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# PRIVATE ORDERINGS

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Lisa Bernstein\*, Alan Morrison\*\*, and J. Mark Ramseyer†

The articles in this symposium were part of an interdisciplinary conference on *Private Orderings* sponsored by the Centre for Corporate Reputation at the University of Oxford, Saïd Business School, in September 2014. Through their work, the authors explore the ways that legal and extralegal rules and institutions, networks, reputation, and social capital interact to shape regimes of private ordering.

In *The Medieval Law Merchant: The Tyranny of a Construct*, Emily Kadens argues that although private ordering may indeed be a powerful force, the classic example used to illustrate its promise, the “story” of the medieval law merchant, is nothing but a myth. It is, of course, a widely accepted myth that continues to influence the development of commercial law.<sup>1</sup> Kadens traces the origin of the idea of a uniform and universal merchant-created custom to the seventeenth century. She introduces evidence that casts doubt on the traditional account of medieval trade, and provides an alternative account of the way medieval merchants did business. Kadens demonstrates that merchants did not conduct transnational trade during the middle ages through a spontaneous private order.<sup>2</sup> Rather, they relied on a mix of governmental actions, individual intermediaries, private institutions, and networks of trading relationships. Town governments heavily regulated sales, and merchants expected to be bound by the town’s laws—laws that foreign traders learned through local information brokers, such as innkeepers, notaries, and sales brokers. These local intermediaries also introduced foreign traders into local exchange networks and thereby enabled them to do business without any uniform and universal law merchant.<sup>3</sup>

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1 For a discussion of the role of the law merchant in the Common European Sales law, see Bernstein (2013).

2 See also Benson (1989, p. 646–647).

3 See also Kadens (2012) (suggesting that the types of universal merchant customs whose existence the law merchant story assumes did not exist, and would not have been expected to exist in the Medieval

Mark Ramseyer and Lisa Bernstein make explicit the roles played by networks and social capital in securing compliance with the law and in supporting commercial exchange (roles that were implicit in Kadens' description of medieval commerce). In *Social Capital and the Formal Legal System: Evidence from Prefecture-Level Data in Japan*, Ramseyer, draws on verifiable proxies for social capital across prefectures in Japan, and explores the connection between levels of social capital and citizens' propensity to keep their commercial promises and comply with legal mandates. He uses the data to "identify environments where social norms both constrain behavior and substitute for judicial enforcement." He finds that where "social capital is high people do indeed more willingly comply with social norms." They pay their debts, comply with legal mandates, and are in general less litigious than individuals in contexts with lower levels of social capital.

In *Private Ordering, Social Capital and Network Governance in Procurement Contracts: A Preliminary Study*, Bernstein draws on social capital theory to better understand contractual relations between original equipment manufacturers in the mid-west and their suppliers. She explores the ways that contract provisions, contract administration mechanisms, and other formal structures created by buyers and suppliers interact with the forces created by repeat dealing, relational social capital, and the positions of buyers and suppliers in the network of relevant firms (structural social capital), to support the creation and maintenance of cooperative contractual relationships. She demonstrates that together these mechanisms and social forces can adequately reduce shirking, bond relationship-specific investment, control opportunism, and support both joint and supplier led innovation—largely outside the shadow of the law.

Robert Scott and Alan Schwartz's contribution, *Third Party Beneficiaries and Contractual Networks*, argues that recognizing the embeddedness of certain types of bilateral (dyadic) contracts in networks of relations should fundamentally change the contexts in which efficiency-minded courts give so-called third-party beneficiaries of contracts the right to sue on the contracts. Based on a large sample of cases, they observe that courts applying third-party beneficiary doctrine tend to focus on the "intent" of the contracting parties to benefit the third parties, and suggest that this inquiry focuses on the wrong normative question. In their view, courts should define the class of third-party beneficiaries entitled to sue, by looking at "whether it would [have been] ex ante profitable for the network contracting members to serve the potential beneficiary class to which the plaintiff belongs." In turn, this inquiry would facilitate "optimal network

period and that the best available historical evidence shows that such customs as did exist were highly local in nature, and rather vague in content, embodying basic equitable norms of fairness rather than industry-specific merchant practices)

formation and function.” Like Bernstein, they conclude that any understanding of complex dyadic contracts among sophisticated commercial actors will be highly incomplete unless understood in the context of the network of firms and individuals surrounding the contracting parties.

Alan Morrison and William Wilhelm’s *Trust, Reputation and Law: The Evolution of Commitment in Investment Banking*, develops a taxonomy for classifying various governance mechanisms between the poles of legal and private order. Morrison and Wilhelm then draw on this taxonomy to explore how technological change in the investment-banking industry contributed to changes in the ways that relationships between banks and their clients are governed. They document the shift from governance based on informal understandings backed by implicit reputation-based sanctions toward governance achieved through formal, arms-length, legal constraints. They then explore the challenges posed by this shift for the application of legal doctrines and the choices faced by regulatory policymakers.

Picking up on the theme of how approaches to public law and regulation might be affected by a better understanding of the forces of private order, in *Herding Towards Rationality: Following Others to Debias Anticipated Regret*, Jennifer Arlen and Stephan Tontrup caution that behavioral law and economics scholars have too quickly encouraged law makers to intervene in private orderings, when the decisions that give rise to these orderings may be affected by cognitive bias. In the real world where people are making decisions that matter to them, argue Arlen and Tontrup, they frequently realize how these biases may affect their decision-making. As a result, they both can, and do, take steps to debias their decisions. To illustrate this process, Arlen and Tontrup present a series of laboratory experiments demonstrating that regret bias (which is at the heart of the status quo bias and endowment effect) can be, and in the experimental context they study is, counteracted by another bias—the so-called herding bias. They conclude that lawmakers must take the interaction among biases and individuals’ awareness of the ways these forces might affect their decisions into account before intervening on paternalistic grounds.

Industry and trade associations can work publicly and privately to increase the security of property rights. They can also work publicly and privately to transfer rents from others to themselves. In *Business Associations, Lobbying, and Endogenous Institutions*, Maria Larrain and Jens Prüfer ask when associations do the former, and when the latter. They note that the marginal returns to increased property right security fall as that security rises: the better the legal structure, the lower the returns to improving it further. They then model the dynamic by which industry and trade associations shift from efforts to increase property rights (good lobbying) to efforts to extract and transfer rents (bad lobbying) as the efficiency of the institutional environment (the strength of property rights) increases. If the

state does not adequately secure property rights, associations will themselves try to increase the security of property rights. But as the security of those property rights increases, they will turn instead to rent-seeking.

In *Building Legal Order in Ancient Athens*, Barry Weingast, Gillian Hadfield, and Frederica Carugati challenge prevailing distinctions between public ordering and private ordering. The article provides a detailed account of how Athens was able to achieve stability, order, and growth—the outcomes usually associated with centralized legal institutions—without creating the types of formal courts, prosecutors, and judges that scholars commonly assume to be necessary to the operation of such institutions. They conclude that an understanding of how order was achieved in ancient Athens suggests that the development of legal order in “weakly centralized developing countries” may turn less on formal legal institutions, and more on decentralized and impersonal institutions that communicate information about how people behave, and therefore create incentives to adhere to social norms.

All of the papers at the conference were enriched by the remarks of the commentators—John Armour, Douglas Baird, Ronald Burt, Hugh Collins Avinash Dixit, Joshua Getzler, Bentley MacLeod, Catherine Mitchell, Jonathan Morgan, Andrew Tuch—who challenged the authors to think outside the boxes of their respective disciplines.

As conference organizers, we hoped that bringing together scholars with a wide variety of methodological perspectives would expand the scholarly conversation on private order. We could not have been more pleased. And if the conference yielded any one lesson, it was that the social forces and institutions that make private ordering effective can and do operate in contexts that are not characterized by the conditions that the legal literature commonly associates with their success such as small, geographically concentrated, socially or ethnically homogenous groups. Rather, the effects of social networks, interpersonal relationships, reputation, and private institutions are considerations that need to be routinely taken into account by courts, policymakers, and lawyers drafting contracts if they are to make either profit maximizing, or social welfare maximizing decisions.

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