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# Transnational economic activism and private regulatory power

PANAGIOTIS DELIMATIS\*

## Abstract

*Private bodies involved in global regulatory governance shape and monitor economic behavior. Much of the transformative forces of economic activity have been private-driven, typically put into practice through an often-impressive apparatus of voluntary standard-setting. Despite the ever-increasing regulatory powers that are transferred to such private actors, their dominance remains largely unaffected by regulatory disasters that they partly cause. Existing literature appears to suggest that the State “orchestrates” private regulatory activity, thereby retaining a high level of control. In reality, the opposite occurs: crises, broadly defined as disruptive events, empower the resilience of such forces or generate new ones at the transnational level. Against this backdrop, the present article argues that the State increasingly fails to control this type of transnational economic activism. Private regulatory bodies use crises as opportunities to reorganize and become more assertive in norm-creation, overriding and substituting for State powers. Free from organizational hierarchies, formal accountability structures, scrutiny, pressure and obligation, private bodies enhance their collective memory and identity and grow stronger through crises, creating the necessary conditions for a new era of dominance of private authority. Such phenomena call for a reconsideration of how public regulatory activity and supervision can harness potentially harmful private rulemaking.*

## I. INTRODUCTION

Economic activity cannot function without a system of governance that establishes a set of rules and procedures governing property rights, and their exchange and enforcement. This nourishes a demand for authority, which is often supplied by private regulatory bodies. Technical expertise; the State’s inability to acquire and maintain such costly expertise; and the contemporary

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ideological power of neoliberal ideology justify this transfer of authority.<sup>1</sup> Private bodies have held sway over economic regulation and co-shaped trade regulation for much of modern history, often through adversity and crises events. Their participation in the creation and bureaucratic legalization of prescriptive rules (including the monitoring and enforcement thereof) became necessary and soon indispensable. Successive globalization waves allowed for the expansion of private authority beyond national borders, leading transnational private regulation to become a key staple of global economic governance.<sup>2</sup> Yet, the growth of private regulatory power did not hinder the occurrence of regulatory disasters (that is, events of varying scale and scope resulting from the – often unintended and unforeseen – consequences of the design or operation of a regulatory system and its interactions with other systems).<sup>3</sup> Existing theories fail to explain this phenomenon of enduring market supremacy.<sup>4</sup>

Against this background, this article argues that regulatory disasters and crises empower such private-driven forces or generate new ones, whereas existing checks and balances are not fit for purpose. To describe the ills of private collective action, we introduce the concept of ‘free riding of private ordering’. Free riding refers to an individual or group that benefits from group actions without bearing the corresponding share of the costs incurred by the group.<sup>5</sup> This phenomenon is particularly visible in the fields of product markets and finance. In these areas, free-riding has occurred in that private bodies benefitted from a powerful, State-derived veil of legitimacy without, however, contributing to or internalizing the costs of, first, legitimacy acquisition and, second, ensuing regulatory disasters with substantial financial consequences for taxpayers. Traditionally, such free-riding on the legitimacy of the State has been *re-active* for the most part. It starts with private bodies responding favorably to State calling for a certain type of assistance by private parties, for instance, in the form of public-private partnerships or through full delegation of powers.

Our key argument is that a transition towards *proactive* free-riding occurs, whereby private forces regulate ever-expanding types of economic activity, without being affected by regulatory disasters. The continued dominance of private authority through crises is premised, we argue, on the continuous promulgation and strategic use of *voluntary* standards that are rapidly prepared,

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<sup>1</sup> Cf. C. Cutler et al. (eds.), *PRIVATE AUTHORITY AND INTERNATIONAL AFFAIRS* (1999).

<sup>2</sup> The WTO agreement has recognized as much in its agreements on technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS) respectively, ensuring that both agreements cover governmental and private technical or SPS standards. For the TBT, see P. Delimatsis, “‘Relevant international standards’ and “‘recognised standardisation bodies’” under the TBT Agreement’ in *THE LAW, ECONOMICS AND POLITICS OF INTERNATIONAL STANDARDIZATION* (P. Delimatsis ed., 2015). For the SPS, see WTO, ‘Private Standards and the SPS Agreement’, G/SPS/GEN/746, 24 January 2007.

<sup>3</sup> J. Black, *Learning from Regulatory Disasters*, 10:3 *POLICY QUARTERLY* 3 (2014).

<sup>4</sup> Also V. Schmidt and M. Thatcher, ‘Theorizing ideational continuity: The resilience of neo-liberal ideas in Europe’, in *RESILIENT LIBERALISM IN EUROPE’S POLITICAL ECONOMY* (V. Schmidt and M. Thatcher eds., 2013), at 13.

<sup>5</sup> P. Fontaine, *Free riding*, 36 *JOURNAL OF THE HISTORY OF ECONOMIC THOUGHT* 359 (2014).

adopted and diffused to pre-empt rules by public rule-making competitors.<sup>6</sup> In this regard, we introduce the novel concept of ‘voluntary economic activism’ because it captures the voluntary nature of the standards and the opportunistic behaviour towards authority appropriation. Globalization only accelerates the expansion of this phenomenon at the transnational level. Overall, drawing on an interdisciplinary inquiry on theories of resilience, the objective of this article is to set the foundations for a theory that explains the empowerment and resilience of private authority during crises. In doing so, this article contributes to the emerging literature arguing for a renewed focus on distribution of power and market insulation mediated through law nowadays.<sup>7</sup>

The remainder of the article proceeds as follows. We draw from ecosystems theory in Section II to unravel the phenomenon of the resilience of private collective action, using examples from the world of finance and product markets. In this Section, we underscore the importance of malleability, flexibility, mutability, and heterogeneity as foundational traits of organizational continuity. Section III discusses how the role of crises (and crisis management) has been largely neglected in the private governance scholarship. Section IV complements the largely theoretical analysis of organizational resilience by discussing the essential features of the transition towards a proactive role of private regulatory bodies. Based on the analysis offered, Section V sets the foundations for studying the potential emergence of a new theory of private collective action and underscores the importance of further research to test the new theory put forward and the hypotheses associated with it. Section VI concludes.

## II. THE RESILIENCE OF PRIVATE COLLECTIVE ACTION

### A. *Resilient systems under ecosystems theory*

Resilience is a heavy-laden yet malleable concept that permeates different issue-areas in the public discourse about global governance.<sup>8</sup> It has a positive connotation and is typically associated with and viewed under the prism of risks or shocks, which will often be exogenous to the subject but may also result from internal conflicts and system dynamics, jeopardizing the existence or survival of the subject, at least in its previous form.<sup>9</sup>

Resilience is the ability of recovery to the state of equilibrium that a subject would have depending on the risk management strategy it will employ. A resilient system survives successfully through

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<sup>6</sup> N. Malhotra; B. Monin ; and M. Tomz, *Does Private Regulation Preempt Public Regulation?*, 113:1 AMERICAN POLITICAL SCIENCE REVIEW 19 (2019).

<sup>7</sup> J. E. COHEN, *BETWEEN TRUTH AND POWER: THE LEGAL CONSTRUCTIONS OF INFORMATIONAL CAPITALISM* (2019); also J. Britton-Purdy ; D. Singh Grewal; A. Kapczynski; and K. Sabeel Rahman, *Building a Law-and-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE LAW JOURNAL 1784 (2020).

<sup>8</sup> J. Walker and M. Cooper, *Genealogies of Resilience: From Systems Ecology to the Political Economy of Crisis Adaptation*, 42:2 SECURITY DIALOGUE 143 (2011).

<sup>9</sup> C. S. Holling, *Resilience and stability of ecological systems*, 4 ANNUAL REVIEW OF ECOLOGY AND SYSTEMATICS 1, at 17 (1973).

the four phases of growth and accumulation, reorganization and renewal.<sup>10</sup> Each of these phases represents an adaptive cycle in a complex adaptive system.<sup>11</sup> Perturbations can lead to a ‘tipping point’<sup>12</sup> of such a disruptive nature that triggers a paradigm shift, thereby creating a new equilibrium, allowing for the continuation of the system.<sup>13</sup> The occurrence of a tipping point is typically evidenced by the delay of recovery or by the fact that a system has become more vulnerable or fragile to small changes, resulting in a critical transition.<sup>14</sup> The transition is non-linear and the new equilibrium reached is not necessarily better.

Organization studies identified several characteristics that allow systems to continue or recover in times of uncertainty. For instance, an important feature would be the organization’s intrinsic value for those attached to it and the possibilities that they have to raise their voice and be part of a potential way out of the crisis.<sup>15</sup> Another feature relates to the cultural construction of the institutional preferences in a given system, which allow exploiting uncertainty to promote reform and normative change strategically.<sup>16</sup> More often than not, actor docility and collaborative learning are important factors for the continuous fitness of a given system.<sup>17</sup>

Thus, resilience would entail flexibility rather than rigidity, and persistence rather than collapse.<sup>18</sup> Various institutional characteristics have been identified as enhancing resilience: diversity or heterogeneity (in terms of composition and responses to disturbances) as well as low connectivity are among the most important ones.<sup>19</sup> Conversely, high connectivity renders systems more prone to disturbances and leads to knowledge becoming overly homogenized, which may severely affect optimal management. Overall, it appears that systems are more resilient when they are moderately connected while maintaining high levels of heterogeneity.<sup>20</sup>

When applying these theoretical insights to private regulatory regimes, we observe that a regulatory system can show its resilience by internalizing any succession of regulatory and

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<sup>10</sup> B. Fath; C. Dean and H. Katzmair, *Navigating the Adaptive Cycle: An Approach to Managing the Resilience of Social Systems*, 20:2 *ECOLOGY AND SOCIETY* 24 (2015).

<sup>11</sup> C. S. Holling, *Understanding the Complexity of Economic, Ecological, and Social Systems*, 4 *ECOSYSTEMS* 390 (2001), at 393ff.

<sup>12</sup> M. Scheffer et al., *Catastrophic shifts in ecosystems*, 413 *NATURE* 591 (2001).

<sup>13</sup> C. S. Holling; L. H. Gunderson and G. D. Peterson, *Sustainability and Panarchies*, in *PANARCHY – UNDERSTANDING TRANSFORMATIONS IN HUMAN AND NATURAL SYSTEMS* (L. H. Gunderson and C. S. Holling eds., 2002) 63, at 74-75.

<sup>14</sup> Y. Li et al, *An analysis of power law distributions and tipping points during the global financial crisis*, 13:1 *ANNALS OF ACTUARIAL SCIENCE* 80 (2018), at 85.

<sup>15</sup> Cf. A. HIRSCHMAN, *EXIT, VOICE AND LOYALTY – RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES* (1970).

<sup>16</sup> G. Capoccia, *Critical junctures and institutional change*, in *ADVANCES IN COMPARATIVE-HISTORICAL ANALYSIS* (J. Mahoney and K. Thelen eds., 2015), at 147.

<sup>17</sup> H. Simon, *Organizations and Markets*, 5:2 *JOURNAL OF ECONOMIC PERSPECTIVES* 25 (1991), at 35.

<sup>18</sup> J. Ruhl, *General Design Principles for Resilience and Adaptive Capacity in Legal Systems – With Applications to Climate Change Adaptation*, 89 *NORTH CAROLINA LAW REVIEW* 1373 (2011), at 1389.

<sup>19</sup> E. OSTROM, *UNDERSTANDING INSTITUTIONAL DIVERSITY* (2005).

<sup>20</sup> R. Biggs et al, *Toward Principles for Enhancing the Resilience of Ecosystem Services*, 37 *ANNUAL REVIEW OF ENVIRONMENT AND RESOURCES* 421 (2012), at 429.

governance paradigms (growth and accumulation), leading to new constructs of alternative governance (reorganization and renewal), while preserving the characteristics of the previous regime. Additionally, establishing a framework that safeguards malleability, docility, heterogeneity and resourcefulness while maintaining moderate levels of connectivity among membership enhances the resilience of the private regulatory regime.<sup>21</sup>

Finally, private rule-makers need shock-proof ideas, notably in their interaction with public authority. Ideas can show resilience through adaptive processes of metamorphosis (old ideas returning in new guises), absorption (of seemingly contradictory ideas) and hybridization (adaptability in different contexts).<sup>22</sup> This approach would emphasize the heterogeneous and inclusive nature of ideas that aspire to be (or have been) resilient, provided that a connecting factor, even if only loose and remote, brings them together. This coalescence can be the result of centripetal forces but often will result from active inclusion management of a strategic nature.<sup>23</sup>

### *B. The rise of private collective action to prominence*

Indirect governance (delivered via several private rule-making bodies acting as governance intermediaries, be it trade associations; professional bodies; private contractors delivering public services such as transport, health, security or education; or associations of firms to which the State delegated a given task) has been a hallmark of neoliberalism.<sup>24</sup> Technocratic governance and the gradual introduction of self-correcting processes led to a transformation, reconfiguration and retrenchment of the role of the State.<sup>25</sup> The boundaries between economic and political rationality blurred and political action was subsumed to economic rationality.<sup>26</sup>

The emergence of private regulatory regimes often resulted from well-functioning, self-contained ecosystems focused on addressing a collective action problem.<sup>27</sup> Economics<sup>28</sup> contended that public goods such as regulations can be produced by non-state actors<sup>29</sup> or demonstrated the efficiency of non-legal mechanisms created by non-public close-knit groups.<sup>30</sup> The evolution of

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<sup>21</sup> Also E. Partiti et al, *Evolutionary Dynamics of Transnational Private Regulation*, 13:4 TRANSNATIONAL LEGAL THEORY 431 (2022), at 435.

<sup>22</sup> V. Schmidt and M. Thatcher, *Why are neoliberal ideas so resilient in Europe's political economy?*, 8:3 CRITICAL POLICY STUDIES 340 (2014), at 341.

<sup>23</sup> C. Ansell et al., *Understanding inclusion in collaborative governance: a mixed methods approach*, 39:4 POLICY AND SOCIETY 570 (2020).

<sup>24</sup> E. P. STRINGHAM, *PRIVATE GOVERNANCE – CREATING ORDER IN ECONOMIC AND SOCIAL LIFE* (2015).

<sup>25</sup> P. Kjaer, *Law and Order Within and Beyond National Configurations*, in *THE FINANCIAL CRISIS IN CONSTITUTIONAL PERSPECTIVE – THE DARK SIDE OF FUNCTIONAL DIFFERENTIATION* (P. F. Kjaer et al. eds., 2011), at 418.

<sup>26</sup> S. PICCIOTTO, *REGULATING GLOBAL CORPORATE CAPITALISM* (2011).

<sup>27</sup> C. Roger and P. Dauvergne, *The Rise of Transnational Governance as a Field of Study*, 18 INTERNATIONAL STUDIES REVIEW 415 (2016), at 422.

<sup>28</sup> P. Mirowski and D. Plehwe (eds), *THE ROAD TO MONT PÉLERIN: THE MAKING OF THE NEOLIBERAL THOUGHT COLLECTIVE* (2009).

<sup>29</sup> R. Coase, *The Lighthouse in Economics*, 17:2 JOURNAL OF LAW AND ECONOMICS 357 (1974).

<sup>30</sup> R. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBOURS SETTLE DISPUTES* (1991).

private regulation lies back at early successes of self-regulatory patterns.<sup>31</sup> The transnational evolution of private rule-makers often resulted from the ability of visionary individuals to build bridges;<sup>32</sup> to function at the intersection of different regulatory systems and international law; and to act as facilitators, mediators or intermediaries to enroll other individuals.<sup>33</sup> In addition, their structure, culture, output and processes has oftentimes developed in parallel, depicting a certain homogeneity, which was likely due to internal demands or organizational desire for legitimacy and acceptance.<sup>34</sup>

Transnational private rule-makers adopt behavioural standards on regulatory issues from climate change to labour rights; promote, monitor and enforce those standards; and often offer administrative services such as certification and accreditation. Their very existence is bottom-up and incentive-based, as they are driven by consumer demand, deterrence of State intervention, low transaction costs and reputational benefits.<sup>35</sup> Various resilience-related traits identified above can be matched with the modus operandi of transnational rule-makers: Malleability, flexibility and relatively low (transaction) costs have defined the resilience of private regulators and their ideas.<sup>36</sup> The expedite draft and review of their rules and related resourcefulness demonstrates their transformative capacity and mutability that sustain their dominance in norm-making.<sup>37</sup> If needed, private bodies at the national and international level would work towards the creation of co-regulatory constellations and other types of partnership between the private and the public.<sup>38</sup>

### C. *Resilience of private authority through shocks*

Exogenous shocks (such as financial crises or environmental catastrophes) increase the likelihood of non-incremental organizational change globally. Urgent calls follow for a new regulatory paradigm in dealing with a certain area, be it food safety, technology and its use, finance or accountancy services. Although the recent financial crisis spotlighted policy-making failures, such regulatory disasters have been diachronic.<sup>39</sup>

Current scholarship underlines the role of the State (previously a monopoly regulator), which,

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<sup>31</sup> C. CUTLER, *PRIVATE POWER AND GLOBAL AUTHORITY: TRANSNATIONAL MERCHANT LAW IN THE GLOBAL POLITICAL ECONOMY* (2003).

<sup>32</sup> C. Coglianese and E. Mendelson, *Meta-Regulation and Self-Regulation*, in *THE OXFORD HANDBOOK OF REGULATION* (R. Baldwin et al. eds., 2010), at 146; also L. Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 11 *JOURNAL OF LEGAL STUDIES* 115 (1992).

<sup>33</sup> F. Grisel, *The Centres and Margins of Transnational Law: Potential Developments and Methodological Challenges*, *JOURNAL OF LAW AND SOCIETY* 1 (2022), at 5.

<sup>34</sup> P. DiMaggio and W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48:2 *AMERICAN SOCIOLOGICAL REVIEW* 147 (1983).

<sup>35</sup> P. PRAKASH, *VOLUNTARY PROGRAMS: A CLUB THEORY PERSPECTIVE* (2009).

<sup>36</sup> K. Abbott and B. Faude, *Choosing Low-Cost Institutions in Global Governance*, 13 *INTERNATIONAL THEORY* 397 (2021).

<sup>37</sup> R. Ellickson, *The Market for Social Norms*, 3: 1 *AMERICAN LAW AND ECONOMICS REVIEW* 1, 22 (2001).

<sup>38</sup> I. AYRES AND J. BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* (1992); and N. GUNNINGHAM AND P. GRABOSKY, *SMART REGULATION* (1998).

<sup>39</sup> C. REINHART AND K. ROGOFF, *THIS TIME IS DIFFERENT – EIGHT CENTURIES OF FINANCIAL FOLLY* (2011).

through soft influence and other voluntary means, enlists the third party (here, a non-State body) via material or ideational support and nudges it toward governance goals that align to the State's.<sup>40</sup> Such orchestration may be beneficial for both sides: whereas the State economizes on resources, the private body at issue increases its legitimacy as the prime collaborator of the State in a given issue-area.<sup>41</sup> Other theories focus on the delegation relationship, suggesting that agency-related challenges shall be resolved by the State as the last resort and ultimate commander;<sup>42</sup> for instance, information asymmetries shall be addressed through disclosure requirements for financial institutions.

These theories suggest that significant State intervention would occur in case of misuse of delegation or deviation from the pursuit of public interest objectives.<sup>43</sup> However, what we observe instead is that ever-increasing powers are transferred to such private actors and that their relative power is growing, free from any substantial level of accountability.<sup>44</sup> Actually, little has changed in the regulation of economic activity to challenge the resilience of private authority despite significant regulatory disasters.<sup>45</sup>

#### D. *The centrality of finance and product markets*

Such observations call for more theoretical and empirical work on the mechanics of the reinvigorating forces of private economic regulation, especially in finance and product markets, where striking levels of resilience with obvious consumer welfare implications are discernible. Several scholars have previously pinpointed conflicts of interest that permeate private regulation, from credit rating agencies,<sup>46</sup> professional associations,<sup>47</sup> and accounting,<sup>48</sup> to label accreditation bodies<sup>49</sup> and ICT private standard-setters.<sup>50</sup> However, in finance and product markets, private collective action has taken a largely unchallenged pole position despite crisis events.

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<sup>40</sup> K. Abbott, P. Genschel, D. Snidal and B. Zangl (eds), *INTERNATIONAL ORGANIZATIONS AS ORCHESTRATORS* (2015).

<sup>41</sup> J. BRAITHWAITE AND P. DRAHOS, *GLOBAL BUSINESS REGULATION* (2000).

<sup>42</sup> D. Lawrence, *Private Exercise of Governmental Power*, 61 *INDIANA LAW JOURNAL* 647 (1986).

<sup>43</sup> L. Pauly, *Global Finance, Political Authority, and the Problem of Legitimation*, in *THE EMERGENCE OF PRIVATE AUTHORITY IN GLOBAL GOVERNANCE* (R. B. Hall and T. Biersteker, eds, 2002), at 76.

<sup>44</sup> Also A. Page, *Self-Regulation: The Constitutional Dimension*, 49:2 *MODERN LAW REVIEW* 141 (1986).

<sup>45</sup> C. CROUCH, *THE STRANGE NON-DEATH OF NEO-LIBERALISM* (2011).

<sup>46</sup> A. Johnston, *Corporate Governance is the Problem, Not the Solution: A Critical Appraisal of the European Regulation on Credit Rating Agencies*, 11 :2 *JOURNAL OF CORPORATE LAW STUDIES* 395 (2011).

<sup>47</sup> P. Delimatsis, *The Future of Transnational Self-Regulation – Enforcement and Compliance in Professional Services*, 40:1 *HASTINGS INTERNATIONAL AND COMPARATIVE LAW REVIEW* 1 (2017); M. Reed, *Elites, Professions and the Neoliberal State: Critical Points of Intersection and Contention*, 5:3 *JOURNAL OF PROFESSIONS AND ORGANIZATION* 297 (2018).

<sup>48</sup> H. McVea, *Predators and the Public Interest: “The Big Four” and Multidisciplinary Practices*, 65:6 *MODERN LAW REVIEW* 811 (2002).

<sup>49</sup> E. PARTITI, *REGULATING TRANSNATIONAL SUSTAINABILITY REGIMES* (2022).

<sup>50</sup> P. Delimatsis; O. Kanevskaia; and Z. Verghese, *Strategic Behavior in Standards Development Organizations in Times of Crisis – The Case of IEEE*, 29:1 *TEXAS INTELLECTUAL PROPERTY LAW JOURNAL* 127 (2021).



While one can observe a struggle over control when the public and the private interact in regulating the economy, the two sectors of finance and product markets in particular appear to have intrinsic characteristics (for instance, complexity, risk, uncertainty, impact on public goods) and a peculiar culture (for instance, extensive professionalization and technical avant-gardism) which show how embedded they are in the relevant public bureaucracies. This is a trait that, as we will show later, most likely favors the normativity of any rule-making activity private forces in these sectors undertake. Additionally, private regulatory activity in both issue-areas entails an important degree of constitutionalization.

Therefore, the two areas constitute test-beds for the theoretical background of institutional resilience and the role of crises. In what follows we briefly identify certain illustrative examples, which could lead to further research in the two issue-areas of private standard-setting through the conceptual lens proposed in this article.

## 1. Finance

Finance is an important area for our purposes, as it not only exemplifies the problem of domestic enforcement in a global economic environment but also the fluidity of authority, whereby public and private regulators and enforcers interact. Private rulemaking in finance has evolved the last three decades hand-in-hand with globalization. Privatization during the '80s and ensuing financialization were key in sustaining the neoliberal global order.<sup>51</sup> The politics of finance changed dramatically in early 2000s on the occasion of the 2004 Basel Accord, which coincides with the emergence of transnational business associations lobbying the BCBS directly.<sup>52</sup> The soft law that was created jointly by bankers and independent national central bankers in London, New York or Basel would initially create voluntary benchmarks. However, they soon became important normative benchmarks or mandatory technical requirements referenced in State laws, for instance, through the incorporation of Basel II and, more recently, III in legislative instruments.<sup>53</sup>

Several examples from the world of finance demonstrate the resilience of financial private rule-making despite crises. Other than the unsuccessful enforcement for criminal activity (for instance, only one small US community bank, Abacus, with assets of \$282 million was accused for mortgage fraud in the US),<sup>54</sup> a striking example was the scandalous manipulation of the London Interbank Offered Rate or 'Libor', the most important inter-bank interest rate globally that determined the price of multiple financial instruments and contracts. The use of Libor has been pervasive, from

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<sup>51</sup> G. KRIPPNER, *CAPITALIZING ON CRISIS: THE POLITICAL ORIGINS OF THE RISE OF FINANCE* (2011).

<sup>52</sup> A. Newman and E. Posner, *Structuring transnational interests: the second-order effects of soft law in the politics of global finance*, 23:5 *REVIEW OF INTERNATIONAL POLITICAL ECONOMY* 768 (2016).

<sup>53</sup> P. Delimatsis, *Financial Innovation and Prudential Regulation – The New Basel III Rules*, 46:6 *JOURNAL OF WORLD TRADE* 1309 (2012).

<sup>54</sup> J. Fan, 'The Accused', *New Yorker*, 12 October 2015; also N. Feldman, 'Why the Law Failed to Punish Wrongdoers in the Financial Crisis', *Wall Street Journal*, 24 May 2016; K. Freifeld, 'Abacus bank acquitted of all charges in N.Y. mortgage fraud trial', *Reuters*, 4 June 2015, available at: <https://www.reuters.com/article/us-abacus-federal-acquittal/abacus-bank-acquitted-of-all-charges-in-n-y-mortgage-fraud-trial-idUSKBN0OK21620150604>.

mortgages to student loans to financial derivatives. The scandal entailed banks falsely inflating or deflating their rates to profit from trades.<sup>55</sup> Libor was administered by the British Bankers Association (BBA), calculated by Thomson Reuters based on data submitted by major London banks.<sup>56</sup>

As information about rigging was released, the UK Financial Services Authority recommended the transfer of Libor oversight and governance away from the BBA.<sup>57</sup> Crucially, a tender process had to be run by an independent committee to choose the new administrator. The Financial Conduct Authority (FCA) guaranteed the overall success of the process of transferring the Libor administrator. The call for tender resulted in the transfer in 2013 of the Libor administration from BBA to the NYSE Euronext Rate Administration Ltd, a UK-based company, licensed by the FCA,<sup>58</sup> which is a private body.

NYSE Euronext is a Delaware corporation headquartered in New York. It was acquired by the IntercontinentalExchange (ICE), an energy-related commodities trading company, in 2012. The ICE Benchmark Administration (IBA) is currently the Libor administrator.<sup>59</sup> An oversight committee composed of sixteen members oversees IBA. Crucially, only three members of this committee are representatives of regulators: The Bank of England, the National Bank of Switzerland and the US Federal Reserve. The three bank representatives have an observer status.

Often, efforts for dominance and intensive lobbying by private bodies lead to strengthening their regulatory power. For instance, the International Swaps and Derivatives Association (ISDA), a transnational coalition of banks with a crucial role in the over-the-counter (OTC) derivatives market, has managed to maintain and even strengthen the role that its successive Master Agreements have played in OTC transactions. One successful action was to codify the contractual language used by market actors into a Master Agreement (MA), thereby minimizing transaction costs.<sup>60</sup>

Another, more important accomplishment for ISDA was to successfully lobby for ISDA's netting

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<sup>55</sup> Economist, 'The rotten heart of finance', 7 July 2012.

<sup>56</sup> Economist, 'Bangsters – How Britain's rate-fixing scandal might spread – and what to do about it', 7 July 2012.

<sup>57</sup> Financial Services Authority (FSA), 'The Wheatley Review of LIBOR: final report', September 2012.

<sup>58</sup> 'The Hogg Tendering Advisory Committee announces that NYSE Euronext is to be the new LIBOR administrator', Press Release of 9 July 2013, available at: <https://www.gov.uk/government/groups/hogg-tendering-committee-for-libor>.

<sup>59</sup> ICE Libor had to be replaced by the end-2021 with a system of Secured Overnight Financing, Risk-Free Rates (SOFRs) which will be administered by central banks (eg SONIA for Bank of England and SOFR for the Fed) . However, new financial contracts maturing after the end of 2021 continue to reference Libor. Crucially, ICE administration will offer alternative benchmarks as of June 2023, thereby competing with the benchmarks offered by central banks: see <https://www.fintechfutures.com/techwire/ice-benchmark-administration-provides-update-on-intention-to-launch-usd-sofr-spread-adjusted-ice-swap-rate-as-a-benchmark/>. More interestingly, ISDA appears to promote the use of ICE's benchmark in its Fallbacks Protocol: See <https://www.isda.org/a/mnLgE/ISDA-Guidance-USD-LIBOR-ICE-Swap-Rate-041323.pdf>.

<sup>60</sup> J. Braithwaite, *Standard Form Contracts as Transnational Law: Evidence from the Derivatives Markets*, 75 MODERN LAW REVIEW 779 (2012).

rules so that ISDA members are able to net out their positions before the imposition of the judicial stay that would occur in ordinary bankruptcy proceeding. The justification given was that any other solution may increase systemic risk.<sup>61</sup> However, the financial crisis showed that such favouritism unavailable to other creditors weakens the incentives of derivatives counterparties for market discipline, as they do not need to cater for counterparty solvency.<sup>62</sup>

During its lifetime, ISDA successfully resisted various attempts to subject OTC derivatives to public oversight; such efforts continued in the post-crisis financial landscape.<sup>63</sup> ISDA remained the private regulator *par excellence* in global derivatives contracts: it collaborated with the 18 largest banks and the FSB for the adoption of the Resolution Stay Protocol, which is yet another indication of ISDA's regulatory role in the derivatives market via its MA but also the collective capacity of private actors active in international financial markets to swiftly (re-)create and repair the relevant markets through standard-setting.<sup>64</sup>

Crucially for our purposes, ISDA managed to remain relevant in the post-crisis landscape by pursuing an adaptation strategy that focused on more intensive and swift standardization of key contractual terms for credit default swaps (CDS) and diversified its responses to criticism through cooperation with other industry associations. Furthermore, through the creation of the CDS determination committees (DC), ISDA has also become the de facto arbiter of credit event questions globally. After the controversy this governance issue sparked, in 2018, ISDA transferred the role of credit derivatives DC secretary to DC administration services, Inc (DCAS). Still, although ISDA no longer participates in the DC process, DCAS is a Delaware-incorporated subsidiary of ISDA.<sup>65</sup> In addition, it appears that DCs continue favouring the seller side in the composition of committees, even if a supermajority if required. More recently, ISDA entered the field of financial data governance, to occupy early on the field of digital documentation in OTC derivatives markets.<sup>66</sup>

Despite significant regulatory instruments and intensive standard-setting efforts globally, ranging from the Dodd-Frank Act and the Basel III standards to the market surveillance that FSB exercises, lobbying efforts by the financial industry were largely successful in delaying implementation of reforms or restricting their scope.<sup>67</sup> Unprecedented regulatory changes impacted significantly

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<sup>61</sup> K. Borowicz, *Contracts as Regulation – The ISDA Master Agreement*, 16:1 CAPITAL MARKETS LAW JOURNAL 72 (2021), at 85.

<sup>62</sup> M. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STANFORD LAW REVIEW 539 (2011).

<sup>63</sup> B. Carruthers, *Financialization and the institutional foundations of the new capitalism*, 13:2 SOCIO-ECONOMIC REVIEW 379 (2015), at 389.

<sup>64</sup> G. Morgan, *Legitimacy in financial markets: credit default swaps in the current crisis*, 8 SOCIO-ECONOMIC REVIEW 17, 39-40 (2010)

<sup>65</sup> ISDA, 'ISDA transfers Determinations Committees Secretary Role to New Independently Managed Company', 12 October 2018, available at: <https://www.isda.org/a/P6dEE/DCAS-Appointed-DC-Secretary-final.pdf>.

<sup>66</sup> See: <https://www.isda.org/2023/01/30/bringing-legal-certainty-to-digital-asset-derivatives/>.

<sup>67</sup> P. Ban and H.You, *Presence and influence in lobbying: Evidence from Dodd-Frank*, 21:2 BUSINESS AND POLITICS 267 (2019)

public-private interactions in that unparalleled lobbying occurred by trade associations.<sup>68</sup> More recently, the collapse of Silicon Valley Bank and Signature Bank was attributed to a regulatory rollback, yet another product of lobbying efforts by the financial industry, that kept community and mid-size banks outside the scope of Dodd-Frank.<sup>69</sup>

Another example of resilient private dominance is the Institute for International Finance (IIF), a lobby that used the 1988 Basel Accord as an opportunity to expand its membership and resources with a view to reviving the organization. It reframed its mission to capitalize on and influence to its liking the new political landscape of business advocacy that was emerging with the transnational benchmarking that occurred at BIS.<sup>70</sup> Soon, from an organization in crisis in the late '80s, IIF became the BCBS' most important industry interlocutor and the leading transnational industry lobby in finance, thereby changing the ecology of BIS and the politics of banking regulation.<sup>71</sup> IIF overcame an organizational crisis through the identification of new stakeholders; an expansion of its transnational advocacy and internal change to facilitate new activities and accommodate members.<sup>72</sup> Crucially, however, IIF increased its relevance both towards markets and public regulators. It has shaped an ever-increasing part of financial regulation by entering the realm of standard-setting in sovereign debt crisis resolution in the wake of the Greek sovereign debt crisis and overcoming competition by other private bodies.<sup>73</sup>

More recently, it appears that a similar institutional structure was followed in the creation of the Global Financial Markets Association (GFMA), through which international banks coordinate their lobby efforts in the new regulatory landscape that emerged post-crisis, notably through the creation of the FSB. At the national level, delays in the transposition of Basel III or attempts to make transitional arrangements permanent suggest that efforts for industry lobbying are coordinated at different levels.

If anything, the examples mentioned above underscore the resilience of private regulatory bodies overtime and the deeply embedded public private interactions that render very difficult a paradigm shift in financial regulation.<sup>74</sup> As regulators are risk-averse and often lack resources and expertise, complexity can lead to limited intervention, while industry associations extend their power and

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<sup>68</sup> E. Spitler, *The Long Game: The Decade-Long Effort to Dismantle the Dodd-Frank Act*, 24 NORTH CAROLINA BANKING INSTITUTE 1 (2020).

<sup>69</sup> R. Burns and J. Rock, 'SVB said it was too small to need regulation. Now it's "too big to fail"', *The Guardian*, 17 March 2023.

<sup>70</sup> E. Tsingou, *Transnational Private Governance and the Basel Process: Banking Regulation and Supervision, Private Interests and Basel II*, in *TRANSNATIONAL PRIVATE GOVERNANCE AND ITS LIMITS* (J. Graz and A. Nolke eds, 2008).

<sup>71</sup> K. Borowicz, *Standard-Setting and Organizational Resilience – The Case of the Institute for International Finance*, in *THE EVOLUTION OF TRANSNATIONAL RULE-MAKERS THROUGH CRISES* (P. Delimatsis, S. Bijlmakers and K. Borowicz eds, 2023), at 85.

<sup>72</sup> Newman and Posner, *supra* note 52.

<sup>73</sup> J. Blom, *The Institute of International Finance: From Poacher to Gamekeeper?*, 23:1 BUSINESS AND POLITICS 153 (2021).

<sup>74</sup> J. Karremans and A. Héritier, *The emergence of transnational hybrid governance: how private risks trigger public intervention*, in *GOVERNING FINANCE IN EUROPE* (A. Héritier and M. Schoeller eds, 2020), 137, 143.

aggressively proselytize actors, networks and objects or create coalitions.<sup>75</sup> Non-State bodies and industry associations active in the field steer the regulatory agenda towards their preferred solutions (through swift reorientation of their purpose and activities; showcasing of their expertise; rapid promulgation of amended versions of their industry-led standards; market shaping and steering; intensive lobbying, individually or by combining forces with other private bodies) offering little opportunity to regulators for reflective deliberation.<sup>76</sup> This form of transnational intellectual capture leads to policy appropriation by private financial rule-makers.<sup>77</sup>

## 2. Product markets

Similar phenomena can be traced in product markets, whereby private standard-setters have proliferated at a rapid pace in the last three decades. Product safety became the prerogative of private bodies (companies and associations thereof) which have proactively sought participation and influence in standard-setting and certification.<sup>78</sup> Some of these private bodies such as the ISEAL Alliance or the Global Food Safety Initiative (GFSI) have built coalitions to also assume a meta-governance role. Through its codes, for instance, ISEAL Alliance governs the conduct of the Forest Stewardship Council (FSC), the Marine Stewardship Council (MSC) or Fairtrade International.<sup>79</sup> The GFSI Benchmarking Requirements allows for the recognition of food safety standards and certification schemes.

This type of non-governmental organization (NGO) activism arguably fills a gap between increased consumer awareness and procrastination of public authorities (for instance, due to intense lobbying by producers).<sup>80</sup> By implication, then, the involvement of a private regulator impacts both the efficiency of public regulation (either in complementing it or, as we argue, substituting for it) and the economic performance of the relevant sector (including the level and type of investment). Such involvement may be beneficial for social welfare if, *inter alia*, private intervention has previously addressed information asymmetries sufficiently.<sup>81</sup> However, it may also perpetuate an industry-led approach that focuses on ex-post mitigation of loopholes in safety and quality assurance rather than preventive action to anticipate problematic aspects within the supply chain. For instance, research in the US medical devices sector suggests that corporate

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<sup>75</sup> H. McKEEN-EDWARDS AND T. PORTER, *TRANSNATIONAL FINANCIAL ASSOCIATIONS AND THE GOVERNANCE OF GLOBAL FINANCE – ASSEMBLING WEALTH AND POWER* (2013).

<sup>76</sup> R. Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *YALE LAW JOURNAL* 1521, 1591 (2005). *Contra* P. Conti-Brown and B. Feinstein, *The Contingent Origins of Financial Legislation*, 99 *WASHINGTON UNIVERSITY LAW REVIEW* 145 (2021).

<sup>77</sup> E. Tsingou, *Club governance and the making of global financial rules*, 22:2 *REVIEW OF INTERNATIONAL POLITICAL ECONOMY* 225, at 228 (2015).

<sup>78</sup> J. Doh and T. Guay, *Corporate Social Responsibility, Public Policy, and NGO Activism in Europe and the United States: An Institutional Stakeholder Perspective*, 43:1 *JOURNAL OF MANAGEMENT STUDIES* 47 (2006).

<sup>79</sup> S. Bernstein and H. van der Ven, *Best Practices in Global Governance*, 43:3 *REVIEW OF INTERNATIONAL STUDIES* 534 (2017).

<sup>80</sup> Cf. C. Rhodes, *Democratic Business Ethics: Volkswagen's Emissions Scandal and the Disruption of Corporate Sovereignty*, 37:10 *ORGANIZATION STUDIES* 1501 (2016), at 1513.

<sup>81</sup> J. Daubanes and J.-C. Rochet, *The Rise of NGO Activism*, 11:4 *AMERICAN ECONOMIC JOURNAL* 183 (2019).

lobbying positively affects product recalls rather to the detriment of investments in product safety.<sup>82</sup>

The proliferation of private schemes setting voluntary safety standards is a recent phenomenon that can be traced back to previous crises. Certifications for forestry products (FSC), coffee (UTZ, Rainforest Alliance) and other commodities were set up after the commodity price collapse and increasing deforestation, while the food crisis of end-2000's led to the emergence of private biofuel certification. Private schemes on labour certification such as the Social Accountability International and the Fair Labour Association (FLA) resulted from bad sweatshop conditions and scandals in the garment industry.<sup>83</sup> GlobalG.A.P. and the GFSI are the progeny of the BSE scandal and food safety concerns.

Calls for better quality and safety, increased responsibility and accountability by retailers led to the emergence of such schemes that expand the scope of self-regulation.<sup>84</sup> Additional reasons for such emergence are the need to minimize reputation costs, the possibility for the creation of new markets for certified products,<sup>85</sup> the growing outsourcing and global diffusion of the production by supply chains which call for better monitoring and standardization but also efforts to deter State intervention.<sup>86</sup> Surely, such a context may lead to the emergence of private schemes. For example, the International Cocoa Initiative (ICI) was created by the chocolate industry – and supported by regulators – in the wake of evidence about child labour in cocoa plantations in Western Africa. FLA's creation in 1999 aimed at eliminating labour abuses in the apparel sector and shielded the industry from public intervention.<sup>87</sup> The Bangladesh Accord was a bottom-up, corporate approach after the Rana Plaza collapse to improve worker safety in the ready-made garment industry.<sup>88</sup>

Crises that threaten self-regulatory idealism can also trigger the expansion of private standard-setting activities towards new regulatory ventures. For example, in the aftermath of the horsemeat scandal, the GFSI, an industry-led private scheme composed of the biggest retailers worldwide, swiftly created a food fraud think tank, amended its Guidance document for food safety standards and included food fraud in its benchmarking requirements, thereby ensuring it continued its legitimacy-enhancing regulatory activity in the food sector, in the shadow of the State. Another

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<sup>82</sup> V. Giannett and R. Srinivasan, *Corporate Lobbying and product recalls: an investigation in the US medical device industry*, 50 JOURNAL OF THE ACADEMY OF MARKETING SCIENCE 941 (2022).

<sup>83</sup> E. Partiti, *Human Rights Due Diligence and the Evolution of Voluntary Sustainability Standards*, at 136.

<sup>84</sup> D. P. Baron, *Morally Motivated Self-Regulation*, 100 AMERICAN ECONOMIC REVIEW 1299 (2010).

<sup>85</sup> T. Bartley, *Certification as a mode of social regulation*, in HANDBOOK ON THE POLITICS OF REGULATION (D. Levi-Faur, ed., 2011), at 441.

<sup>86</sup> J. Wouters et al., *Private standards, global governance and international trade: the case of global food safety governance*, in Marx et al., (eds), PRIVATE STANDARDS AND GLOBAL GOVERNANCE – ECONOMIC, LEGAL AND POLITICAL PERSPECTIVES (2012), 255, at 258.

<sup>87</sup> S. Greenhouse, 'Critics Question Record of Monitor Selected by Apple' (New York Times, 13 February 2012); R. Locke, *THE PROMISE AND LIMITS OF PRIVATE POWER: PROMOTING LABOR STANDARDS IN A GLOBAL ECONOMY* (2013).

<sup>88</sup> J. Reinecke and J. Donaghey, *The Politics of Collaborative Governance in Global Supply Chains – Power and Pushback in the Bangladesh Accord*, at 154.

example relates to the resilience of the American Petroleum Institute (API), which became co-regulator and enforcer of safety standards in the wake of the Deepwater Horizon oil spill in 2010.<sup>89</sup>

Crucially, deterring or delaying public regulation even in the aftermath of crises that shook consumer trust is the objective of transnational economic activism by private bodies. In the EU, the European Automobile Manufacturers' Association (ACEA) successfully lobbied the European legislature for two decades against binding emission targets by proposing – but never fully implementing – a voluntary, industry-led standard and later self-testing methods.<sup>90</sup> In the US, the Cosmetic, Toiletry, and Fragrance Association (CTFA, now known as the Personal Care Products Council) created a “talc task force” and, encouraged by Johnson&Johnson approved in mid-70s an industry-wide, voluntary standard that would not detect chrysotile asbestos in cosmetic talc. While the self-regulatory preemption occurred in the US, this asbestos-related scandal had global repercussions that spanned three decades.<sup>91</sup>

Finally, the dominance of a culture that favours corporate interest over product safety may be preserved through the often-problematic use of private certification mechanisms. For instance, the PIP scandal demonstrated how insufficient safety and quality checks by private certifiers such as TÜV Rheinland exposed thousands of women to substandard silicone implants. While the EU introduced a new Medical Devices Regulation to attenuate safety-related concerns, strict liability for such private certifiers is not yet part of a public response.<sup>92</sup> In the case of biofuels, certification in the EU is done by a limited group of accredited private bodies such as Bonsucro and ISCC, which potentially creates conflicts of interest and streams of undue influence.

Overall, it appears that each scandal or related crisis in the supply chain or at the downstream level leads to yet another decline in the perceived ability of the State to effectively regulate and guarantee product safety. In addressing more recent crises, it remains unclear as to how much control and effective supervision the public authorities actually exercise, as the private regulatory landscape becomes increasingly convoluted and multifaceted (often with retailers playing a dubious role in production, standard-setting and certification) and by implication contests the State legitimacy and ability to regulate product safety.<sup>93</sup>

### III. THE ROLE OF CRISES IN CHALLENGING RESILIENCE

To date, the role of crises as a driver that activates resilience-related reactions by private rule-

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<sup>89</sup> M. Nieves, *The Case of the American Petroleum Institute and the Deepwater Horizon Oil Spill*, 197.

<sup>90</sup> European Parliament Report on the inquiry into emission measurements in the automotive sector, A8-0049/2017; also A. Neslen, ‘UK, France and Germany lobbied for flawed car emissions tests, documents reveal’ (The Guardian, 24 September 2015).

<sup>91</sup> C. Cep, ‘Johnson&Johnson and a New War on Consumer Protection’ (New Yorker, 19 September 2022).

<sup>92</sup> C. Glinski and P. Rott, *Regulating Certification Bodies in the Field of Medical Devices: The PIP Breast Implants Litigation and Beyond*, 2 EUROPEAN REVIEW OF PRIVATE LAW 403 (2019).

<sup>93</sup> T. Havinga et al (eds.), *THE CHANGING LANDSCAPE OF FOOD GOVERNANCE: PUBLIC AND PRIVATE ENCOUNTERS* (2015).

makers has been largely neglected. Yet, crises are extraordinary, erratic events that threaten the core values of a given system, thereby revealing the weaknesses of regular structures. Exogenous crises (but also internal heated situations such as *intra*-institutional conflicts or intensive competition due to *inter*-institutional pluralism)<sup>94</sup> test the resilience of private authority and strengthen its incentives to internalize the need for change.

Crises are moments of severe mutation that lead to an oscillation of a given system at the interstices of regularity. A crisis can be instant or grow gradually,<sup>95</sup> notably if it is internal (for instance, a growing sense of de-legitimization within an organization). It is often linked to a regulatory disaster. Depending on its severity, such a critical moment is expected to allow for recovery or the establishment of a new status quo. However, it may lead to disruption and the collapse of the system, depending on the system's resilience and internal dynamics.<sup>96</sup>

More generally, external triggering points that challenge the institutional status quo; question the legitimacy, practices and mechanics of a given organization; and call for urgent introspection, action and radical institutional reform may also test the resilience of that institution.<sup>97</sup> As a concept, resilience is strongly associated with crises, as it entails a process of adaptation, improvisation to find responses to shocks, and recovery. If we view crises as a dynamic process that evolves overtime, resilience and crises are two closely interrelated concepts. Just as recovery cannot exist without a preceding crisis, resilience presupposes a disturbance that causes adversity and awakes organizations' institutional reflexes.<sup>98</sup>

For our theoretical inquiry, crises are decisive moments to test private rule-makers' flexibility and adaptability; diversity of strategies and responses; entrepreneurial attitude, malleability, and resourcefulness. This may lead, for example, to internal reorganisation as a reaction to a crisis (eg the case of IIF or GlobalGAP) or to proactive lobbying to strengthen their regulatory role in the market, but also in legislation (eg, ISEAL Alliance, FSC or ISDA). Introducing crises as a variable in our theoretical construct can offer robust explanations about institutional resilience and capacity to maintain and increase regulatory space through adversity to the detriment of the State.<sup>99</sup>

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<sup>94</sup> A. Marx and J. Wouters, *Competition and Cooperation in the Market of Voluntary Sustainability Standards*, in Delimatsis (ed), *supra* note 2.

<sup>95</sup> T. Williams et al., *Organizational Response to Adversity: Fusing Crisis Management and Resilience Research Streams*, 11:2 ACADEMY OF MANAGEMENT ANNALS 733 (2017).

<sup>96</sup> A. Rinscheid et al., *Why do junctures become critical? Political discourse, agency, and joint belief shifts in comparative perspective*, REGULATION AND GOVERNANCE (2019).

<sup>97</sup> See, for instance, the literature on standards battles: Luis Cabral and T. Kretschmer, *Standards battles and public policy*, in STANDARDS AND PUBLIC POLICY (S. Greenstein and V. Stango eds., 2006), at 329.

<sup>98</sup> M. Scheffer et al., *Dynamic Interaction of Societies and Ecosystems –Linking Theories from Ecology, Economy, and Sociology*, in Gunderson and Holling (eds), *supra* note 13, 195, at 202.

<sup>99</sup> J. Black, *Critical Reflections on Regulation*, 27 AUSTRALIAN JOURNAL OF LEGAL PHILOSOPHY 1 (2002), at 4.



#### IV. HOW PRIVATE RULE-MAKERS FREE-RIDE

##### A. *The initial rise to authority*

The recent decrease of public authority is linked to the continued influence and popularity of neoliberalism. Neoliberal concepts such as free trade, competition, liberalization and laissez-faire enable the emergence of private regulation.<sup>100</sup> While the State prioritizes certain social responsibilities, aligning with ordo-liberal ideas that advocate for a strong role of the State in specific areas and a facilitating role in market governance, this situation creates favourable conditions for collective opportunistic behaviour by private rule-making bodies.<sup>101</sup> Essentially, crises allow private bodies to consolidate their autonomy and actively seize regulatory power.

Crises within a given organizational ecosystem serve as catalysts that empower these privately-driven forces or create to new ones. Meanwhile, existing checks and balances and a strict approach towards rule-of-law enforcement fail to fulfil their original purpose. These privately-driven forces become virtually uncontrollable in relation to their supposed principals, the States. Any potential cooperation with the State then is not the result of orchestrated efforts by governmental actors to improve regulatory performance. Instead, we propose that it is yet another strategy to expand the domain of private authority. This process of increasing co-optation of regulatory authority is most likely to occur in the aftermath of intermittent crises, when the potential for opportunistic actions is at its peak.

When delegation of regulatory power backfires, the State is faulted by the public opinion<sup>102</sup> and acts through extreme instruments such as bailouts or import bans. Meanwhile, a peculiar organizational progeny evolves apace,<sup>103</sup> detached from political constraints, which the State (in its capacity as principal) is unable to reverse. Counter-intuitively, the independence of public regulatory and supervisory authorities exacerbates such phenomena<sup>104</sup>. At best, these sub-national actors can countenance certain types of behavior by private bodies or seek to participate in transnational networks through governance partnerships that strive for a stable, yet fragile, state of cooperation – or else, ‘regulatory peace’.<sup>105</sup>

In this case, regulators appear to act as intermediaries between the State and private bodies.<sup>106</sup>

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<sup>100</sup> D. Fuchs and A. Kalfagianni, *The Causes and Consequences of Private Food Governance*, 12:3 *Business and Politics* 1 (2010).

<sup>101</sup> Cf. O. Williamson, *Opportunism and its Critics*, 14 *MANAGERIAL AND DECISION ECONOMICS* 97 (1993).

<sup>102</sup> J. Black, *Rebuilding the Credibility of Markets and Regulators*, *LAW AND FINANCIAL MARKETS REVIEW* 1-2 (2009).

<sup>103</sup> Cf. T. JOHNSON, *ORGANIZATIONAL PROGENY – WHY GOVERNMENTS ARE LOSING CONTROL OVER THE PROLIFERATING STRUCTURES OF GLOBAL GOVERNANCE* (2014).

<sup>104</sup> T. Bach et al., *The role of agencies in policy-making*, 31:3 *POLICY AND SOCIETY* 183 (2012), at 185.

<sup>105</sup> K. Nicolaidis, *Trusting the Poles? Mark 2: towards a regulatory peace theory in a world of mutual recognition*, in *REGULATING TRADE IN SERVICES IN THE EU AND THE WTO – TRUST, DISTRUST AND ECONOMIC INTEGRATION* (I. Lianos and O. Odudu eds., 2012).

<sup>106</sup> K. Abbott et al, *Theorizing Regulatory Intermediaries: The RIT Model*, 670 *ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE* 14 (2017).

However, these intermediaries would tend to be unduly influenced by the agents (that is, the regulatees) rather than the principal (the State), which deters timely regulatory intervention.<sup>107</sup> Examples abound. One could think of the rather marginal role of the European Commission in the standard-setting activities of the European standardization organizations (ESOs), the cooperation struggles with private certifiers or the regulation of derivatives discussed earlier.

We term the underlying phenomenon ‘free riding of private ordering’ and observe the evolutionary process that nourishes private authority in finance and product markets activities. Arguably, in the two areas of product markets and finance that we explore, such free-riding has been *re-active* for the most part. It is the result of a process whereby, at the initial stage, private bodies respond favorably to straightforward and sometimes urgent messages conveyed by the State calling for assistance.

### *B. The transition to proactive free-riding and voluntary economic activism*

As exogenous crises affect the distribution of authority to public and private actors, significant power shifts with potentially longstanding effects occur. Currently, we are witnessing a transition from a phase of *reactive* free-riding, that is, a process where private bodies were offered authority by the State, towards a phase where private bodies *actively* claim authority by a worn-out State after a crisis. We view *proactive* free-riding as an incipient phenomenon observed empirically, which emerges out of several decades of bounded rationality, theories of uncontested technical superiority, the ideational flexibility of neoliberal rhetoric and an increasingly globalized economic activity.

Proactive free-riding is the very manifestation of voluntary economic activism at the transnational level. Private rule-makers have political agency, a well-defined ‘governance space’ and policy preferences that they want to defend and see expressed in policymaking.<sup>108</sup> The success of proactive free-riding lies on the core rule-making activities that such private bodies undertake, notably the continuous promulgation of voluntary standards that are promptly prepared, adopted and diffused to pre-empt rules by public rule-making competitors and thus ensure increased authority and continuous dominance.<sup>109</sup>

In line with the theory of resilience discussed earlier,<sup>110</sup> proactive free-riding results from a lengthy process of volatility and shifting authority where complex adaptive regulatory organizations are active. Private power accumulation is a continuous process that starts with the delegation (explicit or tacit) of power and thus the transfer of legitimacy to a private body. Thereon, through rule-making and intensive drafting of standards, the private body accumulates knowledge and

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<sup>107</sup> Cf. C. PARKER, *THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY* (2002).

<sup>108</sup> See S. Renckens, *The instrumental power of transnational private governance: Interest representation and lobbying by private rule-makers*, 33:3 *GOVERNANCE* 657, at 658 (2020).

<sup>109</sup> Cf. A. Héritier and S. Eckert, *New Modes of Governance in the Shadow of Hierarchy: Self-Regulation by Industry in Europe*, 28 *JOURNAL OF PUBLIC POLICY* 113 (2008).

<sup>110</sup> See *infra*, Section II.A.

reconfirms its output legitimacy internally while building trust externally as a reliable interlocutor. Those initially indifferent in contributing (indeed, free riders exist even *within* a given private rule-making body) see the opportunity and rally more actively, as they recognize that low-cost, high-impact authority is potentially up for grabs. Crises suddenly become opportunities for growth.

Crucially, whereas the values and objectives of a complex adaptive system of this type are aligned, the characteristics and motivations of the group are not necessarily homogenous. Rather, heterogeneity allows a particular group to overcome distress and adversity, thereby enhancing its resilience in the long run. In line with ecosystems resilience theory, diversity and heterogeneity allow for the strategic use of complexity and exercise of authority in the long run.<sup>111</sup> Such traits ensure sufficient flexibility to be shielded from *internal* challenges of due process and balance of interests, and *external* attacks of arbitrariness and lack of legitimacy.<sup>112</sup>

Crises constitute opportunities to accumulate wisdom and develop the capacity to expect the unexpected, absorb it and grow.<sup>113</sup> They allow private bodies to enhance their collective memory and identity and eventually use a critical tipping point to grow stronger.<sup>114</sup> At that moment, the critical transition occurs: the private rule-making body overrides State power and dominates a regulatory field, thereby creating slowly a new equilibrium and stable state of authority in the system.<sup>115</sup> From an economic viewpoint, this may be an actual market tipping, that is, a situation where all stakeholders adhere to the new normal, monopoly-like situation. The more users (regulatees) adhere to the new reality and the higher the user engagement the more valuable (but also harder to break) this reality becomes for the State.<sup>116</sup>

Proactive free-riding is aterritorial. Potent transnational elites gradually reinforce their autonomous standard-creating authority and expand their subjects' group, thereby producing authoritative collective action of including and excluding beneficiaries of their activities.<sup>117</sup> In this evolving constellation, the State and the private bodies are no longer complements, but increasingly become substitutes. Absent any authority to adapt hard law, private bodies shape global economic processes through the derived normativity of the standards that they promulgate

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<sup>111</sup> Additionally, diversity and heterogeneity are relative and volatile in that, at any given moment, exploiting the current levels or exploring lower (or higher) levels of variation to increase the system's adaptive capacity may be warranted. R. AXELROD AND M. COHEN, *HARNESSING COMPLEXITY – ORGANIZATIONAL IMPLICATIONS OF A SCIENTIFIC FRONTIER* (2000), at 32ff.

<sup>112</sup> C. Fiedler et al., 'Membership, Governance and Lobbying in Standard-Setting Organizations', TILEC Discussion Paper No 2018-42.

<sup>113</sup> C. Folke et al., *Adaptive Governance of Social-Ecological Systems*, 30 *ANNUAL REVIEW OF ENVIRONMENT AND RESOURCES* 441 (2005).

<sup>114</sup> B. Goldstein (2009), *Resilience to Surprises through Communicative Planning*, 14:2 *ECOLOGY AND SOCIETY* 33 (2009).

<sup>115</sup> Also M. Janssen, *The Future of Surprises*, in Gunderson and Holling (eds), *supra* note 13, 241, at 250.

<sup>116</sup> Cf. M. Katz and C. Shapiro, *Systems Competition and Network Effects*, 8:2 *JOURNAL OF ECONOMIC PERSPECTIVES* (1994), 93.

<sup>117</sup> O. Perez and O. Stegmann, *Transnational Network Constitutionalism*, 45:1 *JOURNAL OF LAW AND SOCIETY* 135 (2018).

and quickly diffuse in a globalized business landscape.

More importantly, one remains to wonder about the actual role and importance of law as an ordering device at the two levels of institutions and State rules. How can one explain the mismatch between the expectations vis-à-vis public supervisory authorities and their lack of action? Granted, designing and implementing ex post legal sanctions is costly, making it tempting to rely on market solutions, and market reputation in particular.<sup>118</sup>

As transnational economic activism is a lengthy, dynamic process in a field that public authorities are expected to supervise, the characteristics of the reaction of public authorities to authority usurpation is hard to trace. Yet, certain important insights emerge if we consider the examples of regulatory inaction in financial and product markets mentioned earlier. First, as suggested earlier, it appears that bounded rationality and path dependencies are critical factors, encouraging inaction. States' bureaucratic apparatus undermines any adequate and timely regulatory and supervisory responses. Additionally, cognitive biases developed during repeated interactions with the regulatees negatively affect the appetite for decisive action and enforcement of existing laws.<sup>119</sup> Regulators are reluctant by nature, which leads them to procrastinate in conditions of market euphoria (overconfidence) and peer pressure.<sup>120</sup> Economic prosperity brings with it pressures for further deregulation, deterring any regulatory intervention.<sup>121</sup>

Relatedly, such regulatory inaction may be the result of cultural capture, that is, the interaction of supervisors with interest groups that increases industry influence through certain mechanisms, in particular group identification (i.e. supervisors would act in a manner that conforms to the expectations of the groups with which they identify); status (for instance, the status of financiers and the financial sector as a whole may induce deference by supervisors); and relationship networks (a community of supervisors and regulatees is created that gives rise to relationship pressures in favor of the regulated industry).<sup>122</sup>

Crucially, regulators are lured to inaction due to proactive adoption by private bodies of self-regulatory initiatives and standards, even if they are shallow and superficial.<sup>123</sup> Indeed, signs of market discipline in finance and manufacturing dissuade regulatory intervention. Additionally, private and public lawmaking in complex sectors is often so intertwined that a future decoupling becomes virtually impossible. Public laws typically incorporate private standards by reference,

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<sup>118</sup> J. Ganuza; F. Gomez; and M. Robles, *Product Liability versus Reputation*, 32:2 JOURNAL OF LAW, ECONOMICS AND ORGANIZATION 213 (2016).

<sup>119</sup> C. Needham, *Listening to Cassandra: The Difficulty of Recognizing Risks and Taking Action*, 78 FORDHAM LAW REVIEW 2329, at 2347 (2010).

<sup>120</sup> E. Avgouleas, *The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy*, 9:1 JOURNAL OF CORPORATE LAW STUDIES 23, 41 (2009).

<sup>121</sup> E. Gerding, *The Next Epidemic: Bubbles and the Growth and Decay of Securities Regulation*, 38 CONNECTICUT LAW REVIEW 393, 422 (2006).

<sup>122</sup> J. Kwak, *Cultural Capture and the Financial Crisis*, in PREVENTING REGULATORY CAPTURE – SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT (D. Carpenter and D. Moss, eds, 2014), 71.

<sup>123</sup> N Malhotra et al., *supra* note 6.

acquiesce to them; complement and support them; or implement them.<sup>124</sup> However, they rarely change their underlying rationale, direction or (light) regulatory approach. Also, on the brink of a crisis, regulators and supervisors are occupied with crisis management. Eventually, stricter regulations that follow are frivolously enforced or the regulators have recourse to cosmetic changes, a type of indulgent regulation that allows for the upholding of a system that turns random disruptive advantage to lasting advantage for private bodies.<sup>125</sup>

## V. ELEMENTS OF A NEW THEORY OF PRIVATE COLLECTIVE ACTION

From what preceded, it appears opportune to explore ways that allow harnessing transnational economic activism in the fields identified earlier. For that, it is necessary to revisit existing theories of private collective action, including the concepts, actors and processes of private governance in finance and product markets, and undertake meticulous empirical, longitudinal studies before contemplating interventions in an ecosystem that has shown its resilience in multiple occasions.<sup>126</sup> Such studies would have to be thorough; although voluntary economic activism renders free-riding feasible, its practice has traditionally involved very creative forces of private nature, legal engineering and general rule ingenuity (think of codes of conduct, bylaws, guidelines and recommendations, performance and design standards and other persuasion-based instruments).

From the rudimentary view of strategies used by the private rule-makers identified in Section II and based on insights from complexity and resilience theories as well as law and economics and behavioral sciences, we propose that certain prerequisites must be met for a system to enter the proactive free-riding stage. Private rule-making bodies should possess four distinct capacities: growth; development; survival; and renewal. Thus, the system at stake should display a certain level of *internal energy for activation*, including available resources and the ability to pursue the organization's self-interest;<sup>127</sup> information feedback loops; entrepreneurial and innovative leadership to grow and invest in structure-building. The latter will be the result of experimentation, stable network connections; internal trust-building and dependencies.

Moreover, to develop further, the system should exhibit sufficient self-organization to retain information and capital acquired during the growth phase, thereby strengthening its qualitative indicators. The system would also be keen to continued development, which may be crucial for withstanding crises. When confronted with an inevitable crisis of unknown scale, a system must improvise to sustain vital functions. The prior accumulation of resources and innate traits of the

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<sup>124</sup> G. Shaffer, *Theorizing Transnational Legal Ordering*, 12 ANNUAL REVIEW OF LAW AND SOCIAL SCIENCE, 231-253 (2016).

<sup>125</sup> J. Black, *Paradoxes and Failures : The "New Governance" Techniques and the Financial Crisis*, 75:6 MODERN LAW REVIEW 1037, at 1048 (2012).

<sup>126</sup> Cf. M. Jacobides; C. Cennamo ; and A. Gawer, *Towards a theory of ecosystems*, 39 STRATEGIC MANAGEMENT JOURNAL 2255 (2018).

<sup>127</sup> Cf. T. Bütthe, *Engineering Uncontestedness? The Origins and Institutional Development of the International Electrotechnical Commission*, 12:3 BUSINESS AND POLITICS 1 (2010).

system structure enable existing and emergent leadership to invest effort in its survival, leading to new knowledge, new forms of adaptive capacity and, ultimately, resilience.

At this stage, certain factors increase the likelihood of survival during crises. These include modularity (low interdependence among components while preserving the system's collective memory), diversity and heterogeneity (both *in function* to allow for emergent leadership, and *in responses* to enable swift, adaptable actions). Effective communication, information intermediation, and timely yet robust decision-making (such as creating new standards and organizational rules) equally contribute to survival. Subsequent renewal phases may result in a system re-orientation, drawing on lessons learned for future development.<sup>128</sup>

In this phase of proactive free-riding, private rule-makers aim to expand and/or confirm their governance space. The timing of this phase depends on variables like the determination of private bodies to adopt new or modify existing standards quickly and the determination of overseers during crises. Public regulators, overseers and even judges often relinquish control to private bodies due to political constraints, uncertainty, issue complexity and bounded rationality.

The complexity of finance and product safety adds to the challenge of understanding the internal dynamics and social interactions among stakeholders. However, whereas private regulatory entities, often acting in uncharted waters, fail in their mission, the State rarely coerces them and even less reclaim authority to protect the public interest.<sup>129</sup> Even if such private bodies disappear, new, typically private-driven, contenders regain strength.<sup>130</sup>

The current wave of voluntary economic activism is both anarchic and conservative, exhibiting similarities to past iterations of rule-making, while showcasing new, innovative characteristics that enhance resilience and dominance. Stable private regulatory bodies are characterized by low connectivity, high diversity, collaborative learning, system innovation strategies, smoothed transition and identity-building.<sup>131</sup> We argue that, whereas delegation of power contributes to their empowerment, crises allow them to capitalize on certain tipping points that strengthen their status and influence. Standard-setting is key in this development. While existing literature describes the dynamics among standard-setters, it fails to explore the possibility of common mindsets *within* private regulatory bodies to exploit the State's weaknesses during crises. Notably, in these complex ecosystems, periods of crisis are often followed by intensified private standard-setting, thereby expanding their output in the form of standards.

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<sup>128</sup> Fath et al, *supra* note 10.

<sup>129</sup> M. Feintuck, *Regulatory Rationales beyond the Economic: In Search of the Public Interest*, in Baldwin et al (eds), *supra* note 32.

<sup>130</sup> Cf. J. Morse and R. Keohane, *Contested multilateralism*, 9 REVIEW OF INTERNATIONAL ORGANIZATIONS 385 (2014). Also O. Williamson, *The Lens of Contract: Private Ordering*, 92:2 AMERICAN ECONOMIC REVIEW 438 (2002), at 440.

<sup>131</sup> Cf. A. Haldane and R. May, *Systemic risk in banking ecosystems*, 469 NATURE 351 (2011); and C. Freeman and C. Perez, *Structural crisis of adjustment, business cycles and investment behaviour*, in TECHNICAL CHANGE AND ECONOMIC THEORY (G. Dosi et al. eds, 1988).

This new form of antagonistic private ordering deserves closer attention and research, as it may shed light on the evolution of contemporary private collective action. Emphasis should be placed on studying the nature of rules adopted in crisis moments, the role of diversification and heterogeneity, and the potential for homogeneity to lead to fragility in complex, interactive regimes.

By way of illustration, in the two areas discussed earlier, finance and product markets, heterogeneity is a common feature of resilient institutions active at the transnational level. Catering for heterogeneity in membership, for instance, was a crucial reform in the mechanics of ISDA, the IIF, the Institute of Electrical and Electronics Engineers (IEEE), or the FLA and the GFSI. Other than increasing the legitimacy of a given body, adding more diverse voices in the decision-making appears to improve deliberation and mutual learning. Crucially, heterogeneity does not need to be a built-in feature of a system *ex ante* but rather is a characteristic that can be remedied later in the process; that is, even when the tipping point has been reached. How timely the system will react is of crucial importance and decisive for its survival. A good example of such reaction constitutes the account regarding the ISO 26000 standard on corporate social responsibility. While the ISO standardization process is relatively rigid, the path dependency traits of ISO's institutional mechanics did not prevent it from opening up the process for the development of this particular standard to address the growing upheaval about its involvement in this area.<sup>132</sup>

Following the analysis above, future research should investigate whether private rule-makers adopting heterogeneous and diversified structures and mechanics increase their authority, notably after regulatory catastrophes by swiftly adopting new (or modifying existing) standards to maintain and strengthen their relevance. Testing the observations and hypotheses made above would allow for the verification of a new regulatory theory of private collective action focusing on standard-setting activities, the heterogeneous nature of private bodies and properties such as modularity, enriching the proposed theory.

## VI. CONCLUSION

Drawing from various disciplines that examine the efficiency and rationality of systems and institutions, this article presented a new conceptualization of crisis-proof private authority, challenging existing theories of delegation, orchestration and private collective action. While far from exhaustive, we argued that illustrations of private authority resilience in the realm of finance and product safety call for a more careful look into the dynamics of private and public authority interactions following regulatory shocks. While, in certain instances, orchestration by public authorities or collaboration with private rule-makers occurs, in other cases – such as the financial and products markets that we discussed earlier – contestation and competition characterizes public-private regulatory interactions.

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<sup>132</sup> S. Bijlmakers and G. van Calster, 'You'd be surprised how much it costs to look this cheap: A case-study of ISO 26000 on social responsibility' in P. Delimatsis (ed), *supra* note 2, at 275.

We introduced the concept of proactive free-riding as a key expression of opportunism by private regulatory bodies, using crises as catalysts to gain more regulatory power. In stressing the centrality of the role, effects of and reactions to crises, our analysis aspires to recalibrate the study of private governance. Two key features of resilient systems were highlighted: heterogeneity in membership and crisis responses, and rapid standard-setting activities after regulatory catastrophes. While the first feature is already identified in the environmental ecosystem scholarship, the second is connected to resilience of private governance for the first time in the relevant literature.

The article proposed voluntary economic activism as a strategic effort by private bodies to maintain and expand their regulatory authority through voluntary standards development. In our setting, standards development is used strategically vis-à-vis the public authorities to maintain and expand regulatory authority. Overall, we contend that transnational economic activism determines the direction and fate of transnational governance.

The present article provides a new, more comprehensive conceptual framework for the study of exogenous and endogenous factors that shape the creation, (co-)evolution, transformation and resilience of private regulatory bodies, allowing empirical research on the evolutionary dynamics of private governance. It also highlights the need for policymakers and scholars to carefully study instances of interaction between private and public actors. The behavioral limitations identified in the article aside, finance and product markets are complex areas, suggesting a shift from risk-focused regulation towards addressing uncertainty. This may entail, for instance, damage control strategies during crises.<sup>133</sup> Reclaiming authority may not be necessary (indeed, both public and private governance modes can fail),<sup>134</sup> but exploring safeguards to harness private power is essential. Future research should reflect critically on the advantages and disadvantages of such measures.

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<sup>133</sup> Cf. S. Schwarcz, *Systematic Regulation of Systemic Risk*, 1 WISCONSIN LAW REVIEW 23, 39 (2019).

<sup>134</sup> M. Howlett and M. Ramesh, *The two orders of governance failure: Design mismatches and policy capacity issues in modern governance*, 33:4 POLICY AND SOCIETY 317 (2014).