

Private Lawmaking

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This article argues that a significant amount of law is privately made and suggests that privately made law should be subjected to the same kinds of questioning as publicly made law, considering in the end whether privately made law might be considered “molecular federalism.” Private lawmaking, through which one private group makes rules that govern much larger groups, extends well beyond the boundaries of relatively well-known examples of private legislatures like the American Law Institute and the Uniform Law Commissioners. The phenomenon includes the practical ability of private entities to make law governing many kinds of corporate, commercial, and consumer transactions, from credit cards to letters of credit. After suggesting the broad scope of private lawmaking through an inductive argument, the article shifts to linguistic analysis to show that the artifacts resulting from these private processes are best considered law and are inadequately described by terms like contract, norms, private ordering, or self-regulation.

The article goes on to a tentative assessment of private lawmaking, asking about efficacy, representation, respect for autonomy, and similar matters. The article ends by emphasizing that much of the legitimacy of private lawmaking depends on competition in lawmaking and surmises that under competitive circumstances, private lawmaking may function as federalism on a molecular level. Because the number of potential lawmakers is much greater, molecular federalism may multiply the benefits of state-based federalism. It may also enhance its quality, enabling bottom-up lawmaking instead of top-down imposition of rules by the state.

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INTRODUCTION

This article focuses on a dual argument. First, much law is privately made. In other words, there is something we should call *law*, that carries much of the effect of legislation or case law, but that is privately made. It is not made in a meaningful sense by government legislatures or courts. Public legislatures and courts remain important, for they make law as well. Indeed, following Justice Holmes, this article uses the word *law* to denote a rule that predicts how a court will act.¹ The authority of publicly made law is fully recognized here, in addition to the authority of privately made law. Although not all law is privately made, and most privately made law depends ultimately on the power of the state—power the state lends, dependably and in generous measure—enough law is privately made that we should care.

That point leads to the second argument: we need to ask the same sorts of questions of privately made laws that we ask of publicly made laws. Later, the second proposition will require refinement. The sorts of questions we need to ask about privately made laws differ from the standard questions because privately made laws result from an undemocratic but potentially market-disciplined process. The qualification of the second point will consider the possible effect of competition between private regulatory regimes and will also take into account

¹ See Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 458 (1896) (“[A] legal duty so called is nothing but a prediction that if a man does or omits certain things he will be made to suffer in this or that way by judgment of the court;—and so of a legal right.”). This definition is not unusual, especially in the context of commercial law. See, e.g., James J. White, *The Influence of International Practice on the Revision of Article 5 of the UCC*, 16 NW. J. INT’L L. & BUS. 189, 189 (1995).

the possibility that competition may be absent. Where competition or its potential exists, I argue that private lawmaking is a kind of “molecular federalism.”

The conceptions advanced here are new, although the underlying facts are not. The broad role of private lawmaking in the current American polity has largely escaped scholarly attention, although perceptive writers have noted the phenomenon in a few instances. This article aims to show that private lawmaking is a pervasive and important element of contemporary lawmaking, not confined to distant medieval or nascent electronic realms² or to the relatively limited roles of the American Law Institute (“ALI”), the Uniform Law Commissioners,³ and analogous organizations. Nor is private lawmaking as well tamed as in corporate and securities law, where private regulation takes place under the watchful monitory eye and powerful regulatory arm of the Securities and Exchange Commission.⁴ The tasks undertaken here are urgent, as corporate misconduct (measured in large part by privately made rules) and credit card power (enforced through privately made rules) boldly make headlines. But this article is not about those current issues in particular; they are covered simply because the phenomenon described here is so broad. Private lawmaking has not replaced public lawmaking, even in the commercial world, but it is a robust component of commercial and consumer life. Private lawmaking is unavoidable now—a political fact we would do well to recognize—and it will remain inevitable for the foreseeable future.

After defining some key terms and disposing of other introductory points in Part I, the argument begins in Part II on relatively familiar ground. The work of the ALI in fashioning the Restatements of the Law is known to every law student in the first week of law school, as is the Institute’s joint project with NCCUSL on the Uniform Commercial Code. Not quite as well known are the private

² See GILLIAN K. HADFIELD, PRIVATIZING COMMERCIAL LAW: LESSONS FROM THE MIDDLE AND DIGITAL AGES (Stanford Law Sch., John M. Olin Program in Law & Econ., Working Paper No. 195, 2000), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=220252 [hereinafter HADFIELD, LESSONS]; Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000) [hereinafter Hadfield, *The Price of Law*]; Gillian K. Hadfield, *Privatizing Commercial Law*, REGULATION, Spring 2001, at 40, available at <http://www.cato.org/pubs/regulation/regv24n1/hadfield.pdf> [hereinafter Hadfield, *Privatizing Commercial Law*] (emphasizing this point); Gillian Hadfield & Eric Talley, On Public versus Private Provision of Corporate Law (Oct. 2001) (unpublished manuscript), available at <http://www-rcf.usc.edu/~etalley/hadtall.pdf> (last visited Apr. 13, 2003).

³ The National Conference of Commissioners on Uniform State Laws is also called NCCUSL, the Conference, or the Uniform Law Commissioners. When the Conference was named, people were apparently less focused on acronyms. Unwieldy as it now is, the name used to be worse—the Conference of State Boards of Commissioners on Promoting Uniformity of Law in the United States. See Unif. Law Comm’rs, *History*, at <http://www.nccusl.org/nccusl/aboutus.asp#history> (last visited Apr. 13, 2003).

⁴ See Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78s (2000).

rulemaking roles of the securities exchanges, which are the subject of Part III. That Part also discusses how private lawmaking is sometimes confused with self-regulation. Part IV continues the inductive exercise by taking up a number of less familiar examples of private lawmaking, by which private bodies make rules that govern millions of people, companies, and transactions, both in consumer and commercial contexts. The first argument—that much law is privately made—concludes in Part V, in which I defend the idea that these privately made rules should be considered law. For ease of exposition, the arguments are put forward with relatively few qualifications in the first few parts. Part V acknowledges a number of objections to the argument and grants some concessions.

The second half of the article takes up the related point, that we should question privately made law just as we question publicly made law. Part VI considers some of the questions of equality, exclusivity, representation, efficiency, and other values. Part VII takes up a crucial characteristic of private lawmaking, which is the effect of potential competition in lawmaking. The discussion focuses on federalism and the possible federalism-related benefits that could accrue if lawmaking occurs on a molecular level instead of being centered on the state. In the end, the article considers a few implications of the arguments advanced and draws some conclusions.

I. PRELIMINARY TASKS

Before beginning in earnest, some definitions are required. They will show that the first part of the argument is not a mere tautology (of course private law is privately made!). To be clearer, *private law* here refers to the law governing relations among persons, including juridical persons such as corporations. The law of contracts, the law of torts, and the law of commercial transactions are prime examples. Private law is typically contrasted with *public law*, which governs the relations involving the government (e.g., constitutional law, criminal law). Sometimes people say that the provisions of a contract are the “private law” between the parties; this article will avoid that usage because it is confusing in the context of the current argument.⁵ Here, *private law* will refer exclusively to the legal rules in those bodies of law that govern relations among persons. For example, the rule that contracts generally require consideration is a rule of private law.

Private law is not the same as *privately made law*. At least in the beginning, the consideration requirement was a rule of private law, but it was not a privately made rule. It was a rule of common law developed by the courts.⁶ The

⁵ *But see* White, *supra* note 1, at 190.

⁶ *See* J.H. Baker, *Origins of the ‘Doctrine’ of Consideration*, in LAWS AND CUSTOMS 336 (1977); J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 386–88, 399–400 (3d ed. 1990).

consideration requirement, then, was *publicly made law*,⁷ although it is a rule of private law. In our times, though, some of the consideration rules are privately made. The ALI—a private organization—makes them, packages them in a Restatement, and quite successfully encourages their adoption by public lawmakers, usually the courts. The ALI, whose role is reasonably well recognized, is only a small part of the private lawmaking phenomenon.

One further distinction may aid in explanation. On the one hand, some rules are made by private legislatures like the ALI. Such bodies undertake various projects for the good of society. The membership of these private legislatures enjoys some benefit because the membership is part of society, but otherwise it has no direct stake. This situation generally describes the work of the ALI and NCCUSL. The ALI is not a significant contracting or property-holding party. It does not concoct the Restatements of Contracts or Property for its own economic benefit as a contracting party or property-holding party. Rather, the ALI and NCCUSL are conceived as little legislatures, with projects considerably broader than their economic interests. Such bodies produce what I will call *legislative rules*. (The product of actual public legislatures is *legislation*.) On the other hand, associations of economic actors make some rules for their own benefit. The rulemakers, in other words, are significantly involved in the transactions being regulated. The members of the Banking Commission of the International Chamber of Commerce are engaged in the business of letters of credit. Those letters of credit incorporate rules made by the Banking Commission. As such rules are often incorporated as a matter of contract, I will refer to them as *contractual rules*. Both legislative rules and contractual rules, as those phrases are used here, are examples of private lawmaking.

Before we see how, two notes on scope are necessary. First, this article will concentrate on what might broadly be called commercial or business law. To some extent this focus may be a matter of happenstance; they are the areas I happen to know best. Readers will likely come up with many other examples of private lawmaking. Homeowners' associations,⁸ standard-setting organizations,⁹ and others come immediately to mind. Possibly, though, the case is stronger in the commercial area than elsewhere. In commercial law in particular, and business law in general, many of the great legal edifices have been built on the law of contract. Contract is an important (although perhaps not essential)

⁷ See Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEG. STUD. 115, 115 (1992) (describing a similar idea referred to as "state-created law").

⁸ See Robert C. Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519 (1982) (discussing homeowners' associations and their effects); see also Laura T. Rahe, Student Article, *The Right to Exclude: Preserving the Autonomy of the Homeowner's Association*, 34 URB. LAW. 521 (2002).

⁹ See Chris Sagers, *Antitrust Immunity and Standard Setting Organizations: Who, After All, Is the Government* (2002) (unpublished manuscript, on file with author).

ingredient in private lawmaking. Areas less amenable to private structuring through contractual building blocks may be less susceptible to private lawmaking. Such questions are beyond the scope of this article.

Second, part of the point of this article is to emphasize the breadth of private lawmaking and to draw together the interests of those who know commercial law with those, like constitutional scholars, whose memories of contract and commercial law may be hazy. This purpose has a significant drawback: the article describes a number of legal institutions and transactions in enough detail so a newcomer can understand what is happening, but without so much as to prevent some consideration of several large fields (contracts, securities markets, and payment systems). This approach means that the experts in a particular area will find only the details they already know, while those unfamiliar with the area will find only enough to discover the basic idea. More particularly, scholars of commercial and corporate law will not be surprised by the phenomena described in the first three or four parts of the article. Still, the argument to those scholars is that they should be surprised, not by the mechanics, but by the character of what has happened.

We have taken for granted the way the systems work without attending to how the lawmaking function has been privatized before our eyes. Something aside from “private ordering” has occurred: private groups are exercising important segments of lawmaking power, affecting millions who are not group members. On the other side of the equation, experts in constitutional law and related areas will no doubt be frustrated by a commercial lawyer’s naïve approach to democratic polity in general and American federalism in particular. But they will perhaps be interested to see how in various commercial contexts, as a practical matter, the lawmaking function has been partially reallocated from the government. Similarly, economists may be surprised by a loose approach to competition and efficiency. This article challenges the economists and the scholars of public law to bring their expertise to bear on areas that they otherwise might ignore.

II. FAMILIAR TERRITORY—RESTATEMENTS AND THE UCC

Scholars have occasionally written about two “private legislatures,”¹⁰ the ALI and NCCUSL, and a description of private lawmaking begins smoothly with

¹⁰ See David M. Lawrence, *Private Exercise of Governmental Power*, 61 IND. L.J. 647, 688 (1986) (considering privatization issues from the standpoint of constitutional non-delegation doctrine); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595, 597 (1995) (using the term to describe the ALI and NCCUSL); see also James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096, 2096 (1991) (“NCCUSL[] is a legislature in every way but one.”).

Others have followed the usage, sometimes including analogous bodies such as UNIDROIT. See, e.g., Clayton P. Gillette, *Rules, Standards, and Precautions in Payment*

those examples. The ALI produces the “Restatements of the Law” of various fields, including the *Restatement of Contracts*. The courts frequently and generally follow the Restatements, and thus the Restatements constitute law according to Justice Holmes’s definition.¹¹ The Uniform Commercial Code, which is a joint project of NCCUSL and the ALI, is law in a more obvious sense. By and large, it has been enacted by statutes in every jurisdiction in the country.¹²

The ALI and NCCUSL, the Restatements and the UCC: they are familiar, and they are easy to understand. They are only a starting point for the first argument; private lawmaking happens on a vastly larger scale than these two private legislatures represent. But we can appreciate that phenomenon by proceeding one example at a time.

A. *The Uniform Law Commissioners*

For over a century the Uniform Law Commissioners have been hard at work furnishing the country with uniform laws.¹³ The Conference is composed of lawyers, appointed in various ways, who at least nominally represent their states.¹⁴ By 1906 the Conference approved a Uniform Sales Act, which achieved passage in most states.¹⁵ Since then, the Commissioners have approved over 200 uniform laws, most prominently in the fields of commercial law, family law, probate, and decedents’ estates.¹⁶ By far the most successful project has been the UCC.¹⁷ There were some fits and starts along the way,¹⁸ and the success rate is

Systems, 82 VA. L. REV. 181, 197–98 (1996); A. Brooke Overby, *UNCITRAL Model Law on Electronic Commerce: Will Cyberlaw Be Uniform?*, 7 TUL. J. INT’L & COMP. L. 219, 222 (1999) (NCCUSL); Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT’L L. 44, 49 (2001) (Hague Conference); Paul B. Stephan, *Accountability and International Lawmaking: Rules, Rents and Legitimacy*, 17 NW. J. INT’L L. & BUS. 681, 689–90 (1996) (including UNIDROIT, the Hague Conference, and the ICC); Nicholas S. Zeppos, *From the Trenches and Towers*, 23 LAW & SOC. INQUIRY 657 (1998) (ALI).

¹¹ See *supra* note 1 and accompanying text.

¹² All states have adopted at least parts of the Code. Adoption is explained further in the next part.

¹³ NCCUSL was founded in 1892 after the nineteenth-century failure of the Field codes to gain national enactment. See STEVEN J. BURTON & MELVIN A. EISENBERG, *CONTRACT LAW: SELECTED SOURCE MATERIALS* vi (2001).

¹⁴ The makeup of the Conference is discussed in more detail *infra* in Part VI.E (on representation in the private lawmaking process).

¹⁵ See BURTON & EISENBERG, *supra* note 13, at vi. The Uniform Sales Act is the predecessor of UCC Article 2, as acknowledged *passim* in the comments to Article 2.

¹⁶ See Unif. Law Comm’rs, *supra* note 3.

¹⁷ By focusing on the UCC, the text admittedly concentrates on the stoniest case. Some other NCCUSL projects, which do not enjoy the ALI imprimatur, have met with notably less success (e.g., the Uniform Computer Information Transactions Act). Two states have enacted

not perfect, but at this point almost all of the Code has been enacted almost everywhere. Revised Article 9 (governing secured transactions) has been adopted by statute in every state. Article 2, which governs sales of goods, is the law in every state but Louisiana (because of its civil-law tradition).¹⁹ There are various exceptions; to take one example, New York has not enacted the most recent version of Article 3, which governs negotiable instruments, continuing to use a slightly older version. So there are certainly some minor variations here and there. Still, the UCC is the law of the land, with only small exceptions—quite technical except perhaps to some very specialized lawyers.

Any ordinary citizen might well think that the law of the land was publicly made. It was not. The ALI and NCCUSL made it. There is a formal public intermediation in that the UCC would not be the statutory law anywhere were it not passed by the state legislatures. And it is true that the public intermediation has some meaning some of the time. The UCC is subject to various non-uniform amendments.²⁰ Much of the time, though, the states do what they are told. Whatever deal was made in the private legislature becomes the deal in the public legislature.

UCITA. See MD. CODE ANN., COM. LAW II § 22-101 (2002); VA. CODE ANN. § 59.1-501.1 (Michie 2002). Three states have anti-UCITA statutes. See IOWA CODE § 554D.104 (2002); N.C. GEN. STAT. § 66-329 (2002); W. VA. CODE § 55-8-15 (2003).

¹⁸ Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code 1949–1954*, 49 BUFFALO L. REV. 359 (2001) [hereinafter Kamp, *Downtown Code*]; Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code 1940–49*, 51 SMU L. REV. 275 (1998); Allen R. Kamp, *Between-the-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context*, 59 ALBANY L. REV. 325 (1995); see also Ingrid Michelsen Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn's Attempt to Achieve the Good, the True, the Beautiful in Commercial Law*, 73 GEO. L.J. 1141 (1985); Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465 (1987).

¹⁹ Robert E. Scott, *The Rise and Fall of Article 2*, 63 LA. L. REV. 1009, 1046 (2003) (detailing the conventional story as a “dramatic success”); see also David V. Snyder, *Comparative Law in Action: Promissory Estoppel, the Civil Law, and the Mixed Jurisdiction*, 15 ARIZ. J. INT'L & COMP. L. 695 (1998), reprinted in LOUISIANA: MICROCOSM OF A MIXED JURISDICTION (Vernon V. Palmer ed., 1999) (treating the unusual case of Louisiana contract law).

Because I had access to his working paper, I was to some degree able to take into account Dean Scott's new work for purposes of this article. Unfortunately, I was not able to consult prepublication versions of the other contributions to the extraordinary symposium in honor of Chancellor William D. Hawkland, *Unifying Commercial Law in the 20th Century: Understanding the Impulse and Assessing the Effort*, 62 LA. L. REV. 991 (2002), which was published just before this article went to press.

²⁰ The non-uniform amendments are too numerous to list. Few are prominent except to specialists. They are listed in the *Uniform Laws Annotated*, whose volumes are published and/or re-issued periodically, with supplements published annually.

There are good arguments for this result, and they can be hard to resist. Commercial law, UCC proponents argue, is technical and apolitical: the “Uniform Commercial Code”—even the title induces yawns. The Code is the triumph of a “dry and technical system,”²¹ and the public would do well to be grateful that the highly compensated experts who know the system voluntarily bestow upon society the largess of their expertise. There is no real question, in this account, of giving the political henhouse to the well-clad foxes. The work requires experts, and the experts are the heart of the UCC drafting process. If a legislator or legislature were to reject or revise the work of expert craftsmen, all manner of untoward results could come about, and they would be completely unforeseeable to the inexpert.

Moreover, the need for uniformity in commercial transactions is obvious. Any state with the idiosyncratic gumption to reject any part of the UCC would thereby raise transaction costs for doing business in the state. The state would put itself at a competitive disadvantage for attracting businesses and their transactions, and the tax revenue they bring. What legislature would reject the UCC? Instead, legislatures have accepted the UCC with open arms, contenting themselves with occasional tinkering that would not noticeably detract from the proponents’ goals of enacting uniform law, controlled by expensively shod experts.

B. *The American Law Institute*

The UCC is a joint project of NCCUSL and the ALI, so much of the previous argument carries as much weight with the ALI. But just as NCCUSL has myriad uniform laws to its credit aside from the UCC, there is also more to the picture on the ALI side. That part of the legal landscape is made up of the Restatements.²²

The ALI was founded in 1923 to improve the law, its founders said, and before long they settled on the idea of restatements.²³ Its membership purports to comprise the elite of the law, including the leaders of the bar, the bench, and the

²¹ OLIVER WENDELL HOLMES, *The Profession of the Law: Conclusion of a Lecture Delivered to Undergraduates of Harvard University on February 17, 1886*, in COLLECTED LEGAL PAPERS 29, 29–30 (1920).

²² There is a large collection of literature on the Institute, its history, its undertakings, and its impact. They have been discussed reasonably recently by several noted scholars in a symposium, the footnotes of which collect the important scholarship. Symposium, *The American Law Institute: Process, Partisanship, and the Restatements of the Law*, 26 HOFSTRA L. REV. 576 (1998).

²³ See BURTON & EISENBERG, *supra* note 13, at iii. See generally *Report of the Committee on the Establishment of Permanent Organization for the Improvement of the Law Proposing an American Law Institute*, 1 A.L.I. PROC. 1 (1923) (providing information on the founding of the ALI).

professorate.²⁴ Their first product was the *Restatement of Contracts* (1932), which purported “to clarify and simplify the law and to render it more certain.”²⁵ By 2001 the ALI had approved Restatements on subjects ranging from agency, property, restitution, and security to foreign relations, unfair competition, and the law governing lawyers. Many of the Restatements are now in their second or even third rounds, reflecting updated precedent, further thinking, and expanded scope.²⁶

As with uniform laws, a formal public intermediation occurs before any part of a Restatement becomes the kind of official “law” as that term is commonly used. Indeed, until a court or a legislature adopts a rule from the Restatement, the “law” in the Restatements is not the law anywhere, as one prominent scholar argued when the first Restatement was published.²⁷ His statement is no longer accurate, however, either in any ordinary sense of the word *law*, or in the sense defined above.²⁸ At this point, innumerable courts have adopted countless rules from the Restatements. By and large, if the Restatement states the rule, that is the end—as Gregory Maggs has pointed out, *ipse dixit*.²⁹ Although there are occasional exceptions to this general rule, and it is not susceptible of perfect proof in any event, it seems generally to hold. I will refer to this idea as the *ipse dixit* hypothesis.

To be sure, a court will occasionally try to resist a Restatement rule, although such resistance is not always successful.³⁰ Or perhaps the court might engage in a little judicial fine-tuning of the rule. But the same is true of the rules ordinarily called law. The appropriate point of comparison is not some perfect, ideal law. Little if any law is perfectly authoritative: some rules will apply in some jurisdictions but not others; some will apply at certain times and not others. Some

²⁴ The makeup of the ALI membership and its exclusive nature are discussed in more detail *infra* Part VI.E (on representation).

²⁵ *Introduction*, in *RESTATEMENT OF CONTRACTS* viii–ix (1932).

²⁶ For general information, see The American Law Institute web site at <http://www.ali.org> (last visited Apr. 13, 2003).

²⁷ Charles E. Clark, *The Restatement of the Law of Contracts*, 42 *YALE L.J.* 643, 654 (1933) (“[T]he resulting statement is the law nowhere and in its unreality only deludes and misleads.”).

²⁸ See *supra* note 1 and accompanying text.

²⁹ Gregory E. Maggs, *Ipse Dixit: The Restatement (Second) of Contracts and the Modern Development of Contract Law*, 66 *GEO. WASH. L. REV.* 508, 512–13 (1998). *Contra* Gary T. Schwartz, *Considering the Proper Federal Role in American Tort Law*, 38 *ARIZ. L. REV.* 917, 948–49 (1996).

³⁰ Eric Mills Holmes, *Restatement of Promissory Estoppel*, 32 *WILLAMETTE L. REV.* 263, 427–33, 478–83 (1996) (discussing the rejection (or perhaps more accurately, attempted but unsuccessful rejection) of *RESTATEMENT (SECOND) OF CONTRACTS* § 90 by the courts of North Carolina and Virginia); see also 3 *CORBIN ON CONTRACTS* 159–63 (Eric Mills Holmes & Joseph M. Perillo eds., rev. ed. 1996).

courts even in the same jurisdiction will move to a new rule, others will find it ill advised, or politically too soon. We still call those rules law, and we think of them as law. The benchmark for comparison is not law in some ideal sense. The ideal does not exist.

In another sense, the rules of the Restatements are very much the law before a court even looks at any particular rule. Following Justice Holmes's definition of *law* (the law is simply a prediction about what a court will do),³¹ the Restatement is a good predictor. Before a court makes a decision, then, the Restatement is *law* simply because it is a good indicator of what the court will do. In that sense, it is perhaps only a little different from actual precedent, which is itself a good (but far from perfect) indicator of how a court will act. Both in the early days and currently, the ALI itself promotes the idea that Restatements have a status similar to judicial precedent. "Many Institute publications have been accorded an authority greater than that imparted to any legal treatise, an authority more nearly comparable to that accorded to judicial decisions."³² Or, as the first Restatement said, its sections could be regarded not only "as the product of expert opinion" but "as the expression of the law by the legal profession."³³

All of which is to say that the Restatement itself makes up part of the common law. Perhaps the first Restatement was not law when the ALI first passed it. Then, no one could know how the courts would treat it.³⁴ We know now. And because the Restatements (as well as the UCC) are law, NCCUSL and the ALI are legislatures—albeit private ones.

C. Political Economy in NCCUSL and ALI

The ALI and NCCUSL have been in the lawmaking business a long time, and they now provoke a reasonably steady stream of scholarly criticism of the sort ordinarily directed at more usual lawmaking bodies, namely public legislatures and courts. One body of articles discusses how the ALI and NCCUSL are subject to the same sort of political goings-on that we associate with governmental legislatures. Scholars have uncovered the problems of lobbying, special interests, and capture.³⁵ Other scholars have sought to show

³¹ See *supra* note 1 and accompanying text.

³² See Am. Law Inst., *About The American Law Institute*, at <http://www.ali.org/ali/thisali.htm> (last visited Apr. 13, 2003).

³³ *Introduction*, *supra* note 25, at xii.

³⁴ Cf. Clark, *supra* note 27.

³⁵ See, e.g., Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture and the Race to the Bottom*, 83 IOWA L. REV. 569, 584–88 (1998); Edward L. Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551, 586–92 (1991) [hereinafter Rubin, *Efficiency*]; Edwin L. Rubin, *The Code, the Consumer, and the Institutional*

how the ALI and the Uniform Law Commissioners are subject to the same sort of political-scientific analysis that can be applied to other political bodies.³⁶ Still others have sought to defend the traditional notions about the relatively limited, expert, apolitical role of the ALI and NCCUSL.³⁷

These are important issues, but beside the point for the more fundamental point pressed here. The thrust here is that the ALI and NCCUSL do make law, at least in a practical sense. Whether ALI and NCCUSL are apolitical expert altruists or shrewd political lawyers matters only if they are successful in their lawmaking endeavors. If they enjoy only insignificant success, their nature is insignificant. But as should be apparent now, their success has been highly significant. In some areas of private law, their success has been pervasive. Although they are not the only lawmakers, that hardly takes away from their success. If the authoritative public decisionmakers like courts and state legislatures follow the dictates of the ALI and NCCUSL, we have identified a de facto source of law.

Structure of the Common Law, 75 WASH. U. L.Q. 11, 12, 67 (1997); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743, 781–87 (1993); Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System*, 49 OHIO ST. L.J. 1251, 1253–61 (1989); see also Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1044–52 (1993); Jonathan R. Macey, *The Transformation of the American Law Institute*, 61 GEO. WASH. L. REV. 1212, 1216–31 (1993). Further authorities are collected in Henry Gabriel, *The Revision of the Uniform Commercial Code—How Successful Has It Been?*, 52 HASTINGS L.J. 653, 659 n.18 (2001), and Fred H. Miller, *Realism Not Idealism in Uniform Laws—Observations from the Revision of the UCC*, 39 S. TEX. L. REV. 707, 708 n.5 (1998).

³⁶ See Schwartz & Scott, *supra* note 10; Robert E. Scott, *Is Article 2 the Best We Can Do?*, 52 HASTINGS L.J. 677 (2001); see also Robert E. Scott, *The Mythology of Article 9*, 79 MINN. L. REV. 853 (1995); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1803–22 (1994); Scott, *supra* note 19; Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436, 1446–47 (1997); Clayton P. Gillette, *Politics and Revision: A Comment on Scott*, 80 VA. L. REV. 1853 (1994) (refining this concept).

³⁷ Peter A. Alces & David Frisch, *On the UCC Revision Process: A Reply to Dean Scott*, 37 WM. & MARY L. REV. 1217 (1996); Miller, *supra* note 35; A. Brooke Overby, *Modeling UCC Drafting*, 29 LOY. L.A. L. REV. 645 (1996); Donald J. Rapson, *Who Is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249, 255–66 (1994); see also Peter A. Alces & David Frisch, *Commercial Codification as Negotiation*, 32 U.C. DAVIS L. REV. 17 (1998); Iain Ramsay, *The Politics of Commercial Law*, 2001 WIS. L. REV. 565; Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909, 915–22 (1995) (suggesting how NCCUSL and ALI private lawmaking could be reformed and constrained).

These three footnotes seem to divide the commentators into camps, but they do not always fit neatly. I hope readers will not be confused and authors will not be offended, but this method of rough division seemed more useful than lumping the articles into one string cite.

To be clear: I have not shown that all law is privately made, nor even that all of the law of contracts and commercial transactions is privately made. Nor have I shown that the law made by NCCUSL and the ALI is purely private, as formal public intermediations by the legislatures or the courts are necessary. But I do hope to have shown that a fair amount of law is privately made, and that there is enough privately made law that we should care who is making it and how. Still, we have only just begun to see how law is privately made. Private lawmaking ranges far more widely.

III. SECURITIES MARKETS

Although reasonably well-known to scholars and practitioners of corporate law, to most in the legal profession the rulemaking function of the securities exchanges is less familiar than the work of the ALI or NCCUSL. The complexity of private law in making the securities markets could easily justify extended discussion, but the account here will be simplified. Even in outline the securities markets provide a robust example of private lawmaking, including its potentially competitive aspects. The historical aspects of the story also shed light on the differences between the paradigm of the two-party contract, which is most familiar, and the model of private lawmaking, which I argue below is more descriptive and more accurate for the types of private ordering discussed in this article.³⁸ The account at this point leaves out the role of the Securities and Exchange Commission ("SEC"); its power will be acknowledged below, where the article suggests that the potential for government oversight detracts little from the primary argument.³⁹ The story begins with a group of brokers that became the New York Stock Exchange.⁴⁰

A. An Introduction: The New York Stock Exchange and Its Competitors

For the first part of its existence, in the late eighteenth and nineteenth centuries, the NYSE did not establish uniform or firm requirements for the companies whose stocks it would list. The exchange did impose standards on the companies that sought listing with the exchange, but the standards were variable, even subject to dickering. The results of this negotiation between the exchange and each issuer of securities were set down in the contract that constituted the

³⁸ See also *infra* note 140 and accompanying text (discussing private ordering literature).

³⁹ See *infra* Part V.C.1; *infra* note 190 and accompanying text.

⁴⁰ See Bus. Law Comm. on Fed. Reg. of Sec., ABA, *Special Study on Market Structure, Listing Standards and Corporate Governance*, 57 BUS. LAW. 1487 (2002). The explanation in the text largely follows the *Special Study*. Because the study was unpublished at the time of writing, subsequent citations are to sources published earlier.

listing agreement.⁴¹ The listing requirements at that time are best understood according to the contractual rather than the private-lawmaking paradigm because they were negotiated and thus variable. A term that can be negotiated cannot even be called a rule, much less a law. The same is true of listing standards. They were simply matters of contract.

This state of affairs would not survive the nineteenth century, however. By 1900, contracts for listing on the NYSE required particular forms of financial disclosure to the public, certain safeguards for investors, and annual reports to shareholders. The twentieth century saw further evolution both of financial disclosure requirements for listed companies and for standards of corporate governance. Annual shareholders meetings were required in 1909, quarterly earnings statements in 1923, and one-share/one-vote standards were in place by 1926.⁴² With the establishment of these uniformly applicable rules for listing companies, the NYSE was shifting from being a contracting party to being a private lawmaker. The rules could be enforced through fines or if necessary, expulsion.⁴³ The rules the NYSE made would directly affect (eventually) thousands of companies and millions of investors.⁴⁴ The indirect effects of these rules are felt much more broadly, throughout the nation and the world, as our economy bounds or fizzles in tandem with the stock market. As recent events show only too well, standards for financial disclosure and corporate governance are not matters of only academic and regulatory interest. The capitalization of companies and of countries bears the harsh impact of these rules, their enforcement, or their laxity.

The New York Stock Exchange, however, has been far from the only player. From its inception in the mid-nineteenth century, the American Stock Exchange (“Amex”)⁴⁵ has sought to compete with the NYSE. One of the prime ways that it has competed is in the requirements for listing on the exchange. Its early role was to give companies a place to grow until they could meet the listing requirements of the NYSE, which demands much larger companies.⁴⁶ While the NYSE made rules that applied to and affected thousands of companies and millions of

⁴¹ See Douglas C. Michael, *Untenable Status of Corporate Governance Listing Standards Under the Securities Exchange Act*, 47 BUS. LAW. 1461, 1465–66 (1992).

⁴² See GILBERT W. COOKE, *THE STOCK MARKETS* 215–16 (1964); GEORGE L. LEFFLER, *THE STOCK MARKET* 430 (1951); Michael, *supra* note 41, at 1467–68; Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 693–98 (1986).

⁴³ See HADFIELD, *LESSONS*, *supra* note 2, at 18.

⁴⁴ See SEC. INDUS. ASSOC., *SELECTED INDUSTRY STATISTICS*, available at http://www.sia.com/reference_materials/pdf/keystats.pdf (last visited Apr. 13, 2003).

⁴⁵ Originally, and well into the twentieth century, the Amex was called the New York Curb Exchange.

⁴⁶ The requirements actually sound in terms of revenues, capitalization, and the like. See NEW YORK STOCK EXCHANGE MANUAL § 4300 (1999) [hereinafter NYSE MANUAL].

investors, the Amex did the same, but with different, more lenient rules. Other exchanges and trading markets have performed, and currently perform, similar functions, the Nasdaq now being the chief competitor for the NYSE.⁴⁷ This is competitive private lawmaking, a phenomenon that is of great importance to the second half of this article.⁴⁸ Here it is also worth noting that although competition can be documented among securities exchanges, perfectly efficient markets should not be assumed. The market in legal regimes, like other markets, can sometimes suffer from market failures.⁴⁹

B. *The Self-Regulatory Misnomer*

Despite the usual portrayal in the media, politics, and even statutes and regulations, these markets are not aptly described as self-regulatory organizations.⁵⁰ The markets do not simply regulate themselves. More precisely, those who make the rules, and even those whom the rulemakers at least nominally represent, regulate the conduct of many entities other than themselves. Consider the two currently predominant trading markets.

The NYSE is still a membership organization, and much of the power, if not quite all, resides in the members of the organization (barring government intervention).⁵¹ Simply speaking, the members traditionally have been those in

⁴⁷ According to the most recently and readily available statistics, the NYSE lists about 3000 companies and the Nasdaq 5000 (plus another 1400 less capitalized companies or “SmallCaps”). Amex now lists about 700. NYSE market capitalization was over \$11 trillion in February 2002 with dollar volume of about \$800 billion. Nasdaq numbers were \$2.5 trillion and \$681 billion. Amex dollar volume came in at \$50 billion. The statistics are more complicated than given here, but this picture is more than adequate for present purposes. *See Comparing Three Markets—NASDAQ, NYSE, and Amex, at* http://www.marketdata.nasdaq.com/mr_outline3.asp (last visited Mar. 18, 2003).

Further competition is already being felt from alternative trading systems or electronic trading and communication networks. *See generally* Regulation of Alternative Trading Systems, Exchange Act Release No. 34-40760, 1998 SEC LEXIS 2794 (Dec. 8, 1998); Jonathan Macey & Maureen O’Hara, *Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective*, 28 J. LEGAL STUD. 17 (1999); *see also* Jonathan Macey & Hideki Kanda, *The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges*, 75 CORNELL L. REV. 1007 (1990). Potential consolidation internationally could also affect competitive lawmaking in this area. *See* JOHN COFFEE, COMPETITION AMONG SECURITIES MARKETS: A PATH DEPENDENT PERSPECTIVE (Columbia Law Sch., Ctr. For Law & Econ. Studies, Working Paper No. 192, 2002), *available at* <http://papers.ssrn.com/abstract=283822> (discussing the potential for consolidation and shrinkage through global and technological innovation).

⁴⁸ *See infra* Parts VI, VII.

⁴⁹ *See* Macey & O’Hara, *supra* note 47.

⁵⁰ *See, e.g.*, Securities Exchange Act of 1934 § 19(b)(2), 15 U.S.C. § 78s(b)(2) (2000).

⁵¹ *See infra* Part V.C.1.

the business of trading in securities, such as brokerage houses. The members are not, by and large, the companies who are listed or who want to be listed. Nor are investors members.⁵² Until 1938 or so, the story ended there, and the members could run their market as a private club—a system the members found congenial, but that was hardly popular.⁵³ Matters came to a head when in that year, in one of its periodic and seemingly inevitable scandals, a Wall Street stalwart (a former NYSE president!) was caught embezzling and was duly sent to Sing Sing.⁵⁴ In the aftermath of the scandal, a reformed constitution took some of the exchange functions from members and assigned them to paid executives who were not members. The new constitution also provided for some public representation on the board of governors and enhanced representation for exchange members who dealt with the public.⁵⁵ Still, though, the power lies in members of the exchange,⁵⁶ and those members are investment bankers, dealers, and brokers, as the Congress recognized even as it implemented so-called self-regulation.⁵⁷ The rules for who can be listed on the NYSE directly affect not only the members of the exchange, but also companies who are listed, who want to remain listed, and who would like to be listed. The Exchange regulates much more than itself.

Similarly, the Nasdaq, until recently, has been owned by the National Association of Securities Dealers (“NASD”).⁵⁸ As its name suggests, the NASD is comprised of securities dealers.⁵⁹ The NASD has not included, by and large,

⁵² Less simply, these bald statements have to be qualified for particular occasional firms. For instance, some firms that own or control a membership on the exchange are listed on the exchange (e.g., Citigroup). These instances are exceptional, however, and the basic point remains. The vast majority of listed companies are not members of the exchange.

⁵³ See WILLIAM O. DOUGLAS, *DEMOCRACY AND FINANCE* 64–66 (J. Allen ed., 1940); see also LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* ch. 8C (2d ed. 1988). The observations about private lawmaking are mine; Professor Loss stresses the idea of “cooperative regulation” by both the SEC and the exchanges. See *id.*

⁵⁴ The SEC investigation is published in three volumes, *IN THE MATTER OF RICHARD WHITNEY* (1938).

⁵⁵ See 4 SEC ANN. REP. 20 (1938); see also NYSE CONST. art. I, § 3(r), reprinted in 2 N.Y.S.E. Guide (CCH) ¶ 1003 (1984).

⁵⁶ See NYSE CONST., art. IV, § 2, reprinted in 2 N.Y.S.E. Guide (CCH) ¶ 1153 (1984). Although the board is divided between public members and industry members, the power of election remains in the Exchange membership.

⁵⁷ See S. REP. NO. 75-1455 at 3–4 (1938); H.R. REP. NO. 75-2307, at 4–5 (1938).

⁵⁸ At the time of writing, the Nasdaq is going public. If this process is accomplished, the situation in the text will be altered, but not generically. One group will still have the power to govern many others, it appears, although the details are not set at present. See, e.g., J. Alex Tarquinio, *Why Nasdaq Sputters in Its Own Stock Sale*, N.Y. TIMES, Nov. 10, 2002, § 3, at 6.

⁵⁹ See Nat’l Ass’n of Sec. Dealers, Homepage, at <http://www.nasd.com> (last visited Apr. 13, 2003) (“[E]very securities firm doing business with the US public is a member of this private, not-for-profit organization. . . . NASD registers member firms, writes rules to govern their behavior, examines them for compliance and disciplines those that fail to comply.”).

the companies who are listed or who want to be listed. Nor does the NASD include investors. To be sure, the NASD and the NYSE both have to take into account the wishes and concerns of putatively listed companies and of the investing public. Competitive pressure, if nothing else, would assure that. More directly, the public enjoys some representation because of the organic reforms instituted after the 1938 Whitney scandal.⁶⁰ But the rules in the end are made by one group and wind up governing much larger groups, and the members of those larger groups enjoy limited representation, making them disproportionately powerless. The difference between who the regulators are and whom they represent, on the one hand, and those who are regulated, on the other, can be measured in the millions. Neither the NYSE nor the Nasdaq is a self-regulatory organization in this sense. They are private lawmakers.⁶¹

IV. A STEP FURTHER INTO THE PRIVATE REALM

The discussion so far has made some attempt at dispatch and brevity. The ALI and the Uniform Law Commissioners, and to a lesser extent the securities exchanges, provide a useful starting point for the argument because their role as private legislatures is not startling. Yet the argument has barely begun. Groups that are even more private than the ALI, NCCUSL, and the securities exchanges show other ways that privately made rules become law. Let us start with a strident if not exactly familiar example.⁶²

⁶⁰ See *supra* note 56 (on board composition and election).

⁶¹ On regulation by the markets that affects investors, for better or worse, see, for example, George J. Benston, *Regulation of Stock Trading: Private Exchanges vs. Government Agencies*, 83 VA. L. REV. 1501 (1997); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119 (1987); David A. Lipton, *The SEC or the Exchanges: Who Should Do What and When? A Proposal to Allocate Regulatory Responsibilities for Securities Markets*, 16 U.C. DAVIS L. REV. 527 (1983); Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453 (1997); Michael, *supra* note 41; Sam Scott Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE L. REV. 853 (1985); and Adam C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Monitors*, 85 VA. L. REV. 925 (1999). See generally CAROLINE M. BRADLEY, TECHNOLOGY, DEMUTUALISATION AND STOCK EXCHANGES: THE CASE FOR CO-REGULATION (Soc. Sci. Research Network, Working Paper No. 312157, 2002), available at <http://papers.ssrn.com/abstract=312157>; Adam C. Pritchard, *Self-Regulation and Securities Markets*, REGULATION, Spring 2003, at 32, available at <http://www.cato.org/pubs/regulation/regv26n1/pritchard.pdf> (comparing securities exchanges' and government's incentives to regulate securities markets).

⁶² The example is not familiar, but it is not unknown. See Stephan, *supra* note 10, at 701, 714–16; White, *supra* note 1, at 189. Even less known is the private lawmaking world of BOLERO, which has sought to bring bills of lading into the electronic realm. See RONALD J. MANN & JANE K. WINN, ELECTRONIC COMMERCE 297–300 (2002). Here I would like to

A. *Letters of Credit and the International Chamber of Commerce*

Many of the most important rules that govern letters of credit are made by the International Chamber of Commerce, which is a private organization that to normal Americans is largely inaccessible. One court has explained the view of one plaintiff-citizen, for whom the ICC was something approaching Oz.⁶³ Regardless of whether any ordinary citizen can actually find it, its role as maker of rules for letters of credit is virtually indisputable. To understand the importance of these rules, a little background is necessary.⁶⁴

Commercial letters of credit are typically issued by banks when the parties to a contract are unwilling to extend enough credit to each other to complete a transaction. In the modern world, this scenario is common. We no longer live in the days (if they ever existed) when commercial sales were expected to involve a simultaneous exchange. Now at least, either the seller must ship the goods before receiving payment, thus extending credit to the buyer, or the buyer must prepay and thus extend credit to the seller. In many contexts, and especially internationally, the parties are not willing. A letter of credit solves the problem and allows the transaction to take place.

In a simple case, the buyer's bank issues the letter of credit to the seller. This "credit" (as it is called, shorthand) obligates the bank itself to pay the seller. The bank will only pay, however, if the seller presents documents from a carrier (e.g., a ship line) proving that the goods have been shipped, and perhaps even an inspection certificate from a third party attesting to the quality of the goods. The seller feels safe because it has the payment commitment of a bank, and the buyer feels safe because the bank will not give out any money—ultimately, the buyer's money—unless the necessary documents are presented. The buyer simply stipulates beforehand what documents will provide adequate reassurance, and these documents will be required by the terms of the letter of credit.

acknowledge a more general intellectual debt to RONALD J. MANN, *PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS: CASES, MATERIALS, AND PROBLEMS* (1999); the way that some of the material is presented in his coursebook and teacher's manual prompted me to begin thinking about the conceptions put forward in this article.

⁶³ See *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 571 (App. Div. 1998) ("[E]fforts to locate and contact the ICC had been unsuccessful and that apparently the only way to attempt to contact the ICC was through the United States Council for International Business, with which the ICC maintained some sort of relationship."). It should be admitted that the ICC does have a web site that is not particularly hard to find. A Yahoo search for "international chamber of commerce" on February 15, 2002, turned up the correct site ([iccwbo.org](http://www.iccwbo.org)) as the first match. On the other hand, the web site lists contact information that is almost entirely European, with "general enquiries" to be directed to Paris. See Int'l Chamber of Commerce, *Contact Us*, at http://www.iccwbo.org/home/intro_icc/contact_us.asp (last visited April 14, 2003).

⁶⁴ See MANN, *supra* note 62, at 215–42.

Unsurprisingly, the scenario is usually more complicated from the standpoint of the law, although the complicated structure is meant to ease and simplify the transaction for the buyer and seller. Consider even the paradigmatic sale of corn,⁶⁵ brought into an international context, where simultaneous exchange is impossible. Assume that the buyer is in China and is unknown to the seller. The buyer's bank (say, the Hong Kong Commerce Bank)⁶⁶ may also be untrustworthy or unknown to the seller (say, an industrial resident of Gary, Indiana). The seller might not be much more willing to trust the Hong Kong Commerce Bank to pay than the buyer itself. If that were the case, a confirming bank (say, J.P. Morgan Chase in New York) would be included. Hong Kong Bank, acting on behalf of its customer (the buyer), could engage J.P. Morgan to confirm the credit without too much difficulty or even too much cost, although there would certainly be a fee.⁶⁷ The seller would trust J.P. Morgan to pay. The last link is that if J.P. Morgan lacks any branches in or near Gary, it engages the Third Indiana Bank⁶⁸ to advise the seller of the credit.

This simple sale of corn to an overseas buyer now involves five parties and the publicly made law of several jurisdictions. The transaction could keep cadres of Wall Street lawyers busy documenting the transaction for a long while. Yet no decent Wall Street lawyer would need to spend much time on this transaction. It can easily be ordered from a legal menu available at the bank.⁶⁹ To the buyer and the seller, this process should be simple, and it is pretty simple. The law's job is to take care of the complexity, and it does. Its job is two-fold: it has to specify the fundamentals to make sure the transaction accomplishes its purpose, and it has to assure that the terms of the credit are understandable. Across countries and cultures, this task is daunting.

The interesting part is the source of this law.⁷⁰ It is contained in the International Chamber of Commerce Uniform Customs and Practice for

⁶⁵ See *Morton v. Lamb*, 101 Eng. Rep. 890 (K.B. 1797).

⁶⁶ I have made up the Hong Kong Commerce Bank for purposes of this explanation. So far as I know, no such bank exists.

⁶⁷ An American bank that confirms a credit issued by an ordinary bank in a reasonably stable country would charge a fee ranging from 1/20 to 1/10 of 1% per calendar quarter that the credit was outstanding, although conversations with bankers and businesses suggest that those fees can vary considerably. An advising bank typically charges a small fee, such as \$75. See MANN, *supra* note 62, at 220–21.

⁶⁸ I have made up this bank as well.

⁶⁹ The bank forms may well have been drafted by the Wall Street lawyers. But because this transaction is standard, and because of the rules discussed in this section, the drafting is simple and need not start from scratch. Moreover, the cost of the forms can be spread over many transactions.

⁷⁰ MANN & WINN, *supra* note 62, at 295.

Documentary Credits (“UCP 500”).⁷¹ Virtually all letters of credit incorporate it by reference. Each letter of credit will have at least three parties (i.e., buyer, seller, and issuing bank), but more parties would be common, for the reasons explained above. Aside from those involved in the issuance and negotiation⁷² of the credit itself, more are involved when the essential other documents are included. Consider the transport companies and ocean lines that issue bills of lading. These parties vary geographically as well as in sophistication, class, and presumably politics. Yet all of these players—numbering in the hundreds of thousands, if not millions—will have their conduct governed by the forty-nine articles of the UCP, none of which was ever put before a legislature.

One striking characteristic of these transactions is the claim—implicit in the assertion above that the UCP is the most important source of law—that the UCP is more the law of letters of credit than UCC Article 5, which also purports to govern letters of credit. A few reasons explain this claim. Most generally and most simply, much of Article 5 is made up of default rules, which become irrelevant if the parties so agree (e.g., by incorporating the UCP as a matter of contract).⁷³ Someone might object that the current Article 5 was expressly designed to mesh well with the UCP⁷⁴ and therefore will not be displaced often by mere incorporation of the UCP into a letter of credit. Yet the objection proves the point: as a matter of practice, the legislation—which itself originates in privately made legislative rules, devised by the ALI and NCCUSL—molds itself to the (practically speaking) higher authority of the UCP. The UCP has led the way, and as the reporter for UCC Article 5 has acknowledged, in case of conflict other concerns had to yield to the banks, and their UCP.⁷⁵

The claim that the UCP is more the law than is Article 5 was even stronger until quite recently because of a New York peculiarity. New York is the most

⁷¹ The UCP is a sixty-page pamphlet (including a few pages of ads) measuring roughly four-by-eight inches and available from the author-cum-publisher for \$14.95, plus shipping and handling. Informal conversations with experts suggest that international letters of credit incorporate the UCP at percentages in the high nineties; purely domestic credits are in the lower nineties. See Ross P. Buckley, *The 1993 Revision of the Uniform Customs and Practice for Documentary Credits*, 28 GEO. WASH. J. INT’L L. & ECON. 265 (1995) (95%) (citing PAUL TODD, *BILLS OF LADING AND DOCUMENTARY CREDITS* vii (1990)); Sandra Stern, *New York Enacts Revised Article 5 for UCC*, N.Y. L.J., Oct. 4, 2000, at 1 (“well over 90 percent”); James G. Barnes, *Internationalization of Revised UCC Article 5 (Letters of Credit)*, 16 NW. J. INT’L L. & BUS. 215, 216 (1995) (“substantially all cross-border commercial letters of credit”).

⁷² Issuance and negotiation are explained in more detail in INT’L CHAMBER OF COMMERCE, UNIF. CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS arts. 2 (“meaning of credit”), 9 (“liability of issuing and confirming banks”), and 10.b.ii (meaning of negotiation) (1993) [hereinafter UCP 500].

⁷³ See U.C.C. § 5-103(c) (2001). Default rules and their role are explained further *infra* Part V.A.3.

⁷⁴ See U.C.C. art. 5 (prefatory note) (2001).

⁷⁵ See White, *supra* note 1.

important American jurisdiction for letters of credit since it is the foremost financial center in the country and a well-established leader in commercial law. In fact, the terms according to which the dominant New York banks would confirm letters of credit were the origin of the UCP.⁷⁶ The reason that UCP dominance was so clear was that Article 5 in New York did not apply at all if the parties incorporated the UCP,⁷⁷ which they do almost all of the time.⁷⁸ Almost always, then, the UCP applied to the transaction and the UCC did not. The result is no longer as stark because revised Article 5, now in New York as elsewhere, applies when the parties adopt the UCP. Still, the bottom line is much the same. To the extent that the provisions of the UCP displace Article 5, the UCP governs.⁷⁹ In letters of credit, the UCP is more “the law” than Article 5.

To get a flavor for how the UCP matters in real transactions and real disputes, consider the tasks the drafters of UCP 500 undertook. Several problems had arisen under the regime of UCP 400. Many, and possibly most, presentations under letters of credit (i.e., sellers presenting documents in order to get their money) were rejected because the documents did not strictly comply with the requirements of the credit.⁸⁰ As the UCP working group acknowledged, this fact would not only diminish the commercial usefulness of letters of credit but could

⁷⁶ See *id.* at 189–90.

⁷⁷ See, e.g., *E & H Partners v. Broadway Nat’l Bank*, 39 F. Supp. 2d 275 (S.D.N.Y. 1998).

⁷⁸ See *supra* note 71.

⁷⁹ See N.Y. U.C.C. LAW § 5-103 & cmt. 2 (McKinney 2001) (effective Nov. 2000). It should be noted that the UCP does not govern certain issues and gives incomplete guidance on others, including fraud. Where the UCP does not resolve the issue, courts have to look to Article 5 or other sources of law. See *Mid-America Tire, Inc. v. PTZ Trading Ltd.*, 768 N.E.2d 619 (Ohio 2002); see also James G. Barnes & James E. Byrne, *Letters of Credit: 2000 Cases*, 56 BUS. LAW. 1805, 1811–12 (2002).

Under the revision, a few issues governed by Article 5 are not subject to variation by agreement. See U.C.C. § 5-103(c) (2001). But these are not issues contradicted by the UCP anyway and in any event are unlikely to raise much of an issue. Part of the point of revising Article 5 was to assure its consonance with the UCP. See UCC art. 5 (prefatory note); White, *supra* note 1. The invariability applies: to some conceptual definitions, variation of which would change the nature of the transaction from a letter of credit to something else (which can be done without any problem, just so long as the thing does not purport to be a letter of credit); to a rule preventing issuance of a credit that remains in force in perpetuity; and to a rule requiring reasonable consent to an assignment of proceeds in certain circumstances. The last of these could raise an issue, but the parties’ ability to define reasonableness—so long as the definition is not manifestly unreasonable—dulls any teeth such a rule might otherwise have. See U.C.C. § 1-302(b) (2001) (formerly § 1-102(3)).

⁸⁰ UCP 500, *supra* note 72, at 4 (“Some surveys indicate that approximately fifty per cent of the documents presented under the Documentary Credit are rejected because of discrepancies or apparent discrepancies.”); see also Ronald J. Mann, *The Role of Letters of Credit in Payment Transactions*, 98 MICH. L. REV. 2494, 2495 n.3 (2000) (collecting authorities citing discrepancies in 50% to 70% of presentations).

have an important financial impact on the parties. Put more simply, if the chances are that the bank will not in fact pay—which is the crucial function of the letter of credit—then the viability of the product is seriously undermined, and the beneficiary-cum-seller might find itself holding the (empty) bag.⁸¹ This situation coincided, unsurprisingly, with a “marked increase in litigation” involving letters of credit.⁸² The UCP was partially at fault for this situation, if only by error of omission, and UCP 500 seeks to “list, in detail, the elements of acceptability for each category of transport document.”⁸³

Although the UCP is sometimes considered nothing more than a guide to international banking practice, it is much more. To see how the UCP is privately made law rather than simple custom, consider not only the dynamic of the problem just explained but also another development in UCP 500: the definition of negotiation. The meaning of negotiation was an important and controversial issue in the last revision of the UCP, the dispute resting on whether a negotiation should require giving value, now required by UCP 500, as opposed to examining documents and passing the credit to the next bank in the chain. Money-center banks on the coasts, which typically do give value before passing the credit along, won the debate. At stake was the ability to charge fees for negotiation, which the midwestern banks were doing without advancing any money.⁸⁴ This was not a descriptive process of redacting banking custom; it was a legislative process by which some banks made the rules of the game for their gain (and the loss of others).⁸⁵

Perhaps the most salient reason that the UCP ought not be considered mere usage of trade is that it is not sufficiently known to all of the players in the transaction. To be a usage of trade, a practice must be so regularly followed as to

⁸¹ Mann, *supra* note 80, at 2498, 2521–33 (questioning whether letters of credit serve the conventionally conceived function and suggesting that they may fulfill a signaling function); cf. Jacob I. Corré, *Reconciling the Old Theory and the New Evidence*, 98 MICH. L. REV. 2548 (2000); Clayton P. Gillette, *Letters of Credit as Signals*, 98 MICH. L. REV. 2537 (2000); Avery Wiener Katz, *Informality as a Bilateral Assurance Mechanism*, 98 MICH. L. REV. 2554 (2000).

⁸² See UCP 500, *supra* note 72, at 4.

⁸³ *Id.*

⁸⁴ Telephone Interview with Boris Kozolchik, United States Council on International Banking, Inc. (July 16, 2002) (the sole American member of the Working Group for UCP 500); see also DOCUMENTARY CREDITS: UCP 500 AND 400 COMPARED—AN ARTICLE-BY-ARTICLE ANALYSIS (1993) (ICC Publication No. 511) (offering a more in-depth analysis); Boris Kozolchik, *Towards New Customs and Practices for Documentary Credits: The Methodology of the Proposed Revision*, in 1993 COMMERCIAL LAW ANNUAL; Boris Kozolchik, *The “Best Practices” Approach to the Uniformity of International Commercial Law: The UCP 500 and the NAFTA Implementation Experience*, 13 ARIZ. J. INT’L & COMP. L. 443 (1996), reprinted in MAKING COMMERCIAL LAW: ESSAYS IN HONOUR OF ROY GOODE 357 (Ross Cranston ed., 1997).

⁸⁵ Cf. Lisa Bernstein, *The Questionable Empirical Basis of Article 2’s Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 740–41 (1999).

justify an expectation that it will be followed in the transaction in question.⁸⁶ Courts have often refused to visit a usage of trade of one industry on a party who is not part of that industry.⁸⁷ The buyer and seller may be unfamiliar with the customs of international banking, and there is no reason to expect them to be. Tellingly, the banks do not rely on a usage of trade argument. Rather than suggesting that the UCP is *ipso facto* part of the agreement as a usage of trade (which is automatically included in agreements governed by the UCC),⁸⁸ the banks incorporate them expressly.

In the end, the rules privately made by the ICC Banking Commission have a direct impact on everyone who uses commercial letters of credit, or who is affected by them (like transport companies, ocean lines, and express services)—a vast proportion of those involved in international trading, and even some domestic trading. The device through which these rules become law are thousands or millions of contracts that incorporate unprinted contract terms. A nice aspect of this example of privately made law is that the UCP is incorporated so pervasively that we can see it as something appropriately called law, rather than the particular and peculiar terms that two contracting parties happened to include in their agreement. Since the rules of the UCP are almost always the legal rules applicable to letters of credit, they are every bit as much law as are statutory enactments that are indisputably called law.

Admittedly, the law of letters of credit is a small area of the varied landscape of commercial lawmaking, and comparatively an even smaller area of the vast world of lawmaking in general. But it is just an example—a salient one, because of the availability of statistics about the nearly universal rate of UCP incorporation by contract. Still, letters of credit are not the heart of the commercial world, and Article 5 is not the best-known beauty of the UCC family. We are only at the beginning, though. Other work is beginning to show that the famous heart of the Code, Article 2 (on sales) is becoming irrelevant as more and more actors opt into privately devised legal regimes.⁸⁹ That is work for other articles. The same phenomenon is demonstrated perhaps even more widely in the rules that govern the checks written by the bulk of American society.

⁸⁶ See U.C.C. § 1-303(c) (2001) (formerly § 1-205(2)).

⁸⁷ See, e.g., *Coregis Ins. Co. v. Fleet Nat'l Bank*, 793 A.2d 254, 259–60 (Conn. App. Ct. 2002) (Peters, J.); *Oil Ins. Ass'n v. Royal Indem. Co.*, 519 S.W.2d 148, 150 (Tex. App. Ct. 1975).

⁸⁸ See U.C.C. § 1-201(b)(3) (2001) (formerly § 1-201(3)).

⁸⁹ See Scott, *supra* note 19, at 1012 (“[L]arge numbers of commercial parties have opted out of the sales provisions of the Code.”).

B. Rules for Checks and the Abdication of Legislation

The rules for checks directly affect almost everyone. Some people may get along without checks, but they are few. Predictions of the check being obviated by plastic or electronic means of payment are still awaiting fulfillment.⁹⁰ This section shows how the rules that govern checks are privately made. The example is particularly helpful because it shows multiple facets of private lawmaking. In this instance, we can see how what eventually became legislation started as rules formulated by banks, as well as how those rules were eventually codified by a private legislature, and finally passed into legislation. In addition, this example shows a peculiar abdication of legislation, which bows humbly to bankers' preferences.

The tale of the check laws begins with the pre-UCC rules of banks for dealing with checks. Before the 1960s, the Negotiable Instruments Law, which had been approved by NCCUSL in 1896 and was eventually adopted by all forty-eight states,⁹¹ contained some rules pertaining to checks, which are negotiable instruments. But the NIL was about negotiable instruments in general, which include certain promissory notes and drafts other than checks. The NIL did not regulate many of the myriad issues pertaining particularly to checks (like the details of the check collection process). For the most part, rules on checks particularly were contained in rules adopted by the American Bankers Association ("Bankers").⁹² When the UCC achieved widespread adoption starting in the 1960s, Article 3 of the UCC replaced the NIL and Article 4 of the UCC replaced the Bankers' check collection rules. After UCC adoption, we indisputably have a statutory law of negotiable instruments (UCC Article 3) and checks (UCC Article 4), although as argued above, that law was privately made.⁹³

Before UCC adoption, the same transactions and issues were governed by more or less the same rules, except that the law of negotiable instruments (including checks and other instruments) was contained in a statute and the law of

⁹⁰ In 1999 less than 20% of consumer spending was by credit card. *See* United States v. Visa U.S.A., Inc., 163 F. Supp. 2d 322, 334 (S.D.N.Y.), *modified*, 183 F. Supp. 2d 613 (S.D.N.Y. 2001).

⁹¹ *See* Gregory E. Maggs, *The Holder in Due Course Doctrine as a Default Rule*, 32 GA. L. REV. 783, 784 (1998).

⁹² American Bankers Association is not abbreviated here by the usual "ABA" acronym because of the potential for confusion with the American Bar Association, which also functions as a private lawmaking body in ways beyond the scope of this Article (e.g., the making of ethics rules that affect not only the conduct of lawyers but the kind and quality of legal services available to the public). *See generally* Ted Schneyer, *Special Issue: Institutional Choices in the Regulation of Lawyers*, 65 FORDHAM L. REV. 33 (1996).

⁹³ *See supra* Part II.A.

checks was contained in rules made by an industry association, which were then adopted by statute in a number of jurisdictions.⁹⁴ The adoption of UCC Article 4, which in the end was essentially a “refurbished version” of the Bankers’ rules,⁹⁵ simply brought more uniform adoption to the Bankers’ rules. If we call Article 4 *law* now, we should recognize that the Bankers’ rules were law then. The only difference between the two is that the status of Article 4 as uniform legislation displaced the status of the Bankers’ rules, which were originally matters of custom and contract (and thus subject to displacement by common law decisionmaking) until being enshrined in statute.⁹⁶ As explained in more detail below,⁹⁷ being on a lower rung in the legal hierarchy detracts little from the status of the Bankers’ rules as law. And more importantly, as a matter of fact, the current equivalent of the Bankers’ rules do *not* occupy a lower rung.

The current equivalent of Bankers’ rules are higher in the hierarchy because of a remarkable provision in Article 4 that perhaps is evidence of its former existence as privately made contractual rules. (They are now privately made legislative rules, as those terms are defined in Part I.) Article 4 gives associations of banks the power to preempt almost anything they want. Understanding the doctrine behind this point requires several statutory steps, but they are worth the trouble.

Most of the steps are unremarkable. Section 4-103 begins by allowing the rules of Article 4 to be varied by agreement.⁹⁸ This rule is unsurprising; much commercial law consists of default rules.⁹⁹ The interesting part comes in subsection (b). “Federal Reserve regulations, operating circulars, clearinghouse rules and the like have the effect of agreements . . . whether or not specifically assented to by all parties interested in items handled.”¹⁰⁰ Ignore the part about the Federal Reserve regulations; the significance comes in giving “clearinghouse

⁹⁴ See generally Hal S. Scott, *The Risk Fixers*, 91 HARV. L. REV. 737 (1978).

⁹⁵ See Rubin, *Efficiency*, *supra* note 35, at 555; see also Kerry Lynn Macintosh, *Liberty, Trade and the Uniform Commercial Code: When Should Default Rules Be Based on Business Practices?*, 38 WM. & MARY L. REV. 1465, 1523 (1997).

⁹⁶ See Scott, *supra* note 94, at 739–62.

⁹⁷ See *infra* Part V.C.1.

⁹⁸ Here is the full text of U.C.C. § 4-103(a)–(b) (2001):

(a) The effect of the provisions of this Article may be varied by agreement, but the parties to the agreement cannot disclaim a bank’s responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank’s responsibility is to be measured if those standards are not manifestly unreasonable.

(b) Federal Reserve regulations and operating circulars, clearinghouse rules, and the like have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled.

⁹⁹ Default rules are discussed in more detail *infra* Part V.A.3.

rules and the like¹⁰¹ legally binding force when not all of the parties have agreed to them.¹⁰²

To see the power given to the banks, let us move beyond law to fact. The New York Clearing House Association (the “Clearing House”) is a group of a few of the nation’s largest banks.¹⁰³ A quick glance at the list will probably suggest that no democratic or republican election was involved in constituting the Clearing House, unless the constituency were a select and unusual group. In fact, “minimal publicity” for the group is a characteristic deemed worthy of touting.¹⁰⁴ Yet this group makes some of the most important clearinghouse rules, and those rules will affect when people get their money and will also affect questions of liability on issues such as stop-payment orders, checks returned for insufficient funds, check-kiting, and so on.¹⁰⁵ The Clearing House operates one of the largest clearinghouses in the country and has the ability to expand to cover the nation.

Of course, practically none of the individuals or companies whose checks are cleared through the Clearing House know anything about the Clearing House or its rules. Nor would they suspect that the rules made up by its constituent banks have the force of law. Perhaps not everyone will be affected by the rules of the New York Clearing House Association. Many, if not most people, will be governed by other clearinghouse rules, depending on where the check is going to or coming from. That does not matter. Whatever the regional clearinghouse association is, it will likely be made up of reasonably prominent banks. The banks will make the rules that govern not only themselves, but also their relations with their customers and even those who are not their customers, but whose checks pass through the system. The clearinghouse rules will affect all check-writers, who have no say in the rulemaking.¹⁰⁶ Here, privately made rules do not become

¹⁰⁰ U.C.C. § 4-103(b) (2001).

¹⁰¹ *Id.*

¹⁰² Article 4A contains a similar but less strident rule. *See* U.C.C. § 4A-501(b) (2001). Article 4A, which governs certain wire transfers of money, has much narrower applicability and limits the direct effect of system rules to consenting parties. *See id.* §§ 4A-102 to -104, 4A-108, 4A-501(b).

¹⁰³ *See* The N.Y. Clearing House Ass’n, *Our Board*, at <http://www.theclearinghouse.org/board.htm> (last visited Apr. 13, 2003) (listing its owner banks as: ABN AMRO; Bank of America, N.A.; The Bank of New York, Bank One, N.A.; Citibank, N.A.; Deutsche Bank Trust Company Americas; Fleet National Bank; HSBC Bank U.S.A.; J.P. Morgan Chase Bank; Wachovia Bank, N.A.; and Wells Fargo Bank, N.A.).

¹⁰⁴ *See id.*

¹⁰⁵ *See id.*

¹⁰⁶ Perhaps one might qualify this statement by saying that customers can vote with their feet, that is, the market endows bank customers with the power if not the right of democracy. Such arguments will be explored further below, but in any event, they seem weak in this context because the oligarchic power of the clearing house, be it NYCHA or a local clearing house, will be practically inescapable for any check-writer.

law through actual agreement or contract. They are made law by the fiat of section 4-103(b).¹⁰⁷

C. Credit Card Associations

Our society thrives on credit, and the credit industry attempts to entice consumers into more of it billions of times a year. The rules on credit extension implicate the purchasing decisions of millions of American consumers.¹⁰⁸ Less often noticed, the rules of the credit card industry also affect millions of merchants, including businesses large and small. Just as the credit card issuers send millions of direct-mail solicitations to consumers, the credit card processors (which may be the same banks) engage representatives to sign up merchants to accept credit cards.¹⁰⁹ The rules privately made by the Visa and MasterCard associations thus affect millions of consumers and merchants and regulate thievery, embezzlement, fraud, and the viability of Internet purchasing. They determine cardholder liability for unauthorized use of credit cards, and they impose rules on merchants, establishing when it is worth trying to prevent unauthorized use and when it is not. These rules pervade our economy, and not only our economic society, but our social one. Of course, the rules are made by associations of banks that issue credit cards.

Very recently, the power of credit card associations has received a modicum of notoriety because of two lawsuits, both of them sounding in antitrust,¹¹⁰ as

¹⁰⁷ U.C.C. § 4-103(b) (2001). Credit for exposing the dynamics behind the payments articles in particular, and the UCC more generally, should probably go to Ed Rubin, *see supra* note 35 (citing sources); Frederick K. Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 YALE L.J. 334, 360 (1952).

As acknowledged below, Article 4 as state statutory law is subject to preemption by federal law, as has occurred to a limited extent in the field of check collection. *See Expedited Funds Availability Act*, 12 U.S.C. §§ 4001–4010 (2000); *see also* Regulation CC, 12 C.F.R. pt. 229. *See generally infra* Part V.C.1.

¹⁰⁸ *See Trans Union LLC v. Fed. Trade Comm'n*, 536 U.S. 915 (2002) (Kennedy, J., dissenting).

¹⁰⁹ *See* E-mail from Charles N. Curry, Esq., Shannon, Gracey, Ratliff & Miller LLP, to author (July 29, 2002) (on file with author); *see also, e.g.,* Rodney Ho, *Credit-Card Use to Finance Business Is Soaring, Says Survey of Small Firms*, WALL ST. J., Sept. 25, 1997, at B2 (detailing the sometimes neglected small businesses that use credit card debt for financing).

¹¹⁰ One of the cases is reported. *See United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y.), *modified*, 183 F. Supp. 2d 613 (S.D.N.Y. 2001); *see also* David A. Balto & Brian K. Grube, *The VISA-MasterCard Decision and Its Implications for High Tech Markets*, 57 BUS. LAW. 1313 (2002). The credit card associations have appealed, though the Justice Department has not. *See* Brief for the United States at 1–5, *United States v. Visa U.S.A., Inc.* (2d Cir. June 28, 2002) (No. 02-6074(L)) (page-proof version). The appeal is pending at the time of writing, and the district court has stayed its order in the meantime. *See United States v. Visa U.S.A., Inc.*, 2002-1 Trade Cases P73,586, 2002 WL 638537, at *2 (S.D.N.Y. Feb. 7,

well as the attempt to change the bankruptcy laws. Although the details of the suits are not of immediate concern here,¹¹¹ they do provide a helpful amount of information about how the credit card industry regulates itself—and a fair segment of the rest of society. As the facts show in *United States v. Visa U.S.A.*, the rules of the Visa and MasterCard associations govern the conduct of thousands of banks, which in turn impose corresponding rules on cardholders and the merchants who accept the cards.

Four companies dominate the market for credit and charge cards:¹¹² Visa, MasterCard, American Express, and Discover. Visa and MasterCard are joint ventures, each comprised of thousands of banks that issue the cards. American Express is a publicly owned company, and Discover is owned by Morgan Stanley Dean Witter.¹¹³ Visa and MasterCard will be the focus here, largely because more information is available about them.¹¹⁴

Put simply, Visa and MasterCard make rules that apply to their member banks. If the member banks do not follow the rules, they will be penalized and could be ejected from the association,¹¹⁵ depriving them of the ability to participate in the extremely profitable Visa or MasterCard product (the profit margin being about 26%).¹¹⁶ The member banks, assuming they remain in good standing, issue cards to cardholders or make agreements to work with merchants who accept the cards, or both. In its role of making cards available to consumers, a bank is an “issuer.” In its role of working with a merchant, a bank is a

2002). The other case has not yet reached a judgment but is currently pending in the United States District Court for the Eastern District of New York. *See, e.g.,* John R. Wilke, *Debit-Card Suit Now Can Proceed as Class-Action*, WALL ST. J., June 11, 2002, at A2.

¹¹¹ Some of the antitrust issues, however, are discussed further *infra* Part VII.D.

¹¹² Credit cards allow the cardholder to pay only part of the balance each month, while charge card statements must be promptly settled in full. *See Visa*, 163 F. Supp. 2d at 331.

¹¹³ *See id.* at 327.

¹¹⁴ The kind of information about the credit card industry required for this article is difficult to find. The two antitrust suits have made a fair amount of information public, although it often only hints at the facts important for present purposes. To the extent possible, I have tried to note information from the published decision in the *Visa* case. I have also relied on the helpful but relatively general account available in MANN, *supra* note 62, ch. 2, assgt. 7, as well as a few secondary articles. Much important information is closely guarded, kept as a trade secret. Some of it I have uncovered through interviews with sources in the credit card industry, both on the bank side and on the merchant side. Although the information presented here is not proprietary or confidential, these sources could be compromised by publication of their names or affiliations. Because of the need for scholarly assessment, however, I would welcome inquiries from interested scholars who need more information about these sources. Sources included lawyers or former lawyers for a major issuing and acquiring bank (one of the banks listed *supra* note 103, acting through affiliates), and for a credit card association; as well as merchants and an expert consultant to merchants.

¹¹⁵ *See Visa*, 163 F. Supp. 2d at 329, 332, 385.

¹¹⁶ *See id.* at 336.

“merchant bank” or “acquiring bank.” The rules establish fees for using the credit card system, which processes transactions, checks authorizations, and the like. The fees are collected largely through a “merchant discount” or “interchange fee,” which is collected from the merchant who accepts the card. When the merchant sends the transaction through, the merchant actually receives only ninety-eight percent of the total amount, on average. The rest is split between the merchant bank, which keeps about 0.6% for its services and allows the issuing bank to keep the remaining 1.4%.¹¹⁷ In addition to the discounts, merchants must also pay a small, flat per-transaction fee.¹¹⁸ The discounts, which can be varied for different transactions and/or different merchants, are an important mechanism for governing merchant conduct.

By rule, the credit card associations used to prohibit the use of credit cards in remote transactions. A generation ago, mail and telephone orders¹¹⁹ could not use Visa or MasterCard. The rule was thought necessary to prevent fraudulent transactions, since by mail or telephone the cardholder would not be present, and at least in some instances would not be able to provide a signature. More recently, the credit card associations have allowed merchants to accept credit cards in remote transactions, but the merchant must both pay an increased merchant discount and accept the risk of a fraudulent transaction—a risk that is ordinarily borne by the issuer.¹²⁰ This rule both makes remote transactions possible and makes them more expensive. Some of this expense is passed from the merchant to the consumer.¹²¹

Other rules require merchants to follow particular security procedures, and the rules establish fines—and they are indeed called “fines”—for violations of the rules. Internet payment security is dominated by the credit card rules.¹²² The level of security is set by these rules; a certain amount of security is provided,¹²³ but higher security has been foregone.¹²⁴ In any event, the merchants must follow the rules, and serious misconduct will result in the revocation of their ability to accept the card. That penalty could well prove fatal for certain kinds of merchants.¹²⁵

¹¹⁷ See *id.* at 332.

¹¹⁸ See MANN, *supra* note 62, at 113; see also Ronald J. Mann, *Information Technology and Non-Legal Sanctions in Financing Transactions*, 54 VAND. L. REV. 1627, 1634 n.30 (2001) (including further fee information and information on debit cards).

¹¹⁹ In the industry these are known as MOTO transactions; they now include Internet transactions as well.

¹²⁰ See MANN, *supra* note 62, at 113.

¹²¹ See *Visa*, 163 F. Supp. 2d at 337.

¹²² See *id.* at 353–57 (STT and SET technologies).

¹²³ See *id.*

¹²⁴ See *id.* at 347–53 (discussing lack of the use of chip-based smart-card technology).

¹²⁵ See *id.* at 337.

Examples of the rules could be multiplied (the chief impediment being the difficulty of getting information),¹²⁶ but these examples should suffice. Through rulemaking that is entirely private and even sometimes secret, associations of banks decide to what extent credit cards can be used for payment. They decide what level of risk is acceptable in terms of theft, fraud, and the like. They decide who should bear the risk of the fraudulent transactions. They, in short, regulate a market involving millions of companies and consumers. Their rules apply uniformly—perhaps, in terms of monitoring and enforcement, even more uniformly—than publicly made law. The rules are privately made, but they are law.

D. Its Own Little Legal World: A Weak Case, for Comparison and Definition

From the private regulation of the credit card industry we turn to much smaller associations, for purposes of comparing the effect of private rules and refining the idea of private lawmaking. Although they are not well known to the public, among scholars of commercial law a few little self-contained legal worlds have become known through the valuable research of Lisa Bernstein and others.¹²⁷ The diamond dealers provide the most glittering example.¹²⁸ Less picturesque but similar are the grain merchants,¹²⁹ the cotton industry,¹³⁰ and others.¹³¹ Let us pause a moment with the most seductive example.

The peculiar distribution method for diamonds is notorious, with stories of blood at the source of the rocks and a crushingly powerful monopoly at the root of distribution. Recent developments may have softened the story a little, but the fundamentals remain much the same. The monopolist, De Beers, sells boxes of diamonds sight unseen to diamond merchants. At that point, the diamonds enter the part of the market in which our interest lies. Before reaching ordinary retail outlets, the diamonds are bought and sold among merchants who have access to diamond “bourses” located in a few locations around the world; each bourse is a

¹²⁶ See *supra* note 114.

¹²⁷ See also HADFIELD, LESSONS, *supra* note 2, at 15–17.

¹²⁸ See Bernstein, *supra* note 7; BARAK D. RICHMAN, COMMUNITY ENFORCEMENT OF INFORMAL CONTRACTS: JEWISH DIAMOND MERCHANTS IN NEW YORK (Harvard Law Sch., John M. Olin Ctr. for Law, Econ. & Bus., Discussion Paper No. 384, 2002), available at <http://papers.ssrn.com/abstract=349040>.

¹²⁹ See generally Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996).

¹³⁰ See generally Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001).

¹³¹ See generally Bernstein, *supra* note 85.

trading club.¹³² The New York Diamond Dealers Club is one, and it formed the center of Professor Bernstein's first study.¹³³

Disputes are inevitable. The controversies are resolved not by courts but by arbitrators who are diamond merchants.¹³⁴ They have no special knowledge of or need for publicly made law. The law of arbitration does not require the arbitrators to apply the law as long as there is no serious procedural irregularity or appearance of bias.¹³⁵ Instead, the arbitrators decide "on the basis of trade custom and usage, a little common sense, some Jewish law, and, last, common-law legal principles. There are *no* general rules of damages."¹³⁶ Damages assessed against the defendant might not be paid to the plaintiff; punitive damages might be ordered to be paid to a Jewish charity instead.¹³⁷ The judgments are enforceable, if necessary, through exclusion of the recalcitrant merchant from the bourses worldwide and occasionally through prosecution before a Jewish rabbinical court. These enforcement mechanisms mean that the enforcement powers of the state (e.g., confirming the arbitration in court and initiating sheriff's sales or the like) are rarely necessary. Losing his business or ostracism from his community is a plenty powerful incentive to force compliance with the final award or, if need be, to enter the club's private bankruptcy system.¹³⁸

In many ways, these diamond merchants constitute a world unto themselves, and at least from the standpoint of most of society, they appear to have a law of their own. In this respect, they are a nice instance of privately made law. By my terms, though, they present a weak example. Because they are so separate, the law of their own is only their law. Although it might have some impact on retail diamond prices, which affect people who are not members of the exchange, the rules of the bourse are of little or no concern to anyone who is not a member; few people are members. It seems closer to the paradigm of the two-party contract than to the paradigm presented in this article, when one small group makes rules that affect many thousands or millions of others. Compared to the rulemaking done by so-called "self-regulatory organizations" like the securities markets, which in fact regulate far more than themselves,¹³⁹ the diamond dealers really are quite close to the idea of self-regulation. They rule themselves; they regulate their own transactions. They do not regulate the conduct of others. In other words, they

¹³² See Bernstein, *supra* note 7, at 117–18, 121.

¹³³ See generally *id.*

¹³⁴ See *id.* at 115, 124–26.

¹³⁵ See generally Steven J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703 (1999).

¹³⁶ See Bernstein, *supra* note 7, at 127.

¹³⁷ See *id.*

¹³⁸ See *id.* at 124–30.

¹³⁹ See *supra* Part III.B.

seem more like rules than like *law*. Pursuit of this linguistic intuition takes us to the next section.

V. CALLING IT *LAW*

So far, the argument has proceeded by example, examining varying situations across the long landscape of commercial transactions, whether involving international finance or consumer purchases. We have seen how the idea of private lawmaking works in each of those examples, and I have tried to be careful and explicit about the use of the word *law*. The word is important; the lawmaking functions that rest in private hands have, to my mind, been somewhat obscured by the otherwise informative literature on private ordering.¹⁴⁰ That much of the private ordering literature discusses non-legal enforcement through the use of norms, rather than law, has not helped to reveal the private power to make law.¹⁴¹ Although other scholarship has recognized the lawmaking power made available through standard form contracts, it has tended to focus on consumer protection issues and has pressed a narrower case. These are important phenomena, to be sure, but they differ from the private lawmaking process in question here.¹⁴²

In this part of the article, I seek to further justify use of the word *law* to describe the phenomenon discussed above. Understanding the phenomenon as mere self-regulation or private ordering is not appropriate. The artifacts of private lawmaking are not the result of bargaining over contract terms, nor do they derive from members of a body that is simply deciding how to govern itself, nor are they best described as norms. In the paradigm put forward here, particular groups succeed in governing much wider groups, as shown above, and *lawmaking* is a better descriptor. In this part of the article, the argument shifts from induction to

¹⁴⁰ Some of the leading works include: Symposium, *Law, Economics, and Norms*, 144 U. PA. L. REV. 1643 (1996); Avery Katz, *Taking Private Ordering Seriously*, 144 U. PA. L. REV. 1745 (1996) (focusing on economic efficiency); Symposium, *Empirical Research in Commercial Transactions*, 98 MICH. L. REV. 2421 (2000); and Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123 (1997) (offering a more philosophical example). See also Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319 (2002) (noting private credit ratings are used to satisfy government-established regulatory requirements). *Contra* Margaret Jane Radin & R. Polk Wagner, *The Myth of Private Ordering: Rediscovering Legal Realism in Cyberspace*, 73 CHI.-KENT L. REV. 1295 (1998); see also *infra* note 219.

¹⁴¹ See ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); see also Macey, *supra* note 140; Symposium, *Law, Economics, and Norms*, *supra* note 140.

¹⁴² See generally W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971); see also *infra* notes 146–50 and accompanying text (discussing Slawson).

linguistics, following in the line of linguistic and analytic inquiry that has lasted for generations.¹⁴³

A. *The Baggage Law Carries*

The preceding intuition—that bourse rules seem more like rules, and the UCC, UCP, clearinghouse rules, and the like seem more like law—is accurate, as more exploration will show. Before beginning, let us establish two clear poles. *First*, a country club has rules. Lots of country clubs have various rules. Those rules seem like rules, not like law. *Second*, the United States Code contains innumerable rules that certainly seem like law.

We can now begin by unpacking the intuition. Why do the bourse rules seem more like rules than like law? Part of the answer lies in their effect. The rules adopted by the bourse seem to have the effect of rules; the rules adopted by NCCUSL or the ALI or the New York Clearing House Association or Visa or MasterCard seem to have the effect of law. The rules adopted by the bourse affect a small, discrete group. The rules adopted by the other organizations affect millions of people and businesses. Those who are so regulated have little practical choice in the matter, short of using only cash. The bourse rules seem considerably closer to the country club handbook than to the United States Code.

1. *Numbers and Groups*

Several separate points come out here. *Law* ordinarily means more than the “law between the parties” in a two-party contract.¹⁴⁴ *Law* affects many people or businesses. It need not affect everyone. We have no trouble referring to the Automobile Dealer’s Day in Court Act¹⁴⁵ as a *law*, although few citizens are or aspire to be automobile dealers or manufacturers. Still, the number of parties affected certainly seems to have something to do with whether something is called a law. The examples treated in Parts II, III, and IV, except the diamond bourses and other trading clubs, affect many thousands or millions of people. The examples relied on above involve not the “law” between two parties, or among

¹⁴³ I have written elsewhere of the effect of Wittgenstein’s grammatical and linguistic insights on questions of commercial law. See David V. Snyder, *Language and Formalities in Commercial Contracts: A Defense of Custom and Conduct*, 54 SMU L. REV. 617 (2001). Readers seeking further literature on the subject should see the sources cited *id.* at 637 n.138. But much more prominent thinkers have shown its utility better than I could. See, e.g., Richard Craswell, *Do Trade Customs Exist?*, in THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 118 (Jody S. Kraus & Steven D. Walt eds., 2000) (discussing and citing the work in so-called pragmatics—better described to non-philosophers as linguistic pragmatism).

¹⁴⁴ See also *supra* note 6 and accompanying text.

¹⁴⁵ 15 U.S.C. §§ 1221–1225 (2000).

three or four, or even a hundred or a thousand. Although in some examples (e.g., letters of credit and credit cards) contract is the legal device by which the rules become binding, the typical two-party contractual paradigm is inappropriate. The two-party paradigm expands to include a few parties without too much strain. The concerns of private law do not change that much if there are, say, four parties in a sale of a house from one married couple to another, or even the more likely scenario of nine parties (once financiers, agents, and an escrowee are included). The strain comes in thinking about rules that will be imposed on thousands or millions. The examples here involve a group or body—a lawmaker—establishing uniformly applicable rules for thousands or millions of others. This is not the stuff of contract.

A focus on the parties to whom the privately made law applies should also illuminate why the two-party contractual model is inapposite to the kind of private lawmaking discussed here. More than thirty years ago, Professor Slawson argued that virtually all standard-form contracting constitutes private lawmaking.¹⁴⁶ That argument is left to the reader's judgment; the point is that here the case for private lawmaking is stronger. Professor Slawson was discussing how, for instance, an automobile manufacturer makes more warranty law in a day than Congress would dream of making, arguing that the warranty terms are imposed on the consumers by the automaker.¹⁴⁷ Paradigmatically, one party "imposes" terms on another, and does so in thousands or millions of contracts. In the cases discussed in this article, the terms are not imposed by one party on another. The terms are supplied by some private entity or body on *both* contracting parties. The ICC makes the rules that bind the banks and the other parties to a letter of credit.¹⁴⁸ Visa and MasterCard associations make the rules that bind the banks, the merchants, and the consumers to credit card transactions.¹⁴⁹ (While none of those parties have to enter such transactions, and while many of the rules are default rules, that does not make them any weaker than publicly made law, as will be discussed shortly.)¹⁵⁰ The privately made rules discussed here present a considerably stronger case of private lawmaking than a manufacturer's form.

2. General Applicability

Aside from the number of parties affected, a law is expected to have reasonably general applicability. The Automobile Dealer's Day in Court Act affects all automobile franchisors and franchisees. How generally applicable are

¹⁴⁶ See Slawson, *supra* note 142.

¹⁴⁷ See *id.* at 530–31.

¹⁴⁸ See *supra* Part IV.A.

¹⁴⁹ See *supra* Part IV.C.

¹⁵⁰ See *infra* Part V.A.3.

the examples given in Parts II, III, and IV? Compared to the Auto Dealer's Act, they are quite generally applicable. The UCP is the example with the most limited application. All of the other examples apply much more broadly, covering much of American society. What businesses are not affected by the UCC, which is the product of ALI and NCCUSL? Few can escape the effects of the stock market rules, as recent events have demonstrated with high drama. Nor is it realistic for most to avoid check rules and credit card rules.

On the other hand, a distinction is possible here. Privately made law need not be generally applicable, and a few particulars help show how. Although it may not be possible to escape credit card rules generally, it is not necessary to withdraw from the credit economy if Visa rules are objectionable. MasterCard rules might be better, or American Express or Discover. This brings up an important point with respect to privately made law: possibilities for competition in lawmaking are enhanced. Some competition exists in the arena of publicly made law because of the federalist system. The opportunities for competition in lawmaking are multiplied when the laws are made by private bodies rather than sovereign ones.¹⁵¹ This point brings up the possibilities of molecular federalism, which are treated below.¹⁵² For now, though, the point is that privately made laws are as generally applicable, often more so, than publicly made laws.

3. *Only Default Rules?*

One potential objection to the argument is that in the contract-based examples, the privately made law is not binding on anyone absent voluntary agreement. The objection, however, detracts little from the argument. In the law of contract and commercial transactions, the vast majority of the law is made up of default rules, along with some coordination principles that are subject to manipulation. Thus, even if some of the privately made law discussed above is nothing more than default rules, that fact hardly can mean that they are not properly called *law*. Much of what is commonly called law is typically made up of default rules.

So-called default rules are rules of law that can be displaced by contrary agreement. By contrast, mandatory rules are rules of law that cannot be displaced by agreement. In Contracts and Sales classes, default rules are often called gapfillers. The best example is the rule that if the parties fail to specify a place for

¹⁵¹ See generally Ware, *supra* note 135; Gary Spitko, *Gone but Not Conforming: Protecting the Abhorrent Testator from Majoritarian Cultural Norms Through Minority-Culture Arbitration*, 49 CASE W. RES. L. REV. 275 (1999); Ronald J. Krotoszynski, Jr., *The New Legal Process: Games People Play and the Quest for Legitimate Judicial Decision Making*, 77 WASH. U. L.Q. 993, 1034-42 (1999).

¹⁵² See *infra* Part VII.

delivery of goods, the seller's business is usually the place for delivery.¹⁵³ A more typical Article 2 gapfiller resorts to reasonableness. Suppose the parties want to make a contract and leave the price to be agreed later, yet the later time comes and they never come to an agreement on the price. The court can supply a reasonable price¹⁵⁴ rather than find the contract too indefinite to be legally enforced.¹⁵⁵ But in any case, if the parties agree on the place for delivery, or agree on a price, then these sections of the UCC will have no effect on the transaction. They are not relevant if there is no gap to be filled.

The familiar gapfillers of the Contracts course are just a small fraction of the default rules in the Code. The rules on implied warranties frequently are not taught as default rules, but they are. Consider the implied warranty of merchantability, under which goods sold by a dealer in goods of the kind are warranted by implication to be fit for their ordinary purpose.¹⁵⁶ The parties are free to agree, however, to an "as is" sale, in which case the goods need not be fit for anything,¹⁵⁷ assuming there are no other warranties. The implied warranties of merchantability, fitness, and even title are all subject to simple—and sometimes even implied—disclaimer.¹⁵⁸ As they are subject to variation by agreement, they are no more than default rules. The same is true of the damages rules.¹⁵⁹ Indeed almost all of the Code is taken up with default rules.¹⁶⁰

There are some mandatory rules, but there are not many, and they are not as mandatory as they might appear at first. Under the UCC, the parties cannot disclaim the "obligations of good faith, diligence, reasonableness and care."¹⁶¹ The parties may, however, set their own standards by which these obligations are

¹⁵³ "Unless otherwise agreed (a) the place for delivery of goods is the seller's place of business or if he has none his residence . . ." U.C.C. § 2-308(a) (2001); *see also* Snyder, *supra* note 143, at 635–36.

¹⁵⁴ U.C.C. § 2-305(1)(a)–(b) (2001):

The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if
 (a) nothing is said as to price; or
 (b) the price is left to be agreed by the parties and they fail to agree

¹⁵⁵ The common law before the Code often held such contracts unenforceable. *See id.* cmt. 1.

¹⁵⁶ *See id.* § 2-314.

¹⁵⁷ *See id.* § 2-316.

¹⁵⁸ *See id.* §§ 2-312(2), -316.

¹⁵⁹ *See id.* § 2-719.

¹⁶⁰ *See* U.C.C. § 1-302 (2001) (formerly § 1-102(3)) (explaining that with some exceptions, "[t]he effect of provisions of this Act may be varied by agreement"); *see also id.* §§ 4-103(a), 4A-501(a), 5-103(c).

¹⁶¹ *See id.* § 1-302 (formerly § 1-102(3)).

to be measured as long as these “standards are not manifestly unreasonable.”¹⁶² So even these few central mandatory rules are subject to redefinition by the parties. Moreover, they do not always apply. For instance, the obligation of good faith applies to the performance or enforcement of a contract or a duty, but it does not apply to all aspects of the transaction (e.g., negotiation of contract terms).¹⁶³ A bank collecting a check must exercise ordinary care in four enumerated actions,¹⁶⁴ but no provision imposes a general duty of ordinary care on banks. Moreover, parties can circumvent the mandatory rules altogether simply by opting for arbitration, a device that is becoming increasingly common.¹⁶⁵ Thus, on examination, the core mandatory rules are hardly stalwart columns.

Some other rules are not subject to variation by agreement, although again we will look in vain for any decently fortified mandatory regime.¹⁶⁶ Many of these are no more than coordination principles,¹⁶⁷ such as the rules about where to file public notices of security interests in personal property.¹⁶⁸ The parties to a transaction cannot vary such rules by agreement because the rules are largely for the benefit of those who are not party to the agreement. A potential lender contemplating a secured loan to a borrower needs a reliable rule to know where to check to see whether the borrower has already given the same collateral to another lender. If the borrower is a corporation incorporated in Delaware and the lender searches the public records in Delaware and finds nothing, the lender knows that it need not worry about another lender claiming priority in the same collateral.¹⁶⁹ The system would not work if the borrower were allowed to agree with a previous lender that public notices would be given in Alaska; giving effect to such an agreement would defeat the purpose of public notice.

Still, there is not much terribly mandatory here. True, there is something, but it is abstract: the security interest in the collateral will not be effective against third parties unless there is a public notice filed in the state of incorporation. The

¹⁶² *Id.*; see also *id.* § 4-103(a).

¹⁶³ See *id.* § 1-304 (formerly § 1-203).

¹⁶⁴ See *id.* § 4-202(a) & cmt. 1. The four actions are presentment, “sending notice of dishonor or nonpayment or returning an item,” “settling for an item,” and giving notice of loss or delay. *Id.*

¹⁶⁵ See Ware, *supra* note 135.

¹⁶⁶ See, e.g., U.C.C. § 5-103(c) (2001).

¹⁶⁷ A standard illustration of a coordination principle is that in the United States driving on the right side of the road is generally required. No principle of justice is implicated. People simply need to coordinate their actions for the sake of safety and efficiency. That the law requires driving on the left side of the road in Great Britain hardly makes it an unjust society. Everyone coordinating according to the same principle is all that matters.

¹⁶⁸ See generally U.C.C. §§ 9-301 to -307 (2001).

¹⁶⁹ See *id.* §§ 9-308 to -310(a). The example in the text is simplified. For example, it does not take account of the exceptional possibility of automatic perfection. See *id.* § 9-309. But it should serve the illustrative purpose necessary for the textual argument.

factual result of this particular rule, on the other hand, is easily manipulable. If the borrower and an earlier lender for some reason wanted Alaska to be the jurisdiction for filing public notices, they could simply incorporate a wholly owned subsidiary in Alaska and transfer the collateral to the subsidiary beforehand. Rarely is there any objection to these coordination principles. Often the parties will not care to vary a coordination rule. If the coordination principle interferes, they can often work around it.¹⁷⁰

The meaning of all of this for the current argument is that much commercial legislation is simply off-the-rack contract terms. Even putting aside the ALI and NCCUSL, the privately made rules discussed in Part IV are the same. In a way, the argument may be even stronger because the privately made terms are stronger than the legislative terms. The legislatively made terms only apply in the absence of an agreement to the contrary. As a practical matter, the privately made law will often displace any publicly made default rules, particularly in the cases where it is likely to matter. Thus, the privately made law is what is actually put into operation. It winds up having legally binding effect more than the terms contained in legislation.

This, of course, is an empirical claim, and evidence is only available to substantiate the claim in certain areas, such as letters of credit.¹⁷¹ Many other transactions are much less susceptible to counting. We know from personal experience that the legislative default rules are displaced a lot of the time. How often do we see disclaimers of consequential damages? What is harder to know—perhaps impossible—is whether consequential damages are allowed in more contracts than they are disclaimed in. It matters little, though. The primary point is that even to the extent privately made rules are merely off-the-rack contract terms, the same is true of legislation that is indisputably law. The privately made rules, in this respect too, are law.

4. *Privately Made Mandatory Rules: When Escape Is Impossible*

Not all privately made law consists of default rules or off-the-rack contract terms. The legislation mentioned in the previous section includes some mandatory rules, even if they are not terribly muscular. As we think about these weakly mandatory rules, we come to see that privately made law has both identical and similar creatures.

Identity presents the easiest case. All of the mandatory rules discussed in the previous section are privately made law in the sense that they are made by NCCUSL and the ALI. As acknowledged above, the argument must admit that a formal public intermediation is necessary. The concession is not a great one,

¹⁷⁰ A potential objection to this hypothesis (i.e., that coordination principles are innocuous) is taken up *infra* Part VI.C.2.

¹⁷¹ See *supra* note 71 and accompanying text.

however, especially with respect to the UCC, almost all of which receives the necessary approval from the public intermediary. As is also mentioned above, much the same can be said of the Restatement rules, which courts largely adopt according to the *ipse dixit* hypothesis.¹⁷² So even many mandatory rules, speaking *de facto*, are privately made.

This is not all. Begin by considering whether all privately made rules (other than the ones made by the ALI and NCCUSL) that are labeled as defaults actually are. The UCP provides an apt illustration. Its first article recognizes that the provisions are default rules. “They are binding on all parties . . . unless otherwise expressly stipulated in the Credit.”¹⁷³ The idea is essential to the nature of the UCP, which only becomes binding on the parties by the parties’ own adoption of them.¹⁷⁴ Yet the theoretical smoothness of the idea is subject to innumerable practical imperfections. Most importantly, just finding a bank of national or international repute—and such a reputation is essential to the function of the letter of credit¹⁷⁵—to issue a credit that does not incorporate the UCP verges near to impracticability. Moreover, it is beyond conception that the fundamental rules on basic liability *vel non* could be varied.¹⁷⁶ Is it possible to conceive of an issuing or confirming bank that is not liable to pay a credit according to its terms (subject, of course, to the qualifications in the UCP itself)?¹⁷⁷

To the extent that credits not governed by the UCP are unavailable, the UCP becomes the essential law of letters of credit. Pause a moment here to consider the effect of this state of affairs. For association members, that is, members of the Banking Commission of the International Chamber of Commerce, the effect is that adherence to the Commission-made rules (i.e., the UCP) is practically required in order to stay in the business of letters of credit. It perhaps bears mentioning that these constituents are large international banks or associations of banks. The alternatives are to try to effect change in the rules, which is theoretically possible, as the UCP is revised every decade or so,¹⁷⁸ or to defect from the ICC-imposed regime, which is also theoretically possible but practically

¹⁷² See *supra* note 29 and accompanying text.

¹⁷³ See UCP 500, *supra* note 72, art. 1.

¹⁷⁴ See *id.* (explaining that the UCP “shall apply to all Documentary Credits . . . where they are incorporated into the text of the Credit”).

¹⁷⁵ See U.C.C. § 2-325(3) (2001); see also *supra* Part IV.A (explaining the purpose of letters of credit and how they work).

¹⁷⁶ See UCP 500, *supra* note 72, arts. 7, 9.

¹⁷⁷ See *id.* art. 9(a)–(b).

¹⁷⁸ The UCP was originally promulgated in 1933, with revisions promulgated in 1951, 1962, 1974, 1983, and 1993. The UCP 500, which is the 1993 version, remains effective, although a 12-article supplement for electronic transactions took effect April 1, 2002. See *id.* at inside front cover; UCP 500 + eUCP COMPREHENSIVE BOOK VERSION (2002). Another revision is currently being discussed. Telephone interview, *supra* note 84.

questionable. Those who are not constituents have only the latter alternative, which is not much of a choice, unless they think they can influence the revision process.¹⁷⁹ If we assume that a business needs letters of credit—and that need applies to many buyers and sellers, especially those doing business internationally—then it must abide by the UCP.

The situation is much the same in other examples, and they in some ways present clearer cases. A diamond merchant must obey the “mandatory” rules of the bourse or forego the benefits of the exchange, which would be damaging and very possibly fatal to his business. The credit card associations are the same too. Participants, whether members of the association or not, must adhere to the mandatory rules or be excluded. Privately made law has at least as much bite as publicly made law.

5. *A Thought Experiment*

In concluding this part of the argument, a thought experiment may be helpful. It is drawn from reality, although somewhat stylized here for the sake of simplicity.¹⁸⁰ Suppose a longstanding federal statute gives persons a right or entitlement, *X*, which accrues when a person buys something. While nothing in the statute prohibits waiver of the entitlement, the Supreme Court has held that a mere notice by the seller or manufacturer does not suffice to do so. A contract, however, can result in a waiver. Eventually, virtually all sales contain a contractual waiver of *X*. The courts uphold the waivers.

Now, in this state of affairs—and it portrays accurately almost all scenarios, since the law rarely prohibits waivers outright—what is the *law*? A lawyer who tells a buyer-client, “Federal law says you have *X*,” gives incomplete advice that does not pass the test of competence. A competent lawyer, knowing the federal statute but also having seen the contract, and knowing the others like it and the decisions upholding them, would probably have to say, “Under the law, you do not have *X*.” In only a theoretical sense is the *X* entitlement still the law. In practical terms, the law has given the buyer nothing. Private lawmaking, through

¹⁷⁹ Telephone interview, *supra* note 84 (explaining that extensive surveys are involved, with the possibility for input from many banks and other players); *see also* UCP 500, *supra* note 72, at 5 (“[T]he Working Group’s analysis was conducted by utilising various information sources available to the banking industry and the transport industry, and by drawing upon [the Working Group members’] own considerable knowledge.”).

¹⁸⁰ It was inspired by Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 IND. L.J. 1125, 1130 (2000). Many readers will see that my not-so-hypothetical example is drawn from the current controversy over potential contractual modification of the rights afforded by the first-sale doctrine first announced by the Supreme Court and eventually codified in the Copyright Act. It is not too far removed from other contexts, however, such as the Magnuson-Moss Act. *See* Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301–2308, 2310(d)(2) (2000).

nothing more than customary form terms, has undermined statutory law. It happens all the time.¹⁸¹

B. *Sovereignty and the State*

Law carries associations of sovereignty, so to some it may seem nonsensical to speak of privately made law. Thinking explicitly of the role of the sovereign may help, and it will also help show the limits of the argument advanced here. I fully admit that the sovereign could refuse to honor privately made law, whether in the form of restatements, megalateral contracts,¹⁸² or plain old contracts. Further, legislation and common law shape the way public institutions—which still monopolize coercive legal power—view the law agreed by parties to a contract; their agreement will be viewed through the lenses of the parol evidence rule or the unconscionability doctrine.¹⁸³ To some, these admissions may make it wrong to speak of a contract as creating any sort of law. Those who would take such a position would have a heavy fight, since courts have been referring to contracts as “the law between the parties” for ages.¹⁸⁴ The law agreed by the parties is their law, but within limits, just as publicly made law has its own limits (like federal and state constitutions, doctrines of implied repeal, and so on). To see the limits on private lawmaking does not lead one to think that the power is very limited; at bottom it leads to an appreciation for how much latitude current law and politics accord to private lawmaking.¹⁸⁵

Instead of taking on such a battle, let us instead be practical and realistic. Although the state could refuse to honor privately made law, it does not. Politically, doing away with private parties’ ability to make contracts is not on the

¹⁸¹ See, e.g., Marcel Kahan & Michael Klausner, *Antitakeover Provisions in Bonds: Bondholder Protection or Management Entrenchment?*, 40 UCLA L. REV. 931 (1993). Although done in a different context, this empirical study shows how broadly used bond terms in a time of aggressive corporate takeovers protect management more than shareholders (who might be thought to enjoy statutory protection) or bondholders (for whom extra-contractual protection was contemplated). Certainly this study also shows that contractual terms can be displaced by mandatory publicly made law, but as explained in the immediately following sections, this fact does not detract much from the argument in the text.

¹⁸² Megalateral contracts refer to the identical contracts to which thousands or millions of parties assent, such as identical credit card rules imposed by contract on millions of contracting parties.

¹⁸³ See HADFIELD, LESSONS, *supra* note 2, at 5–7.

¹⁸⁴ See, e.g., *Oil Field Supply & Scrap Material Co. v. Gifford Hill & Co., Inc.*, 16 So. 2d 483, 484 (La. 1943); see also White, *supra* note 1, at 189–90.

¹⁸⁵ Unconscionability provides a nice example. Courts are accorded broad regulatory power to police contracts by UCC section 2-302. The power is rarely invoked; the cases doing so have achieved the status of curiosities. See David L. Shapiro, *Courts, Legislatures, and Paternalism*, 74 VA. L. REV. 519, 534–35 (1988); Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 752 (1982).

table.¹⁸⁶ The idea is worthy of consideration in some academic circles, perhaps, but such a move is not within the realm of current possibility, and that is the realm in which this article seeks to operate. The state has ceded enough sovereignty to private parties to make these private agreements. Plus, the state has agreed to enforce these privately made agreements (within limits, which are discussed below). So we might see the situation as something of a sandwich,¹⁸⁷ and the state brings the bread. Between the two pieces of bread—that is, between (1) the state’s cession of sovereignty to make a binding agreement and (2) the state’s willingness to enforce that agreement—is the interesting part of the sandwich.¹⁸⁸ The meat of it is privately made. Put simply, the state is a necessary part of the formula, but the actions of the state are dictated by privately made rules.

C. Objections and Concessions

The argument advanced above is hardly bulletproof, and a number of objections could easily be raised. This section of the article recognizes some of the objections and answers them. Other objections require some concessions, which can be made without detracting too much from the argument. Perhaps the most logical starting point is that privately made law is subject to change by publicly made law.

1. Changing Private Law

True, publicly made laws can certainly preempt privately made law. In most cases, a legislative or judicial decision can simply abrogate a privately made rule or substitute a publicly made one. Sometimes the public power is broad, such as the ability of Congress to regulate commerce.¹⁸⁹ Sometimes public power is more limited, but still powerful, as with SEC oversight of the rules of the securities exchanges.¹⁹⁰ The same is just as true of publicly made law, so this objection is

¹⁸⁶ Realistic commentators seem to confine any regulatory exhortations to drawing attention to particular terms or to correcting for market breakdowns. *See, e.g.,* Radin, *supra* note 180, at 1161–62.

¹⁸⁷ Thanks to Tayyab Mahmud, who suggested the sandwich analogy, although he was using it to try to explain why my argument is wrong.

¹⁸⁸ It is of course possible to emphasize the bread, and ultimately the emphasis must be a matter of taste. HADFIELD, LESSONS, *supra* note 2, at 5–9 concentrates, to my mind, on the bread.

¹⁸⁹ *See* U.S. CONST. art. I, § 8, cl. 3.

¹⁹⁰ The power of the SEC in this regard is contained primarily in the Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78s (as amended in 1975), but it has been limited to some extent by *Business Roundtable v. SEC*, 905 F.2d 406, 407 (D.C. Cir. 1990), which seems to have seriously chilled the SEC in some respects. The argument in the text does not depend on a

not terribly strong. In other words, privately made rules are subject to displacement by public authorities, but so are publicly made rules, which we would certainly call law. That privately made rules are subject to displacement does not make them any the less law. Let us examine the objection and the facts.¹⁹¹

First consider state law,¹⁹² which typically governs most transactions classified under the headings of contract and commercial law, and to a large but lesser degree, the law of corporations and securities. State law governs these transactions only as a matter of tradition. Since the transactions fall squarely, even literally, within the power of Congress under the Commerce Clause, federal legislation is possible.¹⁹³ In fact Congress has exercised its power in numerous statutes, all of which preempt state law under the Supremacy Clause.¹⁹⁴ Federal intervention is so common that the specifics are too numerous to list usefully. Some examples include Magnuson-Moss, which preempts the UCC rules on disclaimers of warranties as well as the usual American rule for attorneys' fees,¹⁹⁵ the Truth in Lending Act, which regulates the consumer liability rules for credit cards,¹⁹⁶ and the Electronic Fund Transfer Act, which does the same for debit

tightly constrained SEC, however. The argument still holds as long as Congress and the SEC allow the exchanges to exercise a significant amount of rulemaking power.

¹⁹¹ Here we will leave aside the points that much publicly made law is theoretically subject to change by private parties, and that privately made law, while also subject to such change, is probably changed much less frequently. These points have already been addressed above. *See supra* Part V.A.3. (default rules).

¹⁹² *State law* here refers to law publicly made by a state or commonwealth of the United States (e.g., by the courts or by the legislature, acting on their own, and not simply adopting what was handed them by the ALI or NCCUSL). It is not the same as "state-created law," as that phrase is used by Professor Bernstein. *See* Bernstein, *supra* note 7, at 115.

¹⁹³ U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."). On the question of federalization of commercial law, see, for example, E. Hunter Taylor, Jr., *Foreword: Federalism or Uniformity of Commercial Law*, 11 RUTGERS-CAM. L.J. 527 (1980); and Neil B. Cohen & Barry L. Zaretsky, *Drafting Commercial Law for the New Millennium: Will the Current Process Suffice?*, 26 LOY. L.A. L. REV. 551, 557-61 (1993). For discussions opposing federal intervention, see Norman Silber, *Why the U.C.C. Should Not Subordinate Itself to Federal Authority: Imperfect Uniformity, Improper Delegation and Revised Section 3-102(c)*, 55 U. PITT. L. REV. 441, 446-54 (1994); and Overby, *Modeling UCC Drafting*, *supra* note 37, at 684-87.

¹⁹⁴ *See* U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land.").

¹⁹⁵ *See* Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301-2308, 2310(d)(2) (2000).

¹⁹⁶ *See* 15 U.S.C. §§ 1631-1649 (2000); *see also* Federal Reserve Board Regulation Z, 12 C.F.R. pt. 226 (2002).

cards.¹⁹⁷ Before Congress stepped in, state law permitted private parties more freedom to structure their transactions, and those private parties took advantage of that freedom. Congress changed the state law through its preemptive power to regulate commerce, and thus changed the terms of countless transactions.

Even aside from the subjection of state law to federal law, the ways that various publicly made laws can be displaced by other publicly made law can easily be multiplied. State law can preempt local law, and in the commercial context this power distribution has had a lot of bite recently. Local jurisdictions that have attempted to regulate so-called predatory lending have sometimes found their laws gutted by state laws protecting peddlers of mortgages and snake oil.¹⁹⁸ Courts and legislatures, even within the same jurisdiction, constantly seesaw in a never-ending game of law changing. Even when the Supreme Court plays the trump card—invoking the Constitution—the seesaw slows but the teetering is hardly over.¹⁹⁹

Not only is there the usually unrealistic possibility of constitutional amendment, there is the possibility of what might be termed temporal preemption: the ability of a later lawmaker to undo the work of an earlier one. The Supreme Court, like other courts, can overrule itself.²⁰⁰ What one legislature does can be undone by a later legislature. So, while privately made rules are subject to subsequent change by the government, so are publicly made rules. I will grant the small concession that privately made law is a little lower in the great hierarchy. Theoretically, therefore, it is more ephemeral than publicly made law. From a practical (i.e., empirical) standpoint, we do not know whether privately made law is displaced more frequently or in more important ways than publicly made law. Publicly made law and privately made law are subject to subsequent change.²⁰¹ Both are in fact changed, with reasonable frequency and

¹⁹⁷ See 15 U.S.C. §§ 1693–1693r (2000); see also Federal Reserve Board Regulation E, 12 C.F.R. pt. 205 (2002).

¹⁹⁸ The reference in the text is intentionally vague, maleficent predatory lending being difficult to distinguish from beneficial subprime lending. See generally Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002). For examples of state laws preempting local laws that attempt to regulate predatory lending, and the ongoing battles in this arena, see, for example, 2001 Ohio HB 386, Ohio 124th Gen. Ass., reg. sess. (approved by the governor Feb. 22, 2002); and Teresa Dixon Murray, *Cleveland Wins Round on Lending Law; Court Move to Block Mortgage Law Rejected*, PLAIN DEALER (Cleveland), July 27, 2002, at C1.

¹⁹⁹ See, e.g., *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 557 (1985) (overruling *Nat'l League of Cities v. Usery*, 426 U.S. 833 (1976)); see also *United States v. Morrison*, 529 U.S. 598, 645–46 (2000) (Souter, J., dissenting). See generally Richard H. Fallon, Jr., *The “Conservative” Paths of the Rehnquist Court’s Federalism Decisions*, 69 U. CHI. L. REV. 429, 430 nn.2–3 (2002).

²⁰⁰ See sources cited *supra*, note 199.

²⁰¹ The problem of change, including legal change, is a large and complex subject involving both public and private attempts to regulate that change. See David V. Snyder, *The*

fair import. But both remain useful tools for planning conduct and resolving disputes. Both are appropriately called *law*.

2. *Inertia, Custom, and Usage of Trade*

The previous section required a small qualification. I am prepared to grant more. First, default rules contained in legislation are preexisting, and they might be sticky.²⁰² Although the parties can displace any default rule by agreement, and much of the law of contracts and commercial transactions consists of default rules, displacing them can be difficult, expensive, or both. This is easiest to see in disclaimers of implied warranties. As mentioned above, the UCC provides that a sale of goods by a dealer in such goods will carry an implied warranty that the goods are fit for their ordinary purpose, among other things.²⁰³ The merchantability rule is only a default rule, however; the parties can displace it. To do so they must jump through certain hoops. Mere agreement is not enough; magic words help, as does a conspicuous disclaimer.²⁰⁴ These special rules make it more difficult and more expensive to change the default.

An analogy may help. In the previous section we saw that the public legislature could bar a route that private parties might otherwise take, and might even bar a route that everyone takes. The public legislature might also choose a lesser step. It might not completely bar the path, but it might put up a warning by the path, using more or less dire language depending on the state-perceived dangers. Or the public legislature might require everyone who wants to take the path to obtain a permit or to meet certain qualifications. The state might even put an obstacle in front of the path, requiring people to get around it or move it. Legislatures have done all of these things, in various ways.

For the most part (although not entirely),²⁰⁵ these sorts of moves are within the power of public lawmakers but not private ones. The legislature can choose to take the first spot, to make everyone go to the trouble and expense of displacing

Law of Contract and the Concept of Change: Public and Private Attempts to Regulate Modification, Waiver, and Estoppel, 1999 WIS. L. REV. 607; see also E. ALLAN FARNSWORTH, CHANGING YOUR MIND: THE LAW OF REGRETTED DECISIONS (1998).

²⁰² See Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583 (1998). Here I am putting aside the argument that most of the relevant legislation is in fact privately made. The point is made *supra* in Part II.A.

²⁰³ See U.C.C. § 2-314 (2001).

²⁰⁴ See *id.* § 2-316(2)–(3). A conspicuous disclaimer may be required according to some views, and making the disclaimer conspicuous certainly helps, but the statute does not expressly require that all effective disclaimers be conspicuous. See *id.*

²⁰⁵ See Korobkin, *supra* note 202, at 1605–06 (on inertia of form contract terms).

the publicly made rule. This may even have certain benefits as well as costs.²⁰⁶ In other words, just as the public lawmakers have the power to displace privately made law, they have the power to take advantage of inertia. They can put the burden on the parties to agree otherwise, and the agreement to act otherwise requires an investment on the part of the private players because agreement is costly.

This objection does not carry as much weight as it might, however. It can be no greater objection than the previous one (that a public lawmaker can change the privately made law and displace it with publicly made law) as it posits a public lawmaker doing something less than completely displacing the privately made law. Moreover, public lawmakers have ceded a great deal of their power in this regard through doctrines of usage and custom.

The current law of usage of trade is most familiar. Every transaction within the UCC is presumed to include any applicable usage of trade, which is defined as “any practice or method of dealing having such regularity of observance . . . as to justify an expectation that it will be observed with respect to the transaction in question.”²⁰⁷ The key rule is contained in the definition of *agreement*, which under the UCC includes usage of trade.²⁰⁸ The parties are theoretically free to displace usage of trade by express agreement,²⁰⁹ but this is easier said than done. Effective displacement requires at least that the parties “carefully negate” the usage.²¹⁰ Because of this doctrine, any privately made rule that rises to the level of usage of trade—and several of the examples discussed in Part IV may do so, and are even so labeled—they (rather than publicly made law) gain the advantage of inertia. Custom is itself privately made law.

More too might be said in response to this objection, with a wider geographic view and a greater historical depth. Centuries of legal thought and legislative action show that custom is itself law in a similar if lesser sense than legislation. Often there will be no publicly made legislation to take advantage of inertia, and in all such instances any prevailing custom will be the law to be displaced. When

²⁰⁶ The literature on penalty default rules is large. The seminal article is Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87, 91 (1989).

²⁰⁷ See U.C.C. § 1-303(c) (2001) (formerly § 1-205(2)).

²⁰⁸ See *id.* § 1-201(b)(3) (2001) (following largely former § 1-201(3)) (“‘Agreement’ means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act.”).

²⁰⁹ See *id.* §§ 1-303(e), 2-208(2)–(3).

²¹⁰ See *id.* § 2-202 cmt. 2. See generally Snyder, *supra* note 201, at 632–38 & n.121 (collecting authorities).

deciding disputes, courts have turned to custom since time out of mind.²¹¹ Custom, the product of private action, has been recognized for centuries as *law*.

3. *The Authority of Privately Made Law*

When we speak of law, we refer to something authoritative. We are accustomed by long tradition to see law as the product of king, parliament, and court,²¹² brought on by social contexts from baronial power bids in the Middle Ages²¹³ to progressive political triumphs near the reach of our own memories. Curiously, we consider the concept modern through a simple adjustment in vocabulary, thus accommodating democratic American innovations, and by the remarkably single addition of the administrative agency to the list of lawmakers.²¹⁴ Yet while we legal pedestrians have treated the law and its history as a matter of rules and technicalities with lives of their own, masters recognize the law in the mouths of its individual makers.²¹⁵ When those makers are great men or powerful institutions, the authority is easy to see and their product is what we are most used to calling *law*.

Yet privately made law carries its own authority, and by comparison the publicly made default rules may seem less authoritative. For it is a curious kind of law that parties can agree to displace, and we have already noticed that much contract and commercial law is no more than that. As far as default rules go, the most authoritative is likely the most immediate. Publicly made default rules are the most remote. The rules confected by an actor's own community or association are likely to carry much greater weight. Deviation from those readily accessible, perhaps even internalized customs—norms—will likely prove more difficult than stepping away from distant public solutions that are probably accessible only

²¹¹ This phenomenon occurs in both civil law and common law. *See, e.g.*, S.F.C. MILSOM, *HISTORICAL FOUNDATIONS OF THE COMMON LAW* 2 (2d ed. 1981); A.N. Yiannopoulos, *Legislation and Custom as Sources of Law: The Louisiana Experience*, in *ESSAYS ON EUROPEAN LAW AND ISRAEL* 201 (Alfredo M. Rabello ed., 1996); *see also* H.L.A. HART, *THE CONCEPT OF LAW* 246 (1961); Michael Akehurst, *Custom as a Source of International Law*, 47 *BRIT. Y.B. INT'L L.* 1 (1977); Symposium, *Responding to the Legal Obstacles to Electronic Commerce in Latin America: General Questionnaire*, 17 *ARIZ. J. INT'L & COMP. L.* 23 (2000) (documenting Latin American sources). For a current reassessment, using more new-fangled tools, see Francesco Parisi, *Sources of Law and the Institutional Design of Lawmaking*, 19 *J. PUB. FIN. & PUB. CHOICE* 95 (2001) (considering “three main sources of law, namely, (a) legislation; (b) judge-made law; and (c) customary law”).

²¹² *See generally* SIR FREDERICK POLLOCK & FREDERIC WILLIAM MAITLAND, *THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I* (reissued 2d ed. 1968).

²¹³ *See, e.g., id.* at 179–80.

²¹⁴ MILSOM, *supra* note 211, at xxiii–lxxiii. Once pious heresy, *see id.* at xxv, acclamation has now made the view orthodox.

²¹⁵ *See id.* at lxxi (“[Maitland] listened for his Alan and Bernard, his circumspect Roger and blundering Ralph.”).

through the expensive intervention of legal advice. In terms of practical authority, privately made rules seem to compare well with publicly made ones.

4. *Only a Piece of a Piece of the World*

The most important qualification is that these arguments are limited in scope. They have been limited to certain areas of the law of contracts, corporations, securities, and commercial transactions. Perhaps many areas of the law are different, being pervaded or even monopolized by publicly made law. The objection is a cogent one.

The argument here has proceeded by induction, citing examples to demonstrate a principle that applies more widely than the examples themselves. An inductive argument cannot answer questions about how far private lawmaking extends, leaving such questions to the reader's knowledge and imagination.²¹⁶ Partly as an instrument in that effort, I have also pressed a linguistic argument, thinking about what artifacts or processes we can suitably call *law*. No doubt such visual musing about linguistic intuition is a risky business, far removed from the nearly tangible logic of Euclidean geometry. Such methods are not without basis, however,²¹⁷ and the law, famously, is not susceptible to geometrically logical analysis.²¹⁸ The arguments here are limited, and they need to be, but they should suffice for the limited purpose here. First, I have sought to show that some law is privately made. I do not suggest that all law is privately made, or even that all contract or commercial law is privately made. As the introduction states, this article simply seeks to expose a phenomenon that exists broadly enough that we should care. The second purpose of the article is to show how that care might be expressed: enough law is privately made that we should ask questions of it just as we ask questions of publicly made law. That is the task of the next part.

VI. STANDARD QUESTIONS

We—citizens, lawyers, and especially academicians—are accustomed to questioning publicly made law. Yet privately made law gets off easy. It is less visible. But since it has the effect of law, it is just as appropriate a target as publicly made law—possibly more so, since it is not the product of public processes. I begin the project of asking questions in this part of the article, but this can only be a beginning, and the ideas in this part are only meant to sketch the

²¹⁶ Given recent events, the private lawmaking role of the Financial Accounting Standards Board is on the minds of many. Numerous scholarly papers have mentioned FASB, although many are not yet in print. A valuable and early entry to reach print is Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319 (2002).

²¹⁷ For authorities, see *supra* note 143.

²¹⁸ See OLIVER WENDELL HOLMES, JR., *THE COMMON LAW* 1 (1881).

kind of inquiry that might be pressed but has not been so far.²¹⁹ Since we are only beginning to see privately made rules as law, more research and thought will be required before better answers can be advanced.²²⁰ Nevertheless, a beginning seems useful as a way to suggest a path for future work.

A. *How Well Does Privately Made Law Work?*

The scholarly literature is filled with careful analysis of whether publicly made rules work well: whether they are efficacious, whether they further sound policy, and (above all, lately) whether they are economically efficient. For the most part, the real objects of this work are specific rules, announced in particular cases or promulgated in particular statutes or regulations. To some degree, however, these kinds of questions can be asked on a broader scale. Realizing that we are sketching in rough strokes, a few observations are possible.

Private rulemaking, one suspects, would work relatively well in a number of contexts. As already noted, much private rulemaking focuses on default rules. Probably the best way to make default rules is to tailor them to the preferences or even preexisting practices of particular groups. To the extent those groups are able to legislate for themselves, and in so doing to displace the publicly made

²¹⁹ Cf. HADFIELD, LESSONS, *supra* note 2, at 47. Because she sees private lawmaking as “futuristic” (i.e., in the world of cyberspace), *see id.* at 1, or past, except for occasional “pockets” like trade associations, *see id.* at 15, or stock exchanges, Professor Hadfield does not see much current privately made law to question. Much of her work focuses on how private lawmaking should be fostered. *See id.* at 47–63. This is an important undertaking, but different from the one suggested here. In very recent work, Professor Hadfield has directed a number of questions at the ICANN process of private lawmaking, assessing the ICANN experience according to the principles developed in her earlier pieces. *See* Gillian K. Hadfield, *Privatizing Commercial Law: Lessons from ICANN*, 6 J. SMALL & EMERGING BUS. L. 257, 264–67 (2002). Because she considers legitimate private lawmaking to be confined to the economic role of law (and thus the promotion of efficiency), Professor Hadfield does not address the democratic values that I seek to pursue here. *See id.* at 263 (stating the aim is “to explore whether it is possible and desirable to privatize the legal regime generating those legal rules that, as a matter of public interest, have efficiency as their *only* goal”) (emphasis in original); *see also id.* at 267.

²²⁰ Little of the scholarship undertakes this broad task, as much of the private ordering literature focuses primarily on efficiency and other relatively narrow views of legitimacy. *See, e.g.,* Katz, *supra* note 140, at 1745 (“For economists and economically influenced lawyers, this typically means focusing on economic efficiency.”). Steven L. Schwarcz, however, has begun to question private ordering in ways consonant with those suggested here, and he concentrates on the kinds of checks typically associated with administrative lawmaking (e.g., notice and comment, direct government oversight), which is not emphasized—or advocated—here. *See* Schwarcz, *supra* note 216, at 324–45. A different analysis is offered in Macey, *supra* note 140. Another project takes on a similar task in the international arena. *See* Robert O. Keohane & Joseph S. Nye, Jr., *Between Centralization and Fragmentation: The Club Model of Multilateral Cooperation and Problems of Democratic Legitimacy* (Feb. 2001) (unpublished manuscript, on file with the John F. Kennedy School of Government, Harvard University).

default rules, the process seems attractive. It is more likely to achieve the goal—Llewellyn's goal—of molding law to commerce, and of molding the publicly made law to immanent commercial norms.

A separate but related point is that private rulemaking seems likelier to be nimble, responding more quickly, flexibly,²²¹ and efficiently.²²² Markets are more likely to respond appropriately with optimal levels of regulation through competition, rather than relying on the bureaucratic (and monopoly-prone) chop of the state and the lawyers who can practice state-made law.²²³ In the past decade or so formerly closed markets have opened. Businesses have had to adapt. Electronic commerce was invented. The world spun past the law, creating immeasurable friction. The law is changing and politicians have anxiously catered to new needs. But public institutions have been slow, and there is some real value in being slow,²²⁴ especially for the public lawmaker. Perhaps private institutions can be faster, or at least involve less wasted effort.²²⁵ They might also be able to avoid the entropic tendencies of law²²⁶ that push the common law into ever greater complexity.²²⁷

This point in turn raises some important examples. As political bodies sought to foster the new electronically based economy, especially during its boom days, screens filled as new laws scrolled by at rates beyond comprehension. Some states rushed in with digital signature statutes. Perhaps the most prominent was the Utah Digital Signature Act, which was passed in 1995.²²⁸ It has been largely irrelevant. The statute sought to implement a particular standard and to establish a

²²¹ For a brief consideration, see Lawrence, *supra* note 10, at 654–55.

²²² The economists' work on private ordering suggests efficiency is relatively well served by the competition enabled by private lawmaking, although some work also shows how inefficiencies can result as well. See sources cited *supra* note 140. See also Hadfield & Talley, *supra* note 2.

²²³ See generally Hadfield, *The Price of Law*, *supra* note 2; HADFIELD, LESSONS, *supra* note 2, at 38–47. For a cautionary note, see Hadfield, *supra* note 219. Cf. James Boyle, *A Nondelegation Doctrine for the Digital Age?*, 50 DUKE L.J. 5 (2000); Tamar Frankel, *The Managing Lawmaker in Cyberspace: A Power Model*, 27 BROOK. J. INT'L L. 859 (2002); Jay P. Kesan & Rajiv C. Shah, *Fool Us Once Shame on You—Fool Us Twice Shame on Us: What We Can Learn From the Privatizations of the Internet Backbone Network and the Domain Name System*, 79 WASH. U. L.Q. 89 (2001); Jonathan Weinberg, *ICANN and the Problem of Legitimacy*, 50 DUKE L.J. 187 (2000).

²²⁴ See, e.g., Suzanna Sherry, *Haste Makes Waste: Congress and the Common Law in Cyberspace*, 55 VAND. L. REV. 309, 315–16 & nn.19–21 (2002); see also Neal Devins, *Congress as Culprit: How Lawmakers Spurred on the Court's Anti-Congress Crusade*, 51 DUKE L.J. 435, 436 (2001); Francesco Parisi et al., *The Value of Waiting in Lawmaking* (2001) (unpublished manuscript, on file with the George Mason University School of Law).

²²⁵ See Hadfield, *Privatizing Commercial Law*, *supra* note 2, at 41.

²²⁶ Hadfield, *The Price of Law*, *supra* note 2, at 1002.

²²⁷ See Hadfield, *Privatizing Commercial Law*, *supra* note 2, at 44.

²²⁸ See Utah Digital Signature Act, §§ 46-3-101 to -504 (2002).

coordination principle for making binding electronic contracts.²²⁹ The market has been slow to put the technology to such a use, however, and the purported coordination principle never became sufficiently generalized to be useful.²³⁰ Instead, most states followed the first private lawmaker on the scene. In 1999 NCCUSL promulgated a technologically neutral Uniform Electronic Transactions Act.²³¹ More than forty states adopted it by 2002, including Utah.²³² Now further private coordination is being sponsored and encouraged,²³³ which by all lights and recent experience seems a superior method of achieving coordination than through public legislation. But this example is just one among many. Publicly made law seems continually to disserve the developing economy.

A further related point comes up here. Privately made law, at least in a number of instances, may be less likely to result in freezing or “encrustation,” as some scholars have put it.²³⁴ Charles Goetz and Robert Scott have worried that statutory and judicial encouragement and recognition of immanent commercial law result in custom becoming rigid. This result can follow from simple path dependence; following the status quo is easier than innovation, and a free ride on previous effort can be nice.²³⁵ By simply following past practice, commercial customs can thus freeze or become encrusted. What may be the worst example, as

²²⁹ See *id.* § 46-3-102(3), (4).

²³⁰ See, e.g., MANN & WINN, *supra* note 62, at 289–91; Jane K. Winn, *The Emperor's New Clothes: The Shocking Truth About Digital Signatures and Internet Commerce*, 37 IDAHO L. REV. 353 (2001).

²³¹ See UNIF. ELEC. TRANSACTIONS ACT § 2, cmt. 4 (1999).

²³² Something of a wrench was thrown in when Congress passed the Electronic Signatures in Global and National Commerce (E-SIGN) Act, 15 U.S.C. §§ 7001–7031 (2000). To some degree the federal act gives way if a state adopts UETA. See 15 U.S.C. § 7002(a)(1) (2000). The questions are complex, however, and unnecessary for the present inquiry.

²³³ See *Industry Consortium Hopes to Issue Draft Guidelines on E-Authentication by Mid-Year*, 8 Elec. Com. & L. Rep. (BNA) 60 (Jan. 22, 2003); *Industry Guidelines for Electronic Signatures, Records Seek to Promote Online Contracting*, 7 Elec. Com. & L. Rep. (BNA) 858 (Aug. 28, 2002).

²³⁴ See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 288–305 (1985); see also Clayton P. Gillette, *Harmony and Stasis in Trade Usages in International Sales*, 39 VA. J. INT'L L. 707, 721–32 (1999); Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. REV. 813 (1998); Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 J. LEGAL STUD. 377 (1997); Snyder, *supra* note 143, at 630–31.

²³⁵ See generally Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting* (or “the Economics of Boilerplate”), 83 VA. L. REV. 713 (1997); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998); Korobkin, *supra* note 202; Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479 (1998).

usual,²³⁶ comes from UCC Article 4. It validates as *prima facie* ordinary care the adherence to any “general banking usage not disapproved by this Article.”²³⁷ Such a provision discourages innovation by legally deeming a bank that ventures past established usage to have sailed outside the safe harbor of ordinary care.²³⁸

Private lawmaking is obviously no solution to the general problem. Much of the freezing that takes place is a result of the actions of the private lawmakers themselves. The worst example is itself a product of private lawmaking. Perhaps it is not the most private since it is the product of the generalist NCCUSL rather than a specialized association, but it is privately made nonetheless, and all the more so since the fingerprints of the banks’ lobbyists are unusually prominent. But the kind of lawmaking that is at the most private end of the continuum would seem most likely to be adapted and revised as the world changes and practices develop. This is a matter of conjecture, but it surely seems easier for an industry association to innovate than to get legislation passed in Congress or the many states.

B. Law Outside Paradise: Conjectured Costs and Benefits

This is simply more conjecture, but it seems plausible to guess that in many circumstances private lawmaking will be a relatively inexpensive process. Private lawmaking cannot be compared to some perfect law handed down costlessly as legal manna in paradise. Privately made law would seem to have two principal competitors for comparison: publicly made law and two-party contracts.

Privately made law is certainly not free. How the investment is made and how much is required will vary with the circumstances, and we do not and probably cannot know how much it costs to make privately made law. But picturing the bodies that make privately made law, and considering their processes—especially when thinking of focused industry groups that do not dally with outsiders—we may well guess that the rules are a lot cheaper than the alternatives. The other options would be legislation drafted from scratch in fifty states, or canned legislation in fifty states that was drafted and supplied by a central source. Sometimes, at least, private lawmaking is likely to be considerably less time consuming and expensive than public lawmaking.

Negotiating many discrete contracts is the other possibility. Anything requiring actual negotiation is likely to be expensive and time-consuming, especially when per-transaction costs are multiplied over thousands or millions of transactions. It is easier, of course, to impose terms in adhesionary two-party contracts. But it is easier and cheaper still to centralize the formulation and drafting across many parties. The tentative conclusion has to remain: we cannot

²³⁶ See *supra* Part IV.B (discussing UCC § 4-103).

²³⁷ See U.C.C. § 4-103(c) (2001).

²³⁸ See MANN, *supra* note 62, at 91–92.

know for sure, and we certainly cannot know generally. But a significant amount of the time, private lawmaking seems likely to be cheaper than the alternatives.

C. Respect for Autonomy

A typical question to ask of publicly made laws is whether they respect individual choice, and if they do not, whether the law is worth the sacrifice of autonomy. The answers for privately made laws appear mixed.

1. Escape and Competition

As a theoretical matter, privately made laws only have legal meaning for those who voluntarily opt into the private regime. Parties will be subject to the UCP only if they sign documents voluntarily submitting themselves to that private regime. People are subject to the credit card rules only if they agree to be bound by those rules. Because these privately made rules are meaningless without an autonomous election into their regime, they would seem to show perfect respect for autonomy. And the rules of the UCC and the Restatements are only binding to the extent they are adopted or followed by public lawmakers, who would presumably compromise autonomy only where necessary. The theoretical answer is rosy on the autonomy score.

What makes all of these privately made rules look like law, however, is that they are widespread in the economy and difficult or virtually impossible to escape. On this more practical level—and the argument throughout has been on this level—escape is impracticable. Staying free of the UCP in a letter of credit transaction will be a tall order. Few individuals in our economy still function only with paper money. Of those few, even fewer do so by choice. The UCP and the credit card rules, as a practical matter, are not escapable.

On the other hand, the potential for competition provides some reassurance. If the UCP rules were bad in some significant way for a meaningful segment of the market, the market would presumably provide a solution (for an appropriate price). Similarly, if another way of conducting consumer-type credit transactions were preferable to the credit card rules, an efficient market would make the alternative available. In other words, to the extent choice is economically important, privately made rules remain open to competitive alternatives. While these other options may be expensive to develop, that fact does not take away from autonomous choice. A party who prefers the alternative only slightly will instead take advantage of the existing (and nearly free) privately made rules. A party who prefers the alternative more strongly will be willing to pay. It is a matter for autonomous choice, constrained only by the fact that certain choices are less expensive than others.

Rules made by private legislatures like NCCUSL and the ALI are not open to the same kinds of competitive pressures as rules like the UCP or the credit card

industry. Under the *ipse dixit* hypothesis, the product of these private lawmaking bodies becomes legally indistinguishable from publicly made law, except with respect to the lawmaking process itself. In other words, because these rules actually gain the public imprimatur, they in effect are publicly made laws. What can be said for them is that the examples we have considered generally accord a fair amount of respect to autonomy. As we have noticed, their great bulk is comprised of default rules, which are subject to change in accord with autonomous decisionmaking, or coordination principles, which are discussed next.

2. *A Note on Coordination Principles*

This article argued above that coordination principles are generally innocuous in the sense that parties do not generally care to exercise choice on issues governed by coordination principles. We do not care whether we drive on the right side of the road or the left, just so long as everyone follows the same rule. To the extent parties care about such issues, coordination principles are frequently subject to manipulation.²³⁹ Coordination principles, in other words, are important, but they are not particularly important to the arguments here.

On the other hand, in some situations coordination rules could conceivably impinge on autonomy. This fact is essentially neutral, however, as privately made coordination rules work the same as publicly made ones. Still, the point is worth stating: sometimes parties will want to change the coordination principles, and in some cases those principles will be insusceptible of the kind of change that the parties would like. For example, records of security interests in personal property are generally indexed according to the debtor's name.²⁴⁰ This system works well when the loan and the collateral are centered on a known debtor. Frequently, for example, a single loan is made to a single debtor, which offers many items for collateral. One filing against the debtor is helpful; the alternative—filing many notices, one against each item of collateral—would be unwieldy. So for many transactions this system seems to work fine.

In some settings, though, a debtor-centered system is inconvenient and dangerous. Who the debtor is and what its name is can become difficult questions, for instance, when trusts or individuals are concerned. In some cases, an asset-centered system may work much better. Instead of filing a notice under the debtor's name, the secured party would file a notice under the asset itself (e.g., in the title registry with respect to a particular automobile, or in the copyright registry with respect to a particular movie). A lender would not have to worry about whether the debtor's name is James Gibson Wheeler or Jim Wheeler or J.G. Wheeler or the like. He would not have to worry about whether the trust

²³⁹ See, e.g., *supra* notes 167–69 and accompanying text.

²⁴⁰ See U.C.C. §§ 9-503 cmt. 2, -506(c) (2001).

owns property or the trustee owns the property. The lender can simply look up the record for a car with a unique vehicle identification number and thus feel considerably safer. Similarly, a lender to a film venture would not have to concern itself with precisely what entity holds the copyright, which can be particularly problematic if the copyright is transferred to multiple business entities from the conception, revision, production, distribution, and archiving of the film. A lender might feel safer filing the notice of the security interest in one central place for the whole country, where any other potential lender or buyer would know to look.

We can see, then, that sometimes a debtor-based system works best and sometimes an asset-based system works best. Our law implements these principles through the general debtor-based rule under Article 9,²⁴¹ subject to asset-based rules in particular areas.²⁴² The law reflects the idea that different methods of filing and search will work better or worse depending on the context. In some instances, however, the parties will not be satisfied with the state of the rules. While we might assume that asset-based filing works best for copyrights—at any rate, that is the state of the law—in some copyright lending situations, the system is grossly inconvenient, if not downright impractical. If a lender is taking as collateral a whole film library, consisting of 145 films, 145 filings will be necessary in an asset-based system. Only one filing would be necessary in the usual Article 9 system.²⁴³ Yet the parties cannot change the coordination principles by exercising autonomous choice.

The design of coordination principles, while usually innocuous,²⁴⁴ may impinge upon autonomy sometimes. But this is the nature of coordination principles—and even rules themselves²⁴⁵—and privately made rules do not appear to be any different from publicly made ones. Some people may find it more convenient to drive on the left side of the road, but it is more important to have a rule that is simple enough for everyone to know and follow than to honor autonomy in this situation.

²⁴¹ See *id.*

²⁴² See *id.* § 9-311; Nat'l Peregrine, Inc. v. Capitol Fed. Savs. & Loan Ass'n (*In re Peregrine Entm't, Ltd.*), 116 B.R. 194 (C.D. Cal. 1990) (Kozinski, J.); Copyright Act, 17 U.S.C. §§ 101, 201, 205 (2000).

²⁴³ See *In re National Peregrine, Ltd.*, 116 B.R. at 202 n.10.

²⁴⁴ See *supra* Part V.A.3.

²⁴⁵ A particularly useful but often overlooked analysis is in Frederick Schauer, *Rules and the Rule-Following Argument*, 3 CAN. J.L. & JUR. 187 (1990), reprinted in WITTGENSTEIN AND LEGAL THEORY 225 (Dennis M. Patterson ed., 1992).

3. *Paternalism*

On this count some difference may be observed between legislative rules and contractual rules.²⁴⁶ Although both sets of rules betray occasional signs of paternalism, the tendency seems more pronounced in legislative rules. Contractual rules appear to tend away from paternalistic concerns, with the chief exceptions apparently market-driven, which would suggest that they are not paternalistic after all. Rather, they are bargained-for, valued terms, in the sense of being demanded by the market. One interesting question, as will appear, is exactly which market demands the concession, or better put, which competitive forces are at work.

As one would expect, the UCP evinces little paternal solicitude, and presumably the parties to letters of credit should rarely be in need of much parental guidance.²⁴⁷ The story is much the same with the diamond dealers' rules, which even cut off resort to public bankruptcy protection for anyone who hopes to remain viable in the business.²⁴⁸ Other contractual rules, such as those in the credit card context, show little if any parental concern. On many views, in fact, the credit industry does just the opposite, enticing the consumer with attractive introductory rates only to thrust up the rates later—a business practice that hardly shows the kind of concern associated with parents. The credit card industry employs some devices that are even more deceptive.²⁴⁹

Some of the credit card rules do protect consumers, and that of course is the interesting part of the story. Two instances demonstrate two different market-related ideas. In one, the credit card associations put in place a rule limiting cardholder liability for unauthorized transactions with a debit card. Although federal law would permit considerably greater liability,²⁵⁰ the credit card associations limited consumer liability to fifty dollars.²⁵¹ Apparently because

²⁴⁶ Recall that the phrases *legislative rules* and *contractual rules* are defined *supra* Part I.

²⁴⁷ Cf. *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1289 (7th Cir. 1985) (“[R]efusal to enforce penalty clauses is (at best) paternalistic—and it seems odd that courts should display parental solicitude for large corporations.”).

²⁴⁸ See Bernstein, *supra* note 7, at 128–29.

²⁴⁹ Even the Office of the Comptroller of the Currency found some practices beyond the pale. See *Consumer Credit—Credit Cards: Providian National Bank Settles OCC Charges of Unfair and Deceptive Credit Card Practices, Greenspan Says Agencies May Use FTC Act to Target Banks' Unfair, Deceptive Practices*, 70 U.S.L.W. 2777 (June 11, 2002) (reporting the \$330 million fine of Providian National Bank of San Francisco for unfair and deceptive practices in violation of Federal Trade Commission Act § 5, 15 U.S.C. § 45).

²⁵⁰ Electronic Fund Transfers Act § 909(a), 15 U.S.C. § 1693g(a) (2000); Federal Reserve Board Regulation E, 12 C.F.R. § 205.6 (2002).

²⁵¹ See, e.g., Saul Hansell, *Visa Reduces Liability on Lost or Stolen Debit Cards*, N.Y. TIMES, Aug. 14, 1997, at D4 (noting Visa and MasterCard reduction of liability to \$50—or zero if reported quickly—and threat of federal legislation).

federal lawmakers were considering changes to the publicly made rules, the credit card associations moved first, regulating the relationships between themselves, the cardholders, and the merchants before Congress could change the regulatory landscape.²⁵²

Another instance demonstrates how the credit card associations moved as an apparent concession not to potential competitive lawmaking but to cardholder demand. Consumer fears about Internet fraud were hampering the ability of the credit card associations to capture the consumer Internet payment market (B2C or B2P). As an apparent response to these consumer concerns, and perhaps in a reaction to moves by American Express, the Visa and MasterCard associations implemented zero-liability schemes for fraudulent credit card transactions over the Internet. Consumers evidently felt reassured, and credit cards now occupy virtually all of the B2P payment market, despite earlier predictions that credit cards could not work on the Internet²⁵³ as well as ongoing efforts by Web-based companies to move into the payments market.²⁵⁴ Competition again drove the rulemaking.

On the legislative rulemaking end, more paternalism is apparent. Whether this seeming pattern is anything more than accidental is hard to tell. Llewellyn put quite a fair amount of paternalist legislation in the earlier drafts of the UCC; some but not all of it survived the hearing and enactment process.²⁵⁵ Probably the most prominent example is the unconscionability rule,²⁵⁶ which (at least as applied) prevents some people from making certain presumably bad choices.²⁵⁷ These paternalistic traces are not limited to Llewellyn²⁵⁸ or the UCC. The *Restatement (Second) of Contracts*, in one of its more controversial provisions,²⁵⁹ shows similar concern about the hapless victim of the ubiquitous form contract. Under the *Restatement* rule, unexpected terms in a form fail to become part of the contract if they are sufficiently important.²⁶⁰ The members of the ALI, at the

²⁵² See Electronic Fund Transfers Act § 909(a), 15 U.S.C. § 1693g(a) (2000), which remains unchanged.

²⁵³ See, e.g., MANN, *supra* note 62, ch. 2, assgt. 16.

²⁵⁴ See generally MANN & WINN, *supra* note 62, at 457.

²⁵⁵ See Kamp, *Downtown Code*, *supra* note 18.

²⁵⁶ See U.C.C. § 2-302 (2001).

²⁵⁷ See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 450 (D.C. Cir. 1965) (Danaher, J., dissenting).

²⁵⁸ See U.C.C. § 2A-108 (2001).

²⁵⁹ See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981); James J. White, *Form Contracts Under Revised Article 2*, 75 WASH. U. L.Q. 315, 323 (1997); cf. Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 458–59 (2002).

²⁶⁰ Technically, the rule is slightly more complicated, or at least circumlocutory:

same time that they expect parties to be bound to agreements regardless of whether they have read or understood the documents,²⁶¹ attempt to protect such people from any significant folly.

To some observers, the private lawmaking process is particularly prone to such paternalism, fraught as the ALI and NCCUSL are with left-leaning academics.²⁶² Certainly one may see such tendencies in the process, but the final outcomes seem to be considerably softened by business interests that appear thoroughly capable of protecting their interests.²⁶³ Softened even unto mush, one might say.²⁶⁴ Too much consumer protection could turn the privately made rules into academic debates²⁶⁵ rather than privately made law. The bottom line seems to be that privately made law, at least in the examples under examination here, shows some traces of paternalist tendencies, but they rarely rise to the point of raising serious concerns about respect for autonomy. Closely related to paternalist concerns—what may in fact be the same concern, differently stated—arises from problems of exclusivity.

D. *Exclusivity and Equality*

Although privately made legislative rules seem innocuous enough, in that they usually reach a general adoption level that approximates publicly made laws and thus raise few exclusivity problems, many contractual rules raise grave issues of exclusivity, and thus of equality. A number of private lawmaking regimes

Where the other party has reason to believe that the party manifesting assent [to a writing when he has reason to believe like writings are regularly used to embody terms of agreements of the same type] would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.

RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

²⁶¹ See *id.* § 211(2).

²⁶² As the former reporter for the Article 2 revision has said (with tongue perhaps only partly in cheek), at least the first part of the process was perceived as being shaped by “a bunch of liberal law professors.” See Audio tape: Proceedings of Joint Session of Sections on Contracts and Legislation, Association of American Law Schools: Statement of Richard E. Speidel (Jan. 7, 2001) (on file with Cleveland State University Law Library).

²⁶³ See Richard E. Speidel, *Revising UCC Article 2: A View from the Trenches*, 52 HASTINGS L.J. 607, 617 (2001). See generally Symposium, *Perspectives on the Uniform Laws Revision Process*, 52 HASTINGS L.J. 603 (2001) (including views of Fred Miller, Gail Hillebrand, Lance Liebman, Henry Gabriel, Neil B. Cohen, and Robert E. Scott); Linda J. Rusch, *A History and Perspective of Revised Article 2: The Never Ending Saga of a Search for Balance*, 52 SMU L. REV. 1683 (1999).

²⁶⁴ This is largely the view of Schwartz and Scott, *supra* note 10, as Jean Braucher noted, see Symposium, *Questions and Answers*, 52 HASTINGS L.J. 691, 699 (2001).

²⁶⁵ See James J. White, *Comments at the 1997 AALS Annual Meeting: Consumer Protection and the Uniform Commercial Code*, 75 WASH. U. L.Q. 219 (1997).

envision an economic club (and what some might call a cartel).²⁶⁶ Some aspects of this clubbishness raise antitrust concerns, which receive treatment separately.²⁶⁷ The issue for the moment is the kind of exclusivity that has more paternalist and efficiency-related concerns in mind, although we should note clearly that this supposedly “benign” exclusivity could easily have the same monopolistic or oligarchic effects.

Perhaps the problem might be described by analogy to a private garden. The commons is the place of tragedy.²⁶⁸ The private garden is the place for idylls. Readers who have enjoyed some probing London walks will know the private garden: it is often a fenced green space in a city square, surrounded by graceful well-kept townhouses. The fence has a gate, and the gate is locked. Often dense shrubbery lines the inside of the fence, but a peek through a break will reveal a space that is beautiful and green. The garden is not open to the public. It is owned by an association of private parties, frequently the proprietors of the surrounding townhouses. The garden is exclusive, membership being confined to those who can afford it, those who have a sufficient stake in it, those who will treat it well, perhaps even those who will not detract too much from its atmosphere. Too many people would undo the privacy of the garden, condemning it to the commons tragedy. If the commons is tragic, why not a private garden?

Commerce knows private gardens too. The New York Diamond Dealers Club is a commercial private garden. It is kept small enough to be manageable. Even qualified merchants are excluded.²⁶⁹ We might call this an efficiency concern: too many traders would be unwieldy and inefficient. Sufficiently small groups help establish reputations that make doing business easier and more efficient.²⁷⁰ Reputation is particularly important in contracting contexts, since the legal remedy is undercompensatory.²⁷¹ In smaller groups helpful shortcuts and customs can also become readily established.

²⁶⁶ See John R. Wilke, *Debit-Card Suit Now Can Proceed as Class Action*, WALL ST. J., June 11, 2002, at A2 (quoting plaintiff’s counsel with respect to “credit-card cartel”); see also *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y.), *modified*, 183 F. Supp. 2d 613 (S.D.N.Y. 2001).

²⁶⁷ See *infra* Part VII.D.

²⁶⁸ See Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243, 1244–45 (1968); see, e.g., ELINOR OSTROM, *GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION* 182–84 (1990). Of course the anti-commons can have tragedies of its own. See, e.g., Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621 (1998).

²⁶⁹ See Bernstein, *supra* note 7, at 119.

²⁷⁰ See *id.*; Richman, *supra* note 128; Clayton P. Gillette, *Reputation and Intermediaries in Electronic Commerce*, 63 LA. L. REV. 1165 (2002).

²⁷¹ The law school orthodoxy is that expectancy damages are awarded in contracts cases, putting the aggrieved party in the position it would have occupied had the contract been kept. See E. ALLAN FARNSWORTH, *CONTRACTS* § 2.1 (3d ed. 1999). In reality the damages are

Other private gardens are essentially paternalist in nature. This is the case with the select group of people known as accredited investors. Special opportunities for investing are reserved for these accredited investors, who are generally institutions or “high net worth individuals.”²⁷² The returns are high, but so are the risks. Hoi polloi are thus excluded. It is for their own good, after all; they would not understand the risk involved. (But they will not enjoy the gains either.)²⁷³ This example illustrates the paternalistic urge behind exclusivity.

Let us now see how these principles might hypothetically be put into operation in the context of private lawmaking. The New York Diamond Dealers Club is predominantly Jewish,²⁷⁴ and observation suggests that a large number are Orthodox Jews.²⁷⁵ For the sake of efficiency (and all the other goodies that go with small and exclusive clubs), confining membership to the Orthodox might make excellent sense. Perhaps the rule might be slightly better tailored by confining membership to those who speak Yiddish fluently. That way non-Jews would not be excluded on grounds of religion, and a fair number of Jews would be excluded, since many Jews would lack the language skills. As important business is actually conducted in Yiddish,²⁷⁶ this would be an eminently sensible rule, one might argue. Everyone could understand each other; members would be working within their own communities of discourse;²⁷⁷ unusual customs and hours would not seem odd,²⁷⁸ and everything would be very efficient. Moreover, ignorant Christians, Muslims, Jews, and others would be protected from the

seriously undercompensatory. *See, e.g.*, *United States v. Stump Home Specialities Mfg., Inc.*, 905 F.2d 1117, 1121–22 (7th Cir. 1990) (Posner, J.).

²⁷² *See* Rule 501(a), 17 C.F.R. § 230.501, Rule 506(b)(2)(ii), 17 C.F.R. § 230.506 (2002); *see also* 17 C.F.R. § 230.144A (2002). *See generally* Securities Act § 4(2), 15 U.S.C. § 77d(2) (2000). Some scholars suggest a similar rule to protect homeowners from inappropriate loans by imposing a “suitability” requirement. *See Engel & McCoy, supra* note 198.

²⁷³ Theoretically hoi polloi might participate by engaging a qualified “purchasers representative.” *See* Rule 501(h), 17 C.F.R. § 230.50(h). The practical effect of this theoretical possibility, however, is limited. At the very least, it raises a barrier to entry, and the barrier is imposed on those most likely to be deterred by added cost because, by definition, they do not enjoy high net worth.

²⁷⁴ *See Rabinowitz v. Olewski*, 473 N.Y.S.2d 232, 234 (N.Y. Sup. Ct. 1984).

²⁷⁵ *See Richman, supra* note 128, at 9.

²⁷⁶ *See Bernstein, supra* note 7, at 121 (“[H]andshake accompanied by words *mazel u’broche* creates a binding agreement.”) I am grateful to Professor Jeffrey Veidlinger for linguistic assistance.

²⁷⁷ *See Snyder, supra* note 143, at IV.B; *see also* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 882 (1992); Richard A. Epstein, *Confusion About Custom: Disentangling Informal Customs from Standard Contractual Provisions*, 66 U. CHI. L. REV. 821, 824 (1999).

²⁷⁸ Orthodox Jews need to stop work Friday afternoon to prepare for the Shabbos, which takes place from Friday at sundown until Saturday at sundown. During the Shabbos, no work (as defined by recondate religious law) is allowed.

inevitable missteps, misunderstandings, and mistakes—some potentially quite costly—that would arise from doing business with the Orthodox.

From the standpoint of respect for equal human worth and dignity, of course, this hypothetical rule would border on the egregious. This kind of judgment is expressed in the 1866 Civil Rights Act, in which the right to contract and to own property is protected without regard to race and religion, among other things.²⁷⁹ Innumerable state laws express similar judgments, including the laws that would apply in New York.²⁸⁰ And to be clear, the New York Diamond Dealers Club has no such rule,²⁸¹ and I presume would certainly never consider one. Still, the kind of private lawmaking power that we accord to groups through the power of contract raises these sorts of questions. Whenever we allow private gardens—and they are beautiful—questions of exclusivity and equality arise.

E. Representation: Maybe a Little, Haphazardly

The most obviously troubling aspect of privately made laws is that they are privately made. They are not a product of public democratic processes, except in occasional haphazard ways. Often, the sponsoring organizations for legislative rules like the idea of representation and make efforts to include those who might be affected. The sponsors will even subsidize some groups in order to hear their voices. The makers of contractual rules tend to be less magnanimous.²⁸²

The clearest example of the exclusive lawmaking process of contractual rules is the credit card rules. Not only are they not subject to public input when they are made, they are kept secret. Although the rules will affect many people aside from the rulemakers, the rulemaking is done by a group that excludes many of the affected parties. Slightly less extreme is the UCP. It is a product of a working group within the Banking Commission of the ICC and in the end was made by ten men, almost all of whom represent banks or associations of banks. All are

²⁷⁹ 42 U.S.C. § 1981(a):

All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens

²⁸⁰ N.Y. EXEC. LAW § 296 (Gould 2002); N.Y. CITY ADMIN. CODE § 8-101 (McKinney 2002).

²⁸¹ In fact, about 10% of members are not Jewish. See Richman, *supra* note 128, at 9 n.24 (citing Robin Pogrebin, *Struggling to Bring Back the Glitter*, N.Y. TIMES, Aug. 23, 1998, § 14, at 1).

²⁸² See Miller, *supra* note 35. For a different take on the question of democracy in private lawmaking, see Slawson, *supra* note 142. Professor Slawson sees the democratic question as revolving around the real agreement of the two parties to the contract. See, e.g., *id.* at 530; see also *supra* notes 146–47 and accompanying text (discussing Slawson).

European or British in affiliation, save one. Nine represent banks (or associations of banks) or are bankers. The tenth was an ICC employee, who provided staff support.²⁸³

In considering the impact of private lawmaking on representation, it is useful to remember who the lawmaking bodies are. The ALI does not purport to be representative or democratic. The founding ideal was the opposite. The ALI founders set out to fix the law that resulted from public and democratic processes, and they aimed to do a better job at lawmaking than could happen without their elite guidance. The last thing the ALI founders wanted was a political lawmaking process answerable to the populace.²⁸⁴ So the ALI is not a representative lawmaking body, and historically, at least, it has not aimed to be.

The National Conference is a bit different, although it certainly has its own elitist aspects.²⁸⁵ It is quasi-political, in the sense that the governor appoints the commissioners from most states.²⁸⁶ Some might say it is a governmental organization,²⁸⁷ or even a democratic body;²⁸⁸ primarily NCCUSL insiders, and most prominently, its former executive director take this line.²⁸⁹ The funding comes from state appropriations, grants, and royalties on the UCC.²⁹⁰ While the funding through state appropriations may give NCCUSL the appearance of governmental status, it is not part of any government. And in terms of funding, the reliance on royalties from the UCC, its most successful product, emphasizes its private nature. Governments do not habitually depend upon royalties derived from asserting intellectual property rights in and charging money for the laws they produce.

Regardless of how public or political these private lawmaking bodies claim to be, their vulnerability to industry influence is inevitable. It has become common enough to discuss whether interest groups have “captured” legislatures or agencies, and this sort of question is now leveled with some frequency at the ALI and NCCUSL.²⁹¹ The mere prospect of capture in the enacting statehouses

²⁸³ See UCP, *supra* note 72, at 6; Telephone Interview, *supra* note 84. For a mild qualification (about the use of surveys and soliciting comments from affected parties or industries), see *supra* note 178.

²⁸⁴ See Lance Liebman, *The ALI and the UCC*, 52 HASTINGS L.J. 645, 647 (2001) (quoting G. Edward White, *The ALI and the Triumph of Modernist Jurisprudence*, 15 LAW & HIST. REV. 1 (1997)).

²⁸⁵ See White, *supra* note 10, at 2096–97.

²⁸⁶ See Fred Miller, *The View from Experience*, 52 HASTINGS L.J. 621, 623 (2001).

²⁸⁷ *Id.* at 621.

²⁸⁸ Neil B. Cohen, *Taking Democracy Seriously*, 52 HASTINGS L.J. 667 (2001) (conflating the NCCUSL process with democracy).

²⁸⁹ Fred Miller was the executive director of NCCUSL through 2001. The current executive director is William Henning.

²⁹⁰ Miller, *supra* note 286, at 623.

²⁹¹ See, e.g., Schwartz & Scott, *supra* note 10, at 643; see also *supra* notes 35–37.

may effectively render the private lawmaking bodies the objects of capture themselves.²⁹² A subsidiary point of this article, though, is that in many important instances, no capture is needed. Capture implies that a once independent being has been reduced to possession or control. The organizations that make the credit card rules and that formulate the practices for letters of credit were never public bodies captured by a particular industry. So when we broaden the view to include private lawmaking bodies other than the ALI and NCCUSL, we can see that many were born in captivity.

Even for the ALI and NCCUSL, which purport to make decisions independent of the wishes of industry or other special interests, capture is a constant theme. It has been discussed ably elsewhere,²⁹³ and this is not the place to rehash the arguments. However, in summary it is worth noting that the arguments, which are at least plausible and to many convincing, suggest that wealthy, well-organized groups exert disproportionate power.²⁹⁴

Capture is not unique to private lawmaking bodies. Public bodies are even more prominently accused.²⁹⁵ The question becomes whether private lawmaking bodies—at least those that were not born in captivity—are easier to capture than public ones. The answer appears complex, and certainly too complicated to consider in detail here. The easy observation is that the answer is likely to vary according to the characteristics of the different lawmaking bodies—and, not to be forgotten—the characteristics of the group attempting the capture.

Scholars have only begun to consider these questions. As discussed above, Professors Schwartz and Scott have compared the private lawmaking process of the UCC with potential public analogs. And as Professor Janger has argued, NCCUSL and the ALI may be effectively captured more easily because they need to anticipate potential capture of (at least some) statehouses. On the other side of the equation, the putative captors are differently placed. Wealthy business or industry groups seem to have a decided advantage when the playing field is larger.²⁹⁶ That is to say, when the lawmaking process is more protracted and diffuse, ranging over many years or many states, the wealthy seem to have more success. Less wealthy and more diffuse interest groups seem to do better in Congress, which, whatever its faults, is located in one place. Certainly there are

²⁹² See Janger, *supra* note 35, at 579; Larry T. Garvin, *The Changed (and Changing?) Uniform Commercial Code*, 26 FLA. ST. U. L. REV. 285, 359–60 (1999).

²⁹³ See *supra* notes 35–37 (collecting conflicting authorities).

²⁹⁴ For the most part, these are the authorities cited *supra* note 35.

²⁹⁵ See generally GORDON ADAMS, *THE POLITICS OF DEFENSE CONTRACTING: THE IRON TRIANGLE* (1981). For a collection of authorities, see Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L.J. 31, 42 (1991); and Ronald J. Krotoszynski, Jr., *The Inevitable Wasteland: Why the Public Trustee Model of Broadcast Television Regulation Must Fail*, 95 MICH. L. REV. 2101, 2117–18 (1997).

²⁹⁶ Gail Hillebrand, *What's Wrong with the Uniform Law Process?*, 52 HASTINGS L.J. 631 (2001).

countless examples of the UCC giving the advantage to business or banking interests, with countervailing consumer protections to be found in reactive and preemptive federal legislation. Rules on warranties of goods,²⁹⁷ availability of funds,²⁹⁸ and protection from creditors' remedies²⁹⁹ quickly come to mind.

The problem of capture, then, while fitting snugly under the rubric of representation, is really a separate issue. Public bodies whose representativity is monitored with extraordinary care, such as the United States House of Representatives, appear just as subject to accusations of capture. But this fact should not diminish the unavoidable fact that private lawmaking will be representative in, at best, a haphazard way. Some private rulemaking organizations might constitute themselves in such a way as to achieve good representation. Some will not. Whether they do seems irrelevant to their success in getting their privately made rules accepted as law. The purportedly "state governmental" body of NCCUSL has had no more success than the avowedly elitist ALI.

As we cannot depend on representation as a justification for private lawmaking,³⁰⁰ the alternative justification—and perhaps a better one, given the vulnerability of representative bodies to capture—is competition. Representation does not work well; can competition work better? Theoretical arguments suggest that it might. Whether theory will survive the marketplace is, as always, a more difficult question. At the moment—before too much reality interferes—there is reason for optimism. The hope comes from viewing competitive lawmaking as a form of federalism.

VII. MOLECULAR FEDERALISM

A. *Competitive Private Lawmaking*

The hopeful side is premised on the potential for bottom-up lawmaking,³⁰¹ and the necessarily non-exclusive character of truly private lawmaking. The

²⁹⁷ See Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301–2308, 2310(d)(2) (2000).

²⁹⁸ See Expedited Funds Availability Act, 12 U.S.C. §§ 4001–4010 (2000).

²⁹⁹ While state law often emphasizes creditors' rights, the rights of consumer debtors have traditionally received significantly better protection under the federal bankruptcy laws. Perhaps the most useful debtor-protection citation is 11 U.S.C. § 362 (2000), providing an automatic stay of creditors' collection actions the instant that someone files for federal bankruptcy protection.

³⁰⁰ For consideration of the representation question in contexts very different from those discussed here, see Lawrence, *supra* note 10, at 669–72.

³⁰¹ See JAY P. KESAN & ANDRES A. GALLO, OPTIMIZING INTERNET REGULATION (Univ. of Ill. Coll. of Law, Law & Econ., Working Paper No. LE02-001, 2003), available at <http://papers.ssrn.com/abstract=289668> (discussing and analyzing both regulatory models).

usual, public lawmaking model depends on some public body deciding what the law is and announcing it in the appropriate mode (enacting a statute, promulgating a regulation, issuing an executive order, handing down a judgment). Although in the United States most public lawmaking bodies have at least some pretense at representation and accountability, this model is top-down lawmaking. The rule is authoritatively made by the public authority, which is the apex of the pyramid; and the rule will apply to everyone in the jurisdiction, the wide base of the pyramid. This is the form of our representative, republican democracy, and seems inherent in public lawmaking where direct democracy is impracticable.³⁰²

By contrast, in a private, competitive lawmaking scheme, different putative private lawmakers can compete for adherents. Those adherents could be legislatures, courts, or contracting parties. If the terms of the UCP became objectionable to enough users of letters of credit, they could seek alternatives through the marketplace. Less simply, they could devise their own regime, which they could publish and incorporate as a contractual term in letters of credit. In any event, competition remains possible. Obviously the ICC and the UCP may have considerable advantages because they came first.³⁰³ The effects of path dependence in private lawmaking will make themselves felt as in public lawmaking.³⁰⁴

The obstacles to reform are not nearly as great with private lawmaking, however. No new legislation is required, no reversal of judicial precedent, no instigation of an administrative agency. Market participants simply need to convince—whether through force of argument or more straightforwardly, by paying a price—a counterparty to accept a different regime. Just as citizens (including corporate citizens) are not bound to stay in a state, they are not bound to a private legal regime. Terms of some kinds of corporate contracts may become so highly standardized as to become law, in a sense: If issuance of corporate bonds requires Terms *A* and *B* because of standardized expectations, where *A* and *B* come to have legally standard judicial meanings, then terms *A* and *B* are law just as much as a state law that says that issuance of large bonds requires board approval. Yet exit to another state, or paying a higher interest rate

Less hopeful about private lawmaking, albeit in the different context of legal development (or lack thereof) through increased arbitration, is Chris A. Carr & Michael R. Jencks, *The Privatization of Business and Commercial Dispute Resolution: A Misguided Policy Decision*, 88 KY. L.J. 183 (1999–2000) (arguing that since the common law aids commercial development and privatizing dispute resolution stunts the growth of the common law, privatized dispute resolution is misguided).

³⁰² See DONALD KAGAN, *PERICLES OF ATHENS AND THE BIRTH OF DEMOCRACY* (1991) (discussing classical Athens, the most prominent example of direct democracy). For the idea of direct democracy, see *id.* at xiii, 1–2.

³⁰³ Cf. *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 353 (S.D.N.Y. 2001).

³⁰⁴ Cf. *supra* note 235 (citing sources).

in order to avoid terms *A* and *B*, both remain viable. American experience has witnessed all of these phenomena. With molecular federalism, the consumers of the laws are always free to make other laws of their own.³⁰⁵

In this way, privately made laws give hope for bottom-up lawmaking, that is, lawmaking done by the consumers rather than by the state. The laws come from the base of the pyramid, not the apex. By this light, everyone is a potential lawmaker. Whether the potential lawmaker becomes an actual lawmaker is simply a question of whether enough other parties decide to join the regime. That dynamic raises the idea of molecular federalism. Just as private lawmaking should be subject to question and criticism, it also holds great potential. With good reason, Americans can be enthusiastic about federalism. Molecular federalism, based on the small-scale compounds of private lawmaking, offers similar potential. To understand the molecular dynamic, let us first consider the shape of public federalism.

B. *Federalism and Public Lawmaking*

Federalism in the United States is a double phenomenon. In its first aspect, power is divided between the national government (the federal government) and more local governments (the states). In its second aspect, the power of the states is allotted to many entities (about fifty at the moment, depending on how one counts), each of which is sovereign in its jurisdiction. The second aspect is subject to the first; the sovereignty of each state within its own borders is subject to the power conceded to the nation.³⁰⁶ In other words, federalism has a vertical aspect (the first) and a horizontal aspect (the second).³⁰⁷

Federalism permits experiments in democracy,³⁰⁸ but viewed differently, it allows for competitive lawmaking. For the lawmaking to take on a fully

³⁰⁵ See generally Kahan & Klausner, *supra* note 235; Klausner, *supra* note 235; Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 J. LEGAL STUD. 377 (1997).

³⁰⁶ This power derives from the Supremacy Clause, U.S. CONST. art. VI, cl. 2, subject to whatever limits there are on federal power. See generally *id.* amends. X, XI; *United States v. Morrison*, 529 U.S. 598 (2000) (invalidating Violence Against Women Act); *United States v. Lopez*, 514 U.S. 549 (1995) (invalidating Gun-Free School Zones Act).

³⁰⁷ On the horizontal and vertical characterization, see Kevin H. Smith, *Justice for All?: The Supreme Court's Denial of Pro Se Petitions for Certiorari*, 63 ALB. L. REV. 381, 409 n.101 (1999) (citing, *inter alia*, Dan L. Burk, *Federalism in Cyberspace*, 28 CONN. L. REV. 1095, 1100 (1996)).

³⁰⁸ See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (“It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory and try novel social and economic experiments.”); see also FELIX FRANKFURTER, *THE PUBLIC AND ITS GOVERNMENT* 49 (1930) (“[O]ur federalism calls for the free play of local diversity in dealing with local problems.”); Akhil Reed Amar, *Five Views of Federalism: “Converse-1983” in Context*, 47 VAND. L. REV. 1229 (1994) (elaborating on this point).

competitive character, we need to conceive of consumers of laws. Although perhaps a bit strange, the concept is not too difficult. Parties can, within limits, choose the law that will apply to their transaction. Courts generally honor choice of law clauses, at least if the chosen jurisdiction bears a reasonable relation to the transaction.³⁰⁹ More recent trends allow even greater freedom, at least for commercial parties,³¹⁰ following the lead of some prominent commercial jurisdictions³¹¹ and business practices in international transactions.

Scholars have begun to consider the idea of regulatory competition, primarily in the public realm. They have focused their attention on corporate law and securities markets³¹² or on the effect of choice-of-law clauses,³¹³ particularly in

³⁰⁹ See former U.C.C. § 1-105 (still in force in these states, although now replaced by NCCUSL and ALI with U.C.C. § 1-301).

³¹⁰ See U.C.C. § 1-301 (2001); see also U.C.C. §§ 4A-507(b), 5-116(a) (2001) (validating choice of law in particular contexts). This freedom is tempered by paternalism in consumer transactions, see U.C.C. § 1-301 (2001); U.C.C. § 2A-106 (2001), and the need for immutable rules for the sake of coordination. See, e.g., *id.* §§ 9-301 to -307. For other specific choice of law rules, see *id.* §§ 4-102, 4A-507, 5-116, 8-110.

³¹¹ See N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 2002) (allowing parties to choose New York law in large transactions even if the transaction does not bear a reasonable relation to New York).

³¹² Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553 (2002); Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111 (2001); Jonathan R. Macey, *Displacing Delaware: Can the Feds Do a Better Job Than the States in Regulating Takeovers*, 57 BUS. LAW. 1025 (2002); Lucian Arye Bebchuk & Allen Ferrell, *On Takeover Law and Regulatory Competition*, 57 BUS. LAW. 1047 (2002); Stephen J. Choi, *Law, Finance, and Path Dependence: Developing Strong Securities Markets*, 80 TEX. L. REV. 1657 (2002); Anthony Ragozino, *Domesticating the United States' Securities Laws: The Ninth Circuit Joins the Majority in Enforcing Forum Selection and Choice of Law Clauses Displacing U.S. Law in Richards v. Lloyd's of London*, 10 PACE INT'L L. REV. 31 (1998); see also Richard Revesz, *Federalism and Regulation: Some Generalizations*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES 3 (Daniel C. Esty & Damien Geradin eds., 2000) [hereinafter REGULATORY COMPETITION]; Daniel C. Esty & Damien Geradin, *Regulatory Co-Opetition*, in REGULATORY COMPETITION, *supra*, at 30; Daniel Shaviro, *Some Observations Concerning Multi-jurisdictional Tax Competition*, in REGULATORY COMPETITION *supra*, at 49; Jonathan R. Macey, *Regulatory Competition in the US Federal System: Banking and Financial Services*, in REGULATORY COMPETITION *supra*, at 95; Paul B. Stephan, *Regulatory Cooperation and Competition: The Search for Virtue*, in TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 167 (George A. Bermann et al. eds., 2000); Hadfield & Talley, *supra* note 2. For a discussion of why the usual public choice analogy of politics to markets falls short, see ROBERT D. COOTER, *THE STRATEGIC CONSTITUTION* (2000), and Parisi, *supra* note 205.

³¹³ Erin Ann O'Hara, *Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law*, 53 VAND. L. REV. 1551 (2000); Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151 (2000); Amelia Boss, *The*

the electronic context.³¹⁴ There is also some work on the uniform law process.³¹⁵ The scholarship is still new, and it has not yet achieved a consensus. As might be expected, there are optimists and pessimists, depending in part on politics, method, and discipline. Even scholars with the same basic approach have not yet come together.³¹⁶ All of this scholarship has implications for molecular federalism, although little of it is squarely on point.

To extrapolate on the optimistic side, we might gather from these scholars that the parties will choose the most efficient rules among the many choices. Efficiency is most likely to be fostered when choices are available. Different parties can choose different regimes for different needs. A unitary regime, to achieve efficiency, would have to devise the most efficient rule, and it would have to work efficiently across countless industries and transactions. A unitary regime is therefore an unattractive option. More choices, at least initially, are better: assuming the parties behave as the economists would have them do, a competitive rulemaking environment will allow not only the most efficient rules but also an efficient degree of uniformity or diversity. In other words, molecular federalism, in the presence of competition and an efficient market, should lead not only to relatively efficient rules but also to an appropriate number of regulatory choices.

Needless to say, the assumptions may not hold, and other problems could arise. The benefits of competition can be great, but realists must temper their optimism with knowledge of potential market failure and the occasional emergence of markets for lemons.³¹⁷ If such a race to the bottom were to occur,

Jurisdiction of Commercial Law: Party Autonomy in Choosing Applicable Law and Forum Under Proposed Revisions to the Uniform Commercial Code, 32 INT'L LAW. 1067 (1998); William J. Woodward, Jr., "Sale" of Law and Forum and the Widening Gulf Between "Consumer" and "Nonconsumer" Contracts in the UCC, 75 WASH. U. L.Q. 243 (1997); see also Richard K. Greenstein, *Is the Proposed UCC Choice of Law Provision Unconstitutional?*, 73 TEMP. L. REV. 1159 (2000).

³¹⁴ Bruce H. Kobayashi & Larry E. Ribstein, *Uniformity, Choice of Law and Software Sales*, 8 GEO. MASON L. REV. 261 (1999); Macey & O'Hara, *supra* note 47; Larry E. Ribstein & Bruce H. Kobayashi, *State Regulation of Electronic Commerce*, 51 EMORY L.J. 1 (2002).

³¹⁵ Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131 (1996).

³¹⁶ See Erin Ann O'Hara, *Economics, Public Choice, and the Perennial Conflict of Laws*, 90 GEO. L.J. 941, 941 n.2 (2002); Paul B. Stephan, *The Political Economy of Choice of Law*, 90 GEO. L.J. 957, 957 n.2 (2002). Both O'Hara and Stephan discuss Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L.J. 883 (2002), and Andrew T. Guzman, *Public Choice and International Regulatory Competition*, 90 GEO. L.J. 971 (2002).

³¹⁷ Sometimes competition simply results in all suppliers racing to the bottom. This can happen because consumers do not have enough information about quality and are therefore unwilling to pay for higher quality. When this phenomenon occurs, only low quality products will be available. See George Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970). A debate, though not new, still rages among

the competition will have failed. That result, of course, is not limited to private lawmaking.³¹⁸ Yet all of these possibilities are still largely at the stage of question and hypothesis. More solid conclusions will have to await further research.

C. *Private Lawmaking as Molecular Federalism*

Molecular federalism can be conceived in the same double mold as the more familiar variety. In its vertical aspect, private lawmaking power is subject to the preemptive power of governmental lawmaking, to the extent the state has such lawmaking power. (Just as the limits on federal preemptive power are currently subject to changing and controversial decisions of the Supreme Court, so are the limits on general governmental power changing in controversial ways.)³¹⁹ In its horizontal aspect, competing bodies can put forth different potential regimes and seek adherents. When they start getting many thousands of contractual adherents, or achieve public passage of the privately made rules, then the private rules have become law, as argued in the first half of the article.

If we like federalism, then we must like molecular federalism all the more. Privatized federalism, or molecular federalism, shares the attributes of American federalism but multiplies the benefits. In addition, it does not depend on awkward and unrealistic geographic boundaries. This fact is particularly important because of increased globalization and technological innovation. As the world slips from its geography, the traction of multiplicitous private jurisdictions that are not tied to geographical boundaries grows.³²⁰ Competition among private lawmakers

corporate law scholars about whether a race to the bottom has occurred or is happening in the law of corporations. See William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985); Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?*, 45 SYRACUSE L. REV. 1193 (1995); see also *supra* note 312 (citing sources).

³¹⁸ Leading articles on the question of a race to the bottom in corporate law are cited in the preceding note.

³¹⁹ See generally U.S. CONST. amends. X, XI. Perhaps most interesting is the question of when the government must pay compensation in order to make laws. For a recent treatment of the question, which implicates the Takings Clause as well as substantive due process, see Ronald J. Krotoszynski, Jr., *Expropriatory Intent: Defining the Proper Boundaries of Substantive Due Process and the Takings Clause*, 80 N.C. L. REV. 713 (2002).

³²⁰ The danger, however, is that increasing globalization could lead to increased centralization and bureaucratization—word-izations all evocative of a future without federalism. Cf. Barry Friedman, *Federalism's Future in the Global Village*, 47 VAND. L. REV. 1441, 1443, 1471–83 (1994) (“[A]s we become subject to regulation that develops farther and farther from our grasp, there will be a strong incentive to reinvigorate local and state government.”).

offers further benefits too. Competitive private lawmaking is likely to produce regulatory products that are more highly differentiated. Molecular federalism, in other words, is more likely to meet different kinds of diverse regulatory needs.³²¹ A couple of examples will help illustrate the idea.

The standards of corporate and securities laws vary from jurisdiction to jurisdiction, within the United States (because the states retain control of much corporate law) as well as in other countries. In addition, the standards—for financial disclosure and corporate governance—for listing on stock exchanges vary from exchange to exchange, both within the United States and without. This multiplicity of jurisdictions gives benefits not only to the exchanges, who are able to differentiate themselves by focusing on different parts of the securities-trading market,³²² but to companies who want to be listed and investors who want to consider whether to invest.

The multiplicity of regulatory regimes allows the companies and investors to decide which set of laws is most beneficial. Because investing, like life, is neither simple nor monolithic, the many different regimes offer different benefits for different people, companies, and circumstances. Investors and companies can even choose to use several regulatory regimes.³²³ Some portion of investment dollars might be used for newer, riskier, smaller ventures that do not meet the listing requirements, say, of the NYSE. Some other part of the portfolio can be targeted toward surer investments, such as American companies listed on the NYSE. So the portfolio is mixed and diversified, taking advantage of different jurisdictions just as companies take advantage of the most advantageous jurisdictions when deciding where to locate their operations.

On the company side, the benefits are similar. A new company may need access to the capital markets but lack the size or capitalization required by some markets.³²⁴ On the other hand, a successful and highly capitalized new company can signal its success and capitalization by opting into one of the more stringent markets. Recent evidence shows how some foreign firms are opting into the more demanding regime applicable to American companies by identifying themselves as “U.S. issuers” even though they qualify for the less stringent rules applicable to

³²¹ This conclusion has been shown by work in the provision of corporate law. *See* Hadfield & Talley, *supra* note 2; *see also* Garvin, *supra* note 292, at 349–50 (uniform law, if ill advised, could have serious effects because it is unavoidable).

³²² *See, e.g.*, 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 220 (3d ed. 1990); Michael, *supra* note 41.

³²³ *See* Press Release, Citigroup, Citigroup to Begin Trading Today, Following Completion of Merger of Citicorp and Travelers Group (Oct. 8, 1998), at <http://www.citigroup.com/citigroup/press/981008a.htm> (stock traded on two exchanges).

³²⁴ Perhaps the most stringent is that of the NYSE. *Compare* NYSE MANUAL § 102.01 (1999), *with* NASD MANUAL § 4300 (1999).

“foreign private issuers.”³²⁵ The diversity of regimes is thus useful for different companies of different status.

Similar phenomena can now be observed in electronic commerce. The electronic realm, by its nature, is independent of territory. From any perspective, territoriality is defeasible at best, and generally artificial. For a company whose relevant actions happen only in cyberspace, where is the company located? It need not be a corporation or other registered organization, so it may have no jurisdiction of organization. Its actual place may be unknown, unidentifiable, or mobile. One could look at where the server is, but server locations are easily moved. The person may be anywhere, and may be constantly moving.³²⁶ These facts make territorial ideas of jurisdiction impracticable.

Because of this fact, and perhaps because of the lack of any specific regulation, several competing private lawmaking regimes have arisen. Privacy, which has received much talk and attention, is most prominent. Web-based businesses can join a voluntary regulatory regime and can signify adherence to their customers. Just as some investors once sought the “quality” supposedly represented by American companies,³²⁷ customers of web businesses who care about such matters can choose to do business only with companies that have signed on to the non-territorial, privately made laws sponsored by TRUSTe, BBBOnline, or WebTrust.³²⁸ Again, however, experience teaches caution.³²⁹

³²⁵ EDWARD B. ROCK, COMING TO AMERICA? VENTURE CAPITAL, CORPORATE IDENTITY AND U.S. SECURITIES LAW (Univ. of Penn. Law Sch., Inst. For Law & Econ., Research Paper No. 02-07, 2002), available at <http://papers.ssrn.com/abstract=313419>; see also Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 916–17 (1998) (discussing the making of multiple choices available to issuers and investors).

³²⁶ See generally MANN & WINN, *supra* note 62, at 743.

³²⁷ See, e.g., Sharon R. King, *Dow Tumbles 207 in Global Decline*, N.Y. TIMES, June 16, 1998, at A1 (“A flight to quality has helped the American markets all year, but only the Treasury market benefited yesterday.”).

³²⁸ See David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1399 (1996). TRUSTe is its own nonprofit company. BBBOnline is sponsored, as its name suggests, by the Better Business Bureau. WebTrust is sponsored by the American Institute of Certified Public Accountants. Thousands of e-businesses had signed on to one of these “seal” programs by 2000. See MANN & WINN, *supra* note 62, at 213; see also HADFIELD, LESSONS, *supra* note 2; KARIM JAMAL ET AL., PRIVACY IN E-COMMERCE: DEVELOPMENT OF REPORTING STANDARDS, DISCLOSURE AND ASSURANCE SERVICES IN AN UNREGULATED MARKET (Yale Int’l Ctr. for Fin., Working Paper No. 02-17, 2002), available at <http://papers.ssrn.com/abstract=309753>.

³²⁹ See, e.g., MARK R. PATTERSON, ON THE IMPOSSIBILITY OF INFORMATION INTERMEDIARIES (Fordham Univ. Sch. of Law, Law & Econ., Research Paper No. 13, 2001), available at <http://papers.ssrn.com/abstract=276968>; see also *supra* note 316 and accompanying text.

Of course privacy is not the only issue of concern online, and in fact, it may not be the most important. General questions of trust- and creditworthiness seem at least as important and at least as susceptible to competitive private lawmaking. In theory the solution appears elegant, and there seem to be enough Internet activists to hope that competitive private lawmaking would not simply be a monopolistic or cartel-based exercise in so-called self-regulation.³³⁰ This hope must be considered together with the concomitant fear of private power on the Internet, unchecked by competitive forces.³³¹ I would suggest that considering these issues from the standpoint of competitive private lawmaking, and asking questions not only about equality, dignity, and freedom, but also about competition, might be fruitful.

The benefits of privatized federalism must be tempered by the knowledge that the privately made laws are not the product of democratic processes. As discussed in the previous section, much of the normative good in privately made rules depends on the existence of competition, or at least the potential for it. To make normative judgments about whether molecular federalism is good we cannot depend on the warm “federalism” label. Instead, we have to ask whether the rules that result from allowing private lawmaking—i.e., privatized federalism—are the result of a competitive process, given that they are not the product of a democratic one. And if there was not any actual competition, then we must ask whether there was a reasonable possibility of competitive lawmaking. Put in opposite terms, if the privately made rules were not right for a significant part of the market, was there any reason that the adversely affected parties could not devise a private legal regime of their own?

This is not the sort of question we are used to asking of laws. We do not ask whether laws that were passed by a state legislature or by Congress were subject to competition. Because much of the justification for privately made laws must come from competition, we must ask the question.³³² The alternative is to kowtow to a monopolistic or oligarchic lawmaker who has no known source of legitimacy. This is a crucial point, and it is the qualification mentioned at the

³³⁰ See *supra* Part III.B. (differentiating true self-regulation from private lawmaking); see also Hadfield, *supra* note 219.

³³¹ The most prominent writer in this vein is LAWRENCE LESSIG, *CODE: AND OTHER LAWS OF CYBERSPACE* (1999).

³³² Note that the text does not suggest that democratic legitimacy is not a concern when considering issues of “corporate-to-corporate commercial dealings,” nor does it suggest that the state must monopolize the “justice sphere” of the legal system “for reasons of democratic legitimacy,” unlike Hadfield, *Privatizing Commercial Law*, *supra* note 2, at 40, 44–45. See also Hadfield, *supra* note 219, at 263 (seeking to disaggregate democratic function of law from market function of law); cf. Hadfield & Talley, *supra* note 2, at 23 (corporate and commercial law may implicate questions of justice in addition to efficiency). The approach in text is more consonant with that of Schwarcz, *supra* note 216 (recognizing the fairness and justice stakes in commercial regulation).

outset of the article. The introduction said that we would want to ask the same questions of privately made laws as we ask of publicly made laws, subject to one qualification. We have now gone through a tentative interrogatory exercise, asking about efficiency, equality, representation, and so on. The difference, highlighted in that exercise, is that competition plays the crucial role of giving legitimacy to privately made laws.

The inquiry into competition or potential competition is not a simple one. Experience suggests that even in an initially competitive environment, unregulated competition will not always last. In other words, it is unrealistic to see no role for government. Regulation of private lawmaking may therefore be necessary in some circumstances, just as regulation is necessary in policing more conventional sorts of markets—for example, to prevent monopolization. The regulation, when needed, does not have to be invasive. Regulation may happen through the passage of enabling rules,³³³ allowing parties to opt for private or alternative regulatory frameworks when such options would otherwise be precluded. As Professor Hadfield has pointed out, publicly made laws can facilitate efficient competition between private lawmakers.³³⁴ There is good reason to be hopeful about such enabling governmental intervention. Current work suggests that the method works well in capital markets subject to the jurisdiction of the SEC, even if there is also reason for caution.³³⁵

The government might foster competition in other ways as well. It can set up markets, encourage standardization where it would be helpful for competition, reduce transaction costs, instigate market development, or spark reform. An example will illustrate: Compared to credit cards, potential consumer liability for misuse of ATM and debit cards is lightly regulated. While consumer liability for fraudulent use of a stolen credit card is capped, almost absolutely, at fifty dollars, similar liability for a debit card can increase from fifty to five hundred dollars, or even an unlimited amount, depending on what the consumer does and when. When the government began to move toward changing the debit card rules, the debit card industry itself began to compete by decreasing or eliminating cardholder liability altogether.³³⁶ Nothing was required from the government aside from lumbering around a bit. Once the issue was raised, competition took

³³³ Potentially, government enabling of private lawmaking could raise issues under the constitutional non-delegation doctrine. At one point, the doctrine had real teeth. *See generally* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935); Carter v. Carter Coal Co., 298 U.S. 238 (1936); Panama Refining Co. v. Ryan, 293 U.S. 388 (1935). It may now have passed into desuetude, or perhaps it may be ready for a decent burial. *Cf.* Lawrence, *supra* note 10. *See generally* Eric A. Posner & Adrian Vermeule, *Interring the Nondelegation Doctrine*, 69 U. CHI. L. REV. 1721 (2002). Those questions are beyond the scope of this article.

³³⁴ *See* Hadfield, *Privatizing Commercial Law*, *supra* note 2, at 45; HADFIELD, LESSONS, *supra* note 2, at 61–63.

³³⁵ Macey & O'Hara, *supra* note 47; *see* Hadfield, *supra* note 219.

³³⁶ *See supra* note 251–52 (citing sources relating to zero-liability or \$50 cap).

care of the rest, and consumers can hardly complain about it any more. Competition did the job in the end, but some loud government inaction appears to have been necessary.

D. *The Undue Constraints of Antitrust Law*

Given the heightened emphasis on competition, the antitrust laws come immediately to mind. The problem is that the antitrust laws were designed for regulating markets in commodities other than laws, and laws are different from commodities in important ways. Further, while questions about competition or the potential for it are important, they are not the only inquiry. Because these rules come to have the effect of law, we also need to ask the hard questions about autonomy, dignity, paternalism, and equality. For these reasons, antitrust law has a role to play in regulating the market in privately made laws, but the traditional antitrust inquiries are considerably too constrained to give normative assurance that the laws that regulate so much of American life are legitimate.³³⁷

The decision in *United States v. Visa, U.S.A., Inc.*,³³⁸ is an example of how the antitrust inquiry is too constrained. The court could ask only whether the rules made by the association of card-issuing banks “resulted in a significant adverse effect on competition or consumer welfare,”³³⁹ all of which the court defined in solely economic terms. The emphasis under the antitrust laws had to be on harm in particular markets, as defined by strictly economic analysis.³⁴⁰ At best, the antitrust analysis will always revolve around economic questions, and often quite technical ones.³⁴¹ Often, even the economic questions are not asked, since at least some private lawmaking is currently exempted from antitrust laws.³⁴² We—the millions of members of the public who use credit cards and the millions of businesses who take them—are the ones being regulated by the rules made by associations of banks. They have the same effect as law, to us. It is not enough for us to know the answers to some economic questions.

³³⁷ A law is *legitimate*, as the term is used here, only if—among other things—the law is not the product of a nongovernmental monopoly. Cf. Macey, *supra* note 140 (arguing that it is impossible to distinguish legitimate rules from illegitimate ones); Schwarcz, *supra* note 216, at 324–29.

³³⁸ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y.), *modified*, 183 F. Supp. 2d 613 (S.D.N.Y. 2001).

³³⁹ *See id.* at 327.

³⁴⁰ *See id.* at 334–40.

³⁴¹ *See, e.g., id.*

³⁴² *See Miller v. Am. Stock Exch., Inc.*, 317 F.3d 134; *Friedman v. Salomon/Smith Barney, Inc.*, 313 F.3d 796 (2d Cir. 2002); Sagers, *supra* note 9 (discussing standard-setting organizations and the *Noerr-Pennington* doctrine of antitrust immunity).

VIII. CONCLUSION

The ideas suggested here have advanced along three paths. Beginning with an inductive argument, I have tried to show that much lawmaking rests in private hands. The literature that has gone before has often been too narrowly particular or theoretically abstract, obscuring the practical ability of private bodies to make law. The inductive exercise is meant to show how private bodies govern many disparate areas of corporate and commercial law. The examples also demonstrate how this private lawmaking power is not adequately described simply as “self-regulation” or “private ordering,” nor is the power implemented through the kind of bargaining assumed by a contractual analysis. Instead, private lawmaking is accomplished through a variety of means, including legislative and judicial adoption. The private lawmaking that is put in place through contracts involves mass contracting in which uniform rules are incorporated across countless transactions, binding millions of parties, a tiny fraction of whom have any practical or moral responsibility for the making of those rules. The examples show how the private lawmaking phenomenon slices across the continuum of commercial transactions, whether they involve letters of credit used by relatively sophisticated, purely commercial actors, or credit cards used by consumers.

Linguistic inquiry reinforces the tentative conclusions drawn from induction. The rules that are privately made bind mindless numbers of people and businesses, uniformly and generally. They do not bind with perfect uniformity or generality, but they are often as uniformly and generally binding as publicly made law, sometimes more so. Put more technically, careful consideration of the rules that are indubitable law reveals that much commercial legislation and common law is comprised of default rules or coordination principles; by comparison, privately made law is put into binding operation perhaps as much as, or more than, publicly made law. Whether privately made law binds more often or less is an empirical question, for which available data is spotty. We do know that in some areas, like letters of credit, the privately made law is pervasive. In other areas we can only surmise.

These are quantitative questions, and well worth exploring, but they do not detract from the qualitative point: much law is privately made. Exactly how much is a matter of little import; enough law is privately made that we should care. The fact that law is privately made hardly relieves us of our duty to ask difficult questions of the private lawmaking process and the rules that result from it, to assure that such rules that have the effect of law are consonant with democratic values, even if those laws are not the product of democratic processes. Questions about respect for autonomy and equality, representation and efficiency, are as important in the private lawmaking realm as in the public one. The arguments offered here, I hope, should help show the political dimension to questions that

otherwise might glaze the eyes, seeming like technical issues of economic plumbing.

Reflection on these questions, at this point, can only be tentative. The conceptions are too different; the beginnings of social scientific analysis have not yet reached firm conclusions. But novelty does not excuse the exercise, and a start is offered here. Some thought has accentuated the hopeful: private lawmaking, potentially, can work as molecular federalism. It multiplies the benefits of state-based federalism by increasing the sheer number of potential lawmakers. At the same time, molecular federalism offers inherent, non-quantitative advantages. It gives power to the base of the pyramid, allowing control to the *demos* instead of confining it to the apex. The potential for competition permits this dynamic, as everyone is a potential private lawmaker—not through the negotiation of a two-party contract, which only helps two parties, but through the confection of a little regime to which whole groups can adhere.

A focus on the hopeful should not obscure reality. Hope must be tempered by knowledge of market failures and monopolies, markets for lemons and rules of oligarchs. Sometimes, experience teaches, competition fails, and competition is the cornerstone of the hopeful side of private lawmaking. Without it, or its realistic potential, molecular federalism is no more than practical abdication. Current realities have only begun to be explored, and we do not know much even about the current state of private lawmaking, much less about its potentials. Before we can know these things, we must pay better attention to private lawmaking, and to the law-like effects of privately made rules.