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Legal Coding Beyond Capital?

Katharina Pistor
Columbia Law School, kpisto@law.columbia.edu

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DIALOGUE AND DEBATE: A SYMPOSIUM ON MARTIJN HESSELINK'S RECONSTITUTING THE CODE OF CAPITAL

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Katharina Pistor

Columbia University School of law, New York, USA
Corresponding author. E-mail: kpisto@law.columbia.edu

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Abstract

Capital, I argue in 'The Code of Capital: How the Law Creates Wealth and Inequality', is coded in law.[1] Legal coding is a process that adapts and molds formal law over time, often without explicit *ex ante* sanctioning by a legislature or a court. Several characteristics of formal law make it susceptible to coding, including its inherent incompleteness, the strong endorsement for private autonomy, and decentralised access to a state's consolidated means of coercion.[2] Would a progressive European Code of Private Law (EPL-code), as proposed by Hesselink, alter any of this and what would it take to ensure that the principles enshrined in this code would in fact be realised? These are the questions I will address in this short essay.

Keywords: capitalism; private law; coercive powers; incomplete law

1. Introduction

Martijn Hesselink has written a powerful critique of my book, 'The Code of Capital'.[3] He is correct that at the heart of 'The Code of Capital' lies a social justice concern. As Lisa Herzog put it in her review of the book, '[i]t does not matter what exactly one's theory of justice is – these practices will come out as wrong from pretty much *any* theoretical perspective'.[4] Hesselink pinpoints two effects of the coding of capital that are particularly concerning to me, namely 'rising inequality and withering democratic control'.[5] I would add to this an even deeper concern, namely that strategic private actors appropriate for private wealth creation one of, if not *the* most formidable collective resource, the legal system, and often without taking into consideration how this might affect others or society as a whole. Their claim that their strategies are 'legal' is the code word for accessing the centralised means of coercion that allows them to uphold their claims against others.

To remedy this state of affairs, I proposed a series of strategic, incremental reforms that were designed to roll back the excesses of private legal coding and to increase the policy space in order to realise social and distributive concerns. Hesselink faults my strategic incrementalism as falling short of rectifying the problems I identified in the book. His own proposal is a progressive

[1]K Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press 2019).

[2]These issues will be fuller explored in a forthcoming book entitled 'The Laws of Capitalism'.

[3]M W Hesselink, 'Reconstituting the Code of Capital: Could a Progressive European Code of Private Law Help us Reduce Inequality and Regain Democratic Control?' 1 (2) (2022) European Law Open 316–343.

[4]L Herzog, 'The Laws of Knowledge, Knowledge of Laws: A "Political Epistemology" Perspective on Pistor's The Code of Capital' 11 (2021) Accounting, Economics, and Law: A Convivium 27–35.

[5]Hesselink (n 3).

European Code of Private Law (EPL-code)[6]: A set of normative principles that would be developed in a bottom-up, democratic fashion with the normative power of constitutional principles.

I find his idea intriguing and worth exploring further. For reasons explained below, however, I fear that without a clear-eyed understanding of how incremental legal change can erode legal principles that are enshrined in statutes, codes, or constitutions on the one hand and, critically, a reconfiguration of the conditions for accessing the consolidated means of coercion on the other, the EPL-code will fall short of expectations.

2. Private law challenges

The intuition behind the proposal for an EPL-code is to ground private law in Europe in social justice principles. Rather than leaving it to the everyday practice of legal coders, litigants, courts and regulators, the normative foundations for private law should be elevated to constitutional principles that guide future coders and law enforcers. In the best of all worlds, lawmakers and law enforcers would embrace and uphold these principles, and private actors might internalise them to a point that the need for constant monitoring and enforcement would give way to a mere backstopping function. However, we do not live in such a world, not even in the European Union (EU) with its more publicly minded spirit as compared to the liberal, or even libertarian, animus one can find in the Anglo-Saxon capitalist orders of today. No doubt, there is stronger consumer protection and labour law in the EU, and recent developments in the realm of data protection promise to reign in the powers of Big Tech. Indeed, well-designed laws can counter the free-wheeling coding of capital as we know from the history of the New Deal in the USA and the 'golden age' of constrained capitalism during the post-war era in Europe.[7] Experience suggests that legal and regulatory constraints of this kind tend to erode over time. There are several reasons for this.

First, law is inherently incomplete.[8] This follows from an extension of economic contract theory, which has long established that contracts are incomplete, which in essence is a recognition that the future is unknown and unknowable.[9] It follows that it is impossible to anticipate all future contingencies and address them in the contract. Law is by definition even more incomplete than are contracts. Where a contract seeks to specify the terms of a deal, a law must anticipate a multitude of deals now and in the future. It is worth noting that the major codifications of civil and commercial law of the 19th and early 20th centuries are still with us. They created the foundation for private law, including contract, property, business organisation, family, and inheritance law and were designed to be long lasting, rendering them highly incomplete. These codes have been adapted over time; they were also complemented with statutes and regulations that offered more specific rules for certain legal domains that were deemed to require special treatment. Still, much in the original wording has been left unchanged. The longevity of these codes is startling given the massive social, political, and economic transformations around them. This would have been impossible without the constant adaptations of these codes to the changing environment by attorneys, courts, and only occasionally, by legislatures. However, as I show in my book, this adaptation has disproportionately benefited the holders of capital, not the least because they had the resources to pay lawyers for complex coding strategies that others could ill afford.

Second, private actors have powerful incentives to find gaps in the scaffolding of laws and regulations and to exploit them for private gain. Law's incompleteness is a fertile ground for legal arbitrage, that is, for compliance with the letter of the law even as end runs are devised around its spirit. This is not to say that all regulations are rendered mute, but to suggest that in a highly

[6]Pistor (n 1).

[7]See T Piketty, *Capital and Ideology* (Harvard University Press 2020), especially Chapter 11 at 486.

[8]K Pistor and C Xu, 'Incomplete Law' 35 (2003) Journal of International Law and Politics 931–1013.

[9]O Hart and J Moore, 'Foundations of Incomplete Contracts' 66 (1999) Review of Economic Studies 115–138.

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competitive environment in which even small modifications in the rules that govern a transaction can affect the bottom line, eroding the effectiveness of law that is designed to constrain the coding of wealth will become the goal of many a new coding strategy.

Third, lawmakers and adjudicators often support private interests that endorse free markets, free movement, and private autonomy, even when these principles are in tension with principles of distributive justice, when they threaten to destabilise the financial system or destroy the environment. Examples abound, including the jurisprudence of the CJEU on the free choice of corporate law in accordance with the principles of the free movement of (legal) persons and capital[10] or the endorsement of temporary work agencies as a run-around labour law. Secondary Union law has also played a critical role in expanding the scope for the legal coding of capital by prioritising negative integration, or the removal of barriers to domestic markets, over positive integration, which would have required a consensus to establish new, European-wide principles for governing markets. Neither is the EU immune to lobbying. A prominent example is the financial collateral directive, which effectively altered the priority rules in the bankruptcy codes of member states by requiring them to grant 'safe harbours', or exemptions from the law, for derivatives.[11] Ironically, the EU managed to go even beyond English bankruptcy law, which had served as a model for close-out netting.[12]

Fourth, a lot of legal change occurs without policing by a court or endorsement by a legislature. Almost all parties comply with almost all of their contractual obligations almost all of the time, to paraphrase my late colleague, Louis Henkin, who made a similar remark about states and international law.[13] That is parties comply with the terms as negotiated. Even if one party breaches the terms of the contracts, the other might not challenge the breach, because the transaction costs might be too high, the outcome too uncertain, or both. As a general rule, in the world of private law, private actors police each other. This creates a powerful first mover advantage, which strategic actors can exploit to their benefit. They can bargain for terms that may be pushing the limits of existing law without fear, because even if they are successfully challenged eventually, the gains, which they made in the interim, may be well worth the gamble.[14] Sometimes regulators monitor law compliance and bring enforcement actions on their own.[15] How effective they are depends not only on the quality of the legal rules but also on the resources allocated to law enforcement activities. Underfunded regulators (or tax authorities) will not be able to uphold the law. An alternative is to empower private agents to bring enforcement agents by, for example, granting them a multiple of damages they occurred or by creating class actions. Even where permitted (as a general rule civil law countries have been reluctant to empower private policing of public regulation), they are not always a good substitute for public enforcement. The reason is that they need high powered incentives, such as contingency fees for lawyers, which can turn law enforcement into a hunting ground for private attorneys.

Fifth, the state's policing powers over the contents and legal validity of transactions are often further reduced by allowing private parties to shop not just for law but also for the forum where their disputes are aired and resolved, including a choice between state courts and private arbitration tribunals. While most countries remain reluctant to enforce the verdicts of foreign courts without further scrutiny (a new convention on the enforcement of foreign court verdicts has

[10]The leading case is Case C-414/16 Egenberger, ECLI: EU: C: 2018: 25.

[11]E R Morrison, M J Roe and C S Sontchi, 'Rolling Back the Repo Safe Harbors' 69 (2014) Business Law Journal 1016–1047.

[12]See L Gullifer, 'What Should We Do about Financial Collateral?' 65 (2012) Current Legal Problems 1–34.

[13]See L Henkin, *How Nations Behave: Law and Foreign Policy (2nd ed.)* (Columbia University Press 1979) at 47: 'Almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time'.

[14]A good example is the case of the patent for the BRCA breast cancer gene, which was granted in 1994 and which the US Supreme Court finally struck down in 2013. Not only did Myriad Genetics, the company that owned the patent, reek substantial profits in the meantime, it was also able to create a huge database with the help of the patent. See B M Simon and T Sichelman, 'Data-Generating Patents' 111 (2017) Northwestern University Law Review 377–439.

[15]This is what Xu and I call 'reactive law enforcement' in Pistor and Xu (n 8).

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not entered into force yet), most countries will enforce the rulings of foreign or international arbitral awards unless the basic procedural rules have been violated or 'the recognition of the award would be contrary to the public policy of that country', a condition that has been narrowly construed.[16]

If these comments capture at least in part how private law operates in practice, we must ask ourselves, what, if anything the EPL-code would change. According to Hesselink, the code shall consist of broad principles, not detailed rules. If they are to govern many scenarios over a long period of time, this only makes sense. But it also implies that these principles must be interpreted when applied to specific case of lawmaking or law enforcement. This raises the question, who is in charge? An obvious answer is judges and regulators. As law enforcement agents they will have to apply the code's principles to cases that come before them. Courts are designed to be reactive law enforcers; they cannot bring their own actions. Some thought would therefore have to be devoted to incentivising private or public agents to bring cases in the first places. Regulators often initiate their own enforcement actions if empowered by law. But this raises again the resource question and their spectre of possible regulatory capture. Finally, courts would be the ultimate arbiters of how to apply broad principles to a changing world. How they would implement the EPL-code is difficult to predict and may well vary over time. As Joseph Weiler has pointed out, courts have been instrumental in the transformation of Europe.[17] This has not changed since the 1990s, but arguably the direction of change has. The CJEU case law on free movement and free capital flows has contributed substantially to breaking down barriers or to 'negative' rather than 'positive' integration.[18]

If regulators are fully committed to the principles of the EPL-code and sufficiently resourced to enforce them, the prospects for turning normative principles of social justice into legal action are pretty good. Giving the EPL-code the status of constitutional principles should also remind legislatures that they have to create conditions for their effective enforcement, but this is, of course, no guarantee that they will do so. Conversely, relaxing any of these assumptions will reduce the power of the code. This suggests that the EPL-code is likely to have only limited impact as long as the legal infrastructure for upholding the law remains unchanged. It might inspire some to structure private legal relations in accordance with principles of distributive justice, but it is unlikely to stop others from exploiting legal devices as a source of private wealth.

3. Complementing the EPL-code

In light of the above analysis, I suggest that the EPL-code should be complemented with a reconfiguration of how existing law is adapted to future change on the one hand, and access to the consolidated means of coercion on the other.

A careful study of legal history shows how much legal change occurs outside the legislature, the centrepiece of a democratic system of lawmaking.[19] Legislatures are often too slow and often too dysfunctional to offer timely relief in the face of massive socioeconomic change and the legal change that accompanies it as parties seek answers on how to treat new activities under old laws.[20] There are many causes for this dysfunctionality, but one can be attributed to the slow-moving

[16]See Art V2(b) of the 1958 New York Convention on the Recognition and Enforcement of Foreign and International Arbitral Awards.

[17]J Weiler, 'The Transformation of Europe' 100 (1991) Yale Law Journal 2403–2484.

[18]F W Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford University Press 1999).

[19]Foundational for a classification of these changes from the perspective of social scientists, see W Streeck and K Thelen, 'Introduction: Institutional Change in Advanced Political Economies' in W Streeck and K Thelen (eds), *Beyond Continuity: Institutional Change in Advanced Political Economies* (Oxford University Press 2005) 1–39.

[20]For the common law, see O A Hathaway, 'The Path Dependence of the Law: The Course and Pattern of Legal Change in a Common Law System' 86 (2001) Iowa Law Review 601–661.

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legislative processes that were designed for a different age and are not fit for the pace of change nor the scope of challenges we face today. As a result, legislation has become primarily a framework with the details left to be filled in by judges, administrators, or regulators.[21] These roles are often underpaid and overworked, and they are hardly a match for well-paid lawyers that will press their own (or their clients') legal interpretations of the law onto them.

Turning first to the adaptation of law without formal legal change, as noted earlier, the law changes all the time even in the absence of formal change by statute or precedent (where it is available). Legal interpretation, analogy, gap filling, choice of law and forum, and so forth are the standard tools for any lawyer; they are also the tools for coding capital. The basic question is whether this process is best left to decentralised forces, subject only to the occasional vetting that occurs if coding strategies are challenged by another private party or a public enforcement agent, and if not, what viable alternatives might be available. I do not believe that centralising the adaptation process is feasible or desirable. There is therefore much to be said for legal pluralism and bottom-up legal change. The pace of socioeconomic and technological change and the complexity of modern societies has reached a point where we should question the capacity of our representative institutions to cope with them and in a timely fashion, if at all. Not surprisingly legislatures increasingly rely on experts or outsource entire legislative drafting projects to law firms — to actors who in the ordinary course of business are more likely to code capital than to concern themselves with questions of distributive justice. A related issue is, how to ensure that there are sufficient feedback loops that alert the legislature or specialised legislative committees to the need for change. Much of this happens today via informal channels, including lobbying, which are not equally available to all.[22] Alternatively, one might expand the rule-making authorities out of administrative agencies and regulators. They are closer to the ground and their own enforcement actions are a natural feedback loop to flag where change might be needed to ensure compliance with the law, including the principles an EPL-code would establish. However, increasing the power of regulators raises questions about their own accountability. Administrative agencies and regulators as part of the executive branch, delegating to them the power to adapt the law beyond what they already do, could undermine the division of powers and lead to a further erosion of democracy, that is, the idea of government by the people.

The crisis of democracy, including the oldest democracies around, has been widely noted.[23] Many students of democracy have highlighted the need for greater citizen participation, in the form of liquid or 'open' democracy.[24] They propose to replace the institutions of representative democracy with mechanisms of citizen empowerment. Models of liquid democracy wish to empower citizens to vote on most policy issues directly or delegate their participatory right to others while retaining the right to retract that power at any point in time. Open democracy, in contrast, asks citizens to participate themselves on policy matters for which they are recruited by lotteries that are meant to ensure that a representative cross-section of society is put in charge. Whether either model is suitable as a general governance tool for complex polities at the national or supra-national (EU) levels, is a question I cannot address here. My claim is more moderate: I am arguing that for adapting existing law to changing circumstances in cases that have broad

[21]To give just one example for the inability of the legislature to clarify a legal issue over which courts had disagreed, the standing of plaintiffs in securities law suits in the USA, see J A Grundfest and A C Pritchard, 'Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation' 54 (2002) Stanford Law Review 627–736.

[22]For the EU, see P Bouwen, 'The Logic of Access to the European Parliament: Business Lobbying in the Committee on Economic and Monetary Affairs' 42 (2004) Journal of Common Market Studies 473–496.

[23]A Applebaum, *Twilight Democracy: The Seductive Lure of Authoritarianism* (Random House 2020); D Runciman, *How Democracy Ends* (Profile Books 2018); S Levitsky and D Ziblatt, *How Democracies Die* (Viking 2018).

[24]H Landemore, *Open Democracy: Reinventing Popular Rule for the Twenty-First Century* (Princeton University Press 2020); C Blum and C I Zuber, 'Liquid Democracy: Potential, Problems, and Perspectives' 24 (2015) The Journal of Political Philosophy 162–182.

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social effects beyond the parties to the dispute, democracy would be best served if citizens, or more generally residents, were to endorse such change. Convening ad hoc peoples' committees that would comprise of individuals selected from a cross-section of residents might be useful institutional innovation. Examples for the kinds of cases that should be referred to a committee would include the classification of Uber or Lyft drivers as entrepreneurs rather than employees, the privatisation (or re-socialisation) of large-scale housing projects, or the right of data producers to prevent others from extracting their data without consent or compensation.

Cases, such as these, often make an appearance in court, but they are of much greater policy relevance than a single dispute between two parties; they touch on policies matters that should not left to a judiciary. Unfortunately, legislatures often do not respond in a timely fashion and, default, leave the adaptation of the law to changing circumstances in the hands of private actors and the occasional courts case, the outcome of which depends much on how the case was framed.

In the alternative, one might consider a petition process to the legislature or to special committees that answer to the legislature.[25] However, one needs to be mindful of the danger of capture, which besets existing legislative committees at most parliaments already. Alternatively, one might constitute an ad hoc peoples' committee to decide how existing law should be adapted to a changing environment. The questions put before these committees should be clearly circumscribed. They should not be tasked with writing new law but with determining the scope of existing rules and their application to new fact patterns. In short, a citizens committee would operate similar to juries in common law systems. In principle, juries rule on facts, not the law, but drawing this distinction is often complicated. After all, only facts that are relevant for a specific legal question are the facts at issue and this raises the question whether certain facts still fall within the ambit of a rule. Still, it is fair to say that the ad hoc citizens committees I have in mind have a more policy-oriented objective. They should consider, whether new fact patterns, such as the use of freelance drivers by car hiring companies, are sufficiently similar to employment relations to be covered by labour law or not. The reason for not leaving this decision in the hands of the judiciary is that these are in fact broad policy, not narrow legal issues.

To ensure that the right cases make it to peoples' committees, and not to the courts, one might require courts to submit cases that came before them which meet some well-defined criteria that establish their broad policy relevance to these committees and then wait for the committee's ruling before applying the law to the said case. Critically, this should only be one, and perhaps not the most important path to these committees. It often takes years for cases to be litigated and courts might prefer to issue a narrow legal ruling rather than referring their cases to peoples' committees. A petition process that would allow affected parties to trigger the convocation of such committees without having to first litigate would be an important complementary procedure.

Concerning the fundamental question of how to select citizens for these committees, using lotteries that ensure that a representative cross-section of the people is selected, seems promising. They would open a space for direct participation, which is lacking in most democracies today. Moreover, the lottery procedure would make it nearly impossible to game the system or flood it with money and donations to ensure that the 'right' people are selected.

Turning finally to the question of access to the means of coercion, or law enforcement, I would also favour relatively decentralised access, but would call for greater public regarding oversight. The current system, which combines relatively free choice of law and forum with international law that requires states to execute arbitral awards without reviewing their merits, has turned state courts into enforcement agents that can be hired for a fee. It effectively strips adjudication of its public regarding aspect, as arbitral proceedings are not public, nor are arbitral rulings published. Subjecting the execution of arbitral awards (and perhaps even the choice of law) to greater scrutiny will raise concerns about legal certainty – a sacrilege in the eyes of many capital

[25]I am grateful to Martijn Hesselink for raising this issue in comments to an earlier draft of this paper.

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owners and their lawyers who have come to rely on their private coding strategies being reliably enforced with few, if any, questions asked. However, as I have argued elsewhere, this notion of legal certainty encourages aggressive coding strategies that focus on the black letter of the law while disregarding its purpose, including social justice concerns.[26] Indeed, subjecting access to the consolidated means of coercion to greater scrutiny may be one of the most important contributions the EPL-code might make.[27]

More generally, overhauling the current system of litigation should be on the agenda of reforming the system of private law. Pitching individuals against each other in an adversarial process that assumes formal equality has always been at odds with the unequal bargaining power, resources, and sophistication different parties bring to the table. Broadening access to the courts has revealed the impossibility of operating system in a fair and equitable fashion. Most court systems are in dire need of reform already. They are underfunded, judges are underpaid, and court houses have barely, if at all, kept up with modern information technologies. Furthermore, while they are inundated with small claims, they see big commercial or financial cases increasingly only when they have to sign off an executing arbitral award.

Instead of patching up the system once again, it is time to overhaul it. There should be much greater room for collective actions, especially where standard contracts are common, or injuries are largely comparable. Burdening individuals to bring cases is a recipe for insulating from legal oversight powerful economic players who can dictate the terms of their contracts and shift the costs of their actions to others. Revisiting the expanded use of mandatory arbitration will also be critical. Without changes in procedural law, even a mandatory EPL-code can be easily muted.

4. Concluding comments

In his critique of 'The Code of Capital', Martijn Hesselink has argued that the list of incremental reforms that I suggested at the end of my book, including a principle against granting exceptions for capital from existing binding law, a roll back for private arbitration, and restrictions on the free choice of law, does not amount to a full reform programme. As an alternative, he proposes a new progressive European Code of Private Law. This EPL-code would serve as an anchor for the normative principles that shall guide private law in the future. This is an ambitious proposal and I do have much sympathy for it. However, I also fear that it might fall short in its own ways for two reasons: It underestimates the political economy of existing capitalism, the economic power and the cognitive sway it is having over us, including over judges and other law enforcers. Second, an EPL-code would likely face similar problems as existing law. It would be necessarily incomplete and subject to interpretation, if not blatant legal arbitrage – which is one of the most powerful strategies for coding capital. Leaving this to the same institutions that have been charged with upholding the law in the past is not be enough.

Taking up the gauntlet that Hesselink has thrown for a comprehensive reform agenda, in this brief response I have tried to sketch out a reform agenda that would place the interpretation of existing law and its adaptation to changing circumstances into the hands of the people, not the courts. As always, the devils lie in the details, but I would argue that absent complementary structural reforms of legal change and law enforcement, an EPL-code is unlikely to succeed.

Competing interests. The author has no conflicts of interest to declare.

[26]K Pistor, 'The Value of Law' 49 (2020) Theory and Society 165–186.

[27]This is one of the incremental strategies I suggest in Pistor (n 1) at Chapter 9.

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