]he appointment of members shall be made in such a manner as to ensure, as far as possible, an adequate balance in terms of range of competencies, geographical origin and gender' and that '[t]he group shall include experts from the following categories: ... scientific and research organisations, academia, ... legal practitioners, ... experts representing the civil society' is, however, quite self-explaining.

One can also easily draw certain parallels to the drafting process of the DCFR. Although the DCFR was the direct result of work carried out by groups of legal scholars, interest groups were not fully disregarded even at that time. The Commission installed a (separate) network of interest group representatives, known as

[74] A complete list of the original Expert Group members is available at e.g. http://europa.eu/rapid/press-release_IP-10-595_en.htm. Accessed 30 July 2013.

[75] A complete list of the latest Expert Group members is available at http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=2475. Accessed 30 July 2013.

[76] Hugh Beale, Eric Clive, Torgny Håstad, Martijn Hesselink, Irene Kull and Anna Veneziano were already active in the Study Group on a European Civil Code; Luc Grynbaum Jerzy Pisulinski and Hans Schulte-Nölke were members of the Acquis Group.

[77] See Sect. 2.1 *The EU and Democratization* above.

[78] See 2001 White Paper, p. 10.

CFR-net,[79] trying to ensure that the stakeholders' voices were heard. Lucinda Miller comments on this as follows:

> [a]t first glance, the Commission has adopted a highly participatory model, encouraging input from a range of different stakeholders. This form of governance, one that is preceded by a round of public consultations, appears attractive owing to its seemingly democratic credentials. In the absence of a European society, the Commission seems to be finding a substitute through the public, academic and stakeholder involvement to lawmaking.[80]

In her very accurate observations of the DCFR drafting process Miller identifies an imbalanced composition of CFR-net and further criticizes that the members were picked by the Commission, 'which considerably strips the process of any democratic appeal'.[81] She rightly links this issue explicitly to democratic concerns, 'most clearly from the perspective of an 'input' democracy model'.[82]

Returning to the CESL, one can draw a similar conclusion. From a geographical point of view one might say that the Expert Group was relatively well-balanced, but (especially) the 'democratic' balance is questionable. Only one member (directly) represented consumer interests. The same is of course true with respect to interests of the business side, which had also only one direct representative in the Expert Group. The allocation of seats between direct representatives from the business and consumer sides is, however, not the key issue in the context of the Expert Group. It is rather the comparatively low *overall* weight given to consumer interests that is again unfortunate. From a practical point of view it might be understandable that the Commission mainly invited (DCFR-draft-) experienced, legal scholars to the Expert Group. This, however, does not justify the imbalanced democratic input (note: in terms of the composition of the Expert Group) on the CESL draft.

Again, and as seen before when discussing the general democratic deficit issue in the context of European lawmaking,[83] this does not tell us much about the democratic output. In order to evaluate the democratic value of the CESL one thus should also take a look at the actual impact consumer concerns played on the CESL draft wording. Adding output findings to the already made input observations might complete the picture.

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[79] The members' list of the CFR-net can be found at http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/cfr_net_members_en.pdf. Accessed 30 July 2013.

[80] Miller (2011), p. 117. In a similar vein is Hans-W. Micklitz's comment, when he says that '[i]t is equally common ground that the European Commission is trying to organise and to finance a substitute for the absence of a European society by establishing academic networks, by seeking input from European and national lobby groups, from European and national non-governmental organisations . . . at an early stage.'—see Micklitz (2008), p. 29. For further critical comments see e.g. Schulte-Nölke (2011), p. 12.

[81] Miller (2011), p. 118.

[82] Ibid., p. 119. Miller also rebuts the possible counter-argument that the DCFR (in contrast to the CESL) would just be an academic paper and not a political tool, when she, based on an actual example, argues that even if the DCFR were to remain merely an academic paper, it would be 'a potent source of authority for answering questions of private law.'—ibid., p. 120.

[83] See Sect. 2.3 *Input Deficiencies in European Lawmaking* above.

5.3 BEUC and the Drafting Process of the CESL

The actual imbalance of represented interests in the Expert Group might have been one of the driving factors behind the Commission's decision to install one more transnational network to facilitate the CESL discussions of the Expert Group: soon after the installation of the Expert Group the Commission set up the Round Table of European key stakeholders in the area of contract law (hereinafter, *Key Stakeholders Group*). This time, academics were not invited, but again, from a consumer's point of view, the composition of the group was quite imbalanced. The Key Stakeholders Group was composed of ten members from various larger interest groups, of which most represented business interests; only one member directly represented consumer interests: BEUC.

It was not the first time that BEUC entered the stage in the concrete CESL drafting process. When the Commission opened the consultation period for comments on the Green Paper on policy options for progress towards an European contract law for consumers and businesses[84] in July 2010 (hereinafter, *2010 Policy Options Green Paper*), BEUC submitted an opinion paper raising concerns about alleged, fundamental misconceptions regarding the necessity for and likely practical consequences of an optional instrument, questioning issues such as the actual need for the CESL, its perceived optional character or the claimed certainty it should bring for consumers in case they really would have the chance to opt-in.[85] In addition, other issues were found to be of greater practical importance for consumers when shopping online, such as language issues, raising consumers' awareness with regard to their (already existing) rights or the enhancement of dispute settlement procedures.[86]

BEUC was tilting at windmills. In the 2010 Policy Options Green Paper the Commission made it clear that it would not really consider taking a step backwards, i.e. considering whether or not the CESL was actually needed as a realistic option: in that Green Paper the Commission introduced seven alternative options for the future of the DCFR. Although at first sight the options seemed to be equally ranked, a closer inspection revealed that the Commission strongly favoured option 4, i.e. a 'Regulation setting up an Optional Instrument of European Contract Law',[87] as was rightly pointed out by Miller in her analysis of the possible future of the DCFR shortly after the publication of the 2010 Policy Options Green Paper.[88] And although in the first session of the Expert Group Jonathan Faull, the initial chairman

[84] Green Paper from the Commission on policy options for progress towards a European Contract Law for consumers and businesses, 1 July 2010, COM(2010) 348 final.

[85] BEUC (2010).

[86] Ibid., p. 4.

[87] For details see Green Paper from the Commission on policy options for progress towards a European Contract Law for consumers and businesses, pp. 9–10.

[88] Miller (2011), pp. 136–139.

and then—Director General of DG Justice, tried to give the impression that 'the Commission still has a very open mind regarding the political outcome of the process'[89] by explaining that '[the Expert] Group's work should be seen as a feasibility exercise which does not prejudge the future [Commission] decision on the need and/or legal form of such an instrument',[90] Dirk Staudenmayer, the chairman of most subsequent Expert Group sessions and then—Head of the Contract Law Unit of DG Justice[91] requested the Expert Group to proceed '"as if" a decision to develop a potential Instrument had been taken'.[92]

BEUC thus had no alternative but to submit also substantial comments on the Expert Group's elaborations during the course of the Key Stakeholders Group's sessions.[93] The procedure was in principle as follows: the Expert Group, which had the lead in drafting the CESL, would identify certain areas of the DCFR which were to be transformed into CESL rules and forward the regarding provision to the Key Stakeholder Group for comments, either in its original DCFR version or already slightly amended. BEUC analyzed the passages and answered with written comments on the provisions, hoping that the Expert Group would take BEUC's comments into consideration when preparing the Proposal. One has to admit: BEUC's efforts were not completely in vain. The Expert Group actually shared some concerns and (sometimes) changed the draft wording accordingly. In response to BEUC's comments, provisions such as merger clauses (Art. 72 CESL)[94] or the loss of the right to terminate if termination is not given within a reasonable time (Art. 119 CESL)[95] were eventually limited to B2B cases.[96] While these amendments should be appreciated, one must also note that in various other cases the Expert Group ignored BEUC's justified concerns. It would go beyond the scope of this chapter to list all shortcomings of the final draft. Exemplarily one can identify the following three cases:

1. The rule of Art. 61 CESL[97] about language issues if contracts exist in more than only one language version was taken over from the Expert Group's initial proposal. Art. 61 CESL states that: 'Where a contract document is in two or more language versions none of which is stated to be authoritative and where there is a discrepancy between the versions, the version in which the contract was originally drawn up is to be treated as the authoritative one.' As BEUC

[89] See European Commission (2010–2011), first meeting, p. 1.

[90] Ibid.

[91] A current version of the organisation chart of DG Justice is available at http://ec.europa.eu/justice/about/files/organisation_chart_en.pdf.

[92] See European Commission (2010–2011), tenth meeting, p. 1.

[93] BEUC (2011).

[94] For BEUC's critique see BEUC (2011), Part I, p. 2.

[95] For BEUC's critique see BEUC (2011), Part IV, p. 9.

[96] Compare Art. II.—4:104 (4) DCFR with Art. 72 (3) CESL (merger clauses) and Art. III.—3:508 DCFR with Art. 119 (2) (a) CESL (loss of right to terminate).

[97] Compare with Art. II.—8:107 DCFR.

rightly points out, this is insofar regrettable as it might lead to disadvantages for the consumer if he or she (rightly) relies on the translated contract version (maybe even translated by the business party to the contract), as under normal circumstances 'the version in which the contract was originally drawn up' would always be the contract version drawn up in the language of the business side and not the consumer's language.[98]

2. Rules about the time of delivery were made laxer compared to an earlier CESL draft. Whereas the Expert Group recommended the wording '[u]nless a contract concluded at a distance between a business and consumer provides otherwise, a business must perform the obligations as soon as possible and no later than 30 days after the contract was concluded' in that earlier draft,[99] it finally retained the wording of Art. III. - 2:102 DCFR (3). Art. 95 (2) CESL states that '[i]n contracts between a trader and a consumer, unless agreed otherwise by the parties, the trader must deliver the goods or the digital content not later than 30 days from the conclusion of the contract.' The term 'as soon as possible' was removed from the final wording and the Expert Group – against BEUC's advice – missed the chance to introduce a consumer-friendlier wording.
3. The order of imputation of payments in relation to monetary obligations of Art. 128 (6) CESL would put e.g. German consumers in a worse situation compared to Art. 497 (3) BGB if the CESL governed their contracts. The order of imputation under Art. 128 (6) CESL would be: (1) expenses, (2) interest, (3) principal, whereas under Art. 497 (3) BGB the principal would come second, and interests third.[100]

When one contrasts the DCFR and the final draft version of the CESL with BEUC's comments one can clearly see that the Expert Group did not always choose the most consumer-beneficial standards. And it even gets worse: despite BEUC's push for a stronger consideration of consumer interests and the Expert Group's willingness to follow some of BEUC's advice, one cannot deny the fact that none of the major concerns was invalidated. In its current wording the CESL would practically still be a non-voluntary tool for consumers[101] and it would still create uncertainty as the average consumer would not be able to decide which sales law regime is the better one in the concrete case—the already existing traditional sales law or the CESL—without further research.[102] In fact, the Commission gives the impression that *every* consumer could benefit from the CESL rules when it says that 'the Common European Sales Law would guarantee a high level of consumer protection by setting up its own set of mandatory rules which maintain or improve the level of protection that consumers enjoy under the existing

[98] For details of BEUC's critique see BEUC (2011), Part II, p. 6.

[99] For BEUC's comments on that draft see BEUC (2011), Part III, p. 12.

[100] For BEUC (2011), Part III, p. 16.

[101] See Wrbka (2011), pp. 109–112.

[102] See ibid., pp. 106–107.

EU consumer law'.[103] While it might be true that the average level of European consumer protection would be raised, consumers would not be put into a better situation in every single case, as there are areas where the CESL would provide for less protection than already existing national rules.[104] And last but not least, the Commission has failed to give comprehensible explanation for why the CESL would be necessary for consumers at all.

BEUC hit the wall put up by the Commission. Although BEUC's involvement in the CESL drafting process was better than nothing, BEUC's efforts were not fully successful. But one cannot blame BEUC for this. It rather shows that it is eventually the Commission which decides to what extent legislative proposals shall be democratized, both from an input as well as an output perspective.[105]

6 Conclusion

The relationship between consumers and European policy-making is clearly not tension-free. What is believed to strengthen the Internal Market is not always in the best interests of consumers. And believing that the Internal Market can flourish by primarily lending substance to the wishes of the supply side, i.e. the businesses, and not (also) the demand side is a flawed assumption. In order to function properly, legal rules must be accepted by both sides. The EU started to realize this to some extent when it was confronted with pressure from various interest groups in the early 1990s. In order to strengthen the public acceptance of its decisions, but also in order to react more easily to the actual needs of social and economic actors, the Commission expanded its synergizing activities by inviting interest groups to the political dialogue and by building networks, both for the pre-decision as well as the post-decision making stage.

BEUC as the core consumer interest group has been playing an important role in this context. Not only does it regularly provide consumers with relevant legal information at any stage, but BEUC traditionally is also very active in the policy-making process due to its lobbying activities and the involvement as network member at the drafting stage of legal acts. One can understand BEUC's role as a commitment to the democratic enhancement of both, the input activities as well as the output legitimacy of EU decision making, as BEUC acts as an antipode to the numerically superior business lobbyists.

[103] European Commission (2011), p. 9. The same wording can be found in Para. 11 of the Preamble of the Proposal.

[104] See Wrbka (2011), pp. 112–114.

[105] Having commented on the CESL draft and its creation from a consumer's point of view, I would also like to draw a parallel to observations made from the opposite direction. Ironically, concerns about the appropriateness and suitability do not solely rest with consumers. It seems that also the general suitability for the business side is not fully assumed. For a short critique see e.g. Basedow (2011), p. 169.

One cannot deny the fact that BEUC has positively contributed in various areas. At the same time the EU is on the horns of a dilemma; how far does it want to go? Does it really want to democratize its decision-making in the area of consumer law beyond the status quo? Then it would have to further strengthen the influential powers of BEUC and other consumer interest groups, guaranteeing a true balance of power. This, however, could only be achieved by restraining efforts to please the business side.

The drafting of the CESL illustrated this struggle of interests. BEUC's competences were limited from the beginning. There was no room left for convincing the other actors, including the Commission, of the—from a consumer's perspective—practically *really* important issues in cross-border B2C transactions. BEUC was only able to act within the limits permitted by the Commission. Or in other words: the decision to draft the CESL had already been made before BEUC had the chance to raise its voice in the stakeholder network. And even there it could only take a back seat.

Of course one will find voices that say that the involvement of BEUC and other interest groups is enough for calling the CESL a democratically satisfactory product. But this assumption is not completely correct. Being part of a network, in our case the Key Stakeholders Group, is of course better than nothing, but the input BEUC was able to exert was very limited (at best), and the outcome of the network elaborations were clearly not in the best interests of consumers. After more than a decade of intense preparations it was only logical that the Commission wanted to present an actual result, but in keeping with the motto 'first things first', the Commission should have first tackled more pressing B2C cross-border sales issues and not have proposed a sales law regime which might create more questions than it could answer.[106]

The involvement of the BEUC was a good beginning, but clearly not enough. In this sense and although the basic policy seems to have shifted into a consumer-friendlier direction, the observations made by Andrew McGee and Weatherill more than 20 years ago in the context of the then Single Market remains apposite today. In 1990 they wrote:

> Far less successful have been the consumer ... interests, whose concerns seem largely to have been overridden. This too need not be a cause for surprise, but it is important to ask the fundamental question, what sort of Single Market is being created here? The answer seems to be that it is a Market in which business flourishes, relatively free from protective regulation, but the legitimate interests of other social groups are at risk of being ignored.[107]

[106] See e.g. Sect. 5.3 *BEUC and the Drafting Process of the CESL* above; Wrbka (2011), p. 14; or for concrete data: The Gallup Organization Hungary (2011), p. 19.

[107] McGee and Weatherill (1990), p. 595.

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The "European Business Register EEIG" as a Network of European Commercial Registers

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Contents

1 Introduction

Within the European Union (hereinafter, *EU*), "commercial register law" is, although partly harmonized by EU directives, still a very national matter—there are, at the time of writing, 28 different registers. In some jurisdictions they are administrated by (independent) courts, other countries have created special public authorities (bound by instructions), in some parts of the EU the national "Chambers of Commerce" have been entrusted with the administration of Commercial Registers, other countries have declared the Economics Ministry as competent for that issue. Although there have been several attempts, an "EU-wide unified Commercial

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Register" (or at least a connection between national registers arranged by an EU initiative and governed by EU officials) is still pending—but recently in progress. Since there exists nevertheless a significant public interest in easy access to all national registers—"as if they were one"—it was surprisingly up to a private initiative to create such a common "Network of National Business Registers and Information Providers", the European Business Register (hereinafter, *EBR*), which is currently conducted by a private law based "European Economic Interest Group" (hereinafter, *EEIG*) domiciled in Brussels. It connects the domestic registers and transmits the information online from the (national) source register directly to its user. The legal basis for the cooperation between national Commercial Registers is the so-called "Information Sharing Agreement" between national authorities. The "EBR EEIG" not only coordinates the network of activities between information distributors, technical partners and national registers. Over the years, the EBR has achieved some kind of "market power": it issues generally only one license per country, typically to a national internet provider, to join the EBR network as an "information distributor". Accordingly, the question arises if a private law based "network agreement" (such as an EEIG) gives sufficient democratic legitimation to the only "European Commercial Register" that enables citizens to cross-border enter other countries' registers.

2 Commercial Registers[1] and Company Law as a Competence of the National Lawmaker

Filing requirements for sole traders and companies for their listing in a public commercial register (which is, usually depending on the legal form and/or the annual business volume compulsory in most legislations of the world[2]; in some cases a registration is possible on a voluntary basis[3]), vary a lot from country to country,[4] and sometimes from state to state within a federation.[5] *Merkt* remarks that an introduction in US-American company law is '*an introduction into nothing or a 50-point introduction*'.[6]

[1] The term "Commercial Register" (equivalent to "Business Register") used in this paper determines all central, commercial and companies registers within the meaning of Article 3 of the Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent, OJ L 258, 1.10.2009, p. 11.

[2] See Davies (2008), pp. 750–754.

[3] For Austria, see e.g. Told (2009), § 8 Para. 30–37.

[4] See for example a very good comparative schedule http://www.rba.co.uk/sources/registers.htm. Accessed 30 July 2013.

[5] For USA, see Merkt and Göthel (2006), pp. 153–178.

[6] Ibid., p. 153.

Surprisingly, another "big federation"—the EU—each of them from the cultural, language, ethnic, cultural and last but not least legal point of view, very diverse to each other (in any case much more than the US-"member states" are)—possesses a much higher standard in civil and company law approximation and unification. For example, the Unions' directives for company law harmonized large parts of accounting law,[7] rules of the minimum amount of the registered capital and maintenance of the assets of a public limited company,[8] shareholders rights,[9] the main structure of cross border merger[10] and splitting[11] procedures and set common standards of takeover law.[12]

In addition, European Union law provides at present three partly unified company forms: The SE ("Societas Europaea", "European Public Limited Company"),[13] the EEIC ("European Economic Interest Grouping") and the SCE ("Societas Cooperativa Europaea", "European Society").[14] An almost completely unified "European Private Limited Company" (SPE) is still pending.[15]

Although there are occasional complaints about the "low degree" of legal harmonization in company law, compared to the US, the EU has nowadays reached a standard of law approximation a US-American can only dream of—or, depending on the viewpoint, have nightmare about. In the US, company law diversity is—contrary to the European approach—generally regarded as a benefit: an entrepreneur can take advantage of the well-known "Delaware-effect" (US states compete to attract incorporations).[16] As such, different company laws open significant opportunities for entrepreneurs.[17]

With regard to the registration of companies and certain other legal entities into a public register, the EU has set a wide range of common minimum standards. In

[7] Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, OJ L 222, 14/08/1978, pp. 11–16.

[8] Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital, OJ L 264, 25/09/2006, pp. 32–36.

[9] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14/07/2007, pp. 17–24.

[10] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on crossborder mergers of limited liability companies, OJ L 310, 25/11/2005, pp. 1–8.

[11] Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies, OJ L 378, 31/12/1982, pp. 47–54.

[12] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142, 30/04/2004, pp. 12–23.

[13] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ L 294, 10/11/2001, pp. 1–7.

[14] Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE), OJ L 207, 18/8/2003, pp. 1–12.

[15] See Krejci (2008), pp. 156–159.

[16] See Cary (1974), pp. 663–705.

[17] See Ratka (2012), pp. 56–65.

general, the "Disclosure Directive"[18] statutes—most notably—minimum contents of national Commercial Registers: According to its Article 2, member states have to ensure the disclosure of certain documents and information. Article 3 Paragraph 1 *leg. cit.* regulates that there has to exist an open-to-public register in each member state: "(...) a file shall be opened in a central register, commercial register or companies register, for each of the companies registered therein." Paragraph 2 *leg. cit.* instructs the member states to fully "automate and electronize" their national registers.[19] Other important parts of the Disclosure Directive deal with the validity of acts on behalf of the company in the pre-registration stage,[20] the general interdiction of the ultra vires doctrine[21] and the nullity of the company.[22]

[18] Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent, amending Council Directive 68/151/EEC.

[19] 'Member States shall ensure that the filing by companies, as well as by other persons and bodies required to make or assist in making notifications, of all documents and particulars which must be disclosed pursuant to Article 2 is possible by electronic means. In addition, Member States may require all, or certain categories of, companies to file all, or certain types of, such documents and particulars by electronic means. All documents and particulars referred to in Article 2 which are filed, whether by paper means or by electronic means, shall be kept in the file, or entered in the register, in electronic form. To this end, Member States shall ensure that all such documents and particulars which are filed by paper means are converted by the register to electronic form. The documents and particulars referred to in Article 2 that have been filed by paper means up to 31 December 2006 shall not be required to be converted automatically into electronic form by the register. Member States shall nevertheless ensure that they are converted into electronic form by the register upon receipt of an application for disclosure by electronic means submitted in accordance with the measures adopted to give effect to paragraph 4.'

[20] Article 8: 'If, before a company being formed has acquired legal personality, action has been carried out in its name and the company does not assume the obligations arising from such action, the persons who acted shall, without limit, be jointly and severally liable therefor, unless otherwise agreed.'

[21] Article 10: 'Acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs (...) The limits on the powers of the organs of the company, arising under the statutes or from a decision of the competent organs, may not be relied on as against third parties, even if they have been disclosed.'

[22] Article 12: 'The laws of the Member States may not provide for the nullity of companies otherwise than in accordance with the following provisions: (a) nullity must be ordered by decision of a court of law; (b) nullity may be ordered only on the grounds: (i) that no instrument of constitution was executed or that the rules of preventive control or the requisite legal formalities were not complied with; (ii) that the objects of the company are unlawful or contrary to public policy; (iii) that the instrument of constitution or the statutes do not state the name of the company, the amount of the individual subscriptions of capital, the total amount of the capital subscribed or the objects of the company; (iv) of failure to comply with the provisions of the national law concerning the minimum amount of capital to be paid up; (v) of the incapacity of all the founder members; (vi) that, contrary to the national law governing the company, the number of founder members is less than two.'

To sum it up, the Disclosure Directive establishes common standards for minimum contents of the national Commercial Register, a common scope of authority of the companies' representatives and a fully harmonized catalogue of reasons to declare a company void.

3 Why No Common Commercial Register?

The "Disclosure Directive" remains silent on the question of the legal nature of the national Commercial Registers, which is therefore completely up to the member states. The reason for the Unions' regulatory abstinence can be seen in the very different traditions of the member states concerning this matter. In central Europe (e.g. Germany, Austria, Hungary, Czech Republic, Slovenia), the Commercial Register is conducted by a court, in minor cases not by a "full" judge, but by a special trained registrar.[23] Other countries (e.g. Switzerland) have created special administrative bodies and argue that to register a company is clearly an administrative act and has therefore no "contradictory nature" that would justify involving courts in those matters.[24] Related to that, the European Court of Justice holds the view that a court of first instance conducting a public register (like the Commercial Register, but also the Land Register or the Maritime Register) acts as an authority of public law. As such, the proceeding is not judicial and therefore has no competence to refer a preliminary ruling to the ECJ.[25] For the same reason, some countries delegate the Commercial Register to special departments of the Government (e.g. Sweden: the Ministry of Economics),[26] whereas others entrust this issue to the local chamber of commerce (e.g. Italy).[27]

In my opinion, the court's competence is to be preferred. It is declaredly the most expensive, but also the "best" system. A judge is by nature, the best placed to ensure the necessary level of substantial control of applications in a Commercial Register proceeding. Admittedly, there is not a lot to control when a small sole trader wants to register himself (for that reason such cases are delegated to registrars under the

Apart from the foregoing grounds of nullity, a company shall not be subject to any cause of non-existence, absolute nullity, relative nullity or declaration of nullity; see Fischer-Zernin (1986), p. 283.

[23] See Ratka (2012), p. 41.

[24] See ibid., p. 42.

[25] ECJ, Decision 10.7.2001, Case C-86/00, HSB Wohnbau-GmbH; EuZW 2001, 499; see also ECJ 21.2.1974, Case 162/73, Birra Dreher/Administrazzione delle Finanze dello Stato, Slg 1974, 201; ECJ 19.10.1995, Case 111/94, Job Centre, Slg. 1995 I-3361, 3387, EWS 1996, 421.

[26] See Ratka (2012), p. 43.

[27] See ibid., p. 44.

supervision, direction and guidance of a judge[28]). However, when it comes to evaluating whether a complicated clause in the articles of association or the articles of incorporation of a private or public limited company is approvable or void (and therefore the company information is to be registered or not), or if a merger agreement is in line with the provision of the Stock Companies Act, or if the creditors have been secured, or the dissenting minority shareholders have been compensated with a fair price, or if the share exchange ratio is "reasonable", then a judge seems best-equipped to make such judgments.

In addition, a commercial court is—successional to registration—competent for lawsuits between the shareholders, the management and the shareholders, the supervisory board and the shareholder.[29] In those cases the commercial court as the authority of registration can be seen as some kind of "one stop shop". It "uncontradictorily" registers the company, but is also competent for all subsequent contradictory matters that may occur within a company. In the continental European view it is an unacceptable shortcoming, for example of the British system, that a completely untrained civil servant or even a computer system registers unaudited companies and gives them legal capacity and nothing less than limited liability to its shareholders and leaves it to the so-called "*ex-post*-control" of third parties to rebuke illegalities in the founding or registration process.[30] Competent "*ex-ante*-control" seems preferable to "*ex-post*-control".[31]

Nevertheless, these fundamental differences show that it is not only not possible, but also undesirable to create a unified "EU Commercial Register" or even unified national Commercial Registers that goes beyond the minimum harmonization level as mentioned above.[32] The inequalities in the level of registration control, especially between the German and the British system, are the main reason why the Union currently cannot agree on a completely unified company form for private limited companies ("Societas Privata Europea", SPE).[33] The German fear concerns a situation where a SPE registers—unaudited by an automatic registration system—in the British register and transfers its registered seat afterwards to Germany. The EU principle of mutual recognition and/or the principle of origin[34] would forbid German authorities from re-checking the registration and applying German standards of registration control. The Commercial Register remains very much a national matter and, on balance, that is probably for the best.

[28] See e.g. paragraphs 8–10 of Austria's *Rechtspflegergesetz*, BGBl. Nr. 560/1985.

[29] See e.g. Nowotny (2007), pp. 133–153.

[30] See Krejci (2008), pp. 208–213.

[31] See Krejci (2011), pp. 39–46.

[32] See Sect. 2 *Commercial Register and Company Law as a Competence of the National Lawmaker* above.

[33] See ibid.

[34] Lengauer (2012), Article 26 para 4–7.

4 National Register: International Business

Although there are—as pointed out—very good reasons to keep Commercial Registers in the national jurisdiction instead of transferring the competence to Brussels, "day to day business" is confronted with a lot of factual obstacles for using foreign registers. Language problems, technical problems and the frequent need to register at national information providers with all personal data including the bank account. The application and the use of a Commercial Register is not free of charge; the fees differ from member state to member state. Many of the Commercial Registers are accessible online, some only offline. Some provide online only very basic information free of charge (such as name and address), some disclose also document records (e.g. the memorandum of association, the annual balance sheet) on the Internet. This makes the application of a national Commercial Register, especially for foreigners, very complicated and expensive.[35]

A Common Internal Market—offering its citizens the free movement of goods, service, people and capital—has to be organized like a single home market and therefore also has to ensure the fast, safe and reliable access to all information available about business partners. In other words, if the lawmaker of the Internal Market—the Union—cannot or does not want to agree on a common Commercial Register, they should at least ensure that national registers are connected and easily accessible. This is nothing unique, but embraces the approach adopted by a number of national laws that opt for de-centralization. In some countries the Commercial Register is organized at national level (e.g. Sweden, Ireland and Denmark), in others at regional (e.g. Austria)[36] or even local level (e.g. Germany). In the latter case, the connection between regional and local registers has also to be mastered.

5 Excursus: The EEIG as an Instrument of Cross-Border Networks

The above mentioned EEIG—which was originally based on the pre-existing French *groupement d'intérêt économique* (G.i.e.)—is one of the, at least partly, unified company forms provided by EU regulations.[37]

The EEIG has—unlike most other company forms—a limited corporate purpose: Article 3 Paragraph 1 EEIG-regulation limits it 'to facilitate or develop the economic activities of its members and to improve or increase the results of those activities; its purpose is not to make profits for itself. Its activity shall be related to the economic activities of its members and must not be more than ancillary to those

[35] See Zib and Auer (1993).

[36] See Krejci (2013), pp. 73–114.

[37] See Anderson (1990), p. 9.

activities'. This should lead to better results than the members acting alone. An EEIG's activities have to be related to the economic activities of its members, but must not replace them.[38] Moreover, an EEIG may not employ more than 500 persons (Article 2 Paragraph 2).

An EEIG can be established by companies, firms and other legal persons governed by public or private law which have been formed in accordance with the law of a member state and which have their registered office in the European Union; it can also be formed by individuals carrying on an industrial, commercial, craft or agricultural activity or providing professional or other services in the EU. As a precondition for forming and incorporating an EEIG, it must have at least two members from different Member States (Article 4). An EEIG may not invite investment by the public (Article 24).[39] Any profits of an EEIG will be deemed to be the profits of its members and will be apportioned either according to the relevant clause in the contract or, as a default rule, in equal shares (Article 21). The contract for the formation of an EEIG shall include at least its name, its official address and objects, the name, registration number and place of registration, if any, of each member of the grouping and the duration of the grouping, except where this is indefinite (Article 5). The contract must be filed at the registry designated by each Member State (Articles 6 and 7).[40] The EEIG has to have at least two organs: The members acting collectively and the manager or managers (Article 16). The embodiment of the rest of the law applicable to an EEIG is up to the member states.

All in all, the EEIG is a very suitable instrument for cross-border cooperation and therefore especially for cross-border networks. Also the psychological effects should not be forgotten. If natural persons, companies, firms or other legal bodies—all of them "nationals"—cooperate cross border, in negotiations always the question arises on which national law applicable the parties should agree. At the end, one party has to draw back and accept the other party's law. But if the parties agree on the establishment of an EEIG as some kind of "neutral vehicle" for their cross-border cooperation, the psychological barrier to cooperate is lowered, though the EEIG-partners still have to choose in which national Commercial Register the EEIG should be registered.

Existing examples of EEIGs are "ARTE" (a French–German Network of TV channels providing high quality cultural program, "EALA" (European Advertising Lawyers Association), "EDCTP" (European and Developing Countries Clinical Trials Partnership), "Rail Manche Finance" (Network of funders of the tunnel between England and France), "EURESA" (operational cooperation and collaboration among European insurance companies belonging to the Social Economy), "Eurocité basque Bayonne – San Sebastian" (Network of Railway Companies), "European Business School Paris" (Network of Public Schools), "Thalys" (Network of Railways), "EVI" (European Vaccine Initiative) and the "European

[38] See in detail Grundmann (2007), pp. 704–707.

[39] See ibid., p. 705.

[40] Grundmann (2007), p. 706.

Business Register EEIG" (see Sect. 6). At the time of writing, there are approximately 1,000 EEIGs in existence.[41]

6 "European Commercial Register EEIG"

6.1 Preface: Functioning of the EBR

For the reasons outlined above, the EBR is not a separate "European register", but a network of national Commercial Registers that are still maintained by national public authorities.[42] The EBR EEIG, initially (though co-initiated and financed by the EU Commission), was a private law based initiative to overcome the troubles and obstacles of the cross-border use of Commercial Registers. Recently, it has triggered the EU Commissions' "Business Register Interoperability Throughout Europe (BRITE)" project, the goal of which is to develop an interoperability model for Commercial Registers to interact with each other.[43]

The EBR EEIG "manages" the network of activities between national technical partners, information distributors and Commercial Registers. It supplies its users with comparable, official information from the national registers connected to the EBR network. Currently the EBR exists of 28 partners and gives access the information stored in 27 national Commercial Registers. Some countries—Austria, Denmark, France, Germany, Greece, Italy, Latvia, Luxembourg, Malta, Netherlands, Norway, Spain, Sweden—are themselves, as legal persons of public law, members of the EBR EEIG.

The basis of the EBR is the so-called "Information Sharing Agreement": The EBR partners obligated themselves to provide access to the information stored in their domestic Commercial Register database. A precondition to be able to do that was the full "electronization" of the Commercial Register, which has been the presetting of the amendment of the "Disclosure Directive" a few years ago.[44]

The data from domestic registers are made retrievable via the EBR in so-called "standardized reports". By using the EBR, the user gets easy access to (1) the legal name of a company, (2) the registered office, (3) people representing the company (i.e. managing director, board of directors, and supervisory board), (4) the subscribed capital with a single account (via EBR-licensed national "information distributors").

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[41] Dine and Koutsias (2007), p. 338.

[42] See Sect. 2 *Commercial Register and Company Law as a Competence of the National Lawmaker* above.

[43] See Sect. 8 *From Private to Public Network? A New Directive for Interconnection of Commercial Registers: BRITE* below.

[44] See Sect. 2 *Commercial Register and Company Law as a Competence of the National Lawmaker* above.

Only for further information and/or to enter also the documents the user still has normally to refer directly to the domestic registers, but for some national registers additional information products are available from various countries which allow access to a much wider range of information. This includes also articles of association, annual accounts, annual returns, balance sheets and profit and loss statements.[45]

6.2 Development

The idea of the EBR has a long history[46]: Its origins lie in technical cooperation between Commercial Registers from 1992; its content was mutual technical support and continuous meetings between national experts. In addition, France, Italy, Denmark and the UK took part in a pilot project which aimed to build a multilingual access to at least a standard set of company information in foreign registers.[47] They didn't create such a system in practice, but at the end the project report attested to the "feasibility" of this idea, and that there could be in future "an Internet connection between registers". From 1996–1998 another EU project launched the first actual service and provided access to 12 registers, namely Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Norway, Spain, Sweden and the UK. In 1998, the EBR—which was based on a private-law treaty—established an EEIG for its further activities. On one hand, this "transformation" was a step forward, because a "simple" treaty has been changed into a corporate form, but on the other hand it was, and is, not the "perfect solution", since it is for some national Commercial Register not allowed by national public law to become partner of an EEIG because of the joint and personal liability of the partners for its debts. In other words, the "treaty making power" to become a member of a company like the EEIG is unclear in some member states.

From 2001, another project (the "European Commercial Register-Open Network") created a technical platform in order to make the integration of new EBR partners easier, and a so-called "common user interface" to be able to launch the service for third parties. In 2004, the prospected new platform started with 14 providers: Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Norway, Spain and Sweden. In 2004, the "Information Sharing Agreement", mentioned above, was put in place. The network partners obliged themselves to give each other access to information stored in the Commercial Registers. Successively, other countries became partners of the EBR network.

[45] http://www.ebr.org. Accessed 30 July 2013.

[46] In detail, Knechtel et al. (2000).

[47] See the planned "standardized reports", Sect. 8 *From Private to Public Network? A New Directive for Interconnection of Commercial Registers*: *BRITE* below.

In 2003 the Union set a milestone by enacting the amendment of the Disclosure Directive.[48] This forced the member states to create a fully electronic domestic Commercial Registers at the latest by 1 January 2007. As a result, this enabled the EBR to offer its services to all member states of the EU.

From 2007–2012 the number of countries from which registers the EBR EEIG can provide access has grown to 26; 20 of them are EU member states, which also means that the EBR EEIG has set also information exchange agreements with non-EU member states and has, therefore, grown to a information platform network reaching beyond the borders of the EU. In addition, the "old platform" successfully migrated into a new one in 2011 and now provides some additional services for its users. The "EBR 3.0 Registry Platform" has a centralized new architecture for the exchange of Commercial Register information.

7 Disadvantages: Limitations—Shortcomings

Unfortunately, third countries cannot become full members of the EBR EEIG, since membership is only open to legal or natural persons with a seat or central administration in the EU (Article 4 Paragraph 1 EEIG-Regulation).[49] Therefore, third countries or organizations must not be members of an EEIG. As a result it should be noted that the EEIG is not the proper legal instrument in case the EBR plans sustainable growth across the borders of the EU Internal Market.

In addition, the question arises; why a project like the EBR which is of enormous common interest—it is common sense (everywhere in the EU, perhaps except the UK[50]) that the guidance of a Commercial Register is in the public interest and should, therefore, not be given over to private companies—is run by a private law-based EEIG, though all its members are public legal persons.

Another disadvantage of the EEIG is not only the joint and personal liability of its partners (Article 24 EEIG-regulation), but also that—unlike within the EU decision making process, where in most cases a qualified majority is sufficient to take a decision and a dissenting member state can be overruled—all decisions have to be taken by common consent (Article 16, 26 EEIG-Regulation). As a result, only one member could block an essential decision on the development of the EBR or block the affiliation of new members.

[48] See Sect. 2 *Commercial Register and Company Law as a Competence of the National Lawmaker* above.

[49] Grundmann (2007), pp. 706–707.

[50] See Sect. 2 *Commercial Register and Company Law as a Competence of the National Lawmaker* above.

8 From Private to Public Network? A New Directive for Interconnection of Commercial Registers: BRITE

The EU Commission seems to have noticed these shortcomings and recently published—based on its "Green Paper" on the interconnection of Commercial Registers—a new proposal in June 2012.[51] The Directive aims to be the starting point for the so-called BRITE ("Commercial Register Interoperability Throughout Europe") project.

The Directive directly (and not anymore only the EBR EEIG agreement) requires all member states to link up their Commercial Registers electronically; automated data transmission should thus be possible between all Commercial Registers.

The lack of interconnection occurs at present for registered branches of foreign companies. Although a Directive[52] requires companies to disclose a lot of data and documents when they enter a foreign market by setting up a branch, companies often don't update this information, which potentially affects business partners when the register of the branch is not notified of the dissolution or the insolvency of the company. The EU Commission estimated that 'approximately 15% of the branches of foreign companies examined do not have an existing company behind them.'[53] On the other hand, the Commission outlined that the absence of cooperation between Commercial Registers 'puts administrative burden on companies as they have to update the content of the register of the foreign branch'.[54] Article 1 of the proposed Directive makes it mandatory for the Commercial Register of a foreign branch to send information by electronic means to the register of its company about the changes in the registered data.

The intended electronic and automatic interconnection is also expected to improve cooperation between Commercial Registers in cross-border transactions and mergers by ensuring better electronic links between them. For example, the register in Member State A could directly inform itself about the stage of proceeding at the register in Member State B in case a cross border merger[55] between companies of those two affected countries takes place. Article 2 of the proposed Directive contains therefore modifications making it clear that Commercial

[51] Directive 2012/17/EU of the European Parliament and of the Council of 13 June 2012 amending Council Directive 89/666/EEC and Directives 2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers, OJ L 156, 16.6.2012, pp. 1–9.

[52] *Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, OJ L 395, 30.12.1989, pp. 36–39.*

[53] See the preface to the Directive 2012/17/EU.

[54] Ibid.

[55] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on crossborder mergers of limited liability companies, OJ L 310, 25.11.2005, pp. 1–9.

Registers send each other notifications by electronic means in cross-border merger procedures and empowers the Commission to determine in delegated acts the technical details of the communication between the registers. It is also planned that the details of the delegation and data protection are to be regulated in the Directive.

Article 3 of the proposed directive makes sure that the documents in the member states Commercial Registers are always current. They have to ensure that the registered data is updated within 15 calendar days after a change occurs. In order to comply with this requirement, member states have to ensure that the companies file the relevant changes on time and the change is registered without any delay.

Compared to the "EBR EEIG Network", the proposed Directive plans to improve cross-border access to a common minimum set of registered business information by requiring member states to make the documents and particulars listed in Article 2 and registered under the Directive's requirements available through a single "European platform", for example a central, Union-run web-service that allows search in all EU Commercial Registers. As there are still a lot of differences between Member States, in addition an additional piece of information should be attached to every data transmission; it should explain the content of the national law applicable, in particular to what extent third parties can rely on it ("public trust").

The Commission estimates that facilitating cross-border electronic access to business information will "generate annual savings of more than 69 million euro" and is also useful for consumers:

> 33% of individuals in the EU ordered online, but cross-border shopping reached only 7%. Consumers underlined that one of the reasons for not buying in another country was the difficulty of establishing whether a seller (usually a company) was trustworthy or not, mainly due to insufficient information and language problems. Today's proposal should increase confidence and transparency in the European single market, ensuring a safer business environment for consumers.[56]

In conclusion, the new Directive makes the current voluntary co-operation between Commercial Registers (EBR EEIG) compulsory, governed and supervised by the Union.

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[56] See the preface to the Directive 2012/17/EU.

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The International Competition Network, Its Leniency Best Practice and Legitimacy: An Argument for Introducing a Review System

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Contents

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1 Introduction

When discussing transnational regulatory networks (hereinafter, *TRN*), the International Competition Network (hereinafter, *ICN*) is often mentioned as an example.[1] This network, connecting 123 national and supra-national competition enforcement agencies directly with each other,[2] has arisen out of the failed attempts to establish a truly international competition law to combat the ever progressing globalization of anti-competitive behavior.[3] It was believed that a more informal approach would enable the growth of a common understanding on competition law and its enforcement. The common understanding could then serve as the basis for the formulation of "best practices" on which the national legislations could converge.

Among the areas of competition law identified by the ICN to be part of this process to reach a common understanding was one of the most egregious forms of anti-competitive behavior, namely cartel formation. The competition enforcement agencies sought to share their experiences for identifying cartels. One of the tools most extensively discussed in this respect has been leniency programs. In the Anti-Cartel Enforcement Manual, the drafting and implementation of an effective leniency program received a separate chapter.[4] Compared to other tools of detecting cartel behavior, which are only being discussed in smaller subsection of another chapter,[5] this represents a substantial part of the total.

Devoting a whole chapter on the topic of leniency must indicate the importance that the competition enforcement agencies have attributed to the leniency program as an enforcement tool against cartels. Such a status can be read from many statements made by officials. James Griffin, summarizing the past 10 years of the operation of the United States (hereinafter, *US*) leniency program, praised this leniency program for leading to an increase in the number of cartel prosecutions and the amount of fines imposed.[6] Philip Lowe, detailing the history of European cartel enforcement, indicated that the real change in enforcement came with the adoption of the leniency program.[7]

If the leniency program is that important for the enforcement of cartel laws, special attention is laudable. Nevertheless, the optimism of the competition enforcement agencies, worrying voices can be heard among scholars writing on the various leniency programs. The strategic use of leniency programs has been identified as problematic for a well-functioning leniency program.[8] Leniency

[1] See e.g. Verdier (2009), pp. 150–161; Slaughter (2004), pp. 175–177; Raustalia (2002), pp. 35–43.

[2] See ICN (2012a), p. 3.

[3] See Sect. 2 *The Growth of a Transnational Regulatory Network in Competition Law* below.

[4] See ICN (2009), Chapter 2.

[5] See ICN (2009), Chapter 1.

[6] Griffin (2003).

[7] Lowe (2003), p. 11.

[8] Sokol (2012).

programs that are driven by foreign leniency applications are criticized for not offering a proper incentive scheme.[9] Other studies have revealed the weakness of leniency programs to trigger a race to the enforcement agencies.[10]

The critique that has been formulated towards the leniency programs is indirectly also a critique of the ICN's best practices. The best practices are being shaped by the experiences of the local competition enforcement agencies. If these experiences show flaws, they will automatically be reflected in the best practices. Through the best practices, the flaws will find their way to other competition laws or their enforcement regime. By using the example of the best practices on leniency, this chapter will concretize the idea developed by Yane Svetiev on the need for a review system of best practices.[11] Only by installing such a system, the ICN can keep its legitimacy as a norm setter for its members.

To develop this idea, this contribution will be structured as follows. The following section will give an idea why in the area of competition a transnational regulatory network has developed that aims at formulating best practices to converge on. Section 3 will provide details on the ICN's best practices on the drafting and implementation of a successful leniency program. To identify that these best practices have their origin in several decades of experimenting, Sect. 4 will map the experience of the US and the European Union (hereinafter, *EU*). That these experiences do not necessarily reflect the best outcomes will be subject of Sect. 5. This section will summarize some of the critiques that have been formulated to the previously introduced leniency programs. Best practices cannot be conciliated with critique, unless one accepts that the best practices should be open for review. Only in this way, the best practices can keep their legitimacy. Section 6 will unravel this discussion by focusing both on legitimacy issues and review of best practices. Before concluding in Sect. 8, Sect. 7 details on how this review could be conceptualized. An argument is made that the evaluation should be done by impartial evaluators and extends beyond just reviewing what has been considered as best practice.

2 The Growth of a TRN in Competition Law

2.1 The Internationalization of Competition Law

In his article, *Evolving toward What? The Development of International Antitrust*, Harry First posits that 1982 marked a milestone for the enforcement of competition

[9] Stephan (2005).
[10] Van Uytsel (2012).
[11] Svetiev (2012), pp. 285–290.

law.[12] It was the year in which William Baxter, then head of the Antitrust Division of the Department of Justice (hereinafter, *DOJ*), met with the head of the Commission's Directorate-General for Competition to discuss a potential divergent outcome of the respective enforcement agency's investigation into the behavior of IBM. The worry that drove Baxter's action was that the Commission was about 'to order IBM to disclose computer interface specifications, a remedy that Baxter thought was unwarranted'.[13] This disclosure order would extend beyond the territory of the then European Community. In other words, the European Commission would not have been able "to localize the effects of what they do."[14]

Even though First refers to this event as the fact that 'antitrust was internationalizing',[15] the more important fact is that it Baxter's visit showed the direction in which international competition law was heading. In the absence of an international competition law, and the increasingly willingness of enforcement authorities to assert jurisdiction over foreign conduct resorting effects in their territory, national enforcement authorities had to coordinate their activities in order to avoid conflicting outcomes.

The level of coordination was twofold. On the one hand, the knowledge of the existence of divergent views on competition law between different jurisdictions incentivized the enforcement authorities to start looking into the possible coordination of their general policies. On the other hand, the ever increasing liberalization of the world economy brought about more international orientated competition law cases. Many cartels had no longer just domestic effects, but effects worldwide. Merger increasingly occurred across borders. In order to streamline enforcement, either in terms of finding evidence or in terms of applications and substantive outcome, the enforcement authorities turned bilateral agreements to facilitate the investigations.

2.2 From Bilateral Cooperation Agreements to the International Competition Network

The bilateral agreements on cooperation and the informal channels for cooperation may have facilitated the consultations between the competition law enforcement authorities, the formal and informal contacts did not overcome all of the problems caused by the extraterritorial reach of competition laws. The incidents with the proposed acquisition of McDonnell Douglas by Boeing and of Honeywell by General Electric most eloquently illustrate this issue. The divergent views on the interpretation of the consequences of conglomerate mergers in both dossiers clearly

[12] See First (2003), p. 23.
[13] Ibid., p. 24.
[14] Ibid.
[15] Ibid.

indicated that focusing on the procedural aspects of competition law was not going to provide a satisfactory answer. With the one merger being substantially altered and the other one prohibited, these two 'high profile and acrimonious cases were something of a wake-up call to the antitrust officials in both the United States and Europe'.[16]

Within the context of the dispute between the EU and the US on what is a better understanding of competition law, the International Competition Policy Advisory Committee (hereinafter, *ICPAC*) was established in 1997.[17] This advisory committee was to assist the US DOJ in looking for the 'new tools, tasks and concepts that will be needed to address the competition issues that are just arising on the horizon of the global economy'.[18] The Committee was composed of 13 members. Besides the Committee chairpersons, James Rill and Paula Stern, and its executive director Merit Janow, seven business and foundation executives and three professors were attracted to take part in the hearings, deliberations and formulation of recommendations.[19] Three years after its establishment, ICPAC submitted a report to Attorney General Reno and Assistant Attorney General Klein.[20] This report contained numerous recommendations, one of which was the establishment of a Global Competition Initiative (hereinafter, *GCI*).[21]

Eleanor Fox, one of the professors taking part of ICPAC, described the outset of the GCI as follows:

> The GCI was envisioned as a virtual, voluntary forum with no ground address or secretariat, no power to make binding rules, and no power of adjudication. The idea for the enterprise stemmed from the realization that antitrust authorities, business people, and experts lacked a forum for the sharing of views and experiences, for close cooperation, and for exploration of common issues that could lead to convergence or harmonization.[22]

It was Assistant Attorney General Klein who took the initiative to launch the proposal at the international level. At the Tenth Anniversary Conference for European Merger Control, Joel Klein indicated that the bilateral efforts were not a sufficient answer to the problems that were caused by globalization. There should also be a focus on the substantive part of competition law. However, he acknowledged that there was not forum suitable for this job.[23] Inspired by the proposal of setting up a GCI, Klein called for an initiative at the global level, something that may eventually pave the way for multilateralism within the field of competition law.[24]

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[16] Janow and Rill (2011), p. 27.

[17] See First (2003), p. 33.

[18] See Fox (2011), p. 113.

[19] See ibid.

[20] See ibid., at 114.

[21] See ibid.

[22] Ibid.

[23] See First (2003), p. 33.

[24] See Fox (2011), p. 114.

Even though the idea for a GCI was positively welcomed, the contours of this Initiative had still to be drawn. At a meeting in Ditchley Park, organized by the International Bar Association, with support from the American Bar Association Antitrust Law Section and the Fordham Corporate Law Institute,[25] it became clear that the government agencies wanted to take control over the GCI.[26] However, without support of the US, it was unclear whether the GCI would be a viable initiative. As early as the Ditchley Park meeting, there was no certainty on whether the newly inaugurated President George Bush and his administration would back up the initiative.[27]

Attracted by the idea that the new initiative would only cover competition law and focus on issues for which solutions would be achievable, the newly appointed Assistant Attorney General, Charles James, and Timothy Muris, newly appointed to the position of Chairman of the Federal Trade Commission, were eager to support the GCI.[28] Once ascertained of this support, further consensus was being sought among other competition law enforcement authorities. By the time that the Fordham International Antitrust Conference was being held in 2001, this consensus was achieved among 14 jurisdictions.[29] The enforcement authorities of these 14 jurisdictions used the opportunity of the Fordham Conference to launch the initiative and named it the International Competition Network.

2.3 The Role of ICN as a TRN in Convergence

The ICN has, from its establishment, aimed at 'addressing antitrust enforcement and policy issues of common interest and formulate proposals for procedural and substantive convergence through a result-orientated agenda and structure'.[30] The idea of convergence has been complemented with the encouragement of 'the dissemination of antitrust experiences and best practices'[31] and promoting the 'advocacy role of the antitrust agencies'.[32] This initial aim has been restated in the Operational Framework that the Steering Committee formulated in 2012.[33] The ICN's website incorporates a short restatement of this mission statement. In what it

[25] See www.internationalcompetitionnetwork.org. Accessed 30 July 2013.

[26] See Fox (2011), p. 114.

[27] See ibid.

[28] See ibid.

[29] See www.internationalcompetitionnetwork.org. Accessed 30 July 2013 (Australia, Canada, European Union, France, Germany, Israel, Italy, Japan, Korea, Mexico, South Africa, United Kingdom, United States and Zambia).

[30] ICN (2001), p. 1.

[31] Ibid.

[32] Ibid.

[33] See ibid.

calls its mission statement on the top of the ICN website, the ICN advocates the 'the adoption of superior standards and procedures in competition policy around the world, formulate proposals for procedural and substantive convergence, and seek to facilitate effective international cooperation to the benefit of member agencies, consumers and economics worldwide'.[34]

Convergence is an idea that is pervasively present in all these documents. Convergence has therefore been given much more attention in the document elaborating the vision for the second decade of the ICN, convergence was given a context. In broad lines, the ICN Steering Committee defined convergence as the 'voluntary adoption of widely-accepted norms of competition policy, substantive standards, procedures and levels of institutional capacity'.[35] Inherent in the concept of convergence is divergence. One can only move in the direction of widely accepted standards if the current practices are different from each other. This is also reflected in the vision on the second decade. Convergence is described as running through three different stages. Convergence, as also has been identified by Maurice Stucke, can only occur if there is an agreement on norms, standards and procedures that have been divergent in the past.[36] Therefore, the first stage towards convergence is the implementation of different norms, standards and procedures. This will allow for experimentation to see which of these norms, standards and procedures are more effective than the others. Sharing the information and experiences of the experimentation is the second stage. This part of the process will facilitate the identification of best practices, which could be then put forward as the benchmark.[37] The role of the ICN in this evolutionary process is to 'promote the flow of information about different agencies' ongoing experiments and feedback from these experiment'.[38] The third stage is that individual jurisdictions opt for the benchmark, the norm that has received consensus as being the best possible solution for specific problems.[39]

The description of the ICN's role in the convergence process colludes very well with what Anne-Marie Slaughter has termed an information network.[40] Across the various member organizations of the ICN, there is a lot of information on how they operate on a procedural and substantive level. The information is so overwhelmingly vast that it creates a 'paradox of plenty',[41] in which not much attention is paid to the essence at stake. In order to come to some kind of common view, Robert Keohane and Joseph Nye emphasize the need to have 'editors, filters, interpreters

[34] www.internationalcompetitionnetwork.org. Accessed 30 July 2013; see also Maher and Papadopoulos (2012), p. 74.

[35] ICN (2011), p. 5.

[36] Stucke (2012), p. 158.

[37] See Hollman et al. (2012), p. 92; Stucke (2012), p. 158.

[38] Stucke (2012), p. 158.

[39] ICN (2001), pp. 5–6.

[40] See Slaughter (2004).

[41] Keohane and Nye (1977), p. 89.

and clue-givers, as well as "evaluators" in distilling power for the plentitude of information'.[42] The ICN fulfills this role. This TRN actually collect[s] and distill [s] information about how their members do business.[43] In order to have an operational end product, Slaughter has indicated that the TRN's work usually end up in 'a code of "best practice," meaning a set of the best possible means for achieving a desired result'.[44]

Stucke sees the ICN's cartel leniency program as a good example of this process. Various members of the ICN had implemented a leniency program and have experimented with different formulations of the leniency programs. These experiments allow other members to learn in what format the leniency program will work well and see whether that format is well suited for their jurisdiction. The latter part of the convergence process has been guided by a best practice, which was, according to the ICN's Steering Group, not too complex to formulate due to the relatively narrow differences in this area. Stucke notices, with reference to the ICN's website, that this has led to a massive implementation of the leniency program in various jurisdictions.

3 The ICN's Best Practices on Leniency

Before the Cartel Working Group started to compile the best practice on the implementation of a leniency program in Sydney in 2004,[45] several independent studies were already undertaken by economists to map out in what kind of situation a leniency program would operate efficiently. The economists made some general predictions, put forward guidelines related to the cartel member's behavior and prescribed how enforcement authorities should handle leniency applications. Even though these economic studies rely on models, limiting their scope of applicability due to the dependency on the parameters within which these models were framed,[46] a common line is detectable in the conclusions of these studies. There is a general agreement that leniency programs, of which the actual content may differ according to the theoretical study, will induce cartel participants to come forward with information on illegal cartel activity.[47]

The Cartel Working Group, that elaborated the best practices for the ICN, added more specifications to this analysis. The Cartel Working Group does not necessarily disagree with the economists' conclusions, but this Working Group obviously only

[42] Ibid.

[43] Slaughter (2004), p. 53.

[44] Ibid.

[45] See Mehta and Sakkers (2011), p. 269.

[46] See Motta and Polo (1999), p. 22.

[47] See e.g. Bigoni et al. (2008), pp. 13–14; Chen and Harrington (2005), p. 17; Spagnolo (2005), pp. 16–23; Brenner (2005), pp. 33–34; Ellis and Wilson (2001); Motta and Polo (1999), p. 22.

wants to focus on 'best practices', thus things that work properly. Therefore, the Working Group basically stated that a successful implementation of a leniency program requires several prerequisites. Among these prerequisites is the high risk of detection, significant sanctions, and transparency and certainty regarding the application of the leniency program.[48] Even though transparency and certainty regarding the application is not a prerequisite, but rather something that is part of the conceptualization of the leniency program itself, the Working Group recommends a leniency program for cases in which the enforcement authority is not aware of the cartel or where the authority is aware of the cartel but does not have sufficient evidence to proceed to adjudicate.[49]

The economic studies also looked into the need to have a distinction between a pre-investigation and a post-investigation leniency application. Disagreement exists in relation to the moment leniency should be provided. Massimo Motta and Michele Polo assume that lenient treatment is not only efficient in the pre-investigation stage, but also in the post-investigation stage.[50] Giancarlo Spagnolo, on the contrary, argues that cartels are convicted to disappear once they are detected. Hence, there is only a need to focus on cartels that are not yet under investigation.[51] However, starting from the presumption that a leniency program functions on the basis of a cost-benefit analysis, there would be no reason to exclude this kind of rational behavior from the post-investigation stage. A majority of the literature confirms this viewpoint.[52]

The best practice developed by the ICN does not provide much detail on the distinction between a pre- and post-investigation leniency application. Indirectly, it is possible to deduct from the best practices that both a pre- and post-investigation leniency application could be a good practice. First, when discussing the full and frank disclosure requirement, the guiding text formulates that leniency may also be available after an investigation has commenced. However, this guiding text limits this possibility to the first eligible applicant.[53] Second, the best practice on subsequent applicants does not exclude the possibility that a leniency program extends to more than one applicant. Whether the subsequent applicants defect before or after a dawn raid is left open in the formulation of best practice.[54]

In order to convince cartel members to defect the cartel and come forward with information leading to the breakdown of the cartel has been discussed in the economic literature in relation to the amount of leniency that should be offered.

[48] ICN (2009), Chapter 2, p. 3.

[49] Ibid., p. 4.

[50] See Motta and Polo (2001); Motta and Polo (1999), p. 15.

[51] See Bigoni et al. (2008), p. 24; Spagnolo (2000a), p. 6.

[52] See, e.g., Chen and Harrington (2005), p. 12; Feess and Walzl (2003), pp. 7–8 and 17; Ellis and Wilson (2001), pp. 17–18.

[53] See ICN (2009), Chapter 2, p. 8.

[54] See ibid., p. 9.

In an optimal situation, a generous reward is offered to the applicant.[55] Less aggressive leniency programs, which only offer a reduction, will be less effective.[56] Again, the more lenient treatment is offered in less courageous programs the more effective these moderate programs will be.[57] Whether the program is courageous or modest, the probability of reporting increases if the lenient treatment is restricted to a certain number of firms. The fewer the number, the more likely it will be that a cartel participant will come forward with information.[58] Some studies even point out that rewards for individuals will be more effective than the ones for corporations.[59]

The ICN best practices are again not very informative about the level of leniency that would achieve the best result. Nevertheless, when discussing what the subsequent leniency applicants should receive, it is stated that these should receive less than full leniency.[60] Indirectly, we can conclude that the best practice for the first applicant is to give immunity and thus guarantee that no penalty will be imposed. How much the second applicant or any subsequent application should receive is not stipulated in the best practice. It has been stipulated that in some jurisdictions a 50 % reduction in fines is applied. Another option would be to make the level of leniency dependent on the quality of the information or evidence or the speed with which they report.[61]

Even though the observations of the economic studies focus mainly on a cost-benefit analysis of the cartel participants, indirectly they have also an impact on the behavior of the competition authorities. By concluding that certain incentives have a positive effect on reporting the illegal cartel activity, these incentives should not be jeopardized by actions of the competition authority. This has an impact on the substantive formulation of a leniency program. A leniency program should neither grant powers to competition authorities to "second-guess" the application, nor contain provisions obstructing or obscuring the application process.[62]

[55] See Spagnolo (2005), pp. 18–19; Spagnolo (2000a), p. 12; Spagnolo (2000b), p. 37 (indicating that the size of the discount determines the prevention of negative consequences for a leniency program).

[56] See Chen and Harrington (2005), p. 16 (stating that partial leniency programs can enhance the formation of cartels).

[57] See ibid. (arguing that more leniency is making collusion less profitable); Spagnolo (2005), pp. 20–22; Spagnolo (2000a), pp. 10–11.

[58] See e.g. Spagnolo (2005), pp. 17 and 26; Ellis and Wilson (2001), p. 23; But see Motchenkova and van der Laan (2005) (stipulating that in a cartelized economy complete exemption from the fine should be granted to all the self-reporters. The paper only agrees with limiting the leniency to the first firm in an economy not knowing a high degree of cartelization); Motta and Polo (1999), p. 21 (saying that leniency should be provided to any firm revealing information).

[59] See Aubert et al. (2003); But see Festerling (2005).

[60] See ICN (2009), Chapter 2, p. 9.

[61] See ibid.

[62] See Motta and Polo (1999), p. 4 (stating that they start from a basic model).

The Cartel Working Group devoted much attention to this last aspect. Several conditions that could be attached to a leniency program are being discussed in the best practices. Full and frank disclosure of information is regarded as a best practice.[63] Similar, the ongoing cooperation of the leniency applicant is seen as necessary.[64] Confidentiality of the identity of the leniency applicant and his information will also contribute to a better functioning leniency program.[65] Another category of good practice in relation to the enforcement authorities link to the fact that there needs to be a guarantee that the enforcement authorities cannot jeopardize the application[66] and that there needs to be insurance on the certainty for applicants where investigations are closed without an enforcement action.[67] When engaging with the enforcement agency, a leniency applicant should be able to reserve its position in the queue and submit information after he has made the reservation. In other words, the creation of a marker system is a good practice.[68]

4 Lessons Drawn from Three Decades of Experimentation

When the ICN started to elaborate the best practices on the leniency program, not that many jurisdictions had experimented with a leniency program. The US has the longest experience. The US could draw lessons from not only the conceptualization of its original leniency program, but also from legal changes to that program. The ICN could also revert to the relatively long experience of the EU with a leniency program. Similar as to the US, the EU also has amended its leniency program once before the Cartel Working Group started to concentrate on the issue of designing an efficient leniency program.

4.1 Pre- and Post-Investigation Leniency Applications

The only jurisdiction that has been experimenting with pre-investigation incentives has been the US. Their original *Corporate Leniency Policy* (1978 Leniency Policy),[69] which was established in 1978, offered a lenient treatment only in the pre-investigation stage. Corporations could not enjoy lenient treatment under this policy once the DOJ had started its investigation. When the 1978 Leniency Policy

[63] See ICN (2009), Chapter 2, p. 8.
[64] See ibid.
[65] See ibid., p. 10.
[66] See ibid., p. 11.
[67] See ibid.
[68] See ibid., p. 7.
[69] See Shenefield (1978), para. 50,388.

came up for revision in the 1990s,[70] one of the elements that changed in the policy was exactly this point of the scope of the leniency program.[71] The program was expanded to leniency for the post-investigation stage, creating the presumption that this expansion would augment the likelihood of discovering and punishing illegal cartel activity.[72]

If this policy change had been the only one, the subsequent increase of applications would definitely have been enough proof of the necessity to have a leniency program in the post-investigation stage.[73] However, as will be indicated below, many other reasons have prevented the 1978 Leniency Policy to be successful. Therefore, the policy change cannot be more than a presumption of the necessity to have a leniency program for the post-investigation stage.

Welfare considerations oblige to consider the installation of a leniency program in the post-investigation stage. Investigations are costly. Competition authorities, which have a suspicion on illegal cartel activity, will have to make the necessary human, financial and material resources available to start an investigation. Obtaining information from the cartel participants has its limitations, though. The inspections at business premises or private houses of company employees will only give positive results if physical evidence exists. Whether or not this evidence exists, the competition authorities will have to find out. Unless they have specific information about the existence of the information and the place to find it, they will have to spend a lot of time going through many documents with the risk of finding nothing at all. In the latter case, all the resources made available are wasted.[74]

The costs of a certain method of investigation should be weighed against its benefits. If the costs outbalance the benefits, the use of that method is not justified.[75] A less costly method should be preferred. It seems clear that leniency programs can, if they are well designed, lower the search costs. Indeed, as Wouter Wils indicates, these costs will be shifted from the competition authority to the company and its staff.[76] Since they are more familiar with the illegal activity, collecting the relevant

[70] For various other reasons discussed below, the 1978 Leniency Policy did not turn out to be successful. According to the Antitrust Division of the DOJ, 17 corporations applied for leniency between 1978 and 1993. Six requests were denied and ten corporations qualified for amnesty. Only four out of these ten corporations qualified for amnesty before 1987, the year in which an amnesty program for individuals started. All the other requests followed, suggesting that the increased success of the Leniency Policy is partly due to the instigation of this policy. Over the whole time span, six requests for leniency were denied. At the time of revision, still one request was pending. The initial Leniency Policy had an average of approximately one leniency application per year. See Kobayashi (2001), pp. 728–731.

[71] Klawiter (2007), pp. 490–491.

[72] Bingaman (1993).

[73] See Hammond (2000), f. 2; see also Stephan (2005), pp. 4 and 15 (indicating that the difficulty to get data on the US Amnesty Program).

[74] See Wils (2005), p. 148.

[75] See Wils (2005), p. 143.

[76] See ibid., p. 148.

information will likewise be much cheaper. Whereas this analysis says something about the desirability of a leniency program in the post-investigation stage, nothing can be deducted from these considerations as to how the leniency program should look like in detail.

4.2 Immunity as an Incentive Inducing Cartel Defection

The explicit silence on the need to provide immunity for the first applicant in a leniency application as a best practice is somehow peculiar given the explicit lesson that could be drawn from the US and EU experience. It could be said that, as long as immunity is guaranteed in a pre-investigation stage, firms are willing to reveal information on illegal cartel activity. Providing guaranteed immunity in a post-investigation stage does not seem to be a necessity in order to induce firms to cooperate with competition authorities in the framework of a leniency program. A combination of the lack of guaranteed immunity with the existence of leniency in the post-investigation stage seems to support collusion. It is not possible to draw conclusions on whether this immunity should be restricted to the first applicant or whether reductions should be offered to any subsequent applicant.

These conclusions are based upon the following considerations. The US Leniency Policy, whether it was the 1978 or the 1993 version, limited the lenient treatment to the first company successfully applying. The difference between being the first and the second is immense in the US context. The first corporation will enjoy immunity, while the second, theoretically speaking,[77] will have to bear the consequences of a cartel prosecution.[78] This difference is supposed to set up a race between corporations to the door of the Antitrust Division of the DOJ.[79] This race, usually referred to as the "race to the courthouse door,"[80] will mortgage cartel activity. It will be very hard to establish the necessary trust among corporations to engage in cartel activity.[81] In the 1993 format, the Leniency Policy got about three applications for immunity per month.[82] However, in the two first years after the new policy, only 15 corporations applied.[83]

[77] See Harrington (2006), p. 15 (stating that the United States has besides its Corporate Leniency Policy also the possible to enter in plea-bargaining. Hence, corporations, which do not qualify for leniency, can hope that the DOJ enters in a plea bargain. However, the DOJ is not committed to provide lower penalties via this option. It belongs to their discretional power to do so).

[78] See Harding and Joshua (2003), p. 216 (giving the message to would-be leniency applicants that they must "cooperate or else – remember it hurts to come in second").

[79] See Kobayashi (2001), pp. 729–730.

[80] See Conner (2008) (mentioning that the US has not only the Leniency Policy but also plea bargaining).

[81] See Harding and Joshua (2003), pp. 215–216.

[82] See Spagnolo (2006), p. 37.

[83] See Spratling (1995).

Even though the 1996 Leniency Notice did not conceptualize a guaranteed immunity, its practice has some relevance for assessing the theoretical considerations above. Whereas the level of leniency may have been uncertain under this program, the differences between the amount of reductions was minimal. Of all cases during the period when the 1996 Leniency Notice was in force, only three cases were related to immunity.[84] All the rest were leniency cases after the Commission did a dawn-raid.[85] Even though the degree of leniency in the pre-investigation stage was still higher than in the post-investigation stage, undertakings did not attempt to reveal any information in the pre-investigation stage. This may indicate that the undertakings have been waiting until the moment they had to save their skin. In other words, absence of a clear incentive triggers a waiting game.

When immunity became established as a certainty in the 2002 Leniency Notice, a shift was noticeable from a waiting game to an assertive use of the leniency program. Rather than waiting and applying for reduction, the undertakings engaged in illegal cartel activity straightly applied for immunity.[86] The majority of leniency applications in the 3 years after the adoption of the 2002 Leniency Notice was for immunity and submitted before an investigation took place.[87] The data on the remaining part of the applications do not allow categorizing these applications for reduction in the pre- or post-investigation stage. It is not unthinkable, however, that at least a part of the applications situate in the post-investigation stage.

With an average of 25 applications for immunity per year, the 2002 Leniency Notice reaches 11 applications less than the 1993 Leniency Policy. Whether this difference is attributable to the fact that a second, third and even fourth undertaking can enjoy leniency thus causing a waiting game, is difficult to say. However, if we know that nearly half of the immunity applications in the US have occurred at the post-investigation stage, while the immunity application in the EU are all in the pre-investigation stage, the conclusion that leniency to more than one firm leads to a waiting game, most likely does not hold. The risk was not too high before.

The expected leniency discount needs to be sufficient in order to outweigh the possible gains of the cartel. In this respect, both the EU and the US have put a full immunity of 100 % forward. The higher the penalties that can be waived, the higher the success rate of a leniency program. This also implies that the infringer must be able to calculate the amount of the fine. In order to fortify the strength of the immunity, the US has also regulated that the treble damages, usually applicable to antitrust infringements, will be reduced to single damages.

[84] See Van Barlingen (2003), p. 17; see also Bloom (2007), pp. 549–550.

[85] See Van Barlingen (2003), p. 17.

[86] See Spagnolo (2006), pp. 13–14; Van Barlingen (2003), p. 17; see also Bloom (2007), p. 548.

[87] See Spagnolo (2006), p. 13.

4.3 Subsequent Leniency Applications Impairing the Race to Defect

The 1978 Leniency Policy granted complete immunity to the first successful applicant in a pre-investigation stage. There was no leniency provided under this program for any other cartel participant. The 1993 *Corporate Leniency Policy* (1993 Leniency Policy) did not change this. It only added immunity for the first successful applicant in the post-investigation stage.[88] A different approach was taken by the EU. The 1996 Leniency Notice provided for immunity or reduction for the first successful applicant in the pre-investigation stage. Subsequent applicants in this stage could enjoy leniency as well. In the post-investigation stage, only reduction was offered to the applicants.[89] The revision of this policy in 2002, only changed the format of immunity in the pre-investigation stage.[90] The 2006 revision did not change anything related to the incentives.[91]

To know whether the US's approach towards leniency is more effective than the European one, both systems have to be contrasted with each other. In an empirical assessment of the 1996 Leniency Notice, Stephan Andreas investigated whether the Notice could induce undertakings to come forward and reveal an illegal cartel.[92] In a period between 1996 and 2005, Stephan counted 33 cartel cases in which the Commission had taken a decision.[93] Out of the 33 cases, 20 were triggered by a leniency application.[94] The 20 cases could then be further divided in two categories: cases that have a US preceding or simultaneous investigation, or cases that were only investigated in the EU.[95] The former outnumbered the latter by eight, allowing Stephan to cautiously conclude that 14 EU leniency cases are likely to be on the back of a successful US Leniency Policy.[96] Indirectly, the author suggests that the US Leniency Policy was better conceptualized.

More important than the observation that EU leniency cases are preceded by investigations in other jurisdictions, the leniency applications in the EU were mainly after dawn-raids by the Commission were held.[97] In other words, the 1996 Leniency Notice was most successful in the post-investigation stage. This Notice

[88] See Department of Justice (1993).

[89] See European Commission (1996).

[90] See European Commission (2006).

[91] See European Commission (2006); see also Sandhu (2007), p. 148.

[92] See Stephan (2005), pp. 5–6.

[93] See ibid., p. 5; see also Bloom (2007), p. 550.

[94] See Stephan (2005), pp. 5.

[95] See ibid., pp. 5–6.

[96] See ibid., p. 6; see also Van Barlingen (2003), pp. 16–17 (revealing, as an insider, that nearly all of the leniency application in the 6 years of operation of the 1996 Leniency Notice has been the result of dawn-raids organized by the Commission due to close cooperation with competition authorities from other jurisdictions, like the United States, Canada and Japan).

[97] See Van Barlingen (2003), p. 17.

was not conceptualized to induce undertakings to come forward with information in a pre-investigation stage. In fact, immunity was only granted in three cases over a period of 6 years. This is in stark contrast with the 2002 Leniency Notice, which was able to attract 20 applications for immunity in the first year of being in operation,[98] with a similar amount of applications in each of the next 2 years.[99] Unlike the 1996 Leniency Notice, the 2002 Leniency Notice establishes automatic immunity.

4.4 Discretional Granting of Leniency and Its Counterproductive Effects

The 1978 Leniency Policy attached several conditions for receiving immunity.[100] Most of the conditions were reasonable. In exchange for immunity, the applicant had to be the first to provide with candor and completeness previously unknown information, to promptly terminate its participation in the illegal activity, to continuously assist the Antitrust Division of the DOJ in their investigation, and to restitute the injured parties if possible. Further, the applicant should not have coerced others to participate or being the originator or leader of the illegal activity. However, one condition in specific was problematic since it was not in the control of the applicant. Even if the corporation would have met all the previously mentioned conditions, the DOJ could refuse immunity based on the criteria of "reasonable expectation."

The condition of reasonable expectation implies that whenever the DOJ has a reasonable expectation that it would have discovered the reported illegal activity even if the corporation had not reported it, the DOJ would not grant any lenient treatment.[101] The insecurity created by this provision was immense. The cost-benefit analysis to cooperate or to come forward with information could not be made anymore.[102] For each calculation, the potential applicant had to predict the judgment of the DOJ. Without precedents, such a prediction is hard to make. Therefore, corporations chose to err on the side of caution and made the calculations on the worst presumptions, making the balance nearly always incline to the cost side. Nearly no corporation came forward with information.

Indeed, the 1978 Leniency Policy was barely used. According to the Antitrust Division of the DOJ, 17 corporations applied for leniency between 1978 and 1993.[103] Six requests were denied, one case was pending and ten corporations

[98] See ibid., p. 17; see also Blum et al. (2008), p. 213; Riley (2005), p. 378.

[99] See Blum et al. (2008), p. 213.

[100] See Kobayashi (2001), pp. 729–730.

[101] See ibid., p. 729.

[102] See Harrington (2006), p. 21.

[103] See Spratling (1995), Part V.

qualified for immunity at the time of revision.[104] Only four out of these ten corporations qualified for immunity before 1987, the year in which a leniency program for individuals started. All the other six requests followed, suggesting that the increased success of the Leniency Policy is partly due to the instigation of this policy.[105] The initial Leniency Policy had an average of approximately one leniency application per year.[106] Once the immunity was granted automatically, the application rate increased 20-fold.[107]

The situation in the EU was slightly different. The 1996 Leniency Notice was indecisive as to the degree of leniency provided to a cooperating undertaking. Rather than stating that an undertaking that is the first to successfully cooperate would be granted immunity, the 1996 Leniency Notice left a discretional margin to the Commission. The first undertaking to report in a pre-investigation stage would benefit a reduction of 75 % or more. In the best case, this could amount to immunity. In a post-investigation stage, the first undertaking would enjoy a reduction between 50 and 75 %. The criterion to choose the degree of leniency was the decisiveness of the evidence to reveal the existence of an illegal cartel. Hence, it was up to the Commission to assess the value of the evidence provided.

Assessing the value of evidence provided is an internal process of the Commission. It entirely depends on how much evidence the Commission already has and what it will be able to acquire. Unless the applicant for leniency does not have a clear view on this aspect, as far as it is possible for evidence that may be acquired in the future, he will not be able to calculate his potential benefit of applying. From the viewpoint of a potential applicant, this leniency program will be perceived as 'there *might* be *some* relief in relation to a *potential* fine from the Commission'.[108]

The Commission saw the 1996 Leniency Notice as a success. Mario Monti, the at that time Competition Commissioner, stated in a press release in July 2001 that '[t]he Leniency Notice has played an instrumental role in uncovering and punishing secret cartels'.[109] Yet, this chapter has already put forward a study of Stephan to refute this viewpoint.[110] Due to the uncertainty of obtaining immunity, there was no longer a need for undertakings to reveal any information in the pre-investigation stage. Taking the worst-case scenario in mind for the pre-investigation stage while making the calculus, the undertakings would have found out that it equaled with the worst-case scenario in the post-investigation stage. That is 10 % reduction of the

[104] See ibid., Part V.

[105] See Harrison and Bell (2006), p. 212, f. 22; see also Bloch (1995), p. 4.

[106] See Kobayashi (2001), p. 729; see also Leslie (2006), p. 454.

[107] See Spagnolo (2006), p. 37.

[108] Harding and Joshua (2003), p. 219.

[109] Monti (2000); Considering that the inspection carried out by the Commission were mainly based on leniency application, the statement of Monti makes sense. See Bloom (2007), p. 552 (mentioning that two-thirds of the inspections were based on leniency applications).

[110] See Stephan (2005), pp. 5–6.

penalty. Nearly all of the leniency applications thus also happened in the post-investigation stage, after the Commission started investigation.[111]

Making immunity uncertain and putting the subsequent reduction penalties close to each other has consequently led to a major waiting game by the undertakings. Johan Carle, Pervan Lindeborg and Emma Segenmark somehow confirm this result of the 1996 Leniency Notice in the following terms:

> [S]ince its entry into force in July 1996, the 1996 Notice has, as far as we are aware, merely been applied in approximately 16 cartel cases. In the majority of these cases the co-operating entity was only granted a reduction of 10–50 per cent. A very substantial reduction of 75 per cent has, as far as we have been aware of, been granted in a handful of cases under the 1996 Notice.[112]

Somewhat contradictory to his previous statement, Monti acknowledged that better results in this waiting game could be achieved by giving better incentives to the undertakings.[113] However, it turned out that the way in which the incentives were conceptualized, was wrong.

4.5 The Importance of Clear Conditions

A leniency program is a complex web of conditions, related to information, order of application, time of application, obligations for the leniency applicants or the role the cartel participant has played. The broader the scope of the leniency program, the more complex this web will be.

Leniency programs are conceptualized in order to get information about illegal cartel activity. The US 1993 Leniency Policy stipulates in relation to information that the DOJ does not have received the information yet; the applicant reports it with candor and completeness.[114] In a post-investigation stage, the information should be likely to result in a sustainable conviction.[115] The EU 2006 Leniency Notice is much more detailed. The first information submitted should enable the Commission to carry out targeted inspections[116] or to find an infringement of article 101 TFEU[117] on the condition that the Commission does not have enough evidence yet to pursue either of them.[118] The information should be complete.[119] Further, the

[111] See Harding and Joshua (2003), p. 219.

[112] Carle et al. (2002), p. 265.

[113] See Monti (2001) (stating that "this fight can produce better results if companies are given a greater incentive to denounce this kind of collusion").

[114] See Department of Justice (1993), para. A, 1 and 3.

[115] See ibid., para. B, 2.

[116] See European Commission (2006), point 8 (a).

[117] See ibid., point 8 (b).

[118] See ibid., point 10 and 11.

[119] See ibid, point 12 (a).

information should not be falsified nor disclosed to other persons.[120] For subsequent applications, the information should represent a significant added value.[121]

The time element in a leniency program points at the stage in which the applicant files for leniency. There are two stages; the application is filed either in the pre-investigation stage or in the post-investigation stage. The 1993 Leniency Policy does not stipulate the element making the difference between both stages, but these stages are clearly separated.[122] In the 2006 Leniency Notice, the distinction between the two stages is less clearly described. The post-investigation stage is indirectly pointed at by stating that immunity can be obtained if the applicant provides information leading to the establishment of an infringement of article 101 TFEU EC, presuming that this can happen even after the Commission has done a targeted investigation.[123] Hence, a targeted investigation seems to be a lever between a pre- and a post-investigation stage.

Within the time element, it is important to know the order in which the applications are submitted to the competition authorities. The 1993 Leniency Policy determines that the first applicant can obtain immunity, whether it is in the pre- or post-investigation stage.[124] Similarly, the 2006 Leniency Notice mentions that the first applicant will be able to obtain immunity.[125] For the second, third and any other applicant, only a reduction of the penalty is available.[126] Both systems provide for a marker system to secure the first position in an immunity application.[127] For a reduction application in the EU, the order will be provisionally determined based on the order of submission on the condition that the information contains significant added value.[128] The order is final at the moment the Commission takes the final decision.[129]

Within the obligation part, several conditions are grouped together. Some of the obligations are related to the illegal activity directly. The 1993 Leniency Policy requires the applicant to prompt and effective actions to terminate the illegal activity.[130] Similarly, the 2006 Leniency Notice requires the applicant to have ended its involvement in the alleged cartel immediately following its

[120] See ibid., point 12 (a) and (c).

[121] See ibid., point 24.

[122] See Department of Justice (1993), para. A and B.

[123] See European Commission (2006), point 8 (b).

[124] See Department of Justice (1993), para. A, 1 and para B, 1.

[125] See European Commission (2006), point 8.

[126] See ibid., point 23.

[127] See Sandhu (2007), pp. 150–152 (describing the EU marker which has been included in point 15 of the 2006 Leniency Notice); Klawiter (2007), pp. 498–499 (describing the US marker).

[128] See European Commission (2006), point 29; see also Van Barlingen and Barennes (2005), p. 15.

[129] See European Commission (2006), point 30.

[130] See Department of Justice (1993), para. A, 2 and para B, 3.

application.[131] The obligations in relation to information have been discussed above. Other obligations relate to the cooperation with the competition authorities. Both the 1993 Leniency Policy and the 2006 Leniency Notice demand continuous cooperation with the competition authorities.[132] Still another obligation relates to the injured parties, be it only in the US. The 1993 Leniency Policy asks for restitution of injured parties where possible.[133]

In relation to the cartel participants, both the 1993 Leniency Policy and the 2006 Leniency Notice have provisions in relation to coercion. The programs do not allow immunity to be given to corporations that have coerced other parties to participate in the cartel.[134] The 1993 Leniency Policy also has one in relation to the ringleader. It stipulates that the leader or the originator of the illegal cartel activity cannot claim immunity.[135] In the post-investigation stage this is put under the general concept of unfairness.[136] The latter does not limit the scope of application for the ringleaders, but it does so for undertakings that have been coercing others to undertakings to participate. These undertakings will only be eligible to apply for reduction but not for immunity.

The above-described conditions already reflect the experimentation with leniency programs for about three decades. Some of the conditions have not been problematic at all from the beginning. The conditions on coercion have been part of the earliest leniency programs of the US, the 1978 Leniency Policy, and the EU, the 1996 Leniency Policy, without much change. Similarly, the obligation to terminate the illegal activity and to continuously cooperate with the competition authorities has been part of the leniency programs since they were established in the US and the EU. The conditions in relation to information and order have caused more controversy and uncertainty for the application of the leniency programs. Besides, some concepts, such as ringleader and originator, have a history track of changes.

The problems in relation to the information provisions in the respective leniency programs are twofold. On the one hand, the applicant has to overcome the burden of finding out whether the illegal cartel activity has already been reported on or not. On the other hand, the applicant has to assess the meaning of general terms as "illegal activity,"[137] "sustainable conviction,"[138] "targeted inspection,"[139]

[131] See European Commission (2006), point 12 (b).

[132] See European Commission (2006), point 12 (a); Department of Justice (1993), para. A, 3 and para. B, 4.

[133] See Department of Justice (1993), para. A, 5 and para. B, 6.

[134] See European Commission (2006), point 13; Department of Justice (1993), para. A, 6 and para. B, 7.

[135] Department of Justice (1993), para. A, 6.

[136] See ibid., para. B, 7.

[137] See ibid., para. A, 1.

[138] See ibid., para. B, 2.

[139] See European Commission (2006), point 8 (a).

"infringement of Article 81"[140] or "significant added value".[141] During the nearly three decades of experimenting with leniency, the US and the EU have learned a lot in this regard. Especially the EU has been paying attention to these aspects, as it revised its Leniency Notice in 2006 to reflect the necessity of creating transparency in relation to information.

The 1993 Leniency Notice requires previously unknown information from the first applicant in order to consider immunity from penalties. Something similar is inscribed in the 2006 Leniency Notice. The Commission may have already enough evidence for adopting the decision to carry out a dawn raid or for finding an infringement of EC, and so nullifying the right to obtain immunity. If the applicant is not aware of the deal that is on the table, the leniency application will be a poker game.[142] However, it will be a distorted poker game. The competition authority would play with its cards close to its chest, while the applicant has to put all its cards on the table.[143] Much has been done to avoid this kind of situation, both in the US and the EU.

The US DOJ's approach towards this problem has been to allow anonymous non-prejudicial immunity inquiries.[144] The inquiry only needs to reveal information about the particular industry or a specific area of economic activity.[145] The EU approach is different.[146] Anonymous inquiries are not accepted.[147] Instead, the Commission has devised a hypothetical application mechanism. This system exists since the 2002 Leniency Notice.[148] Unlike the US inquiry, the hypothetical application will need to supply quite a lot detailed information amounting to the level of evidence.[149] Whether one system should be preferred above the other, depends on the conception of the leniency program. Anonymous inquiries may result in an abuse when more firms can enjoy lenient treatment, while in a system creating a race to the courthouse door it may work perfectly.

[140] See ibid., point 8 (b).

[141] See ibid., point 24.

[142] See Joshua (2007), p. 520.

[143] See ibid.

[144] See Arp and Swaak (2002), p. 63.

[145] See ibid.

[146] See European Commission (2006), point 19.

[147] See Van Barlingen (2003), p. 17 (opining that anonymous inquiries would undermine the cartel enforcement completely as the cartel partners can check whether the cartel has been reported or not. In the latter case, they can simply walk away without undertaking any further action).

[148] See European Commission (2002), point 16; see also Germont and Anderson (2007), p. 688.

[149] See Van Barlingen (2003), supra note 89, at 19 (indicating that a list of evidence has to be presented. The actual application will then compare the submitted evidence with the previously hypothetical application's list).

Generally formulated conditions related to information constitute the other major problem. Again, each of the investigated jurisdictions has such concepts in its leniency programs. The 1993 Leniency Policy has such a general concept in the pre-investigation stage, "illegal activity," and in the post-investigation stage, "sustainable conviction." With "targeted investigation," "infringement of Article 81," or "significant added value," the 2006 Leniency Notice has more generally formulated conditions. The two previous versions of the Leniency Notice had similar conditions included. However, unlike the 2006 Leniency Notice, the previous versions did not elaborate on the meaning of these generally formulated conditions. A case-by-case evaluation had to prosper the necessary precedents.[150] Judging from the Commission's reaction in 2006, this work method did not provide the necessary clarity and certainty.

Left with a great deal of discretion, the Commission had to be 'vigilant to ensure consistency'.[151] Consistent treatment is not always easy to pursue. The EU practice has shown that the distinction between concepts started to blur, by asking more evidence than required under the one condition and less than required under the other condition.[152] Therefore, the DOJ has adopted a twofold policy. First, the initial amount of information does not need to be more than a "good cartel story,"[153] which will expand, mainly driven by the DOJ, later on.[154] Second, the DOJ will "err in favour of the applicant where there is a genuinely close call."[155] The Commission has never made statements in this regard. Instead, it has reformed its 2002 Leniency Notice in 2006 to create "upfront certainty on the part of a would-be leniency applicant as to the information and evidence required by the Commission."[156] Conditions like "targeted investigation,"[157] "infringement of Article

[150] See Joshua (2007), p. 517.

[151] Ibid., p. 517.

[152] See ibid., pp. 517–518 (stating that "practitioners coming in under 8(a) are finding that they are sometimes required by officials to provide far more evidence that what ought to suffice to enable the Commission to mount a dawn raid." They further refer to the fact that "if a dawn raid produces only slim pickings, statements originally made by the amnesty applicant's lawyers to support the 8 (a) application may well be used in the Statement of Objectives as a proof of the substantive violation").

[153] Ibid., p. 519; see also Cseres et al. (2006), p. 4.

[154] See Joshua (2007), p. 519.

[155] Ibid., p. 517.

[156] Sandhu (2007), p. 153.

[157] See European Commission (2006), point 9. This point stipulates that the undertaking needs to prepare a corporate statement giving a detailed description of the cartel agreement (aim, activities, functioning, market scope, cartel participants), of the leniency applicant, and of the other competition authorities that will be approached. Further, all evidence in possession of the applicant has to be added to this statement.

81 EC,"[158] and "significant added value."[159] By clarifying these concepts, the time element has become much more transparent then before.

Information that has to be submitted to the competition authorities in the US and the EU differs considerably. Whereas the US 1993 Leniency Policy reaches certainty by its simplicity, the EU 2006 Leniency Notice achieves it by a detailed description of what has to be submitted. This complexity has been extended to the issue of inquiring whether the Commission already has enough information about the cartel and so to check whether the applicant can still enjoy immunity. This can be explained to avoid any kind of abuse. However, the complexity surrounding the submission of information could explain why the Commission still attracts less leniency applications.

A firm, calculating whether it is profitable to defect the cartel, needs to be sure that it can win the race to the courthouse door. In other words, the leniency procedure needs to offer the firm the certainty that, when it makes the initial step, the position secured by this step does not get lost. The initial step may have to be taken in quite a rush. Yet, in order to obtain immunity, the firm has to come forward with enough information related to the illegal cartel. The hastiness, in which the initial step had to be taken, may have caused a lack of time to prepare the information as evidence sufficiently. The incompleteness of the application may not be a problem at first. However, when another firm realizes what happened, it may be inclined to submit an application containing more relevant information. Due to the high value of the second applicant's information, he may supersede the first application. Such a situation can occur if the initial step does not secure the order of application.

The 1996 and 2002 Leniency Notice reflected this situation.[160] Undertakings applying for leniency derived benefit from submitting extensively documented leniency application to the Commission. Incomplete leniency applications were dangerous in two ways. First, the application could have been rejected on the ground that it did not fulfill all the substantive conditions.[161] Second, another undertaking may be getting ahead and offer a "smoking gun"[162] to the Commission.[163] Commission officials have pointed out that in the latter case it is the Commission's practice that 'the moment the second applicant submits evidence, the first applicant can no longer supplement its application with further evidence. Its

[158] See ibid., point 11. This point stipulates that the undertaking needs to prepare a corporate statement giving a detailed description of the cartel agreement (aim, activities, functioning, market scope, cartel participants), of the leniency applicant, and of the other competition authorities that will be approached. Further, incriminating evidence has to be added to this corporate statement.

[159] See ibid., point 25. This point stipulates that written evidence from the period in which the illegal cartel was active has greater value that subsequently established evidence. Incriminating evidence prevails above general or indirect evidence. Compelling evidence will also have more significant added value. See Sandhu (2007), pp. 153–154 (stating that a marker for the reduction applications would create even more incentives).

[160] See European Commission (2002); European Commission (1996).

[161] See Joshua (2007), p. 522.

[162] Ibid.

[163] See ibid.

application will be evaluated on the basis of the evidence it had submitted until the moment the second application was made'.[164] This uncertainty, combined with generally formulated conditions related to information, have without a doubt scared off risk averse undertakings to make use of the leniency program.

The US practice differs in that it allows the applicant to put down a marker, a sign keeping a place in the queue. This marker can be easily set. A call to the Antitrust Division of the DOJ requesting a marker with the explanation that the corporation needs more time to collect the evidence is usually sufficient.[165] The marker will be granted, almost always together with a time limit. Within this time limit, the applicant has, in principle,[166] to perform his promises; this is collecting and arranging information allowing him to make a proffer. The proffer is basically an outline of what the applicant is able to offer, and it does not need to be evidence.[167] At the end of the proffer, a conditional leniency letter can be asked. The actual grant of immunity will follow in short order.[168] In other words, evidence is looked for after the granting of immunity and largely driven by the DOJ.[169]

A marker system contributes to the predictability of a leniency program. Several scholars have therefore argued that a similar system should be introduced in the Leniency Notice. This happened in 2006.[170] The marker system that the Commission introduced has a set of objective conditions to be fulfilled. Yet, they are not sufficient to guarantee that the marker will be granted. This is reflected in two elements. First, the Commission *may* grant a marker.[171] Second, the applicant has to *justify* its request for the marker.[172] The former will likely have an effect on risk-averse undertakings. Rather than applying for a marker, they probably prefer to make a full immunity application. In doing so, they may have lost the race or at least delayed the whole process. It is clear that the race to the regulator is undermined.[173] The latter puts the applicant in a defensive position. What else than disclosing a cartel could justify the request for a marker? How detailed does the applicant have to describe his inability to come forward with the necessary information at the moment?[174] For sure, without much more clarity on this aspect, undertakings may be dissuaded from approaching the Commission.

[164] Van Barlingen and Barennes (2005), p. 10.

[165] See Klawiter (2007), p. 499; Joshua (2007), p. 519.

[166] See Klawiter (2007), p. 499 (stating that there have been cases in which the time limit attached to a marker has been extended. However, this will be most unlikely when there is a second applicant that is willing to come forward with information).

[167] See Joshua (2007), p. 519; see also Reynolds and Anderson (2006), p. 85.

[168] See Joshua (2007), p. 519.

[169] See ibid.

[170] See European Commission (2006), point 15.

[171] See ibid., point 15.

[172] See ibid., point 15.

[173] See Sandhu (2007), p. 151.

[174] See ibid., p. 152.

5 Critical Voices on the Existing Experience with Leniency Programs

Leniency programs have been generally praised for their success in detecting cartel behavior. Even though the general optimism on the function of leniency programs, some studies have pointed out the weaknesses of the operation of a leniency program. It is not the purpose of this contribution to review all critiques towards the leniency programs, but to summarize some of the most recent ones. The focus will be mainly on the US and EU leniency programs, as they have been the main source of inspiration for the ICN best practices.

In the US, Daniel Sokol,[175] based upon earlier studies of Nathan Miller,[176] has argued that the leniency program may not be used properly. Before critiquing the use of the leniency program in the US, Sokol evaluates the benefits of having a leniency program. Leniency programs have been praised for their ability to incentivize cartel members to defect. In the case of the US, this incentive constitutes the escape of criminal conviction and treble damages. The condition for receiving this lenient treatment is, of course, the provision of full cooperation with the DOJ in its cartel enforcement.[177] The US further tries to improve its enforcement by offering an Amnesty Plus program.[178] This program allows for firms, already convicted for their role in a different cartel to benefit from a sentencing discount for revealing its role in a still undetected cartel. Of course, the lenient treatment will apply to this newly revealed cartel.

Sokol suggests that the success of the leniency program may be deducted from the increase in cartel fines, the number of people who spent time in jail and the number of days people have spent time in jail.[179] Nevertheless, there is still skepticism whether the existing US cartel regime offers optimal deterrence. Even with the leniency program in place, the formation of new cartels is not necessarily prevented or the stability in existing cartels is not necessarily negatively affected.

The sub-optimality of the US leniency program is based upon the idea that too generous leniency programs may create strategic behavior. This strategic behavior is to provide the enforcement authorities with information on behavior that is not a clear cut violation of the competition law. An empirical survey conducted by Sokol suggests that competitors often are reluctant to defend themselves against these cartel charges.[180] Rather than taking the risk of a fully litigated trial, Sokol indicates, that these competitors often opt for a settlement. In other words, firms

[175] See Sokol (2012).
[176] See Miller (2007).
[177] See Sokol (2012).
[178] See ibid.
[179] See ibid.
[180] See ibid.

are using the leniency program to punish other competitors.[181] Problematic in this scheme is the DOJ's willingness to settle on behavior that is not a clear cut violation.[182]

A further critique derived from a survey that Sokol has held among practitioners, is the transparency and legal certainty surrounding the procedure of the leniency application.[183] A lack of transparency will increase the risk of dealing with the DOJ and consequently lead to the continuation of the cartel. Besides a reference to the placing of the marker, it is not immediately clear which of the provisions need more transparency. Other elements that contributed to a risk of coming forward, and that applies to individuals, is the distorted trust towards in-house counsels after Stolt-Nielsen.[184]

The leniency applications in the US will also be affected by follow-up prosecutions in other jurisdictions. The complex web of leniency applications that a firm may have to go through in other jurisdictions may create additional uncertainty. It is not for sure that leniency can be obtained in all the other jurisdiction or that similar conditions or rules apply in all these different jurisdictions. One of the elements that has been identified as problematic in another jurisdiction is the absence of an attorney-client privilege in the Europe for in-house lawyers.[185]

Cross-border cases enable a link with the critique towards the European leniency program. In a recent case, the Pfleiderer case, it was made clear that the content of a leniency application is not protected against a discovery procedure that could be started in the US.[186] The discovery procedure, which would be requested in the framework of a private damages claim, will make firms cautious of applying for leniency in Europe if they haven't applied in the US.

The waiting game that may result from the potential discovery procedure is not the only one operating under the European leniency program. Studies done by Marie Goppelsroeder, Maarten Pieter Schinkel, and Jan Tuinstra on the one hand,[187] and Dennis Gärtner and Jun Zhou on the other hand,[188] hold that there may be no race at all under the European leniency program. More in specific, with econometric tests, these scholars reveal that a majority of the leniency applications are done when the cartel has already collapsed or is on the verge of dying. It has been identified by these studies that it is a phenomenon running over nearly two decades, meaning that it is not specific to one of the different formats that the European leniency program has known. This kind of critique has followed the much

[181] See ibid.

[182] See ibid.

[183] See ibid.

[184] See ibid.

[185] See ibid.

[186] See Case C-360/09, Pfleiderer AG v. Bundeskartellamt (14 June 2011). For discussion, see Cauffmann (2012).

[187] Goppelsroeder et al. (2009).

[188] See Gärtner and Zhou (2012).

earlier detected form of delay, which existed in the fact that the European leniency program mainly triggered leniency application following an application in the US.[189] Margaret Bloom, however, does not agree with the conclusion that these follow-on applications show the weakness of the European leniency program, but rather reveal the more effectiveness of criminal sanctions.[190]

Nicolo Zingales, theorizing about the possibility that a leniency program could render sanctions ineffective, formulates another critique. The idea behind his reasoning rests on the generosity of leniency programs. If a leniency program offers lenient treatment well beyond the first applicant, there is an inherent danger that the total amount of sanctions decreases, with a possible stabilizing effect on cartels.[191] Due to lower sanctions, firms will not be as deterred anymore as they used to be. Even though Zingales does not offer any kind of data on the effect of the leniency program on the amount of fines, he opines that it would be better for the EU to follow the American example by limiting the leniency to much less applicants.[192] Some years earlier to Zingales study, Cento Veljanovski has conducted a survey on the effect of the leniency program on the average fine for a cartel.[193] His survey revealed that there was a substantial reduction in the average overall fine and the average fine for a firm.[194] This negative effect on deterrence is even further aggravated by appeal judgments.[195]

6 The Leniency Good Practices as the Benchmark for Convergence

6.1 Critique to the Source of the Best Practices Affecting Its Legitimacy

The ICN aims at norm setting or public policy making. Even though the ICN would like to steer the behavior or determine the freedom of the ICN's members, it is not operating within the framework of what is the usual practice for international law making. The ICN is a forum, which is not created by an international treaty, allowing the competition agencies to engage with its foreign counterparts. There

[189] See Stephan (2005).

[190] See Bloom (2007), p. 552.

[191] See Zingales (2008), p. 27.

[192] See ibid., pp. 27–28.

[193] See Veljanovski (2007), p. 10.

[194] See ibid. (mentioning that the average overall fine reduced from 161.7 million euro to 96.4 million euro and that the average fine for a firm dropped from 30.5 million euro to 18.2 million euro).

[195] See ibid.; see also Stephan (2007), pp. 6–7.

is no reliance anymore on the head of state or the foreign ministry to lead the negotiations.[196] The contacts with the foreign counterparts happen now directly, even though these agencies are not allowed to bind the State as understood under Article 7 of the Vienna Convention.[197] The ICN does further not aim at creating a formal treaty or any other kind of traditional source of international law. The ICN operates by formulating guidelines that, in the best case, take the format of best practices. For this purpose, the ICN, and thus the enforcement agencies, is assisted by private actors and other international organizations.

Operating outside the framework of what is the usual practice for international law making has made the transnational regulatory networks open for criticism. The aspiration of the ICN to steer the behavior of its members raises the question whether this network should be eligible to exert this kind of power over its member agencies. Indirectly, this will affect the public in general. However, unlike in a parliamentary system, the general public cannot give its approval or disapproval over the policies pursued by the ICN. Any control, through voting for example, is being denied to the general public. Furthermore, as these networks operate transnationally, there is also a problem of a global general public, which most likely does not exist as of today. This has been the basis for a legitimacy critique.[198]

To formulate an answer to the growing legitimacy problematique of these transnational regulatory networks, the concept of legitimacy has been widely debated and rethought. It is not the purpose to "get bogged down in the particularities of the debates".[199] As Chris Brummer states, it is sufficient to concentrate on the dominant approach that splits legitimacy into two categories: input and output legitimacy.[200] Input legitimacy is concerned with the involvement of the governed.[201] Output legitimacy deals with the quality of the rules and whether they are any effective.[202] Organizational qualities are thus not the only elements that can contribute to legitimacy, but also the organization's accomplishments. Legitimacy can thus also be derived from the ability to solve problems.[203]

The need for the ICN to rely on output legitimacy has been pointed out by several scholars.[204] Even though the ICN is a non-exclusionary organization, allowing each enforcement agency to become member,[205] and gives the opportunity to each member to fully participate,[206] it cannot be denied that mature

[196] See Nanz (2011), p. 60.

[197] See Pauwelyn (2012), p. 19.

[198] See e.g. Risse (2004).

[199] Brummer (2012), p. 179.

[200] See ibid.

[201] See Szablowski (2007), p. 17, n. 27.

[202] Ibid.

[203] See Brummer (2012), p. 179.

[204] See ibid.

[205] See Fox (2011), p. 125.

[206] See www.internationalcompetitionnetwork.org. Accessed 30 July 2013; see also Fox (2011), p. 125; Maher and Papadopoulos (2012), p. 85.

enforcement agencies are the main driver behind of the ICN's activities and policy setting.[207] This inequality cannot be balanced by the presence of non-governmental advisors, because their role is somehow controlled. NGAs can participate in the Annual Conference. However, the Steering Group and the host agency of the Conference can control the participation of the NGAs in terms of geographical origin or background.[208] This possibility has been included to prevent that the Conference would be captured by a certain interest group.[209] The Steering Group has also power to rely on NGAs for other purposes than the Conference. NGAs can be consulted for a particular or potential project, for issues to be considered in a Working Group or by the Steering Group, or for assisting in the drafting of work products of the Working Groups.[210] ICN member agencies are free to consult with NGAs at their own discretion and this to seek information or expertise. Calvin Goldman, Robert Kwinter and Navin Joneja stipulate that NGA input is encouraged.[211] However, the member agencies are the main driving force behind the ICN objectives and work products. NGAs do not only come from North-America, Europe or Japan, but also from jurisdictions with newly established agencies.[212] Structures have been built into the ICN operational framework not to prioritize any of the NGAs or to let one particular interest be overrepresented.[213] Nevertheless, as Fox warns, the defense bar and the industry associations are predominantly represented.

Due to the deficit of input legitimacy, the ICN should not yield to cease its existence. The ICN could have moral authority because it is a forum where expert knowledge is gathered. The knowledge on how to solve competition law disputes is a common good for global affairs.[214] However, in order not to lose its authority, the ICN should show that it has the ability to solve problems and that it is not captured or manipulated by interest groups, private or public, when solving these problems. In other words, the ICN may be vulnerable by threats to its reputation.[215] In order to prevent the loss of moral authority, the quality of the norms, standards and procedures suggested should be a fact.

The ICN can only guarantee that the suggested norms, standards and procedures are effective when it is monitoring the outcome of the convergence process. Monitoring the convergence process entails the possibility of also questioning the best practices. Thus, just like Stucke understands, the ICN's best practices should

[207] See Hollman and Kovavic (2011), p. 58 (without support of the wealthy agencies, the ICN will collapse).
[208] ICN (2012b), Article 7.2 (i).
[209] Ibid.
[210] Ibid., Article 6 (iii) (a)(b)(c) and (d).
[211] See Goldman et al. (2011), p. 383.
[212] See ibid., p. 384.
[213] ICN (2012b), Article 7 (i).
[214] See Risse (2004), p. 13.
[215] See ibid.

not be seen as the creation of a fixed end product.[216] The adoption of best practices by the members does happen voluntarily and divergence may occur in this process. The divergence may be inspired by the different legal structure of the adopting jurisdiction,[217] a different economic structure of the adopting jurisdiction,[218] or simply the idea that it will function better in a different way.[219] Evaluation has to make this clear. However, the evaluation needs to go further. It may well be that there is no divergence from the best practice, but that the leniency program has not the desired outcome.[220] Also in this kind of cases, it is necessary to evaluate the best practices and correct shortcomings. These could exist in gaps, unexpected shifts, or wrong predictions.

The process of convergence is a constant evolutionary process, forcing the ICN to periodically revise its best practices to reflect the continuous experimentation. Continuous experimentation should then also enable the ICN to reflect what the best practices are taking the specificities of the members, such as, among others, the size of the economy or the stage of development, into consideration.

6.2 Evaluating the Benchmark

Svetiev has also acknowledged the need for constant monitoring of the best practices.[221] When developing his framework against which he tries to legitimacy the operation of the ICN, Svetiev heavily relies on benchmarking in a corporate environment. In a corporate environment, Svetiev argues, the benchmarking will seldom be about just copying.[222] Several restraints, such as IP rights or business sensitive information, will not allow for creating a model benchmark identical to what is being applied in a certain firm. The absence of these restraints in a regulatory context and the often willingness of jurisdictions to voluntarily offer their rules and institutions as model creates a risk of ending up with sub-optimal equilibriums due to the just following what has been identified as the best practice. The end result may be sameness, with as a consequence that the adopted best practice is not necessarily optimal for the jurisdiction implementing the best practice. Even though these concerns exist, Svetiev indicates that even a mere transplantation of rules seldom leads to identical outcomes in the receiving jurisdiction.[223]

[216] See Stucke (2012), p. 159.
[217] See Svetiev (2010), p. 28.
[218] See ibid., pp. 28–29.
[219] See ibid., p. 28.
[220] See ibid., p. 29.
[221] See ibid.
[222] See ibid., p. 27.
[223] See ibid.

In spite of this conclusion, Svetiev indicates that the best practice selection in the ICN may in fact lead to sub-optimal practices or to practices that are not suitable for the entire membership.[224] One of the element identified as the cause is the minoritarian bias in the agenda setting of the ICN and its working groups.[225] Financially well-resourced enforcement agencies, which are often the more mature enforcement agencies, have more possibilities to influence the agenda setting. Once issues are on the agenda, other problems arise. Less mature enforcement agencies may not have enough experience to discuss and evaluate the proposals.[226] Very often there even exists already a consensus over the issues that have been put on the agenda, so that no profound discussion takes place.[227] In some cases, the issues on the agenda are salient to the majority of the jurisdictions that they even do not participate in the discussion.[228]

Svetiev does not seem to find the minoritarian bias entirely problematic. The ICN is not conceptualized to look for a well suited solution towards a specific problem, but for experiences, substantive or procedural, that work in other jurisdictions.[229] If such experiences are identified, enforcement agencies looking for solutions should transform these experiences to suit the task and the local environment in which they are supposed to operate. The ICN best practice benchmarking is thus not going to lead to 'disruptive innovation in antitrust implementation strategies'[230] or 'broad dissemination, and improvement, of practices actually useful to the participating authorities in their day-today work'.[231]

Even though the ICN is not seeking for innovations to the enforcement strategies or substantive law, the outcome of the search for best practices may still be affected by the minoritarian bias. The best practice benchmarking may be constrained by framing the problem in a certain direction or by offering an already existing consensus. This existing consensus may, for example be built upon wrong premises

[224] See ibid., pp. 27–31.

[225] Neil Komesar has pointed out that the more agencies participate and the more complex the issue at stake, there is an 'enhanced possibility of minoritarian bias and the prospect of "rent-seeking"'. The ideas or interest of the majority risk to be underrepresented. Komesar (2001), p. 153. Another point of critique on the participation within the ICN is on the bias towards the more mature and richer competition jurisdictions. The financially well-resourced agencies will face difficulties to organize workshops or the Annual Conference. This in turn may jeopardize their chances to be a member or chair of the Steering Group or the chair of a Working Group. With less chance of being a member of the Steering Group, these financially restrained agencies will have less power to influence the agenda setting of the ICN. Further, due to the fact that they will most likely not be chairing a Working Group, these agencies will also not be the ones holding the pen when the first drafts of the recommended practices are written. See Hollman and Kovavic (2011), p. 58 (without support of the wealthy agencies, the ICN will collapse).

[226] See Fox (2011), p. 126. See Sokol (2007), p. 107.

[227] See Svetiev (2010), pp. 28–30.

[228] See ibid. See also Monti (2012), p. 351.

[229] See Svetiev (2010), p. 35.

[230] Ibid.

[231] Ibid.

or even blunt errors. This kind of problems can only be overcome if a structure of revision for these best practices is implemented. Revision possibilities would render best practices provisional, 'in the sense that they can be revised in the light of data from reports about implementation and the outcomes achieved'.[232] When writing his paper, revision procedures were not in place in the ICN structure. This has not changed yet. However, the ICN has instigated that it would revise its best practices during the second decade of its existence.[233]

Svetiev argues that the ICN should formalize some form of processes of 'gathering and distributing knowledge about how those best practices are implemented'.[234] In other words, best practices should be only a first step in formalizing the interactions in a network. This control on implementation should not be about counting the number of jurisdictions that have followed the best practices, but rather of what the outcome is 'from either following or diverging from the endorsed practice'.[235] To effectuate the evaluation model, the ICN has to introduce a duty to report. This does not mean that the non-binding nature of the best practices should be affected. It can still exist next to duty to report.[236]

7 Evaluating Leniency Best Practices

7.1 An Argument for Non-Governmental Advisors as Evaluators

Enforcement agencies have a tendency to overstate the success of their leniency programs. The general attitude of the enforcement agencies is to emphasize one aspect of the leniency program to reiterate its success. The US DOJ refers to the ever-increasing level of the total amount of fines.[237] In the US, where there are custodial sentences, there has also been a reference to the significant increase in the total number of days spent in jail.[238] The European Commission admits that most of the cartels that have been detected by the European Commission are detected after one cartel member has confessed and asked for leniency.[239] In making this

[232] Ibid., p. 31.

[233] ICN (2012a), p. 12.

[234] Svetiev (2010), p. 36.

[235] Ibid.

[236] See ibid., pp. 36–37.

[237] See e.g. Griffin (2003), pp. 2–3.

[238] See ibid., pp. 3–4.

[239] See overview on cartels http://ec.europa.eu/competition/cartels/overview/. Accessed 30 July 2013.

statement, there is an automatic reduction of the measure of the success of a leniency program to the number of decisions.[240]

However, the data these officials rely on could be misleading. The data they look at to make these statements are usually the data numbering the total amount of applications the total amount of decisions taken or the increase of the total amount of fines. This data does not reveal what is driving the leniency program. It is not possible to detect whether the applications for leniency are sincere applications or part of a strategy. The data also does not reveal whether leniency is mainly driven by foreign follow-on actions or not. Displaying only the scale of the fines does not reveal a possible change in the method of calculating the fine.

The tendency to overstate the success of the leniency program and downplay any kind of criticism has been explained by public choice theory.[241] The DOJ is in need of budget for its antitrust division. Being able to present improvements in detection due to the leniency program and, subsequently, a high rate of settlements of these detected cases, the DOJ is able to paint a positive picture of its activities. The positive picture will enable the DOJ to justify its budget, even if in other parts of the enforcement there may be declines noticeable. Sokol evokes the idea that '[t]o suggest that the "golden child," as one practitioner described the leniency program, makes the DOJ less worthy of political and financial support'.[242] The DOJ has, still according to empirical research of Sokol, 'shown an unwillingness to reexamine the leniency program and responds overwhelmingly negatively to any criticism of the program'.[243]

Having conducted interviews with both officials from the JFTC and the EU Commission's DG Comp, the current author cannot but agree with the finding that enforcement authorities tend to positively evaluate their leniency program and see no point in formulating any critique towards their leniency program.[244] Whether public choice reasoning is really driving their enthusiasm is not immediately obvious. It is for sure though that the increased number of decisions or the smoothness with which these decision can be reached are part of the explanation to view the leniency program as a necessity.

Against the backdrop that enforcement agencies tend to mask flaws in their leniency programs and have reasons to do so, an argument could be made that these enforcement agencies would not be the best placed to evaluate best practice. Indeed, questioning the best practices would inherently implicate that the leniency programs that are the basis for these best practices are also flawed. This does not downplay the role of the enforcement agencies. They hold the key to lots of information, which is necessary for the evaluation of any kind of best practice.

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[240] Kroes (2003).

[241] Sokol (2012), pp. 213–214.

[242] Ibid., p. 213.

[243] Ibid.

[244] See Van Uytsel (2012).

The information that is held by the enforcement agencies may not be enough to come to profound conclusions. Part of the implementation of the legislation that is based upon the ICN's best practices is done by lawyers and other legal advisors. These actors are, in the framework of the ICN, categorized as non-governmental actors. The extensive survey that Sokol has held among lawyers in the US is an example of how lawyers hold information regarding competition law and its enforcement.[245] The kind of information these lawyers have provided to Sokol is something that would most likely not become apparent by just analyzing data from enforcement agencies. Dave Anderson, a practicing competition lawyer and non-governmental advisor to the ICN, seems to agree with this analysis. In his prospect for the future, Anderson sees the role of lawyers as, among others, to keep the best practices relevant and alive.[246] At the end, lawyers have a "behind-the-scene view"[247] on the facts that lead to the operation of best practice inspired legislation.

Enforcement agencies could function as an agent for information disclosure on the application of the best practice. Reports will unavoidably lead to another paradox of plenty, which has to be edited down to useful conclusions. The lack of a formal secretariat inside the ICN, would make the enforcement agencies responsible for handling this information. The problem is that, unlike with the generation of best practices, these reports have to be screened not for commonalities but for eventual disruptions in the application of the legislations reflecting the best practices. The occupational priorities of the enforcement agencies would probably mean that they are not best placed to engage in this activity. Furthermore, the data may display the need for new trends in the best practices, eventually requiring engaging in innovative legislative work. Among the non-governmental advisors, academics or research institutes would be best placed perform this task. This kind of suggestion is not completely new. It has been recognized during the ICN Conference in Seoul that NGAs could be attributed a greater role.[248] Certain substantive areas allow for more input from the NGA. In specific, the criteria for leniency and amnesty were mentioned as an area in which NGA could contribute.

7.2 Evaluating the Implementation and Not the Form

There have been suggestions as how to evaluate the best practices of the ICN. Some propose to compare the legislative instruments with the best practices and see to what extent the best practices are reflected in the legislative instrument.[249] This

[245] See Sokol (2012).

[246] See Anderson (2011), pp. 283–284.

[247] Ibid., p. 283.

[248] Goldman et al. (2011), pp. 390–391.

[249] See e.g. Rowley and Wakil (2007), p. 29.

kind of exercise provides an overview of the degree of convergence in form. However, it is not possible to deduct from this exercise whether either the convergence or divergence has led to results that are better or worse than what legal instruments after which the best practices were modeled, are generating.[250]

In a different area than the leniency program, Maria Coppola and Cynthia Lagdameo looked into the extent to which the ICN members implemented the best practices for merger notification and review.[251] Their study starts from a table representing the main best practices and mapping out which country's legislation is in conformity with these best practices. The table clearly shows that there is a huge discrepancy between the best practice and the current legislative landscape. This leads to the conclusion that either the best practices are not universal or that considerable work needs to be done. Based upon the overwhelming support for the best practices, which is reflected in the tiny number of changes that do not conform the best practices and the absence of any regime compliant with the best practices that changed to a non-compliant regime, the authors opt for the latter conclusion.[252]

It needs to be stipulated that before reaching this conclusion, Coppola and Lagdameo have highlighted some barriers to implementation.[253] Several of those barriers, such the lack of resources, unclear formulation of the best practices and the non-suitability of the best practices, may imply that some reflection on the best practices is needed as well. It is not sufficient to only look at the degree of convergence; the reasons for divergence have to be revealed as well. Only then proper conclusions can be drawn.

Other scholars have argued along the lines of Coppola and Lagdameo for evaluating the implementation of the best practices. For the leniency program, Kirtikumar Mehta and Ewoud Sakkers stipulate, for example, that the global promulgation of leniency programs based on the standards developed and promoted by the ICN is one of the better examples of how the ICN has contributed to convergence of law.[254] The convergence in form may well be a fact; it is, nevertheless, not possible to deny the critique on the operation of several of the leniency programs.

In order to evaluate the current best practices on leniency, the ICN could design questionnaires to be sent to the enforcement agencies. Detailed information could be collected on various issues related to the leniency program, besides the already available data on the number of leniency applications and decisions following these applications.

In order to evaluate the operation of a leniency program, data could be collected on the following issues. In order to see whether there is a race among the cartel

[250] See Fox (2011), p. 125.

[251] See Coppola and Lagdameo (2011).

[252] See ibid., p. 315.

[253] See ibid., pp. 312–314.

[254] See Mehta and Sakkers (2011), p. 274.

participants, more detailed information is necessary on the timing of application. In other words, data needs to be collected on whether the applicant applied before or after the down-raid. In systems that allow for more than one firm to apply before the down-raid, it may be worthwhile to see how many firms did in fact apply in the pre-investigation stage.

Deterrence could be deducted from various other variables. Information on the duration of the cartel could be an element contributing to assess the deterrent effect of the leniency program. Deterrence could also be evaluated by collecting data on whether the cartel is still operational at the time of the leniency application. The report could also make a distinction between leniency applications that have an endogenous cause. Having many of this kind of applications suggests could also suggest the lack of deterrent effect.

More difficult to assess are the conditions attached to a leniency program. Data could be collected on how many firms succeed in maintaining their position in the queue. Other data that could is the speed with which the leniency application can proceed to a formal decision. Since continuous cooperation is usually required, how many times firms have to be contacted before an investigation can lead to a decision.

Leniency programs may trigger a huge number of applications. Not all of these applications necessarily lead to a decision. In order to make an evaluation of the leniency program, it may be worthwhile to have data on why there is a discrepancy between the two. It could indicate a case overload due to an overly easy conceptualization of the leniency program. Nevertheless, it would also allow for making an argument that the leniency program is an invitation for submitting applications on behavior that is not a clear-cut violation of competition law. Connected to this, data could be collected on whether the leniency applications lead to a decision of the enforcement agency or to a settlement.

The enforcement agencies could further submit data the kind of cartels that are being revealed by the leniency program. This kind of data could be supplemented by data on whether there is a decline or increase in the detection of certain types of cartels. Having this data would enable to draw conclusions on whether a more diversified set of enforcement tools is necessary or not.

The reasons for applying for leniency may be more difficult to deduce from the data available to the enforcement agencies. Nevertheless, the enforcement agencies will be able to indicate whether firms have been under investigation in more than one cartel and whether these investigations link with each other through leniency applications. This is probably the extent to which the enforcement agencies can assist in detecting the reasons on why firms come defect a cartel. Due to the limited capacity of the agencies in this respect, the information provided to the ICN could be supplemented by information that is available to among lawyers. This information could be collected through academics, as Sokol did in his empirical research on the functioning of competition law, or by lawyers themselves. Both can contribute this information in their capacity of non-governmental advisors.

7.3 Evaluation to Fill Gaps

The leniency program may have to be evaluated for what it is. However, the critiques formulated towards the operation of a leniency program are not always a direct critique to the formulated best practices. The negative assessment of the US leniency program is not directed at the way how the leniency program is conceptualized. The critique is rather oriented at the operational link between the leniency program and settlements. It only requires a brief look at the best practices to know that the Cartel Working Group has not provided any information on this issue.

The interaction of the leniency program with other sanctioning systems has been almost left untouched. The best practices formulate guidance on how a leniency program should be conceptualized in a bifurcated enforcement model or on how leniency will work in a parallel civil and criminal model.[255] In the former model, the best practice advocates a consistent leniency policy between the different authorities investigating and prosecuting cartels.[256] The latter model requires a clear articulation of the application policy in order to avoid unpredictability and uncertainty.[257]

The interaction of the leniency program with other sanctions or enforcement tools is just one example of issues that are not covered in the best practices. Another element that is not elaborated in detail is the need to have post-investigation leniency program, even though many of the leniency programs have been experimenting with this kind of leniency as well. Much more guidance may be required in this respect. At the end, it has been pointed out that too generous leniency programs can either make the leniency program ineffective in terms of deterrence or create a waiting game in order to come forward with information.

The best practice also only focuses on a single format of a leniency program. There has been no attention paid to a distinction between the level of development of the competition law or its enforcement agency. A leniency program may have a serious impact on the enforcement agency. Alan Riley commented that the European leniency program has serious implications for the European enforcement policies. Riley summarizes this issue by stating that:

> DG Competition is now in many ways the victim of its own success; leniency applicants are flowing through the door of its Rue Joseph II offices, and as a result the small Cartel Directorate is overwhelmed with work. ... It is open to question whether a Cartel Directorate consisting of only approximately 60 staff is really sufficient for the Commission to tackle the 50 cartels now on its books.[258]

Therefore, the best practices could offer guidelines on what the impact may be of the conceptualization of a leniency program in a certain way. The ICN best

[255] See ICN (2009), Chapter 2, p. 12.

[256] See ibid.

[257] See ibid.

[258] See Riley (2010), p. 4.

practices could give guidelines in one way or another. Another option would be to provide guidelines on how to prioritize cases.

Other gaps than the ones described above may be uncovered by analyzing the operation of a diverse set of leniency programs. In order to increase its appeal, the ICN should try to close these gaps or even provide a more diverse set of best practices. In doing so, the ICN could increase its acceptance among its members, and so eventually to greater convergence of competition law.

8 Conclusion

National competition law enforcement agencies have organized themselves in an informal framework to elaborate common principles on competition law and its enforcement, which they would like to use to influence each other's behavior. In doing so, they created a transnational regulatory network, which they named the ICN. Within the framework of the ICN, information on the operation of various competition law practices is being gathered and analyzed in order to formulate best practices. These best practices should inspire the ICN members to voluntarily adjust their substantive law or their enforcement practices. Convergence is thus the ultimate goal.

Convergence only can occur when an agreement can be reached that a certain practice is better than the others. Hence, it is argued that convergence always presupposes a period of experimentation. However, even if there has been a period of experimentation followed by a period of convergence to an agreed standard, it may turn out that the standard to which was converged is not a proper standard. To avoid such a situation and to increase the legitimacy of the transnational network as a regulator, it has been argued that a revision of these standards should be possible.

By relying on the ICN's best practice of the leniency program, it has been argued that the standards are arrived from decades of experience in the US and the EU. This experience is, however, subject to critique. Indirectly, this critique will also affect the best practices. In order to prevent that such critique would jeopardize the best practices, a revision system should be set up. It has been further argued that this revision system should be impartial, due to which a certain category of NGAs would be better placed to perform this evaluating exercise. Another element of the argument has been that the evaluation should not be restricted to what currently exists as a best practice, but that also gaps and shortcomings should be identified. Only if this kind of system is established could the ICN keep its legitimacy as an effective regulator.

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Part IV
Networked Governance, Investment and Finance

Evolving Hierarchies in Transnational Financial Networked Governance: The Relationship Between the International Accounting Standards Board, the Financial Stability Board and the G-20

Karsten Nowrot

Contents

1 The Changing Regulatory Reality of the Global Economic Order and the Emergence of Network Concepts in International Economic Law

The global economic order, i.e. the configuration of the relations and interactions of the various different supra-state, sub-state, non-state and state actors involved in transnational economic transactions,[1] is more recently undergoing profound, if not unprecedented changes with regard to its normative structure. This mirrors, to a large extent, developments which have already been identified in the legal literature

[1] See e.g. Tietje (2009), pp. 3 et seq. On the underlying sociological concept of the "international system" in general see for example Hoffmann (1961), pp. 207 et seq.; Bull (1977), pp. 9 et seq.

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concerning the composition and overarching normative framework of the international system as a whole.[2]

In the past, normative rules governing the international economic system were almost exclusively created by states and could thus, depending on their origin, be more or less neatly categorized and divided as belonging either to the domestic law of an individual country or, alternatively, to the realm of public international law. In this connection, various developments have already for quite some time given rise to the question as to whether the term 'international economic law'[3] is limited to rules of public international law dealing with transboundary economic relations[4] or whether it also covers the respective bodies of domestic public and private legal norms of individual states having an effect on international trade as well as investments, and is thus in fact characterized by an interconnection of various different areas and means of regulation that transcend the traditional distinctions between international and domestic law, as well as between public and private law.[5] Furthermore, a growing number of legal scholars have identified as well as more or less comprehensively analyzed the phenomenon of the so-called 'law merchant' or *lex mercatoria*, an autonomous body of regulations created and independently enforced by private economic actors to govern their international trade relations without the involvement of nation-states.[6]

However, in light of the profoundly changing mechanisms of law-making and law-realization,[7] which increasingly shape the current normative structures of the global economic order, it becomes more and more apparent that the traditional three-sided distinction between public international law, domestic law and the *lex mercatoria* is an inadequate conceptual approach to describe the characteristics of the normative rules governing transboundary economic relations.[8] Indeed, the regulatory structure of the international economic system—in the same way as the international system as a whole—indicates the evolution of a functional unity between international law and domestic law.[9] Furthermore, the normative structure of the global economic order is currently characterized by an interconnected

[2] From the numerous contributions on this issue, see e.g. Delbrück (2001), pp. 1 et seq.; Higgins (1999), pp. 78 et seq.

[3] Generally on the controversially discussed definition of international economic law see also, e.g., Herdegen (2013), pp. 3 et seq.; Aksar (2011), pp. 5 et seq.

[4] This view is taken, e.g., by Schwarzenberger (1966), pp. 7 et seq.; VerLoren van Themaat (1981), pp. 9 et seq.

[5] On this perception see for example Ortino and Ortino (2008), p. 89; as well as already Erler (1956), p. 16.

[6] For a comprehensive analysis of this phenomenon, see e.g. De Ly (2001), pp. 159 et seq.; Kassis (1984), pp. 271 et seq.

[7] Generally on the notion of 'law-realization' as being distinct from the considerably narrower term 'law-enforcement' see Tietje (2001), pp. 264 et seq., with further references.

[8] See thereto especially Tietje (2002a), pp. 404 et seq.; for an overview see also Tietje and Nowrot (2004), pp. 341 et seq.

[9] Tietje (2004), pp. 5 et seq.

plurality of various subjects and sources of law. Thereby, the former distinction between so-called 'hard law' and non-binding regulatory instruments is increasingly blurred.[10] In addition, the legal rules that are relevant for economic transactions that transcend national frontiers are created in law-making processes and are implemented by law-realization mechanisms in which a wide range of different public, intermediate, and private actors take part. Transboundary economic relations, irrespectively of whether they are of a more public or exclusively private nature, are in a normative sense thus increasingly determined by what can be described as a plurality of various different kinds of legal norms as well as other steering instruments resulting from cooperative efforts of, inter alia, governmental, intermediate and non-state entities.[11]

In particular as a result of the processes of globalization,[12] states are more and more induced to create and participate in formal and informal cooperative mechanisms with not just other countries and international organizations, but also with ever more influential non-state actors such as NGOs, business associations, trade unions and transnational enterprises, in order to provide an effective regulatory scheme for the political, economic, ecological and social processes they are unable to control and channel when acting alone.[13] Furthermore, also with regard to the sub-state level, it becomes increasingly obvious that states are, contrary to the previously dominant perception,[14] often no longer acting as solid units in international relations. Rather, in particular administrative units below the level of government are, frequently in cooperation with non-state actors, participating in international regulatory regimes such as public and intermediate standardization organizations in the transnational economic realm,[15] thereby contributing to what has been described in the legal literature as the evolving phenomenon of the 'disaggregated state'.[16] Finally, to mention but one further example, overall quite effective institutionalized regulatory mechanisms and organizations have been developed and founded by non-state actors like NGOs, business associations, transnational corporations as well as trade unions that function basically without any significant involvement of governmental actors. Among them are the Global

[10] See for example Brummer (2011), pp. 305 et seq.; Abbott and Snidal (2000), pp. 421 et seq.

[11] See also already Calliess and Zumbansen (2010), pp. 11 et seq.; Tietje and Nowrot (2006), pp. 19 et seq.; Vesting (2004a), pp. 252 et seq.; Berman (2005), pp. 492 et seq.

[12] Generally on the processes of globalization, see e.g. Delbrück (2001), pp. 1 et seq.; Tietje (2001), pp. 164 et seq., each with further references.

[13] With regard to the increasing need for these kinds of cooperative regulatory efforts, see e.g. Delbrück (2004), pp. 32 et seq.; Reinisch (2001), pp. 271 et seq.; Sassen (2000), pp. 110 et seq.

[14] On the previous understanding of foreign policy as an exclusive prerogative of the government as the head of the executive branch, see e.g. Cottier and Hertig (2003), pp. 265 et seq.

[15] Concerning the transnational cooperation of administrative units see for example Tietje (2011a), pp. 21 et seq.; Möllers (2005a), pp. 351 et seq.; Raustiala (2002), pp. 17 et seq.

[16] On this perception see especially Slaughter (2004), pp. 12 et seq.; Slaughter (2005), pp. 35 et seq.

Reporting Initiative (hereinafter, *GRI*),[17] the International Air Transport Association[18] and the Marine Stewardship Council.[19]

These and many other features of the regulatory reality in the current global economic order demonstrate the profound changes in its normative structure which have led to the emergence of transnational normative steering processes that do not substitute the nation-state, but require us to broaden our understanding of international economic relations[20] and call for an analysis of the possible need for a reconceptualized understanding of the normative structure which forms the regulatory framework for the interactions taking place in the international economic system.

Against this background and in light of these findings, an increasing number of scholars from the fields of jurisprudence and social sciences have more recently taken recourse to the term and concept of 'networks' in order to describe and capture the evolving steering structures and phenomena resulting from numerous formal as well as informal interactions between a variety of governmental, intermediate and non-governmental actors cooperatively developing legal rules and other types of steering instruments for the global economic order.[21] This reinforces the prominent position occupied by the notion of 'networkism'[22] in many other academic disciplines[23]; a perception which even gave rise to the stipulation of a new and interdisciplinary scientific paradigm of network analysis.[24]

The emergence of networks—commonly understood as polycentric and relatively stable structures, lying in the borderland between hierarchical organizations and purely market-oriented mechanisms[25]—has for example already been identified and articulated in the legal literature with regard to the transboundary cooperation of national bureaucracies in the European realm[26] as well as in the

[17] On the Global Reporting Initiative see for example Nowrot (2009a), pp. 117 et seq.; Dingwerth (2007), pp. 99 et seq.

[18] For a more detailed account of the International Air Transport Association, see e.g. Havel and Sanchez (2009), pp. 755 et seq., with further references.

[19] For a more comprehensive analysis of this transnational steering regime see Tamm Hallström and Boström (2010), pp. 61 et seq.; Nowrot (2009b), pp. 705 et seq., with further references.

[20] For this observation see already Tietje (2002b), p. 503.

[21] On this perception see for example Petersmann (2012), p. 298 ('Intergovernmental 'networks' [...] have become one of the defining characteristics of multilevel economic governance.'). Generally on the emergence of networks as a new independent category of actors in the international economic system see also Nowrot (2009c), pp. 81 et seq., with numerous further references.

[22] Nickel (2006), pp. 167 et seq.

[23] On this perception see Peters (2006), p. 601 ('currently en vogue in various disciplines'); as well as for example Ladeur (2011), p. 639; Eifert (2002), p. 90; Jansen (2006), p. 11.

[24] See thereto for example Schweizer (2003), pp. 152 et seq.; Pappi (1987), p. 11; Weyer (2000), p. 1. Generally on the term and concept of scientific paradigms Kuhn (1996), pp. 43 et seq.

[25] See e.g. Peters (2001), pp. 217 et seq.; Powell (1996), pp. 214 et seq.; Waschkuhn (2005), p. 22; Kappelhoff (2000), p. 25.

[26] On this perception see for example Craig (2011), pp. 84 et seq.; Bignamini (2005), pp. 809 et seq.

international system as a whole,[27] the structural interrelationship between the European Union and its member states,[28] the regulatory structure of the global information order,[29] the transnational interactions between courts and other judicial institutions,[30] cooperative governance structures in the realm of a so-called "societal constitutionalism"[31] and institutionalized regulatory regimes that emerged as a result of cooperative efforts by non-state actors, international organizations and/or domestic governmental and administrative entities like the GRI, the United Nations Global Compact[32] and the Forest Stewardship Council.[33]

Another field of transboundary economic and business law in which the ordering idea of 'governance networks' has also gained considerable prominence in recent years is the normative framework of the international financial architecture.[34] Whereas subsequently to the end of World War II, the international legal regime dealing with monetary and financial issues was in the first two decades of its existence from an institutional perspective primarily shaped by the activities of international governmental organizations,[35] in particular the Bretton Woods institutions in the form of the International Bank for Reconstruction and Development (also called World Bank) and the International Monetary Fund (hereinafter, *IMF*), since the 1970s the governance structure of the international financial architecture underwent considerable modifications. First and foremost as a consequence of an increase in the intensity of globalization of financial markets since the end of the 1960s, a governance framework parallel to the Bretton Woods institutions was created in order to deal with the regulatory challenges resulting from these novel developments in the international economic system.[36] This newly emerging global regime on financial markets primarily comprised—and also still as of today

[27] Raustiala (2002), pp. 4 et seq.; Slaughter (2004), pp. 36 et seq.; Tietje (2011a), pp. 23 et seq.; Oeter (2011), pp. 239 et seq.

[28] Ladeur (2009), pp. 1357 et seq.; Ladeur (1997), pp. 46 et seq.; Slaughter and Burke-White (2006), p. 337; Peters (2001), pp. 215 et seq.

[29] See for example Tietje (2011b), pp. 8 and 10.

[30] Slaughter (2004), pp. 65 et seq.; Slaughter (2000), pp. 204 et seq.

[31] See thereto Teubner (2012), pp. 42 et seq., 158 et seq.; Teubner (2004), pp. 3 et seq.; Fischer-Lescano and Teubner (2004), pp. 1017 et seq.

[32] Generally on the United Nations Global Compact, see e.g. Braun and Pies (2009), pp. 253 et seq.; Nowrot (2005), pp. 5 et seq., each with further references. Specifically on the characterization of this transnational regulatory regime as a network see for example Ruggie (2001), pp. 371 et seq.

[33] For a more detailed description and analysis of the Forest Stewardship Council see Dingwerth (2007), pp. 144 et seq.; Nowrot (2009d), pp. 865 et seq.; Tamm Hallström and Boström (2010), pp. 44 et seq. On the qualification of this organization as a network, see e.g. Pattberg (2005), p. 185.

[34] On the term and concept of the 'international financial architecture' see for example, e.g., Tietje (2011c), pp. 11 et seq., with numerous further references.

[35] Generally on the characteristics and legal status of international governmental organizations see for example Crawford (2012), pp. 120 et seq., 166 et seq.

[36] Generally on these developments see for example Norton (2010), pp. 263 et seq.; Tietje (2011c), pp. 18 et seq.; Buckley and Arner (2011), pp. 73 et seq.; Arner (2011a), pp. 241 et seq.; Brummer (2012), pp. 60 et seq.

comprises—not of international organizations in the classical sense of public international law, but rather of a considerable number of informal governmental, intermediate and non-governmental institutions who are more recently frequently characterized as governance networks and whose coordinating and cooperating activities are, inter alia, aimed at the development of international standards for this increasingly important area of transboundary financial transactions.[37] Among the various respective international standard setting bodies in the form of regulatory networks are for example the Basel Committee on Banking Supervision,[38] the International Association of Insurance Supervisors (hereinafter, *IAIS*)[39] and the International Organization of Securities Commissions (hereinafter, *IOSCO*).[40]

Against this background, the subsequent analysis intends to focus on the structural features of and in particular the interrelationships between influential transnational steering regimes in one notable segment of the international financial architecture—the international standard-setting activities in the realm of financial reporting or accounting; an area of economic and business law that is frequently and rightly considered to be of central importance for transnational business.[41] In this connection, the following evaluation of these issues is divided into three parts. The first part provides an introductory discussion of the functions and limits of the network concept as an analytical tool for the description and conceptualization of transnational steering mechanisms in the international economic system. Subsequently, the second part describes and analysis the recently emerging hierarchical relationships between three transboundary steering institutions, frequently qualified as networks, in the regulatory field of financial accounting standards, namely the private International Accounting Standards Board (hereinafter, *IASB*), the intermediate Financial Stability Board (hereinafter, *FSB*) as well as the intergovernmental Group of 20 (G-20). On the basis of the findings made in this section, the third part

[37] On this perception see for example Eernisse (2012), p. 253 ('TRNs [transnational regulatory networks] – including the FSB, BCBS, IOSCO, and IASB – have come to dominate the field of international financial law.'); Arner and Taylor (2009), p. 489 ('Policy networks have been at the centre of the new forms of cooperation and coordination that nationally based regulatory agencies have used to adapt to the realities of the global financial system in the past thirty years, with international standard-setting bodies being at the core of their response.'). Generally on the network structures in the institutional regulatory framework of global financial markets see also, e.g., Levit (2005), pp. 182 et seq.; Alexander et al. (2006), pp. 34 et seq.; Marcussen (2006), pp. 180 et seq.; Zaring (2005), pp. 578 et seq.

[38] See thereto, e.g., Rost (2009a), pp. 319 et seq.; Barr and Miller (2006), pp. 15 et seq.; Alexander et al. (2006), pp. 37 et seq.

[39] On this non-governmental organization see for example Baker and Mathews (2009), pp. 377 et seq.; Alexander et al. (2006), pp. 61 et seq.; Brummer (2012), pp. 78 et seq.

[40] For further details on this regulatory institution, see e.g. Alexander (2009), pp. 439 et seq.; Alexander et al. (2006), pp. 55 et seq.; Rost (2007), pp. 137 et seq.

[41] Generally on the importance of international accounting standards for transboundary business activities see for example Sharma (2010), pp. 141 et seq.; Herdegen (2013), pp. 334 et seq.; Weber (2012), 164. Specifically on the role of accounting standards in the recent global financial crisis see Arner (2011b), pp. 1604 et seq.

is devoted to an evaluation of the underlying reasons for and motives behind the evolution of the respective hierarchical structures, prominently among them concerns for legitimacy in transnational economic networked governance. Adopting a broader perspective, this final section also addresses some wider implications arising from these structural developments for the future of transnational economic networked governance in general and in particular the role played by state actors therein.

2 Functions and Limits of the Network Model in Transnational Economic Governance

It hardly needs to be emphasized that the concept and analytical approach of the network model has already for a number of years increasingly been taking recourse to in a by now considerable number of academic disciplines.[42] This surely applies more recently in particular also to the field of jurisprudence in general and the area of international (economic) law in particular.[43] Thereby, in particular in light of its growing popularity, the term 'network' has occasionally already for quite some time been issued by some scholars the rather 'mixed blessing'[44] of being not more than merely a 'buzzword'.[45]

Despite the criticism voiced against this concept also by a considerable number of legal scholars,[46] applying the network model to certain steering regimes in the international economic system should not merely be regarded as mirroring something like a popular trend. Rather, it constitutes a, in principle, legitimate approach to describe and thereby also categorize a variety of steering mechanisms that are—although not all of them of recent origin—with regard to their increasing practical importance as a whole a notable feature in the international economic system that cannot—at least in its entirety—be captured by applying traditional legal and organizational categories.[47]

Nevertheless, it should also be stressed that the application of the term and idea of networks is no substitute for—and thus does not release from—an analysis of the organizational structures of these steering phenomena as well as their relationships

[42] See thereto, e.g., Krücken and Meier (2003), p. 75; Jansen (2006), p. 11; Peters (2006), p. 601; Ladeur (2011), p. 639; Eifert (2002), p. 90.

[43] On the last mentioned observation see only Tietje (2011c), p. 33 ('the network concept, which is already quite popular in international law').

[44] Nohria (1992), p. 3.

[45] Compare for example Börzel (1998), pp. 253 et seq.; Marin and Mayntz (1991), pp. 11 et seq.; Röhrle (1994), p. 2; Weyer (2000), p. 1.

[46] See e.g. von Bogdandy and Dann (2010), p. 890; Walter (2007), pp. 201 et seq.; Mager (2008), pp. 394 et seq.

[47] Generally on this perception see already Möllers (2005b), pp. 285 et seq.; Schuppert (2012), § 16, paras. 134 et seq.; Vesting (2004b), p. 64; Nowrot (2007a), pp. 6 et seq.

among each other. As already frequently and rightly been emphasized, the strength of the network model lies primarily in its value as a descriptive category. To the contrary, its utility as a methodological approach for the conceptualization of the respective cooperative regimes is at least at first sight rather limited.[48] Therefore, it is surely not sufficient to merely take recourse to this concept when trying to clarify the in its openness from a legal perspective rather irritating term 'network'.[49] Rather, there is a clear need to move beyond a descriptive network model in order to provide the necessary theoretical basis for its conceptualization and normative evaluation. This task requires first and foremost the identification of a suitable approach for the analytical penetration of the organizational structures of and interrelationships between respective transnational regulatory networks.[50]

From the perspective of legal science, recourse can be taken in this regard to ideas currently under discussion primarily in connection with the conceptualization of the European Union's normative order as well as the overarching juridical structure of the international system as a whole that are in principle also applicable to the dogmatic analysis of networks. Thereby, based on their methodological approaches it is possible to identify two main lines of argumentation in the literature that can be characterized as the 'sui generis approach' and the 'transfer approach' respectively.[51] The 'sui generis approach' is based on the assumption that the novel phenomenon does not only require a new descriptive categorization. Rather, also the respective conceptualization cannot take recourse to traditional state-centered models but—precisely in order to overcome the 'perseverance of the 'touch of stateness"—necessitates the development of equally unprecedented analytical concepts.[52]

This line of reasoning has already occasionally found manifestation also in the legal literature on networks. Examples are provided by the qualification of networks as 'legal institution sui generis'[53] or the expression of doubts as to the possibilities to conceptualize these steering phenomena on the basis of familiar categories.[54] Nevertheless, as also already been emphasized by a considerable number of legal scholars, such calls call for the application of models sui generis as being at the core of this approach—if taken as the analytical starting point—have certain dogmatic flaws. Not only has the qualification of a phenomenon as sui generis itself being said to be unhelpful from a dogmatic point of view and rather reflecting classificatory

[48] See thereto, e.g., Kenis and Schneider (1991), p. 44; Chiti (2000), p. 330; Nowrot (2007a), pp. 9 et seq.; Poto (2007), p. 646.

[49] Franzius (2006), p. 197.

[50] See also for example already Ziller (2004), pp. 280 et seq.; Messner (2000), pp. 38 et seq.; Nowrot (2011), pp. 258 et seq.

[51] Nowrot (2007b), pp. 124 et seq.

[52] See for example Shaw and Wiener (2000), pp. 65 et seq.; Schmitter (1996), pp. 132 et seq.; Luhmann (1971), p. 14.

[53] Teubner (2003), p. 46.

[54] Schuppert (2012), § 16, para. 134 et seq.; Vesting (2004b), pp. 64 et seq.

incompetence as well as mirroring awkwardness.[55] Rather, it is in particular also the accompanying assumption of the need for a 'conceptual tabula rasa' that is difficult to reconcile with the commonly shared perception of legal analysis adopting a comparative approach being oriented towards the identification of similarities with already existing categories and concepts.[56]

In light of these findings, also the following assessment of the interrelationships between transnational governance networks in the field of financial accounting standards will primarily be based on the 'transfer approach' which generally revolves around an assessment of the applicability—by way of a deliberate transfer and thus if necessary with adjustments—of traditional state-centered and other familiar ordering concepts such as democracy, hierarchy, federalism or the rule of law to new normative steering phenomena.[57] While in general already for quite some time and in particular at present increasingly been taken recourse to with regard to the European Union and the international legal system as a whole, this approach has so far been largely neglected in the admittedly only recently intensified discussions on the conceptualization of the organizational structures developed by and the connections emerging between international governmental, intermediate and private regulatory networks.

3 Evolving Hierarchies in Network Governance: The Relationship Between the IASB, the FSB and the G-20

Although there is as of today still no agreement on the constitutive elements of networks in general, they are nevertheless at least regularly characterized as informal, often complex[58] but nevertheless 'loosely-structured' dialogue-, learning- and standard-setting for a with a 'horizontal form of organization'.[59] According to this perception the respective characteristics distinguish networks on the one side from traditional, predominantly hierarchically-organized regulatory mechanisms operating at the domestic level and on the other side from conventional international governmental organizations with their often quite elaborate institutional

[55] See e.g. Schütze (2012), pp. 48 and 67; MacCormick (1999), p. 142; Dann (2006a), p. 55.

[56] See thereto in particular von Bogdandy (2006), p. 10 ('Yet this demand clashes with the very nature of legal thinking, which, at its heart, is comparative and dependent on the repertoire of established doctrines of viable institutions.'); Nowrot (2007a), pp. 17 et seq.; as well as generally also Alexy (2010), p. 18 ('This more than suffices to qualify comparison as a third basic operation in law.').

[57] Generally on this approach see for example von Bogdandy (2010), pp. 735 et seq.; Nowrot (2007a), pp. 18 et seq., with further references.

[58] Specifically on the 'complexity inherent in network structures' see for example Easley and Kleinberg (2010), p. 4.

[59] Generally thereto, e.g., Raustiala (2002), p. 5; Vesting (2004a), pp. 259 et seq.; Kadushin (2012), pp. 14 et seq.; Möllers (2006), p. 331; Verdier (2009), pp. 117 et seq.

structures and a membership only being open to certain categories of actors, in particular states and in some cases other international organizations.[60]

This general characterization of networks most certainly continues to apply to many, probably even the majority of the respective transnational steering regimes. Nevertheless, an increasing number of administrative, intermediate and private governance networks have not only acquired a remarkable degree of organizational consolidation,[61] thereby more and more also displaying structural features that can be captured and systemized by taking recourse to formally predominantly state-centered concepts such as federalism and parliamentarianism.[62] Rather, more recently there are increasingly also hierarchical arrangements evolving within and in particular in the relationships between different regulatory networks. A telling example in this regard is the emerging relationship between the private IASB, the intermediate FSB as well as the intergovernmental Group of 20 (G-20) in the realm of financial reporting standards.

With regard to the goal of achieving 'convergence to a single set of high-quality accounting standards',[63] a quite central role is currently played by the IASB, the standard-setting body of the private International Financial Reporting Standards Foundation (hereinafter, IFRS Foundation).[64] The IASB, established in April 2001 as the successor institution to the International Accounting Standards Committee (hereinafter, *IASC*) founded already in June 1973,[65] comprises of 16 individuals, appointed by the Trustees of the IFRS Foundation for a term of 5 years primarily on the basis of their professional competence and practical experience in the realm of financial accounting and reporting.[66] The primary steering instrument developed and continuously revised by this transnational governance network[67] are the International Financial Reporting Standards (hereinafter, *IFRS*),[68] recommendations in the form of a voluntary set of rules that require incorporation into the domestic legal

[60] See for example Witte et al. (2000), pp. 179 and 184.

[61] On this perception see also, e.g., Warning (2006), pp. 322 et seq.; Möllers (2005a), p. 371.

[62] See thereto Nowrot (2005), pp. 18 et seq.; Nowrot (2007a), pp. 19 et seq.; Nowrot (2011), pp. 260 et seq.

[63] See The G20 Los Cabos Summit Leaders' Declaration, 19 June 2012, para. 43, available on the Internet under http://www.g20.org/documents. Accessed 30 July 2013.

[64] See IFRS Foundation Constitution, para. 1, last updated December 2010, available on the Internet under: http://www.ifrs.org/The-organisation/Governance-and-accountability/Constitution/Documents/ConstitutionDec2010.pdf. Accessed 30 July 2013.

[65] On the origins and development of the IASC and the IASB see for example Rost (2009b), pp. 366 et seq.; Tamm Hallström (2004), pp. 75 et seq.

[66] See IFRS Foundation Constitution, paras. 24 et seq., last updated December 2010, available on the Internet under: http://www.ifrs.org/The-organisation/Governance-and-accountability/Constitution/Documents/ConstitutionDec2010.pdf. Accessed 30 July 2013.

[67] On the qualification of the IASB as a network see e.g. Pan (2010), p. 262; Zaring (2012), p. 699; Eernisse (2012), p. 253.

[68] For the current version of the IFRS of 1 January 2012, see the information available on the Internet under http://www.ifrs.org/IFRSs/Pages/IFRS.aspx. Accessed 30 July 2013.

systems by national authorities in order to become legally binding for business enterprises and other addressees. Despite this need for legislative or administrative approval at the domestic level, however, it has already frequently and rightly been pointed out that in light of the growing success of the IFRS on the international scene, in particular among major jurisdictions, governmental authorities of many individual states enjoy in practice an increasingly limited discretion to deviate from the financial reporting standards adopted by this ultimately self-mandated[69] private regulatory network in their respective domestic legislation.[70]

Already for a number of years, the IFRS Foundation has responded to the concerns voiced against the standard-setting activities of the IASB and the normative challenges this governance networks faced with regard to, inter alia, aspects of transparency, participation, accountability, orientation towards the common good, and, from a broader perspective, the increasingly important issue of legitimacy[71] by, for example, requiring the IASB to meet in sessions open to the public, to publish so-called "exposure drafts" on all its projects for public comments and to carry out general public consultations on a regular basis.[72]

Furthermore, it is particularly noteworthy in the present context that the IFRS Foundation more recently established internal elements of institutional oversight and thus of hierarchization in the form of, first, the Due Process Oversight Committee (hereinafter, *DPOC*), a standing committee of the trustees of the IFRS Foundation that convenes at least four times a year and meets with the members of the IASB at least once a year,[73] and, second, in particular a Monitoring Board of public authorities. The last mentioned body, established in April 2009,[74] comprises of one member of the European Commission, the Chair of the IOSCO Emerging

[69] See Richardson and Eberlein (2011), p. 220.

[70] See on this issue for example Huber (2008), pp. 390 et seq.; Richardson and Eberlein (2011), pp. 217 et seq.

[71] On these concerns and challenges, see e.g. Bradley (2011), pp. 480 et seq.; Arner and Taylor (2009), p. 494; Ruddigkeit (2011), pp. 18 et seq.; Richardson and Eberlein (2011), pp. 217 et seq.; Jordan (2011), pp. 333 et seq.; Huber (2008), pp. 390 et seq.

[72] See IFRS Foundation Constitution, paras. 34 et seq., last updated December 2010, available on the Internet under: http://www.ifrs.org/The-organisation/Governance-and-accountability/Constitution/Documents/ConstitutionDec2010.pdf. Accessed 30 July 2013; see also, e.g., Rost (2007), pp. 177 et seq.; Richardson and Eberlein (2011), pp. 224 et seq.

[73] For details on the DPOC see the information available on the Internet under http://www.ifrs.org/DPOC/Pages/DPOC.aspx. Accessed 30 July 2013. See also more recently, e.g., Report of the Due Process Oversight Committee Meeting of 22 January 2013, available on the Internet under http://www.ifrs.org/Alerts/Governance/Documents/2013/DPOC-Report-January-2013.pdf. Accessed 30 July 2013.

[74] See thereto Memorandum of Understanding to Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation, 1 April 2009, available on the Internet under http://www.ifrs.org/The-organisation/Governance-and-accountability/Documents/Monitoring_Board_Mou080110.pdf. Accessed 30 July 2013; and the Charter of the IASCF Monitoring Board, 1 April 2009, available on the Internet under http://www.ifrs.org/The-organisation/Governance-and-accountability/Documents/Monitoring_Board_Charter.pdf. Accessed 30 July 2013.

Markets Committee, the Chair of the IOSCO Technical Committee, the Commissioner of the Japan Financial Service Agency, the Chair of the US Securities and Exchange Commission, and on the basis of an observer status, the Chair of the Basel Committee on Banking Supervision.[75] In accordance with Paragraph 18 of the 2010 IFRS Foundation Constitution, the Monitoring Board is intended to 'provide a formal link between the Trustees and public authorities', with this hierarchical institutional arrangement seeking 'to replicate, on an international basis, the link between accounting standard-setters and those public authorities that have generally overseen accounting standard-setters' in the respective domestic realms.[76]

In addition to these developments that might appropriately be characterized as processes of internal institutional hierarchization in transnational network governance, it is at least equally significant that the IASB as an important international standard-setting body of a private character is also—this time from an external perspective—subjected to the supervision by another regulatory network in the realm of international financial governance—the FSB.[77] The FSB was established in April 2009 by the G-20[78] as the successor institution of the Financial Stability Forum (hereinafter, *FSF*) founded in February 1999 by the Finance Ministers and Central Bank Governors of the Group of Seven.[79] The membership of this intermediate organization, which most recently on 28 January 2013 acquired the status of an association under Swiss civil law and is domiciled in Basel (Switzerland),[80]

[75] See IFRS Foundation Constitution, para. 21, last updated December 2010, available on the Internet under http://www.ifrs.org/The-organisation/Governance-and-accountability/Constitution/Documents/ConstitutionDec2010.pdf. Accessed 30 July 2013.

[76] *Ibid*., para. 18. On the comparable governance structures in U.S. accounting standardization see e.g. Mattli and Büthe (2005), pp. 237 et seq.

[77] Concerning the characterization of the FSB as a transnational governance network see for example Pan (2010), p. 253; Catá Backer (2011), p. 797; Eernisse (2012), p. 253; Zaring (2010), p. 486.

[78] See Declaration on Strengthening the Financial System, G-20 London Summit, 2 April 2009, available on the Internet under http://www.mofa.go.jp/policy/economy/g20_summit/2009-1/annex2.html. Accessed 30 July 2013.

[79] On the origins and development of the FSF and the FSB see for example Carrasco (2010), pp. 203 et seq.; Porter (2009), pp. 345 et seq.; Manger-Nestler (2011), pp. 187 et seq., 215 et seq.; Ruddigkeit (2011), pp. 5 et seq.

[80] See Articles of Association of the Financial Stability Board of 28 January 2013, available on the Internet under http://www.financialstabilityboard.org/publications/r_130128aoa.pdf. Accessed 30 July 2013. See thereto also The G20 Los Cabos Summit Leaders' Declaration, 19 June 2012, para. 46, available on the Internet under http://www.g20.org/documents/. Accessed 30 July 2013. ('We endorse the recommendations and the revised FSB Charter for placing the FSB on an enduring organizational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies, while maintaining strong links with the BIS. [. . .].'); as well as Communiqué of Ministers of Finance and Central Bank Governors of the G20, Mexico City, 4–5 November 2012, para. 18, available on the Internet under http://www.g20.org/documents/. Accessed 30 July 2013. ('We welcome the FSB's progress in implementing the measures endorsed at Los Cabos to

comprises in accordance with Article 3 of its 2013 Articles of Association and Article 5 of its 2012 Charter[81] of three different types of actors. The first category of members are public authorities from jurisdictions responsible for maintaining financial stability, currently respective bodies from 25 jurisdictions, among them the Japanese Ministry of Finance, the Saudi Arabian Monetary Agency, the Reserve Bank of India, the Security and Exchange Commission of Brazil, the South African Ministry of Finance, the China Banking Regulatory Commission, the European Commission, and the US Department of the Treasury. The second type of members comprises international financial institutions like the IMF, the Bank for International Settlements (hereinafter, *BIS*), the World Bank and the Organisation for Economic Cooperation and Development (hereinafter, *OECD*). Finally also international standard-setting, regulatory and supervisory bodies are eligible to be a member of the FSB, among them currently the IAIS, the IOSCO, the Basel Committee on Banking Supervision, and the IASB itself.[82]

The prominent position occupied by the FSB within and even beyond the current international financial architecture is already indicated by the fact that it occasionally has even been regarded as something like a fourth pillar of global economic governance—alongside the World Trade Organization, the IMF and the World Bank.[83] Thereby, it is for the present purposes particularly noteworthy that this transnational governance network has primarily been established for the purpose of coordinating "at the international level the work of national financial authorities and international standard setting bodies (hereinafter, *SSBs*) in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies".[84] In line with this overarching purpose, the FSB is in accordance with Article 2 (1) (e) of its 2012 Charter entrusted with the task of undertaking "joint strategic reviews of and coordinat[ing] the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities and addressing gaps". The respective steering and supervisory functions exercised by the FSB with regard to standard-setting bodies like the IASB finds its normative manifestation for example in the fact that these regulatory networks are under Article 6 (3) of the 2012 FSB Charter required to report to the FSB on their work with the overarching aim of strengthening "support for strong

strengthen its capacity, resources and governance. We look forward to its establishment as a legal entity by our next meeting and its full implementation by September 2013. [...].').

[81] Charter of the Financial Stability Board, last amended on 19 June 2012, Annex A, available on the Internet under http://www.financialstabilityboard.org/publications/r_120809.pdf. Accessed 30 July 2013.

[82] For a complete list of current FSB members see Charter of the Financial Stability Board, last amended on 19 June 2012, Annex A, available on the Internet under http://www.financialstabilityboard.org/publications/r_120809.pdf. Accessed 30 July 2013.

[83] On this perception see e.g. Tietje (2011c), p. 38; Manger-Nestler (2011), p. 169; as well as the contributions in Griffith-Jones et al. (2010).

[84] See Article 1 of the Charter of the Financial Stability Board, last amended on 19 June 2012, available on the Internet under http://www.financialstabilityboard.org/publications/r_120809.pdf. Accessed 30 July 2013.

standard setting by providing a broader accountability framework". Despite the fact that the still rather informal steering regime established by the FSB is not endowed with the competence to issue legally-binding decisions, the rather broad mandate and functions as an "agenda setter"[85] given to this governance network vis-à-vis respective private and intermediate standard-setting institutions such as the IASB nevertheless suggests the emergence of a hierarchical relationship between these regulatory networks.[86]

However, it also needs to be emphasized that the FSB serves in this connection primarily as a kind of "bridge institution"[87] between the sectoral standard-setting bodies like the IASB on the one side and the G-20 on the other side. The intergovernmental network of the G-20[88] has not only played a central role in the establishment of the FSB. Rather, the FSB is also generally and rightly regarded as being in a continued position of subordination to—and thus itself in a hierarchical relationship with—the Group of 20.[89] This is not only evidenced by the frequent reference to the G-20 in the preamble of the 2012 FSB Charter. Rather, Article 4 of the Charter explicitly states that the FSB "will discharge its accountability, beyond its members, through publication of reports and, in particular, through periodical reporting of progress in its work to the Finance Ministers and Central Bank Governors of the Group of Twenty, and to Heads of State and Governments of the Group of Twenty".

The G-20 was originally established in the aftermath of the Asian financial crisis of the late 1990s at the initiative of the G-7[90] finance ministers and central bank governors in September 1999.[91] Its membership comprises of 19 countries—Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa,

[85] On the distinction between agenda-setters and mere standard-setters in the international financial architecture see Brummer (2012), pp. 67 et seq.; Brummer (2011), pp. 275 et seq.

[86] On this observation see also already Catá Backer (2011), pp. 784 et seq.; Ruddigkeit (2011), pp. 17 et seq.; as well as, albeit more cautious, Helleiner (2010), pp. 13 et seq.

[87] See Catá Backer (2011), p. 793 ('The FSB assumes the role of a bridge institution.'); Ruddigkeit (2011), pp. 23 et seq. From a broader perspective see also Farrar and Parsons (2012), p. 386 ('It [the FSB] has been positioned by the G20 to be at the centre of both international and national dialogue, and it provides a point of connection for governments and international bodies of experts [. . .] as well as institutions such as the IMF and the World Bank.').

[88] On the qualification of the Group of Twenty as a governance network see for example Wouters and Ramopoulos (2012), p. 764; Lovett (2011), p. 49.

[89] See in this connection for example Arner (2011b), p. 1594 ('The FSB can therefore be seen as the central organization responsible for coordinating detailed development of the G-20 international regulatory reform agenda and also for monitoring its implementation.'); Ruddigkeit (2011), pp. 21; Zaring (2012), p. 698 ('the reporter to the G20 and the enforcer of its schedule').

[90] On the origins and development of the G-7 (now G-8) starting from the so-called "Library Group" of 1973, see e.g. Brouder (2009), pp. 95 et seq., with numerous further references.

[91] For a more detailed account of the emergence and subsequent activities of the G-20 see Norton (2010), pp. 275 et seq.; Wouters and Ramopoulos (2012), pp. 763 et seq.; Manger-Nestler (2011), pp. 212 et seq.; Eernisse (2012), pp. 241 et seq.

Turkey, the United Kingdom and the United States of America—as well as the European Union. In addition, the G-20 maintains close relations with a number of international organizations, among them the IMF, the World Bank, the World Trade Organization (hereinafter, *WTO*), the OECD and the International Labour Organisation (hereinafter, *ILO*). In the first 9 years of its existence, this governance network only met in the form of the G-20 finance ministers and central bank governors. Respective proposals to upgrade the so-called "G-20 Finance" to something like an "L20" ("Leaders 20") received little political support in the beginning and the middle of the previous decade.[92] Rather, it was only in reaction to the global financial crisis of 2008 that the G-20 heads of state and governments convened for the first time at the Washington D.C. summit in November 2008. Since then, six more G-20 summits have so far taken place, with this intergovernmental network already from September 2009 being considered by its members as "the premier forum for our international economic cooperation".[93]

And indeed, the role and functions now assumed by the G-20 are not only to be regarded as the most important institutional development evolving from the recent global financial crisis.[94] Far beyond its central position in the international financial architecture, this transnational governance network has more recently emerged—in the words of Douglas W. Arner and Ross P. Buckley—as "the new global coordinating mechanism in economic and financial matters"[95] or—to mention but one further characterization—"the most important room for global economic governance".[96] In light of these findings and adopting a broader perspective, one can thus in principle agree with the observation recently made by Jan Wouters and Thomas Ramopoulos that the "post-2008 G20 has changed the international economic institutional architecture and thereby global economic governance as we knew it. It has introduced an informal element together with overtly political—rather than technocratic—imperatives at the top of the international system of economic governance".[97] The position occupied by this intergovernmental network within—or more precisely at the top of—the emerging hierarchical relationship between the

[92] See thereto Brouder (2009), p. 114.

[93] G-20 Leaders' Statement, The Pittsburgh Summit, 24–25 September 2009, para. 50, available on the Internet under http://www.g20.org/documents/. Accessed 30 July 2013.

[94] On this perception see e.g. Tietje (2011c), p. 31.

[95] Arner and Buckley (2010), p. 24.

[96] Napolitano (2011), p. 316; see also, e.g., Farrar and Parsons (2012), p. 386 ('the lead player in the international conversation during and in the aftermath of the GFC [global financial crisis]'); Brummer (2012), p. 70 ('perhaps today's most visible body for international economic coordination').

[97] Wouters and Ramopoulos (2012), p. 764; in this connection see also for example the observations made by Manger-Nestler (2011), p. 214 ('Since the beginning of the crisis, the G20 has impressively demonstrated that this forum has the ability to act quickly and unconventionally and to develop 'global' solutions, [...].'); and Napolitano (2011), p. 316 ('The establishment of the G-20 as the 'premier forum of economic global governance' was fundamental in transfusing new blood into multilateralism, overcoming the limits to the authority and legitimacy of the Group of Seven (G-7) industrialized countries.').

IASB, the FSB and the G-20 in the realm of international financial reporting standards clearly supports this proposition and can thus be regarded as a kind of pars pro toto for the overall status of this steering body in the global economic order.

4 Promoting Legitimacy: The Rise of Gubernative Structures in Transnational Financial Networked Governance

The previous evaluation has not only illustrated the central role played by transnational governance networks in the regulatory field of financial accounting standards. Rather, in addition to this already for quite some time established feature of this area of international financial and business law, the analysis has also revealed a considerably more recent trend, namely the emergence of hierarchical relationships between the private, intermediate and intergovernmental regulatory networks involved. These processes of a hierarchization of network structures are not only intended to foster coherence in the development of international standards. By establishing something like a multi-level system of accountability of private standard-setting bodies to public actors, they also have the potential to contribute to the legitimacy of the steering functions exercised by transnational regulatory networks in the realm of financial reporting.

The legitimacy challenges that arise from the steering activities of governance networks in the transnational realm have already been qualified as "emerging as one of the central questions – perhaps the central question – in contemporary world politics".[98] Taking into account the complexity of these issues—which are in addition intrinsically tied to the controversy about the legitimacy of the changing regulatory structures on the domestic level as well as in the international system as a whole[99]—it hardly needs to be emphasized that it will neither be feasible to nor is this contribution aimed at elaborating on all the manifold implications of the possible existence of and potential remedies for the alleged "chronic lack of legitimacy"[100] of these types of network governance in something even close to a comprehensive way.[101] Rather, this final section focuses primarily on the implications arising from the development of hierarchical network structures for the legitimacy of transnational economic networked governance as a whole.

[98] Moravcsik (2005), p. 212.

[99] Generally thereto for example Delbrück (2003), pp. 29 et seq.; Krisch (2006), pp. 247 et seq., each with further references.

[100] Picciotto (1996/1997), p. 1047; see also, e.g., Möllers (2005a), p. 380.

[101] For a more comprehensive assessment see for example Slaughter (2004), pp. 217 et seq.; Möllers (2005a), pp. 378 et seq.; Cashore (2002), pp. 515 et seq.; Hamann and Ruiz Fabri (2008), pp. 481 et seq., each with further references.

In light of the fact that the diversity and complexity of regulatory mechanisms in the international realm does in general not allow for the establishment of comparable allocative structures, it is also among legal scholars more and more recognized that traditional concepts of democratic legitimacy developed under the conditions of the territorial nation-state such as in particular the one requiring "unbroken" and preferably rather short "chains of legitimacy"[102] constitute an increasingly inadequate approach for legitimizing the respective transnational steering regimes.[103] Concerning the resulting need for a conceptual change of legitimacy it is possible—by taking recourse to the distinction between "input-oriented" and "output-oriented" models developed by Fritz W. Scharpf[104]—to identify three main lines of argumentation in the literature. Some scholars have developed—on the basis of exclusively 'input-oriented' legitimizing strategies—transnational concepts of democracy such as in particular the model of a 'cosmopolitan democracy' by David Held,[105] even though its implementation in practice appears for the time being rather unrealistic.[106] On the other end of the spectrum are those academics that argue for entirely 'output-oriented' models of transnational legitimacy.[107]

The majority of those legal scholars, however, who are currently sympathetic towards a conceptual change of the understanding of legitimacy, favor more complex approaches comprising of 'input-oriented' as well as 'output-oriented' elements.[108] According to these pluralistic models, it is necessary to determine with regard to every individual regulatory regime whether a sufficient number of legitimizing factors exist that substitute or mutually reinforce each other.[109] Although there is no numerus clausus with regard to the potential aspects to be taken into account,[110] it is nevertheless possible to identify a number of factors to which particular importance is frequently attributed to in the legal literature. Among them is from an 'output-oriented' perspective the effective realization of the common good, generally regarded as one of the most important legitimizing factors for the respective regulatory structures.[111] In order to facilitate this optimal orientation towards the realization of the common good, a prominent position is—in the realm

[102] For such an approach see for example Böckenförde (2004), § 24, paras. 9 et seq.

[103] On this perception see e.g. Kingsbury et al. (2005), pp. 48 et seq.; Delbrück (2003), p. 30.

[104] Scharpf (1972), pp. 21 et seq.

[105] See for example Held (1995), pp. 221 et seq.

[106] See thereto for example Zürn and Leibfried (2005), p. 22; Delbrück (2003), p. 40; Peters (2001), pp. 750 et seq.

[107] See e.g. Peters (2001), pp. 580 et seq.

[108] On this perception see for example Krisch (2006), pp. 247 et seq.; Schliesky (2004), pp. 588 et seq.

[109] See e.g. Trute (2012), § 6, paras. 56 et seq.; Schliesky (2004), p. 719.

[110] Schliesky (2004), p. 719.

[111] On this perception see e.g. Schuppert (2003), p. 416; Trute (2012), § 6, para. 53; Schliesky (2004), p. 691.

of 'input-oriented' factors—occupied, inter alia, by the requirements of public accountability, transparency in the decision- and rule-making processes as well as of opportunities for participation by interested and affected actors.[112]

When applying these pluralistic approaches to transnational governance networks in the realm of financial reporting, it becomes apparent that the recently emerging hierarchies between the relevant international steering regimes has first and foremost to be regarded as an attempt by state actors to establish—or rather reestablish—governmental steering capacity vis-à-vis the activities of private international standard-setting bodies, thereby providing, on the basis of mechanisms of public accountability, for a certain remedy to the legitimacy challenges these non-governmental actors are frequently confronted with.[113] In addition, these new informal institutional arrangements in the transnational realm mirror the increasingly shared perception that in particular also the drafting of financial reporting standards, in order to be acceptable and successful, requires not only technical expertise but also political competence and value-oriented decisions.[114]

From a broader perspective, the hierarchical relationships between the IASB, the FSB and the G-20 thereby also illustrate the fact that the international financial architecture requires more than merely technical and administrative structures. Rather, it also calls for respective 'gubernative' arrangements.[115] The term 'gubernative', also referred to as government in the narrow sense of the meaning, thereby characterizes those public authorities that are to distinguished from 'administrative' entities on the basis of their competences and responsibilities to adopt the central political decisions in a community and are thus entrusted with the task of political leadership.[116]

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[112] See e.g. Krisch (2006), pp. 247 et seq.; Cassese (2005), pp. 688 et seq.; Delbrück (2003), pp. 40 et seq.; Charnovitz (2012), pp. 218 et seq.

[113] See also, in particular with regard to the function of the FSB, Catá Backer (2011), pp. 783 et seq.; Ruddigkeit (2011), pp. 20 et seq.; Brummer (2012), pp. 192 et seq.

[114] See e.g. Richardson and Eberlein (2011), pp. 217 et seq.; Mattli and Büthe (2005), pp. 225 et seq.; Huber (2008), pp. 390 et seq.

[115] On this perception see also already Pan (2010), p. 283; Tietje (2011c), pp. 40 and 43; as well as for example Manger-Nestler (2011), p. 186 ("The 'groups' are gubernative committees, [. . .]."), p. 198 ('informal 'gubernative' formations, like the G20'); p. 202 ('At present, the G20 represents gubernative structures of a global financial regulatory framework, [. . .].'); Wouters and Ramopoulos (2012), p. 764 ('overtly political – rather than technocratic – imperatives at the top of the international system of economic governance').

[116] See also for example Dann (2006b), p. 2 note 1 ('The notion of the "gubernative" is not very common, but captures more precisely than the notions of "executive", "government" or "administration" what is meant here. The notion is based on the distinction between the politically responsible leadership of the executive branch (the gubernative) and the hierarchically subordinated administration or bureaucracy. Both together form the executive branch. The term "government", which is often used to name the political pinnacle of the executive branch, is too vague, since it can also mean all branches of government and the process of governing.'). For a more detailed account on the gubernative and the distinction between gubernative and administrative structures, see e.g. von Bogdandy (2000), pp. 107 et seq.; Tietje (2001), pp. 188 et seq., each with further references.

In this regard and despite its undisputable shortcomings,[117] the G-20 appears—in the absence of viable alternatives[118]—for the time being the only transnational governance network that is endowed with the essential legitimacy[119] and, at least equally important, the required political authority to function as the central gubernative regime in the complex multi-layered international financial system in general[120] and with regard to the international standard-setting activities in the realm of financial reporting in particular.

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[117] For a rather critical evaluation of the G-20 in this regard see in particular Charnovitz (2012), p. 218 et seq.; as well as for example Manger-Nestler (2011), pp. 214 et seq.

[118] See in this connection for example on the proposal to establish a "Global Economic Coordination Council" brought forward by the *Stiglitz* Commission in September 2009, Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, 21 September 2009, paras. 21 et seq., available on the Internet under http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf. Accessed 30 July 2013.

[119] Concerning the legitimacy of the G-20 and other so-called "G-Groups" see for example Brouder (2009), pp. 104 et seq.; Tietje (2011c), p. 43; Napolitano (2011), pp. 315 et seq.

[120] On this perception see also in particular already Tietje (2011c), pp. 31 et seq., 43 et seq.

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The OECD Principles of Corporate Governance in Emerging Markets: A Successful Example of Networked Governance?

Mathias M. Siems and Oscar Alvarez-Macotela

Contents

1 Introduction

The Organisation for Economic Co-operation and Development (hereinafter, *OECD*) is a group of 34 member and 6 partner countries, belonging to the wealthiest of the world. As these 40 countries account for 80 % of world trade and investment, the OECD sees itself in a 'pivotal role in addressing the challenges

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facing the world economy'.[1] Notably, many of its recommendations are aimed at the law-makers of emerging markets and less developed countries and at businesses themselves. For example, the OECD Principles of Corporate Governance are intended to assist governments as well as stock exchanges, investors and private corporations in the improvement of their corporate governance institutions.[2] This chapter aims to understand more closely how the OECD Principles operate in emerging markets. It also discusses whether they can be seen as a successful networked form of governance that does not simply rely on hierarchical forms of law making and law enforcement.

The term and scope of 'emerging markets' requires a brief explanation. It refers to countries that are neither developed nor developing, sometimes also called newly industrialised countries or rapidly developing economies.[3] The focus of this chapter is on emerging markets in Latin America in particular Mexico and to a lesser extent Brazil. These two countries are part of the BRIC (Brazil, Russia, India, China) or MIST (Mexico, Indonesia, South Korea, Turkey),[4] which are seen as the potentially most significant economic players of the future. Of course, there are many differences within the group of emerging economies, for instance, some but not all of them are also 'transition economies' facing specific problems of corporate governance reform.[5] Still, we believe that many of our findings should be applicable to all of the emerging markets.

The structure of this chapter is as follows. Section 2 sets the scene in providing an introduction into the origins and rationale of the OECD Principles and how they may relate to the concept of 'networked governance'. Section 3 addresses how far the law-makers of emerging markets have taken account of the OECD Principles. But we also argue that a more contextual understanding is needed in order to evaluate the success of the OECD Principles. Thus, Sect. 4 discusses how the OECD Principles operate at the 'micro level', for instance, in the relationship between companies and their shareholders, and Sect. 5 explores the specific question of whether their substantive rules really 'fit' within emerging markets. Section 6 examines whether the global financial crisis of 2008 points towards the need to re-visit the corporate governance model of the OECD Principles. Finally, Sect. 7 returns to the topic of networked governance in transnational business law in order to critically evaluate the nature and operation of the OECD Principles.

[1] OECD (2013).

[2] For references and details see Sect. 2 *Setting the Scene*: *The OECD Principles and* '*Networked Governance*' below. In addition, the OECD has developed Guidelines on Corporate Governance of State Owned Enterprises and Guidelines on Multinational Enterprises, not discussed in this chapter.

[3] For a good overview see Nielsen (2011).

[4] See Roughneen (2011). South Africa is sometimes added to the former group, thus, this group becomes BRICS, see http://www.brics5.co.za/. Accessed 30 July 2013.

[5] See e.g. Avilov et al. (1999); Pistor et al. (2000); Fox and Heller (2006).

2 Setting the Scene: The OECD Principles and 'Networked Governance'

2.1 Introduction to the OECD Principles

The initial version of the OECD Principles of Corporate Governance was adopted in 1999 and the revised one in 2004.[6] Both versions were drafted in the aftermath of financial crises, namely, the Asian financial crisis and the dot-com bubble. This is clearly reflected in their aims, for example, the Foreword to the OECD Principles 2004 refers to the 'contribution good corporate governance makes to financial market stability, investment and economic growth'.

The OECD Principles were prepared by the OECD Business Sector Advisory Group and subsequently adopted by the OECD Council, i.e. the responsible ministers of the OECD member countries. In addition, the process involved a variety of other actors: the OECD's Business and Industry Advisory Committee (hereinafter, *BIAC*) and Trade Union Advisory Committee (hereinafter, *TUAC*) contributed to the drafting process, the World Bank and the International Monetary Fund (hereinafter, *IMF*) participated as observers, regional roundtables and further meetings consulted with non-member countries, and a public consultation was conducted.[7] In the literature this has been praised as an example of an inclusive process that protects and promotes a wider common interest.[8]

Yet, this procedural balance does not answer the question which interests have been most influential. Here, a first position may be that the OECD's own interests were dominant, for instance, given the 'expert culture' it is said to enjoy.[9] Second, it has been suggested that the OECD Principles were mainly shaped by the lobbying of international institutional investors, in particular through the International Corporate Governance Network (hereinafter, *ICGN*), representing institutional investors who represent funds of more than 18 trillion US Dollars.[10] This influence could also be a reflection of the expectation that legal unification could reduce the costs of investing in companies from more than one country.[11]

But third, it can also be seen that the laws of the OECD member countries have been a main source of influence. As the Preamble of the OECD Principles 2004 states: '(t)he Principles represent a common basis that OECD member countries consider essential for the development of good governance practices'. Indeed, the

[6] See OECD (2004).

[7] See Bouchez (2007), pp. 109–110; Fazio (2008), p. 107.

[8] Baker (2012).

[9] Martens and Jakobi (2010), p. 14.

[10] Porter and Webb (2008). Note that the ICGN has also developed its own Global Corporate Governance Principles, ICGN (2009).

[11] The aspiration to reduce transaction costs is a frequent topic in the literature on harmonisation: see, e.g., Mattei (1997), pp. 94, 219.

main six sections of the OECD Principles deal with the key topics of most company laws as they apply to publicly traded companies in those countries. They are: (1) ensuring the basis for an effective corporate governance framework, (2) the rights of shareholders and key ownership functions, (3) the equitable treatment of shareholders, (4) the role of stakeholders in corporate governance, (5) disclosure and transparency, and (6) the responsibilities of the board. To be sure, there are also some examples where choices have been made. For example, the statement that there should be a 'sufficient number of non-executive board members capable of exercising independent judgement'[12] is based on the use of independent board members in Anglo-Saxon countries. By contrast, the relevance of stakeholder interests in corporate governance[13] is not the mainstream view in those countries but seems to be the result of continental European models.[14] In some cases it can also be seen that no agreement could be reached, for example, on the principle of 'one share one vote'.[15]

More generally, the OECD Principles have been formulated in a fairly general fashion. This is deliberate as they are not supposed to be a uniform 'code' but to offer different possibilities as to how good corporate governance practices can be achieved. To be more precise, the OECD Principles operate as non-binding international standards at various levels. In the first instance, they are aimed at law-makers in emerging markets and less developed economies. This also includes stock-exchanges as far as they decide on corporate governance rules for listed companies.[16] But, secondly, the voluntarity of the Principles may be reduced in practice. On the one hand, this is the result of international organisations. The Financial Stability Board (FSB), the World Bank and the IMF regard the OECD Principles as one of the international standards countries are urged to adopt.[17] On the other hand, the use of the OECD Principles is the result of market pressure, namely as far as countries want to stimulate foreign investment.[18] Third, at the level of companies it may simply be the case that they have to apply laws based on the OECD Principles. In addition, as far as company laws leave options for companies, the OECD Principles function as guidance for good practice. Here too, then, it may

[12] OECD Principles (2004), VI.E1.

[13] OECD Principles (2004), IV, VI.C.

[14] See also Baker (2012), p. 397 (on compromise nature of Principles); Kaufman and Englander (2006); Ceroni (2008).

[15] See the Annotation to OECD Principles (2004), III.A.1.

[16] Cf. WFE (2009), p. 33 (WFE support of OECD Principles). See also Christiansen and Koldertsova (2009).

[17] See Sect. 3 *The Impact of the OECD Principles on State Legislation* below.

[18] Though it is doubtful whether such a positive relationship between adopting international benchmarks and foreign investment actually exists. See Perry-Kessaris (2003).

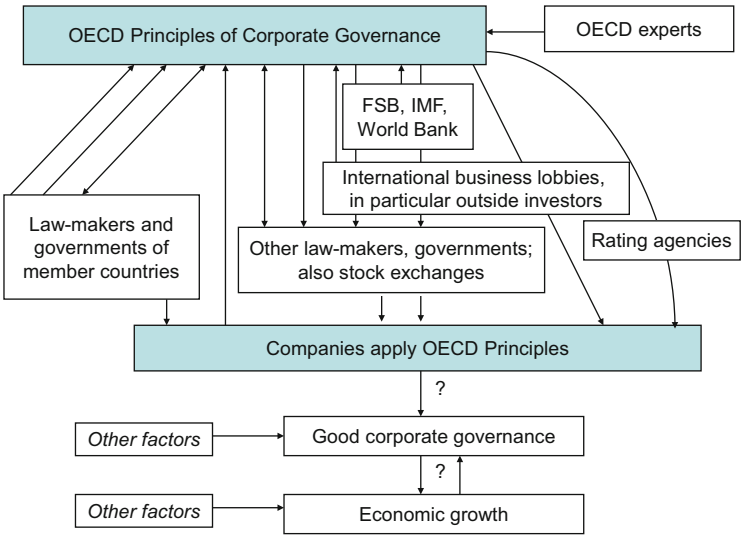

Fig. 1 Overview of the functioning of the OECD principles

matter that companies would be interested in implementing the Principles in order to attract investments, for example, by way of improving investor protection or by way reducing the costs of legal diversity.[19] This is also fostered by the fact that rating-agencies use the OECD Principles in order to rank the quality of firm-level corporate governance.[20]

Figure 1 illustrates this complexity of both the drafting and the impact of the OECD Principles. Further details and explanations will follow in the subsequent parts of this article.

Since the adoption of the OECD Principles researchers have examined whether and how they have been applied in countries of Africa and the Middle East,[21] Europe and Asia,[22] and Latin America.[23] This chapter builds on insights from these studies. In addition, it is suggested that the concept of networked governance can be helpful in the understanding and assessment of the OECD Principles.

[19] See also Center for International Private Enterprise (2011): 'In emerging markets all over the world, corporate governance can give companies a competitive edge'.

[20] Sherman (2004).

[21] Guobadia (2001); Abu-Tapanjeh (2009); Sharar (2010); Al-Saeed (2012).

[22] Tsipouri and Xanthakis (2004); Jesover (2001); Iu and Batten (2001); Chen et al. (2011); Khan (2012).

[23] See notes 55, 62 and 63.

2.2 Networked Governance and the OECD Principles

In the literature there are a number of voices that have related the OECD to the concept of networks. Yet, this has not been done in a uniform way. For example, when the OECD is called a 'catalyst' for the creation of 'transgovernmental regulatory networks',[24] this could mean that the acts of the OECD, such as the OECD Principles, are seen as networks. But some also seem to consider the OECD itself as a network, describing it as 'an important institutional network', being 'part of the evolving global political superstructure'.[25] Finally, some statements refer to the relations of the OECD to other entities, calling the OECD an important 'node in the growing networks of transnational governance' and saying that the evolving networks 'include other international organizations, appointed experts, and representatives of civil society associations'.[26] Notably, such a network may also define what it means to be a 'modern state'.[27]

A more proper understanding has to relate networks to the concept and challenges of governance. One pressing challenge faced by contemporary policymakers is to cope with the rising interdependence between different policy levels and sectors worldwide.[28] The challenge is complex because it implies simultaneously tackling other factors such as a public demand for greater accountability towards the citizens, a general expectation of seeing policies that are technically feasible and acceptable by a new generation of stakeholders which is playing an active role in the policymaking processes, and (closely related to the latter) a growing demand for less vertical interventions.[29] All in all, these factors drive the quest for fresh modes of governance that are effective to manage the potential of networks in a given society.[30]

Not all of the different approaches to governing large human organisations are conducive to a rational exploitation of the resources pooled within those collectivities. The academic debate on networked governance has focused on the concept of policy network in relation to three main modes of governance—vertical, market and networks: 'vertical' refers to a top-down structure, depending on a well-organised group with an effective legal system; the 'market' model assumes that actors effectively coordinate by self-interest, yet, this depends on necessary incentives for all participants; and by 'networks' is meant a series of informal relationships between individuals who see each other as peers, creating an implicit

[24] Slaughter (2004), p. 46.

[25] Ougaard (2010), p. 45.

[26] Mahon and McBride (2008), p. 21; McBride and Mahon (2008), p. 278.

[27] Porter and Webb (2008), p. 44.

[28] OECD (1995), p. 73.

[29] European Commission (2001), pp. 6–8. See also Schout and Jordan (2008).

[30] Jordan and Schout (2007), p. 56.

understanding of membership equality and commitment to shared responsibilities built on trust and loyalty.[31] These modes coexist and are interdependent in practice. Hence, the combination of those modalities is crucial since their complementarities and clashes lead to more or less successful outcomes.[32]

The notion of networked governance is built around three components[33]: (1) the interplay between actors from national and international levels as well as from the public and private sectors; (2) transitions in power relationships where individuals and new organisations are taking over the role of liaising and coordinating with stakeholders and becoming influential in activities previously undertook by well-established hierarchical levels, and (3) growing relevance of co-operative and peer-group decision-making processes and 'soft-law'.[34] Therefore, the study of networks is offering a way towards politically acceptable means to add value to activities at the domestic level by working closer with countries increasingly interrelated.

Against the advantages of networked governance some of its potential drawbacks may be relevant to the OECD Principles: it does not work well for organisations where hierarchical cultures and, thus, vertical institutions, such as powerful states, are markedly dominant. It is also less effective in settings where stakeholders have dissimilar cultural values and lack of explicit common goals. In addition, as this governance mode coordination is built on trust and loyalty rather than administrative commands (hierarchy) or prices (markets), it matters that trust is primarily a spontaneous phenomenon that takes time to develop.[35]

The factors and considerations stated in this section provide us with analytical criteria to look at empirical data in our quest to understand if the institutional processes behind the inception, implementation and evolution of the OECD Principles respond to a successful form of networked governance. This is examined in the following sections.

3 The Impact of the OECD Principles on State Legislation

The laws of most developed countries widely correspond to the OECD Principles.[36] Moreover, as far as law-makers have not incorporated all elements of those Principles, there often exist corporate governance codes that operate on a 'comply

[31] Jordan and Schout (2007), pp. 15–16. For an overview of the emerging literature on policy networks see also Börzel (1998).

[32] Börzel (1998), pp. 262–263; Jordan and Schout (2007), p. 17.

[33] This is despite some ambiguity in the scholarly definition which has been acknowledged in dedicated reviews of literature on that topic, e.g., Börzel (1998), pp. 254–255.

[34] Coen and Thatcher (2008), pp. 50 and 67.

[35] See also Sect. 5 *The Substantive Fit of the OECD Principles* and Sect. 6 *Recent Developments* below.

[36] References in Siems (2008a), p. 227.

or explain' basis. Here, the expectation is that institutional investors have sufficient expertise to monitor the right level of compliance with good corporate governance practices. By contrast, in other parts of the world—notably in countries that have (or used to have) autocratic political regimes—there may be insufficient experience with a distinction between rules that 'must' and 'may' be adopted. Thus, here, it seems to be more likely that law-makers simply impose good corporate governance standards by way of binding rules.[37]

Another point to consider is whether a country is a member of the OECD. For example, this may lead to a difference between Mexico and Brazil since only Mexico is a member of the OECD, having joined in 1994.[38] There have also been discussions about a possible membership of Brazil. In 2010 the OECD Deputy Secretary General Richard Boucher indicated that the OECD would 'love to have Brazil as a member'.[39] However, he also expressed the view that this may be contentious as the OECD 'has historically been seen as somewhat of a "rich man's club"'. Indeed a Brazilian politician even took the position that joining the OECD would be 'political suicide', claiming that Mexico became isolated in Latin America due to its membership of the OECD and NAFTA in the early 1990s.[40]

One of the requirements for joining the OECD is a country's 'positioning' to the existing OECD instruments,[41] also described as 'voluntary but constrained policy transfer'.[42] The current roadmap for Russia's accession illustrates that a review of corporate governance policies such as the OECD Principles can play an important role.[43] Of course, Mexico already joined the OECD before the first version of the OECD Principles was enacted in 1999. Thus, for Mexico a first point to note is that the OECD Principles are categorised as 'recommendations', as distinguished from 'decisions' of the OECD, meaning that they are not legally binding on the member countries.[44] Moreover, the OECD has no formal enforcement powers but assesses

[37] See also the subsequent discussion of the situation in Mexico, Sect. 4, below.

[38] Carroll and Kellow (2011), p. 259 (noting that Mexican membership aimed to ensure regional balance as some Eastern European countries also joined). For the list of OECD members see http://www.oecd.org/general/listofoecdmembercountries-ratificationoftheconventionontheoecd.htm. Accessed 30 July 2013.

[39] Brazil already participates in some of the OECD bodies. See Schewel (2010); Ougaard (2010), pp. 41–42.

[40] PRLog.Org (2009) (quoting the former Brazilian Finance Minister Rubens Ricupero).

[41] See http://www.oecd.org/general/oecdenlargement.htm. Accessed 30 July 2013.

[42] Carroll and Kellow (2011), p. 164.

[43] See http://www.oecd.org/russia/therussianfederationandtheoecd.htm and http://www.oecd.org/daf/corporateaffairs/russia. Both accessed 30 July 2013.

[44] See http://webnet.oecd.org/oecdacts/ (search for 'recommendations') and http://www.oecd.org/legal/oecdlegalinstruments-theacts.htm. Accessed 30 July 2013.

the policies of its member countries by way of peer reviews and surveys. While some of these peer reviews evaluate the policies of a particular country in detail, the OECD Principles are not included in these country studies.[45] However, in 2011 the OECD started a limited thematic peer review on the application of the OECD Principles. The four reports, produced until the end of 2012, contain interesting comparative information on selected countries and topics,[46] while they do not provide a clear policy assessment about the general compliance of particular countries with the OECD Principles as a whole.

But in addition, we need to consider the influence of the FSB, the IMF and the World Bank. Both Mexico and Brazil are members of the FSB. The OECD Principles are part of the so-called Compendium of Standards which the members have 'accepted as important for sound, stable and well functioning financial systems'.[47] Yet, the FSB does not evaluate the implementation of the standards itself, but considers the reviews of the IMF and the World Bank, namely the reports of the Financial Sector Assessment Program (hereinafter, *FSAP*) and the Reports on the Observance of Standards and Codes (hereinafter, *ROSCs*).[48] In the FSAP reports some references to sound corporate governance are made, yet, without going into details of the OECD Principles.[49] By contrast, the ROSCs of the World Bank examine each individual aspect of the OECD Principles in order to assess a country's quality of corporate governance, based on a methodology developed by the OECD.[50] This interest of the World Bank in corporate governance is also reflected in the Global Corporate Governance Forum (hereinafter, *GCGF*), in 1999 co-founded together with the OECD, and now part of the World Bank with the OECD as a 'donor partner'.[51]

However, the effect of the ROSCs should also not be overstated. The ROSCs are not conducted on a regular basis but only when a country asks for such an assessment, in particular, when it requires significant loans from the IMF and the World Bank.[52] In 2007, the OECD also published a document explaining how the ROSCs should assess the implementation of the OECD Principles. Implementation is assessed in relative terms, namely as fully, broadly, partly or not implemented.

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[45] See http://www.oecd.org/site/peerreview/. Accessed 30 July 2013 and, e.g., Martens and Jakobi (2010), pp. 10–11; Porter and Webb (2008), pp. 49–52.

[46] OECD (2011a, b); OECD (2012a, b). A similar selective report is IOSCO (2007a) (in consultation with the OECD).

[47] See http://www.financialstabilityboard.org/cos/index.htm. Accessed 30 July 2013.

[48] See http://www.financialstabilityboard.org/activities/peer_reviews.htm; http://www.financialstabilityboard.org/activities/peer_reviews.htm. Both accessed 30 July 2013.

[49] See http://www.imf.org/external/np/fsap/fssa.aspx. Accessed 30 July 2013.

[50] See http://www.worldbank.org/ifa/rosc_cg.html; also http://www.imf.org/external/NP/rosc/rosc.aspx. Accessed 30 July 2013. In 2007 the European Bank for Reconstruction and Development (EBRD) conducted a similar assessment for the countries of Eastern Europe and Central Asia: EBRD (2007).

[51] See http://www.gcgf.org/. Accessed 30 July 2013.

[52] See Khan (2012), p. 225.

Moreover, the OECD takes the view that 'outcomes' matter, meaning that functional equivalents are also accepted.[53] But, here then, it also needs to be considered that in practice countries may well feel that they should comply with the OECD Principles in exactly the way they are phrased in the text: there is no catalogue of what 'functional equivalents' may be acceptable, and the 'box-ticking nature' of the ROSCs provides an incentive to fully comply with them—and not to come up with a different solution.

In the case of Mexico and Brazil, the most recent ROSCs of the OECD Principles are from 2003 to 2005, respectively.[54] By contrast to more recent ROSCs of other countries, the assessments do not provide aggregate scores for compliance with the OECD Principles and their main sub-categories. However, it can be seen that the results are somehow mixed with the most frequent categories 'broadly' or 'partly' implemented. This does not necessarily mean that the OECD Principles had no effect in these countries. In Mexico and Brazil corporate governance has become a major topic since the late 1990s. In particular, in both countries voluntary codes of good corporate governance have been issued and subsequently updated. This process has been identified as a result of the OECD Principles.[55] And, unlike Mexico,[56] in Brazil a further voluntary improvement of corporate governance has been implemented by way of a premium segment of the stock market with a higher level of shareholder protection (the Novo Mercado).[57] In a quantitative study by one of us it has also been shown that the level of shareholder protection increased in both Mexico and Brazil between 1995 and 2005.[58]

It is interesting to note that the World Bank's more recent ROSCs of the OECD Principles also refer to another set of indicators, namely the performance of countries in the 'protecting investors' category of the World Bank's Doing Business Report.[59] This reference is somehow unfortunate since the Doing Business Report has been widely discredited in the literature, for instance, for imposing a one-sided Anglo-Saxon legal model to other parts of the world.[60] More plausible is the recent approach of the OECD that starts with the OECD Principles but then uses regional

[53] See OECD (2007), pp. 9–14.

[54] They are available at http://www.worldbank.org/ifa/rosc_cg.html. Accessed 30 July 2013.

[55] For Mexico see Alvarez-Macotela (2008), p. 125. For Brazil see Fazio (2008), p. 111.

[56] See Sect. 4 *The Operation of the OECD Principles at the 'Micro Level'* below.

[57] See Gilson et al. (2011).

[58] See Siems (2008b), pp. 122–123.

[59] See e.g. World Bank (2010), p. 33 referring to World Bank (2008).

[60] See e.g. the special issues of the American Journal of Comparative Law vol. 57 (2009), issue 4, the University of Toronto Law Journal vol. 59 (2009), issue 2, and the BYU Law Review vol. 2009, issue 6.

roundtables in order to address some of the more specific local problems. For example, a Roundtable for Latin America has met on annual basis dealing with a variety of topics since the year 2000.[61]

This latter trend has also led to two empirical investigations specifically dealing with Latin American countries. A paper by Carlos Henrique Kitagawa and Maísa de Souza Ribeiro compared the board integrity and director independence in Argentina, Brazil, Chile and Mexico.[62] This was based on nine questions on problems outlined in the OECD White Paper on Corporate Governance in Latin America from 2003.[63] With respect to the positive law, the result is somehow mixed, for instance, most of the countries have only few, if any, legislation on board committees; overall, however, Mexico is said to have a higher rate of compliance than the other three countries. Another study was conducted by the OECD itself, dealing with the same countries plus Columbia, Panama and Peru.[64] This study uses the OECD Principles from 2004 as a starting point but also refers to the aforementioned White Paper. Here again, the result is somehow mixed but relatively similar in most of the countries: compliance in the main categories but not with regard to some of the more specific recommendations, such as the responsibility of boards to engage in risk management and internal evaluations.

As both of these studies were based on firm surveys, they also address how far companies actually complied with those recommendations. The need for such a law-in-practice perspective is in line with the more general position of the OECD. It is said that:

> [T]he Principles should be considered a living document. It is an OECD priority to make sure that they are widely disseminated and actively used. This will include a continuing policy dialogue where policymakers, regulators and standard-setters will be able to exchange practical experience of implementing the Principles.[65]

A recent journal article by Andrew Baker has praised the OECD Principles for such 'experimental deliberative governance'.[66] It also sounds plausible that in Latin America an OECD-sponsored initiative called 'Companies Circle' has the aim to share best practice between companies and provide feedback to the Latin American

[61] See http://www.oecd.org/daf/ca/latinamericanroundtableoncorporategovernance.htm. Accessed 30 July 2013.

[62] Kitagawa and Ribeiro (2009).

[63] OECD (2003).

[64] OECD (2011c).

[65] Jesover and Kirkpatrick (2005), pp. 128–129 (note that both authors work for the OECD). The role of enforcement has also been stressed following the financial crisis of 2008. See OECD (2010), para. 14, and Sect. 6 *Recent Developments* below.

[66] Baker (2012). But also see de Búrca et al. (2013) (suggesting a mode of 'experimentalist governance' which goes beyond 'orchestrated networks').

Roundtable.[67] Yet, the following two sections we will also present a more nuanced perspective of the 'OECD Principles in context'.

4 The Operation of the OECD Principles at the 'Micro Level'

In Mexico, the implementation of the OECD Principles has partly been driven by the federal government. But the coordination efforts have also been both based *on* and influenced *by* networks of stakeholders. Importantly for the purpose of our analysis, those networks have consisted of peers (e.g., gremial organisations and associations of companies by economic sector and by federations of businesses organisations) but also of stakeholders across sectors, geographical regions within Mexico and internationally. Yet, overall, most influential has been a proactive attitude towards the OECD Principles by Mexico's government and by the leading financial and businesses associations.

Mexico's proactive approach on the topic obeys to the strategic importance that its membership to the OECD has represented for the Mexican government and to the promising scenario it creates for Mexico's private sector,[68] more specifically among the elite businesses that are capable and willing to compete in the global markets. Private sector efforts have been orchestrated by the Business Co-ordinator Council (CCE by its initials in Spanish). Mexico has also shown some leadership in matters of corporate governance: Mexico's code of best corporate practices adopting the OECD Principles (hereafter 'the Code') was the first in Latin-America and one of the first in the world. The CCE has produced a number of guidelines, testimonials, practical examples in order to facilitate implementation of the Code and related material,[69] being the result of intensive and coordinated interplay between several domestic nodes of further networks in Mexico and across countries.

The main audit firms (Deloitte, KPMG, Ernst & Young, PwC, etc.) were actively involved. Deloitte, in particular has played a leading role in the every-day implementation of the OECD Principles in Mexico by means of its partnership with the

[67] See http://www.oecd.org/brazil/corporategovernanceinlatinamerica.htm. Accessed 30 July 2013.

[68] According to Chong and Lopez-de-Silanes (2007), p. 433: 'Mexico was concerned about corporate governance mainly as a result of the lack of growth in domestic markets and the damaging experience in East Asia, where economies were emerging from the 1997–1998 crisis. . .'.

[69] http://www.cce.org.mx/CMPC/. Accessed 30 July 2013.

Table 1 Domestic nodes of networks interacting in the production of official material to support the implementation of the OECD principles at the micro-level in Mexico

	Members and participants	
Categories	Organisations	Represented businesses[a]
Confederation of businesses (bringing together a total of nearly 671,000 business organisations)	Mexico's Business Co-ordinator Council (CCE)	12 broad business associations
	Confederation of Industrial Chambers (CONCAMIN)	46 industrial chambers; 14 regional chambers of industry; 3 generic chambers of industry, and 44 associations of the different productive sectors in the Mexican economy
	Confederation of Chambers of Commerce, Services and Tourism (CONCANACO)	650,000 businesses, which amount for more than 53 % of the formal employment in Mexico
	Confederation of Mexican Employers (COPARMEX)	120 groups, organised in 65 business centres; 10 federations; 3 representations, and 14 delegations, and 28 working commissions
	Mexican Council of Businessmen (CMHN)	Main executives of most significant Mexican corporations
	National Agricultural Council (CNA)	174 partners and associated corporations
	Mexico City's Chamber of Commerce (CANACO-Mexico City)	20,000 business entrepreneurs based in Mexico City
	National Chamber of Industry (CANACINTRA)	12 Industrial sectors; 80 Delegations; 9 Urban offices, 9 Committees, and 158 Commissions
	Mexican Business Council of International Trade, Investment and Technology (COMCE)	87 business committees across the country
	National Association of Department stores and Supermarkets (ANTAD)	103 business chains in the country
Gremial organisations of financial firms from banking, securities market and insurance	Mexican Association of Banks (AMB), Mexican Securities Industry Association (AMIB), Mexican Association of Insurance Companies (AMIS)	

(continued)

Table 1 (continued)

Categories	Members and participants	
	Organisations	Represented businesses[a]
Leading Mexican Universities	ITAM, UP, UIA, UNAM, IPN, La Salle, EBC, the University of Monterrey, and the 'Anahuac University Network' (ten institutes of higher education, with presence in Chile, Italy, Mexico, Spain and the US)	

[a]Information from the following websites (all accessed 30 July 2013): http://www.cce.org.mx/el-consejo-coordinador-empresarial; http://www.concamin.mx/concamin.php; http://www.concanaco.com.mx/informacion-institucional-concanaco-servytur/que-es-la-concanaco.html; http://www.coparmex.org.mx/index.php?option=com_content&view=article&id=47&Itemid=107; http://www.cce.org.mx/asociados/; http://www.cna.org.mx/encontacto_historico/Encontacto/encontacto_25oct2012.htm; http://www.camaradecomerciodemexico.com.mx; http://www.canacintra.org.mx/index.php?option=com_content&view=article&id=117&Itemid=170; http://www.comce.org.mx/contenido.php?id_contenido=1&con=contenidos; http://www.antad.net/index.php?option=com_content&view=article&id=73&Itemid=219

World Bank and the Centre of Excellence in Corporate Governance (CEGC by its initials in Spanish).[70] The CEGC has also developed an original Corporate Governance Index that helps companies in their self-assessment relative to the codes of best practices.[71] Moreover, the CEGC publishes scores on the average compliance of Mexican firms with the OECD Principles, thus supplementing the ROSCs which just look at the quality of implementation based on the positive law.

It can be seen that a great variety of institutional actors with many members and participants are essential to the operation of the OECD Principles in Mexico (with more details provided in Table 1). But this can also lead to complex challenges. This is not so much due to the number and variety of them but in view of the combination of formal and informal networks among those groups. For example, consider the Mexican stock market. The key players in this market are the financial intermediaries, listed companies and investors, plus the financial authority. Each of these groups has created formal networks among them.[72] However, it cannot be assumed that those groups are defined and constrained by conventional borders. There is an informal overlapping of roles that conventional wisdom assumes to the role played by different economic agents, in this case investors, listed firms and financial intermediaries.[73] The roles of investors and intermediaries are also blurred

[70] See CEGC (2013a, b).

[71] CEGC (2011) and OECD (2011c), p. 4.

[72] Brokerage firms via the AMIB and the Mexican Stock Exchange (MSE); banks via the AMB; listed firms via the CCE and the Mexican Association of Investor Relations (AMERI); investors via the Mexican Association of Independent Investment Advisers (AMAII) and, indirectly, via collective investments such as pension and mutual funds, and the financial authority via organisations such as the IOSCO.

[73] Some of the wealthiest families are simultaneously investors, controlling shareholders of listed firms and financial intermediaries. Financial firms also invest in the market, and non-financial firms engage in an informal system of finance providing capital and credit. Alvarez-Macotela (2008), pp. 141 (note 70), 245 and 348.

on account of strategic alliances. Previous securities law and its enforcement were insufficient to upgrade the levels of trust by investors in local stockbrokers, which partly explains an informal solution where foreign investors started participating in the Mexican equity market by bringing with them their trusted financial intermediaries.[74]

Potentially problematic is the strategy of the Mexican law-maker. It enacted a new securities market law (hereinafter, *SML*) and substantially revised the existing company law. The new SML created three new types of public companies, namely the SAPI,[75] the SAPIB,[76] and the SAB,[77] whereby all firms listed on the MSE must be SABs. This new approach to securities law means that the SML ended up regulating not only listed firms but also some non-listed companies. It makes mandatory to comply with the Code but at different degrees, depending on the type of corporation. As articulated by Sam Podolsky in an OECD publication:

> The new law enforces Corporate Governance for SAPIs even though they are not publicly traded! And (...) makes a legal obligation for publicly held corporations to comply with modern practices of corporate governance (it is not voluntary anymore!). This new move by the Government of Mexico, and accepted by the private sector, represents a major advance in corporate governance in Mexico.[78]

Though not all of these provisions are perfectly suitable for non-listed companies, the positive effects were apparently regarded as more significant. The blurred division between governance rules for listed and non-listed firms in Mexico has to do with the strategic role that Mexico's government has assigned to the support and promotion of small and medium sized enterprises (hereinafter, *SMEs*). As these firms employ in excess of 60 % of the Mexican active population in the formal economy,[79] the Mexican law-maker took the view that significant economic growth can only be achieved by approximating the corporate governance standards of SMEs to those of large listed companies.[80]

But, looking at two specific examples, it can be seen that there is some reluctance of Mexican firms to fully adopt practices of good corporate governance. First, the board of directors in the average listed firm has ten members, three of them usually independent and three other related to the company. Almost four out of ten board members are also shareholders of the firm, which shows the high percentage of

[74] Alvarez-Macotela (2008), p. 298.

[75] Limited liability corporation aimed at promoting domestic and foreign investment by providing some protections not established under ordinary company law in Mexico, e.g. not subject to the supervision of the financial authority; minority shareholders have additional protection such as the right to appoint a director and an examiner, the right to call a meeting having 10 % of the equity's firm, puts, calls, tag-along, drag-along, etc.

[76] Limited liability corporation, similar to SAPIs but they are expected to become publicly traded in less than 3 years i.e. a transition vehicle to become a SAB.

[77] Limited liability corporation publicly traded, i.e. firms that issue shares listed on the MSE.

[78] Podolsky (2006), p. 3. Note: exclamation marks are original from the OECD's paper.

[79] Podolsky (2006), p. 5.

[80] Kersbergen and Waarden (2004), p. 147.

family-owned firms in Mexico. Moreover, some of the top firms in Mexico have boards comprising more than 15 directors, a large proportion of them hold a friendship or close personal connection with members of the controlling family.[81] Second, a recent study by Deloitte shows that in a series of annual surveys among the top listed and non-listed firms in Mexico one of the topics where there is greater 'opportunity', i.e. failure in adoption of the OECD Principles, is in the succession plan. The dominant nature of family-firms in Mexico tends to be reflected in a lack of interest to look after such theme. The negative trend identified on that particular topic shows a substantial gap in a culture of prevention and a business vision that helps to separate the family bonds from the working of the businesses.[82] As Bruce Kogut explains about emerging markets: 'governance is exercised through powerful clubs that constitute the social and business networks among owners, directors, and managers. However, the dynamics of simple behaviors can be quite surprising!'[83]

India is a much similar case to Mexico in relation to which the GCGF has recently drawn attention.[84] With some variations and at different degrees, all emerging markets share the challenge of dominant family-businesses and deep-rooted cultural traits on which informal institutions relevant to corporate governance are built,[85] a topic further explored in the subsequent section.

5 The Substantive Fit of the OECD Principles

5.1 Suitability for Emerging Markets

The OECD Principles do not reflect a model of corporate governance that can simply be applied universally. They are unsuitable for economic environments traditionally dominated by ineffective formal institutions. Market players differ in their expectations about company and securities law depending on their characteristics and motives to take part in the stock market and to engage in other business activities. An important difference exists between those economic agents who acknowledge themselves as members of a group whose dealings in the market are crucially underpinned by personal connections as the source of reciprocal trust (insiders), and those players who do not benefit from such personal ties (outsiders). Because law frequently fails to offer adequate protection to outsiders, informal solutions substitute and compete with legal institutions, sometimes in ways which

[81] OECD (2011c), p. 31.

[82] Deloitte (2012), p. 42.

[83] GCGF (2013). See also infra note 85.

[84] Kar (2011), p. 6.

[85] Kogut (2012); Claessens and Yurtoglu (2013); Iu and Batten (2001), p. 60.

are convergent with the goals of company and securities law, but often in ways which are not.[86]

The prevalence of family-businesses and related networks is a recurrent theme in scholarly articles and policy-reports on the application of international corporate governance standards in emerging markets.[87] As such structures are seen as an unfavourable condition to the well working of the market economy, a 'win-win solution' could evolve from reinforced market governance. Yet, family firms may be disinclined to change their strategies simply by market pressures: 'increased governance pressures could make it more costly to indulge in (. . .) family-centred preferences. Alternatively, better markets for corporate control could allow families to hire professional managers while maintaining the beneficial elements of family ownership.'[88]

In an institutional context where there is no dominant rule of law, associated to lack of credible commitment with regards enforcement,[89] having a family-business is an effective response to the gap in trust in the legal system. It is not a pre-condition opposed neither to a professionalisation in the running of businesses nor to transparency and accountability. Hence, the aforementioned unsuitability does not simply come from family capitalism.

Concentrated corporate ownership is common among emerging markets such as South Korea, the Czech Republic, Hungary and Poland. Family ownership and business group affiliation is a common pattern too in emerging markets from Latin America such as Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Yet, the processes and control structures of companies from all those countries are also very different. Furthermore, and contrary to expectations based on the 'globalization/convergence' literature, market-oriented legal and economic reforms in country level governance aimed at promoting investor protection, have not reduced highly concentrated ownership among publicly listed firms in emerging markets during the first decade after the adoption of the OECD Principles.[90]

The OECD Principles are present in most modern company laws across countries as they apply to publicly traded companies. However, the degree to which they are observed in practice varies much between the leading OECD countries and other countries where informal institutions, corruption, and weak rule of law are dominant features.[91] It follows that designing and implementing the OECD Principles in emerging markets is a remarkable challenge. That explains the growing number of studies and guidelines in order to facilitate the process of integrating the

[86] Alvarez-Macotela (2008), p. 2.

[87] See generally Morck and Steier (2005), p. 6: 'Anglo-American shareholder capitalism is exceptional. Other systems predominate (. . .) the most common system of corporate governance in the world is *family capitalism*'.

[88] Bertrand and Schoar (2006), p. 94.

[89] North (1993), p. 19.

[90] Aguilera et al. (2012), pp. 321, 332 and 339.

[91] Alvarez-Macotela (2012), p. 510; Black (2001).

Principles at the micro-level.[92] Yet a main difficulty is to identify functional equivalents (whether formal or informal) in countries with different views and values.[93] It also needs to be ensured that the adoption of the Principles delivers sufficient incentives for the stakeholders in emerging markets and to develop practices to cope with country-specific features of corporate governance in emerging markets.[94]

The OECD Principles are also incompatible with institutional contexts dominated by other informal institutions besides family-ownership, for example, corruption and the tricks to create opacity in the running of businesses and avoid accountability.[95] The OECD Principles are based on the assumption that those negative elements are usually not present in the OECD member countries. But, for instance, some Mexican entrepreneurs do not find attractive the transparency imposed on public companies for entirely plausible reasons: a significant number of entrepreneurs whose companies could go public belong to strata of Mexican society targeted by organised crime, particularly since the 1990s. This argument has explanatory power in particular between 1998 and 2013, when the quality and quantity of information disclosed by public companies has allowed access to sensitive information about some of the wealthiest families in Mexico. In this regard, company and securities laws clash with a social context in Mexico where kidnapping and violet robberies became common and affect individuals of the upper and middle socioeconomic layers of society.[96]

Despite the mixed degree of suitability of the OECD Principles for emerging markets, policymakers must respond to the broader shifts in governance. There are growing signs of transition in modes of governance taking place from national to international spheres, but also flowing to sub-national and regional levels. These new forms of governance rely on international standardisation bodies complemented by local agencies for implementation and enforcement.[97] Moreover, whether the Principles are feasible to adopt or not is perhaps less relevant compared to whether they actually provide sufficient incentives to shift informal agendas and traditional institutions in countries emerging from weak official means of coordination, high ownership concentration and dominant pyramidal control. In those institutional contexts, the role of family firms has been effective to succeed in

[92] See Sect. 3 *The Impact of the OECD Principles on State Legislation* above. See also IOSCO (2007b).

[93] For a helpful contribution comparing Islamic and OECD Principles, see Abu-Tapanjeh (2009), pp. 564 and 565.

[94] See Chen et al. (2011), pp. 132 and 134, and more generally Caron et al. (2012).

[95] For the case of Mexico see Alvarez-Macotela (2008), pp. 147–152. For the case of China see Wang (2001), pp. 169–170.

[96] Alvarez-Macotela (2008), p. 154.

[97] See Sect. 2 *Setting the Scene*: *The OECD Principles and* '*Networked Governance*' above, and Kersbergen and Waarden (2004), p. 153.

tunnelling practices from the insider's standpoint as well as in self-protecting from the risk of suffering from it from the outsider's position.[98] One way in which the OECD and related organisations are responding to such scepticism is the growing number of more contextual initiatives such as the regional roundtables, and the series of publications specific to Latin America and India.[99] The focus on emerging markets that are non-OECD members also leads to the question of whether the OECD membership is relevant or not.

5.2 Does OECD Membership Matter?

Corporate governance was not a matter of concern for businesses and government leaders in institutional contexts where political rather than business ability used to be more decisive to success: for example, in the context of a financial system where bankers chiefly lent to themselves and their family businesses.[100] The situation has changed in emerging markets, as some business people mirror governance movements taking place in more developed countries. The pressure is also faced by newly privatised companies. The shift to the current interest in good corporate governance comes from a global movement, fostered by the World Bank and the economic literature, seconded by the OECD and related organisations.[101]

It is uncertain the extent to which OECD membership matters for the adoption of the Principles in relation to listed companies, for example, the 35 listed companies of the MSE's main index as compared to the 31 companies listed on Brazil's Novo Mercado (as of January 2013). However, acquiring the image of a business from an OECD member country is important in practice and its value is additional to the degree of compliance with the OECD Principles. Thus, the adoption of the Principles is one point in the check-list of country-level actors interested in the OECD status. Mexico in particular has achieved substantial progress using the OECD Principles in part because their adoption converged with Mexico's accession to the OECD (and NAFTA) in the 1990s. The Principles became an opportunity for Mexico to show commitment and leadership within the Latin-American region and within the OECD. Likewise, corporate governance progress in Turkey has been partly fuelled by external developments, for instance, its interest in accession to the

[98] Chen et al. (2011), p. 132: 'We find that in China, none of the 'good' practices prescribed by the OECD. . . is effective in attenuating the negative consequences of controlling-shareholder expropriation on corporate performance'.

[99] Kar (2011). See also Sect. 3 *The Impact of the OECD Principles on State Legislation* above.

[100] Traditionally, bankers in Mexico developed the informal institution of lending primarily to themselves and their family members. Credit was restricted to those few entrepreneurs who happened to have family connections with the few people controlling banks. See Haber (2008), pp.39 and 46.

[101] Husted and Serrano (2002), p. 337.

EU.[102] While the same level of willingness may not exist in other emerging markets, Brazil, Chile, India, Indonesia, South Africa, Russia and China are likely to be displaying extraordinary efforts in this matter at the macro and micro level relative to less developed countries.

6 Recent Developments

The scepticism expressed in this chapter, may invite two fundamentally different suggestions on how to transform the nature of the OECD Principles. On the one hand, they may be seen as too insensitive to local particularities. Thus, the suggestion would be to transform them into a mere 'common frame of reference'[103] that facilitates the discussion about corporate governance across borders. On the other hand, the soft nature of the Principles, the vagueness of many provisions, the possibility of functionally equivalent solutions, and the unclear target audience (see Fig. 1) may be regarded as the main problems. Thus, the suggestion could be to have more detailed rules enacted as a binding treaty of international law but that it would then be for companies to decide whether they want to opt into this OECD model of corporate governance, for example, in order to attract international investments.

The OECD itself reflected on a possible reform of the OECD Principles in the aftermath of the financial crisis. An initial report from February 2009 suggested re-examining the adequacy of the Principles. This would have been in line with other discussions about corporate governance reform, for instance, in the European Union.[104] Yet, two subsequent reports have been more positive about the current version:

> [A]t this stage, there is no immediate call for a revision of the OECD Principles. In general, the Principles provide for a good basis to address adequately the key concerns that have been raised. A more urgent challenge for the Steering Group is to encourage and support effective implementation of already agreed standards.[105]

For example, as indicated earlier, the OECD has started thematic peer reviews on the application of the OECD Principles.[106] In addition, the relationship between corporate governance and financial stability is not a straight-forward one. Both the

[102] See OECD (2006), pp. 53–54 (details on how the Turkish authorities 'are committed to pursue reforms').

[103] This term is inspired by the Common Frame of Reference proposed for a European Contract Law. See http://ec.europa.eu/consumers/rights/contract_law_en.htm. Accessed 30 July 2013.

[104] See e.g. Mukwiri and Siems (2014).

[105] OECD (2009a). Similar OECD (2010). The previous report was OECD (2009b). See also http://www.oecd.org/daf/ca/corporategovernanceprinciples/corporategovernanceandthefinancialcrisis.htm. Accessed 30 July 2013.

[106] See Sect. 3 *The Impact of the OECD Principles on State Legislation* above.

1999 and the 2004 version of the OECD Principles emerged following severe financial crises. This background is reflected in their aims, as it is expected that good corporate governance increases financial market stability, investment and economic growth. But the dimension and features of the recent global financial crisis in 2008 calls into question the extent to which the adoption of such principles have indeed contributed to financial stability. The reasons for this crisis are complex, going beyond corporate governance.[107] Yet, it seems remarkable that this crisis was most severe in the most advanced economies which had corporate governance rules similar to those of the OECD Principles. Moreover, the general debate of whether there is empirical proof that certain rules of company law and corporate governance 'matter' for financial development has not produced unambiguous results.[108] Interestingly, there has also been no comprehensive cross-country empirical research using the OECD Principles and the corresponding ROSCs as a source of measurement. Therefore, we agree that, without such information, any hasty revision of the OECD Principles would not be appropriate.

There is also need to reflect on the power structures of the OECD and the application of the OECD Principles for members as well as non-members more generally. When the OECD was founded in 1961, it followed a centre-left Keynesian approach but in the 1980s it became more 'neoliberal', notably with a study on Structural Adjustment and Economic Performance in 1987 and with the unsuccessful negotiations for a Multilateral Agreement on Investment in the mid 1990s. Today, a mixed policy is said to be dominant, not least due to the majority of European countries.[109] It is suggested that this is also reflected in the OECD Principles—thus, we do not follow the view that they are just a one-sided promotion of Anglo-Saxon corporate governance.[110]

7 Conclusion: The OECD Principles as Networked Governance

The OECD Principles are a good example of networked governance. They were envisioned in an inclusive process, and the application of the Principles involves a variety of private and public parties, often in a non-hierarchical way.[111] However, making such networks work is a challenging task. As research by Elinor Ostrom

[107] For more details see e.g. Cheffins (2009); Konzelmann and Fovargue-Davies (2012).

[108] For good overviews see Xu (2011); Aguilera and Jackson (2010); Brown et al. (2011); Claessens and Yurtoglu (2013).

[109] See Mahon and McBride (2008), p. 14; McBride and Mahon (2008), p. 279. For the ongoing attempts of the OECD to liberalise investment see Williams (2008).

[110] For such a view see Soederberg (2003). See also Sect. 2 *Setting the Scene*: *The OECD Principles and* '*Networked Governance*' above.

[111] See Sect. 2 *Setting the Scene*: *The OECD Principles and* '*Networked Governance*' above.

and others has found, cooperation requires trust and needs the support of trust-building institutions such as network management. The interaction between individual parties makes them realise the need for institutions and to identify interdependencies, as well as the need for monitoring mechanisms and independent courts. As a result, they gradually adapt and effective networks emerge built on the basis of a culture of trust.[112]

Do we appreciate that such processes are taking place in relation to the OECD Principles? At first sight one could think that the level of homogeneity among OECD members is high and somewhat comparable to that of the EU Member States. However, this is not the case. For example, the membership of Mexico, Chile and Turkey introduces complexity, and deeper complexity is added by the fact that the Principles are aimed at both members and non-members, including countries with considerable lesser democratic and economic development, combined with much greater cultural diversity. To illustrate the point, we can mention the dissimilar levels of overall development, cultural values and governing institutions such as the working of the law from both members (Mexico, Turkey, South Korea) and non-members (e.g., India, Indonesia, Brazil and South Africa) compared to the rest of OECD members. The contrast is extreme when comparing with Malawi, Uganda, Zimbabwe, Latvia, Argentina, Peru or Bhutan—but also when comparing with Singapore (another non-member country).

Consequently, the use of the OECD Principles implies going far beyond the task of coordinating a relatively homogenous multinational network. On the contrary, the subject-matter shares the features of a so-called 'wicked problem': it embodies many actors, many administrative levels, many policy phases, and many sectors.[113] Most crucially, the more countries the Principles are intended to cover the greater complexity due to lack of homogeneity. Therefore, the coordination capacities within the multinational setting in question should be seen as interrelated instead of independent. Part of the problem is that, if one level of governance requires the capacities of other levels for the overall system to function effectively, it is uncertain how this affects both the design and use of the coordination mechanisms, as well as its efficacy.

This 'wickedness' of the OECD Principles is somehow softened by their flexible nature. When a country decides not to implement them, substitution by private parties (see Fig. 1) will occur as far as the OECD Principles are appropriate for the company in question. By contrast, making the OECD Principles fully mandatory is problematic if in a particular country such an undifferentiated version of global corporate governance standards does not work well for many of the domestic companies. Thus, in this case it is preferable to let the networked governance of business organisations evolve spontaneously.

[112] Ostrom (1990); Keohane and Ostrom (1995), pp. 22–23. See also Jordan and Schout (2007), p. 37; Alvarez-Macotela (2008), pp. 51–52.

[113] Cf. e.g. Rittel and Webber (1973); Meuleman (2013), p. 42 (wicked problems as escaping logics of hierarchies and markets).

Beyond networked governance, it is clear that social, cultural and economic differences play a role at both the country and firm level. As the OECD Principles are based on a common understanding of its member countries, they are likely to be incompatible with institutional contexts dominated by informal institutions, such as family firms-governance, corruption and the tricks to veil or obscure the transparency and accountability assumed as the basis of the Principles for the leading OECD countries.[114] Of course, culture is not static. It may change slowly to adapt to the transition in circumstances, as the experience of developed countries shows.[115] But this also requires the corresponding informal institutions, such as an organised civil society where stakeholder engagement plays a fundamental role, something which cannot be assumed in many emerging markets (and even less so in developing countries).

Thus, to conclude, we are not sure whether the OECD Principles can be regarded as a success. While features of networked governance are clearly visible in the drafting and operation of the Principles, the practical effectiveness may be hindered by the lack of well-functioning local institutions. In particular this is the case when possible functional equivalents exist but are invisible to outsiders. Moreover, while appreciating that the OECD has engaged in activities such as regional roundtables in order to take account of the local context, the Principles themselves are based on the corporate governance model of the OECD member countries not perfectly suitable for emerging markets. Recent events also point towards skepticism of whether adoption of the Principles can prevent future financial crises.

As the OECD Principles are considered to be a 'living document',[116] it is also suggested that such a 'too-early-to-tell conclusion' is not inappropriate. Indeed, it is the very feature of complex networks for governance that such rules are dependent on time and context. Thus, our findings may also be relevant for other rules of networked governance as the OECD Principles may well be seen as a prototypical case for such legal instruments as they emerge in more and more areas of law.

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[114] See Sect. 5 *The Substantive Fit of the OECD Principles* above.

[115] See Morck and Steier (2005), p. 58: 'Many countries now considered to have highly trustworthy institutions, including institutions of corporate governance, were profoundly corrupt only a few generations ago. There seems to have been an evolution toward ever less popular tolerance of corrupt elites everywhere, except perhaps in Britain'.

[116] See Sect. 3 *The Impact of the OECD Principles on State Legislation* above.

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The Role of Investor Networks in Transnational Corporate Governance

Charlotte Villiers

Contents

This chapter explores the role of investors in the context of transnational business governance. Investors are a heterogeneous constituent group but collectively they are a potentially powerful force for bringing corporations to account and for holding companies to standards. Indeed, shareholder activism has been influential in the development of corporate governance and corporate social responsibility. This chapter considers the potential of investors as a participant in a system of networked governance. One organizational structure that investors have used for collective action is the UN Principles for Responsible Investment initiative, which provides a platform for collaborative engagement with companies on environmental, social and governance issues. The Principles have attracted more than a 1,000 signatories who have pledged to screen investments based on ESG considerations. Signatories also agree to promote ESG decisions and reporting by their investee companies. Through this study the relationships between public and private regulatory actors and their contributions to standard setting and enforcement are considered. The chapter also addresses the following questions: To what extent can responsible

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investment by institutional investors and their engagement with investee companies help to improve global corporate governance and global environmental governance? How possible and how legitimate is it for institutional investors to shape corporate and environmental regulation through the UN Principles? What are the possible benefits of the UN Principles in the pursuit of networked governance? What are the limitations? How do shareholders reconcile the tensions between promoting environmental protection and social justice and maximising returns on their investments? How do investors interact with other social movement participants? What are the implications for democracy, transparency, accountability and organizational learning? What impact does the network or social movement activity have on the role of nation states and global institutions in developing transnational corporate governance standards and corporate social responsibility?

1 Introduction

With the development of global trade and capital markets, large companies do not operate only on a local or national level. Many companies conduct their operations internationally. As companies have been able to operate globally with the help of communications and transport technologies they have contributed to global economic development and they have helped to provide goods and services in emerging economies. However, these developments have come at the price of labour and human rights abuses, a widening gap between rich and poor within and across nations and climate change and environmental damage.[1]

From a legal and regulatory perspective economic globalization has introduced serious challenges for corporate governance and corporate social responsibility. Structurally, companies are increasingly more complex, and how decisions are made and executed is much more difficult to monitor and control. The liberalization of markets and technological advances that make transnational trade possible also make more difficult the tasks of regulating the flow of capital, protection of individuals from labour and human rights abuses, and protection of the environment.[2] Such conditions enhance international competition for capital investment leading to the potential for market flight which, in turn, increases state obedience to corporate demands and encourages states to deregulate the markets.[3] Firms also have the ability to influence the process of regulation[4] and the increasingly global

[1] For a balanced account that sets out the benefits and the evils brought about by large companies in a globalized context see Stiglitz (2006), especially chapter 7, pp. 187–210.

[2] King and Pearce (2010), p. 252.

[3] Ibid.

[4] For a discussion of the power of the modern corporation and its ability to work in association with the bureaucracy, see Galbraith (1970).

nature of regulatory oversight has expanded the political concerns of corporations and stakeholders beyond the confines of a single nation.[5] Nation states alone are unable to provide the apparatus for controlling corporate activity and for bringing companies to account for wrongdoings. Movements have therefore shifted their gaze to international institutions. The recent establishment of the UN Business and Human Rights Forum is a good example of this trend.[6] As is expressed by Cadman, modern corporate governance consists of 'mechanisms to reach collective decisions about transnational problems with or without government participation.'[7] The consequence is a move away from top-down, command and control administrative models towards governance typified by the social, political and collaborative nature of the interactions. Ruggie similarly talks about an on-going evolution towards the more abstract concept of governance, based on the dynamic interplay between civil society, business and public sector.[8]

Waddock describes a system that recognises the major importance and power of companies and the development around those companies of a constellation of pressures to make them pay attention to the stakeholder, society and the environment in order to retain their licence to operate.[9] She describes at the global level an emerging institutional infrastructure on corporate responsibility that uses mechanisms such as peer pressure, visibility, rankings, activism, and increasingly, mandate to pressure companies to improve their effects on people, the planet, and societies.[10] Much of this activity relies on coalition building between concerned parties, leading to an increasing tendency for collaboration in many sectors where political and economic trade-offs also exist.[11] This is described by Clark and Crawford as collective action or 'coordinated behaviour that allows those with a common concern to potentially affect social and political change among firms, the state or other dominant societal institutions.'[12] The emerging system is a set of institutions and actors drawn from and beyond government; a blurring of boundaries and responsibilities for tackling social and economic issues; power dependencies in relationships between the institutions involved in collective action; autonomous self-governing networks of actors combining resources, skills and purposes into a long term coalition or regime with ultimate power to act; capacity to achieve goals that do not rest on power of government to command or use its authority.[13] This system relies on international collaboration and coordination[14]

[5] Scherer and Palazzo (2008).

[6] See the website at http://www.ohchr.org/EN/Issues/Business/Pages/ForumonBusinessandHR2012.aspx. Accessed 30 July 2013.

[7] Cadman (2010); Haufler (2001), p. 1.

[8] See Ruggie (2003) and further Ruggie (2004).

[9] Waddock (2008).

[10] Ibid., p. 87.

[11] Overdevest (2004), p. 192.

[12] Clark and Crawford (2012), p. 155, citing King (2008).

[13] Stoker (1998).

[14] Gray (2009).

with a preference for interaction between decentralised networks made up of multiple actors operating at multi-levels.[15] This networked governance has three theoretical functions: information-sharing, capacity building and implementation and rule setting.[16]

Shareholders, especially those in the Socially Responsible Investment (SRI) category, increasingly participate in this developing infrastructure. In the arena of corporate responsibility, the SRI movement has been identified as an important private regulatory group for disciplining corporations and obliging them to adhere to the values relevant to CSR and sustainable development in the absence of effective enforceable national or international standards. Shareholders are seen as part of a network, together with social movements, for creating and enforcing new standards in corporate governance and corporate social responsibility.[17] King and Pearce observe that SRIs create a link between shareholder activism and the external political environment:

> A primary function of SRI managers is to measure desirable corporate behaviour systematically, collect information about companies, and use the measurement system to create corporate ratings. Although the ratings systems are designed to educate potential investors to make better-informed decisions, they also influence the rated firms to respond by implementing practices that will improve their standing as socially responsible companies.[18]

King and Pearce also note that SRIs have shaped the extent to which shareholder activism is focused on contentious social and political issues. They highlight the social policy issues championed in shareholder resolutions and initiated through the coordinated efforts of SRIs and movement activists.[19]

The UN has recognised the potential influence of SRIs, and shareholders more generally, in the tasks of regulating and disciplining companies. The development of the UN Principles for Responsible Investment is based on those objectives. The UN PRI started as a set of principles established by the investor community which were then given support by the UN. These principles provide us with an opportunity to explore in this chapter the potential role of shareholders and of networking at an international level, in pursuit of higher corporate governance and CSR standards, as well as their role more generally in the developing system of global governance. The structure of the chapter is as follows: Sect. 2 outlines the existing theories that place shareholders at the heart of corporate governance, Sect. 3 describes what role they play in practice and the extent to which they act collectively, Sect. 4 outlines the theories of networking and collective action in the corporate governance context, Sect. 5 focuses on the UN PRI as an example of network governance and

[15] Scholte (2008).

[16] Andonova et al. (2009), p. 53.

[17] For an early discussion on shareholders acting collectively as a social movement in the context of corporate control see Davis and Thompson (1994).

[18] King and Pearce (2010), p. 257.

[19] Ibid.

Sect. 6 comments upon the potential and the limitations of the contribution of the UN PRI and shareholders to network governance.

2 Shareholders in Corporate Governance and Corporate Social Responsibility

Shareholders are key players in corporate governance theory. The predominant economic and corporate law theories—at least in Anglo-American literature—present shareholders as 'owners' and as 'principals' in the agency model of corporate governance.[20] Such identity features attribute significant power to shareholders in corporate governance. Their role is to monitor the actions of managers and to ensure that managers act in the company's interests. Thus they are given voting powers and rights to appoint and remove the managers. Their ability to act collectively strengthens their potential power. They might put this into practice for example, as shareholders with direct ownership using shareholder resolutions or utilizing indirect ownership via a consortium of shareholders, making requests for information.[21] As Clark and Crawford explain, 'shareholders in a firm can use their ownership stake to affect change, such as by suing the firm, or they can band together with other shareholders, who do not have a direct ownership in the same firm, and argue for change more generally.'[22]

Institutional investors have, at least since the early 1990s, been identified as having special corporate governance potential owing to their possession of blocks of votes through their shareholdings.[23] In the UK, for example, the Cadbury Committee, in 1992, identified institutional investors as strategically important.[24] The Myners Report on the role of institutional investors published in 2001[25] also highlighted their importance in the corporate governance arena. Institutional investors are really the major players in the world's financial markets: they control over 84 % of total shareholdings in the UK, for instance, and over 61 % in the US—where they also stand for over 80 % of all share trades.[26] Pension funds' growth has arisen with beneficiaries of mandated contributions, and pension funds are regarded as the building blocks of the world's capital markets; the driving force of international financial flows.[27] Institutional investors have frequently been endowed with

[20] For an overview of the theoretical role of institutional investors see e.g. Gillan and Starks (2003).

[21] Clark and Crawford (2012), p. 153.

[22] Ibid., p. 152.

[23] Gillan and Starks (2003) above.

[24] Cadbury Committee Review (1992).

[25] Myners Review (2000, 2001).

[26] Sandberg (2011), p. 143.

[27] Sparkes (2002), p. 4.

the term 'universal owners' due to their large market presence and exposure and this term has been adopted by international organisations such as the UN. Institutional investors typically have diversified investments across asset classes, sectors and geographies with long time horizons. This leads to the universal ownership hypothesis that links between performance of large diversified investment portfolios and the economy overall.[28] Thus public pension funds represent the most important constituency of universal owners given the depth of their capital pools, their position as fiduciaries to broad ranging social cohorts and their long term investment horizon.

According to Seitchik,[29] a portfolio investor benefiting from a company externalising costs might experience a reduction in overall returns because the externalities adversely affect other investments and lead to taxes, insurance premiums, inflated input prices and physical cost of disasters. In this context institutional investors are effectively denied the ability to exit when faced with dissatisfactory equity performance, so, increasingly, they are concerned with fundamental firm value and associated risks, and they are more likely to address proactively issues of concern. They will use professional service providers and investment managers who seek to meet the needs of the institutional investors. This gives to such investment activities strong market force which travels through the institutional investment value chains, giving them huge economic and political power.

Shareholders gain salience from the contributing factors of power, legitimacy and urgency.[30] Their power may provide a coercive, utilitarian or normative influence on management.[31] Shareholder governance mechanisms such as voting rights, shareholder resolutions or legal proceedings give them coercive rights. They may exercise utilitarian power through financial reward or punishment, i.e. investment or divestment and they may exercise normative power through links to reputation risks.[32] Legitimacy may be individual, organisational or societal.[33] Individual legitimacy may be derived by the professionalism, status or level of experience of the individual actors, whereas organisational legitimacy is derived from the level of credibility of the organisation within the market and societal legitimacy is the level of community support expressed for the objective pursued by the actors.[34] The business case for the actor's goal may provide pragmatic legitimacy.[35] Urgency 'refers to the degree to which an issue is tackled and perceived by management as requiring immediate attention, in terms of time and sensitivity.'[36]

[28] Hawley and Williams (2005).

[29] Seitchik (2007).

[30] Hebb et al. (undated). On shareholder salience see Gifford (2010). See also Mitchell et al. (1997).

[31] Hebb et al. (undated).

[32] Ibid.

[33] Ibid.

[34] Ibid.

[35] Ibid.

[36] Ibid.

The potential for change in corporate behaviour through the influence of the SRIs may also come as a result of their coalitions into a social movement which has the four features identified by Arjaliès: a collective identity, sharing individual resources in the pursuit of a common purpose, aiming to change existing institutions, and providing a new orientation for society.[37] Traditionally, those social movements aim to transform institutions by opposing them from the outside, but more recently, they have also emerged inside those institutions and seek transformation from within by adopting compromise or conflict approaches.[38] The SRI movement has also operated both outside and inside the asset management field and has sought to build a culture of investing based on long term profitability and that incorporates ESG issues into investment decisions. It has done this partly by coalition building with outside organisations such as NGOs and trade unions.[39] Shareholders may form alliances with like minded activist groups to engage multiple corporations in collaborative endeavours to find solutions to the environmental challenges.[40]

SRI has become a growing trend that has spilled over into the pension fund sector with an eye on the long term benefits in raising firm level social and environmental standards. Pension funds are driven by the global pressure and global regimes for social and environmental standards.[41] The resulting shift in SRI from margin to mainstream also empowers institutional investors seeking to engage and influence corporate social and environmental behaviour. As the majority owners, with an SRI focus, pension funds have the power to request and instruct corporate executives to include ESG guidelines in their business objectives. Thus SRI issues find a place on the corporate agenda.[42]

Shareholder activism and corporate social responsibility have developed through numerous stages in the US and the UK over the last few decades.[43] Responsible investment is particularly relevant and has a variety of methods. However, responsible investment is not clearly defined, its characteristics being determined then by investors, asset managers and organisations. Responsibility might thus be regarded as a 'subjective value embedded in regulative, normative and cultural, cognitive social institutions in combination with the diversity of social institutional forms throughout the world'.[44] Generally, however, it means taking ESG issues into account. Gray also notes that responsible investment includes not treating environmental consequences of economic growth as externalities but internalising them as financial risks within their decision making processes. These may include positive

[37] Arjaliès (2010), p. 59.
[38] Ibid., pp. 59–60.
[39] Ibid., p. 60.
[40] Clark and Crawford (2012), p. 155, citing Reid and Toffel (2009).
[41] Sjostrom (2008), p. 150.
[42] Sparkes and Cowton (2009), p. 49.
[43] See Waddock (2008); O'Rourke (2003), pp. 229–230.
[44] Gray (2009), p. 7.

and negative screening as well as a best in class selection. Positive screening leads to including companies, for example, by identifying companies of the future or choosing companies focused on renewable energy or clean technologies. Negative screening excludes companies. Typically, negative screening has meant exclusion of companies involved in making undesirable products such as those manufacturing or selling tobacco or arms. A best in class approach searches for companies in a sector compared and ranked with the best ESG performance in that sector. Responsible investing may also include engagement with companies on ESG issues, using shareholder rights individually or collectively to influence and encourage companies to improve their ESG performance.[45]

Since the 1980s institutional investors have frequently worked with religious organisations and trade unions and their activism often takes the form of shareholder resolutions. Indeed, the shareholder resolution is the predominant form of expressing dissatisfaction with a firm's practices.[46] The public nature of shareholder resolutions makes them a powerful activism tool and can encourage other firms and stakeholders to take notice and possibly to modify their own practices. Frequently, they are termed as alternatives to regulation which is regarded as a threat to the firm. They are generally used as a way not of influencing the final voting results, but more to provide a possibility of entering into dialogue and to advocate for transparency.[47] So for the shareholders the resolution gets around the problem of lock in—the inability to sell the shares at the right price—and they can also present an opportunity for dialogue between shareholders and management, and the shareholders might represent a broader set of interests.[48] In this way, resolutions may be seen as a form of political expression,[49] giving to shareholders a political role.

3 Shareholders in Practice

Despite the theoretical importance of shareholders in corporate governance and CSR in practice their record is rather mixed.[50] The effectiveness of shareholder advocacy, resolutions or managed investments for creating corporate change is not conclusive.[51] This might partly be explained by the fact that institutional shareholders are a heterogeneous group, having varied characteristics and ESG priorities.

[45] Sørensen and Pfeifer (2011), p. 60.
[46] Clark and Crawford (2012), p. 153.
[47] Clark and Crawford (2012), p. 154, citing O'Rourke (2003).
[48] Clark and Crawford (2012), pp. 153–154.
[49] Ibid., p. 153, citing Vogel (1978).
[50] Renneboog et al. (2008).
[51] Haigh and Hazelton (2004).

Some are likely to be more active than others. Thus, some commentators such as Wen remain pessimistic about the potential of SRI and shareholder activism:

> Considering the fact that current SRI practice still largely remains voluntary in its nature and lacks systematic regulatory protection, SRI's positive effect would be even more limited and it is predictable that it will remain as a minor investment trend in the Anglo-Saxon world for a relatively long period of time.[52]

A major obstacle to SRI activism is the profit maximisation goal so firmly fixed in the corporate and investment psyche. Alongside their claims for goals of virtue institutional investors still generally have a very definite goal of profit and seeking competitive advantage in the financial and investment marketplace.[53] Standard textbooks on corporate finance emphasise the focus on shareholder wealth maximisation and they also highlight that investment decisions are concerned with 'how much not to consume in the present in order that more can be consumed in the future' and that the decision criterion is 'to maximise the present value of lifetime consumption.'[54] The advantage of the profit maximisation goal is that it provides a clear measure of performance. However, it frequently leads to short termism which conflicts with longer term and social objectives partly because the long term risks of climate change are not easy to measure or evaluate. Seen the other way round the problem appears intractable: since SRI is considered as an obstruction to short term gains it has not achieved as wide popularity as might have been hoped. Indeed, Wen suggests that there still exists a lack of motivation to engage in SRI practice.[55]

Although it is accepted by fund managers that social considerations and performance are an integral aspect of a corporation's long-term value, it appears difficult to merge these social intangibles with financial considerations in practice as investors lack confidence in the idea that these socially responsible elements will add profit to the companies in which they invest.[56] This is not too surprising given that financial market theories do not sit comfortably with morality considerations. On the one hand, some claim that there are good business reasons for socially responsible investments, based on the view that screened funds may generate

[52] Wen (2009). See also Guyatt (2005), pp. 142–144.

[53] This is clearly articulated in a number of statements as well as policy documents. See e.g., Black (2010). See also World Economic Forum (2011), p. 11, and UNEP FI and UN PRI (2011).

[54] Generally, in such textbooks, shareholder wealth is defined as the discounted value of after-tax cash flows paid out by the firm; the stream of dividends aid to the shareholders. See e.g. Copeland et al. (2005), pp. 19–20. Others define shareholder wealth as being measured by stock price, which is safeguarded against the manipulation possible for accounting profits. See e.g. Boatright (2008), pp. 190–191. However, stock price is also influenced by a variety of factors beyond management's control, such as investor psychology and market irrationality. Stock price may reflect the preferences of shareholders with little stake in the firm and thus may not be a good guide for managing a firm in the long run. Other terminology representing shareholder wealth include the 'blissful shareholder model', and the 'extended balance sheet model' (Boatright 2008).

[55] Wen (2009).

[56] Ibid.

competitive returns, because they take advantage of the superior long term performance of socially responsible corporations, since they tend to be well run and are less likely to face scandals or crises.[57] On the other hand, SRI funds might be riskier because they are less diversified. Furthermore, efficient capital markets theory would suggest that all publicly available information is already reflected in the price of the stocks and so investors cannot expect to beat the market on a risk-adjusted basis.[58] To be fair, markets are not perfectly efficient but the SRI claim is bold because it is suggesting that the link between social performance and financial performance is generally ignored in the market. Yet stock prices frequently reflect the fact that a firm has made an investment in order to avoid future liabilities.[59] Thus tobacco company shares are generally already discounted in the market to take account of the industry's potential liability.[60] Under the efficient capital markets theory SRI funds might produce superior returns only if their screens consistently reflect information that the market has somehow missed.[61] This efficient capital markets theory is part of what Boatright describes as the new finance, modern finance theory, and includes also other doctrines such as the irrelevance theorem, the capital asset pricing model and option pricing theory. All of these together are not necessarily wrong but they do not take into account or give rise to ethical considerations in investing.[62]

In addition, as institutional investors play dual roles, as both the principals of portfolio companies and as agents with a fiduciary responsibility to their beneficiaries, they experience a conflict in serving the interests of these roles as both owner-shareholders and intermediaries.[63] Indeed, Richardson and Cragg suggest that the fiduciary duties of financial institutions are presently 'not conducive to ethical investment' because they require financial intermediaries to invest carefully in the interests of their beneficiaries and in accordance with the purpose of the particular fund.[64] They must also exercise skill and diligence and follow the financially orientated, 'prudent investor rule'.[65] Beneficiary interests are generally deemed to be financial and so ordinarily restrain pension funds from sacrificing returns for ethics. The controversy over fiduciary duties was addressed by the now famous Freshfields Report on investors' fiduciary duties and the ESG element.[66] The report suggested that integrating SRI considerations into an investment analysis so as to predict more reliably financial performance 'is clearly permissible and

[57] Boatright (2008), pp. 121–122.
[58] Ibid., p. 122.
[59] Ibid., p. 123.
[60] Ibid., p. 123.
[61] Ibid.
[62] Ibid., pp. 132–134.
[63] Wen (2009), citing Ingley and Van Der Walt (2004), p. 535.
[64] Richardson and Cragg (2010), p. 32.
[65] Ibid., p. 32.
[66] Freshfields Bruckhaus Deringer (2005).

is arguably required'.[67] However, not everyone regards that report as uncontroversial and it is likely that institutional investors still identify this potential conflict of interests and duties as relevant.[68] Such persistent lack of clarity with regard to the fiduciary duties of investors 'combined with a tendency for courts and commentators to equate prudence with adherence to the status quo,[69] have continued to dissuade trustees from adopting investment strategies that break with convention.'[70] In addition, the terminological ambiguities in the umbrella concept of SRI could lead to the ethical elements being overridden by the business case and the quest for financial advantage as the basis for justificatory SRI.[71]

Sørensen and Pfeifer point to further barriers to deeper integration of climate change factors into investment analysis. These include lack of knowledge of investors and limited resources for addressing climate change related risks and opportunities across their portfolio. Climate change disclosures remain inadequate for investors' needs since they are inconsistent and the scope of reporting is limited, and there remains a lack of clarity around uncertainties in the reported data.[72] Other barriers to effective engagement include need for more expertise, long term commitment, business lobby activities and lack of incentives for asset managers.[73]

There is a need to influence policy regulators and not just companies. Indeed, regulatory uncertainty and the limited scope of regulation and frequent changes to the regulatory regime are important obstacles—or disincentives—to integrating climate change into investment analysis since they dilute market signals relevant to the investment decisions.[74] Globalisation presents further complexities: movement of finance, companies operating in different locations, different stock exchanges and so on.

One possible answer to these problems might be found in the potential for shareholders to form networks and to act collectively for the purpose of positive influence on corporate behaviour and global regulation of transnationals. Indeed, network governance has been identified as an important development in the field of global governance. The next section of this chapter will outline, briefly, the theoretical claims for the relevance of networks.

[67] Ibid., p. 13. For a further progressive view of the fiduciary duty see Hawley et al. (2011).

[68] See, for example, the observation by UNEP FI that some investors remain uncertain about how they may exercise their discretion to consider ESG issues: UNEP FI (2009), p. 64.

[69] See e.g. in the UK the case of *Cowan v Scargill* [1985] 1 Ch 270.

[70] Woods and Urwin (2010), p. 15.

[71] Ibid., p. 3. See also Richardson (2009).

[72] Villiers and Mahönen (2014).

[73] See UNEP FI/UN PRI, Universal Ownership (2011), p. 38.

[74] Sørensen and Pfeifer (2011), p. 67.

4 Networks and Theories of Collective Action

One outcome arising from the move from government to governance,[75] and the corresponding shift from state dominance and the classic command and control mode of regulation is the focus on networks. Networks contribute to a participatory model of governance in which public and private actors collaborate with each other. International organizations have increasingly shifted towards network governance models as a way to gain a presence in policy fields in which traditional regulatory models, such as standard setting, are more difficult to achieve.[76] In a similar fashion, social networks are formed by social structures comprising individuals and/or organizations and are joined together by one or more types of interdependency, exchange or interest or by a collective identity and who interact around issues of conflict.[77] A number of writers have pointed out the potential benefits of networking and the positive role it can play. John Ruggie, for example has highlighted the learning opportunities arising out of network governance.[78] Other theoretical advantages are that networks encourage solidarity by strengthening the linkages between different activists and they provide information and resource flows for enabling action.[79] Networking might raise the profile of the participants and can serve to increase their legitimacy and, in turn, can enable the network to influence policy processes, agenda setting and outcomes.[80] Indeed, international organizations have been identified as entrepreneurial actors in promoting the formation of networks, since these can help to leverage their authority and convene power and they are able through this process to carve out a role for themselves in areas where they do not have a clear mandate.[81] Thus they may 'promote general declarations of good conduct and then involve public and private actors in the further spreading and implementing of the principles.'[82] In the context of regulation of multinational companies, such enterprises might also regard networks favourably since they are 'more flexible and less intrusive than traditional government regulation and they can be integrated into existing corporate procedures for governance of global supply chains.'[83]

Networks provide the participants with new opportunities for collective action.[84] For shareholders, it can be a way of getting round the free rider problem. At the least, acting collectively in networks can reduce monitoring costs and encourage

[75] Scholte (2008).
[76] Baccaro and Mele (2011), p. 452.
[77] Bendell and Ellersiek (2009), p. 2.
[78] Ruggie (2002).
[79] Bendell and Ellersiek (2009), p. 9.
[80] Ibid.
[81] Baccaro and Mele (2011), pp. 452 and 462.
[82] Ibid., p. 465.
[83] Ibid., p. 453.
[84] Ibid., p. 10.

pooling of resources. Coalition building might be one way in which shareholders can increase their levels of power, legitimacy and urgency, since coalition building helps to increase their size as a group.[85]

In the context of global governance and regulation of corporate activities networking has been identified as an important mechanism for the relevant international bodies such as the UN. Thus in the area of ethical investment the United Nations Environmental Programme on Financial Investment (UNEP FI) has highlighted the norm building role of the UNEP FI global public–private partnership which follows the network model of governance. UNEP FI has engaged with the UN Global Compact and investment industry representatives to develop responsible investing. The main benefit of this process is to strengthen 'the gathering, processing and diffusion of reliable information (including rankings) on company performance, so as to clearly differentiate between good and bad performers based on a set of credible and verifiable criteria. It is likely that this information would then be used in investment and funding decisions by other economic and social actors such as ethical finance institutions, public procurement agencies and so on.'[86]

Another important example of networking in the area of global corporate governance is found in the UN PRI. I turn to these Principles in the next section.

5 The UN Principles of Responsible Investment

The UN PRI provide us with an interesting example of collective action. In 2005 the United Nations Secretary-General invited a group of the world's largest institutional investors to develop collectively the Principles for Responsible Investment. Twenty institutional investors from 12 countries agreed to participate in this process. This investor group benefited from the support of a 70-person multi-stakeholder group of experts from the investment industry, intergovernmental and governmental organisations, civil society and academia. The process was coordinated by the United Nations Environment Programme Finance Initiative and the UN Global Compact. The Principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary (or equivalent) duty. The main objective is 'to drive responsible investment practices across all asset classes and regions.'[87]

[85] Hebb et al. (undated).

[86] Baccaro and Mele (2011), p. 464.

[87] Letter from Wolfgang Engshuber, Chair of UN PRI, in UN PRI Annual Report 2012.

The six Principles are as follows:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

After the Principles were developed the UN PRI Initiative was created as a mechanism to help investors to implement the Principles. The PRI Initiative supports investors by sharing best practice, facilitating collaboration and managing a variety of work streams. The PRI Secretariat co-ordinates the adoption of the Principles by additional investors, provides comprehensive resources to assist investors in implementing the Principles, and facilitates collaboration among signatories. Under the Reporting and Assessment tool an annual survey collects data from signatories regarding their performance in implementing the six principles. From 2013 signatories are obliged to respond to the survey. Their responses are summarised by the Institution in its annual reports and in its generalised progress reports. The PRI Engagement Clearinghouse, established in late 2006, provides signatories with a forum to share information about collaborative engagement activities they are conducting, or would like to conduct. Signatories can outline their corporate engagement activities and initiatives in an effort to seek support and to refine their strategies. The Clearinghouse is based around a private, online forum for signatories to pool their resources and influence, and seek changes in company behaviour, policy or systematic conditions.

The Initiative is funded by an annual subscription fee introduced for all signatories. As of November 2012 the PRI consists of 1,162 signatories, including 272 asset owners, 711 investment managers and 179 professional service partners, with over 1,000 investment institutions have become signatories, with assets under management valuing approximately US$32 trillion.[88]

The PRI Mission set out in the Annual Report 2012 reveals that the PRI investor network has a multilayered regulatory objective. First, from an institutional perspective the mission is to improve capabilities and governance internally. The second level is the aim for the UN PRI to extend its footprint and build relationships with internal and external stakeholders. Thirdly the UN PRI aims to support

[88] Most recent PRI annual list of signatories, November 2012, available at http://www.unpri.org/press/pri-publishes-annual-lists-of-new-and-delisted-signatories/. Accessed 30 July 2013.

signatories in operationalising the Principles. The fourth goal is to support the creation of sustainable capital markets. This multilayered regulatory agenda shows the UN, through the PRI, as a public private partnership example, putting into practice its own entrepreneurial goals, as well as giving to the investors a chance to be involved in better self regulation and in shaping the regulatory agenda to influence the behaviour of their investee firms.

The Principles work as a voluntary framework by which investors can incorporate ESG issues into their decision-making and ownership practices. The aim is that by such action investors would be able to align more effectively their objectives with those of society at large. The emphasis is on collaborative engagement in cooperation with a minimum of two institutional investors.[89] As an enabling organisation to overcome barriers to collective action and to provide an infrastructure for investors to work together and maintain, over time, continuity of engagement, the UN PRI facilitates deliberative negotiation over legitimacy of ESG issues.[90] The PRI might correspond with the description by Kahler of networks as structures and networks as actors and forms of coordinated or collective action designed to change outcomes and policies.[91] They might be seen as a 'collection of actors, that pursue repeated, enduring exchange relations with one another but without a legitimate organizational authority to arbitrate and resolve disputes that may arise during the exchange.'[92]

How successful has the UN PRI been? The success of the PRI is open to debate. The signatories of the UN PRI have certainly been active. For example during 2011–2012, the Clearinghouse facilitated contact with more than 1,300 companies on an ESG issue, including use of votes, letter writing or holding in-depth discussions.[93] The PRI also organised more than 40 "webinars" during that period, bringing together investors, companies, policymakers and academics to discuss ESG themes and responsible investment practices and case studies. There have been a number of achievements made through the activities of the signatories to the UN PRI.[94] These include, publication of guidance on the link between executive remuneration on ESG issues, responsible business with high risk and conflict-affected areas, and senior gender diversity on boards.[95] However, the fact that empirically issues such as boardroom diversity and excessive remuneration are still considered as unresolved major problems indicates that the PRI still has a long way to go before achieving its goals in a meaningful way which actually changes company behaviour and corporate culture.

[89] Sievänen et al. (2012), p. 1.

[90] Gond and Piani (2013).

[91] Kahler (2009), pp. 4–5.

[92] Podolny and Page (1998).

[93] UN PRI Annual Report 2012.

[94] Ibid.

[95] See interview with the Executive Director of the UN PRI, James Gifford, in UN PRI Annual Report 2012, p. 6.

Reporting and assessment and the clearing house remain voluntary and information is confidential. Therefore the external audience cannot determine the degree of success of the UN PRI as an organisation or the degree of success of the corporate engagement activities of individual institutional investors. This lack of transparency can undermine the legitimacy of the organisation.[96] Additionally, there are no strict guidelines, no clearly delineated structure of accountability and no enforcement mechanisms.[97] Currently, signatories will be delisted only if they do not pay their annual membership fee. These features could have the effect of weakening the force of the UN PRI. However, from 2013 signatories may be delisted if they fail to participate in the reporting and assessment process.

Some highlight the positive influence of the UN PRI. For example, Hebb, Hoepner and Majoch suggest that the UN PRI have been successful because they have societal and pragmatic legitimacy, normative power, coalition building and they reflect the values of management.[98] Others question the legitimacy claims surrounding the organisation. Gray, for example, speaks about moral, pragmatic and cognitive legitimacy. He notes the moral legitimacy gained by public institutions in joining the UN PRI but suggests that this can be lost as a result of lack of transparency and failure to attain improvements in corporate behaviour.[99] The relationship with civil society actors for the purpose of organisational learning is also questionable. It is at least necessary to identify the external audience with whom dialogue should be developed. Arguably this audience should include anyone affected by the behaviour of the corporations financed by the investors and any beneficiaries of the investors. It is not clear that this is the case.

Constituency building or networking can lead to positive behavioural changes by multinational companies through giving them access to the consortium in which all the participants share a common concern. Thus shareholders might prefer the coalition building approach of allying with other shareholders because 'it magnifies the awareness of a common concern in an attempt to hasten management's response to those concerns.' Thus the PRI acts as a form of constituency building and 'information exchange based on shared actions and outcomes derived from a broader base of concerned parties'. How the firm reacts will reflect on the potential success of this form of alliance. The firm could engage in a corporate political action by becoming a participant in the social movement about the environment through its voluntary participation with others concerned about climate change. Thus by providing information voluntarily in response to a third party request for information the firm can itself put pressure on other firms or stakeholders to respond

[96] Gray (2009).

[97] The PRI has created a new framework for requiring mandatory disclosure of some indicators from 2013. Failure to report could result in being publicly delisted from the Initiative. Other than this there are no sanctions for non-compliance with the principles. The UN PRI relies on reputational risks as an incentive to ensure active compliance by signatories.

[98] Hebb et al. (undated).

[99] Gray (2009).

to environmental policy issues and influence those others through collective action. However, such provision of information could also be an attempt by the company to keep politicians at bay. This might explain why often the worst environmental performers tend to disclose more to mitigate their political risk and firms in environmentally sensitive industries make more campaign contributions.[100] Whilst this can be positive it is also possible that firms themselves seek coalition building and to use shareholders and activists as intermediaries in their attempts to shape government policies in favourable ways.[101]

6 Is Shareholder Network Governance Effective?

The proliferation of investor-led governance networks might be regarded as an innovative form of public governance created and managed by private organizations for specific purposes.[102] Such networks seek to influence climate change, environmental issues and health and human rights issues. The joint UNEP FI and UN PRI document on universal owners, for example, highlights the PRI Public Policy Network as encouraging investor involvement in the public policy process.[103] Whilst it is difficult to assess with certainty how effective these networks and coalitions have been in terms of their outputs and outcomes,[104] it is clear that many such networks are 'powerful instruments of persuasion, socialization, and affect the construction of climate change – linked corporate environmental and social responsibility norms'.[105] This positive view of the involvement of investors in sustainability and CSR matters has characterised the UN's support for the UN PRI initiative. The UN sees the involvement of investors as integral to a stable financial sector, necessary for achieving a sustainable economy. The main role for investors, through the UN PRI, is 'to foster the development of a global financial system that is better attuned to long-term risk and opportunity, and incentivises actors throughout the investment chain to embed the principles of stewardship, sustainability and responsibility within everything that they do.'[106] Thus the UN Under-Secretary-General and Executive Director of UNEP emphasises the need for concerted action between financial institutions, business and the global policy-making community.[107] Similarly Georg Kell, the Executive Director of the UN Global Compact has expressed the UN's commitment to accelerating the growth of

[100] Clark and Crawford (2012). See also Cho et al. (2006).

[101] Clark and Crawford (2012), p. 171.

[102] Macleod and Park (2011).

[103] UNEP FI and UN PRI Joint document 2011.

[104] For doubts on the delivery of the promises of SRI see Schepers and Sethi (2003), pp. 11–32.

[105] MacLeod and Park (2011), p. 56.

[106] Letter, Wolfgang Engshuber, Chair, UN PRI, UN PRI Annual Report 2012.

[107] Foreword to UN PRI Annual Report 2012.

responsible investment practices within financial markets and encouraging investors to act as catalysts for channelling finance into the green economy. As Kell expresses positively:

> Through integrating sustainability issues directly into their investment processes, greater engagement with companies on environmental, social and governance issues, and support for projects with positive social and environmental impacts, PRI signatories are directly contributing to the greening of business and industry, job creation and social inclusion. They are also helping society address sustainability challenges such as social inequity, climate change, resource scarcity and biodiversity loss.[108]

Whilst the shareholder activists and the SRI industry have been identified as important for disciplining corporations and encouraging them to improve their ESG performance as well as having relevance to the development of global governance structures there are limits and problems. Boatright suggests that the best positive impact of SRI is that it 'provides an opportunity for smaller companies to compete in the crowded, noisy market for equity.'[109] But SRI is less likely to have an impact on larger, more heavily traded corporations though the pioneering practices of the smaller firms might later be adopted by mainstream companies which can enable SRI to make a difference ultimately.[110]

The level of shareholder activism is, in reality, limited. Shareholder proposals have mostly been submitted by religious groups, and they tend to target the largest companies and companies whose practices are of special concern to society, such as food, tobacco, textiles and apparel. Thus shareholder proposals are made on interest-based and identity-based motives.[111] The research evidence so far is limited but what is available presents a sceptical stance. The suggestion is that such proposals lead to compromise solutions between shareholders and corporations; shareholders may be able to influence the corporation but often only with tradeoffs. In some cases shareholder action might have a negative impact since it could encourage companies to face the shareholders and spend resources resisting the action rather than on improving their corporate social performance.

One of the key features of RI is engagement but it is difficult to track the success of informal engagement processes when the discussions take place behind closed doors.[112] As O'Rourke, suggests, there is clearly more work to be done in ensuring transparency of shareholders as well as the corporate activity.[113] Nor does shareholder activism substitute for formal regulation and control since it achieves only voluntary change by companies and is limited to those shareholders who already have the power of ownership and those with time and resources to engage.[114]

[108] Ibid.
[109] Boatright (2008), p. 124.
[110] Ibid., 125.
[111] Sjostrom (2008), p. 146.
[112] O'Rourke (2003), p. 237.
[113] Ibid.
[114] Ibid.

Whilst such informal efforts might result in corporate responsibility, this is not as strong as corporate accountability that more likely comes from legally binding, externally driven measures leading to laws to enforce environmental accountability on companies. Such accountability would provide a stronger protection for communities that face the negative impacts from corporate activities.[115] In comparison, shareholder resolutions and campaigns are more likely to bring about incremental rather than radical changes and they tend to be limited to specific issues for each proposal so they tend only to lead to CSR doing little more than 'softening the edges of "business as usual".'[116] At best, perhaps, shareholder activism provides an opportunity to open up the debate on CSR and environmental responsibility to a broader audience both within and outside companies.

The problem identified above that SRI activities still seek profit based prosperity which may then conflict with their behaviour changing goals is likely to limit the potential of SRI as a force for good in CSR and corporate governance terms. Richardson and Cragg, for example, note that over time, the ethical case for SRI has been increasingly downplayed and the prevailing justification is the business case. In part, this adoption of the business case arose in an attempt to gain access to money from the broader investing world in order to expand SRI and to bring about real change. Marrying it to the business case would help to legitimise the SRI movement. In the words of Welker and Wood: 'by framing social and environmental questions in the lingua franca of materiality and shareholder value, advocates can also create a seemingly unassailable case for taking such concerns seriously by asserting that whatever is being argued for is financially motivated and thereby free of parochial values, politics, and interest groups.'[117] Yet, the business case can also be a source of weakness for SRI over the long term. As Richardson and Cragg point out, the business case SRI is a problematic benchmark for several reasons: often there is a counterveiling business case for financing irresponsible activities, given the failure of markets to capture all social and environmental externalities; secondly, even if investors care about such concerns, there may be no means of financially quantifying their significance for investment purposes; and thirdly, even if such factors can be financially quantified they may be deemed to be such long term financial benefits that they become discounted or ignored.[118] The problem is that the business case loads onto SRI rhetoric about how being virtuous can achieve prosperity and this can lead to the result that unless financial advantage can be demonstrated, pollution or social inequities or economic injustices will be ignored, especially in the absence of government regulation and stakeholder pressure.[119]

[115] See further Clapp (2005), p. 31.

[116] Ibid.

[117] Welker and Wood (2011), p. S65.

[118] Richardson and Cragg (2010), p. 21.

[119] Ibid., p. 36.

One of the theoretical benefits of networks is that they increase power for the participants on three levels: they gain bargaining or leverage power, social power and power of exit or delinking.[120] These might operate across and beyond the network. Thus leverage power and social power might come as a result of the ties created by the collective grouping and so gives to those involved greater bargaining power or influence over those they are negotiating or seeking to influence. Exit power occurs within the network and helps participants influence the nature of the grouping with the threat of exit. The flexible nature of the network makes exit possible. Such power is stronger if the network seeks to constrain exit. The legitimacy and power aspects of collective action may be undermined as a result of the privatisation of corporate governance, and also by the lack of transparency, accountability and enforcement that are obstacles to the effectiveness of this process. Other potential problems that might arise through engagement of the private sector with multilateral institutions might include fragmentation of the system and a distortion of policy objectives, as well as a shift in the balance between different agencies and geographical distortion.[121] On the other hand private sector participation can enhance the power, legitimacy and authority of the established multilateral institutions by bringing finances and, more importantly, new ideas as the multilateral institutions lend themselves to representation of diverse interests and to such new ideas and policies.[122] Similarly, public private partnerships that are initiated or facilitated by intergovernmental organisations do not necessarily lead to a power shift but can be seen as innovations that help to reinvent the intergovernmental system.[123] The international governance regime has evolved into what some regard as a 'new world order'[124] of network governance, which has transformed state-centred governance into more disaggregated governance agencies using information networks to coordinate policy issues across borders. This has led to increased importance of corporations and other private actors and public private partnerships performing government functions, including negotiating the substance of regulations and providing expertise and monitoring compliance with regulations.[125] As is noted by Susan Strange: 'Where states were once the masters of markets, now it is the markets which, on many crucial issues, are the masters over the governments of states'.[126] Strange observes the emphasis on technology, the costs of which have increased the salience of money and of multinational corporations in the international political economy. National economies have been integrated into one single global market economy. This diffusion of authority away from national governments has left a 'yawning hole of

[120] Kahler (2009), pp. 12–13.
[121] Bull et al. (2004), pp. 486–488.
[122] Ibid., pp. 492–494.
[123] See further Andonova (2010).
[124] See e.g. Slaughter (2004).
[125] Ibid., p. 9.
[126] Strange (2000), p. 149.

non-authority, ungovernance'.[127] The very nature of global institutions is that 'they are far removed, not only in a physical sense but also in terms of control and accountability'.[128] Consequently, 'the possibility for slippage, agency drift, and loss of information along the way is likely to be severe. As a result international institutions are likely to lose touch with the sentiments of their original constituents.'[129] This 'new world order' has generated a proliferation of pubic private partnerships that effectively privileges the powerful, 'providing a mask for lucrative privatisation, weakening state responsibility or capacity, or simply "greenwashing" or "bluewashing"'.[130] Democracy and trust issues have become especially significant.

7 Democracy Issues

Democracy requires government by the people. At an international level this might be presented in a number of guises including a form of liberal democratic internationalism or a radical communitarianism which offers more direct participation on a functional rather than a territorial basis, or cosmopolitanism which imagines a universal community and minimises the idea of sovereign statehood and national citizenship.[131] Yet, there appears to be little faith in the strength of democracy at the level of international governance.

George Monbiot gave a stark impression of the democratic deficit in the international regulatory environment when he stated that democracy 'stands at the national borders, suitcase in hand, without a passport.'[132] The UN, as an institution, is frequently criticised for its lack of democracy. Its own Security Council, for example, is renowned for having given special status to the so called great powers since 1945.[133] The General Assembly also gives a 'misleading appearance of egalitarianism'[134] since it is an assembly of states rather than of people and so citizens' concerns are represented by their states, 'however repressive, unaccountable or unrepresentative they may be'.[135] Moreover, the financial actors themselves have been given too much status in the international regulatory space and said by

[127] Ibid., p. 154.

[128] Caporaso and Madeira (2012), p. 97.

[129] Ibid., p. 97.

[130] See Pitts III (2009), note 107, citing Friends of the Earth 2002 at http://www.globalpolicy.org/reform/business/2002/0802type2.htm. Accessed 30 July 2013.

[131] See further McGrew (2000).

[132] Monbiot (2003), p. 1.

[133] Singer (2004), p. 144.

[134] Ibid., p. 146.

[135] Monbiot (2003), p. 22.

some to have 'become the world's kingmakers'.[136] This is especially so when private enterprise in finance, industry and trade have gained increasing status at the international level,

As noted above, in the environmental arena, public–private partnerships appear to have proliferated particularly dramatically, possibly because of the greater prominence of technical expertise and also because the international agencies have encouraged them in order to enhance their own external legitimacy and to raise funds.[137] Public–private partnerships have the potential for broadening participation and providing spaces for deliberation on global public goods, since they aim to promote learning, dialogue, and the spread of best practices.[138] However, the problems of these public–private partnerships is that they are self mandated and the definition of their relevant constituents/stakeholders is arbitrary.[139] They also involve power structures and patterns of exclusion. In addition, as they seek to be more inclusive, they may become less efficient and less effective at problem solving and their chains of representation and accountability become less clear.[140] The power relations between north and south, between governmental and private authority and between global professionals and local grassroots are often mirrored rather than transformed by these public–private partnership activities.[141]

How might we resolve the problem of the democratic deficit? First, as Caporoso and Madeira suggest, 'if democracy is rule by the people, we must ask "who are the people" at the global level'.[142] They also suggest that we might identify 'the people; by the common predicaments in which people find themselves in the global structure. This may be achieved by noting what affects people. Thus, 'almost all people are affected (though in different ways) by global warming, ozone depletion, water scarcities, worldwide trade, and by the work of people in countless locations. To be affected by globalization means to have a stake in it.'[143] Second, it is necessary to recognise that 'democracy requires active participation and representation, not just the benevolent engineering of policies that are favoured post hoc.'[144] A healthy democracy allows participation of individuals within the governance process.[145] This is very difficult on a global scale. As Caporaso and Madeira

[136] Ibid., 75.

[137] Andonova (2010).

[138] Bexell et al. (2010), pp. 90–91.

[139] Ibid., p. 91.

[140] Ibid.

[141] Ibid.

[142] Caporaso and Madeira (2012), p. 93.

[143] Ibid., p. 95.

[144] Ibid., p. 97.

[145] Bexell, Tallberg and Uhlin define democracy in terms of representative democracy, participatory democracy and deliberative democracy: See Bexell et al. (2010). See further on representative democracy: Dahl (1967); on participatory democracy see Pateman (1970); Barber (2003). On deliberative democracy see Fishkin (1991) and Habermas (1996).

observe, on a global scale participation might be limited to monitoring the websites of international institutions to stay informed and joining advocacy groups that lobby on global issues.[146]

Another viewpoint is offered by Bexell et al., who suggest that the participation of transnational actors in global policy making has the potential to democratise global governance by expanding participation and enhancing accountability. For Bexell et al., transnational actors denote 'the broad range of private actors that organize and operate across state borders, including NGOs, advocacy networks, social movements, party associations, philanthropic foundations and TNCs.' Whilst international institutions have frequently been criticised for their democratic deficit, offering access to those institutions for transnational actors holds a promise of enhanced democratic legitimacy through expanded participation because such participation goes beyond state representatives which provides no more than an indirect representation of the people and so transnational actor involvement offers to the citizens a complementary channel for influence.[147] Bodies such as NGOs and social movements may give voice to those citizens and encourage them to be involved or those bodies might at least raise awareness of decisions and actions taken by international institutions.[148] Nevertheless there are a number of pitfalls admitted by Bexell et al.; these include the lack of balanced participation leading to privileged access to the economically powerful TNCs.[149] Additionally, the NGOs represented tend to be the better organized and well funded, whilst marginalized groups from developing countries tend to be highly underrepresented. Furthermore many such transnational actors are given limited access to the international institutions and their participation is limited to performing services for the institution, access to the international courts, participation in conferences, and making use of complaints procedures. Rarely are they invited to the decision making stage of international activity.[150]

Caporaso and Madeira make a radical suggestion: 'to make the transition to politics, people with a common stake must become aware of their collective predicament and must mobilize to alter their situations through bargaining, protest or public policies.'[151] The use of communications technologies including internet, texting, social networking, makes possible this swift mobilization, as has been witnessed in recent episodes of civil disobedience across the world. As Pitts suggests, 'The billions of cell phones in the world will increasingly be used to record, upload, forward, and display corporate and other abuses'. Such communications technologies do not only make possible "efficient cross border financial flows, just in time production, and economic globalization" "but they also empower

[146] Ibid., p. 122.

[147] Bexell et al. (2010), pp. 86–87.

[148] Ibid.

[149] Ibid.

[150] Ibid.

[151] Caporaso and Madeira (2012), p. 96.

rapid, bottom-up democratic "WikiAdvocacy" by individuals, citizen journalist bloggers, and self organizing coalitions, while simultaneously allowing greater scrutiny and pressure from investors, consumers, communities, established NGOs, and other market monitors."[152]

These technological advances might be seen potentially as a hindrance to collective action since they come as an extension of the growth of consumerism and as part of the landscape of new forms of industrial relations, and the rise in virtual reality 'associated with the rise of increasingly individualistic and narcissistic personality structures.'[153] Such developments are more likely to be barriers to effective collective action since society is reduced 'to individuals with a decreasing understanding of real social relations and links between social and environmental systems.'[154] This technology can have the effect of further separating people and diminishing community and social interaction. On the other hand a more optimistic view is that 'cyberspace networks are capable of generating new possibilities for social interaction, work and political participation. They can overcome some of the individualism and separation of modern life. They also bring all kinds of information to people and thus enable them to become better informed and politically active citizens.'[155] Dickens points out that through these technologies, 'as regards resistance to globalization and environmental degradation, emergent social movements are proving extraordinarily adept at using and transforming new forms of media to organize themselves and capture public attention. The kinds of society they propose and the kinds of social and environmental risks they are clearly trying to avoid all transcend the idea of a "virtual society" in which people and their environment are only experienced on computer screens.'[156] Dickens goes on to suggest that there is 'no necessary reason why a network society should automatically focus on depthless images and virtual realities. It can also be used to understand, and mobilize against, some of the big issues of the day, such as global environmental change and social justice.'[157]

These technological developments have certainly made it possible for large groups to mobilise quickly and offer a new possibility for the progression of social movements which may provide possibilities for meaningful participation by a broad group of interested parties. Indeed, there has been a growth of global justice social movements and protest groups. Their primary characteristics are that 'they develop a fundamental, meta-political critique of the social order and of representative democracy, challenging institutional assumptions regarding conventional ways of "doing politics" in the name of a radical democracy.'[158] They are different from

[152] Pitts III (2009), p. 335.
[153] Dickens (2004), p. 148.
[154] Ibid.
[155] Ibid., p. 163.
[156] Ibid., p. 164.
[157] Ibid., p. 165.
[158] Della Porta and Diani (2006), p. 9.

workers' movements in that they do not necessarily seek material gain, but challenge diffuse notions of politics and of society themselves. They seek to defend interpersonal solidarity against the great bureaucracies and they resist the expansion of political administrative intervention in daily life and seek personal autonomy.[159] Della Porta and Diani have defined social movements as a distinct political process, consisting of mechanisms through which actors engaged in collective action: are involved in conflictual relations with clearly identified opponents; are linked by dense informal networks; and share a distinct collective identity.[160] A social movement process is in place to the extent that both individual and organized actors, while keeping their autonomy and independence, engage in sustained exchanges of resources in pursuit of common goals.[161] Collective identity is strongly associated with recognition and the creation of connectedness and brings with it a sense of a common purpose and shared commitment to a cause, which enables the activists and or organisations to regard themselves as inextricably linked to other actors, not necessarily identical but compatible in a broader collective mobilization.[162] The establishment of movements such as Occupy, Interoccupy and the more recent embryo of the People's Assemblies show the potential for collective mobilization and shared causes.

King and Pearce illustrate the potential of extra-institutional tactics of persuasion and disruption for generating influence. Persuasive tactics, for example, communicate a movement's message to a broad audience and make claims that politicise and vilify a practice and convince third parties of the immediate need for change.[163] This may be achieved through protests that draw media attention to create public interest and support for their cause, as well as negative attention on the target of the protest, and disruption through subversive tactics such as boycotts and protests that destabilize elites and alter the target's ability to carry out its own goals and resources and eventually threatens the authority of powerful market actors.[164]

8 Conclusions

The increasing power of large corporations and their ability to operate globally has brought significant challenges to nation states as regulators as well as to international institutions such as the UN. Such institutions have seen a need for collaborating with financially resourced organisations as well as organisations with expertise on specific issues such as climate change. Institutional investors have

[159] Ibid.
[160] Ibid., p. 20.
[161] Ibid., p. 20.
[162] Ibid., p. 21.
[163] King and Pearce (2010), pp. 254–256.
[164] Ibid.

thus played an increasingly important role as a disciplinary influence on corporate actors for CSR purposes and at the same time they have become important actors in the global environmental governance arena. Their SRI activities have been developed through networks and through public private partnerships with governmental and intergovernmental institutions. For SRI institutions this has helped to raise their profile and to provide them with certain features of legitimacy. Whilst SRI is not yet mainstream its share of the investment markets has grown significantly and this has given them greater salience for corporate governance and CSR purposes. The number of signatories joining up to the UN Principles for Responsible Investment indicates a strong willingness among investors to engage with CSR issues and to seek to influence companies to behave better. Those signatories have been active in a variety of ways and the Principles are contributing to a broader campaign for more sustainable corporate activities.

Nevertheless, even with their stated virtuous objectives, such players are still focused on profits and good financial returns. This presents a potential conflict with their aims for improving corporate behaviour for the benefit of the environment and society. Such profit focus has the potential to narrow the debates and to reduce the overall impact of the SRI sector in terms of environmental and social impact. To give to the SRI industry such high levels of political power is potentially dangerous, especially in the light of continuing environmental destruction, labour and human rights abuses and the growing divide between rich and poor nationally and internationally. For long term legitimacy and effectiveness the international regulatory arena needs to find new ways to engage not just the financial players but stakeholders and citizens affected by the activities of multinational and transnational corporations. NGOs go some way towards opening access but they cannot fully permit access to the policy and decision-making arena, given their own limited democracy credentials.

Network governance offers the potential for a broad collaboration between different groups and individuals with common goals. However, these can also be problematic in terms of lack of formality and lack of transparency. Yet there are windows of opportunity for collective action and potentially more confrontational methods of influence. The technologies that made globalisation possible have the potential also to assist with effective collective action. The investor movement has a necessary and important role to play but their own limitations as a force for real power change point to a need to search beyond those investors and to offer a more positive role for the citizens who are affected by corporate activities and by policies created at international level. Citizens and other stakeholders may bring with them the expertise that investors cannot provide alone. It is necessary now to search for ways in which investors and other stakeholders and citizens can coordinate their actions and work out a consensual agenda for a more sustainable form of globalisation and global governance. Not only might this approach lead to the legitimacy that the international players have been searching for in the new global governance arena but it might also lead to a more genuine change of behaviour by companies in the interests of society and the environment.

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