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***Coincidentia oppositorum: Hybrid Networks Beyond Contract and Organization***

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**I. The Impossible Necessity of Sociological Jurisprudence**

'Network is not a legal concept'.<sup>1</sup> If Richard Buxbaum's apodictic judgement is true, then lawyers have little to say about networks. Should they wish to make appropriate judgments when business networks, franchising arrangements, just-in-time-systems, or virtual enterprises do cross their paths, then they must consult social scientists, such as economists, organizational theorists and sociologists. For better or for worse, they must engage in law in action and in sociological jurisprudence.

Lawrence Friedman would agree with such a realist approach. Already in his first major monograph on Contract Law<sup>2</sup> he explored the law in action rather than the law in the books.<sup>3</sup> In his later works<sup>4</sup> he demonstrated the responsiveness of the legal order to the manifold forces of economic, technological, and social change. In Friedman's perspective, the legal system functions largely as a dependent variable, with lawmakers responding to underlying developments in science, medicine, technology, economic organization, and shifting moral beliefs. In his recent book on "American Law in the Twentieth Century" he states his case quite clearly: "The main theme of this book is that law is a product of society."<sup>5</sup>

Yet, 'sociological jurisprudence' is a pipe dream. After a heated debate for almost a century lawyers know that logically-speaking, it is an oxymoron - like a white raven. Practically-speaking, it necessarily falters in the face of the normative closure of the legal system. This is a lesson we are correctly taught, not only by traditional doctrine and by Max Weber's theory of formal legal rationality, but also by advanced systems theory.<sup>6</sup>

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<sup>1</sup> Buxbaum, Richard (1993) "Is 'Network' a Legal Concept?", 149 *Journal of Institutional and Theoretical Economics*, 698, 704.

<sup>2</sup> (1965) *Contract Law in America: A Social and Economic Case Study*. Madison: University of Wisconsin Press.

<sup>3</sup> In his own words, "The working rules of contract are not necessarily the rules the casebooks talk about ... . Business cannot go on without contracts; but it also cannot go on without trust, understanding, and common sense. The real world of contractual behavior was far more complex than the lawbooks suggested.": Friedman, Lawrence (2002) *American Law in the Twentieth Century*. New Haven: Yale University Press, 385.

<sup>4</sup> E.g. (1985) *Total Justice*. New York: Russell Sage Foundation; (1990) *The Republic of Choice: Law, Authority And Culture*. Cambridge: Harvard University Press; and (1999) *The Horizontal Society*. New Haven: Yale University Press.

<sup>5</sup> (2002) New Haven: Yale University Press, 517.

<sup>6</sup> For legal doctrine, e.g. Pawlowski, Hans-Martin (1999) *Methodenlehre für Juristen: Theorie der Norm und des Gesetzes. Ein Lehrbuch*. Heidelberg: C.F. Müller, 74ff.; for formal legal rationality, Weber, Max (1978) *Economy and Society*. Berkeley: University of California Press, 85f.; for contemporary systems theory, Luhmann, Niklas (2004) *Law as a Social System*. Oxford: Oxford University Press, Ch. 2.

However, Friedman always remained sceptic with regard to formal rationality and the autonomy of the legal system: "...my view, in brief, is that formal legal argument as such probably does not make much of a difference in the world. ... I suspect that there was much less formal rationality, in fact, in the nineteenth century, in Germany and elsewhere, than Weber thought. He may have confused style with substance ... It seems perfectly obvious that social context determines what legal arguments will be used and which ones will strike judges and others as persuasive."<sup>7</sup> And: "Perhaps law has a life of its own; but if so it is a very limited life. Law certainly has its own language. It has its customs and rituals. Every case ... presented a legal issue; each one came wrapped in a cloak of technicality, the lawyer's own special ropes, strings, and bits of glue. But every case - and every statute, every administrative rule - also had a context, a background. And it is the background which made the problem seem like a problem in the first place - defined it, constructed it - and in the end, help dictate, or influence, the way the system solved it (or failed to solve it)."<sup>8</sup> However, Friedman does not believe in going for history, sociology, or economics of law to look for right answers. His legal heroes are neither supreme court judges and their formal legal arguments, nor theoretical or empirical neighbouring sciences as such. Friedman suggests to look for the societal conflicts and struggles, his heroes are the individuals who advance these struggles to the courts and thereby change the legal system.

Against this background, I seek to support and simultaneously to undermine the claim for legal autonomy through concrete example. My concrete observations are about new network phenomena, how they irritate the courts and provoke the judges to juridical adventures. I will raise the question of whether restrictions in the two common ways in which the law observes its social environment—judicial and legislative reality reconstructions—systematically preclude an adequate treatment of such new social phenomena. Does the law indeed need a third mode of observing so-called 'social reality'? Business co-operation networks provide an example for the observation that this third approach cannot simply be secured through the social sciences, but is instead wholly dependent upon a unique combination of legal doctrine and reflexive social practices. I describe this 'third way' as an effort to irritate the legal system selectively with particular demands from its social environment. I still call it sociological jurisprudence, although, and rather because, this is the same form of *necessary* pipe-dream that is represented by a 'legal policy analysis', or by 'legal economics'. Trying to take a couple of paces along this impossible but necessary third way, I shall demonstrate how the legal qualification of networks, in particular their legal conditions and their legal consequences, can be tackled through confrontation with non-legal social reality constructs.

*Thesis 1:* It is a scientific misconception of the law to believe that empirical results or theoretical insights from the social science can guide law to any significant degree. The decisive legal irritations are not supplied by interdisciplinary contact with social science disciplines *stricto sensu*, but with normatively-loaded 'reflexive practices' in various social fields. *My example:* the dramatic extension of liability throughout network systems is a judicial reaction to social perceptions of the risks posed by economic networks.

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<sup>7</sup> Friedman, Lawrence (1999) "Taking Law And Society Seriously", 74 *Chicago-Kent Law Review*, 529, 532 f.

<sup>8</sup> (2002) *American Law in the Twentieth Century*. New Haven: Yale University Press, 517.

*Thesis 2:* The ‘translation’ of reflexive social practices into legal doctrine is not a direct knowledge transfer from the social to the legal. Private law doctrine can only be persuaded to develop conceptual innovations by its own, internal, path-dependent evolutionary logic. *My example:* Network is not a legal concept. It is a social construct and its legal complement can only be reconstructed within the law, possibly by developing ‘relational contract’ into ‘connected contracts’ (*Vertragsverbund*).

*Thesis 3:* It is one of the most important achievements of sociological jurisprudence that it has been able to support law’s contribution to the problem of how to deal with paradoxes within social practice. *My example:* Networks emerge when actors are confronted by their environment with paradoxical demands. Law reacts to such network paradoxes with a new legal concept of ‘double-attribution’.

## **II. Piercing the Contractual Veil in Distribution Networks: Three Levels of Legal Reality Construction**

A Japanese car importer built up a dealer distribution system in Germany. The importer had only succeeded in gaining German market entry relatively late in the day and had difficulties in finding responsible dealers. As a consequence, the importer’s marketing efforts were reliant upon working relationships with dealers whose business credentials and solvency were not immediately apparent. The contracts stipulated that vehicles would remain the property of the importer up until full payment of the sales price. A customer took possession of a vehicle from a dealer, paying an initial installment on the sales price. The customer was given the vehicle, keys and road license, but not ownership papers since, according to the distribution contracts, these remained in trust until the full payment of the sales price. Under pressure from the dealer and his incorrect claim that full payment was necessary for the internal sales completion, the customer paid the remainder of the sales price, without, however, receiving the vehicle’s ownership papers. On the insolvency of the dealer, the importer demanded the return of the vehicle from the customer. The customer then claimed that the importer, as the central actor within the distribution system, was liable for the failure of the direct dealer to fulfil his legal obligations.

In a courageous judgment, the Karlsruhe Appeals Court (*Oberlandesgericht*), departed radically from contractual privity, a fundamental principle of German private law.<sup>9</sup> By “piercing the contractual veil”, the Court made the network center directly liable, although there was no contractual link between customer and center whatsoever. The Court first confirmed the importer’s demand for the return of property<sup>10</sup> and then rejected the customer’s claim to the receipt of property in good faith on the basis that the customer’s naiveté constituted gross negligence.<sup>11</sup> Employing a daring sleight of hand, however, they then allowed a compensation claim against the importer. The Court finally decided in favor of direct liability of the central distribution node, holding the importer responsible for the dealer’s breach of legal obligations, notwithstanding the latter’s independence.

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<sup>9</sup> OLG Karlsruhe (1989), 2 *Neue Zeitschrift für Verkehrsrecht*, 434.

<sup>10</sup> § 985 of the German Civil Code (BGB).

<sup>11</sup> § 932(II) BGB and § 366 of the German Commercial Code (HGB).

The grounds for this decision, however, are highly unconvincing. The Judgment is an explosive mix of German law's principles of organizational responsibility, of directors' liability and of *respondeat superior* for the acts of individual agents. The quality of the Judgment still does not improve, however, even if we make a clear distinction between the various grounds for liability. Either the Court should have fundamentally changed at least one of these principles, explicitly distinguishing it from previous precedent, or, it should have rejected piercing the contractual veil. Currently, precedent in German law would refute the Court's finding that the construction of a business network with dealers of a dubious character constitutes organizational liability.<sup>12</sup> To date, organizational liability has only been applicable to authentic legal persons. Its extension to other group phenomena remains in any case anchored in the law of associations, and thus organizational liability has no application to simple contractual relationships.<sup>13</sup> By the same token, in such a case, breach of directors' liability is precluded by the conditions of the delictual general clause.<sup>14</sup> Equally, the escape hatch of *respondeat superior* is closed since independent enterprises simply do not qualify as "agents" in tort law.<sup>15</sup> In view of these problems, it is little wonder that the Appeal Court cooked up a strange mixture of these three liability forms and thus neatly evaded the question of whether and, if yes, how it wished to overrule precedent by piercing the contractual veil of a business network which is made up by bipolar contracts.

'The soundest judgment with the dullest opinion' - is the Judgment best summed up by this cruel phrase? Certainly, the result is plausible and the justification weak. However, the Judgment is not simply wrong. Rather, the Court was called upon to tackle phenomena that cannot be addressed within the concepts of contract and tort—the network phenomenon. In the last decades, a massive increase in contractual networks has confronted the law with the troublesome implications of an evolutionary trend, which it cannot as whole decode using its own analytical tools. Independent business units commit themselves to closely interconnected cooperation networks and undermine thereby the distinction between market and hierarchy and the distinction between contract, torts and corporation. Were distribution systems organized under the law of corporations and labor law, we would still be confronted by the liability problem, but this would no longer be an issue of piercing liability, neither would it violate the principle of contractual privity. The dealer's behavior would simply be imputed to the manufacturer/primary dealer, according to established rules of principal/agent law,<sup>16</sup> on the basis of the contractual obligations of the corporation. By contrast, were the distribution organized between independent business units in a competitive market, then relationships with the external partners of the distribution system could not give rise to piercing liability. In conclusion then, establishing a network between independent enterprises causes judicial irritation. An integrated distribution system which, on the one hand, entails more than simple market relationships, but, on the other, does not create any true

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<sup>12</sup> § 31 BGB. Cf. Heinrichs, Helmut (2003) in Palandt, Otto: *Bürgerliches Gesetzbuch*, 62<sup>nd</sup> ed. München: Beck Verlag, § 31, 3.

<sup>13</sup> Roth, Herbert (1989) "Anmerkung zu OLG Karlsruhe", 2 *Neue Zeitschrift für Verkehrsrecht*, 435.

<sup>14</sup> § 823(I) BGB.

<sup>15</sup> § 831 BGB. Cf. Thomas, Heinz (2003) in Palandt (fn. 12) § 831, 8. Several authors urge the courts to overrule this old principle, Roth (fn. 13); Bräutigam, Peter (1994) *Deliktische Außenhaftung im Franchising*. Baden-Baden: Nomos Verlag, 130ff.; Pasderski, Edgar (1998) *Die Außenhaftung des Franchisegebers*. Aachen: Mainz Verlag, 174.

<sup>16</sup> § 278 BGB.

organizational relationships, forces the judges to pierce the contractual veil, but at the same time, causes them huge difficulties when they attempt to justify this decision.

'Judicial irritation' has a double significance.<sup>17</sup> Judges are irritated by networks and are provoked to respond to anomalies with piercing techniques that contradict the logic of their own system. In turn, judicial precedent on piercing irritates doctrine, which regards such seemingly equity-oriented *ad hoc* exceptions to privity of contract as a challenge to the workability of doctrinal concepts.<sup>18</sup> Is traditional doctrine in a position to qualify network phenomena such that simple equitable exceptions can be transformed into conceptually precise legal network rules? Or, is the only source of help here 'sociological jurisprudence'?

### **Approach 1: Casuistry**

Even the most detailed case law analysis has little if any help to offer. The blinkered reality perspectives of courtroom proceedings prevent an appropriate recognition of the trend to networking. Since the courts' reality construction is founded in two-party proceedings, it necessarily dissects the complex relationships, that multilateral networking establishes, into bilateral claims and counter-claims. Working from the viewpoint of plaintiff or defendant, this reality construction can only take limited note of the overarching conflicts and risks that networks entail. In this perspective, any doctrinal approach seeking to generalize from case law can only but reproduce the claim and counterclaim culture and conclude by just balancing out the interests of the two parties.

As a consequence then, doctrine should decisively free itself from systematically limited judicial models that can only react to the irritations of networks with individual equitable corrections. These models are not to be criticized for the manner in which they demarcate conflict: 'rather, the reality construction entails the recognition of only two contrasting spheres of influence, represented either by the plaintiff or by the defendant. In this manner, courtroom proceedings are projected into the social order such that points of legal reference are in turn identified within the social order'.<sup>19</sup> Such proceedings are fatal with regard to networks precisely because the latter are distinguished by their extra-positional effects.

### **Approach 2: Political Law-Making**

Similarly, following policy-oriented trends within legal doctrine, it is not enough simply to adopt the reality constructs that emerge from the legislative process. Such a perspective entails too ready an acceptance of the world views of practitioners, who

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<sup>17</sup> For a concise analysis of judicial irritation in franchise law, Joerges, Christian (1991) "Status and Contract in Franchising Law", in: *idem* (ed.) *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States*. Baden-Baden: Nomos Verlag, 11ff., 21ff.

<sup>18</sup> For comprehensive discussion of piercing the corporate veil, see, Rehbinder, Eckhard (1969) *Konzernaußenrecht und allgemeines Privatrecht: Eine rechtsvergleichende Untersuchung nach deutschem und amerikanischem Recht*. Bad Homburg: Gehlen Verlag, 69ff; *idem* (1997) "Neues zum Durchgriff unter besonderer Berücksichtigung der höchstrichterlichen Rechtsprechung", in: Assman, Heinz-Dieter (ed.) *Wirtschafts- und Medienrecht in der offenen Demokratie: Freundesgabe für Friedrich Kübler*, Heidelberg: C. F. Müller Verlag, 493, 496ff.

<sup>19</sup> Luhmann, Niklas (1965) *Grundrechte als Institution: Ein Beitrag zur politischen Soziologie*. Berlin: Duncker & Humblot Verlag, 206.

prepare and pre-structure legislation. This can only implicate law within the uncontrolled balancing of interests that takes place in opportunistic reaction to transient social pressures and political preferences. Similarly, it is not enough to adopt a 'legislative policies' perspective since this means to accept the reality constructs of political parties and national and European political institutions, who likewise alienate 'real' social conflicts through the filtering processes of power and consensus politics.<sup>20</sup> In network matters, legislative interventions are paradigmatic examples of political tunnel vision. European initiatives to free franchising from the strictures of competition law were selective responses to the highly effective lobbying activities of interest groups.<sup>21</sup> Similarly, in Germany, purchase money loans have been regulated, from the exclusive perspective of consumer protection, even though they also raise comparable regulatory problems in other contexts.<sup>22</sup> Were doctrine nothing but a systematic reproduction of interest groups' and legislators' policies, then it would only intensify existing inadequacies within the political reality constructs.

### **Approach 3: Reflexive Social Practices**

Legal doctrine will only make a genuine contribution to the law of networks, if and when it establishes, as opposed to case law and legislation, a 'third way' of approaching the reality of change in economic organization. Today, this is no longer possible through the 'silent power' of autonomous legal conceptualization. Instead, what is needed is an explicit 'structural coupling' of law with reflexive practices in different fields of society. All intensive co-operation notwithstanding, structural coupling does not merge social and legal practices, it ensures the autonomy of law.<sup>23</sup> At all costs, however, one must avoid, the scientific misconception, current within sociological jurisprudence and legal economics, that the law simply adopts social science conclusions.<sup>24</sup> This misconception is fed by the notion that the social sciences supply the empirical facts and the theoretical generalizations, from which follow the law's normative perspectives. Notwithstanding the significant role that scientific analysis may play in identifying the workings of networks, law needs to be far more concerned with normative orientations in society that neutral sciences are simply not in a position to provide. Such orientations can only be found in the normatively-loaded *dogma* within society; that is, in discourses in which social practices reflect upon their own self-perceptions. Legal doctrine itself, as well as the mother of all dogmas, theology, are organized as academic disciplines, but they are, of course, not social sciences in the strict sense. They represent social practices of law and religion reflecting upon themselves. The same holds true for other academic disciplines – at least for some of their subdisciplines –, such as business management, economics and political science, which do not as such form a part of the disinterested, value-neutral social-scientific search for truth. Instead, they are the manifestation of reflexive practices taking place in different social sectors. They make part of what David Sciulli calls "collegial formations", that is, the specific

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<sup>20</sup> Here one is drawn into the dilemmatic juridification of 'legislative policies', see, Steindorff, Ernst (1973), "Politik des Gesetzes als Auslegungsmasstab im Wirtschaftsrecht", in: Paulus, Gotthard (ed.) *Festschrift für Karl Larenz*. München: Beck Verlag, 217ff.

<sup>21</sup> Shapiro, Martin (1998) "Globalization and Freedom of Contract", in Scheiber, Harry (ed.) *The State and Freedom of Contract*. Stanford: Stanford University Press, 269-363, 285ff.

<sup>22</sup> For an extensive analysis, see Heermann, Peter (1998) *Drittfinanzierte Erwerbsgeschäfte: Entwicklung der Rechtsfigur des trilateralen Synallagmas auf der Grundlage deutscher und U.S.-amerikanischer Rechtsentwicklungen*. Tübingen: Mohr Siebeck Verlag, 98, 92ff.

<sup>23</sup> Cf., on the structural coupling of legal theory and social sciences, Luhmann (fn. 6) Ch. 11, VII.

<sup>24</sup> Posner, Richard (1987) "The Decline of Law as an Autonomous Discipline: 1982-1987", 100 *Harvard Law Review*, 761-780.

organizational forms of the professions and other norm-producing and deliberative institutions within society.<sup>25</sup> It is social practices in the worlds of business, economy and politics that each create their own self-descriptions, which in turn inform and guide the underlying social practices. At least, in each discipline, an internal distinction must be made between scientific discourse and reflexive social practice. In the case of law, legal theory as reflexive counterpart to legal practice needs to be distinguished from legal sociology as a social-scientific observation of law.<sup>26</sup> Similarly, in the other social sciences we need to distinguish between discourses taking part in social practices, and discourses taking part in scientific observation of those social practices.

What we are looking for then, is an autonomous legal reconstruction of normative social orientations; orientations that law can glean in its interchange with reflexive social practices. How do they perceive chances and risks of the network revolution? This gives us two advantages above the common scientific misconception. Reflexive social practice, in enjoyable contrast to the normative poverty of scientific analysis in its narrow sense, provides us with a plethora of normative perspectives—the famous *idées directrices* of social institutions, the normative expectations, social demands, political rights and utopian hopes of individual participants within them, as well as principles gained in political conflicts on the ground, principles that concern their overall social purposes and their contributions to different constituencies.<sup>27</sup> This is what social science in the strict sense could never produce, much less legal doctrine create from within itself. At the same time, however, the law, will, in juridifying partial social rationalities, enforce its own particularist-universal orientation above the particularist-universal orientations of other forms of reflexive practice. For example, when it comes to structural corruption, law needs to distance itself from the results of social practices. Sociological jurisprudence, currently cloaked in the mantle of scientific study, should thus in fact be identified as a specifically legal mode of dealing with the collision between different social rationalities.<sup>28</sup>

## 1. Business Studies

It is noteworthy that several legal studies on hybrid networks have now developed a heightened sensitivity for business studies - in our words, for a reflexive social practice that formulates the normative preconditions for business success. These legal forays across the borders have proved successful, since they have discovered opportunities and risks posed by hybrid networks, and have allowed this material to inform their legal solutions. Pioneering analyses of franchising made early detailed reference to business studies and established their legal concepts in close proximity

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<sup>25</sup> Sciulli, David (1992) *Theory of Societal Constitutionalism*. Cambridge: Cambridge University Press; idem (2001) *Corporate Power in Civil Society: An Application of Societal Constitutionalism*. New York: New York University Press.

<sup>26</sup> Luhmann (fn. 6) Ch. 1, 11.

<sup>27</sup> These are phenomena that normative sociology focuses on, particularly Fuller, Lon (1969) *The Morality of Law*. New Haven: Yale University Press; Selznick, Philip (1969) *Law, Society and Industrial Justice*, New York: Russell Sage; idem (1992) *The Moral Commonwealth: Social Theory and the Promise of Community*. Berkeley: University of California Press; Ewald, Francois (1986), *L'État providence*. Paris: Grasset; Friedland, Roger and Alford, Robert (1992) "Bringing Society Back In: Symbols, Practices, and Institutional Contradictions", in: DiMaggio, Paul and Powell, Walter (eds.) *The New Institutionalism*. Chicago: Chicago University Press, 232-263.

<sup>28</sup> For an elaboration, Teubner, Gunther (1997) "Altera Pars Audiatur: Law in the Collision of Discourses", in: Rawlings, Richard (ed.), *Law, Society and Economy*. Oxford: Clarendon, 149-176.

to the organizational demands of franchising systems.<sup>29</sup> The resulting legal typology maps interest conflicts into different types of franchising (subordination, coordination, coalition and federation), subjecting each type to a specific regulatory regime (relational contract, partnership and corporate groups). Risk analyses of new forms of 'systemic' dependence in just-in-time arrangements base themselves upon detailed organizational studies that have unveiled, in particular, the importance of computer based integration as compared to merely contractual or corporate dependence, and, via analogy of the law of corporate groups, have drawn legal consequences.<sup>30</sup>

## 2. Legal Economics

Indeed, reference to reflexive social practices in business management has been fruitful, especially where legal concepts of network phenomena need to be developed according to the motivation of actors. Nonetheless, if the task is one of reconstructing the network revolution in its relevance for economy and society as a whole, then the business perspective is far too narrow. Empirical business studies tend to focus only upon network effects on individual firms and fail to recognize general economic and social implications. Their normative viewpoint is similarly limited, since they concentrate upon efficiency, effectiveness and (occasionally) legitimacy of the individual network. This is far too restricted a basis for a legal appraisal of network opportunities and risks.

A step forward can be made here by taking into account reflexive theories of economic practice and, above all, ideas from transaction-cost theory, property rights theory and economic institutionalism. Certainly, such theories conceive of themselves not as reflexive social practices, but as integral part of the scientific-knowledge system. 'Pure' scientific theorems, however, devoid of all preconceptions, would never handicap themselves with normatively loaded concepts and orientations, such as the *homo oeconomicus* or 'economic efficiency'. Taking normative orientations, particularly, efficiency concerns, as their starting point, legal studies of money transfer systems and other networks in the private sector are seeking to analyze and come to terms with the innovative yet highly controversial category of a 'network contract'.<sup>31</sup> Other studies on symbiotic contracts, inspired by institutional economics, have successfully demonstrated the efficiency gains of networking and consequently advocate their legal institutionalization.<sup>32</sup> Economic studies on network effects and their various legal implications are similarly profitable.<sup>33</sup>

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<sup>29</sup> Martinek, Michael (1987) *Franchising: Grundlagen der zivil- und wettbewerbsrechtlichen Behandlung der vertraglichen Gruppenkooperation beim Absatz von Waren und Dienstleistungen*. Heidelberg: Decker & Schenck Verlag, 231ff.

<sup>30</sup> Nagel, Bernhard, Riess, Birgit and Theis, Gisela (1989) "Der faktische Just-in-Time-Konzern: Unternehmensübergreifende Rationalisierungskonzepte und Konzernrecht am Beispiel der Automobilindustrie", 42 *Der Betrieb*, 1505ff., 1506ff.; *idem* (1990) *Just-in-Time-Strategien: Arbeitsbeziehungen, Gestaltungspotentiale, Mitbestimmung*. Düsseldorf: Hans-Böckler-Stiftung.

<sup>31</sup> Möschel, Wernhard (1986) "Dogmatische Strukturen des bargeldlosen Zahlungsverkehrs", 186 *Archiv für die civilistische Praxis*, 211ff.; Rohe, Mathias (1998) *Netzverträge: Rechtsprobleme komplexer Vertragsverbindungen*. Tübingen: Mohr & Siebeck Verlag, 66ff., 81ff. and *passim*.

<sup>32</sup> Schanze, Erich (1991) "Symbiotic Contracts: Exploring Long-Term Agency Structures Between Contract and Corporation", in: Joerges, Christian (ed.) *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States*. Baden-Baden: Nomos, 67ff., 89ff.; *idem* (1993) "Symbiotic Arrangements", 149 *Journal of Institutional and Theoretical Economics*, 691ff.; Kirchner, Christian (1993) "Unternehmensorganisation und Vertragsnetz: Überlegungen zu den

### 3. Social Theory

However, if law is concerned with embedding business networks within their broader political and social context, it must engage in a legal reconstruction of sociological network theories.<sup>34</sup> If law is to develop 'socially-appropriate' legal concepts, the analysis of market-networks must be broadened to take into account reflexive practices of other social environments. We are concerned here, all cognitive hurdles notwithstanding, with legal reconstruction of the normativity inherent to social practice. As for networks, social theory informed legal forays into status-based and contractual relationships within franchising are particularly noteworthy, since they unveil the semi-autonomous status of network participants and attempt to give them legal security.<sup>35</sup> Studies of standard term contract regulation for just-in-time contracts, reveal the role which case law can play in the promotion of productive networks and in limiting institutional misuse.<sup>36</sup>

### III. Translation Problems: Networks as Connected Contracts

However, I repeat: "Network" is not a legal concept'. All joyous legal contact with reflexive social practices notwithstanding: legal arguments only begin where other reflexive theories end. The debate is on the appropriate form of regulation for business networks, virtual business, just-in-time systems, franchising chains and other co-operative contracts. They are generally established through bilateral contracts yet give rise to multilateral (legal) effects. Hybrid networks are remarkably disruptive social phenomena. They can neither be subsumed under the category of market, nor under the category of organization. Following long indecision, sociologists and economists have responded to this confusion with theories characterizing networks as autonomous institutions, very different from the usual forms of economic co-ordination.<sup>37</sup> How is law to respond, however? Should it, as

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rechtlichen Bedingungen zwischen Unternehmensorganisation und Vertragsnetz", in: Ott, Claus and Schäfer, Hans-Bernd (eds.) *Ökonomische Analyse des Unternehmensrechts*. Heidelberg: Physica, 196ff., 202ff.; *idem* (1996) "Symbiotic Arrangements as a Challenge to Antitrust", 152 *Journal of Institutional and Theoretical Economics*, 226ff.; *idem* (2000) "Horizontale japanische Unternehmensgruppen (keiretsu) im deutschen Konzernrecht", in: Baums, Theodor, Hopt, Klaus J. and Horn, Norbert (eds.) *Corporations, Capital Markets and Business in the Law: Liber Amicorum Richard M. Buxbaum*. London: Kluwer Law International, 339ff., 351ff.; for a fruitful legal-economic analysis of cooperation contracts, Kulms, Rainer (2000) *Schuldrechtliche Organisationsverträge in der Unternehmenskooperation*. Baden-Baden: Nomos Verlag, 55ff., 240ff.

<sup>33</sup> Lemley, Mark and McGowan, David (1998) "Legal Implications of Network Economic Effects", 86 *California Law Review*, 479ff.

<sup>34</sup> The social embedding of economic interchange is the objective of economic sociology, which has a closer empathy with the analytical interests of legal scholarship than do purely economic analyses. Representative, Smelser, Neil and Swedberg, Richard (eds.) (1994) *The Handbook of Economic Sociology*. Princeton: Princeton University Press.

<sup>35</sup> Joerges (fn. 17) 17ff.

<sup>36</sup> Casper, Steve (1995) "How Public Law Influences Decentralized Supplier Network Organization: The Case of BMW and Audi", *WZB-Discussion Paper FS I*, 95-314; *idem* (2001) "The Legal Framework for Corporate Governance: Explaining the Development of Contract Law in Germany and the United States", in: Hall, Peter and Soskice, David (eds.) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. Oxford: Oxford University Press, 387ff., 397ff.

<sup>37</sup> For an economic theory of networks most prominent, Williamson, Oliver (1985) *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: Free Press; *idem* (1991) "Comparative Economic Organization: The Analysis of Discrete Structural Alternatives", 36 *Administrative Science Quarterly*, 269ff.; *idem* (1996) *The Mechanisms of Governance*. Oxford: Oxford University Press. For a sociological theory of networks most prominent, Powell, Walter (1990)

innovation-friendly lawyers suggest, declare networks or symbiotic contract to be *sui generis* legal institutions sailing in the Bermuda-triangle between contracts, torts and corporations?<sup>38</sup>

In my opinion 'network' is not suited to play the role of a technical legal concept. Networks traverse private law concepts. Legally-speaking, they can take the form of corporate, contractual or tortious special relationships. For this reason alone, legal doctrine cannot simply adopt the term 'network' as a legal concept. Yet, the disciplinary barriers are even higher. Current ideas about knowledge transfer are misleading. Law cannot simply accept social structures of network at face value; for example, the social preconditions for intensive co-operation. Neither can it simply adopt particular elements within social science definitions, such as the economic formula 'hybrid between market and hierarchy', or the sociological formula 'trust-based exchange system'. Instead, it must itself re-construct anew the constitutive contours of the correlating legal definition out of its own path-dependent evolutionary logic.<sup>39</sup>

However, any attempt to subsume networks simply under traditional private law concepts is, making a long story short, doomed to failure.<sup>40</sup> First: company law is inappropriate for market networks, since pooling of resources and joint decision-making do not suit the decentralized network structure. Secondly: given the radical individualism of single nodes in networks, contract law is indeed the correct systematic arena but needs to be considerably transformed for the opportunities and risks of market networks. Thirdly: an independent legal category of a 'network contract', which is based on traditional law of agency, is not appropriate for the decision structure of business networks. It follows that doctrinal qualifications of networks need be based upon the development of an 'organizational contract law', - the law of 'controrgs' if you like - which recognizes their hybrid nature through the inclusion of 'organizational', i.e., not only relational but as well multi-lateral, elements within the contract.<sup>41</sup> Here, one needs to exploit the developmental logic of a rudimentary, but already established form of organizational contract law. In German law the notion of *Vertragsverbund* ('connected contracts'), has been developed - a doctrine that is ripe for further evolution in the network sphere.

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"Neither Market nor Hierarchy: Network Forms of Organization", 12 *Research in Organizational Behavior*, 295-336.

<sup>38</sup> For symbiotic contracts as a third institution between contract and organization, Schanze (fn. 32); Kirchner (fn. 32). For network contracts as an institution *sui generis*, Möschel (fn. 31), Rohe (fn. 31).

<sup>39</sup> See Amstutz, Marc (2003) "Vertragskollisionen: Fragmente für eine Lehre von der Vertragsverbindung", in: Amstutz, Marc (ed.) *Festschrift für Heinz Rey*. Zürich: Schulthess Verlag, 161-176, 164ff, for a particularly clear distinction between social system and legal system.

<sup>40</sup> For more details Teubner, Gunther (2004) *Netzwerk als Vertragsverbund: Virtuelle Unternehmen, Franchising, Just in Time in sozialwissenschaftlicher und juristischer Sicht*. Baden-Baden: Nomos Verlag, Ch. 2.

<sup>41</sup> For a special law of 'controrgs', i.e. an 'organizational contract law' for networks, see Teubner, Gunther (1991) "Beyond Contract and Organization? The External Liability of Franchising Systems in German Law", in: Joerges, Christian (ed.) *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States*. Baden-Baden: Nomos Verlag, 105-132, 129ff.; *idem* (1993) "Piercing the Contractual Veil: The Social Responsibility of Contractual Networks", in: Wilhelmson, Thomas (ed.) *Perspectives of Critical Contract Law*. Dartmouth: Aldershot, 211-240, 231ff.; *idem* (2002) "Hybrid Laws: Constitutionalizing Private Governance Networks", in: Kagan, Robert, Krygier, Martin and Winston, Kenneth (eds.) *Legality and Community: On the Intellectual Legacy of Philip Selznick*. Berkeley: Berkeley Public Policy Press, 311-331, 320ff.; *idem* (Fn. 40), Ch. 3.

To quote a doctrinal authority from Germany:

“The notion of connected contracts is used to describe any plurality of contracts which refer to each other within either bilateral or multilateral relationships, whose interconnection gives rise to direct legal effects (of a genetic, functional or conditional nature), whether these simply result in an effect of one contract to the other (or others), or whether one can also observe mutual effects.”<sup>42</sup>

It is the ‘economic unity’ of several bipolar contracts which is determinative for the connected contracts. However, this concept also entails a strange paradox that time and again gives rise to harsh critique of the entire construction: multiple contracts are directed to a single economic goal, which can only be achieved if all contracts are performed, but which is again also entirely dependent upon the legal independence of each of the contracts. Legally-speaking, this results in the strained formula that each and every contract is legally distinct but also builds an economic unity upon which the law can focus.

However, the critique that this is all quite arbitrary,<sup>43</sup> goes wrong. Instead, in order to understand the mystery of connected contract, we must make productive use of this ‘unbearable contradiction’. The undeniable contradiction found within the notion of the ‘economic unity of distinct contracts’ is not simply to be regarded as a yet to be corrected logical mistake within doctrinal reasoning, but is instead itself the exact juridical correlate of the social reality of hybrids, the bedrock for their productivity, and the source of those risks to which the law must find appropriate responses.<sup>44</sup>

#### **IV. The Role of Law in Social De-Paradoxification Processes**

This contradiction is absolutely central to networks. Private law must respond with sensitivity to the *coincidentia oppositorum* manifest within networks. The main thesis is as follows: certain economic developments expose actors to a ‘double-bind’ situation, which they react to with the aid of an internally contradictory network structure. The double-bind situation typical for networks arises where: (1) The social environment makes ambivalent, contradictory or paradoxical demands of business entities which they must respond to; (2) such demands are so central to business survival that they cannot be simply ignored, and (3), their explicit thematization is

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<sup>42</sup> Gernhuber, Joachim (1989) *Das Schuldverhältnis: Begründung und Änderung, Pflichten und Strukturen, Drittwirkungen*. Tübingen: Mohr & Siebeck, 710. Similar, Larenz, Karl and Wolf, Manfred (1997) *Allgemeiner Teil des Bürgerlichen Rechts*. 8<sup>th</sup> ed. München: Beck Verlag, 469f.; Esser, Josef and Schmidt, Eike (1995) *Schuldrecht: Ein Lehrbuch. Allgemeiner Teil I 1*. 8<sup>th</sup> ed. Heidelberg: Müller, 214.

<sup>43</sup> Wolf, Ernst (1978) *Lehrbuch des Schuldrechts. Zweiter Band: Besonderer Teil*. Köln: Heymanns, 62f.

<sup>44</sup> The relationship of network building to contradictory external demands made on business is the focus for many social science analyses, albeit dealing with different aspects of the problem: Cameron, Kim and Quinn, Robert (1988) “Organizational Paradox and Transformation”, in: Quinn, Robert and Cameron, Kim (eds.) *Paradox and Transformation: Towards a Theory of Change in Organization and Management*. Cambridge, Mass.: Ballinger, 1ff.; Buxbaum (fn. 1) 701; Funder, Maria (1999) *Paradoxien der Reorganisation*. München: Hampp; Sauer, Dieter and Lang, Christa (ed.) (1999) *Paradoxien der Innovation: Perspektiven sozialwissenschaftlicher Innovationsforschung*. Frankfurt: Campus; Luhmann, Niklas (2000) *Organisation und Entscheidung*. Opladen: Westdeutscher Verlag, 407ff.; Hirsch-Kreinsen, Hartmut (2002) “Unternehmensnetzwerke – revisited”, 31 *Zeitschrift für Soziologie*, 106-124, 107.

highly problematical.<sup>45</sup> The institutional answer to these problems is neither contract nor organization, but hybrid network, since this construct allows for the transformation of external incompatibilities into internally manageable contradictions. In turn, private law needs to respond in two ways with innovative doctrinal concepts: on the one hand, it normalizes and stabilizes network-specific contradictions; on the other, it combats various consequences of these contradictions.

In more detail: Hybrid constructions within the triangle of contract, organization and network, facilitate escape from the double-bind situation. They constitute institutional arrangements that make network logic, as opposed to simple contractual or organizational logic, resistant to contradictory social environmental demands. More precisely, hybrids react to paradoxical situations (in their broadest sense) that threaten the operational capacities of actors. They do so through their ambivalence (A is or is not A), their contradictory nature (A is not A) or their paradoxical character (A because not A).<sup>46</sup> Generally-speaking, there are two modes of escape from such imbroglios. The one is repressive, suppressing contradictions by admitting only one of the contradictory instructions and dismissing the other. The other is constructive, seeking to make paradoxes fruitful, to the degree that it establishes a more complex representation of the world. This is what is meant by 'morphogenesis', which Krippendorff suggested for dealing with paradox:

'Unless one is able to escape a paradoxical situation which is what Whitehead and Russell achieved with the theory of logical types, paradoxes paralyze an observer and may lead either to a collapse of the construction of his or her world, or to a growth in complexity in his or her representation of this world. It is the latter case which could be characterized as morphogenesis'<sup>47</sup>

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<sup>45</sup> On the paradoxical double-bind situation, see the classic text by Bateson, Gregory (1972) *Steps to an Ecology of Mind*. New York: Ballantine; Watzlawick, Paul, Beavin, Janet and Jackson, Don (1967) *Pragmatics of Human Communication: A Study of Interactional Patterns, Pathologies, and Paradoxes*. Ch. 6. For the application of the double-bind to organizations, see Simon, Fritz (1997) *Die Kunst, nicht zu lernen: Und andere Paradoxien in Psychotherapie, Management, Politik*. Heidelberg: Carl-Auer-Systeme.

<sup>46</sup> 'Paradoxes', in their narrowest sense, denote situations such as 'A because not A'. In a wider rhetorical sense, 'paradoxes' include ambivalence and contradictions that inhibit thinking within a given framework. Social science and law are best served by the wider definition that encompasses inhibition effects, as well as the potential to overcome them. For a general pragmatic perspective on contradictions and paradoxes, see Gumbrecht, Hans Ulrich and Pfeiffer, Ludwig (eds.) (1991) *Paradoxien, Dissonanzen, Zusammenbrüche: Situationen offener Epistemologie*. Frankfurt: Suhrkamp Verlag; Watzlawick, Beavin and Jackson (fn. 45) Ch. 6. On paradoxical situations within economic enterprises, see, Neuberger, Oswald (2000) "Dilemmata und Paradoxa im Managementprozess", in: Schreyögg, Georg (ed.), *Funktionswandel im Management: Wege jenseits der Ordnung*. Berlin: Duncker & Humblot Verlag, 173-219, 187ff. On the legal treatment of paradoxes, see, Fletcher, George (1985) "Paradoxes in Legal Thought", 85 *Columbia Law Review*, 1263ff.; Suber, Peter (1990) *The Paradox of Self-Amendment: A Study of Logic, Law, Omnipotence and Change*. New York: Lang and <http://www.earlham.edu/~peters/writing/psa/index.htm>.

<sup>47</sup> Krippendorff, Klaus (1984) "Paradox and Information", in: Dervin, Brenda and Voigt, Melvin (eds.) 5 *Progress in Communication Sciences*. Norwood: Ablex, 45ff., 51f. On paradox and morphogenesis in social systems, see Luhmann, Niklas (1990) "Sthenography", 7 *Stanford Literature Review*, 133-137; *idem* (1997) *Die Gesellschaft der Gesellschaft*. Frankfurt: Suhrkamp Verlag, 57f. On exemplary reactions to the paradoxical demands of just-in-time systems, Eisenhardt, Kathleen and Westcott, Brian (1988) "Paradoxical Demands and the Creation of Excellence: The Case of Just-in-Time Manufacturing", in: Quinn, Robert and Cameron, Kim (eds.) *Paradox and Transformation: Towards a Theory of Change in Organization and Management*. Cambridge, Mass.: Ballinger, 169ff., 191.

If in a double bind situation people choose contractual arrangements, they tend to repress one of the two contradictory messages. If they choose integrated hierarchical organizations they do the same thing for the other message. Under certain conditions, however, hybrid arrangements provide for an institutional environment where paradoxical communication is not repressed, not only tolerated, but invited, institutionally facilitated and, sometimes, turned productive. Hybrids as a highly ambiguous combination of networks with contracts and organizations seem to be the result of a subtle interplay between different and mutually contradicting logics of action.

In the particular context of hybrid networks, the double-bind stems from the imposition of environmental demands upon actors to simultaneously obey different and contradictory operational imperatives. Some of these demands derive directly from contradictory economic pressures. Others result from a collision between economic requirements on the one hand, with scientific, cultural, medical and political principles, on the other.

Contradictory demands can be traced to economic trends that have increasingly overburdened individual firms and have forced them to engage in networking: 'trends such as increased technological complexity, increased pressure on productivity and costs, as well as simultaneous market demands for a high degree of flexibility'.<sup>48</sup> Empirical studies on intra-company co-operation have systematically researched the particular contradictions to which firms are exposed. Increasingly, the market demands 'flexible specialization'. Following the demise of standardized mass production, the demand is for 'client-specific mass production'. This goal gives rise to a barely surmountable contradiction between flexibility and efficiency. The trend in production is towards 'systemic rationalization'. This optimization standard cloaks a contradiction between complexity and reliability. Similarly, business organization is required to follow the goal of 'decentralized self-direction', laying itself open to a contradiction between the autonomy of and oversight over decentralized business units. Business organization is then left with the question of whether they can choose only one organizational structure, or whether they must, seek out the far harder path of combination, fusion and trade-offs.<sup>49</sup>

Networks are confronted with the problem of how to translate contradictory demands into internal structures, such that operational burdens are sustainable.<sup>50</sup> The determinative innovation of networks is that they transform external contradictions into a tense, but sustainable, 'double-orientation' within the operational system. One and the same operation is exposed, both to individual network node orientations and to the collective orientation of the network, and is simultaneously constrained and liberated by the demand that it must find a balance in each context.<sup>51</sup>

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<sup>48</sup> Hirsch-Kreinsen (fn. 44) 107.

<sup>49</sup> Semlinger, Klaus (1993) "Effizienz und Autonomie in Zulieferungsnetzwerken: Zum strategischen Gehalt von Kooperation", in: Staehle, Wolfgang and Sydow, Jörg (eds.) 3 *Managementforschung*. Berlin: de Gruyter, 309-354, 313ff.

<sup>50</sup> Semlinger (fn. 49) 332; Hirsch-Kreinsen (fn. 44) 120.

<sup>51</sup> On the key concept of 'double-attribution', see Teubner (1991) (fn. 41) 119ff.; *idem* (1993) (fn. 41) 226ff.; *idem* (2002) (fn. 41) 324ff. For double-attribution from a social science perspective, see Scharpf, Fritz (1991) "Die Handlungsfähigkeit des Staates am Ende des Zwanzigsten Jahrhunderts", 32 *Politische Vierteljahresschrift*, 621-634, 621ff.; Littmann, Peter and Jansen, Stephan (2000) *Oszillodox: Virtualisierung - die permanente Neuerfindung der Organisation*. Stuttgart: Klett Verlag, 69f.; Windeler, Arnold (2001) *Unternehmensnetzwerke: Konstitution und Strukturation*. Wiesbaden:

In contrast to contracts or organizations, which exhibit either an individual or a collective orientation, networks have created a double social orientation for individual operations. Each operation within the hybrid must simultaneously meet both the normative demands that stem from bilateral relations between individual actors, as well as those that stem from the network as a whole. The result is a remarkable degree of self-regulation within networks. This furnishes the key explanation for the conclusion of economists that networks and nodes engage in a specific form of profit-sharing, distinguishable from forms of profit-sharing found within other social contexts.<sup>52</sup> Whilst the law of corporations first attribute profit to the corporation and then oversee its distribution to members, networks provide for a simultaneous distribution to the net and its nodes. All transactions profit both the network and individual actors.<sup>53</sup> This type of profit-sharing acts as a constraint, since all transactions must pass the double test. At the same time, however, it acts as an incentive, since all network gains are always related to individual gain.<sup>54</sup>

## V. Legal Conditions: Dual Constitution of Connected Contracts

How is the law to respond to this transformation of external contradictions into an internal - simultaneously individual and collective - orientation? Law cannot just map network structures into its concepts. Under the network irritation it has to find its own answers. In terms of legal facts: through dual constitution of connected contracts. In terms of legal consequences: through a selective double attribution to individual contractual partners and to the network as a whole.

Any attempt to reconstruct the legal conditions for a business network must pay due regard to the internal evolution of doctrine. It is for this reason that the legal concept of 'connected contracts', which has now been incorporated into the German Civil Code,<sup>55</sup> is so attractive for networks. Its particular characteristics derive from the legal logic of synallagmatic contracts.<sup>56</sup> To date, in German law, purchase money loan has been the major object of the law of connected contracts. Moving away from its peculiarities, to attempt to develop a more general legal concept of connected contracts that also encompasses business networks, we can extrapolate from both case law and recent legislative advance to define three legal conditions.<sup>57</sup> Together, these three conditions constitute the surplus value of the dual constitution of the

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Westdeutscher Verlag, 194f., 224. For double attribution in the law of networks, Collins, Hugh (1999) *Regulating Contracts*. Oxford: Oxford University Press, 248ff.; Supiot, Alain (2000) "Les nouveaux visages de la subordination", 63 *Droit Social*, 131ff., 135.

<sup>52</sup> Brickley, James and Dark, Frederick (1987), "The Choice of the Organizational Form: The Case of Franchising", 18 *Journal of Financial Economics*, 401ff., 411 ff.; Dnes, Antony (1991) "The Economic Analysis of Franchising and its Regulation", in: Joerges, Christian (ed.) *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States*. Baden Baden: Nomos Verlag, 133-142, 136ff. For an especially interesting empirical study, see Norton, Seth (1988) "An Empirical Look at Franchising as an Organisational Form", 61 *The Journal of Business*, 197-218, 202ff.

<sup>53</sup> Dnes (fn. 52) 136ff.

<sup>54</sup> Norton (fn. 52) 202ff.; see also, Klein, Benjamin and Saft, Lester (1985) "The Law and Economics of Franchise Tying Contracts", 28 *Journal of Law and Economics*, 345ff., 349ff.

<sup>55</sup> § 358 BGB (*Verbundene Verträge*).

<sup>56</sup> Gernhuber (fn. 42) 710ff.

<sup>57</sup> For a recent restatement of doctrine and jurisprudence of connected contracts, Habersack, Mathias (2003) in *Münchener Kommentar zum Bürgerlichen Gesetzbuch*. München: Beck. 4<sup>th</sup> ed., § 358, 26ff., 36ff.

connected contracts as against a simple mass of disconnected bilateral contracts within a market.

1. reciprocal reference of bilateral contracts to one another, either found within the document and/or distilled from contractual practice ('multi-laterality'),
2. a contractual reference to the overall project of the connected contracts ('relational purpose'),
3. a close and significant cooperation relationship between the participants within the multi-lateral relation ('economic unity').

Does this mean that business networks are simply made up of a multitude of bilateral contracts? Is their only distinguishing characteristic that a relational agreement should be added to more commonplace agreements? No: rather, what lurks beneath the three legal conditions is the social specificity of networking, which cannot as such be captured within legal categories. As we said: Sociological jurisprudence is an oxymoron. Network is not a legal concept. There is good reason why lawyers work with mysterious formulations in this area: 'purposive nexus', 'unity despite division', 'accessory acts', '*causa consumendi*'.

Seen from the distance of systems theory, the entire matter can be understood as a difference of two closed systems: social practices and legal doctrine. From the sociological standpoint, it is the network's specificity that a contractual system observes its environment in a somewhat unusual manner. Usually, contracts focus their observations on markets and market conditions, in particular market prices, and adapt their decisions and internal structures to them. The network situation differs from this 'normality': where simple market observation no longer suffices, the system redirects its observation away from general market conditions and observes other contractual systems within the market, and orients itself in line with changes here rather than changes within the market.<sup>58</sup> Systems thus use networking to attempt to establish a symbiotic relationship with other systems, such that they can gain higher control of their environment. The fusion within such hybrid networking does not make a 'unity' out of individual contracts, rather each contract remains autonomous in relation to its own function and its contributions to the environment.<sup>59</sup> Thus the 'relation' between contracts becomes a mutual observation between two separate contracts, each of which autonomously pursue their own project, but adapt themselves to one another through internal reflection.<sup>60</sup> It is simply not possible, that this sociological picture of reciprocal reflection appears on the screens of the law. Instead, what we see on these screens are the three legal conditions of the connected contracts mentioned before - 'mutual referencing' of contracts, 'relational purpose', and 'co-operative relationship' - that establish the legal connectedness of the contracts.

If this is true for the legal construction of networks, then classical contract law needs to undergo some considerable modifications. In contractual networks, a heteronomous private order superimposes its demands on autonomous bilateral

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<sup>58</sup> Luhmann (fn. 44) 407ff.

<sup>59</sup> Castells, Manuel (2000) *The Rise of the Network Society*. Oxford: Basil Blackwell, 187; Teubner (2002) (fn. 41) 330.

<sup>60</sup> Amstutz (fn. 39) 164ff.

contracts. The reference of one contract to another entails the inclusive acceptance by the contractual partners of a foreign private order. Each bilateral contract must submit to a coherent overall system that needs to be respected. In practice, contractual conclusion is more or less reduced to a simple decision to enter into a homogeneous private order. Reference to other contracts is similar in nature to regard for standard contract terms, for customs of the market, or for social and technical norms. All in all, the bilateral contracts are caught in the institutional logic of networks: entry as a bilateral access to a multilateral order, trust-based interaction, decentral co-ordination of a quasi-organization, orientation of individual operations to the network purpose.

Taken together, the three conditions reconstruct the legal equivalent of a non-contractual “spontaneous social order” which comes out of a multiplicity of bilateral contracts. This is the *proprium* of social networks reconstructed in law as connected contracts. However, in marked contrast to Hayek’s spontaneous order, the discovery processes of competitive markets, it is networking and co-operation, rather than market and competition, that are the sources of spontaneous order.<sup>61</sup> Within such spontaneous orders, the stability of the relationship between legally independent units is deduced from beyond bipolar provisions.<sup>62</sup> ‘Beyond’ bipolar provisions—this is the core of the argument. Various social co-ordination mechanisms of a non-contractual nature—reciprocal observation, anticipatory adaptation, co-operation, trust, self-binding, responsibility, negotiation, stable relationships<sup>63</sup>—constitute the overarching order of networking and stamp the network’s character upon each bilateral contractual relationship.

## **VI. Legal Consequences: Selective Double-Attribution to Contract Parties and to the Network**

What holds good in relation to the legal conditions of the network as connected contracts, also holds good for its legal consequences. The double orientation in networks which are the result of a subtle interplay between contradictory logics of action, must also find its resonance within the law.<sup>64</sup> This is true both for internal relations between participants within the network, as well as for its external relations. The appropriate legal response is a selective (!) double-attribution of network acts to the contract parties and to the network, varying according to different structural contradictions within the network

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<sup>61</sup> On spontaneous ordering in competitive markets and legal evolution, see, Hayek, Friedrich (1973) *Law, Legislation and Liberty. Volume 1: Rules and Order*. London: Routledge & Paul, 72ff.; Vanberg, Viktor (1986) “Spontaneous Market Order and Social Rules: A Critical Examination of F. A. Hayek’s Theory of Cultural Evolution”, 2 *Economics and Philosophy*, 75ff., 79ff.; Cooter, Robert (1994) “Decentralized Law for a Complex Economy”, 23 *International Review of Law and Economics*, 443ff., 447f. On the important distinction between different types of spontaneous order, especially between markets and relational contracts, see Gordon, Robert (1994) “Hayek and Cooter on Custom and Reason”, 23 *Southwestern University Law Review*, 453ff.

<sup>62</sup> Windeler (fn. 51) 240.

<sup>63</sup> For discussion on the mechanisms and effects of such non-market spontaneous orders, see Gordon (fn. 61) 459; Sydow, Jörg and Windeler, Arnold (2000) *Steuerung von Netzwerken: Konzepte und Praktiken*. Opladen: Westdeutscher Verlag, 1ff., 12ff.; Windeler (fn. 51) 240ff.

<sup>64</sup> ‘Resonance’ is not deployed here as a metaphor, but instead forms an important element within the theory of structural coupling. For the resonance of social problems within the law, see Luhmann (fn. 6) Ch. 10.

## First Contradiction: Bilateral Exchange versus Multilateral Association

There is a first - should we say the standard - constellation of hybrid networks in which they appear as the result of contradictory demands from the market. Economic transactions, especially when they deal with knowledge based products, are simultaneously exposed to the contradictory demands of bilateral exchange and multilateral relations.<sup>65</sup> An important explanation for the contradictory nature of behavioral expectations is the uncertainty of economic actors about future market development. Despite their antagonistic interests, this uncertainty forces the parties to long-term exchange contracts to develop closely coordinated behavioral patterns, be they constructed along hierarchical or heterarchical lines.<sup>66</sup>

The traditional solution to such a collision between operational logics was a simple 'either-or' decision. The suggestions made in the literature that we should qualify networks either as exchange contracts or as a 'corporation' derives from this tradition. Result is the well-known rigid separation between market and hierarchies supported by similarly rigid rules of anti-trust law, contract law and corporation law. However, the enforced dichotomy between market/organization, or between contract/corporation censors a more productive solution. Each institutional answer, market or hierarchy, contract or organization, represses the paradox. Each favors predominantly one of the contradictory orientations while pushing the other into the darkness of informality where it is sometimes discovered by subversive sociologists interested in the dark side of formal institutions.

The various routes out of these conflicts, which we characterized above as 'morphogenesis', converge within the specific institutional logic of networks. The relevant concept within organizational theory is 'detotalisation'. In order to react to external paradoxes, the network must give up its monolithic unity and 'recreate external diversity within its own institutions and functions'. In such a process 'antagonistic relationships (in this case, bilateral exchange and multilateral cooperation) are nurtured with one and the same partner — which cannot but prove to be a paradox should sectoral and temporal differentiations be ignored or "totalized".<sup>67</sup> Empirical studies have demonstrated that this internal division and recombination of exchange and cooperation is in fact possible on the ground. Within successful business networks, actors have been able simultaneously to maintain the logic of exchange within 'contractual' sectors, such as logistics, quality, quantity and pricing, and combine it with trust-based cooperation within 'relational' sectors such as R&D and joint planning and construction.<sup>68</sup> Detotalisation strategies thus aim to institutionalize new internal differences within a business 'totality' that is indelibly marked by contradictions. The notion detotalisation, thus means to internalize

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<sup>65</sup> On contradictory environmental demands as a network building impetus, see the sources in fn. 44. In addition, Reiss, Michael (1998) "Mythos Netzwerkorganisation", 4 *Zeitschrift Führung + Organisation*, 224-229, 224ff; Köhler, Holm-Detlev (1999) "Auf dem Weg zum Netzwerkunternehmen? Anmerkungen zu einem problematischen Konzept am Beispiel der deutschen Automobilkonzerne", 6 *Industrielle Beziehungen*, 36-51, 36ff.; Sydow and Windeler (fn. 63) 6ff.

<sup>66</sup> Kulms (fn. 34) 227ff.

<sup>67</sup> Neuberger (fn. 46) 207ff.

<sup>68</sup> Bieber, Daniel (1997) "Probleme unternehmensübergreifender Organisation von Innovationsprozessen", in: Bieber, Daniel (ed.), *Technikentwicklung und Industriearbeit: Industrielle Produktionstechnik zwischen Eigendynamik und Nutzerinteressen* Frankfurt: Campus, 111-140, especially 124f.

external contradictions, to legitimate them as simple tensions, and to contribute to their contextual resolution through internal differences.

In stark contrast to the duties of good faith governing exchange contracts on the one side and to duties of loyalty to the association on the other, the legal category that is best suited to capture the network logic, to give it institutional support, and to compensate for some of its negative implications, is surely the duty of loyalty to the network. This duty is distinguished by virtue of its double orientation within one formula to both network and contract. This duty explicitly adopts the contradiction between individual and collective elements within the network.

The primary achievement of this duty is the internal translation of externally imposed insoluble contradictions into manageable conflicts between different levels and subsystems within the network, between nodes, relations, the centre, and the network in its entirety.<sup>69</sup> The duty of loyalty therefore fulfills the following task in law: *create an internal differentiation between various temporal, social and functional sectors, in order to translate initially contradictory demands into clear, contextually-determined, expectations.*

The legal formula is thus as follows: to distinguish situations in which an intensified duty of loyalty to the network exists, from situations in which only the contractual duty of good faith will apply, albeit that each obligation must be modified with reference to the other. The legal task is one of distinguishing between contractual good faith and duty of loyalty to the network. At the same time, however, care must be taken to ensure that this duty is not simply equated with the duty of loyalty within corporation law, but is rather, for its part, given a decentralized bias. Such differences clearly educe from the repeatedly discussed distinction between a network and a collective: the pervasive combination of autonomy and association. This combination is better served by a contractual, legislative and judicial apportionment of duties of loyalty—in contrast to resource-pooling within a single hand or a legal person—which takes over the task of the context-dependent fine tuning of autonomy and association.<sup>70</sup>

## **Second Contradiction: Competition versus Cooperation**

Here we are concerned with a second typical constellation in which hybrid networks evolve as an answer to external contradictions. Especially in the case of knowledge-based products, economic decisions are not merely subject to the tensions between bilateral exchange and multilateral organization, but are also to the conflict between competition and co-operation.<sup>71</sup> Paradoxical commands given to network participants are 'cooperate with one another!' and, simultaneously, 'compete against one another!' Knowledge-oriented production gives rise to a contradiction between two fundamental forms of social experience. Within competition, individual goals can only be achieved at the cost of another, while within cooperation, individual goals are

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<sup>69</sup> Semlinger (fn. 49) 332.

<sup>70</sup> See Kulms (fn. 34) 231, 261.

<sup>71</sup> For the cooperation/competition conflict, see Sydow, Jörg (1999) *Management von Netzwerkorganisationen*. Wiesbaden: Westdeutscher Verlag, 279-314, 299ff.; Littmann and Jansen (fn. 51) 64ff.; Semlinger, Klaus (2000) "Kooperation und Konkurrenz in japanischen Netzwerkbeziehungen", in: Sydow, Jörg and Windeler, Arnold (eds.) *Steuerung von Netzwerken*. Opladen: Westdeutscher Verlag, 130ff., 141ff.

wholly compatible with those of others. This justifies the usual practice of institutionalizing a strict distinction between the two: market or organization.

Recent business studies nevertheless suggest that it is possible to conceive of alternatives to the rigid institutional separation of competition and cooperation. And these alternatives do work in practice. The increased incidence of hybrid networks can be seen as a refined reaction to the contradictory demands of cooperation and competition.<sup>72</sup> 'Co-opetition' is the new magic formula that promises that competitive advantages will flow out of the combination of cooperation and competition, that manages to combine organization and contract with network elements.<sup>73</sup> Coopetition would then constitute a social model that would allow, no, even demand, that competitors would be congruent with cooperation partners.

One should nonetheless keep a certain distance from such purely combinatory approaches and emphasize 're-entry' effects in this context. A simple mixture of competitive and cooperative behavioral patterns does not provide easy exit out of paradoxical oscillation. In the technical sense defined by Spencer Brown, re-entry has nothing to do with ending the division between the two sides of an either-or decision.<sup>74</sup> On the contrary, the distinction between competition and cooperation must not be ended, and must, instead, be strictly maintained and institutionalized in a legal form. At the same time, this same distinction makes a second appearance. Now, however, it is re-introduced to one side of the institutional divide, and once again institutionalized within it.

Mixed competition-cooperation forms only cease to be ideological, in the sense that they simply pursue one only one orientation under the semantic cloak of 'combination', if and when they are subject to re-entry conditions. By the same token, neither do they simply squander the gains of each social model that only become apparent by virtue of their institutional separation. Instead, and insofar as re-entry secures the stable identity of the distinction, they can maximize such advantages. This, however, seems only possible under three conditions:

- 1) Sustainable institutionalization of market competition through the conclusion of parallel and distinct bilateral contracts (i.e., exactly *not* by the creation of a unitary organization)
- 2) Institutionalization of the re-entry of the cooperation/competition distinction within the system of contracts, such that market competition is overlain by a sphere of operational cooperation.
- 3) Situationally-defined internal demarcation between operational spheres.

Any attempt to institutionalize hybrids legally, must pay due regard to such complications. It is exactly this complex of questions which German private law has yet to find a response to. We are faced here with the difficult question of whether legal obligations can be established at all between network participants who are not contractually bound to one another. The problem is whether legal sanctions exist for the incorrect behavior of a participant within a delivery chain or a system of

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<sup>72</sup> See, in particular, Jarillo, Jose, (1993) *Strategic Networks: Creating the Borderless Organization*. Oxford: Oxford University Press; Neuberger (fn. 46) 207ff.

<sup>73</sup> Littmann and Jansen (fn. 51) 64ff.

<sup>74</sup> Brown, George Spencer (1972) *Laws of Form*. New York: Julian Press, 56ff.; 69ff.

networked contracts.<sup>75</sup> The legal postulate of a mutual contractual liability of non-contractual partners within the network is becoming increasingly pressing. It is the result of increased network relations within the provision of goods and services. The privity of contract principle notwithstanding, arguments of fairness and prevention demand restitutionary liability in such cases. The liability of strangers to the bilateral contract within the network for damages is the consequence.

### Third Contradiction: *Unitas multiplex*.

In a third constellation hybrid networks appear as a response to contradictions within the attribution of social action. Who, in the positive sense, benefits from success and profit, who, in the negative sense, suffers loss and liability—individual or collective actors? Is the network simply a trust-based relationship between individual actors, or, does it form an independent collective, making its appearance as a new actor which becomes in itself a point of attribution of action and responsibility?<sup>76</sup> In this case too, the traditional approach of a strict division between contract and organization found both in sociological theory and in legal doctrine supplies inappropriate solutions. Social practice within hybrid networks has, however, identified its own solution: 'double-attribution'. This attribution technique is one of the most important characteristics of hybrid networks, facilitating the distinction between simple attribution to individual actors in the case of the contract, and attribution to collective actors in the case of the organization. One and the same economic transaction is doubly attributed; to individual actors as network nodes and to the overall network.

This new form of attribution, however, gives rise to new risks that in turn demand a new legal form of network responsibility to external actors that is distinguishable both from individual liability and from the collective liability of organizations. Although, the 'piercing of the contractual veil' proves its worth as a general formulation to establish network liability, a distinction must be made between two typical situations, i.e., between centralized and decentralized networks. Various hybrid networks are so centralized and the autonomy of their nodes so limited that they are little more than hierarchical organizations in contractual clothing. Such networks are just a strategic effort to evade the imperative provision of law. Empirical data confirm the suspicion that companies deploy disaggregation strategies in order to avoid the application of tort and labor law.

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<sup>75</sup> Picker, Eduard (1987) "Vertragliche und deliktische Schadenshaftung: Überlegungen zu einer Neustrukturierung der Haftungssysteme", 42 *Juristenzeitung*, 1041ff.; *idem* (1999) Gutachterhaftung: Außervertragliche Einstandspflichten als innergesetzliche Rechtsfortbildung", in: Beuthien, Volker (ed.) *Festschrift für Dieter Medicus*. Köln: Heymann, 397ff.; Möschel (fn. 31), 187 ff.; Rohe (fn. 31) 98.

<sup>76</sup> For networks as mere relations between individual actors and not as collective actors: Heydebrand, Wolf (1999) *The Network Metaphor as Key to the Analysis of Complex Production and Service Relation in a Global Economy*. Stuttgart: Akademie für Technikfolgenabschätzung in Baden-Württemberg; Tacke, Veronika (2000) "Netzwerk und Adresse", 6 *Soziale Systeme*, 291-320, 317. For networks as collective actors, however, under specified conditions: Teubner, Gunther (1993) "The Many-Headed Hydra: Networks as Higher-Order Collective Actors", in: McCahery, Joseph, Picciotto, Sol and Scott, Colin (eds.) *Corporate Control and Accountability*. Oxford: Clarendon Press, 41-60, 54ff.; *idem* (1993) (fn. 41) 226ff.; Sydow, Jörg and Windeler, Arnold (1998) "Organizing and Evaluating Interfirm Networks", 9 *Organization Science. Special Issue: Managing Partnership and Strategic Alliances*, 265ff.; Castells (fn. 59) 177f., 187, 209, 214; Windeler (fn. 51) 225ff. A salomonic solution: Luhmann (fn. 44) 408: Networks will "become social systems of their own, once they constitute clear boundaries and a history of recursive events on which trust will be based".

In the case of decentralized networks, we return to our example of the marketing of private automobiles. Although the external liability of the network, and not just that of its individual nodes, should be legally guaranteed, the piercing of the contractual veil should not result in unitary collective liability. Rather, the appropriate form of liability is a decentralized, multiple and collective combination of network liability and the liability of nodes who have in fact participated within the operation under scrutiny. In contrast to comprehensive collective liability in the case of formal organizations, this leads to a re-individualization of collective liability within networks. Analogous to the well-known concept of 'market share liability', one might make use of the notion 'network share liability'; a form of liability that is particularly significant in situations where the root cause of damage cannot be traced back to individual nodes, but only to the network itself. Such cases do not involve a traditional collective actor whose assets might serve as the object liability claims. Nonetheless, the network does serve as a point of reference for the attribution of liability and as the springboard for the re-individualization of liability amongst individual nodes. Such a re-individualization is particularly to be promoted in cases where the individual contribution of nodes to damage can no longer be clearly distinguished. In such a situation, liability could be met through the *pro-rata* liability of participating nodes, calculated in accordance within their degree of participation within the network.

#### **4. Fourth Contradiction: Intersystemic Networks**

A final conflict between different operational logics becomes apparent within a third constellation of hybrids. In the effort to promote technological transformation, the state provides extensive grants to joint research projects between particular industrial branches and independent research institutions. This results in a loosely organized network establishing close relationships between the relevant industries, participating research institutions and public authorities that have an interest in such co-operation. The network is charged with the pursuit of successful innovation. Its attitude to transaction costs, however, is as irrational and extravagant as a series of UN conferences.

This is a conflict between different social rationalities that again disturbs institutional arrangements. Participating actors demand to be allowed to behave in accordance with different and contradictory behavioral logics. The case of public-private research networks would require rational actors to observe three mutually incompatible categorical imperatives. Hybrid networks, in this case, appear as manna from heaven, being exactly tailored to bridge multiple contradictory rationalities. They facilitate mutual interference between rationalities without the imposition of hierarchical order.

Can a legal concept of network respond to such demands? In the case of mixed network regimes, the simple evolution of legal norms to support the transaction costs advantages and efficiency gains of networks, as opposed to contractual or corporate arrangements, is clearly not enough. In reality, such networks only offend against the imperatives of transaction cost minimization and allocative efficiency. Nonetheless they are successful innovators. The role of legal concepts of the network is therefore, in this case of mixed public-private regimes, far more one of developing principles of institutional autonomy, of establishing fundamental rights, of securing procedural fairness, of ensuring the rule of law and of fostering political responsibility.

This points to one of the central tasks of a law of hybrid networks. In contrast to traditional legal concepts, such as 'contractual purposes' or 'business interest', this involves the evolution of a legally applicable concept of 'network interest'. As a counterpoint to instrumental autonomy, I call this the legally secured 'reflexive autonomy' of individual sub-units within the network. Within integrated organizations, be they private concerns, public corporations or mixed form, rules on organizational procedure are always oriented in line with the common purpose. The character of this common goal is determinative in the case of a decentralization or delegation of functions. Decentralized units are afforded the freedom to use their local knowledge in order to choose the appropriate concrete means of pursuing the common aims of the entire organization, or, legally-speaking, the 'business interest'.

This is entirely different within intersystemic networks. Legal norms must not merely afford network nodes a heightened degree of protection for their autonomy. Instead, they must supply a different form of protection in that, despite centralization, they must guarantee reflexive capacities, i.e., the capacity of nodes to balance out (of network relations) their own independent concept of their social function and contribution to their environment. Within intersystemic networks of scientific knowledge, politics and the economy, this leads us in the direction of a quasi-constitutional guarantee for scientific freedom in the face of political and economic inter-references within the borders of a mixed network. This idea is in fact generalizable. In contrast to the case of companies, in which legal guarantees of the autonomy of subsidiaries protect the profit interests of the parts against the whole and vice versa, we are required, in the case of intersystemic networks, to respect the institutional integrity of health, education, journalism, technology and art, not only within a decentral (not simply decentralized) structure of autonomous nodes, but also within the inclusive network. Although it still makes sense to conceive of a common company interest in the form of procedural and material legal norms within corporation law, the 'network interest' can only be created out of the depths of the compatibility of autonomous network participants.