



Economic Analysis of International Commercial Law Reform Project 5th Workshop

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Discussion Paper 3

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Applying the Economic Assessment of International Commercial Law Reform Project Framework to Domestic Assessments

UNIDROIT staff have asked me to prepare a short paper the potential application of the Economic Assessment of International Commercial Law Reform Project framework to assessments of domestic commercial law reform that relate to international reform. This paper undertakes that evaluation, based on the framework in its current state as of the fourth meeting for the project held on 8-9 October 2018 at UNIDROIT headquarters. Most of the discussion so far has been on using the framework for assessments of global commercial law reform and not for assessments of follow-on domestic law reform. This paper seeks to set out some tentative questions to frame the discussion.

In my view, the best way forward on the domestic front is to link the framework as much as practical to existing cost benefit analysis (CBA)-type policies and practices in use at the domestic level. I am unaware of any application of CBA or other methods of economic assessment to commercial law reform at the domestic level. Countries have, however, used CBA or other methods to evaluate financial regulation, in both in *ex ante* and *ex post* contexts. The distinction between regulation and transactional law may not be as clear-cut as it may be assumed.

For evaluation of secured transactions law, a substantial law and economics literature could be adapted for use in a CBA-type framework. Much of this literature is theoretical and inquires why rational creditors use secured credit, which goes to the question of what benefits it provides to creditors and the costs it might impose on unsecured creditors.

What follows is an examination of the criteria developed in the current framework within the context of domestic law. The discussion is organized along the lines of the criteria set forth in the current framework. It is general at this stage. It could be further developed with more detail about particular domestic legal systems. This would be a comparative exercise. OECD research on regulatory impact assessment might also prove useful in its collection of domestic policy and practices.

A. The Net Direct Impact of the New Rules

The focus in this Section A is mainly on US federal law, though not exclusively so, and guidance and is meant to be illustrative only. Further work could expand to other jurisdictions and become more fine-grained. The UK Financial Conduct Authority and the Bank Of England, for example, have developed CBA methods that could be explored.

Factor A, the “net, direct impact of the new rules, rather than those applicable in the absence of reform” is a standard factor used in CBA and should be present in most CBA-type analyses performed by governments at the national and sub-national levels. I will not revisit the substantial history of CBA in US federal rule-making, dating back to Executive Order No. 12291 issued by President Reagan, which has since been superseded. In *Business Roundtable v SEC*, 647 F.2d 1144 (D.C. Cir. 2011), the U.S. Court of Appeals for the District of Columbia Circuit held that the U.S. Securities and Exchange Commission (SEC) promulgation of a regulation on shareholder participation in proxy voting for candidates for election to corporate boards of directors was unlawful because the SEC failed to provide an appropriate economic assessment of the regulation as required by statute. Partly in response to *Business Roundtable*, the SEC published a memo dated 16 March 2012 to staff of its rulemaking offices on “Current Guidance on Economic Analysis in SEC Rulemaking.”

The SEC memo provides:

It is widely recognized that the basic elements of a good regulatory economic analysis are: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis. As a general matter, every economic analysis in SEC rulemakings should include these elements, and the following guidance addresses ways to strengthen these aspects of our economic analyses. (footnote omitted)

This guidance clearly reflects the factors set forth in factor A in the framework and no doubt encompasses elements of factors B through D. The memo sets forth the following factors to consider in SEC rulemaking: (1) “clearly identify the justification for the proposed rule;” (2) “define the baseline against which to measure the proposed rule’s economic impact,” (3) “identify and discuss reasonable alternatives to the proposed rule,” and (4) “analyse the economic consequences of the proposed rule and the principal regulatory alternatives.”

U.S. federal statutes often usually require that agencies to “consider” costs and benefits but not necessarily to demonstrate that a set of rules maximizes net benefits or that benefits exceed costs. A recent example of just such a statute is Section 1022(b)(2)(A) of the Dodd-Frank Act, 12 U.S.C. §5512, which establishes rule making standards for the Consumer Financial Protection Bureau (CFPB). Section 5512(b)(2)(A) provides that the CFPB shall consider the potential benefits and costs to consumers and others, including “the potential reduction of access by consumers to consumer financial products or services resulting from such rule” and the impact of proposed rules.

U.S. Office of Management and Budget Circular A-4, “Regulatory Analysis” (68 Federal Register 58366 (Oct. 9, 2003)) offers guidance to U.S. federal agencies on CBA and on what to do when CBA cannot be performed. It explains that U.S. federal agencies should use CBA when feasible, and cost-effectiveness analysis, the comparing of the costs of alternative approaches, when not. When quantification is not possible or unreliable, Circular A-4 explains that agencies should attempt to quantify benefits or costs as much as practical and otherwise exercise “professional judgment” in regulatory rulemaking. On other hand, CBA and CBA-like methods could be seen as facilitating professional judgment.

Professional judgment could be understood to be the main approach currently used in private commercial law reform in many countries. It is probably the best characterization for commercial law reform in the United States and the United Kingdom.

B. The Net Impact of the New Rules as a Network

Measurement of network effects is relevant at the national as well as the international level. Five factors would seem relevant to network effects at the domestic level:

(1) How a state is constituted, as in how it allocates law making functions and jurisdictional powers across its constituent parts. Network costs and benefits will vary, for example, to the extent that a state distributes legislative and judicial jurisdiction through a federal or other constitutional structure.

(2) The form in which global commercial law reform comes to the state. An international convention will likely have to be ratified at the national level, in a national legislature. The network effects of a model law may depend on whether the law is implemented at the national or sub-national level. The network effects of commercial law reform in the form of guidance or handbooks will also depend on whether the guidance is to be implemented at the national or sub-national level.

(3) The numbers of ratifications or adoptions by states, and their constituent parts if relevant.

(4) Whether the global law reform at issue requires domestic implementing legislation or will have direct effect. This will depend on the form of the law reform instrument. It will also depend on the domestic law and constitutional arrangements of the state.

(5) How courts will apply the new law, which will depend on the allocation of judicial jurisdiction in a state.

C. Net Systemic, Including Developmental, Impact of the New Rules

The factors identified in section B above may be relevant here and discussion of how to distinguish relevant factors for sections B and C would seem to be necessary.

D. Extent that New Rules Will be Effectively Applied and Enforced by Courts and Authorities

Much of the discussion in paragraphs 20-23 of the Report of the Fourth Meeting of the Economic Assessment of International Commercial Law Reform Project (January 2018) appear to be relevant to domestic legal systems.

The factors identified under section B may be relevant to factor D. The fifth factor under section B – whether judicial jurisdiction is distributed in a state and how – could be important here. The phenomena of circuit splits and majority/minority jurisdictions in the United States are examples of how effective application by courts may be affected by the distribution of judicial competence. Executive agency enforcement – its nature, effectiveness, and approach – may be relevant to factor D as well.

It is unclear why factor D is currently characterized dichotomously, which means it is expressed as being of only two values. Some form of ordinal structuring of this factor would seem to be more sensitive.

E. Expected Net Cost of Creating and Transitioning to the New Rules

At the domestic level, factor E would appear to a function of the nature of the state, as explained above. Here we have to be sensitive to overlap.