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THE PRIVATE LIFE OF PUBLIC LAW

Michael P. Vandenbergh*

This Article proposes a new conception of the administrative state that accounts for the vast networks of private agreements that shadow public regulations. The traditional account of the administrative state assigns a limited role to private actors: Firms and interest groups seek to influence regulations, and after the regulations are finalized, regulated firms face a comply-or-defy decision. In recent years, scholars have noted that private actors play an increasing role in traditional government standard setting, implementation, and enforcement functions. This Article demonstrates that the private role in each of these functions is far greater than others have identified. Furthermore, it argues that only when this private regulation is considered can the accountability and efficacy of the administrative state be judged. Using environmental regulation as an example, the Article examines a wide range of empirical data to demonstrate that public law requirements spawn a vast body of private agreements. These second-order regulatory agreements range from provisions in corporate acquisition agreements between private firms to "good neighbor agreements" between private firms and nonprofit groups. Second-order agreements concern not only environmental regulation, but worker safety, health care, and other areas. The dynamic regulatory account developed in the Article suggests that second-order agreements alter the parties that have interests in regulatory outcomes, the incentives they face, and the performance of the regulatory regime. The recognition of second-order agreements suggests a new agenda for empirical and theoretical work on the public regulatory measures that will generate the optimal blend of public and private regulation.

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INTRODUCTION

This Article argues that the existing account of agency regulation, even as updated by private governance scholars in recent years, is incomplete. The current account fails to recognize that the regulatory administrative state is profoundly influenced not just by public regulations or public-private agreements entered into in lieu of public regulations, but by agreements entered into between regulated firms and other private actors in the shadow of public regulations.1 This Article calls these agree-

ments private second-order regulatory agreements. The agreements are private in that the parties to the agreements are nongovernmental entities. They are second-order in that they are entered into in response to the existence or absence of first-order government regulatory requirements. This Article demonstrates that these private-private agreements have a profound effect on the principal concern of administrative law: the legitimacy of public regulation.

Given the uncertain status of administrative agencies in the constitutional scheme, administrative law scholars seek to identify the measures necessary to enhance the legitimacy of agency action. To examine legitimacy, they explore the optimal allocation of oversight authority among the branches of government to enhance the accountability and efficacy of agency action. Over time, models of administration have evolved from the concept that agencies simply serve as a transmission belt for detailed legislative pronouncements, to an emphasis on agency expertise, to measures that ensure interest group representation, to an emphasis on presidential control. Although views of the appropriate control mechanism have evolved, the story about private actors has remained essentially static: Firms attempt to influence regulations, but once an agency promulgates a regulation, a private firm is assumed to either comply or not comply.

In recent years, administrative law scholars have directed attention to the role of private parties in public governance. Some have focused on the privatization of traditional public functions, such as prisons and social service programs. Others have focused on the extent to which governo...

2. See infra notes 54–56 and accompanying text. For convenience, second-order agreements are presumed to involve two private parties in the remainder of this Article, although more than two private parties are involved in many of these agreements.


7. See, e.g., Michele E. Gilman, Legal Accountability in an Era of Privatized Welfare, 89 Cal. L. Rev. 569, 571 (2001) (analyzing privatization of welfare system); Gillian E. Metzger, Privatization as Delegation, 103 Colum. L. Rev. 1367, 1369 (2003) (noting private...
ment agencies contract, either formally or in a metaphorical sense, with private actors to establish or enforce regulatory standards. They have argued that traditional models of the administrative state should recognize that public-private negotiated regulatory solutions or government-stakeholder network structures now profoundly affect the development, implementation, and enforcement of regulatory requirements. This new private governance focus emphasizes that agencies often develop, implement, and enforce standards not just through the traditional adjudicatory or notice-and-comment rulemaking processes, but by entering into agreements with private actors to form "public/private hybrids." Accordingly, questions of agency legitimacy and oversight should consider the "aggregate accountability" of the new regulatory approaches that emerge from public-private negotiations.

The second-order agreements identified in this Article require an extension of the private governance insight and suggest that the regulatory process is far more dynamic than administrative scholars have acknowledged to date. The dynamic regulatory account developed here suggests that regulation or its absence induces changes in the regulated firms, the private parties with whom they enter into agreements, and ultimately the regulatory state. The regulatory process thus cannot be ana-

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9. Some have argued that the product of this new involvement by private parties is often preferable to pure public law commands. See Freeman, Private Role, supra note 8, at 674. Others have expressed reservations. See, e.g., Sidney A. Shapiro, Outsourcing Government Regulation, 55 Duke L.J. 389, 432-34 (2003) (using transaction cost analysis to identify shortcomings of outsourcing government regulation); Stewart, Administrative Law, supra note 5, at 454 (“As between the new methods of regulation, I tend to favor economic incentive systems over network strategies because I think they are more likely to be efficient and effective and because they fix clearer legal and political accountability in the government.”).

10. See infra notes 32-47 and accompanying text.

11. Freeman, Private Role, supra note 8, at 549.

alyzed by assuming that the regulator and the private actor are in a period of stasis after an agency promulgates a regulation or enters into a regulatory contract with a private actor.

Instead, the process is more dynamic in two principal ways. First, the firm subject to first-order regulation often enters into second-order agreements with other private actors. These agreements then influence the incentives of the regulated firm and induce the other contracting parties to have an interest in the regulatory scheme. Second, the new incentives and interested parties that arise from second-order agreements then affect the achievement of regulatory goals, the extent to which Congress, the President, and the courts can oversee agency actions, and ultimately the public appetite for government regulation.

Second-order agreements are not unique to administrative regulation. They are the product of private Coasian bargaining that can be expected in response to many sources of risk, including common law torts, natural disasters, and others. Although private agreements are not distinctively the product of the administrative state, the way we think about the administrative state will be deepened and enriched if we account for these agreements. The dynamic regulatory account suggests that the effects of second-order agreements not only should be factored into regulatory decisionmaking, but also that these agreements are an important aspect of the regulatory regime itself. Second-order agreements affect who actually pays the costs of regulatory requirements and thus who has incentives to develop, implement, and enforce regulatory requirements. In addition, second-order agreements may displace public regulatory functions with similar private functions (e.g., standard setting, monitoring and enforcement, and dispute resolution) conducted out of the public eye, and therefore undermine regulatory transparency.

14. Guido Calabresi recognized the importance of identifying the party that will actually bear the cost of a legal liability and the problem of externalization by transfer. Guido Calabresi, The Costs of Accidents: A Legal and Economic Analysis 147-48 (1970) (“[T]he search for the cheapest cost avoider requires a comparison of the cost avoidance potential of those who will actually bear the accident costs after transfers, rather than of the initial loss bearers.”); see also id. at 246 (“The fault system ignores altogether the effect of externalization by transfer. . . . [I]t never asks who really pays.”). The argument that second-order agreements can be regarded as an integral part of the regulatory scheme is consistent with Hans Kelsen’s view that private contracts represent a delegation of state authority to private parties, just as common law represents a delegation of state authority to courts. Hans Kelsen, General Theory of Law and State 204 (Anders Wedberg trans., 1945).
Yet, in other situations, these agreements may improve regulatory quality by inducing more efficient implementation of public regulations. They also may increase responsiveness to public preferences: Second-order agreements are a legal vehicle by which nonprofit groups can convert public preferences into private regulatory requirements on firms, thereby bypassing captured agencies and elected officials. Understanding the influence of second-order agreements thus permits a more complete assessment of the regulatory state, and enables policymakers to anticipate the effects of second-order private bargaining in the design of regulations and to recalibrate regulations after private bargaining has occurred.

This Article uses environmental law to demonstrate the shadow law of second-order agreements. It shows that in response to public environmental laws, private firms have entered into a range of agreements with other private actors—not just with government agencies. Furthermore, the pervasiveness of these agreements suggests that they may have a profound effect on the private firms' and agencies' incentives, and on the achievement of societal environmental goals. Environmental agreements often appear as provisions in corporate acquisition agreements, credit agreements, commercial real estate sales agreements and leases, and product sales and service agreements. Other environmental second-order agreements emerge as stand-alone agreements, such as environmental insurance agreements and agreements reached between private firms and nonprofit groups. In some cases, these private-private agreements simply shift the costs of regulatory compliance to other parties. In others, they enable private firms to create new environmental standards or avoid existing standards. They also create contractual incentives in a new set of institutions to monitor, enforce, and resolve disputes regarding compliance with standards.

The environmental regulatory regime is a fitting regulatory area to demonstrate the influence of second-order agreements for several reasons. Environmental law is the largest single regulatory area in terms of major rulemakings (those with over $100 million in annual impact on the economy). It requires the expenditure of roughly $200 billion dollars per year in compliance costs. Finally, it has had a profound effect on

15. By choosing a single field of analysis, this Article follows the approach that suggests that insights can often be gained by focusing on specific areas and institutions before seeking broader generalizations. See Edward L. Rubin, Commentary, The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions, 109 Harv. L. Rev. 1398, 1425-34 (1996) [hereinafter Rubin, New Legal Process].


the cases\textsuperscript{18} and policies\textsuperscript{19} that have shaped modern administrative law. But the analysis does not stop at environmental law. Rather, the analysis has important implications for broader administrative law, as well as for other regulatory fields in which private firms enter into agreements that affect the achievement of public regulatory goals, including worker safety, consumer product safety, health care, and labor law.

This Article proceeds in five Parts. Part I examines the leading models of the administrative state and concludes that none accounts for private second-order regulatory agreements. It then sets forth an overview of the dynamic regulatory account necessary to reflect the influence of second-order agreements. Part II sets forth the empirical case for a more dynamic account, using environmental second-order agreements as a focused area of study. Part III then examines the implications of second-order agreements for the accountability and efficacy of the regulatory state. It suggests that by acknowledging the influence of second-order agreements, a richer, more complete understanding of the regulatory scheme can emerge.

Part IV turns to the normative implications of the more dynamic account of the regulatory state and identifies potential first moves for Congress, the President, the courts, and regulatory agencies. Part V concludes by identifying important directions for research and the implications of second-order agreements for regulatory areas outside of environmental law. The recognition of second-order agreements thus suggests a new agenda for empirical and theoretical work in many regulatory fields that are of interest to administrative law scholars.

I. THE EVOLVING STORY OF AGENCY LEGITIMACY

A. The Traditional Account

Administrative agencies present a challenge for administrative law scholars. Agencies are neither mentioned in the Constitution nor directly responsive to the electorate, leaving their democratic legitimacy unclear. Administrative law scholars have sought to ground the legitimacy of agency actions in a variety of theories.\textsuperscript{20} Early models of administration assumed that agencies simply serve as "transmission belts" for de-

\begin{footnotesize}

\textsuperscript{19} See Croley, supra note 16, at 865-66.

\textsuperscript{20} This overview of the traditional account is drawn from several sources. See Bressman, supra note 3, at 469-91; Kagan, supra note 4, at 2253-72; Stewart, Reformation, supra note 5, at 1671-78.
\end{footnotesize}
tailed legislative pronouncements. The accountability of agencies thus was thought to run from the electorate through Congress in the form of precise statutory directives. During the New Deal era, the broad delegations of authority and growth in the regulatory state undermined the notion that agencies were simply transmission belts. Agency legitimacy during this period was grounded in the superior expertise of agency officials, and agencies were expected to exercise self-control in the exercise of their discretion.

Several decades later, concerns about the ability of industry to capture agencies and growing skepticism about the value of expertise contributed to the development of an alternative model. In the new interest-representation model, the legitimacy of agency action was thought to be a function of agencies' ability to replicate the electoral process through interest group representation. The function of congressional and judicial oversight in this view was largely to ensure adequate interest group access to the regulatory process. More recently, many scholars have emphasized the role of presidential control. In this model, the President's direct electoral accountability is a basis for asserting greater presidential direction of agency regulatory decisionmaking.

Regardless of the model, the traditional account of the regulatory state has retained an exclusive focus on governmental actors as regulators. Administrative law scholars have examined the allocation of oversight authority among the branches of government to enhance the accountability and efficacy of agency action. Although views concerning the appropriate branch to conduct oversight and the extent of that oversight have evolved over time, the regulatory models have been essentially

21. Stewart, Reformation, supra note 5, at 1675.
23. See Kagan, supra note 4, at 2253; Stewart, Reformation, supra note 5, at 1676–81.
26. See Freeman, Private Role, supra note 8, at 546 (suggesting that in traditional accounts agency is principal unit of analysis).
27. See Kagan, supra note 4, at 2331–46 (arguing for presidential administration as way to “make administration accountable to the public” and “efficient or otherwise effective”).
static with respect to the role of private actors: The private firms that are
the regulatory targets are assumed to engage in statutory and regulatory
lobbying, as are private interest groups. Once an agency promulgates a
regulation, however, the regulated firms are assumed to make a comply-
or-defy decision. The models differ widely in how to justify agency coer-
cion of regulated firms and on how to control or monitor the regulatory
apparatus. Yet, all existing models share an assumption that agencies are
the relevant regulating bodies and that private firms are the relevant reg-
ulated entities. Put differently, the traditional accounts of the adminis-
trative state start from the premise that public regulations are the legal
requirements that induce firms to change behavior. Although firms may
be subject to market or social influences based on these regulatory deci-
sions, the legal regulation of their behavior is largely fixed at this point.
Missing from this view is a recognition that private actors, not just agen-
cies, play a regulating role.

B. The New Focus on the Private Role

A growing body of scholarly work in recent years has taken a critical
initial step in the direction of a more robust view of the private role in
public governance. This private governance scholarship is less concerned
with the specific model of agency oversight and more concerned with a
broader, more transcendent recognition of the extent to which private
parties perform traditional government functions. The private govern-
ance scholarship has focused on two principal areas: (1) the privatization
of public services, such as prisons and social support programs; and (2)
the extent to which government agencies contract with private actors to
establish or enforce regulatory standards. The latter is the focus of this
Article.

Private governance advocates have noted that agencies often con-
duct traditional regulatory functions not just through unilateral action,

28. See Freeman, Private Role, supra note 8, at 636 (noting lobbying roles of interest
groups and regulated industries).
29. See id. at 546–48.
30. See sources cited supra note 7.
31. See sources cited supra note 8; see also Lawrence A. Cunningham, Private
Standards in Public Law: Copyright, Lawmaking and the Case of Accounting, 104 Mich. L.
Rev. (forthcoming 2005) (manuscript at 3, 28–29, on file with the Columbia Law Review),
accounting standards were set . . . by a private not-for-profit professional association . . .
whose standards were given the SEC's imprimatur by reference . . . "); E. Donald Elliott,
Toward Ecological Law and Policy, in Thinking Ecologically: The Next Generation of
Environmental Policy 170, 183–84 (Marian R. Chertow & Daniel C. Esty eds., 1997)
describing movement from "command and control" to "command and covenant"); Geoffrey C. Hazard, Jr. & Eric W. Orts, Environmental Contracts in the United States, in
Environmental Contracts and Regulatory Innovation: Comparative Approaches in the
United States and Europe 71, 76–82 (K. Deketelaere & Eric W. Orts eds., 2000)
[hereinafter Environmental Contracts] (evaluating environmental contracts as form of
regulation).
but by entering into agreements with private actors. These public-private negotiated regulatory solutions are sometimes referred to as "public/private hybrids" or "government-stakeholder network structures." Private governance scholars have suggested that public/private hybrids are involved in the three principal functions traditionally assigned to public agencies: the setting, implementation, and enforcement (including monitoring) of standards. Private participation in standard setting occurs through negotiated rulemaking, agency adoption of standards developed by private organizations, agency use of enforcement discretion to encourage the development of private codes of conduct, and audited self-regulation. Private participation in implementation occurs through traditional agency permitting and planning processes, agency use of enforcement discretion to encourage voluntary self-regulation programs, and agency site-specific agreements with private actors. Private participation in monitoring and enforcement occurs through citizen suits and qui tam actions, negotiations with regulated parties during agency enforcement actions, and regulatory directives that require industry to self-monitor and report.


33. See Freeman, Private Role, supra note 8, at 554 (referring to "public/private hybrids"); Stewart, Administrative Law, supra note 5, at 448 (referring to "government-stakeholder network structures").

34. See, e.g., Freeman, Private Role, supra note 8, at 653–57.

35. See, e.g., id. at 638–43 (noting that private organizations develop consensus standards that are often incorporated by reference by agencies); see also Shapiro, supra note 9, at 401 (noting federal adoption of standards developed by American Conference of Governmental and Industrial Hygienists).

36. See, e.g., Freeman, Private Role, supra note 8, at 646–49 (noting that trade associations and independent private organizations have developed private environmental management standards).


38. See Freeman, Private Role, supra note 8, at 657–59.

39. See id. at 636–64.


41. See Freeman, Private Role, supra note 8, at 660–61.
The private governance account reveals inadequacies in the traditional models of the administrative state. It shows that coercive authority does not run only from agencies to regulated firms, as the traditional models assume. Rather, coercive authority also runs from public/private hybrids to private firms. Thus, the private governance account notes that the legal requirements that induce firms to change behavior emanate not just from agencies, but from public/private hybrids.

Private governance scholars consider the ways in which public/private hybrids affect the goals of the administrative state. Such hybrids may, for example, enable government to achieve regulatory objectives at lower cost than traditional public regulation. At the same time, however, public/private hybrids raise difficult accountability concerns. The traditional administrative law means of ensuring agency accountability through judicial review of rulemaking and similar measures may do little to ensure that public/private hybrids are transparent and responsive to the electorate. Importantly, scholars have argued that concerns about the accountability of agencies should be redirected to a new search for alternative accountability mechanisms that can assure the aggregate accountability not only of agencies, but of the new public/private hybrids.

In this view, public/private hybrids might be understood as an opportunity to locate new means of accountability. For example, the public/private hybrids themselves may be subject to nontraditional accountability measures, such as public participation in the drafting of private codes of conduct and in the negotiation of public-private regulatory agreements. In turn, these codes and agreements may then play an important role in holding regulated firms accountable to government and the electorate.

42. Private governance enthusiasts have noted that the public/private hybrids they have identified should not only lead to a new focus on aggregate accountability, but that they also may affect the public appetite for regulation. See id. at 664–73; Stewart, Administrative Law, supra note 5, at 448–51.

43. See, e.g., Dana, supra note 40, at 38–40 (discussing HCPs as cost-reducing method for Endangered Species Act enforcement). But see Stewart, Administrative Law, supra note 5, at 454 (concluding that economic incentive systems "are more likely to be efficient and effective").

44. Elliott, supra note 31, at 184–85; see also Freeman, Private Role, supra note 8, at 593–94 (arguing that hybrids necessitate "think[ing] of accountability as an aggregation of mechanisms emanating from complex regimes" and "force[ ] us to acknowledge that the project of constraint cannot meaningfully be divided from that of facilitating good governance").

45. As with public/private hybrids, second-order agreements will not be constrained by traditional constitutional nondelegation and due process doctrines. See Freeman, Private Role, supra note 8, at 666.

46. See, e.g., id. at 549 (suggesting that aggregate accountability arises from "a mix of formal and informal mechanisms, emanating not just from government supervision, but from independent third parties and regulated entities themselves").

47. Id. at 666–67.
C. Toward a More Dynamic Account

Private governance advocates have stopped one important step short of recognizing the full extent of the private role in public governance: They have not included the influence of agreements entered into by private parties in the shadow of public regulations.\(^{48}\) In addition, although other areas of scholarship on regulation, such as informational regulation,\(^{49}\) reflexive law,\(^{50}\) and economic incentive approaches,\(^{51}\) also capitalize on the fact that private actors play a role in the creation, implementation, and enforcement of regulatory standards, none has accounted for the influence of second-order agreements on the administrative state. This Article argues that the regulatory analysis should not be limited to private actions that have been the subject of explicit agency participation or encouragement.

The new, more dynamic account proposed here recognizes that the legal requirements that induce firms to change behavior emanate not just from agencies or public/private hybrids, but from other private parties who have contracted with the regulated firms. This account thus reflects

\(^{48}\) For example, Jody Freeman has noted that in some cases agencies have adopted standards developed by private organizations and have provided enforcement and other incentives for industry trade associations and stakeholder groups to formulate private standards. Freeman, Private Role, supra note 8, at 639–40, 644, 647–48. Although Freeman suggests that the public-private dichotomy is not valuable, her approach to private governance has retained the agency as a component of the analysis. See id. at 564–74. She thus has retained much of the traditional public law focus on government. See id. at 665 (“Virtually every arrangement analyzed here features formal agency oversight or government licensing, or some other mechanism of [government] supervision.”).


\(^{50}\) Reflexive law enthusiasts have suggested that, in an increasingly complex society, regulation should focus less on commanding behavior and more on inducing firms to engage in self-reflection and self-regulation. See, e.g., Eric W. Orts, Reflexive Environmental Law, 89 Nw. U. L. Rev. 1227, 1252–68 (1995); Gunther Teubner, Substantive and Reflexive Elements in Modern Law, 17 Law & Soc'y Rev. 239, 266–81 (1983). Reflexive legal strategies seek to shift firm behavior not through direct commands, but through “the processes of intermediary institutions,” using flexible, information-based measures. Orts, supra, at 1264; see also Richard B. Stewart, A New Generation of Environmental Regulation?, 29 Cap. U. L. Rev. 21, 134–43 (2001) [hereinafter Stewart, New Generation] (“The procedural and structural role of government under a theory of reflexive law has many aspects, but the simplest level is to ensure individuals have information about the environmental performance of organizations: external transparency.”). Informational regulation and reflexive law enthusiasts have recognized that firms must have incentives to behave in socially desired ways if regulatory commands are to disappear, “like the Chesire Cat,” Stewart, Administrative Law, supra note 5, at 451, but they have provided few details on the source of these incentives.

not only the coercive authority public agencies and public/private hybrids exercise over regulated firms, but the coercive authority that private firms exercise over one another in response to the existence or absence of public or quasi-public directives. This Article suggests that second-order agreements have no less, and may have far more, influence on the accountability and efficacy of the regulatory state than do public/private hybrids.

II. THE EMPIRICAL CASE FOR A MORE DYNAMIC ACCOUNT

In Part II, this Article examines the texts of private second-order regulatory agreements to evaluate their importance for the regulatory state. These agreements are critical to understanding the regulatory state, yet they largely have escaped notice in the administrative law literature. They may have been overlooked because they do not fall neatly into the domain of public or private law scholars. The law at stake when a lawyer drafts a second-order agreement may appear to administrative law scholars to be a matter of private contractual law, and therefore outside their field of interest. To private law scholars, a second-order agreement may

52. Second-order agreements are distinct from most of the public/private hybrids that have been identified by the private governance enthusiasts in that they are purely private agreements, rather than ones that agencies have explicitly endorsed, either through formal adoption or the exercise of enforcement discretion. See, e.g., Freeman, Private Role, supra note 8, at 647–48 (noting that many types of voluntary and audited self-regulation are supported by exercise of agencies' enforcement discretion).

53. For example, the research discussed in Part II suggests that thousands of second-order environmental agreements were entered into just in 2001 and just by publicly held firms. In contrast, only roughly a dozen negotiated rulemakings (commonly referred to as "reg negs") have been conducted to date by the federal Environmental Protection Agency (EPA), and they have not been widely used by other agencies. See Eric W. Orts & Kurt Deketelaere, Introduction: Environmental Contracts and Regulatory Innovation, in Environmental Contracts, supra note 31, at 1, 12. In the environmental regulatory area, public-private contracting measures thus far amount to a "few experiments." Freeman, Private Role, supra note 8, at 667. For example, although Habitat Conservation Plans have been available for more than twenty years, only roughly 250 have been finalized. See Andrew J. Hoffman et al., Cognitive and Institutional Barriers to New Forms of Cooperation on Environmental Protection, 45 Am. Behav. Scientist 820, 828 (2002). In addition, two of the leading EPA-private contractual efforts, Project XL and the Common Sense Initiative, have had little effect on regulatory policy. See Cary Coglianese, Is Consensus an Appropriate Basis for Regulatory Policy?, in Environmental Contracts, supra note 31, at 93, 110–11. The point is not that these hybrids are not important, but that there is reason to believe that second-order agreements may have equal or greater effects on firm behavior.

pose no particularly interesting question simply because it involves the shifting of public regulatory duties or creation of new private duties in response to public regulations. Only when the public effects of these private agreements are evaluated does their importance become clear.

Second-order agreements also may have been overlooked because the analysis requires a focus on texts that are not the typical fare for legal scholars: agreements between private parties. After more than a century of near obsession with judicial opinions and government directives, scholars are only beginning to lay the intellectual foundation for the study of private agreements as legal texts. In addition, second-order

of public-private distinction began in reaction to _Lochner_ and culminated with Legal Realists); Benjamin C. Zipursky, Philosophy of Private Law, in _The Oxford Handbook of Jurisprudence and Philosophy of Law_ 625, 630, 649 (Jules Coleman & Scott Schapiro eds., 2002) (noting that difference between state and private party bringing an action “has been discarded in recent years by legal scholars because it appears to presuppose a naïve understanding of private law as self-executing”). Law and economics scholars also downplay the distinctions between private and public law. See Robert H. Mnookin, The Public/Private Dichotomy: Political Disagreement and Academic Repudiation, 130 U. Pa. L. Rev. 1429, 1434–99 (1982). Yet, if asked, many of us could point to areas of private law (often including torts, contracts, property, trusts and estates, corporations, and partnerships) and public law (often including criminal, immigration, welfare, and administrative law). See Zipursky, supra, at 626–29.

55. Although second-order agreements are the product of Coasian bargaining, they do not fit neatly into the influential application of the Coase Theorem to the problem of pollution by Guido Calabresi and Douglas Melamed. See Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1111–12 (1972) (noting that environmental regulations can be thought of as protecting public goods with an inalienability rule). The Calabresian analysis focuses attention on the initial creation of the regulatory-compliance obligation and its inalienability and draws attention away from the fact that parties create new, private environmental obligations and that they trade businesses or facilities even if the regulatory obligations imposed on the businesses or facilities are inalienable.

56. Even critics of the public-private distinction have noted the importance of whether a governmental party has created and may enforce a right or duty. See, e.g., Karl E. Klare, The Public/Private Distinction in Labor Law, 130 U. Pa. L. Rev. 1358, 1382 (1982) (“The real issue is what sort of enforcement mechanism is desirable regarding a particular set of rights.”); see also Frank I. Michelman, States’ Rights and States’ Roles: Permutations of “Sovereignty” in _National League of Cities v. Usery_, 86 Yale L.J. 1165, 1167 (1977) (distinguishing between “governmental and nongovernmental _powers and forms of organization_”).

57. See Daniel A. Farber, Is the Supreme Court Irrelevant? Reflections on the Judicial Role in Environmental Law, 81 Minn. L. Rev. 547, 547–48 (1997) (noting limited Supreme Court influence on environmental law); Michael J. Klarman, How Great Were the “Great” Marshall Court Decisions?, 87 Va. L. Rev. 1111, 1183 (2001) (“Perhaps it is natural that law professors, who study, teach, and write about Supreme Court decisions for a living, would be inclined to assume that those decisions have dramatic consequences in the world.”); Rubin, _New Legal Process_, supra note 15, at 1429 (noting the “somewhat obsessive preoccupation with the judiciary” in the academy).

58. See Edward L. Rubin, The Nonjudicial Life of Contract: Beyond the Shadow of the Law, 90 Nw. U. L. Rev. 107, 112 (1995) [hereinafter Rubin, _Nonjudicial Life_] (“Because of the emphasis on this judicially-oriented theory in both legal education and legal scholarship, the vast world of transactional behavior has been underemphasized.”).
agreements are often difficult to obtain. To study second-order agreements systematically, one often must identify public repositories of private documents and examine the original texts.

Examining the text of private agreements, however difficult, is well worth the effort. This study focuses in particular on several types of environmental second-order agreements and their principal provisions, based on a quantitative and qualitative review of agreements filed with the federal Securities and Exchange Commission (SEC). The study also examines publicly available agreements between private firms and nonprofit groups, as well as a number of secondary texts. In combination, these sources demonstrate the types and tremendous number of second-order agreements.

The analysis explores the extent to which second-order agreements bring new private parties into the regulatory regime and induce private parties to play the standard setting, implementing, monitoring, and enforcing functions traditionally reserved for government. Second-order agreements create the legal means and in some cases the incentives for private parties to perform each of these functions. In addition, second-order agreements create the legal means for private parties to perform two functions not contemplated by the traditional or private governance accounts: standard avoidance and private dispute resolution. After demonstrating in Part II the types of regulatory functions that second-order agreements induce private parties to play, Part III examines the effects on the accountability and efficacy of the regulatory state.

A. Second-Order Agreements

In the decades following the enactment of the principal environmental laws in the early 1970s, firms have bargained with other private actors around the regulatory commands, and the number and influence of environmental second-order agreements has surged.59 Second-order agreements became common after Congress enacted the Superfund statute (the Comprehensive Environmental Response, Compensation and Liabil-

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ity Act (CERCLA)) in 1980. Second-order agreements predate CERCLA, however, and concern much more than CERCLA liability.

The environmental regulatory regime has two principal characteristics that induce second-order bargaining and that are shared by many other regulatory schemes. First, the costs imposed by environmental regulations pose a substantial risk for private parties. Not only are ongoing compliance costs often substantial, but an unwitting buyer or other party may face liabilities arising from past releases of hazardous substances and the current condition of the property, regardless of whether caused by their regulatory violations.

Second, most environmental costs can be allocated between the parties, whether implicitly through adjustments in the purchase price, interest rate or rent, or through explicit terms allocating known or contingent liabilities. Environmental statutes typically have been interpreted to allow private parties to transfer the costs of environmental compliance among themselves but not to allow an indemnity to serve as a defense to liability in the first instance. As a result, although the primary compliance duty often remains with the business or facility owner or operator, in many cases there is no bar to trading the business or facility itself or reallocating the costs of compliance through indemnification. Thus, firms often have both the incentive and the ability to reduce compliance costs through private bargaining.

Firms enter into environmental second-order agreements either as a part of a larger agreement or as a stand-alone agreement. Part II.A.1 examines second-order agreements that are embedded in larger agreements, before Part II.A.2 turns to stand-alone agreements. The objective is not to provide a complete analysis of private contracting, but to identify


61. For example, second-order agreements may allocate the costs of compliance with air pollution, water pollution, worker safety, and land use requirements. See, e.g., Credit Agreement Between BJ Services Co. and Bank of America, N.A., et al. §§ 1.01, 5.08 (June 27, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter BJ Services Agreement] (defining “Environmental Laws” to mean “all Laws relating to environmental, health, safety and land use matters”).


63. See, e.g., CERCLA § 107(e)(1), 42 U.S.C. § 9607(e)(1) (providing that “[n]o indemnification . . . shall be effective to transfer from . . . any person who may be liable for a release” and “[n]othing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section”); Chem. Waste Mgmt. v. Armstrong World Indus., 669 F. Supp. 1285, 1294-95 (E.D. Pa. 1987) (interpreting § 107(e)(1)).

the most important types of second-order agreements and the extent to which they create incentives for private firms to perform regulatory functions.

1. Embedded Agreements. — Many agreements have embedded environmental provisions. Corporate acquisition agreements (whether structured as mergers, asset purchases, or in other ways), credit agreements, commercial real estate agreements (including sales agreements and leases), and agreements for the sale of goods or services are reviewed here.

   a. Acquisition Agreements. — Among the most influential types of environmental second-order regulatory agreements are those that are found in corporate acquisition agreements. Acquisition agreements are used in the market for corporate assets, and the market is substantial: In years of economic expansion, more than 6% of all manufacturing plants are involved in asset sales and mergers and acquisitions.\(^6^5\) In 2001, the total value of all mergers and acquisitions in the United States exceeded $795 billion.\(^6^6\)

   Many of the acquisition agreements used in corporate acquisitions include environmental provisions. Public companies are required to file material acquisition agreements with the SEC.\(^6^7\) Although the agreements filed with the SEC pertain only to publicly traded firms and thus form only a subset of all acquisition activity, they provide a glimpse of how common environmental provisions have become. For instance, a sample of the agreements filed with the SEC suggests that publicly traded firms filed more than 1,000 acquisition agreements in 2001.\(^6^8\) More than 70% of these agreements contain environmental provisions,\(^6^9\) and the

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68. These are the results of the search of the LexisNexis EDGARPlus Exhibits database “description” search field using all caps and the terms “acquisition agreement,” “asset purchase agreement,” “merger agreement,” “stock agreement,” and “asset agreement” for agreements filed in 2001. An agreement was categorized as an acquisition agreement if it involved the transfer of all or substantially all of the assets of a firm or business unit, or if it involved a change of control of more than 50% of the voting shares of a firm. To estimate the total number of acquisition agreements filed in 2001, the results from this search for the fourth quarter of 2001 (October, November, and December 2001) were examined. The results yielded 1,051 documents which, upon examination, included 314 acquisition agreements. The estimated number of acquisition agreements filed in 2001 was calculated by multiplying the total number of documents retrieved by the search for all of 2001 (3,749) by the total number of acquisition agreements (314) divided by the total number of documents retrieved by the search for the fourth quarter of 2001 (1,051). This calculation yielded an estimated annual total of 1,120.

69. Results of evaluation of the fourth quarter 2001 acquisition agreements identified supra note 68, using full text search with the terms “hazard! Or environment! Or toxic
percentage is likely to be higher for acquisition agreements involving firms in industrial sectors.

An analysis of the text of numerous acquisition agreements suggests that these agreements have evolved to include several common provisions that enable firms to identify and shift environmental risks. Representations and warranties, covenants, indemnities, and dispute resolution provisions are among the most important. Representations and warranties include statements by the seller and the buyer regarding the state of the business that is being acquired and other matters, backed by warranties regarding the accuracy of the information. In addition to representations backed by warranties, acquisition agreements also often include schedules narrowing the disclosure or identifying or excluding certain information. Covenants prescribe the pre- and post-closing conduct of the parties. Indemnities enable the parties to allocate risks explic-

Or chemical Or waste." The results yielded 227 acquisition agreements with environmental provisions (72% of the 314 total agreements).


71. See, e.g., DPT Agreement, supra note 70, § 3.12 (providing seller's environmental representations and warranties); see also Gilson & Black, supra note 70, at 1576-601 (discussing representations, warranties, indemnification, and opinions as examples of private ordering designed to overcome the costless-information assumption of capital asset pricing theory).

72. See, e.g., DPT Agreement, supra note 70, § 3.12(b) (providing qualifier "except as set forth on Schedule 3.12" to seller's environmental representations and warranties). See generally Elizabeth Glass Geltman, Environmental Law and Business: Cases and Materials 663-909 (1994) [hereinafter Geltman, Environmental Law].

73. See, e.g., Gilson & Black, supra note 70, at 1565-67; Geltman, Environmental Law, supra note 72, at 549-648; Agreement and Plan of Merger Between Respironics Holdings, Inc. and Novamatrix Medical Systems, Inc. § 5.07 (Dec. 17, 2001), available at LexisNexis, EDGARPlus Exhibits Database (requiring seller to notify buyer of certain events). Environmental covenants included as a part of a merger agreement in some cases include explicit provisions enabling or restricting the gathering of information (e.g., enabling a potential buyer to conduct a pre-closing environmental assessment of a real estate parcel, or limiting the individuals in a plant that the buyer may interview). See, e.g., Asset Purchase Agreement Among Heritage Marketing Corp. et al. and IST Corp. § 5.3 (Dec. 18, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter Heritage Agreement] (requiring seller to provide access "for the purpose of performing a Phase I" environmental assessment); see also Michael B. Gerrard, A Proposal to Use Transactions to Leverage Environmental Disclosure and Compliance, in Moving to Markets in Environmental Regulation: What We've Learned After 20 Years (Jody Freeman & Charles Kolstad eds., forthcoming 2005) (manuscript at 2, on file with the Columbia Law
and dispute resolution provisions enable the parties to resolve differences in a process and forum that they select in advance, often a private forum. By using these and other provisions, buyers and sellers have enormous flexibility during agreement negotiations to allocate the environmental risks associated with the acquisition. Once the allocation is memorialized in the agreement, it creates private, legally enforceable contract rights that steer the behavior of the buyer and seller.

The existence of regulatory risks and the ability to allocate them between the parties induce firms to serve many of the functions typically considered the province of public agencies, including monitoring and enforcement, implementation, standard setting, and dispute resolution. Assume, for example, that a firm contemplates selling a subsidiary. A sophisticated seller may anticipate that at the conclusion of negotiations it will enter into an acquisition agreement with several types of environmental provisions. The provisions will require the seller to represent that the target business has no material environmental liabilities, to covenant that it will provide the buyer access to enable diligence to be conducted pre-closing, and possibly to indemnify the buyer for pre-closing environmental conditions on its properties.

The prospect that environmental risks can be shifted may induce the seller to reduce the risks posed by a facility even if there is a low risk of government inspection or enforcement, so the seller may have incentives to engage in self-monitoring and implementation even before a prospective buyer has been identified. The seller will know that information asymmetries exist with potential buyers and that information acquisition is not costless. The seller may be concerned that the prospective buyer will rely on limited evidence of environmental risks or regulatory non-compliance as a surrogate for a more thorough understanding of the

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74. See, e.g., Heritage Agreement, supra note 73, § 10.2 (providing indemnity for buyer from damages suffered from seller's environmental liabilities including its failure to comply with air emissions permit). Although indemnities are covenants between the parties, see, e.g., Geltman, Environmental Law, supra note 72, at 549, they are identified separately here because of their substantial and distinctive influence on firms' incentives. For example, the purchaser of a facility from a large manufacturer may seek an indemnity for releases of hazardous substances that occurred prior to the purchase by the new owner. See Elizabeth Glass Geltman, Shifting Environmental Risk: A Guide to Drafting Contracts and Structuring Transactions 1–2 (1999).

75. See Geltman, Environmental Law, supra note 72, at 649–50.

76. This is a common deal structure. See, e.g., Heritage Agreement, supra note 73, §§ 2.7, 10.2 (providing environmental representations, warranty, and indemnity).


78. See Gilson & Black, supra note 70, at 1576–605 (noting that transactional lawyers use representations, warranties, indemnifications, and opinions to address failure of costless information assumption).
risks presented by the target business, or for management competence more generally. As a result, the seller may conduct environmental assessments and may comply or overcomply with regulatory requirements before offering the business for sale.\footnote{79}{See, e.g., Symposium: The Environment and the Law, Panel II: Public Versus Private Environmental Regulation, 21 Ecology L.Q. 431, 468 (1994) [hereinafter Symposium Panel II] (discussion by Richard Lazarus) (describing free market forces as "one of the most significant enforcement devices" and noting that "[n]ow every time someone thinks about buying a business or not buying a business, they are concerned about the environmental liabilities affiliated with it" so "[t]hat means everyone starts cleaning up because they have to worry about how it is going to affect their market price"). Other types of transactions also may be influential but are beyond the scope of this Article. See, e.g., Cynthia Williams, The Securities and Exchange Commission and Corporate Social Transparency, 112 Harv. L. Rev. 1197, 1308-10 (1999) (advocating broader environmental disclosure requirements under securities laws).}

In turn, the buyer may be unwilling to rely on the seller's representations regarding the business and may conduct her own assessments. The buyer also may have independent regulatory incentives to conduct pre-closing diligence.\footnote{80}{CERCLA provides an innocent purchaser defense for parties that conduct all appropriate inquiry into the status of the property. Recent amendments have provided explicit innocent purchaser relief if the acquiring party conducts an initial environmental investigation (known as a "Phase I" assessment) that meets the standards of the Association for the Society of Testing and Materials (ASTM). See Small Business Liability Relief and Brownfields Revitalization Act, Pub. L. No. 107-118, §§ 102, 221–223, 115 Stat. 2356, 2356-360, 2368–374 (2002) (codified as amended at 42 U.S.C.A. §§ 9601, 9607, 9622 (2002)). Although the ASTM Phase I assessment requirements only explicitly address CERCLA liability, Phase I assessments often identify other environmental risks, and many firms conduct enhanced assessments that encompass regulatory compliance.}

Acquisition agreements often provide for the buyer to conduct environmental assessments (often called Phase I assessments) prior to the closing.\footnote{81}{See, e.g., Agreement and Plan of Merger Between Equivest Finance, Inc. and Cendant Corp. § 6.3(d) (Dec. 2001), available at LexisNexis, EDGARPlus Exhibits Database (providing rights to conduct pre-closing Phase I and Phase II assessments). The covenants often provide that if a Phase I uncovers potential problems, the buyer may conduct a Phase II assessment. See, e.g., id.}

In addition, buyers have access to publicly available data such as toxic chemical release information and government compliance data. These sources are routinely used in diligence activities.\footnote{82}{See Bradley C. Karkkainen, Information as Environmental Regulation: TRI and Performance Benchmarking, Precursor to a New Paradigm?, 89 Geo. L.J. 257, 261 (2001); Michael P. Vandenbergh, Order Without Social Norms: How Personal Norm Activation Can Protect the Environment, 99 Nw. U. L. Rev. 1101, 1144–45 (2005) (noting use of Toxic Release Inventory data by corporate firms).}

Whether conducted by the seller or the buyer, a tremendous amount of preacquisition environmental monitoring occurs. For example, according to one estimate, approximately 250,000 Phase I assessments are conducted annually in the United States, and the total annual expenditures on these private environmental assessments exceed $500 million
per year. These private monitoring expenditures contrast sharply with the public expenditures for related activities: The entire annual operating budget of the federal EPA enforcement office in recent years has been roughly $400 million. The EPA enforcement budget is thus a limited indicator of the total amount of environmental monitoring that is occurring. The massive amount of private monitoring can be expected to generate information that facilitates market pressure on firms to correct environmental noncompliance and reduce other environmental liabilities. In some cases, the information also will trigger an obligation to report matters to government agencies. As a result, the pre-closing private monitoring can be expected to increase compliance over that expected if only government monitoring is taken into account.

Second-order agreements also induce firms to function as private monitors and enforcers long after the closing. In our hypothetical transaction, the indemnity creates an incentive for the seller to ensure that the buyer is not acting in a way that will trigger indemnified liability. The seller can enforce restrictions on the buyer through informal contacts, denial of indemnification claims, and litigation, depending on the terms of the dispute resolution provisions. Because it often occurs in informal business-to-business contacts, and disputes are often resolved through private dispute resolution processes, the amount of postacquisition monitoring and enforcement is difficult to assess. Nevertheless, anecdotal evidence suggests widespread postacquisition monitoring and en-

83. See Gerrard, Proposal, supra note 73, at 5 (citation omitted). Phase I assessments are also conducted in connection with entry into credit agreements and real estate sales and leases, so the entire $500 million cannot be attributed solely to acquisitions. Phase I assessments, however, generally are associated with some form of second-order agreement.


85. In some cases the acquisition agreement may affect private implementation by enabling the buyer to insist not only that it be allowed to conduct environmental assessments, but also that the seller remediate identified problems prior to closing.

86. Of course, an indemnitor may place restrictions on the indemnitee in order to limit the indemnitor’s exposure (e.g., to not excavate a particular parcel), and the restrictions may discourage remediation.

87. See Agreement and Plan of Merger Between Hall-Houston Oil Co. and Energy Partners, Ltd. § 10.10 (Dec. 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter Hall-Houston Agreement] (providing for private arbitration of disputes concerning agreement); see also David Charny, Nonlegal Sanctions in Commercial Relationships, 104 Harv. L. Rev. 373, 392–97 (1990) (providing typology of nonlegal sanctions); Rubin, Nonjudicial Life, supra note 58, at 131 (describing prevalence of self-help provisions in contracts and asserting that “[t]hey have profound effects on the commercial arrangements in our society and on the way in which disputes are resolved by nonjudicial actors”).

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Whether the net effect of this private post-closing monitoring and enforcement is to increase compliance with regulatory requirements or simply to shift burdens among private parties, or both, is unclear, but it is clear that these agreements make it more difficult for government agencies and the public to determine who is calling the shots in any particular regulatory matter.

Acquisition agreements also may affect the implementation of regulatory requirements for additional reasons. A first is simply management focus. In many firms, the chief executive officer and chief financial officer are likely to be more involved in decisionmaking regarding the environmental risk shifting that occurs in acquisition agreements than they are in day-to-day environmental management, and the transactional process may be the only time they give sustained attention to environmental issues. Second, acquisitions may enable least-cost avoiders to purchase firms or assets with high regulatory-compliance costs. The trading of regulatory-implementation obligations may be explicit in the agreement, such as where one party agrees to indemnify another for Superfund cleanup costs or regulatory-compliance costs, or the agreement may simply generate the information necessary for the environmental costs to be reflected in the purchase price or other aspects of the transaction. The net result of these transactions will include lower costs of regulatory implementation and may include less resistance to regulatory requirements and increased compliance rates.

In some cases, acquisition agreements also serve a private standard setting function and may induce firms to meet or exceed regulatory requirements. For example, to lower its indemnity risk, the seller may insist on terms in the agreement that require the buyer to comply with relevant

88. Despite the widespread existence of private dispute resolution provisions, a number of disputes over indemnity provisions have produced reported court decisions. See Geltman, Environmental Law, supra note 72, at 549–607 (citing cases regarding private enforcement of environmental covenants). Of course, the extent of the private monitoring and enforcement is in part a function of government enforcement activity. See Neil K. Komesar, Imperfect Alternatives: Choosing Institutions in Law, Economics, and Public Policy 163–77 (1994).

89. For example, management may focus on environmental issues because of a concern that socially responsible investors may influence the environmental review and terms of the transaction. See Grabosky, supra note 59, at 435–36; Johnston, supra note 59, at 16–17.

90. For example, after it becomes clear that a new air regulation is going to impose additional costs on a facility, a firm may sell the facility or the subsidiary that operates it to a buyer that may be able to comply at lower cost because of its technical expertise, economies of scale, or other factors.

91. See, e.g., Jonathan R. Macey, Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules, 82 Cornell L. Rev. 1123, 1146 (1997) ("Rational actors in the private order will enter into only mutually beneficial agreements."); Maksimovic & Phillips, supra note 65, at 2021 ("[M]ost transactions in the market for assets result in productivity gains.").
government regulations. The effect is to create a second cause of action in the event of a regulatory violation, with one cause of action held by the government based on public law and one held by the promisee for breach of contract. In addition, the agreement may include provisions that require the buyer to exceed regulatory standards. For example, the agreement may prohibit the buyer from using certain chemicals or from engaging in other environmentally risky activities.

Acquisition agreements also affect the extent to which disputes are resolved in public courts. These agreements thus have implications for the transparency of regulatory implementation and dispute resolution. For example, acquisition agreements often include provisions that require the use of alternative dispute resolution. Firms may view courts as unable to reliably and efficiently determine liability and damages in complex environmental cases, leading private parties to view judicial intervention as unpredictable, slow, and expensive. In addition, alternative dispute resolution may enable firms to keep environmental or business information confidential. Of course, firms have incentives to keep the environmental information shared or generated during an acquisition from regulators and the public. Confidentiality provisions that prohibit the disclosure of environmental compliance and related information are common in acquisition agreements. Firms thus often use second-order agreements to ensure that disputes and firm information generally are shielded from public view.

b. Credit Agreements. — Credit agreements also commonly include environmental provisions. A sample of the credit agreements filed with the SEC suggests that firms filed more than 1,500 credit agreements in

92. See, e.g., Asset Purchase Agreement Between Executive Conference, Inc. and Summit Acquisition LLC § 2.3(d) (Nov. 30, 2001), available at LexisNexis, EDGARPlus Exhibits Database (requiring buyer to assume post-transaction environmental compliance obligations).

93. See Geltman, Environmental Law, supra note 72, at 549.

94. See infra notes 176-186 and accompanying text.

95. See Hall-Houston Agreement, supra note 87, § 10.10 (requiring arbitration of agreement disputes). Of the 227 acquisition agreements with environmental provisions, 25% (56 of 227) had private dispute resolution provisions.

96. Lisa Bernstein has identified several sources of inefficiency that have led to the use of extralegal enforcement of contracts, including uncertainty of recovery, courts' damages calculations, and delays in obtaining judgments. See Lisa Bernstein, Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions, 99 Mich. L. Rev. 1724, 1739-44 (2001). Firms in environmental disputes routinely face all of these conditions.

97. Private disputes may be litigated as contract actions in federal or state court, and some alternative dispute resolution outcomes can be challenged in court. For a review of environmental dispute resolution, see Peter L. Winik & Michael P. Vandenbergh, Alternative Dispute Resolution: Environmentally Sound, Legal Times, Sept. 16, 1996, at S40.

98. Of the acquisition agreements with environmental provisions, 56% (126 of 227) had confidentiality provisions. See supra note 69.

2001, and almost 70% of these include environmental provisions. The percentage is likely to be even higher for credit agreements with borrowers in industrial sectors. In addition, the analysis here focuses only on public companies, but privately held firms enter into credit agreements with environmental provisions as well.

Lenders have conflicting incentives regarding the regulatory compliance of their borrowers. On the one hand, at the outset of the transaction a lender has an incentive to identify low-risk borrowers. Similarly, after the loan is entered into, a lender has incentives to ensure that its borrower does not violate the law or engage in liability-creating behavior if doing so will interfere with repayment of the loan or put the lender directly at risk for the liabilities of the borrower. On the other hand, lenders have incentives to ensure that compliance does not drain funds that could be used to repay the loan. Sophisticated banks facing this situation might not direct borrowers to violate laws, but might simply demand loan repayment and force the borrower to conclude that repayment requires noncompliance. This mismatch in private and societal incentives has been noted in the agriculture sector, where the demands

100. These are the results of the search of the LexisNexis EDGARPlus Exhibits database "description" search field using all caps and terms "credit agreement" and "loan agreement" for agreements filed in 2001. An agreement was categorized as a credit agreement if it involved an agreement by a creditor to lend funds or extend credit or delay or forhear the repayment of funds. See, e.g., Credit Agreements Act, 815 Ill. Comp. Stat. Ann. 160/1(1) (West 1999) (defining credit agreement). Minor amendments (of ten pages or fewer) to existing credit agreements were not treated as credit agreements. To estimate the total number of credit agreements filed in 2001, the results from this search for the fourth quarter of 2001 (October, November, and December 2001) were examined. The results yielded 1,815 documents which, upon examination, included 514 credit agreements. The estimated number of credit agreements filed in 2001 was calculated by multiplying the total number of documents retrieved by the search for all of 2001 (6,356) by the total number of credit agreements (514) divided by the total number of documents retrieved by the search for the fourth quarter of 2001 (1,815). This calculation yielded an estimated annual total of 1,799. To estimate the percentage of all credit agreements with environmental terms, a full text search was conducted of the fourth quarter 2001 credit agreements (as identified above) with the additional terms "hazard! Or environment! Or toxic Or chemical Or waste." Of the 514 credit agreements filed in the fourth quarter of 2001, 69% (357 of 514), were found to include environmental second-order provisions.

101. Lenders became particularly focused on the environmental risks of borrowers following the Fleet Factors decision, which raised concern that lenders might become liable for CERCLA response costs simply by having the capacity to influence a debtor's treatment of hazardous materials. See United States v. Fleet Factors Corp., 901 F.2d 1550, 1557 (11th Cir. 1990). Congress later scaled back the scope of lender liability, but lenders are still at risk if their oversight of borrowers strays beyond the bounds provided by the CERCLA amendments. See Small Business Liability Relief and Brownfields Revitalization Act, Pub. L. No. 107-118, §§ 102, 221-223, 115 Stat. 2356, 2356-360, 2368-374 (2002) (codified as amended at 42 U.S.C.A. §§ 9601, 9607, 9622 (2002)). In addition, the costs of environmental compliance still create repayment risks.
of lenders or insurers to protect their interests in crops may induce them to dictate pesticide use at greater than socially optimal levels.\textsuperscript{102}

The extent to which lenders press borrowers for environmental compliance or noncompliance is ripe for empirical study. In the interim, it is clear that lenders have incentives to select low-risk borrowers and often have incentives to demand regulatory compliance or overcompliance during the term of the loan. As a result, in many instances lenders have incentives to engage in traditionally public regulatory functions, including monitoring and enforcement, implementation, standard setting, and dispute resolution. Credit agreements enable lenders to serve these functions through many of the types of provisions identified in the discussion of acquisition agreements.\textsuperscript{103}

Credit agreements are particularly important vehicles for private monitoring and implementation in the pre-closing period.\textsuperscript{104} Prospective borrowers have incentives to present a low-risk regulatory profile to lenders, and they may self-monitor and implement regulatory requirements that would otherwise be ignored. Some lenders provide incentives for this type of anticipatory action by offering interest rate reductions for companies that have strong compliance records or that overcomply.\textsuperscript{105} Lenders monitor at the outset through credit agreement provisions that enable the lender to review Phase I assessments or other assessments prior to closing.\textsuperscript{106}

Lenders also include provisions in credit agreements that establish their right to monitor debtors during the term of the loan and to enforce regulatory compliance (e.g., by declaring noncompliance to be a breach of representation and an event of default).\textsuperscript{107} Borrowers may implement


\textsuperscript{103} See discussion supra Part II.A.1.a. See generally Credit Agreement Between Steak N Shake Co. and Fifth Third Bank, Indiana (Central) (Nov. 16, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter Steak N Shake Agreement] (providing for environmental matters in various provisions).

\textsuperscript{104} See Neil Gunningham, Environmental Management Systems and Community Participation: Rethinking Chemical Industry Regulation, 16 UCLA J. Envtl. L. & Pol’y 319, 436 (1998) ("Commercial third parties, such as insurance companies or lenders, may also serve as surrogate regulators, enforcing their interests through withdrawal or denial of insurance or access to capital.").

\textsuperscript{105} See id. at 402 ("[I]n Canada Responsible Care companies now have 'several points' deducted from their project financing rates." (citation omitted)).

\textsuperscript{106} See, e.g., Third Amendment to Credit Agreement Among Affinity Group, Inc. and Fleet National Bank et al. § 5(j) (Dec. 5, 2001), available at LexisNexis, EDGARPlus Exhibits Database (providing that "Administrative Agent shall have received reports . . . which . . . shall include a Phase I environmental assessment for each of the Facilities" and "[s]uch reports shall be conducted by . . . consulting firms reasonably satisfactory to the Administrative Agent").

\textsuperscript{107} See Revolving Credit Agreement Among National Technical Systems, Inc. et al. and Comerica Bank-California et al. § 6.12 (Nov. 21, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter National Agreement] (providing that borrower
regulatory directives in anticipation of or in response to lender monitoring and enforcement. Credit agreements often provide mechanisms that allow escalating private enforcement, and much of the lender enforcement likely takes place in informal contacts.\textsuperscript{108} Formal disputes may be resolved through private dispute resolution proceedings, but credit agreements more commonly provide for resolution in public courts than do acquisition agreements.\textsuperscript{109} Credit agreements also often impose confidentiality requirements on the information exchanged between the parties.\textsuperscript{110} Given the largely private nature of lender environmental enforcement, the actual extent of enforcement is difficult to demonstrate. Anecdotal accounts suggest, though, that a substantial amount of lender enforcement occurs both before and during the term of the loan.\textsuperscript{111} For example, lenders' pre-closing monitoring has induced a leading lawyer to suggest that they are "the most diligent enforcers of environmental law."\textsuperscript{112}

must "notify Agent and Lenders immediately of any notice of a hazardous discharge or environmental complaint . . . [;] permit Agent and each Lender to inspect the premises, to conduct tests thereon . . . [;] and at Borrower's expense, provide a report of a qualified environmental engineer").


\textsuperscript{109} Compare National Agreement, supra note 107, § 11.9 (providing that disputes will be litigated in state and federal courts), with Amended & Restated Credit Agreement Among Hauser, Inc. et al. and Wells Fargo Bank et al. § 9.09 (Dec. 7, 2001), available at LexisNexis, EDGARPlus Exhibits Database (providing for arbitration with appeal rights in public courts). Although roughly 25% of the acquisition agreements with environmental provisions contained alternative dispute resolution provisions, only 7% (24 of 357) of the credit agreements with environmental provisions had alternative dispute resolution provisions. See supra note 100.

\textsuperscript{110} Of the credit agreements with environmental provisions, 57% (203 of 357) included confidentiality provisions. See supra note 100. This figure compares favorably to the 56% (126 of 227) of acquisition agreements with environmental provisions that included confidentiality provisions. See supra note 69.

\textsuperscript{111} As British Secretary for the Environment Michael Howard noted, "The penalties for poor environmental performance that the financial world will exact are likely to be far more swift and certain than anything governments have been able to achieve." Grabosky, supra note 59, at 442. For example, a higher interest rate on a prospective loan or a threatened default on an existing loan may gain the CEO's or CFO's attention in a way that a $50,000 regulatory penalty directed at a particular facility may not. See also Douglas G. Baird & Robert K. Rasmussen, Private Debt and the Missing Lever of Corporate Governance, 154 U. Pa. L. Rev. (forthcoming 2006) (manuscript at 4, on file with the Columbia Law Review) ("[L]oan covenants now play a central role in corporate governance.").

In addition, credit agreements often serve standard setting functions: They create private rights to enforce public standards and they create new, more stringent private standards. As discussed above, credit agreements often require borrowers to comply with environmental regulations and at times require borrowers to overcomply. For example, some credit agreements prohibit the borrower from allowing the release of any hazardous substance from a facility, even though some releases are lawful, and other credit agreements require the borrower to establish an environmental management system, even though there is no regulatory requirement to do so. Failure to comply or overcomply with environmental regulations thus may be an act of default that enables the lender to impose penalties or cancel the loan.113

Finally, in some cases, two layers of second-order agreements may induce lenders to play regulatory roles. For example, a lender may demand inclusion of environmental terms in a credit agreement, but the lender’s demand may be the product of commitments the lender has made to nonprofit groups.115 This Article calls agreements between private firms and nonprofit groups “environmental performance agreements” and addresses them in more detail in Part II.A.2.b below.

In sum, the effect of credit agreement environmental provisions is to provide lenders, which often have an interest in ensuring that debtors do not engage in environmentally risky behavior, with the legal right to monitor and enforce their interests during the course of the loan. As a result, borrowers may be subject to nongovernmental constraints on violating regulatory requirements or engaging in risky behavior during the term of the loan that exceed the constraints imposed by government enforce-

113. See, e.g., Steak N Shake Agreement, supra note 103, § 6.i (“The Company shall not allow or permit to continue the release or threatened release of any Hazardous Substance on any premises . . . .”); Credit Agreement Among Hanover Compressor Co. et al. and JP Morgan Chase Bank et al. § 7.8(c) (Dec. 15, 1997, as amended Dec. 3, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter Hanover Agreement] (providing that borrower must “[m]aintain a program to identify and promote substantial compliance with and to minimize prudently any liabilities or potential liabilities under any Environmental Law”).

114. See Steak N Shake Agreement, supra note 103, § 8.f (providing that events of default include “[f]ailure by the Company to comply with or perform any covenant stated in . . . Section 6 of this Agreement [regarding, inter alia, releases of hazardous substances]”).


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ment and standard setting alone. Thus, the net effect of credit agreement environmental provisions is likely to include an increase in compliance and decrease in environmental liability-creating behavior by private firms over that predicted by models of the regulatory state that do not account for the effects of second-order agreements.

c. Real Estate Agreements. — Environmental provisions are also common in commercial real estate sales agreements and leases (collectively, real estate agreements). The size of the real estate sales and lease markets is tremendous. For example, the total value of commercial real estate transactions ranged from a high of approximately $65 billion in 1997 to a low of approximately $19 billion in 2000.

In addition, the review of SEC filings demonstrates that commercial real estate agreements commonly include environmental provisions. The focus here is on commercial real estate lease agreements. These agreements are subject to SEC filing requirements, and a sample suggests that firms filed more than 700 with the SEC in 2001. In addition, almost 80% of the leases reviewed contained environmental provisions. The percentage containing environmental provisions can be expected to

116. See Gerrard, Proposal, supra note 73, at 14–15 (“Environmental assessments prior to property transfer have a powerful economic logic.”). A number of additional types of environmental second-order agreements regarding real estate are worthy of further review but are beyond the scope of this Article. See, e.g., John Pendergrass, Sustainable Redevelopment of Brownfields: Using Institutional Controls to Protect Public Health, 29 Envtl. L. Rep. 10,243 (1999) (evaluating land use controls).


119. See 17 C.F.R. § 229.601 (2004). The results of the search of the LexisNexis EDGARPlus Exhibits database “description” search field using all capital letters and the term “lease agreement” for agreements filed in 2001. An agreement was categorized as a commercial real estate lease agreement if it involved transfer of a leasehold interest in commercial real estate. Minor amendments (of ten pages or fewer) to existing lease agreements and subleases that incorporated the terms of a principal lease by reference were not treated as lease agreements. To estimate the total number of commercial real estate lease agreements filed in 2001, the results from this search for the fourth quarter of 2001 (October, November, and December 2001) were examined. The results yielded 1,551 documents which, upon examination, included 228 lease agreements. The estimated number of lease agreements filed in 2001 was calculated by multiplying the total number of documents retrieved by the search for all of 2001 (5,918) by the total number of lease agreements (228) divided by the total number of documents retrieved by the search for the fourth quarter of 2001 (1,551). This calculation yielded an estimated annual total of 869.

120. To estimate the percentage of all commercial real estate lease agreements filed in 2001 that included environmental terms, a full text search was conducted of the fourth quarter 2001 lease agreements with the additional terms “&hazard! Or environment! Or toxic Or chemical Or waste.” Of the 228 commercial real estate lease agreements filed in the fourth quarter of 2001, 181, or 79%, were found to include environmental second-order provisions.
be far higher in industrial sectors, and the raw numbers can be expected to be much higher if leases entered into by privately held companies are included.

The parties to commercial real estate leases face many of the same incentives as the parties to acquisition and credit agreements, and, not surprisingly, the provisions closely parallel those found in acquisition or credit agreements. In turn, lease agreements induce or enable private parties to play many of the same regulatory functions. For example, private environmental monitoring, enforcement, and implementation often occur in advance of entry into commercial leases. The landlord has incentives to present a clean bill of health to a prospective tenant and may take preemptive steps to resolve compliance issues. In addition, prospective tenants often conduct diligence, typically including Phase I environmental assessments.

Landlords have ongoing interests in the property occupied by a tenant by virtue of a lease and often require provisions in leases that enable them to monitor the tenant's activities. Many also include provisions that require compliance with regulatory standards or set more stringent standards. For example, some leases not only require regulatory compliance, but also prohibit the tenant from using any hazardous materials.

121. See, e.g., Lease Agreement Between Corridor Park Pointe II, L.P. and Intelligent Reasoning Sys., Inc. § 13 (Dec. 6, 2001), available at LexisNexis, EDGARPlus Exhibits Database (allowing landlord to conduct environmental inspections and requiring tenant to comply and over comply with environmental laws, report environmental events, and indemnify landlord).

122. See id. (laying out tenants' tasks with respect to inspecting and handling environmental matters).

123. See, e.g., Office Lease Between Pacifica Holding Co. and Garden Fresh Rest. Corp. § 6.8 (Dec. 27, 2001), available at LexisNexis, EDGARPlus Exhibits Database [hereinafter Pacifica Lease] ("Landlord shall have the right . . . to inspect, investigate, sample and/or monitor the Premises, including any air, soil, water, groundwater or other sampling."). Private parties may play similar roles following real estate sales where the seller has indemnified the buyer. See, e.g., Real Property Agreement Between Dover Downs Entm't, Inc., et al. and Dover Downs Int'l Speedway, Inc. § 2(h) (Nov. 21, 2002), available at LexisNexis, EDGARPlus Exhibits Database (providing indemnity for "[a]ll liabilities associated with claims . . . which relate to the condition of any real property at the time of transfer, including the environmental condition thereof").

124. See, e.g., Lease Agreement Between Del Mar Cap. Group/Ridgeview, LLC and Cytovia, Inc. § 6.2(c) (May 28, 1998), available at LexisNexis, EDGARPlus Exhibits Database (requiring Lessee "to take all investigatory and/or remedial action reasonably recommended [by Lessor], whether or not formally ordered or required"); Lease Agreement Between the Esplanade on Redhill LLC and Irvine Sensor Corp. § 6.2(a) (Oct. 1, 2001), available at LexisNexis, EDGARPlus Exhibits Database ("Lessee shall not engage in any activity . . . which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance . . . with all Applicable Requirements."); Pacifica Lease, supra note 123, § 6.5 ("Tenant and each of its affiliates . . . shall not bring onto the Premises or the Building any Hazardous Material (other than customary amounts of Hazardous Materials used for office supplies and cleaning materials . . .) . . . "). Seventy-two percent (130 of 181) of the leases with environmental provisions included one or more over compliance requirements. In contrast, less than 1%
Anecdotal information suggests that landlord enforcement of environmental lease terms is common. In some cases, leases also include dispute resolution provisions. As a result, disputes often are resolved in private forums, raising the transparency concerns noted in connection with acquisition and credit agreements.

**d. Sales and Service Agreements.** — Some agreements for the sale of goods and services have explicit environmental provisions while others lack explicit environmental provisions but are entered into in large part because of their environmental effects. Sales and service agreements often are not filed with the SEC, but a number of sources suggest that environmental provisions are becoming more common. Sales and service agreements with environmental terms induce private firms to play many of the same monitoring and enforcement functions as do other embedded second-order agreements. The distinctive features of these agreements, however, concern standard setting and standard avoidance.

In many cases, sales and service agreements may induce a net increase in the regulatory compliance of private firms. For example, some agreements set private environmental standards for the product purchased or sold, and some also impose standards on the manufacturing process, manufacturing facility, or firm. These agreements may re-

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125. See Donald I. Berger, Environmental Issues in the Landlord-Tenant Context, in Environmental Aspects, supra note 118, at 477, 488 ("[I]nspection rights may be particularly important as a means to allow the landlord to verify whether the tenant is complying with applicable legal requirements and lease restrictions on hazardous materials use.").

126. See, e.g., Lease Agreement Between Metro Two Hotels, LLC and Hersha Hospitality Mgmt. §§ 40.1-40.3 (Nov. 15, 2001), available at LexisNexis, EDGARPlus Exhibits Database (requiring arbitration of lease disputes). Interestingly, only 9% (17 of 181) of commercial real estate leases with environmental provisions also included confidentiality provisions, as compared to 56% of acquisition agreements and 57% of credit agreements. An additional issue for further study is why firms appear to opt for confidentiality provisions more often in acquisition agreements and credit agreements than in real estate lease agreements.

127. Although sales agreements are subject to U.C.C. Article 3 requirements and services agreements are subject to common law requirements, the differences between the two types of agreements are not important for the analysis in this Article.

128. See, e.g., Jennifer Nash, Are EMSs the Answer?, 4 Innovation, Mgmt. Sys. & Trading Comm. Newsletter 17, 20 (2004) (noting that several manufacturers impose environmental management requirements on suppliers). In some cases, firms file these types of agreements with the SEC. See, e.g., AN Supply Agreement Between Orica USA, Inc. and El Dorado Chem. Co. § 22 (Nov. 1, 2001), available at LexisNexis, EDGARPlus Exhibits Database (requiring ammonia purchaser to “comply with all safety and health Laws and Environmental Laws, regulations and codes of conduct applicable to the performance of its duties hereunder” and requiring buyer to “promptly” undertake remedial actions and report environmental incidents to seller).

129. See, e.g., Grabosky, supra note 59, at 429–31 (noting that some firms require suppliers to have environmental policies and conduct environmental audits); Steve Nix,
quire that the supplier or purchaser comply with or exceed regulatory requirements. For example, several of the major domestic automakers require that their suppliers meet private standards for environmental management systems. Consumer retailers and chemical manufacturers also impose environmental requirements on suppliers. Similarly, in the forest products industry, some large paper companies require that independent timber cutters follow best management practices for reducing water pollution from logged areas.

The inclusion of environmental provisions in purchase and sale agreements demonstrates another way in which second-order agreements may induce a net increase in regulatory compliance. Even though the party demanding environmental provisions may be able to escape legal liability for its suppliers' or purchasers' behavior, it nevertheless faces incentives to insist on these provisions. The incentives may arise from consumer or shareholder pressure, concerns about tort liability, or the personal norms of firm owners, managers, or customers. In addition, large, high-profile firms may be concerned that misbehavior by less visible firms will generate public pressure for sector-wide government regulation. In any event, the agreements are a vehicle by which regulatory and other pressures brought to bear on one group of firms are transferred to a sec-

Guidelines for Preparing a Timber Sale Contract, at http://members.aol.com/JOSTNIX/contract.htm (last visited Sept. 1, 2005) (on file with the Columbia Law Review) (noting that timber sale contract forms include provisions requiring compliance with environmental guidelines). Chemical manufacturers often include and enforce environmental performance requirements in contracts with distributors or purchasers of their chemicals. Gunningham, supra note 104, at 414 (noting that large chemical firms impose "specified levels of environmental performance," evaluate customers' environmental management systems, and enforce purchaser compliance with regulations by threatening to end business relationship).

130. See Grabosky, supra note 59, at 436 (noting that some banks have imposed environmental requirements on their materials suppliers); Nash, supra note 128, at 20 (noting that major domestic automakers require that suppliers implement ISO 14001 as condition of doing business); cf. Cary Coglianese & David Lazer, Management-Based Regulation: Prescribing Private Management to Achieve Public Goals, 37 Law & Soc'y Rev. 691 (2003) (examining case studies of management-based regulation in variety of regulatory situations).

131. See Grabosky, supra note 59, at 430 (noting that Wal-Mart and the Body Shop have imposed environmental requirements on suppliers); Gunningham, supra note 104, at 411-17 (discussing product stewardship and manner in which environmental practices of suppliers can be controlled in chemical industry).

ond group of firms, thus extending the reach of regulatory and other incentives beyond the targeted firms.

On the other hand, some sales and service agreements may undermine incentives for regulatory compliance. For example, some agreements have the opposite effect of standard setting: They enable firms to avoid regulatory requirements. Environmental regulations provide numerous incentives for large firms to contract with smaller firms to outsource production not because the smaller firm is more efficient but because it is able to avoid reporting obligations or to externalize the environmental costs of production. Small businesses are able to take advantage of numerous exemptions from regulations and often escape government enforcement.

Although firms have incentives to avoid disclosure and externalize costs, the extent of this standard avoidance is difficult to assess. The transaction costs associated with contracting out disclosure and regulatory compliance, coupled with reduced economies of scale due to production outsourcing, may outweigh the benefits of disclosure avoidance and cost externalization. In some cases, the magnitude of a liability may be so great that even a small risk of financial or reputational harm from a contracted-out service will create an incentive not to contract with an independent third party. The incentives firms face regarding disclosure

133. See Gunningham, supra note 104, at 415 n.281 (noting "temptation which some chemical companies have succumbed [to] in the past, namely to sub-contract some of the dirtiest or most hazardous operations relating to chemical manufacture").


135. See, e.g., Jay B. Barney et al., Organizational Responses to Legal Liability: Employee Exposure to Hazardous Materials, Vertical Integration, and Small Firm Production, 35 Acad. Mgmt. J. 328, 328 (1992) (concluding that liability from employees' exposure to hazardous materials leads larger firms to reduce vertical integration and to increase contracting with small firms); C. Steven Bradford, The Cost of Regulatory Exemptions, 72 UMKC L. Rev. 857, 857 (2004) (noting that economists and legal scholars have paid little attention to regulatory exemptions, with exception of small business exemptions which have focused on extent to which larger companies use exemptions to avoid standards).

136. For example, one might assume that large oil firms would have contracted with small, independent firms to avoid the requirements of the Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484 (codified as amended in scattered sections of 33 U.S.C. (2000)). Yet a recent study concluded that although some firms responded in this way, many large oil firms appear to have determined that despite the low likelihood of liability for third-party contractors, the potentially catastrophic magnitude of the liability made the risk of this approach too high. Brooks, supra note 59, at 109–10. The parent firms have maintained some distance from the oil transport business, however, by conducting the transport through subsidiaries and by using subsidiary names that do not relate to the parent. Id.
and other requirements, and recent examples of standard avoidance, however, suggest that substantial avoidance activity may be common.137

For example, the federal Toxic Release Inventory (TRI) provisions of the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) require periodic reporting of toxic chemical releases, but only by firms that have more than ten employees and that meet certain other threshold requirements.138 Similarly, the Resource Conservation and Recovery Act (RCRA) imposes expensive disposal requirements on firms that generate more than 1,000 kilograms of hazardous waste per month, but imposes far less stringent standards on firms that generate less than 100 kilograms per month.139 Thus, even aside from any monitoring or enforcement disparities between large and small firms, these environmental regulatory provisions create strong incentives for large firms to contract with small firms in ways that may have the effect of externalizing environmental harms.140 Empirical studies are only beginning to be performed on private firms' responses to these incentives, but TRI reporting141 and RCRA waste handling,142 as well as water pollu-

137. See, e.g., Lynn M. LoPucki, The Death of Liability, 106 Yale L.J. 1, 3 (1996) (concluding that because of growth in judgment-proof entities, soon no economic players will have wealth exposed to liability); Al H. Ringleb & Steven N. Wiggins, Liability and Large-Scale, Long-Term Hazards, 98 J. Pol. Econ. 574, 574 (1990) ("[L]iability changes appear to have led to a large increase in small corporations in hazardous sectors.").


140. For example, if a firm generates 1,100 kilograms of hazardous waste per month and the firm can subcontract the work to twelve small plating firms, each of which will generate just under 100 kilograms per month, the contracting may generate cost savings. The savings may arise because the plating firms can qualify as conditionally exempt small quantity generators and can take advantage of an exemption from certain reporting and waste disposal requirements. See 40 C.F.R. § 261.5. These small quantity generators can send the untreated waste to certain municipal solid waste landfills that can receive hazardous wastes but are not required to meet the more stringent standards for treatment, storage, and disposal facilities promulgated under Subchapter III of the RCRA. 1d. For a discussion of subcontracting around tort liability, see Mark J. Roe, Corporate Strategic Reaction to Mass Tort, 72 Va. L. Rev. 1, 49–51 (1986).

141. To avoid TRI reporting, a large firm could contract out processes that use or release chemicals to firms that have fewer than ten employees or that do not use or release listed chemicals at levels above the TRI thresholds. A recent study of firms' responses to TRI requirements suggests that avoidance of federal TRI reporting may be common. Lori Snyder Bennear, Strategic Response to Regulatory Thresholds: Evidence from the Massachusetts Toxic Use Reduction Act 2 (June 27, 2005) (unpublished manuscript, on file with the Columbia Law Review) (concluding that firms appear to be strategically reducing toxic chemical use below threshold amounts rather than reducing releases overall).

tion\textsuperscript{143} and mining\textsuperscript{144} standards, are areas in which there is reason to believe that firms contract around regulatory thresholds to achieve standard avoidance. Firms can use second-order agreements to avoid regulatory standards and can do so in ways that often will not be transparent to policymakers or the public. If policymakers do not understand when firms use second-order agreements to implement or avoid regulatory standards, they will not be able to tailor regulatory measures to induce desired outcomes.

2. Stand-Alone Agreements. — Firms also enter into many types of environmental second-order agreements that are not embedded in larger agreements. These stand-alone agreements include environmental insurance agreements and a catchall category that this Article calls "environmental performance agreements." The performance agreement category includes agreements between private firms and agreements between private firms and nonprofit groups.

a. Environmental Insurance Agreements. — Environmental insurance policies have many of the same effects on the regulatory scheme as do streams that are expensive to treat, and is heavily impacted by environmental regulations. As a result of these characteristics, many firms decide to outsource their metal finishing to job shops.

\textsuperscript{143} For example, many large poultry processing firms have contracted with small poultry farmers to outsource poultry production. See Susan Bruninga, Water Pollution: Many More Animal Feedlots Need Permits Under Final Regulation Announced by EPA, Daily Env't Rep. (BNA) No. 242, at AA-1 (Dec. 17, 2002) ("According to the National Chicken Council, more than 90\% of broiler chicken production takes place on independent farms whose owners contract with the companies."). By entry into second-order agreements with smaller contract producers, the large processing firms have avoided triggering water pollution control requirements. See Kathy Lundy Springuel, Maryland: Maryland Agency Ends "Co-Permitting" of Poultry Processors, Farm Contractors, St. Env't Daily (BNA) No. 117, at A-8 (June 18, 2003) (reporting Maryland Department of the Environment's abandonment of efforts to establish a "co-permitting" system "that would have required major poultry processors to play a larger role in the nutrient-management activities of farmers with which they contract to raise their livestock"). Efforts to stop the use of second-order agreements to avoid water quality standards have encountered fierce resistance. See Bruninga, supra.

\textsuperscript{144} In the 1980s, large mining firms took advantage of an exemption from Surface Mining Control and Reclamation Act of 1977 (SMCRA) requirements for mines of two acres or less. See Pub. L. No. 95-87, § 528(2), 91 Stat. 514 (1977) (current version at 30 U.S.C. § 1278 (2000)). Some large firms divided coal holdings into two-acre plots and subcontracted the coal mining to independent firms on a plot-by-plot basis, repurchasing the coal after it was mined. See Lily Whiteman, Recent Efforts to Stop Abuse of SMCRA: Have They Gone Far Enough?, 20 Envtl. L. 167, 171-73 (1990) (asserting that many major corporations "hired small, independent companies to apply for mining permits and dig the coal" and "[a]fter completing the illegal extraction, the lessor bought the coal back from the company"). Other large firms formed multiple new, separately incorporated subsidiaries and conducted the mining of the two-acre plots through the subsidiaries. See id. at 172 (asserting that "companies formed shell corporations, which shared the same equipment, employees, offices, and stockholders, to unearth illegitimate pits"). After national media attention, Congress closed the two-acre loophole. See Act of May 7, 1987, Pub. L. No. 100-34, § 201(a), 101 Stat. 300, 300.
indemnities in acquisition, credit, and real estate agreements.\textsuperscript{145} The availability of insurance coverage for environmental risks has varied over time.\textsuperscript{146} Recently, insurers have introduced a wide range of new policies explicitly drafted to insure against certain types of environmental risks, and many corporate acquisition and real estate agreements now are accompanied by one or more environmental insurance policies.\textsuperscript{147} Environmental insurance policies are available to insure against liabilities arising from past or current releases of hazardous substances, cost overruns on remedial projects, and liabilities incurred by lenders.\textsuperscript{148} Firms have purchased environmental insurance to spread risks and to capture potential gains from the efficiencies generated by insurers who have experience at multiple sites and economies of scale in managing remedial matters.\textsuperscript{149}

As with acquisition and other agreements, environmental insurance agreements often create incentives for private parties to play traditional regulatory functions. Insurers often vary premiums for firms that can demonstrate compliance or overcompliance with environmental regulations.\textsuperscript{150} Environmental insurance policies also often create private obligations to comply with public regulatory standards or set more stringent standards. The prospect of higher insurance premiums and the monitoring of insureds by insurers may influence firms' implementation of environmental standards.\textsuperscript{151} Insureds have incentives to engage in pre- and post-closing self-monitoring and implementation, and insurers have in-

\textsuperscript{145} See generally Geltman, Environmental Law, supra note 72, at 931–1033 (discussing comprehensive general liability policy and process of shifting risk through insurance). Insurance is also important in other regulatory areas. See, e.g., Harter & Eads, supra note 8, at 227 (discussing influence of insurance on worker safety).


\textsuperscript{147} See Benjamin J. Richardson, Mandating Environmental Liability Insurance, 12 Duke Envtl. L. & Pol'y F. 293, 297–300 (2002) [hereinafter Richardson, Insurance] (discussing development and types of pollution liability insurance).

\textsuperscript{148} Anna Amarandos & Diana Strauss, Environmental Insurance as a Risk Management Tool, 15 Nat. Resources & Env’t 88, 89–91 (2000).

\textsuperscript{149} See Richardson, Insurance, supra note 147, at 294–95.

\textsuperscript{150} See Karkkainen, supra note 82, at 324 n.280 ("[F]irms participating in Responsible Care saw their insurance premiums fall by ten percent on average, and in some cases as much as fifty percent . . ."). Insurance rates were a motivating factor in the chemical industry's adoption of the Responsible Care environmental management program. See Gunningham, supra note 104, at 402–03.

\textsuperscript{151} Pollution liability insurance can cover fines, penalties, and punitive damages, but noncompliance is often excluded from insurance coverage, thus maintaining the incentive for compliance and compliance monitoring. Stephen M. Sommers & Michelle C. Kales, Acquiring and Disposing of Environmentally Contaminated Property, 34 Colo. Law. 11, 23 (2005). In addition, insurance can be expected to increase compliance if the insurer monitors more aggressively than the government and enforces through policy cancellation and premium adjustments. See Gunningham & Grabosky, supra note 59, at 118–20.
centives to conduct pre-closing monitoring and post-closing monitoring and enforcement.\textsuperscript{152}

Anecdotal information suggests that insurers do monitor compliance on an ongoing basis.\textsuperscript{153} For example, concerns among marine insurance underwriters about the adequacy of government inspections of vessels have led them to employ marine inspectors to survey ships that they are considering insuring.\textsuperscript{154} As with other second-order agreements, some types of environmental insurance thus may induce increases in compliance and decreases in environmentally risky behavior by firms.

b. Environmental Performance Agreements. — Private firms also reach agreements with private nonprofit groups in some cases. These environmental performance agreements often require a level of performance that equals or exceeds government regulatory requirements. The agreements occur between firms and community, national, and international nonprofit groups.

At the community level, firms have reached "good neighbor agreements" with local community groups to take particular steps to ameliorate or compensate for the risk the facility poses to the community. Good neighbor agreements often include provisions in which a firm agrees to provide information to the local community beyond that required by law, agrees to reduce emissions below legal requirements, or agrees to provide local subsidies, such as public health clinics or park facilities.\textsuperscript{155} The total number of these agreements thus far is unclear, but they number at least several dozen in the United States.\textsuperscript{156} In addition, the many industrial

\textsuperscript{152} See Clifford G. Holderness, Liability Insurers as Corporate Monitors, 10 Int'l Rev. L. & Econ. 115, 127 (1990) ("[T]he totality of the evidence supports a monitoring role for insurance companies.").

\textsuperscript{153} See Gunningham & Grabosky, supra note 59, at 118–20; see also Paul K. Freeman & Howard Kunreuther, The Roles of Insurance and Well-Specified Standards in Dealing with Environmental Risks, 17 Managerial & Decision Econ. 517, 529 (1996) ("By monitoring its insureds activity . . . insurance companies provide enormous incentives for their insureds to comply with the [environmental] standards.").

\textsuperscript{154} Gunningham & Grabosky, supra note 59, at 119.

\textsuperscript{155} See, e.g., Good Neighbor Agreement Between Stillwater Mining Co. and Northern Plains Resource Council et al. §§ 3, 4, 11 (May 8, 2000), available at http://www.northernpalns.org/pdf/Good_Neighbor_Agreement.pdf (on file with the Columbia Law Review) (requiring firm to disclose confidential information to citizens' representatives, to fund committees required by agreement, and to place conservation easements on firm property); Good Neighbor Agreement Between Union Oil Co. and Communities for a Better Environment et al. §§ 1.1, 1.2, 1.4 (Apr. 7, 1995) (on file with the Columbia Law Review) (requiring Unocal to release information, conduct health studies, and fund a medical clinic).

facilities and up to 30,000 local environmental groups in the United States suggest that there is substantial potential for growth in the number of good neighbor agreements.

Some firms have reached agreements with national nongovernmental organizations, as opposed to community groups, that set new environmental standards for the firms. Perhaps the best known of these types of agreements is one reached between McDonald's and the Environmental Defense Fund (now Environmental Defense) regarding food packaging. Similarly, some banks have made commitments to comply with the Equator Principles, which require banks to include requirements for environmental assessments in project finance loans in developing countries. Home products firms also have entered into agreements with environmental groups regarding the purchase of tropical woods.

Good neighbor agreements and agreements with national or international groups provide private nonprofit groups with contractual rights
to engage in traditional government regulatory functions. The agreements enable firms to head off community opposition to facility operations or pressure for government regulatory measures by agreeing to private standards and oversight. They also enable firms to signal management competence or social philosophy to shareholders, employees, customers, and regulators. Once again, regulatory models that overlook the effects of second-order agreements will fail to account for these influences on firm behavior.

B. The Rise of the Transactional Regulatory Lawyer

An additional indication of the potential influence of second-order agreements is the growth of the bar whose practice consists of negotiating, drafting, monitoring, and enforcing these agreements. Again, this Article turns to environmental law to demonstrate the trend. Similar activity is occurring, however, in health care, labor, and other regulatory areas.\(^{162}\)

Many environmental lawyers today practice what has become known as transactional environmental law. One might expect that the environmental practice at many corporate law firms would have atrophied in the last decade given that Congress has enacted no major federal environmental legislation since 1990 and that the Superfund litigation boom has wound down.\(^{163}\) Many law firm environmental practices did decline during the second half of the 1990s, but they have demonstrated greater resilience than one might expect.\(^{164}\) The continued viability of environmental practices can be explained in part by the growing importance of second-order agreements and the transactional practices that involve negotiating, drafting, monitoring, and enforcing them.\(^{165}\)

In fact, an analysis of the practices at the top fifty law firms in the United States ranked by profits per partner by *The American Lawyer* demonstrates the importance of the transactional environmental practice.\(^{166}\) As of 2004, all but six of the top fifty law firms stated that they have an environmental practice, and of the forty-four that have an environmental practice, the descriptions of the firm environmental practice available on the Internet for these firms indicate that all of the firms advise clients on the environmental issues associated with commercial transactions.\(^{167}\)

\(^{162}\) See, e.g., Gilson & Black, supra note 70, at 640 ("[T]he business lawyer's role is to cast a transaction in the form that minimizes the cost to the client of the variety of complex and conflicting regulatory systems that may touch on the transaction.").

\(^{163}\) See Gerrard, Trends, supra note 112, at 3.

\(^{164}\) See id. at 4 (noting that amount of transactional environmental work has continued to be high).

\(^{165}\) See id. (noting increase in transactional environmental work and agreements and enforcement that accompany it).

\(^{166}\) This analysis examined the practice descriptions of the top fifty firms in 2002 profits per partner as identified by *The American Lawyer*. See A Growing Millionaires' Club, Am. Law., July 2003, at 147, 147–49.

\(^{167}\) For the data on the top fifty firms in profits per partner for 2002, see id.
Further work will be necessary to determine the importance of these environmental transactional practices, but it is clear that these practices are widespread among the top firms.

The largely unnoticed growth in the influence of second-order agreements has generated a gap between what law students are taught and what many lawyers do. Although almost 90% of the top fifty private law firms in the country have a transactional environmental practice, only a quarter of the top nineteen law schools in the country identify the topic in descriptions of introductory or advanced environmental law classes.\(^1\)

Similarly, none of the leading environmental law casebooks gives sustained attention to the implications of second-order agreements for firm behavior and the regulatory state.\(^2\) Nor is the topic typically covered in any detail in casebooks on corporate transactions.\(^3\) Yet negotiating and


\(^3\) Casebooks on corporate acquisitions have only brief discussions of environmental matters. See, e.g., William W. Bratton, *Corporate Finance: Cases and
enforcing second-order agreements requires a deep understanding of the regulatory scheme, how it affects firm behavior, and how to bargain in its shadow. For example, a buyer who obtains representations from a seller regarding the common sense term "hazardous wastes" may be sorely disappointed to learn when he seeks to enforce the agreement that there are many "hazardous substances" that can generate substantial liability yet do not qualify as "hazardous wastes." The product of transactional environmental lawyers laboring on behalf of private clients in thousands of transactions thus raises important questions not only for legal theory, but for legal education as well.

III. Effects on the Regulatory Administrative State

The existence and influence of second-order agreements suggest that traditional accounts of the regulatory administrative state, even as updated by private governance scholars, are impoverished. Firms respond to regulatory directives not simply by seeking to influence their formation and then making a comply-or-defy decision, but by bargaining around them with other private actors in various ways. Part II demonstrated that the resulting second-order agreements are likely to have substantial effects on firm behavior and the practice of law. This Part discusses the implications for the regulatory state, focusing particularly on the effects of second-order agreements on regulatory accountability and efficacy. The effects of second-order agreements on accountability and efficacy are in large part a function of the alignment of interests between public and private actors, including both the firms that are subject to government regulations and the private entities that contract with them.

A. Accountability

Second-order agreements influence accountability at several levels: the accountability of Congress and the President to the electorate; the


172. See Kagan, supra note 4, at 2331–39 (examining transparency and responsiveness to assess accountability). For a discussion of the potential responses by Congress, courts, and agencies, see infra Part IV.

173. This approach follows roughly along the lines of microinstitutional analysis. See Rubin, New Legal Process, supra note 15, at 1425–35 (explaining methodology of institutional microanalysis). The central question in comparative institutional analysis is who is in the best position to generate a legal requirement or resolve a legal dispute. The choices typically are among three different institutions: private markets, politicians, and courts. See Komesar, supra note 88, at 55–150. Second-order agreements complicate the division of institutions by requiring consideration of the dynamic institutional interactions that occur when private parties bargain around regulatory duties.
accountability of agencies to Congress, the President, and the courts; and
the accountability of regulated firms to agencies. Second-order agree-
ments influence accountability at each of these levels and in some cases
also affect the direct accountability of regulated entities to the electorate
(e.g., through good neighbor agreements). The recent private govern-
ance scholarship has asserted that accountability can arise not only from
the formal governmental constraints on agencies, but also from the con-
straints that arise from nontraditional sources, such as contracts between
agencies and regulated parties.174

This Part argues that second-order agreements are perhaps the most
important nontraditional influence on accountability.175 Second-order
agreements alter the accountability of regulated firms to the agencies that
regulate them and induce a new set of private actors to become involved
in the regulatory scheme. These private actors affect the performance
of existing regulations and the shape of new regulations. Now indemnitors,
banks, insurers, lessors, and others have interests in implementing, creat-
ing, and avoiding regulatory standards. As a result, these institutions also
have incentives for private monitoring, enforcement, and dispute resolu-
tion. They also have incentives to lobby for or against government regu-
lation, and their private agreements also affect the public appetite for
government regulation.

1. Transparency. — Transparency facilitates accountability by provid-
ing the information necessary for the electorate and each branch of gov-
ernment to oversee regulatory activity. The existence of second-order
agreements requires that transparency be analyzed not simply in terms of
agency regulatory actions, but in terms of the actions of private entities
that are performing traditional governmental regulatory roles. The focus
here is on the extent to which these agreements affect publicly available
information regarding regulatory processes (e.g., standard setting, imple-
mentation, and enforcement) and the achievement of regulatory objec-
tives.176 The analysis suggests that the effects of second-order agreements
are not uniform: They reduce transparency in some cases and increase it
in others.

174. As Jody Freeman has noted, "[v]irtually every arrangement" included in the new
public/private hybrids she identifies involves formal agency oversight in some form, yet the
traditional means of assuring accountability do not provide meaningful constraints.
Freeman, Private Role, supra note 8, at 665. Freeman identifies "a private decisionmaker’s
internal procedural rules, its responsiveness to market pressures, its agreements or
bargains with other actors, informal norms of compliance, and third-party oversight, for
example," but she focuses in particular on the accountability that may arise from legally
enforceable contracts between agencies and regulated parties. Id. at 665–66.

175. Second-order agreements thus provide some of the incentives that reflexive law
enthusiasts assert will induce firms to act in self-reflective, self-regulatory, and ultimately
pro-environmental ways. See, e.g., Kleindorfer & Orts, supra note 157, at 160–61.

176. See Kagan, supra note 4, at 2392 ("[A] fundamental precondition of
accountability in administration [is] the degree to which the public can understand the
sources and levers of bureaucratic action.").
Second-order agreements reduce transparency in many situations. At the outset, second-order agreements reduce transparency by introducing an additional layer of institutions into the regulatory process, adding enormous complexity to the administration of the regulatory state. This complexity undermines attempts by government and the public to understand the effects of regulations on firm behavior. For example, second-order agreements that implement regulatory standards by transferring the costs of compliance often will reduce the transparency to the agency and the public of the identity of the private party that is directing environmental decisionmaking.\textsuperscript{177} The regulatory decisionmaking process of the agency itself may be no more or less transparent than it was before, but now the identity of the party calling the shots at the receiving end of the regulation may be unclear. A firm’s response to an agency enforcement action thus may depend on whether the firm is indemnified by another private firm or has procured insurance for the matter. The indemnitor or insurer may be directing the firm’s response, but that fact may be far from apparent to the agency and the public.\textsuperscript{178} For example, if an indemnity or insurance policy includes a duty to defend and indemnify in response to a civil suit but not an administrative order, a firm may have stronger incentives to resist an order than a civil suit. Insurance law in California and several other states now provides for this odd outcome.\textsuperscript{179}

In some cases, second-order agreements that create new standards also reduce transparency. When standards are created between two private firms, such as occurs when a landlord prohibits the use of a hazardous chemical by a tenant, the process of forming the standard will take place in negotiations that are almost entirely out of the public eye. Similarly, when these new private standards are enforced, the enforcement will often be through a quiet phone call from a property manager to a company representative, and more substantial disputes will often be resolved through contacts between lawyers for both parties or through private dispute resolution proceedings.\textsuperscript{180} Although standard creation in

\begin{itemize}
\item \textsuperscript{177} Empirical studies have identified a wide range of factors that appear to influence firm behavior. See discussion infra notes 287–289. Second-order agreements make predicting firm behavior more difficult. For example, an insurance policy may create an incentive in an insured not to expend funds on remediating a contaminated site until the insured is sued or is ordered to act by a regulatory agency (because of the definition of a “claim”). Alternatively, a voluntary cleanup of a contaminated site may not be an act of default under bank loan covenants, whereas receipt of a cleanup order or civil action may be; thus a debtor may have incentives to initiate voluntary cleansups.
\item \textsuperscript{178} Although the terms of an indemnity or insurance policy may be set forth clearly, the existence of an indemnity or insurance policy may not be known, at least initially, to an agency. In addition, any dispute between the insured and the insurer or indemnitor and indemnitee may take place in a private proceeding. As a result, the agency and the public will struggle to understand the firm’s behavior.
\item \textsuperscript{179} See Foster-Gardner, Inc. v. Nat'l Union Fire Ins. Co., 959 P.2d 265 (Cal. 1998) (holding that California EPA's order notifying insured of responsibility to remediate pollution not a "suit" giving rise to insurer's duty to defend).
\item \textsuperscript{180} See Winik & Vandenbergh, supra note 97, at S40.
\end{itemize}
second-order agreements among private firms thus may induce regulated firms to meet or exceed regulatory objectives, it may do so through processes and with results that are largely opaque to government and the public.

Even more problematic transparency effects arise from second-order agreements that are used for standard avoidance. The negotiations and resulting agreements between firms regarding standard avoidance are typically far from public view, but the transparency issue that occurs with second-order standard avoidance may be much more fundamental. To the extent that policymakers are captured by a special interest group, second-order agreements provide a means to reduce the transparency of special interest favors. Rather than placing an explicit provision in a statute or regulation that provides a direct, relatively obvious benefit to the special interest, elected officials can use provisions that enable parties to derive a benefit indirectly via second-order bargaining.181

Second-order standard avoidance agreements also may not be transparent to courts for several reasons. First, these agreements often will have private dispute resolution provisions, thus disputes over them by the contracting parties will not be litigated in public courts in the first place. In addition, to the extent they exploit loopholes rather than violate existing laws, they will not be the subject of government enforcement actions, even if agencies are aware of them. The lack of court decisions may undermine the ability of courts to articulate norms.182 Second, even if courts have an opportunity to review them, the public effects of these private agreements may be far from obvious, and current legal doctrines provide few avenues for courts to review these public effects. Courts may view them simply as private contractual disputes rather than as integral parts of the regulatory scheme and may apply standard contract doctrines rather than any type of greater scrutiny.

Private monitoring and enforcement also reduce transparency in several ways. The costs of private enforcement are borne by private parties using private funds, not by agencies whose budgets are submitted by the President for congressional action, and thus are less transparent than the costs of public enforcement. The lack of transparency regarding the total societal resources devoted to enforcement then influences the extent to which Congress and the President can rationally allocate public resources to regulatory agencies. Moreover, transparency regarding the effectiveness of agency enforcement is reduced because the typical ways of measuring the success of government enforcement actions (by counting the

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181. For example, when Congress enacted the Surface Mining Control and Reclamation Act, had it provided that a large firm could avoid the restrictions of the Act if it only operated on two-acre parcels, the benefit conferred to the large mining firms would have been clear. See supra note 144. It is not clear that the two-acre parcel exemption was the product of a special interest deal, but the two-acre exemption serves as an example of how such a deal might be facilitated by second-order agreements.

number of inspections, orders, civil and criminal actions, penalties recovered, etc.) capture even less of the state of enforcement and compliance than Congress, the President, and the public think they do. These traditional “beans” do not account for the hundreds of millions of dollars spent by private parties on monitoring and enforcement. It may be possible to modify government enforcement actions in ways that would provide far more overall public-private enforcement than now occurs. In the absence of measures of private as well as public monitoring and enforcement, however, the actual extent of the monitoring and enforcement induced by the regulatory state is not transparent to agencies or their overseers, much less to the electorate.

In some cases, second-order agreements also may enhance transparency. For example, enhanced transparency regarding both firm compliance and the achievement of regulatory goals may occur if pre- and post-closing monitoring and post-closing enforcement generate information that becomes publicly available. Tremendous amounts of private monitoring occur, including soil, water, and other sampling in some cases. This activity then appears to generate a substantial amount of private enforcement. The extent to which the information becomes public knowledge, however, is far less clear. In some cases, private monitoring conducted pursuant to second-order agreements may lead to knowledge of prior releases or violations that are subject to federal or state reporting requirements. Similarly, the identification of environmental matters in a representation or schedule, which in some cases may be obtained through information requests or as a part of discovery in enforcement litigation, also may become publicly available. These documents may then serve as roadmaps to government enforcers or private litigants.

Transparency also may be enhanced when firms and nonprofit groups reach second-order agreements that create new private disclosure standards. The process of arriving at a new standard, which in many cases will involve pressure from a nonprofit followed by negotiations among the parties, is likely to be relatively transparent, given the incentives of the nonprofit to provide public disclosure. The agreement reached through the negotiations also is generally likely to be publicly available. Perhaps most important, the second-order agreement itself often requires

183. See supra note 83.
184. For examples of federal laws that require reporting of past releases and violations if they are discovered, see Arnold W. Reitze & Steve Schell, Reporting Requirements for Nonroutine Hazardous Pollutant Releases under Federal Environmental Laws, 5 Envtl. L. 1 (1998) (evaluating reporting requirements).
185. See, e.g., Credit Agreement Among AGL Resources Inc., AGL Capital Corp. and Sun Trust Bank et al. Schedule 4.16 (Dec. 18, 2001), available at LexisNexis, EDGARPlus Exhibits Database (discussing status of cleanup costs for facilities). In many cases, however, parties can structure data collection in ways that do not trigger public reporting requirements. As a result, much of the information generated through private monitoring remains private.
186. See supra text accompanying notes 154–161.
additional data collection and disclosure, such as the environmental assessment process that banks have agreed to conduct by committing to the Equator Principles. Similarly, good neighbor agreements often require firms to provide more data to local communities than is required under federal or state laws. The net effect of these types of standard creation agreements is often an increase in the transparency of a firm's lending practices, toxic releases, or other actions.

In sum, substantial transparency effects can be expected from second-order agreements. Second-order agreements often render the regulatory regime less transparent, but increase transparency in some important ways as well. Additional research will be required to understand which of these effects occur in which context and the net effect on the regulatory regime.

2. Responsiveness. — Administrative law scholars have suggested that responsiveness facilitates accountability by providing the link between the electorate and agency regulatory activity.187 In this view, the electorate exerts pressure on the President, Congress, and agencies to conform agency actions to public preferences. Second-order agreements affect the extent to which the regulatory state responds to public preferences, and the analysis here examines several of the most salient effects: capture, inertia, expressive effects, and judicial oversight.

a. Capture. — Second-order agreements have mixed effects on capture, one of the principal barriers to agency responsiveness. On the one hand, the lack of transparency of second-order agreements generally, and of second-order standard avoidance agreements in particular, may facilitate capture on several levels. As discussed above, Congress, the President, and agencies may be more able to hide special interest regulatory deals behind the veil of legal requirements written to facilitate second-order transactions. As a number of scholars have noted, complex, technology-based regulations provide a fertile feeding ground for interest group capture,188 second-order agreements that enable companies to avoid standards outside of the public eye may have a similar effect.

On the other hand, to the extent capture prevents Congress or the President from acting despite public support for regulation, second-order standard setting agreements may provide the legal vehicle for the public to meet an unsatisfied demand for government action. The creation of new contractual duties may play this gap-filling function for the environ-

187. See, e.g., Kagan, supra note 4, at 2332 ("[P]residential leadership establishes an electoral link between the public and the bureaucracy, increasing the latter's responsiveness to the former."). The extent to which the administrative regulatory state should respond to public preferences is beyond the scope of this Article. For a discussion of this topic, see Bressman, supra note 3, at 469-91. This Article's approach assumes that some level of responsiveness is desirable and examines how second-order agreements influence that responsiveness.

188. See, e.g., Richard B. Stewart, Madison's Nightmare, 57 U. Chi. L. Rev. 335, 341 (1990) ("The exercise of administrative discretion is heavily influenced by organized economic and ideological interest groups . . . .").
mental regulatory regime in situations in which customers, shareholders, employees, or the local community demand better environmental performance than captured government entities require. Second-order standard creation agreements may provide a degree of certainty between the parties about the expectations for behavior and the ability to enforce those expectations. As a result, a firm may agree to a new obligation to avoid market or social sanctions, rather than regulatory sanctions. The firm’s actions may better align with public preferences than do those of government, whether the President or Congress.

Good neighbor agreements provide a good example at the local level. Recent empirical research suggests that one of the principal influences on firms’ environmental performance is a concern less about formal regulatory compliance and more about the “social license” that a facility may need to operate successfully. The social license reflects the range of ways in which the local community can influence the regulatory process (e.g., through opposition in permit proceedings), employee morale and hiring, and other areas beyond regulatory requirements. As a result, even if a firm or industry group has captured government, the local community may be able to undermine the capture by demanding higher standards and formalizing them in a second-order agreement.

Second-order agreements also may have the effect of reducing capture in other ways. To the extent regulatory functions are provided by private firms, fewer opportunities for capture should arise.

189. Peter Grabosky has noted that consumers may be more demanding than regulators. Grabosky, supra note 59, at 427 (reporting comment of employee of Swedish company that “it would be easy if we only had to cope with the regulators” because “it is the consumer’s pressure that challenges us most”).

190. This gap-filling phenomenon has been noted as a benefit of informational regulation in developing countries. See, e.g., Shakeb Afsah et al., Regulation in the Information Age: Indonesian Public Information Program for Environmental Management 5–8 (World Bank, Economics of Industrial Pollution Control Research Project Working Paper, 1997), available at http://www.worldbank.org/nipr/work_paper/govern/govern5.pdf (on file with the Columbia Law Review) (describing government-mandated public disclosure of pollution by private actors in order to provoke pressure from other private groups to lower pollution levels); see also Lee P. Breckenridge, Nonprofit Environmental Organizations and the Restructuring of Institutions for Ecosystem Management, 25 Ecology L.Q. 692, 692–700 (1999) (describing growing reliance by environmental regulators on private enforcement efforts of nonprofit environmental organizations). For example, Congress has not required domestic banks to prepare environmental assessments of the effects on the projects they finance in developing countries. If the lack of statutory action reflects the banks’ capture of Congress, second-order agreements, such as the banks’ agreement to abide by the Equator Principles, may provide a means by which public demand for environmental standards is translated into private obligations that circumvent the captured governmental body.


tion, public ends may be more cheaply attained through private law, a topic explored in Part III.B.\textsuperscript{193} The lower costs of private monitoring, enforcement, and implementation of environmental requirements may reduce firms' incentives to expend funds to capture policymakers or otherwise oppose regulatory requirements.

b. Inertia. — Although agency capture is more widely discussed, inertia may be equally responsible for mismatches between government actions and public preferences.\textsuperscript{194} To the extent agencies understand the effects of second-order agreements on private firms, they may be able to leverage agency regulations and enforcement.\textsuperscript{195} The increased monitoring and enforcement induced by some second-order agreements also may reduce government inertia by providing the time for lawmakers and regulators to focus on the remaining important sources of social harms. For example, although firms have been and will continue to be a leading source of environmental harms, many less traditional sources (e.g., small businesses, agriculture, and individuals) have gone almost unregulated in the public environmental law era.\textsuperscript{196} To the extent private monitoring and enforcement relieves some pressure on regulators, the regulators may have a greater ability to focus on the contributions of these other source categories and the steps necessary to reduce their emissions.

c. Expressive Effects. — The expressive effects of second-order agreements also may differ from those of public regulation. In turn, the differences in expressive effects may influence the responsiveness of the regulatory state. For example, whether the institution that creates and enforces an environmental requirement is public or private may affect informal norms regarding environmental protection.\textsuperscript{197} As Carol Rose has noted, both public command-and-control regulations and tort law convey "a rhetoric of responsibility."\textsuperscript{198} An executive branch action to enforce a public law, in particular a criminal law, "typically carries with it a fairly

\textsuperscript{193} See Macey, supra note 91, at 1140–43.
\textsuperscript{194} See Kagan, supra note 4, at 2263–64.
\textsuperscript{195} See infra Part III.B. Of course, since agreements often follow standard forms, firms may, at the margin, be less receptive to substantial changes in the content of regulations. On the other hand, professional rent seeking by attorneys seeking to justify additional legal work based on uncertainty in the underlying law may counteract that tendency.
high level of moral opprobrium."\textsuperscript{199} In contrast, one may often incur private law liability without triggering moral opprobrium.\textsuperscript{200} If a private party, not the state, drafted the provision from which an obligation arises or if a private party initiates a private enforcement action, a less powerful signal may be sent of the social consensus regarding the moral blameworthiness of the underlying behavior. A substantial portion of the compliance and performance of firms is the product of normative influences,\textsuperscript{201} thus the differences in the expressive effects may influence the behavior of regulated firms.

In addition, appeals to moral outrage have fueled much of the public support for environmental regulation.\textsuperscript{202} To the extent outrage is fed by media coverage of government regulatory actions, displacement of public by private regulation may reduce the demand for environmental protection in the general public. A private dispute resolution proceeding regarding whether an indemnity action covers certain remediation or compliance costs, or a public dispute between a firm and a bank or insurance company about compliance with an environmental requirement, may have little effect on public demand for environmental regulation.

The expressive implications do not all run in one direction, however. To the extent second-order agreements lead to legal actions that signal support for norms of corrective justice and do not associate environmental protection with governmental control or loss of private autonomy, public support for environmental protection measures generally may increase.\textsuperscript{203} These legal actions may be more consistent with norms of fairness and autonomy because a specific private party will have been wronged and compensated, as opposed to an action that simply responds to a requirement to protect the general welfare.

Strong government enforcement also can undermine the signaling function of cooperation and undermine prosocial norms.\textsuperscript{204} Studies suggest that environmental noncompliance often arises from the complexity of the public environmental laws and that managers who face enforcement actions where the underlying violation resulted from that complexity are likely to believe that the government enforcement violated fairness

\textsuperscript{199} Zipursky, supra note 54, at 650.
\textsuperscript{200} See id. at 651.
\textsuperscript{203} Private law is commonly thought to impinge less on individual freedom than public law. See Freeman, Private Role, supra note 8, at 588.
\textsuperscript{204} See Posner, supra note 197, at 1791 (suggesting that government enforcement weakens signal that compliers belong to desirable category of "good types").
and autonomy norms. These government enforcement actions thus may induce firm managers and employees to be less willing to comply in the absence of a threat of formal legal sanctions in the future. To the extent the enforcement of environmental laws and demands for overcompliance arise from private parties, fairness and autonomy norms may be less likely to be triggered. Many business managers may perceive market-based pressures as more legitimate than government-based pressures.

d. Judicial Oversight. — The growth of second-order agreements also may undermine the extent to which courts are able to oversee the responsiveness of the regulatory state. Although second-order agreements affect the implementation of public regulations, courts often approach them as if they were indistinct from other private agreements. For example, the Supreme Court failed to account for the public role of private agreements in the leading decision regarding private allocation of public environmental liability, *United States v. Bestfoods*. In the years following the enactment of CERCLA in 1980, firms began to incur substantial cleanup cost liabilities. Broad liability provisions and high cleanup costs induced firms to search for ways to enter into contracts to spread, reduce, or avoid these costs. Firms sought to avoid liabilities by selling assets, structuring acquisitions as asset purchases rather than mergers, or structuring and operating parent-subsidiary relationships in ways that minimized the risk to the parent.

Not surprisingly, in the 1980s and 1990s, the federal courts were called upon numerous times to interpret the effects of contract terms on CERCLA liability. Other decisions addressed related issues of corporate law, such as the effect of asset purchases on corporate successor lia-

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206. See Vandenbergh, Beyond Elegance, supra note 201, at 84–85 (citing studies that indicate resistance among managers subject to aggressive enforcement).

207. See Grabosky, supra note 59, at 437.


209. Asbestos liability, increasing regulatory-compliance costs, and other environmental costs also provided incentives. See Richardson, Insurance, supra note 147, at 297–300.

210. See, e.g., Don Grant & Andrew W. Jones, Are Subsidiaries More Prone to Pollute? New Evidence from the EPA’s Toxics Release Inventory, 84 Soc. Sci. Q. 162, 172 (2003) (concluding that TRI emissions rates of subsidiaries are significantly higher than those of other facilities).

211. See, e.g., Fisher Dev. Co. v. Boise Cascade Corp., 37 F.3d 104, 109–10 (3d Cir. 1994) (interpreting whether general release from liability was release from CERCLA liability); Niecko v. Emro Mktg. Co., 973 F.2d 1296, 1300 (6th Cir. 1992) (interpreting effect of “as is” clause in contract for sale of property on CERCLA liability).
bility and the implications of the corporate form for parent liability arising from subsidiaries. The decisions varied, but many courts signaled that they would read contractual language and contractual relationships in ways that resulted in firms, rather than government, bearing cleanup costs. In some cases, courts expressly stated that in light of the remedial goals of CERCLA they were developing what amounted to a federal common law of contracts with environmental effects. These courts viewed firms’ private contracts through the lens of their public effects, and the courts’ decisions reflected an understanding of the growing importance of second-order agreements.

The growth of this new species of federal private law came to an abrupt halt in 1998 with the Bestfoods decision. Prior to Bestfoods, several circuits read CERCLA to enable corporate parents to be held liable for the CERCLA response costs of their subsidiaries on the basis of their actual control over or authority to control the subsidiary. In Bestfoods, the EPA sued a parent corporation to recover response costs incurred during the cleanup of a wholly-owned subsidiary’s facility, but the Court concluded that parental control over a subsidiary was insufficient for the parent to incur CERCLA operator liability. In addition, the Court found nothing in CERCLA that expressly rejected the limited liability traditionally accorded to a parent corporation for the acts of its subsidiary based simply on its ownership of the shares of the subsidiary.

Although the decision can be viewed as simply a narrow interpretation of CERCLA and the effects of CERCLA on common law principles of corporate law, the important point here is that the Supreme Court declined to adopt the circuit courts’ focus on the public effects of both cor-

212. See, e.g., La.-Pac. Corp. v. Asarco, Inc., 910 F.2d 1260, 1262-65 (9th Cir. 1990) (concluding that asset purchaser was not successor for purposes of CERCLA liability).
213. See, e.g., United States v. Kayser-Roth Corp., 910 F.2d 24, 26-27 (1st Cir. 1990) (concluding that parent may have CERCLA operator or owner liability if corporate veil is pierced).
214. See id. at 26; see also Tom McMahon & Katie Moertl, The Erosion of Traditional Corporate Law Doctrines in Environmental Cases, Nat. Resources & Env't, Fall 1988, at 29, 29 (concluding that courts in environmental cases “significantly erode traditional corporate law protections of shareholders and successor corporations”).
215. See, e.g., Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91 (3d Cir. 1988) (“The meager legislative history [of CERCLA] available indicates that Congress expected the courts to develop a federal common law to supplement the statute.”); see also Stephen B. Presser, Thwarting the Killing of the Corporation: Limited Liability, Democracy, and Economics, 87 Nw. U. L. Rev. 148, 149 (1992) (examining “the plot to murder the American corporation by eroding the rule of shareholder limited liability”).
217. See Schiavone v. Pearce, 79 F.3d 248, 255 (2d Cir. 1996) (concluding that six circuits at the time allowed parents to be held directly liable because they controlled or had authority to control a subsidiary, while only two circuits limited parent liability to situations in which corporate veil could be pierced).
219. Id. at 61-63.
porate and contract law.\textsuperscript{220} These courts had begun to develop a federal common law that would increasingly force firms to internalize environmental harms otherwise externalized through contracts or changes in corporate form. In contrast, the \textit{Bestfoods} Court effectively rejected the notion that CERCLA required that corporate law—and by implication other areas affected by second-order agreements—be read to minimize the externalization of environmental liabilities.\textsuperscript{221}

In doing so, the Court expanded the ability of private firms to use postregulatory bargaining to externalize, as well as transfer, liabilities. The Court thus gave short shrift to the public effects of private second-order agreements. In the process, it reduced the responsiveness of the regulatory state by circumscribing the extent to which federal courts can police private second-order agreements that have public effects. To explore the influence of second-order agreements on the efficacy of the regulatory state, Part III.B examines cost-effectiveness and rational priority setting, and concludes that second-order agreements have both positive and negative effects.

B. \textit{Efficacy}

The legitimacy of the regulatory state is a function not only of its accountability to the electorate, but of the outcomes of the regulatory process. Perceptions that regulatory actions are arbitrary or are not achieving their objectives may be as likely to undermine legitimacy as perceptions of unaccountable regulators.\textsuperscript{222} To explore the influence of second-order agreements on the efficacy of the regulatory state, Part III.B examines two criteria: cost-effectiveness and rational priority setting.

I. \textit{Cost-Effectiveness}.—Second-order agreements may enable the regulatory state to deliver benefits at lower costs than it could deliver without them.\textsuperscript{223} Private ordering is widely regarded as more efficient than government regulation, and so long as private and public interests align, second-order agreements are likely to increase the cost-effectiveness of the regulatory regime.\textsuperscript{224}

For example, some agreements may shift the costs of implementing regulatory directives to least-cost avoiders. Others create monitoring and enforcement incentives and authority in the hands of private actors who

\textsuperscript{220} See id. at 63 ("'In order to abrogate a common-law principle, the statute must speak directly to the question addressed by the common law.'" (quoting United States v. Texas, 507 U.S. 529, 534 (1993))).


\textsuperscript{222} See, e.g., Bressman, supra note 3, at 468; Kagan, supra note 4, at 2339.

\textsuperscript{223} Cf. Robert Cooter & Thomas Ulen, Law and Economics 93–94 (3d ed. 2000) (suggesting that normative Coase Theorem holds that one should "[s]tructure the law so as to remove the impediments to private agreements").

\textsuperscript{224} See, e.g., Macey, supra note 91, at 1140–41 (noting advantages of private ordering).
are subject to market pressure to perform these tasks efficiently. Similarly, private standards are likely to be more flexible in their terms and application than government regulations, allowing for adaptation to changing conditions.\textsuperscript{225} They also tend to be more closely tailored to reflect the costs of control and the risks created by the specific behavior or site. Many of the costs that uniform government standards impose thus can be avoided. Lower private compliance costs may lead to increased compliance with government regulations, assuming that other factors remain the same.

In addition, dispute resolution between private firms pursuant to second-order agreements often may be more cost-effective than dispute resolution in public courts. Many disputes that cannot be resolved through informal contacts turn on narrow, industry-specific or field-specific technical issues. In fact, the importance of these types of issues early on generated calls for the formation of "science courts."\textsuperscript{226} To the extent private dispute resolution agreements facilitate more sophisticated analysis of technical issues or the use of mediators or adjudicators with relevant expertise, private dispute resolution may be more efficient than the use of public courts.

Finally, those second-order agreements that induce private firms to undertake public regulatory functions may enable government to leverage private actions and reduce government administrative costs. They also may reduce opportunities for bureaucratic empire building.\textsuperscript{227} Second-order agreements thus have the potential to affect both overall regulatory costs and the extent to which those costs are borne by the taxpayer.\textsuperscript{228}

Of course, these advantages are not achieved when firms are acting in ways that are contrary to public regulatory objectives. Second-order agreements that enable standard avoidance are perhaps the best example. In addition to standard avoidance agreements, standard setting agreements that have anticompetitive effects (e.g., attempts to raise costs for new market entrants through imposition of complex or stringent stan-

\textsuperscript{225} See id. at 1141-42 (arguing that private charities are more efficient than government welfare programs because they can tailor standards of eligibility to individuals in particular community).


\textsuperscript{227} See Symposium Panel II, supra note 79, at 461-62 (discussion by C. Boyden Gray).

\textsuperscript{228} The comparative advantage of private regulation may be particularly great at the international level. See Ann Florini, Business and Global Governance: The Growing Role of Corporate Codes of Conduct, Brookings Rev., Spring 2003, at 4, 5 ("A company with a brand name such as Levi Strauss or Wal-Mart effectively controls a long chain of frequently shifting suppliers based primarily in low-wage countries . . . .").
dards) will often also have costs that exceed the value of their benefits. Second-order agreements that arise from industry-wide trade groups may be particularly susceptible to anticompetitive behavior.

2. Rational Priority Setting. — One of the principal criticisms of the regulatory state, and environmental regulation in particular, is the inability of policymakers to make rational choices regarding which risks deserve the greatest expenditure of societal resources. In the last decade, the use of cost-benefit analysis and prioritization based on the comparative risks of various problems has been the focus of substantial attention. Although there is a wide divergence of views about how to account for risks that are not amenable to quantitative analysis, few disagree that rational priority setting of some sort is desirable. The private ordering that is accomplished through second-order agreements, on balance, may add efficiency, but also may complicate regulatory priority setting.

Perhaps the most important effects of second-order agreements on priority setting relate to the distribution of costs and benefits. For example, although much of the recent focus on rational regulatory prioritization focuses on reducing the aggregate risks of environmental harms to the current population, rational regulatory prioritization also involves other factors, such as the distribution of risks. A first distributional issue that receives limited attention is the intergenerational equity involved when one generation consumes irreplaceable resources or destroys environmental conditions that will be needed for future generations. On

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233. For example, some have argued that one of the most costly and least efficient provisions of the federal Superfund statute is its creation of private rights for recovery of response costs. See, e.g., Symposium Panel II, supra note 79, at 445-54 (discussion by Peter Huber). At the same time, the incentives spawned by this system are largely responsible for the proliferation of second-order agreements. See discussion supra notes 208-214.

234. But see Macey, supra note 91, at 1141 (suggesting that norms may generate distributional justice even in private ordering).

balance, private firm incentives created through second-order agree-
ments cannot be expected to reflect public preferences on these issues. Standard creation agreements between private firms and nonprofits, how-
ever, may be a vehicle through which public preferences for intergenera-
tional equity bypass government capture or inertia and are imposed on 
firms via the threat of consumer or other public pressure.236

Second-order agreements have more to offer regarding the alloca-
tion of risks among current racial, ethnic, economic, or other groups.237 Much attention has been focused on whether discriminatory motives are 
behind variations in the distribution of pollution, but in some cases ineq-
uitable distribution may arise simply from the use of broad regulatory 
standards. In these cases, second-order agreements may fill a gap left not 
because of a failure in the implementation of the regulatory regime, but 
as a part of its organic design.

As Dan Esty recently noted, environmental standards have been set 
on a broad social level, and these standards leave uncompensated those 
who are exposed to emissions that cause harms but that are nevertheless 
below established regulatory limits.238 Thus, around any factory X that 
meets the Clean Air Act regulatory standard for hazardous air pollutant Y 
there will be a group of individuals who are exposed to some meaningful 
risk from Y. Under the command-and-control system, although the regu-
lation may maximize general social welfare, those who live in the vicinity 
of factory X may suffer some meaningful, but uncompensated, harm. Pri-
ivate tort actions provide one response, but the challenges presented by 
causation and determination of damages, among others, may make tort 
remedies more available in theory than in practice.239

The emergence of good neighbor agreements suggests that these 
types of second-order agreements may be facilitating redistribution in 
the form of compensation for local communities that are bearing the bulk of 
the risks created by industrial facilities. In short, the agreements may be 
filling the gap that often exists between no socially unacceptable harm on 
the one hand and no uncompensated individual harm on the other. New 
developments in information technology may make compensation 
through second-order agreements increasingly possible.240 If true, then

236. See id. at 690 (noting that markets are unable to reflect preferences of future 
generations).
237. See Vicki Been, Locally Undesirable Land Uses in Minority Neighborhoods: 
Disproportionate Siting or Market Dynamics?, 103 Yale L.J. 1383, 1392–97 (1994) 
(examining racial and economic disparities in siting of environmentally risky facilities); 
Richard J. Lazarus, Pursuing “Environmental Justice”: The Distributional Effects of 
Environmental Protection, 87 Nw. U. L. Rev. 787, 792–807 (1993) (examining racial and 
economic distribution of environmental benefits and burdens).
239. See James E. Krier & Stewart J. Schwab, Property Rules and Liability Rules: The 
240. See Esty, supra note 49, at 153 (arguing that compensation to pollution victims 
becomes feasible when transaction costs, including information costs, decrease).
the use of these agreements may proliferate in situations where individuals believe they have suffered some harm but where their claims are unlikely to form the basis for a successful tort action.

IV. THE PATH FORWARD

The complex effects of second-order agreements on the regulatory state make the path forward equally complex. One lesson is straightforward: As private governance scholars intuit, we should assess the constraints on and performance of the regulatory state in the aggregate. The private governance scholars have noted that government-private contracts and other public/private hybrids induce private parties to play regulatory roles, making a singular focus on government incomplete.

This Article has argued that we must include not only agreements to which the government is a party, but also those between private parties.

Even if we adopt an approach to evaluating the performance of the regulatory state that accounts for second-order agreements, we will face a daunting task in delineating when government should encourage these agreements. In some cases, second-order agreements simply supplement government regulation. In other cases, they displace or undermine government regulation. Where private incentives align with public incentives, second-order agreements may enhance the overall accountability and efficacy of regulation. In other cases, the incentives may be mixed, or the agreements may present tradeoffs. For example, agreements that increase efficacy (e.g., by inducing private monitoring) may reduce accountability (e.g., by displacing public monitoring).

A mechanistic approach to second-order agreements might lead us simply to mirror the principles commonly used in administrative law. To enhance accountability, we might impose public requirements on private transactions, such as stringent disclosure requirements on private agreements and the information that they generate. We might prohibit agreements that facilitate capture. Similarly, we might increase efficacy by barring agreements that fail social cost-benefit assessments when externalized costs are included or by subjecting them to rational prioritization based on the public risks they create.

Most of these approaches are implausible from a political or practical standpoint, which suggests that we must seek nontraditional means of ensuring accountability and efficacy. Instead, we might look to comparative microinstitutional analysis. Such analysis requires identifying the

241. See Freeman, Private Role, supra note 8, at 549.
242. See supra notes 34-41 and accompanying text.
243. Private governance scholars have only mentioned private-private agreements in passing. See, e.g., Freeman, Private Role, supra note 8, at 665 (noting that "agreements or bargains with other actors" might constrain private actors).
244. See, e.g., Rubin, New Legal Process, supra note 15, at 1413-16 (describing new institutional economics).
relevant categories of second-order agreements and the parties that have a stake in regulatory outcomes by virtue of those agreements, assessing the extent to which the agreements displace versus supplement government regulations, and evaluating the extent to which the interests of the parties to the agreements align with public interests. This analysis begins to suggest a number of moves that government actors (Congress, the President, the courts, and agencies) could make. Several of those moves are sketched below.

A. Congress and the President

1. System-Level Accountability: Measuring and Steering the Performance of Agencies. — Both Congress and the President typically seek to hold agencies accountable by evaluating quantitative measures of agency activity—the number of major rulemakings or enforcement actions conducted, the size of agency enforcement staffs and budgets, the total number of enforcement actions taken, the magnitude of penalties collected, and similar measures—rather than of the underlying social conditions to which the agency action is directed. Second-order agreements influence the outcomes of public regulatory goals—the socially desired conditions—but their influence is largely missed by the traditional measures of agency accountability. Furthermore, second-order agreements induce changes in firm regulatory activities, yet Congress and the President monitor agency regulatory activities. As a result, second-order agreements can have substantial effects on whether regulatory objectives are achieved, but function largely off the radar screen of Congress and the President, the two branches of government directly accountable to the electorate.


246. See, e.g., Daniel A. Farber, Whither Socialism?, 73 Denv. U. L. Rev. 1011, 1014 (1996) (“[W]e need to do something [in a private law scheme] that we do poorly even in public law . . . which is to monitor the outcomes in some systematic way. It's actually rather shocking how badly we do that in public law.”).

247. In some cases, second-order agreements may accelerate achievement of desired social conditions in ways that are not transparent to Congress and the President. For example, the number of public enforcement actions may fall, yet skillful leveraging of these public actions may induce a wave of private enforcement actions (ranging from telephone calls from loan officers to cancellation of agreements or triggering of formal dispute resolution proceedings) that are conducted out of the public eye. Second-order agreements also may induce overestimates of regulatory success. For example, the EPA reports to Congress on hazardous waste generation on a biennial basis, using waste generation reports the EPA receives from regulated facilities. See 40 C.F.R. § 262.41(a) (2004). Yet the hazardous waste generation that these facilities report to the EPA may fall in a given year because the firms subject to reporting requirements entered into agreements to shift hazardous waste generation to small firms. See supra note 138 and accompanying text.
The existence of second-order agreements underscores the need for Congress and the President to focus on system-level accountability and to create accountability measures that assess achievement of overall regulatory objectives or social conditions, in addition to agency regulatory activity. System-level performance measurement is difficult to achieve and is subject to confounding variables, and over the years Congress and the President have taken inconsistent steps in this direction. For example, Congress has enacted the Government Performance and Results Act, which requires agencies to develop (and design programs to achieve) indicators of their performance. Yet the indicators developed to date often relate more to agency activity levels than to social conditions.

Similarly, the National Environmental Policy Act of 1969 (NEPA) required the White House Council on Environmental Quality (CEQ) to report annually to Congress and the President on the state of the environment. The annual reports provided a valuable baseline for assessing whether the environmental regulatory scheme was achieving societal goals. Yet in a rush to reduce the size of government, in 1996 Congress added language to an appropriations bill that removed dozens of statutory requirements for agencies to report to Congress, including the NEPA report. The CEQ then took the opportunity to stop producing the report altogether, even though a separate provision of NEPA arguably still requires an annual report to the President. Ironically, the NEPA report and similar government reports may be necessary to increase the efficiency and reduce the size of regulatory agencies. In any event, second-order agreements highlight the need for these types of social condition-based performance measures.

Once system-level measures are in place, Congress and the President will be in a better position to oversee agency action. Congress will be in a better position to use the budget process and oversight hearings. The

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250. National Environmental Policy Act of 1969, Pub. L. No. 91-190, § 201, 83 Stat. 852, 854 (1970) (repealed 2000) (requiring President to transmit to Congress an Environmental Quality Report which shall set forth "(1) the status and condition of the major natural, manmade, or altered environmental classes of the Nation, including, but not limited to, the air, the aquatic . . . and the terrestrial environment . . . ; (2) current and foreseeable trends in the quality, management and utilization of such environments").


252. See National Environmental Policy Act § 204(7), 83 Stat. at 855 (requiring Council "to report at least once each year to the President on the state and condition of the environment").
President also will be in a better position to make budget and regulatory risk prioritization decisions and to evaluate the effectiveness of agency actions. Equally important, the electorate will be in a better position to understand and influence Congress, the President, and the agencies directly. Although public understanding of technical data is often limited, the media and interest groups have incentives to facilitate the distribution and evaluation of system-level reports regarding changes in social conditions.253

2. Activity-Level Accountability: Measuring and Steering the Performance of Regulated Firms. — Similar steps may be possible to increase activity- or firm-level accountability. As we have seen, second-order standard avoidance agreements can reduce the transparency, and thus the accountability, of firms to agencies. For example, the current environmental regulatory regime typically imposes hazardous waste reporting and handling requirements on "generators" and imposes toxic chemical release reporting requirements on the "owners" or "operators" of facilities.254 Firms have incentives to bargain around these regulatory requirements to externalize environmental harms and to restrict the public disclosure of polluting activity.255 Large firms can contract out production to small firms that qualify for statutory exemptions for hazardous waste reporting and handling. Large firms also can contract out production to small firms to avoid toxic chemical release reporting requirements. These types of second-order agreements enable firms to externalize environmental harms and reduce the amount of publicly available information about the quantity of industrial pollutants generated and released.

Firms also may use second-order agreements to avoid reporting obligations that might otherwise arise during corporate acquisitions. The seller in a corporate acquisition has incentives to control the sampling that a buyer may want conducted during preacquisition diligence. Yet the seller, which is often subject to reporting obligations as the owner or operator of a facility, may agree to have the buyer conduct the sampling. The buyer, which is neither the owner nor the operator of the facility, may not have reporting obligations in the event contamination is detected. Instead, the buyer may simply decline to proceed with the transaction without providing the data to the seller. Again, by structuring ac-

253. An example of an additional statutory scheme that involves the collection and publication of data from which the public and policymakers can infer whether the regulatory regime, broadly construed, is meeting its objectives is the TRI. See Emergency Planning and Community Right-to-Know Act of 1986 § 313, 42 U.S.C. § 11023; Karkkainen, supra note 82, at 259-63.

254. See supra text accompanying note 139.

255. Federal statutory requirements limit the parties obligated to report releases of hazardous substances. See 42 U.S.C. § 11004(a) (requiring release reporting by "owner or operator of the facility" from which release has occurred); id. § 9603(a) (requiring release reporting by "[a]ny person in charge of a vessel or an offshore or an onshore facility").

256. See supra notes 136 and 140 and accompanying text.
tivities through second-order agreements, the firms may avoid statutory reporting obligations.

Congressional action could remedy many of these uses of second-order agreements. For example, it may be possible to add to the definitions of regulatory targets in some programs to supplement facility- or operator-based approaches with ones that also regulate based on a firm's relationship to a product or activity. Contracting out a process that releases toxic chemicals thus would not enable a firm to avoid reporting the release of those chemicals. Similarly, to account for the development of information in acquisitions and other corporate transactions, Congress could require disclosure of environmental information not just based on who is in charge of a facility, but based on possession of certain types of information.

Whether Congress should take these steps is a far more difficult matter. Although in some cases second-order agreements may enable firms to externalize environmental harms or keep information out of the public domain, restricting private contracting and creating broader disclosure requirements obviously will have costs as well. The costs of requiring regulators to police private contracting are likely to be high. In addition, broader disclosure requirements for firms engaged in commercial transactions might generate more disclosure of the information generated, but they also might discourage the generation of information in the first place, undermining the substantial private monitoring that now occurs. Assessing the optimal balance between private ordering and public intervention in these situations will require further research. Nevertheless, as the effects of second-order agreements become better understood, Congress may be able to draft language that accounts for the effects of post-regulatory private bargaining without being unduly burdensome. Although any new requirements would create standards around which parties could bargain, skillfully drafted activity-level requirements may reduce the ability of firms to use second-order agreements to avoid regulatory requirements.

B. The Judiciary

Courts can influence the effects of second-order agreements on the regulatory state in a variety of ways. Scholars differ on the appropriate

257. For example, the TRI now only requires toxic chemical reporting from facilities that meet certain requirements. See supra notes 140–141 and accompanying text. If TRI required the manufacturer to report all toxic chemical releases above a particular threshold from toxics used in the manufacture of a particular product, the characteristics of the facility and the legal relationship between the manufacturer and the business entities that contributed to the manufacture of the product would no longer be a means by which second-order standard avoidance agreements could be drafted.

258. See supra note 139 and accompanying text.
role of the courts in the regulatory state.\textsuperscript{259} This Part focuses on three areas worthy of further study: oversight of agency rulemaking, review of the private disputes regarding second-order agreements that are litigated in public courts, and statutory interpretation.

Judicial review of agency rulemaking could account for the influence of second-order agreements. Hard look review of agency rulemaking currently requires an agency to demonstrate that it has engaged in a deliberative regulatory process, including examination of the relevant data, careful consideration of statutorily relevant factors, consideration of all important aspects of a problem, and provision of a satisfactory explanation for its action.\textsuperscript{260} As endorsed by the Supreme Court's decision in \textit{Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co.}, the hard look doctrine enables courts to require reasoned decision-making by agencies.\textsuperscript{261} By forcing agencies to provide a satisfactory explanation for their actions, the hard look doctrine enables courts to reduce the incentives agencies face to advance private over public interests.\textsuperscript{262}

The previous discussion of second-order standard avoidance agreements suggests that agencies may not always advance private over public interests through explicit regulatory exemptions. Instead, agencies may advance private interests by drafting regulations that enable favored groups to avoid regulatory requirements through second-order agreements. For example, a regulation that imposes environmental standards on an industrial activity based on a size requirement may be easily avoided by subcontracting the regulated activity into smaller units. Following the hard look doctrine, a court could conclude that an agency that has failed to examine the effects of second-order agreements on the implementation of a regulation has failed to consider all important as-

\textsuperscript{259} See, e.g., Bressman, supra note 3, at 527–33 (contrasting approaches to judicial oversight based on differing views of importance of political accountability and administrative arbitrariness).

\textsuperscript{260} See, e.g., \textit{Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.}, 463 U.S. 29, 43 (1983); see also Cass R. Sunstein, Deregulation and the Hard-Look Doctrine, 1983 Sup. Ct. Rev. 177, 182 ("All of these [hard look doctrine] developments can be understood as an effort to ensure that the agency's decision was a 'reasoned' exercise of discretion and not merely a response to political pressures.").

\textsuperscript{261} See 463 U.S. at 43 (requiring agency to "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made'" (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962))).

\textsuperscript{262} See, e.g., Bressman, supra note 3, at 528 n.313 (noting that hard look doctrine "tends to inhibit decisions that are precisely calculated to advance private interests or agency objectives at public expense"). In addition, courts arguably already police congressional behavior by subjecting statutes that reflect special interest deals to heightened scrutiny. See, e.g., Cass R. Sunstein, Naked Preferences and the Constitution, 84 Colum. L. Rev. 1689, 1704–27 (1984) (reviewing judicial scrutiny under dormant Commerce, Privileges and Immunities, Equal Protection, Due Process, Contracts, and Eminent Domain Clauses).
pects of a problem, and the court could require that the outcomes of regulations, after consideration of these effects, not be arbitrary. Although adding to the burden agencies face in justifying their decision-making can cause ossification of the rulemaking process, the benefits of inducing agencies to consider the second-order effects of their regulatory directives and the occasional identification of a hidden favor may well justify the administrative costs.

Courts also could account for the public effects of second-order agreements when resolving disputes over the interpretation and enforceability of these agreements. Even though the agreements are formed between private parties, the agreements often have important public effects. In some cases, the agreements may enable firms to avoid reporting and pollution control requirements. In other cases, such as those involving environmental indemnities, the agreements may determine whether an environmental cleanup will be conducted with private or public funds. Private parties seek judicial decisions on matters ranging from the enforceability of these agreements to the meaning of various provisions. Courts already take the public effects of private agreements into account in a variety of areas and could do so regarding these types of second-order agreements as well. For example, courts could subject regulatory avoidance agreements to heightened scrutiny. Greater judicial scrutiny would have substantial government and private costs, but it would reflect the public effects of these private agreements.

Courts also could interpret existing statutes in ways that bolster incentives for the creation of socially beneficial second-order agreements. In that light, the Supreme Court's recent narrow interpretation of CERCLA section 113(f) in Cooper Industries, Inc. v. Aviall Services, Inc. demonstrates a particular lack of concern for the role of private bargaining and private incentives in environmental law. For nearly twenty years, federal courts had almost uniformly assumed that CERCLA section 113(f) allowed a private party to sue other parties for contribution after the private party conducted a voluntary Superfund site cleanup. The risk that a private party will act in this way under section 113(f) is an

263. See Motor Vehicle Mfs., 463 U.S. at 45 (noting that agency rule would be arbitrary and capricious if agency "entirely failed to consider an important aspect of the problem"); cf. Jim Rossi, Bargaining in the Shadow of Administrative Procedure, 51 Duke L.J. 1015, 1050–57 (2001) (arguing that hard look review should examine effects of private settlement on content of regulations).


265. See E. Allan Farnsworth, Contracts § 5.2 (4th ed. 2004) (noting judicially developed doctrines for denying enforcement of contracts based on public policy); see also Morris R. Cohen, The Basis of Contract, 46 Harv. L. Rev. 553, 562 (1933) ("[A] contract . . . cannot be said to be generally devoid of all public interest.").


267. See Aviall Servs., Inc. v. Cooper Indus., Inc., 312 F.3d 677, 688 n.21 (5th Cir. 2002) (en banc) (citing eight circuits that had interpreted CERCLA to allow contribution
important driver for the explosion of private environmental second-order agreements discussed in this Article. Without noting these effects, however, the Supreme Court recently adopted—at the urging of the Solicitor General and with almost no amicus opposition by environmental groups—a reading of section 113(f) that will preclude private parties that conduct voluntary cleanup actions from recovering other contributors' share of the cleanup costs.\textsuperscript{268} Under CERCLA, in the absence of a section 113(f) private right of action, firms will only face a risk of bearing cleanup costs if a government agency initiates an enforcement action.\textsuperscript{269} The result is that far fewer Superfund cleanup actions will occur and that the public fisc will bear the enforcement costs of those that do.

In sum, the recognition that private second-order agreements have important public regulatory effects could induce courts to account for these public effects in a variety of ways. Judicial involvement could occur through review of agency rulemakings, interpretation of second-order agreement provisions in private disputes, and interpretation of statutes that achieve statutory goals in part through their influence on second-order agreements. In each case, courts could improve the accountability and efficacy of the regulatory regime if their decisions reflected an understanding of the public effects of private second-order agreements.

C. Agencies

A better understanding of second-order agreements also could enhance agency decisionmaking. As an initial step, whether required by courts or simply as a matter of good government, agencies could assess the potential effects of second-order agreements on firms' responses to regulation and draft regulations in ways that will enhance desired effects and discourage others.\textsuperscript{270} Although the EPA and other agencies are re-
required to conduct cost-benefit analyses of major regulations and policies, these analyses typically do not assess the effects of second-order agreements on benefits or costs. Regulations that induce private oversight of regulated firms (e.g., by creditors and landlords) are likely to generate higher compliance rates (and thus increased environmental benefits and compliance costs) than regulations that do not induce private oversight. Yet cost-benefit analyses typically assume a fixed rate of compliance (often full compliance) by regulated firms. If regulatory options differ in the extent to which they generate private monitoring and enforcement arising from second-order agreements, however, the resulting differences in compliance rates will be overlooked.

Similarly, ex ante EPA estimates of the expected costs of regulations often have exceeded the actual costs. If least-cost avoiders are acquiring firms, business units, or facilities with high compliance costs, they may be reducing the costs of regulations. For example, in an industry sector that is about to face new environmental compliance costs, a firm that has access to better technology or has a better managed environmental compliance program may acquire a firm that will incur higher compliance costs. Yet this phenomenon remains unexplored. On the benefit side, the EPA may underestimate the environmental benefits of regulations and programs if it does not account for the influence of second-order agreements on firm behavior, such as the private monitoring, enforcement, and implementation that occur as a result of acquisitions, requirements such as those included in the New Jersey Industrial Site Recovery Act (ISRA), N.J. Stat. Ann. § 13:1K-6 to 13:1K-18 (West 2003), to impose obligations upon permit transfer, see Gerrard, Proposal, supra note 73, at 14.


274. See, e.g., Harrington et al., supra note 272, at 309–13 (listing hypotheses regarding why ex post costs often are lower than ex ante cost estimates, but not including influence of firm acquisitions or other changes in institutional arrangements that lead to more efficient compliance).
Credit agreements, and real estate transactions. Alternatively, the EPA may overstate the environmental benefits if the analysis does not account for second-order standard avoidance agreements.

The most promising opportunities will arise, however, in enforcement strategy and the exercise of agency enforcement discretion. Agency resources could be redirected from areas in which private enforcement arising from second-order agreements is vigorous to those in which it is less so. When government enforcement actions are taken, the actions could be structured to facilitate private enforcement. For example, agencies could structure enforcement actions to take advantage of the form of government enforcement action (e.g., a civil suit or administrative order) that is most likely to trigger underlying insurance or indemnity rights. Agencies could notify creditors or landlords directly when enforcement actions are taken. Agencies also could opt to take small numbers of actions that seek large penalties rather than large numbers of actions that seek small penalties. This strategy may leverage private enforcement because many second-order agreements require sellers, debtors, and tenants to report material violations of law to buyers, lenders, and landlords, but these agreements often do not require reporting of nonmaterial violations. If the larger penalty amounts exceed materiality thresholds, the public enforcement actions framed in this way will generate additional private enforcement.

CONCLUSION

The recognition of private second-order regulatory agreements requires a new, more dynamic account of regulation and suggests curricular reforms as well as a broad research agenda. Not surprisingly, law school curricula track academic scholarship. The lack of focus on second-order agreements in law school regulatory curricula leaves students


277. See Johnston, supra note 59, at 3 (discussing "transactional multiplier").
with an incomplete view of the forces that influence corporate behavior. For students who will ultimately practice in regulatory fields, whether for private firms, government, or nonprofit groups, a hole now exists in their understanding of their field. The hole is not in an obscure niche of law practice but is at the "red hot core" of what many regulatory lawyers do every day. Although new lawyers can quickly come up to speed on the mechanics of second-order agreements through the plethora of continuing legal education programs, the absence of academic training leaves a gap in their ability to bring to bear more transcendent, theoretical approaches to their practice. This Article is a first step in closing that gap.

The dynamism introduced into the regulatory scheme by second-order agreements also requires theoretical and empirical research to develop a more sophisticated understanding of how firms respond to regulation and how that response affects government and the electorate. A first step on the empirical front is to understand just how widespread second-order agreements are and how they affect firm behavior in a variety of settings. The discussion in Part II demonstrates the extent and potential influence of second-order agreements for the environmental regulatory regime. A brief review of the documents included in the data set of acquisition, lease, and credit agreements suggests that second-order agreements also are likely to be influential in other heavily regulated areas, such as labor and employment, worker safety, food and drug

278. Cf. Gilson, supra note 70, at 303-06 (advocating for changes in legal education to reflect developments in practice and theory of business acquisitions).


280. See, e.g., Credit Agreement Between Numatics Ltd. and Lasalle Business Credit § 9(j) (Nov. 28, 2001), available at LexisNexis, EDGARPlus Exhibits Database (providing that employees of borrower have no collective bargaining agreement and that borrower has not suffered any material labor difficulty in last five years); Amended and Restated Loan and Security Agreement Between Color Spot Nurseries, Inc. and Fleet Capital Corp. § 7.1.18 (Nov. 20, 2001), available at LexisNexis, EDGARPlus Exhibits Database ("No Inventory has been produced in violation of the Fair Labor Standards Act . . . ."); Credit Agreement Among Insight Health Services Acquisition Corp. et al. and Bank of America, N.A. et al. § 6.24 (Oct. 17, 2001), available at LexisNexis, EDGARPlus Exhibits Database ("There are no collective bargaining agreements or Multiemployer Plans covering the employees . . . and . . . none of the [borrowers] has suffered any strikes, walkouts, work stoppages or other material labor difficulty within the last five years."); id. § 6.12 (providing representation regarding Employee Retirement Income Security Act compliance).

281. See, e.g., DPT Agreement, supra note 70, § 3.21 (including representation that "Seller has complied in all material respects with . . . Occupational Safety and Health Law"); BJ Services Agreement, supra note 61, §§ 1.01, 5.08 (defining "Environmental Laws" to mean "all Laws relating to environmental, health, safety and land use matters" and including representation by borrower regarding compliance with "Environmental Laws").
Identifying the extent and influence of second-order agreements in each of these areas will require further study. A second step on the empirical front is to explore the extent of the influence that second-order agreements have on firm behavior. There is ample reason to believe that these agreements influence firm environmental behavior, and they may provide a more satisfying explanation of a perennial puzzle about the behavior of corporate firms: why many firms comply with public regulations most of the time. Given the very low mean and median fines in many regulatory programs, deterrence theory appears to predict that firms will comply at lower levels than are typically observed in empirical studies. Other market effects, social norms, and private codes of conduct may explain part of the excess observed

282. See, e.g., Loan Agreement Between Discovery Laboratories and Pharmabio Development, Inc. § 5.01 & Exhibit A (Dec. 10, 2001), available at LexisNexis, EDGARPlus Exhibits Database (including a representation that borrower is in compliance with Federal Food, Drug, and Cosmetic Act).

283. See, e.g., Lease Agreement Between Certain Affiliates of Senior Housing Properties Trust and FS Tenant Holding Co. Trust et al. § 4.3 (Jan. 11, 2002), available at LexisNexis, EDGARPlus Exhibits Database (requiring Medicaid and Medicare compliance).

284. See, e.g., Partnership Interest and Asset Purchase Agreement Between Dobson Cellular Systems, Inc. and Cellco Partnership § 5.7 (Dec. 6, 2001), available at LexisNexis, EDGARPlus Exhibits Database (providing representation of seller regarding compliance with Federal Communications Commission requirements).


287. See Mark A. Cohen, Monitoring and Enforcement of Environmental Policy, in 3 International Yearbook of Environmental and Resource Economics 44, 47 n.6 (Henk Folmer & Tom Tietenberg eds., 1999) (noting concept that compliance rates are higher than predicted is a "stylized fact"). Given the low rates of inspection and low mean and median fines for noncompliance, numerous studies have suggested that firm compliance rates should be quite low, even accounting for tit-for-tat government enforcement strategies. See Winston Harrington, Enforcement Leverage When Penalties Are Restricted, 37 J. Pub. Econ. 29, 29–31 (1988) (presenting seemingly contradictory data on underenforcement of regulations and high compliance levels); Clifford Rechtschaffen, Deterrence vs. Cooperation and the Evolving Theory of Environmental Enforcement, 71 S. Cal. L. Rev. 1181, 1205–12 (1998) (discussing mixed data on enforcement and compliance).

288. See Stewart, New Generation, supra note 50, at 131 (discussing role of self-regulation in environmental regulatory system); Vandenbergh, Beyond Elegance, supra note 201, at 76–78 (discussing effect of norms on behavior of corporate managers).

289. It is unclear whether private codes of conduct increase firm compliance rates. Compare Gunningham, supra note 104, at 352 (concluding that chemical industry self-regulation program is "not appropriate for use as a 'stand alone' or single instrument of environmental protection" but that it "may still achieve far more than conventional..."
compliance, but second-order agreements suggest an additional explanation: Many firms may be complying not only because they perceive a risk of government enforcement of a public regulatory duty, but because they also perceive a risk of private enforcement of the public regulatory duty or of additional private duties.

In addition, second-order agreements may help explain why firms in some cases exceed regulatory requirements. Second-order agreements are a vehicle through which command-and-control, market, and social incentives are channeled into legal requirements between private parties. By crystallizing these incentives and creating explicit legal authority in private parties to monitor, enforce, and create standards, many second-order agreements may increase the pressures for social-regarding behavior by private firms. Second-order agreements thus may induce firms to self-reflect and self-regulate. When viewed in this light, the prospects for the private accountability desired by private governance advocates become somewhat brighter.291

An additional step in the research on second-order agreements will involve both empirical and theoretical examinations of how changes in firm behavior arising from these agreements affect the regulatory state. Public and private law scholars will need to be engaged in this work. Administrative law scholars will need to examine the effects of these purely private agreements on the public regulatory scheme. Private law scholars will need to examine whether the public effects of these private agreements warrant distinct treatment from other purely private agreements. This Article has not attempted to identify every implication for academics regulatory approaches"), with Andrew A. King & Michael J. Lenox, Industry Self-Regulation Without Sanctions: The Chemical Industry's Responsible Care Program, 43 Acad. Mgmt. J. 698, 713 (2000) (concluding that members of chemical industry self-regulation program "do not improve faster than nonmembers").

290. Many firms participate in voluntary reduction programs. See Esty, supra note 49, at 145 n.93. Firm overcompliance appears to be common, and studies of firm participation in government voluntary reduction programs have found only a loose correspondence with variables (e.g., heavy reliance on consumer product sales) that one might assume are associated with an economic return from overcompliance. See, e.g., Seema Arora & Timothy N. Cason, Why Do Firms Volunteer to Exceed Environmental Regulations? Understanding Participation in EPA's 33/50 Program, 72 Land Econ. 413, 426 (1996) (concluding that EPA voluntary program participants were more likely to be in industries with greater consumer contact).

291. Reflexive and informational regulatory enthusiasts assume the incentives exist for firms to engage in social-regarding behavior. The looming question is what will provide sufficient incentives when social and profit maximization goals do not align. If command-and-control regulation is deemphasized, why would a profit-maximizing firm respond to information by self-reflecting or self-regulating? A range of nonregulatory incentives have been offered, but there is a lingering sense among many scholars that the picture is incomplete and thus that these strategies risk creating suboptimal levels of regulatory performance by firms. See Stewart, New Generation, supra note 50, at 133 (noting that advocates of reflexive and informal regulatory techniques believe these should be used in combination with, rather than instead of, legal controls on conduct).
and policymakers but to suggest that our understanding of regulation will be incomplete until we account for the private bargaining that occurs around public regulations.