



**UNIDROIT Foundation
EA ICLR 5th Workshop
Project Group Meeting
10-11 April 2019**

Foundation 2019
EA ICLR Report
October 2019

Report for the Fifth Meeting of the Economic Assessment of International Commercial Law Reform Project

1. The fifth meeting of the Economic Assessment of International Commercial Law Reform (EA) Project was held on 10-11 April 2019 at the headquarters of UNIDROIT in Rome, Italy. The EA project is a joint undertaking between the UNIDROIT Foundation, the Commercial Law Centre of Harris Manchester College at Oxford University, and the Global Business Law Institute at the University of Washington.
2. *Professor Ignacio Tirado, Secretary-General of UNIDROIT, and Professor Jeffrey Wool, President of the UNIDROIT Foundation and Secretary-General of the Aviation Working Group, who served as Co-chairs for the meeting, opened the session with a short welcome address.*
3. The fifth workshop had several objectives:
 - (i) Further develop the content of each variable;
 - (ii) Explore the relationships between the variables;
 - (iii) Resolve specific challenges faced when applying the framework;
 - (iv) Discuss the content of the explanatory guide to accompany the framework.
4. The workshop brought together experts, including economists, lawyers, and academics, from leading international organisations and universities involved in international commercial law reform projects, or the undertaking of economic assessments for such projects. A full list of participants is available in Annex 8 of this Report.

Summary of the outcomes of the 4th workshop and discussion of the objectives for the 5th workshop

5. After the Co-chairs welcome address, *Professor Wool* explained the project's background and introduced the framework. He stressed the importance of further discussing the content of the framework's variables, the relationships between them, and how the framework could be used in different contexts. He further explained the organisation of the workshop, noting that there would be three sessions dedicated to discussion papers prepared by experts (Annexes 2-4), as well as smaller group discussions for specific variables (the agenda for the workshop can be found in Annex 1).

Application of the framework during different phases of a commercial law reform project

6. *The UNIDROIT Secretariat* presented a discussion paper, highlighting the distinction drawn between ex ante and ex post assessments. Within these two broad timeframes, there were several stages at which an assessment could be conducted, and the input and outputs

of an assessment would be different at each one of these stages. Ex ante assessments primarily sought to justify and orient the drafting and negotiation of an instrument, whereas ex post assessments sought to determine the effectiveness of the reform.

7. From UNIDROIT's perspective as a standard setter, ex ante assessments would be useful to determine whether a reform project should be undertaken. It was underlined that such an assessment was often complex because data was scarce and difficult to obtain. It was concluded that at the ex ante stage, the framework could not rely solely on empirical data but must also use assumptions about how the legal reform would be implemented, qualitative data and proxy data. It was agreed that ex ante assessments of instruments that were not yet developed should largely remain simple. *Several participants* recommended that the entity requesting or commissioning the law reform should participate in the ex ante evaluation.

8. *The UNIDROIT Secretariat* suggested that though ex ante and ex post assessments would not be identical, the two types of assessments should be methodologically consistent. *The workshop participants* agreed that an accurate quantitative assessment may be impossible early in the ex ante phase.

9. *The participants* agreed that the explanatory guide to the framework should explain that empirical data would be scarce ex ante, especially in earlier phases, which would necessitate the assessment relying on assumptions and qualitative content. The economic assessment would then gradually gain empirical precision as the content of the reform was developed, adopted and implemented. Participants also agreed that the empirical data required for quantitative economic assessments should be identified early and that the project should seek to ensure the collection of accurate data to the greatest extent possible.

10. The research paper relating to this discussion can be found in Annex 3 of this report.

Relationship between the framework's variables

11. *Jordi Paniagua (University of Valencia)* and *Andrew Myburgh (IFC)* presented their discussion paper (available in Annex 2 of this report). They suggested that the framework's variables should be used differently in ex ante assessments and ex post assessments.

12. They proposed that ex ante, each variable could be qualitatively assessed and given a rating. These ratings would then be factored in the framework to obtain an economic assessment score. The proposed approach would not purport to provide a full quantitative economic assessment but would help to determine whether these law reform efforts were viable. Experiences from other organisations, such as the World Bank, underlined that early assessments of viability enhanced the chances of success of a project.

13. *The participants* agreed that obtaining an economic impact score ex ante would be complementary with the broader goals of economic assessments generally and avoid the challenges posed by the preparation of ex ante economic assessments for proposed reforms with scarce quantitative data. It was noted that the impact score would be useful in determining viability of proposed reforms, but should not be understood as a ranking of law reform initiatives.

14. *The authors* considered that ex post assessments would generally be able to rely on empirical data to reach quantitative measures of economic impact. *Professor Paniagua* introduced different economic models used to demonstrate and assess the economic effects of trade law reform. He noted that the framework was not necessarily the best model to make an ex post assessment in every situation, and that the explanatory guide would need to detail the framework's application at the ex post stage in order to maximise its suitability for such assessments.

15. *A participant* raised the issue of causation in conducting economic assessments. *The authors* agreed that it was difficult to adequately determine the relevant scope of causation. It was explained that economic literature presented different ways of addressing causation in ex post assessments:

- a. Compare with what would have happened if another measure had been implemented;
- b. Assume that there was causation at a specific date after the reform was implemented. If a change in the date caused a significant change in the results, this would suggest that the reform had caused the result;
- c. Use another variable that was related to law reform but not to another economic factor as a predictor.

Variable specific group discussions

16. The workshop then divided into smaller groups to analyse each individual framework variable and the relationship between them. Complete reports for the discussion in each group can be found in annexes 5-7 of this document.

Variables A and B (led by Ignacio Tirado)

17. With regards to Variable A, the group agreed that the primary objective of the law reform must be identified from the start to constitute a benchmark and that this objective should respond to a market failure or a need identified by the market. Variable A should include the direct impact of the reform and the likely (in an ex ante assessment) or realised impact (in an ex post assessment). There was discussion on whether Variable A should include the costs, including the opportunity costs, of a reform.

18. Variable B was defined as determining whether the law reform would create, or has created, synergies, blocks or substitution effects, with existing regulations. The group agreed that this variable could, in circumstances, be negative. It was discussed whether it should include all legal networks or only international networks, and agreed that domestic legal network effects would be captured under Variable A. The consensus was to take all networks into account in Variable B.

19. The group also agreed that the moment at which an evaluation was conducted would impact not only the available data but also the relative significance of the variables. The assessment of the implementation of a secured transactions law reform could rarely be conducted immediately after it entered into force.

20. Finally, the group agreed that it was important to consider whether the reform replaced existing legal frameworks or introduced regulations to a field which was previously unregulated.

21. A detailed report on the Variable A and B discussion can be found in Annex 5.

Variables C and E (led by William Brydie-Watson)

22. The group discussed the usefulness of a rating system for enumerating the frameworks inputs and outputs, noting that while this had benefits ex ante, it did not always provide a reflective and self-explanatory outcome. Additionally, the group noted that Variable C should give consideration to existing models and standard economic methodologies that identified systemic effects of rule changes. A difficulty was that systemic effects differed not only because of the content of the reform, but also because of their subject matter. For example, reform of contract law would tend to have less systemic effects

than credit law reform, which would influence the results of the assessment. This difficulty should be explained in the explanatory guide to the framework, as results would not have the same meaning depending on the subject matter of the reform.

23. Variable E covered the transition costs of a law reform. The group noted that this would include the costs of adoption of the reform, its implementation, and any required institution building.

24. A detailed report on the Variable C and E discussion can be found in Annex 6.

Variable D (led by Jeffrey Wool)

25. Variable D was defined as seeking to determine whether the law reform was operative or not. The group agreed that this variable required empirical data on the implementation of a reform and would primarily be used for ex post assessments; ex ante, it might be necessary to assume that there will be effective implementation, if necessary, with an arbitrary correction coefficient. The group confirmed the relevance of the factors identified during the fourth workshop:

- a. Doctrinal issues on the rule of law;
- b. Imperfect functioning of the rule of law;
- c. Informational limitations;
- d. Institutional capacity or resource-related limitations;
- e. Implementation-related limitations;
- f. Lack of stability of the rule maker or rule applying entities;
- g. Rapid and unpredictable changes of legal and economic structures and policy;
- h. Intentional resistance;
- i. The effects of signalling; and
- j. An analysis of the system as a whole, looking at regulatory competition put forth by a legal treaty system.

26. The group also confirmed that indices used by large international organisations should be relied upon. The indices used should be those closest to the subject matter of the law reform and should not take into account broader factors such as general human rights assessments of States or general measures of wealth.

27. The group acknowledged that Variable D was politically and mathematically important. Two pertinent questions were raised:

- a. How often should the data be refreshed? The group agreed that this should be as often as possible, and dependent upon the indices used.
- b. How detailed should the score be? It was agreed that a five-tier structure would be satisfactory going from absence of implementation to total implementation. It was agreed that the intermediary categories would require more discussion.

28. The group identified that as empirical data would be collected ex post, there would be an increasing overlap between Variables A, B and C and Variable D. Gradually, more importance should be given to the empirical data in the first three variables than to the coefficient in variable D.

29. A detailed report on the Variable E discussion can be found in Annex 7.

Application of the framework for domestic assessments and international assessments

30. Professor John Linarelli (Durham University) presented his paper discussing whether the framework could be used to evaluate domestic commercial law reform.

31. The discussion that followed highlighted that Variable B posed a difficulty with regards to the use of the framework for the evaluation of domestic law reforms. *The participants* agreed that Variable B should include costs and benefits which would not be observed but for the existence of a legal network. This should take into account network externalities but should be limited to neutral elements.

32. The research paper relating to this discussion can be found in Annex 4 of this report.

Further exploration of Variable D

33. At the start of the discussion, it was noted that Variable D considered effective application by courts and authorities; *some participants* proposed that effective application by beneficiaries should also be included. However, *other participants* noted that effective application by beneficiaries should be measured in Variable A since it meant determining whether a rule was used in comparison to another rule. It was agreed that the main goal of Variable D was to prevent double counting and hence its text should be kept as it was.

34. It was highlighted that Variable D was a coefficient that ranged from 0 and 1, underlining its mathematical importance in the formula. As highlighted by the small group discussion, the participants agreed that this could be difficult to apply but nonetheless should be maintained.

Using the framework to evaluate soft law instruments

35. The issue of whether the framework could be used to conduct an economic assessment of soft law instruments was considered.

36. *A participant* noted that the drafting and negotiation of soft law and hard law instruments in international standard-setting bodies were different. In both cases, the starting point was the identification of a need for regulation. Then, the nature of the instrument was decided upon. For the standard-setter and the States, much more caution was exercised when drafting hard law rather than soft law.

37. Two potential solutions were identified:

- a. Consider that the framework did not apply to soft law; or
- b. Apply the framework to soft law instruments on the basis of two assumptions:
 - i. For the sake of the evaluation, the instrument could be considered to be hard law;
 - ii. The international instrument's core characteristics would be used to determine its "hard law" effect.

38. The participants agreed that the second option was preferable, and that the framework should be applicable to soft law. It was not practicable to guarantee that a soft law instrument would be fully implemented but these assumptions would allow an ex ante economic assessment to be conducted to the extent possible. Since ex post assessments would be able to consider a broader range of empirical data, they would be better suited to take into account the soft or hard nature of the legal reform.

Future steps for the project

39. *The Co-chairs* noted that there had been agreement on the structure of the framework. It was noted that further discussion was needed as to whether to use a comma after “net” in the descriptions of Variables A and B.

40. *All participants* agreed that the framework sought to be an available indicative tool for stakeholders in commercial law reform, entailing the possibility of comparing ex ante and ex post assessments.

41. *The participants* agreed that for the next session, a skeletal structure of the explanatory guide to the framework should be drafted and distributed in advance. This guide would include details on the variables and their compositions; explanations on the differences between ex ante and ex post assessments as well as between global and domestic assessments; and discussions on the framework’s scope and purpose. It was also decided that after the sixth workshop, conclusions from this project group should be formalised into an academic article and opened for discussion within the academic and professional communities.

Outcomes

42. The workshop had the following outcomes:

- iii. The general structure of the framework was agreed upon;
- iv. It was agreed that it should be possible to apply the framework to all types of commercial law reform and at all stages of its development and implementation, but that adaptations in the content of the variables and their relative weights were necessary;
- v. It was agreed to start drafting the skeletal structure of the explanatory guide to the framework. This would be distributed before the next workshop and opened for comments. This project group should clearly identify issues that required further discussion; and
- vi. Remaining issues should be the focus of discussion papers prepared for the next session.

The agenda for this meeting can be found in Annex 1.

The discussion papers can be found in Annexes 2-4.

The rapporteurs’ reports for the discussions of the small group discussions on specific variables can be found in Annexes 5-7.

A list of participants can be found in Annex 8.

The Formula, as confirmed at the end of the workshop, can be found in Annex 9.

ANNEX 1 – Agenda

**Economic Analysis of International Commercial Law Reform Project
5th Workshop**

10-11 April 2019, Rome, Italy

Agenda

Co-Chairs: Ignacio Tirado (UNIDROIT Secretary-General)
Jeffrey Wool (UNIDROIT Foundation President)

Wednesday, 10 April	
8: 45 – 9: 00	Registration
9: 00 – 9: 10	Welcome by the co-chairs
9: 10 – 9: 30	Background of the project and introduction to the framework
9: 30 – 10: 00	Summary of the outcomes of the 4 th workshop and discussion of the objectives for the 5 th workshop
10: 00 – 11: 15	Application of the framework during different phases of a commercial law reform project (ex ante – ex post)
11: 15 – 11: 30	Coffee break
11: 30 – 12: 30	Relationship between the framework's variables
12: 30 – 14: 00	Lunch break
14: 00 – 17: 00	Small group discussions on different variables/issues
End of Day 1	
Thursday, 11 April	
9: 00 – 10: 00	Reports on the small group discussions
10: 00 – 11: 00	Application of the framework for domestic assessments and international assessments
11: 00 – 11: 15	Coffee break
11: 15 – 12: 30	Further exploration of the Variable D elements
12: 30 – 14: 00	Lunch Break
14: 00 – 15: 00	Discussion on the proposed structure for the guidance document

15: 00 – 16: 00	Future steps for the project
16: 00 – 16: 15	Closing remarks
End of Day 2	

ANNEX 2 – Discussion Paper 1**Relationship between the framework's variables***Prepared by Andrew Myburgh & Jordi Paniagua*

The effort made by the Oxford-UNIDROIT project on economic assessment of international commercial law reform is laudable. The interaction between internal law scholars and economists in defining specific economic impacts of international law reform has been traditionally low in the first stages of law reform conception. Introducing economic considerations (efficiency, welfare gains, costs) in the incipient law reform is not only desirable but also necessary to correctly assess ex-post effects of law reform.

This project has worked to develop the Economic Assessment of International Commercial Law Reform Project "EA ICLR" Framework¹. The framework describes the economic impact (economic assessment [EA]) of an international law reform as a result of:

$$EA=(A+B+C)*D - E$$

Where (A) are direct effects, (B) is network effects, (C) is systematic effects, (D) is implementation of the law and (E) is the cost of implementing the law reform initiative. Although not stated in the formula, the intention is that the framework captures economic impact across countries, interdependencies across countries, and how these effects play out over time.

The framework is informed by a view of how legal reform has an economic impact but is not derived from a formal economic model. This would be difficult, as economists have moved away from "one size fits all" models of the kind described by the EA framework. Instead, they have moved towards economic models that are highly context specific and could not typically be applied across different law reform efforts. They have done in this part to be clear in what contexts their models are valid and under what assumptions. This allows for the validity of models to be tested using appropriate statistical techniques (as Harvard's Dani Rodrik (2015) suggests).

Because the framework is not derived from an underlying theory there are difficulties implementing the approach. This paper suggests two approaches to do doing this that are partly complementary. The first is (i) as a structured framework for evaluating commercial law reform initiatives when they are still nascent, and (ii) as an input to formal economic analysis. This short note will discuss both approaches in turn.

The EA formula as a structured framework

The framework could be used to establish an "Economic Assessment" score for proposed initiatives. The score would be derived using qualitative indicators for the formula such as 1 (small effect) to 4 (large effect). What is a "large" and "small" could be determined relative to other initiatives such as the Aircraft Equipment Protocol, the MAC Protocol, the NY Convention and others.

The intention is that the score would facilitate a quick evaluation of the reform's likely impact at an early stage in the process. This would inform decisions to "go" / "not go" ahead with a proposed commercial law reform initiative. The approach would thus guide an evaluation of the likely impact of the reform, facilitate comparison across potential law reform initiatives, and do this without the investment of substantial time and money. One approach would be for the score to be determined by UNIDROIT's staff in consultation with

¹ An alternative description could be the REAIL framework: Rapid Economic Assessment of International Commercial Law Reform

external experts. It would lay the groundwork for a subsequent detailed analysis of the kind conducted for the Aircraft or MAC protocols.

Category	Rating	Proposed factors to consider	Proposed sources of evidence
<p>(A)</p> <p>Direct Effects:</p> <p>The benefits that stakeholders will experience from the reform initiative.</p>	<i>A score from 1-4</i>	The direct effects of a legal law reform initiative are likely to be a result of factors such as the size of the market(s) affected by the law reform in terms of investment, trade flows, expenditure, and the expected change in those markets brought by the legal reform. For example, the expected fall in the interest rate at which lenders provide loans	<p>The size of the market(s) could be evaluated using trade and FDI data. There is also useful datasets on Non Performing Loans and similar.</p> <p>The expected change could be determined based on interviews with legal authorities, companies and financiers involved in the market.</p>
<p>(B)</p> <p>Network Effects:</p> <p>The benefits that will arise as more countries adopt and implement the law reform</p>	<i>1 - 4</i>	The expected network effects are likely to be a result of the benefit of legal harmonization across countries, and the number of countries that join.	The benefit of legal harmonization could be evaluated through discussions with general counsel at firms affected by the reform
<p>(C)</p> <p>Systemic effects:</p> <p>The knock on impacts of the law reform initiative</p>	<i>1 - 4</i>	The systemic effects are (arguably) a function of issues such as the multiplier effects.	This could be evaluated using economic data sets that evaluate multiplier effects . Firms active in the markets, and economic research could provide guidance.
<p>(D)</p> <p>Implementation of the law</p> <p>The extent, that the new rules have been or will be effectively applied by courts and authorities</p>	<i>0 - 1</i>	The difficulty of implementing the law will (to some extent) be a function of the level of legal sophistication in a country, and the extent of changes required by the legal reform.	The general counsel at firms could provide guidance.
<p>(E)</p> <p>Expenditure on establishing and</p>	<i>1 -2</i>	This will depend on the magnitude of legal reforms required, and where they will occur.	Past experience of UNIDROIT's expenditures, as well as a sense of what costs are

implementing reform			required on a national level
(EA) Economic Assessment score:	<i>A score from - 2 to 10 calculated from the results above</i>	$(A+B+C)*D - E^2$	

Broadly similar frameworks are used in a wide variety of contexts such as for evaluating debtor risk, determining whether a transaction is anti-competitive, or whether an investment has a socially beneficial impact. While the details of such approaches vary they typically entail referencing a pre-determined set of indicators against pre-specified benchmarks. For example, in antitrust cases authorities typically look at how concentrated the market is (the indicator) and consider whether it is highly concentrated or not by reference to a benchmark. In the case of antitrust cases, if one firm has 80% market share the market is concentrated and so a merger is more likely to be anti-competitive. These frameworks range from an approach that has an underlying formula and so reaches a single score (as below) to one that just specifies a range of factors to be considered in reaching a decision. Both approaches are equally valid and the approach described below can be used for both approaches.

An approach to calculate the score is described below (or factors to be considered).

The economic impact score could be calculated as below. A possible rating system would be:

- (0-1) Low economic impact which implies these reforms are not pursued
- (2-3) Medium economic impact suggests reforms can be pursued
- (3-10) High economic impact likely, suggests reforms should be pursued

The strength of this approach is:

- General application: It can be applied to a wide range of cases
- Background: Factors have been verified by experts in the field
- Qualitative: By being inherently qualitative (a scale from 1 to 4) it provides a consistent "measuring stick" for evaluating impact and so avoids issues around quantification such as the relevant units, bounds, relative vs. absolute terms
- Structure: Provide guidance to an analyst that is asked to review a prospective law. Facilitate comparison across different reform initiatives as all these initiatives are evaluated using a broadly similar approach
- Perception: Introducing the relevance of economic analysis in early stages of law reform.

The weakness of this approach is that it is:

- Subjective in that the analyst will ultimately decide how large the effect is by selecting the relevant benchmark. This can be reduced somewhat by explicit reference to previous reform initiatives, for example the direct impact could be found to be "large" because it is a large market (same size as the international aircraft market), and the size of the change is substantial (similar to the change brought by the NY Convention).
- Aggregated in that all three effects (direct, network, and systemic) are assumed to make the same contribution to economic impact.

² Note that this formula could be different. For example $(A+B+C)*(N*D) - E$, where N is countries adopting so as to capture $(A+B+C)$ is intensity of impact), the formula could also be $((A*B*C)^{1/3} * (N.D) - C)$ (where multiplying A, B and C captures that the effects are probably cumulative). The ultimate scoring system would be broadly similar and it is worth noting that maintaining simplicity for calculation is important in practice.

- Empirical flexibility: The formula's closed-form definition limits its empirical applicability
- Economic modelling: The formula is not derived from a standard economic model.

The EA formula as a starting point for formal economic analysis

From an academic economics perspective, an attempt to use the formula in a tractable empirical way in its current state is a rather frustrating effort. To actually evaluate EA using the framework (or a more sophisticated) one is very difficult because one would need:

- An appropriate measure of benefit – one could use trade flows, value add, investment and so on. It is likely that all these measures would be appropriate,
- An understanding of the relationship between the different variables, does changing the law have the same effect on output, or investment? It is plausible that this relationship is different across variables
- A way to aggregate across countries and time. This is not shown explicitly in the formula above but in practice one would want to capture across all countries and there are likely to be important inter dependencies between them.

To reach a broader audience that include academic economists, our suggestion would be to maintain the essence and the insights of the formula with but a different packaging. For example, in its simplest terms, the economic impact of law reform is viewed as a general function of a set of variables:

$$EA \rightarrow f \{X_1, X_2, X_3, \dots, X_n\}$$

Where X1 could refer to the level of legal development, X2 refers to transport costs, X3 to costs of production and so on. The specific definition of the function, values and weights of the variables should be part of the technical economic modelling. The advantage of using a more general high-level and mathematical independent specification is its flexibility and adaptability to a specific context. The expected values and the form that they interact is precisely the task of economic modelling and hypotheses testing. The most efficient way to construct realistic models is to agree on the key ingredients (and maybe expected values) and tailor them to specific cases. In our opinion, this approach would reach an ampler consensus on economics and law academia.

For example, we could be interested in studying how law reform fosters growth in international trade (our expected outcome). If we where we can estimate the ex-post effects of legal reform, we could use the gravity equation of international trade (Anderson, 2011) feed with the information provided by expert's assessment score.

If we were interested in an ex-ante analysis, we should turn to quantitative trade models, which incorporate the channels through which trade affects consumers, firms and workers. These applied general equilibrium models provide estimates of how real incomes change under different trade policies, using readily available data on trade volumes and potential trade barriers (Kehoe et al., 2017). In this scenario, the EA ICLR framework could be used to feed the model with the expert's analysis on the trade policy changes due to law reform.

References

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ANNEX 2 – Discussion Paper 2

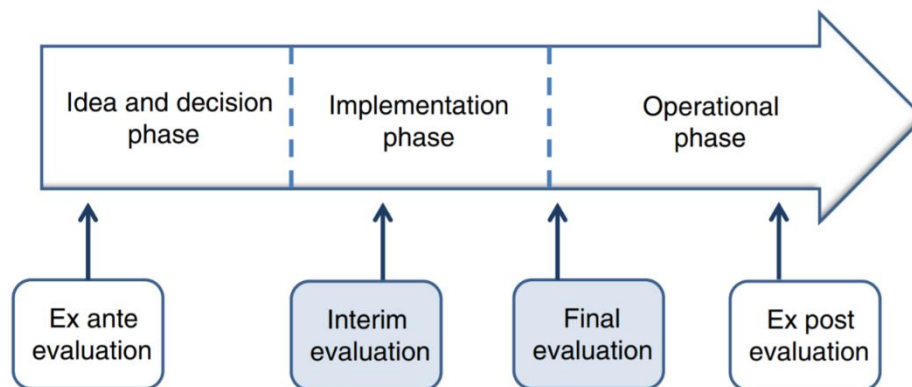
The application of the framework during different phases of a commercial law reform project

Prepared by the UNIDROIT Secretariat

In principle, the EA framework should be able to be applied to all types of commercial law reform, whether domestic, regional, or international, and be applicable at all stages of the development of the solution, whether *ex ante*, or *ex post*. The value of the framework is in its adaptability and flexibility in applying to a broad range of legal reforms at any stage of their development.

However, designing a framework that can be applied at any stage of an instrument's development raises a number of issues. This paper further examines the differences in the framework's application for *ex ante* and *ex post* assessments and raises questions of the types of data that would be useful in different stages of the development of a legal instrument.

Samset and Christensen³ divide up projects designed to bring economic benefits into the following phases:



Similarly, international commercial law reform projects could be divided up in the following way:

Conceptual phase	Negotiation phase	Pre-adoption phase	Post Adoption	Post Entry into force	Post global adoption
Ex Ante Assessment			Ex Post Assessment		

In economic theory, *ex ante* corresponds to the more traditional expression in law of *A priori*, and refers to the apprehension of a situation before it is constituted. Conversely, in economics, *ex post* corresponds in law to *A posteriori*, referring to a reaction of an organism to a particular situation or development.

Ex ante assessment

An *ex ante* assessment should be the natural first step of any international commercial law reform project. In the experience of the World Bank, an evaluation of more than 1000 investment cases revealed that 80% of projects that conducted a thorough feasibility study and secured 'Quality at Entry' were successful, whereas only 35% of those with poor preparation were successful.⁴

³ Samset, K, and Christensen, T, 'Ex Ante Project Evaluation and the Complexity of Early Decision-Making' (2015) 17 Public Organization Review.

⁴ World Bank. (1997). Evaluation Results 1994, The International Bank for Reconstruction and Development, Washington D.C.

Large parts of an ex ante assessment, particularly prior to the adoption phase, are based on assumptions because of limitations in the availability of data. Data can be limited concerning history, facts and interpretations, leading to a selection of decision premises influenced by organisational structures and actors' roles.⁵ Availability of limited amounts of data often leads to more reliance on experience, opinion or at worst, on guesswork. According to Samset and Christensen, this is a disadvantage but not a hindrance. The combination of facts and well-founded assumptions are usually the most important tool in an economic assessment at an early phase. Conducting an ex ante assessment tends to provide better results than developing an instrument without systematic analysis, even though the information base is weak.

Conceptual phase: Within UNIDROIT's working methodology, the conceptual phase is equivalent to the either a project being proposed for the UNIDROIT Work Programme or the Secretariat undertaking a feasibility study for a proposed project. During the conceptual phase, an EA can provide information about the possible impact of a potential instrument, before the decision to invest substantial resources into the project is made. During the conceptual phase, the ex ante economic assessment should attempt to be relatively simple, as it may be necessary to undertake several basic assessments of different potential solutions to a legal problem (for example, it may be necessary to prepare ex ante assessments for potential soft-law and a hard-law instruments responding to a particular legal problem). In terms of scope, ex ante assessments in the conceptual phase aim to identify which alternative solution to a particular problem will yield the greatest economic benefit and provide the most efficient model. At this phase, the EA may not need to go any further than identifying the different elements to be considered under each of the framework's variables. As no particular legal rules would have been drafted at the conceptual phase, the specifics will be necessarily vague and, in most cases, it will be impossible to make a quantitative assessment in terms of the potential dollar value impact of the proposed reform. Furthermore, EAs attempting to forecast material economic benefits at the conceptual stage risk being discredited and potentially damaging the project.

An important element at this stage is omitting details and less-relevant information that helps in avoiding analysis paralysis. This is also an argument for avoiding drowning the initial process with detailed, quantitative information. The lack of quantitative information ex ante can be challenging, and as such, the need for precise and detailed information increases with the advance of the process. In the latter stages, such information tends to be more readily available.⁶

Negotiation phase: Once a potential legal solution has been agreed, negotiations in relation to that instrument begin. Under UNIDROIT's working methodology, this would be through a Study Group or Working Group of international experts. As negotiations unfold and the instrument's provisions become more concrete, the ex ante economic assessment can be more specific in detailing the elements to be considered under each variable in the framework. Where there is sufficient certainty and data available, it may be possible for the EA to provide a quantitative estimate of the possible economic impact of the draft instrument.

Pre-adoption phase: Once negotiations for the draft instrument are complete, there will often be a period of time before the instrument is adopted, either by a Diplomatic Conference for a treaty or through a legislative body for a soft-law instrument. At this stage in the process, the rules in the draft instrument are usually well defined, which should allow for a relatively robust EA to be delivered, which includes an estimate of the possible economic impact. It may also be possible for EAs at this stage of the process to identify particular provisions or rules in the draft instrument that will have a particularly large effect on the

⁵ Simon, H. A. (1957). *Administrative Behaviour*. New York: Macmillan

⁶ Williams, T., & Sunnevaag, K. (2009). *Making essential choices with scant information. Front-End decision making in major projects*. UK: Palgrave Macmillan.

economic impact of the instrument. This information could be vital to negotiating states as they finalise the instrument.

Ex post assessment

Ex post evaluations undertaken after an instrument has been finalised or has entered into force provide learning information to improve design and decisions for similar projects in the future, as well as improve the implementation process and encourage greater adoption.⁷

Among the common issues faced in determining a methodology for conducting ex post economic assessments are the formulation of an appropriate counterfactual and the deterrent effect of enforcement.⁸ In consideration of the uniform application of the framework, a counterfactual may be determined in the form of an absence of the developed law, or one of the alternatives considered in the pre-conceptual phase.

Evaluation ex post should in principle consider the objective and constraints that were faced by those developing the commercial law reform ex ante. As an example, from a report by the DG Competition for the European Commission, *an evaluation of whether a particular decision led to an increase in consumer welfare may be inappropriate if such objective was not meant to be pursued ex ante, or alternatively, if constraints were imposed which restricted the pursuit of this objective. In other words, the metric ex post should be consistent with the decision-making problem ex ante. An evaluation of outcomes which does not control for the parameters of the decision ex ante will thus necessarily be biased against the authority if observed decisions merely reflect deficiencies of the framework in which they were taken.*⁹

Post adoption: In conducting a post-adoption analysis, if there is limited implementation of the relevant instrument and the instrument did not change radically through the adoption process, the data available may not differ greatly from that available for an economic assessment undertaken at the ex ante pre-adoption phase.

Post entry into force: Once there is a sufficient level of implementation regarding the relevant reform, the data available following implementation can be utilised to determine whether the reform has had the anticipated impact determined in the ex ante assessment. Issues regarding causation can arise during this phase. Further, assuming there is only a limited number of States that had implemented the relevant reform, ex post assessments at this phase will likely need to be on a domestic level, focussing on the particular jurisdictions that have adopted the reform.

Post global adoption: Once there has been widespread implementation, a full global assessment as to whether the instrument has had the predicted economic impact can be undertaken. Given the long lapse between adoption of an instrument and its widespread adoption, this final phase might need to be undertaken over one decade after entry into force (or longer).

Annex I of this document was prepared by Professor Jeffrey Wool as another method of visualising how the framework could be applied throughout various stages of a commercial law project.

Annex II of this document are comments on the above discussion prepared by Dr. Juan S. Mora-Sanguinetti.

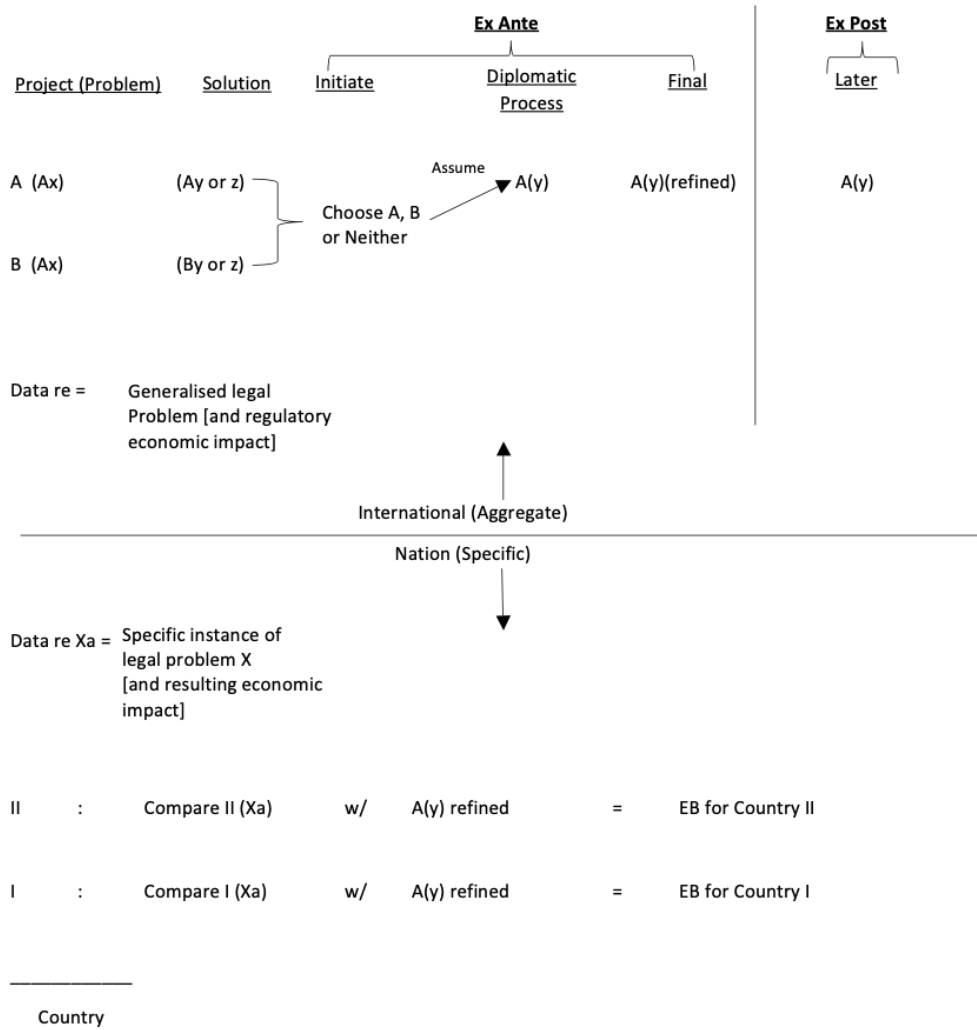
⁷ Andersen, B., et al. (2008). Effektvurdering av store statlige investeringsprosjekter (Impact Assessment of Major Public Investment Projects, Concept report no. 19, Norwegian University of Science and Technology.

⁸ http://ec.europa.eu/dgs/competition/economist/ex_post_evaluation.pdf

⁹ Neven, D., and Zenger, H., 'Ex post evaluation of enforcement: a principal-agent perspective', see http://ec.europa.eu/dgs/competition/economist/ex_post_evaluation.pdf

ANNEX I

Economic assessments at different stages



ANNEX II

**Some comments to the "Discussion Paper 2"
(Juan S. Mora-Sanguinetti¹⁰)
Banco de España - Eurosystem**

I

From a pure economic analysis point of view, the *ex ante* and *ex post* problematic that the paper exhibits is very similar to the one faced by research in standard economics. The "evaluation" of a problem can be done from a theoretical point of view (when confronting a lack of data, which is what happens in our case in the "ex ante" stage) or from an empirical point of view, when there is an adequate amount of data available for the analysis (usually *ex post*). The "theoretical" analysis is constructed using "models" that simplify reality. In general, for this debate, there are many references, but we can consult an old/"classic" reference like Friedman (1966).

For the "ex ante" analysis, the researcher could construct a "theoretical model", based on pure mathematical reasoning. For example, "DSGE" models, which are so popular today, are theoretical models and are used for several subjects (such as monetary policy ... But they are also used to "reason" about the effects of a possible simplification of the regulation of a country) (by way of example for Spain: López et al., 2008 and Andrés et al., 2006).

In any case, the ultimate objective, from my point of view, should always be to collect the data that allow us to make the analysis from an empirical point of view (and to correct, if necessary, the *ex ante* or theoretical analysis, following a scientific method).

Obtaining data should therefore always be present throughout the analysis. In that sense I would propose the following:

- The "ex ante" analysis should foresee, at least from a very general point of view, what kind of data would be necessary to make an *ex post* evaluation. The framework could provide a general indication of how similar projects have been evaluated with data on other occasions or by other institutions.
- The framework should include the "obligation" that the implementer ("user") generates statistical information, indicators and information on effective implementation. This information will be used in a complementary manner to some other information that may be generated by third parties not directly involved in the implementation process (such as the national judicial systems, which would report on litigation, or national statistical services).

II

More generally, I think it would be useful for "Discussion Paper 2" to mention the efforts made at the European level to improve the evaluation of the new regulations. We can also learn from those experiences. There are "guidelines" and initiatives in this sense both from the OECD and the European Union (and specific country level).

- On the side of the European Union: "Better regulation: guidelines and toolbox". https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.
- On the side of the OECD (for the specific case of Spain): OECD (2014) (see reference below).

¹⁰ Email: juans.mora@bde.es My opinions regarding my participation in this project of UNIDROIT are always personal and not on behalf of the Banco de España (such disclaimer must appear next to my name).

- At the national level, for example for Spain (although similar regulations can be found in other countries): Royal Decree 931/2017 on "Regulatory impact reports". In Spain it is requested that each new norm justify why the norm is necessary (as opposed to the alternative of not adopting any regulation at all) (article 1. a) 3 of RD 931/2017) and an explanation about its coherence with the principles of necessity, efficiency and proportionality (article 1. a) 2).

These texts refer, for example, to the methodology on how to conduct an ex ante evaluation. The "ex ante" situation is understood as the moment in which a new regulation has been passed (or is going to be passed by a national parliament) but has not yet been enforced.

III

Finally, I mention a point of minor importance but that connects us with some discussions related to the literature on "big data". A new regulation (or regulatory proposal) (at a stage prior to the ex post evaluation) could provide indications based on "structural metrics" and "linguistic metrics" [many references can be cited, but by way of example: Waltl and Matthes (2014) or Mora-Sanguinetti (2019)].

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ANNEX 4: Discussion Paper 3**Applying the Economic Assessment of International Commercial Law Reform Project Framework to Domestic Assessments**

Prepared by John Linarelli

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.

ANNEX 5**Rapporteur's report for the Variables A and B Group Discussions***(Prepared by Edouard Adelus)*

Variables A and B
Ignacio Tirado (<i>Group Leader</i>)
Murat Sultanov
Mathias Siems
Federica Ippoliti
Thomas Traschler
John Linarelli
Scott Schumacher

1. *Prof. Ignacio Tirado* introduced discussions and decisions held during the previous session (see EA ICLR 4th Workshop Report). He stated that the goal of the current session was to brainstorm on the content of variables A and B:

- i. Variable A: the net, direct impact of the new rules, rather than those applicable in the absence of reform, applied *ex ante* or *ex post*;
- ii. Variable B: the net, impact of the new rules as a network, that is, the existence of international rules, applied *ex ante* or *ex post*.

Variable A

2. The discussion first focused on Variable A. It was described as aiming to assess the new law in and of itself rather than as an element of a legal order or a broader regulatory environment. This raised two questions.

3. *What is/are the primary objective(s) or aim(s) of the law reform?* This objective should be identified from the start. It would then be used as a measure or benchmark to characterize the result obtained by using the framework. *Ex ante*, this would mean assessing whether undertaking these efforts is justified; it would rest on the assumption that the result of these efforts will be implemented. *Ex post*, this would require looking into the limits and difficulties of implementation to determine whether the primary objective was reached.

4. *What is the scope of causality we will limit ourselves to?* It was underlined that Variable A should not be confused with Variable E. The former focuses on the net costs and benefits of the reform itself. The latter focuses on the institutional and transitional costs of enacting and implementing this legal reform. Variable D was also described as different since it considers political and institutional risks that may limit the effective implementation of the reform but it does not, unlike Variable A, consider the intrinsic quality of the new rule.

5. The issue of scope of causality was linked with that of the externalities of the assessed law reform. The discussion sought to determine whether all potential externalities should be considered when conducting the assessment; i.e. at which point the link would be too tenuous to consider that the effect is effectively caused by the law reform. The participants agreed that externalities that should be considered include opportunity costs or the consequences of the new law on already existing regulations. Some specific elements that were considered:

- i. Market failures: identified through market data and/or market actors;
- ii. What is undertaken in comparable jurisdictions;
- iii. Whether the law reform will be adopted through a hard law or a soft law instrument. If it is a soft law instrument, it might be necessary to identify what are its essential elements; i.e. those that have to be implemented by domestic lawmakers for the domestic regimes to be considered implementations of the international law reform;

- iv. Whether the assessment was conducted ex ante or ex post: ex ante, it will likely be necessary to assess different alternatives of what the final version of the new rule will be.

Variable B

6. The group agreed that the aim of this variable is to assess the new law in relations to existing legal frameworks.

7. First of all, this would require identifying the relevant international and/or domestic legal frameworks that it will interact with. Then, an analysis of the interactions between the new law and the previously identified legal frameworks will be conducted. Ex ante, it will be necessary to envision the different potential versions of the new law.

8. The group envisioned several issues:

- i. Compare the primary objectives of the new law and the existing legal frameworks: do they support or oppose each other?
- ii. In practice, do these different regulations (or would they if the analysis is conducted ex ante) block each other or foster synergies?
- iii. Is there an increase in legal certainty and predictability?
- iv. Are the supported transactions improved?

9. Like in previous workshops, the participants agreed that the result could be envisioned according to 'high' and 'low' ranges of compatibility. This would especially be the case for ex ante assessments where precise quantification may be difficult.

General discussions

10. The group also agreed to propose to the plenary workshop that effective application of the new law by its beneficiaries as well as by courts and authorities should be included in Variable D.

11. The group also highlighted the consequences of conducting an assessment at a specific point in time. For example, it was explained that a credit law or insolvency law reform could not be properly assessed until several years after its implementation. The group also insisted on the importance of cultural aspects in the sense that each country has its own equilibrium. From the point of view of standard-setting international organisations, this diversity is supposed to be taken into account during the elaboration phase of the law reform.

ANNEX 6**Rapporteur's report for the Variable C and E Group discussions***(Prepared by William Brydie-Watson)*

Variable C+E
William Brydie-Watson (<i>group leader</i>)
Valeria Sukhova
Robert Trojan
Jordi Paniagua
Isabelle Rueda
Mark Walter
Charles Mooney
Marek Dubovec

General observations

1. The group agreed that the framework has the potential to be a practical and usable communication tool for Institutions considering potential international commercial law reform (ICLR) initiatives to illustrate the potential economic impact of a particular reform.
2. It was also agreed that if the framework were uniformly used (at least by one organisation), the framework's value is that it is relatively, simple, transparent and easy to understand for both lawyers and economists in setting out an ex ante assessment of proposed ICLR, and the variables underpinning the assessment.
3. The rating system proposed in Discussion Paper 1 was considered to have merit as an ex ante tool. Further consideration is required in relation to how the ratings would be evaluated ex post.
4. The group advised that the rating system proposed should not be used to rank different proposed ICLR, this is not the purpose of the tool.
5. The group underlined that the user guide for the document should stress that the framework only provides one additional mechanism for assessing whether an ICLR reform should be pursued, and should not be considered as the most important or ultimate factor for an organisation in deciding whether to pursue a particular project.
6. It was also highlighted that the user guide for the document (or whatever the accompanying document for the framework will be) needs to clearly set out the assumptions and limitations underpinning the framework (that go beyond the three caveats currently in the framework).
7. The group considered that the next step should be for the framework to be road-tested against ex ante ICLR reforms currently underway at both domestic and international level. The project should partner with organisations currently involved in these reforms undertake such tests.

Variable C

8. It was reaffirmed that Variable C should be interpreted broadly, covering both partial equilibrium and global equilibrium effects (as agreed at the 4th Workshop).
9. It was noted that for economists, Variable C is relatively easy to determine, as there are many existing models (for example the [OECD input/output tables](#)) that can determine the systemic effects (or "spill over effects") of a particular reform in relation to the relevant sectors. Economists tend to spend less than 10% of their time on this issue. The group considered that direct effects under Variable A are much more challenging to evaluate.

10. The group considered that by applying the existing models for measuring the systemic effects, the rating for Variable C in an ex ante assessment can be determined in a relatively objective manner, on a scale of 1 – 4. It should be clear ex ante which types of reforms are likely to have significant systemic effects (for example, secured transaction reforms are likely to have higher systemic effects due to their impact on the credit markets and lending, whereas contract law reforms are less likely to have higher systemic effects, unless they directly lead to an increased number of contracts being agreed).

11. However, the group highlighted that the framework (or its accompanying document) emphasises that just because a particular ICLR does not have a high systemic impact (or overall EA) does not mean it is not a valuable reform. For example, it is likely that the framework would not have considered the CISG to have a high systemic impact, because it did not lead to a large increase in sales transactions (in most cases the sales to which it applies would have been made anyway). However, the CISG's broader benefits, in improving predictability in commercial relationships, avoiding disputes and lowering resolution costs are extremely significant. These types of benefits are not well reflected in the framework (and perhaps don't need to be as it's not the purpose of the tool to examine all broader non-economic effects of ICLR).

Variable E

12. It was reaffirmed that Variable E should be interpreted narrowly, as the opportunity costs (of not retaining the status quo) should continue to be considered in each individual variable (as net impacts).

13. The rating of 1-2 appeared to the group as reasonable. The transition costs measured in Variable E will be made up of:

- a. The cost of negotiating and adopting the instrument; and
- b. The cost of implementing the instrument, including legislative implementation, technical assistance and capacity building.

14. The group agreed that Variable E should measure the costs of proper and full implementation (sufficient consultation, capacity building etc). In limited circumstances, it could also capture any general opportunity costs of not implementing the ICLR under consideration that were not captured under the individual variables.

15. The group held that further consideration of the relationship between Variables D and E is required. In the current framework, they have no relationship (as Variable E is considered after Variable D was already been applied to Variables A, B and C). For example, could a larger investment in implementation activity measured by Variable E impact on the risks measured by Variable D?

Annex 7**Rapporteur's report for the Variable D Group discussions***(prepared by Hamza Hameed)*

D – Political/Institutional Risk
Jeffrey Wool (Group Leader)
Hamza Hameed
Orkun Akseli
Anna Veneziano
Juan Mora Sanguinetti
Laura Pierallini
2 UW Students
1 UNIDROIT Researcher

Summary of the discussion on Variable D of the Framework

1. At the outset, the structure and precise aim of the group discussion was outlined such that the group was to start with a consideration and review of the progress which the discussion on Variable D had made during the 4th Workshop for this Project – this discussion was based upon the document found in Annex III of the Report for the 4th Workshop, and had been summarised in the report itself between paragraphs 21-23.

2. The sensitive nature of Variable D was underlined such that the determination or categorisation of the level of political risk in a particular State would always be controversial to the State in question, and to others. Moreover, the impact of D to the entire framework was very significant considering that it was a multiplier to the amalgamation of Variables A, B, and C. Without adequate consideration given to Variable D, economic assessments served largely a marketing purpose rather than realistically reflecting the impact of a commercial law reform project. One mechanism to account for Variable D was what economists had relied upon in the MAC Protocol economic assessment, where a certain arbitrary percentage was deducted to account for non-compliance; another mechanism was what was presently being discussed, which would be a mathematical derivative based on real data.

3. Prima facie, any State that became party to a hard law instrument undertook such an exercise with the intention to comply with the system it was participating in. Legal certainty, or confidence in the legal system was presumed. However, the implementation and compliance towards an instrument was not the same in every jurisdiction, and this was what political risk pertained to. The following elements were consensually identified as an exhaustive list of contributing factors towards the determination of political risk:

- a. Doctrinal issues of the rule of law;
- b. Imperfect functioning of the rule of law;
- c. Informational limitations;
- d. Institutional, capacity, or resource related limitations;
- e. Implementation related limitations;
- f. Lack of stability of the rule maker or rule applying entities;
- g. Rapid and unpredictable changes of legal and economic structures and policy;
- h. Intentional resistance, whether based on notions of sovereignty or protectionism;
- i. The effects of signalling; and
- j. An analysis of the system as a whole, looking at regulatory competition put forth by a legal treaty system.

4. Factors a-e were noted to be clear possible reasons for courts within a jurisdiction to implement the adopted law reform incorrectly; whereas factors f-i were seen as intrinsically linked to political circumstances found within a particular jurisdiction. All factors

a-i were determined to have the capacity to either push the value of Variable D down or up, depending upon their relevance to a particular jurisdiction. Whereas factor j was deemed to wholly be a factor that improved the score for Variable D and could not have a negative impact on it. Additionally, it was also noted that private sector, or industry support was not an actionable or measurable factor that had bearing on the political risk to compliance of any commercial law reform project.

5. The need for examples to go alongside each factor was stressed by the experts – this would constitute the discussion on these factors in the explanatory document which would accompany the framework. A prominent example referenced throughout the discussions of the group related to the insolvency of Avianca Brasil, which was predominantly a case of factor f where the Courts simply refused to apply the Cape Town Convention despite their obligation to do so under Brazilian law.

6. The importance of the usage of the term 'effectively' within the framework was emphasised – this underpinned the entire Variable and stressed upon the importance of compliance to an instrument. No changes were proposed to the current text of Variable D as it presently appeared in the Framework.

7. It was agreed that more often than not, the form of government (democratic, communist, monarchy etc), nor the sovereign wealth of a country, did not have an impact on the value of D. As such, the value of D was to be determined with a reliance on highly specific and tailored indices corresponding with core rule of law issues as identified by factors a-j. The data extracted from these indices should be refreshed as often as practicable such that every new assessment should make reference to the latest version of the data available. As a best practice, reliance should be made on indices that included active consideration and updates for emergency realities. Reference was made to the four annexes which are used by the AWG for its Compliance Index and the need to keep in mind the political sensitivities associated with using a particular index.

8. Thereafter, additional issues that needed to be considered were given attention with the following propositions agreed upon by the group:

a. **Ex ante vs. ex post:** Upon consideration, it was noted that factors a-i identified above applied primarily to determination of political risk ex ante, on a largely domestic level, and through a select percentage, or amalgamations at an international level. The following grid was developed as a useful exercise towards understanding the type of economic assessment being conducted:

Ex Ante	Ex Post	Ex Ante	Ex Post
Economic Assessments of a Domestic Nature		Economic Assessments of a Regional or International Nature	

It was agreed that the elements to consider and prioritise would vary depending upon the type of economic assessment being conducted. As such, for Variable D, the paradigm was heavily country specific with almost all data to be collected on an individual country level. For ex ante, data directly from specific indices would be used to determine D for any country. In the case of an ex ante global assessment, the mechanism used to calculate D could either be the one relied upon by the MAC Protocol economic assessment, wherein a

specific percentage was deducted from the overall economic benefit to cater for noncompliance based on an amalgamation of the general proxy data available country by country; or the value could be derived by looking at the complexity of the instrument being negotiated, as this was often the primary contributing element which impacted several of the factors listed above.

For domestic economic assessments conducted ex post, the participants agreed on the usefulness of the AWG Compliance Index model of precedent based adjustments to the proxy data available. This was such that the initial number would be derived through reliance on data from indices as a proxy, and then this would be adjusted by a predictive value derived from legal actions taken within any State towards the implementation, or non-implementation of the instrument in question. The predictive value would be calculated using a mathematical process and would be based on the collection of qualitative incident-based expert reports from individual States. Adjustments would be made at least twice a year, with emergency adjustments made for extreme cases as they happened.

In the unlikely event of an ex post global or regional assessment, the value for Variable D would always be derived through an amalgamation or average of the individual States being considered.

b. **Granularity, Mechanics of the score, and Hierarchy of the factors:**

Additional work would need to be conducted to determine the mathematical model to calculate D based on the above methodology. This would factor in the hierarchy or importance to be given to different factors from the aforementioned lists depending upon the type of assessment being undertaken.

It was agreed that a five-tier structure would be useful, with numerical ratings assigned to each State of 0.2, 0.4, 0.6, 0.8, and 1. Consideration was also given to whether it should be a six-tier structure with the additional inclusion of a zero rating; there was no conclusion on this matter.

It was also noted that additional work needed to be done to determine the hierarchy of factors depending upon the type of economic assessment being conducted.

c. **Determination of political risk for soft law instruments:**

It was agreed that the issue of soft law and the application of the framework to commercial law projects with a soft law outcome, was a more holistic issue which should be initially discussed in the plenary.

ANNEX 8**List of participants**

1. Andrew Myburgh (IFC) (Participating Remotely)
2. Anna Masutti (Università di Bologna)
3. Anna Veneziano (UNIDROIT)
4. Charles Mooney (University of Pennsylvania)
5. Federica Ippoliti (UNIDROIT Foundation)
6. Hamza Hameed (UNIDROIT)
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9. Jeffrey Wool (UNIDROIT Foundation)
10. Jennifer Varzaly (Cambridge University)
11. John Linarelli (Durham University)
12. Jordi Paniagua (University of Valencia)
13. Juan Mora Sanguinetti (Bank of Spain)
14. Laura Pierallini (Studio Pierallini)
15. Louise Gullifer (Oxford University) (Participating Remotely)
16. Marco Nicoli (UNIDROIT Foundation)
17. Marco Ricceri (EURISPES)
18. Marek Dubovec (NatLaw)
19. Mark Walter (DAI)
20. Mathias Siems (European University Institute)
21. Murat Sultanov (IFC)
22. Orkun Akseli (Durham University)
23. Rob Cowan (Aviareto)
24. Robert Trojan (NatLaw)
25. Scott Schumacher (University of Washington)
26. Souichirou Kozuka (Gakushuin University)
27. Thomas Traschler (Max Planck Institute for Comparative and International Private Law)
28. Valeria Sukhova (EURISPES)
29. William Brydie-Watson (UNIDROIT)

ANNEX 9**EA ICLR Framework at April 2019**

(no change)

$$\underline{\mathbf{EI}} = [(\underline{\mathbf{A}} + \underline{\mathbf{B}} + \underline{\mathbf{C}}) \times \underline{\mathbf{D}}] - \underline{\mathbf{E}}$$

WITH CONFIDENCE LEVEL FROM __ [INSERT 1-5]

Where –

- **EI** is economic impact
- **A** is the net, direct impact of the new rules, rather than those applicable in the absence of reform, applied ex ante or ex post
- **B** is the net, impact of the new rules as a network, that is, the existence of international rules, applied ex ante or ex post
- **C** is the net, systemic, including developmental, impact of the new rules, rather than those applicable in the absence of reform, applied ex ante or ex post
- **D** is the extent, measured from 1 to 0, that the new rules have been or will be effectively applied by courts and authorities
- **E** is the expected (ex ante) or actual (ex post) net cost of creating and transitioning to the new rules. E does not increase over time

*The analytic framework: -

- does not address the question of how the relevant impacts will be distributed
- does not address the non-quantifiable impacts of retaining or changing existing rules
- would be applied and compared with other law reform options which seek the same objective