Adaptation Mechanisms in Private Law

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Abstract Contracts are risk allocation mechanisms and, as with legal relationships generally, are social relationships. If circumstances change, the content of such relationships also changes. Adjusting such relationships to changed circumstances may be done either using a bottom-up approach, via courts, or in an top-to-bottom approach by the legislator. Implied terms, frustration of purpose, impossibility, judicial amendment of contract and the adaptive application of the rules concerning breach of contract are the tools of judicial adaptation. Intervention via legislation may be more efficient if there are a large number of cases. While legislative or administrative rule-making is determined by political decisions, judge-made rules are influenced by the constrained options of judges. That is, the latter cannot impose a standard of conduct on non-litigants, and the courts cannot handle all legal problems—many of which are not brought to court or end in settlement.

1 Introduction

The expectations that the law creates for social and economic actors have a specific relationship to changes in society and the economy because they not only enforce but shape the latter at the same time. Until the beginning of the twentieth century, changes in private law were characterised by natural, harmonious adaptation. Even if the changes were as profound as the dismantling of feudal property systems and the emergence of modern private property or the development of business companies and commercial law, they were the result of processes that were well adapted to the

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rhythm of social and economic development and therefore partly fitted into the framework of legal thought. And if the framework needed to be adjusted, it could be done in such a way as to preserve the logical order of the law.

The typical method of adaptation in civil law is *bottom-up* development: courts decide on the disputes that come before them, and the principles that emerge from the decisions define a body of law, which, if the legislator sees fit, can be translated into written civil law rules. The written regulations thus created are typically defined at a high level of abstraction to be sufficiently flexible and applicable in cases similar in substance to the earlier rules but different in fact and certain details.

The reverse, *top-to-bottom* direction of rule-making comes to the fore when the legislator wants to correct existing law. This is usually done either because the legislator intends to override judicial practice or because the bottom-up, socially and economically embedded responses to judicial practice take time to develop, and the legislator sees more risk in sustained uncertainty than in the adverse effects of direct intervention. These adverse effects are primarily manifested in a poorly defined scope of application in terms of social appreciation and demand, regulatory loopholes leading to uncertainty, and gaps in the legal system, leading to uncertainty.

The economic analysis of law analyses these problems as the difference between standards and rules.[1] These models distinguish between the latter on the basis of how precise the law is and how much room it leaves for judicial discretion. Standards are less precise; they leave more room for judicial balancing. The main question here, however, is different. This analysis assumes that the same accuracy can be achieved through legislative and judicial rule-making. For example, even if standards (general clauses) exist in private law, judicial practice can produce rules as accurate as legislative or regulatory acts. But the process of rule-making is different. The first part of the analysis concentrates on the rule-making process—why the scope, costs, timing, and expected lifetime of rules are different in the case of legislation (or regulation) and judicial rule-making. The second part focuses on the circumstances when the two methods result in different rules. This section will present the typical differences between the rules made by courts and by legislators (or administrative branches).

2 Contracts as Risk Allocation Vehicles

Contract law protects trust in the promise of another party. This trust corresponds to the moral norm that promises must be kept. Contracts are, however, social relations,[2] and it seems obvious that if social and economic circumstances change, contracts must adapt to these changes. This requirement appears to be incompatible with the principle of the binding force of contracts. Because of the high costs of contracting

[1] For an overview of the relevant literature, see, for instance, Luppi and Parisi (2011), pp. 43–53.

[2] MacNeil (1974), pp. 691, 715; Kohler (1921).

and information gathering, contracts are never complete: they are never able to fully and perfectly spread the risks of unforeseen future changes. Thus, social and economic changes make it necessary to adapt contracts by law or through the courts. However, such intervention is often considered undesirable because of interference with the private autonomy of the parties.

Since contracts are necessarily incomplete, it is the task of private law to offer solutions for the redistribution of risks when unforeseen and unforeseeable circumstances make performance much more difficult for the obligor than they expected when they concluded the contract. This is supported by the idea that social justice in contractual relations should be promoted. The gaps in incomplete contracts can be filled by implied terms or by specifying general clauses such as the requirement of good faith and fair dealing. Both the general rules of private law and doctrines, such as *hardship*, impossibility, *frustration of purpose*, *loss of the basis of the transaction*, *imprévision* or *clausula rebus sic stantibus* and specific rules about contracts can deal with such cases. The legislator may also intervene using ad hoc legislation if the change of circumstances affects a wide range of contracts and is a social problem.

Doctrines pointing in this direction are the building blocks of the arguments made by the courts. A judgment is, in fact, the result of weighing up the interacting values relevant to the case. With regard to the binding force of contracts, the autonomy of the parties, their responsibility for themselves, the (objective) value of the exchange as established by an external party and the trust in the promise of the other party are the relevant values, which may vary in strength depending on the facts. In the flexible system of private law, a court's judgment on the binding force of a contract is the result of weighing up these relevant values according to their strength in the circumstances. In other words, the more informed and uncoerced the consent, the less relevant the (objective) value of the exchange as determined by an external party. However, a lack of information about unforeseen circumstances may undermine the value initially attributed to the exchange, and this may also open the door to the need to correct a contract according to the social evaluation.

3 Judicial Risk Allocation: The Doctrinal and Regulatory Framework of Contract Law

3.1 Implied Terms

Legal systems involve a wide range of doctrines and rules that deal with the redistribution of the risk of circumstances unforeseeable to parties at the time of the conclusion of a contract. These solutions are designed to ensure that the contract conforms to society's general values and requirements. The conditions implied by any of the relevant doctrines are part of the basis of contracts and primarily relate to the existence or non-existence of facts which are so obvious and so unlikely to fail that the parties did not think it worthwhile to stipulate them expressly.

Regarding the addition of the general clause of good faith and fair dealing, traditional Hungarian private law doctrines followed the German model before the Second World War.[3] The requirement of good faith and fair dealing is part of Hungarian private law along the lines of the German *Treu und Glauben*[4] and its function. Since § 1:3 of Act V of 2013 of the Hungarian Civil Code, it has been an integral part of all private legal relationships, including contracts. The contracting parties are bound by this obligation even if it has never been concluded or negotiated. To promote the relevant social values, the courts must give concrete form to the general clauses on a case-by-case basis, taking account of the specific facts. In other words, the courts may derive from the requirements of good faith and fair dealing specific rights and obligations in the relationship between the contracting parties, even if they have never negotiated or imposed such rights and obligations. This also applies to Hungarian private law in force, although it is not reflected in current court practice. This option is available to the courts if they consider it fair and reasonable in the circumstances of the case or if the application of the otherwise applicable rules does not lead to a socially satisfactory result.

3.2 Impossibility and Frustration of Purpose

After a contract is concluded, circumstances may change, resulting in the contract becoming unenforceable. If performance becomes impossible due to a change in circumstances after the conclusion of the contract, this will result in the termination of the contract, or the obligation to perform in kind will be converted into an obligation to pay damages. Hungarian contract law treats the impossibility of performance as a form of breach of contract. It follows that if the defendant is responsible for the impossibility of performance, they may be liable for damages under the rules of liability for breach of contract. The performance of the contract may be rendered impossible by physical circumstances (e.g. the subject matter of the contract has been destroyed) or because the contract has lost its purpose. This is the case, for example, when a shareholder agreement becomes impossible to perform because the court has rejected the application for the registration of the company.[5] Alternatively, a lease contract would be considered to have lost its purpose and to have been terminated because it was impossible to conclude if the tenant entered into it with the intention of establishing an industrial estate, but the industrial estate was not ultimately established for reasons for which neither party is responsible.[6]

[3] Kelemen (1937), p. 88.
[4] Földi (2001), p. 105.
[5] EBH 2006. 1428.
[6] BH 2007. 370.

A contract also terminates for impossibility if performance would be so difficult for the obligor that it cannot be reasonably expected.[7] This would be the case, for example, if the parties had contracted to exchange accommodation, but one of them fell ill after the conclusion of the contract and medical treatment was only available to them at their original place of residence.[8] Impossibility may also occur because of a change in the legal environment. This is the case when an obligation to provide a service that was legal at the time the contract was concluded becomes illegal due to a change in the law after the contract was concluded.[9] A supplementary interpretation of the contract or the presumption of *implied terms* also means that the rights and obligations laid down in the contract are subject to certain conditions (purpose), even if these are not fixed by the parties. Once this basis for the contract has ceased to exist, the enforceability of the contract ceases. This statement is also valid in Hungarian private law.

Legal impossibility may provide a response to the direct consequences of legal restrictions, while impossibility due to the frustration of an objective may provide an answer to the consequences of changes in social behaviour. With respect to the sharing of the risk of legislative action in relation to the COVID-19 pandemic, the question is whether the performance of the rights and obligations contracted by the parties depends on the absence of such limitations or difficulties. The answer does not follow from the internal logic of private law. It is a question of policy to be decided by the court and may require a different approach with commercial and non-commercial contracts. In our view, a finding of impossibility due to frustration of purpose should be subject to much stricter requirements in commercial relationships than in non-commercial relationships. This view seems to be supported by the approach followed by the courts in international commercial disputes.

An important feature and limitation of impossibility is that it provides a 'black or white' answer as to the binding force of the contract. This is very much in line with the market paradigm in that it does not give a new contract to the parties but leaves it to them to decide whether they want to renegotiate the contractual relationship. However, this may impose a significant social cost if the termination of the contract affects third parties or entails excessive transaction costs and is not an optimal solution. This is particularly the case with long-term contracts, as parties invest in performance with a predictable return in the longer term. Therefore, terminating a long-term relationship would entail high costs. This may not only be less efficient but also unfair.

[7] BH 1986. 489.
[8] BH 1985. 101.
[9] BH 2002. 235.

3.3 Clausula Rebus Sic Stantibus

In long-term contractual relationships, the parties are particularly exposed to risks arising from changes in circumstances. Transaction costs can be reduced by adapting contracts to changed circumstances while maintaining the original balance of rights and obligations and conforming to social values rather than by applying the law's doctrine of impossibility, which would sever the socio-economic link between the parties. Adapting a contract to changed circumstances by judicial modification is achieved by applying *clausula rebus sic stantibus,* which is a general rule, particularly the requirement of good faith and fair dealing, or specific rules at different levels of abstraction of private law. Contract modification is reasonable in long-term relationships. With such contracts, there is a high probability that risks will arise that the parties do not allocate because of the high costs involved. Impracticability makes the contract unenforceable. Therefore, the parties must renegotiate their contract if they want to maintain their legal relationship. In contrast, the *clausula rebus sic stantibus* and *hardship* doctrines open the way to a review of the contract. However, as a consequence, one party may find itself in a contract that it might never have entered into.

As far as long-term contracts are concerned, the Hungarian Civil Code provides for a special rule on the amendment of contracts by a court. Either party may claim a judicial amendment of the contract if, as a result of a circumstance arising in the long-term legal relationship between the parties after the conclusion of the contract, performance of the contract under unchanged conditions would be prejudicial to their substantial legal interest, and the possibility of a change in circumstances was not foreseeable at the time of the conclusion of the contract; the change in circumstances was not caused by them; and the change in circumstances does not fall under the scope of the normal business risk [Art. 6:192 (1) of the Civil Code]. There is a strong argument that the court is not entirely free to formulate a modification of the contract but can only modify the contract by applying the dispositive rules of the Civil Code.

3.4 Application of the Rules on Breach of Contract

The rules of the Civil Code, similar to the solutions of the various unification products, allow a party to be exempted from liability for breach of contract if it can prove that the breach of contract occurred for a reason beyond its control ('irresistible'). The concept of *beyond control* is a completely open concept that can be used by the court to spread the risk. Thus, in the context of the exemption from liability for breach of contract, the court may also allocate risks unforeseen by the parties at the time the contract was concluded.

4 Re-Allocating Risks Through Legislation

In crises affecting the whole economy, the judicial route is often complemented by the legislative or regulatory route: at the government's initiative, such instruments are used to revise the original contracts and modify the rights and obligations of the parties—in other words, to distribute losses between them. The present analysis is concerned with when this takes place and when it is left to classical contract law (and the courts) to deal with the situation.

The Hungarian economy has been hit by several major shocks in recent decades. Without claiming to be exhaustive, the significant economic downturn following the change of regime, with the associated fall in income and inflation, was a major shock; contracts signed in the second half of the 1980s were particularly hard hit; following the economic crisis of 2008, the significant depreciation of the forint caused particular problems with the repayment of loans to households and municipalities (and companies), many of which were in francs and euros (loans denominated in foreign currency); the closures caused by the COVID-19 epidemic paralysed a significant part of the economy, leading to a significant loss of income for debtors, but also for tenants of businesses, for example.

5 Differences in Rules

In the previous section, we assumed that the decisions made by the court and the regulators (government, bureaucracy) are the same. We focused on the differences in timing, accuracy, and the costs of rule-making. In this part, we look at why the content of the rules created in the two diverging ways can be different.

When rules are enacted by legislative acts or regulations, we are faced with political decisions. The motivations behind these decisions can be understood with the help of public choice theory models. However, due to a lack of space, our analysis and model will be a bit one-sided. The focus will be on judicial lawmaking. We assume that the main findings of public choice models are well-known, and we concentrate on the areas where judicial decision-making differs from political-bureaucratic decisions. In this regard, three main elements might be identified: different opportunities, different objectives, and different incentives.

5.1 Different Opportunities

It is worth starting with the fact that due to the structure of the legal system, courts have different options from those of legislators and regulators. Courts can decide only on the issues that are brought before them. Courts can only confer rights on the parties concerned and impose new obligations on them. For example, in a credit

crunch, the courts can only redistribute rights and obligations between creditors (banks) and debtors, while governmental-political regulators can impose costs directly on third parties in the resolution of the problem. For example, during the Hungarian foreign currency crisis, the regulation allowed debtors to get out of debt by paying a third of the debt while the government itself took on a third of the debt. (The third part had to be covered by the banks.)

5.2 *Different Individual Objectives and Preferences*

As an argument in favour of governmental-political regulation, it is sometimes made expressis verbis that court decisions pursue different goals than the government. Such divergence is often explained by the various preferences of rule-makers. Perhaps the best-known model related to the preferences of judges is that of Richard A. Posner. However, other goals are also specified in the literature.

Utilitarianism and Welfare Maximisation Richard A. Posner's original (very strong) claim was that judges typically follow utilitarian principles—more precisely, because the utility or (subjective, non-monetary) benefits on which utilitarian logic is based are difficult to measure, they are welfare-maximizers.[10] A (weaker) version of this claim argues that utilitarian principles are the easiest to follow—and therefore, judges often relegate other preferences to the background. For example, if they try to promote the fair distribution of wealth, they must first engage in a political-philosophical debate about distributional justice. Only after defining the meaning of justice or fairness can they consider what decision this definition requires in the given case for particular parties. This political-philosophical debate can be avoided by seeking efficient rather than fair or just decisions.[11]

Coherence Models Many argue that the underlying principle behind judicial decisions is that the legal system's coherence should be preserved.[12] Perhaps one of the best-known such arguments arises in the context of credit: judges are overly committed to the principle of pacta sunt servanda and, thus, to creditor protection. They attempt to enforce the original terms in the credit contract even when legislators or bureaucrats attempt to protect debtors and ease the burden of credit.[13]

[10] Posner (1979), Cserne (2015), pp. 188–189; Zywicki and Stringham (2011), p. 108.

[11] Zywicki and Stringham (2011), p. 109.

[12] See, e.g., Hayek (1978), Rizzo (1980).

[13] See, e.g. *Study on means to protect consumers in financial difficulty* (2012), p. 12.

5.3 Evolutionary Models

An alternative to preference-based explanations is the so-called evolutionary model.[14] Most of these models assume that judges have the same preferences as other social actors—for example, those working in government: they crave the recognition of their colleagues, promotion, higher pay, etc.[15] However, because incentives in the judicial system are different to those in political-bureaucratic institutions, they may serve to satisfy the same demands.[16] The other key building block of evolutionary models is the incentive for the litigants and other parties. First, this leads to a so-called selection effect, i.e., jurisprudence does not encounter all possible types of cases—problems that result in judicial decisions have well-defined characteristics. Problems that are not referred to court (do not start or end in a settlement) have no chance of improving case law.[17] Litigants (potential litigants) determine what cases the court encounters and (partly) what kind of arguments and information it is confronted with in a given case. In this respect, parties are involved in a game (in economic terms), and to win this game, they decide how much and what resources to use. The amount of resources that are used can affect the chances of a favourable decision being made. Models typically conclude that the expected result of this game is inefficient—a barrier to efficient decision-making.[18] (Or, in a weaker version, they at least assume that an efficient result is harder or slower to achieve.)[19]

The Role of the Parties in Influencing Decisions In the process of judicial decision-making, the judge does not have all the information.[20] They rely heavily (although not exclusively) on the evidence and arguments provided by the parties. One of the best-known models assumes that litigants who mobilise more resources to persuade the court are more likely to prevail.[21] Therefore, case law is primarily determined by those who can mobilise more resources to win a case.

Several elements can influence the amount of resources deployed to persuade a court. One of the most common explanations is that the amount of such resources

[14] Rubin (1977), p. 56.

[15] Pritchard and Zywicki (1999), pp. 409–521.

[16] Zywicki (2003a), p. 1551–1633.

[17] Hadfield (1992), pp. 583–616; Fon and Parisi (2003), pp. 419–433; De Mot (2011), p. 134; Depoorter and Rubin (2017), p. 132.

[18] For such a model in the case of judicial decisions, Tullock (1997).

[19] There are theories, such as Gary S. Becker's, which stress that in certain circumstances, the presence of interest groups can explicitly steer policymakers towards effective decisions. Becker (1983).

[20] Aranson (1982), pp. 289–319; Rizzo (1980).

[21] Galanter (1974), pp. 95–160; Hirshleifer (1982); Rubin (1977), pp. 51–63; Zywicki and Stringham (2011), p. 110; Depoorter and Rubin (2017), pp. 134.

depends on the size of the subjective stakes of the particular lawsuit.[22] On the one hand, this depends on the amount of money or rights, etc., that can be won or lost in the given lawsuit. Not only that, it is possible that one of the parties is a "repeat player" who will face several similar cases. For them, the stakes of the case are raised by the fact that the decision can be used as a reference in other lawsuits. If one of the parties is a repeat player, they are more likely to win. Consequently, judge-made rules tend to favour them precisely because of the correlation between the stakes and the use of resources.[23]

Repeat players may not only be defendants or plaintiffs. They may include a lawyer who will represent others in similar cases. But the former may also be a socioeconomic group whose members recognise that the decision in a particular case will affect their positions. They may also be interested in providing resources to support one of the litigants. However, for such groups, resource mobilisation is more difficult. On the one hand, they may not know about the case. On the other hand, even if they are aware of it, they may be held back by what is known as the collective action problem: they may try to free-ride and wait for others.[24] Therefore, case law is expected to be more favourable to lawyers and socioeconomic groups that are in a better position to obtain information and overcome collective action problems.

Accepting or Challenging Precedents: The Chance of Overruling *Ceteris paribus,* filing a case is more likely if the plaintiff perceives higher stakes.[25] This leads to the so-called selection effect[26]: Judges will only be able to decide on cases based on plaintiffs' decisions.[27]

However, case law is influenced not only by decisions about filing but also by decisions about appeals. As appeals are also more likely when the stakes are high for the losing party, there is less chance of overruling previous case law concerning legal problems when the stakes are low. In these cases, few lawsuits are filed, and few appeals are likely.

The Place of Litigation Litigants can sometimes choose the place of litigation and thus the court as well—or even the judge, if applicable. Two cases should be distinguished here: (1) when the choice of the forum is decided unilaterally by the applicant, and (2) when parties decide together (for example, when they agree on the place and form of dispute resolution ex-ante in a contract). If the plaintiff is able to make a unilateral decision on the forum, cases are typically brought before judges and courts that are likely to rule in favour of the plaintiff. That is, it shifts this

[22] Zywicki and Stringham (2011), p. 111.

[23] Rubin (2011), Zywicki and Stringham (2011), pp. 110–111.

[24] For analysis of the collective action problem see Olson (1971).

[25] Priest and Klein (1984), Depoorter and Rubin (2017), p. 130.

[26] Fon and Parisi (2003), pp. 419–433; De Mot (2011), pp. 134–135.

[27] Landes and Posner (1979), pp. 235–284; Rubin (2011), pp. 96.

jurisprudence in the direction of precedents that are more favourable to the plaintiff.[28]

Joint decisions, however, are typically made on the basis of at which court the parties expect to maximise their joint benefits and minimise transaction costs. As these courts are more likely to be chosen, the law will evolve towards decisions that maximise the former's joint economic benefits. (These decisions are not always efficient because the costs and benefits of external stakeholders may not be taken into account by the parties and the court.)[29]

Settlement The chances of changing judicial practice are affected not only by the fact that not all cases have the same chance of going to trial but also by the fact that some cases end without a judgment: the parties reach a settlement between themselves. The importance of the selection effect based on settlement was first articulated by Paul H. Rubin in an article from 1977.[30] The argument, which often appears later in the literature, is that settlement is more likely in a case when the case law favours the party with the higher stakes. So, this selection effect based on such settlements also predicts that precedents—the 'established jurisprudence' that favours the party that gains less than the opposing party—have a greater chance of being overridden.

This claim is complemented by the model of Keith N. Hylton,[31] who claims that the plaintiff's knowledge, in addition to the size of the stakes, affects the chance of bringing suits. Hylton shows that cases come before the courts when the more informed party has a better chance of prevailing. In contrast, the party that has more information but is more likely to lose will not take the case to judgment. Therefore, publicly available court judgments will be assembled into a jurisprudence which is more favourable to the more informed party.[32]

Hylton's model is based on George L. Priest and Benjamin Klein's observation that more cases reach the point of court rulings when jurisprudence is more unpredictable.[33] This is an additional, separate selection effect: courts mainly encounter cases with less clear rules. Therefore, jurisprudence moves toward eliminating uncertainty. It is worth noting that settlements can effectively act as indirect

[28] Fon et al. (2005), Klerman (2007), pp. 1179–1226; Zywicki (2006), pp. 1141–1195; Depoorter and Rubin (2017), p. 135.

[29] Stringham and Zywicki (2011), pp. 497–524. Of course, this choice of forum is only really an effective factor if (i) the case is new or of doubtful classification not yet covered by established case law [Fon and Parisi (2003), pp. 419–433] and (ii) it is known to the parties before which judge they can expect a decision. For example, if judgments are handed down in chambers and it is, therefore, more difficult to identify the preferences of individual judges, this type of forum selection is less attractive [De Mot (2011), pp. 135–136; Depoorter and Rubin (2017), p. 135.]

[30] Rubin (1977).

[31] Hylton (2006), pp. 33–61.

[32] De Mot (2011), pp. 139–140; Depoorter and Rubin (2017), pp. 135–136.

[33] Priest and Klein (1984), pp. 1–56.

forum choices. In places where the chances of a decision unfavourable to the decision-maker are high, cases tend to end in settlements.[34]

The models discussed in the previous section focused on the decisions of the litigants, their lawyers, and external socioeconomic groups; evolution was explained by their choices. Another group of evolutionary models concentrates on judges. These models usually predict path dependence: they claim that judges, when faced with a problem, basically follow previously established practices. They do so even if they are not obliged to by a precedent or established jurisprudence.[35]

Appeal, Promotion Some explain the evolution of the legal system in reference to the rules on the promotion of judges. The career progression of judges is often crucially influenced by whether the higher court will overturn their judgments on appeal. If this is the case, the decisions of judges who want to be promoted can largely be explained by their reluctance to deviate from established case law at the higher instance; at the lower instance, they are reluctant to innovate. This is why established practice is maintained.[36]

Reputation Erin O'Hara's model[37] goes one step further and examines why judges follow the decisions of other judges even when there is no precedent or established case law—i.e., they would not be obliged to do so. Of course, this could be explained by the previous goal (desire for promotion), but O'Hara offers another explanation. He points out that judges may be concerned about their reputation. Judges are players in a repeated game: if their decisions differ from those of other judges in one case, they may expect that their decisions in other cases will be negated by these colleagues in the form of 'sanctioning'.[38]

However, as Timur Kuran emphasises, there is an opposite effect as well[39]: Judges who deviate from precedents or established jurisprudents and change the rules can also gain a reputation. Of course, thiIs is only if the majority of judges find the new rule acceptable and follow it. However, making such decisions—even in the light of high potential reputational gains—is highly risky.

Judges and Forum Choice *The possibility of direct and indirect forum choice impacts* the decisions of judges who want to attract (or eventually discourage) cases.[40] Judges who want to attract cases are more likely to make decisions that are more favourable to plaintiffs (or to those deciding where to bring a case).

[34] Stearn and Zywicki (2009).

[35] Kornhauser (1992a), pp. 169–185; Kornhauser (1992b), pp. 441–470; Roe (1996), pp. 641–668; Hathaway (2001), pp. 601–665; Zywicki and Stringham (2011), p. 113; Wangenheim (1993), pp. 381–411.

[36] Posner (1994), pp. 1–41.

[37] O'Hara (1993), pp. 736–778.

[38] Whitman (2000), pp. 753–781; Depoorter and Rubin (2017), p. 133.

[39] Kuran (1990), pp. 1–26.

[40] Fon et al. (2005), pp. 43–56.

Lobbying at Courts According to rent-seeking models, winners and losers of a rule are willing to devote resources to influence rule-making. This influence may be formal or informal, legal or illegal. However, the effects of lobbying differ in terms of the two types of rule-making. It is generally accepted that government decisions might play a more important role in this respect. As Thomas C. Merrill points out, a dollar or euro spent on lobbying has a greater influence on the content of future laws or regulations than if the same amount of money were spent on influencing a court ruling.[41]

But there are also counter-arguments. Some models suggest that in some cases, the impact of decisions made by judges can be more substantial—and therefore, the stakes (the gains or losses) are higher in the case of judge-made rules. For example, the two types of rule also have different life expectancies. Legislative acts are able to override both the former government-driven rules and judicial decisions. (In contrast, courts are not able to override legislative acts or regulations.) However, the political costs of changing the two types of rules are different. In the case of overriding judge-made rules, legislators and politicians must accept the risk—greater or lesser—that their action will be interpreted as a deprivation of the rights of independent courts, possibly with political consequences.

Similarly, the stakes for influencing judges are higher when the scope of their rules is broader.[42] While statutory and regulatory rules typically try to define precisely the range of cases in which they can be applied, they can also be relied upon in the broader context (in all 'similar' situations). For example, legislation may specify who can or must apply specific legislation to loans made by whom and when. Or, eventually, the dates from which rules apply to leases of premises and until when they apply. On the other hand, if such specific rules come from a judicial decision, the latter may be cited as a precedent in many 'similar' cases.

6 Conclusion

This chapter has demonstrated why the two types of rule-making can result in different rules. While legislative or administrative rule-making is determined by political decisions, judge-made rules are influenced by the constrained options of judges (they are not able to impose a standard of conduct on non-litigants), by selection effects (courts cannot address all legal problems—many of them are not brought to the court or end in settlement). As presented, court-made rules are likely to be favourable to parties who (i) are able to mobilise more resources to win, (ii) have higher stakes (e.g. because they are repeat players), (iii) are associated with socioeconomic groups with more resources, more information and more capability

[41] Merill (1997), pp. 219–230.

[42] Zywicki (2003b), pp. 1–26; Stringham and Zywicki (2011), pp. 121–123.

to cope with collective action problems, and (iv) are able to choose the place of litigation. Judge-made rules are less likely to change frequently and dramatically than legislation as there is a strong tendency to path-dependence in court decisions: judges are motivated to follow previously established practices.

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