The Timing and Source of Regulation

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I. INTRODUCTION

The distinction between specific concrete rules and general abstract principles has engaged legal theorists for decades.[1] This rules–principles distinction has also become increasingly important in corporate and securities law, as well as financial market regulation. One prominent example is the contrast between U.S. rules-based accounting—which attempts to specify in detail what parties should disclose—and European principles-based accounting—which sets forth only general notions of disclosure.[2]

This Article adds two important variables to the rules–principles debate: timing and source. Although these two variables are relevant to legal theory generally, the specific goal here is not to address and engage the rules versus principles literature directly. Rather, the goal here is to ask whether the debate about financial market regulation might benefit from a more transparent analysis of temporal and legal source variables. That is, the *when* and *where* of the application of both rules and principles.

From capital requirements, to investment restrictions, to disclosure rules, much modern financial market regulation is focused on ex ante regulation.[3] This focus on ex ante regulation is especially true outside the

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1. *See* H. L. A. HART, THE CONCEPT OF LAW (Penelope Bulloch & Joseph Raz eds., 1994) (1961); Ronald Dworkin, *The Model of Rules I*, *in* TAKING RIGHTS SERIOUSLY 14 (Harvard Univ. Press 1977).

2. *See, e.g.*, William W. Bratton, *Enron, Sarbanes–Oxley, and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023 (2003) (discussing the rules–principles debate in the context of the collapse of Enron and responsive regulation). *See generally* KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES (2007).

3. *See* Frank Partnoy, *ISDA, NASD, CFMA, and SDNY: The Four Horsemen of Derivatives Regulation?*, *in* BROOKINGS-WHARTON PAPERS ON FINANCIAL SERVICES 213 (Robert E. Litan & Richard Herring eds., 2001). I first set forth the analytic structure for analyzing the source and timing of regulation in this article, and I draw explicitly from it in this essay.

United States and England, particularly in Asia, where regulators rely less on the private attorney general role of the plaintiffs' bar.[4] In contrast, decades ago, regulators throughout the world, but particularly in the United States, took more of an ex post approach. These regulators emphasized adjudication or regulatory assessment after-the-fact based on general principles rather than specific rules.[5] This Article seeks to provide a framework for understanding and assessing the shift from ex ante to ex post and from principles to rules.

In theory, rules or principles can be either specified in advance or applied after-the-fact, and can be applied both by private or public means. For example, either a regulator or private party might favor principles that are established early and then adjudicated later. Alternatively, a regulator or private party might favor principles that are established later, only after a dispute occurs. Likewise, a regulatory approach might specify rules in advance of a transaction, or it might do so later on in the event of a dispute. In a dispute involving either principles or rules, the ex post adjudicator might be private or public: either an arbitrator or a judge.

The complexity of modern markets has led to the proliferation of ex ante rules, which purport to provide greater certainty to regulators and market participants.[6] In some cases, that certainty is important and welcome. In other cases, it has deleterious consequences. The proliferation of rules raises numerous policy questions, including whether financial markets would be better served by greater regulatory uncertainty. Market participants, then, would be less able to calculate the expected benefits and costs of complying with regulation based on anticipated probabilities and magnitudes.

4. *See* Douglas Arner, Professor, Univ. of Hong Kong Dep't of Law, Remarks at the Fifth Annual Berle Symposium, *The Purpose and Nature of Financial Regulation* (May 13, 2013) (transcript available at Seattle University School of Law Library). Of course, the public civil enforcement role is arguably more significant and influential outside the United States, particularly in Australia.

5. *See* Frank Partnoy & Lynn E. Turner, *Bring Transparency to Off-Balance Sheet Accounting*, (Roosevelt Inst. White Paper, Mar. 2010), *available at* http://www.rooseveltinstitute.org/sites/all/files/Off-Balance%20Sheet%20Transactions.pdf; http://www.rooseveltinstitute.org/policy-and-ideas/ideas-database/bring-transparency-balance-sheet-accounting.

6. In many prominent cases, this certainty is illusory. As of September 3, 2013, 280 of the rulemaking deadlines under the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 had passed, yet there were final rules in place for only 108 (39%) of those items. *See Dodd–Frank Progress Report*, DAVIS POLK (Sept. 3, 2013), http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/; *see also Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Pending Action*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml (last visited Sept. 3, 2013).

This Article does not seek to comprehensively answer the central questions about the optimal regulatory approach in financial markets, but instead, it poses a new way to ask those questions. For example, might ex ante principles act as an information-forcing mechanism and create incentives for private actors to internalize the costs of their behavior? Might the twin pillars of securities law—disclosure and enforcement—be better supported by a less certain regulatory approach that specifies broad principles ex ante, and then provides for adjudication of compliance ex post? Might there be advantages to simply banning "proprietary trading" as a general principle and then leaving the specific definitional challenges and issues for adjudicators to resolve and formulate in future disputes, instead of attempting to specify the categories of permitted activity ex ante in a rules-based approach such as the Volcker Rule?[7] Should parties be permitted to avoid fraud-related claims by including broad non-reliance provisions in contracts? Should judges scrutinize disclaimers based on the actions of a party with superior information or sophistication?

These are difficult questions, but they can be made more tractable by framing them in terms of the timing and the source of the relevant legal rules and principles. The goal here is to provide an analytic model to assess crucial aspects of these questions by focusing on the different types of ex ante and ex post regulatory approaches, and the relative advantages and disadvantages of each in modern, complex financial markets. The normative conclusions of this Article will necessarily be tentative, but my suggestion is that in many cases, there is wisdom in the historical approach based on after-the-fact assessment. Thus, regulators and policy makers might benefit from considering the advantages of moving away from ex ante regulation in the direction of ex post adjudication.

II. THE TIMING AND SOURCE OF LEGAL RULES AND PRINCIPLES

The 2x2 diagram below illustrates the analytic structure offered here and the four polar approaches to regulation. Essentially, the four divisions are based on answers to two questions. First, how much regulatory substance should be specified upfront, before or at the time of a

7. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, § 619.

transaction, as opposed to in the future? Second, who should do the specifying? In other words, what is the timing and source of regulation?

	Ex Ante	Ex Post
Private	Contract	Arbitration
Public	Regulation	Adjudication

The Article's positive claim is that regulation can be situated in, evolved along, or moved toward four different paths, depending on the timing and source of applicable legal rules. The applicable legal rules can be generated either ex ante or ex post, from entities that are either public or private.

A. Contract

The upper left quadrant—"Contract"—houses regulation that is specified in advance by private actors. This form of private "regulation" is increasingly prevalent. For example, one notable use of such private ordering in the financial markets is in over-the-counter derivatives, where hundreds of trillions of dollars of notional value of transactions are governed by documents created by the International Swaps and Derivatives Association, a trade group known as "ISDA." U.S. corporate law also generally allows for extensive private ordering through ex ante specification of default rules.

Private ordering through contract has obvious benefits, particularly when market participants are engaged in repeat play and there are reputational consequences to breaches. Ex ante contract rules are most likely to be optimal when transaction and agency costs are low, when there is parity of information and sophistication between counterparties, and when the expected costs of market failures (particularly externalities and moral hazard) are minimal. Private ordering is less likely to be optimal when these conditions do not exist.

Private actors can gather the capacity to specify ex ante rules through lobbying and influencing regulators and legislators. Thus, private contract does not necessarily become a libertarian regime. Parties specifying legal rules can enjoy oligopolistic advantages due to being a first mover, such as barriers to entry or explicit exercise of market power. Both ex ante rules and principles are potentially subject to such influence. Private parties often have an information or sophistication advantage over public entities and are potentially more nimble and flexible. As a result, private ordering can better reflect private preferences, especially when large institutions are contracting with each other and there is repeat play.

B. Arbitration

The upper right quadrant—"Arbitration"—involves the assessment of parties' conduct after the fact, typically based on generalized principles. For example, broker–client disputes are perhaps the most prominent example of this form of regulation. Perhaps U.S. corporate law might ultimately permit corporations to opt for arbitration in their bylaws, charters, or both. Interestingly, ISDA documentation typically specifies that disputes involving over-the-counter derivatives will be resolved in federal court in New York or under British law in London, but not through arbitration.

Private arbitration can provide for helpful assessment of parties' conduct after-the-fact, typically based on generalized principles. Arbitration is especially useful when parties have not specified contingencies ex ante or when they have done so but in an ambiguous manner. As with contract, arbitration can be subject to various forms of influence and market failure, including asymmetries in sophistication and information.

Moreover, arbitration typically does not generate the benefits of precedent more generally associated with common law. Instead, disputes and results typically remain private and are therefore less useful to parties anticipating or engaged in future disputes. The result can be inconsistent application of ex ante principles and disparate results. Of course, the same problems can be true of public adjudication by judges, but at least there is a public record of judicial decision making.

C. Regulation

The lower left quadrant, labeled "Regulation," includes most modern financial and securities regulation. This body of legal rules has grown in recent years, as Congress and federal regulators have specified numerous detailed rules for disclosure, conduct, capital requirements, and other substantive decisions and actions. The increasing specification of legal rules ex ante has created opportunities and incentives for regulatory arbitrage,[8] particularly in areas related to tax, accounting, and credit ratings. It has also created "regulatory licenses," entitlements that enable oligopolistic private actors to influence and determine compliance with regulation.[9]

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8. *See* Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010); *see also* Jordan Barry, *On Regulatory Arbitrage*, 89 TEX. L. REV. 69 (2011); Frank Partnoy, *Financial Derivatives and the Costs of Regulatory Arbitrage*, 22 J. CORP. L. 211 (1997).

9. I used the term "regulatory license" in Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L. Q. 619 (1999). Credit

Public regulation has potential benefits that are not generated by private contract. In theory, regulation can address market failures that private ordering cannot. However, regulators are subject to capture, and the public choice literature has demonstrated how regulation can favor particular groups instead of benefiting society overall. To some extent regulatory arbitrage is helpful in identifying rules that might be too costly to justify their benefits. Yet regulatory arbitrage also can generate inefficiencies, reduce transparency, and help private actors, whose public benefits exceed its private costs, avoid regulation. Regulatory licenses have the potential to assist regulators who are unable to police or understand financial markets on their own, but they introduce distortions and over reliance, both of which can lead to serious problems (and were arguably at the center of the recent financial crisis). Much modern financial regulation incentivizes regulatory arbitrage and creates regulatory licenses.

D. Adjudication

Meanwhile, the lower right quadrant, labeled "Adjudication," has grown smaller, particularly in the most complex parts of the financial markets. This decrease in adjudication exists even while it remains prominent in other areas of corporate and securities regulation where, perhaps not coincidentally, the legal principles and rules are less certain. These areas include insider trading, deal litigation, "plain vanilla" securities class actions, and, periodically, scandal-related litigation (e.g., options backdating and subprime-related fraud).[10]

Adjudication can fill gaps left by contract and regulation. In addition, adjudication can potentially fill the gaps in a more complete and public manner than arbitration can. Through adjudication, courts can address financial scandals and disputes in public ways that can both deter future abuse and create a framework for a new generation of private ordering. Likewise, adjudication allows courts to scrutinize prosecutions and settlements, thereby influencing not only private conduct but also regulator and prosecutor behavior.[11]

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rating-dependent regulation has been one of the most prominent recent examples of regulatory licenses.

10. For example, in *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007), the Delaware Chancery Court forcefully maintained that the Delaware courts would be an adequate and desirable venue for assessing stock option backdating disputes, finding that the directors faced a substantial likelihood of liability for their roles related to backdating.

11. Judge Rakoff's rejection of the Securities and Exchange Commission settlement in the *Citigroup* litigation was a prominent example. *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

Nonetheless, the use of adjudication has declined because it is expensive and courts face scarce resources. Moreover, existing adjudication has become less useful because the body of cases addressing particular issues is so narrowly targeted and specialized that on-point precedents relevant to complex financial transactions can be unavailable. To some extent, uncertainty can be addressed by more sophisticated judicial reasoning. However, it is difficult to draw connections between disparate areas of finance, even for the most financially sophisticated judges.[12]

Overall, the above 2x2 diagram can be used to consider different types of financial regulation and, more generally, to assess the source and timing of legal rules and principles. However, most regulation is not isolated within one of the four quadrants. Instead, it is a blend of one or more aspects of ex ante/ex post timing and public/private sourcing. For example, securities exchange-based regulation is primarily in the lower left quadrant, but elements of some rules—such as the independence requirements of directors—are necessarily assessed ex post. Conversely, although broker-dealer regulation is primarily in the upper right quadrant, some basic requirements are specified in advance. Nonetheless, although the lines are blurred, the polar modes of regulation are useful for analytic purposes.

One question raised by the shift in some areas of financial regulation from ex post to ex ante specification and from public to private is determining the optimal degree of regulation certainty. Some private actors—particularly large financial institutions—benefit from certainty and seek the detailed specification in ex ante rules through lobbying. Conversely, other market participants—such as less sophisticated investors—benefit from uncertainty and prefer vague notions of fiduciary duty or fraud that can be enforced ex post.

The classic elements of securities laws already have a degree of uncertainty built into them through the ex post enforcement of broad, open-ended principles such as the general prohibition of fraud. Disclosure requirements and materiality are examples, as is securities fraud, where

12. For example, even judges in Delaware have struggled to articulate standards for boards of directors and the management of business risk. *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009); *In re* Goldman Sachs Grp., Inc. S'holder Litig., No. 5215-VCG, 2011 WL 4826104 (Del. Ch. Oct. 12, 2011). It remains an open question whether courts should decide disputes involving business risk under different standards or whether judges will view cases involving complex financial products as analogous to cases involving business risk. Oliver Wendell Holmes famously told the story of a Vermont justice of the peace who, after considering a suit brought by one farmer against another for breaking a churn, ruled for the defendant because he had looked through the statutes and could not find anything about churns.

uncertainty is common.[13] The question is whether the costs of uncertainty are outweighed by the benefits of deterrence. Specifically, are market participants reasonably well situated to understand what "core conduct" will be prohibited ex post and therefore avoid straying too close ex ante? The answer depends on assumptions about the social value of deterred transactions. For example, one might accept the deterrence of transactions that fall into the gray areas of insider trading, but not the deterrence of structure finance activities that fall into the gray areas of suitability. The effects of uncertainty vary in the context of complex modern financial practice. The next Part considers the application of the timing versus source rubric in the context of financial innovation.

III. Application to Financial Innovation

To illustrate the application of this analytical model to particular areas of regulation, this Part briefly considers the regulation of selling complex financial products, including derivatives. Financial intermediaries divide such transactions into two categories: counterparty transactions and client transactions.[14] Counterparty transactions include over-the-counter derivatives transactions and other privately negotiated transactions. Banks generally refer to a wide range of such transactions as "market-making," varying from traditional market-making activities, such as stock trading, to newer activities, such as credit default swaps and collateralized debt obligations.[15]

Over time, the rights and obligations of parties to such transactions have moved from ex post public adjudication based on principles to ex ante specification of rules by private organizations.[16] Financial institutions, particularly banks and investment banks, negotiated and lobbied for this shift away from ex post facto adjudication; likewise, in recent

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13. For example, the uncertain regulation of insider trading includes questions such as, "Was there a fiduciary duty breach?" or "what constitutes a benefit to a tipper?" There are no specific ex ante rules that suggest answers to such questions; instead, courts adjudicate the questions ex post. *See* ALAN PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH, ch. 25 (2010).

14. *See* GOLDMAN SACHS BUSINESS PRINCIPLES AND STANDARDS COMMITTEE REPORT (2010), *available at* http://www.goldmansachs.com/who-we-are/business-standards/committee-report/business-standards-committee-report.html.

15. For example, one might ask whether the Abacus collateralized debt obligation transaction was more analogous to the sale of financial instruments or to market-making.

16. *See* EDWARD SWAN, BUILDING THE GLOBAL MARKET: A 4000 YEAR HISTORY OF DERIVATIVES (2000). Early derivatives were privately negotiated contracts not covered by any specific regulatory regime in which the parties would expect to be able to enforce obligations through contract-related litigation, if at all.

years, financial institutions also have explicitly lobbied against and rejected both private adjudication and public ex ante rulemaking.[17]

Today, the over-the-counter derivatives markets—the largest markets in the world, financial or otherwise—are dominated by private legal rules, typically specified in one or more standard form documents. In this context, the most common source of private ex ante rules are the derivatives documents provided by the ISDA. The primary membership of ISDA is composed of the major derivatives dealers, whose officers dominate the officer and director positions within the ISDA.[18] Derivatives "end-users" are not permitted to vote or to serve as officers or directors. Historically, ISDA has been an effective advocate for its dealer client base and has been less sensitive to end-users.[19]

The core document used by most derivatives market participants to document and govern their transactions is the ISDA Master Agreement (ISDA Master). The ISDA Master contains a brief description of the most basic boilerplate terms governing the relationship between two derivatives counterparties; it is rarely subject to extensive negotiation. In addition to the ISDA Master, the counterparties also typically enter into an ISDA Schedule Agreement (ISDA Schedule), which specifies more detail about their particular relationship. The ISDA Master and ISDA Schedule are roughly comparable to a corporation's articles and bylaws, respectively. Then, for individual transactions, the parties typically sign a Confirmation, a third document that specifies the terms of a particular derivative transaction. In the corporate context, a Confirmation is roughly analogous to a contract or the minutes from a board meeting approving a contract.

Interestingly, ISDA documents typically do not provide for arbitration. In fact, the standard 1992 ISDA Master form does not contain an arbitration clause. Instead, section 11(b) of the agreement provides that each party submits irrevocably to the jurisdiction of the appropriate courts (English courts or federal courts in the Southern District of New York).

One reason ISDA agreements do not provide for arbitration is because suitability, or "know your customer," requirements apply in arbitration. Although ISDA documents include non-reliance disclaimers that

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17. The most prominent example involved the negotiations that led to the passage of the Commodity Futures Modernization Act of 2000 at the end of the Clinton Administration.

18. *Board of Directors*, ISDA, http://www2.isda.org/about-isda/board-of-directors/ (last visited Oct. 23, 2013).

19. *See* FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS 44–45, 140–50 (Public Affairs, 2009).

purport to preclude application of suitability rules in arbitration, derivatives market participants might nevertheless prefer court to arbitration if they perceive that judges (who are bound by the securities laws and rules of contract) are more likely to enforce those disclaimers than arbitrators (who are bound by Financial Industry Regulatory Authority rules).[20] An interesting question is to what extent the counterparty versus client distinction should matter in adjudicating suitability. Specifically, should an ex ante agreed-upon classification by the parties affect whether the arbitration or adjudication quadrant is the appropriate form of regulation?

Like many financial contracts, ISDA documentation includes numerous private legal rules, such as the various representations and warranties of parties and the mechanisms for calculating payments owed following credit events or default. Private parties can use the privatization of legal rules strategically based on information or sophistication asymmetry, or potentially in ways that generate externalities. They can lobby for rules that benefit ISDA members but disadvantage other private parties. For example, ISDA has successfully lobbied for legislation and regulatory opinions in numerous nations confirming the enforceability of certain provisions. These nations have given a range of assurances that they will enforce ISDA documents and language, including favorable protection for over-the-counter derivatives in bankruptcy, such as enforceable netting and settlement outside the reach of the automatic stay.

This favorable bankruptcy treatment of swaps is controversial, raising many questions.[21] How should regulators address pressure between ex ante private specification and ex post public adjudication? For example, what kinds of duties do counterparties to sophisticated financial contracts owe to each other? How should judges interpret a clause specifying

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20. Historically, arbitration rules included a suitability principle, even in disputes involving sophisticated financial parties and contracts. For example, NASD Rule of Fair Practice 2310(a), promulgated pursuant to Section 15A of the Exchange Act, provided:

> In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for each customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

FINRA Rule 2310(a) (repealed 2010), *available at* http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=9859. This NASD suitability rule applies to institutions, as well as to individuals, and historically, the vast majority of institutional end-users assumed that derivatives dealers are subject to a suitability obligation. *See* Partnoy, *supra* note 3. The application of suitability principles today is less clear.

21. Stephen J. Lubben, *Derivatives and Bankruptcy: The Flawed Case for Special Treatment*, 12 U. PA. J. BUS. L. 61 (2009).

that there are no such duties or that they are minimal? Obviously, judges will show deference to the parties' specifications in private agreements, but should that deference be absolute?

At some point, a judge might find that a duty arises based on evidence of a substantial information or sophistication gap between the parties, especially if such a gap generated a degree of trust in the relationship. Likewise, an adjudicator might find that at some point a contract is so one-sided that it takes on adhesion-like qualities, particularly if it is a standard form contract not subject to negotiation.

For many transactions, the existing contract language might provide a basis for an adjudicator to find that the more sophisticated party has undertaken duties to the less sophisticated party. Even one-sided agreements include basic trust-related representations, and both parties presumably assumed that such representations are enforceable. More generally, parties expect that a duty of good faith and fair dealing will govern their activities.

With respect to suitability, the key issue is the relative bargaining power of the parties—not the absolute sophistication level of the less sophisticated party. Relative bargaining power matters to the question of whether a standard-form contract term is actually an agreed-to part of a particular contract. If a term is not agreed upon, judicial creation of protective default rules can contribute to market efficiency. Absent these rules, parties with substantial information or sophistication disadvantages will exit, just as many end-users did from certain segments of the derivatives markets in the mid-1990s. Interestingly, when end-users began recovering substantial settlements related to those 1990s transactions, those settlements created de facto default rules, or at least "default principles," which encouraged end-users to reenter the markets. A similar result might follow from recent post-financial crisis settlements against banks. However, those disputes are ongoing, and it remains unclear whether they will be sufficiently broad to lead investors back into complex transactions based on subprime mortgages.

One explanation for ISDA's dominance is that ISDA is simply more efficient than other rule providers and that the economies of providing standard-form contracts naturally will lead to a single provider. However, although standard-form derivatives documentation can be cost reducing, there are some reasons to believe that ISDA's virtual monopoly on the creation of legal rules might itself be problematic. For instance, ISDA's first-mover advantage has created a substantial barrier to entry for any competing provider. In addition, ISDA dealer members exercise market power in creating legal rules. This market power is another example of a market failure that might lead regulators to be skeptical of ex ante rules-based contractual approaches and to implement an ex post principles-based adjudication instead.

In general, privately sourced regulation is double-edged. On one hand, it is likely to be more informed than it might otherwise be. On the other hand, privately sourced regulation is likely to be less equitable and balanced, and to favor derivatives dealers over end-users. Parties to financial contracts frequently value certainty and accordingly try to specify as many contingencies as possible in advance. Bond contracts, venture capital term sheets, and merger agreements are examples of specifying contingencies. The ex ante specifications in such contracts often evolve into standard-form documents, in which many terms generally become standard and are not negotiated. Even the corporation, in the view of some scholars, has been primarily a private "nexus of contracts" among various participants, including shareholders and stakeholders (though much of corporate law involves the assessment of ambiguities and gaps in the ex ante specifications). In sum, issues of timing and source of legal rules are raised in numerous business contexts.

IV. CONCLUSION

This Article has set forth an analytic model for assessing the timing and source of regulation. It is meant to be a simple, straightforward "idea" article, not to resolve the questions about the relative advantages of each regulatory quadrant.

The central idea of the model is that one can distinguish regulatory regimes by asking two questions: First, what is the timing of the specification of the rules or principles at issue? Are they specified ex ante or ex post? Second, what is the source of the rules or principles? Are they public or private? The answers to these questions suggest four categories of regulatory regime: contract, arbitration, regulation, and adjudication. The model does not dictate which regime might be optimal in a particular setting; however, it can be used to distinguish among regimes and to trace how regimes might change over time.

As regulatory challenges spread throughout the world, including to Asia, this timing-source model might be useful to policy makers and market participants trying to assess optimal regulation. There are advantages and disadvantages to each quadrant, and the normative consequences of a shift from ex post adjudication to ex ante contractual private ordering remain unclear. Nevertheless, the argument here is that understanding such a shift is preferable to simply ignoring it.