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Rethinking Private Regulation in the
European Regulatory Space

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Abstract

The European regulatory space is changing. The role of private regulation is increasing more as a complement of public regulation than as an alternative to it. The emergence of new regulatory models coordinating public and private regulators has characterized the last decade. They reflect the crisis of the regulatory state but at the same time pose serious questions to the legitimacy and accountability of private regulators. The paper distinguishes five different models: public regulation, co-regulation, delegated private regulation, ex post recognized private regulation and private regulation. Within these models it concentrates on the differences between pure private regulation and modes through which public and private actors coordinate to perform regulatory activity. The paper addresses the questions posed by these changes in terms of rule-making and monitoring. It focuses particularly on three dimensions: the alternative between monopolistic private regulators and plurality of regulators, the conflict of interest and the liability regimes. It underlines on the one hand the opportunity for new rules and on the other hand the necessity to distinguish between private regulators operating in coordination with public institutions and those whose regulatory power is embedded in freedom of contract. These two typologies present different issues. Different modes of control should be used to correlate the new powers with new liabilities. The legitimacy of private regulators and their contribution to a democratic regulatory regime will depend on the ability of legislators and private parties to device adequate European and transnational rules and institutions. This is the main challenge ahead.

Keywords

Regulation, Regulatory competition, Liability, Judicial review

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Rethinking private regulation in the European regulatory space

Fabrizio Cafaggi

1. Introduction

The regulatory space is under continuous redefinition at different institutional levels, both in Europe and worldwide. The increased regulatory function of private law and the development of modes of regulation involving a plurality of actors have changed substantially the conventional view of the regulatory state¹. These new developments require us to thoroughly rethink the governance structures associated with regulatory processes and the interaction between private and public regulators².

Forthcoming in F. Cafaggi, *Reframing self-regulation in European Private law*, Kluwer, 2006

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¹ See C. Parker, C. Scott, N. Lacey, J. Braithwaite, *Regulating law*, OUP, 2004; the essays in *La Régulation, Nouveaux modes? Nouveaux territoires?*, *Revue française d'administration publique*, n. 109, 2004; M. Taggart, *The nature and the functions of the state*, in *The Oxford Handbook of Legal Studies*, P. Cane and M. Tushnet (eds), OUP, 2003, 101; H. Collins, *Regulating contract*, OUP, 1999 spec. 5 ff., 219 ff.

More specifically on the evolution of the regulatory state from different disciplinary perspectives, see C. Scott, *Regulation in the age of governance: the rise of the post regulatory state*, in J. Jordana and D. Levi Four (eds), *The politics of regulation*, Edward Elgar, 2004 p.145 ff.; P. Rosanvallon, *Le modèle politique français*, UH, Seuil, 2004; E. Glaeser and A. Schleifer, *The rise of the regulatory state*, *Journal of economic literature*, 2003, 401-425; R. Baldwin and M. Cave, *Understanding regulation: Theory, strategy and practice*, OUP, 1999, part. 125 ff. G. Majone, *The regulatory state and its legitimacy problems*, 22 *West European Politics*, 1, ff. (1999); A. Dixit, *The making of economic policy – A transaction-cost politics perspective*, MIT press, 1997; G. Majone, *From the positive to the regulatory state. Cases and consequences of changes in the mode of governance*, 17 *Journal of Public Policy* 139 (1997) I. Ayres and J. Braithwaite, *Responsive regulation, Transcending the deregulation debate*, part. 101 ff.,

² See R. Rhodes, *Understanding governance: Policy networks, Governance, reflexivity and accountability*, Buckingham, Open University Press 1997; G. Teubner, *Breaking Frames: the global interplay of legal and social systems*, *American Journal of comparative law*, 1997, 45, 149; R. Dehousse and C. Joerges, *Good governance in Europe's Integrated Market*, OUP, 2002; C. Joerges and G. Teubner, *Transnational governance*, OUP, 2004; C. Scott, *Regulating constitutions*, in C. Parker et al., *Regulating law*, op. cit., 226 ff ; J. Scott and D. Trubek, *Mind the Gap: Law and new approaches to governance in the European Union*, 8 *ELJ*, 2002, 5; A. Heritier, *New modes of governance in Europe: Policy-making without legislating?*, in A. Heritier (ed), *Common Goods: Reinventing European and International Governance*, Boston, 2002, 185; D. Trubek and L. Trubek, *The coexistence of new governance and legal regulation: Complementarity or rivalry?*, Working Paper of the New Governance project, available at http://www.eu-newgov.org/datalists/Deliverables_list.asp, 4.

Current times have been characterized in particular by relevant changes concerning the relationship between public and private actors in regulatory processes³. On the one hand private actors, particularly (but not only) regulatees, have been more often involved in regulatory processes through different participatory forms⁴. On the other hand the development of self-regulation has expanded the role and the power of private regulators⁵. These changes have affected the very definition of regulation⁶. The development of participation and the increase in self-regulation as an independent regulatory strategy present important challenges to the design of a European regulatory framework⁷.

Private rule-making is a very old phenomenon, subject to cyclical revivals in relation to the different ways in which the interaction of the public and private spheres are modeled⁸. What is new then about the involvement of private actors in the regulatory process? The most important novelty is the integrated nature of the new regulatory models. This phenomenon is taking place at the European level and to different degrees at national levels⁹. Such an

³ The choice of focusing on the distinction between public and private actors is related to the emphasis that legal thinking and practice still place on it. Different ways of describing changes in regulatory processes have been used and should be considered, in my view, not as alternative but as complementary perspectives for explaining changes and addressing the problems that these changes may bring about.

⁴ On the role of participation in regulatory processes see G. Napolitano, *Regole e mercato nei servizi pubblici*, Il Mulino, 2005, p. 107 ff. F. Bignami, Three generations of participation rights in European administrative proceedings, *Jean Monet W.P.* 11/03; K. Lenaerts, Procedural rights of private parties in the Community administrative process, 1997, *CMLR*, p. 531.

⁵ In the current debate, private regulators may refer to two very different hypotheses: one in which each individual actor, firm for example, is given the power to self-regulate its own conduct; the other in which regulatees and third parties either through a contractual or an organizational arrangement create a private legal entity that should regulate. In the second part of the essay I will focus on the latter leaving aside cases in which private regulation occurs at the individual level. On this distinction see J. Black, *Constitutionalising self-regulation*, 1996, *The Modern Law Review*, 59, 26, where the author acknowledges in the first model the positions of I. Ayres and J. Braithwaite, and their self-enforced regulation model (see, *Responsive regulation, transcending the deregulation debate*, OUP, 1992), and A. Ogus' consensual regulation model (see, *Regulation, Legal form and economic*, *Oxford Journal of Legal Studies*, 15, 1995, 97), and in the second model, A. C. Page's Self-regulation model (*The constitutional dimension*, *Modern Law Review*, 49, 1986, 141-167).

⁶ For different perspectives on the changing definition of regulation see C. Parker and J. Braithwaite, *Regulation*, in *Oxford Handbook of Legal Studies*, P. Cane and M. Tushnet, eds, p. 119 ff., G. Timsit, *La Régulation. La notion et le phénomène*, *Revue française d'administration publique*, La régulation. Nouveaux Modes, Nouveaux territoires, p. 5 ss., M.A. Frison Roche, *Définition du droit de la régulation économique*, in *Les régulations économiques : légitimité et efficacité*, sous la direction de M.A. Frison Roche, Presses de sciences po. et Dalloz, 2004, p. 7 ff.

⁷ On this design see the indications coming from the Sapir report, *An agenda for a growing Europe*, Andre Sapir et al., OUP, 2004, where the recommendation is twofold: towards steered networks and towards partnerships, "*The enlarged EU should move further towards decentralised implementation of market regulation by developing both steered networks of national and EU bodies operating within the same legal framework and partnerships of autonomous national bodies cooperating with each other and with EU bodies. In steered networks, ultimate responsibility remains with the relevant EU institution, hierarchically related to relevant national bodies, whereas in the partnerships, ultimate responsibility remains with each national institution. Choices between these models – or any hybrid thereof - should depend on the degree of market integration, the kind of regulatory coordination that is needed (e.g., harmonisation versus information exchange) as well as the need to be close to the markets*".

⁸ See A. Greif, P. Milgrom and B. Weingast, *Coordination, commitment and enforcement: the case of the merchant guild*, *Journal of political economy*, 102, 1994, 745; P. Schmitter, W. Streek, *Private interest governments, beyond market and state*, Sage, 1984. In different perspective, F. Galgano, *La globalizzazione nello specchio del diritto*, Bologna, 2005.

⁹ In relation to the common law systems, see T. Prosser, *Regulatory contracts and stakeholder regulation*, *Annals of public and cooperative economics*, 2005, p. 37; H. Collins, *Regulating law*, op. cit., passim. In the Italian system, see G. Gitti (ed), *L'autonomia privata e le autorità indipendenti*, Bologna, 2006; N.

evolution poses the problem of potentially divergent foundations of private regulation, partly grounded on private autonomy, partly on delegation by public power. These foundations may translate into different legal regimes or combinations of private and public law.

Important changes have occurred in relation to public regulation as well¹⁰.

While in the recent past, private regulation has been used to define regulatory spaces not covered by the public sphere, today there is a strong trend towards different forms of co-regulation¹¹. The major phenomenon we are witnessing at global level, but to different degrees, is a move from a world in which public and private regulators occupy different and independent spaces in the regulatory domain to a world in which they coordinate through hierarchy, cooperation and/or competition¹².

At present there is no symmetry between private and public regulatory spheres and private and public regulation. Indeed, private regulators participate in regulatory activities traditionally located into the public domain, while the public sphere of regulation is often occupied by both public and private regulators. The public sphere of regulation is populated by both public and private regulators, conversely the private sphere is often affected by public intervention. Furthermore private regulators and private regulation do not necessarily coincide. Private regulators may be found applying legislation or administrative regulations, whilst public regulators often make use of codes of conduct or contractual arrangements in their dealings with the regulated and are thus increasingly subject to contract law.

Regulatees' involvement has affected law-making and produced a re-distribution of the regulatory power between public entities and private actors.

These changes have occurred primarily in relation to welfare and market regulation and, more broadly, have touched institutions that had long been thought to belong quite clearly to either the public or the private domain¹³.

Lipari, *La formazione negoziale del diritto*, Riv. dir. civ., 1987, I, p. 307, and F. Cafaggi, Introduction to F. Cafaggi (ed), *The Institutional framework of European private law*, OUP, 2006, p. 1.

¹⁰ For an overview see OECD Working party on regulatory management and reform - Designing independent and accountable regulatory authorities for high quality regulation, p. 72 ff. and in particular the essays of F. Gilardi, *Evaluating independent regulators*, G. Majone, *Strategy and structure. The Political economy of agency independence and accountability*, p. 126

See D. Geradin, R. Munoz, N. Petit (eds) *Regulatory authorities in the EC: A new paradigm for European governance*, EE, 2005, and R. Caranta, M. Andenas, D. Fairgrieve (eds), *Independent administrative authorities*, British Institute of comparative law, 2005, D. Cohen, A. Heritier, M. Thatcher, *Refining regulatory regimes in Europe - The creation and the correction of markets*, EE, 2005.

In relation to the evolution of administrative law see also G. Falcon (ed.), *Il diritto amministrativo dei paesi europei*, Padova, 2005, J. Ziller (ed.), *What is new in European administrative law?*, EUI W.P. 2005/10. On the European level see also the Draft Interinstitutional Agreement on the operating framework for the European regulatory agencies, (COM(2005)59 final, 25.02.2005) where the Commission proposes that, in accordance with the principles of good governance, a framework should be established setting out the conditions relating to the creation, operation and control of "regulatory" agencies, which help to improve the implementation and application of Community legislation, taking into account in particular the criteria of coherence, effectiveness, accountability, and participation and openness.

¹¹ The interinstitutional agreement on better law making, among the European Parliament, the Commission and Council, O.J. 31.12.2003, C 321; and the *The White Paper on governance*, 25.7.2001, COM(2001) 428 final.

¹² To capture the coordination aspect in its multiple dimensions several metaphors have been employed. See e.g. B. Eberlein, *Formal and informal governance in Single Market regulation*, in *Informal governance in the European Union*, T. Christiansen and S. Piattoni (eds.), Edward Elgar, 2003, 150-172. For a comparative examination of the issue George A. Bermann, Matthias Herdegen and P. Lindseth (eds.), *Transatlantic regulatory cooperation: legal problems and political prospects*, OUP, 2000.

¹³ It should, however, be recognized from the outset that an accurate historical examination would show that cyclical modifications have shifted functions from the private to the public sphere and vice versa.

The expansion of private regulation is perceived - somewhat ideologically - either as an expression of privatization or as a tool intended to re-regulate liberalized or deregulated fields in a more regulatee-friendly environment. However, in many cases we observe that, more than privatization, there has only been a partial re-allocation of regulatory power, within a framework of coordination, between public and private actors¹⁴. Functionally private regulation as much as public regulation may serve the purpose of enhancing contractual freedom or protecting weaker parties.

Thus, the more relevant role of private actors does not (necessarily) coincide either with deregulation or with a lower degree of regulation. There are areas in which a direct positive correlation between the role of private regulation and the increasing amount of regulation is shown. The traditional sectors of professional regulation demonstrate that the involvement of professional associations in regulatory processes has often brought about hyper or even over-regulation¹⁵.

The specific aspects analyzed in this paper concern the role of private regulators more than the participation of individual regulatees in regulatory processes¹⁶. Participation of individual regulatees in the regulatory process is instead a crucial part of ensuring the effectiveness of the regulatory activity and avoiding unlawful exercise of regulatory power by the private regulator¹⁷.

For a broader perspective see W. Van Gerven, Mutual Permeation of Public and Private Law at the National and Supranational level, *Maastricht Journal of comparative law*, 1998, 5, 1, 7-24.

On the evolution of private and public institutions see E. Brousseau, Networks effect and the economics of private institutions and S. Deakin, The return of the Guild? Network relations in historical perspective, both presented at the EUI conference on The Governance of enterprises and the role of networks organised by F. Cafaggi, in December 2005.

¹⁴ See T. Prosser, *Law and the regulators*, OUP, 1997; F. Cafaggi, Le rôle des acteurs privés dans le processus de régulation : participation, autorégulation et régulation privée, *Revue française d'administration publique*, n. 109, 2004, p. 23 ss ; B. Du Marais, *Droit public de la régulation économique*, Paris, Presses de Sciences Po et Dalloz, 2004, p. 484 ss. ; J. Black, Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a post Regulatory World, 2001, 54 *Current Legal problems*, p. 103 ss ; M. Salvati, I rapporti tra Stato ed economia come rapporti tra regolazione pubblica e privata, in C. Franchini, C. Paganetto (eds), *Stato ed economia all'inizio del XXI secolo*, Mulino, 2002, p. 29 ff; D. Oliver, The underlying values of public and private law, in M. Taggart (ed), *The province of administrative law*, Hart, 1997, p. 217 ff.

¹⁵ See Communication from the Commission: Report on competition in professional services, Brussels 9.2.2004, COM (2004) 83 final and the Resolution of the European Parliament on market regulations and competition rules for the liberal professions 16.12.2003. In particular see para. 91, where the Commission suggests that the review and, where necessary, the reform of potentially restrictive existing rules and regulations will require the concerted efforts of all actors involved, each in its area of competence. Moreover at para. 93, the Commission invites the regulatory authorities of the Member States to review the legislation or regulations within their remit. They should in particular consider whether the existing restrictions pursue a clearly articulated and legitimate public interest objective, whether they are necessary to achieve that objective and whether there are no less restrictive means to achieve this. See also on the different models of professional regulations and their impact on competition rules: I. Paterson, M. Fink, A. Ogus, *Economic impact of regulation in the field of liberal profession in different EU Member states*, Institute for Advanced studies, Vienna, January, 2003, 23 ff..

¹⁶ For a recent critical examination see F. Bignami, Three generations of participation Rights in European Administrative Proceedings, Jean Monnet Working Paper 11/03 available at www.jeanmonnet.org.

¹⁷ Recent research on the influence exercised by regulatees over public regulators shows that regulation of participation is not only a matter of granting access but it is the expression of guaranteeing equal access to otherwise very unequal regulated members. See D. Coen, A. Heritier, M. Thatcher, (eds) *Refining regulatory regimes in Europe: The creation and corrections of markets*, EE, 2005. See also A. Heritier, *Redefining the regulatory space*, in D. Coen and A. Heritier, *Redefining regulatory regimes: Utilities in Europe*, EE, 2005; S. Smismans, *New Modes of Governance and the Participatory myth*, European

The rationales for the involvement of private regulators in regulatory processes differ quite significantly depending on the sector¹⁸. Furthermore, they also differ in relation to individual modes of regulation: i.e. within co-regulation or private regulation the choice of models might be based on different combinations depending on the sector under scrutiny¹⁹. It is therefore highly relevant to identify the reasons provided to justify the involvement of private actors in the regulatory processes under consideration²⁰.

The main justifications are generally related to combined market and government failures.

Knowledge, expertise and information are often suggested as a basis for private regulators' involvement²¹.

1) Asymmetric information is often relied upon as an important ground for regulatory intervention. It is arguable, however, that asymmetric information between regulators and regulatees may itself justify the transfer of regulatory power to private actors or simply their involvement²².

2) A second rationale is the legitimacy of regulatory power. Legitimacy has different aspects in relation both to regulatees and to third parties who might be affected by the regulatory process. A regulatory process based on the separation between regulators and regulated, as is often the case in public regulation, may lack legitimacy and consensus on the part of actors whose conduct should be affected by the regulatory activity.

Governance Papers (EUROGOV), 2006, available at <http://www.connex-network.org/eurogov/pdf/egp-newgov-N-06-01.pdf>.

¹⁸ Each sector defines a market in which the failures to be addressed by regulation might be different.

¹⁹ For example a clear relation between the use of expertise and co-regulation is expressed in the European Commission, European Governance, White Paper, Brussels, 25.7.2001, COM(2001) 428 final: "*Co-regulation combines binding legislative and regulatory action with actions taken by the actors most concerned, drawing on their practical expertise. The result is wider ownership of the policies in question by involving those most affected by implementing rules in their preparation and enforcement. This often achieves better compliance*".

It is unclear whether this approach would imply a selection of the regulated or a wider selection by giving a broad and preferable interpretation encompassing all those affected. Even if we consider only the expertise element it is clear that consumers' expertise may be almost as valuable as that of industries.

For a critique of the expertise rationales for involving private actors and the preference for interest representation see F. Bignami, Three generations of participation Rights in European Administrative Proceedings, op. cit.

²⁰ See C. Scott, Accountability in the regulatory state, 27 Journal of law and society, 2000, 38-60.

²¹ E.g. I. Ayres and J. Braithwaite, Responsive regulation, transcending the self-deregulation debate, op cit., A. Ogus, Regulation, Legal form and economic theory, Oxford, 1994; Id., Rethinking Self-Regulation, op cit., C. Parker and J. Braithwaite, Regulation, in The Oxford Handbook on Legal Studies, P. Cane and M. Tushnet (eds.) op cit., p. 126, focusing on Teubner's regulatory trilemma and examining effectiveness, responsiveness and coherence. G. Majone, Strategy and structure. The Political economy of agency independence and accountability, in OECD Working party on regulatory management and reform. Designing independent and accountable regulatory authorities for high quality regulation, G. Majone, Strategy and structure. The Political economy of agency independence and accountability, p. 136.

²² In this case the risk of capture of regulators depends on the nature and the source of information, which is flowing from regulatees, thus, tools aiming at differentiate the source of information are increasingly used. They differentiate not independent from interested sources, rather these tools introduce a knowledge-enhancing process where all the actors are involve so as to build up the necessary knowledge. See for example the shift in the role of consumer associations in tobacco litigation cases, where they were defined only as interested actors, and currently as networks where knowledge is produced and widespread), as in case of tobacco litigation in US and, increasingly, in Europe.

The shift from traditional models of regulation towards different models of responsive and smart regulation tries to address these issues²³. But legitimacy also poses the question of the role of private actors other than regulatees, whose interests can be deeply affected by the regulatory process²⁴. For example, in the area of environmental regulation, the interests of environmentalists and those who are living in proximity to polluted areas are generally internalised by regulatory activities²⁵. In the area of product safety, consumers, users and households are affected by dangerous products²⁶. Effective regulatory processes require that standard setting obtains legitimacy from industry and consumers, buyers and bystanders²⁷. Responsiveness also requires a different institutional structure, in particular a different function for judicial review²⁸.

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- ²³ See I. Ayres and J. Braithwaite, *Responsive regulation, transcending the deregulation debate*, op cit.; J. Braithwaite, P. Drahos, *Global Business Regulation*, Cambridge University Press, 2000, J. Braithwaite, *Rewards and regulation*, *Journal of Law and Society*, 29, 1, 2002, p. 12.
On smart regulation N. Gunningham and R. Johnstone, *Regulating workplace safety: Systems and sanctions*, OUP, 1999; N. Gunningham and J. Rees, *Industry Self-Regulation: an Institutional perspective*, *Law and Policy*, 19, 4, p. 363; N. Gunningham and P. Grabosky, *Smart regulation: Designing environmental policy*, OUP, 1998; N. Gunningham and D. Sinclair, *Regulatory pluralism: Designing policy mixes for environmental protection*, *Law & Policy*, 1999, 21, p. 49.
- ²⁴ See R. Baldwin and M. Cave, *Understanding regulation: Theory, strategy and practice*, op cit., which addresses the issue in terms of fairness: "...schemes of self-regulation are liable to criticisms of unfairness insofar as non members may be affected by regulatory decisions to which they have no access. Past experience suggests that self-regulators have a sporadic, unstructured and patchy record of consulting those with interests in the workings of their systems." Then in relation to the possibility of judicial intervention concerning duty to ensure participation in self-regulation: "*The Courts might act to demand proper access for affected parties on the lines noted above to discuss accountability but, as yet, self-regulators are free from general duties to consult non-members before taking decisions or devising policies. Nor are they subject to general duties to give reasons for the actions or the decisions they have taken*", at 131.
See L. Hancher and M. Moran, *Organizing Regulatory Space*, in L. Hancher and M. Moran (eds.), *Capitalism, Culture and Economic Regulation*, Oxford University Press, 1989: "*Questions about who participates in and benefits from regulation are certainly important: explaining the complex and shifting relationships between and within organizations at the heart of economic regulation is the key to understanding the nature of the activity.*", at 271.
- ²⁵ N. Gunningham, A. Kagan, D. Thornton, *Social licence and environmental protection: Why businesses go beyond compliance*, LSE, Centre for the Analysis of Risk and Regulation discussion paper, visited Dec. 2004 (<http://www.lse.ac.uk/collections/CARR/pdf/Disspaper8.pdf>). See also E. Orts and K. Deketelaere, *Environmental contracts*, Kluwer Law international, 2001; R. Stewart, *A New Generation of Environmental Regulation?*, 29 *Cap. U.L Rev.*, 2001, 21; R. Revesz, *Foundations of Environmental Law and Policy*, OUP, 1997, reprinted by Foundations Press, 2000; G. Teubner, L. Farmer and D Murphy, *Environmental Law and ecological responsibility - The concept and practice of ecological self-organization*, J. Wiley & Sons, 1994.
- ²⁶ See F. Cafaggi, *Responsabilità del produttore*, in *Trattato di diritto privato*, directed by N. Lipari, Padua, 2003, vol. IV, p. 997
- ²⁷ See F. Cafaggi, *A coordinated approach to civil liability and regulation in European law*, *Rethinking institutional complementarities*, in F. Cafaggi (ed) *The Institutional framework of european private law*, OUP 2006, p. 191 ff., S. Whittaker, *Liability for products*, English law, French law, and European harmonisation, OUP, 2005, p. 204, S. Weatherill, *EU Consumer Law and policy*, EE, 2005, p.199 ff...
- ²⁸ See P. Cane, *Administrative law as regulation*, in C. Parker et al., *Regulating law*, op cit., p. 216 part. and 218 and J. Black, *Proceduralising regulation*, Part I, *Oxford Journal of Legal Studies*, 20, 2000, 597 and Part II, *Oxford Journal of Legal Studies*, 21, 2001, 33; F. Denozza, *Discrezione e deferenza: il controllo giudiziario sugli atti delle autorità indipendenti regolatrici*, MCR, 2000, p. 469 ff.; M. Rescigno, *Autorità indipendenti e controllo giurisdizionale: le parole e la realtà*, AGE, 2002, p. 461 ff. See also *Petite Affiche*, January 2003, monographic issue on *Regulateurs et juges*, in particular J.F. Lepetit, *Etat, Juge et Régulateur*, p. 9 ff, and F. Dupuis-Toubol, *Le juge en complémentarité du régulateur*, p. 17 ff.

3) A third justification for the involvement of private actors is to increase compliance with standards. The use of private regulation, in particular self-regulation, should increase the level of compliance since regulated parties are those who define the standards and therefore are assumed to set them appropriately for the purpose of compliance²⁹.

In this perspective, particular emphasis is laid on accountability, its implications concerning procedural guarantees and the choice of organizational models that provide for the active participation of private actors³⁰.

The involvement of private actors at different levels and, from a more radical perspective, the transfer or delegation of regulatory power to private regulators pose important questions concerning private regulators' accountability and liability. The governance of the regulator is crucial. In particular the choice of the legal form (company, mutual, association, foundation, consortium), its for profit or non profit nature, its democratic or hierarchical structure³¹. Hence, governance choices of private regulators aim to respond to some of the accountability concerns; nevertheless, governance alone may not be sufficient and judicial control serves to complement an adequate governance structure.

In order to promote some or all of the goals just outlined (acquisition of information and expertise, legitimacy, compliance, accountability), an appropriate governance design for private regulators is therefore required³². Otherwise the risk remains that the self-interest of the selected private actors will prevail³³.

New modes of regulation in the framework of coordination should be seen as a means of tailoring regulation to the needs of different markets and social actors. They should not be

²⁹ R. Baldwin and M. Cave, *Understanding regulation: Theory, strategy and practice*, op cit., 127.

³⁰ The concern of accountability has been among the most recurrent problems concerning the involvement of private parties in rule-making. For an account of the U.S. experience see J. Freeman, *Private parties, public functions and the new administrative law*, in D. Dyzenhaus, *Redrafting the rule of law*, Oxford, Hart, 1999, at 331 ff.: *"Both agency incorporation of privately set standards and agency reliance on expert panels arguably warrant greater scrutiny than would standard-setting based solely on in-house expertise. The difficulty of course is distinguishing in-house expertise from dependence on private parties, since private parties are so well integrated into the traditional standard setting process. These public/private arrangements, whether formal or informal, engender doubts about impartiality, independence, conflicts of interest and self-dealing that remain insufficiently addressed by the mere existence of agency oversight or the application of procedural rules governing private conduct. Imposing even more constraints on private actors (producer groups, standard setting organizations, and expert panels) is one way to try to provide more accountability, but perhaps at the risk of undermining the special advantages of private contributions."*

For a general overview of accountability that also considers these issues see C. Harlow, *Accountability in the European Union*, OUP, 2002 and A. Arnall and D. Wincott (eds), *Accountability and legitimacy in the European Union*, OUP, 2002.

³¹ For a more detailed analysis see F. Cafaggi, *Gouvernance et responsabilité des régulateurs privés*, RIDE, 2005, p. 111 ff.

In relation to stock exchanges where the debate concerning governance of private regulators has been very rich see *Regulatory issues arising from exchange evolution*, Report of the technical committee of the International organisation of Securities Commission, IOSCO 2005, and prior to that *Issues paper on exchange and demutualization*, June 2001 available at www.iosco.org.

³² See The OECD Report on Regulatory reform, *Synthesis*, Paris, 1997, 27-28.

³³ Pearce and Tombs argue that profit maximizing firms will always be "amoral calculators" who only comply with regulatory requirements when the penalties are strict enough. Incentives for self-regulation must therefore be backed up by forms of regulation in the public sphere that are punitive enough to make sure companies consistently do their sums right. F. Pearce and S. Tombs, *Hazards, law and class: Contextualising the regulation of corporate crime*, *Social and Legal Studies*, 6, 1997, 79-107. There are sceptical approaches that hold the view that conflict of interest is so deep as to suggest rejection of private regulation as a regulatory device. See also D. McBarnet and C. Whelan, *The elusive spirit of the law*, *Modern Law Review*, 54, 1991, 848 ff.

interpreted as vehicles for de-regulation: on the contrary they represent devices for improving regulatory effectiveness. Coordination among different regulators thus poses new challenges to private law concerning the governance and the activity of private regulators that this paper tries to assess.

The paper proceeds as follows: Section two defines the main issues posed by the new regulatory models. Section three focuses on the difference between self-regulation and private regulation. Section four introduces a taxonomy of coordinated forms. Section five identifies three main questions posed to private regulatory law by the use of these new models: the design of the regulatory framework, the regulation of conflict of interest and the liability regimes. Section six addresses the alternatives of monopoly and regulatory plurality. Section seven concerns conflict of interest; section eight examines liability regimes of regulatory pluralism. Concluding remarks follow.

2. Three fundamental questions and the challenges faced by private regulatory law

The process of changing the allocation of regulatory power poses some fundamental questions in relation to the involvement of existing private regulators or the creation of new private regulators that will only be partly addressed in this essay. They constitute the necessary conceptual framework within which a new private regulatory law will arise.

- 1) The juxtaposition between technocratic and interest-based models of regulatory bodies.
- 2) The private-public law divide and the new regulatory processes³⁴.
- 3) The reallocation of regulatory power between regulators and the judiciary.

1) Technocratic versus interest-based regulatory bodies.

In the domain of public regulation there has been a transfer of regulatory power from governmental bodies to independent agencies or authorities both at the national and

³⁴ The changed nature of these bodies, i.e. the formation of regulatory hybrids that use both public and private law instruments and have governance structures different from purely private or public regulators impose a change in the legal framework. On regulatory hybrids see J. Black, *Constitutionalizing self-regulation*, 1996, MLR, and *Decentering regulation: Understanding the role of regulation and private regulation in a post-regulatory world*, *Current Legal Problems*, 54, 2001, 103 ff. A. Murray and C. Scott, *Controlling the new Media: Hybrid Responses to new form of power*, *Modern Law Review*, 2002, 65, 4, 505; and C. Scott (ed), *Regulation*, Ashgate/ Dartmouth, 10.

supranational level³⁵. This change has been stimulated (amongst other causes) by the need to acquire technical expertise and to promote independent decision-making³⁶.

The experience of contemporary development of private regulation both outside and inside coordinated mechanisms is somewhat different. Self-regulatory bodies, whose regulatory power is sustained by freedom of contract and self-organization, tend in the main to represent the interests of their members, the regulated firms in the majority of cases, while the technical expertise of the members of governing bodies is generally instrumental to interest representation³⁷. Moreover, independence from political power does not constitute the main reason for the development of self-regulation and the creation of self-regulatory bodies. Clearly private regulation is not independent from the regulated although regulators and regulated do not necessarily always coincide³⁸. As we shall see, a slightly different set of justifications is given for the creation of new or the involvement of existing private regulators in frameworks of coordination with public regulators. In the case of co-regulation, while by definition the private regulator is self-interested (i.e. it promotes the interests of its members), the ability to provide knowledge and expertise may often constitute an important complementary justification³⁹.

The difference between the technocratic and the interest-based model operates both in relation to the governance of private regulators and to the procedures they must comply with⁴⁰.

³⁵ See OECD contributions cit. supra n. 10; D. Geradin, R. Munoz, N. Petit (eds) *Regulatory authorities in the EC: A new paradigm for European governance*, EE, 2005,

See G. Majone, *From the positive to the regulatory state: causes and consequences of changes in the mode of governance*, *Journal of Public Policy* 17:2, 1997, 139–167; A. La Spina, G. Majone, *Lo stato regoalatore*, Mulino, 2000; G. Amato, *Le autorità indipendenti*, in AAVV., *Storia d'Italia, Annali 14, Legge diritto giustizia*, Einaudi, 1998; F. Merusi, *Democrazia e autorità indipendenti, un romanzo quasi giallo*, Mulino, 2000; F. Merusi, M. Passaro, *Le autorità indipendenti*, Mulino, 2003; S. Cassese, *Lo spazio giuridico globale*, Bari-Roma, 2003.

³⁶ At the European level this position has been advocated by G. Majone (ed.), *Regulating Europe*, Routledge, 1996.

³⁷ The question of the technical or interest-based organisation is crucial for deciding applicability of competition law to self-regulatory arrangements. In particular the composition of the board and the procedures to appoint the members has attracted the attention of ECJ case law.

³⁸ See F. Cafaggi, *Gouvernance et responsabilité des régulateurs privés*, cit. ; W. Cesarini Sforza, *Il diritto dei privati*, Giuffrè, 1963, p. 84.

³⁹ It should be clarified that in the case of public agencies and authorities the concern about independence is related to government and other public authorities; in relation to private regulators, independence concerns the relation between regulator and regulatees. The independence of the private regulator from government is generally assumed, given the private nature of the regulator. This assumption becomes highly debatable in co-regulatory arrangements. On the contrary, the main problem within private regulation is how to make these regulators accountable towards the public entities and the final beneficiaries.

⁴⁰ To exemplify the effects of the two approaches on the governance of the private regulator: an interest-based model of private regulator would probably have a board composed mainly of members representing the different interests of both regulatees and possibly third parties, with a limited number of independent 'directors' providing technical expertise.

A technocratic board would mainly be composed of experts, whilst it would only indirectly represent the interests of regulatees and third parties.

See for a more detailed examination, section seven on conflicts of interest, *infra*.

See that in case of a delegation of powers from State to a private body, competition rules should be considered, because the Court takes account of whether the cooperation of the undertakings is carried out in an "institutionalised" setting, or whether the law provides some kind of legal framework for the cooperation, specifically whether the decision-making body (i) comprises experts rather than representatives of affected participants in the market, (ii) who are required to consider the public interest rather than private interests. If these conditions are met, the body will escape classification as a private undertaking or association of undertakings. See *infra* at n. 120 ff.

The partial transfer of regulatory power from public to private regulators poses therefore a fundamental choice between three alternative options:

(1) to bring about significant changes in the regulatory environment, moving from public regulation to a form of private interest-based model of regulation (as a consequence of the adoption of current models of private regulators) thereby exacerbating the conflict of interest;

(2) to constrain private regulation within the technocratic model by institutionalizing the role of experts and technocrats and reducing or 'hiding' the conflict between general and particular interests and perhaps externalizing interest representation.

(3) to reshape governance structures of private regulators, in order to at least compromise between these two different and sometimes conflicting needs (i.e. interest representation and technical expertise based on independent actors)⁴¹.

2) *The private-public law divide and the new regulatory processes.*

The attribution of regulatory power to private regulators with the aim of pursuing the public interest has already contributed to the creation of regulatory hybrids⁴². In these cases, for example, private regulators have generally to comply with principles of transparency, accountability, and participation, typical of public regulators, significantly reducing their freedom of contract: as a consequence, the basic private law principles that characterize their organizational models are significantly altered⁴³. Judicial review has often but not always been applied to regulatory hybrids⁴⁴.

⁴¹ Current public regulators provide some level of interest representation through participation. In fact the juxtaposition may be framed less dramatically by saying that while administrative agencies or independent authorities satisfy technical expertise through governance and interest representation through participatory procedures, private regulators tend to favour interest representation in the governance dimension and acquire expertise through committees or other participatory devices.

⁴² See J. Black, *Decentering regulation: Understanding the role of regulation and private regulation in a post-regulatory world*, *Current legal Problems*, 54, 2001, 103 ff. Black writes: "*The hallmarks of the regulatory strategies advocated are that they are hybrid (combining governmental and non-governmental actors), multifaceted (using a number of different strategies simultaneously or sequentially) and indirect...*", at 111. She describes decentered regulation as follows: "*'Decentered regulation' thus involves a move away from an understanding of regulation which assumes that governments have a monopoly on the exercise and control, that they occupy a position from which they can oversee the actions of others, and that those actions will be altered pursuant to government's demand. 'Decentering' thus refers to changing (or differently recognized) capacities and limitations of those capacities. Essentially decentered regulation involves a shift (and recognition) of such a shift from the state to other multiple locations, and the adoption on the part of the state of particular strategies of regulation.*" Ibid. 114.

See also F. Ost and M. Van de Kerchove, *De la pyramide au reseau? Pour une theorie dialectique du droit*, *Facultés Universitaires Saint-Louis*, 2002; C. Scott, *Analysing regulatory space: Fragmented Resources and institutional design*, *Public Law*, 2001, 329 ff.; R. Baldwin and M. Cave, *Understanding regulation*, op cit., I. Ayres and J. Braithwaite, *Responsive regulation, transcending the deregulation debate*, op cit.

⁴³ See in the UK experience the *Code of Practice on Access to Government Information* (first edition 1994, changed in 97) written by the Government establishes that both local and central authorities have to be correct and transparent when they deal with political and administrative matters. These are norms that the governing body gives itself and has to respect – a moral commitment, not a legal one; this self-regulation will give people access to the measures and proceedings of public powers. In case the code is not respected, a citizen may apply to the Ombudsman (art 11 of the Code) who will find a solution to the problem concerning the *freedom of information* by means of an exhortation which, because of its own nature, is not legally binding for the Government. However, such exhortations have proved more effective than binding decisions, in particular the fact that the code is enforced by the Ombudsman should be seen as one of its main strengths and as a positive reminder and reinforcement of Parliament's constitutional role of holding

When coordinated regulatory processes take place, they are generally broken into phases or stages to be performed by either or both types of regulators⁴⁵. This higher level of complexity, associated with interactions among different regulators, will increase the necessity to create regulatory hybrids simultaneously deploying conventional private and public law instruments or creating new devices, by combining the two⁴⁶. Contract, tort, corporate law, and the law of associations have therefore been or should be modified to serve the purpose of governing regulatory hybrids. These changes should relate to governance and liability questions as well. Regulatory hybrids in this context may follow different principles from those associated with private regulators performing regulatory functions in the general interest.

3) The changing allocation of powers between regulators and judiciary.

The re-allocation of regulatory power between public and private actors and the new roles of private regulators has also caused a change in the role of the judiciary and in particular the scope and functions of judicial review⁴⁷. The increasing regulatory power of

the government to account, see in this sense G. De Minico, A hard look at self-regulation in UK, in EBLR, 1, 2006, 183.

⁴⁴ For a comparative analysis see M. Andenas and D. Fairgrieve, *Judicial review in International Perspective*, Kluwer Law International, 2000.

⁴⁵ Regulatory processes are generally described as encompassing at least three functions: standard setting, implementation and monitoring and, lastly, enforcement. Within public regulation they can either be performed by the same authority or by different ones (administrative agency and judiciary); symmetrically, the same organizational pattern applies to private regulators, and again the number of subjects performing regulatory functions can vary. When functions are performed by different entities but within the public or the private chain there is a certain level of homogeneity of legal instruments. However, even within discrete regulatory processes, the intersection between public and private law has already been quite significant. The move towards coordinated regulatory arrangements requires a reconsideration of the use of public and private law and shows the emergence of new instruments to be applied.

⁴⁶ Existing examples of regulatory hybrids at European Union level are voluntary instruments concerning environmental protection and sustainable development, such as the environmental management and audit scheme (EMAS) and the eco-label licensing scheme. The relevant Community legislation concerning eco-labels includes: Regulation of the European Parliament and of the Council on a revised Community Eco-label Award Scheme, 2000/1980/EC; Commission Decision on a standard contract covering the terms of use of the Community Eco-label, 2000/729/EC; Commission decision establishing the European Union Eco-labelling Board and its rules of procedure, 2000/730/EC. The relevant Community legislation concerning EMAS includes: Regulation of the European Parliament and of the Council of 19 March 2001 allowing voluntary participation by organisations in a Community eco-management and audit scheme (EMAS), 761/2001/EC; Decision on guidance for the implementation of Regulation (EC) No 761/2001 of the European Parliament and of the Council allowing voluntary participation by organisations in a Community eco-management and audit scheme, 681/2001/EC.

⁴⁷ In the British experience see P. Cane, *Self-regulation and judicial review*, *Civil Justice Quarterly*, 1986; G. Borrie, *The regulation of public and private power*, *Public Law*, 1989, 552; D. Pannick, *Who is subject to Judicial review and in respect of what*, op cit.; J. Black, *Constitutionalizing private regulation*, op cit.; D. Oliver, *Common values and the public-private divide*, Butterworths, 1999.

For a broader perspective concerning the relationship between judicial review and regulation see P. Cane, *Review of executive action*, in P. Cane and M. Tushnet (eds), *The Oxford Handbook of Legal Studies*, op cit., 146; Id., *Administrative law as regulation*, in C. Parker et al., *Regulating law*, op cit., 216; S. Halliday, *Judicial review and compliance with administrative law*, Hart, 2004; M. Hertogh and S. Halliday (eds), *The impact of judicial review: International and interdisciplinary dimensions*, Cambridge University Press, 2004.

In France see *Petites Affiches, Régulateurs et juges*, 23 Janvier 2003, in particular J. F. Lepetit, *Etat, juge et Régulateur*, 9 ff.; M.A. Frison Roche, *Les qualités du régulateur face aux exigences du droit*, *ibidem*, 15; F. Dupuis-Toubol, *Le juge en complémentarité du régulateur*, *ibidem*, 17; J. Marimbert, *L'ampleur du contrôle juridictionnel sur le régulateur*, *ibidem*, 41; P. Devolvé, *Le pouvoir de la sanction, l'organisation et le*

private actors even within a cooperative scheme increases the need for judicial scrutiny to prevent conflicts of interest and to preserve the pursuit of regulatory goals⁴⁸. In relation to private regulators a new balance between traditional techniques of judicial enforcement in private law and judicial review related to administrative law is needed⁴⁹.

(1) When there is a total transfer by a legislative act without delegation (i.e. when the regulatory power is exercised solely by private regulators and they are not considered to perform a public function), judicial monitoring takes the usual form of private law enforcement⁵⁰. Freedom of contract severely constrains the ability of judges to interfere with the ‘internal’ decision making processes of self-regulators. Often they provide internal conflict dispute resolution that might also serve a quasi-regulatory function.

(2) When the regulatory process is entirely allocated to private regulators but they are deemed to perform a public function then judicial review is based on different principles, partly derived from judicial review of public regulators but mainly arising from principles and rules based on private law enforcement⁵¹.

(3) When a coordinated scheme is adopted, a different mixture of judicial systems is in place, drawing partly from public and partly from private legal rules concerning judicial enforcement⁵². Judges solve disputes arising between public and private regulators as ‘contractual partners’ in the regulatory process but they also constitute the ‘guarantors’ of the interests pursued by these new modes of regulation. The role of judges is increased by the new allocation of regulatory power, although their tools might have changed from traditional monitoring of command and control regulation to a more cooperative mode.

The correlation between the different questions is quite evident. Both interest-based and technocratic models might require a significant yet quite different role for private regulators. The choice between the two has a strong impact on the role performed by judges who might act as social mediators in interest-based models and as controllers and custodians of technocratic expertise, on behalf of the final beneficiaries, in technocratic models. These different functions may affect the devices used to regulate the process but also those employed to monitor and control its outcomes by judges.

contrôle du marché, *Petites Affiches*, n. 185, 17 septembre 2001, 18; M. Collet, *le contrôle juridictionnel des actes des autorités administratives indépendantes*, LGDJ, Bibliothèque de droit public, tome 233, 2003; M.A. Frison Roche, *Règles et pouvoirs dans les systèmes de régulation*, Paris, Presse de Sciences po/Dalloz, vol. 2, 2004.

⁴⁸ This evolution would increase the role of judges as standard setters even when performing enforcement functions.

⁴⁹ An illustration of this problem is provided by English case law. See for example *Gorringe v. Calderdale MBC* [2004] 1 WLR 1057. For a broad account see *Monetary remedies in public law*, a discussion paper, Law Commission, October 2004, available at www.lawcom.gov.uk.

⁵⁰ The power of judges to review private regulations enacted by private organizations such as corporations or associations is quite limited as shown by comparative corporate law or comparative law of associations.

⁵¹ See in the British experience for example *R v Panel on Takeovers and Mergers ex p. Datafin plc* and another, 1987 1 All ER, 564 where judges stated that a body exercising power with a public element or public law functions would be subject to judicial review.

On the British experience see *ex multis* M. Andenas and D. Fairgrieve, *Misfeasance in public office, Governmental liability and European influences*, ICLQ, 2002, 51, 757.

See also D. Oliver, *The singularity of the English public-private divide*, in M. Andenas and D. Fairgrieve, *Judicial Review in International perspective*, op cit., 319.

Concerning financial regulators in the British experience, see J. Black, P. Muchlinski, P. Walker, *Commercial Regulation and Judicial Review*, Hart, 1998.

⁵² In particular, on the relationship between delegation of regulatory power and subjection to judicial review in the British experience, see P. Cane, *Self-regulation and judicial review*, op cit., 324. Others have claimed a relationship between judicial review and the exercise of monopolistic regulatory power. See D. Pannick, *Who is subject to judicial review and in respect to what?*, op cit.

These fundamental challenges require an examination of current and potential models of private regulation and governance of regulators that should be designed consistently with the goals pursued in the processes of reallocation of regulatory power within coordinated schemes.

3. Private regulation, conventional modes and new challenges: reframing self-regulation

The recent developments suggest further to focus on two features: (1) the multiple facets of private regulation, (2) the new modes of regulation with different forms of coordination between private and public regulators.

Within the realm of private regulation a distinction should be made between self-regulation as a form that refers to regulatory activities performed exclusively by the regulatees and other models in which several private constituents concur in the definition of standards, in monitoring and in enforcement activities⁵³. In the latter case there might be participation of both (1) actors whose conduct is regulated (regulatees) and (2) actors who benefit from that regulation (beneficiaries). In participatory private regulation conflicting interests can concur in the regulatory process⁵⁴. By way of example, in industrial regulation, the first model would only directly involve regulated industries, leaving outside consumers, individual or associations, environmentalists and the like⁵⁵. In the second form the private parties most affected by the regulation would participate, perhaps in differing ways, in the regulatory process⁵⁶. In this case the regulators do not coincide (at least not entirely) with the regulated⁵⁷. Technically we are outside pure self-regulation but still inside private regulation.

⁵³ For this distinction see F. Cafaggi, *Le rôle des acteurs privés dans le processus de regulation: participation, autorégulation et régulation privée*, cit. supra note 14, p. 23.

Concerning the role of the beneficiaries in regulatory processes and their weaker positions vis-à-vis the regulatees, see M. Thatcher, *Analysing regulatory reform in Europe*, JEEP, 2002, p. 859, part. 866, and B. Du Marais, *Droit public de la régulation économique*, op cit. p. 568-9.

⁵⁴ In the literature, one of the problems which is not often addressed is how the new forms of regulation, especially self-regulation, can solve different types of conflicts; i.e. conflicts among different categories of regulatees or between regulatees and third parties who are affected by regulation. As I will show, there is no conclusive evidence that private regulation or self-regulation achieve better outcomes in solving these conflicts than traditional regulation. It may happen that asymmetric interest representation in governance bodies increases conflicts and shifts to the liability question issues that should be solved otherwise. See infra.

⁵⁵ Leaving affected private parties outside does not imply excluding them from any protection. It only means that they will not be part of the regulatory body. However, they can participate in the regulatory process through consultation, and they may be indirectly protected if the private regulator has to take their interests into account.

⁵⁶ For this distinction see F. Cafaggi, *Un diritto privato europeo della regolazione?*, supra note 00

⁵⁷ An example can clarify the difference between regulatees and beneficiaries, taking into account the fact that the behaviour of some actors can be relevant in the framework of a regulation without being directly regulated by it. In case of unfair commercial practices, in particular regarding misleading advertising, if the European legislator decides to use as standard consumer the average one or the less competent one, the consumers can be defined as regulatees or as beneficiaries? Although the standard is defined so as to regulate the activity of the professionals, it can also have indirect effects of the behaviour of consumers, because is the standard is the consumer *moyen*, the others below and above the average can change their attitudes. The formers will try to be more cautious in order to converge to the standard; whereas the latter will reduce their

This distinction affects the ability to promote and protect different interests. However it does not imply that within self-regulation interests other than those of regulatees cannot be pursued. It only implies that, within self-regulation, the governing body of a self-regulating entity is mainly or exclusively within the domain of regulatees, while in private regulation, private regulators express multiple interests and translate these into multi-stakeholder organizations. In the remaining I will use the term private regulation to encompass both self-regulation, where regulators and regulatees coincide, and participatory private regulation⁵⁸.

This essay attempts to distinguish between different forms of private actors' involvement in rule-making processes and focuses in particular on private regulators participating in a broader and cooperative regulatory relationship. This is a growing phenomenon consistent with the evolution of self-regulation into private regulation. In fact the stronger the participation in coordinated models of regulation, the more likely one is to find private regulators rather than pure self-regulators.

Some of the regulatory processes, currently defined as private rule-making, are better described as cooperative regulatory networks concerned with rule-making and standard implementation⁵⁹.

One common key feature of these phenomena is the complementary nature of private and public regulators/regulations. Various cooperative ventures between private and public actors have recently developed both at European and member state level. Other forms of venture are simply a modern version of early phenomena concerning private law-making.

The forms of conventional private regulation may have relatively little in common with other forms of private regulation where public entities, formally or informally, either delegate to or share the rule-making power with private actors. In relation to the latter, as we shall see, forms of delegation should be differentiated from forms of cooperation where there is no transfer but rather sharing of regulatory power among public and private regulators⁶⁰.

From a normative perspective therefore the legal regimes of private regulation should differ if (1) there is a purely private regulatory activity or (2) if a private regulator is acting on the basis of delegation or (3) within regulatory power-sharing with a public entity. The former is part of contract or organizational law, while the latter have been defined as regulatory

level of precaution either converging to the average standard. See F. Cafaggi, *Un diritto privato europeo della regolazione?*, cit., p. 247

⁵⁸ See F. Cafaggi, *Un diritto privato europeo della regolazione?*, cit.

⁵⁹ The cooperative structures differ from purely private regulation which, at least in the past, has often developed independently from and, at times, in opposition to public regulation. The latter may represent a defensive method through which private parties organize their activities. In other instances private regulation expresses the need to coordinate private activities in order to reduce transaction costs. Thirdly it may be an anti-competitive device played against other private parties to create barriers to entry or to preserve reputation.

See on this issue E. Chiti, C. Franchini, *L'integrazione amministrativa europea*, Bologna, 2003; E. Chiti, *Le agenzie europee – Unità e decentramento delle amministrazioni comunitarie*, Padova, 2002; E. Vos, *Reforming the European Commission: what role to play for European Agencies?*, CMLR, 2000, p. 1113 ff.; E. Chiti, *The emergence of a community administration: the case of european agencies*, CMLR, 2000, p. 309 ff.; R. Dehousse, *Regulation by networks in the European Communities and the role of European Agencies*, in *J. Eur. Publ. Policy*, 1997, p. 246 ff.

⁶⁰ On the issue of delegation of regulatory power at the EU Level see G. Majone, *Delegation of regulatory power in a mixed polity*, *ELJ*, 3, 2002, 329; P. Lindseth, *Delegation is dead, Long live delegation: Managing the democratic disconnect in the European Market-Polity*, in C. Joerges and R Dehousse, *Good governance in Europe's Integrated Market*, op cit., 139 ff.; K. Lenaerts, *Regulating the regulatory process: 'delegation of powers' in the European Community*, *ELR*, 1993, 18, 41.

With specific reference to private actors, see also C. Joerges, H. Schepel, E. Vos, *The problems with the involvement of non governmental actors in Europe's legislative Processes: the case of standardization*, *EUI working paper*, Law 99/9.

hybrids that borrow some of their features from administrative law and some from private law. Some legal systems make a further distinction between the (criteria used to define the) nature of the regulatory body and the (criteria used to define the) nature of the rules that these bodies generate and apply.

There is not always symmetry between the (public/private) nature of a body and the (public/private) rules it deploys. A private regulator for example, can be defined as a public body in terms of the functions it performs, but it can use a combination of public procedural rules such as publicity, transparency, and private contractual substantive rules to regulate the activities of members, their obligations towards other members or third parties.

The criteria used to define the nature of the private regulatory body and the rules it enacts and/or applies vary in different member states⁶¹. These criteria affect both the choice of rules concerning interpretation and those concerning validity⁶².

4. A taxonomy: locating private and self-regulation in coordinated regulatory processes

It is perhaps useful at this point to provide a brief description of different regulatory modes where some form of coordination between public and private regulators takes place. Numerous classifications have been offered at the European level⁶³. Academic debate has also

⁶¹ For a first comparative account see F. Cafaggi (ed.), *A Comparative study of European self-regulation*, forthcoming, and the different national reports.

⁶² For example in the British experience and in relation to validity rules it is argued that : " ... *if the body is held to be public then it is subject to the principles of rationality as set out in Kruse v. Johnson, to the principles of procedural impropriety, notably the position as to consultation, and to the doctrine of legitimate expectations; and if it is private, then contract law.*" However she immediately points out that, "*Things, however, are rarely straightforward....With regard to the application of public-law principles to self-regulatory bodies, it may be that the formal categorisations of illegality, irrationality and procedural impropriety are eschewed*" J. Black, *Reviewing Regulatory Rules: Responding to hybridisation*, in J. Black, P. Muchlinski, P. Walker, *Commercial Regulation and Judicial Review*, op cit., 149 ff..

⁶³ Classifications of different types of private regulation are numerous both in scholarly literature but also in regulatory agencies and policy documents.

See *The Current State of Co-regulation and self-regulation in the single market*, EESC pamphlet series, available at www.esc.eu.int/smo/publications/2018_Cahier_EN_SMO_def.pdf.

At the European level the Commission has addressed this issue in several documents, not always in a consistent manner. In the Action Plan "Simplifying and improving the regulatory environment" (Brussels, 5.6.2002 COM (2002) 278 final.), the main difference between private regulation and co-regulation is that the former operates without any legislative Act while the latter presupposes a legislative Act.

In defining a framework for co-regulation the Commission clarifies that "*the co-regulation mechanism, within the framework of a legislative act, must be in the interest of the general public*" This reference is clearly aimed at preventing the use of co-regulation as a device to enhance the interests of a certain group of regulated private actors. Then the Commission defines what should be contained in the legislative Act: "*Within this regulatory framework the legislator establishes the essential aspects of the legislation: the objectives to achieve; the deadlines and mechanisms relating to its implementation; methods of monitoring the application of the legislation and any sanctions which are necessary to guarantee the legal certainty of the legislation*". It then continues: "*The legislator determines to what extent defining and implementing the measures can be left to the parties concerned because of the experience they are acknowledged to have gained in the field. These provisions such as sectoral agreements, must be compatible with European competition law*". The Commission then points out that the principle of transparency of legislation applies

led to the definition of different typologies, often in an attempt to rationalize what has been occurring at the national level⁶⁴.

At least four forms of interaction between public power (whether legislative or administrative) and private regulators can be identified.

1) Public regulation.

There has been a strong development of new modes of public regulation in recent years⁶⁵. Different models have developed among which IRA (Independent regulatory agency)

to co-regulation and that the parties who are selected must be considered to be representative, organised and responsible.

The European Parliament Council and Commission Interinstitutional agreement on better law-making (31.12.2003, 2003/C 321/01) provides a useful set of definitions concerning different regulatory strategies: Para. 18 defines co-regulation as a mechanism “*whereby a Community legislative act entrusts the attainment of the objectives defined by the legislative authority to parties which are recognised in the field (such as economic operators, the social partners, non-governmental organisations, or associations). This mechanism may be used on the basis of criteria defined in the legislative act so as to enable the legislation to be adapted to the problems and sectors concerned, to reduce the legislative burden by concentrating on essential aspects and to draw on the experience of the parties concerned*”

Para. 22 defines self-regulation “*as the possibility for economic operators, the social partners, non-governmental organisations or associations to adopt amongst themselves and for themselves common guidelines at European level (particularly codes of practice or sectoral agreements)*”.

As a general rule, this type of voluntary initiative does not imply that the Institutions have adopted any particular stance, in particular where such initiatives are undertaken in areas which are not covered by the Treaties or in which the Union has not hitherto legislated. As one of its responsibilities, the Commission will scrutinise self-regulation practices in order to verify that they comply with the provisions of the EC Treaty.

⁶⁴ In the British scholarly literature see J. Black, *Constitutionalising self-regulation*, op cit.: “*Broadly, we can identify four types of possible relationship: mandated private regulation, in which a collective group, an industry or profession for example is required or designated by the government to formulate and enforce norms within a framework defined by the government, usually in broad terms; sanctioned private regulation, in which the collective group itself formulates the regulation which is then subjected to government approval, coerced private regulation, in which the industry itself formulates and imposes regulation but in response to threats by the government that if it does not the government will impose statutory regulation, and voluntary private regulation, where there is no active state involvement direct or indirect in promoting or mandating private regulation*” at 27.

In a different article Black describes what kind of legal instruments are used, see J. Black, *Reviewing Regulatory Rules: Responding to hybridisation*, op cit. The author affirms that, “*... the forms regulatory bodies can take and the nature of their relationship with those that they regulate, with government and with statute, are multifarious. They may be set up by Charter, by statute, incorporated under the Company Acts, or be unincorporated associations. Their rules may be a species of delegated legislation, contractual, or without legal basis. They may have to conform to legislative requirements or be drawn up in consultation with government. Their rules may perform the Government's obligation to implement EC directives, compliance with them may confer exemption from or be deemed to be compliance with legislative requirements; their breach may be subject to legislative sanctions, regulatory sanction or no sanctions at all*” at 136–7. See also R. Balwin and M. Cave, *Understanding regulation*, op cit.

⁶⁵ See D. Geradin, R. Munoz, N. Petit (eds) *Regulatory authorities in the EC: A new paradigm for European governance*, EE, 2005, R. Caranta, M. Andenas, D. Fairgrieve (eds), *Independent administrative authorities*, British Institute of comparative law, 2005, D. Cohen, A. Heritier, M. Thatcher, *Refining regulatory regimes in Europe. The creation and the correction of markets*, EE, 2005, M. Clarich, *Le Autorità indipendenti*, Bologna, 2005, C. Parker and J. Braithwaite, *Regulation*, in the *Oxford Handbook of Legal Studies*, op cit., 119; C. Scott, *Analysing Regulatory space: Fragmented resources and Institutional design*, op cit.; Id. *Regulation*, 2003; M.A. Frison Roche, *Règles et pouvoirs dans les systèmes de régulation*, *Science Po/Daloz*, 2004, B. Du Marais, *Droit public de la régulation économique*, op cit., G. Amato, *Autorità semi-indipendenti ed autorità di garanzia*, RTDP, 1997, p. 659 ss.

has become predominant⁶⁶. Different reasons have been provided to explain its significant success in such different institutional contexts⁶⁷.

The relationship between regulators and regulatees has radically changed in many areas. Public policies have undergone strong contractualization, promoting the involvement of private actors at different stages and levels⁶⁸. On the one hand, incentive-based regulation has often substituted command and control⁶⁹. On the other hand, regulatees have been implicated in different ways in the regulatory process through participation⁷⁰.

I have already mentioned that the involvement of private actors in regulation has taken different forms and I have recalled the traditional, yet often blurred distinction between consultation and participation⁷¹. In several regulatory domains there has been a shift from

⁶⁶ See OECD, *Designing independent and accountable regulatory authorities*, an overview, op cit. p. 81 where, among the four different identified models, IRA covers 60%. The four models are Ministerial department, Ministerial Agency, Independent advisory body, independent regulatory authority.

⁶⁷ For the purpose of this essay, it is important to underline the aspect of delegation since it may affect the framing of interaction with private regulators. On the different rationales based on delegation that explain the developments of IRA see G. Majone, *Strategy and structure. The political economy of agency independence and accountability*, op cit. p. 130 ff.; Eberle and E. Grande, *The erosion of state capacity and the European innovation policy dilemma: a comparison of German and EU information technology policies*, Wien, Institut für Höhere Studien, 2000.

⁶⁸ See on these questions T. Prosser, *The limits of competition law, Markets and public service*, OUP, 2005, Id. *Regulatory contracts and stakeholder regulation*, *Annals of public and cooperative economics*, 2005, pp. 35 ff. G. Napolitano, *Regole e mercato nei servizi pubblici*, Bologna, 2005.

⁶⁹ One current example is the sale of pollution permits based on Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC. Furthermore, there are also voluntary licensing schemes: Regulation of the European Parliament and of the Council on a revised Community Eco-label Award Scheme, 2000/1980/EC; Commission Decision on a standard contract covering the terms of use of the Community Eco-label, 2000/729/EC; Commission decision establishing the European Union Eco-labelling Board and its rules of procedure (2000/730/EC).

See in the US perspective but with general implications R. Stewart, *Administrative law in the twenty first century*, 78 NYU L.R. 2003 437, part. p. 448. See for the EU perspective G. De Burca, J. Scott, *New Governance, law and constitutionalism*, Working Paper of the New Governance project, available at http://www.eu-newgov.org/datalists/Deliverables_list.asp, 4.

⁷⁰ At the European level, consider the social dialogue process (also in Art. 138-139 of the EC Treaty) by which the European social partners have been empowered to negotiate agreements in order to regulate social policy matters governing working conditions. The success of this process depends on the existence of well-established representative bodies at national and European level, ready and able to take responsibility in the negotiation process and at the implementation stage.

It is beyond the scope of this paper to engage in a full examination of the selection mechanism processes of private actors in consultation and participation, but it is worth observing that sector legislation has recently intervened to define more stringent criteria. This process is consistent with the trend toward increasing procedural regulation at European level that leaves Member States the power and the responsibility to define detailed implementation mechanisms. See on these questions S. Smismans, *Law, legitimacy and European Governance: Functional participation in social regulation*, OUP, 2004.

⁷¹ See F. Bignami, *Three generations of participation rights in European administration proceedings*, Jean Monet WP, 11/03.

See in securities sector the application of Lamfalussy process, which centred on a four-level approach to achieve better quality legislation. The essential novelty consists in adding two intermediary levels (Level 2 and 3) to the traditional legislative process, each of them to be supported by a new committee – the European Securities Committee (ESC), in which representatives from national ministries are enabled to represent Member States in the formal decision-taking process at European level, and the Committee of European Securities Regulators (CESR) in which the national securities regulators provide technical input to the decision-taking process and enhance co-operation and networking amongst national securities regulators to ensure common implementation standards. Although the outcome of CESR is not binding on the national regulators, it carries considerable authority, and in this case consistent guidelines are proposed for the adoption of administrative regulations at national level.

consultation to participation, promoted at the European level since the nineties and underlined with great emphasis in the Commission White Paper of 2001 and subsequent policy documents and directives in specific areas⁷².

Important changes have also occurred within each mode: the meaning of consultation and its associated procedures has changed over time, with much the same evolution occurring in the field of participation⁷³. In relation to consultation more than participation, effectiveness has been a central concern⁷⁴.

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- Joint interpretative recommendations and common standards regarding matters not covered by EU legislation. Where necessary, these could be adopted into Community law through a level 2 procedure.
 - Comparison and review of regulatory practices to ensure effective enforcement throughout the Union and define best practice.
 - Regular peer reviews of administrative regulation and regulatory practices in Member States, the results of which are reported to the Commission and to the ESC. See Second Interim Report Monitoring Lamfalussy Process, Brussels, 10.12.2003, p. 31.

⁷² See Communication from the Commission towards a reinforced culture of consultation and dialogue - General Principles and minimum standards for consultation of interested parties by the Commission, 11 December 2002, COM 2002/704 Final. European Commission, European Governance: Better Lawmaking, COM(2002)275 (5 June 2002), European Commission, Action plan "Simplifying and improving the regulatory environment", 5 June 2002, COM(2002)278.

But see also the White Paper on governance where participation is one of the five principles underpinning good governance. According to the White Paper, at 10, "[t]he quality relevance and effectiveness of EU policies depend on ensuring wide participation throughout the policy chain - from conception to implementation. Improved participation is likely to create more confidence in the end result and in the Institutions which deliver policies. Participation crucially depends on central governments following an inclusive approach when developing and implementing EU policies". In the same text the Commission indicated the necessity to regulate consultation procedures by enacting a Code of conduct that sets minimum standards.

See the Lamfalussy process where it is stated that "Bringing the benefits and the costs of market consultation together suggests that market consultation is a highly useful tool but that an optimal amount of consultation needs to be found by policymakers so as to balance the associated costs and benefits. Where competing interests exist among market participants, policymakers and market participants can achieve better policy outcomes by working towards a reasonable compromise. However, conflicts of interest among market participants cannot be "consulted away"". See second interim Report Monitoring the Lamfalussy Process, supra n. 71.

⁷³ For an example in the environmental area, see Directive 2003/4/EC of the European Parliament and Council 28 January 2003 on public access to environmental information, in particular art. 7, para. 2, concerning the evolution of the meaning of consultation in relation to the Environmental Impact Assessment. In particular see the preceding Directive 2001/42/EC 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment, Art. 6 on consultations, and Directive 2003/35/EC providing for public participation in respect of the drawing up of certain plans and programmes relating to the environment and amendments, with regard to public participation and access to justice Council Directives 85/337 and 96/61 EC.

The regulatees themselves have also become active in introducing self-regulatory measures at European Union level, for example: the European Advertising Standards Alliance (EASA) presented its new code of conduct to a group of Commission officials, consumer groups and trade associations at a hearing in Brussels. The presentation was made on 1st October 2004 at the Single Market Observatory of the European Economic and Social Committee (EESC). The charter provides basic principles in ethical standards for advertising and states that self-regulation "*can provide appropriate redress for consumers, a level playing field for advertisers, and a significant step towards completing the Single Market*". The charter is based on a network of national self-regulatory bodies, each enforcing a code of conduct tailored towards its culture. However, they remain consistent because all these national rules are based on the International Chamber of Commerce's Codes of Marketing and Advertising Practice.

⁷⁴ In the area of environmental protection see article 3, para. 4, Dir. 2003/35/EC, "*The public shall be informed, whether by public notices or other appropriate means such as electronic media where available, of the following matters early in the environmental decision-making procedures referred to in Article 2(2) and, at the latest, as soon as information can reasonably be provided:*

In this context I consider both the consultation and participation of private regulators to regulatory processes⁷⁵. I will examine these phenomena only in order to identify differences between them and co-regulation, delegated private regulation, ex post recognized private and self-regulation and the applicable regimes of private regulatory law⁷⁶.

Conventionally, consultation is perceived as a weaker form of involvement, as compared to the direct participation of private regulators. However, on closer scrutiny of the actual regulatory processes involved, it appears that while in formal terms consultation may be said to be the weaker mode for involving private regulators, in practice it can turn out to be very stringent condition. Thus weaknesses and strengths should be evaluated by looking at current practices together with an examination of formal rules⁷⁷. Both strategies can be used depending on the role attributed to private regulators, but it is extremely important that rules on the decision-making processes are well defined before consultation takes place so that formal consultation does not translate into participation through informal negotiations⁷⁸.

(a) the request for development consent; (b) the fact that the project is subject to an environmental impact assessment procedure and, where relevant, the fact that Article 7 applies; (c) details of the competent authorities responsible for taking the decision, those from which relevant information can be obtained, those to which comments or questions can be submitted, and details of the time schedule for transmitting comments or questions; (d) the nature of possible decisions or, where there is one, the draft decision; [...]", and art. 6, para. 2, Dir. 2001/42/EC, "The authorities referred to in paragraph 3 and the public referred to in paragraph 4 shall be given an early and effective opportunity within appropriate time frames to express their opinion on the draft plan or programme and the accompanying environmental report before the adoption of the plan or programme or its submission to the legislative procedure". In the telecommunications area, article 6, Dir. 2001/21/E, "Member States shall ensure the establishment of a single information point through which all current consultations can be accessed. The results of the consultation procedure shall be made publicly available by the national regulatory authority, except in the case of confidential information in accordance with Community and national law on business confidentiality". In the realm of financial markets, the market abuse directive 2003/6/EC, article 11, "Member States shall establish effective consultative arrangements and procedures with market participants concerning possible changes in national legislation. These arrangements may include consultative committees within each competent authority, the membership of which should reflect as far as possible the diversity of market participants, be they issuers, providers of financial services or consumers". See also J. Scott and J. Holder, Law and 'new' environmental governance in the European Union, in G. De Burca and J. Scott (eds), Law and new approaches to governance in the European Union and the United States, Hart, 2005; J. Holder, Environmental Assessment: the regulation of decision-making, OUP, 2004, 1.

⁷⁵ Notice that I focus on consultation and participation of regulators and not regulatees.

⁷⁶ They may take place at the level of both the individual person or organization and of the collective entity (the private regulator). While the differences between participation and co-regulation of individual regulatees are quite well defined, they become less clear in relation to private regulators involved in public regulation through consultation or participation. Still participatory rights should be distinguished from direct involvement in the regulatory processes, especially in the light of radical differences from the perspective of liability and the conflicts of interest that the two forms bring about.

⁷⁷ If the public regulator negotiates ex ante or simply submits drafts to the major private actors that will have to be consulted ex post then the informal negotiation becomes a strong yet not transparent participatory mechanism with the double effect of:

- 1) undermining the consultation process, because prominent private actors would probably have had their incorporated in the regulation;
- 2) distorting the consultation process, by preventing public debate from occurring.

⁷⁸ Informal consultation with private regulators takes place very often in order to acquire ex ante consensus on particular regulatory standards or monitoring practices. For example in the area of product safety often the protocols concerning product recalls or other forms of intervention defined by Directive 2001/95/EC on general product safety have been through informal consultations between administrations and manufacturers' associations.

Judicial review is very relevant and the tests used by judges vary according to the legal system⁷⁹. Their functions can vary from information acquisition to interest representation⁸⁰.

2) Co-regulation.

A different yet related change in the regulatory space has been the expansion of co-regulation, where private regulators have been called upon to take part in different stages of the regulatory process⁸¹. This participation, as I have mentioned, differs from other forms because it translates into an engagement of a single or a plurality of private regulators in some independent segment of a regulatory procedure⁸². So for example, private regulators will determine technical standards according to general principles defined by legislative act and applied by an administrative agency, whose compliance can be monitored by a private independent entity and enforced by the judiciary. Alternatively private regulators can adopt codes of conduct, to which individual firms can adhere, while public regulators monitor compliance⁸³.

⁷⁹ For the UK experience concerning the Wednesbury formula see P. Craig, Theory and values in Public law: a response, in P. Craig and R. Rawlings (eds), Law and administration in Europe - Essays in honour of Carol Harlow, OUP, 2003, 38.

Specifically in relation to participation and judicial review, see S. Smismans, Functional participation in EU delegated regulation: Lessons from the United States at EU's Constitutional moment, Indiana Journal of global legal studies, 2005, p. 599 ff.

⁸⁰ This distinction is now part of the legislative jargon. See for example in the environmental area Directive 2001/42/EC. Recital 9 states: "*This directive is of a procedural nature and its requirements should either be integrated into existing procedures in Member states or incorporated in specifically established procedures*".

⁸¹ An example of co-regulation is concerned with listing in financial markets. Directive 2001/34, which amends and integrates previous directives, defines a system of co-regulation. Such a system has been implemented in different ways in MS. For a comparative assessment of co-regulation in financial markets see G. Ferrarini, Securities regulation and the rise of pan-European markets: An overview, in G. Ferrarini, K. Hopt and E. Wymeersch (eds), Capital markets in the age of Euro: cross border transactions, listed companies and Regulation, Kluwer Law International, 2002, 241 ff.

Examples of co-regulation are frequent in other sectors. For example, in the media sector, a "*new tendency to think outside of traditional regulatory squares is also taking effect at the national level. It is becoming increasingly common for the audiovisual legislation to make reference to codes or a mixture of legislative rules and co-regulatory rules recognised*". For example, in the UK, television and radio advertising is regulated by statutory authorities with their own codes of practice, involving mandatory pre-clearance. By a form of co-regulation, this is carried out by sectoral self-regulatory organizations set up by the broadcasters. The European Advertising Standards Alliance (EASA) speaks for co-regulation in the media sector. See S. Nikoltchev (Ed.), Co-Regulation of the Media in Europe, European Audiovisual Observatory, 2003.

For a more detailed examination see F. Cafaggi, Un diritto privato europeo della regolazione?, Pol. Dir. 2004, p..

⁸² This definition differs from that provided by the Commission, which is based upon the existence of a legislative Act. The presence of a legislative Act, however, may characterize co-regulation, delegated self-regulation, mandated self-regulation and promoted self-regulation.

⁸³ For recent examples of these models see, in the financial markets, arts 124 bis and 124 ter of the Italian TUIF recently introduced by l. 262/2005. Moreover, in the Italian legal system, in the privacy sector, it is possible that the codes of conduct drafted by professional associations can become a public legal standard, i.e. they can be enforced not only towards the members of the association, but erga omnes (see art. 12 of the D. lgs. 196/2003).

See also the Directive on unfair trade practices 2005/29, art. 6 par. 2 where it provides that "[a] commercial practice shall also be regarded as misleading if, in its factual context, taking account of all its features and circumstances, it causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise, and it involves:

(a) ...

(b) non-compliance by the trader with commitments contained in codes of conduct by which the trader has undertaken to be bound, where:

Though the term is mainly used to describe the standard-setting process, forms of co-regulation have also been developed for monitoring compliance with standards, for dispute resolution and enforcement functions, where the regulatory power is shared between public and private actors⁸⁴. Co-regulation poses important questions as to the changes required both to the organization and the activities of private regulators and more broadly to different private law regulatory activities.

Co-regulation imposes duties on both public and private regulators. These duties have different natures. They operate between the parties but may also be enforced by third parties⁸⁵. Often the private regulator has a duty to regulate or to supervise regulatees, enforceable by public regulators. An important set of obligations arise towards regulatees, who may or may not be members of the organization of the private regulator. Finally there are duties towards the final ‘beneficiaries’ of the regulatory processes⁸⁶. Involvement in co-regulation may also affect the governance structure of the private regulator, imposing specific obligations concerning who (which stakeholders) should take part in the organization and how the regulatory activity should be performed⁸⁷.

3) **Delegated private regulation.**

Delegated private regulation requires recognition by a public entity [able to exercise regulatory power (agency, administrative body etc.,) or at least able to confer it] of the need for regulatory action and an awareness of the fact that private regulators might be better positioned to regulate.

Delegated private regulation is based on a formal act, generally legislative, although some legal systems recognize the possibility, through administrative acts, to delegate to private actors the power to enact private regulation. When there is direct delegation by legislation private regulators face most of the problems raised in relation to IRA⁸⁸. When IRAs, or other administrative entities, delegate to private bodies, there is sub-delegation, which raises both constitutional and institutional questions.

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- (i) the commitment is not aspirational but is firm and is capable of being verified, and
 - (ii) the trader indicates in a commercial practice that he is bound by the code”.

In relation to legal standards based of codes of conduct see F. Cafaggi, Contractualising standard setting in tort law, to be published.

⁸⁴ See for example in the field of product safety the Commission decision 2004/418/EC of 29 April 2004, laying down guidelines for the management of the Community Rapid information System (RAPEX) and for notification presented in accordance with Article 11 of Directive 2001/95, O.J. 30.4.2004, L 151/83.

“ Other measures and actions that authorities can adopt or take and should notify are:

- agreements with producers and distributors to take actions necessary to avoid risks posed by products;
- agreements with producers and distributors to organise jointly the withdrawal, the recall of products from consumers and their destruction or any other relevant action
- agreements with producers and distributors to coordinate the recall of a product from consumers and its destruction.” L.151/90 f.

⁸⁵ Notice that enforceability by third parties is limited and vary quite substantially from country to country.

⁸⁶ I call them final because I take the view that the regulated subjects can also be considered direct beneficiaries of the regulation. See on the difference between regulatees and beneficiaries F. Cafaggi, *Un diritto privato europeo della regolazione?* cit.

⁸⁷ In the area of financial markets there are several examples. If the private regulator takes the legal form of a for profit company, co-regulation may impose that some regulatory activity can not be performed by the board but must be approved by the shareholders’ meeting. See the legal regime of Borsa spa (the Italian stock exchange company) defined by the TUIF and recently modified by l. 262/2005.

⁸⁸ In relation to the delegability of regulatory power to private parties and to the modes of delegation, European legal systems differ quite substantially. These differences pose serious problems to the implementation of directives that allow or promote such a mode.

This strategy is often proposed in European Directives to be implemented by MS as an alternative to public regulation and co-regulation⁸⁹. In areas like financial markets delegation is subject to quite restrictive conditions⁹⁰. In this case the delegator transfers the regulatory power to the delegatee who has a duty to exercise it. This transfer limits the discretion of the private regulatory body since it defines the goals, the means, or both, governing the activity of that body⁹¹. Sometimes it not only affects the activity but also the governance design of the

⁸⁹ See for instance the Market abuse directive 2003/6, art. 12 where the following alternatives are defined: "The competent authority shall be given all supervisory and investigatory powers that are necessary for the exercise of its functions. It shall exercise such powers: a) directly; or b) in collaboration with other authorities or with the market undertakings; or c) under its responsibility by delegation to such authorities or to the market undertakings; or d) ..."

See in the field of product safety, directive 2001/95 on General product safety (hereinafter the GPS directive). The procedure for the definition of technical standards is set out in article 4 of the GPS directive: "For the purposes of this Directive, the European standards referred to in the second subparagraph of Article 3(2) shall be drawn up as follows:

- (a) the requirements intended to ensure that products which conform to these standards satisfy the general safety requirement shall be determined in accordance with the procedure laid down in Article 15(2);
- (b) on the basis of those requirements, the Commission shall, in accordance with directive 98/34 of the European Parliament and of the Council of June 22 1998 laying down a procedure for the provision of information in the field of technical standards and regulations and of the rules on information society services call on the European standardisation bodies to draw up standards which satisfy these requirements;
- (c) on the basis of those mandates, the European standardisation bodies shall adopt the standards in accordance with the principles contained in the general guidelines for cooperation between the Commission and those bodies."

In the area of unfair trade practices, see directive 2005/29 at art. 11, par. 1, where it is stated that "It shall be for each Member State to decide which of these facilities shall be available and whether to enable the courts or administrative authorities to require prior recourse to other established means of dealing with complaints, including those referred to in Article 10. These facilities shall be available regardless of whether the consumers affected are in the territory of the Member State where the trader is located or in another Member State.

It shall be for each Member State to decide:

- (a) ...
- (b) whether these legal facilities may be directed against a code owner where the relevant code promotes non-compliance with legal requirements".

⁹⁰ See art 48, directive 2004/39 of 21 April 2004, on markets in financial instruments amending Council directives 85/611/EC and 93/6/EC and directives 2000/12/EC of the European Parliament and of the Council and repealing Council directive 93/22/EC.

"Any delegation of tasks to entities other than the authorities referred to in paragraph 1 may not involve either the exercise of public authority or the use of discretionary powers of judgement. Member States shall require that, prior to delegation, competent authorities take all reasonable steps to ensure that the entity to which tasks are to be delegated has the capacity and resources to effectively execute all tasks and that the delegation takes place only if a clearly defined and documented framework for the exercise of any delegated tasks has been established stating the tasks to be undertaken and the conditions under which they are to be carried out."

See also art 24, par. 2 dir. 2004/109/CE of Parliament and Council of 15 December 2004.

⁹¹ For example, environmental agreements may be concluded within the framework of a regulation or a directive. In this case, there exists a legislative European Act and the environmental agreement. According to the Communication from the Commission to the European Parliament, the Council, the Economic and Social Committees and the Committee of the Regions, Environmental Agreements at Community Level within the framework of the Action Plan on the Simplification and Improvement of the regulatory environment the co-regulation may take different forms, in some of which the legislative Act defines the specific features of the agreement while in others only the goals or targets are defined. "*Environmental agreements can also be concluded in the framework of a legislative act, i.e. in a more binding and formal manner in the context of regulation, thereby enabling the parties concerned to implement a specific piece of community legislation. Within this regulatory framework the legislator establishes the essential aspects of the legislation: the objectives to achieve; the deadlines and mechanisms relating to its implementation;*

regulator, by imposing what the board can and cannot do⁹². These constraints translate into limits on freedom of contract to design the governance structure of the private regulator and to implement it. The key point is that the private authority is empowered by the public one; this empowerment produces relevant legal consequences in terms of powers and responsibilities of the private regulator and forces a redefinition of the way freedom of contract can be exercised. Delegated private regulators have to ensure participation of different stakeholders, and transparency and openness of their procedure, to a higher degree than would have been expected of them as purely private regulators⁹³. Unlike private regulation whose foundation is freedom of contract, in this case private regulatory power derives from a conferral by a public entity.

Delegation provides the legitimacy to enact universally binding rules despite their production being private. So even if on the governing body only regulatees (or only a fraction of regulatees) are represented, the regulatory activity might nonetheless involve the definition of standard contract forms with third parties (firms and suppliers, firms and consumers etc).

methods of monitoring the application of the legislation and any sanctions which are necessary to guarantee the legal certainty of the legislation. Co-regulation is usually initiated by the Commission, either on its own initiative or in response to voluntary action on the part of industry. Under co-regulation arrangements, the European Parliament and the Council would adopt, upon a Proposal from the Commission, a directive. This legal Act would stipulate that a precise, well-defined environmental objective must be reached by a given target date. It would also set the conditions for monitoring compliance, and introduce enforcement and appeal mechanisms. It need not contain detailed provisions on how to reach the objective. The legislator determines to what extent defining and implementing the measures can be left to the parties concerned because of the experience they are acknowledged to have gained in the field. These provisions must be compatible with European competition law", at 8.

⁹² See in the area of financial regulation art. 21 dir. 2003/71/CE ed art. 39 and art. 48, c.2 dir. 2004/39/CE, art. 24 dir. 2004/109/CE

In the area of technical standards the agreement between Cen and Cenelec and the Commission 2003, (General Guidelines for the cooperation between CEN, Cenelec and ETSI an the European Commission and the European Free Trade Association, 28 March 2003, (2003/C 91/04))

⁹³ See for example the General Guidelines for the cooperation between CEN, Cenelec and ETSI an the European Commission and the European Free Trade Association, 28 March 2003 (2003/C 91/04). "The institutional rules of the European Standards Organizations should ensure that European Standardisation, in particular where it supports European policies and community regulation remains fully accountable to all the interested parties in Europe, that is, that the standardisers take into account the broadest possible range of views in drawing up standards and other documents and that the procedures (during development, inquiry and voting) are open and transparent." And then: "...The European Commission and EFTA expect the European Standards Organisations CEN, Cenelec and ETSI to:

- Maintain the standardisation infrastructure and procedure to meet legitimate needs (including safety, health, consumer and environmental protection) in Europe, and actively cooperate to ensure that stakeholders gain the maximum benefit of the European standardisation infrastructure and links with other standards organisations.
- Ensure that structures and procedures allow for the highest possible degree of openness, transparency and representativeness. Procedures should be transparent and ensure independence from vested interest. Further efforts should be made to increase the participation of interested circles, especially public authorities, manufacturers, small and medium-sized enterprises, consumers, workers and environmental interest groups, at the national and European level in the drafting of standards and other deliverables and in ensuring their views are adequately taken into account."

But see in relation to participation, the Communication from the Commission to the European Parliament and the Council on the role of European standardisation in the framework of European policies and legislation, COM (2004) 674 final of 18 October 2004 and Council Conclusions 21-21 December 2004 where the Council stated: "(the Council) notes that adequate participation in standardisation of all parties concerned (social partners, NGOs, environmental interest groups, consumers, SMEs, authorities etc) is not sufficiently implemented at present within all member states. European standardisation should be recognised as a strategic tool for competitiveness and for uniform application of technical legislation in the internal market. The commitment of everybody should be reactivated in this respect", p. 7.

This effect could not be produced except through delegation because of the privity of contract principle and its functional equivalent in other legal systems (*relativité du contrat*, *relatività del contratto*, etc) and the rule of law principle⁹⁴. Delegation also often imposes enforceable obligations to pursue the public interest and prevents private regulators from discriminating or acting contrary to principles of pluralism.

4) **Ex post recognized private regulation.**

In some cases, private regulation in the form of self-regulation is carried out autonomously and independently by private actors, aiming to regulate their own activities, and this has subsequently been recognized at European or member state level through hard or soft law⁹⁵. There are two different types of ex post recognized private regulation obtained through legislative acts: one in which recognition refers to the rules enacted by the private regulator and the other in which recognition refers to the regulator itself. In the former, privately produced rules become norms with general effect by means of recognition; whereas in the latter, the private or self-regulatory bodies themselves receive ex post recognition of their 'public functions' which extends the scope of legal effect to third parties. The recognition of the private regulators provides legitimacy to the overall activity and therefore bears more resemblance to delegated private regulation. Here we refer to recognition by a public regulator or by a legislative act. It is a different matter entirely when judges are asked if a certain body is amenable to judicial review and must decide whether it is a private or a public body.

An intermediate hypothesis between delegated private regulation and ex post recognized private regulation is that in which private regulation, produced by the private or self-regulator, has to be approved by a public authority to become effective. Unlike ex post recognition, where private regulation operates in any case in the private sphere, here regulation is subject to approval in order to become effective on regulatees; and, unlike delegation, in such a case no ex ante principles or guidelines are provided. To give an example, while recognition may expand the sphere of those affected by the private regulation from members of the regulatory entity to third parties, approval is a condition for effectiveness of legal rules for both regulatees and third parties. The case of approval is functionally intermediate because if effectiveness is dependent on approval, and the approval procedure is based on predefined criteria, presumably the private regulator will comply with these criteria in order to obtain the approval of the public entity. Even if approval only occurs afterwards, functionally it can be compared to a delegation without encompassing the duty of the delegatee to regulate. The discretionary power enjoyed by the private regulator is broader than in delegated private regulation but narrower than in ex post recognized private regulation.

⁹⁴ See S. Whittaker, *Privity of contract and the tort of negligence: future directions*, 16 OJLS, 1996, 191; D. Dyzenhaus (ed.), *Recrafting the rule of law: the limits of the legal order*, Hart, Oxford; N. Walker, *Sovereignty and the differentiated integration in the European Union*, ELJ, 4, 1998, 355.

⁹⁵ See the Communication of 2001 *Simplifying and improving regulatory environment*, COM (2001) 726, where the Commission indicated a potential legal base in the Treaty. "*There is provision under the Treaty for agreements between social partners at European level, which can be implemented either by binding Council Act or by dint of procedures and practices proper to the social partners and the member states (see articles 138 and 139 of the Treaty). Creating Community norms by way of such agreements pays more heed to the principles of proportionality and subsidiarity.*"

As examples of the ex post recognised self-regulation, we can see that in the UK television and radio advertising is regulated by statutory authorities with their own codes of practice, involving mandatory pre-clearance. By a form of co-regulation, this is carried out by sectoral self-regulatory organizations set up by the broadcasters. Note also the UK's former financial services ombudsmen boards, the Banking Code compliance board, the Advertising Standards Authority, and the Direct Marketing Authority, where a majority of people outside the regulated industry are required on the supervisory board.

Ex post recognition by hard law provides legitimation and extends the effects and the binding nature of private regulation to third parties. When private regulation is only legitimized by soft law, its non-binding nature might prevent the recognition of the binding nature of private regulation⁹⁶. However private regulation recognised ex post, through recommendations or opinions, can strongly influence the expansion of the domain of regulatory effects.

5) Judicial definition of a regulatory body

A different type of ex post recognition is *judicial* recognition. This phenomenon occurred in many legal systems long before legislative recognition developed and continues to occur⁹⁷. There are two different types of judicial activity related to the identity of private regulator:

- a) definition of the nature of a regulator to evaluate amenability to judicial review and tort liability of the regulator;
- b) application of rules enacted by a private regulator to non members or third parties.

As to the first question legal systems have developed different criteria to define whether a regulator is subject to judicial review⁹⁸.

Judges have looked into privately defined standards of conduct defined by professions, industries, associations and have given them binding force through different legal devices: in particular custom and state of the art in tort law.

Preliminary conclusions

Private regulators, operating within a scheme of coordination with public regulators, may exercise regulatory powers different from those employable by purely private regulators. In particular they can produce rules whose effects go beyond the members of the organization.

⁹⁶ One example of these two possibilities is environmental agreements: “[a]n environmental agreement can either be recognised by soft law (a recommendation or an exchange of letters) or through hard law (a decision). The Commission may also propose monitoring and reporting mechanisms for evaluating the attainment of the environmental objective in the form of a decision by the European Parliament and the Council. If an agreement considered in a Commission recommendation or exchange of letters fails to deliver the expected results the Commission can make use of its right of initiative and propose appropriate binding legislation”, (p. 13 Communication on Environmental agreement).

⁹⁷ As an example, see Finnish marketing law which requires companies to comply with good marketing practice. The Finnish Consumer Ombudsman for example has negotiated and approved B2C standard contracts, e.g. construction agreements, travel agreements, and warranties related to various consumer products. Despite their unofficial nature, the standard contracts that have been approved by the Consumer Ombudsman are usually not considered as unfair (Consumer Protection Act bans unfair contract terms) consumer practices, if contested in court.

⁹⁸ For the English system, see Monetary remedies in Public Law, A discussion paper, Public Team law commission, 11 October 2004, available at www.lawcom.gov.uk ss., Hickman T. The reasonableness principle: reassessing the public sphere, Cambridge Law Journal, 2004, 166 ss., Harlow C., State liability. Tort and beyond, Clarendon, OUP, 2004, P. Craig, Administrative law, 5 ed., Oxford, 2003, p. 893 ff., B. Markesinis, J.P. Coester-Waltjen, S. Deakin, Tortious liability of statutory bodies: A comparative and economic analysis, 1999.

For a comparative account see R. Caranta, Public law illegality and governmental liability, in D. Fairgrieve, M. Andenas, J. Bell, Tort Liability of public authorities in comparative perspective, The British Institute of international and comparative law, 2002, p. 271 ss; D. Fairgrieve, State Liability in Tort, OUP, 2003; D. Sorace, Il risarcimento dei danni da provvedimenti amministrativi lesivi di interessi legittimi, comparando, in G. Falcon, Il diritto amministrativo dei paesi europei, op cit. p. 227 ss.

They are also subject to judicial scrutiny in ways different from those traditionally employed in private law⁹⁹.

For this reason it is appropriate to subdivide the private regulatory space between:

- (1) the sphere occupied by purely private regulators, whose effects should normally be limited to members;
- (2) that occupied by private regulators performing regulatory functions in the public interest; and
- (3) that characterized by co-regulation or delegated self-regulation where private regulators interact with public actors, legislators and/or regulators on formalized grounds, whose effects can go beyond the members.

5. Framing the effects of coordination between public and private regulators on private regulatory law. Three issues.

Although a fully fledged comparative analysis of the different forms is beyond the scope of this essay, some very brief general considerations should be noted about these alternative or complementary strategies. The taxonomy of new regulatory modes is instrumental to the identification of main distinctions between coordinated strategies, encompassing public and private regulators, and purely private regulation or self-regulation.

The remaining part of this essay focuses on the comparison between co-regulation, delegated, ex-post recognized private regulation and purely private regulation, in order to point out the differences associated with some aspects of private regulatory law that should be applied¹⁰⁰.

The choice between these strategies poses some challenges to the law of private organizations concerning the ability of governance design to achieve the goals that are at the origin of these new regulatory processes. These challenges are to promote more informed, accountable and pluralistic standard setting, monitoring and enforcement. But more broadly it should force a rethink of the legal regimes that characterize private and self-regulation when deployed within a coordinated regulatory strategy, delegated or ex post recognized private regulation.

⁹⁹ An interesting example is provided by English case law concerning the nature of Lloyd's. See *R (West) v. Lloyd's of London* [2004] EWCA Civ. 506: "It does not help to refer to the respondents as regulators or to describe the system administered by the Corporation of Lloyd's as a regulatory regime...The fact is that even if the Corporation of Lloyd's does perform public functions, for example the protection of policy holders, the rights relied on in these proceedings relate exclusively to the contract governing the relationships between Names and their members' agents...Lloyd's is not a public law body which regulates the insurance market... The department of trade and industry does that. Lloyd's operates within one section of the market. Its powers are derived from a private Act which does not extend in the insurance business other than those who wish to operate in the section of the market governed by Lloyd's and who, in order to do so, have to commit themselves by entering into the uniform contract prescribed by Lloyd's. In our judgement neither the evidence nor the submissions in the case suggest that there is such a public law element about the relationship between Lloyd's and the Names as places within the public domain and so renders susceptible to judicial review."

¹⁰⁰ Purely private regulation as the expression of freedom of contract will therefore not be considered in this context.

Three key questions in particular will be addressed in relation to the new private regulatory law developed by these coordinated strategies:

1) **Regulatory pluralism.** The choice by the legislator or the public regulator to design the regulatory space with a monopolistic private regulator or with a plurality of private regulators cooperating or competing among themselves. This question is becoming very relevant with the expansion of regulatory tasks at the European level¹⁰¹.

The choice may be under different constraints at the MS and at European level since it might be necessary to include in the definition of the regulatory space not only the horizontal dimension (i.e public-private) but also the vertical dimension (i.e Union, MS, and regional competences). Thus one should not only consider horizontal but also the vertical plurality of private regulators.

Examples of monopolistic private regulators are more common at state level; but in some areas, such as media and financial markets, it is not uncommon to find a plurality of private regulators in a cooperative or competitive relationship even within one MS¹⁰². Examples of a plurality of private regulators however are more common at the supranational level: for example, the different stock exchanges operating in MS¹⁰³. Other examples may be found in the area of media, advertising, professional associations, product safety, environment etc¹⁰⁴.

In every Member State there is generally a private regulator or a hybrid and it may cooperate/compete with other private regulators operating in other MS. Monopolistic and pluralistic structures are compatible with both contractual and organizational models of

¹⁰¹ An example is related to technical standardization. With the new approach the CEN/Cenelec has gained substantial monopolistic power over European technical standardization. It is true that the Commission can allocate the task to different bodies but subject to the final approval of the CEN/Cenelec. See Guidelines (2003) OJ C/91/7. On this matter see E. Vos, *Health and Safety Regulation - Committees, Agencies and Private bodies*, Hart, 1999; M. Egan, *Constructing a European Market*, OUP, 2001.

¹⁰² In the area of media, private regulators may be divided into different media (press, TV, internet broadcasters) but also into different activities such as advertising, protection of minors. In the area of financial markets often there are several associations or companies that perform some regulatory function. For example the stock exchanges have their own rules often complemented by codes of conduct enacted by financial intermediaries, institutional investors (pension funds). Furthermore in relation to pension funds in many Member States there are many associations that represent pension funds and to some, though limited extent perform regulatory functions (see for example the Netherlands, Italy, etc).

¹⁰³ There are several supranational associations of stock exchanges: FESE, Federation of European Securities exchanges, FIBV, International Federation of stock exchanges. Analogous supranational structures exist in several fields from media to advertising, however, the extent to which they perform regulatory functions themselves or exercise pure coordination among national private regulators differs from sector to sector. See on this question IOSCO, Report of the technical Committee, Issues Paper on Exchange demutualization, June, 2001, IOSCO Emerging markets Committee of the International Organization of Securities Committee, Exchange demutualization in Emerging markets, M. Bagheri and C. Nakajma, *Competition and integration among stock exchanges: the dilemma of conflicting regulatory objectives and strategies*, OJLS, vol. 24, 2004, pp. 69-97.

¹⁰⁴ E.g. the European Advertising Standards Alliance (EASA) and the network of chambers of commerce (International Chamber of Commerce, ICC).

private regulation¹⁰⁵. But the choice of organizational models of each private regulator affects the features of monopoly and plurality¹⁰⁶.

In making the choice between monopoly and plurality, the alternatives of internal and external pluralism should also be redefined. There is a need to take into account different interests in the regulatory processes. When the choice is in favor of private regulatory monopoly, the need for interest representation can in part be addressed: (a) by applying to private regulators' activities the participatory rules generally deployed by public regulators; (b) by designing a governance structure able to represent sufficiently diversified interests; and/or finally, (c) by guaranteeing a system of liability able to protect those interests whose voice finds no representation within the organization or which do not translate into participatory rights. The choice of regulatory plurality enhances external pluralism and might promote stronger interest-based forms of private regulator to the extent that a homogeneous set of rules is defined and the exit option for regulatees is available at low costs. It therefore requires framework rules applicable to all private regulators and to their relationships¹⁰⁷.

2) **Conflict of interest.** The assignment of regulatory power to self-regulatory bodies or to private regulators may cause conflicts of interests to arise especially if regulators and regulatees, even if only in part, coincide¹⁰⁸. This is less problematic in the context of pure self-regulation where the effects are limited to members, more problematic in pure private regulation, but it becomes highly contested in coordinated frameworks.

The conflict of interest regime, usually applied to private organizations such as corporations or non-profit organizations, may not be suitable to address properly the conflicts of interest that arise in rule-making. Nor might the regime applied to public independent authorities. This dimension, which does not surface so strongly in purely private self-regulated areas, reach tremendous importance when private regulatory power is exercised, at least in part, in the public interest, i.e. to benefit third parties¹⁰⁹. When coordinated modes of

¹⁰⁵ These models can be simple ones or divided between contractual and organizational. Within organizational models, we find companies, associations, and less frequently consortia and foundations.

But the organization can be more complex. For example stock exchanges may be a group with a holding and several subsidiaries. The Italian stock exchange company is a group. The holding is Borsa italiana s.p.a. and then there are four companies Bit system S.p.a., Piazza affari gestioni e servizi s.p.a, Cassa di compensazione e garanzia s.p.a, Monte Titoli s.p.a..

¹⁰⁶ A plurality structure based on multiple contracts among regulatees differs from a regulatory design based on multiple companies or associations. Both internal organizations and exit mechanisms may vary quite significantly.

¹⁰⁷ See on this question F. Cafaggi, Self-regulatory competition, paper presented at the first SIDE Conference, Siena, November, 2005.

¹⁰⁸ In relation to financial markets see the regulation of conflicts of interest concerning private regulators responsible for stock exchanges. For a classification of the different types of conflict of interest in this area see Regulatory issues arising from exchange evolution, Report of the technical committee of the International organisation of Securities Commission, IOSCO 2005, and earlier the Issues paper on exchange and demutualization, June 2001, available at www.iosco.org. cit upra note

On the issue of conflicts of interest concerning private financial regulators see C. Di Noia, Customer-controlled firms: the case of financial exchanges, and G. Ferrarini, Securities regulation and the rise of pan-European markets: An overview, op cit., 173 ff. and 241 ff.. At the European level see also the Communication from the Commission on Credit Rating agencies, (OJ 11.3.2006, C 59/02).

¹⁰⁹ See for example Regulation 23.9.2004 of the Italian Stock exchange approved by Consob with Act n. 14735, 12.10.2004 where under organizational principles concerning the company an obligation is undertaken to adopt an organizational model aimed at preventing conflicts of interest from arising. In particular art. 1.2 point 2.

regulation operate, public regulators play (or ought to play) a strategic role in monitoring conflicts of interest¹¹⁰. But judicial monitoring is also relevant.

The link between the governance dimension of private regulators operating in co-regulatory regimes and conflict of interest regulation is crucial in this area. Conflict of interest can only be addressed contextually by looking at the governance and the activity of the private regulator. Conflicts of interest may differ depending on whether the legal form of the private regulator is a for-profit company or a non-profit association. Combining profit maximization and fairness in regulation may require particular organizational arrangements unnecessary to the legal form of an association or a foundation. Separation between the regulatory activity and the general management of the organization might therefore become important. Regulatory activity should be subject to a special legal regime and when the regulator performs many activities (i.e. sells services to the regulatees or even to third parties), organizational separation should take place.

3) **Liability of private regulators.** Governance of private regulators is crucial to ensure an adequate balance of different interests related to the regulatory process but it would be insufficient if it were not linked to a system of liability rules that provides incentives to regulate (addressing the failure to regulate) and to regulate correctly (addressing the problem of abusive or wrongful regulation). This implies a new mix of judicial review and private law enforcement which may contrast with the current state of the law in many member states¹¹¹.

The difficulty of associating judicial review with traditional liability remedies is still relevant at member state level in relation to public regulators¹¹². But steps forward have also been made in the development of European law in relation to liability. For private regulators the possibility of coupling validity rules (parallel to typical remedies of judicial review) to void regulatory acts and liability rules is less problematic.

The three questions just underlined oblige to reframe the legal regimes of private regulation. The transfer of regulatory power to private regulators can increase the efficiency and efficacy of regulatory processes only if an appropriate governance design and a set of enforceable liability rules are put in place¹¹³.

There is a clear concern both at the European and MS levels that this transfer may disempower public authority. This is the reason why it is often repeated that public entities should maintain monitoring and controlling power over private regulators¹¹⁴.

In a framework of coordination, the need for public authorities to maintain an important role is clear. However, public control can also occur through judicial review applied to private regulators, while the involvement of private regulators enables a broader

¹¹⁰ See in relation to private financial regulators G. Ferrarini, L'ammissione a quotazione: natura, funzione, responsabilità e self-listing, AGE, 2002, 11 ff. 14.

¹¹¹ See F. Cafaggi, Gouvernance et responsabilité des régulateurs privés, RIDE, 2005, 111 ff.

¹¹² See P. Cane, Administrative law as regulation, op cit., 221 “ *Traditionally, damages have not been available as a remedy for breaches of administrative law standards as such, although such a breach may attract a damages remedy if it is also a breach of contract or a tort... Damages are now available against Member States of the European Union for breaches of Community law, and for breaches of human rights and the UK human rights act 1998*”.

¹¹³ See R. Baldwin and M. Cave, Understanding regulation, op cit.

¹¹⁴ See P. Craig, Public law and control over private power, in M. Taggart (Ed.), *The Province of Administrative Law*, Hart, 1997.

range of control systems above and beyond those traditionally associated with the regulatory state¹¹⁵.

The difference between pure private regulation or self-regulation as independent strategies and private regulation operating in a coordinated framework has been underestimated both from a theoretical perspective and insofar as the legal consequences it brings (or should bring) about are concerned.

In a context where freedom of contract and freedom of association is at work and purely private regulation or self-regulation operates, dissatisfaction with one private regulator may direct regulatees towards the formation of a new association, corporation or foundation to regulate their conduct¹¹⁶. In these cases the main aim is to provide satisfactory protection of the members, while the need for third party protection is relatively low, since self-regulation should mainly affect regulatees. When private regulation operates in a coordinated framework with public regulators and it assumes public interest function, protection of third parties and collective interests becomes an important factor in standard setting and in the other functions such as monitoring and enforcement that are not specifically considered in this essay. This difference should lead to some differentiation of legal regimes.

In the following part, I shall address the three questions with two aims:

a) to show the functional correlation among the modes of 'organization of the regulatory space', i.e. the influence of the alternative monopolistic and pluralistic dimensions, and the legal regimes of conflict of interest and breach of regulatory obligations and associated liabilities.

b) The need to consider that private regulators should operate in a different legal regime both from that applied to purely private regulators and that applied to public regulators, independent authorities and agencies.

6. Monopoly versus regulatory plurality

The general question is how and according to which principles should the choice be made between a private regulatory monopoly and a plurality of private regulators¹¹⁷. These alternatives have different consequences inherent to the choice and composition of the private regulatory body. The choice also affects the conflict of interest regime and the type of regulatory duties and obligations that arise for private regulators towards regulatees and third parties. Finally it might affect amenability to judicial review¹¹⁸. Regulatory plurality increases

¹¹⁵ For this perspective see J. Black, *Decentring regulation: Understanding the role of regulation and private regulation in a 'post-regulatory' world*, *Current Legal problems*, 2001, 54, 103 ff. and C. Scott, *Regulation in the Age of governance: The rise of the post-regulatory state*, op cit.; Id. *Regulating Constitutions*, op cit., 229 ff.

¹¹⁶ As I have recalled, the need for regulation can emerge directly from the regulatees as well as from the public authorities, often in order to address some type of failure or resource distribution need.

¹¹⁷ Some deny the legitimacy of monopolistic private regulation allowing only for a plurality of SROs. See G. Majone, *Strategy and structure - The Political economy of agency independence and accountability*, in *OECD Working party on regulatory management and reform - Designing independent and accountable regulatory authorities for high quality regulation*, p. 137. As it will be shown remedies provided by competition law and by organizational and contract law may reduce the dangers associated with the monopolistic position of the private regulator.

¹¹⁸ See text below and footnote 137 ff.

the exit options of regulatees and might be compatible with a more flexible regime of liability of regulators.

It is clear that the legislative or administrative power to make the choice between monopoly and plurality is limited by the principles of freedom of contract and association¹¹⁹. Moving to a sector by sector analysis, the legislative power to regulate might also be constrained by specific constitutional principles, such as freedom of speech in the media regulation¹²⁰. Legislators and public regulators, when empowered by a legislative Act, can only choose, with some limitations, on whom they wish to confer regulatory power. They cannot prevent the emergence of purely private regulators, exercising their own original regulatory power over members. Therefore, the alternative, analyzed in the following sections, does not address the overall design of regulatory space that should encompass also purely private regulators, but only that which can be defined by some of the types of public entities' intervention mentioned above.

There are several examples, both at European and MS level, of the conferral of regulatory power on private regulators but not many criteria are spelled out to define the choice between a monopolistic or pluralistic structure. There are however clear constraints¹²¹.

One evident set of constraints is provided by competition law, to the extent that it is applicable to regulatory activities as distinguished from productive activities¹²². It should be clarified that according to ECJ case-law competition law only applies to regulation of economic activity while it does not apply to deontological regulation¹²³. It is therefore quite relevant to have a clear definition of the two types of regulations, since ethical and deontological rules might have a strong economic impact but yet not be subject to the constraints of competition law.

At the European level the issue has been addressed by the ECJ in relation to different categories of associations, especially professionals. The exercise of private regulatory power may have anticompetitive effects, especially in relation to price fixing, recommended prices, advertising regulations, entry requirements and reserved rights, regulations governing business structure and multidisciplinary practices¹²⁴. Two different types of liabilities are generally distinguished in relation to private regulations for breach of competition rules: liability of associations of undertakings for violations of Article 81 EC and state liability,

¹¹⁹ The legislator cannot define the regulatory space by imposing that only one private regulator operate without violating the principles of freedom of contract and association. Only when specific reasons, associated to the sector, require such action can the regulatory space constrain the self-organising power of firms and individuals.

¹²⁰ To impose a monopolistic regulator in this area may reduce freedom of press and freedom of speech and therefore it would be more appropriate to leave the potential regulated to choose between monopoly and plurality or presumably even more coherent to define plurality of private regulators.

¹²¹ See in relation to co-regulation and delegation of private regulation concerning governance design of private regulators text and footnote above pp..

¹²² For references concerning the US legal system see Handbook on the antitrust aspects of standard setting, ABA, section of antitrust law, 2004; M. D'Alberty, G. Tesauro (eds.), *Regolazione e concorrenza*, Bologna, 2000.

¹²³ See Commission decision, 7 April 1999, 1999/267/EC (OJ L 106, 23.04.1999), and the judgement of the Court of First Instance in Case T-144/99, *Commission v. Netherlands* [2001] ECR I-03541.

¹²⁴ See Communication from the Commission: Report on competition in professional services, Brussels 9.2.2004, COM (2004) 83 final; Resolution of the European Parliament on market regulations and competition rules for the liberal professions 16.12.2003.

See also on the different models of professional regulation and their impact on competition rules: Economic Impact of regulation in the field of liberal profession in different EU Member states, I. Paterson, M. Fink, A. Ogus, *op cit.*, 2003, H. Vedder, *Competition Law and consumer protection: how competition law can be used to protect consumers even better – or not?*, in *EBLR*, 1, 2006, 89 ff.

when the delegation of regulatory power, attributed to private associations, is in breach of competition law¹²⁵. Very rare is the case of abuse of dominant position by the private regulator.

As to the liability of associations of undertakings, the ECJ has held that homogeneous rules apply to professional associations, to be considered enterprises, whether they are purely private, or they act in the public interest, perform public functions, have some public law status¹²⁶. However the identification of the nature of the members of the association and that of the governing body may play a very important role for the purpose of applying competition rules¹²⁷.

¹²⁵ See also the Report on competition of professional services: “*State regulation which imposes or favours anticompetitive conduct or reinforces its effects, infringes Articles 3(1)(g), 10(2) and 81 EC. Where a State delegates its policy-making power to a professional association without sufficient safeguards, that is without clearly indicating the public interest objectives to respect, without retaining the last word and without control of the implementation. The Member state can also be held liable for any resulting infringement*”, at p. 4.

It should be stressed, in this case, that one of the factors upon which the Court decides on the private or public nature of the professional association is the State capacity of control upon the professional association. If the professional body conveys only an opinion or a draft decision subject to approval by a national authority there is no delegation of powers. If, on the other hand, State approval permits a mere rubber-stamping by the State of the act in question, then there is nothing to ensure that the act serves a public policy interest rather than a private interest. Prior to CIF and Mauri, the notion of State approval was interpreted in the latter rather than the former manner. There has only been one case, Customs agents (Case C-35/96, *Commission v. Italy*, [1998] ECR I-3851, para. 60), where the formal nature of the State approval was so apparent (it amounted to no more than a rubber-stamp) that the Court determined that by making the association of customs agents responsible for setting the tariffs of services by means of national legislation, the Italian State “wholly relinquished to private economic operators the powers of the public authorities as regards the setting of tariffs” and found that Italy had failed to fulfil its obligations under Art 81 EC in conjunction with Arts 10 and 3(1)(g) TEC.

¹²⁶ See ECJ C-309/99 *Wouters* [2002] ECR I-1577. After clarifying that a professional association is an undertaking the Court states the applicability of article 81, given the fact that the association is neither fulfilling a social function (based on the principle of subsidiarity), nor exercising powers which are typically those of a public authority. “*It acts as the regulatory body of a profession, the practice of which constitutes economic activity*”, (para 58).

It lists other elements that ensure the applicability of article 81 such as the composition of the governing body, since the members are designated by the professionals and not by a public body (para. 61), the lack of a specific public interest in performing its regulatory functions (para. 62), the immateriality of the fact that it is regulated by public law (para 65).

It then adds: “*According to its very wording, Article 85 of the Treaty applies to agreements between undertakings and decisions by associations and undertakings. The legal framework within which such agreements are concluded and such decisions taken, and the classifications given to that framework by their various national legal systems are irrelevant as far as the applicability of the Community rules on competition and in particular Article 85 of the Treaty are concerned*” (para 66).

The interpretation of ECJ jurisprudence given by the Commission is even stronger. “*A professional body acts as an association of undertakings for the purposes of article 81 when it is regulating economic behaviour of the members of the profession...It makes no difference that some professional body have public law status or have certain public interest tasks to perform or allege that they act in the public interest.*” (Report on competition of professional services, para. 69-70)

¹²⁷ Not only has the Luxembourg Court held that competition rules would not apply if the majority of the members are designated by public authorities; it has also stated that there is an infringement of Article 81 where a member state divests its own rules as to the character of legislation by delegating to private economic operators responsibility for taking decisions affecting the economic sphere. This would occur if the decision is attributed to a group of experts while it would not be the case if it is entrusted to a body composed only of professionals. See C-35/99 *Arduino* [2002] ECR I-01529, para. 36, 37 and 43, 44, “... *the fact that a Member State requires a professional organisation to produce a draft tariff for services does not automatically divest the tariff finally adopted of the character of legislation. That would be the case where the members of the professional organisation can be characterized as experts who are independent*

Liability of associations of undertakings for anticompetitive rules can arise, not only in relation to members but also towards third parties, who can claim damages¹²⁸.

As to the liability of the State, it occurs when the anticompetitive elements have been defined in the delegating Act that confers power on the association¹²⁹. In the past, undertakings or associations adopting anticompetitive rules in compliance with national legislation were not held liable to sanctions¹³⁰. With the more recent jurisprudence, the ECJ has approved the competition authorities' disapplication of anticompetitive measures imposed by the State on the self-regulatory body and has recognized the power of national competition

of economic operators concerned and are required under the law, to set tariffs taking into account not only the interests of the undertakings or associations of undertakings but also the public interest and the interests of undertakings in other sectors or users of the services in question”.

In the last situation the combination of divestiture and breach of competition rules would bring about state liability. But in the specific case, “... *the Italian State cannot be said to have delegated to private economic operators responsibility for taking decisions affecting the economic sphere, which would have the effect of depriving the provisions at issue in the main proceedings of the character of the legislation ... Article 5 and 85 of the Treaty do not preclude a member State from adopting a law or regulation which approves on the basis of a draft produced by a professional body of members of the Bar a tariff fixing minimum and maximum fees for members of the profession, where the State measure forms part of a procedure such as that laid down in the Italian legislation.*” (Arduino para. 43 and 44).

¹²⁸ See *Courage v. Crehan*, 20.9.2001, Case C- 453/99 [2001] ECR I-6297. In relation to the nature of liability established in *Courage* see W. Van Gerven, *The emergence of a common European Law in the area of Tort law: The EU Contribution*, in D. Fairgrieve and al., *Tort Liability of Public Authorities in Comparative Perspective*, 140 ff.

¹²⁹ See for example *Wouters*, op cit. par. 68, 69, 70. In relation to the principle of institutional autonomy raised by the German Government (par. 55) the Court defines two approaches : “*The first is that a Member state, when it grants regulatory powers to a professional association, is careful to define the public interest criteria and the essential principles with which its rules must comply and also retains its power to adopt decisions in the last resort. In that case the rules adopted by the professional association remain state measures and are not covered by the Treaty rules applicable to undertakings. The second approach is that the rules adopted by the professional associations are attributable to it alone. Certainly insofar as Article 85(1) of the Treaty applies, the association must notify those rules to the Commission. That obligation is not however such as unduly to paralyse the regulatory activity of professional associations, as the German Government submits, since it is always open to the Commission inter alia to issue a block exemption regulation pursuant to Article 85(3) of the Treaty. The fact that the two systems described in paragraphs 68 and 69 above produce different results with respect to Community law in no way circumscribes the freedom of the member states to choose one in preference to the other*”.

But see in particular case *Arduino*, op cit., par. 34 and 35, “*Although Article 85 of the Treaty is, in itself, concerned solely with the conduct of undertakings and not with laws or regulations emanating from member states, that article, read in conjunction with Article 5 of the treaty, nonetheless requires the member States not to introduce or maintain in force measures even of a legislative or regulatory nature which may render ineffective the competition rules applicable to undertakings... The court has held that Articles 5 and 85 of the treaty are infringed where a Member State requires or favours the adoption of agreements, decisions or concerted practices contrary to article 85 or reinforces their effects, or where it divests its own rules of the character of legislation by delegating to private economic operators responsibility for taking decisions affecting economic sphere*”.

See also Case C-198/01 *Consorzio Industrie Fiammiferi (CIF)*, 9.9. 2003, ECR I par. 51. See also first comments to the opinion in J. Temple Lang, *National measures restricting competition and national authorities under article 10 EC*, ELR 397-406; and P. Nebbia, case note in *CMLR* 2004, 838-849.

Temple Lang suggests that the conclusions, the legal power to disapply state legislation and regulations if contrary to Community law, should go beyond competition law and apply to community legislation, 399.

¹³⁰ See *Commission and France v. Ladbroke Racing* Case 359/95 [1997] ECR I 6265 par. 33: “*Articles 85 (now 81) and 86 (now 82) apply only to anticompetitive conduct engaged in by undertakings on their own initiative ...If anti-competitive conduct is required of undertakings by national legislation or if the latter creates a legal framework which itself eliminates any possibility of competitive activity on their part, Articles 85 (now 81) and 86 (now 82) do not apply. In such a situation, the restriction of competition is not attributable, as those provisions implicitly require to the autonomous conduct of the undertakings*”.

authorities to review the anticompetitive regulatory practices¹³¹. The ‘state action defence’ has been narrowed and the scrutiny of anticompetitive regulations enacted by professional associations on the basis of delegation of power by public entities is now much broader¹³². An

¹³¹ See CIF, op cit. par. 58 “*In light of the foregoing considerations, the answer to be given to the first question referred for a preliminary ruling is that, where undertakings engage in conduct contrary to Article 81(1) EC and where that conduct is required or facilitated by national legislation which legitimises or reinforces the effects of the conduct, specifically with regard to price-fixing or market sharing arrangements, a national competition authority, one of whose responsibility is to ensure that Article 81 EC is observed:*

- *has a duty to disapply the national legislation;*
- *may not impose penalties in respect of past conduct on the undertakings concerned when the conduct was required by the national legislation;*
- *may impose penalties on the undertakings concerned in respect of past conduct where the conduct was merely facilitated or encouraged by the national legislation whilst taking due account of the specific features of the legislative framework in which the undertakings acted”.*

See, thus, Report on competition of professional services, par. 79: “*In its recent Consorzio Industrie Fiammiferi or CIF judgment the European Court of Justice decided that where undertakings engage in conduct contrary to article 81(1) and where that conduct is required or facilitated by state measures which themselves infringe articles 38(1)(g), 10(2), and 81/82 a national competition authority has a duty to disapply those State measures and give effect to Article 81. The consequence of that judgement is that when a decision by a national competition authority to disapply national legislation has become definitive, the State compulsion defence is no longer available. For the period prior to the decision to disapply the legislation the State compulsion defence is valid and the undertakings enjoy immunity from fines and also from damage claims”* The national antitrust authorities and national courts can therefore intervene and issue orders in relation to future conduct once the anticompetitive nature of the state measure has been declared. (See also par. 82 and 83 in relation respectively to Antitrust authorities and to Courts).

¹³² See the Report on Competition of professional services, par. 85, 86, and 87: “*The Arduino judgment suggests that State measures delegating regulatory powers to private operators could be challenged under Articles 3(1)(g), 10(2) and 81 unless the public authorities have the final word and exercise effective control of the implementation. In the Arduino case, the participation of the professional association in fee-setting was limited to proposing a draft tariff and the competent minister had the power to amend the tariff, and therefore there was no challengeable delegation to private operators. In the Commission’s view State measures delegating regulatory powers which do not clearly define the public interest objectives to be pursued by the decisions of last resort or to control implementation can therefore be challenged under those rules. Based on the above principles the Commission’s view is that the following can be challenged under Art 3(1)(g), 10(2) and 81 and 82 EC:*

- *“rubberstamp approvals”, including simple validations and tacit approvals, granted by member states for agreements or decisions where the legislative procedures in force do not provide for checks and balances and/or for the authority to carry out consultations;*
- *practices whereby the authorities of a Member state are only entitled to reject or endorse the proposals of professional bodies without being able to alter their content or substitute their own decisions for these proposals.”.*

Then the Commission concludes “Where a State adopts or maintains in force measures which are contrary to Articles 3(1)(g) 10 and 81 the Commission and other Member states can start infringement proceedings under Articles 226 and 227. Moreover, by virtue of the primacy of Community law, national courts and national administrative bodies have a duty to interpret state regulations in the light of those community provisions and , if necessary, a duty to disapply State regulations which are in conflict with the Treaty. According to the already quoted CIF judgment the latter duty applies also in cases in which national competition authorities investigate conduct of undertakings required by state legislation to engage in the conduct under investigation. Finally, persons negatively affected by the State measures in issue can introduce an action for damages against the member state for breach of community law”.

See also Case Mauri, C-250/03, Order of the Court 17 February 2005, where the test applied - especially in the light of the CIF judgment - seems a departure from the previous case-law: it requires Member States to actively supervise all kinds of delegated decisions and thus prevents private actors from acting anti-competitively behind the shield of “State action”. Measures formally approved but not genuinely and actively supervised by the State do not constitute State action, and would therefore be condemned for breach of the duty of sincere cooperation. If this stricter standard is applicable in the context of delegation, it means that the Member States can be held liable for delegation not only if the State wholly gives up its

important distinction has been made between imposed and encouraged anticompetitive conduct¹³³. In relation to private regulators, which exercise regulatory power, this distinction may have important consequences if read in the light of the distinction between mandated and promoted self-regulation.

The following conclusions can be drawn: only when the adoption of the anticompetitive rules has been imposed by the Act conferring the regulatory power can the undertakings avoid penalties for past conduct. When the adoption was merely encouraged or facilitated, private regulators may be sanctioned when they engage in anticompetitive regulatory practices. Courts, particularly the ECJ, and competition authorities have addressed the limits on the discretion of public authorities when delegating regulatory power, whereas the issue of constraints on designing the regulatory space has not been explicitly tackled.

Competition law at European and national level severely affects the decision concerning both to whom and how private regulatory power should be allocated¹³⁴. In both cases, monopoly and plurality, competition law can be applied: in the **first** case the control by competition law would be mainly associated with abuse of dominant position; in the second, with unlawful concerted practices.

In making the choice, a trade-off should be sought between the benefits of private regulation and the potential anticompetitive effects it might produce. Opening up the space for regulatory plurality should be considered if the risks of anticompetitive effects, caused by monopoly, are high. This conclusion does not exclude the possibility of delegating or allocating regulatory power, which is certainly permitted, but only for different sets of pro-

legislative power, by not making provision for the supervision of delegated decisions, but also when it does not examine the rights conferred on private actors by national procedural rules. See J. Szoboszlai, *Delegation of State regulatory power to private parties – Towards an Active Supervision Test*, in *World Competition*, 29, 1, 2006, 74.

¹³³ This distinction was firstly made by Autorità garante della concorrenza e del mercato (AGCM) in the case concerning CIF and then accepted by the ECJ in *CIF v. AGCM*, op cit. par. 56.

¹³⁴ See the Notice of the Commission 6.1.2001, 2001/C 3/02, at point 162 where it states that “Agreements to set standards may be either concluded between private undertakings or set under the aegis of public bodies or bodies entrusted with the operation of services of general economic interest, such as the standards bodies recognised under Directive 98/34/EC. The involvement of such bodies is subject to the obligations of Member States regarding the preservation of non-distorted competition in the Community” and then at point 167, “The existence of a restriction of competition in standardisation agreements depends upon the extent to which the parties remain free to develop alternative standards or products that do not comply with the agreed standard. Standardisation agreements may restrict competition where they prevent the parties from either developing alternative standards or commercialising products that do not comply with the standard. Agreements that entrust certain bodies with the exclusive right to test compliance with the standard go beyond the primary objective of defining the standard and may also restrict competition. Agreements that impose restrictions on marking of conformity with standards, unless imposed by regulatory provisions, may also restrict competition”, Finally at points 174 and 175 the Commission clarify that “There will clearly be a point at which the specification of a private standard by a group of firms that are jointly dominant is likely to lead to the creation of a de facto industry standard. The main concern will then be to ensure that these standards are as open as possible and applied in a clear non-discriminatory manner. To avoid elimination of competition in the relevant market(s), access to the standard must be possible for third parties on fair, reasonable and non-discriminatory terms.

To the extent that private organisations or groups of companies set a standard or their proprietary technology becomes a de facto standard, then competition will be eliminated if third parties are foreclosed from access to this standard”. In case of environmental agreements see point 188, “Environmental agreements come under Article 81(1) by their nature if the cooperation does not truly concern environmental objectives, but serves as a tool to engage in a disguised cartel, i.e. otherwise prohibited price fixing, output limitation or market allocation, or if the cooperation is used as a means amongst other parts of a broader restrictive agreement which aims at excluding actual or potential competitors.”

competitive remedies, depending on the setting private regulators operate in. When remedies for monopolistic abuses are held insufficient then plurality should be chosen.

Another set of constraints is linked to freedom of association and freedom of contract. The freedom of regulatees to self-organize and to define their own rules and associated level of discretion cannot be limited beyond a certain level, even if those limitations are based on protection of public interests. The rationale for using private regulators is, at least partly, associated with their ability to benefit from freedom of contract. If the limits posed on that freedom are too burdensome, there is no scope or at least less scope for private regulation. But principles of transparency, efficacy, efficiency, and accountability should also be listed as criteria upon which the choice should be based.

The two settings can now briefly be analyzed in more depth.

a) When the private regulator is a monopolist

When the private regulator is a monopolist, the legal regime should reflect the relationship with the regulatees providing them with sufficient voice and representation (internal interest representation of regulatees and final beneficiaries)¹³⁵. As already mentioned, there is an alternative between self-regulation, where only the regulatees participate to the organization, and participatory private regulation, where other constituencies are also given membership and/or a voice in governance¹³⁶.

Monopolistic regulatory power can also affect how judicial review should operate¹³⁷. Though not decisive, the existence of a regulatory private monopoly, legitimized by public authorities either through co-regulation or delegated regulation, should be one criterion by which to subject its activity to judicial review, and to some extent, to the control of its governance. For example, in order to take seriously internal pluralism concerns, rules regarding fair interest representation and non-discrimination should be policed by Courts. Amenability to judicial review should not be necessarily associated to the public status of the private regulator.

¹³⁵ The role of pluralism in regulatory processes varies quite substantially in relation to each regulatory area. However the principle of non-discrimination among the regulated is present almost everywhere from media to financial markets, from electricity to telecommunications. See for example the Italian Stock exchange regulation of October 2004 art. 1.2.1 concerning non-discriminatory practices.

¹³⁶ See for this distinction F. Cafaggi, *Le rôle des acteurs privés dans le processus de regulation: participation, autorégulation et régulation privée*, in *La Régulation, Nouveaux modes ? Nouveaux territoires ?*, *Revue française d'administration publique*, 109, 2004, 23, and *Id.*, *Un diritto privato europeo della regolazione?*, *Pol. Dir.* 2004, p 205 ff.

¹³⁷ In the British experience the argument to consider judicial review of private regulators was rejected by the Courts, because the presence of monopolistic power was said not to justify itself judicial review. But the case law is not consistent. Compare *R v. City panel on Takeovers and Mergers ex p. Datafin plc* [1987] 2 WLR 699 with *R. v. Football Association Ltd ex p Football League Ltd* [1993] 2 All ER 833 and *R v. Chief Rabbi of the United Hebrew Congregations of GB and the Commonwealth ex p. Wachmann* [1993] 2 ALL ER 249

Absence of monopolistic power has been held as a sufficient rationale for not applying public law. See J. Black, *Constitutionalising self-regulation*, op cit. 34 ff. "*[t]he significance of the contractual source of power and the denial of relevance of institutional power is evidenced in the courts' rejection of the exercise of monopoly power as a ground for review. It is clear that even if the power exercised is monopolistic and submission can not realistically held to be consensual this does not make the power public so as to render susceptible to review*". See also P. Craig, *Public law and control over private power*, op cit. and *Id.* *Administrative law*, op cit. p. 815 in relation to *R. v. Football Association Ltd Ex p. Football League Ltd* op cit.. For a different view see Pannick, *Who is subject to judicial review and in respect of what?* [1992]P.L. 1.

Legal remedies enabling represented parties to have redress in the case of arbitrary or abusive exercise of regulatory power should be put in place¹³⁸. Legal systems should not rely merely on control by administrative authority but should provide private parties with a right to action before the Courts¹³⁹. These rights should be specific and limited to avoid opening the litigation floodgates. But the danger of a deluge of litigation can also be tackled by looking at alternatives to compensatory remedies¹⁴⁰.

An appropriate governance design may contribute to preventing litigation. In fact when there is a regulatory monopolistic power, the lack of ‘exit remedies’ should lead to a governance design of the private regulator, enabling all relevant interests to be adequately represented. Such representation is the result of membership and participatory rights conferred on regulatees and third parties. The multi-stakeholder nature of these organizations requires a governance system tailored to the regulatory function they perform.

b) Private regulatory plurality.

There are two different potential scenarios of regulatory plurality. The first is illustrated by a plurality of regulators that performs all the regulatory functions, i.e. standard setting, monitoring and enforcement. The second is one in which each function is attributed to an independent private regulator who is expected to coordinate with the others¹⁴¹. In this essay for the sake of simplicity I will only consider the first hypothesis.

¹³⁸ The ECJ jurisprudence has been quite restrictive when interpreting the nature of professional body having a dominant position. See for example Wouters, *op. cit.* par. 111 and 112, “By its third question the national court is asking, essentially, whether a body such as the Bar of the Netherlands is to be treated as an undertaking or as a group of undertakings for the purposes of Article 86 of the Treaty. First since it does not carry on an economic activity, the Bar of the Netherlands is not an undertaking within the meaning of Article 86 under the Treaty.” And then it states, “The legal profession is not concentrated to any significant degree. It is highly heterogeneous and is characterised by a high degree of internal competition. In the absence of sufficient structural links between them, members of the Bar cannot be regarded as occupying a collective dominant position for the purposes of article 86 of the Treaty. In light of the foregoing considerations, the answer to be given to the third question must be that a body such as the Bar of the Netherlands does not constitute either an undertaking or group of undertakings for the purposes of Article 86 of the Treaty”.

It is quite remarkable the different conclusions reached to show that the regulatory activity normally carried out by the Dutch bar association is an economic activity: “...a professional body such as the Bar of the Netherlands ... acts as a regulatory body of a profession, the practice of which constitutes an economic activity”, Wouters, *op. cit.* par. 58.

In the British experience Courts have argued that they would intervene if the private regulator abuses its regulatory power or makes discriminatory rules. See *R v. Disciplinary Committee of the Jockey Club, ex p. Aga Khan* [1993 2 All ER] 853 at 873. For a detailed discussion of the grounds for judicial review related to abuse of discretionary power, distinguishing illegality from irrationality, reasonableness and proportionality see P. Craig, *Administrative law*, third ed. OUP, 2003, pp. 551 ff. and 609 ff..

¹³⁹ Differences among legal systems concern both purely private regulators and private regulators to which public law applies. In relation to the first category the differences are mainly related to divergence in contract law, law of organizations and civil liability. In relation to the second category, they are concerned with the different boundaries between judicial review and private law remedies defined by MS in the European Union. On this question see F. Cafaggi, *A comparative study of self-regulation in Europe*, and the national reports, *op. cit.*

¹⁴⁰ See F. Cafaggi, *Gouvernance et responsabilité des régulateurs privés*, RIDE, 2005, p.111 ff..

¹⁴¹ In this model we can have a private regulator setting standards, another monitoring compliance and a third enforcing rules that have been violated. Coordination among the three is indispensable to ensure effectiveness of the regulatory process. Examples of this fragmentation are relatively rare while it is more common to have a unified structure in which independent bodies act to implement each function.

A second alternative is concerned with single versus multiple regulatory relationships. In the first scenario, a regulated firm can only be regulated by one private regulator (exclusivity), in the second scenario, regulatory relationships may be multiple. This multiplicity may depend for example on the multinational nature of the firm operating in a number of nationally regulated markets. In this case the firm may choose to have single or multiple regulatory relationships (for example listed companies in stock exchanges as private financial regulators, but also firms subject to safety and environmental regulation).

I will concentrate here on the first scenario (single regulatory relationship) but consider the second one for the purpose of contrasting it with monopolistic private regulatory power¹⁴².

While frequently today in practice we have multiple regulatory relationships, based on national legal systems, in the future design of a European regulatory framework the choice between monopolistic and pluralistic private regulatory regimes may be grounded on different legal bases from those associated with different nationalities. Markets and regulators may have different boundaries from those associated with nation states. This is the case for competing private orderings.

When regulatory power is conferred on many private regulatory bodies, the composition of each single body and, more generally, its governance structure may be less relevant to ensuring regulatory plurality since regulatees should have the possibility of selecting their regulator from many existing ones, if adequate information is provided. In fact one of the reasons for choosing a pluralistic model of private regulation is to widen the possibilities for choice among different organizational models of private regulation.

Plurality of regulators however, is neither a necessary nor a sufficient condition for achieving regulatory pluralism: not necessary, because pluralism can be achieved by having pluralistic interests represented within a monopolistic private regulator; and not sufficient, because a plurality of private regulators can collude and reduce representation by using common exclusionary rules. For this reason the use of antitrust limitations is highly necessary to guarantee pluralism in the context of plurality.

In order to promote pluralism, i.e. interest representation of different constituencies, a plurality of regulators has to be associated with principles that guarantee a balance between differentiation and homogeneity. Private regulators have to be sufficiently different to make the regulatees' choice meaningful but not too different to make the choice useless or extremely costly in relation to hold-up problems¹⁴³. Again the example of stock exchanges might be useful to identify the right combination between differences and homogeneities.

Therefore the existence of multiple private regulators implies that framework rules should be provided (either by the public authority, legislator or public regulator, or through private regulation, i.e. a regulatory contract among self-regulatory bodies to determine the rules subject to Competition Law constraints). These rules should define common regulatory principles and allow regulatees to move from one private regulator to another, without incurring excessive costs.

Plurality of private regulators and some power of regulatees (and third parties) to choose among them does not necessarily imply the adoption of a regulatory competition

¹⁴² For a more detailed analysis see F. Cafaggi, *Self-regulatory competition*, presented at first SIDE Conference, November 2005.

¹⁴³ To promote regulatory pluralism when it is feasible and cost-effective is very important, but it is subject to the condition that there is sufficient uniformity defined by the public entity, otherwise each regulator will create its own domain and, especially in the case of economic activities (firms, professional activities), a high differentiation of the regulatory framework may generate inefficiencies due to hold-ups.

model¹⁴⁴. The competitive nature of the interaction might depend on the incentives of regulators, i.e. whether their main goal is to attract as many regulatees as possible or to ensure the production of club goods (such as standards).

I will first address the question of common framework rules, necessary to allow compatibility with homogenous regulatory goals, and then the problem of free movement of regulatees, focusing on the regulatory relationship and right to withdraw.

Assuming that a common framework of rules is produced, plurality should ensure that regulatees have a free initial choice to select the private regulator but also a subsequent choice to exit and move from one private regulator to another. This result can be achieved by ensuring a right to change private regulator, but the main problem concerns specific investments made by private parties, especially regulatees, in the regulatory relationship¹⁴⁵. Shifting may be made quite expensive. If the regulatory process is conceived of as an incomplete contract (from an economic perspective) between regulators and regulatees who make (or are required to make) specific investments in the regulatory relationship, it may be costly for them to move to a different private regulator when sunk regulatory costs are high¹⁴⁶. Private regulators, acting in a competitive framework, may regulate opportunistically in order to increase the level of specific investments owed by each regulatee, to lock them in. This result can be achieved through the definition of standards tailored to the specific regulators but also through specific monitoring procedures that imply the adoption of specific organizational features by regulatees.

Protection of regulatees' specific investments then becomes relevant both for the single 'regulatory contract' (the 'contract' that each private regulator signs with regulatees) and for the common framework¹⁴⁷. If there is a general principle that all private regulators have to comply with (for example, the protection of regulatees' specific investments in the adoption of technical standards), the common framework should be directed at identifying a system of rules that preserves specific investments when regulatees move from one private regulator to another or that reduces the power of private regulators to require specific investments by regulatees.

¹⁴⁴ For an introduction to the preconditions for regulatory competition to occur and the distinction with regulatory coordination see R. Baldwin and M. Cave, *Understanding regulation*, op cit., 180 ff.

¹⁴⁵ Such a relationship may have different legal features. If the regulated are required to be members of the organization that exercises private regulatory activity then the relationship will have contractual nature. If membership is not required the regulatee may be subject to the private regulation without being a member. This might be the case if the private regulator adopts the form of a foundation (so far a rare model, but one likely to develop in the future).

¹⁴⁶ In the case of self-regulation the regulatory incomplete contract will be made between the regulator and the regulatees. Technically the contract is that which creates the regulator and it is based on an agreement among regulatees. Notice that while in the realm of private regulation the contract is generally made between regulatees and the regulator, in the domain of public regulation the contract is between the legislator and the regulator. This difference is based on a very hierarchical view of public regulation which should be rethought in the light of increasing direct participation of regulatees and third parties. When dealing with co-regulatory models the two perspectives should be integrated and the regulatory contract between regulatees and regulator typical of private regulation must be integrated with the regulatory contract between legislator and public regulator.

¹⁴⁷ The regulator may vary the level of specific investment for each regulatee only within a general principle of reasonableness. Of course when tailored standards are agreed upon by the individual regulatees they can be very specific since the regulatee can freely decide to bear these costs. For example in the area of product safety, specific standards can be negotiated, especially between regulator and regulatees, when the defect arises or becomes known only after the product is distributed. These standards in case of product recall may be very specific. If a regime of regulatory plurality were in place (currently the regime is monopolistic), the manufacturer might have to bear high costs to move to a different regulator.

A plurality of private regulators can operate within different schemes. In particular it can either use a cooperative or a competitive framework. I should underline that here I am considering the relationship among private regulators, while I have assumed and continue to assume that public authorities and private regulators act within a coordinated framework. However, public and private regulators could act in a competitive fashion as well. The adoption of a competitive structure between public and private would raise different questions¹⁴⁸.

When private regulators can perform different complementary functions they tend to operate in a cooperative framework. Framework rules are here designed to promote the creation of a network of private regulators, to enhance information and knowledge-sharing, to define monitoring procedures etc. This can be described as a network framework for private or self-regulatory cooperation¹⁴⁹.

When private regulators are institutionally built as alternatives, the system of plurality of private regulators I have described may mirror regulatory competition applied to private regulators, and thus it can be defined as a framework of private or self-regulatory competition¹⁵⁰.

Some comparative assessment concerning monopoly versus plurality of private regulators

From what has just been outlined, it emerges that compliance with pluralism in relation to interest representation requires control over the conduct of private regulatory bodies. The need of control poses the problem of how private regulation should be regulated, and this will vary depending on whether the private regulator is a monopolist or whether there is a plurality of regulators¹⁵¹.

In particular, regulation of 'private regulation' operating within a coordination scheme with a public regulator will affect control mechanisms and costs.

Control over private regulators is needed in order to prevent abusive monopolistic regulatory behavior when there is a single private regulator; control is also needed when there

¹⁴⁸ See F. Cafaggi, *Self-regulatory competition*, cit. supra note 00

¹⁴⁹ There is an increasing body of literature concerning network theory applied to cooperation among public regulators while less attention has been devoted to networks of private regulators. At the European level the presence of both network of purely private regulators and networks of mixed public and private regulators is now quite significant.

As to networks of private regulators they operate in the professional fields (e.g. CCBE for lawyers) and in industrial fields (for example, the network of private regulators concerning advertising).

As to networks that encompass both private and public regulators there are examples at international level (IOSCO for financial markets).

See F. Cafaggi, *Self-regulatory competition*, cit. supra note 00

¹⁵⁰ See on this paragraph, A. Ogus, *Regulation*, op cit., 110. Ogus suggests that competition among self-regulatory associations is more prevalent than is often supposed. Competition would eliminate rents stemming from monopolistic regulatory power. See also J. Kay and J. Vickers, *Regulatory reform: an appraisal*, in G. Majone (ed.), *Deregulation or re-regulation? Regulatory reform in Europe and in the United States*, St. Martin's Press, 1990. See also F. Cafaggi, *Self-regulatory competition*, paper presented at the first SIDE conference, Siena, November 2005.

¹⁵¹ This paragraph highlights a more general question concerning the functional relation between the design of the regulatory space and substantive regulatory rules. Not only is the design not neutral but it severely affects the choice of regulatory strategies and techniques. For example a trade-off between concentration of power in the regulatory space and cooperation between regulators and regulatees may be defined. The higher the level of concentration of regulatory power is, i.e. monopoly, the more participatory the process of rule-making should be. Less concentration of regulatory power can be compatible with a more hierarchical structure of the regulatory process since the exit remedy is available for each regulatee.

is a plurality of private or self-regulatory bodies in order to ensure that common regulatory principles are complied with and that freedom of choice for regulatees is ensured both initially and along the process. Some of the anticompetitive effects might be the goal of private regulators; they might collude in order to segment the regulatory market and lock regulatees in. Competition rules and pro-competitive remedies may be used to reduce this type of conduct¹⁵². As I mentioned earlier these two settings may differ, in which case different types of control may be required.

Beyond competition law devices, one can distinguish between centralized hierarchical control, and diffused control, using market-based instruments. It is important to notice that types of control may differ according to the different regulatory strategies which can be sector-specific. Therefore control by public regulators in the electricity sector may be different from that in the telecom sector, financial markets or product safety in relation to different functions performed by the private regulator. Control might also differ in relation to different coordinated strategies: co-regulation, delegated private regulation or ex post recognized private regulation. It will generally be low in ex post recognized regulation, high in co-regulation and delegated private regulation, and intermediate in mandatory and promotional private regulation.

The different levels of control are associated with different costs and generally the stricter the control, the higher the costs. The main difference lies in the nature of control and the devices used to exercise it. These differences have an effect on costs.

When there is a single monopolistic regulatory body, the use of diffused control over the private regulator is possible but peer control of the private regulators and market control is absent, thereby reinforcing the need to resort to either hierarchical or incentive-based control by the public regulator and to judicial monitoring and enforcement.

Some types of bottom up control may be established by the monopolistic private regulator in order to combine hierarchical and diffused dimensions. But it would not operate in relation to differences in rule-making, rather it would focus on compliance with regulation.

Plurality of self-regulatory or private regulatory bodies allows the linking of hierarchical modes of control by public authorities with diffused control by the regulatees, and with market control when some level of competition among regulators is allowed. We should point out that plurality of private regulators is compatible with a purely competitive, purely cooperative or a mixed regulatory space.

The choice between pluralistic and monopolistic structuring of the regulatory domain operates differently in relation to cooperative modes of regulation and those purely private. While in the latter the alternative is left to regulatees but for the competition law limits which apply to both cases, in the former some of the values pursued by the choice of a cooperative regulatory model may be undermined by the use of a monopolistic model and suggest the promotion of regulatory plurality especially when operating at the European level.

7. Conflict of interest and private regulation

The use of private regulation poses severe problems of conflict of interest, with substantial differences between the cases of pure private regulation and that of coordinated

¹⁵² See F. Cafaggi, *Self-regulatory competition*, cit.

models, be they co-regulation, delegated regulation or ex post recognized regulation. They particularly occur when the regulatees are given the power to regulate their own actions, producing effects not only on themselves but also on third parties¹⁵³. Conflicts of interest are therefore especially relevant when private regulation affects third parties who do not participate in the regulatory body, but they may occur even when the participation of third parties is ensured.

There are at least two possible phenomena concerning rule-making:

a) private regulators regulate actions in a way that maximize their own benefits without taking into account the public interest, but without specifically harming third parties;

b) private regulators, while regulating (by the setting or implementation of standards) externalize the costs of their regulating towards third parties (for example consumers, environment, workers or other industries that are not represented in the regulatory authority).

What kind of conflict of interest regulation should be in place to avoid these problems?

A pure 'transfer' of conflict of interest regulation concerning public authorities may not be sufficient to address the problem. As is well known, one of the main problems concerning conflicts of interest in the realm of public regulation is capture. But in private regulation capture is almost the premise since regulators and regulatees coincide partially or totally.

The private interests of public regulators may be very different from those of private regulators¹⁵⁴.

Two dimensions of conflicts of interest in private regulatory activity should at least be considered:

a) the individual dimension¹⁵⁵. When a single, individual regulator takes personal advantage of its position to benefit from its activity in standard setting or in standard implementation;

¹⁵³ This effect occur when the privity requirement or functionally equivalent principles can be overcome somewhat.

¹⁵⁴ See R. Baldwin and M. Cave, *Understanding regulation*, op cit., A. Ogus, *Regulation*, op cit., and for a different perspective W. Streeck and P. C. Schmitter (eds.), *Private Interest Government*, Hart, 1985.

¹⁵⁵ See for example the New York Stock Exchange Directors' Code of Business Conduct and Ethics, adopted April 1, 2004.

"Article 2. Conflicts of interests.

Directors must avoid conflicts of interests between himself or herself and the NYSE. A "conflict of interest" exists when a director's personal or professional interest is adverse to the interests of the NYSE. Conflicts of interest may also arise when a director, or members of his or her family, or an organization with which the director is affiliated receives improper personal benefits as a result of the director's position as such ...Although it would not be possible to describe every situation in which a conflict of interest may arise, the following are examples of situations where the rules are clear. No director, when acting for the NYSE, may directly or indirectly (such as through a family member):

- Accept any benefit, gift or entertainment that would be illegal or result in any violation of law;
- Accept any gift of cash or cash equivalent (such as gift certificates, loans, stock)
- Accept or request anything as a "quid pro quo", or as part of an agreement to do anything in return for the benefit, gift or entertainment;
- Participate in any activity that he or she knows would cause the person giving the benefit, gift or entertainment to violate his or her own employer's standards.

The following are examples of situations that may constitute a conflict of interest. Situations such as these should be brought to the attention of the chair of nominating and Governance Committee for review and clearance before any action is taken:

- Competing with the NYSE for the purchase or sale of property, services or other interests

b) the group dimension. When the group of regulatees, members of the private regulator, takes advantage of its position to obtain benefits at the expense of other categories which are external to the regulatory body. This problem should be dealt with as an externality problem.

It is important for this purpose to underline the insufficiency of the ‘agency’ perspective when looking at private regulators¹⁵⁶. The conflict of interest problem only partly coincides with misalignment of incentives between public and private regulators. As mentioned the incomplete contracting perspective seems to be more promising in this respect.

The problem of conflicts of interest at the individual level could then be solved by mandatory disclosure associated to liability rule in case of violation.

Whereas the problem of conflicts of interest at collective level could be solved by addressing both governance and activity. In particular by:

a) defining a composition of the regulatory body that effectively represents the plurality of affected actors. Different choices can be made as to the way this representation should materialize, and it is not necessarily the case that different interests should be represented in the same way;

b) defining decision-making procedures that are transparent and increase deliberation. This would resemble the disclosure strategy at collective level. It is important to notice that interest representation can also occur at the decision-making stages by resorting to participatory rights. Therefore, the overall strategy of interest representation should encompass both the composition criteria of the governance body outlined above and the involvement of affected parties not represented in the regulatory body. Private regulators may set standards or procedures aimed at maximizing their own benefits at the expenses of other industries or categories such as consumers, workers, environment etc.

c) addressing the governance question so as to define a design capable of minimizing conflict of interest.

A particularly relevant question, in this respect, is the distinction between the use of a non-profit versus a profit-making model¹⁵⁷. In general the choice of non-profit models should be preferred over profit-making models because among other things, it supposedly minimizes the conflict of interest problem. The use of a profit-making model would imply that members of the body governing the private regulator maximize their own interests

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- Having an interest in a transaction involving the NYSE, a customer or supplier (other than as a director of the NYSE and not including routine investments in publicly traded companies).
 - Receiving a loan or guarantee of an obligation as a result of a director’s position with the NYSE
 - Engaging in any conduct or activities that disrupt or impair the NYSE’s relationship with any person or entity with which the NYSE has or proposes to enter into a business or contractual relationship
 - Accepting compensation in any form, for services performed for the NYSE from any source other than the NYSE
 - Either a director or a member of a director’s family receiving benefits, gifts or entertainment from persons or entities who deal with the NYSE where a benefit, gift or entertainment is intended to influence the director’s actions as a member of the Board, or where the acceptance could create the appearance of a conflict of interest.”.

¹⁵⁶ Agency theory is generally applied to administrative law. For a discussion see W. Bishop, A theory of administrative law, *Journal of legal studies*, 19, 1990, 489.

For a broader discussion concerning economic theories of administrative law and a critique of the public choice approach see S. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 *Col. L. R.* 1998, 1.

¹⁵⁷ The debate has been particularly rich in relation to Stock exchanges and private financial regulators. See F. Cafaggi, *La responsabilità dei regolatori privati. Un itinerario di ricerca tra mercati finanziari e servizi professionali*, MCR, 2006, to be published.

through the activity they perform at the expense of interests of third parties, generating externalities¹⁵⁸. This has shown to be highly problematic in relation to financial markets and particularly stock exchanges¹⁵⁹. To solve these problems some have suggested the use of a non-profit form¹⁶⁰. As the non-profit literature shows however, the use of non-profit forms for economic activity is not costless and efficiency problems arise¹⁶¹. However these inefficiencies are less likely to occur when the non-profit form is applied to regulatory activity than to productive activity. In normative terms then the non-profit form should be preferred over the profit-making one.

8. Private regulators, coordinated regulatory strategies and liability systems.

The exercise of a regulatory activity by private regulators within a coordinated framework poses specific problems concerning liability that cannot easily be solved either by transposing the liability systems applied to public regulators or by employing contractual or organizational liability designed for private organizations¹⁶².

It is important to point out that liability of private regulators may arise for various reasons in relation to regulatory activity, implementation of standards, supervision, monitoring compliance, and enforcement. In this essay I will concentrate on liability related to rule-making and standard setting activities¹⁶³.

It might be useful to start with some brief references to the current debate in relation to the liability of public regulators at national and European level and then address the issue of

¹⁵⁸ For a more detailed examination of the relation between conflict of interest regulation in the realm of cooperative regulatory arrangements see *infra*.

¹⁵⁹ The debate about demutualization of stock exchange is an example of the seriousness of conflict of interest problem that may arise when the for profit form is chosen. See IOSCO reports *supra* note 00
See for example the UK regulation of financial market, which provide a great trust in self-regulation, but, later, this behaviour has changed: the public body was given back the powers of regulation and *enforcement* which had previously been given to self regulatory organisations of markets; a disciplining framework was defined in which the public body makes use of few and controlled elements of self-regulation. In order to understand to rationales of this change see the analysis provided by the English Joint Committee, in its First and Second Report, available at <http://www.FSA.gov.uk/development/legal/>.

¹⁶⁰ If the goal of the for profit corporation regulating the stock exchange is to maximize shareholders' value a potential conflict may arise with regulatory objectives that are aimed at benefiting investors. Even if in the long run the two may coincide, in the short run the regulator may externalise some of the costs on investors to maximize its own profits. The probability of a conflict of interest increases when the companies are themselves listed. Self-listing poses obvious problems of governance as well. On this question see G. Ferrarini, *L'ammissione a quotazione: natura, funzione, responsabilità e self-listing*, AGE, 2002, 11 ff. 39 ff.. On a more general level J.W. Carson, *Conflicts of interest in self-regulation: Can demutualized exchanges successfully manage them?*, World bank policy research working paper 3183, December 2003, F. Cafaggi, *Responsabilità dei regolatori privati*, MCR, 2006, p. .

¹⁶¹ See H. Hansmann, *Ownership of enterprise*, HUP, 1996.

¹⁶² In relation to commercial regulation in the UK see J. Black, *Reviewing Regulatory Rules: Responding to hybridisation*, *op cit*. Black suggests that: "... *when non-statutorily based rules are in issue, the court is giving greater leeway to the body in the interpretation of its own rules*".

¹⁶³ For a broader account concerning also liability for supervisory activity of private regulators see F. Cafaggi, *Gouvernance et responsabilité des regulateurs privées*, RIDE, 2005, 111 ff.

private regulators' liability comparing purely private bodies and those operating in the context of coordinated regulatory schemes¹⁶⁴.

The legal regimes concerning the liability of public regulators are quite diverse at the Member State level¹⁶⁵. Differences concern the relationship between illegality and fault, the possibility of using public law and/or private law remedies; in particular the conditions for civil liability arising alongside those for judicial review¹⁶⁶. In some systems the level of discretion attributed to the regulator affects the ability of the potential claimant to resort to civil liability and to claim damages¹⁶⁷. It also varies in relation to different regulatory fields¹⁶⁸. Even within the same sector variations are quite common.

¹⁶⁴ For a comparative account see D. Fairgrieve, N. Andenas and J. Bell (eds), *Tort liability of public authorities in comparative perspective*, The British Institute of International and Comparative Law, 2002. See also in relation to state liability in tort, D. Fairgrieve, *State liability in tort*, 2003, OUP.

¹⁶⁵ In particular the boundaries between illegality and fault are drawn differently. In many legal systems, certainly the majority of illegal acts do not necessarily give rise to liability. Liability arises only when certain conditions of illegality occur. On the other hand liability based on fault or on other regimes may arise even if the Act of the administration, in particular the Independent Administrative Authority, is lawful. See the different contributions in D. Fairgrieve, N. Andenas and J. Bell, *Tort Liability of Public Authorities in Comparative Perspective*, op cit. According to Fairgrieve "*Modern French administrative liability is premised upon the parity between public law illegality and administrative fault, a proposition which has been rejected in English law*", D. Fairgrieve, *State Liability in Tort*, op cit., 18

¹⁶⁶ In the UK "*in the tort of negligence, an ultra vires administrative act which causes loss does not per se give rise to liability. Satisfying the conditions for annulment in a judicial review action does not equate with wrongfulness as expressed in the breach of a duty of care in negligence*". See D. Fairgrieve, *State liability in tort*, op cit., 41. Monetary remedies in Public law,

In France, when conditions for judicial review arise it is frequent that a claim based on the general principles of liability will also arise.

In Italy the relationship between liability associated remedies and judicial review associated remedies is subject not only to scholarly debate but also to divergent case law. See Cons. Stato sez. VI sent. n. 5196, 19 luglio 2004: "L'effetto ripristinatorio derivante dall'annullamento giurisdizionale dell'atto illegittimo costituisce già una riparazione nella maniera più specifica, e pertanto soddisfattiva in tutto o in parte, a seconda delle circostanze, sia dal punto di vista materiale che giuridico rispetto alla situazione di illiceità caratterizzata dalla situazione di illegittimità dell'atto imputabile alla pubblica amministrazione". Then it points out "esiste una differenza ontologica tra riparazione e reintegrazione specifica operata dall'autore dell'illecito (ai sensi dell'art. 2058 c.c. richiamato dall'art. 35 del d.lgs. 80/98) e la ripristinazione effettuata attraverso l'annullamento giurisdizionale dell'atto illegittimo, di cui è autore il giudice amministrativo, cui spetta la potestà demolitoria dell'atto. Si vuole cioè dire che la tutela demolitoria costituisce anch'essa la primaria possibilità di riparazione in forma specifica, tra l'altro operata anche al fine del ripristino della legalità della attività amministrativa, oltre che nell'interesse del ricorrente, anche se tale riparazione operata direttamente ad opera del giudice, deve distinguersi dalla riparazione operata sotto controllo giudiziale e su condanna del giudice (la condanna ad un facere contemplata dal rimedio dell'art. 2058 c.c.) in quanto esiste una distinzione che passa tra la sentenza di condanna e quella costitutiva, reclusiva, estintiva demolitoria."

To define the relationship between liability and invalidity of the harmful act the same Court later stated: "L'ordinamento consente al giudice amministrativo di verificare:

- se l'accoglimento della domanda principale di annullamento dell'atto impugnato – in sede giurisdizionale o straordinaria – comporti una tutela pienamente soddisfacente;

- se sia il caso di disporre, anche in alternativa, la condanna ad un risarcimento qualora il ricorrente non possa conseguire dall'annullamento – e dalle connesse statuizioni coercibili col giudizio di ottemperanza – una piena tutela (in ragione della irreversibile esecuzione dell'atto, ovvero una effettiva utilità (per un ostacolo derivante dal diritto pubblico, quale l'impossibilità giuridica di emanare un ulteriore provvedimento. Emendato dal vizio già riscontrato, o la consolidazione della posizione di un terzo).

Cfr. Consiglio di Stato sez. VI, sent. n.1047, 14.3.2005.

¹⁶⁷ In the UK, the debate has examined which requirements of a tort claim are affected by the existence of discretionary power. There is a tendency to refer to discretion in terms of the question of breach of duty rather than that of the existence of a duty of care. See P. Craig, *Administrative law*, fifth ed., 2003, p. 898

The debate at comparative and European level has focused mainly on the liability of financial regulators¹⁶⁹. The national case law shows significant differences among MS even in this area¹⁷⁰. For example in the area of banking and financial institutions' supervision, different objective and subjective standards are employed in various MS¹⁷¹.

The ECJ has intervened with an opinion concerning credit supervision, taking quite a restrictive view about the admissibility of liability¹⁷². This opinion is consistent with the

and Gorringer v. Calderdale MBC [2004] UKHL, 15. For a more general account see Monetary remedies in public law, op cit. p. 47 ff.

¹⁶⁸ Not so much in relation to duties, though different levels of discretion might justify different tests as to the seriousness of the breach but mainly in relation to recoverable damages.

¹⁶⁹ At the European level see Peter Paul et al. v Bundesrepublik Deutschland, 12 October 2004, Case C-222/02, ECR 2004 I-09425. which dealt with supervisory measures by the competent authority for the purposes of protecting depositors, and the liability of the supervisory authorities for losses resulting from defective supervision. For a comparative account after Peter Paul, see M. Tison, Do not attack the watchdog! Banking supervisor's liability after Peter Paul, CMLR, vol. 42, 2005, p. 639 ss; D. Siclari, Drittbetrogenheit del dovere d'ufficio, öffentlichen Interesse ed esclusione della responsabilità dell'autorità di vigilanza bancaria nell'ordinamento tedesco, *Giurisprudenza italiana*, 2005, p. 390; M. Poto, La Corte di giustizia ed il sistema tedesco di vigilanza prudenziale: la primauté si scontra con il vecchio adagio ubi maior, minor cessat, *Rivista italiana di diritto pubblico comunitario*, 2005, p. 1050; C. Proctor, Regulatory Liability for Bank Failures, The Peter Paul Case, *Euredia* 2005 p.75; M. Carrà, La (ir)responsabilità dello Stato per omessa vigilanza bancaria, *Giornale di diritto amministrativo*, 2005, p. 1175; J.H. Binder, The Advocate-General's Opinion in Paul and Others v Germany – Cutting Back State Liability for Regulatory Negligence?, *EBLR*, 2004, p. 463.

¹⁷⁰ See D. Fairgrieve, M. Andenas and J. Bell (eds.), *Tort Liability of public authorities in comparative perspective*, op cit.; and D. Fairgrieve, *State liability in tort a comparative study*, op cit.

See in the UK the opinion of the House of Lords in *Three Rivers District Council and others v. Governor and Company of the Bank of England* (2000) 2 WLR 1220.

In France, see the opinion rendered by la Cour administrative d'appel de Paris, 30 Mar 1999, *El Shikh*, *AJDA*, 1999, 951. For liability in the area of banking supervision D. Fairgrieve and K. Belloir, *Liability of the French State for Negligent Supervision of Banks*, in *E.B.L. Rev.* 1999, 10, 13; for a broader perspective see B. Du Marais, *Droit de la regulation economique*, 2004.

In Italy, see the opinion rendered by Corte di Cassazione, sent. n. 3132, of March 3, 2001 and more recently Cass. Ord. n. 6719, 2003, Corte d'Appello Milano, 2004, in *Foro it. I*, 2005, c. and Consiglio di Stato, Ad. Plenaria, n. 5, 2003.

With regard to the British experience see, in particular, the debate concerning BCCI and the Three Rivers case, M. Andenas, *Liability for supervisors and depositors' rights - The BCCI and the Bank of England in the House of Lords*, *Euredia*, 2000, p 388-409; M. Andenas and D. Fairgrieve, *Misfeasance, Governmental liability and European Influences*, op cit., 187 ff. See M. Andenas and D. Fairgrieve, *To supervise or to compensate? A comparative study of State liability for negligent banking supervision*, in M. Andenas and D. Fairgrieve (eds), *Judicial review in International perspective*, *Liber Amicorum Lord Slynn*, Den Haag 2000, 333-360.

¹⁷¹ *In The UK the requirement of bad faith for the tort of misfeasance in public office has been held necessary by the House of Lords. However the interpretation of what bad faith means in this context is debated both in the case law, where there is a clear distinction between majority and minority and in the scholarly debate that has taken place afterwards. Particularly important is the separation between misfeasance and dishonesty. Bad faith for the majority is recklessness without any intention to harm.* See *Monetary remedies in Public law*, op cit.

In Italy see R. Caranta, *Public law illegality and governmental liability*, in D. Fairgrieve and al., *Tort liability of public authorities*, op cit., 271 ff.

¹⁷² See P. Paul v. Bundesrepublik Deutschland, C. 222/02, judgment rendered 12.10.2004. In a preliminary judgement the Court was asked the following questions by the German Bundesgerichtshof: “

(1) (a) *Do the provisions of article 3 and 7 of the Directive 94/19 confer on the depositor in the event of his deposit being unavailable, in addition to the right to be compensated by a deposit fund scheme up to the amount specified in Article 7(1) the more far reaching right to require that the competent authority avail themselves of the measures mentioned in article 3(2) to (5) and, if necessary revoke the credit institution's authorisation? [...]*

previous case law concerning state liability for breach of Community law reaffirming the conditions set out in *Brasserie du Pecheur*, *Factortame* and *Bergaderm*¹⁷³. The opinion is related to liability for defective supervision. The Court ruled that Directive 94/19 EC does not preclude national rules which exclude individual rights to compensation for defective supervision if compensation is otherwise ensured¹⁷⁴. This case and the debate around liability

(2) (a) *Do the provisions, as listed below, of directives harmonising the law on the prudential supervision of banks – either individually or in combination and, if so, from what date onwards – confer on the saver and investor rights to the effect that the competent authorities of the member States must take prudential supervisory measures, with which they are charged by those directives, in the interests of that category of persons and must incur liability for any misconduct.*

Or does directive 94/19 on deposit guarantee schemes contain an exhaustive set of special provisions for all cases of unavailability of deposits? [...]

(3) *Should the Court find that all or any of the directives cited above confer(s) on savers or investors the right to require the competent authorities to vail themselves of prudential supervisory measures in their interest, the following further questions are submitted:*

(a) *Does a right for a saver or investor to have prudential supervisory measures taken in his interest in proceedings brought against the Member State concerned have direct effect in the sense that national rules which preclude such a right must be disregarded or*

(b) *Does a member state which has failed to respect that right of savers or investors when transposing directives incur liability only in accordance with the principles governing claims for damages against the State under Community law?*

(c) *In the latter case, has the member state committed a sufficiently serious breach of Community law where it has failed to recognise that a right to have prudential supervisory measures taken is conferred?"*

On the first question the Court is quite explicit. The directive does not preclude member states from excluding liability of supervisory authorities conditional upon the fact that compensation of the depositor is ensured. Par. 32 *"...if the compensation of depositors prescribed in the directive 94/19 is ensured, Article 3(2) to (5) thereof cannot be interpreted as precluding a national rule to the effect that the functions of the national authority responsible for supervising credit institutions are to be fulfilled only in the public interest, which under national law precludes individuals from claiming compensation for damage resulting from defective supervision on the part of that authority."*

See also par. 47 concerning the answer to the second question.

What is most problematic and somewhat surprising is the idea stated by the Court in par. 42, 43, 44 that harmonisation concerning prudential supervision systems does not require harmonisation of liability systems of national authorities. Par. 42 states that *"... the harmonisation under directives 77/780 89/2999 and 89/646 since it is based on Article 57 (2) of the Treaty, is restricted to that which is essential, necessary and sufficient to secure the mutual recognition of authorizations and of prudential supervision systems, making possible the granting of a single license recognised throughout the Community and the application of the principle of home member state prudential supervision"*, while par. 43 *"However, the coordination of the national rules on the liabilities of national authorities in respect of depositors in the event of defective supervision does not appear to be necessary to secure the results described in the preceding paragraph"*.

¹⁷³ See P. Craig and G. de Burca, *EU law, text, cases and materials*, OUP, third ed. 2002. W. van Gerven, J. lever and P. Larouche, *Tort law*, OUP, 2000.

For liability to arise three conditions have to be met: *" (1) the rule of law infringed must be intended to confer rights on individuals (2) the breach must be sufficiently serious (3) there has to be a causal link between the breach of the obligation resting on the authority and the damage sustained by injured parties"*

See *Deutsche Genossenschaftsbank v SA Brasserie du Pêcheur*, Case 148/1984, [1985] ECR I 1981 and *Laboratoires pharmaceutiques Bergaderm SA and Jean-Jacques Goupil v Commission of the European Communities*, Case C-352/1998, [2000] ECR I 529,1 part. par. 43

On this point W. Van Gerven, *The emergence of a common European Law in the area of Tort law: The EU Contribution*, and Tridimas, *Liability for Breach of Community law: Growing up and mellowing down*, both in D. Fairgrieve and al., *Tort Liability of Public Authorities in Comparative Perspective*, op cit., respectively 132 and 169 ff.

¹⁷⁴ Rulings of the ECJ in *Paul v. Republic of Germany*: *"If the compensation of depositors prescribed by directive 94/19 EC of the European Parliament and of the Council of May 1994 on deposit guarantee schemes is ensured, Article 3(2) to (5) of that directive cannot be interpreted as precluding a national rule to the effect that the functions of the national authority responsible for supervising credit institutions are to*

of banking supervisory authorities show that there is a strong separation between harmonization of standard setting and differentiation of liability systems, still left to the discretionary choices of the MS¹⁷⁵. Such a divide may impair the level of protection of depositors and investors and represent a typical case of (partial) harmonization of rules without harmonization of institutions¹⁷⁶.

Neither academic debate nor judicial intervention have yet considered thoroughly the complementary question concerning liability for failure to regulate or for defective regulation of public regulators¹⁷⁷. In the context of public regulation the question of liability poses important challenges to the level of discretion that these regulatory entities (should) enjoy and the limits that discretion imposes on liability standards¹⁷⁸. It is certainly the case that such

be fulfilled only in the public interest, which under national law precludes individuals from claiming compensation for damage resulting from defective supervision on the part of that authority". The opinion takes an even stricter view than that presented by AG C. Stix Hackl, on November 25th 2003, where liability limited to individual damages was recognised. On the opinion see J.H. Binder, *The Advocate-General's opinion in Paul and others v. Germany - Cutting back state liability for regulatory negligence*, EBOR, 2004, 463. The approach of the AG when describing the different functions of supervision is interesting, though highly debatable; in particular, the idea that since there is a plurality of goals of supervision among which only one is depositors' protection, then no individual rights can be recognised. See in particular par. 76 And 77 of the opinion.

¹⁷⁵ It is important to remember AG Tesaro's words in *Brasserie* pointing out the need to develop a European standard given the differences concerning State liability at MS level. Analogous points were made by AG Leger in *Kobler* par. 121: "I am of the opinion that a simple reference to national law would have considerable drawbacks in terms of coherence in the effective protection of the rights derived by individuals from Community law, which include the right to redress. As Advocate General Tesaro pointed out in his Opinion in *Brasserie du pecheur and Fcatortame* a mere reference to national law would be a danger of endorsing a discriminatory system, in so far as for a given infringement Community citizens would receive different protection, some non at all."

The principle of procedural autonomy as applied to compensation for State liability should be read in the light of these statements. See par. 58 of the *Kobler* judgement.

¹⁷⁶ The question of liability, though it clearly impinges on substantive rules, affects the operations of institutions, particularly national authorities that have to regulate and supervise regulatees.

¹⁷⁷ But see T. Tridimas, *Liability for breach of community law*, op cit. p. 168. "*Although Haim II refers to the liability of public law bodies, it is submitted that national law is not in principle precluded from devolving liability to a body governed by private law to which public functions have been delegated and which, in the exercise of those functions, is responsible for an actionable breach of Community law.*"

¹⁷⁸ The ECJ has often underlined the function of discretion in a finding of state liability and established an inverse correlation: the higher the discretion, the lower the standard of liability or the seriousness of the breach. In *Bergaderm*, the issue of discretion was dealt with in a similar manner for legislative and administrative acts. See T. Tridimas, *Liability for beach of community law*, op cit., 175: "*The most important aspect of Bergaderm is precisely this, ie, that it links liability with discretion irrespective of the administrative or legislative character of the measure. It also recognises that, in certain cases, the Community administration may enjoy ample discretion and may be called upon to make choices which are equally difficult, complex and sensitive as same conditions. It thus opens the way for the test of manifest and grave beach to be applied as a condition governing liability for administrative acts, where the administration enjoys wide discretion.*"

For the British experience see P. Craig and D. Fairgrieve, *Barret, negligence and discretionary powers*, Public law, 1999, 626.

In Italy, the relationship between the level of discretion, the standard of liability and recoverable harms has been clearly stated in the case law: "... appare di ineludibile rilievo distinguere a seconda della tipologia dell'attività amministrativa dal cui concreto esercizio dipende il conseguimento del bene della vita: in concreto il giudizio prognostico pone problemi diversi e si atteggia in modo differenziato a seconda che il soddisfacimento della pretesa sia correlato ad attività vincolata, tecnico-discrezionale o discrezionale pura. Il rischio che il giudice abbia a sostituirsi all'amministrazione, sia pure in modo virtuale e nella sola prospettiva risarcitoria, diventa tanto più consistente quanto più sono intensi i margini di valutazione rimessi alla seconda nel riconoscere al privato, asseritamene leso, il bene della vita." Consiglio di Stato, sez. VI, sent. n. 1945 15.4.2003.

discretion is higher in the context of rule-making than in that of monitoring and supervision, but the debate about supervisory liability shows that a high level of discretion is held to be appropriate even within supervision¹⁷⁹.

Whether protection of regulatory discretion could justify the exclusion or limitation of liability is an open question¹⁸⁰. The level of discretion a public authority is granted when performing a regulatory function affects the judgment on liability, in particular the evaluation concerning seriousness of breach¹⁸¹.

In the context of a coordinated mechanism implementing European directives at MS level, where public and private regulators operate within the same regulatory chain, it is important to recall that, according to the ECJ, when a breach of Community law occurs it is

¹⁷⁹ The evolution of European case law is however unclear on the matter, both as regards the distinction between legislative and administrative acts and within the latter between rule-making and monitoring or supervision. The problem is even worse when dealing with judicial discretion and judges' liability under European law. See *Kobler* C-224-01, *Gerhard Kobler v. Republik Österreich*, 30 September 2003.

While State liability for breach of Community law is now deemed applicable to the three powers, it would be desirable if different criteria were used, in relation to the different types of discretion attributed to the legislative, administrative and judicial powers, when evaluating the seriousness of the breach. See for example the Opinion of AG Leger in *Kobler* par. 138 ff. and the judgement of the Court par. 53: "With regard more particularly to the second of those conditions and its applications with a view to establishing possible State liability owing to a decision of a national court adjudicating at last instance, regard must be had to the specific nature of the judicial function and to the legitimate requirement of legal certainty... State liability for an infringement of Community Law by a decision of national Court adjudicating at last instance can be incurred only in the exceptional case where the Court has manifestly infringed the applicable law".

¹⁸⁰ See T. Tridimas, *Liability for breach of community law*, op cit., 167: "*The issue whether an independent administrative authority as opposed to the State is liable may depend on whether it had any discretion in taking the decision which amounted to a serious breach of community law. If the administrative authority was bound by national legislation in taking the decision, it might be more difficult to hold it liable for the ensuing breach of community law. If, by contrast, it enjoyed discretion under national law and could have exercised it in such a way as to commit a serious breach, it would be easier to allocate the liability to the authority itself.*"

¹⁸¹ For the differences concerning legislative, administrative and judicial discretion, see footnote 170. See W. Van Gerven, *The emergence of a common European Law in the area of Tort law*, op cit., 132: "*the content of the condition of serious breach does not depend on the general or individual nature of the Act but on the circumstance that the authority concerned had a wide discretion or, to the contrary, only a considerably reduced discretion or no discretion at all; in the case of wide discretion the decisive test is whether the authority manifestly and gravely disregarded the limits on its discretion whilst in the case of (almost) no discretion the mere infringement of Community law may be sufficient to establish a sufficiently serious breach*". Citing *Brasserie du Pecheur*, par. 56, Van Gerven states "*Whether there is a serious breach in a situation of wide discretion for which it must however, according to case law of the ECJ, take the following factors into consideration: "The clarity and precision of the rule breached, the measure of discretion left by that rule to the national or community authorities, whether the infringement and the damage caused was intentional or involuntary, whether any error of law was excusable or inexcusable, the fact that the position taken by a Community institution may have contributed towards the omission, and the adoption or retention of national measures or practices contrary to community law; fault, subjective or objective, is not a condition except where the aforementioned factors include an element of fault.*"

See also T. Tridimas, *Liability for breach of community law*, op cit., 152 specifying that according to Dillenkofer the application of those conditions may vary depending on the nature of the breach.

See also P. Craig, *Administrative law*, fifth ed. OUP, 2003, p. 933: "It is clear from the ECJ's judgements in *Brasserie du Pecheur* and *Factortame* that while the finding of a serious breach could involve "objective and subjective factors connected with the concept of fault", liability could not depend on any concept of fault *going beyond* the finding of a serious breach of Community law. This requires a word of explanation. Where there is some significant measure of discretion, and/or where the meaning of the Community norm is imprecise, illegality per se will not suffice for liability."

for national law to decide ‘who is responsible for what’ even when the creation of the regulator and the content of the regulation derives from European law¹⁸².

So far the general rule is that MS cannot escape liability by pleading the internal distribution of powers and responsibilities. However, according to ECJ jurisprudence, under certain conditions the State may devolve liability to a public body, different from the federal state¹⁸³. This conclusion has been interpreted such that the State must ensure that reparation is granted but it may allocate the burden in different ways¹⁸⁴.

Delegation of regulatory power to public regulators has been given specific attention in relation to the doctrine of breach of Community Law. The breach of regulatory obligations that regulators, public, private or both, have to comply with in relation to European law may

¹⁸² See W. Van Gerven, *The emergence of a common European Law in the area of Tort law*, op cit., and T. Tridimas, *Liability for breach of community law*, op cit., respectively at 131 fn. 26, and 165 ff.

Van Gerven states: “*It is for national law to decide which branch, organ or authority is liable to provide compensation provided however (i) that a member state may not escape liability by pleading the distribution of power and responsibilities as between bodies which exists within the national legal order, particularly in a Federal State (see ECJ case C-302/97 Konle v. Austria [1999] ECR I-3099 para 62) or by claiming that the public authority responsible for the breach of community law does not have the necessary power, knowledge, means or resources (see ECJ, Case C- 424/97, Haim II 2000 I-5123, para 27) and moreover (ii) that the national law concerned may not be contrary to the principles of effectiveness and equivalence*”.

¹⁸³ See Haim, par. 30, 31 and 32, “*As regards member States with a federal structure the Court has held that, if the procedural arrangements in the domestic system enable the rights which individuals derive from the Community legal system to be effectively protected and it is no more difficult to assert those rights than the rights which they derive from the domestic legal system, reparation for loss and damage caused to individuals by national measures taken in breach of Community law need not necessarily be provided by the Federal state in order for the Community law obligations of the member state to be fulfilled*”. Moreover at par. 31 “*That is also true for those member states, whether or not they have a federal structure, in which certain legislative or administrative tasks are devolved to territorial bodies with a certain degree of autonomy or to any other public law body legally distinct from the state. In those member states reparation for loss and damage caused to individuals by national measures taken in breach of community law by a public law body may therefore be made by that body*”. And finally, at par. 32: “*Nor does community law preclude a public law body, in addition to the Member state itself from being liable to make reparation for loss and damage caused to individuals as a result of measures which it took in breach of community law*”.

¹⁸⁴ See T. Tridimas, *Liability for breach of community law*, op cit., 166: “*In Haim II the Court declared that a Member State may not escape liability by pleading the distribution of powers and responsibilities as between the bodies which exist within the national legal order or by claiming that the public authority responsible for the breach does not have the necessary power, knowledge, means or resources. A further obligation derives its origins from the Reve and Comet case law. The procedural arrangements and the conditions from reparation laid down by national law must not be less favourable than those relating to similar domestic claims (principle of equivalence) and must not be so framed as to make it excessively difficult to obtain reparation (principle of effectiveness).*

The dictum that a Member State may not avoid liability by claiming that the body responsible for the breach of community law did not have the necessary power, knowledge, means or resources is of considerable importance. It is phrased in general terms and appears to be a minimum requirement deriving from the principle of effectiveness. If that is correct, it must be honoured in all cases, ie, even if national law does not guarantee an equivalent degree of protection for comparable claims based on national law. The issue may be crucial in relation to independent public bodies which enjoy budgetary autonomy.

Subject to the requirements stated above, it is up to each Member State to ensure the way individuals obtain reparation. Thus, in Member States with a federal structure, reparation for damage need not necessarily be provided by the federal state. Analogous principles apply to States with unitary structures. In Haim II, it was held that where a member State devolves legislative or administrative tasks to a public law body legally distinct from the state, reparation for loss caused by measures taken by that body may be made by it and not by the State. Similarly Community law does not preclude a public law body from being liable to make reparation in addition to the State itself. It follows from Haim II that a Member State may devolve liability to an independent public law agency responsible for the breach or be jointly liable with such an agency”

therefore constitute a breach of Community law and give rise to reparation if the conditions for extra-contractual liability are satisfied. Specific questions arise in relation to breach of competition law when there is a delegation of regulatory power to a private body¹⁸⁵.

8.1 Liability of private regulators

We can now start examining the issues concerning liability of private regulators in the context of coordinated regulatory processes. Different liability regimes are employed at national levels and in relation to different private regulators operating within a pure private or self-regulatory scheme.

The focus of this section is devoted to rule-making by private regulators and potential liability for breaching their regulatory obligations. It should be clear by now that the regulatory functions fulfilled by private regulators are not only the definitions of standards and the actions of regulated parties but also to protect third parties who may be harmed by the conduct of regulatees¹⁸⁶. The distinction, made at the outset, between private regulation and self-regulation should therefore be recalled to examine the consequences for liability purposes¹⁸⁷. In private regulation, as already pointed out, the actors who participate in the regulatory processes are not only the regulatees but also third parties who may be (generally negatively) affected by the regulation. Direct participation implies that they are either contractual parties, if a contract is used, or members of the organization, if an organizational model has been adopted. This status may provide all the parties with (equal or different) rights that may be actionable and justiciable under contract or organizational law in case of liability. Such rights may however grant different degrees of power within the contractual arrangement or within the organization. Thus within private regulation, regulatees and beneficiaries may have different degrees of protection.

There is a third possibility, when the relationship between regulator and regulatee is neither contractual nor organizational but is created by a unilateral administrative act giving rise to reciprocal duties and rights on the part of the private regulator and the regulatees. This scenario can arise in the framework of co-regulation or delegated private regulation. In this case the liability for breach by the regulator and by the regulatee is based primarily on extracontractual liability, although some legal systems might also envisage the possibility of applying contractual liability or both.

When a self-regulatory model is adopted, unlike in participatory private regulation, there is direct participation only by regulated parties, while third parties may have consultation rights and are generally protected by extracontractual liability for breach of regulatory obligations, given the difficulty generated by the principle of privity of contract. In some cases however, contractual protection may be afforded by qualifying third parties as

¹⁸⁵ See text *supra* and footnotes n. 122 ff. If the delegation of regulatory power encompasses anticompetitive measures the breach of community law by the state does not depend upon the violation of the enterprises acting upon those rules. A state measure, legislative or administrative act, which reduces competition may breach Treaty provisions even if it is not followed by a breach of Arts 81 or 82 by the enterprise. See Ag Van Gerven Joined cases C48/90 Netherlands v. Commission [1992] ECR I-565. On this issue see F. Cafaggi, *Liability of private regulators for violations of competition law*, forthcoming.

¹⁸⁶ This would certainly be the case when the private regulator breaches duties arising from competition law as it is stated in *Courage v. Crehan*.

¹⁸⁷ See *supra*.

holders of a right to be protected on the basis of the contractual relationship between regulator and regulatees¹⁸⁸.

A second important variable concerns the effects on liability produced by the governance model. In particular the nature of contractual liability, when a pure regulatory contract is adopted, is different from organizational liability based on company law. A breach of the regulatory contract would occur in the first case, whereas a breach of fiduciary duty would occur in the second. Within organizations, differences also arise in relation to the distinction between organizations with legal personality and those without (and according to some systems whether or not there has been incorporation). In many legal systems, the standards for breach of fiduciary duties are generally more lax than those for breach of contract. Hence contractual liability would provide better protection for regulatees.

The conditions of liability of private regulators are therefore defined in different ways according to the nature of claimants, their standing, the nature of the legal relationship with the regulator and the causes of action. The issue of liability is also related to the role of judicial review in relation to private regulatory bodies. Legal systems differ in the definition of boundaries between applicability of judicial review to private regulators and the use of civil liability (in tort or contract) as a complementary device for policing regulatory activities. Remedies vary accordingly. In this essay I will not address the complex question of the interaction between liability regimes, judicial review of private regulatory bodies and other systems of control¹⁸⁹.

There are at least three different cases of breach of regulatory obligations which should be considered in this context:

- 1) Failure to regulate
- 2) Abuse of regulatory power.
- 3) Defective or wrongful regulation. Violation of principles concerning the regulatory function.

We can now briefly examine the three different hypotheses:

8.1.1 Failure to regulate. A failure to regulate, which could occur at various levels (rule-making, detailed regulation implementing statutory standards, etc) implies the existence of a duty to regulate, imposed on the private regulator. Such a duty can have a contractual, administrative or legislative basis. It exists in relation to purely private regulation, where the members of an association can claim a breach if the regulator fails to regulate a certain issue and damages are causally linked to this breach. However, in the coordinated framework analyzed above, this duty has different sources and functions. It often arises out of the legislative or administrative act which confers regulatory power; for this reason it is not only owed to the regulatees and to the public regulator but also in some cases to specific third parties, whose level of protection may be decreased or become nonexistent through the breach. The level of discretion attributed to the private regulator may concern the choice of the regulatory strategy but rarely affects the choice between regulating and not regulating. Therefore failure to exercise a duty to regulate by a private regulator constitutes a breach when a specific duty to regulate has been violated. A breach is a necessary yet not sufficient condition for liability to arise. To have a cause of action there must be a causal link between the omission (failure to regulate) and the harm suffered. The plaintiff, regulatee or beneficiary,

¹⁸⁸ See F. Cafaggi, *Modelli di governo e riforma dello Stato sociale*, in F. Cafaggi ed., *Modelli di governo, riforma dello stato sociale e ruolo del terzo settore*, Bologna, 2002, 57 ff.

¹⁸⁹ For a detailed analysis see F. Cafaggi, *Gouvernance et responsabilité des régulateurs privés*, op cit. p. 111.

has to show that s/he would not have suffered the loss or s/he would have suffered a reduced loss had the regulation been in place¹⁹⁰.

There are at least three potential remedies if a breach of the duty to regulate occurs and a causal link is established:

1) The use of an injunction. Judges may order private regulators to enact a regulation to comply with their obligations. The enforceability of such an obligation is very problematic and in several legal systems an injunction would be considered an illegitimate interference with freedom of contract and freedom of organization and/or with regulatory discretion¹⁹¹.

2) Contractual or organizational liability depending on the adopted organizational model. In a coordinated framework, where public and private regulators interact, they may also have reciprocal duties under a contractual scheme. Therefore, the private regulator may be held liable to the public authority for failure to comply with the assumed 'contractual obligation' to regulate¹⁹². A different type of contractual liability may arise towards the regulatees insofar as the governance model is associational or contractual¹⁹³. A third type of contractual liability may operate towards third parties under the principle of third party beneficiaries or when a duty to protect third parties arises out of the regulatory contract (obligation de sécurité, doveri di protezione nei confronti del terzo).

3) A variant on the second type of redress and a potentially concurrent cause of action is extracontractual liability. The private regulator can be held liable for damages towards third parties and in some cases even towards regulatees. *To some extent this liability can also be grounded on rationales used to make the State liable for breach of Community law*¹⁹⁴.

¹⁹⁰ Losses for failure to regulate can occur for different reasons. An example is when a regulatee suffers harm caused by the activity of another regulatee whose harmful act could not have been committed had the regulation been in place. The act is therefore lawful since the regulation was not enacted but the purpose of the regulation would have been to declare that act unlawful. A second example may concern a consumer who is harmed by a regulated firm whose activity should have been performed differently had the regulation been in place.

For a more detailed examination see F. Cafaggi, *Gouvernance et responsabilité des régulateurs privés*, RIDE, 111 ff.

¹⁹¹ See for example under English law. Under judicial review, prerogative remedies (quashing orders, prohibitory orders and mandamus), injunctions and declarations are available. In private law proceedings, prerogative remedies are unavailable. See *Monetary remedies in public law*, op cit. 2.9: "These (prerogatives, injunctions and declarations) remedies, which are available in judicial review proceedings differ from remedies available in private law actions in two key respects. First the prerogative remedies can not be obtained in private law proceedings. Secondly, all remedies in judicial review proceedings are discretionary."

¹⁹² Lack of relevant case law shows that conflicts among regulators are often solved on different basis, because the public regulator often has the power to remove the members of the board of the private regulator, when serious violations have taken place.

¹⁹³ There is a debate concerning what kind of contractual liability can be applied. In the British context, it is debated whether general contract law principles or government contract principles should be applied. See M. Freedland, *Government by contract and public law*, (1994) Public law, 86.

¹⁹⁴ Some specific problems are related to the fact that in this case liability would stem from an omission. As is usually the case, the causal link between omission and harm is not easy to prove and the conditions of liability for omissions are different depending on the Member State. This problem might be even wider in relation to regulatory omissions. The question is rarely addressed even in relation to public authorities. However when it has been addressed the claim has been that omission in tort law should be treated differently from omission by public bodies. See on the English system, P. Craig. *Administrative law*, op cit. p. 902 ff. Recalling Lord Hoffmann in *Stovin v. Wise*, Craig articulates the conditions for liability to arise in case of omission: "There were, said his Lordship, two minimum conditions for basing a duty of care on the existence of statutory power in respect of an omission to exercise the power. It must have been irrational for the authority not to have exercised the power, so that there was in effect a public law duty to act; and there must be exceptional grounds for holding that the policy of the statute conferred the right to

Other problems are related to the type of recoverable damages, in particular the losses incurred are purely economic¹⁹⁵. These would depend on the regulatory field concerned, whether it is financial markets, environmental protection, product safety, consumer protection, deceptive advertising etc. In some cases failure to regulate may produce pure economic losses, in others personal injuries or harm to property, and in some both types. Here the availability of remedies usually depends on the general rules in civil liability and contract law¹⁹⁶. Furthermore, the civil liability threat is relatively ineffective since it may come too late and it may also redress only some of the harm done, without providing for the recovery of damages for the whole loss.

Liability is not the only remedy available concerning the failure to regulate. A supplementary remedy available only in the case of co-regulation and sometimes delegated private regulation is substitution power. The public authority in case of serious breaches can substitute the private regulators and enact the regulation¹⁹⁷. Governance design and substitute power may provide better solutions to failure to regulate than civil liability in organizational, contract or tort law in case of a failure to regulate.

8.1.2 Abuse of regulatory power. A second case of breach of regulatory obligations is when the private regulator exceeds its regulatory power either because it regulates in an area in which it has no competence, or because it exercises its power in ways that negatively affect parties and activities that should not be involved, as for example would be the case when the regulation maximizes the benefits of the regulatees at the expense of third parties, generally other industries or consumers¹⁹⁸. Unlike the previous case, here liability is related to action not to omission. The regulator should not have regulated on the matter because it did not have the power to do so.

Here the remedies can take the form of validity rules, whereby judges or supervisory authorities may strike down these rules as void, with potential consequences on the contractual and non-contractual relationships that have taken place in reliance on them¹⁹⁹.

compensation on those who suffered loss if the public power was not exercised. The very fact that the Parliament had conferred discretion on the public body rather than a duty was some indication that the policy of the statute was not to create a right to compensation". See also S. F. Deakin, B. Markesinis, Markesinis and Deakin's tort law, Clarendon Press, 2003.

¹⁹⁵ See. M. Bussani and V. Palmer, Liability for pure economic losses in Europe: Frontiers in Tort Law, Cambridge University Press, 2003.

¹⁹⁶ See for a general and updated comparative overview, H. Micklitz and U. Magnus, Comparative Analysis of national liability for remedying damage caused by defective consumer services, Study commissioned by the European Commission, 2004.

¹⁹⁷ This structure has been theorized by I. Ayres and J. Braithwaite in the framework of the so-called regulatory pyramid and it exists in many legal systems. See I. Ayres and J. Braithwaite, Responsive regulation, op cit.

¹⁹⁸ In relation to the British experience, see S. Whittaker, Judicial review in Public law and contract law: The example of 'student rules', Oxford Journal of Legal Studies, 21, 2001, 193 ff. And also Id. Public and private law-making: Subordinate legislation, Contracts and the status of 'student rules', ibidem. See also J. Black, Reviewing Regulatory Rules: Responding to hybridisation, op cit., 152: " ... as regards the issue of the rules' validity, then SRA rules may be struck down on the basis that they are outside the board's statutory powers or, if there are none, then outside its actual (in the case of incorporated bodies) or deemed (in the case of unincorporated ones) constitution, or outside the scope and purposes of the broad statutory framework in which they operate."

¹⁹⁹ For example if the private regulator has enacted a void or voidable regulation and contracts have been signed based on this regulation. When these contracts become void because of the voidness of the regulatory act, parties may be harmed and claim damages. Whether these damages may be claimed in tort, contract or organizational law, depends on the position that contracting parties have vis-a-vis the private regulators and the divide between these fields that each legal system defines.

Validity rules can be supplemented with liability rules when there is an abuse of regulatory power, which is more likely to occur where the private regulator is a monopolist²⁰⁰. Here again damages may be caused to regulated parties who may be members of the private regulatory body or external to it, depending on the chosen organizational model. But abuse of regulatory power is likely also to cause harm to third parties.

8.1.3 Wrongful or defective regulation. Breach of regulatory obligations. A third case is related to regulation that has been enacted. This violation can take the form of a breach of legal principles which the private regulator(s) has to comply with. As mentioned, different rules concerning the regulatory process should operate depending on whether the private regulator is a monopolist or there is a plurality of private regulators cooperating and/or competing. When a plurality of private regulators exists, an additional set of framework rules and principles govern the relationships between regulators, especially when the relationship is a competitive one. These rules are intended to ensure that competition is fair but also that it occurs, and therefore they draw both from the rules governing unfair competition and from competition law itself.

Violations of principle may involve procedural rules covering the decision-making process or the implementation process: for example, transparency or participation, the duty to give adequate reasons or to provide an *ex ante* evaluation of the regulatory impact by the potential regulation.

In relation to substantive principles, rules enacted by the private regulator can be in breach of the principle of non-discrimination or fairness *vis-à-vis* regulated parties. Other substantive general principles are proportionality and effectiveness. Similarly, for violation of substantive rules, the sanction may be invalidity of the act, which is often associated with liability of the private regulator. As mentioned, very rarely is invalidity of a private regulation declared, because it can have dramatic effects on the relationship generated by that regulation with regulatees or third parties.

8.2 Assessing the liability question in relation to the organization of the regulatory space

It is easy to recognize that the need for liability as a deterrent varies significantly depending on whether the private regulator is a monopolist or operates in a context of regulatory plurality. However no explicit relevance for differentiating liability regimes has so far been attributed to the organization of the regulatory space, i.e. to the fact that the private regulator is or is not a monopolist.

In the case of a single regulatory relationship, if regulatees can move because there is a plurality of regulators and a framework set of rules is well defined, they can also respond to omission, abuse and breach of their regulator by using exit mechanisms; while in the context of a monopoly, only one's voice is available. Voice can operate both in the formation of the regulation but also *ex post*, through judicial or dispute resolution mechanisms, before harm occurs. However the legal apparatus available, according to the law of contracts or that governing organizations (non-profit organizations and companies), is relatively weak in terms of its potential to respond to the requirements resulting from liability for rule-making activity.

The role of liability as a compensatory device remains relatively stable in the two different environments although the legal regimes may vary significantly as to the causes of action and the remedies available.

²⁰⁰ These statements do not concern breaches of competition law where the regulator has a dominant position.

The role of liability as a deterrence device varies more significantly as between the contractual and organizational models of private regulations.

The existence of a plurality of regulators, even if it does not reduce the ex ante likelihood of breach, might decrease the ex post degree of harm insofar as regulatory alternatives are available at a low cost and regulatees can anticipate some of the failures and exercise their exit option.

The issue of regulatory discretion as a potential limit on liability for failure to regulate or for defective regulation has a different dimension in relation to private regulators from that examined in the context of public regulators and it should play a different function in the realm of coordinated strategies where control systems over the exercise of regulatory power are more articulated.

In relation to purely private regulators, discretion should be interpreted in the light of the constitutional contract of the organization and the general principles of freedom of contract and association.

A different approach should be taken in the context of co-regulation and delegated private regulation. There might still be reasons to justify a certain level of discretion in relation to the private regulatory activity but it has to be framed within the context of a duty to regulate. This is an obligation that arises out of the contract, when the model is contractual, and constitutes the scope of the organization, when the model is organizational, but it is grounded in the legislative or administrative Act that defines the co-regulatory mode.

9. Concluding remarks

The design of the regulatory space at European level should not focus solely on the potentially strong increasing role of European Independent Agencies but also on the role that private regulators - standing on their own or linked to public regulators at European and/or national level - might play in the near future.

The changing regulatory space and modifications of the public and private domain within it are forcing a rethink of the regulatory strategies and the associated liability and accountability systems. The location of a regulatory space in a multilevel framework increases the possibility of involving a plurality of regulatory authorities, public and private, interacting vertically, horizontally or diagonally. Such interactions at times occur informally, while at other times they are regulated at one level or another. For other matters complex regulatory frameworks are defined in order to consider all levels and dimensions as is the case for financial regulation and the application of the so called Lamfalussy process.

The essay has tried to identify the dimensions according to which the regulatory spaces should be designed, focusing on the use of private regulators and regulations in a context of a coordinated framework with public authorities. Different schemes of coordination have been identified to describe modes of interaction between public and private regulators and systems of accountability towards regulatees and third party beneficiaries.

These schemes are problematic because of the absence of well defined legal regimes.

They differ significantly from pure self-regulation but should not be subject to the same rules designed for public regulators.

Three main questions related to the use of new modes of regulation have been addressed: (1) the choice between a monopolistic and a pluralistic regulatory environment: in

particular who should make the choice between these two models, how it should be made, and what the ensuing consequences may be; (2) the regime of conflicts of interest and (3) the liability regime that these private regulators should be subject to.

As to design of the regulatory space, some preliminary conclusions have been reached. Plurality of regulators is justified if there is some institutional differentiation between regulators; the level of this differentiation should be neither too high, so as to make regulatees' transfer from one regulator to the other unattractive, nor too costly; and should ensure a sufficient level of uniformity so as to make the choice meaningful. If standards are self-defined by different private regulators without sufficient coordination among themselves, the risk of differentiation is such that the regulatory function of private regulation will be lost or dramatically impaired. Since the premise of the essay was that the transfer of regulatory power to private actors be acceptable or should be promoted to the extent that public interest goals are pursued, too high a level of differentiation among private regulators would run contrary to that goal. In particular, the paper suggests that the effects stemming from the choice between monopolistic or pluralistic models arise in particular in relation to the legal regime of conflicts of interest (a still relatively neglected subject in the realm of private regulation) and systems of liability. Having shown the existence of a functional relationship, the paper begins to address the different combination of voice and exit mechanisms that should be identified once the regulatory space has been defined by choosing either monopolistic or pluralistic regimes. These choices are relatively different from those faced when purely private regulators are in place. The regime of conflicts of interest and that of liability also present specific features due to the coordinated framework private regulators operate in. The new functions suggest that a direct transplant from public regulators or self-regulatory regimes might be inappropriate. The specificity given by the choice between monopolistic and pluralistic regimes may further increase the need for an original set of rules to be devised at European level and implemented at MS or infra state level.

These questions pose challenges to the new private regulatory law that deserve greater attention both at European and Member State level by institutions and in the context of scholarly debate.