

# AN APOLOGY FOR ADMINISTRATIVE LAW IN THE CONTRACTING STATE

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## I. INTRODUCTION

With *The Contracting State*,<sup>1</sup> Professor Jody Freeman continues her foray into the role of private actors in government functions, an area in which she has staked her claim as a leading authority. As Freeman has elsewhere noted, private regulation can take many forms: It can involve an industry organization imposing requirements on its members, interest groups negotiating how to limit or condition private conduct that affects them, the state contracting for goods or services, or the state entering into agreements about how to implement or enforce regulations that already exist.<sup>2</sup> *The Contracting State* suggests that these forms of regulatory contractual relationships all reflect some jumble of private law and public law understandings that structure the relationships between the government, regulated entities, and putative beneficiaries of these seemingly schizophrenic regulatory programs. *The Contracting State* does limit its analysis to bilateral contracts,<sup>3</sup> but the article still covers an

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1. See Jody Freeman, *The Contracting State*, 28 FLA. ST. U. L. REV. 155 (2000).

2. See generally Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000).

3. See Freeman, *supra* note 1, at 160 (noting that the bulk of *The Contracting State* is devoted to public-private contracts). I borrow the term "bilateral" from Daniel Farber to refer to contracts between the state and the regulated entity. See Daniel A. Farber, *Triangulating the Future of Reinvention: Three Emerging Models of Environmental Protection*, 2000 U. ILL. L. REV. 61, 61 (distinguishing "bilateral bargaining" between an agency and a regulated entity from other forms of voluntary regulation). Although bilateral contracts raise some interesting issues, I believe that administrative law can accommodate such contractual processes more easily than Freeman's other forms of private governance because the state ultimately retains authority and responsibility for regulations. A scheme in which the state acts only as a facilitator for private regulation opens the process to greater abuse by the representatives of the various interest groups that participate. See generally

amazing breadth of regulatory circumstances. Placing these along the continuum that *The Contracting State* describes, the article includes within its ambit the following types of agreements: (i) procurement contracts, (ii) contracts under which private entities perform government services, (iii) agreements between administrative agencies and regulated entities regarding implementation or enforcement of regulations, and (iv) contracts between an agency and a private entity that specify the requirements that govern the regulated conduct of the entity.

Freeman contends that administrative law has not addressed the role of contracts in regulation.<sup>4</sup> She argues that regulatory contracts, or more particularly the importation of contract principles into the regulatory arena, can enhance accountability.<sup>5</sup> Whether that importation will increase accountability depends, in her view, on particular circumstances; she counsels that in many contexts private law may not sufficiently take into account the special role of the state in regulatory contracts.<sup>6</sup> Nonetheless, the tenor of her article suggests that principles of administrative law have developed without any consideration of private bargaining and, therefore, that we must develop a new administrative law, one that ensures that contractual regulation does not allow abuses by the private contractors or undermine accountability of regulatory programs. Although Freeman does not specify particular developments that would improve accountability in a world of regulatory contracts, she hints at a need to permit contractors to hold the state strictly to its contractual bargains<sup>7</sup> and to allow putative beneficiaries a greater role in negotiating and enforcing certain types of regulatory contracts.<sup>8</sup>

I agree with Freeman's assessment that regulation by agreement between the state and the contractor or regulated entity adds a significant arrow to the quiver of regulatory mechanisms. Like her, I have concerns about how the courts will address such contracts. I, however, do not see contract mechanisms as a means of providing regulatory accountability, but rather as a means of avoiding the overbreadth of traditional regulation and of assigning roles required by the regulatory state to those best able to perform them. Moreover, I fear that emphasis on contract as a means of providing accountability will lead to incorporation of contract law principles that will seriously undermine the flexibility of current administrative processes. Unlike Freeman, I am not certain that administrative law's lack of

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Mark Seidenfeld, *Empowering Stakeholders: Limits on Collaboration as the Basis for Flexible Regulation*, 41 WM. & MARY L. REV. 411 (2000).

4. See Freeman, *supra* note 1, at 198-99.

5. See *id.* at 201.

6. See *id.* at Part.III.A.3.

7. See *id.* at 158.

8. See *id.* at 201.

explicit reference to contractual processes reflects ignorance. Rather, I believe that current understandings of administrative law recognize that over the past several decades much of regulation has been implemented through contract-like processes. Moreover, current understandings seek to place such processes within a framework that allows administrative agencies leeway to structure and implement regulatory programs as they think best. So viewed, to a great extent, administrative law already accommodates bilateral bargaining processes and, with merely a little tweaking, provides sufficient accountability for most of the types of bilateral regulatory contracts that Freeman discusses.

This Comment begins by reviewing the potential benefits of regulatory contracts, stressing in particular that those benefits flow from attributes of contractual relationships other than the desire to hold the government accountable for regulatory policy. The Comment goes on to describe what I consider basic understandings of the current administrative state—that the principal checks on agency policymaking are procedure and politics. Finally, the Comment considers what these understandings imply about how courts should treat government contracts. In particular, the Comment analyzes how these understandings inform when and how government contracts should be enforceable by the nongovernment party or by the public beneficiaries of the contracts for the four types of contracts Freeman identifies in her principal paper.

## II. BENEFITS OF REGULATORY CONTRACTS

Agencies, like other organizations, whether public or private, have always relied on contracts for buying many of the goods and services they use while performing their tasks.<sup>9</sup> A private provider may enjoy an advantage from specialization because it already produces the needed good for the private market. Specialization leads to economies of scale and superior know-how, which in turn allow the private company to produce a superior product at a lower cost than could the agency. It makes no sense for an agency to produce its own office paper just because it uses a lot of it.

Private providers may enjoy the advantage of superior know-how even when the product supplied to the agency is not produced for any

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9. See Geoffrey C. Hazard, Jr. & Eric W. Orts, *Environmental Contracts in the United States*, in ENVIRONMENTAL CONTRACTS AND REGULATORY INNOVATION: COMPARATIVE APPROACHES IN EUROPE AND THE UNITED STATES (Kurt Deketelaere & Eric W. Orts eds., forthcoming 2000) (manuscript at 1-3, on file with the author). Whether a firm should rely on the market to provide goods and services rather than providing the good itself has been the subject of classic articles. See, e.g., Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); Oliver E. Williamson, *The Logic of Economic Organization*, 4 J.L. ECON. & ORG. 65 (1988).

other users. The private company may produce similar, although not identical, products for others. Thus, for example, it is probably wise that the Air Force contracts with airplane manufacturers for its military aircraft rather than trying to design and manufacture these planes in-house.

Traditionally, agencies have been reluctant to contract out core governmental services—services that rely on the state's monopoly over the ultimate coercive powers of seizing property and arresting and confining criminals. As Freeman notes, that reluctance stems in part from the perception that there is something inherently wrong with having private entities exercise such coercive powers.<sup>10</sup> It may also stem from doubts about whether private companies enjoy any informational or scale advantages with respect to such services, which the government has almost always performed itself.

Nonetheless, there is a realization today that private providers may in fact have advantages even in performing such governmental services.<sup>11</sup> For example, consider a complex plant that the Occupational Safety and Health Administration (OSHA) regulates for workplace safety. Although OSHA may well be more knowledgeable than the operator of that plant about how to apply OSHA's standards, and even about how to search a plant for violations of those standards, the operator clearly has more knowledge of the structure and operations of its particular plant. That knowledge may translate into the operator's being the cheaper and more effective monitor of regulatory violations or designer of plant-specific regulatory requirements, assuming it can be given an incentive to perform those jobs aggressively and in good faith.<sup>12</sup> The necessity of providing sufficient incen-

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10. See Freeman, *supra* note 1, at 172-74.

11. See IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 103-06 (1992); EUGENE BARDACH & ROBERT A. KAGAN, *GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS* 219 (1982); cf. Richard B. Stewart, *Regulation, Innovation, and Administrative Law: A Conceptual Framework*, 69 CAL. L. REV. 1256, 1354 (1981) ("Because of limitations of budget, personnel, time, and working experience, regulators cannot hope to develop in-house all the information and specialized experience needed to make effective regulatory judgments in a timely fashion.").

12. The plant operator's superior ability to monitor violations is behind OSHA's "High Injury/Illness Rate Targeting and Cooperative Compliance Program." The agency applied the program to plants whose poor safety record warranted frequent inspection. It promised less frequent inspection to those employers who participated in the program, creating an incentive for companies to perform such monitoring. Despite the program's demonstrated success when tested in Maine, the D.C. Circuit struck down the program, ostensibly because the agency failed to use proper procedure to promulgate what the court termed a substantive regulation. See *Chamber of Commerce of the United States v. Department of Labor*, 174 F.3d 206, 213 (D.C. Cir. 1999).

tives to ensure that companies self-regulate in good faith is one crucial barrier to universal contractual regulation.<sup>13</sup>

Contracts transferring state functions to private entities might also be desirable as a means of avoiding inefficiencies that stem from the state's monopoly position. For example, a private garbage hauler might be more efficient than a government-run operation because the private hauler has had to struggle to survive in a competitive market and therefore, unlike the government, has structured its operations to attract customers and keep costs down. The state might also hope to save costs by avoiding constitutional limitations when it transfers the exercise of its coercive powers over property and persons to a private organization. If, however, these limitations apply because of the coercive nature of the power rather than the lack of market constraints on that power, then the avoidance of these limitations by transferring the coercive power to a private entity seems inappropriate. In fact, the lack of political accountability of private entities might warrant subjecting them to greater limitations in exercising such power.

Finally, contractual regulations are desirable because they are more entity-specific than general regulations.<sup>14</sup> Contracts often take into account the design of an entity's plant, its location, and other unique features. Contractual regulations thus can increase regulatory benefits by deviating from the general regulations set for all similar plants. Specificity is not limited to contract; the government could adopt plant-specific regulations without resorting to voluntary contractual commitments from the regulated entity.<sup>15</sup> The specificity of the information needed to write such regulations and the resources needed to police them, however, pragmatically mandate that the government act in cooperation with regulated entities,<sup>16</sup> and entities are

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13. See AYRES & BRAITHWAITE, *supra* note 11, at 106; see also Stewart, *supra* note 11, at 1346-47 (noting that success of consensus-based regulation depends on "private parties believ[ing] [that] their interests lie in cooperation").

14. See Robert A. Kagan & John T. Scholz, *The "Criminology of the Corporation" and Regulatory Enforcement Strategies*, in ENFORCING REGULATION 67, 73 (Keith Hawkins & John M. Thomas eds., 1984) (observing that "general rules often make little sense if applied rigidly to all particular cases").

15. The Administrative Procedure Act (APA) defines "rule" to include "[any] statement of general or particular applicability and future effect designed to implement . . . law or policy." 5 U.S.C. § 551(4) (1994) (emphasis added).

16. See James Gustave Speth, *Foreword* to BEYOND COMPLIANCE: A NEW INDUSTRY VIEW OF THE ENVIRONMENT at ix, x (Bruce Smart ed., 1992) (asserting that "in the end only the corporate community can efficiently provide the necessary organization, technology, and financial resources needed to design and implement change on the scale required" to implement the environmental changes necessary for the future); see also Bruce A. Ackerman & Richard B. Stewart, *Reforming Environmental Law*, 37 STAN. L. REV. 1333, 1343 (1985) (advocating marketable permits in part on the ground that marketability puts the regulatory "information-processing burden precisely where it belongs: upon business managers and engineers who are in the best position to figure out how to cut back on their plants' pollution costs").

much more likely to cooperate if they can veto the final agency product by refusing to agree. Hence, for many government permits, which essentially are site-specific regulations, the government negotiates the details with the regulatory entity even though it is free to impose conditions in the permit without the entity's consent.<sup>17</sup>

### III. CURRENT UNDERSTANDINGS OF ADMINISTRATIVE LAW

Current understandings of administrative law derive from the post-World War II period that gave rise to the Administrative Procedure Act (APA).<sup>18</sup> In that era, a blueprint of administrative governance that can be characterized as the "public interest" model dominated conceptions about how agencies went about their job of regulating.<sup>19</sup> This model was bilateral in nature, with the two parties entitled to participate being the regulated entity—usually envisioned as a member of some industry—and the regulating agency. Industry members were permitted to present evidence and their views regarding the regulatory decisions that directly affected them. They were also entitled to seek judicial review to ensure that agency regulations did not undermine legislative deals that struck a balance between the interests of the industry and those of putative beneficiaries of the regulatory program. The interests of these beneficiaries were presumed to be protected by the agency. Thus, while the public technically could comment on agency-proposed rules, putative beneficiaries were not seen as proper parties to challenge agency decisions as being insufficiently protective of their interests, and they were excluded entirely from implementation and enforcement of agency regulations.<sup>20</sup>

Under the public interest model, keys to accountability were procedural requirements and political oversight. The APA mandated ju-

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17. For example, in issuing a permit to allow an incidental take of an endangered species by destruction of the species' habitat, the United States Fish and Wildlife Service (USFWS) and a developer seeking a permit negotiate a habitat conservation plan (HCP). The plan, signed by the USFWS, the developer, and sometimes by state and local governments, binds the developer and precludes the government from imposing additional mitigation measures barring extraordinary and unforeseen circumstances. See J.B. Ruhl, *How to Kill Endangered Species, Legally: The Nuts and Bolts of Endangered Species Act "HCP" Permits for Real Estate Development*, 5 ENVTL. LAW. 345, 402-04 (1999); see also Donald C. Baur & Karen L. Donovan, *The No Surprises Policy: Contracts 101 Meets the Endangered Species Act*, 27 ENVTL. L. 767, 771-77 (1997).

18. The APA, ch. 324, 60 Stat. 237, was passed in 1946.

19. See Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1682-83 (1975) (noting that faith in agencies' pursuit of the public interest has withered); Keith Werhan, *The Neoclassical Revival in Administrative Law*, 44 ADMIN. L. REV. 567, 576-78 (1992); see also Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1265-72 (1986).

20. See Stewart, *supra* note 19, at 1713.

dicial-type procedures for fact-finding in formal adjudications.<sup>21</sup> In addition, the Due Process Clause ensured that even when formal APA procedures did not apply, agencies could not deprive regulated entities of their property without first holding extensive fact-finding proceedings.<sup>22</sup> In rulemaking, the procedures were more streamlined and did not distinguish between the interests of regulated entities and those of the public to participate in the agency proceeding. Frequently, however, regulated industries developed ongoing relationships with agency staff and the staff of congressional committees responsible for the particular programs to which these entities were subject. These relationships allowed regulated entities to pressure agencies, both directly and via the threat of congressional action.<sup>23</sup> The agency, however, remained responsible for the ultimate decision. Courts rarely second-guessed the substance of agency decisions.<sup>24</sup> Unless the regulated entity could show that the decision violated a deal struck in the agency's authorizing legislation or that the decision effected a taking of property, courts generally deferred to agency decisions.

The late 1960s saw the rise of the interest group representation model of administrative law.<sup>25</sup> Political scientists and economists identified the problem of agency capture,<sup>26</sup> and shortly thereafter entrepreneurs of grass roots activism organized broad-based interest groups with the stated goal of protecting the public in regulatory matters.<sup>27</sup> Courts began to reject the assumption that agencies would act to protect regulatory beneficiaries, and they created legal doctrines that gave representatives of such beneficiaries access to most administrative proceedings on par with the access enjoyed by regulated entities. For example, courts allowed putative beneficiaries to

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21. See MARTIN SHAPIRO, WHO GUARDS THE GUARDIANS? JUDICIAL CONTROL OF ADMINISTRATION 40-41 (1988).

22. See Stewart, *supra* note 19, at 1673.

23. See *id.* at 1713-14.

24. See Rabin, *supra* note 19, at 1267-68, 1271.

25. See generally Stewart, *supra* note 19, at 1723-60.

26. See MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION 86-90, 155-60 (1955); see also George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 3 (1971). For a comprehensive discussion of capture and the particular mechanisms by which it can come about, see PAUL J. QUIRK, INDUSTRY INFLUENCE IN FEDERAL REGULATORY AGENCIES (1981).

27. See KAY LEHMAN SCHLOZMAN & JOHN T. TIERNEY, ORGANIZED INTERESTS AND AMERICAN DEMOCRACY 74 (1986) (noting the importance of the emergence in the late 1960s of "many new groups—ranging from Common Cause and Ralph Nader's Public Citizen to the National Urban Coalition and the Migrant Legal Action Project—representing broad publics and the less advantaged"); see also GRAHAM K. WILSON, INTEREST GROUPS 49-50 (1990) (remarking that a wide range of interest groups representing broad-based, diffuse interests had developed since the 1970s).

intervene in licensing proceedings that would affect their interests<sup>28</sup> and granted them standing to bring judicial challenges of agency decisions.<sup>29</sup> Congress also began to place burdens on agency decision-making by requiring agencies to collect and analyze information on matters that would affect the public generally, such as environmental impacts.<sup>30</sup>

Despite the decreased trust in administrative agencies that accompanied the interest group representation model, changes in administrative law did not alter the fundamental notion that agencies have broad discretion to structure and administer their regulatory programs. Judicial review of agency action under the "arbitrary and capricious" rubric granted the courts an active role in checking administrative abuses. In some instances, courts exercise their authority seemingly because they disagree with the outcome of an agency decision. But substantively, the fundamental guarantors of accountability remain procedures combined with politics. For example, the "hard look" doctrine, which many complain has hamstrung agency abilities to administer programs,<sup>31</sup> is fundamentally procedural in nature: it demands that an agency fully consider all relevant factors before making a decision and explain how its decision reflects those factors.<sup>32</sup> Rarely do courts strike down agency decisions for being unreasonable or simply wrong rather than for being unreasoned.<sup>33</sup> Hence, even when courts strike down a decision as arbitrary and capricious, the agency often has significant leeway to reinstate the decision if it accompanies the reinstatement with sufficient explanation.<sup>34</sup> If the hard look doctrine has had a significant effect on agency

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28. See, e.g., *Office of Communication of the United Church of Christ v. FCC*, 359 F.2d 994, 1009 (D.C. Cir. 1966); *Scenic Hudson Preservation Conference v. Federal Power Comm'n*, 354 F.2d 608, 616 (2d Cir. 1965).

29. See, e.g., *United States v. Students Challenging Regulatory Agency Procedures*, 412 U.S. 669, 688-90 (1973); *Association of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 158 (1970).

30. See, e.g., *National Environmental Policy Act of 1969*, Pub. L. No. 91-190, § 102, 83 Stat. 852, 853-54 (1970) (codified as amended at 42 U.S.C. § 4332 (1994)). For an account of how NEPA's data collection and analysis requirements significantly changed administrative law, see Rabin, *supra* note 19, at 1286-88.

31. See Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 DUKE L.J. 1385, 1385-86, 1419 (1992); Richard J. Pierce, Jr., *The Unintended Effects of Judicial Review of Agency Rules: How Federal Courts Have Contributed to the Electricity Crisis of the 1990s*, 43 ADMIN. L. REV. 7, 8 (1991).

32. See *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 851-53 (D.C. Cir. 1970).

33. See Mark Seidenfeld, *Demystifying Deossification: Rethinking Recent Proposals to Modify Judicial Review of Notice and Comment Rulemaking*, 75 TEX. L. REV. 483, 491-92 (1997); Cass R. Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177, 183; Patricia M. Wald, *Regulation at Risk: Are Courts Part of the Solution or Most of the Problem?*, 67 S. CAL. L. REV. 621, 636-37 (1994).

34. See William S. Jordan, III, *Ossification Revisited: Does Arbitrary and Capricious Review Significantly Interfere with Agency Ability to Achieve Regulatory Goals Through Informal Rulemaking?*, 94 NW. U. L. REV. 393, 415-17 (2000). In some cases, the D.C. Circuit

authority, it is mostly because Congress has refused to grant agencies the resources they need to perform the kind of analyses the doctrine requires for all but the most pressing problems. This, however, may not be accidental; instead, it may be Congress's way of limiting agency power, and therefore it may be entirely consistent with political accountability (at least to the extent one finds the legislature sufficiently accountable).

Judicial treatment of challenges that contend that agencies acted beyond their statutory authority also manifest the substantive leeway that current understandings grant to administrative agencies. The seminal case of *NLRB v. Hearst Publications, Inc.*,<sup>35</sup> established the precedent that when Congress legislates a national solution to a regulatory problem, to the extent that Congress has not precisely defined the bounds of statutory terms, the courts should defer to the agency's construction when the agency applies the statute to resolve a particular case.<sup>36</sup> The notion that courts should defer to agency interpretations of statutes was further developed in *Skidmore v. Swift & Co.*,<sup>37</sup> in which the Court noted the propriety of giving weight to carefully considered agency positions even when the agency was not a party to the case.<sup>38</sup> The principle of deference to statutory interpretation reached its zenith in *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*<sup>39</sup> In *Chevron*, the Court stated that in the face of statutory ambiguity or silence, courts should defer to a reasonable agency interpretation of a statute that the agency administers.<sup>40</sup>

I admit that not all cases support the understanding that judicial review should provide limited substantive constraints on agency decisionmaking. In particular, two Supreme Court opinions that stretch to find clarity in seemingly ambiguous language<sup>41</sup> seem out of charac-

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has taken to remanding rules without vacating them, which indicates some expectation that the agency can and will cure any problems in justifying the rule following remand. See, e.g., *Allied-Signal, Inc. v. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150-51 (D.C. Cir. 1993) (stating that whether an inadequately supported rule should be vacated depends on the seriousness of problems in reasoning and the extent of disruption that an interim change would cause); see also Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rule-making*, 47 ADMIN. L. REV. 59, 75-78 (1995) (supporting such remands without vacation as a means of reducing burdens on agency rulemaking).

35. 322 U.S. 111 (1944).

36. See *id.* at 130-31.

37. 323 U.S. 134 (1944).

38. See *id.* at 140.

39. 467 U.S. 837 (1984).

40. See *id.* at 843-44.

41. See, e.g., *FDA v. Brown & Williamson Tobacco Corp.*, 120 S. Ct. 1291, 1316 (2000) (holding that despite tobacco's coming within a literal reading of one provision of the Food, Drug & Cosmetic Act, the intent of the statute as a whole was to preclude FDA jurisdiction to regulate tobacco); *MCI Telecomm. Corp. v. AT&T Co.*, 512 U.S. 218, 225-28 (1994) (accepting one dictionary definition of the word "modify" over another in holding that the FCC did not have the power to excuse telephone companies from filing tariffs for FCC approval).

ter with the understanding that judicial review will play a limited role in ensuring substantive agency accountability. These cases, however, are of very recent vintage. The courts have not assessed their full implications for traditional regulatory processes, let alone contractual processes. Nor have the courts clearly accepted the teachings of these cases into administrative law doctrine.

Thus, despite these recent cases, I stick to my assertion that current administrative law understands most complex regulatory programs as reserving to the administering agency authority to exercise broad discretion, but as requiring the agency to provide access and procedures that allow all stakeholders in the program to identify and publicize their concerns with agency decisions. So long as the agency indicates that it took those identified problems seriously and did not treat them in a manner inconsistent with the agency's legislative mandate, the agency eventually will be able to act as it sees fit.

#### IV. ADMINISTRATIVE LAW'S ACCOMMODATION OF BILATERAL CONTRACTUAL PROCESSES

Having laid out the uses of bilateral contracts in regulatory programs and the basic foundations of current administrative law, I turn now to discuss how current law treats the various types of regulatory contractual mechanisms mentioned by Freeman. In particular, I will discuss current methods aimed at ensuring the accountability of such contract mechanisms, analyze how public law would suggest resolving some unanswered questions regarding accountability, and finally analyze the impacts that might occur were one to borrow contract law principles to increase accountability for such mechanisms.

##### A. *Procurement Contracts*

In terms of accountability, procurement contracts pose the fewest problems for the intersection of public and private law. With respect to the contractor, the government acts as any other contracting party rather than as a regulator; hence, there is usually no need to balance public law principles against those of private contract law. But even procurement contracts can be troublesome when the government, purporting to act in its regulatory capacity, makes performance of the contract impracticable or unlawful. In such a situation, two principles of contract law collide: First, in private contracts a party is excused from performance when supervening events, including regulatory change, render the party's promise to perform impracticable.<sup>42</sup> Second, a party to a contract cannot, however, avail itself of the im-

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42. See RESTATEMENT (SECOND) OF CONTRACTS § 261 (1979). The party may still be liable for failure to perform when either the language of the contract or the circumstances indicate that the party assumed the risk of the supervening events. See *id.*

practicability defense when its own conduct is responsible for the impracticability.<sup>43</sup> The first principle recognizes the need for government to address problems that warrant regulatory action, while the second protects against moral hazard.<sup>44</sup>

The solution to this collision is to distinguish between government regulatory actions justified on grounds independent of the contract and actions taken only to improve the government's position as a contractual party. In theory, this distinction may be difficult to draw, and prevention of governmental moral hazard may justify more than minimal scrutiny by the courts to ensure that regulations which render government contracts impracticable have sound justification independent of improving the government's contractual position.<sup>45</sup> Were one concerned only with accountability, the government would be held to the terms of its contract. But the law has generally recognized that government must have the flexibility to change regulations in response to changes in circumstances, even when its own contracts are incidentally affected.

The precise boundary between regulation motivated by the prospect of escaping contractual obligations and that prompted by independent concerns for the public interest was at the heart of the Supreme Court's recent controversial decision in *United States v. Winstar Corp.*<sup>46</sup> *Winstar* involved Congressional passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989

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43. See *id.*

44. A moral hazard occurs when a party to a transaction can engage in behavior that changes the risks to the other party associated with the transaction. See MARK SEIDENFELD, MICROECONOMIC PREDICATES TO LAW AND ECONOMICS 74 (1996).

45. See Hazard & Orts, *supra* note 9, at 21-22. Hazard and Orts suggest that the distinction is more one of degree than kind and that it makes little sense to maintain it. They suggest that the unfairness of having the government renege on its contractual agreements warrants rejecting the distinction between government as sovereign and government as contractual party. See *id.* at 11. They do not, however, directly address the problems of inflexibility that would adhere to forcing the government to pay damages when it adopts regulatory changes that make contractual performance impracticable. Moreover, as long as the government is not motivated by the benefit of breaching its contracts, the unfairness Hazard and Orts perceive is no greater than the unfairness that occurs when government regulation precludes performance of purely private agreements; yet no one suggests reading the Takings and Contracts Clauses of the Constitution to require the federal and state governments to pay damages when regulatory change interferes with purely private contracts. Finally, Hazard and Orts' suggestion that contractual processes involving stakeholders somehow are more democratic than traditional modes of administrative action is fanciful because it ignores the facts that pragmatically, some affected interests will invariably be excluded from the process and that interest groups often take positions counter to the true interests of their members. See Seidenfeld, *supra* note 3, at 429-45; cf. Stewart, *supra* note 19, at 1763-64 (describing the impracticability of ensuring that all interests are represented in any interest representation conception of the regulatory process).

46. 518 U.S. 839 (1996) (plurality opinion).

(FIRREA),<sup>47</sup> which overrode favorable accounting treatment that the Federal Home Loan Bank Board had given to savings and loan associations (S&Ls) that had purchased the liabilities of other, failing S&Ls. Some have read the highly fractured decision in *Winstar* to suggest that the government will be strictly held to its contractual obligations.<sup>48</sup> A close reading of the opinions, however, indicates a majority consensus that the government should not be held to its contractual promise when regulation that primarily affects more than the government contracts renders performance impracticable. The plurality and concurrence seemed to agree that there should be “a rebuttable presumption that by entering a contract the Government does not promise to curtail the exercise of its sovereign power that could affect contractual performance,”<sup>49</sup> but that “governmental action that affects only the Government’s obligations on its own contracts and lacks broader regulatory effects on private contracts is unlikely to [absolve the Government of liability].”<sup>50</sup> Hence, outside of the unique facts of *Winstar*,<sup>51</sup> the opinions in that case reinforce the traditional understanding that the government retains leeway to pass general regulations without incurring liability for performance of ancillary contracts that is rendered impracticable by such regulation.

From the perspective of regulatory beneficiaries, procurement contracts again are not particularly problematic, albeit not for the reasons Freeman states. Freeman asserts that there are no third-party beneficiaries of procurement contracts.<sup>52</sup> But that is not true. If the Air Force pays \$500 for an ordinary wrench, the taxpayer is ad-

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47. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified as amended in scattered sections of 12 U.S.C.).

48. See, e.g., J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings, and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068, 1152 (1997) (noting that seven Justices supported their different conclusions with the same economic reasoning that stressed the government’s need to make credible contractual commitments).

49. Joshua I. Schwartz, *Assembling Winstar: Triumph of the Ideal of Congruence in Government Contracts Law?*, 26 PUB. CONT. L.J. 481, 556 (1997). The most controversial aspects of *Winstar* flow from the conclusion, shared by the plurality and concurrence, that the Bank Board’s approval of the purchasers’ accounting treatment of supervisory goodwill constituted a promise to indemnify the purchasers should subsequent regulation prohibit this treatment. See *Winstar*, 518 U.S. at 865-66. Once the Court so read the transactions between the Board and the purchasing S&Ls, the line the plurality drew between actions as sovereign and actions as contractor and the line it drew between what the government did and what it did not unmistakably promise are entirely consistent with the purposes of the two underlying principles of contract law.

50. Schwartz, *supra* note 49, at 555.

51. *Winstar* was decided against a background of the government’s statutory obligation to pay insured account holders when S&Ls fail. Because of this obligation, although both the Bank Board contracts and FIRREA affected the likelihood of S&L failures and hence the public interest, the primary impact of both was upon the government as insurer and hence was attributable to the government as contractor rather than as sovereign. See *Winstar*, 518 U.S. at 868-70.

52. See Freeman, *supra* note 1, at 165 n.44.

versely affected. Hence, contractual provisions limiting the price of procurement benefit the public fisc and thereby benefit the taxpayer. Moreover, if the Air Force buys a plane that cannot meet the specifications stated in the contract, the national defense may be compromised. Hence, virtually every resident of the United States is a beneficiary of these specifications.

One might restate Freeman's contention to read that the class of beneficiaries is so broad that it is unwise to involve the judiciary to protect them. In legal terms, the harm is generalized, hence the beneficiaries have no standing.<sup>53</sup> This is an accurate characterization of the law, but even if a government contract benefit would redound to a discrete class of individuals there are good reasons for barring enforcement actions by the beneficiaries. Government often has a continuing relationship with its providers and values their continuing cooperation to take advantage of future opportunities for contracting.<sup>54</sup> Government might even wish to exploit efficiencies that might result from modification of the very contract on which the beneficiaries would sue. The beneficiaries, however, often do not have an incentive to maintain a cooperative relationship with the provider; they may be uniquely affected by the current contract and therefore prone to resist forfeiting their benefits for the greater good of other beneficiaries of future contracts. Thus, allowing particularly identified beneficiaries to enforce government contracts is likely to chill cooperation between the government and the contractor that might be essential for the government's overall program.<sup>55</sup>

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53. See, e.g., *ASARCO, Inc. v. Kadish*, 490 U.S. 605, 613 (1989) (plurality opinion); *United States v. Richardson*, 418 U.S. 166, 176-77 (1974).

54. See Stewart MacCauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 63 (1963); see also IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 40-59 (1980) (emphasizing the roles of norms such as mutuality and flexibility in developing the cooperation that drives long-term contractual relationships).

55. Thus, citizen suits have been blamed for the reticence of industry to engage in searching environmental audits. See Elizabeth Glass Geltman & Carey Ann Mathews, *Environmental Democracy*, 22 J. CORP. L. 395, 407 (1997) (reporting that, of the companies that did conduct environmental audits [nearly 75% of those polled], 45% were hesitant to expand their auditing program because they feared their self-policing would be used against them in citizen suits and enforcement actions); *State Attorneys Quiz Browner on Audits, Federal Facilities, Criminal Investigations*, 1994 Daily Env't Rep. (BNA) D13 (Mar. 23, 1994), available at WL 1994 DEN 55. But see Press Release, EPA, EPA Audit Was Substantial Impact on Corrections of Violations by Industry (Jan. 17 1997), available at 1997 WL 16810, at \*2 (noting that during 1996, 105 companies voluntarily reported environmental regulatory violations at over 350 facilities). More generally, industry participants in alternative environmental compliance programs consider "a *sine qua non* for the likely success of [a] program [to be] the rather limited role throughout of public environmental organizations." DANIEL P. BEARDSLEY, *INCENTIVES FOR ENVIRONMENTAL IMPROVEMENT: AN ASSESSMENT OF SELECTED INNOVATIVE PROGRAMS IN THE STATES AND EUROPE* 13, 31 (1996).

*B. Contracts to Deliver Entitlements or Exercise Coercive Governmental Powers*

The second type of contract Freeman identifies involves government arranging to have private entities exercise coercive governmental powers—the powers to deprive an individual of life, liberty, or property. To this category I have added contracts to have private entities deliver entitlements, because the crucial issues surrounding such contracts involve the protection of constitutional rights—either those of individuals who are coerced or those of individuals to whom the entitlement is owed.

If one ignores the impact on constitutional rights, contracts calling for private entities to exercise coercive government powers are merely a subset of procurement contracts. The government pays for a private entity to perform a service for which the contracting agency is responsible. The impact on rights is crucial, however, because such rights provide an important check on the government's exercise of such coercive power; having granted the government such extraordinary powers, the Constitution seeks to ensure that the government invokes them only in circumstances that warrant their use.<sup>56</sup> Since the need for rights stems from the nature of the power, it follows that the government should not be able to sidestep the limitations afforded by these rights merely by hiring an independent contractor to do the miserable deeds.

When government decisions affect individual rights, political accountability provides additional checks on abuse of the government's coercive powers. Because private contractors are not politically accountable, I would argue that they should be subject to greater constraints when making decisions affecting such rights. In fact, that seems to comport with a recent decision of the Supreme Court. In *Richardson v. McKnight*,<sup>57</sup> the Court held that guards at a prison run by a private company do not enjoy qualified immunity from good faith conduct that results in deprivations.<sup>58</sup>

Contracts to have private entities deliver entitlements potentially raise different issues regarding constitutional protections than do

56. Upon proposing the first amendments to the Constitution, James Madison said that the object of the Bill of Rights "is to limit and qualify the powers of government, by excepting out of the grant of power those cases in which the government ought not to act, or to act only in a particular mode." Representative James Madison, Remarks on the Floor of the House of Representatives (June 8, 1789), reprinted in NEIL H. COGAN, CONTEXTS OF THE CONSTITUTION 803, 808 (1999).

57. 521 U.S. 399 (1997).

58. See *id.* at 412. The Court, however, explicitly reserved judgment on the question of whether private prison guards act under color of state law and hence are subject to § 1983 actions. See *id.* at 413. My analysis suggests that private prison guards should be deemed state actors, since they exercise fundamental coercive powers that cannot legitimately be exercised without an express grant from the state.

contracts to exercise coercive power. Government entitlements would warrant treatment similar to that accorded rights that protect against misuse of the state's coercive powers if such entitlements—the so-called new property—were considered as fundamental as traditional property and liberty interests. But by their nature they are not.<sup>59</sup> First, unlike deprivation of traditional liberty and property interests, the provision of entitlements does not constitute a function reserved to government. Private charities provide many of the same goods and services to the needy as do government entitlement programs.<sup>60</sup> Second, while traditional property interests are protected from uncompensated state confiscation by the Takings Clause, and traditional liberty interests cannot be altered by the state even if it is willing to pay compensation, the Constitution provides no barrier to the state substantively altering or even eliminating entitlements.<sup>61</sup> Finally, procedural protections against arbitrary deprivations of traditional property and liberty are premised on a notion of “moral justice,” which aims at reaching the correct answer to whether a person violated the law before fining or imprisoning her. Procedural protections against arbitrary deprivations of entitlements, however, are premised on “bureaucratic justice,” which aims to maximize benefits to the class of those entitled by law to receive them.<sup>62</sup> Thus, the test for whether the government has violated the Due Process Clause when depriving one of an entitlement permits agency procedures that result in remediable errors so long as the cost of the additional procedures to avoid such errors outweighs the expected cost of the deprivation to the recipient.<sup>63</sup> This distinction in the goals of procedural protection is another manifestation of the importance that cur-

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59. Even Charles Reich, who championed the recognition of government entitlements as the “new property” for both procedural and substantive purposes, was more concerned that the government would leverage such entitlements to restrict more fundamental liberties such as those guaranteed in the Bill of Rights than that the denial of such entitlements would directly deprive individuals of something fundamental. See Charles A. Reich, *The New Property*, 73 YALE L.J. 733, 756-64, 785 (1964).

60. See Rob Atkinson, *Altrusim in Nonprofit Organizations*, 31 B.C. L. Rev. 501, 605-06 (1990) (describing goods and services provided by nonprofit organizations).

61. The legal authority to change entitlement programs was starkly demonstrated when Congress modified, and in the long term essentially eliminated, federal welfare. See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996). Case law has held consistently that the Constitution does not protect individuals from loss of entitlements, even when the entitlement program involved the individual paying money to support the program. See *Flemming v. Nestor*, 363 U.S. 603, 617 (1960) (holding that a statute that retroactively made aliens who had been members of the Communist party subject to deportation and, upon deportation, forfeited their entitlement to social security retirement payments was not a taking of property).

62. See JERRY L. MASHAW, *BUREAUCRATIC JUSTICE: MANAGING SOCIAL SECURITY DISABILITY CLAIMS* 23-34 (1983) (distinguishing the “bureaucratic rationality” from the “moral judgment” models of bureaucratic decisionmaking).

63. See *Matthews v. Eldridge*, 424 U.S. 319, 348 (1976) (setting forth the test).

rent administrative law places on allowing the agency flexibility to implement its regulatory programs efficaciously.

Because the nature of power exercised by a private company under a contract to provide entitlements is not essentially governmental, whether actions by the company, even when compelled by the contract, should be subject to constitutional limitation is a difficult issue. On the one hand, contracting out the task of providing entitlements diffuses the role of the government. Because the government no longer controls individual determinations of eligibility for entitlements, such contracting renders unlikely the threat of implementation that, *sub rosa*, reflects illegitimate factors.<sup>64</sup> Hence, to the extent constitutional rights protect against government overstepping its legitimate powers, there is no need to hold contractors to be state actors. On the other hand, the value of the entitlement to those receiving it is no less important because it is actually delivered by a private entity. Hence, to the extent that constitutional protections guard the beneficiaries, as a class, from arbitrary implementation, these protections should apply to the private provider just as they would if the government had implemented the program itself. Supreme Court cases addressing whether private conduct constitutes state action have generally drawn the line at actions that are attributable to the state and situations where the state, along with the private actor, is involved in the actual decision that the plaintiff alleges violates his rights.<sup>65</sup> The Court, however, has yet to resolve the extent to which private contractors distributing entitlements on behalf of the state constitute state actors.<sup>66</sup>

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64. See Reich, *supra* note 59, at 760-64 (discussing the potential for government to leverage entitlements to force individuals to forfeit rights).

65. See *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982); see also *American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 50 (1999) (holding that an initial denial of insurance benefits by a private insurance company under a regulatory program requiring employers to obtain workers' compensation insurance was not state action, even though the state specified the precise bounds of covered claims).

66. Freeman suggests that in *Shalala v. Grijalva*, 526 U.S. 1096 (1999), the Court determined that decisions by health management organizations (HMOs) regarding Medicare coverage pursuant to contracts with the Department of Health and Human Services (HHS) were not state action. See Freeman, *supra* note 1, at 185 n.126. As she noted, however, the Supreme Court merely vacated the court of appeals' decision that such decisions were state action and remanded with instructions to reconsider the case in light of *American Manufacturers Mutual Insurance Co. v. Sullivan*, 526 U.S. 40 (1999). See *id.*; see also *Shalala*, 526 U.S. at 1096. In *Sullivan*, the Court noted that the decision involved regulated insurance benefits that had always been provided by private insurers. Hence, the Court's decision granting certiorari, vacating, and remanding simply asks the lower courts to address the HMO contractor situation in light of its recent opinion regarding workers compensation insurance, and it does not hold that HMO decisions regarding Medicare benefits are not state action.

The most relevant decision regarding conduct by contractors of the state is *Rendell-Baker v. Kohn*, 457 U.S. 830 (1982). In that case, the Court held that the firing of a vocational counselor in a private school for troubled youth was not state action, even though the counselor's position was funded by the state and most of the school's funding came from

Regardless of how one comes out on the state action question, the goal of bureaucratic justice that undergirds due process requirements for entitlements suggests that contracts intended to avoid problems related to the state's monopoly position may not warrant application of due process protections to the private contractor. The position of the contractor in a competitive market may provide adequate protection for the class of intended beneficiaries of the entitlement program.

### C. Settlement Agreements for Enforcement Actions

A third type of regulatory contract Freeman identifies consists of agreements between an administrative agency and a regulated entity regarding enforcement of the agency's regulatory program. Such agreements typically occur after an agency has identified a violation of the statute or regulations that it administers. Instead of commencing a judicial or administrative action seeking a fine from the violator, the agency invites the violator to negotiate an agreement regarding future compliance, payment of penalties, or voluntary restrictions of conduct or provision of benefits, which the agency often has no authority to order directly.<sup>67</sup>

From the perspective of the violator, the other party to these settlement agreements, the agreements may be problematic because they allow the agency to leverage its implementation and enforcement discretion to cajole conduct that Congress did not explicitly authorize the agency to order. Some have objected to this use of agency discretion because public choice theory cautions that agencies have an incentive to use such leverage to maximize their power, and there are seemingly bounds on what an agency may legitimately require in such voluntary agreements.<sup>68</sup> If I am correct in reading the primary constraints on agency conduct as procedural and political, the use of such agreements is, in theory, not problematic. So long as the agency gives affected groups an opportunity to participate in negotiating such agreements, justifies the ultimate agreement it reaches in

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the state. See *id.* at 840-42. The Court noted that the state did not dictate the decision to fire the counselor and had little interest in the personnel matters of the school. See *id.* at 841-42.

67. See Daniel A. Farber, *Taking Slippage Seriously: Noncompliance and Creative Compliance in Environmental Law*, 23 HARV. ENVTL. L. REV. 297, 309-10 (1999) (describing Supplemental Environmental Projects (SEPs) and noting how the EPA has created them as an enforcement mechanism that was never statutorily authorized); see also David A. Dana, *The Uncertain Merits of Environmental Enforcement Reform: The Case of Supplemental Environmental Projects*, 1998 WIS. L. REV. 1181, 1184-91 (describing the EPA's policy on SEPs in detail and arguing generally that SEPs decrease the cost to violators of EPA regulations and hence discourage the deterrent effect of potential penalties for violations).

68. See Lars Noah, *Administrative Arm-Twisting in the Shadow of Congressional Delegations of Authority*, 1997 WIS. L. REV. 873, 883, 911.

terms of the statutory provisions the agency implements and the situation it faces, and does not contravene any explicit statutory prohibition, then the agency has afforded opponents an opportunity to marshal political support against its program and has not acted in disregard of any direct legislative pronouncement on the issue. In many contexts, however, agency procedures fail to provide a visible process that allows those affected to make their concerns known to the agency and ultimately to Congress. In almost all contexts, enforcement settlements either are not judicially reviewable at all or receive at most a soft glance, rather than a hard look, from reviewing courts.<sup>69</sup>

Enforcement settlement agreements also raise interesting questions from the perspective of the purported beneficiaries of regulatory programs. Such agreements implicitly treat regulations as imperfect but malleable instruments for implementing regulatory policy.<sup>70</sup> A general regulation may be ill-suited for a particular plant; the plant owner may serve the goals of the agency's regulatory program more effectively and at a lower cost by taking actions different from those mandated by the regulation.<sup>71</sup> A well-publicized example involved application of a Clean Air Act regulation aimed at reducing benzene emissions to an Amoco oil refinery.<sup>72</sup> Compliance would have cost tens of millions of dollars but reduced benzene emissions only mar-

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69. See *id.* at 926-29 (describing how courts should review administrative consent decrees). The conditions I list under which I find enforcement settlements theoretically unobjectionable imply that such settlements should be subject to judicial review akin to that which applies to other agency regulatory actions. See *supra* text accompanying notes 36-43.

70. Settlements are consistent with a "compliance" rather than a "deterrence" view of enforcement. See Albert A. Reiss, *Selecting Strategies of Social Control over Organizational Life*, in ENFORCING REGULATION 23, 23-26 (Keith Hawkins & John M. Thomas eds., 1984) (describing and distinguishing compliance and deterrence systems of enforcement); Cento G. Veljanovski, *The Economics of Regulatory Enforcement*, in ENFORCING REGULATION, *supra*, at 171, 172 (noting that the compliance model of enforcement relies upon bargaining between the regulator and violator and is "sensitive to the economic and practical difficulties surrounding compliance").

71. See Keith Hawkins & John M. Thomas, *The Enforcement Process in Regulatory Bureaucracies*, in ENFORCING REGULATION, *supra* note 70, at 3, 12-13.

72. This instance of bargaining over enforcement to achieve an environmentally and economically superior outcome was brought to popular attention by a best seller bemoaning the extent to which regulatory rigidity undermined common sense. See PHILIP K. HOWARD, *THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA* 7 (1994). Howard recounts a situation where an EPA rule, implemented after years of development, required specific equipment to be put in smoke stacks in order to filter benzene. See *id.* Amoco Oil Company spent an estimated \$31 million at its Yorktown, Virginia, refinery to comply with the rule. See *id.* However, later discussion between Amoco and EPA officials led to the realization that the rule was almost completely ineffective in practice, as the benzene was primarily emitted at the loading docks rather than at the smokestacks. See *id.* "Once EPA and Amoco officials . . . realized the problem, the solution was easy and relatively inexpensive. Meanwhile, pursuant to the rigid dictates of a thirty-five-page rule that many government experts had spent years fine-tuning, Amoco had spent \$31 million to capture an insignificant amount of benzene at the smokestack." *Id.*

ginally.<sup>73</sup> Amoco agreed to take precautions against leaks at the docks where gasoline was loaded into barges, thereby providing significantly greater reductions in benzene emissions at a much lower cost.<sup>74</sup>

A plant may find compliance difficult for reasons beyond its control, and the agency may decide that it is not in the public interest to force the plant to close down. The enforcement action settlement process recognizes the potential weaknesses in general regulations and views the enforcement process as a subsequent stage in the process of designing regulations that are tailored to the particular context in which they will apply.

Given that enforcement settlement is really part of the process of tailoring regulation, beneficiaries of the regulatory program have a strong claim for inclusion in settlement negotiations. There is no guarantee that the agency will represent beneficiaries' regulatory interests in the settlement. Agency staff may be softer on violators than is warranted simply to avoid the extra work that flows from having to maintain a credible threat of actually bringing an enforcement action. More generally, the agency may negotiate for idiosyncratic benefits in return for a promise not to prosecute, rather than benefits that actually accrue to the intended beneficiaries of the regulatory program.<sup>75</sup> In fact, one study of enforcement suits concluded that regulated entities often viewed the enforcement process as an opportunity to bargain with regulators free from influence by regulatory beneficiaries.<sup>76</sup>

Thus, lessons of public choice theory and political science about agency capture and malaise support inclusion of representatives of regulatory beneficiaries in this process. Nonetheless, administrative law has generally not included putative beneficiaries of regulatory programs in the administrative enforcement process. Despite some early rumblings by the Supreme Court suggesting that individuals sometimes could sue an agency to enforce the law,<sup>77</sup> *Heckler v.*

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73. See *id.*

74. See *id.*

75. See Dana, *supra* note 67, at 1195-1200; see also Peter Schuck, *The Curious Case of the Indicted Meat Inspectors*, HARPER'S MAG., Sept. 1972, at 81-83 (describing how meat inspectors developed a norm that permitted them to accept small gratuities from packers as part of a system to get them to apply regulations in a reasonable fashion).

76. See Cary Coglianese, *Litigating Within Relationships: Disputes and Disturbance in the Regulatory Process*, 30 L. & SOC'Y REV. 735, 757-58 (1996) (noting that bargaining over settlements of litigation allows a company to negotiate with an agency in secret about the scope of a rule).

77. See *Dunlop v. Bachowski*, 421 U.S. 560, 571-72 (1975) (holding that the Labor-Management Reporting and Disclosure Act, 29 U.S.C. § 482(b) (1994), obligated the Secretary of Labor to give reasons for failing to file suit on behalf of a candidate for a union office who alleged a violation of the Act, and that the Secretary's decision not to sue was subject to judicial review to determine whether it was arbitrary and capricious or contrary to law).

*Chaney*<sup>78</sup> sent a strong message that regulatory enforcement was committed to agency discretion by law and hence was unreviewable.<sup>79</sup>

The need for greater participation of beneficiaries in the enforcement settlement process would seem to support Freeman's implicit pitch for using contract principles to increase agency accountability. One mechanism that would empower beneficiaries would be to authorize them to sue on behalf of the government for injunctions against continued violations. There are, however, countervailing concerns. As described earlier, the benefits of regulatory contracts often derive from cooperation between the regulated entity and the agency in a continuing relationship. The agency benefits by getting information from a regulatory violator that makes enforcement much easier and the ultimate remedy efficient. Agencies generally do not have resources to enforce all of their regulations, and having to deal with an industry of recalcitrant regulated entities exacerbates the drain enforcement places on dear regulatory resources.<sup>80</sup> Hence, the agency may sacrifice achieving immediate compliance for cooperation that will help maintain overall compliance with its regulatory program. Interest groups that represent beneficiaries often do not have the same goal of ensuring that the regulatory program operates effectively overall. Unlike the agency, a local interest group organized to promote a single goal related to regulatory compliance, like ensuring that no hazardous substances leak from a particular hazardous waste disposal facility, has little incentive to take into account the greater public good that can come from compromising on enforcement.

The reasons such interest groups might not be willing to compromise to serve the public interest are legion. First, the benefit from compromise may come at another locale, so that the group's members are best served by intransigent enforcement. Second, the nature of the benefits may be unrelated to the goals of the group. Hence, the group leaders will not get credit for compromising in order to secure such benefits, which would decrease the attractiveness of the group to potential members. Since group leaders have their own interests in seeing the group maintained, they might forfeit these other benefits, even though they go in part to group members, to avoid threats to the continued viability of the group.<sup>81</sup> Finally, a subset of individuals may be dedicated to fighting the industry "bad guys."<sup>82</sup> For these

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78. 470 U.S. 821 (1985).

79. *See id.* at 831-32.

80. *See Hawkins & Thomas, supra* note 71, at 11-12.

81. For a general description of interest group pathologies that tend to result in a deviation of group leaders' interests from those of group members, see Seidenfeld, *supra* note 3, at 429-40.

82. *See id.* at 441-42 (explaining why extremist groups are likely to exist on virtually any significant regulatory issue).

individuals, regulations are not malleable and open to reconsideration in order to account for more particular circumstances. Rather, they are rules with moral force whose violators must be brought to justice.<sup>83</sup> Members of these hard-core interest groups are likely to take satisfaction in stopping enforcement settlements altogether. Thus, they have an incentive to sue, regardless of the nature of the violation and the cost to society from preventing it.

The analysis above suggests a return to the fundamental understanding of administrative law—that stakeholders should have access to make their arguments, but not power to dictate final regulatory outcomes. Citizen suit provisions, which are included in numerous regulatory acts and almost every environmental statute, provide a mechanism that, at least theoretically, can achieve this understanding. Citizen suits permit any group with standing to sue to enjoin a regulatory violation and generally allow the group to recover attorney fees and costs for its effort.<sup>84</sup>

Virtually all citizen suit provisions, however, provide that suit may be commenced only after the plaintiff has given the agency administering the statute notice, and only if the agency has not itself commenced a judicial enforcement action against the alleged violator. If the agency brings its own action for enforcement, interest groups that might otherwise sue generally can intervene in the agency action.<sup>85</sup> Hence, such groups have an opportunity to comment on any proposed court-approved settlement of the enforcement action.<sup>86</sup> In

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83. See Dana, *supra* note 67, at 1198 (describing such a moral view of environmental regulation as one possibly held by regulators).

84. See, e.g., Consumer Product Safety Act, 15 U.S.C. § 2073 (1994); Endangered Species Act, 16 U.S.C. § 1540(g) (1994); Clean Air Act, 42 U.S.C. § 7604 (1994). Some statutes allow individuals to seek penalties on behalf of the government. See, e.g., Federal Water Pollution Control Act (Clean Water Act), 33 U.S.C. § 1365(a) (1994). Such citizen suit provisions, however, may give interest groups too great an incentive to sue violators. Groups can sue and threaten huge penalties, even for violations that do not cause serious harm, and use leverage from the suit to obtain a settlement which includes payments to the group. See Michael S. Greve, *Private Enforcement, Private Rewards: How Environmental Citizen Suits Became an Entitlement Program*, in ENVIRONMENTAL POLITICS: PUBLIC COSTS, PRIVATE REWARDS 105, 109 (Michael S. Greve & Fred L. Smith, Jr. eds., 1992).

85. See 33 U.S.C. § 1365(b)(1)(B) (1994); 42 U.S.C. § 7604(b)(1)(B) (1994).

86. Although the agency and the regulated entity can settle the matter out of court, settlements that are not cemented into some judicial order are difficult to enforce. In particular, it is doubtful that an entity could enjoin subsequent prosecution by the government based on an out-of-court settlement. Hence, almost all enforcement-action settlements are reflected in consent decrees. Perhaps more importantly, if the agency and regulated entity decide to forego judicial approval of the settlement, an interest group can file a subsequent citizen suit and argue that the settlement demonstrated that the agency prosecution was not diligently prosecuted. Compare *Atlantic States Legal Found., Inc. v. Pan Am. Tanning Corp.*, 993 F.2d 1017, 1022 (2d Cir. 1993) (allowing a citizen suit for monetary penalties, but not injunctive relief, despite local officials having settled for fines of \$6600), with *Atlantic States Legal Found., Inc. v. Eastman Kodak Co.*, 933 F.2d 124, 127 (2d Cir. 1991) (dismissing a citizen suit for injunctive relief where a state administrative settlement resulted in state court-imposed fines of \$2 million and the prospect of future violations was

essence, by authorizing private entities to enjoin violations, but allowing the agency to block such suits by bringing its own actions, citizen suit provisions check against agency dereliction of prosecutorial duties in a manner that allows affected interest groups to state their concerns before a court; but they do not allow these groups the ultimate decision about whether and when compliance should occur.

Citizen suits have not always worked to encourage the agency to make responsible enforcement decisions after input from stakeholders—that is, to deliberate over enforcement settlements. A major problem with citizen suits today is the underfunding of agency enforcement. Agencies do not have the resources to file their own actions in every citizen suit that the agency believes warrants settlement.<sup>87</sup> Instead, citizen suits have been used to provide meaningful enforcement without the agency having to spend its resources.<sup>88</sup> Some increase in funding for enforcement is probably necessary if citizen suit provisions are to result in deliberative settlements. Another barrier to meaningful input into settlements by stakeholders is the reluctance of the courts to review settlements of enforcement actions with any rigor.<sup>89</sup> Because enforcement involves the prioritization of agency resources, courts are loathe to get actively involved in the process even once the agency has brought an action.<sup>90</sup> If courts viewed the settlement process as part of an ongoing process of regulatory design, they might be willing to apply review akin to the hard

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unlikely), *EPA v. City of Green Forest, Ark.*, 921 F.2d 1394, 1403-05 (8th Cir. 1990) (holding that a consent decree between the government and the violator is a judgment that bars a private plaintiff's suit), and *Student Pub. Interest Research Group v. Georgia-Pacific Corp.*, 615 F. Supp. 1419, 1432 (D.N.J. 1985) (holding that a consent judgment barred claims for all violations covered by that judgment). *But see Sierra Club v. Coca-Cola Corp.*, 673 F. Supp. 1555, 1557 (M.D. Fla. 1987) (holding that the court's decision to issue a consent decree for a settlement between the EPA and the company did not warrant dismissal of a citizen suit that merely sought a penalty in addition to that specified in the decree, while never addressing the impact of the statutory bar to a citizen suit if the government is diligently prosecuting the violation).

87. In most cases, the agency simply ignores a citizen group's notice of intent to sue a violator. See Barry S. Neumann & Jeffrey A. Knight, *When Are Clean Water Act Citizen Suits Precluded by Government Enforcement Actions?*, 30 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 10,111, 10,120 n.123 (Feb. 2000).

88. See Beverly McQueary Smith, *The Viability of Citizens' Suits Under the Clean Water Act After Gwaltney of Smithfield v. Chesapeake Bay Foundation*, 40 *CASE W. RES. L. REV.* 1, 56 (1989-90).

89. See *NLRB v. United Food & Commercial Workers Union*, 484 U.S. 112, 130 (1987) (holding that settlement of an unfair labor practice charge under the National Labor Relations Act was prosecutorial in nature and hence unreviewable); see also *Schering Corp. v. Heckler*, 779 F.2d 683, 686-87 (D.C. Cir. 1985) (rejecting as unreviewable a pharmaceutical company's challenge to a private settlement between the FDA and a competitor because the settlement involved "the sort of balancing of agency priorities and objectives . . . that . . . should not be second-guessed by a court").

90. See *Heckler v. Chaney*, 470 U.S. 821, 831-38 (1985) (according a presumption of unreviewability to agency nonenforcement decisions); Ronald M. Levin, *Understanding Unreviewability in Administrative Law*, 74 *MINN. L. REV.* 689, 715-16 (1990).

look doctrine to enforcement action settlements. That review would go a long way toward making the agency take the concerns of affected interest groups seriously when negotiating such settlements.<sup>91</sup>

#### D. Contractual Regulations

The formulation of provisions that, *ex ante*, specify the bounds of the regulated entity's conduct is the last type of regulatory contract Freeman identifies. The conventional wisdom is that until recently agencies rarely used such contractual regulations, but they now have become staples of regulatory reinvention programs such as the EPA's Project XL.<sup>92</sup> Project XL, however, has prompted significant criticism from environmental interest groups.<sup>93</sup> National groups have little incentive to participate in projects with only local significance, and local groups often do not have the expertise to counter the factual assertions of the project sponsors.<sup>94</sup> Perhaps more importantly, the sponsors get to select which stakeholders to involve in the negotiating process and ultimately the extent to which they can participate.<sup>95</sup> Virtually all sponsors have limited involvement by environmental interest groups to ensure that groups with a reputation for taking a hard line against development are not directly involved in negotiating the agreement.<sup>96</sup> Hence, Project XL may not be a good template for involvement of stakeholders in the process of negotiating contractual regulations.

Instead of emulating experimental programs like Project XL, regulators may do better by taking a close look at some traditional regulatory programs. Many traditional regulatory programs require companies to obtain permits before operating, and the permitting process in fact, if not in theory, actually involves contractual regulation. Under most permit programs, the applicant for a permit must meet some objective minimal standard. If the applicant meets that

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91. See Mark Seidenfeld, *Bending the Rules: Flexible Regulation and Constraints on Agency Discretion*, 51 ADMIN. L. REV. 429, 488-89 (1999).

92. The EPA intends Project XL to allow regulated sources of pollution the flexibility to develop alternatives to existing regulation in order to produce greater environmental benefits at lower cost. Under Project XL, a source proposes a plan specifying alternatives to existing regulation, and if the EPA deems the plan within Project XL's scope, the final plan is negotiated by all those with a stake in its implementation. See generally *Regulatory Reinvention (XL) Pilot Projects*, 60 Fed. Reg. 27,282 (1995); 62 Fed. Reg. 19,872 (1997); see also Seidenfeld, *supra* note 3, at 408.

93. See Rena I. Steinzor, *Reinventing Environmental Regulation: The Dangerous Journey from Command to Self-Control*, 22 HARV. ENVTL. L. REV. 103, 142-43 (1998).

94. See Seidenfeld, *supra* note 3, at 474-77.

95. See Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1, 77 (1997); Bradford C. Mank, *The Environmental Protection Agency's Project XL and Other Regulatory Reform Initiatives: The Need for Legislative Authorization*, 25 ECOLOGY L.Q. 1, 73 (1998); Seidenfeld, *supra* note 3, at 474.

96. See Seidenfeld, *supra* note 3, at 474-80.

standard, the agency often has discretion to structure the permit to further broad statutory goals. The process of formulating a permit almost always involves the agency working with the applicant to achieve what is best for the program and the applicant. In other words, the agency and the applicant often negotiate permit requirements, and the applicant only obtains a permit if both it and the agency agree to those requirements.<sup>97</sup>

Under some permitting programs, the agency negotiates the details of the permit with the applicant and then provides notice of its intent to issue the permit. Stakeholders may then be provided an opportunity to comment on the permit before the agency issues it, and permits are subject to judicial review as final agency action.<sup>98</sup> This permitting process generally implements administrative law's fundamental requirement of meaningful opportunity for stakeholder participation, with ultimate responsibility remaining with the agency. The process does, however, suffer two weaknesses. First, stakeholder involvement may come at too late a stage to have much chance at influencing the mandates in a permit.<sup>99</sup> Once the agency and the applicant have agreed to the details of the permit, the agency is unlikely to reopen issues it considered resolved because of the concerns of affected third parties. Second, even were the agency to allow earlier input about the substance of a permit by stakeholders, there may not be sufficient publicity about the application for the permit and the potential impact of the applicant's proposed operations to generate significant stakeholder involvement at these early stages. But minor tweaking of the process—imposing obligations on the permit-issuing agency to inform the public prior to negotiating the proposed permit and to identify and invite to the negotiation groups affected by the applicant's proposed activity—would significantly alleviate these shortcomings.

## V. CONCLUSION

Professor Freeman has described how regulators increasingly use contract as an important weapon in their arsenals.<sup>100</sup> She suggests that administrative law has not explicitly taken into account the use

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97. See Ashutosh Bhagwat, *Modes of Regulatory Enforcement and the Problem of Administrative Discretion*, 50 HASTINGS L.J. 1275, 1298-99 (1999) (attributing the impact of authorizing agency pre-clearance to its impact on the negotiations between the agency and the applicant).

98. See Ruhl, *supra* note 17, at 376-91 (describing the permitting process for Habitat Contingency Plan permits under the Endangered Species Act).

99. Psychologists have found that commitment to an original position decreases the likelihood that an individual subsequently will choose an alternative, even if the person understands arguments stating why the alternative is better. See ROBERT B. CIALDINI, *INFLUENCE: THE PSYCHOLOGY OF PERSUASION* 67 (rev. ed. 1993).

100. See Freeman, *supra* note 1, at 157-58.

of this weapon and that perhaps public law should allow greater opportunities for private enforcement of government contracts, both by the other parties to the contracts and by those intended to be benefited by them.<sup>101</sup> This Comment suggests that although administrative law doctrine rarely explicitly recognizes contract as a regulatory mechanism, that doctrine includes understandings that allow for the use of contracts as a regulatory mechanism. These understandings, however, suggest that increasing the ability of private entities to enforce government contracts is not an appropriate mechanism for holding agency policy democratically accountable.

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101. See *id.* at 191.