ARTICLES

CONTRACTING WITH THE REGULATED FOR BETTER REGULATIONS

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INTRODUCTION

By almost universal consensus, our existing systems of federal environmental, health, and safety regulation are inefficient in both design and operation. They are also procedurally cumbersome, and give the regulated only limited incentives to suggest new methods of addressing social problems.

Use of "market-based" approaches that give the regulated more freedom to choose the means of social cost reduction, and to "trade" reduction efforts among themselves, is often suggested as an alternative to these existing systems. So is the somewhat similar reform of "devolution" to state and local governments of responsibility for particular programs.

This Article endorses these criticisms of the existing systems. It contends, however, that they do not identify the deepest cause of regulatory malaise. In addition, the criticisms do not recognize that the reform best suited to address that deepest cause is also the reform best suited to encourage market-based approaches and devolution.

This Article argues that failures to distinguish between the *ends* a regulatory program seeks to achieve, and the *means* used to achieve them, and to set priorities among different regulatory ends, constitute a major cause of regulatory dysfunction. Without clear distinctions between ends and means, and clear priority rankings among ends, effective management becomes impossible almost by definition, since neither success, failure, nor improved performance can be measured. The absence of goals and priorities particularly hinders efforts to update regulatory programs to reflect new possibilities created by advancing knowledge, or to construct more ef-

ficient market-based systems for achieving ends. Such systems might be based, for example, on the "trading" of rights to emit pollutants, catch fish, or develop endangered species habitat.[1]

Such failures could be alleviated by adopting a reform mechanism—which I call "regulatory reform contracts"—to transfer into the regulatory process the structural incentives to continually improve the efficiency of means and to continually readjust ends and means that competitive markets provide to market participants.

Competitive markets operate through the continuing reciprocal actions of sellers and buyers. They motivate sellers to produce a given good more cheaply and to discover different ways to meet the same underlying need. Contact lenses replace glasses and are challenged, in turn, by laser vision correction. Producers who offer dramatic price reductions or quality improvements can expect to displace their rivals in the existing market and to profit from an overall market expansion, as purchasers shift their outlays from other goods and services toward the new or cheaper product.

In a similar fashion, regulation depends for its beneficial results on the reciprocal actions of the regulators, who issue commands designed to achieve some social good, and the regulated, who must act to make those commands reality. However, regulatory agencies—the "purchasers" of the services they command to be produced—are far less able to adjust their conduct to the innovative actions of the regulated than most purchasers in private markets. That unresponsiveness in turn discourages the regulated from offering new ways to achieve social benefits.

Regulatory agencies are unresponsive for several reasons. First, they are unresponsive because of confusion between ends and means, and among ends. Most regulatory statutes do not distinguish with any precision between the ultimate end that society has chosen to achieve, which cannot be varied without generating a new social consensus, and the means to that end, which could be varied without calling the legitimacy of the end itself into question. If ends and means were sharply distinguished, it would be easier for an agency to vary the means by relatively summary procedures to better achieve the ends. In the absence of clearly defined ends, it also becomes very difficult to trade a slight reduction in realizing one end for a dramatic improvement in realizing another, since there is no established foundation for comparing the two ends. In the absence of ends-means dis-

1. For a thorough discussion of the ends-means problems that arise when designing "environmental trading markets," see James Salzman & J.B. Ruhl, *Currencies and the Commodification of Environmental Law*, 53 STAN. L. REV. 607 (2000) (discussing growing interest in market-based instruments of environmental protection, and contending such approaches must explicitly commodify environmental impacts by creating markets for their sale).

tinctions, every effort that the statute commands tends to become an end in itself. Ends and means are "conflated"[2] and the distinction between them is lost. This conflation hinders changes in regulatory policy by allowing any change in instruments to be depicted as a change in ends that cannot be legitimately made without generating a new social consensus.

A system built on the absence of clear distinctions between ends and means, and of priorities among ends, reinforces the tendency of regulatory agencies to act as relatively passive brokers among the interests of the pressure groups that surround them, not as independent voices for a distinct conception of the ends and means of regulation.[3] Since such agencies have little power to change even regulatory means by their own actions, they in turn lack strong motives to consider what their ends might be, and what means might be best suited to achieve them. Such an agency may be able to adequately implement a new statute that crystallizes the current balance of political forces; it will be powerless in the absence of legislative action to change a regulatory matrix that has become obsolete.

To change the means of regulatory policy, the rules that articulate those means must be amended. Such amendments must address a wide range of issues and pass through a complex set of procedures that provide many footholds for opponents. Agency reluctance to address these issues and procedures has arguably caused an "ossification" of the agency rulemaking process.[4] Since the payoff to an agency from changing an existing regulation is generally less than the payoff from putting a new program into operation, the reluctance will be greater for changes to an existing program than for regulations issued to implement a new statutory mandate.[5]

2. The term was coined by Professors Ackerman and Stewart, who argued that our current "best technology" system "conflates means and ends, preventing the intelligent assessment of either." Bruce A. Ackerman & Richard B. Stewart, *Reforming Environmental Law*, 37 STAN. L. REV. 1333, 1340 (1985). *See also* BRUCE A. ACKERMAN & WILLIAM T. HASSLER, CLEAN COAL/DIRTY AIR: OR HOW THE CLEAN AIR ACT BECAME A MULTIBILLION-DOLLAR BAIL-OUT FOR HIGH-SULFUR COAL PRODUCERS AND WHAT SHOULD BE DONE ABOUT IT 122-23 (Yale Univ. Press 1981) (distinguishing between our current "means-oriented" framework of environmental legislation, which tells agencies exactly what to do, and a hypothetical superior "ends-oriented" approach which would describe the goal with more particularity and give agencies discretion as to how to achieve it).

3. For descriptions of these different "models" of the agency, *see* Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1 (1998); Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1669 (1975).

4. The term "ossification" was coined by E. Donald Elliott, former General Counsel of the Environmental Protection Agency (EPA). *See* Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 DUKE L.J. 1385, 1385-86 (1992).

5. In many cases, the detail of our current statutes makes legislative action necessary, even for changes in regulatory means. The inherent difficulty of writing and passing legis-

The obstacles to change reinforce each other. Confusion between ends and means, and lack of comparability among ends, obscure the issues at stake and make it difficult to suggest changes or generate political support for them. A passive agency will need more support than an active agency, and more support will be needed to cope with an ossified process than with a streamlined process.

"Regulatory reform contracts" could address each of these problems simultaneously. By this term, I mean a program under a new statute that would authorize agencies to accept offers from the regulated to comply with a set of regulatory obligations different from the obligations defined by existing law, as long as "equal social benefits" would result. The statute would specify the types of obligations that could be traded (for example, "all pollution control obligations under statutes administered by the Environmental Protection Agency (EPA)") and, perhaps, set other conditions as well (for example, forbidding trades that caused violations of air or water quality standards) to legislatively confine the agency's authority to trade off different sets of obligations as socially equivalent. The statute would also subject all such contracts to public comment and limited judicial review. Any contract that met those conditions would be valid.[6]

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lation adds significant new obstacles to those arising from regulatory procedures.

6. Several survey articles and textbooks mention the use of contracts as an alternative to conventional regulation. *See, e.g.*, PETER S. MENELL & RICHARD B. STEWART, ENVIRONMENTAL LAW AND POLICY 420-21 (1994) (discussing industry-wide environmental contracting in the Netherlands and EPA contracting experiments in the United States); CASS R. SUNSTEIN, FREE MARKETS AND SOCIAL JUSTICE 372-73 (1997) (noting environmental contracting may provide an alternative to federal regulation where the government lacks knowledge of the least expensive means of producing the preferred regulatory ends); Eric W. Orts & Kurt Deketelaere, *Introduction: Environmental Contracts and Regulatory Innovation*, *in* ENVIRONMENTAL CONTRACTS: COMPARATIVE APPROACHES TO REGULATORY INNOVATION IN THE UNITED STATES AND EUROPE (Eric W. Orts & Kurt Deketelaere eds., 2001) (explaining collaborative approaches to pollution control through environmental contracts in countries such as Belgium, France, Germany, and the Netherlands, and to some extent in the United States, as flexible means of regulation that may lower the costs of pollution control and may achieve superior environmental results); ENVIRONMENTAL CONTRACTS AND COVENANTS: NEW INSTRUMENTS FOR A REALISTIC ENVIRONMENTAL POLICY? (Jan M. van Dunné ed., 1993) (providing several articles prepared for a conference in Rotterdam on the characteristics of environmental contracts in Belgium, Canada, Germany, the Netherlands, and the United States).

However, there are very few analytical treatments. Of two notable exceptions, one is somewhat uncritically positive. *See* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE (Donald R. Harris et al. eds., 1992). The other exception is almost unqualifiedly negative. *See* David Dana & Susan P. Koniak, *Bargaining in the Shadow of Democracy*, 148 U. PA. L. REV. 473 (1999). Professor Dana later qualified his negative opinion somewhat. *See* David A. Dana, *The New "Contractarian" Paradigm in Environmental Regulation*, 2000 U. ILL. L. REV. 35 (2000) (recognizing while "contractarian" programs show some promise in reducing costs to businesses,

Such an approach would adapt, for regulatory use, the mechanism of reciprocal adjustment that makes competitive markets such a dynamic form of social organization.

It would convert regulated entities, in the form of contract offerors, into advocates of change rather than beneficiaries of gridlock, and would motivate them to disclose new and innovative means of achieving social ends. In turn, such offers could pressure agencies to develop and express their own reasons for approving some such offers, while rejecting others. An agency that could select among offers for "regulatory reform contracts," and defend its choices to the public, would not fit the "passive" model described earlier. Such an agency would need to be far more precise about the relative worth of different regulatory obligations, and far more articulate about the nature of the ends that might justify trading among them, than agencies generally are today. In the process, the agency would become more of an independent actor articulating its own views on the desirable evolution of public policy.

Many issues of regulatory ends and means have proved impossible to clarify by abstract discussion. They might well be made easier to resolve by a context of experience that could help focus the debate.[7] Regulatory reform contracts are ideally suited to clarify such issues by a dialogic process of discussion, experiment, and evaluation followed, if necessary, by more experiments. Moreover, such clarifications would be reached by collaboration, not through the system of top-down commands from the regulators to the regulated that characterizes the current approach.[8]

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they also have potential downsides, such as decreased public participation and regulatory stasis). Unlike this Article, none of these works attempts to relate the use of contracts to the other forces that bear on regulatory agencies and their various constituencies, or to focus on the use of contracts as a method of clarifying regulatory ends and means.

7. According to Michael C. Dorf and Charles F. Sabel:

> [T]he central tenet of experimentalism is that experience matters, or, more precisely, that the best way to assess the viability of plausible but imprecise ideas is to test them in practice under conditions that permit learning from the experience. Experimentalism would be superfluous if its results could be anticipated by reflection. That is why we [the authors] are, broadly speaking, at pains [in their reform suggestions] to make it hard to stop an experiment before the fact simply by imagining possible harms . . . .

Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267, 407 (1998).

In an effort to encourage the agency to reform itself, the National Academy of Public Administration (NAPA) has recommended that the "EPA should end its practice of permitting only those experiments that pose no possibility of increasing some pollution or decreasing some measure of enforceability." NAT'L ACAD. OF PUB. ADMIN., ENV'T GOV: TRANSFORMING ENVTL. PROTECTION FOR THE 21ST CENTURY 62 (Nov. 2000) [hereinafter NAPA], *available at* http://www.napawash.org/napa/index.html.

8. In other words, the contract approach could be the vehicle for departing from the traditional distinction that: "Agency officials are insiders, whereas stakeholders are outsid-

A regulatory reform contract approach would help clarify the distinction between regulatory ends and regulatory means, the nature of regulatory ends, and the relative value of different ends. Each contract would exchange greater performance in realizing one legally-defined obligation for lesser performance in realizing another. To justify such trades, an agency would need to show either that the new approach substituted more effective means of achieving an existing end for less effective means, or that it achieved some social ends so much more effectively that any attendant sacrifice became worthwhile. Both the debate over whether to approve such contracts prospectively, and actual experience with them, would therefore contribute to more precise definitions of regulatory ends and means.

Of course, such a new approach might not fully succeed. But even partly successful efforts could generate a body of new experience and information not available in any other way that may be used to design a regulatory system that achieved social ends in a more effective and flexible manner. Some might argue that the regulatory contract approach would confer too much discretion on regulatory agencies and contract offerors. But their experimental nature, the use of the existing regulatory system as a baseline, and the requirements of notice and comment, would reduce such dangers to a highly acceptable level. Imposition of more elaborate controls would essentially institutionalize the "passive" agency and change it by removing the potential of a contract approach.

This Article concludes by describing how a "regulatory reform contract" approach would encourage the adoption of more generic regulatory changes. Most clearly, it would encourage the growth of "market-based" approaches to achieving regulatory ends as a substitute for "command and control" regulations that directly tell the regulated what to do. Market-based approaches must be designed around a rigorous separation between the ends of the regulatory system, which they define generically, and the economic means used to achieve them.[9] The clarification between ends and means that a regulatory reform contract approach requires would, therefore, furnish a natural prelude to the broader adoption of market-based

ers. Interested parties compete to influence agency decisions and have the right to challenge agency decisions in court, but they have no direct responsibility for devising or implementing solutions to regulatory problems." Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1, 18 (1997). "The role of interest groups is to recommend and advocate policy choices that favor their members, but not to make policy themselves. Pluralism insists on a strict divide between such 'private' groups and the state." *Id.* at 18 n.48.

9. Salzman and Ruhl argue in detail that such programs cannot be designed without specifying "defined environmental goals," stating "[a]bsent this clear articulation of . . . goals, the currency [in which trades are denominated] cannot be adequately determined." Salzman & Ruhl, *supra* note 1, at 631.

approaches.

A regulatory reform contract approach would also encourage the devolution of responsibility for achieving regulatory ends to both states and regulated entities. Sharpening the distinction between ends and means automatically focuses attention on how to measure the adequacy of the means to attain the end. Once such measurement techniques have been developed, it becomes possible for the agency in charge of achieving the ends to allow others to deploy the means, since their success or failure can, at that point, be determined.

Finally, experience with regulatory reform contracts would encourage reliance on contracts as "base load" regulatory mechanisms, not just as experiments. Extending the contract mechanism beyond the level of an experiment would raise, once again, the question of controlling discretion. Giving the regulated a preferential right to suggest changes to the basic regulatory system creates an obvious danger of abuse. Conversely, agencies in possession of wholesale "regulatory contracting" authority[10] allowing them to accept performance that differs from the performance that the rules specifically prescribed, might be tempted to tighten existing regulatory requirements, not for their direct results, but to be able to grant relief to those who offered something else that was difficult or impossible for the government to require directly.

This Article contends that the first such danger could be addressed by more precise definitions of the variations from existing requirements that would still be consistent with attaining the program's overall end. The second danger could be addressed by more precise specification of the rules for setting those requirements themselves. More precise definitions of regulatory ends and more rigorous analysis of new regulations have long been viewed as necessary to improve regulatory performance. By encouraging these practices, the contract approach would make yet another contribution to regulatory reform.

The "regulatory reform contract" approach resembles the program of regulatory experiments called "Project XL" in which the EPA "attempt[s] to negotiate with individual sources to reduce their net environmental impact below what could be achieved by full compliance with existing regulatory standards."[11] Despite some successes, the program's performance to

10. This Article uses the term "regulatory contract" when discussing contracts used as a part of the permanent regulatory system, and "regulatory reform contract" for the experimental contracts on which its analysis is focused.

11. Daniel A. Farber, *Taking Slippage Seriously: Noncompliance and Creative Compliance in Environmental Law*, 23 HARV. ENVTL. L. REV. 297, 309 (1999). *See also* Regulatory Reinvention (XL) Pilot Projects, 60 Fed. Reg. 27,282 (May 23, 1995).

Other provisions in various federal statutes expressly provide for granting regulated

date has been disappointing[12] for reasons that largely confirm the "passive

firms relief from their prescribed obligations in return for the development of cheaper or more effective ways of achieving the prescribed goal. Such authority is contained in section 111(j) of the Clean Air Act, which authorizes a four-year extension of certain compliance deadlines in return for the development of significantly improved technology; *see* 42 U.S.C. § 7411(j) (1994), and section 311(k) of the Clean Water Act, which authorizes a two-year extension; *see* 33 U.S.C. § 1311(k) (1994). These authorities have been almost unused, in part because of the strict conditions that applicants must meet and the limited relief available.

The Occupational Safety and Health Act (OSHA) authorizes both granting experimental variances from otherwise applicable requirements to allow the use of new and improved techniques; *see* 29 U.S.C. § 655(b)(6)(C) (1994), and also granting a permanent variance to an employer that will adopt alternate means that "will provide employment and places of employment . . . which are as safe and healthful as those which would prevail if [the employer] complied with the standard [that is the subject of the variance]." 29 U.S.C. § 655(d) (1994).

According to one study, however, "[t]o date . . . the agency has largely ignored the opportunities that this provision of the Act affords." Charles C. Caldart & Nicholas A. Ashford, *Negotiation as a Means of Developing and Implementing Environmental and Occupational Health and Safety Policy*, 23 HARV. ENVTL. L. REV. 141, 187 (1999).

However, a very similar authority to approve alternative compliance mechanisms under the Mine Safety and Health Act has been extensively used. *See* AYRES & BRAITHWAITE, *supra* note 6, at 115-16 (noting the Mine Safety and Health Administration granted six hundred petitions to modify mandatory safety standards in its first five years).

The "regulatory reform contracts" discussed in this Article also have certain similarities to the "habitat conservation program" under the Endangered Species Act. Under this act, the government assures landowners who agree to dedicate an interest in land to endangered species conservation that no future obligations under the statute will be asserted against them unless compensation is provided for any resulting economic loss. *See generally* Donald C. Baur & Karen L. Donovan, *The No Surprises Policy: Contracts 101 Meets the Endangered Species Act*, 27 ENVTL. L. 767 (1997) (contending landowners who adequately implement approved habitat conservation plans remain relatively secure from additional regulations, fines, penalties or restrictions on lands or other natural resources). In my view, however, the issues raised by habitat conservation plans run well beyond the issues raised by other types of regulatory reform contracts. Regulatory reform contracts seek to discover new methods of achieving social goals that, once discovered, are within the government's legal power to command directly. By contrast, an important motive for habitat conservation plans is undoubtedly to implement the Endangered Species Act in a way that would not be challenged as an uncompensated "taking" of private property. *See* Dana & Koniak, *supra* note 6, at 511-12 ("Faced with the possibility of an intense struggle over the regulation of private land, and the substantial possibility they would lose the struggle, [Secretary of the Interior] Babbitt and pro-environmentalist regulators at [the Interior Department] arrived at the split-the-difference solution of Habitat Conservation Plans.").

To address the legitimacy of such "contracting around" takings concerns would require another article. For that reason, I will discuss habitat conservation plans only peripherally.

12. "Since its creation, Project XL has produced several strong agreements with companies, though as a vehicle for encouraging systematic innovation, the program has been a disappointment." NAPA, *supra* note 7, at 38.

While the EPA set an initial goal of fifty projects, as of the end of 1997, only seven

agency" model.[13] Although Project XL conflicted with many elements of the EPA culture, its proponents did not or could not resolve these conflicts.[14] Often the EPA, rather than making its own decisions on the merits

> XL projects had been finally approved; three were listed by the EPA as "facilitated" but not yet final; nine had reached the intermediate "development" stage; and thirty XL proposals had been rejected or withdrawn for a variety of reasons.

Dorf & Sabel, *supra* note 7, at 384.

"Despite its high profile . . . Project XL has proved a disappointment to virtually all of its outside constituencies. . . . Project XL has . . . been under constant fire from national and local environmentalists and community representatives, who condemn it on the basis of both substance and process." Rena I. Steinzor, *Reinventing Environmental Regulation: The Dangerous Journey from Command to Self-Control*, 22 HARV. ENVTL. L. REV. 103, 124-25, 128 (1998). "[C]ompanies are increasingly discouraged by the unexpectedly high transaction costs of participation . . . . There is frustration over the length of the project review process and confusion over the role of stakeholders . . . ." *Id.* at 128 (quoting TERRY DAVIES & JAN MAZUREK, INDUSTRIAL INCENTIVES FOR ENVIRONMENTAL IMPROVEMENT: EVALUATION OF U.S. FEDERAL INITIATIVES 3 (1996)). *See also* Caldart & Ashford, *supra* note 11, at 182-83 ("Although the [Project XL] program is still in its infancy, it is probably fair to say that it has been far from a clear success.").

Steinzor attributes this failure to the absence of clear standards for approval of these projects, combined with a failure to clearly explain the costs and benefits of individual projects and provide quantitative and enforceable measures of performance. *See* Steinzor, *supra*, at 125-26. This Article argues, by contrast, that the lack of detailed standards for approval is not a flaw in the reform contract approach, but rather part of its essence, and that cures for the defects of Project XL should be sought through legislative authorization and a less passive approach by the implementing agency.

13. For another example tending to confirm the "passive agency" model, see the discussion of the EPA's "toxic release inventory" program in William F. Pedersen, *Regulation and Information Disclosure: Parallel Universes and Beyond*, 25 HARV. ENVTL. L. REV. 151, 181-83 (2001).

14. *See* Freeman, *supra* note 8, at 73 ("Recognizing that Project XL is still very new, EPA officials estimate that only a small minority of staff are genuinely committed to its success.").

> According to one XL administrator, "Philosophically, the greatest resistance to flexibility is within the agency itself . . . . A 'command and control' agency cannot run an initiative stressing innovative approaches . . . ."
>
> . . . .
>
> "EPA hasn't cultivated or rewarded the skills necessary to successful innovation since Reagan was elected," remarked a regional XL team member. "It doesn't know how to experiment. Nor did it attempt to attract the expertise to evaluate research and development proposals floated by the regulated community and our lack of entrepreneurial skills hurt us on Project XL. Instead of . . . participating as a partner in project development, we treated each project as a permit application to be passively processed." A fellow team member replied, ". . . The skills to do XL are not at EPA; the very concept was deeply distrusted."

Lawrence E. Susskind & Joshua Secunda, *The Risks and the Advantages of Agency Discretion: Evidence from EPA's Project XL*, 17 UCLA J. ENVTL. L. & POL'Y 67, 96-97 (1998-99). Mr. Secunda is an EPA employee.

Similarly, the NAPA has concluded, quoting one of its research reports, that "many EPA

of individual projects, sought full consensus among all interested parties,[15] some of whom tended to automatically oppose XL projects as likely to diminish their power under the existing system. However, these tendencies did not operate entirely on their own. They were reinforced by the absence of legal authority for Project XL, which discouraged any steps that might have attracted a legal challenge.[16] Accordingly, legislation affirmatively authorizing "regulatory experiments" represents a critical part of these recommendations.

I. DISCUSSION

A. The Defects of Our Regulatory System

1. Inefficiency Caused by Weak and Unclear Goals

Many studies have concluded that our existing federal environmental, health, and safety regulation systems are inefficient in achieving any reasonable goal that might be set for them.[17] They often intensively regulate some sources of a given narrowly-defined social cost (for example, emis-

officials are 'made profoundly uneasy about the granting of flexibility, and the diminution of traditional accountability and leverage mechanisms under [a more ends/means oriented approach].'" NAPA, *supra* note 7, at 149.

15. According to one study of Project XL:

> Several corporate XL participants and EPA regional team members agreed with the following statement, made by an XL regional engineer team member: In the end, it's EPA's responsibility to make decisions on the efficacy of environmental compliance proposals. Yet the Agency's obsession with stakeholder involvement turned XL into something not entirely relevant to the collaborative development of technology: a stakeholder-designed, from the ground up exercise in process development. That was not XL's stated purpose.

Susskind & Secunda, *supra* note 14, at 105. Of course, the legally shaky ground on which many XL proposals rested also contributed to the desire for consensus.

16. Many XL projects were of such dubious legality that a slogan arose: "If it isn't illegal, it isn't XL." Steinzor, *supra* note 12, at 147. That, in turn, placed a premium on achieving consensus among all potential litigants to avoid a court challenge. This striving for consensus reinforced the agency's natural passive tendencies, since an agency that cannot act without universal consensus among its surrounding interest groups is the very model of passivity.

Several studies have already pointed out the need for legislative authorization for Project XL. *See, e.g.*, 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, 6-7 (1998) (asserting a lack of an "effective organic statute that addresses environmental problems comprehensively"); Thomas E. Caballero, *Project XL: Making It Legal, Making It Work*, 17 STAN. ENVTL. L.J. 399, 418-19 (1998).

17. For a comprehensive survey, see Ackerman & Stewart, *supra* note 2.

sions of a given pollutant) far more tightly than other sources of the same cost.[18] If social cost were defined more broadly, as "risk of premature mortality" or "harm to the environment," such dissimilar treatment would be even greater.[19]

Inefficiency stems directly from the statutory failure to define operationally meaningful ends and to compare and rank different ends. A single statute addressing a particular regulatory area, such as air pollution control, will often focus on the performance of specific tasks without addressing the relationship of these tasks to the ultimate end desired.[20] Consequently, such statutes often fail to provide for trading greater efforts in one direction for lesser efforts in another, even though the reconciling social benefit should be relatively easy to define.

If we consider more than one statute simultaneously, the inefficiencies increase. Presumably an overall "meta-standard" exists that could at least partially reconcile the efforts commanded by all statutory programs that share a broad common label, like "protecting the environment "or "reduc-

18. In its report, NAPA stated:

> [M]any of the most significant sources of pollution and environmental harm in America today are unregulated. Congress and the states have focused their environmental controls on larger point sources of pollution, and on a relatively small number of important products: cars, trucks, gasoline, pesticides, drinking water, and processed foods. Lawmakers have not required farmers, large or small, to take responsibility for runoff of nutrients, pesticides, and sediments from their fields and feedlots. Likewise, municipalities and homeowners have generally avoided regulation of runoff from their streets and yards. . . .
>
> . . .[M]any small businesses, including dry cleaners, printers, and photo-processors, are ignored by regulators because individually they contribute so little pollution that inspecting and taking enforcement actions against them can be a waste of time.

NAPA, *supra* note 7, at 32.

19. A survey of all federal regulations aimed at protecting human life concluded that "better allocations of existing expenditures could save an additional 60,000 lives at no increased costs, and that with better allocations, we could save the same number of lives we now save with $31 billion in annual savings." SUNSTEIN, *supra* note 6, at 322 (citing Tammy Tengs et al., *Five Hundred Life-Saving Interventions and Their Cost Effectiveness*, 15 RISK ANALYSIS 369 (1995)).

20. For a detailed illustration of statutory focus on means rather than ends, see ACKERMAN & HASSLER, *supra* note 2, at 56 (noting that "[r]ather than defin[ing] goals with care and articulat[ing] cost-effective policies to implement them," in setting legislative standards for controlling sulfur oxides emissions from coal-fired power plants, "Congress operated like a peculiarly inept administrative agency, trying to resolve disputable issues of instrumental rationality without asking the most obvious questions [about ends and means]."). *See also* Steinzor, *supra* note 12, at 116 ("In addition to expressing concern about economic inefficiency, critics argue that preoccupation with the rigid standards imposed by command and control regulation allows policymakers to duck the critical question of what the nation's environmental goals should be and how much it should spend to achieve them.").

ing risks to human health." Because of the piecemeal way such statutes are adopted and implemented, however, such reconciliation opportunities are rarely explored. Using the environment as an example, separate statutes address air pollution,[21] water pollution,[22] regulation of newly-generated wastes,[23] clean-up of old waste sites,[24] permissible use of pesticides,[25] protection of endangered species,[26] and development of wetlands.[27] Each statute requires the EPA to issue a multitude of separate regulations, imposing a multitude of compliance obligations, without any operationally effective common purpose between statutes, or (often) within them. Although the resulting obligations will travel under the "environmental protection" label, this legislative agglomeration will in no way authorize the agency to substitute greater achievement of one obligation for lesser achievement of another. Consequently, there is no ability to trade achievements between statutes, even if greater social benefit would result, since there is no way to measure the social benefit.

The more broadly "social cost" is defined, the larger the gap becomes between the best and worst controlled sources, and the greater becomes the resulting inefficiency in achieving any given degree of social cost reduction. Our regulatory system is indisputably less efficient at "protecting the environment" than at "reducing air pollution," and less efficient at "reducing air pollution" than reducing any particular type of air pollution. In certain cases, more generic ends might be attractive simply for the greater efficiency in means for achieving them that would be made possible.[28]

For these reasons, regulatory reform requires both more flexible means of achieving a given end and efforts to define more generic ends, or the

21. *See* Clean Air Act, 42 U.S.C. §§ 7401-7671 (1994 & Supp. V 2000).

22. *See* Clean Water Act, 33 U.S.C. §§ 1251-1387 (1994 & Supp. V 2000).

23. *See* Solid Waste Disposal Act, 42 U.S.C. §§ 6901-6992k (1994 & Supp. V 2000).

24. *See* Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (or Superfund), 42 U.S.C. §§ 9601-9675 (1994 & Supp. V 2000).

25. *See* Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. §§ 136-136y (1994 & Supp. V 2000).

26. *See* Endangered Species Act of 1973, 16 U.S.C. §§ 1531-1544 (1994 & Supp. V 2000).

27. *See* Clean Water Act § 404, 33 U.S.C. § 1344 (1994 & Supp. V 2000).

28. This may well be true, for example, for the program to control sulfur oxides emissions under Title IV of the Clean Air Act. Here, defining the statutory goal as simply the "capping" of nationwide sulfur oxides emissions at a certain level, rather than some more finely calibrated end-state, has allowed regulated sources to achieve the required emissions reductions at spectacularly low cost. *See generally* Bradley C. Karkkainen, *Information as Environmental Regulation: TRI and Performance Benchmarking, Precursor to a New Paradigm?*, 89 GEO. L.J. 257 (2001). Setting a somewhat off-target end to allow the deployment of vastly more efficient means constitutes one example of the "reciprocal determination of ends and means" in the light of experience advocated by Dorf & Sabel, *supra* note 7, at 284.

rules for trading among ends, needed to make such flexible means possible. Unless a common unit of measure can be established for the outputs of different programs, or for the outputs of different efforts under the same program, it will be impossible *in principle* to compare the relative effectiveness of those efforts, or to determine whether society would be better off if it reduced investment in Program A to increase investment in Program B.

The lack of methods to perform these valuations hinders rational regulation at every turn. It makes it difficult to adopt better means of achieving a given end, or to adjust regulatory ends to reflect new technical possibilities, or to abandon means that have become obsolete with the passage of time, or to compare against each other the results of programs even in closely related areas. The inability to perform such tasks in turn encourages agency passivity and failure to update obsolete rules, since the benefits of change cannot be demonstrated. Inability to compare regulatory outputs makes it difficult to adopt "market-based" approaches to controlling social costs, since such programs rest entirely on trading actions with the same social benefit for each other. It also hinders "devolution" of regulatory programs to states and private entities, since without a method of measuring their performance in achieving regulatory goals, there is no way to determine whether the devolution is succeeding or failing.

2. *Failure to Enlist the Cooperation of the Regulated*

Such conflated programs also suffer from inefficiency caused by failure to fully understand the capabilities of the regulated. Many statutes and regulations specifically require regulated entities to use prescribed means of reducing their social costs. In one widely mandated approach, regulated entities must achieve the "best practical" performance of a very particular type of which they are capable, such as reducing releases of a particular pollutant.[29] Such regulations cannot be set without detailed knowledge of

29. Such "best technology" approaches come in a wide variety of formulations. Some expressly forbid any consideration of the environmental benefit to be achieved by applying them. *See* 42 U.S.C. § 7411(a)(1)-(2) (1994) (requiring "new source performance standards" under the Clean Air Act); 33 U.S.C. § 1314(b)(2)(B) (1994) (requiring "best available control technology" standards under the Clean Water Act). Others require strict controls unless the agency can conclude that there would be no adverse effect on human health at higher emission levels. *See* 42 U.S.C. § 7412(d)(1), (d)(4) (1994) (requiring strict "maximum achievable technology" standards for all "major sources" of "hazardous air pollutants" unless a threshold below which health effects do not occur has been established for the chemical in question and emissions are below it); 33 U.S.C. § 1311(g) (1994) (authorizing relaxation of certain Clean Water Act discharge requirements if the discharger can show that no water quality damage will result).

Most "best technology" standards are required by statute, but the EPA has sometimes adopted that approach even when not required by law. *See* Hazardous Waste Treatment

the technical and economic capabilities of the regulated.[30]

Other regulations implement statutory commands to achieve broader social goals—for example, to achieve given levels of air or water quality.[31] It may be impossible to select such levels wisely, however, without understanding the cost of their achievement.[32] To understand such costs, information about the technical and economic capabilities of the regulated will once again be necessary. Even if such costs are ignored when obligations are established, the all but universal practice, once such levels have been set, is to require only those efforts toward achieving them that are within the realistic capabilities of the regulated.[33] To determine the level of those efforts, knowledge of the industry will once again be necessary.

Whether the task at issue is defining "best practical performance," or broad social goals, or the degree of effort required toward those goals, the

Council v. EPA, 886 F.2d 355, 363 (D.C. Cir. 1989) (affirming EPA's selection of a "best technology" approach to treating hazardous waste before its land disposal).

30. This task, moreover, may be getting harder as the economy changes and as the regulatory focus shifts to smaller and non-industrial sources.

> In the past, some categories of large point sources, like coal-burning electricity generating stations or integrated steel mills, shared similar production processes and technologies. Given the pressures of global competition, however, regulators are increasingly unable to keep pace with technological, organizational, and economic changes even in these "mature" industries, not to mention in rapidly evolving new industries.

Karkkainen, *supra* note 28, at 267.

31. For example, the Clean Air Act requires states to adopt plans to impose whatever controls are needed to achieve "national . . . ambient air quality standard." *See* Clean Air Act §§ 110, 171-192, 42 U.S.C. §§ 7410, 7501(1), 7514(a) (1994). Similarly, the Clean Water Act requires the adoption of plans, and the imposition of "point source" controls, sufficient to meet water quality standards. *See* Clean Water Act §§ 402, 301(b)(1)(C), 303, 33 U.S.C. §§ 1342(a)-(f), 1311(b)(1)(C), 1313 (1994 & Supp. V 2000).

32. For example, academics have repeatedly urged at least limited consideration of costs and other practical implications when air quality standards under the Clean Air Act are established. *See* Cass R. Sunstein, *Is the Clean Air Act Unconstitutional?*, 98 MICH. L. REV. 303, 377-79 (1999) (arguing EPA should consider costs when formulating regulations and engage in a detailed "benefits analysis").

33. In many cases, the focus on practical controls is clear from the face of the statute. The Clean Air Act expressly requires use of "reasonably available" and "best available" control technology to achieve air quality standards and does not require the generic adoption of more drastic measures. *See, e.g.*, Clean Air Act §§ 182(b)(2), 189(a)(1)(C), (b)(1)(B) (1994), 42 U.S.C. §§ 7502(b)-(c), 7513a(a)(1)(C)-(b)(1)(B) (1994). Even where the statute does not provide for considering costs and practicalities, almost invariably the courts consider them anyway when standards are enforced. *See* R. SHEP MELNICK, REGULATION AND THE COURTS: THE CASE OF THE CLEAN AIR ACT 261 (1983) (discussing federal courts' role in reviewing and enforcing air pollution control regulations); Karkkainen, *supra* note 28, at 267 ("[B]ecause a purely health-based or media quality-based approach might threaten to bankrupt entire industries, such standards are often subject to explicit or implicit side constraints of economic and technological feasibility.").

regulators will never understand the capabilities of the regulated as well as the regulated themselves. That in turn causes two opposite errors in setting such standards. On the one hand, the regulators in their relative ignorance can set standards that command inefficient costly methods of pursuing a goal.[34] On the other, the regulators can set standards that inefficiently overlook certain methods of reducing impact because they are unknown to the regulators. Though the regulated can be counted on to oppose expensive rules, they will have little incentive to call more effective but more expensive methods of reducing social cost to the attention of the regulators.[35] Finally, even if the standards set are in some sense "optimum" when adopted, the regulatory approach gives the regulated no incentive to suggest their updating to require more control at more expense as knowledge advances.[36]

34. *See* discussion *infra* note 36.

35. Indeed, firms that develop more expensive but more effective technologies may well find themselves "penalized" by regulators by being forced to install it. *See* Richard B. Stewart, *Economics, Environment, and the Limits of Legal Control*, 9 HARV. ENVTL. L. REV. 1, 5, 9 (1985) (discussing how environmental federal regulatory standards usually fail to provide adequate incentives for industry).

36. Sunstein notes:

> Government is rarely in a good position to know what sorts of innovations are likely to be forthcoming; industry will have a huge comparative advantage here. Perversely, requiring adoption of the [best available technology] eliminates the incentive to innovate at all, and indeed creates disincentives for innovation by imposing an economic punishment on innovators. Under the [best available technology] approach, polluting industries have no financial interest in the development of better pollution control technology that imposes higher production costs.

SUNSTEIN, *supra* note 6, at 281-82.

These problems are not confined to the regulatory arena. One study of government contracting for computer services discovered government contracting rules gave vendors no incentive to suggest changes in the product specified by a request for contract offers. Even if the agency accepted the suggestion, the rules would require the government to recompete the contract, with no advantage given to the helpful vendor. *See* STEVEN KELMAN, PROCUREMENT AND PUBLIC MANAGEMENT: THE FEAR OF DISCRETION AND THE QUALITY OF GOVERNMENT PERFORMANCE 66-67 (1990).

Similarly, our current regulatory system provides no incentive for the regulated to suggest any reform that does not immediately save them money, since the government cannot offer them any advantage in return.

The solution suggested by Kelman, which has largely been enacted into law, was to allow contracting officers much more discretion to depart from the rules when that would allow them to accept the offers that best promoted the ultimate goals of the office letting the contract. *See* The Federal Acquisition Reform Act of 1996 (FARA), Pub. L. No. 104-106, 110 Stat. 642 (1996) (codified as amended in scattered sections of 40 U.S.C. and 41 U.S.C.). The initial response has been positive. The reform legislation will likely permit the government to act like any other private sector buyer for many goods and services and permit suppliers to service the government as if it were another private sector customer. *See* Christopher F. Corr & Kristina Zissis, *Convergence and Opportunity: The WTO Government*

Indeed, efforts to reform the rule to make it less expensive will be hampered by the agency's passivity and "ossification" described below.

3. The Passive Agency

Administrative agencies were originally intended to be disinterested repositories of "expert" information that could be applied "objectively" to solve social problems.[37] Today, however, agencies are often viewed as simply brokering the conflicting views of the constituencies that surround them rather than advocating any program of their own. Some analysts view this as the proper function of an agency; others simply observe—and there is much supporting evidence—that agencies are often far too weak politically to do anything more.[38]

Such a passive agency will be uniquely unable to reform its existing programs. New programs come from new statutes, and a new statute by definition resolves political conflicts into a mandate that can give even a passive agency the power to act. But by the same definition, no similar resolution will exist for disputed issues arising under established statutes. Indeed, the habit of passivity may itself diminish both the capacity and the willingness of the agency to develop and recommend legislative changes.

Procurement Agreement and U.S. Procurement Reform, 18 N.Y.L. SCH. J. INT'L & COMP. L. 303, 318-19 (1998). In a similar fashion, this Article suggests that regulatory offices be given power to depart from the rules and accept offers for alternative approaches that better serve the ultimate goals of the regulatory effort.

Although this Article focuses on regulation, experiments in allocating resources through a more rigorous focus on ends and means could also make direct government expenditures more efficient. Before 1995, Congress approved each project to reduce salinity in the Colorado River to meet the obligations of a treaty with Mexico. In that year, Congress authorized a competition under which the Interior Department's Bureau of Reclamation would select and fund the most cost-effective means of pollution reduction. "Under the old system, the bureau's projects cost an average of $70 per ton of salinity removed from the Colorado. Under the new competitive system, costs have ranged from $11 to $36 per ton, and have averaged $26 per ton." NAPA, *supra* note 7, at 81. The NAPA report speculates that the same approach could be used to reform "traditional agricultural subsidies—including those intended to reduce erosion and nonpoint pollution—which the federal government and states have generally handed out equally to all farmers meeting certain criteria." *Id.* at 79-81.

37. Under this "New Deal" model, "[t]he animating force of regulation was the expertise of the agency staff. The detached, neutral, technocratic experts of the agency were viewed as those most able to make the detailed decisions necessary to implement a functioning regulatory program." Philip J. Harter, *Negotiating Regulations: A Cure for Malaise*, 71 GEO. L.J. 1, 9 (1982).

38. *See, e.g.*, Croley, *supra* note 3, at 5, 34-65 (analyzing how well different theories of administrative agencies reflect the reality of the regulatory process); Louis L. Jaffe, *The Illusion of the Ideal Administration*, 86 HARV. L. REV. 1183 (1973) (discussing how political realities impact administrative agencies); Stewart, *supra* note 3, at 1681-88 (analyzing impact of federal courts on administrative agencies).

Moreover, legislative change, which is always difficult, may become even harder after a complex statute has been in operation for a number of years and interests have crystallized around its details.[39]

4. Interest Group Exploitation of Cumbersome Procedures

To update existing programs, an agency must generally amend the governing regulations, even if no statutory amendment is required. To do that, the agency must issue a notice of proposed rulemaking, invite public comment on it, and respond to those comments when it issues the final rule.[40] The adequacy of the agency's response, measured against the often detailed commands of the governing statute, will then be subject to judicial review.[41]

This process, originally conceived as a streamlined alternative to the use of adjudicatory hearings to make policy, has become more complex and resource-intensive to operate in recent years. These complexities stem in part from new analytical requirements imposed to assure major regulations are well planned and socially beneficial.[42] They also stem from reforms designed to open both rulemaking and judicial review to all groups with an interest in the rule in question.[43]

In the views of many, the rulemaking process has also become less certain, since judicial review that takes a severe "hard look"[44] can unpredicta-

39. *See* discussion *infra* note 138.

40. *See* 5 U.S.C. § 553(b)-(c) (1994 & Supp. V 2000) (detailing rulemaking process).

41. *See* 5 U.S.C. § 704 (1994). Section 704 of the Administrative Procedure Act (APA) makes judicial review presumptively available for any "final" agency action. Since the late 1960s, the Supreme Court has markedly expanded the applicable definition of "finality," thus authorizing judicial review of most agency actions as soon as they are issued, without waiting until they are directly applied in an enforcement or licensing proceeding. *See* Abbot Labs. v. Gardner, 387 U.S. 136, 141-42 (1967) (allowing pre-enforcement review of certain regulations issued under the Federal Food, Drug, and Cosmetic Act).

42. The courts have taken the lead in requiring the transformation of the preambles to proposed and final rules into detailed "technocratic" documents addressing the factual and policy issues at stake in comprehensive detail. *See infra* note 44. In addition, every president since Lyndon Johnson has issued executive orders to require greater analysis of the basic cost-effectiveness of rules. *See infra* note 112. Other executive orders require analysis of the impact of rules on other matters. *See* Exec. Order No. 12,606, 3 C.F.R. 241 (1987) (discussing "family values"); Exec. Order No. 12,607, 3 C.F.R. 243 (1987) (considering trade); Exec. Order No. 12,612, 3 C.F.R. 252 (1987) (requiring review of impacts on "federalism"); Exec. Order No. 12,630, 3 C.F.R. 554 (1989) (requiring consideration of private property values).

43. *See* Freeman, *supra* note 8, at 5 n.9 ("As a result of enhanced rights to participate, parties are capable of blocking agency decision making through litigation and procedural delay.").

44. The phrase "hard look," now universally used to describe how the courts have re-

bly invalidate a rule even after it has been promulgated.[45] This is especially true for long and detailed rules—which are also, of course, the most important.[46] These factors make rules difficult to set in the first place, and difficult to amend once established.[47] "Ossification" has been the end result.[48]

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garded agency rules since rulemaking became the primary vehicle of administrative regulation, was originally coined to describe how the courts should force *agencies* to regard the problems before them. *See* Harold Leventhal, *Environmental Decisionmaking and the Role of the Courts*, 122 U. PA. L. REV. 509, 514 (1974) (analyzing the impact of judicial review on environmental regulations).

45. *See generally* JERRY L. MASHAW & DAVID L. HARFST, THE STRUGGLE FOR AUTO SAFETY (1990) (arguing that unintelligently aggressive judicial review caused the National Highway Traffic Safety Administration to largely abandon rulemaking in favor of case-by-case recalls of defective vehicles, a practice with little social benefit).

> With the exception of a few agencies, the judicial branch is responsible for most of the ossification of the rulemaking process.
>
> . . . .
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> Judicial ossification of rulemaking is a function of two variables: (1) judicial imposition of decisionmaking procedures that are costly and time-consuming; and, (2) the high risk of judicial invalidation of a rule on either procedural or substantive grounds.

Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59, 65-66 (1995).

> During the last fifteen years the rulemaking process has become increasingly rigid and burdensome. An assortment of analytical requirements have been imposed on the simple rulemaking model, and evolving judicial doctrines have obliged agencies to take greater pains to ensure that the technical bases for rules are capable of withstanding judicial scrutiny.

McGarity, *supra* note 4, at 1385.

46. "Ossification has been identified as a problem only with respect to major rules predicated on assumptions concerning complicated factual and scientific relationships. Agencies continue to issue hundreds of rules annually in other contexts expeditiously and at a relatively low cost." Pierce, *supra* note 45, at 62.

47. Indeed, such detailed rulemaking procedures may themselves be one method whereby the "passive agency" is maintained. "Administrative procedures erect a barrier against an agency . . . giving politicians (informed by their constituents) time to act before the status quo is changed." McGarity, *supra* note 4, at 1386 n.6 (quoting Matthew D. McCubbins et al., *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431, 442 (1989)). *See also* Jerry L. Mashaw, *Improving the Environment of Agency Rulemaking: An Essay on Management, Games, and Accountability*, 57 LAW & CONTEMP. PROBS. 185, 189 (1994) ("There is surely something to the notion that the current political culture both expects and reinforces underperformance on the part of federal bureaucracies (including their rulemaking efforts).").

48. *See* McGarity, *supra* note 4, at 1412-19 (describing how judicial review results in ossification for specific administrative agencies). *See also* Freeman, *supra* note 8, at 3 ("That the rule-making process is ossified, that implementation is inconsistent, and that enforcement is at best sporadic are by now uncontroversial claims."); Mashaw, *supra* note 47, at 186 ("The machinery of federal rulemaking is widely viewed as so creaky and accident-prone that administrators will resort to almost any other technique to attempt to get their

The record shows, however, that these "ossifying" tendencies have not prevented the implementation of *new* regulatory programs embodying a new political consensus.[49] Their impact on changes to existing programs is undoubtedly more substantial.[50]

The cures for "ossification," suggested by academics, have focused on proposals to reduce the stringency of judicial review of rules so as to avoid the over-documentation and caution allegedly created by the "hard look" approach.[51] Proponents of the change differ as to how much this reform

jobs done.").

49. For example, the EPA took less than ten years each time to issue the great majority of the literally hundreds of rules needed to implement the 1990 amendments to the Clean Air Act and the 1984 amendments to the Resource Conservation and Recovery Act. Congress included in these statutes, however, special "agency forcing" provisions to make sure that the deadlines were at least approximately met. The most widespread was a requirement that implementing rules be issued by a deadline enforceable by "citizen-suit" if it were missed. *See, e.g.*, Clean Air Act § 304(a)(2), 42 U.S.C. § 7604 (1994). Occasionally, Congress has also used a "hammer" provision. This is a default regulatory regime, preferably more burdensome than any regime the agency would be likely to incorporate in regulations, that takes effect if the deadline for regulatory promulgation is *not* met. *See, e.g.*, Solid Waste Disposal Act § 3004(g)(6), 42 U.S.C. § 6901 (1994 & Supp. V 2000) (mentioning partially or completely banning land disposal of hazardous waste if EPA missed statutory deadlines for issuing the applicable treatment standards). Nevertheless, issuance of many rules required by these statutes was neither required by court order, nor necessary to avoid a "hammer" provision.

50. *See* McGarity, *supra* note 4, at 1390 ("Once an agency has endured the considerable expense and turmoil of writing a rule, it has every incentive to leave well enough alone. . . . Even when forced by statute to revisit existing rules, an agency is very reluctant to change them.").

> Conditions in [environmental protection, health and safety, and economic regulation], and our understanding of the underlying science, change so rapidly that the average rule probably has a useful life of no longer than a decade. Agencies should be reviewing and revising their rules on a regular basis. Yet, agencies rarely amend rules because the amendment process is as daunting as the process of promulgating a rule.

Pierce, *supra* note 45, at 61.

51. For example, McGarity sees ossification as the result of overly aggressive judicial application of a basically sound framework strategy:

> The virtues of reasoned explanation almost certainly outweigh the costs. The problem does not lie in the minimal requirements inherent in the [Administrative Procedure Act]. Rather, it lies in overly aggressive judicial [review] to overturn rules that are as well supported as the available information reasonably allows.

McGarity, *supra* note 4, at 1444.

Pierce, by contrast, doubts the soundness of the framework, describing himself as a "skeptic with respect to the grand claims of social benefits made by many proponents of the judicially enforced duty to engage in reasoned decisionmaking." Pierce, *supra* note 45, at 67. From that perspective, he is even more critical of judicial review, which he describes as an essentially arbitrary enterprise in which courts can always find reasons to strike down rules they do not like, an enterprise in which private litigants encourage them most ingeniously. The result is first, to force agencies into endless defensive efforts to document their

would help, and how much would be sacrificed in the process.[52]

One well taken objection asserts that since courts are inherently unpredictable, and act only after the rule at issue has been successfully developed and promulgated, their influence on agency decisions will probably be far smaller than the influence of the internal processes and political dynamics of the rulemaking process itself.[53] Yet many of the administrative process reforms now blamed as causes of "ossification," such as expanded rights to participate in rulemaking and greater attention within the Executive Branch to the costs and benefits of regulation, were hailed at the time, and are still supported, as necessary corrections to the narrow and self-centered focus of the rulemaking agencies.[54] As discussed later, the reform contract ap-

rules, and, second, to discourage rulemaking altogether. Pierce argues that review within the executive branch can force reasoned decision making on the agency at far less cost. *See id.* at 67-69.

I have long believed that this is a fantasy. *See generally* William F. Pedersen, Jr., *Formal Records and Informal Rulemaking*, 85 YALE L.J. 38 (1975) (analyzing administrative rulemaking procedures). Office of Management and Budget (OMB) is subject to many of the same political forces as the mission agencies themselves—forces that naturally lead it either to approve flawed agency rules or oppose them on ideological grounds. Contrary to what Pierce asserts, OMB cannot command anywhere near the same intellectual resources to review a rule as a panel of three judges distinguished enough to have been presidentially appointed to a federal court of appeals. Finally, OMB completely lacks the assistance in focusing the issues that the adversarial litigation process provides the courts. If the OMB review process were changed to incorporate such an element, complaints about *its* costs in delay and undermining agency independence, already loud, would become even more prevalent. *See also* Mashaw, *supra* note 47, at 240-41; McGarity, *supra* note 4, at 1429-36.

52. McGarity concludes his article on ossification by citing cases where ossification was not present, *supra* note 4, at 1420-21, and saying:

> It is impossible to draw definitive conclusions about the extent to which judicial review under the hard look doctrine has contributed to rulemaking ossification. The agencies probably had good reason [because of the novelty, importance, and complexity of the issues] to devote considerable attention to the details of the rulemaking record and agency explanations during the late 1970s and early 1980s. Whether less effort is warranted in the 1990s is not an easily resolved question.

Id. at 1426. *See also Administrative Law Symposium: Questions and Answers with Professors Elliott, Strauss, and Sunstein*, 3 DUKE L.J. 551, 553 (1989) (quoting E. Donald Elliott, former General Counsel of EPA, as saying, "I would take issue with the assertion that we know that the effects of judicial review on the administrative process and on the internal deliberations within agencies are huge.").

53. In his article, Mashaw notes:

> [I]t seems a virtually forlorn hope that we might reduce the uncertainties that drive the adversarial litigation process by working hard on the question of the scope or stringency of judicial review. Legislative language might put a spin on the process, but, given the other contextual factors that influence the scope of judicial review, even that spin might not be very long lasting.

Mashaw, *supra* note 47, at 230-31.

54. According to Christopher DeMuth and Douglas Ginsburg:

proach targets the ossifying tendencies of those reforms without weakening the analytic requirements applicable to major agency decisions.

B. How Current Reform Suggestions Often Miss the Point

Most current suggestions for reforming the regulatory process fail to address, or only crudely address, our regulatory system's lack of clarity about ends and means, or the resulting (and interlocked) problems of inability to adjust to new knowledge, failure to enlist the cooperation of the regulated, passivity, ossification, and difficulty in adopting market-based approaches or devolving responsibility.

Since 1974, every president has required economic analysis and centralized review of all new regulations.[55] Congress has adopted several similar suggestions,[56] and debated many others.[57]

Such requirements do nothing to reform obsolete existing regulations. Indeed, as commenters on "ossification" have pointed out, they will, if anything, discourage revision of existing rules.[58] Although a few presidential

> The characteristic failings of regulation that economists and other scholars have identified are twofold. First, regulation tends to be excessively cautious (forcing investments in risk reduction far in excess of the value that individuals place on avoiding the risks involved). Second, regulation tends to favor narrow, well-organized groups at the expense of the general public. . . .
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> Centralized review of proposed regulations under a cost/benefit standard, by an office that has no program responsibilities and is accountable only to the president, is an appropriate response to the failings of regulation. It encourages policy coordination, greater political accountability, and more balanced regulatory decisions. . . . Assessments of social costs and benefits force regulators to confront problems of covert redistribution and overzealous pursuit of agency goals, which experience has shown to be common . . . .

Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1080-82 (1986).

55. *See* Exec. Order No. 11,821, 3 C.F.R. 926 (1975) (Ford) (formalizing a process begun under President Nixon); Exec. Order No. 12,044, 3 C.F.R. 152 (1978) (Carter); Exec. Order No. 12,291, 3 C.F.R. 127 (1981) (Reagan and George H. W. Bush); Exec. Order No. 12,866, 3 C.F.R. 638 (1993) (Clinton and George W. Bush).

56. *See, e.g.*, Regulatory Flexibility Act, 5 U.S.C. §§ 601-612 (1994 & Supp. V 2000) (requiring a cost analysis and analysis of alternatives for regulations that affect small businesses); Unfunded Mandates Reform Act of 1995, Pub. L. No. 104-4, 2 U.S.C. §§ 1501-1504 (1994 & Supp. V 2000); National Environmental Policy Act of 1969, 42 U.S.C. §§ 4321-4370d (1994 & Supp. V 2000).

57. The most prominent were efforts in the then newly elected 104th Congress to require all new regulations to be justified by cost-benefit analysis before they could legally be promulgated. *See* Job Creation and Wage Enhancement Act of 1995, H.R. 9, 104th Cong. (1995).

58. *See* sources cited *supra* note 50.

orders have directed agencies to re-examine existing regulations,[59] those directives have had little effect.

Yet at any given time, and particularly in these anti-regulatory times, existing regulations will vastly outnumber new regulations being developed. To correct our regulatory system's defects those existing regulations must be amended.

Indeed, even if new regulations were dominant in number, their defects would often become apparent only in actual operation. And even if those rules were free from defect at first, we would still need a mechanism to revise them as they became outdated.

Failure to address old regulations hampers the redefinition of regulatory ends and means. Cost-benefit analysis of a new regulation will inevitably focus on whether that regulation itself would be socially desirable. That in turn tends to limit the participation of the regulated to questioning (or, rarely, supporting) the merits of new regulations viewed in isolation. But the social desirability of that regulation might depend on the ability to combine its issuance with the repeal or modification of older requirements that had become less necessary because the new regulation would achieve their goals more effectively. For example, a new regional program of "acid rain" control might well reduce or eliminate the need for case-by-case regulation of individual emitting sources. Allowing such "trading off" between old and new obligations would encourage the participation of the regulated in the process of regulatory reform, and would clarify ends and means by encouraging focused debate on particular trade-offs. Yet, new and old rules are almost never "packaged" in this manner at present.

Reformers also recommend greater reliance on "consensus-based" approaches to developing rules. Such approaches, too, will be largely restricted to new regulations. Experience with "regulatory negotiations" shows that consensus will be far easier to achieve when addressing a new regulation where the requirements are as yet undefined than for an existing regulation with specific terms.[60]

Finally, reformers recommend greater reliance on "market-based" approaches to controlling social cost under which activities that cause such costs would be assessed a fee, or would be required to obtain an "allowance," for each unit of social cost they caused.

However, market-based approaches are only suited to certain regulatory problems. Accordingly, calls for their wider use beg the question how so-

59. *See* Exec. Order No. 12,866, 3 C.F.R. 638, 644 (1993) (requiring "periodic[] review" of "existing significant regulations" as selected by the agencies themselves); Exec. Order No. 12,044, 3 C.F.R. 152, 155 (1978) ("Agencies shall periodically review their existing regulations . . . .").

60. *See* discussion *infra* note 138.

ciety should determine which problems are suited to such approaches and which are not. Moreover, even where market-based approaches do fit a problem, they differ dramatically from most traditional regulatory systems in the policy decisions and administrative capabilities they require. Reshaping existing regulatory programs along market lines will, therefore, be more difficult to accomplish than less dramatic changes. Proponents of market-based approaches rarely go much beyond a reference to the intrinsic merits of such approaches to explain how to accomplish this transition.

C. Regulatory Reform Contracts as a Solution

All the obstacles to reforming the regulatory system summarized above could be alleviated by a statute that would authorize agencies, acting within legislatively established boundaries, to invite the regulated, on a case-by-case basis, to develop alternatives to existing regulations. Since, under our existing pattern of health, safety, and environmental regulation, states are often in effect regulated parties bound to follow a detailed set of federal requirements,[61] states as well as directly regulated companies should be allowed to develop such offers. If the regulatory agency concluded, after public notice and comment, that the alternative offered would yield reductions in social cost at least equal to those achieved by the existing regulation, it could approve the alternative through a "regulatory reform contract." That contract would be valid for a long, but limited period (perhaps ten years), and could be renewed after its expiration.[62]

Agencies could only approve a limited number of such contracts each year, and the agency, perhaps with the assistance of an outside body,[63] would be required to review the results of each contract and report briefly

61. Our current systems of air pollution, water pollution, and solid waste control present the states with the choice of either self-administration, or federal government administration, of the elaborate regulatory codes. *See* 40 C.F.R. pt. 51 (2000) (listing standards for federal approval of state air pollution control programs); 40 C.F.R. pt. 123 (2000) (delineating standards for federal approval of state water pollution permitting programs); 40 C.F.R. pt. 271 (2000) (providing standards for approval of state hazardous waste control programs). This approach puts enormous pressure on each state to accept the federal matrix for its own programs, since the alternative is for the federal government, operating with fewer resources and less attention to local sensitivities, to apply the same standards to sources within the state.

62. The use of regulatory reform contracts to carry out public policy has been criticized as "locking in" approaches to regulatory problems permanently and thus insulating them from democratic control. *See* Dana & Koniak, *supra* note 6, at 501-02. This criticism would not apply to regulatory reform contracts with a limited life.

63. In a related suggestion, Salzman and Ruhl suggest that an expert body be invited to review analogous offers before their approval. *See* Salzman & Ruhl, *supra* note 1, at 688.

on its implications for the agency's "base load" regulatory programs.[64]

Such an approach would directly address the problems of inefficiency caused by weak and unclear goals, lack of cooperation from the regulated, passive agencies, and ossification outlined above. No more restrictions than those suggested above would be needed to protect against abuse of agency discretion.[65] Finally, it would lead to better regulations. We will discuss each of these points in turn.

1. Regulatory Reform Contracts and the Clarification of Regulatory Ends and Means

i. The Relation between Regulatory Ends and Regulatory Means

In the most general perspective, all regulatory action—indeed, all government action—aims to promote the public welfare.[66] Yet few would argue that regulatory agencies should determine the degree of social investment in defense, education, medical research, and other public priorities that best serves that generic "end." We properly view such topics as the subject of legislative decision.

But, by arguing step-by-step from much narrower tasks, we can build a

64. These conditions, necessary to preserve the experimental nature of the program, would also guard against the use of regulatory reform contracts as a generally applicable "safety valve" to avoid the need to confront and correct the defects in the underlying program. *See* Peter H. Schuck, *When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy Through an Exceptions Process*, 1984 DUKE L.J. 163, 287. It might of course, be possible to correct the defects in the underlying program precisely through the broader use of "regulatory contracts." Under this Article's recommendations, however, that would require either a new rulemaking to reform the underlying program to allow such contracts, or amendments to the authorizing statute.

65. Almost no current federal regulatory programs other than those that govern licensing of new products such as drugs or automobiles forbid states from regulating the same topics as federal regulation as long as they impose controls at least as tight as those federally required. *See*, *e.g.*, Clean Air Act § 116, 42 U.S.C. § 7413 (1994); Clean Water Act § 510, 33 U.S.C. § 1370 (1994); Occupational Safety and Health Act of 1970, 29 U.S.C. § 667(a), (c)(2) (1994 & Supp. V 2000). Accordingly, any entity that wanted its "regulatory reform contract" to have practical meaning would have to obtain changes both in the applicable federal requirements and in any parallel state or local controls, since partial relief would not allow it to change its conduct. Because of this federal preservation of state authority, authorizing regulatory reform contracts would not in any way invade the authority of state and local governments to regulate the conduct involved as they wished, except in those few cases where Congress has already decided that state regulation should be pre-empted.

66. For that reason, Salzman and Ruhl state that from a total society perspective, "the ideal currency [for an environmental trading program] would likely be a measure of social value" though they recognize that the suggestion is impractical because "such measures of utility cannot be calculated with any certainty . . . ." Salzman & Ruhl, *supra* note 1, at 623.

persuasive case for a more limited agency involvement in defining social priorities. That argument begins by defending agency discretion to select better means to achieve a given end.

Aristotle defined the end of action as that for which the action is desired.[67] It follows from this definition that a change in ends requires a change in desire, while a change in means to achieve that end requires only a new assessment of the best way to achieve it.

That distinction maps neatly into a possible division of roles between legislature and regulatory agency. In an ideal world, the legislature reflecting the desires of the people would define the ends, while the implementing agency as a repository of expert knowledge would select (and, where necessary, modify) the means.[68] So, (to use Aristotle's examples) the legislature might define such goals as health, victory in war, or new housing, and leave to others the choice of means.

Aristotle also argues that some ends are desired both for themselves and as a means to some further, more "complete" end.[69] Agency discretion to choose means logically implies some discretion to choose among these "secondary" ends as well. Suppose new means drastically reduce the cost of achieving a given end. A rational economic actor might then elect to purchase more of that particular end, and less of another, than it did before. If the price of oranges goes down, we expect, not only that more oranges will be purchased, but also that apple purchases might decrease. Demand for the two goods is linked because they satisfy related preferences. Stated differently, the ends for which we purchase apples and oranges are not "complete." Both purchases, at least in part, serve some larger end, such as "eating fruit," or "a balanced diet," to which either apple consumption or

67. *See* ARISTOTLE, NICHOMACHEAN ETHICS 13 (Terence Irwin trans., Hackett Publishing Co. 1985). In describing the end of action or the "good," Aristotle says,

> What, then, is the good . . . ? Surely it is that for the sake of which the other things are done; and in medicine this is health, in generalship victory, in house-building a house, in another case something else, but in every action and decision it is the end, since it is for the sake of the end that everyone does the other things.

Id.

68. *See* ACKERMAN & HASSLER, *supra* note 2, at 117-28 (arguing for a division of labor between the legislature and agencies); *see also* SUNSTEIN, *supra* note 6, at 356 ("In general, Congress should let administrators decide on the appropriate means for reaching legislatively decreed ends . . . .").

69. ARISTOTLE, *supra* note 67, at 13-14.

> Though apparently there are many ends, we choose some of them, e.g. wealth, flutes, and, in general, instruments, because of something else; hence it is clear that not all ends are complete. . . .
>
> [A]n end that is never choiceworthy because of something else is more complete than ends that are choiceworthy both in themselves and because of this [further] end.

Id.

orange consumption can contribute.

Similarly, one might expect, in a rational environmental protection system, that if the price of some environmental good—for example, preserving wetlands—went down, more wetlands might be "purchased" through regulatory action, even if that meant less purchase of some related good like end-of-the-pipe water pollution control. In doing that, we might also redefine the ends of our regulatory effort, from "reducing pollution" (which can only be achieved in one way) to a more "complete" formulation such as "protecting diverse aquatic ecosystems," a goal to which both pollution control and wetlands preservation could contribute.

The distinction between ends and means, and between "complete" and "secondary" ends, may be debatable in any particular case. As Salzman and Ruhl point out, an equal trade of apples for apples might also be viewed as an unequal trade of Macintoshes for Granny Smiths.[70]

But our current disorganized and "conflated" statutes tend to resolve almost every doubt in favor of classifying each obligation as an end in itself. Under them, almost any variation from a regulatory requirement arguably implies at least some change in the statutory goals. For example, allowing a factory to reduce emissions by controlling existing emission points rather than new emission points could be viewed, even if it produced superior emission reduction results, as inconsistent with the goal of incorporating control technology into all new construction so as to create a relatively automatic and fool-proof emission reduction system.

Steps to replace old means by new means, substitute competing goods for each other as relative prices change, and redefine ends in response to changing means occur every day in private markets. However, the barriers that "conflated" statutes establish, to the ability of agencies and those they regulate to act with the flexibility of private market participants, hamper any corresponding adjustment in the "market" for regulatory products. Creating that flexibility will require a clearer distinction between the ultimate ends of regulation, its secondary ends, and the means to achieve both.

70. *See* Salzman & Ruhl, *supra* note 1, at 613. To provide a more relevant example, building an air pollution control system around control geared to the number of tons *emitted* may be the only practical approach, but it ignores the different amounts of damage caused when that emission is *deposited* in different places. "Regulating at the source of emission is less environmentally meaningful than at the point of impact, the receptor, but cost and technical constraints force our hand." *Id.* at 623-24. As Salzman and Ruhl recognize, this is a problem for traditional "command-and-control" regulation as well as for more innovative market-based approaches, since the cost and technical constraints apply equally to both forms of regulation. *See id.* at 624 n.36.

ii. Regulatory Reform Contracts as a Method of Clarifying Ends and Means

Regulatory reform contracts would contribute to clarifying both the distinction between ends and means, and the comparability of different ends, at every stage in their development. That clarification would begin with the debate on the legislation authorizing such experiments. That debate would probably center on two questions.

The first question would ask how broad a range of obligations would be open for trading. As Salzman and Ruhl put it, would that range encompass apples for apples, "apples for oranges," or "apples for Buicks?"[71] Since people trade apples for Buicks every day,[72] there can be no objection to such trades in the abstract. Accordingly, any restrictions on trading range would distinguish between those obligations that the legislature was willing to allow agencies to balance against each other—at least in the realm of experiment—and those for which the agency reserved all balancing decisions. For example, the legislature might authorize the EPA only to trade one form of air pollution for another, or it might, more ambitiously, allow trades between air and water pollution, or it might go even further to allow trades between pollution control obligations and measures to protect natural habitats.

The second, closely related question would ask what restrictions should be imposed on trades within that range. Broad trades of the "right to pollute" between different sources of air or water pollution might be limited by a condition that air or water quality standards not be violated, or that any such violations be temporary and be more than compensated by further future reductions. Such restrictions would reflect either another set of decisions that the legislature had reserved for itself, or a judgment that certain trades involved such incommensurable sacrifices and benefits that they should not be made at all. Few would argue, for example, that a company that made Drug A more safe should be allowed in return to make Drug B less safe.

The very act of setting such restrictions would clarify the relationship between those ends that the legislature saw as largely "complete" in themselves, and those means and less complete ends that it was willing to allow an agency to alter by the exercise of regulatory discretion.[73] This step in

71. *See id.* at 613.

72. For example, an apple farmer may sell his crop and buy a Buick with the proceeds. *See id.*

73. In that manner, the legislature would give at least a first-order answer to the Salzman and Ruhl question:

> [T]o what extent should we be willing to let owners of nonfungible environmental features strike deals which the rest of us cannot evaluate through any common medi-

itself would move toward a regulatory system that relies more heavily on such ends-means distinctions. To actually achieve such a system, changes in statutes, and in the public opinions that shape statutes, will eventually be needed. To achieve such a change in public opinion, public opinion must first focus with more particularity on ends-means issues. The debate on regulatory reform legislation would contribute to such a focus.

Once trading boundaries had been set, trades within them could help clarify each of the issues arising above by the test of actual experience.

- Even a relatively unambitious "trading range"—for example, one that only authorized trades of the same pollutant within the same source at the same time—could undermine our current conflated approach by substituting a stronger distinction between ends and means. It might show, for example, that allowing a facility greater freedom to select which of its units to control could lead to greater emissions reductions at less cost. Such a showing could in turn pave the way for abandoning statutory prescription of means and redesigning the underlying statute around the broader goal of achieving release reductions by the most efficient methods.

- The conflated approach could be undermined even further by trades that substituted reductions in releases of a given pollutant at one source for reductions of the same pollutant at another. That approach, for example, could relieve a company of strict controls on its own water discharges if it obtained environmentally equivalent reductions in run-off from roads or farm fields. Positive results from such trades could call into question the tendency of our regulatory system to focus on "major source" control rather than on the control of small sources, particularly where the two sets of sources contribute to the same overall pollution problem.[74]

Other possible results of a "regulatory contracting" approach could re-

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> um of exchange and which many of us might not strike? Put more generally, who should determine the equivalency of such trades?

Id. at 614.

74. "Many of today's environmental problems . . . cannot be solved by clamping down on the emissions of the few thousand largest factories in America. Instead, we must address the effects of thousands of smaller firms and farms whose releases are individually small but cumulatively very large." Daniel C. Esty & Marian R. Chertow, *Thinking Ecologically: An Introduction*, *in* THINKING ECOLOGICALLY: THE NEXT GENERATION OF ENVIRONMENTAL POLICY 1, 2 (Marian R. Chertow & Daniel C. Esty, eds., 1997).

> Traditional regulatory approaches can keep most forms of industrial pollution in check, but they cannot reach many of the remaining sources of pollution and environmental degradation: the large and small users of fertilizers, the hundreds of millions of consumers of electricity and fossil fuels in the United States and the billions of consumers around the world, and the direct physical threats to ecosystems and endangered species.

NAPA, *supra* note 7, at 18.

sult in even more direct challenges to the overall pattern of regulatory "investment" in the pursuit of a broad social goal like environmental protection. For example:

- Allowing trades that reduced the same pollutant at the same location, but that substituted more reductions later for fewer reductions earlier, could call in question the tendency of our regulatory system to rely on what immediately available technology can provide in the short term. It might show that allowing more time to achieve release reduction could allow a broader range of means, such as systematic research and quality improvement programs, to generate substantially greater reductions than would be possible under a short term deadline.

- Allowing trades that reduced the same general type of pollution (*i.e.*, air pollution) at the same location, but that substituted reductions in one type of pollution for increases in another, as long as overall environmental harm was reduced, could force debate on which types of pollution caused more environmental harm.

- Allowing trades that substituted control of one type of pollution for control of another—for example exchanging a lesser reduction in water pollution in return for more drastic reductions in air pollution—would have this same effect on a broader scale.

- Often, environmental values can be protected either by pollution control or by other means. For example, stream ecology could be protected either by limits on factory pollution discharges, or by preserving vegetation along the stream bank. Allowing regulated sources to offer the use of such other methods, instead of required pollution reductions, as means of protecting an environmental value, could focus attention on whether our current system relies too much on technological pollution control and not enough on changes in land use or other types of private conduct as a means of environmental protection.

- Regulatory "ends" often bundle several social goals into one regulatory measure. Wetlands preservation can be desirable because wetlands help purify water, serve as "buffers" against flooding, and provide wildlife habitat. A builder might be willing to create ten new acres of wetlands to expand a rural wildlife sanctuary for each acre of urban wetlands it was allowed to develop. That would pose the question whether the much greater wildlife benefits of that approach more than compensated any loss of urban pollution and flood control benefits—particularly if those services could be performed some other way.[75] To take an-

75. This example is developed from Salzman and Ruhl's observation that allowing de-

> other example, a company might offer to purchase and protect an environmentally sensitive area in return for relief from a portion of its hazardous waste clean-up obligations.[76] Allowing trades like these, that substituted one type of environmentally beneficial activity for another, as long as the overall environmental benefit increased, could challenge more broadly the balance struck by our current environmental protection system between nature protection and pollution control.

Trades like the exchange of hazardous waste clean-up for wetlands might be challenged as illegitimate because they required the comparison of incommensurable obligations. But that objection could be answered, as long as *some* basis of comparison existed, by showing that the exchange was so lopsided, because of the greater value of the good being "oversupplied," as to outweigh any uncertainties in the measurement technique.[77]

Probably the lessons of more narrow trading experiments would be easier to generalize quickly to permanent reforms than the lessons of broader trades. But as the permissible scope of trades increased, their ability to suggest reforms that might greatly increase social benefits would also increase, although actually achieving those benefits might well require significant changes in law and regulations.[78] Authorization of "regulatory reform

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velopers to "mitigate" their wetlands destruction by creating or preserving wetlands somewhere else will be likely to cause a "migration" of wetlands from urban areas where land is expensive to rural areas where land is cheap. *See* Salzman & Ruhl, *supra* note 1, at 666. Although the authors seem skeptical of this development, the discussion in text develops a scenario under which it could be environmentally beneficial. *See id.* at 668-70.

76. Such obligations have been widely criticized as requiring major expenditures for very little return. *See* STEPHEN BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 11-19 (1993).

77. In their article, Salzman and Ruhl note:

> In response to the criticism that one cannot measure risks accurately enough to trade, Elliott and Charnley argue that although one cannot measure exactly, one can still assess the relative magnitude of the options. Thus "easy trades" between seemingly nonfungible options are entirely appropriate if the magnitude of differences between the two risks is large enough with little uncertainty.

Salzman & Ruhl, *supra* note 1, at 633 n.65 (citing and discussing E. Donald Elliott & Gail Charnley, *Toward Bigger Bubbles*, F. FOR APPLIED RES. & PUB. POL'Y 48 (1998)).

78. I have argued that a similar logic applies when an agency discloses information to the public. Disclosure of information that the existing regulatory system can readily assimilate may well lead to rapid change in regulatory approaches since the regulatory apparatus to respond to the information will already exist. By comparison, more generic information that suggests more basic changes in approach will lead to slower changes because of the need to create the implementing mechanisms. However, the potential for social gain from such more fundamental revisions will probably be greater. *See* Pedersen, *supra* note 13, at 193-98.

A similar insight is contained in an article by E. Donald Elliott. He states that a "fundamental paradox" affects "alternative compliance schemes" such as regulatory contracts:

contracts" within a broad range would represent a legislative finding that such potential benefits could justify broad trades despite the potential difficulty of comparing their elements.

Yet at the same time, the potential "gains from trade" would not increase without limit, as the field for regulatory experiments expanded. Instead, if we plotted the range of obligations between which regulatory reform contracts might "trade" against the long-term social gains that such trades might yield, we would probably generate an asymmetric bell curve. At one end of the curve, a very narrow range of permissible trades—for example, trades among different sources of the same air pollutant at a single plant site—would have only limited ability to achieve goals more effectively, or replace our current conflated system with one of strong goals and flexible means.[79] Attempts to trade between highly disparate types of obligations at the other end of the curve, would probably be distinctly less fruitful. A hypothetical statute allowing trades between traffic safety measures and efforts to keep families with children together would generate no useful knowledge because of the difficulty of comparing the two types of obligations. It is in the middle, where diverse programs impose obligations with a significant element of common purpose, that stimulating comparisons could take place, as the examples given earlier in this section suggest.

Questions about relations among ends, about the proper boundary between ends and means, and about the effectiveness of one means compared

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> On the one hand, the more broadly the measures of equivalent compliance are defined, the greater the opportunities for flexibility, improved performance, and cost savings. Thus, a comprehensive risk bubble that would permit one kind of environmental risk to be traded off against another would potentially provide the greatest benefit. On the other hand, the difficulties of measuring "equivalency" become greater the more broadly the concept is defined. Thus, it is inherently easier to equate one pound of sulfur dioxide released in one part of a factory with an equivalent pound of the identical chemical released somewhere else in the same facility. However, as common metrics are developed for comparison purposes, dissimilar environmental risks will be able to be traded off more broadly against one another.

E. Donald Elliott, *Toward Ecological Law and Policy*, *in* THINKING ECOLOGICALLY: THE NEXT GENERATION OF ENVIRONMENTAL POLICY 184 (Marian R. Chertow & Daniel C. Esty, eds., 1997).

This Article adds a political dimension to Elliott's perception, arguing that the very concept of "equivalency" assumes a consensus on ends and means, and that regulatory reform contracts, in addition to possessing the "technocratic" merits that Elliott describes, can serve to increase the ability of the political system to generate a new consensus on these matters.

79. In a somewhat analogous point, Freeman observes that a narrow definition of the "problem" is one cause of failure in regulatory negotiations. *See* Freeman, *supra* note 8, at 33-40. Not infrequently, the group deliberations conclude that the problem should be addressed in a manner entirely different from the manner originally contemplated. If the new approach lies beyond the assumptions that the negotiating group was chartered to address, that group may be unable to pursue it.

to another, are among the most central subject of political debate and decision. Regulatory reform contracts would constitute a series of experiments offered to the public and the political system asking, in effect, to decide whether the trade contained in each contract represented a beneficial exchange that should become a precedent, or a less than optimal exchange that should not be repeated.

2. *Regulatory Reform Contracts and the Cooperation of the Regulated*

A "regulatory reform contract" approach would convert one of the main sources of resistance to change—namely, the regulated states, local governments, or private entities themselves—into advocates for reform. By making a reduction in regulatory cost potentially available, they would give a regulated entity an incentive to disclose its ability to achieve greater social cost reductions, or to achieve equal social cost reductions more effectively. By offering such relief on a case-specific basis, the contract program would "select out" as offerors the members of the regulated community with the most to gain from such disclosure, and would give them an incentive to "break ranks," even when that community as a whole was opposing new initiatives. The result would be analogous to the encouragement of low prices by competitive bidding for contracts. In both cases, the contract format gives the advantage to the offeror that can go furthest to accommodate its counterpart.[80] In addition, the mechanism of offer and approval would enlist the expertise of the regulated themselves, not the resources of overtaxed agencies, to develop the proposal details. Any dangers stemming from that approach could be mitigated by a rule, borrowed from standard contract law, that in cases of contract ambiguity, the ambiguity would be resolved *against* the interest of the regulated offeror.[81] Finally, in negotiating such offers into contracts, the offeror would be unable to use the existing system's legal and political mechanisms for resisting change. Regulation, by contrast, all too often gives the advantage to the most recalcitrant.[82]

By these mechanisms, a regulatory reform contract approach would encourage the disclosure of both new political capabilities and new economic

80. Dorf and Sabel correctly claim that a similar potential advantage could arise from a system in which local jurisdictions enjoyed broad power to set the ends and means of regulatory action, subject to a nationally imposed requirement to compare the results and publicize the most successful. *See* Dorf & Sable, *supra* note 7, at 352-53.

81. *See* RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981).

82. "The [best available technology] approach encourages industry to seek any means to delay and deter new regulation. Industry will have the information as well as the incentive to persuade administrators, courts, and other authorities that a suggested technology is not 'feasible' and should not be required." SUNSTEIN, *supra* note 6, at 282.

capabilities to achieve certain goals. To make an attractive offer, the regulated will have to reveal both their willingness to achieve a result that it would be difficult or impossible for the regulatory agency to force upon them, and (often) features of their technical or management processes beyond the government's knowledge that make a different approach possible. For example, an offer from a state might disclose its willingness to extend a program of accident protection, or discharge control, to small businesses in return for streamlining the requirements applicable to large firms. Similarly, a company might disclose new technical or management capabilities by offering to develop a less polluting product, or to reduce pollution by a new program of worker training. Such disclosures, in turn, would challenge the existing regulatory system and its defenders by showing the potential of alternative approaches. The offer and acceptance approach would turn the very incoherence and inefficiency of the regulatory system into a force for change.[83] States and companies, to be free of a regulatory burden that accomplished inefficiently public ends of secondary importance, would be motivated to suggest ways in which that end could be attained more effectively, or instead, a more valued end could be attained.[84] Such a system of

83. Jason Scott Johnston explains:

> [F]rom a positive point of view, the greater the inefficiency under a particular regulatory regime, the greater will be the gains to be realized from bargaining around that regime. In other words, the more inefficient the existing regime, the greater the rents to be realized from altering that regime.

Jason Scott Johnston, *The Law and Economics of Environmental Contracts*, *in* ENVIRONMENTAL CONTRACTS: COMPARATIVE APPROACHES TO REGULATORY INNOVATION IN THE UNITED STATES AND EUROPE 271, 286 (Eric W. Orts & Kurt Deketelaere eds., 2001).

84. In general, making any entitlement "alienable" will give others an incentive they did not have before to reveal information to the entitlement holder about what they can do for the holder in exchange for the entitlement. Only if land can be sold will its owners be likely to learn what others would pay for the land. In that context, regulatory reform contracts would simply provide one more particular illustration of the general rules of market operation. By making the government's "entitlement" to enforce the existing rules alienable, it would encourage the disclosure of information on potentially superior alternatives to those rules. In a more particular focus, legal scholars have argued that information disclosure could be facilitated by contracts that deliberately assigned to each contracting party a piece of an "entitlement" that is only useful once it has been reassembled, since the effort to reassemble the pieces forces each party to reveal by its offers what it thinks those pieces are worth, information that there is no practical method other than voluntary disclosure to provide to the other contracting parties. *See generally* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement To Facilitate Coasean Trade*, 104 YALE L.J. 1027 (1995). Although no one designed our current regulatory system to divide entitlements, in fact it does so by its very inefficiency. The regulated have the power (if not always the formal right) to keep much information about their technical and organizational capabilities from the government. The inefficient regulatory system matches this "entitlement" with a corresponding power in the government to impose inefficient controls. In that

"regulatory arbitrage" would then in turn help reduce the inefficiencies and inequalities giving rise to such suggestions in the first place.[85]

3. *Regulatory Reform Contracts and the Passive Agency*

The negotiation and approval of individual contracts would carry forward the work of clarifying ends and means that the debate on a regulatory reform contract statute would begin. Each regulatory reform contract would allow a specific agency judgment to override the more generic decisions made by regulation and perhaps even by statute. Public acceptance of such decisions would require agencies with the ability and political mandate to independently judge the worth of offers for redefined ends and new means, to negotiate full contracts arising out of those offers, and to defend the wisdom of their choices in the public arena. The regulatory reform contract approach would therefore force agencies to articulate more directly than at present the ends they believed they should pursue and the most desirable means of pursuing them. Agencies that could do this would not fit the traditional model of a "passive" agency.

Indeed, the very fact that regulatory contracts would be *experiments* in better ways of regulating, conflicts with the passive model. The selection and defense of experiments will require an agency to have its own standards of evaluation. Those standards of evaluation must, in turn, rest on agency views about the directions, within the realm of political acceptability, in which it would be most socially useful for the control efforts it administered to evolve. For these reasons, an agency whose views simply reflect the views of others is unlikely to be able to approve and oversee a

situation, both parties will be able to improve their position if they are allowed to bargain toward a more efficient set of regulations that make use of the "proprietary" knowledge of the regulated. By this logic, then, the Ayres and Talley analysis provides another supporting argument for "regulatory contracting."

85. The "regulatory reform contract" approach could be viewed as a first cousin to more traditional contracts in which one party offers cash in return for performance by another. Such more traditional contracts are also used as tools to reduce social cost, as when the government funds medical research or research into new methods of energy generation or pollution control.

One can imagine a "regulatory reform contract" program in which the government offered to pay for useful changes in the methods of regulatory compliance. However, such cash offers would have important disadvantages over use of changes to the regulatory system itself as the "consideration." Quite apart from the extra cost to the government of offering cash, the government would need to decide what it would ask for, and how much to offer to pay for it. Moreover, a system of cash offers would be far less able than a system of regulatory reform contracts to address cases in which the regulatory system *itself* is the obstacle to better performance. Whenever that is the case, changes in the regulatory system will be needed for better performance without regard to the amount of cash payment offered.

successful series of regulatory experiments.

Regulatory reform contracting would also encourage agencies evaluating contract offers to rely on the individual commitments of contracting parties as a supplement to more objectively verifiable data. By definition, hard data to evaluate the chances that a new approach will succeed is unlikely to be available. Yet an agency that decides to accept as credible the commitment of Company A to a program of future "environmental quality improvement" based on management changes, or success in technical innovation, while rejecting the similar claim of Company B, will implicitly assert its competence to evaluate the intangibles on which the validity of such offers rests in a way that an agency bound by general rules cannot.[86]

Even agency failure to acceptably evaluate or defend regulatory reform contracts might pave the way for future success. Studies both of Project XL and of other programs requiring many agency discretionary decisions have documented how much such programs conflict with elements of current agency culture, which emphasize routine, predictability, and application of settled rules.[87] Failure in analyzing or defending a given regulatory

86. The current regulatory system discourages the use of such approaches, which will be necessary to more effective and efficient control of social cost in the future.

> The still-dominant conception of environmental and health and safety rules as one-time, often numerical limits can be an obstacle to generating different approaches, such as rolling standards, continuous improvement programs, or certification schemes. The persistence of prevailing models of accountability [focused on whether the agency and the regulated have stayed within the limits of the statutory mandate] makes experimentation with different allocations of regulatory authority almost impossible; for instance, we might not recognize the virtues of a system in which information is disclosed to, and monitoring performed by, community groups or third-party auditors, because it does not conform to the familiar model of governmental oversight.

Freeman, *supra* note 8, at 7-8.

Regulatory reform contracts, however, could provide a ready platform for experimentation with such approaches.

In traditional contracts among parties who must deal with each other repeatedly, such flexible relationships are enforced by the power of each party to withdraw from the relationship if the other is too unrewarding to deal with. Kelman recommends that the government make much greater use, in its own contracting decisions, of a simple refusal to award new work to those whose past performance has not been satisfactory. *See generally* KELMAN, *supra* note 36. The relationship between regulator and regulated clearly does not offer quite the same scope for developing informal relationships for mutual benefit as the relationship between contracting parties. But it offers some of them. In particular, regulatory agencies have many ways to make life easier or more difficult for those they regulate, and can (and do) use these powers to distinguish between "good actors" and "bad actors" among the regulated. The power to enter into and renew (or not renew) regulatory reform contracts would inevitably increase agency discretion in this area.

87. *See supra* note 14 and accompanying text. *See generally* Frederick R. Anderson, *Negotiation and Informal Agency Action: The Case of Superfund*, 1985 DUKE L.J. 261.

reform contract would allow retrospective analysis to isolate the cultural elements that had caused the failure, and to do so in the relatively mistake-tolerant setting of an experiment. By contrast, an agency that simply avoids tasks for which it is currently ill-equipped also foregoes any chance of broadening its future organizational capabilities.

If the experimental approach succeeded, the long-run transformation in agencies might be even more profound, as they developed the capability to build one experiment on the foundations of another, thus turning the experimental approach into an institutionalized and incremental force for change.[88]

If such efforts succeeded in creating agencies more skilled than our current regulators at negotiating, evaluating, and explaining "regulatory experiments" the result might be "activist" agencies conforming to a new model of activism. These agencies would not be "New Deal" organizations that themselves decided on the generic "public interest" and pursued it,[89] but organizations that are better judges of the acceptability of different experiments in changing social ends and means, and better advocates in the larger political system for reforms based on those experiments, than the agencies we now possess. Such organizations would not function in isolation from the political system, which may have been the "New Deal" philosophy, but rather as its integral parts.

Regulatory reform contracts would provide a means of overcoming, step-by-step, the forces that make agencies passive. The enactment of authorizing legislation would provide an indispensable start. Thereafter, the contract approach would enlist the support of the regulated in developing proposals for change. It would also allow agencies to develop their skills case-by-case, by first picking a relatively easy approval and then proceeding to more ambitious or debatable trades, as success strengthened both the agency's internal capacity to defend its choices and the willingness of the public to believe it. (In precisely the same manner, increased reliance on information disclosure to accomplish regulatory ends could also lead to

88. Such an evolution would require considerable changes, at least at EPA, according to one observer (an "EPA program and XL engineer") within the agency:

> I never understood the rhetoric about "bold experimentation." I'm a scientist by training. I experiment to "find out." To get answers, I have to carefully design an experiment, monitor it, chart the results and deduce why it came out that way. I then adjust the experiment in accordance with my deductions and go on testing. But the EPA has insufficient will to pursue this kind of long-range, low profile quest. And, on the political level, [EPA] has neither the courage nor the patience.

Susskind & Secunda, *supra* note 14, at 99.

89. *See* ACKERMAN & HASSLER, *supra* note 2, at 4-7 (describing "New Deal ideal" of an agency freed from "central political control" and "judicial oversight" so that it could address the problems within its jurisdiction as expert knowledge dictated).

more activist agencies, since agencies should be freer to advance new positions in characterizing information, which has no legal effect, than in issuing legally binding commands.)[90]

The relatively smaller stakes involved in an experimental contract applicable to a single consenting state or facility, as opposed to a nationally applicable and permanent rule, should also help overcome passivity. Those smaller stakes should reduce both the motive of interest groups to oppose agency initiatives, and if they try, their ability to succeed.[91]

The development by these various methods of more publicly competent agencies should be counted as a benefit of the "regulatory reform contract" approach worth running some risk to achieve. Particularly in these days of rapid innovation in methods of achieving both organizational and social ends, agencies that passively implement an old consensus on conflated ends and means do not provide a return on the resources invested in their operation anything close to the return that could be provided by agencies that made an independent contribution to clarifying and updating those ends and means.

Moreover, as succeeding sections illustrate, the regulatory reform contract approach provides automatic assurances that agencies that rely on such contracts will not escape from political control. Indeed, the regulatory reform contract approach would enhance political control of agencies by generating new debate and unique new data on the appropriate ends and means of regulatory action, and by increasing the ability of agencies to discuss those issues in the public forum and thus clarify them for the legislature.

4. Regulatory Reform Contracts and Correcting Ossification

Commenters have suggested that agencies will avoid the "ossified" rulemaking process by relying more on case-by-case adjudication and informal "guidance" to make policy.[92] This is generally presented as regrettable, since adjudication is taken to mean a cumbersome trial-type hearing, while the development and issuance of "guidance" is not transparent and

90. *See* Pedersen, *supra* note 13, 183-84.

91. According to Mashaw and Harfst, one reason for the abandonment for many years by the National Highway Traffic Safety Administration (NHTSA) of its effort to force the installation of air bags in automobiles was its failure or inability to accept an offer from General Motors to install air bags on a portion of its fleet in a broad-based "pilot project." *See* MASHAW & HARFST, *supra* note 45, at 90, 250-51. Yet, had NHTSA entered into a "regulatory reform contract" with General Motors for this performance, it might well have defused the opposition to air bags by showing that they could work in actual practice. *See* Dorf & Sabel, *supra* note 7, at 362-63.

92. *See* McGarity, *supra* note 4, at 1439-43; *see also* Freeman, *supra* note 8, at 10 n.21.

defeats public participation.[93]

However, "ossification" has been created at least in part, and perhaps in large part, by the all-or-nothing nature of current rulemaking practices, which confronts agencies with the choice of reforming an entire rule, or no reform at all. Regulatory reform contracts could provide a valuable exit from this dilemma, by allowing the agency to build the case for change by a series of small decisions until the data and experience for a generic decision has been gathered.

Such contracts should be less subject to "ossifying" forces than major rules. Since the contracts would not have to meet any statutory test other than (a) falling within the "trading range" defined by the law and (b) passing the highly discretionary test of yielding "equal social benefit," the law would not greatly confine their substantive content. Accordingly, the fear of judicial invalidation of regulatory reform contracts on substantive grounds should not significantly deter agencies from entering into them.[94] Moreover, the demand for ossification should be much reduced by the enlisting of the cooperation of the regulated described earlier.

Reform contract decisions could and should be made subject to the same procedural requirements as rules. But providing notice and comment and a documented decision would be less burdensome when approving a time-limited experimental program than when establishing (or amending) a permanent program of generic regulation. In the first case, the relatively small scale of the contract will limit the facts and issues, while the purpose of the experiment will be precisely to explore uncertain issues, which need not be resolved in advance. By contrast, a broad, permanent rule will raise many more issues, and create much greater pressure for their definitive resolution.[95]

93. *See* McGarity, *supra* note 4, at 1440-43.

94. For this reason, the use of regulatory reform contracts would also constitute an experiment in less stringent judicial review of regulatory decisions, which has been recommended by several commenters as a partial cure for "ossification." *See supra* note 52 and accompanying text.

95. According to Mashaw rulemaking has become so contentious that "[t]o manage effectively the level of rulemaking adversariness generated by the special interest publics in their immediate regulatory environment, agencies may need some institutional devices by which they can reduce the perceived stakes in rulemaking proceedings and constrain the armaments of the combatants." Mashaw, *supra* note 47, at 209-10. Although Mashaw immediately adds that "[i]t is not obvious that any such techniques exist," in fact regulatory reform contracts would serve both his purposes if properly framed. *Id.* at 210. Their case-by-case and experimental nature would "reduce the perceived stakes" while their foundation in mutual consent would "constrain the armaments" of those who might oppose them. Although such experiments, by the same token, would not reform the overall permanent regulatory system, the information they would generate could help create the consensus necessary for such reforms.

D. The Dangers of Abuse of Discretion

A proposal to grant broad freedom to a regulatory agency to accept offers from the regulated to change existing rules must address concerns that discretion would be abused, or that legislative power would be unduly delegated to electorally unaccountable bureaucrats—and to state and local governments and private firms even less accountable to a national electorate.

There is no serious prospect that such concerns would lead courts to disapprove regulatory reform contracts as an unconstitutional delegation of legislative power. Any reform contract program would need authorizing legislation to overcome the forces of agency passivity, to make clear the agency's power to depart from existing law within the prescribed "trading" boundaries, and to assure the enforceability of regulatory reform contracts by negating specific legal doctrines that might make them unenforceable.[96]

96. The central legal questions for regulatory contracts are whether the government can be sued for breaching them, and, if so, the nature of the available remedies. Precisely to guard against the unaccountable contracting away of governmental power, the courts have required that the necessary legislative authorization for such contracts be "unmistakably clear." *See* Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment, 477 U.S. 41, 52 (1986). Courts have also required authorization be expressly delegated. *See* Home Tel. & Tel. Co. v. City of Los Angeles, 211 U.S. 265, 276-78 (1908). In addition, it has long been held that the government may not surrender certain reserved powers by contract. *See* Stone v. Mississippi, 101 U.S. 814, 817-18 (1880). Lastly, the government's sovereign acts do not give rise to a claim for breach of contract. *See* Horowitz v. United States, 267 U.S. 458, 460 (1925).

However, in *United States v. Winstar*, a four-justice plurality found that the unmistakeability and clear statement doctrines did not apply where the only remedy for contract breach was damages rather than specific performance, and where the obligation to pay damages did not effectively forbid the government to change policy in the future. *See* 518 U.S. 839, 843 (1996). Under this approach, a contract forbidding subsequent changes in social security contributions could not be enforced by damages, since the damages would reverse the change. However, a contract forbidding subsequent changes in product safety standards could be enforced by damages, since the obligation to pay damages would not (at least in theory) prevent the government from enforcing the new standard.

The *Winstar* plurality also found the "reserved powers" and "sovereign acts" doctrines inapplicable for the reason just given—that the damage remedy did not prevent future exercise of sovereign power. *See id.* at 880-83. Additionally, the Court rejected a broad reading of the "sovereign acts" defense, suggesting it could only apply to "public and general" acts "relatively free of Government self interest" or factional influence, and with only an "incidental influence" on contracts, and not to "statutes tainted by a government object of self-relief." *Id.* at 896. In a later passage, the Court went further. Analogizing the "sovereign acts" doctrine to an "impossibility" defense (since the sovereign's own public-regarding acts make performance of the sovereign's "private" obligations impossible) the Court's plurality opinion stated that the government, like a private party, could expressly contract to make the sovereign acts defense unavailable, just as a private party can waive an impossibility de-

A statute incorporating the principles advocated in this Article would be immune to attack either as lacking decision making standards, or as delegating undue power to private factions, despite the discretion it would confer.[97]

However, even a legal delegation can be bad policy. To address *that* concern, this section discusses the structural safeguards provided by the

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fense by contract. *See id.* at 908-09. Justices Scalia, Kennedy, and Thomas, concurring, would have made such a waiver the centerpiece of the holding. *See id.* at 919.

In *Winstar,* the Court accepted fairly ambiguous language in the bank supervisory statutes as adequate to overcome the four doctrines that limit government contracting power and to authorize the competent regulatory agencies to contract for a favorable accounting treatment of banks that took over failing savings and loans. The detection of similar ambiguities in the multitude of statutes that might be affected by regulatory reform contracts, and the defense of their adequacy to support such contracts, would themselves be legal tasks so debatable and expensive as to deter widespread use of the contract approach. More important, even if similar ambiguity could be successfully established for such statutes, the unavailability of specific performance under the *Winstar* precedent would be a definite obstacle. The consideration for which private participants in regulatory reform contracts will bargain will be a shield against enforcement of the underlying statute, not the right to sue for damages if such an action is brought.

Legislation would be needed, quite apart from *Winstar* (which did not address the issue) to authorize such specific performance. The courts have never definitively settled whether an order for specific performance of government contracts is *ever* appropriate under existing statutes. The Tucker Act has been read to incorporate prior sovereign immunity doctrines under the current statutory matrix that bar a specific performance remedy. *See* 28 U.S.C. § 1491(a)(1) (1994 & Supp. V 2000). The APA arguably authorizes specific performance. *See* 5 U.S.C. § 702 (1994 & Supp. V 2000). The circuit courts are divided on which reading prevails. *See* Jean O. Melious & Robert D. Thorton, *Contractual Ecosystem Management Under the Endangered Species Act: Can Federal Agencies Make Enforceable Commitments?*, 26 ECOLOGY L.Q. 489, 524-33 (1999).

Legislation would therefore be a necessary prelude to any active "regulatory reform contract" program, both to satisfy the "clear statement" doctrine and to authorize orders for specific performance. In addition, although such a statute probably should not forbid the abrogation of regulatory reform contracts by later "public and general" acts (motivated, for example, by the discovery that a given chemical was far more hazardous than previously believed), it could recite the conditions under which such a subsequent abrogation would be proper, and what its consequences would be. If the new enactment were indeed "public and general," if a reasonable time to adjust to it were given, and if contract participants were free from liability for acts performed in the interim, no damage to the regulatory reform contract program would be likely to result.

97. *See generally* Whitman v. Am. Trucking Ass'ns, 531 U.S. 457 (2001); Touby v. United States, 500 U.S. 160 (1991); Mistretta v. United States, 488 U.S. 361 (1989). A statute authorizing "regulatory experiments" would have other advantages as well. By removing the legal questions raised by many current "regulatory reform contract" initiatives, a regulatory reform contract statute would allow the agency to act somewhat more independently, and would thus increase the capacity of the "regulatory reform contract" approach to encourage the development of more competent and activist agencies. *See supra* note 16.

experimental contract approach, the ability of notice and comment to correct the remaining defects, and the costs of insisting on more elaborate procedures.[98] The next and final section discusses both the immediate benefits of regulatory reform contracts, and the more generic reforms to which they might lead.

1. Structural Safeguards Against Abuse of Regulatory Reform Contracts

Commenters have attacked the use of contracts to implement regulatory statutes both because they treat as means, and trade away, statutory obligations that should be viewed as ends, and because of their alleged tendency to surrender the public interest to the special interests of the contracting parties.[99] Generic use of contracts would also pose another, opposite, dan-

98. The discussion in text concentrates on abuse of discretion because there seems no logical reason why corruption should be a greater danger in a discretionary regulatory system than in a rigid one. Even if the applicable rules were clearly and inflexibly stated, a corrupt regulator could avoid them simply by falsely describing the facts. *See generally* KELMAN, *supra* note 36.

99. *See* Dana & Koniak, *supra* note 6, at 479 (suggesting Congress's use of regulatory contracts may effectively amount to "trad[ing] its law-making authority for money"). This article sees such contracts as intended either to "lock in" the fruits of industry capture of an agency, to compromise a difficult political issue rather than presenting it for resolution by the competent political branches, or to protect private entities who make investments in reliance on government assurances against "opportunistic" changes in the legal framework once the investment has been secured. *See id.* at 495-515. The authors find that only the third of these justifications has substantial merit, and that its merit is insufficient to overcome the profoundly anti-democratic nature of regulatory contracts. *See id.* at 526. Accordingly, they assert, regulatory contracts should be forbidden. *See id.* at 516. The premise of their argument is that regulatory contracts effect a permanent change in a generally applicable regulatory framework. Since this premise does not hold for regulatory reform contracts, the Dana and Koniak criticisms are far less forceful in that context. Indeed, the arguments in this article would be valid even if the government were free to reverse the terms of a regulatory contract by unilateral regulatory action, since the difficulty of making the regulatory change would itself provide the other party to the contract with substantial protection against such changes.

The Dana and Koniak article tacitly assumes that the government knows what it needs to know about the feasibility and the costs and benefits of different regulatory actions, and that the established political processes will tell it what it needs to know about public value preferences, without any need for new tools for discerning either. Accordingly, Dana and Koniak do not address the potential value of regulatory contracts in providing the government with new information about regulatory options, or new material for the social dialogue on regulatory choice, issues at the center of this article's argument. On the contrary, Dana and Koniak argue contracts should be forbidden because "government agents are likely to have insufficient information on which to base regulatory contract decisions, which could lead to inefficient contracting." *Id.* at 549. The statement is entirely unsupported. But even if it were true, the right question is not which vehicle of government action is perfect, but which has the least weaknesses. In that spirit, one might ask, if government agents lack the infor-

ger. If regulatory agencies could, without limit, accept contracts as alternatives to regulatory compliance, that could create an incentive to issue more stringent regulations, not to achieve the legislatively prescribed goals, but to create an "entitlement" to trade for something else the agency had no legislative authority to require, or to exact from the regulated concessions that it might be more just to purchase.[100] Restricting contracts to a limited number of temporary experimental departures from existing rules minimizes both these dangers.

Restricting regulatory contracts to experiments reduces the damage caused by unwise contracts more than it reduces the benefits of wise contracts. In the sphere of immediate results in the particular case, both the costs, if such a contract attempts to trade obligations that society, on reflection, finds incommensurable, or achieves social goals less effectively than adherence to the existing regulations, and the benefits, if it trades commensurable obligations and leads to better performance, will be limited by the contract's case-specific scope. But in the realm of information and innovation, the benefits of a success will far outweigh the costs of a failure. Each success can become the template and the touchstone for future successes, while failures (which may themselves provide valuable information) can be abandoned with no costs beyond the direct impact of the experiment itself.

Both the experimental approach and the use of existing requirements as the baseline also minimize the danger that regulatory requirements will be tightened simply to increase the government's bargaining power. Tightening a generic regulatory requirement for the sake of a trade or two would almost never be worth the work, while tightening the requirements applica-

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mation they would need to contract, how can they be expected to *regulate* efficiently? The contract approach at least provides incentives for one side to provide information and the other to evaluate it accurately, incentives largely lacking in the regulatory process. Beyond that, the article barely mentions the possible use of contracts as a "base load" regulatory tool, authorized by statute and confined within specific barriers. Yet such an approach, which mirrors the framework within which *regulations* are authorized, would seem as free as regulation from the dangers of unaccountable power, while it would allow the government to obtain commitments for types of regulatory performance that could never be directly commanded by regulation, because they depend too much on the use of knowledge or management systems within the unique control of the regulated.

100. Habitat conservation plans are designed to protect against a somewhat analogous danger, namely the continued escalation of regulatory obligations once voluntary compliance with the initial set has been secured.

> [T]he landowners who received "No Surprises" assurances maintain, and some academic commentators agree, that their deals with the government are designed to prevent them from being taken advantage of by committing land to preservation that they might otherwise have developed and then, having made such costly concessions, being forced by "greedy" activist regulators to give up more (and later still more).

Dana & Koniak, *supra* note 6, at 513.

ble to a single entity would be procedurally difficult, and open to legal challenge as discriminatory. Moreover, to the extent that requirements established before the contract program took effect served as the baseline, by definition they would not have been established for bargaining purposes.

Finally, to the extent the danger in the contract approach stems from the more central position of the regulated, rather than the greater discretion granted to the regulatory agency, authorizing only a limited number of contracts would increase the agency's ability to counter these dangers, since the regulated entities would have to compete with each other for a limited number of agency approvals.

2. The Adequacy of Notice and Comment as a Safeguard

Despite these structural protections against abuse, a two-party contract system operating without additional procedures would *not* provide affirmative protection to the interests of third-party beneficiaries of regulatory programs, beyond the protection provided by the agency (or, conceivably, an enlightened offeror) acting as their surrogate. Indeed, by giving the regulated access to the agency to suggest more efficient approaches,[101] it gives the regulated the opportunity (and they already have the motive) to press for more lenient controls, perhaps less protective of the public interest, than would have resulted from application of the traditional regulatory approach.[102] It also gives the other contracting party—the agency itself—the opportunity (and it may already have the motive) to accept, or even press for, politically expedient controls less protective of the public interest than would have resulted from the use of generic rulemaking procedures.

These are not new dangers. The regulatory system already requires many decisions highly analogous to regulatory reform contracts in that they directly bind only an individual entity, but indirectly affect many other members of the public as well. Examples include the issuance or approval

101. One might ask why only the regulated should have the right to suggest departures from the existing regulatory scheme. Why should not the same legislation that authorized "regulatory reform contracts" also give citizen groups or unions an equal right to petition for a site-specific rule that *they* thought would produce equal or greater social cost reduction at less cost? I can see no reason in principle to deny such a right. However, if granted, it would probably yield smaller results than the encouragement of offers from the regulated, since (a) it would not be able to draw on the special knowledge of the regulated, and (b) the regulated would be free to oppose such petitions since they would not have consented to their terms in advance.

102. However, to the extent that the regulated entities are large organizations that must deal repeatedly with regulating agencies and legislatures, they will have motives not to abuse a regulatory reform contract approach. The gains from more lenient regulation at one plant, at one point in time, will be limited, while the losses from diminished credibility and bad publicity will be much less limited.

of permits for air[103] and water discharges,[104] and permits for waste treatment, storage or disposal,[105] to "take" endangered species,[106] to market new drugs[107] or pesticides,[108] or to cut trees or to make other commercial use of national forest land.[109] Here, as with regulatory reform contracts, the agency essentially reviews for approval or disapproval submissions by private persons or non-federal governments.[110] Such decisions already pose both

103. The Clean Air Act requires every "major source" of air emissions to get an operating permit. *See* 42 U.S.C. §§ 7661-7661e (1994). The Act also requires every major source to get a construction permit imposing new control requirements if it is built new or "modified" so that its emissions increase "significantly." *See* 42 U.S.C. §§ 7475, 7502-03, 7511a (1994 & Supp. V 2000).

104. The Clean Water Act requires every discharger of pollutants into the waters of the United States to hold a discharge permit. *See* 33 U.S.C. §§ 1311, 1342 (1994 & Supp. V 2000).

105. Under the Solid Waste Disposal Act, any entity that "treats, stores, or disposes of" hazardous waste must hold an authorizing permit. *See* 42 U.S.C. § 6925(a) (1994 & Supp. V 2000).

106. Section 10 of the Endangered Species Act allows the issuance of permits to "take" an endangered species despite the general ban on such "takings." *See* 16 U.S.C. § 1539(a) (1994 & Supp. V 2000). Permits may be issued if the "taking" would be "incidental" to another lawful activity and would not "appreciably reduce" the chances of the species survival. *See id.* at §§ 1539(a)(1)(B)-(a)(2)(B) (1994 & Supp. V 2000).

107. *See* 21 U.S.C. § 355 (1994 & Supp. V 2000).

108. All new pesticides must be "registered" with EPA, which must find that they will not cause exceedances of food quality "tolerances" and will not otherwise cause "unreasonable adverse effects on the environment." 7 U.S.C. §§ 136a(a), 136a(c)(5), 136(bb) (setting forth registration requirements and standards and defining "unreasonable adverse effects on the environment").

109. *See* 16 U.S.C. §§ 472a, 497-497d (1994 & Supp. V 2000). In short, if we consider all these elements together, "various contractual settlements may already be said to compose a significant part of the corpus of environmental law in the United States. The background of seemingly rule-based statutes and regulations is in fact a shifting inventory of piecemeal contractual negotiations in the context of adversarial rulemaking and enforcement." Geoffrey C. Hazard, Jr. & Eric W. Orts, *Environmental Contracts in the United States*, *in* ENVIRONMENTAL CONTRACTS: COMPARATIVE APPROACHES TO REGULATORY INNOVATION IN THE UNITED STATES AND EUROPE 71-72 (Eric W. Orts & Kurt Deketelaere eds., 2000).

110. "[A]side from providing written and sometimes oral testimony (and unless they mount a legal challenge), [when EPA permits are issued] parties other than the agency and the applicant are not directly involved at either the drafting or implementation stage." Freeman, *supra* note 8, at 16.

According to one observer of the initial EPA issuance of water pollution control permits, these permits were negotiated on an individualized basis incorporating whatever control measures and compliance schedules dischargers would accept. "EPA characterized these permits as grounded on 'best professional judgment;' but they often reflected simply the 'best deal' the Agency could obtain in light of manpower and time constraints and its desire to demonstrate progress." Farber, *supra* note 11, at 302 (quoting Howard Latin, *Regulatory Failure, Administrative Incentives, and the New Clean Air Act*, 21 ENVTL. L. 1647, 1672 (1991)). "Even today, according to a recent General Accounting Office . . . report, 'there is

the danger of improper agency yielding to private or parochial agendas, and improper agency pursuant of unauthorized agendas of its own. Although Salzman and Ruhl argue that such permits are subject to detailed, binding regulations that restrict the agency's freedom in issuing them, this description is often clearly inaccurate.[111]

The almost universal procedure for making these decisions consists simply of a documented notice to the public of the proposed decision, an opportunity for public comment, and a final decision accompanied by a response to the comments received.[112] There is no reason why this procedure cannot serve to test regulatory reform contracts as well.[113]

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no real consistency in how pollutant levels are set in . . . permits' [and compliance schedules]." *Id.* at 302 (quoting Victor B. Flatt, *A Dirty River Runs Through it (The Failure of Enforcement in the Clean Water Act)*, 25 B.C. ENVTL. AFF. L. REV. 1, 17 (1997)).

Such perceptions, of course, hardly prove that the existing system for issuing permits is optimal. But they *do* show that the record will not support objections to regulatory reform contracts as involving an unprecedented delegation of power to the industry and the agency. Indeed, the requirement for detailed articulation of reasons why the "equal environmental benefits" test was met would make regulatory reform contracts more visible to the public and more subject to public control than the issuance of permits reflecting judgments of what was technically and economically feasible for a particular plant and production process.

111. *See* Salzman & Ruhl, *supra* note 1, at 683-85. For contrary examples, see Farber's article describing the existence of wide discretion in issuing discharge permits under the Clean Water Act. *See* Farber, *supra* note 11, at 302. Similarly, the decision whether to issue a permit to fill a wetland is made by "balancing" all feasible uses of the property in question. *See* 40 C.F.R. § 230.10(a), (a)(2) (2000).

> [N]o discharge of dredged or fill material shall be permitted if there is a practicable alternative to the proposed discharge which would have less adverse impact on the aquatic ecosystem . . . . An alternative is practicable if it is available and capable of being done after taking into consideration cost, existing technology, and logistics in light of overall project purposes.

Id. (stating the standard for decision).

112. *See* 5 U.S.C. §§ 553(b)-(c) (1994 & Supp. V 2000). Courts have expanded the very general language of the statutory test into a requirement that the underlying issues be addressed in detail both in the proposal and in the response to comments. *See* Portland Cement Assoc. v. Ruckelshaus, 486 F.2d 375 (D.C. Cir. 1973) (Leventhal, J.).

113. Dana and Koniak conclude, after rejecting as unworkable substantive tests for which regulatory contracts should be deemed valid, and which should not, state:

> Upholding only those regulatory contracts that meet certain procedural requirements for their formation is a much more promising approach. The procedural requirements to which we refer focus on the level of openness, publicity, explicitness, or (as a one-word aggregation of all these) transparency surrounding the formation of the contract and the terms of the contract itself.

Dana & Koniak, *supra* note 6, at 518.

> [The notice-and-comment] requirement dramatically lowers monitoring costs for outside constituencies and thus helps them to participate effectively in policy formation. . . . Notice and comment requirements . . . would add to the costs of agency contracting, but regulatory contracts formed by agencies are (or should be) rare enough, and

Notice and comment on regulatory decisions serves three separate purposes. First, it allows interested persons to probe the "technocratic" support for the decision by examining the quality of its factual and analytic justification, and whether the commitments proposed will be adequately enforceable. Second, it allows discussion, to the extent the underlying statute permits, of more fundamental issues of choice of appropriate ends and means. Finally, the ability of a proposed action to withstand such examination also provides some assurance that improper motives have not led to the decision.[114]

Notice and comment can perform the same functions for regulatory reform contracts.[115] Explaining why the "equal social benefits" test was met would require the parties to detail the benefits expected from the new contract, document the factual and analytical support for their conclusion, and compare those benefits with the benefits from compliance with existing requirements. Since a regulation is only beneficial to the extent it can be enforced, and an experiment is only valuable to the extent its results can be measured, the contract would have to explain the manner in which the contract would be enforceable and would yield measurable results.[116]

> the stakes for democratic governance seem high enough, that the costs of formalized public notice seem justified.

Id. at 523.

114. As McGarity explains:

> The requirement that an agency explain itself . . . can be an effective and relatively inexpensive curb on arbitrariness and reliance upon extra-legal considerations. Even in the absence of other review mechanisms, the requirement for reasoned explanation ensures that the range of agency action is bound by those options that are supportable by facts in the record, reasonable assumptions, and sound policy considerations—and this is the case whether or not the reasons the agency gives are the real reasons that motivate the agency. The requirement that the agency explain itself also apprises affected parties of the legal, factual, and policy bases for the regulation. To the extent that agency rules depend upon critical assumptions and inferences from the existing data, requiring the agency to lay out those assumptions and inferences, and to subject them to outside scrutiny, will enhance the accuracy and legitimacy of the resulting rule. Similarly, the requirement that the agency respond to significant comments helps legitimate the process in the minds of affected parties, even if the agency resolves issues adversely to them.

McGarity, *supra* note 4, at 1444.

115. Indeed, regulations of the Department of Justice require notice and comment on consent decrees settling pollution control cases. These decrees often have certain similarities to regulatory contracts, since they can provide for the clean-up of an entire hazardous waste site, or require comprehensive controls on a major industrial facility. *See* 28 C.F.R. § 50.7 (2001).

116. Steinzor makes the useful suggestion that the EPA should develop standardized instructions for the information that must be disclosed in proposals, including detailed data on the levels of actual, allowable, and to be achieved emissions; the tangible benefits the proposal will achieve; and the potential adverse consequences of the exemptions it entails.

Notice and comment on a regulatory reform contract might well expose the fundamental policy choices at issue more fully, and in a more publicly useful manner, that most comment on regulatory proposals under our current system. Often, the most fundamental issues involved in current regulatory proposals involve narrow questions of interpreting statutes, or evaluating specific aspects of immensely detailed technical records. By contrast, each contract would present the fundamental policy decision whether one pattern of controls would lead to more social benefit than another. The notice document would explain why the agency thought this to be true, and would invite public comment on that explanation. Often, more comprehensive documentation and discussion of the environmental "footprint" of a facility would be necessary to meet such a broadly phrased requirement than is required to support the promulgation of more narrowly focused regulatory standards.[117] By requiring such broader and more publicly accessi-

Companies should be required to respond promptly to reasonable data requests. *See* Steinzor, *supra* note 12, at 125, 130-32, 139.

117. Ackerman and Stewart, in urging a shift from our present fragmented regulatory system to one that sets broad generic limits on pollution discharges, state:

> At present, the BAT ["best available technology"] system focuses congressional debate, as well as administrative and judicial proceedings, upon arcane technological and definitional questions which rapidly outstrip the time and energy that most politicians and citizens are willing to spend on environmental matters. In contrast, [a system of generic pollution reduction] will allow the policymaking debate to take a far more intelligible shape. . . . Speaking broadly, do the American people believe existing environmental objectives are too ambitious [in which case more pollution should be allowed], or do they think that Congress should cut back further on pollution . . . ?
>
> . . . .
>
> . . . In contrast, the BAT system fails to focus attention on the overall rate at which America should clean up the environment, leaving it to unguided and disjointed bureaucratic and judicial decision in an endless series of BAT inquiries into the "availability" of one or another cleanup technology.

Ackerman & Stewart, *supra* note 2, at 1353-55. Sunstein repeats this analysis and adds:

> The focus on the question of "means" also tends to increase the power of well-organized private groups, by allowing them to press environmental and regulatory law in the service of their own parochial ends. . . .
>
> . . . .
>
> . . . By directing attention to means, the current system . . . creates powerful incentives for interest groups to ensure that they are favored in the legislature or the bureaucracy.

SUNSTEIN, *supra* note 6, at 325-26.

In fact, the fundamental issues of environmental policy are far too complex to be captured by the simple more pollution/less pollution dichotomy offered by Ackerman and Stewart. Such a policy must also address, as the authors recognize, possible distinctions in control effort by geographic region and by pollutant. Beyond that, as the authors do not recognize, distinctions may be needed according to the *medium* (air, water, land) into which the pollutant is released. Finally, Ackerman and Stewart do not acknowledge that environmental policy encompasses many efforts that are not regulatory "pollution control" efforts in

ble discussion of the basic issues, the establishment and approval of regulatory reform contracts would carry forward the current trend to rely increasingly on data disclosure and analysis as a tool of public policy,[118] and potentially increase the acceptability of the reform contract approach to environmental interest groups.[119]

To be meaningful, agency compliance with these notice-and-comment requirements would need to be checked by judicial review. As with review of environmental impact statements under the National Environmental Policy Act (NEPA),[120] the focus would be on the adequacy of the analysis of the issue, not on the wisdom of the decision. Experience with NEPA shows that review limited to the adequacy of agency analysis has not led to "ossification" of the process of approving federal actions to which it applies, though it has led to substantive reductions in their environmental impacts.[121]

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the narrow sense at all. These include licensing and cancellation of pesticides, clean-up of hazardous waste sites, efforts to preserve natural habitats on land or in water and the species within them, and the use for all these purposes of such non-regulatory tools as scientific research, purchases of land, and grants to encourage technical innovation.

Such a recognition in no way diminishes the force of Ackerman and Stewart's criticism of the way our current system diminishes public involvement in environmental policy formation. But it does suggest a more flexible and case-specific vehicle is needed to encourage such involvement in a manner that addresses the full range of policy complexity. This Article contends that case specific proposals for "regulatory reform contracts" would serve very well as such a vehicle.

118. *See* Pedersen, *supra* note 13, at 151.

119. According to one study of Project XL:

> EPA has thus far either ignored or resisted providing a readily available incentive to the full spectrum of public interest representatives: disclosure of available information about the nature and scope of pollution and the industry practices that cause it. A pledge to conduct an open discussion of actual emissions, available technologies, the differences in environmental performance between newer and older facilities, the internal competitive dynamics of the industry at issue, worker safety problems, and a slew of other, related issues is likely to prove extremely attractive to environmentalists, who thirst for this kind of information and have great difficulty obtaining it.

Steinzor, *supra* note 12, at 179. Although the discussions of "equal social cost reduction" recommended in the text would not all be likely to cover all these topics, they would probably cover more of them, and give them more central attention, than discussions in support of conventional regulations.

120. *See* 42 U.S.C. §§ 4321-4370d (1994 & Supp. V 2000). The "impact statement" requires a "detailed statement" on adverse short and long-term environmental impacts to be prepared and considered before any "major Federal actions significantly affecting the quality of the human environment" can be taken. 42 U.S.C. § 4332(C) (1994 & Supp. V 2000).

121. According to the most definitive study of NEPA, the "impact statement" requirement has served to weed out some of the most environmentally damaging projects, and to bring about modest reductions in the environmental damage caused by many others. *See* SERGE TAYLOR, MAKING BUREAUCRACIES THINK: THE ENVIRONMENTAL IMPACT STATEMENT STRATEGY OF ADMINISTRATIVE REFORM (1984). *See also* Michael Herz, *Parallel Universes:*

3. The Costs of More Elaborate Safeguards

To fully evaluate whether substantive decision making standards are more elaborate than "equal social benefit," or whether procedures are more elaborate than notice and comment, should be required for regulatory reform contracts, we must also evaluate the costs of such procedures.[122] This

NEPA Lessons for the New Property, 93 COLUM. L. REV. 1668, 1712 (1993) (stating the broad discretion agencies enjoy under NEPA appears to yield better substantive results than the system of highly codified rights that characterizes (or used to characterize) "entitlements" programs like welfare).

That is not a bad record for a purely analytical requirement that does not implement any substantive legal standards. *See* Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 351 (1989). We could expect the requirement to analyze regulatory reform contracts to perform better in that it would have *some* substantive content in the form of the "equal social cost reduction" test.

122. This is a missing topic in much administrative law scholarship. "The focus in recent reform proposals on increasing or diversifying oversight mechanisms assumes that the central problem of administrative law and process continues to be *unconstrained agency discretion*." Freeman, *supra* note 8, at 10 (emphasis in original). "[These proposals] are emblematic of a political moment in which agencies are seen to be dangerously irrational." *Id.* at 10 n.23. Similarly, Christopher Edley notes that the dominant perspective in administrative law, traditionally, has been "to fear discretion, reluctantly accept its presence, and attempt to control it . . . ." CHRISTOPHER F. EDLEY, JR., ADMINISTRATIVE LAW: RETHINKING JUDICIAL CONTROL OF BUREAUCRACY 217 (1990). Dana and Koniak provide a notable example of such thinking through their thoroughgoing rejection of all mechanisms (including the enforceability of garden-variety government contracts) that might diminish the ability of political agents to exercise control over regulatory discretion by changing the rules at any time. *See* Dana & Koniak, *supra* note 6, at 557-58. Such an approach to reform completely overlooks both the possibility that greater social benefits can be obtained by a government commitment *not* to change the rules than by retaining the power to change them, and the insight that this itself is a political judgment that the competent political branches should be free to make.

Once again, these problems are not confined to the regulatory arena. A study of government contracts analyzed in detail the counterproductive impact of the "[v]oluminous rules" that governed government contracting and concluded that "[t]he basic principle . . . should be to increase dramatically the freedom we give public officials to use their judgment in the procurement process . . . [and] to select the means to realize agreed-upon ends." KELMAN, *supra* note 36, at 3, 90-91.

Philip Howard offers the classic popular denunciation of this focus on abuse of discretion to the exclusion of all else in stating:

> Novocaine seems to have been injected into bureaucrats' brains, at least into the lobe where the word *yes* is found.
>
> . . . .
>
> . . . We have deluded ourselves into thinking that the right decisions will be ensured if we build enough procedural protection. We have accomplished exactly the opposite . . . . Public decisions are not responsible because no one takes responsibility.

PHILLIP K. HOWARD, THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA 59-61 (1994).

section discusses why such greater restrictions would reduce the chances of beneficial offers for regulatory reform contracts. The following section discusses, in more concrete terms, the benefits both of the completed contracts themselves and of the broader changes in the existing regulatory system that they might promote.[123]

A regulatory reform contract approach would be intended, in large part, to induce regulated entities to reveal to the government a hidden capability or a hidden willingness to depart from the established legal framework by providing a social good that the government was not currently requiring them to provide, or to provide the same social good by different and more efficient means.[124]

Such offers will suggest to the government the possibility of "gains from trade" created by the ability of a more efficient or more innovative approach to provide more social benefits per unit of resources expended than the established approaches. Those "gains from trade" could, in principle, be divided anywhere along an allocation spectrum ranging from a point that required the regulated entity to provide only the amount of social benefit that the original regulations required, so that any cost savings would be enjoyed by the offeror, to a point at which the regulated entity enjoyed only a small burden reduction, with most of the surplus being devoted to providing additional social benefits.

Clearly, the more limited the share of the "gains from trade" those proposing the new approaches were allowed to keep, the less motivated they would be to make reform suggestions.[125] But a regulatory reform contract

123. In a recent study of EPA management and adaptability, NAPA put forward, as one of its core recommendations, "[r]eplac[ing] the agency's casual demand for 'consensus' with an explicit bias for action." NAPA, *supra* note 7, at 13. In view of the cultural obstacles to such a change, which the study amply documents, it is hard to see how it could be accomplished without some change in the procedures by which decisions for "action" are reached. Regulatory reform contracts could serve as one such procedural change.

124. In this manner, the contract model would undermine the tendency, which regulation's focus on *agency* decisions encourages, for the agency to look only to itself for the solution to regulatory problems.

> [I]nformal rule making and implementation suffers from a conceptual divide between legitimate public and private roles in governance. Because private parties are viewed as purely self-interested and unaccountable, the agency alone promulgates, implements, and enforces regulations; the agency alone is responsible for protecting the public interest. In traditional rule making, interest groups, private parties, and local communities are experienced as a threat to the integrity and expertise of the agency. As a result, regulation overburdens agencies and undervalues the capacity of nongovernmental groups to participate in governance.

Freeman, *supra* note 8, at 13.

125. That is particularly true in that the offer itself will not be cost free. Apart from the immediate costs of its development, it will disclose new information to the government

system that discouraged offers would be inconsistent with an experimental approach, since the government's gains from trade will consist largely in the knowledge of new approaches, for possible more generic future application, that a successful approach would generate.[126] To maximize those gains, the widest possible range of offers should be encouraged. [127]

Moreover, in many cases the "gains from trade" will be difficult to quantify prospectively. Whether the issue is the performance of a new technology or a new approach to management, it will be more difficult for a regulatory agency to predict the extent of future benefits than it would be to establish a regulation that reflects only the use of established approaches.

Regulatory reform contracts should not be approved unless evaluation of their actual performance could show at least retrospectively that the "equal social benefits" had in fact been provided as promised. Those contractors who fell short of the promised performance should be subject to enforcement.[128] However, to require that such contracts provide greater environmental benefits would depart from the relatively firm baseline that existing requirements provide. The difficulty of predicting in advance when a greater benefits test would be met would itself discourage offers for regulatory reform contracts that offered new approaches of somewhat uncertain potential.[129]

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about the offeror's capabilities. That disclosure in turn could increase the government's ability to impose the offered obligations on the offeror through unilateral regulatory action.

126. The question whether a "Project XL" offer must provide for "superior" environmental performance to receive approval, or whether it could be sufficient to provide equivalent environmental performance more efficiently, has been a perpetually contentious issue in project approval and a perennial cause of delay. However according to one comment,

> The debate over the level of superior environmental performance is a red herring. It is focused on the short term quid pro quo of individual test cases and misses the bigger picture of what a new environmental paradigm could achieve in the long term. . . . The alternative compliance model is designed to find and remove needless costs and inefficiency. But it is also predicated on the notion that such alternative systems will broadly advance the cause of environmental protection . . . . Treating this as a short-term leveraging opportunity ignores its real potential for building an environmental management system for the 21st century.

Timothy J. Mohin, *The Alternative Compliance Model: A Bridge to the Future of Environmental Management*, 27 ENVTL. L. REP. 10,345, 10,353 n.73 (1997).

127. Other considerations also support broad agency discretion in approving regulatory reform experiments. It might be good policy for the agency itself to deny approval to the less promising regulatory experiments. But for the legislature to specify detailed standards for determining "less promising" would inevitably constrict the ability of regulatory reform contracts to come up with new and innovative challenges to the means—and, in particular, to the ends—of the current system.

128. Dana and Koniak argue similarly that regulatory contracts should be required to include a "liquidated damages" provision triggered by non-attainment of its terms. Dana & Koniak, *supra* note 6, at 523.

129. The history of "Project XL" provides ample support for these concerns. The EPA

Such procedural restrictions as requiring non-party stakeholders to consent to regulatory reform contracts would negate their promise in much the same manner as imposing tight substantive approval standards. The very point of the regulatory reform contract approach is to allow limited challenges, in the form of experiments, to accepted regulatory ends and means, or to the conflated form in which our current system presents them. Requiring a consensus of those interested in the underlying regulation before a reform contract could be approved would increase the procedural costs of negotiating any contract. It would give those most wedded to the existing system, or most threatened by the suggested changes to it, a veto over challenging experiments. In addition to the extra procedural burden, it would reduce the benefits to the offeror of even a successful "regulatory reform" offer because the other participants would predictably condition their consent on the dedication to their own particular interests of some of the "gains from trade."

More fundamentally, any formal requirement of consensus would codify and thereby strengthen the "model" of the passive agency discussed earlier. It would give the interest groups that surround each agency greater rights over agency decisions than they enjoy under our present notice-and-comment system. By making their consent necessary to a regulatory action, it would formally negate the power of the agency to develop and pursue an active agenda within its sphere of responsibility.

In many cases, an "activist" agency, mindful of the benefits that can stem from broad involvement in designing regulatory programs, might seek such involvement on its own.[130] But requiring such involvement in every case would, for all the reasons given above, undermine the basic ability to

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has tended to insist that XL projects provide environmental performance not just equal, but "superior" to the results of the baseline regulatory program. The result, according to numerous accounts, has not been so much better projects as long delays in approving applications caused by the lack of standards for judgment, which in turn has created dissatisfaction with the XL program itself and a reluctance to apply to it.

130. According to one study:

> Regulatory negotiation clearly emerges . . . as a superior process for generating information, facilitating learning, and building trust. Most significantly, consensus-based negotiation increases legitimacy, defined as the acceptability of the regulation to those involved in its development.
>
> . . . .
>
> . . . [W]e believe it is a fair inference that the unique features of the reg neg process—its collective, interactive and consensual nature—play a key role, either directly or indirectly, in generating increased satisfaction. We are dubious, moreover, that other processes, such as informal policy dialogues, have the potential to produce the legitimacy benefit associated with regulatory negotiation, as some have suggested.

Jody Freeman & Laura I. Langbein, *Regulatory Negotiation and the Legitimacy Benefit*, 9 N.Y.U. ENVTL. L.J. 60, 63-64 (2000).

make such "activist" decisions.

E. Why Regulatory Negotiation Does Not Support the Use of Procedures Beyond Notice and Comment for Regulatory Reform Contracts

"Regulatory negotiation" (or "reg-neg")[131] a method of establishing government standards much discussed in the last fifteen years, explicitly relies on substituting the consensus of all the major interest groups for the normal in-house development of agency rules checked later by public notice and comment. In a reg-neg, an agency that must develop a regulation formally "convenes" a group representing both those outside persons significantly interested in the regulation, and the agency staff. The agency generally also hires a "facilitator" to assist the discussions. The reg-neg succeeds if the negotiating group reaches "consensus" on a proposed regulation.[132] Often, the agency will commit in advance to issue any consensus proposal as its own for public comment, foregoing any additional expression of its own views. Negotiated rules remain subject to judicial review under the otherwise applicable standards. However, no product of a successful reg-neg has ever been judicially overturned, even though the consensus approach has allowed the promulgation of rules of debatable consistency with the underlying statute.

On the other hand, such rules amount to "the tiniest fraction of federal regulations." In the fifteen years between 1982 and 1997, agencies convened sixty-seven formal reg-negs yielding thirty-five final rules. By comparison, the federal government probably promulgated about 45,000 rules during that period.[133]

That result confirms the long-standing scholarly opinion that regulatory negotiations are not suited for all issues. To have a realistic chance of succeeding, they must address cases where, among other necessary preconditions, the differences between the parties on the ends to be achieved are narrow, it is clear the regulation will eventually be issued, and the structure of the decision leaves room for gain by compromise among all parties.[134]

131. Both the term and the practice derive from a seminal law review article by Philip Harter. *See generally* Harter, *supra* note 37. Congress endorsed negotiated rulemaking on an experimental basis and called for its more widespread use in the Negotiated Rulemaking Act of 1990, which it made permanent in 1996. Pub. L. No. 104-320, 110 Stat. 3870 (codified as amended at 5 U.S.C. §§ 571-583).

132. "Consensus" does not necessarily mean formal agreement to the result, but rather an absence of formal dissent.

133. *See* Cary Coglianese, *Assessing Consensus: The Promise and Performance of Negotiated Rulemaking*, 46 DUKE L.J. 1255, 1310 (1997).

134. According to Harter:

Regulatory negotiation is more likely to be successful when no single party can dic-

In addition, the agency participants should take an active role in telling the parties what result will be acceptable.[135] This tactic is particularly potent when a new regulation is being issued, since the very fact that the government has not yet settled the details gives the parties a motive to agree with each other out of fear that the government's approach will be worse.

One might argue that regulatory reform contracts should be subjected to the same "unanimous consent" rules as reg-negs. If the initial departure from the unilateral use of agency discretion to promulgate a rule required unanimous consent, likewise, why should not any subsequent revision of a rule through a regulatory reform contract require unanimous consent?

That logic proves its point where revisions to *negotiated* rules are in question. But both the relatively short list of successful reg-negs, and the restrictive list of conditions for success, suggests how much a unanimous consent requirement will limit the workability of any decision making framework. Two structural arguments also speak against extending a unanimous consent requirement to regulatory reform contracts.

Regulatory negotiations almost without exception have been used to develop new generic rules. In such cases the agency has not yet addressed the proper implementation of the law. Since all stakeholders would be formally equal in the notice-and-comment procedures to issue a new rule that a successful regulatory negotiation would replace, it is appropriate for them all to consent to an alternative disposition. In essence, the requirement of unanimous consent protects the right to an agency decision made after public comment by granting each member of the negotiating group the power to force, as a "default solution," a decision made through those procedures.

However, this argument for consensus, strong where new generic rules are being established, becomes weak when applied to isolated changes to existing rules. Authorizing a limited experiment has far less drastic real impact than permanently establishing or changing a general rule. The availability of an existing regulation to serve as the "baseline" also weakens the argument for consensus. If a regulation already exists, the agency

tate the results without incurring an unacceptable sanction from the other parties. Only a limited number of parties directly interested in the outcome of the regulation should participate in negotiations, and the issues involved in the negotiation should be relatively well-developed and ripe for decision. Moreover, it must be clear to everyone that some form of regulation will be issued in the reasonably near future. The parties must believe that they can each win through negotiation. Issues should not involve fundamental value choices; rather, the parties should be guided by existing criteria reasonably acceptable to the parties. Finally, the parties must have a reasonable expectation that the agency will use the fruits of their labor as the basis of public policy.

Harter, *supra* note 37, at 51-52.

135. *See id.* at 60 (arguing the agency should participate actively in the negotiations).

will *already* have articulated its "default solution" through the established rulemaking procedures, while the question whether the alternative regulatory reform contract approach provides benefits "equal or greater" to that baseline will pass through those procedures as well. Such a pattern presents no negation of the right to comment, and no delegation of rulemaking power to the regulated.

Regulatory negotiation and regulatory reform contracting rest on directly opposing "models" of the regulatory agency. Regulatory negotiation assumes a passive agency that exists largely to validate and enforce the views of its constituencies.[136] The limited set of conditions in which regulatory negotiations have succeeded mirror the circumstances in which this view of the agency will allow collective action to control social costs.[137]

A unanimity requirement is far less suited to the reform of a broad range of existing regulations surrounded by factional pressures.[138] For that reason alone, a more "activist" agency that pursues an affirmative concept of the public interest will be required to give the contract approach a realistic chance of success.[139]

136. Cary Coglianese reflects:

> [M]aking consensus the goal of policy-making would markedly shift the prevailing norms of governance in two ways. First, an emphasis on consensus would "decenter" the state. The government would no longer be, in practice or in theory, the central, accountable decision-maker but would instead become more of a facilitator of bargaining between interest groups, or at most just another player in that bargaining game. Second, a focus on consensus would shift the aim of policy-making away from that which will serve the public interest to that which will be agreeable to those interests that are well represented in the political process.

Cary Coglianese, *Is Consensus an Appropriate Basis for Regulatory Policy?*, *in* ENVIRONMENTAL CONTRACTS: COMPARATIVE APPROACHES TO REGULATORY INNOVATION IN THE UNITED STATES AND EUROPE 97-98 (Eric W. Orts & Kurt Deketelaere eds., 2001).

137. Moreover, even regulatory negotiations generally will not succeed if the agency is completely passive. Studies have shown that success generally requires the agency to take an active role, continually telling the parties what its "default position" will be and pressing them to agree among themselves so as to prevent implementation of that approach.

138. McGarity notes:

> Negotiated rulemaking will probably not be very useful . . . in addressing issues on which the positions of likely participants have already hardened; on the other hand, negotiated rulemaking might be entirely appropriate for new topics, such as regulating risks posed by genetically engineered microorganisms in the pharmaceutical industry, where positions have not yet been formed and where large investments have not yet been made.

McGarity, *supra* note 4, at 1439. Of course, an existing regulation is apt to be the paradigm case of a rule where "the positions of likely participants have already hardened" and "where large investments have not yet been made." *Id.* Such regulations, therefore, are unlikely to be suitable for "regulatory negotiation."

139. Many academic recommendations for greater reliance on "consensus" and less use of adversarial procedure fail to address the obstacles to change that a consensus requirement

II. REGULATORY REFORM CONTRACTS AND MORE PERMANENT REGULATORY REFORM

The "regulatory reform contract" approach, to the extent it succeeded, would create agencies that were more "activist" in the sense of being able to take part more fully in public debates about regulatory ends and means. Within the limited sphere defined by specific approved contracts, that approach would clarify in actual practice the distinction between ends and means and thereby overcome procedural and institutional obstacles to improving the efficiency of agency programs.

Such changes, however, would all take place in the realm of experiment. Those experiments, if successful, would often disclose new technical or management approaches to reducing particular social costs that could then be used to amend individual generic rules.[140]

Regulatory reform contracts could also be expected to lead to more fundamental changes in the design of the entire regulatory system. These changes would be particularly likely to take the form of:

- Greater use of "market-based" approaches to regulation. To suc-

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would create, and therefore fail to suggest how to deal with them. So, for example, Freeman suggests greater reliance on cooperative approaches as a cure for her thoroughly documented criticisms of our current regulatory system, citing the benefits of cooperation in discovering "win-win" solutions by teamwork, and giving the participants a sense of "ownership" of the result that would make enforcement easier. Freeman, *supra* note 8, at 22-27, 40-49, 69-72. However, she fails to address how (or in what circumstances) this approach could overcome factional interests opposed to change, even if the change at issue would be one likely to command broad, but not unanimous, public support. That omission is particularly striking in that she endorses a "flexible, adaptive," and provisional approach to regulation that would require numerous changes as knowledge advanced, one that rests on an "ethic of experimentalism in which errors are not viewed as failures." *See id.* at 28-31. How could such changes be effected if they were all subject to negotiated consensus requirements?

The danger of faction is not theoretical. The Sierra Club has opposed allowing local groups to reach and implement a consensus on local environmental issues precisely because it would diminish the ability of the Sierra Club to stop changes in policy that it did not like. *See The Limits of Collaboration*, HARPERS, Nov. 1996, at 34-36 (citing a memorandum from Michael McCloskey to Sierra Club Board of Directors).

Orts and Deketelaere argue in detail that any diminution in the power of national environmental groups that a contracting approach might create would be balanced by an increase in the power of local environmental groups. Since many of our current environmental problems can only be addressed by local measures such as land use control, the end result might well be a gain for environmental protection. *See* Orts & Deketelaere, *supra* note 6, at 1, 33-34.

140. Studies of Project XL have repeatedly identified, as a key weakness, the failure of the program to provide for evaluating the implications of its results for the permanently established regulatory system. To correct that tendency, any statute authorizing "regulatory reform contracts" should provide an institutional mechanism for mandatory review of those implications.

ceed, market-based approaches require a far more rigorous distinction between ends and means than many present programs provide. Regulatory reform contracts are ideally suited to clarify that distinction on an experimental basis and thus to pave the way to development of full-scale market-based programs.

- Devolution of regulatory decisions currently made at the federal level to regulated states and industries; and

- Greater use of the contract approach itself on a permanent regulatory tool.

A. Regulatory Reform Contracts and the Adoption of Market-Based Control Approaches

1. The Characteristics of Market-Based Approaches

Market-based approaches to controlling "social cost" fall into two main categories, "fee based" and "permit based."[141]

Under a "fee based" approach, sources of social cost are assessed a fee for each unit of social cost that they create. Those sources whose economic cost of abatement is less than the fee will control their social costs rather than pay the fee, while those whose economic cost of abatement is greater than the fee will pay the fee instead. Such an approach is designed to achieve the greatest possible reduction in social cost for any given unit price for such reductions.

Under a "permit based" approach, sources must obtain an "allowance"—which the government issues in limited numbers—for each unit of social cost that they create. Sources can trade the allowances among themselves. Sources whose abatement costs are less than the market price of the allowance will abate their social costs rather than buy an allowance (or will abate and sell any allowances the government may have given them). Sources whose abatement costs exceed that allowance price will buy or keep allowances instead. Such an approach is designed to achieve any given reduction in social cost, represented by the difference between the degree of damaging conduct sanctioned by allowances, and the pre-allowance level of that conduct, at the minimum economic cost.

Both types of market approaches require the regulated entities to "internalize" the social costs represented by the fee or the allowance price, and

141. For a detailed recent summary of different market-based instruments, see Jonathan Baert Wiener, *Global Environmental Regulation: Instrument Choice in Legal Context*, 108 YALE L.J. 677, 704-10 (1999).

create a market incentive to abate those costs in the cheapest manner possible, without any need for government knowledge, much less prescription, of that cheapest manner. Such programs also provide a permanent inducement to discover still cheaper ways to reduce social costs, since by discovering such cheaper methods a source can minimize its fee or its need for allowances. Accordingly, once a market-based program is established, it can encourage innovation and economic efficiency without requiring detailed agency knowledge of the operations of the regulated.

However, market-based approaches require a rigorous separation between ends and means in their design. The end is the reduction of the defined "social cost," the means is the fee or allowance system.

Any market-based program must impose the same fee, or require the same number of allowances, for all activities covered by the program that impose the same amount of social cost. Only such equality leads to economic efficiency.[142]

Social costs, however, are caused both by physical facts and by the ways human beings evaluate them. Only in limited cases will it be clear from the physical facts that the social costs of different activities are, indeed, equal. For example, since any release of a given quantity of a given ozone depleting chemical anywhere in the world has the same adverse impact on stratospheric ozone, the social cost of such releases is the same regardless of the time or place of the release. That in turn makes the "ozone depleter" problem suited by its nature to a "market-based" approach.[143]

In other opposite cases, it will be clear that the costs addressed by a regulatory program are not equal, and that the "equal social costs" judgement cannot be made. For example, we would not allow one drug to create more health risk if risks of another drug were reduced, or allow one hazardous waste site to be left completely unremediated, if another were cleaned up more. Such trades would impermissibly increase the risk imposed on one set of persons in a manner that could not be compensated by reducing the risk on others.[144] Regulatory programs addressing such activities are un-

142. For example, if the same number of allowances were required to do A as to do B, but A were twice as environmentally damaging as B, it would be inevitably true either that A was being under-regulated or that B was being over-regulated. Neither result would be efficient.

143. "[Environmental trading markets] for carbon dioxide and [ozone depleting chemicals] do not raise spatial concerns because the compounds mix in the upper atmosphere independent of the site of emission." Salzman & Ruhl, *supra* note 1, at 627.

144. "[A]lthough acid rain deposition is controlled through a system of transferable allowances to emit pollution, it is doubtful that a similar program could be developed for trafficking in industrial accidents, unsafe aircraft, or tainted meat or poultry." Douglas C. Michael, *Cooperative Implementation of Federal Regulations*, 13 YALE J. ON REG. 535, 545 (1996). The difference between acid rain and the other examples given is precisely the lack

suited by nature to market-based approaches.[145]

In other intermediate cases, the activities at issue will mingle generic effects on large groups with effects or potential effects on smaller groups or individuals. In such cases the program designers will be tempted to subject activities with somewhat differing social costs to the same fee rate or allowance requirement for the sake of administrative simplicity and greater efficiency in reducing aggregate impacts.[146]

For example, the Clean Air Act "acid rain" program in effect assumes that the reduction of a ton of sulfur dioxide emissions anywhere in the country is of equal benefit to a reduction anywhere else.[147] This is not precisely true; it is a simplifying assumption made to make a broad market-based program possible.[148]

Opponents of a "market-based" approach to such problems will argue that the characteristics of individual activities that a proposed aggregation ignores may be more potent sources of social cost than the characteristics that it picks up, so that the category is not in fact restricted to activities that cause the same social cost per unit of activity. For example, activists have objected to proposals to "trade" reductions in hazardous air pollutants on the ground that there are many types of such pollutants, and that unrestricted trading might allow the creation of greater risks even if the overall quantity of pollutants released went down.[149] Proponents will claim that the

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of fungibility in the social costs involved.

145. EPA's guidance for Project XL forbids projects that would endanger worker safety or subject anyone to "unjust or disproportionate" environmental burdens. Regulatory Reinvention (XL) Pilot Projects, 60 Fed. Reg. 27,282, 27,287 (1995).

146. Salzman and Ruhl state:

> [T]he deep reductions mandated in [an environmental trading market] may also alleviate the problem of spatial nonfungibilites. While certain areas might receive more emissions than others, hot spots might still occur, but as a result of net reductions over the *entire* trading area, the local concentrations are not very hot—we may not need to care about heterogeneity of distribution.

Salzman & Ruhl, *supra* note 1, at 639-40 n.83.

147. *See* Clean Air Act, 42 U.S.C. § 7651b(f) (1994 & Supp. V 2000) (allowing power plants, subject to the "acid rain" program, to emit any amount of sulfur dioxide as long as they hold allowances to cover them).

148. Karkkainen explains:

> Market-based approaches and many forms of command regulation attempt to economize on information costs by assuming away local variations in the effects of pollutant emissions. In general, they assume that a given level of emissions will result in a fixed level of harm—that is, they often treat emissions as fungible, regardless of source, location, or background conditions.

Karkkainen, *supra* note 28, at 280.

149. In one such case, community activists argued that an "emissions trading" approach that allowed refineries in Los Angeles to postpone controlling their own emissions by removing old (and highly polluting) cars from the road had resulted in substituting regional

costs allegedly overlooked in the aggregation are non-existent or minor, and that in any event the much greater efficiency in social cost control that a market-based approach makes possible more than compensates for any marginal under-inclusion of local effects.

For these reasons, the imposition of market-based approaches on activities with even slightly heterogeneous effects will always be vulnerable to the argument that it will result in trades that allow environmentally damaging activities to increase more, or to become more concentrated on a particular group, than adherence to the existing system would have allowed.[150]

If program designers accepted such arguments, they might create two or more regulatory categories to subject activities that caused different amounts of social cost to different fee rates or allowance requirements. For example, it has been suggested that programs for trading water pollutants should impose a higher tax, or require more "allowances," for discharges into stream segments that are already highly polluted than for discharges into less polluted segments.[151]

However, there will be a limit to how many different categories can be established before the costs of increased complexity, or the benefits foregone by narrowing the market, exceed the benefits of more precisely defining the social cost.[152] The questions whether (and to what extent) to allow

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reductions in auto emissions of relatively low toxicity for increases in (or a failure to reduce) locally concentrated and more toxic emissions. *See* Salzman & Ruhl, *supra* note 1, at 628-29.

150. Karkkainen also notes:

> [T]here are often mismatches between the geographic scales needed to allow pollution markets to operate efficiently and the zones within which the fungibility of emissions may be fairly assumed. For some pollutants, including many toxic pollutants, emissions may be fungible only on geographic scales so small that they cannot support permit markets.

Karkkainen, *supra* note 28, at 281-82. Attempts to trade toxic pollutants over larger areas may create "hot spots" of concentrated exposures, giving rise to legitimate environmental justice objections. *See id.* at 281-82, 299 n.182.

151. *See* BRUCE A. ACKERMAN ET AL., THE UNCERTAIN SEARCH FOR ENVIRONMENTAL QUALITY 260-81 (1974); s*ee also* Karkkainen, *supra* note 28, at 280-81 ("Permit trading can also be modified by a zoning system so that only emissions within a designated zone are treated as fully fungible, with trades outside the zone prohibited or adjusted to reflect the differential of harm caused by the same pollutant in different zones.").

152. Salzman and Ruhl explain:

> Accounting meaningfully for nonfungibilities across type, space, and time imposes a heavy information burden on those designing and supervising the trading regime. As the cost goes up, parties . . . become less likely to participate and, at a certain point, may reach a state where no trading takes place. . . . As transaction costs increase, potential efficiency improvements are lost. Thus the policy instrument's viability rests on a balance.

Salzman & Ruhl, *supra* note 1, at 636.

trading at all, the geographic area within which trading should be allowed, how many categories to establish, and the exact "trading ratio" (that is, the difference in fee rates or permit requirements) between those categories, will all be fundamental policy choices in the design of any market-based program.

Answering those questions will be operationally equivalent, within the boundaries of each trading program, to defining both the ends of our regulatory efforts, and the means to be used to attain them. Each separate trading program will classify many separate actions into a limited number of regulatory categories of "Activities that Cause the Same Social Cost Per Unit of Activity" and establish trading ratios that define the relative damage created by activities in the different categories. Reducing aggregate activity levels across all regulated categories will be the programs' end. The means will consist of the amount of the fee imposed, or the number of allowances issued, and the mechanisms used to determine and enforce compliance. Since, in a rationally designed system, all means to a given end are fungible, within any given market-based program any pattern of activity reduction that the system yields will be as acceptable as any other.

Market-based programs that rest on broad and aggregated ends sharply distinguished from the means used to achieve them, differ fundamentally in design from our current system of conflated ends and means. The difficulty of bridging that conceptual gap between the old and the new makes market-based programs hard to establish. Since defenders of that system can portray each of its separate commands as an end in itself, they can also argue that the sacrifice of ends required by a market-based approach makes a market approach unacceptable or suspect.

Practical considerations will increase that difficulty. A market-based approach must be able to measure the amount of regulated conduct by each covered entity in each accounting period with more precision than a traditional regulatory program would require. If a regulation establishes a simple "not to exceed" limit, compliance monitoring methods need only be adequate to determine whether source activities are above or below that limit. By contrast, a market-based program requires quantification of the exact amount of the socially damaging activity at issue, so that the required payments or allowance requirements can be reliably assessed. Even apart from the question of ends and means, the need to establish such quantification mechanisms across a large set of sources makes the establishment of market-based programs a complex and expensive—and therefore a controversial—undertaking.

2. *Why Regulatory Reform Contracts Could Lead to Wider Adoption of Market-Based Approaches*

Regulatory reform contracts would focus precisely on distinguishing between the ends and means of regulation, defining broader or more operationally useful ends, and establishing comparability between different but related ends. Because these are also the central questions with which designers of "market-based" control approaches must grapple, regulatory reform contracts would be particularly adapted to address piecemeal the complex set of questions that must be answered to establish "market-based" systems of generic regulation.[153] Individual regulatory reform contracts could explore case-by-case the acceptability and workability of differing categories of "Activities that Cause the Same Social Costs per Unit of Activity." In part, they could clarify the facts behind the dispute. For example, concerns about trading "hazardous air pollutants" could be alleviated by experiments showing that such increases were most unlikely to occur, or could be readily prevented by simple changes to the program.[154] Design of market-based programs will also involve social decisions, running beyond factual accuracy, about what impacts of a given activity constitute a "social cost," when two impacts of somewhat different qualitative

153. A successful regulatory reform contract program would almost certainly contain a large number of experiments with "market-based" approaches, if experience with "Project XL" is any guide. A central theme of Project XL, as implemented to date, is the replacement of "command-and-control" requirements that limit emissions to specific media (air, water and land) with facility-wide "bubbles" and "caps" that allow companies to trade emissions among pollutants and among media. *See* Steinzor, *supra* note 12, at 135.

154. Steinzor objects to emissions trades whenever "overall emissions are traded rather than substantially reduced, [since] the claim that the proposal represents an improvement depends on the far from self-evident conclusion that decreasing emissions in one chemical category or one medium will produce a sufficient benefit to justify increasing emissions in another category or medium." Rena I. Steinzor, *Regulatory Reinvention and Project XL: Does the Emperor Have Any Clothes?*, 26 ENV'T L. REP. 10,527, 10,531 (1997).

As with Dana and Koniak, this assumes that raising a possibility amounts to refuting a position. *See generally* Dana & Koniak, *supra* note 6. In fact, Steinzor's reservations seem far from justified. There seems no reason a *priori* to assume that offerors will suggest, still less that regulators after public comment will approve, more trades that decrease environmental benefits than trades that increase them. Such an assumption, in effect, concludes that the decision rules of a reform contract program, and the procedures that enforce them, will be grossly less effective than the rules and procedures under which our current regulatory system operates, and which have generated the "baseline" from which reform contracts would depart.

It also completely discounts the function of regulatory experiments in developing new approaches to problems and building more competent agencies, apparently (although this is never expressed) because such experiments contain some risk of failure. Yet any experimental approach that does not explicitly accept the risk of failure is doomed from the beginning.

nature can be viewed as separate instances of a larger whole, so that they can be traded against each other as two instances of the same, aggregate "social cost," and when the possibility of increased social costs in some individual circumstances should be outweighed by the ability of a market-based system to provide much greater aggregate reductions. Actual experience with the performance and public acceptance of particular innovations in control approaches could help resolve all such disputes by the test of experience.

This ability to generate experiments quickly would represent the prime advantage of regulatory contracts over more generic market-based approaches. Indeed, case-by-case regulatory reform contracts would inefficiently reduce social costs, when compared to a generic "market-based" approach, since the benefits of each specific contract would be reduced by the amount of the transactions costs necessary to negotiate a detailed contract to cover the particular circumstances at issue.[155] A set of contracts with individual sources allowing them to follow contractually specified management rules for reducing releases, as long as releases were demonstrably reduced, could never be as efficient as a generic regulation establishing an "allowance" system, or the imposition of a pollution tax.

The efficiency gap between regulatory reform contracts and generic regulations would be particularly wide for market-based contracts limited, as such experimental contracts probably would be, to different components of a single regulated source, or to a few sources. Such a contract would lose in efficiency, compared to a general rule allowing widespread trading, not just because of the transactions costs of negotiating individual contracts, but also because of the smaller size of the "market" that the contract would create, which would limit the possible "gains from trade."[156]

155. Salzman and Ruhl argue for subjecting trades between "nonfungible" environmental ends to more detailed review until an acceptable "trading currency" can be devised. *See* Salzman & Ruhl, *supra* note 1, at 672. They suggest evaluating such trades ex post, *see id.*, or requiring pre-implementation case-by-case approval, *see id.* at 672, "to ensure they satisfy the policy goals of the program," *id.*, requiring greater impact analysis prior to each trade. Subjecting such trades to the detailed terms of an individual regulatory reform contract would in effect implement the recommendation.

However, this Article's suggestions differ from Salzman's and Ruhl's in presenting such trades expressly as experiments, in focusing far more than Salzman and Ruhl on the opportunities for such trades to highlight the deficiencies of our existing regulatory system (a topic they do not stress at all) and in outlining the ways in which such an approach could lead to more effective and innovative agencies.

156. Steinzor states:

> While cross-media and cross-pollutant trading within facility-wide caps and bubbles utilize market-based remedies, it is questionable whether such approaches reduce compliance costs as much as possible because they are typically confined to a single facility and the premise of market-based trading is to exploit the advantages of indus-

The inevitable inefficiency of contract by contract establishment of market incentive systems would often be compensated by the ability of such contracts to generate by experiment the information needed to establish more generic market-based programs.[157]

3. *The Special Issues Posed by Permanent Market-Based Programs*

Any expansion of a market-based alternative to existing regulatory approaches into a permanent program would have to address two difficult issues that the experimental approach avoids. These are the "aspirational" sacrifice that trading may entail, and the possibility that trading will lead to exploitation of the regulated.

Aspirational sacrifice would be inflicted on the supporters of a given regulatory obligation whenever a regulatory contract allowed lesser compliance with that obligation than the letter of the law required. It might arise, for example, from allowing a land-owner to avoid its absolute obligation to prevent harm to any endangered species found anywhere on its land by permanently dedicating part of its land to nature preservation.[158] An environmental group might object to the sacrifice of principle involved in

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try-wide economies.

Steinzor, *supra* note 12, at 140.

Similarly, David Dana states:

> Contractarian regulation generally will be characterized by greater transaction costs than command-and-control regulation because, by all accounts, site-specific negotiations are extremely time-consuming. Thus, the social cost/benefit calculus for command-and-control regulation with contractarian regulation is as follows: does the comparative compliance-cost savings of contractarian regulation and the comparative environmental performance benefits (potentially in some cases) outweigh the comparatively greater transaction costs (for all participants) and the comparative costs in the form of reduced environmental performance (potentially in some cases)?

Dana, *supra* note 6, at 51 n.70.

157. According to Judge Posner, one critical difference between decisions based on "standards" like "negligence" or "equal social benefit" and decisions based on more precisely defined "rules" is that "rules economize on information" and "the application of a standard requires the adjudicator to have more information than the application of a rule." RICHARD A. POSNER, THE PROBLEMS OF JURISPRUDENCE 45 (1990). The flip side of this perception is that information is needed to *define* the rules that make such case-by-case information processing unnecessary. A regulatory reform contract approach in essence uses decisions under a standard to generate the information needed to set a rule in the future.

158. The Endangered Species Act forbids any person to "take" any endangered animal. *See* 16 U.S.C. § 1538(a)(1) (1994 & Supp. V 2000). It further defines "take" to include "harass, harm, pursue, . . . capture, or collect . . . ." 16 U.S.C. § 1532(19) (1994). Regulations add "significant habitat modification or degradation where it actually kills or injures wildlife by significantly impairing . . . breeding, feeding or sheltering." *See* 50 C.F.R. § 17.3 (2001). The Supreme Court upheld this rule against a facial challenge in *Babbitt v. Sweet Home Chapter of Cmtys. for a Great Or.*, 515 U.S. 687 (1995).

such a trade even if it improved short-term environmental protection.

The mechanics of potential exploitation of the regulated are more complex, arising from the need, in designing a permanent market-based program, to define both the "baseline" from which trading starts, and the rules for allocating and trading "allowances" among different types of activities. These issues do not arise with regulatory reform contracts.[159] The existing regulatory system provides their "baseline," while the parties to each contract will establish its allowance allocation and trading rules by consent.

The baseline for a market-based program defines its stringency. For a fee program, it will be the fee; for a marketable allowance program, it will be the number of allowances issued to conduct the regulated activity. The generic questions what fee to set, or how many total allowances to issue, simply provide one more example of the familiar conflict between supporters of regulation and the regulated over the appropriate stringency of obligations.

But if the allowance route is chosen, *allocation* of those "allowances" raises more difficult issues. Whenever regulatory requirements and allowances are not allocated to regulated sources in proportion to the social cost those sources generate, the allowance approach will allow exploitation of one class of covered sources to obtain increased control of another. If tight controls are imposed on one set of sources, A, but not on another, B, even though A does not cause more social costs than B, those tight controls may be set simply to generate pressure on A to purchase control efforts from B because B is more difficult than A for the government to regulate directly.[160] For example, if both large factories and small farms were covered by a water pollutant trading system, the large factories might well worry that they would be more tightly regulated than the farms, or receive relatively fewer discharge allowances to meet the same regulation, not because their discharges were more damaging, but to pressure them to "buy" the needed reductions from the farms, which might be more difficult for the government to regulate directly.[161]

159. Except to the extent that an agency, persuaded that an existing rule was unduly burdensome and should be amended, might defer such reforms to trade these burdens for concessions from the regulated in "regulatory reform contracts."

160. The same result would follow if A and B were regulated with the same stringency, but B received relatively more allowances than A in proportion to its pre-control releases.

Of course, even at present sources that are politically easy to regulate are regulated more intensely in proportion to the social cost they generate (or to the cost of reducing it) than sources that are not easy targets. However, the adoption of market-based programs can create an *additional* motive for such differential regulation for the reasons discussed in the text.

161. Elliott, *supra* note 78, at 180, recognizes that a trading approach "allows us to draw into our environmental programs those who currently fall outside but whose activities may be the source of considerable harm. [Regulated] [p]oint sources can contract with [unregu-

The second of these two potential dangers poses far greater intellectual challenges than the first to the successful design of market-based regulatory programs.

Although debates on aspirational sacrifice would be important and legitimate in deciding whether to establish market-based approaches, they would require no adjustments in the conceptual apparatus outlined earlier. Such debates would be, in effect, debates on the extent to which obligations under a given set of programs could in fact be integrated together as means to some larger end. Opponents of such integration would argue that an end, such as endangered species preservation, was simply too unique and incommensurable to be matched in this manner against other social ends, such as stability of landowner expectations, while proponents would argue the reverse. The prospect of such controversies should count as an advantage, not a disadvantage, of the reform contract approach. Such efforts would carry forward precisely the work of clarification and integration of social ends that reform contracting was designed to encourage.

The possibility that a trading system would result in regulation of the politically vulnerable to induce them to mitigate harms that they in no way caused, but that the government found difficult to address directly, raises more troubling issues, since it provides the government with a new motive for the covert abuse of regulatory power. However, since these dangers occur when the same social cost is regulated more strictly at some sources than at others, they would be reduced to the extent that agencies were required to make sure through cost-benefit analysis or some similar approach that each individual component of a regulatory obligation aimed at a given social cost was roughly as cost-effective as every other component.[162] Our current regulatory system, in which each individual regulatory obligation serves as its own goal because it is not justified in terms of anything larger, tends to make such analysis less necessary since each obligation is justified by the *ipse dixit* of legislative authorization. But a system that must guard against allowance allocations and trading ratios set only for their exploitation value has more need of a mechanism for determining the value of each individual obligation in terms of some larger goal, and thus, more need of such tools as cost-benefit analysis. In that manner, the adoption of market-based approaches, because of the new opportunities they create for exploit-

lated] nonpoint sources who may be able to reduce their emissions at lower cost." *Id.* Elliott does not mention the potential for exploitation that would accompany these undoubted instrumental advantages.

162. Such a program, if successful, would forbid the establishment of regulatory obligations simply for their "exploitation value." However, trading would still take place whenever a regulated entity was able to control social costs more efficiently than the government had projected, either because it could apply proprietary information unknown to the government, or because it had developed an innovative new control approach.

ing the regulated, might give new impetus to efforts to rationalize and unify the process by which regulatory obligations are established.

B. Regulatory Reform Contracts and Delegation of Choice of Means to Others

Use of regulatory reform contracts would tend to increase the independence and visibility of regulatory agencies by making them responsible for selecting among reform contract offers and then defending their choice.

That does not mean it would tend to increase the scope of the private activities that the agencies controlled. On the contrary, the contract approach contains a potential "deregulatory" element in its tendency to separate ends from means. The essence of the contract approach is to allow variation in the means of achieving ends as long as the ends themselves are achieved, or to allow less achievement of a secondary end if a more "complete" end is more fully achieved. Experience with regulatory reform contracts could widen the scope of such variation by making ends more generic, and by developing new and more efficient methods of determining the extent to which means achieved them. That increased ability to monitor performance could allow devolution of the performance obligation to states or private entities, while retaining federal monitoring of the results. Such a system would not diminish—indeed, it could increase—the ability of the public to know about and to enforce performance results.[163] A "devolved" regulatory system could be far less intrusively detailed, and depend far less on central government processing of information, than our present system, while being no less effective in achieving its goals.[164]

163. The development and use of such tests would address the "agency" problem described as follows by Jody Freeman:

> Contracting out raises a version of the principal-agent problem that arises whenever legislatures delegate decisionmaking authority to public bureaucracies. Because third-party beneficiaries (and the general public) are one step further removed from the private provider than from the agency, however, the possibility of meaningful public oversight becomes increasingly remote.

Jody Freeman, *The Contracting State*, 28 FLA. ST. U. L. REV. 155, 175 (2000).

If performance can be adequately measured, however, the contract approach could well lead to *increased* responsiveness in achieving the public goals at issue. Private parties to contracts would often enjoy more management flexibility than regulatory agencies subject to civil service requirements. Moreover, enforcement action against them to compel achievement results would probably be easier to undertake successfully than legislative or judicial action to force comparable reforms on a regulatory agency administering an "undevolved" program.

164. *See* Elliott, *supra* note 78, at 176. Elliott suggests one of many ways in which such a decentralized system might work:

> Under the traditional command-and-control system, government processing of infor-

The regulatory reform contract approach would also encourage less detailed federal prescriptions by diminishing the sense of agency "ownership" of the details of the regulatory system that a conflated approach naturally encourages. By granting the regulated the power to suggest alteration of that system if they can provide the desired social goods more effectively some other way, it would force the agency to respond, and thus increase both the agency's ability, and its willingness, to entertain such requests in the future.

These results could be particularly dramatic where contract suggestions from states were concerned. Under our existing system of health and safety regulations, states are, in effect the agents of the federal government both to achieve the ends and to implement the prescribed means of each regulatory system.[165] Yet that system allows states very little freedom to vary the means of attaining the ends they are responsible for attaining. Given that position, and their own legislative power, states should be uniquely able to make "regulatory reform contract" offers that separated the ends and means of regulatory programs in the interest of greater efficiency in attaining the ends by varying the means.

C. Greater Use of the Contract Approach Itself

Fully developed "market-based" trading programs have no need for contracts between the regulated and the government. Their scope, their baseline, the trading ratios, and all other necessary details will be spelled out in the rules of the market. Indeed, an individual contract to vary these rules would only damage market functioning by increasing transaction costs.

In many cases, however, a trading approach will be unsuited to the problem, or the consensus needed to establish it will be unattainable. In such cases, regulatory reform contracts could serve as a template for the future generic use of "regulatory contracts."[166] Even though the task of clarifying goals, defended here as a major benefit of "regulatory reform contracts,"

> mation can become a significant bottleneck that stifles effectiveness, both in setting environmental standards and in enforcing them. Increasingly, the processing and evaluating of environmental information will take place in decentralized nodes, with the role of government becoming setting the standards and spot-checking the system, rather than processing information at the "retail level." Thus, rather than the federal government attempting to regulate chemicals by analyzing all available scientific information on a chemical-by-chemical basis, the government could regulate at the "wholesale" level by setting protocols and criteria for private consensus standards . . . perhaps even establishing when such standards will be recognized as authoritative.

Id.

165. *See supra* note 61 and accompanying text.

166. The use of such contracts would require statutory authorization for all the reasons discussed earlier in this Article.

might not be appropriate for contracts designed for generic use, such contracts could potentially motivate the regulated to suggest different and more flexible methods of achieving the same goal through the offer and acceptance mechanisms described earlier.[167]

A program authorizing such contracts would need to address the dangers of capture by the regulated. Since any increase in the danger of "capture" accompanying a contract approach would stem from a legislatively unconfined freedom of agency decision, that danger could be addressed straightforwardly by a legislatively defined limit on the extent of departure from a defined "baseline" that a regulatory contract could accomplish, or by more precise specification of the standards that any regulatory contract would have to meet.[168]

Such an approach would address delegation concerns exactly as they are addressed in the regulatory context—that is, by limiting the degree of departure allowed from the generally applicable matrix.[169] Those concerns could also be addressed by express approval of particular "trading ratios." If the legislature (or the agency in a generic rule) were to find that two tons

167. The possible use of contracts as a "base load" regulatory vehicle, rather than for the experimental purposes described in this Article, has begun to attract mention in textbooks and survey articles, but has attracted little sustained attention. *See* sources cited *supra* note 6. Ayres and Braithwaite's book stands as a major exception. *See* AYRES & BRAITHWAITE, *supra* note 6, at 106 (presenting an optimistic model of enforced self-regulation where governments and companies would share the task in proposing rules to meet the contingencies of specific companies). The authors argue that in many cases private firms can perform certain functions traditionally performed by government, such as devising compliance regimes, more efficiently than the government. *See id.* at 103-06.

168. Similarly, Ayres and Braithwaite suggest that the government establish a set of "default standards" and allow firms, in consultation with their "stakeholders" to contract around them to a more or less limited extent. *Id.* at 108. The alternative requirements, once established, would become enforceable both by the government and by private citizens. The benefits, according to the authors, would include a reduction in delays, since generic rules covering all cases that could arise in an industry would no longer need to be written; more particularized and "transparent" requirements; quicker implementation and amendment; and greater commitment on the part of the regulated to compliance with rules they had written themselves. *Id.* at 108-20. Although Ayres and Braithwaite do not suggest the ability of contractors to depart from the default standards might be limited, such a qualification would be entirely consistent with their framework.

169. Freeman states:

> If the regulatory goal is lawful, and the agency's exercise of discretion remains within permissible bounds, then . . . contractual regulatory tools raise familiar problems best solved by familiar measures. The legislature might bar the use of contract through constrains on agency discretion or specifically authorize the agency to use contract as an implementation option. Either way, the issue is discretion; contract is decidedly secondary.

Freeman, *supra* note 163, at 157.

of Pollutant A was "worth" one ton of Pollutant B, no delegation concerns would be raised by any individual contract approving such trades. These trades could be approved on a case-by-case basis in circumstances where the work of establishing a full market-based system had, for one reason or another, not been performed.[170] As mentioned earlier, agencies relying on contracts would also need to make sure that contractor performance could be monitored, and accountability enforced.[171]

Such approaches could also be applied, and might well be most effectively applied, to aspects of regulatory obligations other than the actual control obligation itself. The need for government review and approval of compliance information is in itself a source of rigidity in the current regulatory approach. That need could be much diminished if firms were allowed to rely instead on their own management structures,[172] on non-governmental "third party" auditors,[173] or on some combination of the two. Regulatory reform contracts, by allowing firms to demonstrate that such alternative mechanisms would produce equivalent results, might contribute to their wider acceptability.

Since evaluating and approving such limited departures from existing obligations would be in many ways analogous to the negotiating of regulatory reform contracts, such developments would be promoted by the existence of the more competent "activist" agencies that the regulatory reform contract approach would help to develop.

170. The Clean Air Act provides an example of such an approach when it provides that in certain circumstances, obligations to reduce "volatile organic compounds" can be traded on a pound for pound basis for reductions in nitrogen oxides. S*ee* 42 U.S.C. § 7511a(f) (1994).

171. Freeman suggests that to accomplish this, contracts set specific performance standards, that each contract be tracked by an assigned "contract manager," that graduated penalties be authorized, that notice and comment be required for decisions affecting the rights of third-party beneficiaries (for example, nursing home residents), that such beneficiaries be allowed to sue under the contract, that independent third-party monitoring be required, or private accreditation, or minimum insurance requirements, that continual self-monitoring programs be adopted, and that relevant performance data be publicly disclosed. *See* Freeman, *supra* note 163, at 179 n.100, 202-07. Not all these tools may be needed in any particular case, but clearly there is no shortage of tools to address contract accountability.

172. The management of an enterprise will almost always be more able, through its control of internal information and management systems, to detect violations of regulatory requirements than an outside inspector. *See* AYRES & BRAITHWAITE, *supra* note 6, at 105-06. Regulatory agencies already encourage individual entities to develop their own compliance programs by granting a measure of relief from enforcement penalties to violations that such programs detect. *See* Small Business Compliance Policy, 65 Fed. Reg. 19,630 (Apr. 11, 2000) (reducing or waiving penalties for small businesses that disclose and correct violations).

CONCLUSION

With remarkable unanimity, regulatory reform advocates call for less reliance on detailed, formalistic agency commands issued to the regulated, and more reliance on market-based control mechanisms and other flexible means to achieve given ends, so as to enlist the knowledge and consent of others in the regulatory enterprise. Yet, an almost equally uniform failure to suggest procedural mechanisms that might actually accomplish such reform has accompanied this unanimity on substance. This Article has contended that to achieve a less formalistic and agency-centered regulatory system, the procedures for moving toward it must also be less formalistic and agency-centered. It has argued that only procedures such as "regulatory reform contracts" that allow the regulated and the agency greater freedom to change the framework of regulation by their own actions can pass that test. Indeed, such contracts reflect in procedure precisely the decentralized and flexible approaches that are so often endorsed where regulatory substance is concerned.