Report for Recommendation 94-1

Federal Agency Use of Audited Self-Regulation as a Regulatory Technique

Douglas C. Michael
Associate Professor
University of Kentucky College of Law

Table of Contents

Executive Summary

Many federal government programs make use of a regulatory technique known as "audited self-regulation." This is defined as congressional or agency delegation of power to a private self-regulatory organization to implement and enforce laws or agency regulations with respect to the regulated entities, with powers of review and independent action retained by the agency. Each agency's use of audited self-regulation has evolved independently, and together they are varied as the federal government itself. The purpose of this study is a comprehensive review of the major programs of audited self-regulation in selected executive departments and independent agencies, to determine if audited self-regulation as currently practiced is a beneficial regulatory technique and, if so, how it can be expanded or encouraged.

The literature of regulatory reform suggests several advantages of self-regulation. It should yield better rules because the rules are written by those directly involved in the regulated activity and thus have a better knowledge of the activity. The rules should be less rigid because they can be tailored to the industry or group, as opposed to federal rules of general application. And because the rules would be perceived by the regulated entities as more sensible and flexible, there would be a greater incentive to comply. There are some suggestions that costs of regulation to the government would be lower, and that even the overall combined costs would be lower because self-interested groups can regulate more efficiently. Finally, this type of regulation is more suited to modern laws and recent developments in regulatory theory which advocate replacement in many instances of old "command-and-control" regulation with new standards based on performance or outputs.

On the other hand, the literature also recognizes the potential disadvantages. Self-regulation clearly raises the possibility that the rules will be tailored more to the regulated entities' self-interest than the public interest. The enforcement may be varied and unpredictable, because a self-regulatory system has a greater opportunity for the regulators to exercise unreviewable discretion. And in certain subject areas, the concept of self-regulation is simply politically unacceptable.

Applying this literature, this study distills the elements of a successful self-regulatory program. The industry should be one which has members organized, expert, and motivated to comply. The regulation should be one which requires individualized application of general rules. The agency should be one with expertise in its regulatory subject and the skills to effectively audit the self-regulatory activity. In addition, the Constitution and the antitrust laws require a well-developed system of prior notice and opportunity for hearing in rulemaking and adjudication, and plenary control by the agency over all participants in the

regulatory process. Although liability for tort damages on the part of the self-regulatory organization is a concern, the potential for liability is likely limited, and does not have a great impact on the design of a regulatory program.

With these theoretical elements of a successful program in hand, this study next surveys fourteen executive departments and independent agencies. This yields, from seven of those regulators, twelve examples of audited self-regulation. The programs regulate such diverse activities and subjects as student loans, health care quality, stock exchanges, agricultural marketing, nuclear power, and medical testing laboratories.

The findings from these surveys confirm most of the advantages and elements of self-regulation found in the literature; there are two exceptions worth noting. First, most successful programs exist in areas of regulation restricted to single industries, and not across the economy as the literature suggests. Second, claims of cost savings in theory are not substantiated in practice. Although agencies use cost savings as a justification for individual self-regulation, documented cost savings are rare.

The findings from the surveys even more strongly confirm the essential elements for successful programs. By and large, all are present in each; and in the case of programs which were terminated, aborted, or never implemented, we can identify at least one of the essential elements as missing.

The study concludes that audited self-regulation is a valuable regulatory technique, and that it should be systematically considered by departments and agencies when developing or revising regulatory programs. Nonetheless, mandating such consideration by regulators will likely yield poor results, since agencies predisposed to regulatory reform will do so in any event. Therefore, the study concludes that further publicity be given to audited self-regulation: the essential prerequisite elements of the industry, agency and regulation, and the required elements of fair process for a successful program. Once regulators are aware of the utility of this regulatory technique, they may put it to profitable use, simultaneously enhancing their efficiency as well as the public interest.

Introduction

"Self-regulation" seems at first blush to be self-contradicting.[1] If government regulation of an industry or problem[2] is considered necessary, how can that responsibility be then returned to those from whom it was taken? Notwithstanding this apparent contradiction, audited self-regulation[3] is successfully used by federal regulatory agencies. However, it is apparently adopted on an *ad hoc* basis: in one industry or application but not in another which possesses similar characteristics.[4] This study reviews and evaluates these previously uncollected efforts in audited self-regulation to evaluate the general usefulness of this regulatory technique across industries or applications.[5] These insights would be relevant not only to reform of current federal agency

---

[1]*See* BARRY M. MITNICK, THE POLITICAL ECONOMY OF REGULATION 15 (1980) (noting that self-regulation "would seem to be a paradoxically titled form").

[2]"Government regulation," for purposes of this study, is defined as federal government regulation of an entity by legislation and implementing regulations of either an independent or Executive Branch agency. Government regulation as so defined is usually created to cover all aspects of a particular industry (banking, meat packing) or an identified problem or issue across all industries (workplace safety, environmental protection, fair competition). *See* ROBERT E. LITAN & WILLIAM D. NORDHAUS, REFORMING FEDERAL REGULATION 44-45 (1983). For further definitions and general description of the scope of this study, see *infra* Part I.

[3]"Audited self-regulation" is defined *infra* Part I.A.

[4] Many different programs have been tried — by federal agencies, by state and local agencies, and by governments overseas. We have built up what lawyers call "case law:" lots of useful precedents about what works and what doesn't. The trouble is that, unlike case law, these precedents aren't easy to find. Congressional staff or agency employees designing new programs have no systematic way to find out what has been tried before and how well it has worked.

Al Gore, From Red Tape to Results: Creating a Government that Works Better and Costs Less; Report of the National Performance Review 117 (1993).

[5]*See* Paul L. Joskow & Roger C. Noll, *Regulation in Theory and Practice: An Overview* in STUDIES IN PUBLIC REGULATION 40 (Gary Fromm ed. 1981) (noting that "[v]ery little research is available on the comparative outcomes of different regulatory institutions," and that "to those who believe some regulation is desirable or simply inevitable the absence of guidelines on how to accomplish it most efficiently is an important void in scholarly research"). Joskow and Noll describe as part of a research agenda, goals similar to this study.

> Viewing regulatory commissions as organizations and concentrating on the process of regulatory decisionmaking gives useful insights into what is actually happening. The attempts to model and understand regulation from this perspective often give researchers a more complete static and dynamic structural model of regulation rather than just a reduced form. For those interested in incremental policy reform within the context of prevailing institutions as well as exploring possible institutional alternatives, such structural models are extremely useful for positive policy analysis.

Id. at 53.

regulation,[6] but also to design of new programs as well, as new programs of self-regulation are continuously appearing.[7]

This study concludes that, within specific limits, experience has shown that audited self-regulation is a useful technique which should be considered in a systematic fashion by government agencies when formulating regulatory policies. Part I defines and narrows the term "audited self-regulation" to a scope capable of careful inquiry, and distinguishes other related forms of regulation. Part II discusses the potential advantages and limitations of audited self-regulation. Part III extrapolates from these advantages and limitations the characteristics of the regulation, agency, industry and self-regulatory organization which suggest that self-regulation would be successful. In addition, Part III discusses the principal legal requirements of such programs. Part IV is a survey of federal agencies'[8] use or attempted use of audited self-regulation in administration of their statutes, with an evaluation of each against the principles described in Parts II and III. Part V combines the theories of Parts II and III with the programs surveyed in Part IV to

---

[6]In October 1993, President Clinton issued Exec. Order No.12,866, which directs federal agencies to, among other things, "identify and assess alternative forms of regulation." 58 Fed. Reg. 51,375, 51,376 (1993). *See also* GORE, *supra* note 4, at 8 ("Our goal is ... to reinvent the way the government does everything. It is not simply to produce a more efficient government, but to create a more *effective* one.") (emphasis in original).

[7]The Food and Drug Administration adopted in 1993 interim rules for certification of mammographers, relying on private accrediting bodies. *See* 58 Fed. Reg. 67,558 (1993). The use of self-regulation remains under active consideration by the FDA. Telephone interview with Morris Bosin, FDA Planning Office, Feb. 7, 1994. The Federal Energy Regulatory Commission is also considering a program relying in part on self-regulation. *See* Transcript of Proceedings, Plenary Session of the Administrative Conference of the United States, Dec. 10, 1993, at 13.

Outside of the dozens of self-regulatory organizations surveyed in this study, there are hundreds of organizations which operate on a completely voluntary basis outside of any federal mandate. And new programs are created constantly; a few recent examples suggest the variety. Both industry and environmental groups are seeking to establish programs to oversee chemical companies' programs of community awareness and emergency response to accidents, and are looking for models at the self-regulatory efforts in the hospital accreditation and nuclear power industries, discussed *infra* Part IV.B.1 & IV.C. Emma Chynoweth & Karen Heller, *Wanted: A System to Audit Care,* CHEMICAL WK., June 17, 1992, at 28. A private foundation is considering alternatives for a program of self-certification of safety by motor carriers. Telephone interview with David Madsen, Volpe National Transportation Systems Center, July 1, 1993. And banks and financial institutions have historically been prolific in self-regulation in areas where control is necessary and profitable but government regulation lacking. *See* David G. Oedel, *Private Interbank Discipline,* 16 HARV. J.L. & PUB. POL'Y 327 (1993).

[8]The following independent agencies and Executive Departments were surveyed for this study: Department of Agriculture (Agricultural Marketing Service, Animal and Plant Health Inspection Service, and Food Safety Inspection Service), Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Department of Education, Environmental Protection Agency, Federal Communications Commission, Federal Deposit Insurance Corporation, Federal Trade Commission, Department of Health and Human Services (Health Care Financing Administration), Department of Labor (Occupational Safety and Health Administration), National Indian Gaming Commission, Securities and Exchange Commission, Department of Transportation (Federal Aviation Administration), Department of the Treasury (Office of the Comptroller of the Currency, and Office of Thrift Supervision).

distill essential elements of a successful program of audited self-regulation. Finally, Part VI considers the options for achieving the systematic consideration of the use of audited self-regulation.

I. Definition of "Audited Self-Regulation"

A. Types of Regulation Included

Each component of the term "audited self-regulation" is subject to a wide variety of interpretation. This study focuses only on a subset of those interpretations, namely, one which provides a useful model for study and extension. In order to define "audited self-regulation," each term is explained separately below.

"Regulation" as distinguished from other modes of government activity is the alteration of behavior of persons by the federal government.[9] Furthermore, that alteration is accomplished by "the imposition of rules ... backed by the use of penalties."[10] For purposes of this study, a "penalty" includes a denial of conditional government benefits.[11] The terms "rules" and "penalties" in turn suggest that the essential activities of federal regulation are the creation and enforcement of rules.

"Self-regulation" is the delegation of the power to create and enforce rules to an entity outside the federal government. These entities, often known as "self-regulatory organizations" or SROs, are composed principally of regulated entities and their representatives. The source of the delegated authority is in each instance a federal agency to which Congress has itself delegated such authority with permission or command to delegate it further.[12] However, because

---

[9]A broader definition would include as a regulator any entity not directly involved in the activity in question. *See* MITNICK, *supra* note 1, at 4-7; FRED THOMPSON & L.R. JONES, REGULATORY POLICY AND PRACTICES: REGULATING BETTER AND REGULATING LESS 8 (1982). This study is concerned only with the federal government as regulator.

[10]THOMPSON & JONES, *supra* note 9, at 12. This distinguishes regulation from government activities such as persuasion, taxation, direct expenditure or public ownership. *See id.* at 9.

[11]Thompson and Jones exclude "direct expenditures" from their definition of "regulation," but they use the term direct expenditures to refer apparently to unconditional benefits: "grants, subsidies, and transfer payments to individuals and to firms." THOMPSON & JONES, *supra* note 9, at 9. A penalty for failure to comply with a regulation is not distinguishable for purposes of this study from the denial of a benefit for failure to comply with a condition of that benefit.

[12]Express congressional authorization of a self-regulatory program is an essential component of a successful program. *See infra* notes 484-487 and accompanying text. Direct delegation by Congress to a private group is ordinarily accompanied by review of that private group by a federal agency (itself with delegated powers) rather than by Congress directly. *See* David A. Lipton, *The SEC or the Exchanges: Who Should Do What and When? A Proposal to Allocate Regulatory Responsibilities for Securities Markets*, 16 U.C. DAVIS L. REV. 527, 538-40 (1983) (delegation of authority to securities exchanges and

wholesale creation and enforcement of rules is not and likely cannot[13] be passed off by Congress or agencies to other groups, the scope of delegated activity is limited to what is here defined as the "implementation" of rules. Implementation includes the authority to interpret rules imposed by the agency or Congress, to make new rules within the scope of delegated authority, if any, and to enforce these rules by imposing penalties for their violation.[14] Thus, "self-regulation" for purposes of this study is defined as the delegation of power to implement federal laws or federal agency regulations by the federal government to a non-governmental entity.

"Audited" self-regulation is the exercise of this delegated power subject to review by a federal agency.[15] The term "audit" is not used in strict reference to the functions performed by independent public accountants in opining on financial statements, but that function is a useful analogy. The federal agency

---

associations, subject to review by the Securities and Exchange Commission). For a fuller discussion of the development of regulation of the securities industry, *see infra* Part IV.A.1.

[13]See *infra* Part III.B.1 for a discussion of the limitation on Congress' ability to delegate its functions, known as the "nondelegation doctrine."

[14]The addition of enforcement power is necessary to make the function "regulation" at all. *See supra* note 10 and accompanying text. The statement that agencies themselves enforce rules departs, of course, from a strict "separation of powers" theory of government. Davis, however, succinctly disposes of any reliance on such a theory in defining the role of administrative agencies.

> Except for the clear facts that the main legislative power is in Congress, the main executive power in the President, and the main judicial power in the courts, an outstanding characteristic of the American government is the non-separation of the three kinds of powers.
>
> .... .
>
> A thousand questions of [legislative-executive-judicial] classification could be asked that are ... difficult (or impossible) .... .
>
> To the extent that we have avoided such unnecessary questions, we have done well. And we have escaped from a strict version of the theory of separation of powers. Our legislative bodies have conferred all three kinds of powers — and more — on our administrative agencies, and our courts have not disapproved.

1 KENNETH C. DAVIS, ADMINISTRATIVE LAW TREATISE 72-74 (2d ed. 1978).

[15]Congress does not performs this "auditing" function directly; *see supra* note 7 and accompanying text. Indirect review by Congress takes place through hearings on new legislation, appropriations for the agency, or on general oversight. *See* LITAN & NORDHAUS, *supra* note 2, at 62-66. They conclude that Congressional oversight is "generally weak and highly sporadic." *Id.* at 66. Cary gives a different assessment, however, after describing the same basic methods of Congressional review.

> [I]t seems clear that regulatory agencies do not have so much power as they are thought to have. Collectively, as a group of commissions, they do cover a wide spectrum of cases involving many industries and companies within them. .... However, as far as any policy making by an agency is concerned, it seems clear that any major move is subjected to minute scrutiny by Congress.

WILLIAM L. CARY, POLITICS AND THE REGULATORY AGENCIES 58 (1967). And in specific areas, Congress can be extremely effective in oversight, even to the point of directing an agency to retain rules it believes unwise or illegal. *See* Susan L. Bloch, *Orphaned Rules in the Administrative State: The Fairness Doctrine and Other Orphaned Progeny of Interactive Deregulation*, 76 GEO. L.J. 59 (1987).

relies on information produced by the SRO, but verifies that the processes used by the SRO are sound, that those processes are complied with, and occasionally examines the information directly to spot-check its accuracy.[16] But the essence of "self-regulation" as defined in the above paragraph is that the "audit" itself is not a complete review of every action taken by the SRO. In the course of its review, the agency retains the power to require new methods to be used by the SRO and residual regulatory authority over the regulated entities themselves. Thus, this power of "audit" can be defined as the retention by the delegating agency of powers of review and independent action. As used in this study, the term "self-regulation" always refers to "audited self-regulation" in contrast to purely private and voluntary self-regulatory efforts.

Putting the parts of each of these paragraphs together completes the definition. "Audited self-regulation" is defined as the delegation of power to a non-governmental entity, by Congress or a federal agency, to implement laws or agency regulations, with powers of review and independent action retained by a federal agency.

B. Other Types of Regulatory Reform Distinguished

This definition of audited self-regulation delineates a particular area of government regulation which is a current focus of regulatory reform efforts. Other closely related areas are distinguished below.

Congress and federal agencies frequently delegate to private standard-setting bodies the setting of specifications, features, contents, tolerances, and so forth of various things subject to regulation.[17] The key distinction, however, is

---

[16]This is analogous to the evaluation by an auditor of the internal control structure of the entity whose financial statements are being audited. Prior to testing and verifying the actual records of the entity, an auditor is required to evaluate the internal control structure of the entity to confirm the extent to which those underlying records have been accurately produced.

> Tests of controls directed toward the operating effectiveness of an internal control structure policy or procedures are concerned with how the policy or procedure was applied, the consistency with which it was applied during the audit period, and by who it was applied. These tests ordinarily include procedures such as inquiries of appropriate industry personnel, inspection of documents and reports indicating performance of the policy or procedure, observation of the application of the policy or procedure, and reperformance of the application of the policy or procedure by the auditor.

CODIFICATION OF STATEMENTS ON AUDITING STANDARDS §319.35, Statement on Auditing Standards No. 55 (Am. Inst. of Certified Pub. Accountants, 1989).

[17]"The private sector of the economy invests extensive resources each year in developing and revising written standards for products, materials, systems, services, processes, and practices. ... . In their totality, nongovernmental standards concern virtually every aspect of modern society. They exist in bewildering variety and serve many purposes." Robert W. Hamilton, *The Role of Nongovernmental Standards in the Development of Mandatory Federal Standards Affecting Safety or Health*, 56 TEX. L. REV. 1329, 1331 (1978) (ACUS Recommendation 78-4). Hamilton estimated in 1978 that there were at least 60,000 such standards then in use. *Id.* at 1332.

that these standards are voluntary; compliance is not mandated without some action by a federal agency.[18] Of course, "voluntary" standards which are virtually universally recognized may have much the same impact as government-mandated standards.[19] However, without explicit enforcement by the government, these voluntary standards lack an essential attribute of "self-regulation."[20] And when standards are adopted in federal regulations, enforcement remains with the agency adopting the standard; thus the standards themselves are not "self-regulation" in any meaningful sense.

Regulation of entry into and practice of professions and occupations is pervasive in state and local governments.[21] Typically, the legislature designates a board of appointed private citizens to certify entry and to restrict practice in the trade.[22] This regulatory scheme is distinct from audited self-regulation in two

---

[18]The scope of agency adoption of voluntary standards and the processes of adoption were the subjects of Hamilton's investigation. *See id.* at 1446-84. *See also* Office of Management and Budget Circular No. A-119, "Federal Participation in the Development and Use of Voluntary Standards," 47 Fed. Reg. 49,496 (1982) [hereinafter *OMB Circular*] (adopting new policies for agencies in using voluntary standards for regulatory and procurement purposes).

[19]*See* American Soc'y of Mech. Eng'rs v. Hydrolevel Corp., 456 U.S. 556, 570 (1982) (characterizing ASME, a standards-setting body, as "in reality an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce," quoting Fashion Originators' Guild of America v. FTC, 312 U.S. 457, 465 (1941)). A Federal Trade Commission staff report concluded that "private standards and certification can be used to exclude competition or to convey deceptive and misleading information, to the substantial detriment of consumers and the competitive process." BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION, STANDARDS AND CERTIFICATION 65 (1983) [hereinafter FTC STAFF REPORT]. The Department of Justice raised similar concerns in its response to the Office of Management and Budget's policy on the use of standards. *See OMB Circular, supra* note 18, at 49,499, quoting letter to OMB from the Department of Justice that "private [standard-setting] activity is not, by virtue of governmental participation or approval, shielded from the antitrust laws." Not only might failure to comply with "voluntary" standards result in a competitive disadvantage, but there is also a risk of legal liability if the noncompliant product or process resulted in injury.

> An unanswered question at this time is the extent to which such standards are actually enforced in some way by each of these private organizations or otherwise become effective indirectly because noncompliance would result in a greater likelihood of liability in product-liability suits or other litigation brought by persons whose interests have been injured.

MICHAEL S. BARAM, ALTERNATIVES TO REGULATION: MANAGING RISKS TO HEALTH, SAFETY AND THE ENVIRONMENT 58 (1982).

[20]Enforcement is an essential element of regulation; *see supra* note 10 and accompanying text. The extent to which that enforcement may occur through illegal nongovernmental means is not relevant to the present typology and analysis of regulation by lawful governmental enforcement.

[21]*See* Baram, *supra* note 19, at 62 (noting that "over 550 occupations are now licensed in the United States").

[22]A survey of Alabama law indicates the pervasiveness of this type of regulation.

> Designed to regulate every aspect of professions, licensing statutes are frequently amended; the drift of the amendments is increased regulation and complexity. Most statutes define the practice of the occupation regulated, criminalize unlicensed practice,

broad respects. First, it lacks a self-regulatory organization outside of the board or agency; there is no membership organization or private group involved in regulation.[23] Second, the delegation by the legislature to the appointed board is typically complete; the regulation is not "audited" by the legislature which delegates the authority.[24] Such unsupervised delegation has no federal counterpart, and raises different legal issues not applicable to audited self-regulation.[25]

> create a board of examiners for the occupation, and establish licensing, revocation, and appeal procedures.

Note, *Professional Self-Regulation*, 29 ALA. L. REV. 679, 683 (1978).

[23]It could be argued that the profession or trade being regulated is the "self-regulatory organization," since that group is normally the chief sponsor of the occupational regulation in question as well as the group normally involved, at least indirectly, in implementation. *See* BENJAMIN SHIMBERG ET AL., OCCUPATIONAL LICENSING: PRACTICES AND POLICIES 12 (1973) ("A significant characteristic of most occupational licensing is that the regulatory agency is usually composed of practitioners from the trade or profession in question. The impetus for licensing has seldom if ever come from the public in response to a demonstrated need, but rather from associations of practitioners who have usually sought themselves to secure the passage of regulatory legislation."). However, the members of the profession are not given formal control (outside of board membership) over the regulatory process in contrast to the models of self-regulation in this study, although some of the Medicare PROs discussed *infra* Part IV.B.1.c. may lack membership organizations, *see infra* note 368 and accompanying text. This is not to say that the informal control is not important or powerful. Occupational licensing generally has been frequently criticized as collusion thinly coated with a faint public interest. *See, e.g.*, Jonathan Rose, *Occupational Licensing: A Framework for Analysis*, 1979 ARIZ. ST. L.J. 189, Walter Gellhorn, *The Abuse of Occupational Licensing*, 44 U. CHI. L. REV. 6 (1976), SHIMBERG, ET AL., *supra*, at 13-14.

[24]"Once a profession acquires from a legislature the exclusive right to regulate entry, it is expected to regulate itself thereafter to some extent." BARAM, *supra* note 19, at 62. Supervision may be available through the courts by a statutory appeal or by a writ of mandamus, *see* Note, *supra* note 22, at 687 nn. 49-50. Supervision by the legislature could also occur, *see supra* note 15, but such actions are entirely discretionary. There is no systematic review of the delegate's activity comparable to the "audit" discussed *supra* Part I.A. However, in some states the occupational regulation is centralized in one agency, and in some cases that central agency supervises licensing boards. *See* DOUG ROEDERER & BENJAMIN SHIMBERG, OCCUPATIONAL LICENSING: CENTRALIZING STATE LICENSURE FUNCTIONS 4-5 (Council of State Governments Report No. 683, 1980) (describing two models from six states of occupational licensing involving partial or total control by state agencies over licensing boards). Although this involves "auditing" in the sense intended in this study, the underlying activity is nonetheless not "self-regulation." *See supra* note 23.

[25]There are typically three legal issues involved in an occupational licensing and regulation statute. First, the extent of the state's power to interfere with otherwise private activity may be questioned; *see* Note, *supra* note 22, at 686-96. Second, assuming the legislature possesses the power to regulate the activity in question, its ability to delegate that power to a private group may be limited. This is a vital question in state constitutional law though it has long passed to a state of some somnolence on the federal level. *See* David M. Lawrence, *Private Exercise of Governmental Power*, 61 IND. L.J. 647, 649-50 (1986) (criticizing the state court decisions in this area and noting that "[p]rivate exercise of federally delegated power is no longer a federal constitutional issue."). For a fuller discussion of the validity of federal delegation, see *infra* Part III.B.1. Third, antitrust laws may affect the validity of these boards' actions. *See infra* Part III.C.1 (issues regarding professional organizations generally); RANDOLPH P. REAVES, THE LAW OF PROFESSIONAL LICENSING AND CERTIFICATION 287-93 (2d ed. 1993) (issues regarding state occupational licensing agencies in particular). Many other issues are involved in the

Regulators often recruit "delegates" to certify compliance by regulated entities with applicable standards or regulations. If the qualifications of these "delegates" are determined and enforced by a private organization, this would be a program of audited self-regulation, and several are discussed below.[26] However, where the "delegates" are qualified directly by the agency itself, clearly no self-regulation is involved. Nor is the action of the delegate appropriately considered self-regulation, because the degree of supervision by the agency is significantly greater. For example, the Federal Aviation Administration certifies individuals to conduct inspections, tests and training in various areas of pilot and aircraft certification,[27] and the Department of Agriculture certifies veterinarians to make various inspections, examinations and certifications under animal health statutes and regulations.[28] The impetus in both areas is primarily a shortage of federal employees to perform these functions.[29]

Self-regulation is also distinct from a weaker form of regulation: "self-reporting" in the absence of a self-regulatory organization. This is distinct from true self-regulation because the regulated entity is usually given little or no power to interpret any regulation, but merely reports as required by the regulation. And enforcement of the regulation, of course, is limited to the government, except to the extent that a regulated entity "enforces" a law or regulation upon itself through compliance. Self-reporting is a common regulatory technique. Banks, for example, periodically report on their financial condition, disclosing whether they are in compliance with required capital adequacy standards.[30] Regulation of air pollution relies to a large extent on "emissions reduction credits" determined, monitored and traded by holders of those credits.[31] Holders of permits to

---

application of the regulatory statutes; *see generally, id.* (discussing practice issues in licensing, application and disciplinary proceedings).

[26]*See, e.g., infra* Part IV.A.4 (accountants) and Part IV.B (accrediting organizations).

[27]*See* 14 CFR §§183.1 - .33.

[28]*See* 7 CFR §§160.1 - 162.13.

[29]Regarding delegation under the Federal Aviation Act, "[t]he legislative history of the statute indicates that the purpose of this delegation was to avoid a substantial increase in the number of Federal employees." Andrew J. Dilk, *Negligence of Federal Aviation Administration Delegates Under the Federal Tort Claims Act*, 42 J. AIR L. & COM. 575, 575 (1976). Regarding delegation to "accredited veterinarians," the Department of Agriculture regulations state that the accreditation program "is intended to ensure that an adequate number of qualified veterinarians are available in the United States to perform [the specified activities]." 9 CFR §161.1(a).

[30]*See* 12 USC §1817(a)(3) (quarterly "reports of condition" required of all financial institutions whose deposits are insured by the Federal Deposit Insurance Corporation).

[31]Under the Clean Air Act, discharge of pollutants is limited by various overlapping regulations. The EPA's program of emissions reduction credits is a series of economic incentives made available to regulated entities to make compliance with these provisions easier and more flexible. The regulated entities can themselves determine the best methods of compliance with the EPA air standards, and by their reports disclose their compliance or noncompliance with the overall standards. *See generally,* Emissions Trading Policy Statement, 51 Fed. Reg. 43,814 (1986), Robert W. Hahn & Gordon L. Hester, *Where Did All the Markets Go? An Analysis of EPA's Emissions Trading Program*, 6 YALE J. ON REG. 109 (1989),

discharge water pollution report regularly on the content of the discharged water, disclosing thereby whether they are in compliance with the terms of their permits.[32] Similarly, a program during the mid-1980s of allowing refiners to trade "rights" to add lead to gasoline required reports by each refiner on the amount of "rights" held, used, purchased, sold or saved.[33] Perhaps most familiar is the annual report by each taxpayer of income and tax, disclosing thereby compliance with the tax laws.[34]

Audited self-regulation is distinct from a much larger concept known generally as "privatization."[35] Techniques and issues involved in removing government functions entirely from the public sector may begin with self-regulation but quickly move far beyond it.[36]

And of course, as a technique of regulatory reform, audited self-regulation is distinct from deregulation, which ordinarily means removal of regulation altogether.[37] Deregulation, simply defined, is the removal of regulation. And

---

RICHARD A. LIROFF, REFORMING AIR POLLUTION REGULATION (1986), THOMAS H. TIETENBERG, EMISSIONS TRADING (1985).

[32]Under the Clean Water Act, the primary method of regulating discharge of pollutants is the issuance by the EPA or approved state programs of permits to discharge. *See generally* 2 LAW OF ENVIRONMENTAL PROTECTION §12. 05[2] (Sheldon M. Novick et al. eds. 1993). Absent such a permit, any discharge of any pollutant is unlawful. *See* 33 USC §1311(a). Each permit holder is responsible for monitoring its own discharge and reporting the results thereof. *See* 40 CFR §122.41(*l*)(4). If those reports disclose that the terms of a permit have been violated, the permit holder may face significant penalties, either in private litigation or administrative proceedings. *See* Frank M. Thomas, Jr., *Citizen Suits and the NPDES Program: A Review of Clean Water Act Decisions*, 17 ENVTL. L. REP. 10,050 (1987) (discussing enforcement of permit conditions through private litigation); 33 USC §1319(g) (administrative penalties).

[33]Under Section 211(c)(1)(A) of the Clean Air Act, 42 USC §7545(c)(1)(A), the EPA may control the production of any fuel additive "which may reasonably be anticipated to endanger the public health or welfare." The lead rights program entitled a refiner to rights based on the amount of leaded gasoline produced and the current EPA standards for lead, which were diminishing during the course of the program. If the actual lead content was too high, excess rights had to be obtained; if the lead content was lower than permitted, the excess rights could be sold or saved. *See* Regulation of Fuel and Fuel Additives, Final Rule, 47 Fed. Reg. 49,322 (1982); Robert W. Hahn & Gordon L. Hester, *Marketable Permits: Lessons for Theory and Practice*, 16 ECOLOGY L.Q. 361, 381-83 (1989).

[34]*See* I.R.C. §6001 (general requirement of recordkeeping and returns).

[35]*See generally*, Ronald C. Moe, Privatization: An Overview From a Public Administration Perspective (Congressional Research Service Rept. No. 88-201 GOV, March 2, 1988).

[36]*See id.* at 5 (listing "methods for privatization" of "divestitures (selling) of corporate bodies; contracting-out for the performance of services; imposition of user fees; use of vouchers; awarding of franchises; and voluntarism").

[37]MITNICK, *supra* note 1, at 418. *See generally*, Richard B. Stewart, *Reconstitutive Law*, 46 MD. L. REV. 86 (1986) (describing reconstitutive law as an alternative in the middle of a continuum between proscriptive regulation on one end and deregulation on the other). Reconstitutive law, defined as "federal reconstruction of the decisional rules and structures that constitute the several institutional subsystems that make up the greater society," *id.* at 87, would include audited self-regulation as well as the other regulatory reform methods discussed in this section.

regulation, in turn, is the alteration of behavior by the government.[38] Since audited self-regulation by definition assumes a continuing governmental role,[39] it is not deregulation.

II. The Comparative Advantage of Audited Self-Regulation

This Part lays the general background against which audited self-regulation can be evaluated. In general, this method of regulation offers comparative advantages in implementing certain types of regulation, and its potential drawbacks can be limited.

A. Advantages of Audited Self-Regulation

Lawyers, economists and political scientists have created a diverse literature on government regulation. Overall, they have identified five distinct advantages of audited self-regulation over other regulatory techniques. First, rules can be more effective because of the self-regulator's superior knowledge of the subject compared to the government agency. Second, self-regulation allows for more diversity in methods of compliance with legal rules than is possible for a government agency to provide. Third, self-regulation may result in better compliance with rules, no matter who promulgates them or how they are designed, because self-enforcement is more effective and more easily accepted by the regulated entities. Fourth, self-regulation can result in cost savings to the government; and these savings may be greater than the costs imposed on private groups, thus resulting in less costly regulation overall. And finally, self-regulation is consistent with modern regulatory reform characterized by the retreat from bureaucratic "command and control" methods of regulation.

1. Technical Expertise

Private organizations are by their nature comprised of individuals or groups with an interest in and knowledge of the subject area around which they are organized. This makes them useful repositories of expertise to which government regulators can turn. Indeed, this is a primary motivation for government use of private standard setting organizations.[40] Self-regulatory organizations typically

---

[38]*See supra* note 9 and accompanying text.

[39]*See supra* note 15 and accompanying text.

[40]*See* Roberta S. Karmel, *Securities Industry Self-Regulation — Tested by the Crash,* 45 WASH. & LEE L. REV. 1297, 1306 (1988) (noting expertise created by higher salaries, and the ability to achieve consensus in rulemaking); BARAM *supra* note 19, at 53 ("private industry invests considerable resources

begin with "the development of common policies and standards," progressing to monitoring compliance with those standards, and often but less frequently to enforcement of those standards.[41] It is more efficient for government to rely on that collected expertise than to reproduce it at the agency level.[42]

2. Flexibility

A product of the expertise of self-regulators is that they retain the ability to modify their rules in response to technological change more readily than the government agency.[43] More importantly, however, the self-regulator is better able to determine when a rule may be changed to result in better compliance apart from any change in technology. The bureaucratic organization of government agencies and the rigid requirements imposed on their rulemaking inhibit innovation and response to subtle changes in the environment of the regulated entities.[44] The regulated entities retain a more informal structure and the desire created by competition to keep their rules current and cost-effective.[45] This is an especially important advantage of self-regulation because the regulatory initiatives of the past few decades have created rules which cut across industry lines. These are difficult for an agency to implement by general rules applicable to all situations, but better suited to individual rules designed and implemented by each regulated entity.[46]

---

each year in developing and revising its own standards"); Hamilton, *supra* note 17, at 1377 (private committees have "an expertise that probably cannot be matched by the technical staffs of most, if not all, agencies"); Lawrence, *supra* note 25, at 656-57 ("Private delegation may be a practical method of obtaining that sort of otherwise unavailable expertise"); Lipton, *supra* note 12, at 546 (in regulation of certain aspects of stock exchanges, each "would be most familiar with the unique trading structure and needs of its own market"); Thomas P. Grumbly, *Self-Regulation: Private Vice and Public Virtue*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 110 (Eugene Bardach & Robert A. Kagan eds. 1982) (discussing incentives for reform of meat and poultry inspection, one of which was "the fundamental argument that an objective assessment of critical production points carried out by industry personnel could provide *better* consumer protection than a program in which [federal] inspectors ... made subjective determinations") .

[41] KENNETH E. YOUNG, ET AL., UNDERSTANDING ACCREDITATION 59-60 (1983).

[42] The agency will need sufficient expertise in any area in which it regulates to assure the reliability of the delegates' expertise on which it relies, however. And in some areas, the agency may be the source of that expertise. In general, the decision should be made by the entity which can acquire the knowledge in the most cost-effective fashion. *See* Lipton, *supra* note 12, at 545.

[43] *See* Hamilton, *supra* note 17, at 1378.

[44] *See* Karmel, *supra* note 40, at 1305-06; Lawrence, *supra* note 25, at 654-55.

[45] *See* Karmel, *supra* note 40, at 1306; EUGENE BARDACH & ROBERT A. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS 241 (1982) (noting that private decisionmakers will be sensitive to the adverse consequences of overzealous regulation and "are more likely to resist literal interpretations of the rules, to accept substantial compliance, and to fight for discretion when the requirements are inappropriate or unduly burdensome in particular cases"). *See also* BARAM, *supra* note 19, at 58.

[46] *See infra* Part II.A.5 (discussing reliance on self-regulation as an effective means of implementing modern regulatory statutes).

It is possible that the auditing function may reintroduce bureaucratic inflexibility through agency rules not concerning substantive requirements but rather the rulemaking process itself.[47] Thus, the maintenance of flexibility at the regulated entity level requires some amount of residual expertise at the agency level as well.

3. Incentives for Compliance

Self-regulation has the potential to provide greater incentives for compliance. As shown above, self-regulation is likely to produce rules from an expert's knowledge base, tailored to the conditions of the particular industry or workplace. The rules therefore are perceived by the regulated entities, because of their participation, as more "reasonable" from the outset compared with the more inflexible counterparts issued by government regulators.[48] In addition, certain types of conduct are more effectively regulated by the regulated entity itself.[49] Thus, incentives are increased not because

---

[47]Bardach and Kagan follow this process to its logical extreme, resulting in virtual replacement of the self-regulator's rules with agency rules.

> The more regulators or advocacy groups mistrust the motivation of the self-regulating enterprises as a class, or the more regulatory inspectors lack the expertise to evaluate a particular self-regulation system, the more likely they will insist that the enterprise adhere strictly to the written procedures.
>
> The result, of course, is that government "guidelines" come to be treated as binding rules and privately formulated procedures come to be treated with the same legal sanctity as direct government regulations.

BARDACH & KAGAN, *supra* note 45, at 236-37 (1982).

[48]*See* BARDACH & KAGAN, *supra* note 45, at 102-19 (describing how technical regulations create resentment, minimal compliance, lack of cooperation and resistance on the part of the regulated entities); Lawrence, *supra* note 25, at 653 (describing advantages of "pluralism" in self-regulation); Richard W. Jennings, *Self-Regulation in the Securities Industry: The Role of the Securities and Exchange Commission*, 29 LAW & CONTEMP. PROBS. 663, 678 (1964) ("[I]ndustry self-government surely is psychologically more acceptable to the industry regardless of cost. No one likes external controls, least of all businessmen. Opportunity to participate in the regulatory process makes it much more palatable."); Tamar Hed-Hoffman, *The Maloney Act Experiment*, 6 B.C. INDUS. & COM. L. REV. 187, 210-12 (1965). *But see* BARDACH & KAGAN, *supra*, at 219 (cautioning that even the private inspectorate "tends to occupy an outsider or even pariah status").

[49]Consider ethical standards of broker-dealers, for example. Although there is no particular structural reason explaining the difference between "ethics" rules of the Securities and Exchange Commission (the government agency) and the National Association of Securities Dealers (the self-regulatory organization), "in its role of self-regulator of the interrelationships of its members, the NASD has promoted ethical standards of conduct. As a result, the securities business carries out its contractual obligations much more promptly than required by law and performs contracts even in cases where the law does not impose an obligation to perform." Hed-Hoffman, *supra* note 48, at 210. *Accord,* Karmel, *supra* note 40, at 1304. During hearings on the legislation which was to become a key piece of securities industry self-regulation, *see infra* Part IV.A.1, SEC Commissioner George Matthews testified

> "[E]ven if the funds were furnished for a direct government regulatory program, and even if an adequate staff were provided ... a great many of the abuses in the securities business are not matters of definite illegality; they are matters of ethics ... .

the regulated entity is now suddenly more willing to comply,[50] but because compliance has become easier (less costly) and has been recognized as consistent with and not impairing or opposing the entity's goals.

4. Cost Savings to the Federal Government

Self-regulation can result in cost savings to the government if the resulting supervision of regulation requires fewer resources than direct regulation. Although the savings should be readily quantifiable, such calculations are made only rarely.[51] Such cost savings would be a net societal gain, of course, only if the net increase in costs to the industry were lower than the government's cost savings.[52] However, it is possible

---

> There is a vast field for the control of ethical practices in this business, which is not a field which the Government can very well occupy."

SUBCOMM. ON COMMERCE & FINANCE, HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES INDUSTRY STUDY, H.R. REP. NO. 1519, 92d Cong., 2d Sess. 82 (1972) [hereinafter SECURITIES INDUSTRY STUDY], quoting SEC Commissioner George Matthews. *See also* Jeffrey R. Cohen & Laurie W. Pant, *Beyond Bean Counting: Establishing High Ethical Standards in the Public Accounting Profession,* 10 J. BUS. ETHICS 45, (1991) (surveying accountants, finding that they believe self-enforcement of ethical standards is more effective than imposing such standards by government regulation).

[50]Most regulated entities possess an "inherent" willingness to comply with even direct government regulation. Anecdotal evidence suggests compliance rates of 80-90%. *See* BARDACH & KAGAN, *supra* note 40, at 65-66 ("Reflecting on his experience as Office of Price Administration administrator during World War II, Chester Bowles said that 20 percent of the regulated population would automatically comply with any regulation simply because it is the law of the land, 5 percent would attempt to evade it, and the remaining 75 percent would go along with it as long as they thought the 5 percent would be caught and punished. In practice, OSHA relies to a great extent on the presumption that businesses, once apprised of their legal obligations, will abide by the law."). "Experienced regulators acknowledge that if most regulated enterprises were inclined to comply only when the threat of inspection and punishment was imminent, then the entire regulatory program would quickly collapse." *Id.* at 60. One study of OSHA enforcement reviewed existing literature on deterrence, concluding that "[r]eviews of empirical studies have found only weak evidence that detection and punishment is a primary factor in deterring noncompliance. The complexity of perceptual processes that intervene between the threat or experience of legal sanctions and illegal actions may weaken the link between enforcement activities and deterrence ... ." Wayne B. Gray & John T. Scholz, *Does Regulatory Enforcement Work? A Panel Analysis of OSHA Enforcement,* 27 LAW & SOC'Y REV. 177, 178 (1993) (citations omitted).

[51]For example, the Securities and Exchange Commission estimated savings of approximately $400,000 from the 1983 transfer of direct regulation to the National Association of Securities Dealers of the few remaining small broker-dealers who were not already members of and regulated by the NASD or an exchange. H.R. REP. NO. 106, 98th Cong., 2d Sess., at 6 (1983). And the Commodity Futures Trading Commission estimated the initial savings from the creation of the National Futures Association to regulate futures traders at approximately $3.5 million in direct savings and over $16 million in additional costs avoided over the first three years of the program. COMMODITY FUTURES TRADING COMMISSION, NATIONAL FUTURES ASSOCIATION: REPORT TO CONGRESS UNDER SECTION 237 OF THE FUTURES TRADING ACT OF 1982, at 132-33 (1985) [hereinafter CFTC REPORT].

[52]Neither the SEC nor the CFTC studies, *supra* note 51, attempted to measure the additional compliance costs incurred by the self-regulatory agencies. Karmel, *supra* note 40, suggests that "[t]o the extent that self-regulation can operate more casually and without regard to constraints that are imposed upon government regulators, self-regulatory organizations may achieve goals more efficiently and at a lower cost." *Id.* at 1305. Jennings, *supra* note 48, however, estimates that "it is at least doubtful that the

to argue that such costs should have been borne by the regulated entities in any event, as are most costs of regulation, and thus the net savings to the federal government is a good even if viewed in isolation.[53] The solution to limiting government-imposed costs of regulation on private individuals and industry, it is argued, would be to budget this resource as with direct government expenditures.[54]

5. A Cornerstone of Regulatory Reform

Audited self-regulation has the potential to lead modern regulatory reform. Regulatory legislation in the past 30 years has shown a dramatic shift in the scope of the government's role in society. The agencies' inability to correspondingly shift their methods of regulation has been the source of the almost universal discontent with their performance. Self-regulation is widely regarded by researchers as having great potential to produce effective results from the sweeping mandates of modern legislation.

Controls over corporate and social conduct enacted by Congress since the 1960s differ fundamentally from those enacted in the other two great regulatory periods in American history: the Progressive Era[55] and the New Deal.[56] Each of the earlier episodes focused federal regulation on particular industries or discrete segments of the economy.[57] However, the third period, from the mid 1960s to the late 1970s,[58] was unique in its focus on consumer and environmental protection

---

existing two-tier structure [of direct regulation and supervised self-regulation in the securities industry] costs less than direct regulation." *Id.* at 678.

[53]The supporting theory is that the majority of firms in a regulated industry would comply, and incur the costs of compliance, without government direction or enforcement in any event. *See* BARDACH & KAGAN, *supra* note 45, at 66.

[54]See, *e.g.*, the proposals for a "regulatory budget" in LITAN & NORDHAUS, *supra* note 2, at 133-58, and THOMPSON & JONES, *supra* note 9, at 176-89.

[55]The reforms of the Progressive Era date approximately from 1900-15. *See David Vogel, The "New" Social Regulation*, in REGULATION IN PERSPECTIVE 156 (Thomas K. McCraw ed. 1981); Thomas K. McCraw, *Regulatory Change, 1960-79, in Historical Perspective*, in JOINT ECONOMIC COMMITTEE, 96TH CONG., 2D SESS., SPECIAL STUDY ON ECONOMIC CHANGE Vol. 5, Government Regulation: Achieving Social and Economic Balance 8-9 (1980) [hereinafter SPECIAL STUDY ON ECONOMIC CHANGE] (dating this period through 1921, but listing the 19th Amendment as the only significant "regulatory" effort after 1914). Others begin earlier; *see* Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1216 (1986) (dating this period beginning with the Sherman Antitrust Act in 1890).

[56]Rabin, *supra* note 55, at 1243-53, Vogel, *supra* note 55, at 156-57, and McCraw, *supra* note 55, at 8, date the period of New Deal reforms from 1933-38.

[57]There are exceptions, of course. There were significant reforms, for example, in the labor movement and in the electoral system during both periods. And the Progressive Era resulted in many other reforms on the state and local level. *See* Vogel, *supra* note 55, at 160; McCraw, *supra* note 55, at 9-10.

[58]Vogel, *supra* note 55, at 157-58, dates the period from 1964-77; McCraw, *supra* note 55, at 12, from 1960-79. Others date the period generally from the mid-1960s to the middle or late-1970s. *See* Paul W. MacAvoy & Dorothy M. Tella, *The Impact of Regulation on the Performance of Industry*, in *Special*

across any recognized industry lines.[59] The third period also far eclipsed the other two in the number of programs begun and new agencies created.[60]

The resulting almost universal dissatisfaction with the agencies' implementation of these new laws is traced by most researchers to the resilience of the "command and control" method of regulation used in the older, single-industry, price-and-entry regulatory schemes.[61] This regulatory technique responded well to the original problems addressed, namely, the rise of near-monopolies in many industries.[62] However, the new regulation of the 1960s and 1970s, dealing with different types of market failures across different industries, does not fit with the "command-and-control" technique. Identifying individual problems and their solutions via agency rule is impossible because of the sheer

---

Study on Economic Change, *supra* note 55, at 187-88; Richard B. Stewart, *Madison's Nightmare*, 57 U. CHI. L. REV. 335, 339 (1990); CHARLES L. SCHULTZE, THE PUBLIC USE OF PRIVATE INTEREST 2 (1977).

[59]*See* Rabin, *supra* note 55, at 1278-84 (describing the roots of a primarily environmentalist and consumer movement he titles "The Public Interest Era"). *See also* A. Lee Fritschler, *The Changing Face of Government Regulation*, in FEDERAL ADMINISTRATIVE AGENCIES: ESSAYS ON POWER AND POLITICS 40 (Howard Ball ed. 1984) (comparing pre-1960s "[i]ndustrial and economic regulation [which] generally had a well-defined and narrow focus" to the post-1960s social regulation which "focuses less on the formal means and output of production and more on the side effects of production"); Vogel, *supra* note 55, at 162 (observing that new laws "cut across industry lines," "undermining much of the historic distinctions between regulated and unregulated industries"); McCraw, *supra* note 55, at 5 (noting that the across-the-board coverage of new laws does not mean the impact has been uniform; rather there has been a disparity between large and small firms and other varieties of classification within industries "to such a differential extent that it has changed the basis of competition within those industries").

[60]Vogel's comparisons are illustrative.

> From 1900 through 1965, only one regulatory agency was established at the federal level whose primary responsibility was to protect either consumers, employees or the public .... Between 1964 and 1977, ten federal regulatory agencies were created with this as their mandate ....
>
> .... In the broad area of consumer safety and health, five new laws were enacted by the federal government during the Progressive Era, eleven during the New Deal, and a total of sixty-two between 1964 and 1979. Job safety and other working conditions were the focus of a total of five pieces of national legislation during both the Progressive Era and the New Deal; from 1960 through 1978, twenty-one laws were approved in this area. Two statutes regulating energy and the environment were enacted by the federal government during the Progressive Era, five during the New Deal, and thirty-two during the most recent period of increased government intervention.

Vogel, *supra* note 55, at 161-62. *See also* LITAN & NORDHAUS, *supra* note 2, at 44 (counting over 40 pieces of "social legislation" during the 1960-76 period); Fritschler, *supra* note 59, at 41-43 (table listing five Progressive Era programs and ten New Deal programs, with one in each era categorized as "social regulation," and 23 programs from 1962 through 1975, with 17 categorized as "social regulation").

[61]*See, e.g.*, Stewart, *supra* note 58, at 341; McCraw, *supra* note 55, at 7 & 17, SCHULTZE, *supra* note 58, at 46.

[62]*See* MacAvoy & Tella, *supra* note 58, at 178-79; THOMPSON & JONES, *supra* note 9, at 52-53 (but disputing the translation of these economic rationales into regulatory practice).

magnitude of individual problems. Moreover, any general rule destined for cross-industry application will have its absurd results.[63]

A major benefit of the "command-and-control" technique has been its ability to limit discretion in enforcement. This is a heralded value generally in American government.[64] In addition, the predisposition for legalistic rules — specific standards, allegations of violations, and a trial-type adjudication of the facts — was apparent from the lawyers who had from the beginning controlled the field.[65] This technique also had the political advantage of immediate response; once a problem had been identified, a law could be passed and an agency constituted to promulgate regulations immediately.[66] The regulated entities would have the benefit of certain rules, limiting the discretion of the agency, and the regulators and reformers would have the benefit of an impressive array of citations issued under the new law, demonstrating its benefits.[67]

In the late 1970s, however, the preeminence of "command-and-control" began to deteriorate.[68] The rules issued had been demonstrated as largely ineffective, particularly when compared with their costs.[69] The limitation of agency discretion through the promulgation of precise rules led in many cases to

---

[63]*See* Stewart, *supra* note 58, at 343 (observing that because "[b]ureaucrats in Washington simply cannot gather and process the vast amount of information needed to tailor regulations," they "adopt uniform regulations that are inevitably procrustean in application").

[64]*See, e.g.*, McCraw, *supra* note 55, at 7 ("Lawyers and political scientists ... emphasize administrative structure, political feasibility, and due process of law. They hold these values dear, and they expressed them in such laws as the Administrative Procedure Act of 1946."). *See generally* KENNETH C. DAVIS, DISCRETIONARY JUSTICE (1969).

[65]*See* THOMPSON & JONES, *supra* note 9, at 103-04; LITAN & NORDHAUS, *supra* note 2, at 95 ("[w]e characterize such a regulatory philosophy, which simply orders that which is broken to be fixed, as the 'lawyer-regulator's approach' to regulation"); McCraw, *supra* note 55, at 6; SCHULTZE, *supra* note 58, at 73.

[66]*See* MITNICK, *supra* note 1, at 361 (comparing "incentive" and "directive" regulation, concluding that the latter may be the response of choice in a crisis situation); THOMPSON & JONES, *supra* note 9, at 104 ("alternatives that involve incentives for performance change may seem indirect and may not have the [political] appeal of an immediate 'solution'"); MacAvoy & Tella, *supra* note 58, at 187 ("equipment and design standards were appealing because they tended to speed up the regulatory process and thus allowed the agencies to show more evidence of regulatory activity").

[67]*See* BARDACH & KAGAN *supra* note 45, at 34-36.

[68]

> By the late 1970s ..., the expansionist period of the Public Interest Era had ... run its course. For the first time in a century, a discernible political movement sought to reassess the need for regulatory programs that administered markets as a means of promoting the health of particular institutions. This movement was exceedingly widespread: The regulatory system came under close scrutiny by policy institutes and journals, academic disciplines, and politically influential public officials who all came to focus on a clear and dominant emerging theme — deregulation.

Rabin, *supra* note 55, at 1316.

[69]What is particularly important about this criticism is that it came not only from the regulated entities but the interest groups responsible for passage of the regulations in the first place. *See* MacAvoy & Tella, *supra* note 58, at 176-77.

ineffective regulation.[70] The proliferation of cross-industry agencies with no requirement of coordination resulted in businesses subject to multiple and often contradictory commands.[71] In addition, economists had entered the scholarly debate along with the lawyers,[72] advocating and demonstrating that regulation based on standards of output rather than characteristics of input, can be more efficient.[73] And the delegation of power to agencies bent on specific rules became self-sustaining, as there remained no political check on the use of agency power.[74]

---

[70] As rules extend into increasingly complex areas of our environment, workplace safety, health and social rights, their consequences — both deliberate and unintended — also grow. As this happens, we introduce more and more safeguards into the rulemaking process. The result is not always what we want. Hearings, reviews, revisions, more reviews, more hearings, and even more reviews are cumbersome, costly, and time consuming.

GORE, *supra* note 4, at 118. *See also* JAMES O. FREEDMAN, CRISIS AND LEGITIMACY: THE ADMINISTRATIVE PROCESS AND AMERICAN GOVERNMENT 38 (1978) (noting that while the limitation on discretion was originally intended and hailed as a protection of freedom, "for the individual who must relate to them, usually in a role of subordination or dependence, bureaucracies too often appear concerned primarily with formalistic adherence to their own rules, rather than with seeking a personalized response to the peculiarities of his specific circumstances"); BARDACH & KAGAN, *supra* note 45, at 30-57, review the development of this legal environment, and conclude that stricter statutes providing for tough sanctions without discretion increases the power of enforcement officials but also "the incidence of unreasonableness and unresponsiveness." *Id.* at 57. *See also* Cass R. Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407, 413-15 (1990) (demonstrating how reliance on stringent standards leads to the paradox that "overregulation produces underregulation"); MacAvoy & Tella, *supra* note 58, at 187 (proscription of inputs by regulation "meant that regulation dealt with matters once-removed from the aims of the legislation and, probably largely for this reason, was destined to have far less impact than was hoped on accident rates or the quality of the environment"); SCHULTZE, *supra* note 58, at 74 (applying "command-and-control" approach is not appropriate for complex forms of social intervention with output-oriented legislation; "Regulations, however detailed, cannot be written to cover all the individual situations that arise.").

[71] *See* LITAN & NORDHAUS, *supra* note 2, at 44-49; MacAvoy & Tella, *supra* note 58, at 187.

[72] *See* McCraw, *supra* note 45, at 6-7 (describing the historical influence over regulatory philosophy, in turn, of lawyers, political scientists, and finally classical economists).

[73] *See, e.g.*, THOMPSON & JONES, *supra* note 9, at 81-82 (concluding that in only one of four conditions for beneficial regulation, antitrust, is it "unambiguously" the best option, and that reliance on market-based incentives is likely superior under the other three conditions); LITAN & NORDHAUS, *supra* note 2, at 94-98 (discussing the rise of economists' critiques of regulatory policy, demonstrated through numerous studies). Even the traditional antitrust regulation has begun to yield to the economists' suggested use of market-based incentives. *See* Elizabeth E. Bailey and William J. Baumol, *Deregulation and the Theory of Contestable Markets*, 1 YALE J. ON REG. 111 (1984).

[74] This is what Stewart hails as the source of "Madison's nightmare."

> Rather than offsetting each other through mechanisms of countervailing power, as Madison envisaged, these [interest] groups have instead divided power among themselves. This parcelling of power has been accomplished through congressional delegations of authority to functionally specialized bureaucracies. ... .
>
> .... .
>
> The post-New Deal constitutional jurisprudence of majoritarian politics has helped produce this result, because the demands for national regulatory and spending programs have outstripped the capacity of the national legislative process to make

Lawmakers and administrators began to cautiously accept the demise of "command-and-control" regulation. Ironically, the first changes came in traditional single-industry price-and-entry regulation.[75] Eventually, the administrators of "social" regulation began experimenting with output standards instead of input standards, specifying results to be reached and leaving the method of achieving those results to the regulated entities.[76] Thus began the broader acceptance of alternative methods of regulation.[77]

Audited self-regulation thus promises to be a fundamental part of regulatory reform in the foreseeable future. If properly implemented, it promises efficient reorganization of regulation to meet the challenges ahead.[78]

B. Disadvantages of Audited Self-Regulation

The same researchers and analysts have identified three principal potential shortcomings of audited self-regulation. First, because the regulated entities are left directly or indirectly in charge of implementation, self-regulation raises the possibility of not only inadequate enforcement of a regulatory program but also concerted anticompetitive conduct in opposition to the program's goals.[79]

> decisions that are accountable and politically responsive to the general interest. This has subverted the very premises of Madisonian politics.

Stewart, *supra* note 58, at 342. The judiciary, he adds, has only compounded this problem by retreat from review of such issues, as judges claim, without enthusiasm, "the superiority of the political process for resolving issues of social and economic policy." *Id.* at 348. *See also* Sunstein, *supra* note 70, at 434-37 (criticizing reviewing courts' unwillingness to interpret regulatory statutes to require cost-benefit balancing, concluding that this leads to counterproductive overregulation); SCHULTZE, *supra* note 58, at 74 ("[B]y applying the principle and technique [of detailed regulation with adjudication of individual cases] to situations in which social intervention must be pervasive and continuing, we have ended up extending the sphere of detailed governmental control far beyond what is necessary to accomplish the objectives we seek.").

[75] *See* MacAvoy & Tella, *supra* note 58, at 193-94 (discussing deregulation of prices by the Civil Aeronautics Board and the Federal Power Commission).

[76] In the area of environmental regulation, one commentator characterized "command and control" regulation as having four components: (1) writing general rules, (2) writing specific permits, (3) operating in compliance with permits, and (4) enforcement, with only the third under the control of private parties. In most environmental contexts, he notes, "this pure command and control approach has now been altered at least modestly" as "[e]xisting law has granted private parties varying degrees of influence over each of the steps in which government is the prime actor." Barry Breen, *Beyond Command and Control Regulation: Innovative Approaches to Environmental Protection* in 1 LAW OF ENVIRONMENTAL PROTECTION §3.07[2][a] at 3-51 (Sheldon M. Novick et al. eds. 1993).

[77] Stewart, *supra* note 58, at 352, recognizes that "reconstituting" regulatory laws to "steer the overall tendency of institutions' decisions in the desired direction without attempting to dictate particular outcomes in every situation" is the most promising solution to existing regulatory inefficiency "of the centralizing command and control techniques relied upon so heavily in recent decades."

[78] Stewart, *id.* at 355-56, suggests that two "powerful external constraints" on command-and-control regulation will force future reliance on other modes of regulation: the political constraint on increased federal spending and the need to maintain international competitiveness.

[79] *See, e.g,* Grumbly, *supra* note 40, at 98.

Second, even if the self-regulator conducts itself properly and implements the program vigorously, regulation by its nature increases the amount of unreviewable discretion exercised by the self-regulator and even the auditing agency itself. Finally, there are political limitations on the scope and types of regulation which Congress would likely permit to be delegated, no matter how efficient that delegation might be in theory.

1. Inadequate Enforcement

Leaving the regulation to the regulated brings the possibility that an agency could be thereby or was already "captured"[80] by the subject industry. It might thereby subvert the regulatory goals to its own business goals, when the purpose of the regulation in the first place was premised on some market failure.[81] It is widely asserted that even the agencies themselves are subject to significant interest-group pressure,[82] and that pressure could be expected to be even greater upon a group composed itself of industry members. Even with the best of intentions, industry members or self-regulatory groups may be unwilling to commit the resources which vigorous self-enforcement would require.[83]

Furthermore, since any effective industry self-regulatory body consists almost by definition of a large combination of members, any activity taken in concert to standardize their conduct, however wholesome, runs the risk of

---

[80]For a summary of the political and economic theories of capture, see MITNICK, *supra* note 1, at 206-33 (with evidence suggesting "some support" for capture theories), THOMPSON & JONES, *supra* note 9, at 95-101 (describing development of economists' "supply and demand" theory of regulation) and BARDACH & KAGAN, *supra* note 45, at 44-45 (describing the capture theory as "a tenet of academic political science"). The avoidance of capture was a frequent goal of the social legislation of the 1960s and 1970s. *Id.* at 45.

[81]Bardach & Kagan, *supra* note 45, make the somewhat contradictory point that self-regulation can become as burdensome, as fraught with legalistic rules and as ineffective as direct regulation. However, they seem to lay the fault mostly at the feet, again, of the government regulators, who impose unreasonable procedural requirements in place of the unreasonable substantive rules. *See id.* at 234-38.

[82]*See* ROGER G. NOLL & BRUCE M. OWEN, THE POLITICAL ECONOMY OF DEREGULATION 29-41 (1983) (using "interest group" model of the regulatory process, concluding each regulation is beholden to the interest group which originated or currently controls it). Sunstein, *supra* note 70, at 426-28, calls this the regulatory paradox that "independent agencies are not independent." He notes that this is not necessarily more true of independent agencies than executive agencies, however, but the potential is certainly greater. *Id.* at 427-28

[83]*See* Karmel, *supra* note 40, at 1310 ("Vigorous policing by self-regulators of their own members is inherently difficult. Furthermore, [where self-regulators] compete against each other ..., it is extremely difficult for one ... to uphold a standard that a competitor does not enforce."); BARDACH & KAGAN, *supra* note 45, at 219 ("firms may not be induced to hire professional specialists in quality control or safety or environmental protection, or, if they do, to give them any intracorporate clout"); Sam S. Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE L. REV. 853, 862 (1985) ("SROs generally do not appear to have any greater access to industry expertise than their governmental counterparts.").

violation of the antitrust laws if it produces injury to competition.[84] This is a point often raised by antitrust enforcement agencies[85] and the courts as well.[86]

2. Exercise of Unreviewable Discretion

Self-regulation entirely discards what was supposed to be one of the major advantages of "command-and-control" regulation, namely, the adherence by the implementing agency to strict rules and regulations, thereby furthering the fundamental American tenet of reliance on "the rule of law."[87] This is also a source of one of the perceived advantages of the process, however, namely, the ability of the implementing officials to tailor enforcement to particular industries or practices, thereby making it more effective.[88]

It is impossible to predict in the abstract whether an increase in discretion is likely to lead to overregulation or underregulation as measured against any politically or economically "ideal" amount. Pressures push both ways on the decisionmaker, and the results would be very fact-dependent.[89] It is also impossible to reconcile the benefits of more discretion with the perceived harm of unreviewable discretion.[90] The solution lies in properly reviewing and limiting the discretion, not eliminating it altogether,[91] or in simply realizing that the

---

[84]*See* FTC STAFF REPORT, *supra* note 19, at 254-68 (describing how even voluntary standard-setting programs can result in unfair practices and unfair methods of competition); Miller, *supra* note 83, at 867 ("Negative impact on competition may be the most severe drawback of self-regulation.").

[85]*See supra* note 19 and accompanying text.

[86]See *infra* Part III.C.1 for a discussion of how to design self-regulation to best avoid antitrust concerns as expressed by courts.

[87]*See supra* note 64 and accompanying text.

[88]This advantage was cited by critics of command-and-control regulation's inevitable production of broad regulations unsuitable for use by any regulated entity. *See supra* notes 70-71 and accompanying text.

[89]For example, Miller, *supra* note 83, at 860-64, demonstrates how both could happen even in the same agency. "Paradoxically, SROs are charged with providing insulation from more effective government regulation as well as with a tendency to overregulate." *Id.* at 860.

[90]This problem arises not only from a philosophical standpoint of what amount of discretion is acceptable, but from a practical standpoint of designing efficient rules. *See* Colin S. Diver, *Regulatory Precisiôn*, in MAKING REGULATORY POLICY 202-05 (Keith Hawkins & John M. Thomas eds. 1989) (describing the countervailing considerations of "transparency, congruence, and simplicity" in writing efficient rules).

[91]Davis summarizes the contradictions and the solution.

> A rule of law must permit needed discretionary power. It should not eliminate or try to eliminate all discretionary power. .... Discretion is indispensable for individualized justice, for keeping law abreast of new conditions and new understanding, for new governmental undertakings for which rules have not yet been developed, and for some programs for which no one knows how to write rules.
>
> A main goal of a rule of law should be to eliminate *unnecessary* discretionary power. American law and practice are shot through with discretion that can and should be eliminated.

exercise and control of agency discretion is a constantly evolving or revolving phenomenon with no one proper result for any agency or type of regulation.[92]

3. Political Restrictions on Delegation

In some areas of protective regulation, it is simply unnecessary to ask even hypothetically if a particular problem be delegated to self-regulators. Though Congressional oversight of agencies and their programs is often limited, there are clearly topics beyond peradventure.[93] No matter how efficient banks or industry groups might be, Congress would certainly not consider turning any portion of safety and soundness inspections over to the industry in the wake of the savings and loan and bank failures of the 1980s and 1990s.[94]

DAVIS, *supra* note 14, at 115. The unnecessary discretion, he continues, can be checked in among other ways by providing guiding standards when rules are not feasible, and by requiring open statements of standards, findings, reasons for action and adherence to precedent when discretion is exercised. *Id.* at 115-17. BARDACH & KAGAN, *supra* note 45, caution that supervision of self-regulation can result in documentation concerns and responsibilities. *Id.* at 238-39.

[92]Keith Hawkins and John M. Thomas, *Rule-Making and Discretion: Implications for Designing Regulatory Policy* in MAKING REGULATORY POLICY, *supra* note 90, at 263-78, review DAVIS, *supra* note 64, and other scholars' works on discretion, concluding:

> The regulatory process is populated by bureaucracies intent on avoiding criticism, since after all they are government agencies whose policies reflect external political demands. To fail to recognize this dynamic is to assume that an optimal degree of discretion can be defined and structured.
>
> ....
>
> In addition to the well-known constraints of the external political environment, the exercise of discretion is a function of the type of decisionmaking task and the professional values of officials. As a consequence, it is highly problematic to control and change the amount of discretion in the regulatory process.

Id. at 272-73.

[93]William Cary, generalizing from his experience as Chairman of the Securities and Exchange Commission, concluded that "[i]t may seem lacking in courage, but I believe it is safe to conclude that agencies seldom take controversial steps under their rule making power which do not have some support from Congress." CARY, *supra* note 15, at 53.

[94]*See* U.S. DEP'T OF THE TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS Pt. IV (1991) (proposing, in addition to capital maintenance and insurance reforms, increased and improved supervision). *But see* Oedel, *supra* note 7 (describing early banking self-regulation). There are other examples. One is the Federal Communications Commission's "fairness" doctrine. *See generally* Bloch, *supra* note 15. Another is the Department of Agriculture's meat inspection system. Although physical inspection of each animal slaughtered is required by law, *see* 21 USC §§604-605, such inspection is not effective in identifying bacterial infestations which are today considered a primary cause of foodborne illnesses. Nonetheless, Congress rebuffed the Department's attempts to modify the physical inspection system, ultimately removing all funding for the program. *See FSIS to Withdraw SIS But Reproprose Cattle Inspection Charges*, FOOD CHEMICAL NEWS, Aug. 3, 1992; Daniel P. Puzo, *Does Streamlined Beef Inspection Work?*, L.A. TIMES, June 18, 1992, p. H37. The vitality of this impression was demonstrated by the Department's response to the January 1993 outbreak of illness and deaths apparently linked to contaminated beef sold in Washington fast food restaurants. The initial response was to require additional

III. Elements of Effective Audited Self-Regulation

Part II, in describing the development of self-regulation and its attendant advantages and disadvantages, suggests that certain characteristics of an industry, regulatory agency and regulatory statute are required for self-regulation to be effective. These are summarized in Part A below. In addition, various provisions in the Constitution require that the self-regulatory process provide fundamental procedural fairness; these are discussed and applied in Part B below. Finally, Part C discusses the design of a self-regulatory system to avoid, to the extent possible, liability under antitrust or tort law doctrines.

In general, the following conclusions are reached. First, the private entity to which self-regulatory authority is granted must have both the expertise and motivation to perform the delegated task. Second, the agency staff must possess the expertise to "audit" the self-regulatory activity, which includes independent plenary authority to enforce rules or review decisions of the delegated authority. Third, the statute must consist of relatively narrow rules related to output-based standards. It may be either inter- or intra-industry in scope, but should not be limited to traditional rate-and-entry regulation. Finally, the agency's and delegated authority's decisions must observe rules of notice, hearing, impartiality, and written records of proceedings and decisions.

A. Characteristics of the Industry, Regulation, and Agency

1. The Industry

The most important component of effective self-regulation is, of course, the industry itself,[95] or group of industries subject to the regulations.[96] There must be within each firm or an organized industry group individuals able and willing to implement the regulations at hand.

Ability requires expertise. There is no evidence that government is inherently able to attract better experts than private industry or industry groups. What is required is a preexisting investment by the industry in human and

---

inspectors in the slaughterhouses, despite the current inability to test for micro-organisms. *See generally*, Carole Sugarman, *U.S. Meat Inspections Come Under Scrutiny*, WASH. POST, Feb. 9, 1993, Health section, at 9; Richard Gibson & Scott Kilman, *Tainted-Hamburger Incident Heats Up Debate Over U.S. Meat-Inspection System*, WALL ST. J., Feb. 12, 1993, at B1.

[95] *See* THOMAS K. MCCRAW, PROPHETS OF REGULATION 305-06 (1984) (concluding that "[f]or all parties who seek to understand regulation, the most important single consideration is the appropriateness of the regulatory strategy to the industry involved").

[96] In the case of the newer inter-industry regulations, it is difficult to conceive of a particular "industry" save for the regulatory experts to be conscripted for self-regulation, for example, safety engineers or environmental officers at the thousands of different worksites and emissions sites subject to regulation.

perhaps physical capital as well, with the capability to translate the government mandated general standards into firm-specific rules to produce the desired results.[97]

More importantly, the regulated entities must be motivated to comply. This motivation can be supplied by a preexisting professional group which performed many facets of self-regulation,[98] by the spotlight of public scrutiny from interest groups of workers, consumers or others,[99] or by the industry's recognition that effective regulation is in its own economic self-interest.[100] In addition, incentives can be created by the self-regulatory program itself, if it is carefully designed to increase certainty of regulatory outcomes, simplify the process, and provide measurable benefits to outweigh the "startup" costs of implementing and internalizing the new regulatory scheme.[101] Indeed, the roots of self-regulation lie in the spirit of government-industry cooperation in the 1920s, created from the compulsory regulation of many of those same industries during World War I.[102] A meaningful grant of autonomy in the self-regulation arrangement will itself serve to motivate.[103] There may be a certain amount of "inherent" motivation,[104] though this will serve mostly to assure compliance with the regulations once adopted. Of course, in instances where direct government regulation, however cumbersome, is a realistic alternative, it must be always present in the minds of

---

[97] *See supra* notes 40-42 and accompanying text.

[98] This was the case with many of the self-regulatory programs discussed below; *see infra* Part IV.A.1 (securities exchanges), Part IV.B.1.a (hospital accreditation), and Part IV.B.2 (college and university accreditation).

[99] Vogel, *supra* note 55, at 171-75, notes a significant difference of the social regulation of the 1960s and 1970s from that before it in that it was largely imposed on the regulated with outside support from citizen and consumer groups. *See also* Alfred W. Blumrosen, *Six Conditions for Meaningful Self-Regulation*, 69 A.B.A.J. 1264, 1269 (1983) ("Only in this situation will the regulated institutions believe that regulation is permanent.").

[100] *See, e.g*, MCCRAW, *supra* note 95, at 201-02 (contrasting the approaches taken by the Securities and Exchange Commission in regulating over-the-counter dealers, where it had the industry's cooperation, and in reorganizing public utility holding companies, where it had the industry's virulent opposition).

[101] *See* Michael H. Levin, *Getting There: Implementing the "Bubble" Policy*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 59, 90-91 (Eugene Bardach & Robert A. Kagan eds. 1982). Indeed, one measure of a regulatory program which is a good candidate for self-regulation is that it is currently so unwieldy that it would yield such incentives upon reform.

[102] *See* Ellis Hawley, *Three Facets of Hooverian Associationalism: Lumber, Aviation and Movies, 1921-30* in REGULATION IN PERSPECTIVE 97-101 (Thomas K. McCraw ed. 1981) (referring to the programs of Secretary of Commerce Herbert Hoover, building on the initiative of private enterprise demonstrated during World War I).

[103] *See* Gerald P. Berk, *Approaches to the History of Regulation*, in REGULATION IN PERSPECTIVE 197 (Thomas K. McCraw ed. 1981) (citing as examples the period of "Hooverian associationalism" discussed in Hawley, *supra* note 102, and the self-regulation of the over-the-counter securities market by the National Association of Securities Dealers since 1939).

[104] Even with direct government regulation, the rate of voluntary compliance is ordinarily high. *See supra* note 50 and accompanying text.

the regulated entities.[105] Whether the initial force is external or internal,[106] the result must be a genuine willingness on the part of the industry to effectively implement the regulation.

Effective implementation, in turn, means that the "incentive" to comply must not be created by making other groups worse off who are the intended beneficiaries of the regulatory program in the first place. In rate-and-entry regulation, for example, industries are perceived as having monopolistic powers and consumers as unprotected. There is little reason to expect significant self-regulation in traditional rate-and-entry regulation, as it is the cooperation in pursuit of self-interest which is the source of the public injury in the first place.[107]

2. The Regulation

It is apparent from Part II that self-regulation is related primarily to the "social" regulation of the 1960s and 1970s. The major characteristics of those laws are their application across industry lines and the typical focus on "internalizing externalities" in the economic sense, that is, requiring industries to account for costs of production previously unmeasured, such as pollution, unsafe working conditions, unsafe products and the like. It is precisely these types of laws that can be implemented in a uniquely efficient manner by industry because they affect the costs of production, which are complex factors unique to each firm. On the other hand, these "externalities" can be effectively "internalized" only if the costs can be efficiently transferred to industries, something the industry will not like. This is why traditional health and safety regulation has been considered a poor candidate for self-regulation, so long as consumer and labor groups are unable to provide a check on management's motivation to comply with the regulation when it has no economic incentive to do so.[108]

---

[105]*See, e.g.*, Blumrosen, *supra* note 99, at 1267 ("Meaningful self-regulation will be undertaken when the regulated community perceives that it is the lesser evil.") This concept is the source, in federal regulation of securities exchanges and broker-dealers, of the popular historical references to the "big stick" or the "shotgun behind the door" in characterizing the government's reserved powers of direct regulation. *See, e.g.*, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess., pt. 4, at 501-02 & 693-98 (1963). *See also infra* part III.A.3 (residual authority of the agency).

[106]Blumrosen, *supra* note 99, at 1269 (suggesting that the best incentive for self-regulation in employment discrimination law comes from a combination of pressures from the regulating agency for reports and compliance plans and from the public in the form of residual liability).

[107]This is the type of regulation primarily done by the Interstate Commerce Commission, Federal Maritime Commission, Federal Communications Commission and formerly by the Civil Aeronautics Board and Federal Power Commission. Regulation of rates and service typically involves two groups diametrically opposed in a "zero-sum" negotiation over the price, which makes that type of regulation a poor candidate for self-regulation. Telephone interview with Gerald Vaughn, Deputy Bureau Chief for Operations, Common Carrier Bureau, FCC (Feb. 26, 1993). *But see* Bailey & Baumol, *supra* note 73 (market-based regulation possible even in traditionally near-monopolistic industries).

[108]Telephone interview with Neil Eisner, Assistant General Counsel for Regulation and Enforcement, Department of Transportation (Dec. 7, 1992).

In addition, the requirements of the law must be objectively stated, ideally in terms of output requirements or standards.[109] An objective statement of standards allows the self-regulators to measure, and the agency to review, their performance concretely in the same terms as the legal requirements.[110] This also reduces the amount of unreviewable discretion (both by the regulators and the reviewing agency) to a minimum consistent with standards which are still sufficiently adaptable to be realistic.[111] However, the desire for specificity should not deteriorate into "command-and-control" minutiae.[112]

3. The Agency

The most important characteristic of the agency, apart from its legislation discussed above, is expertise.[113] Each of the areas of potential self-regulation requires the "auditors" to have technical knowledge sufficient to evaluate compliance, as well as a knowledge of how to test compliance itself.[114] And there will remain inevitable discretion to be exercised even in supervision of

---

[109]*See* DAVID SCHEONBROD, POWER WITHOUT RESPONSIBILITY 143 (1993) ("instead of complicated laws, the federal government should enact simple laws that would help private arrangements to work better"). He suggests four characteristics of a statute which provides adequate direction: (1) it provides "a clear answer" in most cases; (2) by resolving most cases, it indicates the weight the legislature gives to conflicting goals; (3) courts, rather than agencies, have the final say in interpretation; and (4) it must be changed by legislation. *See id.* at 183. Moreover, providing such "clear answers" does not mean that Congress' need replicate agency regulatory efforts through legislation. *Id.* at 135.

[110]*See* Blumrosen, *supra* note 99, at 1268 (for self-regulation to be effective, standards must be established by law and the results to be achieved must be measurable).

[111]*See* Diver, *supra* note 90, at 226 (demonstrating that concrete guidelines are especially important in "[p]rograms administered on a highly decentralized basis"). Rules enforced through self-regulation would likely fit in this category.

[112]*See* BARDACH & KAGAN, *supra* note 45, at 236-37 (indicating the ease with which agencies could replace unworkable detailed substantive standards with unworkable detailed procedural requirements for meeting substantive standards); SCHULTZE, *supra* note 58, at 87-88 (cautioning that incremental replacement of "command-and-control" with incentive-based regulation is essential to its success).

[113]*See* Grumbly, *supra* note40, at 116 (concluding that if an agency's technicians are not held in high regard by the industry, "any move toward self-regulation may have to be accompanied by substantial efforts to upgrade the regulators' technical and scientific proficiency").

[114]One reviewer of the Securities and Exchange Commission's regulation of securities exchanges confirmed this need.

> SRO [self-regulatory organization] initiative dampens SEC initiative to develop capacity to review SRO actions in a meaningful way. The SROs, though considered public institutions under the law, view investor and public interest through the lens of their members' welfare. Self-regulation thus makes the regulator's task both simpler and more difficult.

Walter Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755, 779 (1984).

compliance with the clearest standards.[115] Furthermore, discretion is required in the agency's own exercise of its reserved enforcement powers. The agency must take sufficient independent action to motivate self-regulation without stifling it.[116] Expertise in discretion is difficult to identify,[117] but it is necessary.[118]

B. Procedural Requirements

Part A above developed as paradigms the elements of the industry, the regulations, and the industry necessary for effective self-regulation. This part discusses legal rules of procedural fairness applicable to any program of group self-regulation.

1. The Nondelegation Doctrine

The Constitution limits the ability of Congress to delegate its lawmaking function to others. This limitation is broadly referred to as the nondelegation doctrine. The only certainties about the nondelegation doctrine are that it lacks a

---

[115]For example, agencies must avoid impatience in adopting incentive-based regulation which may create instead a replica of the prior command-and-control system. *See supra* note 112 and accompanying text.

[116]Blumrosen, *supra* note 99, posits requirements for successful self-regulation which hinge on these discretionary abilities. *See id.*, at 1268 ("A vigorous enforcement program must exist to provide incentives for self-regulation"); *id.* at 1269 ("Administration and interpretation must support and encourage self-regulation").

[117]Successful supervision of self-regulation requires the ability to "exploit the natural incentives of regulated interests to serve particular goals that the regulators themselves have carefully defined in advance." McCraw, *supra* note 95, at 309.

[118]*See* Lipton, *supra* note 12, at 541-48 (developing rules in securities regulation for determining whether duplicate authority should be exercised in a specific instance by the agency or by the self-regulatory authority, but acknowledging that they are not comprehensive and that their "application often requires a subjective interpretation of a regulatory problem").

precise constitutional foundation,[119] it is incapable of precise formulation and application,[120] and that it is doubtful whether it even exists at all.[121]

Paradoxically, although the nondelegation doctrine is perhaps nonexistent, the principles underlying it have always been clear: "Administrators should not have unguided and uncontrolled discretionary power to govern as they see fit."[122] The fundamental question is thus not whether Congress may delegate its power; clearly it may do so.[123] Rather, due process is the main issue.[124] Although the process due in each case cannot be stated in the abstract,[125] the law does or sound

---

[119]"The nondelegation doctrines are derived from the separation of powers principle, which is implicit in the structure of the Constitution." Harold I. Abramson, *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 HASTINGS CONST. L.Q. 165, 187 (1989). The specific constitutional foundations are the vesting of legislative power in the Congress in the first sentence of Article I and the vesting of executive power in the President in the first sentence of Article II, *see* Harold J. Krent, *Fragmenting the Unitary Executive*, 85 NW. U.L. REV. 62, 71-72 (1990), and the vesting of judicial power in the courts as well in the first sentence of Article III. *See* Abramson, *supra*, at 194-97. Courts rely on other grounds equally, however, including the Due Process Clause as well as antitrust laws. *See* Abramson, *supra*, at 199-208 (procedural due process and state action), George W. Liebmann, *Delegation to Private Parties in American Constitutional Law*, 50 IND. L.J. 650, 656-57 (1975) (state action and antitrust law); Stewart, *supra* note 58, at 343-44 (discussing the development of "new subconstitutional principles of administrative law to replace the now waning separation of powers jurisprudence").

[120]*See, e.g.*, Abramson, *supra* note 119, at 208 (commingled concepts resulting in "murky rationales" from the Supreme Court); DAVIS, *supra* note 14, at 160 (charging that limits on delegation are "so vague as to be meaningless"). Interestingly, the most severe criticism is usually reserved for cases discussing delegations to private parties. *See* Krent, *supra* note 119, at 94 (such delegations "coexist with our current understanding of the separation of powers doctrine only uneasily, at best"); Abramson, *supra* at 187 n. 124 (citing various commentators referring to delegation to private parties as "not crystalliz[ing] any consistent principles," "largely confused and unprincipled," and "a conceptual disaster area").

[121]*See* DAVIS, *supra* note 14, at 150 ("the nondelegation doctrine has ... no reality in the holdings"); Stewart, *supra* note 58, at 350 (reinvigorating classic nondelegation doctrines would "amount to a constitutional counterrevolution"), Lawrence, *supra* note 25, at 649 ("Private exercise of federally delegated power is no longer a federal constitutional issue."). The recent cases invalidating analogous Congressional innovations, Bowsher v. Synar, 478 U.S. 714 (1986) and INS v. Chadha, 462 U.S. 919 (1983), do not, strictly speaking, involve delegation of legislative, executive or judicial power, but rather attempts by Congress to expand its powers beyond those granted by Article I. *See* Krent, *supra* note 119, at 77-78.

[122]DAVIS, *supra* note 14, at 206. He continues: "But the courts have found by experience that that purpose cannot be accomplished through the traditional nondelegation doctrine." *Id.*

[123]*See id.* at 149-50. This is as true of delegation to public agencies or employees as to private groups, as decisions under the nondelegation doctrine have not distinguished between delegations to government employees and those to private parties. *See* Krent, *supra* note 119, at 69; Abramson, *supra* note 119, at 210. *But see* SCHOENBROD, *supra* note 109, at 135 ("The Supreme Court has said that time limitations require Congress to delegate but supports this conclusion only with the observation that the federal government does delegate.").

[124]*See* DAVIS, *supra* note 14, at 207 (purpose of the doctrine should be "protection against unnecessary and uncontrolled discretionary power"); Abramson, *supra* note 119, at 209 & n.260 (many commentators have suggested replacing the nondelegation doctrine with the Due Process Clause).

[125]The specific requirements themselves are unclear, and in the case of private parties, there is the threshold question of the existence of "state action" making the private activity subject to constitutional

public policy should[126] in each case provide fundamental process rights. These include rulemaking with broad participation by all affected groups,[127] disqualification of decisionmakers who have conflicting interests,[128] and adjudication on notice, with an opportunity to be heard, following binding general rules, and with explicit findings and reasons.[129]

2. Due Process Requirements

An alternative source of process requirements is the Fifth Amendment, which applies to nongovernmental entities only if they are engaged in "state action" involving an individual's liberty or property interest.[130] Although courts have difficulty with the threshold question of state action in some instances,[131] self-regulatory organizations are clearly so acting.[132] Assuming that one of the

---

requirements in the first place. *See* Abramson, *supra* note 119, at 199-208. In addition, the expansion of procedural rights in reviewing administrative discretion has come to a pronounced halt. Further "judicial innovations" would "respond more to the symptoms of the problem than its underlying roots. ... . Moreover, the current and likely future federal judiciary has little enthusiasm for it." Stewart, *supra* note 58, at 348-49.

[126]See, *e.g.*, Davis' argument for a reconstituted nondelegation doctrine focused on protecting against uncontrolled discretionary power, which he admits would be a "sweeping" change. DAVIS, *supra* note 14, at 206-07.

[127]*See* Stewart, *supra* note 58, at 347. Recommendations of the Administrative Conference of the United States have generally endorsed the rulemaking requirements under the Administrative Procedure Act with slight modifications. *See* Public Participation in Administrative Hearings, 1 CFR §305.71-6, Procedures for the Adoption of Rules of General Applicability, *id.* §305.72-5, Procedures in Addition to Notice and the Opportunity for Comment in Informal Rulemaking, *id.* §305.76-3, and Interpretive Rules and Statements of General Policy, *id.* §305.76-5.

[128]This requirement applies equally to rulemaking and adjudication. *See* Decisional Officials' Participation in Rulemaking Proceedings, 1 CFR §305.80-4 (rulemaking); Abramson, *supra* note 119, at 202, and *infra* note 129 and accompanying text (adjudication).

[129]*See, e.g.*, Edward L. Rubin, *Due Process and the Administrative State*, 72 CAL. L. REV. 1044, 1132 (adherence to precedent, if any, established by general rules), 1145 (notice, opportunity for hearing, independent decisionmaker); Martin H. Redish & Lawrence C. Marshall, *Adjudicatory Independence and the Values of Procedural Due Process*, 95 YALE L.J. 455, 475 (1986) ("the participation of an independent adjudicator is ... an essential safeguard [regardless of context], and may be the only one").

[130]Others have suggested that due process is a common law requirement. *See* WILLIAM A. KAPLIN, THE LAW OF HIGHER EDUCATION 568-69 (2d ed. 11985); Courts Oulahan, *The Legal Implications of Evaluation and Accreditation*, 7 J. L. & EDUC. 193, 223 (1978).

[131]*See* Abramson, *supra* note 119, at 203 & n.219.

[132]*See id.* at 169 (characterizing programs such as audited self-regulation as "formal government deputizing of private persons") & 213 (concluding that "[s]ince, by definition, the private actor has been made a public actor, its action will constitute state action"). *See also* Intercontinental Indust., Inc. v. American Stock Exchange, 452 F.2d 935, 941 (5th Cir. 1971), *cert. denied*, 409 U.S. 842 (1972) (due process required in stock exchange delisting proceeding); Villani v. New York Stock Exchange, 348 F. Supp. 1185, 1188 n.1 (S.D.N.Y. 1972), *aff'd sub nom.*, Sloan v. New York Stock Exchange, 489 F.2d 1 (2d Cir. 1973) (beyond question that due process rights apply to exchange disciplinary proceedings because the exchanges are exercising federal powers); Eleanor D. Kinney, *Suits by Disappointed Applicants: Due Process, etc.*, in PRIVATE ACCREDITATION IN THE REGULATORY STATE 2 (materials prepared for conference sponsored by Am. Bar Ass'n Sec. of Admin. L. & Pract., May 21, 1993) ("Given

protected interests is involved,[133] the issue once again is what process is due in each case. The Supreme Court has remained steadfast in its reliance on a balancing test[134] to determine what process is due, a test which has been criticized and is difficult to apply in the abstract.[135] The requirements in decided cases, however, are very similar to those applied under the nondelegation doctrine above: an unbiased decision maker,[136] notice and an opportunity to be heard, and a right to confront and cross-examine witnesses, for example.[137]

C. Liability of Self-Regulatory Organizations

An additional area of concern in designing a program of audited self-regulation is certainly the exposure to liability which the self-regulatory organizations or individual actors might have. The major sources of any such liability are the antitrust laws and tort law. Although the background issues are discussed below, it is impossible to state in the abstract the "proper" extent of exposure in these areas, since that decision involves policy judgments and the position of the actors in each industry which admit of no "right" answer. For example, although the regulators would likely desire that their liability be severely limited if not eliminated altogether, sound reasons can be given for permitting broad liability under antitrust[138] and tort law.[139]

---

that the decisions of private accreditors in these disputes pertain directly to certification for participation in government-sponsored health insurance programs, the determination of whether state action exists should be straightforward ... .").

[133]It is likely that a program of audited self-regulation will affect liberty or property interests, as with the brokers and listed companies in *Villani* and *Intercontinental Industries, supra. But see* O'Bannon v. Town Court Nursing Ctr., 447 U.S. 773, 786-88 (1980) (decision by government to strip nursing home of accreditation and thus eligibility to participate in Medicaid does not involve residents' Fifth Amendment interests). It is difficult to state in the abstract what interests will qualify for protection. *See* Abramson, *supra* note 119, at 214 n.286.

[134]*See* Mathews v. Eldridge, 424 U.S. 319, 335 (1976).

[135]*See* Abramson, *supra* note 119, at 201-02.

[136]*See Villani, supra,* at 1190-91; Rite Aid Corp. v. Board of Pharmacy, 421 F. Supp. 1161 (D.N.J. 1976), *appeal dismissed,* 430 U.S. 951 (1977) (holding that due process, applicable in this case because of "state action" subject to the Fourteenth Amendment, requires an impartial tribunal, and that a board composed of plaintiff's competitors could nonetheless be impartial provided they have no immediate pecuniary interest).

[137]*See Intercontinental Industries, supra,* at 941-43. *See generally,* Oulahan, *supra* note 130, at 225-26 (concluding that due process in educational accreditation "would seem to require, at the minimum," published criteria for measurement, published procedures for review or appeal of an adverse decision, opportunity for a hearing with representation, and a decision on the record showing the basis of the decision).

[138]*See, e.g.,* Silver v. NYSE, 373 U.S. 341, 359-60 (1963) ("the antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of exchanges which conflict with their duty to keep their operations and those of their members honest and viable").

[139]*See* Peter H. Schuck, *Liability to Those Injured by Negligent Accrediting Decisions,* in PRIVATE ACCREDITATION AND THE REGULATORY STATE 4 (materials prepared for conference sponsored

1. Antitrust Liability

Self-regulation involves by its very nature collusive conduct in restraint of competition, the activity at the very heart of the antitrust laws.[140] It is virtually impossible to obtain an explicit statutory exemption from the antitrust laws.[141] Nor would such an exemption necessarily be wise policy, since antitrust proscriptions have been recognized as beneficial even when operating within a significant regulatory program.[142]

It is difficult to predict the impact of antitrust litigation even in a particular program, much less extend any concepts generally to systems of audited self-regulation, since liability likely does not turn on the structure of the program from the outset, but rather the particular impact on the antitrust plaintiff in a given case. Nonetheless, the process protections discussed in Part III.B above are also relevant to antitrust analysis in two respects: they may permit a court to imply an exemption from the antitrust laws; and they may help define the boundaries between permissible conduct and illegal conspiracies.

An antitrust exemption will be implied only where necessary for the underlying regulatory scheme to work, and only if the agency has made the antitrust inquiry of whether the restraints on competition are reasonable and the least restrictive means toward the regulatory end.[143] Thus, the agency must have the benefit of a fully developed record in order to make an antitrust inquiry adequate for the reviewing court.[144] Process protections are vital in developing such a record. The same considerations would hold true for the deliberations of the self-regulatory organization. Initially, rules for antitrust immunity in the context of audited self-regulation arose primarily from cases in the securities

---

by Am. Bar Ass'n Sec. of Admin. L. & Prac., May 21, 1993) ("If the tort system is to ensure that the social costs of poor accreditation decisions are internalized and borne by those who can best minimize them, it will have to provide an effective cause of action against accreditors.").

[140] *See* 7 PHILLIP AREEDA, ANTITRUST LAW ¶1477 at 343 (1986) ("[T]rade associations are routinely treated as continuing conspiracies of their members"). *But see* Consol. Metal Products, Inc. v. Am. Petroleum Inst., 846 F.2d 284, 293-94 (5th Cir. 1988) ("[A] trade association is not by its nature a 'walking conspiracy,' its every denial of some benefit amounting to an unreasonable restraint of trade."). Whether a conspiracy is found may depend in part on the existence of process protections; *see infra* notes 154-157 and accompanying text.

[141] Such an attempt was rejected by a Congressional committee in SECURITIES INDUSTRY STUDY, *supra* note 49, at 155-64. There are some exceptions, however; *see* 7 USC §608b(a) (exemption from the antitrust laws for agricultural marketing agreements), discussed *infra* Part IV.D.1, and the general grants of immunity to peer reviewers and peer review organizations, *infra* note 168 and accompanying text.

[142] *See* SECURITIES INDUSTRY STUDY, *supra* note 49, at 164, and *supra* note 138 and accompanying text.

[143] *See generally* 1 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW ¶ 224e (1978).

[144] *Id.* at 152. Areeda and Turner focus on the need for deliberation at the agency level, but the same considerations hold true for deliberations of the self-regulatory organization. *See* Silver v. NYSE, 373 U.S. 341, 361-62 (1963).

industry.[145] In a dispute between the New York Stock Exchange and one of its members,[146] the Supreme Court found "unjustifiable" action by the NYSE because it proceeded without notice or hearing in its regulation.[147] Although failure to observe procedural fairness is no longer considered tantamount to an antitrust violation, [148] process requirements nonetheless likely remain relevant in determining whether an exemption should be implied.[149] In a later case, the Court cited the pervasive oversight by the Securities and Exchange Commission of rules of the NYSE in granting an exemption from antitrust liability for price-fixing, activity otherwise clearly illegal.[150] The Court relied upon the existence of oversight authority and the actual use of that authority in balancing competitive and regulatory concerns.[151] Although later cases have suggested it is unlikely that an exemption will be implied,[152] the decision is in any event very dependent on the particular facts of each case.[153]

---

[145]This is perhaps because the audited self-regulation in the securities industry is the most well-established and developed of any model. *See* Marianne K. Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. REV. 475, 476-78 (1984). Smythe notes that it is possible but unlikely that similar antitrust protection would be given to largely voluntary regulatory efforts. *Id.* at 514-15.

[146]Silver v. NYSE, 373 U.S. 341 (1963).

[147]*See id.* at 361-62.

[148]*See* Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 291-93 (1985) (limiting *Silver* to its facts, where lack of procedural protections were relevant in not finding an implied exemption from the antitrust laws in the Securities Exchange Act, and holding that due process concerns generally do not affect analysis of conduct otherwise actionable under the antitrust laws). If there is no impact on competition, therefore, even arbitrary exclusion of a competitor may not be actionable under the doctrines set forth in *Northwest. See, e.g.,* Moore v. Boating Industry Ass'n, 819 F.2d 693, 710-13 (7th Cir. 1987), Goss v. Memorial Hospital System, 789 F.2d 353, 354-55 (5th Cir. 1986). *See generally,* Robert Heidt, *Industry Self-Regulation and the Useless Concept "Group Boycott,"* 39 VAND. L. REV. 1507 (1986).

[149]The repudiation of *Silver* in *Northwest* extended only to the suggestion that procedural protections could save otherwise actionable conduct. *See Northwest, supra,* 472 U.S. at 293. The Court in *Northwest* did not hold that due process protections were irrelevant for purposes of determining whether a regulatory program effected an implied repeal of the antitrust laws, which was the issue before the Court in *Silver*.

[150]*See* Gordon v. NYSE, 422 U.S. 659 (1975). *See also* Austin Municipal Securities, Inc. v. NASD, 757 F.2d 676, 694-95 (5th Cir. 1985) (implied immunity from antitrust liability for investigation by NASD of its members); Harding v. American Stock Exchange, 527 F.2d 1366, 1370 (5th Cir. 1976) (implied immunity for delisting of a company's stock from trading on a stock exchange).

[151]*See* Smythe, *supra* note 145, at 507, *Austin Municipal Securities, supra,* at 695.

[152]*See* 1 PHILLIP AREEDA & DONALD F. TURNER, *supra* note 143, at ¶ 223.2 (Supp. 1993) (reviewing recent cases, all of which failed to find an implied immunity).

[153]*See id.* at 135-36 ("Regulatory regimes also vary widely in the comprehensiveness of their powers over the firms they regulate and in the degree to which ordinary competitive forces are left to operate. Thus, the room left for the continued operation of normal antitrust rules will differ greatly among regulated industries. Such variations mean that the antitrust result will depend on the particular language and structure of each regulatory statute.").

Process protections are also relevant in determining whether there is conduct actionable under the antitrust laws. Disregard or manipulation of process has been held to be actionable anticompetitive conduct,[154] while a showing of compliance with that process can remove the unfairness or impropriety that is an essential element of an actionable conspiracy.[155] Process is all the more important in a program of audited self-regulation, since by definition, there is conduct in restraint of trade;[156] the only protection may be a fair process which prevents a court from finding any conspiracy. Even in the case of unregulated trade associations, extensive procedural protections have been recommended.[157] Those should be extended to audited self-regulation, which has all the more anticompetitive potential.

Thus, there appear to be three separate sources of process requirements in a system of audited self-regulation: the nondelegation doctrine, the due process clause, and antitrust law. The nondelegation doctrine focuses upon the control of discretion; the due process clause focuses on protection of the property interest of the regulated entities, and the antitrust laws focus on the protection of the competitive process. Despite these distinct purposes, there is clearly some overlap among each of these sets of standards. Establishing minimum procedural standards not only further compliance with the nondelegation doctrine,[158] but will likely assure more widespread acceptance by the industry and the public.[159] And the requirement of plenary agency authority over the self-regulator and the regulated entities themselves not only insulates self-regulation from nondelegation and antitrust attacks, but provides more complete assurance,

---

[154]*See* Am. Soc'y of Mechanical Eng'rs v. Hydrolevel Corp., 456 U.S. 556, 570-71 (1982); Indian Head, Inc. v. Allied Tube & Conduit Corp., 817 F.2d 938, 946-47 (2d Cir. 1987), *aff'd*, 486 U.S. 492 (1988). There must, of course, be separate evidence of an economic impact. *See supra* note 148.

[155]*See* Clamp-All Corp. v. Cast Iron Soil Pipe Inst., 851 F.2d 478, 488-89 (1st Cir. 1988).

[156]*See supra* text accompanying note 10 (regulation is defined as alteration of behavior "backed by the use of penalties"). In most cases, even unregulated trade associations are engaging in "continuing conspiracies," *see* 7 PHILLIP AREEDA, *supra* note 140, at 343-46. Thus, voluntary associations which only certify products or services are not in violation of the antitrust law where fair practices or procedures are followed, since there is no actionable conduct. *See* Wilk v. Am. Medical Ass'n, 895 F.2d 352, 374 (7th Cir. 1990); *Consol. Metal Products, supra*, 846 F.2d at 292.

[157]*See* Administrative Conference of the United States, Federal Agency Interaction with Private Standard-setting Organizations in Health and Safety Regulation, 1 CFR §305.78-4. Paragraph 6(c) of that Recommendation states that the standard-setting association should assure that: (1) membership includes all affected groups; (2) notice of action is given to interested parties; (3) interested parties have an opportunity to participate; (4) careful consideration is given to minority views and objections; (5) supermajority approval is required for a standard to be effective; (6) there is an adequate opportunity for review; (7) there is a record maintained sufficient to document compliance with process requirements; and (8) the entire process is open to public scrutiny and review.

[158]*See* Smythe, *supra* note 145, at 509 n.164 ("delegation to the private sector, if done on the securities industry model, would ... avoid the constitutional [nondelegation] problems.").

[159]*See* BARAM, *supra* note 19, at 60.

through agency supervision, of the efficacy of and legitimacy of the self-regulation itself.[160]

2. Tort Liability

Audited self-regulation involves private organizations regulating the conduct of others. Any such limitations on conduct necessarily bring the possibility of claims for damages. No matter how good the procedure, a regulated entity might attack the decision of the self-regulatory organization on the merits.

Lawsuits against self-regulatory organizations fall generally into two categories. First, the regulated entity may directly challenge the particular action: a hospital whose accreditation is stripped, making it no longer eligible for Medicare reimbursement, or a securities broker censured, fined or expelled by the stock exchange. Second, injured third parties may sue for damages: patients whose Medicare coverage was terminated, investors who were defrauded by a poorly regulated market or an unscrupulous broker, or students at a college whose accreditation was not renewed, thus eliminating any possibility for federally-guaranteed student loans.[161]

The first type of action, direct attack on the self-regulator, may be foreclosed by a decision to grant immunity, ordinarily reserved for members of the government,[162] to self-regulatory organizations which exercise quasi-governmental functions, notably prosecution or enforcement.[163] And since

---

[160]*See* Jennings, *supra* note 48, at 679-90 (positing that "any ... public institution to which has been 'delegated governmental power' should be subject to greater governmental oversight in several respects," and presaging several reforms, such as agency review of membership denials and disciplinary actions, review of self-regulatory organization rules and independent authority to make and enforce self-regulatory organization rules, which came to pass in amendments to the securities laws in 1975); Smythe, *supra* note 145, at 509 & n.164 (the framework adopted by the 1975 amendments will provide maximum protection from antitrust immunity, nondelegation attacks while avoiding "an increasingly cumbersome and insensitive federal bureaucracy").

[161]There are, of course, other actions as varied as tort law, not relevant to this study. For example, the same underlying facts as discussed in the hypotheticals in the text might support actions for defamation, fraud or abuse of process. However, these actions require some greater intent on the part of the defendant, and are thus distinguishable from actions sounding in negligence which are the main concern of self-regulators. *See generally,* JOHN D. BLUM ET AL., PSROS AND THE LAW 183-191 (1977). In addition, there are occasional claims for damages caused by self-regulators, but unrelated to the merits of the regulation. *See, e.g.,* Dilk, *supra* note 29, at 593 (discussing Lavitt v. United States, 177 F.2d 627 (2d Cir. 1949), an action "to recover damages ... for the burning of a potato warehouse through the alleged negligence of three potato inspectors"); KAPLIN, *supra* note 130, at 570-71 (discussing Avins v. White, 627 F.2d 637 (3d Cir. 1980), an action alleging defamation of a law school faculty member by an American Bar Association consultant during an accreditation inspection).

[162]*See generally* Butz v. Economou, 438 U.S. 478 (1978) (immunity granted to Secretary of Agriculture in initiating administrative action against commodities dealer); Nixon v. Fitzgerald, 457 U.S. 731, 744-48 (1982) (discussing background and development of governmental immunity doctrine).

[163]*See* Kwoun v. Southeast Mo. Prof. Stds. Rev. Org., 811 F.2d 401 (8th Cir. 1987), *cert. denied,* 486 U.S. 1022 (1988) (immunity from damages caused by action of peer review organization resulting in

governing statutes or regulations provide for agency and ultimately judicial review of the organization's decision, a disappointed regulated entity will ultimately have a cause of action for the relief sought.[164]

The second type of action by third parties, one for damages, is more troublesome. Cases involving such allegations generally are resolved in favor of the self-regulatory organization, however, by imposing a high standard of actionable misfeasance,[165] higher standards for reliance and causation,[166] or simply refusing to extend the accreditor's duty to third parties at all.[167] In some instances there are explicit statutory grants of immunity.[168] However, these statutes are rare, and courts in other areas have been willing to expand duties of those who provide information about a provider of services to the third party consumers of those services.[169]

The extent of private liability is not necessarily relevant in designing a program of self-regulation, unless it is essential to the program that any such liability be eliminated entirely. Otherwise, there are other factors more important to the development of tort law generally and decided only on a case-by-case basis which should determine the outcome of those cases. However, as with antitrust liability, adherence to pristine procedure may nonetheless be advantageous. It

---

exclusion of physician from participation in Medicare and Medicaid reimbursement programs); Austin Municipal Securities v. NASD, 757 F.2d 676 (5th Cir. 1985) (immunity from damages caused by institution of disciplinary proceedings by NASD against member).

[164]Indeed, access to the courts on direct review has been relied upon by courts in several cases finding immunity from liability, assured that there remain safeguards against arbitrary conduct. *See Butz*, 438 U.S. at 515-16, *Kwoun*, 811 F.2d at 408, *Austin Municipal Securities*, 757 F.2d at 690.

[165]*See* 7 USC §25(b)(4) (requiring that plaintiff in action for damages based on violation of provisions of Commodity Exchange Act must establish that the defendant "acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss"). This language, added in 1982, codified the previously-understood standard implied under the Act. Bosco v. Serhant, 836 F.2d 271, 276 (7th Cir. 1987). *See also* Hochfelder v. Midwest Stock Exchange, 503 F.2d 364, 367-68 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974) (stock exchange not liable for failure to enforce its own rules regarding actions of president of member firm unless it knows or has reason to know of the individual's misfeasance, or there are acts or events which would put the exchange on notice of possible violations); Spicer v. Chicago Board Options Exchange, 1990 WL 172712 at 16-17 (N.D. Ill. Oct. 30, 1990) (holding that stock exchanges and their members not liable to investors in market in aftermath of "Black Monday" 1987 for "negligence or simple errors of judgment"). *But see* Evans v. Kerbs & Co., 411 F. Supp. 616, 625 (S.D.N.Y. 1976) (referring to *Hochfelder* as "essentially a negligence standard").

[166]*See* Schuck, *supra* note 139, at 4-5.

[167]*See id.* at 6-8.

[168]*See* 42 USC §1320c-6(b) (immunity for peer review organizations); *id.* §11111(a)(1) (immunity for peer review generally). Agricultural marketing orders, *see infra* Part IV.D.1, provide in each instance for limited liability of the citizens serving on each marketing committee. *See, e.g.,*, 7 CFR §905.88 ("No member or alternate of the committee nor any employee or agent thereof, shall be held personally responsible, either individually or jointly with others, in any way whatsoever, to any handler or to any other person for errors in judgment, mistakes, or other acts, either of commission or omission ... except for acts of dishonesty.").

[169]*See* Schuck, *supra* note 139, at 13-20.

will not, of course, prevent liability for otherwise actionable conduct. But if proper standards of care are in fact followed, documentation of the rules and procedures followed will greatly assist scrupulous self-regulators in their own defense.[170]

IV. Survey of Current Uses of Audited Self-Regulation

This Part surveys existing programs[171] in several widely different regulatory areas. Each program possesses most or all of the required attributes of audited self-regulation as defined in Part I. In each instance, the program is measured against the requirements for effective implementation discussed in Part III, and the benefits of the program are compared with the benefits predicted in Part II.

A. Financial Institutions, Services and Products

Federal regulation of financial institutions is extensive. Each of the areas where audited self-regulation is used or has been considered are discussed below.

1. Securities Exchanges and Market Participants

The long-established model of supervised self-regulation is the regulation of the nation's securities exchanges and broker-dealers by the Securities and Exchange Commission (SEC) in conjunction with the exchanges and the National Association of Securities Dealers (NASD). Collectively, the exchanges and the NASD are referred to in the statute as self-regulatory organizations (SROs).[172]

Although the regulation of securities exchanges and broker-dealers is relatively uniform today, each has a separate origin.[173] The nation's securities exchanges were first federally regulated by the Securities Exchange Act of 1934.[174] Before 1934, the exchanges had on their own imposed a significant

---

[170]BLUM ET AL., *supra* note 161, at 185-86.

[171]The discussion below of the Institute for Nuclear Power Operations, *infra* Part IV.C, does not technically describe an existing program of self-regulation, since the Nuclear Regulatory Commission was prohibited by statute from using the rules of the self-regulatory organization in lieu of its own rules. *See infra* notes 423-425 and accompanying text. Nonetheless, this example is included in the study because it is similar to other programs of formal reliance on self-regulation, and it continues to be an example of informal reliance on self-regulation.

[172]*See* Securities Exchange Act §3(a)(26), 15 USC §78c(a)(26).

[173]The history of the development of regulation of the securities markets has been widely researched. The following discussion is only a brief summary of much fuller treatments elsewhere. For a listing of major works, see 6 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2788 n.3 (3d ed. 1990), and that work itself should also be included, *see id.* at 2787-2816.

[174]Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 USC §§78a-78kk).

degree of regulation on their members.[175] In drafting regulatory legislation, "Congress assumed that its task included incorporating the existing self-regulatory institutions (*i.e.* the stock exchanges) into the new regulatory system."[176] Direct government regulation was discussed,[177] but rejected as impractical.[178]

The original regulation of securities exchanges was modest by current standards. Each exchange was required to register with the SEC, agree to comply with the Act and enforce compliance by its members and adopt rules governing their members including rules requiring discipline for conduct "inconsistent with just and equitable principles of trade."[179] The SEC was given authority to suspend or revoke an exchange's registration and to adopt rules for the exchanges in certain areas.[180]

The securities brokers and dealers themselves were subject to regulation by the exchange if they were at exchange member firms, subject to the above requirements of the Act. However, a significant amount of other trading took place outside the exchanges, or "over the counter," by brokers and dealers who were not exchange members. Regulation of this group proceeded on a parallel track. Because little was known about this market, Congress originally provided in 1934 general rulemaking authority for the SEC over brokers and dealers who were not exchange members.[181] In exercising that authority, the SEC required the registration of these firms, and in 1936 Congress amended the Act to require

---

[175]*See* Jennings, *supra* note 48, at 667-69; Smythe, *supra* note 145, at 480-81; Miller, *supra* note 83, at 869.

[176]Smythe, *supra* note 145, at 481.

[177]*See* SECURITIES AND EXCHANGE COMMISSION, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 4, at 501 (1963) [hereinafter SPECIAL STUDY]. In a later study, a Congressional committee concluded that "[e]vents preceding [the Securities Exchange Act] caused public regard for the exchanges to be so low that it would have been politically feasible to have made even greater changes than those made by that Act." SECURITIES INDUSTRY STUDY, *supra* note 49, at 80.

[178]"Self-regulation was originally advanced and adopted as a feature of Federal control on the ground of practicality. Initially, attention was focused on the exchanges ... and it was thought that the extent of the control necessary, either actually or potentially, made direct governmental intervention ineffective, if not impossible." SPECIAL STUDY, *supra* note 177, at 501.

[179]Securities Exchange Act of 1934, Pub. L. No. 73-291, §6(b), 48 Stat. 881, 886 (1934) (codified as amended at 15 USC §78f(b)(5)).

[180]*See generally* Jennings, *supra* note 48, at 670-71 (summarizing new requirements in 1934). The power to suspend or revoke a registration was regarded, even at its origin, as severe, and it has been rarely used. *Id.* at 671; Smythe, *supra* note 145, at 483; Douglas C. Michael, *The Untenable Status of Corporate Governance Listing Standards*, 47 BUS. LAW. 1461, 1502 n.242 (1992).

[181]*See* Securities Exchange Act of 1934, Pub. L. No. 73-291, §15, 48 Stat. 881, 895-96 (1934). "The brevity and generality of this treatment arose from a realistic recognition of the great difficulties of working out in any detail a suitable plan of regulation at that time, in view of the fact that so little was then known concerning these markets." S. REP. NO. 1455, 75th Cong., 3d Sess., at 4 (1938).

registration of all broker-dealers who effected transactions outside a registered exchange.[182]

Regulation of broker-dealers outside of the securities exchanges suffered from the lack of any preexisting organization comparable to the exchanges on which to build a self-regulatory system. The Investment Bankers Conference Committee, largely created at the SEC's behest, was organized for that task.[183] New legislation was considered necessary to properly constitute that committee as a self-regulatory organization, with regulation patterned after the securities exchanges.[184] As with the exchanges,[185] direct government regulation was considered and rejected.[186]

Although the regulation of over-the-counter brokers was patterned on the regulation of the exchanges, it differed in at least two respects. First, Congress was confronted with organizing the SRO from the outset, rather than taking the exchanges with a long history of voluntary regulation, and was thus able and willing to improve on the exchange model.[187] Second, "[w]hereas the stock exchanges ... resisted governmental oversight, the [over-the-counter dealer SRO was] an outgrowth of a desire by responsible representatives of the ... business for some form of industry self-regulation."[188]

The resulting legislation, known as the Maloney Act,[189] provided for registration with the SEC of "national securities associations" similar to the securities exchanges, but governing nonmember broker-dealers and trading of securities not listed on the exchanges. In addition to the powers granted the SEC over the exchanges, there was added the ability of the SEC to review disciplinary

---

[182]*See* Pub. L. No. 74-621, §3, 49 Stat. 1375, 1377 (1936). *See generally* DAVID A. LIPTON, BROKER-DEALER REGULATION §1.01, at 1-3 to 1-7 (1988). Because most broker-dealer firms which were stock exchange members also effected transactions over-the-counter, this resulted in registration of virtually all broker-dealers (except specialists and floor brokers, who did their trading only on the floor of the exchange) with the SEC. *See id.* §1.01, at 1-6.

[183]*See* SPECIAL STUDY, *supra* note 177, at 604-05. The Committee originated as the Investment Bankers Code Committee, one of several "industry code" groups formed under the National Industrial Recovery Act. Even when that Act was declared unconstitutional in 1935, *see* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935), the code committee continued its activities and reorganized itself, all with the SEC's encouragement. SPECIAL STUDY, *supra*, at 605; *accord* Smythe, *supra* note 145, at 484.

[184]*See* Hed-Hoffman, *supra* note 48, at 205 & n.81.

[185]*See supra* note 177 and accompanying text.

[186]*See* Howard C. Westwood & Edward G. Howard, *Self-Government in the Securities Business*, 17 LAW & CONTEMP. PROBS. 518, 526 (1952); SECURITIES INDUSTRY STUDY, *supra* note 49, at 82-83.

[187]In the wake of the failure of the National Industrial Recovery Act, moreover, the SEC recognized that government regulation must be more comprehensive (to be legally sufficient) as well as less intrusive (to be politically realistic). At the same time, a major scandal at the New York Stock Exchange provided the impetus to distinguish the new SRO from the NYSE, then held in low esteem. *See* Hed-Hofmann, *supra* note 48, at 205 & n.82.

[188]Jennings, *supra* note 48, at 675.

[189]Pub. L. No. 75-719, 52 Stat. 1070 (1938).

proceedings and to propose rule changes, which were considered significant additions.[190] The SEC informally approved the idea of a strong national securities association,[191] and the NASD was registered as the first national securities association shortly after passage of the Maloney Act. It remains the only such organization today.[192]

Thus established on parallel tracks, self-regulation by the securities exchanges and the NASD ran until they were joined in 1975. The change was precipitated by the "paperwork crisis" of 1968-70, when a marked increase in trading volume overwhelmed the antiquated trade-settlement mechanisms in the industry, forcing trading to be curtailed and many securities firms into insolvency.[193] Congress responded initially with the Securities Investor Protection Act of 1970,[194] to safeguard investors from losses due to their brokers' financial difficulties,[195] and then with a comprehensive reform of the self-regulation of the securities industry. In the Securities Acts Amendments of 1975,[196] the self-regulation and SEC oversight was unified and strengthened. Reversing the process of the 1934-38 era, Congress used the pattern of SEC supervision of the NASD as the model, now imposing the stricter provisions of that law on the securities exchanges as well, collectively referring to them in the statute as "self-regulatory organizations" (SROs).[197] In addition, the Act expanded the supervision of the SROs' self-regulation.[198] It provided for complete review and approval by the SEC over the SROs' rulemaking,[199] allowed the SEC to proceed administratively against a substandard SRO,[200] and gave the SEC independent authority to enforce SRO rules in court.[201]

---

[190]*See* Jennings, *supra* note 48, at 675-76; SPECIAL STUDY, *supra* note 177, at 705-06. These changes were referred to as a substantial advance over the pattern of self-regulation applicable to the stock exchanges," Jennings, *supra*, at 677, and as "[t]he existing allocation of regulatory responsibility between the exchanges and the Commission ..., but 'with 1938 improvements.'" SPECIAL STUDY, *supra*, at 606.

[191]*See* SPECIAL STUDY, *supra* note 177, at 606. *But see* Hed-Hoffman, *supra* note 48, at 206 ("One of the unexpected results of the Maloney Act was the emergence of only one organization of broker dealers instead of many."); Westwood & Howard, *supra* note 186, at 526.

[192]*See* SECURITIES INDUSTRY STUDY, *supra* note 49, at 82; Lipton, *supra* note 12, at 528 n.1; Smythe, *supra* note 145, at 478.

[193]For descriptions of the crisis, see SECURITIES INDUSTRY STUDY, *supra* note 49, at 3-13; H.R. REP. NO. 123, 94th Cong., 1st Sess. 44-45 (1975); SECURITIES AND EXCHANGE COMMISSION, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. DOC. NO. 231, 92d Cong., 2d Sess. (1971); 6 LOSS & SELIGMAN, *supra* note 173, at 2897-907.

[194]Pub. L. No. 91-598, 84 Stat. 1636 (1970) (codified at 15 USC §§78aaa-78*lll*).

[195]*See* H.R. REP. NO. 123, 94th Cong., 1st Sess. 45 (1975).

[196]Pub. L. No. 94-29, 89 Stat. 97 (1975) (codified in scattered sections of 15 USC).

[197]*See* H.R. REP. NO. 123, 94th Cong., 1st Sess. 48-49 (1975); S. REP. NO. 75, 94th Cong., 1st Sess. 26-28 (1975); *accord* SECURITIES INDUSTRY STUDY, *supra* note 49, at 112.

[198]*See generally*, S. REP. NO. 75, 94th Cong., 1st Sess. 26-36 (1975).

[199]*See* Securities Exchange Act §19(b)-(c), 15 USC §78s(b)-(c).

[200]*See id.* §19(g)-(h), 78 USC §78s(g)-(h).

[201]*See id.* §21(d)(1), (e)-(f), 15 USC §78u(d)(1), (e)-(f).

Finally, in 1983, Congress closed the remaining gap in self-regulation. Since 1964, all broker-dealers not members of the NASD or an exchange had been subjected to similar self-regulatory rules imposed directly by the SEC.[202] Congress found that the more flexible sanctions available through the NASD were preferable to the limitations on direct SEC action, confirming "the desirability of self-regulation" heralded in the 1975 amendments.[203] Direct SEC regulation was eliminated, and all broker-dealers are now required to be members of either an exchange or the NASD.[204]

This system of supervised self-regulation, continuously modified over the 60 years since its inception, is certainly the longest and most comprehensive federal government experience with audited self-regulation. At each point of major reform, the fundamental soundness of the system has been reaffirmed.[205] Although its origin may have been in part due to the "historical accident" of a preexisting self-regulatory structure in the case of the securities exchanges,[206] it has been built up far beyond this original structure. As it stands today, the system of audited self-regulation contains the attributes identified in Part III above as necessary for effective self-regulation.

Has the audited self-regulation of securities exchanges and broker-dealers produced the benefits which analysts project from such a system? As measured against the theories in Part II, the results are encouraging. There are assertions that the securities industry self-regulation does not result in better rules,[207] more precise and efficient enforcement,[208] congruence with members' preexisting self-interest,[209] nor lower overall costs of regulation.[210] However, in retrospect, most of the reformers call not for scrapping the system, but for recognizing the full

---

[202]This was known as the "SEC Only" or "SECO" program, since these broker-dealers were subject to regulation by the SEC directly and not through any SRO. *See* LOSS & SELIGMAN, *supra* note 173, at 2815.

[203]H.R. REP. NO. 106, 98th Cong., 2d Sess., at 6 (1983). The legislation affected few broker-dealers and generated a small cost savings to the SEC. *See supra* note 51.

[204]*See* Securities Exchange Act §15(b)(8), 15 USC §78*o*(b)(8).

[205]*See, e.g.*, H.R. REP. NO. 123, 94th Cong., 1st Sess. 48-49 (1975); SECURITIES INDUSTRY STUDY, *supra* note 49, at ix; SPECIAL STUDY, *supra* note 177, at 504.

[206]*See* Smythe, *supra* note 145, at 478.

[207]Commentators have questioned the assumed expertise of the self-regulators, *see* Miller, *supra* note 183, at 862, as well as their ability to write better rules in "ethical" areas. *See* Hed-Hoffman, *supra* note 48, at 209-10; *but see* Jennings, *supra* note 48, at 678 (concluding that in this area "the Commission, the Congress, and the industry seem justified in supporting the extension and refinement of the self-regulatory philosophy").

[208]The enforcement has been criticized as too dilatory, *see* Hed-Hofmann, *supra* note 48, at 210-12, and as too swift and unfair, *see* Miller, *supra* note 83, at 865-67.

[209]*See* Hed-Hofmann, *supra* note 48, at 206-08; Miller, *supra* note 83, at 867-68.

[210]*See* Hed-Hofmann, *supra* note 48, at 212; Miller, *supra* note 83, at 864-65; Jennings, *supra* note 48, at 677.

power of the agency as a supervisor of self-regulation;[211] and at each point of reform discussed above, the agency's powers were in fact broadened. It appears that the ability and willingness of the SEC to perform its "audit" tasks vigilantly remains the key to success.

2. Commodity Exchanges and Market Participants

The Commodity Exchange Act[212] provides for comprehensive regulation of the nation's futures[213] markets under the supervision of the Commodity Futures Trading Commission (CFTC). The history of this regulation provides one of the best studies of the progress of audited self-regulation from its earliest origins, in regulation of commodity exchange products and trading practices, to one of its most modern applications, in regulation of the participants in those markets.

Futures markets were first federally regulated in the Grain Futures Act of 1922,[214] which provided primarily for registration of commodity exchanges with the Department of Agriculture and prohibited futures trading outside these registered exchanges. The original purpose of the regulation was to prevent manipulation by forcing all trading onto a registered exchange and requiring those exchanges to police and prevent manipulation.[215] Exchanges were required only to file required reports with the government and to prevent the dissemination by their members of false or misleading information and manipulation of prices.[216] Although the new authority was used by the Department of Agriculture

---

[211]*See* Miller, *supra* note 83, at 885-87; Hed-Hofmann, *supra* note 48, at 217; Jennings, *supra* note 48, at 690.

[212]Commodity Exchange Act, ch. 369, 42 Stat. 998 (1922) (codified as amended at 7 USC §§1-23).

[213]"Futures" is a shorthand reference for a variety of instruments. The original agreement which was the source of business for the nation's boards of trade was a futures contract, which is "a binding agreement to take delivery of or to deliver a known quantity of a commodity which is of a uniform quality at a price specified at the time the contract is made." Marshall J. Nachbar, *Contract Market Self-Regulation Under the Commodity Exchange Act*, 31 CLEV. ST. L. REV. 573, 574 n.2 (1982). The growing trade in primarily agricultural commodities required standardization of these contracts, which was the original impetus for the formation of the nation's commodity exchanges or boards of trade in the mid-19th century. *See* JERRY W. MARKHAM, THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION 4-5 (1987). Since that time, these contracts have grown dramatically in scope, covering not only agricultural commodities but other physical products, financial instruments, foreign currency and market indexes. In addition, the type of contracts has grown in variety, including options on commodities and options on futures contracts. *See* Nachbar, *supra*, at 575-76 & n.4; MARKHAM, *supra*, at 179-249 (describing instruments traded).

[214]Grain Futures Act of 1922, ch. 369, 42 Stat. 998 (1922). The Act was given its current name in 1936; *see* Commodity Exchange Act, ch. 545, §1, 49 Stat. 1491 (1936) (codified at 7 USC §1).

[215]*See* MARKHAM, *supra* note 213, at 15 (noting that this act "forms the core of the current regulatory scheme).

[216]Grain Futures Act of 1922, ch. 369, §5, 42 Stat. 998, 1000 (1922) (codified at 7 USC §7).

to conduct numerous investigations into abnormal trading, "its role was one of investigation and .. actual regulation was conducted by the exchanges."[217]

The underlying rationale for relying on self-regulation of commodities markets fits with several of the hallmarks for successful self-regulation discussed in Part III. The exchanges were recognized as having an economic self-interest in assuring a minimum level of fair play in the trading on their markets.[218] In addition, the exchanges had demonstrated a level of expertise in what was recognized, even in the formative stages, as a complex and technical subject best understood by the participants.[219]

There followed for the next fifty years increasing dissatisfaction with the self-regulatory abilities of the commodity exchanges. In 1936, the Act was significantly amended to require federal registration of brokerage firms (known as futures commission merchants, or FCMs) and traders on the floor of the exchanges,[220] to prohibit by federal statute fraud and excessive speculation,[221] and to require the exchanges to enforce their own rules.[222] And again in 1968, federal authority was further extended to expand the types of prohibited conduct,[223] to give the Department of Agriculture administrative enforcement authority over any market participants,[224] authority to review exchange rules,[225] and to establish for the first time minimum financial requirements for FCMs.[226] Far from

[217] MARKHAM, *supra* note 213, at 18. The exchanges had a long though spotty history of discipline of their members. Though "abuses were rampant" at the exchanges, *id.* at 5, disciplinary actions brought by the exchanges against their members were uniformly upheld in the state courts. *See* Jonathan Lurie, *Commodities Exchanges as Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law*, 28 RUTGERS L. REV. 1107, 1130-38 (1975).

[218] "[T]he purpose of self-regulation is to protect the integrity of the marketplace. An exchange which does not assure the public customer of a fair deal will suffer a large number of dormant contracts." Nachbar, *supra* note 213, at 578.

[219] *See* Lurie, *supra* note 217, at 1137-38 (describing deference by state courts in 1800s to exchange decisions on design of contracts as well as disciplinary proceedings, based on the exchanges' expertise).

[220] *See* Commodity Exchange Act §§4d-4e, as added by the Commodity Exchange Act of 1936, ch. 545, §5, 49 Stat. 1491, 1494-95 (1936) (codified as amended at 7 USC §§6d-6e).

[221] *See* Commodity Exchange Act §§4a-4c, as added by the Commodity Exchange Act of 1936, ch. 545, §5, 49 Stat. 1491, 1492-94 (1936) (codified as amended at 7 USC §§6a-6c).

[222] *See* Commodity Exchange Act §5a, as added by the Commodity Exchange Act of 1936, ch. 545, §7, 49 Stat. 1491, 1497 (1936) (codified as amended at 7 USC §7a).

[223] *See* Commodity Exchange Act §4b, as amended by Pub. L. No. 90-258, §5, 82 Stat. 26, 27 (1968) (codified as amended at 7 USC §6b).

[224] *See* Commodity Exchange Act §6(c), as added by Pub. L. No. 90-258, §5, 82 Stat. 26, 31 (1968) (codified as amended at 7 USC §13b).

[225] *See* Commodity Exchange Act §8(a)(7), as added by Pub. L. No. 90-258, §5, 82 Stat. 26, 33 (1968) (codified as amended at 7 USC §12a(7)).

[226] *See* Commodity Exchange Act §8(a)(3)(I), as added by Pub. L. No. 90-258, §5, 82 Stat. 26, 32 (1968) (codified as amended at 7 USC §12a(3)(I)).

extending self-regulation, the 1968 amendments "reflected a deep animosity between the Agriculture Department and the industry it was regulating."[227]

In 1974, additional authority was granted to the government, and administration of the Act was transferred from the Department of Agriculture to the new CFTC.[228] In addition to expanding government regulation, Congress for the first time since 1922 reexamined and reaffirmed the basic structure of audited self-regulation of the industry.[229] The new CFTC was given authority over the commodities exchanges similar to that previously given the SEC over securities markets.[230] In general, the CFTC was required to approve all exchange rules,[231] and authorized to require new exchange rules in certain areas,[232] and require the exchanges to enforce their own rules.[233]

The above regulatory structure includes most of the elements listed in Part III for effective audited self-regulation. However, the increasing resort to direct regulation of the commodities exchanges suggests a growing frustration over the years on the part of the government with the exchange's abilities. The resulting failure to obtain many of the benefits listed in Part II can be attributed to the lack of incentive to comply on the part of the commodities exchanges. One commentator has argued that the exchanges' monopoly on trading futures-type products has reduced their economic incentive to maintain fair markets, as evidenced by the recent undercover investigation of the exchanges by government agents.[234] When these exchanges were first regulated in 1922, no comparable authorities existed to regulate off-exchange trading, and it was simply prohibited.

---

[227]MARKHAM, *supra* note 213, at 52. Industry opposition to the legislation was strong; *see id.* at 54-55.

[228]*See* Commodity Exchange Act §2(a)(2)-(11), as added by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §101, 88 Stat. 1389, 1389-90 (1974) (codified as amended at 7 USC §4a).

[229]*See* MARKHAM, *supra* note 213, at 63. For a general summary of the provisions of the 1974 legislation, see *id.* at 65-72.

[230]The pattern of supervised self-regulation established in 1938 with the Maloney Act, dealing with the SEC-NASD relationship, was relied upon in the 1974 legislation. That pattern was itself extended the following year to SEC regulation of the securities exchanges. *See supra* Part IV.A.1.

[231]*See* Commodity Exchange Act §5a(12), as added by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §210, 88 Stat. 1389, 1401 (1974) (codified as amended at 7 USC §7a(12)).

[232]*See* Commodity Exchange Act §8a(7), as added by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §213, 88 Stat. 1389, 1404 (1974) (codified at 7 USC §12a(7)) (changes may be made in areas including but not limited to trading and execution requirements, financial responsibility rules, solicitations and recordkeeping).

[233]*See* Commodity Exchange Act §6b, as added by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §212(b), 88 Stat. 1389, 1403-04 (1974) (codified at 7 USC §13a). *See generally*, MARKHAM, *supra* note 213, at 68-70 (summary of new provisions relating to CFTC's authority over contract markets).

[234]*See* Jerry W. Markham, *The Commodity Exchange Monopoly — Reform Is Needed*, 48 WASH. & LEE L. REV. 977, 987-93 (1991).

But today that void has been filled by federal and state securities laws.[235] Thus, if off-exchange trading were allowed, it is argued, "competition could assure that exchanges remain innovative by creating new, more attractive futures contracts and that their marketplaces remain free of fraud and achieve maximum efficiency."[236] Although the economic self-interest underlying effective audited self-regulation may be waning in the regulation of commodities exchanges, it could thus likely be returned.

In contrast to this checkered history of audited self-regulation in the commodities markets, the relatively recent regulation of the participants in those markets makes extensive use of this regulatory technique. From the outset, Congress and the CFTC recognized the need for audited self-regulation in oversight of the entities directing trades on the commodity exchanges.

In the same 1974 legislation which reformed the regulation of commodities markets,[237] Congress authorized the CFTC to register a new type of self-regulatory organization, a "futures association" to regulate industry members.[238] The CFTC would have full oversight of a futures association, comparable to SEC oversight of the securities markets.[239] Such an association "would benefit the [CFTC] by reducing its regulatory burden while allowing it to focus resources on oversight and enforcement functions most appropriate to a Federal agency."[240] Although modeled after the creation of the NASD in 1938, this futures association was fundamentally different. Because there is no "over-the-counter" trading in commodity futures, unlike securities, there was no preexisting organization nor would there be an economic self-interest in regulation among its members.[241] Initial attempts to organize such an association were stymied until Congress in 1978 authorized the CFTC to make membership in such an

---

[235]*See id.* at 1002.

[236]*Id.* at 1003.

[237]*See supra* note 228 and accompanying text.

[238]*See* Commodity Exchange Act §17, as added by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §301, 88 Stat. 1389, 1406-07 (1974) (codified as amended at 7 USC §21).

[239]*Compare id. with* Securities Exchange Act §§15A & 19, 15 USC §§78*o* & 78s, discussed *supra* Part IV.A.1. One significant difference is the scope of oversight with regard to rules. The CFTC's authority under Commodity Exchange Act §17(k), 7 USC §21(k), is limited to certain subjects, in contrast with the SEC's authority under Securities Exchange Act §19(c), 15 USC §78s(c). *See* CFTC REPORT, *supra* note 51, at 147-49. At least one court, however, has indicated that the SEC's §19(c) powers might be restricted in areas not closely-related to its regulatory responsibilities. *See* Business Roundtable v. SEC, 905 F.2d 406, 414 (D.C. Cir. 1990) (stating in dictum that with respect to rules "which do not regulate members and are not related to the purposes of the [Exchange] Act, the [SEC]'s powers will be quite limited").

[240]CFTC REPORT, *supra* note 51, at 15.

[241]*See id.* at 16.

organization mandatory,[242] and in 1982 authorized the CFTC to delegate to such an organization all of its registration responsibilities under the Act.[243] These provisions were added to dispel concerns about antitrust and nondelegation problems.[244] The first and only such organization, the National Futures Association (NFA), was registered by the CFTC in 1981 and has assumed responsibility for broad portions of the Act dealing with all registered industry members, including proficiency testing, audit and financial surveillance, sales practice rules, registration and arbitration.[245]

In the NFA, Congress and the CFTC have provided for a distinct type of self-regulation. It contains the elements of effective audited self-regulation listed in Part III. Interestingly, though, the NFA had no preexisting structure or purpose; its sole function was to take over administration of significant portions of the Act from the CFTC in order to save federal staff resources. The NFA appears to have fulfilled many of the advantages of a system of audited self-regulation discussed in Part II. The technique results in a substantial cost savings to the government, those costs being largely shifted to the regulated industry.[246] More importantly, however, the self-regulation results in many areas in programs which are more detailed, informal and complete than could be undertaken by the CFTC, even if it were fully funded to undertake those programs directly.[247] Thus, in a complement to the regulation of commodities exchanges, one of the oldest examples of audited self-regulation, Congress and the CFTC have created a novel entity, a private organization which "exists solely for the purpose of regulating and does not conduct any commercial function."[248] Although it was created not by the self-interest of its members but by government-mandated membership,[249] it nonetheless fulfills the functions and meets the goals generally recognized for audited self-regulation.

---

[242]*See* Commodity Exchange Act §17(m), as added by the Futures Trading Act of 1978, Pub. L. No. 95-405, §22(4), 92 Stat. 865, 876 (1978) (codified at 7 USC §21(m)).

[243]*See* Commodity Exchange Act §17(*o*), as added by the Futures Trading Act of 1982, Pub. L. No. 97-444, §233(5), 96 Stat. 2294, 2321-22 (1983) (codified at 7 USC §23(*o*).

[244]*See* CFTC REPORT, *supra* note 51, at 17. For a discussion of the nondelegation doctrine and the application of antitrust laws to self-regulatory organizations, see *supra* Part III.B.1.

[245]*See* CFTC REPORT, *supra* note 51, at 20-23.

[246]CFTC staff estimated that in 1983-85 the NFA's operations resulted in $3.5 million in direct savings and $16.2 million in avoided additional costs. CFTC REPORT, *supra* note 51, at 132.

[247]*See id.* at 61 & 73 (review of sales practices), 83 (avoidance of multiple registration compliance costs) & 99-100 (informal disciplinary actions).

[248]CFTC REPORT, *supra* note 51, at A-1.

[249]*See supra* note 242 and accompanying text.

3. Investment Advisers

Under the Investment Advisers Act of 1940,[250] the SEC is charged with the registration of investment advisers.[251] Among other requirements, registered advisers must keep books and records as required by SEC regulations.[252] All such records are subject to "reasonable ... examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors."[253]

In the early 1980s, the number of registered investment advisers began to increase dramatically,[254] so much so that by 1992 the SEC was able to inspect each adviser, on the average, only once each 25 to 30 years.[255] By the mid-1980s, the SEC was considering proposals to use a system of supervised self-regulation for inspection of investment advisers.

In 1986, the NASD began a voluntary experimental program of inspection of its own members conducting advisory activities. In a report issued in 1988, the SEC concluded that this program "demonstrated both the feasibility and ability of the NASD inspectors to conduct adviser examinations."[256] In 1989, the SEC submitted proposed legislation to Congress to authorize the registration with the SEC of investment adviser self-regulatory organizations to conduct adviser inspections subject to SEC oversight.[257] The legislation was patterned after the self-regulation of broker-dealers under the Exchange Act.[258] The new self-regulation was intended to provide more effective inspections, facilitate the development of fair and ethical business practices, and do so at private rather

---

[250]Pub. L. No. 76-768, Tit. II, 54 Stat. 789, 847 (1940) (codified as amended at 15 USC §§80b-1 to 80b-21).

[251]Investment Advisers Act §203(a), 15 USC §80b-3(a).

[252]*See* Investment Advisers Act §204, 15 USC §80b-4. The implementing regulation is Investment Advisers Act Rule 204-2, 17 CFR §275.204-2.

[253]Investment Advisers Act §204, 15 USC §80b-4.

[254]From 1981 through 1991, the number of registered advisers more than tripled, and the amount of assets they had under management increased more than ten times. *See* H.R. REP. NO. 883, 102d Cong., 2d Sess. 16 (1992); S. REP. NO. 312, 102d Cong., 2d Sess. 4 (1992).

[255]*See* S. REP. NO. 312, 102d Cong., 2d Sess. 4 (1992). The SEC does inspect the 500 largest investment advisers every three years, however. *Id.*

[256]REPORT OF THE STAFF OF THE SECURITIES AND EXCHANGE COMMISSION TO THE SUBCOMM. ON TELECOMMUNICATIONS AND FINANCE OF THE HOUSE COMM. ON ENERGY & COMMERCE, 100th Cong., 2d Sess. (1988), *reprinted in* [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,220 at 89,010 (Feb. 1988).

[257]*See* H.R. REP. NO. 883, 102d Cong., 2d Sess. 16-17 (1992); S. REP. NO. 312, 102d Cong., 2d Sess. 4-5 (1992).

[258]*See* S. REP. NO. 312, 102d Cong., 2d Sess. at 4 (1992). The system of broker-dealer supervised self-regulation is described *supra* Part IV.A.1.

than public cost.[259] In addition, it was expected that the investment advisors, having "acquired an interest in regulation to establish their trustworthiness," would be willing to undertake the effort and expense of self-regulation.[260]

The proposed arrangement thus bore the main hallmarks of a program of successful audited self-regulation. There were several preexisting industry groups with demonstrated willingness and ability to undertake the regulatory program. The benefits expected were more efficient inspections, rules more tailored to the experiences of the regulated than government rules might be, as well as significant cost savings to the government. Prior to the 1980s, the investment adviser industry was not considered a candidate for self-regulation, though it had been proposed as early as 1963, because of the lack of a strong organization in a very diverse industry and the resulting lack of professional or economic motivation.[261] However, there was significant industry opposition to the proposed legislation, and it was not enacted.[262] Some industry members believed that the likely self-regulatory organization, the NASD, did not sufficiently understand the specialized nature of investment advice in contrast to the sales and distribution orientation of broker-dealers with which it was more familiar.[263] In addition, the industry believed that direct government regulation would in fact be less expensive, an assertion borne out by the SEC's own study.[264]

After the defeat of the 1989 legislative proposal, the SEC began considering direct government regulation funded by special registration fees assessed on the investment advisers subject to inspections.[265] Legislation to that effect was introduced and passed in both houses of Congress in 1992,[266] but the versions were never reconciled in conference. The House bill provided that the SEC, at its option, could designate one or more of the existing broker-dealers SROs — the exchanges and the NASD — to perform inspections on members not primarily

---

[259] *See* Letter from David S. Ruder, Chairman, Securities and Exchange Commission, to The Honorable Dan Quayle, President of the Senate, June 19, 1989, *reprinted in* [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,422, at 80,188.

[260] TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS 81 (Supp. 1992).

[261] *See* 1 TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS 38 (1978).

[262] *See* H.R. REP. NO. 883, 102d Cong., 2d Sess. at 17 (1992); S. REP. NO. 312, 102d Cong., 2d Sess. 5 (1992).

[263] *See SEC Oversight of Investment Advisers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 102d Cong., 2d Sess. at 129 (statement of SEC Chairman Richard Breeden).

[264] *See id.* at 129-30 & n.15 (statement of SEC Chairman Richard Breeden).

[265] This change of heart was due to the lack of support for the legislation, a change in membership in the SEC, as well as the possibility, existent in 1990 but not earlier, that investment adviser fees might be raised to fund the government's own direct regulation. *See SEC Reconsidering Adviser SRO*, 22 Sec. Reg. & L. Rep. (BNA) 1060 (Jul. 20, 1990) (statement of SEC Commissioner Mary Schapiro).

[266] *See* H.R. 5726, 102d Cong., 2d Sess. (1992); S. 2226, 102d Cong., 2d Sess. (1992). Similar legislation has been introduced in the current Congress; *see Markey Introduces Bills to Reform Gov't Securities Market, Advisers Act*, 25 Fed. Sec. L. Rep. (BNA) 120 (Jan. 29, 1993).

engaged in the investment advisory business.[267] Otherwise, however, the option of supervised self-regulation was eliminated.

This experience of the SEC in investment adviser inspections indicates that self-regulation efforts will founder absent the support of a relatively unified industry. The SEC faced an industry motivated for reform but otherwise still bearing the fragmentation which made self-regulation unworkable prior to the 1980s.[268] Furthermore, the government demonstrated its ability to perform the function at a lower cost, with no additional expense to the taxpayer, since industry would fund the inspections through increased registration fees.[269] The option of direct government regulation thus remained realistic. There remains the potential that the SEC rules will not be as well-tailored to the industry as would SRO rules,[270] but the industry has to date demonstrated little confidence in its own organizations to outperform the government in this area.

4. Accountants

The activities of accountants in preparing, reviewing and opining on financial statements, have been the subject of two systems of audited self-regulation: one under the federal securities laws, proposed in 1987 and ultimately abandoned, and one adopted under 1991 banking reform legislation. Each is discussed separately below.

Various sections of the federal securities laws require that financial statements submitted to the SEC or to investors be "audited," that is, certified by an independent accountant.[271] In order to certify a financial statement, the independent accountant must ordinarily assure that the statement is prepared in accord with authoritative accounting rules known collectively as "generally accepted accounting principles" or GAAP.[272] The procedures followed by the accountant in preparing the certificate in turn are dictated by authoritative literature known collectively as "generally accepted auditing standards" or

---

[267]*See* H.R. 5726, 102d Cong., 2d Sess., §4 (1992).

[268]*See supra* notes 261-263 and accompanying text.

[269]*See, e.g.*, S. REP. NO. 312, 102d Cong., 2d Sess., at 6-7 (1992).

[270]The proposed legislation does not specify standards for SEC rules, so that the SEC "will have the flexibility to provide the greatest amount of investor protection within the available resources." *Id.* at 6.

[271]*See, e.g.*, Securities Act Schedule A, pars. 25-26, 15 USC §77aa(25)-(26) (balance sheet and income statement in registration statements for securities registered for offer and sale under the Act); Securities Exchange Act §12(b)(1)(J)-(K), 15 USC §78*l*(b)(1)(J)-(K) (balance sheets and income statements of issuers registering securities under the Act may be required by the SEC to be so certified); *Id.* §17(e)(1)(A), 15 USC §78q(e)(1)(A) (balance sheets and income statements of registered broker-dealers filed annually with the SEC must be so certified); Regulation S-X, Article 3, 17 CFR §210, art. 3 (general requirement that financial statements required under the securities laws "shall be audited unless otherwise indicated").

[272]*See* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 1, §150.02 (Am. Inst. of Certified Pub. Accountants 1972) (Standard of Reporting No. 1).

GAAS.[273] The SEC, long concerned with audit quality as a cornerstone of the integrity of financial disclosure under the securities laws,[274] proposed in 1987 that the accountants themselves be subject to "peer review" of their audit programs by another accountant.[275] That peer review, in turn, would be done under the auspices of a "peer review organization" or PRO, which would be required to be approved by the SEC.[276]

As with the establishment of regulation of over-the-counter brokers,[277] this system was proposed with one preexisting industry organization at hand. Most accountants are members of the American Institute of Certified Public Accountants (AICPA); accounting firms are members of the AICPA's Division for CPA Firms. Almost all publicly-held companies (those subject to SEC reporting requirements) are audited by firms which are members of that Division's SEC Practice Section (SECPS).[278] The SECPS had a mandatory preexisting program of peer review for its member firms. No firm was at that time required to join the SECPS, and membership in the AICPA is of course voluntary, though most accountants are members.[279]

This proposal by the SEC for mandatory peer review was not classic audited self-regulation, because a PRO under the SEC's proposal would have no direct enforcement authority. If a reviewed accounting firm received an unsatisfactory peer review, it would simply so report. The SEC would make the final determination whether that accountant's certificate met the requirements of the securities laws.[280] In addition, no accountant would be required to join any PRO; the SEC staff would supervise the peer review in that instance.[281]

---

[273]*See* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 58, §508.08 (Am. Inst. of Certified Pub. Accountants 1988). Compliance with GAAS is required under the terms of the accountant's state-issued license to practice. *See* REPORT OF THE NATIONAL COMMISSION ON FRAUDULENT FINANCIAL REPORTING 69 (1987). For a general review of audit procedures and standards, see HANDBOOK OF ACCOUNTING AND AUDITING 5-5 to 5-9 (Robert S. Kay & D. Gerald Searfoss 2d ed. 1989).

[274]*See Independent Accountants; Mandatory Peer Review*, Securities Act Release No. 6695, 52 Fed. Reg. 11,665, 11,668 (1987) [hereinafter *Peer Review Release*] ("As a result of improved audits, the Commission believes that the completeness and accuracy of financial disclosure is improved and the integrity of the financial reporting process is enhanced.").

[275]*See Peer Review Release, supra* note 274.

[276]*See Peer Review Release, supra* note 274, at 11,672-75.

[277]*See supra* note 183 and accompanying text.

[278]*See* HANDBOOK OF ACCOUNTING AND AUDITING, *supra* note 273, at 45-16 (SECPS member firms audit 89% of all publicly-traded companies accounting for 99% of the aggregate sales volume of these companies).

[279]*See* REPORT OF THE NATIONAL COMMISSION ON FRAUDULENT FINANCIAL REPORTING 69-70 (1987).

[280]*See Peer Review Release, supra* note 274, at 11,674.

[281]*See id.* at 11,675-76. This is similar to the "SECO" program for broker-dealers in effect from 1964 through 1983; *see supra* note 202.

Though not a complete model of audited self-regulation, the peer review proposal did meet several of the requirements for successful self-regulation. The detailed rules would be made by the self-regulating body, the PRO, which the SEC believed would have the ability to make more detailed, relevant and constructive rules and applications.[282] The SEC would retain the role of initially approving and supervising the PRO,[283] and would retain final independent enforcement authority.[284] Nonetheless, the proposal contained most of the requirements recognized by commentators as necessary for effective regulation of audit quality.[285] It would meet the need for regulation with the least intrusion and the least cost, compared to direct governmental regulation or creation of a new statutory SRO.[286]

The missing element, however, was industry support for *supervised* self-regulation. The accounting industry generally was supportive of peer review, but chafed at the suggestion that allegedly substandard audits should be subject to full review by a PRO and the SEC as well.[287] A compromise providing for limited access by the SEC staff to SECPS investigation of allegedly substandard audits was reached in 1985,[288] but the SEC in its 1987 proposal made clear that it should have unrestricted access to these records.[289] Instead, in 1990 the AICPA approved a rule requiring its member firms which audit companies subject to SEC reporting requirements to join the Association's SEC Practice Section, and be subject to peer reviews. This identical proposal had been voted down by the AICPA membership in 1986, before the SEC proposal was announced.[290] This action was expected to take most of the momentum away from the SEC proposal,[291] and last year the SEC announced withdrawal of the mandatory peer review proposal.[292]

A similar regulatory scheme for accountants performing audits of financial institutions succeeded in mandating and overseeing accountants' peer reviews

---

[282]*See Peer Review Release, supra* note 274, at 11,669.

[283]*See id.* at 11,675.

[284]*See id.* at 11,676 & 11,677-78.

[285]*See* REPORT OF THE NATIONAL COMMISSION ON FRAUDULENT FINANCIAL REPORTING 70-73 (1987).

[286]*Id.* at 71 (1987).

[287]*See Peer Review Release, supra* note 274, at 11,673-74. A later survey of accountants indicated their strong preference for self-regulation, particularly in the area of ethical standards. *See* Cohen & Pant, *supra* note 49, at 47 & 53.

[288]*See* HANDBOOK OF ACCOUNTING AND AUDITING, *supra* note 273, at 45-20.

[289]*See Peer Review Release, supra* note 274, at 11,675.

[290]*See AICPA Members Approve Proposal to Require Mandatory SRO Membership*, 22 Sec. Reg. & L. Rep. (BNA) 80 (1990).

[291]*See* HANDBOOK OF ACCOUNTING AND AUDITING, *supra* note 273, at 45-2 (Supp. 1992).

[292]*See* Securities Act Release No. 6958A, 57 Fed. Reg. 45,287, 45,288 n.24 (1992) (noting that the SEC "will continue to monitor enrollment in and the peer review activities of the SEC Practice Section").

where the SEC proposal failed. In the Federal Deposit Insurance Corporation Improvement Act of 1991,[293] Congress required annual and periodic reports from federally insured financial institutions, and required that those reports be examined by independent public accountants.[294] An accountant is required to perform an annual audit of the institution's financial statements,[295] review management's report on internal financial accounting controls,[296] and review the institution's compliance with certain laws and regulations.[297] The audits and reports prepared by the accountants are to meet the existing professional accounting standards as modified if necessary by the Federal Deposit Insurance Corporation (FDIC).[298]

The FDIC is authorized to set qualifications for accountants performing the work required by the Act.[299] To be qualified, an accountant must have "received a peer review that meets guidelines acceptable to the [FDIC]."[300] The FDIC's implementing regulations adopt the guidelines of the AICPA's peer review process.[301]

Thus, by incorporating private standards in the Act, Congress effectively delegated to the accounting and auditing standard-setters the promulgation of standards for the financial institutions' financial reports as well as the accountants' review of those reports, management's internal control report and management's compliance report. And by requiring that accountants be approved in a peer review process, the FDIC delegated to peer-review organizations[302] the enforcement of those standards. If an accountant does not perform according to the required standards, there is the possibility of a qualified peer review opinion, resulting in disqualification under the Act. In addition to this delegation, the FDIC retains the independent authority to require additional

---

[293]Pub. L. No. 102-242, 105 Stat. 2242 (1991) (codified as amended in scattered sections of 12 USC).

[294]*Id.*, Title 1, §112(a), codified at 12 USC §1831m.

[295]12 USC §1831m(d).

[296]*Id.* §1831m(c). The institution's management is required to report annually on the institution's internal controls and the effectiveness of those controls. *Id.* §1831m(b)(2)(A)(ii), (b)(2)(B)(ii).

[297]*Id.* §1831m(e). The institution's management is required to report annually on the institution's procedures for ensuring compliance and its actual compliance with "laws and regulations relating to safety and soundness" as designated by federal regulators. *Id.* §1831m(b)(2)(A)(iii), (b)(2)(B)(ii).

[298]*Id.* §1831m(c)(2), (d)(1), (e)(2), (f)(1).

[299]12 USC §1831m(g)(3).

[300]*Id.* §1831m(g)(3)(A)(ii).

[301]Annual Independent Audits and Reporting Requirements, 58 Fed. Reg. 31,332, 31,338 (1993) (guidelines for compliance stating that "[t]he peer review should be generally consistent with AICPA standards").

[302]For a description of the SECPS, the only existing peer review organization, see *supra* notes 278-279 and accompanying text.

or different auditing standards[303] and accounting standards,[304] and may also institute its own enforcement actions against an accountant which may result in that accountant's disqualification.[305]

In both instances, the proposed SEC program and the new FDICIA requirements, effective programs of self-regulation were or would have been created. The bulk of standard-setting and review would be delegated to the private groups with the expertise and incentive to enforce them.[306] The ability of the government to achieve a federal mandate in the financial institution area, but the failure of the SEC to adopt mandatory peer review for auditors of public companies generally, can probably be attributed to the more intense general public concern over bank and thrift failures in the late 1980s compared to the concern over audit failures in the late 1970s and early 1980s.

B. Accreditation for Government Benefit Programs

The other major longstanding use of audited self-regulation is the qualification of recipients under government benefit or grant programs. The use of private accrediting organizations, a form of audited self-regulation, is prevalent under certain programs in health care and education.

1. Health Care Financing

a. Hospitals and Other Providers and Suppliers

Under the federal programs of Medicare[307] and Medicaid,[308] payments are made by the Health Care Financing Administration of the Department of Health

---

[303]*See* 12 USC §1813m(f)(1) (noting that reports prepared by accountants under the act shall meet "generally accepted auditing standards and other applicable standards recognized by the [FDIC]").

[304]A separate section of the Act, P.L. No. 102-242, §121 (1992), codified at 12 USC §1831n, concerns accounting standards. The FDIC and other financial institution regulators are given the authority to require different standards no less stringent than generally accepted accounting principles.

[305]§12 USC §1831m(g)(4)(A). *See also* Annual Independent Audits and Reporting Requirements, 57 Fed. Reg. 42,516, 42,527 (1992) (restating independent enforcement authority in proposed rules).

[306]Cohen & Pant, *supra* note 49, at 46, suggest a combination of a common set of high moral and ethical values and a need to maximize self-interest which accounts for the willingness of the accounting profession to self-regulate.

[307]Health Insurance for the Aged Act, P.L. 89-97, Tit. I, pt. 1, 79 Stat. 290 (1965) (amending the Social Security Act of 1935) (codified as amended principally at 42 USC §§1395-1395ccc). Briefly summarized,

> [t]he Medicare program, designed to finance acute medical care primarily for elderly Americans, also covers some categories of the disabled and those with end-stage renal disease. The program is divided into two parts: Part A, which provides hospital insurance (HI), and Part B, which covers supplementary medical insurance (SMI). The HI component includes short-term hospitalization, skilled nursing care, and home health services, while the SMI portion covers physical services, outpatient hospital care, and laboratory fees, as well as home health care.

and Human Services to health care providers and others who treat eligible patients. Medicare and Medicaid benefits, for example, are available for inpatient hospital services.[309] A hospital, however, must meet several requirements regarding licensing, types and qualifications of staff, operations, environment, quality assurance, and recordkeeping before it is eligible to receive Medicare reimbursement for services rendered.[310] The Act and regulations provide that, in certain instances, accreditation of the hospital by the Joint Commission on Accreditation of Health Care Organizations (JCAHO)[311] shall be deemed to be compliance with the above statutory conditions.[312]

The JCAHO is a private organization sponsored by groups of health care professionals which predated the Medicare and Medicaid programs.[313] Currently,

---

ALAN L. SORKIN, HEALTH ECONOMICS 187 (3d ed. 1992).

[308]Health Insurance for the Aged Act, P.L. 89-97, Tit. I, pt. 2, 79 Stat. 343 (1965) (amending the Social Security Act of 1935) (codified as amended principally at 42 USC §§1396-1396u). Also briefly summarized,

> Medicaid is a combined federal and state program that provides medical assistance to certain categories of low-income persons, including those on welfare and some of the medically indigent (persons whose incomes are too low to pay for medical care). The program is administered and roughly half the costs are absorbed by the state and local governments.
>
> ....
>
> Mandatory eligibility is now required for persons receiving cash assistance under federally funded income-transfer programs. Therefore, persons eligible ... under Aid to Families with Dependent Children (AFDC) are automatically eligible for Medicaid. .... Persons who are mandatory recipients of Supplemental Security Income (SSI) — a federal program for the aged, blind, or disabled — are also automatically eligible for Medicaid .... .
>
> Optional Medicaid beneficiaries are those for whom states may receive federal matching funds but whose coverage is not required by federal legislation. This group includes medically needy families with dependent children whose incomes are above the state AFDC limit, as well as elderly persons who do not qualify for cash assistance. Many of the latter have large medical or nursing home bills.

SORKIN, *supra* note 307, at 197-98. The two programs may overlap in coverage as well. "State Medicaid programs frequently serve to complement Medicare for low-income elderly persons. Medicaid may finance cost-sharing amounts as well as other noncovered services for eligible Medicare beneficiaries who are too poor to pay these bills." *Id.* at 187.

[309]*See* 42 USC §§1395d(a)(1) (Medicare coverage), 1396d(a)(1) (Medicaid coverage).

[310]*See id.* §1395x(e), 42 CFR §§482.21 - .42 (Medicare requirements for basic hospital functions). Identical requirements apply under Medicaid. *See* 42 CFR §440.10(a)(3)(iii) (hospital services must be provided at a hospital which "meets the requirements for participation in Medicare as a hospital").

[311]Originally the organization was known as the Joint Commission on Accreditation of Hospitals, but the Joint Commission now accredits several different types of health care facilities and programs, and changed its name in 1987. *See* Medicare and Medicaid Programs; Recognition of Joint Commission on Accreditation of Healthcare Organizations' Home Care Program Standards and the National League for Nursing's Standards for Home Health Agencies, 52 Fed. Reg. 49,510, 49,510 (1987).

[312]*See* 42 USC §1395bb (Medicare), 42 CFR §488.5 (Medicaid).

[313]JCAHO had its origins in efforts in the early 1900s by the American College of Surgeons to standardize conditions at hospitals, and to certify hospitals which met those minimum standards. *See*

JCAHO accredits most hospitals in the United States, not only for Medicare and Medicaid but for various other federal and state programs.[314] The remaining hospitals are evaluated for eligibility by HHS under contract with state survey agencies.[315]

The JCAHO-HCFA relationship is comparable with the model of audited self-regulation in the securities industry. At the outset of each program, the government was faced with the need to acquire expertise in a technical area involving several thousand regulated individuals and firms.[316] The relationship did not begin as one of audited self-regulation, however. JCAHO-accredited hospitals were conclusively deemed to meet conditions for Medicare participation, indicating Congress' deference to "professional" standards in 1965.[317] The "auditing" of the JCAHO and other accrediting agencies by HCFA was added in later amendments to the Act in 1972[318] and 1984[319] for Medicare, and by HCFA regulations for Medicaid.[320]

James S. Roberts, *A History of the Joint Commission on Accreditation of Hospitals,* 258 J. AM. MED. ASS'N 936, 937 (1987). For a comprehensive background and early history of the JCAHO, see Timothy S. Jost, *The Joint Commission on Accreditation of Hospitals: Private Regulation of Health Care and the Public Interest,* 24 B.C. L. REV. 835, 840-52 (1983).

[314] *See* Roberts, *supra* note 313, at 940.

[315] The Act requires HHS to contract with states willing to perform the survey and accrediting function of hospitals which do not have or seek JCAHO accreditation. 42 USC §1395aa(a). The results of those surveys are transmitted as recommendations to HCFA, which makes the final decision. *See* 42 CFR §§488.11 - .12. *See also* Timothy S. Jost, *Background: Medicare and the Joint Commission on Accreditation of Healthcare Organizations,* in PRIVATE ACCREDITATION IN THE REGULATORY STATE 1, 5 (materials prepared for conference sponsored by Am. Bar Ass'n Sec. of Admin. L. & Pract., May 21, 1993) (JCAHO accredits over 5,000 hospitals; "[a]pproximately 900 of the hospitals certified for participation in Medicare are not Joint Commission accredited. Rather they are certified by state survey agencies under contract with the Secretary.").

[316]

> [T]here was substantial political pressure to get the Medicare program fully operational rapidly. President Johnson, with a large political stake in Medicare, believed that its success depended on maximum access from the beginning of the program, and thus on immediate near universal hospital participation. Those who had to administer the program were greatly relieved to have a fully developed quality certification system ...

Jost, *supra* note 313, at 853-54. For a discussion of similar problems with broker-dealer regulation, see *supra* notes 176-178.

[317] "Linking the conditions for participation to the requirements of the Joint Commission provides further assurance that only professionally established conditions would have to be met by providers of health services which seek to participate in the program." S. REP. NO. 404, 89th Cong., 1st Sess. (1965), *reprinted in* 1965 USCC.A.N. 1943, 1970.

[318] JCAHO accreditation was stripped of its exclusivity in 1972. The Secretary was given independent authority to survey accredited hospitals and to "de-accredit" those which, despite JCAHO accreditation, did not meet the Act's requirements according to the Secretary. *See* Social Security Amendments of 1972, Pub. L. No. 92-603, §244, 86 Stat. 1329, 1423 (1970) (codified at 42 USC §§1395aa(c), 1395bb(b)). These amendments were the result of consumer pressure on the JCAHO in the late 1960s and early 1970s, as well as reports that JCAHO standards were not kept high and were not well enforced. *See* Jost, *supra* note 313, at 855-56. These amendments may yet be mostly unrealized potential; "[i]mplementation of these amendments has been largely inadequate." *Id.* at 915.

Currently, the HCFA has access to the JCAHO accreditation survey for each accredited hospital,[321] may independently accredit or remove accreditation of a hospital,[322] retains authority to add more or different requirements for participation than those of the JCAHO,[323] and can hear informal appeals from denials of accreditation or findings of deficiencies by the JCAHO.[324] Similar oversight and independent regulatory authority were provided in HCFA's recent recognition of the CHAP[325] and the JCAHO[326] to accredit home health agencies for participation in Medicare and Medicaid.

In 1984, Congress amended the Medicare provisions to expand significantly the types of entities on which HCFA may rely to accredit private organizations for participation in Medicare.[327] HCFA has proposed general rules for recognizing any accrediting organization's accreditation as sufficient for participation in these programs.[328] These rules impose conditions similar to the hospital and home health agency rules discussed above with respect to oversight by HCFA,[329] and in addition provide HCFA with plenary authority to directly survey any accredited

---

[319]Audited self-regulation was given a boost in 1984 amendments which significantly expanded the list of health care providers whose qualification for Medicare could be determined by an outside accrediting agency. *See* Deficit Reduction Act of 1984, Pub. L. No. 98-369, §2346, 98 Stat. 494, 1096 (1984) (codified at 42 USC §1395bb(a)). Congress' concerns in expanding the potential universe of self-regulators were primarily competence, *see* H.R. REP. NO. 861, 98th Cong., 2d Sess. 1330 (1984), *reprinted in* 1984 USCC.A.N. 1445, 2018 (their standards must be at least as stringent as the Secretary's, and must be satisfactorily applied), and the potential for undue restriction of services (the Secretary must assure that "the adoption of such standards will not adversely affect competition in the provision of Medicare health services"). *Id.*

[320]Although similar conditions for participation were not articulated under the Medicaid program, HCFA has by regulation made the conditions for participation in both programs equivalent. *See, e.g., supra* note 310 (hospitals), 42 CFR §§440.20(a)(3)(ii) (outpatient services), 440.40(a)(1)(ii) (skilled nursing facility services), 440.70(d) (home health agencies).

[321]*See* 42 USC §1395bb(a)(2).

[322]*See supra* note 315 and accompanying text.

[323]There are additional requirements, notably a utilization review plan, which are not "deemed" to be met by JCAHO accreditation. *See* 42 USC §1395bb(a)(3), 42 CFR 488.5(a). And the Secretary has the authority to adopt more stringent standards than the JCAHO. *See* 42 USC §1395bb(a)(4), 42 CFR §488.5(c). Although HHS has promulgated detailed conditions of participation for hospitals, *see generally* 42 CFR Part 482, it is much less detailed and less-frequently revised than the JCAHO standards. *See* Jost, *supra* note 315, at 6 (HHS standards include 13 conditions of participation, promulgated in 1986; JCAHO accreditation manual contains 28 chapters and is updated annually).

[324]*See* 42 CFR §488.6(f).

[325]Community Health Accreditation Program, a subsidiary of the National League for Nursing. *See* 57 Fed. Reg. 22,773 (1992).

[326]*See* 58 Fed. Reg. 35,007 (1993).

[327]*See* Deficit Reduction Act of 1984, Pub. L. No. 98-369, §2346, 98 Stat. 494, 1096 (1984). The background of prior law and the effect of this amendment are discussed in HCFA's proposed generic accreditation rules, 55 Fed. Reg. 51,434, 51,436 (1990) [hereinafter Generic Accreditation Rule].

[328]*See* Generic Accreditation Rule, *supra* note 327.

[329]*See id.* at 51,437 (description of validation surveys), 51,441 (proposed rule, to be codified at 42 CFR §488.7).

supplier or provider in order to evaluate the adequacy of the accrediting organization's decisions.[330]

The proposed generic accreditation rules differ markedly from HCFA's first attempt at general recognition of private accreditation. In 1982, HCFA proposed to recognize JCAHO accreditation of skilled nursing facilities, intermediate care facilities and home health agencies as sufficient for participation in Medicaid and Medicare (except for intermediate care facilities, which are not Medicare-eligible).[331] The proposed rule contained only a one-sentence description of HCFA's oversight ability and responsibility,[332] and was withdrawn after considerable public and congressional pressure.[333] The 1990 proposed rules reflect a greater understanding of the requirements for effective audited self-regulation consistent with the requirements set forth in Part II above.

The HCFA-JCAHO relationship has fared fairly well when measured against other costs, benefits and requirements of audited self-regulation. It has withstood all challenges based on the nondelegation doctrine to date.[334] There remains, however, significant controversy about the anticompetitive effects of public reliance on private accreditation.[335] In addition, HCFA has expressly

---

[330] *See* Generic Accreditation Rule, *supra* note327, at 51,437-38 (discussing review of accrediting bodies), 51,441-42 (proposed rule, to be codified at 42 CFR §488.9).

[331] *See* Medicare and Medicaid; Survey and Certification of Health Care Facilities, Proposed Rules, 47 Fed. Reg. 23,404 (1982).

[332] "We would also provide that HCFA may revoke deemed status of JCAH-accredited facilities if it determines that accreditation no longer provides reasonable assurance that the facilities meet Federal requirements." *Id.* at 23,406. *Compare id. with* Generic Accreditation Rule, *supra* note 313, at 51,437-38 (discussing review of accrediting bodies), 51,441-42 (proposed rule, to be codified at 42 CFR §488.9).

[333] Jost, *supra* note 313, at 844 & nn.63-64. HHS ultimately withdrew the proposal; *see* Jost, *supra* note 315 at 7.

[334] *See* Cospito v. Heckler, 742 F.2d 72, 86-89 (3d Cir. 1984). Although *Cospito* dealt directly only with the particular and somewhat distinct regulations governing psychiatric hospitals, the court indicated in dictum that a nondelegation doctrine attack on HCFA's reliance on private accreditation of general hospitals would also fail. *See id.* at 88. Professor Jost is critical of this analysis, noting that delegation to the JCAHO "reveals an obvious attempt by the legislature to confer benefits on the member groups of JCAH to secure their support," and as such "is a suspect delegation." Jost, *supra* note 313, at 921. He finds especially pernicious the virtually absolute power of the JCAHO over psychiatric hospitals in certain circumstances where accreditation of one or more "distinct parts" of the hospital is not possible. *See id.* Interestingly, it was this "separate part" accreditation which the court relied on in *Cospito, see supra*, 742 F.2d at 87-88, over a vigorous dissent. *See Cospito, supra,* at 90-91 (Becker, J., dissenting).

[335] For a comprehensive summary of the procompetitive and, in the author's opinion, the dominant anticompetitive effects of private accreditation especially as currently conducted by the JCAHO, see Clark C. Havighurst, *The Place of Private Accreditation Among the Instruments of Government* in PRIVATE ACCREDITATION IN THE REGULATORY STATE (materials prepared for conference sponsored by Am. Bar Ass'n Sec. of Admin. L. & Pract., May 21, 1993), and articles cited therein. For a similar comprehensive summary of antitrust arguments, finding objectionable anticompetitive conduct on the part of the JCAHO but noting then-recent reforms, see Jost, *supra* note 313, at 892-913.

In approving JCAHO's accreditation of home health agencies, HCFA noted some commenters' concerns that JCAHO accreditation of those agencies was explicitly tied to denied that cost savings, either overall or merely to the federal government, is a motivation in adopting this program of audited self-regulation. In both notices approving private accreditation of home health agencies, HCFA noted that the expenditures saved on direct surveys of providers and suppliers will be spent instead on oversight of the private accrediting organization, resulting in negligible overall costs or savings.[336]

b. Clinical Laboratories

The Clinical Laboratory Improvement Act of 1967 (CLIA)[337] requires certification by the Secretary for any laboratory to "solicit or accept materials derived from the human body for laboratory examination."[338] The 1967 Act relied on private accreditation of clinical laboratories, exempting certain privately-accredited laboratories from the certification requirement discussed above, with minimal oversight.[339] In rewriting CLIA in 1988, Congress extended its coverage[340] and added details to the accreditation process, consistent with principles of sound audited self-regulation, which were missing from the 1967 Act.

JCAHO accreditation of the hospital to which the home health agency was connected, and one was required as a condition of the other. HCFA demurred, noting simply that

> [t]he Medicare Act does not restrict the ability of a home health agency to choose among accrediting organizations. It is also our general belief that competition is a healthy force in the marketplace. .... We have raised the issue with the JCAHO, and believe that the Commission itself is taking steps to deal with the emergence of other accrediting bodies.

58 Fed. Reg. 35,007, 35,010-11. Implicit in this response is that this "tying" by the JCAHO does raise some anticompetitive concerns.

[336]*See* 58 Fed. Reg. 35,007, 35,017 (recognition of JCAHO accreditation; regulatory impact statement cost/benefit analysis); 57 Fed. Reg. 22,773, 22,779 (recognition of CHAP accreditation; same).

[337]CLIA was added in 1967 as §353 of the Public Health Service Act of 1944. Pub. L. No. 90-174, 81 Stat. 536 (1967) (codified as amended at 42 USC §263a).

[338]42 USC §263a(b). As the text makes clear, federal regulation of clinical laboratories is not limited to those participating in Medicare or Medicaid. Strictly speaking, therefore, this is not entirely a program of accreditation for government benefits, as indicated in the caption to this Part IV.A.2, but is a program of general health and safety regulation. Nonetheless, it is discussed here because it is partly related to the Medicare and Medicaid programs and follows a similar pattern of reliance on private accrediting organizations.

[339]The statute named the JCAHO, the American Osteopathic Association and the College of American Pathologists as approved private accrediting organizations, and permitted the Secretary to approve other accrediting organizations. These organizations were required only to assure that their standards were equal to or more stringent than the governing federal standards as established by statute and regulation, and that each accredited laboratory continued to meet those standards. *See* Clinical Laboratories Improvement Act Program, Final Rule, 57 Fed. Reg. 33,992, 33,992 (1992) [hereinafter 1992 CLIA Release].

[340]Under the 1967 Act, only laboratories in Medicare or Medicaid or testing specimens in interstate commerce were subject to the certification requirement. *See id.* at 33,992. Compare this limited coverage with the blanket coverage of all laboratories in the 1988 Act, *supra* note338 and accompanying text.

The 1988 Act requires accrediting organizations to inspect laboratories with qualified personnel and as frequently as the Secretary requires, to report any denials, and permits the Secretary to adopt additional criteria.[341] In addition, each accredited laboratory must submit to inspection by the Secretary at any time,[342] make its records available directly to the Secretary,[343] and authorize the accrediting organization to make its inspection reports available to the Secretary.[344] HCFA's implementing regulations essentially impose most of the requirements of audited self-regulation: the accrediting organizations must demonstrate that they have the capacity and capability to require compliance with the Act by the accredited laboratories,[345] and are subject to comprehensive review by HCFA in a periodic sample or in response to allegations of noncompliance.[346]

Closer oversight of the accrediting organizations was necessary, according to the 1988 Act's legislative history, because those organizations did not view enforcement as an integral part of their mission.[347] This reinforces a primary component of self-regulation: the ability to alter conduct. To the extent that any private accrediting organization considers itself to be only "educational," its program is actually one of self-certification only. However, implicit in almost every instance is the ability of the accreditor or auditor to hold the possibility of an adverse decision over the regulated entity if "suggested" changes are not made. The success of this type of action determines whether there is any effective enforcement at the self-regulator's level.

In addition, Congress mentioned cost savings to the federal government as a rationale for private accreditation.[348] However, it is clear that the total cost of regulation to the nation's accrediting organizations, and thus to clinical laboratories, providers, and ultimately to patients, will be higher,[349] even if the federal government's share has been successfully transferred to other entities.

---

[341] *See* 42 USC §263a(e).

[342] *See id.* §263a(d)(1)(C).

[343] *See id.* §263a(d)(1)(D).

[344] *See id.* §263a(e)(1)(B).

[345] *See* 42 CFR §493.506.

[346] *See id.* §493.507 - .511.

[347]

> [T]he Committee ... discovered that reliance on private accreditation has created weaknesses in the administration of quality standards. The Department has effectively delegated all responsibility for enforcement to accrediting bodies. Yet, those bodies have made plain their preference and capacity is for education, not enforcement. Education is an important but limited tool in enforcement.

H.R. REP. NO. 899, 100th Cong., 2d Sess. 13(1988), *reprinted in* 1988 USCC.A.N. 3828, 3834.

[348] *See id.* ("The Committee recognizes that accrediting bodies are committed to assuring quality in laboratory testing and that they conserve federal resources by substituting for public agency surveys.").

[349] One private accrediting organization estimated that it would have to double its fees to comply with the regulations promulgated pursuant to the 1988 Act. *See* 1992 CLIA Release, *supra* note 339, at 34, 010.

c. Peer Review of Medicare Services

Payments under Medicare[350] to providers and suppliers are restricted to eligible patients and services. The most far-reaching limitations, however, are that the service or product must be "reasonable and necessary"[351] and for actual treatment of an illness.[352] Congress had provided for a program of audited self-regulation in applying these particular restrictions and also in determining whether the quality of care provided meets professional standards or could have been provided at a lower cost.[353] This program is known as "peer review," and is provided by Peer Review Organizations (PROs) under contract with HCFA.[354]

PROs are charged with reviewing samples of health care activities subject to payment under Medicare in their geographic areas.[355] If the PRO determines that treatment was not "reasonable and necessary" or could have been provided at a lower cost, it has the ability to deny Medicare reimbursement.[356] And if the PRO determines that the quality of care provided by any person does not meet cost and quality standards, it may deny to that person any further ability to receive Medicare reimbursement.[357] In total, then, it is clear that "[t]he power of PROs over Medicare providers, practitioners, and beneficiaries is sweeping."[358]

The existing peer review process had two predecessors. Initially, in 1965, hospitals were required to have a utilization review plan in order to qualify for Medicare reimbursement.[359] In 1972, dissatisfaction with the focus of the utilization review program on quality of care to the exclusion of escalating costs due to over-utilization led Congress to create the Professional Standards Review Organization (PSRO) program.[360] The PSRO program used "regional nonprofit

---

[350]For a brief summary of Medicare coverage, see *supra* note 307.

[351]42 USC §1395y(a)(1).

[352]*See id.* §1395y(a)(9).

[353]*See id.* §1320c-3(a).

[354]*See id.* §1320c-2(a).

[355]*See id.* §1320c-3(a)(1), 42 CFR §466.71(c). For a discussion of the sampling and review process, see Timothy S. Jost, *Administrative Law Issues Involving the Medicare Utilization and Quality Control Peer Review Organization (PRO) Program: Analysis and Recommendations*, 50 OHIO ST. L.J. 1, 6-9 (1989).

[356]*See* 42 USC §1320c-3(a)(2), 42 CFR 466.71(a).

[357]*See* 42 USC §1320c-5(b), 42 CFR §466.71(b). "As a practical matter, exclusion from Medicare may make it impossible for a physician to practice; thus the PRO's power over physicians is nearly as great as that of state licensure boards." Jost, *supra* note 355, at 2.

[358]Jost, *supra* note 355, at 2.

[359]*See* 42 USC §1395x(e)(6). The requirement remains today, but is superseded for all practical purposes by the PRO program, since no utilization review requirement is imposed where a PRO has assumed binding review for the hospital. 42 CFR §482.30(a)(1). *See* Peter M. Mellette, *The Changing Focus of Peer Review Under Medicare*, 20 U. RICH. L. REV. 315, 323 (1986).

[360]Jost, *supra* note 355, at 4-5; Mellette, *supra* note 359, at 326-28. *See* Pub. L. No. 92-603, §249F(b), 86 Stat. 1329, 1429 (1972). This is the same Act which significantly curtailed the role of the JCAHO in accrediting hospitals under Medicare; *see supra* note 318 and accompanying text.

physicians groups to review independently the use of medical services by beneficiaries of federal medical assistance programs."[361] However, the PSROs could delegate their review functions to hospital review committees, and PSRO recommendations for denial of payment had no binding effect. These two factors were prime contributors to the inability of the PSRO program to either provide consistent utilization guidelines or cost control.[362] As a result, "PSROs never succeeded in meeting the expectations of their supporters or overcoming the criticisms of their increasingly vocal detractors."[363] By the late 1970s, criticism of the PSRO program was mounting, and Congress adopted the PRO system, along with a new method of calculating hospital reimbursements under Medicare, in 1982.[364] The PROs cover a larger geographic area, cannot delegate review functions, and have broader powers to deny payment.[365] Despite the much larger area coverage,[366] the PRO was intended to be a physician-sponsored group, akin to a medical society.[367] Although no longer local, most PROs are physician-sponsored, and to that extent conform to the model of self-regulation.[368] The combination of a fixed-sum Medicare payment determination, based on the diagnosis, and the limited review of PRO denials[369] of payments was intended to create a system with much greater emphasis on cost containment.

---

[361]Jost, *supra* note 355, at 5. "PSRO proponents in Congress anticipated that local medical societies would apply for and receive PSRO designation." Mellette, *supra* note 359, at 328. *See also* BLUM ET AL., *supra* note 161, at 21-26 (discussing problems in implementation of PSRO program regarding size of PSRO area and local physician acceptance).

[362]*See* Mellette, *supra* note 359, at 340 (delegated review), 350 (nonbinding effect of denials).

[363]Jost, *supra* note 355, at 5.

[364]*See* Mellette, *supra* note 359, at 337-41. For a brief description of the operation of this "diagnosis-related group" (DRG) method of prospectively determining payments to be made to hospitals under Medicare, see 42 CFR §412.1(a). The adoption of the DRG method also changed the magnitude of decisions the new PROs would be required to make regarding utilization of hospital services, which was "the object of much review activity by PSROs." Mellette, *supra*, at 341.

[365]Jost, *supra* note 355, at 5.

[366]In designating the PSRO areas, HEW chose a minimum population size of 50,000. BLUM, ET AL., *supra* note 161, at 21-22. By contrast, each PRO was to cover an entire state. Jost, *supra* note 355, at 5.

[367]The local medical society was one of the models for the PSROs. *See supra* note 361.

[368]*See* Jost, *supra* note 355, at 6 (noting that 84% of PSROs are physician-sponsored). The others are typically insurance companies. Although they employ physicians in medical payment reviews, *see id.*, the insurance company PSRO is different from the model of self-regulation used in this study, since the self-regulatory organization can be said to be composed of the regulated entities only a very indirect way. *See supra* Part I.A.

[369]This finality of the self-regulatory organization decision is unusual in models surveyed in this study. Although a beneficiary has a right to appeal outside of the PRO, the practitioner or provider who supplied the goods or services has a right only to a reconsideration from the PRO. *See* 42 USC §1320c-4. Although later amendments to the PRO act required consultation between the PRO and the provider before the decision to deny payment is made, the finality of that decision was not altered. *See* Jost, *supra* note 355, at 67. Although this lack of judicial review is disturbing from the standpoint of proper design of a

Throughout the development of peer review programs in Medicare, it was considered paramount to enlist private entities in the regulatory effort, for at least two reasons which often appear whenever audited self-regulation is considered. First, there was significant pre-existing peer review activity. The medical profession had recognized the need for peer review as early as the early 1900s.[370] Second, the alternative of direct government regulation has always been considered problematic not only because of the staffing requirements but because of the perceived impact of that regulation on the treatment decisions of physicians. Thus, the federal government has relied from the outset on the professional discretion of practicing physicians.[371] At each turn, however, Congress became increasingly frustrated with the profession's emphasis on quality of care, to the apparent exclusion of effective cost control.[372] It is impossible to fault the medical profession for their focus, indeed, it is likely that physicians could not make medical decisions on any other basis.[373] However, that focus resulted in the government regulators' removal of much of the discretion

---

self-regulatory system, it has minimal practical impact due to the relatively small amounts in controversy in each case. *Id.* at 66-67.

[370] *See* BLUM ET AL., *supra* note 161, at 1-2 (early developments in peer review); MEDICAL PEER REVIEW: THEORY AND PRACTICE 11-12 (Paul Y. Ertel & M. Gene Aldridge eds. 1977) (early 20th-century developments in the practice of medicine leading to the necessity of peer review). *See also* Mellette, *supra* note 359, at 324-26 (discussing specific hospital-based programs developed in the 1940s and 1950s).

[371]

> Government involvement with peer review since 1965 gives evidence of two definite trends: First, the government's desire to delegate the review task to physician committees; and second, the government's inability to settle on an acceptable review methodology. Government review delegation can be attributed to both a lack of manpower and a wish to temper governmental control over review to make it more acceptable to the medical profession.

BLUM, ET AL., *supra* note 161, at 3. *See also* Mellette, *supra* note 359, at 327-28 (emphasis on cost control but also on professional judgment and discretion in 1972 amendments); S. REP. NO. 494, 97th Cong., 2d Sess. 42 (1982), *reprinted in* 1982 USCC.A.N.781, 817 (report on 1982 amendments, noting that "peer review has afforded practicing physicians an opportunity on a voluntary and publicly accountable basis to undertake review of the medical necessity and quality of care provided. The [PSRO] program has demonstrated that the concept of peer review is a valid one.")

[372] *See* Jost, *supra* note 355, at 4-6, Mellette, *supra* note 359, at 326-27 (cost-control shortcomings of utilization review) & 334-35 (cost-control shortcomings under PSRO program).

[373] Professors Havighurst and Blumstein examined in detail how physicians determined "need" in relationship to cost of services, *see* Clark C. Havighurst & James F. Blumstein, *Coping With Quality/Cost Trade-offs in Medical Care: The Role of PSROs,* 70 NW. U. L. REV. 6, 25-38 (1975). They concluded

> a sincere concern for his patients' welfare is probably dominant in [the individual physician's] numerous decisions for more and better services. Cost issues, while sometimes admitted, are seen as irrelevant when life, health, and comfort and convenience — in short, the needs — of the patient are at stake. Indeed, with cost constraints lifted by the availability of third-party payment, the physician may regard it as his ethical responsibility to help the patient get all the benefits he can from the common fund.

Id. at 27.

from the self-regulatory system. This suggests, as in the case of health and safety regulation generally,[374] it is difficult for a self-regulatory program to succeed if opposing groups are not given meaningful input in the process.[375] Until the PRO program, cost containment policies had no effective place in peer review, since the only party seeking cost control, the federal government, was by definition removed from the self-regulatory process. The question still remains the appropriate level of government intervention in the cost-quality tradeoff,[376] and how much of this decision-making should be delegated to any private group.[377] But the progression from utilization review to PSRO to PRO in the peer review process has demonstrated the ability of Congress, HCFA and the health care professionals and industry to successively balance, shift and rebalance the elements of an effective system of self-regulation, a process that promises to continue.

2. Higher Education Financing

A variety of federal laws in aid of postsecondary education have been enacted since the end of World War II, providing aid for programs, capital construction, and significant aid to students. Typically, that federal aid has been limited to institutions which meet minimum standards, so that today "[m]ost

---

[374]*See supra* text accompanying note 108.

[375]

> [I]n a regulatory environment, organized consumer pressure is likely to be opposed to stringency and to favor increased quantities and quality of care, especially where such care is at public expense. Provider interests would of course take similar positions.
>
> [T]he functioning of governmental and professional decision-making mechanisms is impaired, though in varying degrees, by the quality imperative and cost-escalating pressures from interest groups ... .

Havighurst & Blumstein, *supra* note 373, at 63.

[376]*See* Mellette, *supra* note 359, at 354 ("PRO review groups are now making many of the same decisions on patient admissions that the attending physician made a few years ago. ... . The government's role in the health care marketplace under prospective payment and the PRO Act has shifted from that of a partner to a controlling interest."). Congress itself seems unsure of the appropriate cost-quality mix, since despite this increasing emphasis on cost control which led to the PRO program, most legislation since has related to potential problems with lower quality health care. *See* Jost, *supra* note 355, at 5-6. For a comprehensive discussion of this cost-quality tradeoff, see Havighurst & Blumstein, *supra* note 373. A more recent review of the prospective payment system, *see supra* note 364 and accompanying text, suggests that it does not help to control costs, because although it "does recognize legitimate deviations from the norm, ... the norm and the allowed variations are managed at such a great conceptual, spatial and regulatory distance from our hospitals that the regulatory task is essentially unmanageable. For those reasons there will continue to be a wide gulf separating our federal regulators from those working within actual institutions." David M. Frankford, *The Medicare DRGs: Efficiency and Organizational Rationality*, 10 YALE J. ON REG. 273, 345 (1993).

[377]Jost, *supra* note 355, notes, for example, the tensions that exist in the PROs sanctioning of providers or suppliers, "by far the most controversial function of the PRO program." *Id.* at 30. "Many of the difficulties of the PRO sanction process can ultimately be traced to the difficulty of engrafting enforcement functions onto what is basically a peer monitoring and education program." *Id.* at 47.

postsecondary institutions and programs attain eligibility for federal funds by obtaining accreditation from one of the accrediting bodies recognized by the Secretary [of Education]."[378] Those standards, in turn, have been provided primarily by private accrediting organizations, subject to an unusual and often controversial oversight role by the Department of Education.

The statutory basis of federal reliance on private accreditation of institutions of higher education was laid principally in the Korean GI Bill.[379] Student aid was available only for courses offered by an institution "accredited and approved by a nationally recognized accrediting agency or association," and the then Commissioner of Education was required to publish a list of such "nationally recognized" agencies.[380] That language was borrowed by later acts providing a variety of federal assistance, providing in each instance that the Commissioner should prepare a list of accrediting organizations recognized under each act.[381]

The system of self-accreditation embraced by Congress dates back slightly more than a century. At that time, colleges began to coordinate their admissions standards and seek some uniformity in preparation in the secondary schools.[382] This concern with uniformity and the lack of an acceptable definition of a "college," extended the accreditation effort to institutions of higher education by 1913.[383] From this beginning grew the six regional associations of colleges which today accredit thousands of institutions of higher education on a general or institution-wide basis.[384] There developed along parallel tracks two other types of accrediting bodies: one for proprietary (for-profit) institutions, which were excluded from the regionals,[385] and another type for specialized accreditation for programs, schools or colleges within the institution.[386]

The early emphasis of accreditation was on uniformity of standards, first for secondary and then for higher education.[387] But the later and modern emphasis is

---

[378]KAPLIN, *supra* note 130, at 573.

[379]Veterans' Readjustment Assistance Act of 1952, Pub. L. No. 82-550, 66 Stat. 663 (1952).

[380]*Id.* §253, 66 Stat. at 675 (repealed 1958). For a comprehensive legislative background, see Matthew W. Finkin, *Federal Reliance on Voluntary Accreditation: The Power to Recognize as the Power to Regulate,* 2 J.L. & EDUC. 339, 343-47 (1973).

[381]*See* Finkin, *supra* note 380, at 348-68 (citing 15 acts passed during the 1958-72 period dealing with institutional or special accreditation); YOUNG ET AL., *supra* note 41, at 240 ("[t]his language reappeared in new legislation as 'boiler plate' over the next thirty years").

[382]*See* WILLIAM K. SELDEN, ACCREDITATION 30-31 (1960) (discussing the foundation of the first regional association, the New England Association of Colleges and Secondary Schools, in 1885).

[383]*See id.* at 35-38; YOUNG ET AL., *supra* note 41, at 3.

[384]*See* YOUNG ET AL., *supra* note 41, at 26-28 (describing the six regional accrediting associations and their membership).

[385]*See id.* at 29.

[386]*See id.* at 24, KAPLIN, *supra* note 130, at 561-62, Oulahan, *supra* note 130, at 193 (each describing differences between institutional and specialized accreditation). The national accrediting bodies, *see supra* note 384, are institutional accrediting organizations.

[387]*See* YOUNG, ET AL, *supra* note 41, at 56; SELDEN, *supra* note 382, at 42.

on the assessment of the institution's compliance with its own standards and progress toward its own goals.[388] Thus, private accreditation is today not a comparison to of uniform standards, but rather a judgment by peers that an educational institution has set its goals and ways to meet them.[389] The move away from standardization once basic admissions and other rules were set is not revolutionary but rather a return to the norm. Higher education in the United States has a tradition of diversity in and local control over academic programs predating accreditation programs.[390]

Part of the tradition of local control of higher education, of course, is a lack of federal control. Even with the extensive institutional and student aid programs of the postwar era, there is little federal control over basic decisions about what should be taught in United States colleges and universities.[391] When Congress

---

[388] *See, e.g.*, SELDEN, *supra* note 382, at 42 ("As proportionately more colleges and universities have been accredited — that is, accepted into membership of the regional associations — increasing emphasis has been placed upon ... stimulating institutional self-improvement [rather than admissions or maintenance of minimum academic standards]"). Another writer describes the change comparatively.

> During the past seventy years, accreditation has changed —
>
> - From a quantitative approach (expressed in scientific requirements) to a qualitative approach (based on more general standards).
> - From an emphasis on making institutions more alike to recognizing and encouraging institutional individuality.
> - From a system heavily dependent on external review to a system based more on self-evaluation and self-regulation.
> - From an initial focus on judging (and accepting or rejecting) an institution to a primary goal of encouraging and assisting an institution to improve its educational quality.

YOUNG, ET AL., *supra* note 41, at 9.

[389]
> [Accreditation] is distinctive in postsecondary education for its respected and carefully developed procedures, based on three fundamental precepts: (1) that the institution must publicly declare its educational purposes and should be evaluated primarily on that basis, (2) that the institution should play the major role in accreditation through the self-study process, and (3) that peer review serves as a necessary validating mechanism.

YOUNG ET AL., *supra* note 41, at 66. *Accord,* Oulahan, *supra* note 130, at 198-99.

[390] *See* SELDEN, *supra* note 382, at 17-20.

[391] This is not to say that federal laws do not have an impact on higher education; for a survey of the more important non-education laws affecting colleges and universities, see KAPLIN, *supra* note 130, at 473-511. However, funding is the main focus.

> The federal government's major function regarding postsecondary education is to establish national priorities and objectives for education spending and to provide funds in accordance with those decisions. To implement its priorities and objectives, the federal government attaches a wide and varied range of conditions to the funds it makes available ... . Cumulatively, these conditions exert a most substantial influence on postsecondary institutions, often leading to institutional cries of economic coercion and federal control. In light of such institutional criticism, the federal role in funding postsecondary education has become a major political and policy issue.

began the aid programs in 1952, it chose to rely on accrediting organizations in part to avoid any such federal control,[392] and in part because the accrediting organizations were recognized as expert and reliable.[393]

The Commissioner (later Secretary) of Education implemented these statutes by publishing the required list, and also by promulgating a list of standards to be met by any accrediting organization in order to be listed. The standards, though originally borrowed from a then-existing accreditation review organization,[394] were important because of the new federal imprimatur.[395] Despite this effect, the initial standards themselves were relatively innocuous.[396]

The criteria remained unchanged over the next 17 years, despite major developments in the relationship of federal law to private accreditation. By the mid-1960s, however, reliance upon accreditation had become commonplace, reaching perhaps its zenith in the Higher Education Act of 1965.[397] In addition,

---

Id. at 511. The idea of federal control of academic decisions, however, has remained an anathema. Congress has said as much, prohibiting any federal employee from directing or controlling "the curriculum, program of instruction, administration, or personnel of any educational institution." 20 USC§1232a.

[392]*See* Matthew W. Finkin, *Reforming the Federal Relationship to Educational Accreditation*, 57 N.C. L. REV. 379, 381 (1985).

[393]*See id.* (noting that reliance on accrediting agencies to avoid federal control requires that review by the federal government would be very limited). Others have less sophisticated explanations, suggesting that, as with the securities and health care accreditation decisions, manpower may have been a concern.

> [T]he more likely explanation is that Congress did not want to get the federal government embroiled in the thankless task of deciding which institutions would and, more important, which would not be eligible for the expanded funding. Accreditation was not that well understood, but the postsecondary education community seemed to have much faith in it.

YOUNG ET AL., *supra* note 41, at 251.

[394]See YOUNG ET AL., *supra* note 41, at 242 (concluding that the original 1952 criteria were "a slightly edited version of the [National Commission on Accreditation] criteria). See also; Finkin, *supra* note 380, at 347 (discussing development of original criteria).

[395]

> By publishing this first list, the federal government profoundly altered the nature of accreditation and, more important, its relationship to the postsecondary education community. First, the federal government had never previously purported to make an explicit statement about who was an accrediting body and what such a body did. ... . Second, accrediting bodies were now, by virtue of the statutory provision, judged to be both "recognized" and "reliable."

YOUNG ET AL., *supra* note 41, at 242.

[396]

> These required *inter alia* that: the scope of the organization be national or regional (i.e. encompassing several states); it serve a definite need; it perform no function that might prejudice its independent judgment; it make available to the public current information on its standards, operations, and accredited programs or institutions; it only accredit institutions which are found on examination to meet pre-established standards; it has some experience in accrediting; and, it has gained general acceptance of its criteria and decisions.

Finkin, *supra* note 380, at 347.

[397]Pub. L. No. 89-329, 79 Stat. 1219 (1965) (codified as amended principally at 20 USC §§1001-1145f). Notable additions in the 1965 Act were reliance on accreditation for guaranteed student loans, and

Congress' single experiment with direct accreditation by the Commissioner of Education in 1964 was dismissed as a failure, and replaced in 1968 with delegation to multiple private accreditation organizations.[398] Thus, by the late 1960s, determination of nationally-recognized accreditation organizations had developed into a significant regulatory task.[399] Amendments to the criteria for "listing" in 1969 and 1974 changed the character of these criteria from "innocuous" to more proscriptive, relying less on the accrediting bodies and more on standards for their composition and operation.[400] In 1972 and 1976, Congress, concerned with continuing abuses in student loan programs, amended the Act to extend the Commissioner's direct regulatory authority over the administrative and financial capabilities of each individual institution of higher

---

in defining an "institution of higher education" for any purpose in the Act. *See id.* §435, 79 Stat. at 1247-48 (codified as amended at 20 USC §1085(b)), *id.* §801(a), 79 Stat. at 1269 (codified as amended at 20 USC 1141(a)); *see also* Finkin, *supra* note 380, at 359.

[398] *See* Finkin, *supra* note 392, at 383-85 and YOUNG ET AL., *supra* note 41, at 253, each referring to the Nurse Training Act of 1964, Pub. L. No. 88-581, 78 Stat. 908 (1964). Direct accreditation by the Commissioner was authorized in the act to accommodate the numerous unaccredited nurse training programs, and the "sheer force of numbers" would have forced him to do so. YOUNG ET AL., *supra*, at 253. However, the ultimatum was delayed until 1968 when Congress approved a compromise. "[T]he alternative chosen to deal with the problem was to increase the number of alternative agencies that could be relied upon, rather than to continue the system of direct federal accreditation (which had never actually been used) or to authorize administrative controls over the private agency." Finkin, *supra*, at 385.

> Congress apparently learned an important lesson from this episode and was cautious about making specialized accreditation a requirement for eligibility in the future. In fact, in the few cases in which it did, such as medical and dental capitation grants, virtually all the schools were accredited by well-established, nationally recognized accrediting bodies and had been for quite some time.

YOUNG ET AL., *supra*, at 253.

[399]

> In a fundamental turnabout, the Office of Education now saw itself as a guardian and protector of the rights of recognized accrediting bodies. ... .
>
> As always, with rights come responsibilities. ... . No longer would OE have to seek out the accrediting bodies that presumably were doing reliable work for use in eligibility determinations. Rather, accrediting bodies would not be expected to petition OE and demonstrate that they deserved a place on the list.

YOUNG ET AL., *supra* note 41, at 255. This is probably the genesis of the Commissioner's and later Secretary's assumption of power "as a guardian and protector" which have been criticized as unauthorized by the underlying statutes. *See* Finkin, *supra* note 392, at 390-402 and *supra* note 380, at 370-74.

[400] *See* Finkin, *supra* note 392, at 385-87; YOUNG ET AL., *supra* note 41, at 256-63.

> These revisions express a fundamental lack of confidence that accrediting agencies adequately function to protect the public interest. They are premised upon the perceived need to make listed accrediting agencies more responsive to the demands of consumer protection, the need for educational change, and the observance of ethical institutional practices, both directly, by so providing in the recognition criteria, and indirectly, by changing the composition of the governing bodies of listed accrediting agencies.

Finkin, *supra*, at 386-87. Or, as Young et al. state more succinctly, "[t]hese new regulations made the commissioner the conscience of education and the public about which accrediting bodies were good and how they could be better." YOUNG ET AL., *supra*, at 259.

education.[401] Significantly, though, Congress did not alter the role of accreditation, but rather sidestepped it, targeting needed reforms with direct regulation.[402] The criteria for "listing" of accrediting organizations were reorganized and expanded once again in 1988, the major changes being addition of examination of assessment of student achievement and limitations on "shopping" for accreditation by institutions.[403] Even these changes drew concerns from commentators that the Secretary was unduly interfering in educational programs.[404]

Much of this landscape was swept clean in the Higher Education Amendments of 1992.[405] Prior recommendations of the Secretary's statutory advisory council recognized a "triad" partnership among the federal and state governments and the private accrediting agencies.[406] Congress essentially codified this triad relationship, specifying requirements for state review,[407] direct federal regulation similar to that begun in the 1970s,[408] and most importantly, Secretarial recognition of accrediting agencies.[409] In particular, the 1992 Act requires the Secretary to detail by rule standards with which to measure each accrediting organization's evaluation of each institution's performance in twelve specific areas which form the core of an institution's educational program.[410]

---

[401]*See* Education Amendments of 1976, Pub. L. No. 94-482, §133(a), 90 Stat. 2081, 2150-51 (repealed 1980). Similar provisions already existed regarding the guaranteed student loan program, having been added in 1972; the 1976 Act extended these requirements to other federal student aid programs. *See* S. REP. No. 882, 94th Cong., 2d Sess. 33 (1976), *reprinted in* 1976 USCC.A.N. 4713, 4744.

[402]*See* Finkin, *supra* note 392, at 390 ("the post-1968 legislation indicates that when Congress sought to tighten controls over institutional activity unrelated to educational quality, to effect policies of consumer protection or financial responsibility, it chose to act directly by means unrelated to the system of institutional or programmatic accreditation"). *Accord,* YOUNG ET AL., *supra* note 41, at 262-63.

[403]*See* Secretary's Procedures and Criteria for Recognition of Accrediting Agencies, 53 Fed. Reg. 25,088, 25,088-89 (1988) [*hereinafter* 1988 Accreditation Rules].

[404]*See id.* at 25,089-90.

[405]Pub. L. No. 102-325, 106 Stat. 448 (1992).

[406]*See, e.g.,* 1988 Accreditation Rules, *supra* note 403.

[407]*See* Pub. L. No. 102-325, §499, 106 Stat. 448, 635-37 (1992) (codified at 20 USC §§1099a to 1099a-3).

[408]*See id.* §499, 106 Stat. at 647-52 (codified at 20 USC §§1099c & 1099c-1). For a discussion of prior legislation, see *supra* notes 401-402 and accompanying text.

[409]*See* Pub. L. No. 102-325, §499, 106 Stat. 448, 642-46 (1992) (codified at 20 USC §1099b).

[410]These areas are:

(A) curricula;
(B) faculty;
(C) facilities, equipment, and supplies;
(D) fiscal and administrative capacity as appropriate to the specified scale of operations;
(E) student support services;
(F) recruiting and admissions practices, academic calendars, catalogs, publications, grading and advertising;
(G) program length and tuition and fees in relation to the subject matters taught and the objectives of the degrees or credentials conferred;

The program of recognizing accrediting agencies bears many of the hallmarks of audited self-regulation. There was a preexisting self-regulatory program, with an economic or institutional and professional incentive to make that self-regulation meaningful. The regulators had collected expertise not easily reproduced by outsiders, in their professional judgment as educators. And they were a ready source of manpower, saving the federal government from the expense of duplicating their efforts with federal employees. Until the 1992 Act, however, any meaningful "auditing" was noticeably absent. The Act requires the Secretary to establish standards for measuring, among other things, the adequacy of the accrediting organization's standards, its enforcement of its own standards, and the fairness of the process used in determining to grant or withhold accreditation.[411]

However, several essential features are missing from this regulatory scheme when compared with a model of audited self-regulation. There is no appeal from the decision of the accrediting agency. There is no ability by the federal agency to specifically approve or adopt rules or standards for the accrediting organizations.[412] And most importantly, there is no independent federal authority to accredit or "de-accredit" individual institutions. All of these are features present in most other models of self-regulation, and as well in federal regulation of these same institutions' fiscal and administrative ability and responsibility.[413] This difference may be explained by the traditionally limited federal role in

---

> (H) measures of program length in clock hours or credit hours;
> (I) success with respect to student achievement in relation to its mission, including, as appropriate, consideration of course completion, State licensing examination, and job placement rates;
> (J) default rates in the student loan programs ...;
> (K) record of student complaints received by, or available to, the agency or association; and
> (L) compliance with its program responsibilities ... including any results of financial or compliance audits, program reviews, and such other information as the Secretary may provide to the agency or association.

20 USC §1099b(a)(5).

[411]*See* 20 USC §1099b(a)(4)-(6). There are no similar provisions in the existing regulations, except perhaps for 34 CFR §602.17(c), (e) & (g), requiring decisions based on published criteria, an "appropriate and fair" appeals process, and precluding conflicts of interest and inconsistent application of standards. Previously, the scope of "due process" in the accrediting decision, now addressed by 20 USC §1099(b)(6), was determined on a case-by-case basis. *See, e.g.*, Marlboro Corp. v. Ass'n of Indep. Colleges and Schools, 556 F.2d 78 (1st Cir. 1977); Marjorie Webster Junior College v. Middle States Ass'n of Colleges and Secondary Schools, 432 F.2d 650 (D.C. Cir.), *cert. denied*, 400 U.S. 965 (1970); Oulahan, *supra* note 130, at 223-26.

[412]Although the Secretary must develop "standards" to measure the standards by which the accrediting organization assesses individual institutions, *see* 20 USC §1099(b)(5), this is one-step removed from rulemaking or review.

[413]*See supra* note 408 and accompanying text.

higher education. The role of the Secretary is limited even by the 1992 Act,[414] and it has been suggested that the limited authority of the past did not even support that modest regulation.[415] And curiously, the idea of dropping the requirement of accreditation for access to these federal programs surfaces occasionally,[416] indicating that this scheme of reliance on private regulation is not entirely settled.

C. Nuclear Power Production

The Nuclear Regulatory Commission (NRC) has the responsibility of licensing the construction and operation of nuclear power plants.[417] Following the 1979 accident at Three Mile Island, the nuclear power industry created the Institute for Nuclear Power Operations (INPO) to set and police its own (industry) standards.[418] The NRC also began a program of improving its regulations. Ultimately, in the area of personnel training, the NRC adopted INPO's standards.[419] Enforcement power was not specifically delegated to INPO; however, the NRC noted that meeting INPO standards was essentially a condition of an initial or continuing license.[420] The NRC indicated that it would itself

---

[414]20 USC §1099b(g) prohibits the Secretary from establishing additional standards not required by the Act, but the accrediting agencies themselves are permitted to do so. And there is the overlay of §1232a, *see* note 391 *supra.*

[415]Professor Finkin argues stridently that many of the existing regulations are clearly beyond the scope of the Secretary's authority. *See* Finkin, *supra* note 380, at 370-74; Finkin, *supra* note 392, at 390-402.

[416]*See* YOUNG ET AL., *supra* note 41, at 266 (proposal in the 1980 reauthorization of the Higher Education Act); H.R. REP. NO. 447, 102d Cong., 2d Sess. 74 (1992), *reprinted in* 1992 USCC.A.N. 334, 407 (original bill ultimately becoming Higher Education Amendments of 1992, approved by committee, would have eliminated the accreditation requirement).

[417]*See generally,* 42 USC §§2131, 2133-2134, 10 CFR §§50.20-.23.

[418]*See* UNITED STATES GENERAL ACCOUNTING OFFICE, NRC'S RELATIONSHIP WITH THE INSTITUTE OF NUCLEAR POWER OPERATIONS 2 (1991) [hereinafter GAO REPORT]. "INPO was formed after the 1979 Three Mile Island accident to promote safety and reliability in the operation of nuclear power plants. INPO is a nonprofit corporation whose membership includes all operators of nuclear power plants in the United States." Critical Mass Energy Project v. NRC, 975 F.2d 871, 874 (D.C. Cir. 1992).

[419]The Commission adopted INPO's standards for training several categories of personnel, first on a temporary basis, *see* Commission Policy Statement on Training and Qualification of Nuclear Power Plant Personnel, 50 Fed. Reg. 11,147 (1985) [hereinafter *1985 Policy Statement*] and then, after a period of review of INPO and licensee activities, on a permanent basis. *See* Commission Policy Statement on Training and Qualification of Nuclear Power Plant Personnel, 53 Fed. Reg. 46,603 (1988) [hereinafter *1988 Policy Statement*]. For an overview of the INPO accreditation history and process, *see Accreditation of Nuclear Training*, NUCLEAR NEWS, Apr. 1993, at 46.

[420]Although the Commission's policy statement indicated that it considered INPO's accreditation as only one method of meeting the license requirements for personnel training, it was "understood" that each licensee would submit to the INPO standards. *See 1985 Policy Statement, supra* note 419, at 11,148. By 1990, all licensees had INPO-accredited training programs. Walter J. Coakley, *Training and Accreditation in the Nuclear Power Industry*, NUCLEAR NEWS, Apr. 1991, at 48.

directly review INPO's accrediting procedures,[421] and would retain plenary enforcement authority.[422]

The NRC thus found effective use of audited self-regulation superior to direct regulation. By taking advantage of a preexisting or at least contemporaneous industry organization with the incentive to engage in meaningful self-regulation, the NRC was able to endorse that organization's regulatory standards as its own. Ultimately, the scheme foundered for failure to comply with the statutory directive that the NRC "promulgate regulations, or other appropriate guidance for the training and qualifications of civilian nuclear power plant [personnel]."[423] The D.C. Circuit ultimately held that the NRC's reliance on INPO was not sufficient,[424] and the NRC has since promulgated final rules of its own directly mandating training program standards, and indicating that accreditation will constitute compliance.[425] The past NRC Chairman has noted that similar initiatives are needed in the area of plant maintenance.[426] Like training, the regulation is suitable for audited self-regulation, as the rules are technical and widely divergent depending on the particular regulated entity involved.[427] To date, however, in part due to legal challenges[428] and public and congressional scrutiny,[429] the NRC is not able to rely on INPO regulations or standards to any meaningful extent.

---

[421] *See 1985 Policy Statement, supra* note 419, at 11,148 ("To assure that the nuclear industry's training program improvements are effective, the NRC will continue to closely monitor the process and its results ... .").

[422] *See id.* at 11,148, *1988 Policy Statement, supra* note 419, at 46,604 (removing statement of discretionary enforcement from 1985 Policy Statement for violations of the accreditation requirement).

[423] 42 USC §10226.

[424] *See* Public Citizen v. NRC, 901 F.2d 147 (D.C. Cir.), *cert. denied,* 498 U.S. 922 (1990).

[425] *See* Training and Qualification of Nuclear Power Plant Personnel, 58 Fed. Reg. 21,904, 21,908 (1993). The Commission will rely on private accreditation and will conduct its own inspections of nonaccredited programs. *Id.* This is reminiscent of the SEC's "SECO" program of broker-dealer regulation; *see supra* notes 202-204 and accompanying text.

[426] *See Carr: Looking at Maintenance, Standardization, Industry "Coziness,"* NUCLEAR NEWS, Nov. 1989, at 36 (interview with then-NRC-Chairman Kenneth M. Carr) ("What I want to see is some sort of a system that gets good maintenance accomplished ... . We must have something — either a rule put out by us or something the utilities do, like they did with their training program.")..

[427] *See id.* ("It's hard to write a good maintenance rule. In the first place, there are too many different kinds of plants, so you can't write a rule to cover them all. And rules must be enforced, so you've got to be careful what you put in them.")

[428] *See supra* note 424 and accompanying text.

[429] *See* GAO REPORT, *supra* note 418, at 1 (indicating that the report was prepared upon the request of several congressmen). The report ultimately concluded that the NRC does not rely to a great extent on INPO reports or information in its regulation, although the GAO recommended that the NRC itself issue public information notices based on INPO reports it receives, because the INPO reports themselves have been held to be exempt from public disclosure. *See id.* at 5-7; *see also* Critical Mass Energy Project v. NRC, 931 F.2d 939 (D.C. Cir. 1991) (holding certain INPO reports exempt from disclosure under the Freedom of Information Act).

D. Agricultural Marketing

In several areas, the Department of Agriculture's Agricultural Marketing Service (AMS) uses various forms of self-regulation in administering various statutes.

1. Marketing Agreements and Orders

Under the Agricultural Marketing Agreement Act of 1937,[430] the Secretary of Agriculture is authorized to facilitate or in some cases impose agreements between producers and handlers[431] of certain agricultural products, in order to regulate the quality and quantity of the products brought to market.[432] Two types of arrangements are authorized by the Act: a marketing agreement, essentially a voluntary agreement between the Secretary and producers,[433] and a marketing order, an agreement among handlers made binding on all handlers in a designated marketing area.[434] Although the two types are provided for separately and apply to different groups of commodities,[435] "[t]he terms ... often are used interchangeably, because a marketing agreement rarely is established without a

---

[430]This statute has a difficult history, having been caught up in the constitutional struggles of early New Deal legislation. The agricultural marketing laws were first enacted in 1935, *see* ch. 641, 49 Stat. 750 (1935), as amendments to the Agricultural Adjustment Act of 1933, ch. 25, 48 Stat. 31 (1933) (codified principally at 7 USC §§601-612). The 1935 amendments were enacted to clarify the extent of the government's power in light of the Supreme Court's decision in A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935), holding the National Industrial Recovery Act unconstitutional as an improper delegation of legislative power. *See* S. REP. NO. 1011, 74th Cong., 1st Sess. 6 (1935); H. R. REP. NO. 1241, 74th Cong., 1st Sess. 8 (1935). The nondelegation doctrine is discussed in detail *supra* Part III.B.1. This portion of the Agricultural Adjustment Act as so amended was in turn reenacted and named the Agricultural Marketing Agreement Act by ch. 296, §1, 50 Stat. 246, 246 (1937) in order to establish that portion's continuing validity in light of the Supreme Court's decision in United States v. Butler, 297 U.S. 1, 74-75 (1936), holding unconstitutional certain taxation provisions of the Agricultural Adjustment Act. *See* S. REP. NO. 565, 75th Cong., 1st Sess. 2 (1937); H. R. REP. NO. 468, 75th Cong., 1st Sess. 2 (1937). The 1937 Act was subsequently held to be a valid delegation of legislative power. *See* United States v. Rock Royal Coop., Inc., 307 U.S. 533, 574-78 (1939).

[431]Handlers are "processors, associations of producers, and others engaged in the handling of any agricultural commodity or product thereof." 7 USC §608c(1).

[432]*See generally*, 1 JULIAN C. JUERGENSMEYER & JAMES B. WADLEY, AGRICULTURAL LAW 284-88 (1982).

[433]*See* 7 USC §608; JUERGENSMEYER & WADLEY, *supra* note 432, at 284-88.

[434]*See* 7 USC §608c; JUERGENSMEYER & WADLEY, *supra* note 432, at 288, 293-95.

[435]Marketing agreements may be reached by producers and the Secretary with respect to "basic agricultural commodities," *see* 7 USC §608(2), defined in *id.* §611 as

> wheat, rye, flax, barley, cotton, field corn, grain sorghums, hogs, cattle, rice, potatoes, tobacco, peanuts, sugar beets and sugarcane, and milk and its products, and any regional or market classification, type or grade thereof.

Marketing orders, in contrast, may be imposed by the Secretary on distributors with respect to a convoluted listing of commodities, consisting primarily of fruits, vegetables, nuts and milk and milk products. *See id.* §608c(2).

marketing order or a marketing order established without an agreement."[436] It is the implementation of the marketing order which provides useful examples of self-regulation.[437]

There are two types of self-regulation involved in agricultural marketing orders. First, before any order may be effective, it must be under a marketing agreement among handlers of more than half of the volume of that commodity in the marketing area,[438] and must be approved by the producers in the marketing area.[439] Second, the implementation of the marketing order is left to local individuals or groups. The Secretary is required to provide for the selection of an "agency" and define its powers and duties, which include limited powers of self-regulation.[440] Pursuant to this authority, each of the 43 marketing orders relating to fruits, vegetables and nuts,[441] provides for the selection of an administrative committee including both producer and handler representatives.[442] And the general regulations applicable to each of the 40 milk marketing orders[443] provide for a market administrator, appointed by the Secretary, whose duties parallel those set forth in the statute.[444]

The first method of self-regulation, approval by producers and, in most instances, handlers as well, was intended to limit the discretion of the Secretary in restricting production and distribution of these commodities. The legislative history of the Act reveals significant concern of both producers and handlers with

---

[436]JUERGENSMEYER & WADLEY, *supra* note 432, at 294. The Act requires that, for any marketing order to validly issue, there must have been proposed a marketing agreement regulating that commodity in the same manner and applicable to the same classes of activity. *See* 7 USC §608c(10).

[437]Because a marketing agreement, standing alone, is a voluntary consensual arrangement, *see supra note* 433 and accompanying text, it lacks the compulsion (apart from the law of contracts) which is an essential element of regulation. *See supra* Part I.A.

[438]*See* 7 USC §608c(8). A marketing order may be approved without such handler agreement if the Secretary determines that the handlers' refusal will impair the objectives of the Act, and if two-thirds by number and production volume of producers also approve the order. *See id.* §608c(9).

[439]With or without handler approval, the marketing order must be approved by two-thirds of the producers, measured both by number and by production or sale in the marketing area. *See id.*

[440]These "agencies" have only the powers to

> (i) To administer such order in accordance with its terms and provisions;
>
> (ii) To make rules and regulations to effectuate the terms and provisions of such order;
>
> (iii) To receive, investigate, and report to the Secretary of Agriculture complaints of violations of such order; and
>
> (iv) To recommend to the Secretary of Agriculture amendments to such order.

7 USC §608c(7)(C).

[441]*See* 7 CFR §§905.1 - 993.602.

[442]*See, e.g., id.* §§905.19 - 905.36 (establishing the Citrus Administrative Committee under the marketing order for oranges, grapefruit, tangelos and tangerines grown in Florida).

[443]*See id.* §§1001.1 - 1139.86. A "market administrator" is appointed by the Secretary for each milk marketing order. *See id.* §1000.3.

[444]*See* 7 CFR §1000.3(b).

the unchecked use of government power to limit access to markets.[445] Although the scope of self-regulation is clearly more limited than other examples in this study, since it extends only to approval or disapproval of the proposed regulatory scheme as a whole package, the rationale for producer and handler approval follows one of the main purposes of self-regulation discussed above: widespread acceptance by the regulated entities.[446]

The second method of self-regulation, delegation of operational activities to administrators and boards, is more classic audited self-regulation. The local committees or boards have the power to interpret and implement the act. Such delegation allows flexibility in administration of the over 80 local marketing orders. "It is clear that Congress contemplated widespread regional variations in the standards governing production of agricultural commodities."[447] Local administration by interested parties is a classic response to the need for flexibility.[448] In addition, in the case of marketing agreements other than for

---

[445]The Senate report on the bill notes that "[t]hese and other restrictive provisions are, in the opinion of the committee, adequately drawn to guard against any fear that the regulatory power is so broad as to subject its exercise to the risk of abuse." S. REP. NO. 1011, 74th Cong., 1st Sess. 3 (1935). In Congressional testimony, Chester Davis, Administrator of the Agricultural Adjustment Administration, noted that

> [t]he Agricultural Adjustment programs are founded upon the democratic principle of majority rule. ... . No one can say with any basis in fact that under the proposed amendment the Secretary of Agriculture could exercise arbitrary power over groups of farmers against their will. The requirement for consent of two-thirds of the producers affected insures that the wishes of the farmers will be carried out.

Amendments to the Agricultural Adjustment Act: Hearings Before the House Committee on Agriculture, 74th Cong., 1st Sess. 16 (1935) [hereinafter *1935 Hearings*]. In keeping with that "democratic principle," the ability of the Secretary to implement a marketing order notwithstanding the objection of a majority of the handlers, *see* 7 USC §608c(9), was the most strenuously opposed provision in the agricultural marketing law passed in 1935. *See 1935 hearings, supra,* at 11 (testimony of Administrator Davis that "this is the point on which I think most of the objections from distributors, handlers and processors of agricultural products will be based"). The limitation of marketing orders (except for milk orders), *see* 7 USC §608c(11)(B), to the smallest practicable area was also intended as a limit on the power of the regulators. *See infra* note 447 and accompanying text.

[446]*See supra* Part II.A.3.

[447]JUERGENSMEYER & WADLEY, *supra* note 432, at 313. The limitation to small areas was intended not only to be more efficient and flexible but to reduce the risk of abuse of regulatory power by the Secretary. *See* S. REP. NO. 1241, 74th Cong., 1st Sess. 3 (1935); H.R. REP. NO. 1011, 74th Cong., 1st Sess. 7 (1935).

[448]*See* Part II.A.1-2. From the outset of the agricultural marketing program, the extent of local variety was wide. "The marketing agreements ... which have been issued and entered into ... have contained a great variety of provisions in order to adopt each particular program to the peculiar problems and circumstances presented in a given area by a particular commodity." H.R. REP. NO. 1241, 74th Cong., 1st Sess. 7 (1935). In addition, "Congress has approved the use of such ... committees on the theory that the most sound decisions will result from permitting those in the area with the greatest knowledge of the industry's needs to make recommendations to the Secretary." Chiglades Farm, Ltd. v. Butz, 485 F.2d 1125, 1134 (5th Cir. 1973), *cert. denied,* 417 U.S. 968 (1974) (citing S. REP. NO. 566, 87th Cong., 1st Sess. 39 (1962)).

milk, the administration is vested in a committee including both producers and handlers, providing representation for both potentially antagonistic interests.[449]

The use of local boards and administrators in the agricultural marketing statutes and regulations has followed requirements for effective audited self-regulation in other respects as well.[450] Although these agencies lack direct enforcement authority, they may recommend enforcement actions to the Secretary,[451] who retains independent investigation and enforcement authority.[452] Any aggrieved party may petition the Secretary for review of a marketing order,[453] and the Secretary retains the independent power to terminate a marketing order or any provision thereof.[454]

Beyond this facially-complete self-regulation, however, the government retains control over the local self-regulators to a degree not found in other programs. Although the statute permits the local boards to implement the marketing orders and adopt rules and regulations to do so,[455] in practice all regulations are "recommended" to the Secretary who then determines whether to begin rulemaking proceedings, and the ultimate regulations are those of the Secretary.[456] The Secretary even retains the ability to summarily reconstitute the membership of each local agency.[457] This retention of power does not make the local agencies superfluous, however. They apparently have some limited

---

[449]*See 1935 Hearings, supra* note 445, at 32-33 (testimony of Administrator Chester Davis, Agricultural Adjustment Administration, that "as a rule [the committees] represent the growers and the business interests equally with the odd member either chosen by the two groups ... or appointed by the Secretary of Agriculture"). Of the 44 existing marketing orders covering nonmilk commodities, only one provides majority representation to handlers, *see* 7 CFR §987.21 (California dates), and five others provide equal or nearly-equal representation to producers and handlers, *see id.* §§907.20 (California navel oranges), 908.20 (California valencia oranges), 925.20 (southeastern California grapes), 955.20 (Georgia Vidalia onions), 981.31 (California almonds). All other committees have producer majorities.

[450]This might be expected, since the legislation was drafted with the nondelegation doctrine in mind, *see supra note* 430, and Congress was arguably aware of the antitrust implications of marketing orders as well, since the Act provides an explicit antitrust exemption for marketing agreements. *See* 7 USC §608b(a).

[451]*See supra* note 440.

[452]*See* 7 USC §608a.

[453]*See* 7 USC §608c(15), 7 CFR §900.52.

[454]*See* 7 USC §608c(16).

[455]*See supra* note 440.

[456]In all but three of the 43 non-milk marketing orders currently on the books, the Secretary retains the authority to replace any agency member or alternate at any time and to summarily disapprove of any agency action, making it void except for acts previously done in compliance with it. *See* 7 CFR §§905.35, 906.53, 907.81, 908.81, 910.82, 911.62, 915.62, 916.62, 917.30, 918.85, 920.62, 921.62, 922.62, 923.62, 924.62, 925.62, 927.34, 928.62, 929.67, 931.62, 932.66, 945.81, 946.72, 947.82, 948.82, 950.82, 953.77, 955.81, 958.82, 959.82, 965.82, 966.82, 967.81, 971.82, 979.82, 984.83, 982.80, 985.65, 989.95, 993.83.

[457]*See id.*

independent authority,[458] "and are intended to relieve the Secretary of the day-to-day burden of administering the marketing orders."[459] Retention of such complete direct regulatory authority where the statute might permit further delegation seems at odds with the principles of supervised self-regulation, but may be appropriate in the particular context of agricultural marketing orders. These regulations limit the type and often the quantity of a commodity which may be brought to market, and are often amended several times each growing season.[460] A regulatory scheme allowing the local agencies to exercise more authority subject to administrative review by an aggrieved party might create delays unacceptable in a market adjustment scheme where time is of the essence.[461]

In addition to these practical reasons for strict control of marketing orders by the Secretary, the strict control makes the local agency's actions more easily defended against legal challenges. Although the statute was drawn against the background of the nondelegation doctrine, the Secretary's total authority has been relied on in some instances as a defense against an attack on the local agencies as repositories of improperly-delegated authority,[462] and as a defense against antitrust challenges to otherwise unprotected conspiracies.[463]

2. Research and Promotion Boards

Federal statutes currently authorize research, consumer information and promotional activity on behalf of fifteen different commodities through research

---

[458]In some marketing orders, for example, the agency is given the authority to initially decide whether a producer is exempt from the order, *see, e.g.*, 7 CFR §§927.110 - .114, 948.132, or the authority to dispose of the quantities of a commodity initially withheld from the consumer market. *See, e.g., id.* §§981.66, 984.56, 985.57, 987.52, 989.67, 993.65.

[459]Farmers Alliance for Improved Regulation v. Madigan, Civ. No. 89-0959, 1991 WL 178117 at *5 (D.D.C. Aug. 30, 1991)

[460]*See, e.g. id.* at *4 ("This regulation takes place through week-by-week control over the volume of each type of fruit .... The amount of fruit which can be shipped in a given week is set by the Secretary, acting with the advice of the relevant Administrative Committee.").

[461]Telephone interview with Tom Walsh, Assistant General Counsel, Marketing Division, Department of Agriculture (July 27, 1993).

[462]*See, e.g.*, Wileman Bros. & Elliott, Inc. v. Giannini, 909 F.2d 332, 337 (9th Cir. 1990) (refusing to consider nondelegation doctrine challenge because "no such delegation has been established on the record"); Chiglades Farm Ltd. v. Butz, 485 F.2d 1125, 1134 (5th Cir. 1973), *cert. denied*, 417 U.S. 968 (1974) (no due process issues raised by operation of local committee because of substantial control of the committee by the Secretary); Whittenburg v. United States, 100 F.2d 520, 522-23 (5th Cir. 1939) (noting that total control by Secretary over the boards avoids delegation problem because the boards "have no actual power").

[463]*See, e.g., Wileman Bros.*, 909 F.2d at 334-36 (holding that conduct not approved by the Secretary may, because of that lack of approval, be outside the antitrust immunity granted in 7 USC §608b). The court did not agree with the defendants' allegation that the Secretary's failure to exercise his summary authority to disapprove any local agency action, *see supra* note 456, was equivalent to approval of that action. *See Wileman Bros.*, 909 F.2d at 337-38.

and promotion boards authorized to assess fees upon all handlers of that commodity.[464] The first such legislation, passed in 1954 relating to wool and mohair, generally authorized the Secretary to make agreements with private entities for advertising and sales promotion programs, with funding for such programs provided by a reduction in price support payments otherwise made to producers.[465] Subsequent statutes, however, have been considerably more detailed in the exact regulation to be undertaken by the Secretary, the amount of assessment to be paid by handlers to fund research and promotion programs, and each provides for a private board to administer those programs, under the Secretary's supervision.[466] These boards propose budgets and research and promotion programs which are effective upon the Secretary's approval. Although the scheme of statutes and regulations may seem similar to the marketing orders discussed above, more latitude is usually given to the decisions of the research and promotion boards, even though the dollar amounts involved are usually larger.[467]

The use of supervised self-regulation in funding research and promotion is a case where the organized industry has created a self-funded program of promotion of its product. There are declining federal revenues available for direct support of these programs,[468] and each of these fifteen industries has

---

[464]*See* 7 USC §§1781-1787 (wool and mohair), 2101-2119 (cotton), 2611-2627 (potatoes), 2701-2718 (eggs), 2901-2918 (beef), 3401-3417 (wheat), 4301-4319 (flowers and plants), 4601-4612 (honey), 4801-4819 (pork), 4901-4916 (watermelons), 6001-6013 (pecans), 6101-6112 (mushrooms), 6201-6212 (limes), 6301-6311 (soybeans), 6401-6417 (milk). The wheat promotion program authorized by the above statute was terminated due to lack of industry interest in 1986. *See* Wheat and Wheat Foods Research and Nutrition Education; Termination Order, 51 Fed. Reg. 39,738 (1986). Although the earliest research and promotion statute, for wool and mohair, was passed in 1954, most are of comparatively recent origin. The last five programs listed (pecans, mushrooms, limes, soybeans and milk) were added as part of the Food, Agriculture, Conservation, and Trade Act of 1990. *See* P.L. No. 101-624 §§1905-1933, 1951-1976, 1999A-1999R, 104 Stat. 3359, 3838-65, 3870-904, 3914-26 (1990).

[465]*See* 7 USC §1787.

[466]*See id.* §§2106(a) (Cotton Board), 2617(a) (National Potato Promotion Board), 2707(a) (Egg Board), 2907(a) (Beef Board), 3405(a) (Wheat Industry Council), 4306(1) (Floraboard), 4606(c) (Honey Board), 4808(a) (National Pork Board), 4906(b) (National Watermelon Promotion Board), 6005(b) (Pecan Marketing Board), 6104(b) (Mushroom Council), 6204(b) (Lime Board), 6304(b) (United Soybean Board), 6407(b) (National [Milk] Processor Advertising and Promotion Board).

[467]Marketing orders typically do not involve collection of fees from handlers nor do they entrust the local boards with money to spend, apart from reimbursement for their administrative costs. Research and promotion orders, on the other hand, impose assessments on each handler and result in considerable sums placed at the disposal of the board responsible for research and promotion for that commodity. Telephone interview with Tom Walsh, Assistant General Counsel, Marketing Division, Department of Agriculture (July 26, 1993).

[468]*Id.* Although many of the assessments under earlier research and promotion programs were voluntary, permitting any handler to request a refund of the assessment, most of those provisions have now been removed entirely or removed subject to approval by a referendum of handlers. *See* 7 USC §§2110(b) (refunds terminated if approved by referendum), 2617(g) (providing for refunds, repealed by Pub. L. No. 101-624, §1940, 104 Stat. 3359, 3866 (1990)), 2712(b) (directing Secretary to amend orders to eliminate

demonstrated a broad consensus for such a program.[469] Each group of industry members would have particular expertise in the needed research, promotion and advertising required in each area. [470] Thus, the need for local expertise and control makes self-regulation an appropriate response. The degree of control retained by the Secretary has been sufficient to rebuff challenges to the research and promotion boards as unconstitutional delegations of legislative power.[471]

V. A Model for the Successful Use of Audited Self-Regulation

Part IV analyzed the collected experience of audited self-regulation of seven agencies or departments in twelve programs spanning over seventy years.[472] Parts

---

refundability), 2907 (refunds terminated if approved by referendum), 4608(h) (refunds terminated unless defeated in referendum), 4813 (refunds terminated if approved by referendum), 6007(f) (same). Only the flowers and plants and watermelon orders retain the unconditional right to a refund of assessments. *See id.* §§4312, 4906(h). The removal of the refundability of assessments is partly industry response to the decline in federal funding of promotion programs. Walsh interview, *supra*. The most recent of these amendments eliminating refundability of assessments in the Egg Research and Consumer Information Act Amendments of 1988 was premised on the same need for funding.

> The egg industry realizes the need to provide sufficient funding to research and address the problems facing them today. A poll was conducted by the egg board of all commercial egg producers ... . Sixty-nine percent of the egg industry, representing seventy-nine percent of the total U.S. production, voted in favor of eliminating refunds of producer assessments.
>
> Borrowing from the success of similar orders that exist for the beef, dairy, and pork industries, the Committee believes that it is essential and in the public interest to authorize and enable the establishment of an orderly procedure for the development and financing (through adequate assessment) of an effective and continuous egg research and consumer information program. The hallmark ... must be the contribution by all commercial egg producers of their fair share.

H.R. REP. NO. 1,024, 100th Cong., 2d Sess. 3-4 (1988), *reprinted in* 1988 USCC.A.N. 3,819, 3,820-21.

[469] Not only is such broad support a de facto requirement for introduction of such legislation in Congress, but support is required to prevail in the referenda typically required in each act.

[470] One court described these programs as

> a "self-help" measure that would enable the ... industry to employ its own resources and devise its own strategies to increase ... sales, while simultaneously avoiding the intrusiveness of government regulation and the cost of government "handouts." ... . [This type of program] resembles a number of recent congressional enactments designed to make various federal regulatory programs partially or entirely self-financing.

United States v. Frame, 885 F.2d 1119, 1122 (3d Cir. 1989), *cert. denied,* 493 U.S. 1094 (1990) (discussing specifically the Beef Promotion and Research Program, but noting that other programs are "identical in most respects," *id.* at 1122).

[471] *See id.* at 1128-29.

[472] The earliest regulatory program discussed in this part was regulation of futures exchanges in 1922. *See supra* note 214 and accompanying text.

II and III summarized the literature of audited self-regulation generally, suggesting some of its benefits and likely characteristics of an environment suitable to its use. This Part compares those theories and the results from the survey, concluding that there is substantial correlation between theory and practice, and extrapolates from this combination the necessary conditions for the successful use of audited self-regulation.

A. Advantages of Self-Regulation Demonstrated in the Survey

Part II of this study discussed various purported advantages of audited self-regulation. The benefits most often cited in adopting programs of audited self-regulation were a significant savings of federal staff compared to equivalent direct federal regulation, reliance on the expertise of the regulated entities, and the ability to avoid having government decisionmakers involved in areas which, for policy reasons, should remain insulated.[473] In some areas of audited self-regulation, powers were reclaimed by Congress or the agency from the self-regulatory organization when it was apparent that more direct supervision or regulation was needed.[474] Some of the programs were unable to succeed not because of problems related to the design of the audited self-regulation, but because of lack of support from the regulated entities.[475]

This experience suggests that the most likely advantages from the list of advantages of audited self-regulation postulated in Part II to actually appear in practice are superior technical expertise and flexibility. In some cases, incentives for compliance were lacking, and none of the programs documented a significant cost savings overall or even just for the federal government alone; in fact, in many programs any suggestions of anticipated cost savings were disclaimed.

B. Elements for Effective Self-Regulation Demonstrated in the Survey

Part III listed elements of the industry, agency and regulation which would be necessary for an effective program. The successful industries, it was predicted, would be made up of firms with the expertise and incentive to shoulder the regulatory load. These characteristics need not be displayed in a preexisting

[473]Examples of such forbidden areas include the practice of medicine, instruction at colleges and universities, and production and distribution decisions of farmers.

[474]Examples of such reclamation of authority include futures market regulation and review of nonmedical (administration and finance) issues in eligibility of health care suppliers for reimbursement under Medicare.

[475]Lack of support from the regulated entities made it difficult for the SEC to pursue its programs of audited self-regulation for accountants and investment advisers.

organized form, however. The survey shows that successful self-regulatory organizations can be established contemporaneously with the regulation; in almost half the programs, this was the case.[476] In the cases where programs were abandoned or modified, these elements of expertise and incentive were missing. The SEC's attempt to regulate investment advisers in this fashion foundered because the existing self-regulatory organizations were not trusted by the investment advisers themselves in their expertise. The CFTC's regulation of futures exchanges and HCFA's regulation of the peer review process each were substantially modified as the agencies discovered through experience that the self-regulatory organization in some instances lacked the incentive to do the job.

The regulations, predicted the literature in Part III, would be the "social regulation" type, cutting across industry lines in health, safety and environmental areas. Interestingly, none of the programs of group self-regulation were of this type. Each was very industry-specific, yet self-regulation was advantageous for the same reason: it effectively deals with diversity. In these programs, the diversity is not in regulated entities scattered among different industries, but in regulated entities all in the same industry, but which nonetheless are to be treated differently. Each broker, physician, accountant, farmer or university president makes decisions individual to his client, patient, crop and market, or institution, at that time and in those circumstances.

The theories in Part III indicated that the best regulations for a self-regulatory program would be those which were sufficiently specific to limit discretion and output or result-oriented. The programs surveyed are a fairly even blend of both. In hospital accreditation, for example, the accreditors are moving to include outputs — quality of care — as well as inputs in determining hospital status. Accreditation in higher education is clearly output oriented; facilities and faculties are no doubt evaluated, but the important question is whether the institution is fulfilling the education mission it has adopted. Standards for securities and commodities brokers are a mixture of inputs — passing standard exams, capital invested in the business, and so forth — to results or outputs — rules against fraud and manipulation, for example. The qualities sought by looking at output standards are clarity and simplicity of measuring results. These apparently are equally available with input standards in the regulatory programs surveyed; it seems to be the clarity which is important. The two programs with arguably the most subjective standards, higher education accreditation and peer

---

[476]Self-regulatory organizations created contemporaneously with the regulation are the NASD, NFA, INPO, agricultural marketing order administrative committees, and agricultural research and promotion boards. Although INPO was created at the same time as the NRC's commandment to examine the operations and personnel policies of nuclear power plants more carefully, there is no suggestion that INPO was created specifically to fulfill that role in lieu of the NRC, although that was the result until litigation revealed that the NRC could not rely directly on INPO programs. *See supra* Part IV.C.

review of accountants, are also the programs with the most difficulty in implementing regulation. The higher education accreditation program is singular in its insulation from review, and the peer review program failed, at least with the SEC, to become mandatory at all.

The agencies, predicted the literature in Part III, would be successful only if they possessed the necessary technical expertise in the subject and in auditing regulation by the self-regulatory organizations. The programs reviewed do not show any preexisting conditions which will demonstrate presence or lack of these abilities. They do show, however, that expertise can be developed in the agency as it can in the industry. Many of the programs of audited self-regulation, particularly where not developed in response to a manpower shortage, were implemented gradually,[477] allowing both sides the ability to develop the necessary skills. Thus, it appears that agency expertise is not a prerequisite; over the broad types of programs and agencies surveyed, each agency appeared capable of developing the necessary expertise. Self-regulatory programs which failed did not fail due to lack of ability on the part of the agency.

The process requirements discussed in Part III, applicable to programs of group self-regulation, were followed in their entirety by virtually every agency program. The major exception appears to be the four programs in health care and accreditation, which provide comparatively limited rights to appeal outside the self-regulatory organization to the government agency.

C. Necessary Conditions for Successful Audited Self-Regulation

The above conclusions can be restated in two groups of necessary conditions for audited self-regulation to be successful. First, the regulation must be effective, that is, it must realize the goals of the regulatory program; second, the regulation must be fair to regulated entities and the public alike.

1. Effectiveness

Audited self-regulation should be considered only where it might be effective. It should be considered by Congress in developing any program of regulation which requires diverse application to individual regulated entities, where there exists or can be created a self-regulatory organization with the expertise and motivation to implement the regulation, and where the federal agency through which the delegation is made has similar expertise and motivation to oversee that implementation, each in a manner consistent with the

[477]For example, the regulation of securities and commodities exchanges continued to develop, as evidenced by the continuous changes in both organic acts reviewed in Part IV.A.1. and 2.

public interest. Similarly, a federal agency charged with implementing an existing program of regulation should consider proposing legislation to Congress to permit audited self-regulation where these conditions exist. Once such a program, agency and self-regulatory organization have been identified, Congress and the agency should together determine the scope of substantive delegation of responsibility to the self-regulatory organization. The agency's authority to delegate to the self-regulatory organization should be explicitly stated in the implementing statute.[478] The agency should also have independent enforcement authority over all regulated entities and independent rulemaking authority for the self-regulatory organization. Both the self-regulatory organization and the agency should be required in their rulemaking to consider the impact of the rule on competition.

Self-regulatory programs have failed where these conditions have not been met. The SEC, in proposing audited self-regulation of investment advisers, was unable to convince the investment adviser industry that there existed or could be created a self-regulatory organization responsive to their needs.[479] The Department of Agriculture was reluctant to grant expansive self-regulatory powers to the nation's commodity exchanges because of lack of confidence in those exchanges' commitment to the public interest.[480] The SEC, in proposing audited self-regulation for auditors of financial statements, was unable to impose upon the AICPA a sufficient regard for the need for effective agency oversight.[481] HCFA and the Department of Education have continually modified their self-regulatory programs in response to concerns that the self-regulatory organizations lacked concern for maintaining competition[482] or vigorous enforcement.[483]

An additional component of effectiveness, apart from the self-regulatory organization's oversight of the regulated entities and the agency's oversight of the self-regulatory organization, is congressional oversight of the agency to assure protection of the public interest. Such oversight is best assured if the program of audited self-regulation is conducted pursuant to explicit congressional authority. In almost all of the programs surveyed in Part IV, Congress specifically acted to create the self-regulatory program. The only exceptions are the SEC's proposed peer-review requirement for accountants and the peer-review program authorized

---

[478]An important part of a successful program of audited self-regulation is explicit statutory statements of the parameters of the program. *See infra* notes 484-487 and accompanying text.

[479]*See supra* note 263 and accompanying text.

[480]*See supra* note 227 and accompanying text.

[481]*See supra* notes 287-289 and accompanying text.

[482]*See, e.g.*, note 335 *supra* (anticompetitive effects of private accreditation of Medicare and Medicaid providers).

[483]*See, e.g.*, HCFA's continuing development of a generic accreditation rule for Medicare and Medicaid providers, *supra* text accompanying notes 327-330, and the amendment of the accreditation of clinical laboratories, *supra* note 347 and accompanying text.

by the FDIC. In neither instance did specific congressional legislation explicitly provide for delegation by the agency to a self-regulatory organization.[484] However, the FDIC's authority can be fairly implied from the statute,[485] and the SEC's program was never adopted. Significantly, the attempt by the NRC to rely on INPO standards was invalidated on the ground that the statute required direct agency regulation.[486] Thus, it is likely that explicit congressional authority is necessary in any event,[487] and is certainly a practical requirement. Congressional hearings and debates will provide legitimacy for the delegation to the agency or department and ultimately to the self-regulatory organization, and Congress in its authorization and subsequent reexamination has the power to assure that the agency and the self-regulatory organization continue to operate with the public interest paramount.

2. Fairness

Audited self-regulation should be considered only where Congress is assured that it can be implemented fairly and in the public interest. In order to maintain standards of fairness consistent with the Constitution and the antitrust laws, the following process protections should be imposed. The self-regulatory organization should engage in its rulemaking on the record, with notice and opportunity for comment given to all affected groups to the extent possible, with particular emphasis on notice to nonmembers who might be adversely affected by the proposed rule, and responses to all significant comments required in the rulemaking record. In its adjudication or other enforcement activities, the self-regulatory organization should again provide notice and opportunity for a hearing to the respondent, and that hearing should be before an impartial decisionmaker

---

[484]The SEC asserted that its authority to implement a peer-review system flowed from the requirement for "certified" financial statements under the federal securities laws, *see supra* note 271, and its general authority under the federal securities laws to define that term. *See Peer Review Release, supra* note 274, at 11,665. The FDIC asserted that its authority to require a peer-review system consistent with AICPA standards flowed from the statute itself, which required accountants to receive "a peer review that meets guidelines acceptable" to the FDIC. 12 USC §1831m(g)(3)(A)(ii); *see* Annual Independent Audits and Reporting Requirements, *supra* note 301, at 31,335.

[485]The language of the implementing statute, *see supra* note 484, suggests that the FDIC would be permitted if not encouraged to rely on externally-prepared peer-review guidelines. In its proposed rules, the FDIC noted that "any other accounting organizations that establish standards for peer review may submit details concerning their programs to the FDIC for consideration and possible approval." Annual Independent Audits and Reporting Requirements, *supra* note 305, at 42,521.

[486]*See supra* notes 423-425 and accompanying text.

[487]Many federal departments and agencies have been given general rulemaking authority. *See, e.g.* Securities Exchange Act §23(a)(1), 15 USC §78w(a)(1) ("The Commission ... shall ... have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this title... ."); 12 USC §1819(a)(tenth) (the FDIC shall have the power "[t]o prescribe ... such rules and regulations as it may deem necessary to carry out the provisions of this chapter ... ."). However, these grants of authority were not relied on in any of the regulatory programs reviewed in this study.

who is required to place in the adjudication record his findings and the reasons therefor. The agency, of course, will be subject to all the requirements of the Administrative Procedure Act in its operations, and should in addition, be the first level of review for all rules and adjudications of the self-regulatory organization, with power to disapprove rules and to modify adjudications and sanctions.

Again, self-regulatory programs have failed where these conditions have not been met. Antitrust liability can result in such instances.[488] And the programs of private accreditation of health care delivery and higher education have been generally criticized for the lack of agency review of self-regulatory decisions.[489]

These conditions should provide assurance that audited self-regulation can result in *better* regulation in the public interest because the prerequisite elements exist and because the program will have the features found in existing successful programs. The ultimate responsibility to assure the public interest rests, of course, in the plenary authority of the agency and ultimately the Congress.

VI. Approaches to Encouraging Audited Self-Regulation

When self-regulation was initially adopted in the securities industry, it was expected that it would serve as a model for other similar ventures.[490] It is evident from the survey in Part IV that the use of this model has been somewhat limited. However, the survey also suggests that audited self-regulation can be a useful technique. It is frequently (but not always) successful, and has a fairly strong theoretical basis, in that the predicted advantages and elements seemed to be borne out by agency experience.

Apart from the securities and commodities industries and regulators, systems of audited self-regulation operate in the federal agencies largely ignorant of each other. Many other industries may be unaware of the technique or its potential application to their programs. To the extent that the benefits of audited self-regulation could be realized from any such properly managed program, as suggested in Part V, it is possible that a systematic government-wide analysis of the potential use of this regulatory technique could spread these benefits more widely. Not only could its use be considered in applications where the regulators are currently unaware of its potential, but different regulators could become aware

---

[488] *See supra* Part III.C.1.

[489] *See supra* notes 369 (limited review of denials of payment by Medicare PROs) & 412-413 and accompanying text (lack of direct authority over higher education accreditation agencies).

[490] *See Hed-Hofmann*, supra note 48, at 187-88; Smythe, *supra* note 145, at 478-79.

of programs already in place at other agencies which might be useful models.[491] This Part discusses the options for implementing more comprehensive consideration of audited self-regulation across the federal government. It concludes that mandating regulatory analysis to include an evaluation of audited self-regulation will likely be counterproductive. However, informal recommendations will probably serve to heighten awareness of the technique in interested agencies, which may be more likely to give audited self-regulation genuine consideration when it is in their best interests.

A. The Futility of Mandatory Regulatory Analysis

In some agencies, such as the SEC or CFTC, the widespread current use of audited self-regulation has probably already served to sensitize the policymakers to its potential use. In other agencies, such as HCFA, the burdens of direct regulation have required them to consider alternatives generally, of which audited self-regulation has proved a promising one. Elsewhere, however, consideration of the technique appears to be fortuitous. If audited self-regulation is to be given systematic consideration by agencies, it must be formally or informally added as a step in their rulemaking processes.

An explicit requirement that this option be considered in each regulatory analysis would dramatically increase the awareness across agencies of its potential benefits.[492] Whether it would do much beyond that, however, is doubtful. What is needed to make regulatory analysis successful is a genuine interest in improving the agency's efficiency.[493] Mandating the procedures does

---

[491]*See supra* note 4.

[492]This is the theory behind recent regulatory reforms requiring measuring of costs and benefits and evaluation of alternative forms of regulation, *see, e.g.*, Exec. Order No. 12,866, §1(b), 58 Fed. Reg. 51,735, 51,735-36 (1993), or the impact on small entities, *see, e.g.*, Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1165 (1980) (codified at 5 USC §§601-612). *See* Paul R. Verkuil, *A Critical Guide to the Regulatory Flexibility Act*, 1982 DUKE L.J. 213, 229 (noting the "optimistic assumption" of the Regulatory Flexibility Act that "highlighting the problems of small business and offering suggestions will allow agencies to solve problems they have largely created"); Jeffrey L. Davis, *Regulatory Reform and Congressional Control of Regulation*, 17 NEW ENG. L. REV. 1199, 1220 (1982) (the purpose of regulatory analysis such as cost-benefit evaluation "is essentially to sensitize [agencies] to the costs imposed by their regulation by forcing them to give explicit consideration to such costs").

[493]*See Agency Procedures for Performing Regulatory Analysis of Rules*, Administrative Conference of the United States, Recommendation No. 85-2, 1 CFR §305.85-2, Introduction [hereinafter ACUS Recommendation] (concluding that "regulatory analysis can be a useful device in rulemaking if it is taken seriously by upper level agency decisionmakers;" BARAM, *supra* note 19, at 153 ("although Congress can and should provide the basic structural features and require compliance by all agencies, the fully detailed structuring of discretion (the criteria to be used for choosing among alternatives to deal with very specific health or safety problems) can come only from the agency"); NOLL & OWEN, *supra* note 82, at 159-60 (summarizing "the collective and steady effort of agencies to improve their capabilities for internal analysis and to use internal studies and general inquiries for examining important policy issues").

not necessarily create the required motivation,[494] especially since the procedures are and probably must be insulated from outside review.[495] Judicial review is not a likely result. Congress was unwilling to provide for judicial review in the Regulatory Flexibility Act,[496] and there is nothing inherently revolutionary about audited self-regulation, despite its advantages, to suggest that Congress would treat it differently. Executive review provides a limited enforcement mechanism,[497] but again it cannot internalize the genuineness with which

---

[494]In evaluating mandatory analysis, one government policy analyst concludes:

> If the ... regulatory agency ... has a history of insensitivity to regulatory costs in general ... it is doubtful that an analysis extracted only by force of law will reflect a great deal of creativity in recognizing and responding to such concerns. It is nearly always possible to marshal a strong contingent of arguments in opposition to alternatives, if the agency is inclined to do so. If, on the other hand, the agency has demonstrated the desired sensitivity and has attempted to fashion reasonable accommodations, it is equally doubtful that a mandatory analysis will have any substantive effect on the character of its regulations.

Davis, *supra* note 492, at 1220. This is not to suggest, however, that there is not an abundance of such "sensitive" agencies.

> Although many Regulatory Impact Assessments [required under Executive Order 12,291, 3 CFR 127 (1982), the predecessor to Executive Order 12,866, *see supra* note 492] were no doubt post hoc rationalizations for decisions reached on other grounds, my examination of the process over a two-year period has convinced me that the requirement has resulted in many genuine efforts to obtain relevant information, analyze that information, probe alternatives, and reach sound regulatory decisions. Whether the effort is worth its substantial costs, however, is open to debate.

Thomas O. McGarity, *Regulatory Reform in the Reagan Era*, 45 MD. L. REV. 253, 267-68 (1986).

[495]Lack of effective judicial review seriously limits the impact of the Regulatory Flexibility Act. *See* Verkuil, *supra* note 492, at 271 (concluding the Act will be effective if the Small Business Administration's Office of Advocacy can expand its limited ability to "alert the courts"); Doris S. Freedman et al., *The Regulatory Flexibility Act: Orienting Federal Regulation to Small Business*, 93 DICK. L. REV. 439, 463 (1989) (concluding that the ultimate effectiveness of the Act is "questionable" given the courts' preclusion of review). Executive Order 12,866, *supra*, also explicitly precludes judicial review. *See id.* §10, 58 Fed. Reg. at 51,744.

[496]*See* 5 USC §611. *See also supra* note 495. The National Performance Review, however, recommends providing for judicial review. *See* GORE, *supra* note 4, at 148 (Recommendation SBA01).

[497]Under Executive Order 12,866, *supra*, for example, the Office of Management and Budget is authorized to require a rule's review under the Order, and to require an agency to reconsider its rule prior to effectiveness. *See id.* at §6(b), 58 Fed. Reg. at 51,742-43. Executive orders are, of course, binding only on the executive agencies. And even then, the nature of the organization suggests that review will be less than searching.

> The line agency ... may have far more facts at its disposal and be more familiar with them. Does the OMB possess the necessary manpower and expertise to deal with a one hundred page proposed OSHA regulation on carcinogens in the workplace? Can it do more than scratch the surface? Perhaps the OMB can deal with regulations that are on their face wasteful, ineffective, or counterproductive, but typically, the advantages and disadvantages of proposals are known only after detailed study of the substantive area at issue.

agencies approach regulatory analysis. Other measures could be more effective but are simply not realistic.[498]

Legislative reforms have a limited potential to spur regulatory reform. Experience with the Regulatory Flexibility Act suggest that mandated procedures will have little if any substantive impact. Mandated program changes would be workable only on a case-by-case basis.[499] While effective, these efforts would necessarily be limited by Congressional resources to a few of the most important industries.[500]

B. Encouraging Self-Interested Regulation

Effective regulatory reform requires self-motivation from the agencies. It will thus be the responsibility of the agencies to lay the groundwork for audited self-regulation independently, within the bounds of existing legislation. When the time comes for Congressional action,[501] the agency will be ready with reforms needed to make the program more effective. Until such time, however, audited self-regulation will be implemented if the agencies are self-motivated to do so. In the final analysis, audited self-regulation lives by its own creed. It is most effective when it is implemented by the agencies closest to each situation, with the expertise and ability to make changes which will work because they are in the agency's and the regulated entities' self-interest.

Most analysts of regulatory policy seem resigned to conclude that an agency's self-interest requires its perpetuation.[502] Even if true, this is not a barrier to effective use of audited self-regulation. Regulatory reform of this type

---

Stephen Breyer, *Reforming Regulation*, 59 TUL. L. REV. 4, 9 (1984) (discussing predecessor to Executive Order 12,866).

[498]*See, e.g.*, Davis, *supra* note 492, at 1227 n.112 (requiring agencies to estimate compliance costs in a regulatory budget and permitting regulated entities to pay "noncompliance fees" to avoid the regulation in question) & 1229 ("generic budget cuts for each agency, permitting the agency to select the regulations to be curtailed). Davis concludes that without Congressional self-restraint on delegation, there is little likelihood of effective regulatory reform. *See id.* at 1233.

[499]It is difficult to hypothesize any form of *mandatory* legislation applicable across agencies to implement a particular regulatory program. To be a valid delegation of power, it would of course need to be accompanied with sufficient standards for use. *See supra* Part III.B.1. Such general standards from Congress, applicable to all agencies, are no more likely to be effective than the general command-and-control standards from agencies are across all industries. *See supra* Part II.A.5.

[500]Judge Breyer contends that there are several regulatory programs which are candidates for individual Congressional attention. Although that is hard and long work, consisting of a significant initial information-gathering effort by Congress, creating political visibility and building a coalition dedicated to reform, he concludes it is the only direction to meaningful regulatory reform. Generic or omnibus proposals, he concludes, are simply too weak to generate an impetus for reform. Breyer, *supra* note 497, at 23; Stephen Breyer, *Two Models of Regulatory Reform*, 34 S.C. L. REV. 629, 646-47 (1983).

[501]The Congressional process envisioned by Breyer, *supra* note 497, at 23, "takes time."

[502]*See* MITNICK, *supra* note 1, at 421.

is not "deregulation,"[503] and does not necessarily mean a reduced role for the agency,[504] but only a more efficient one.

And the agencies' self-interest can be encouraged. A recommendation of the Administrative Conference would make the utility of audited self-regulation more widely known to the policy analysts within each agency.[505] The National Performance Review recommends comprehensive analysis of alternative regulatory program designs, to be available to each agency.[506] Thus, the principles are more likely to be incorporated into each agency's regulatory analysis.[507] The success of this approach depends extensively on the strength of the regulatory analysis by each individual agency. Recommendations of the Administrative Conference, or even elevation of those statements to precatory administrative orders or regulations will be valuable if they serve to educate, but we cannot and should not expect more of them.

Other external factors may motivate agencies to consider audited self-regulation. The resources of federal government are not infinite, nor is the capability of American business to absorb the costs of regulations not borne abroad.[508] These limits have been recognized, for example, in the work of the CFTC and Congress to create the NFA.[509] It is likely that agencies which might be predisposed to considering audited self-regulation are unwilling "to generate SROs from scratch,"[510] and to face an extended trial-and-error experience as did the SEC or CFTC. The model of audited self-regulation described in this article, and distilled to its essential attributes in Part V, draws in large part on the experience of the agencies, the regulated entities, the courts, and scores of distinguished observers over the past 60 years. This experience can be drawn

---

[503]*See supra* notes 37-39 and accompanying text.

[504]Indeed, the existence of any cost savings from self-regulation, though regularly invoked as an advantage, is rarely proved; *see supra* Part II.A.4. Regulatory reform simply means regulating differently — more efficiently — and not necessarily less, although this may be one result. *See* NOLL & OWEN, *supra* note 82, at 159-60.

[505]*See* Marshall J. Breger, et al., *Providing Economic Incentives in Environmental Regulation,* 8 YALE J. ON REG. 463, 494-95 (1991) (Administrative Conference Chairman Breger noting that "[EPA Assistant Administrator and General Counsel E. Donald] Elliot's suggestion that the Administrative Conference study how to create regulatory systems that are more sensitive to market incentives and performance standards is a useful reminder. We have done work in this area in the past ... . We should be doing more.").

[506]*See* GORE, *supra* note 4, at 117-18.

[507]See ACUS Recommendation, *supra* note 493. Recommendation No. 1 indicates that agencies should incorporate a broad range of options at the very beginning of information-gathering and analysis in respect of a rule.

[508]*See* Stewart, *supra* note 58, 355-56 (citing these "external constraints" which will ultimately require less cumbersome and more effective regulation); Dana A. Rasmussen, *Enforcement in the U.S. Environmental Protection Agency: Balancing the Carrots and the Sticks,* 22 ENVTL. L. 333, 337 (1991) ("The reality of finite resources reminds us of our spending for environmental protection").

[509]*See supra* Part IV.A.2.

[510]Miller, *supra* note 83, at 864.

upon without being repeated.[511] Agencies can be exhorted to consider audited self-regulation; many will likely be willing to experiment. In the meantime, the tools can be readied for agencies ready to undertake the task; the seeds can be planted by proclamation, education and informal "sensitizing," and perhaps sprout in genuine interest by an agency which recognizes when audited self-regulation may serve everyone's self-interest. We cannot command that they do so; but we can supply the methods and await the motivation. This is in the final analysis the most effective and perhaps only way to achieve lasting results.

---

[511]The motivations of one researcher examining only the EPA's emissions trading program can be extended to any program of regulation.

> As anyone who has tried it knows, regulatory reform is easier said than done. Reform concepts which appear so disarmingly simple in the abstract world of theory turn out to be distressingly complex when applied. Regulations which from a distance seem so inherently unsupportable, upon closer inspection are discovered to have significant bases of support among various special interest groups. Since the status quo has so much inertia, many promising ideas end up strewn along the wayside. Survivors are few and far between.
>
> What is the price of survivorship? How much of the original idea has to be sacrificed as the cost of gaining a place in the sun? One way to begin to answer these questions is to examine closely those reform packages ... that have survived.

TIETENBERG, *supra* note 31, at xi.

Annotated Bibliography

Abramson, Harold L. *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 HASTINGS CONST. L.Q. 165 (1989). Divides "fifth branch" activities into three types, and suggests that explicit recognition of the differences among them would yield more principled delegation doctrine decisions. Most relevant is the discussion of the asserted purposes of private regulation and the general history of court decisions.

Ackerman , Bruce A., and Richard B. Stewart. *Reforming Environmental Law*, 37 STAN. L. REV. 1333 (1985). A response to Lattin's article criticizing the authors' theories of regulatory reform, contending that Lattin has overstated the authors' proposals for regulatory reform, and reiterating the costs and inefficiencies of "command and control" regulation.

Bacow , Lawrence S. *Private Bargaining and Public Regulation*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 201-20 (Eugene Bardach & Robert A. Kagan eds. 1982). Discusses hypothetical program where union stewards replace OSHA inspectors; relates the advantages of expertise and cost-savings, and how government might encourage such a result, presaging the VPP program later instituted by OSHA.

BARAM, MICHAEL S. ALTERNATIVES TO REGULATION: MANAGING RISKS TO HEALTH, SAFETY AND THE ENVIRONMENT (1982). Discusses use of alternative methods in this area. Especially relevant are Chapter 3 (Private, Voluntary Self-Regulation), discussing how an agency might best use "consensus" standards, and Chapter 6 (Implementation of Alternatives), looking at possible generic legislation authorizing/commanding agencies to consider alternative methods in rulemaking.

Bardach, Eugene. *Self-Regulation and Regulatory Paperwork*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 315-40 (Eugene Bardach & Robert A. Kagan eds. 1982). Provides rationales of information collection by the government, in particular discusses the potential for self-certification as a regulatory technique, not merely a reporting mechanism..

BARDACH, EUGENE, & ROBERT A. KAGAN. GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS (1982). Ch. 7, "Indirect Regulation," considers on a theoretical basis the costs and benefits of self-regulation, and how it can be effectively used.

---

* denotes previous Administrative Conference projects

Berk, Gerald P. *Approaches to the History of Regulation*, in REGULATION IN PERSPECTIVE (Thomas K. McCraw ed. 1981). End paper synthesizing this collection of essays; particularly helpful is the "four functions of regulation." Most relevant here are "policing," which can be done with self-regulation, and standard-setting, which will occur spontaneously but which can be facilitated by regulators.

Blumrosen, Alfred W. *Six Conditions for Meaningful Self-Regulation*, 69 A.B.A. J. 1264 (1983). Those conditions are: (1) standards be established by law; (2) a vigorous government enforcement program; (3) measurable/objective standards; (4) possibility of residual individual liability; (5) incentives for self-regulation — administrative and interpretive, such as plan approval and periodic reporting; (6) sufficient and organized public concern.

Breger, Marshall J., et al. *Providing Economic Incentives in Environmental Regulation*, 8 YALE J. ON REG. 463 (1991). Discusses major issues in broader application of incentive-based environmental regulation: political problems ("license to pollute"), requisite industry characteristics, geographic scope of problem/market, and setting baseline values for trading.

Breyer, Stephen. *Reforming Regulation*, 59 TUL. L. REV. 4 (1984). Stephen Breyer, *Two Models of Regulatory Reform*, 34 S.C. L. REV. 629 (1983). Analyzes "generic" reforms, likely to have little impact, and regulation-specific Congressional reforms based on intensive investigation and political consensus-building, which are more likely to be effective.

CARY, WILLIAM L. POLITICS AND THE REGULATORY AGENCIES (1967). Lectures delivered at Michigan, dealing mostly with his experiences with Congress and the White House as SEC chairman, noting the similarity of the SEC/self-regulatory organization relationship to the SEC's relationship with Congress as supervised oversight.

Cohen, Jeffrey R., & Laurie P. Pant. *Beyond Bean Counting: Establishing High Ethical Standards in the Public Accounting Profession*, J. OF BUS. ETHICS, Jan. 1988, at 55. Discussion of voluntary self-regulation undertaken by the American Institute of Certified Public Accountants (AICPA) and recent calls for government supervision of this self-regulation.

COMMODITY FUTURES TRADING COMMISSION, NATIONAL FUTURES ASSOCIATION: REPORT TO CONGRESS UNDER SECTION 237 OF THE FUTURES TRADING ACT OF 1982 (7 U.S.C. §16a) (1985). Report by CFTC on the initial operation of the NFA, discussing goals and achievement, cost savings to the CFTC, and comparisons of the NFA to other CFTC regulation and a contrast between the NFA and the NASD.

Costle, Douglas M. *Environmental Regulation and Regulatory Reform*, 57 WASH. L. REV. 409 (1982). Costle, former EPA Administrator, criticizes the Reagan administration's regulatory "relief" as not true regulatory reform, which could be more successful. He gives brief examples of "traditional" and "social" regulation, showing how regulatory reform incorporating economic incentives without totally relying on the private sector can be more efficient. One example is the use of "bubbles."

Davis, Jeffry L. *Regulatory Reform and Congressional Control of Regulation*, 17 NEW ENG. L. REV. 1199 (1982). Reviews Regulatory Flexibility Act and Paperwork Reduction Act and related proposed legislation. Concludes that regulatory analysis is inherently flawed because it is only as good as an agency's dedication to regulatory reform, which cannot be legislated; the real problem is Congress' over-delegation of insoluble problems.

DAVIS, KENNETH C. 1 ADMINISTRATIVE LAW TREATISE 59-223 (2d ed. 1978). Ch. 2, discussing philosophical foundations, and Ch. 3, devoted to the delegation doctrine.

DAVIS, KENNETH C. DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY (1969). A jurisprudential treatment of the use of discretion by all administrators from federal agency to local police, and how it might be effectively reviewed and limited. Also includes a useful discussion of the nondelegation doctrine and the reliance on "rules of law" to curb discretion.

Dennis, Jeanne M. Comment, *Smoke for Sale: Paradoxes and Problems of the Emissions Trading Program of the Clean Air Act Amendments of 1990*, 40 UCLA L. REV. 1101 (1993). Analyzes the acid rain emissions trading program and its probable effect on the electric utility industry, suggesting some changes paralleling those made by the South Coast Air Quality Management District.

Dilk, Andrew J. *Negligence of Federal Aviation Administration Delegatees Under the Federal Tort Claims Act*, 42 J. AIR L. & COMM. 575 (1976). Lists types of "representatives" provided by law & FAA regulation: medical examiners, pilot examiners, technical personnel examiners, manufacturers' designated representatives. Also lists other "quasi-representatives" who serve the same functions but are not so anointed by law. Dilk then focuses on Federal Tort Claims Act cases specifically involving FAA and refers to some involving other agencies.

Dudek, Daniel J. & John Palmisano. *Emissions Trading: Why is this Thoroughbred Hobbled?*, 13 COLUM. J. ENVTL. L. 217 (1988). Comprehensive coverage of all six types of emissions trading, their limited popularity, and how they can be improved.

Finkin, Matthew W. *Reforming the Federal Relationship to Educational Accreditation*, 57 N. C. L. REV. 379 (1979). An update and expansion of the author's 1973 article. A review of each major law requiring listing of accrediting agencies, and a review of the substantive and procedural infirmities of the system. Suggested reforms are a residual government agency which directly accredits where others will not, or an independent prosecutorial branch to "decertify" a school upon investigation or complaint, accreditation notwithstanding.

Finkin, Matthew W. *Federal Reliance on Voluntary Accreditation: The Power to Recognize as the Power to Regulate*, 2 J. L. & EDUC. 339 (1973). Discusses in detail congressional intent and motives in each major piece of education-related legislation from 1944 through 1972, and the limited authority of the government to regulate educational accrediting agencies.

FRANKEL, TAMAR. 1 THE REGULATION OF MONEY MANAGERS (1978 & Supp. 1992). Authoritative treatise on investment companies and investment advisers, with brief discussions of investment adviser self-regulation efforts.

Freedman, Doris S., et al. *The Regulatory Flexibility Act: Orienting Federal Regulation to Small Business*, 93 DICK. L. REV. 439 (1989). The authors are Small Business Administration staff charged with "enforcement" of the Regulatory Flexibility Act, concluding that the lack of judicial review has left the Act only with the ability to permit (but not really to require) agencies to recognize the impact of regulation on small business.

FREEDMAN, JAMES O. CRISIS AND LEGITIMACY: THE ADMINISTRATIVE PROCESS AND AMERICAN GOVERNMENT (1978). Most relevant is the analysis of public perception of administrative performance and the public disillusion with regulation by experts, a discussion of the standards for delegation to private parties or groups, which he believes should be (1) disinterestedness and (2) expertise, and a discussion of organic statutes and missions in defining the success of the SEC and the failure of the FTC.

Fritschler, A. Lee. *The Changing Face of Government Regulation*, in FEDERAL ADMINISTRATIVE AGENCIES: ESSAYS ON POWER AND POLITICS 38-51 (Howard Ball ed. 1984). Pursues the differences between the older economic regulation and the newer social or functional regulation. The former was adjudicatory; the latter rulemaking. The former (either originally or later) received support from business and industry, the latter, having their geneses in the "single-issue politics" of the 1960s, were not supported by the regulated. The former had limited costs and likely clear benefits, the latter have widespread costs with benefits difficult to measure, and result because of their cross-jurisdictional reach in overlap and accumulation of regulatory impacts. Concludes by endorsing generalized methods of coordination and reform: streamline, rely on market forces.

Graham, John D. *The Failure of Agency-Forcing: The Regulation of Airborne Carcinogens Under Section 112 of the Clean Air Act*, 1985 DUKE L.J. 100. Notes the inefficient structure of §112, in classic "command-and-control" fashion. Congress mandated decisions without criteria and in areas where there simply are no answers, imposed unreasonable deadlines for compliance, and permitted no cost-benefit valuation.

Gray, Wayne B., & John T. Scholz, *Does Regulatory Enforcement Work? A Panel Analysis of OSHA Enforcement,* 27 LAW & SOC'Y REV. 177 (1993). Reviews a large base of OSHA enforcement actions and injuries at almost 7000 manufacturing plants over six years, using unique techniques intended to eliminate biases in former studies, and finding a small but significant effect of OSHA inspection on the injury rate.

Grumbly, Thomas P. *Self-Regulation: Private Vice and Public Virtue Revisited*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 93-118 (Eugene Bardach & Robert A. Kagan eds. 1982). Analyzes voluntary self-regulation in the context of FSIS' quality control program. Concludes with recommendations for implementation of similar programs, including broad consensus on goals, agency expertise, availability of knowledge base in the industry.

Hahn, Robert W., and Gordon L. Hester. *Where Did All the Markets Go? An Analysis of EPA's Emissions Trading Program*, 6 YALE J. ON REG. 109 (1989). Analyzes four emissions trading programs: offsets, banking, bubbles and netting. Of the four, netting is by far the most widely used. Broader use of these methods would be valuable, the authors contend. Fixing the measurement and transferability of these "rights" would help, but there has been significant pressure on EPA from environmentalists to not refer to these things as "pollution rights" or to expand their marketability.

Hahn, Robert W., & Gordon L. Hester. *Marketable Permits: Lessons for Theory and Practice*, 16 ECOLOGY L.Q. 361 (1989). Similar to the Yale Journal on Regulation paper. Part IV gives some insights into political issues in the acceptance and further use of market-based incentives.

Hahn, Robert W., and Roger G. Noll, *Designing a Market for Tradable Emissions Permits*, in REFORM OF ENVIRONMENTAL REGULATION 119-46 (Wesley A. Magat ed. 1982).

* Hamilton, Robert W. *The Role of Nongovernmental Standards in the Development of Mandatory Federal Standards Affecting Safety or Health*, 56 TEX. L. REV. 1329 (1978). A study of voluntary standards in safety and health areas. Focuses on history, evaluation, case studies (OSHA, CPSC, NRC, FDA, HUD, USCG), and proposed unitary standards.

Havighurst, Clark C., & James F. Blumstein, *Coping With Quality/Cost Trade-offs in Medical Care: The Role of PSROs,* 70 NW. U. L. REV. 6, (1975). Reviews the microeconomics of health care decisions coupled with federal government efforts at cost control. The authors conclude that more competition and a restoration of consumer choice in the area would help control costs, instead of the observed trend (in the then-current PSRO program) to more heavily regulate.

HAWKINS, KEITH, & JOHN M. THOMAS, EDS., MAKING REGULATORY POLICY (1989). Collection of articles directed mostly to agency rule-making. Relevant articles include: Colin S. Diver, *Regulatory Precision,* discussing advantages/disadvantages of specific\precise rules with three case studies (SEC Rule 144, DOT hazardous materials transportation guidelines, FCC broadcast licensing); and Keith Hawkins and John M. Thomas, *Rule Making and Discretion: Implications for Designing a Regulatory Policy*, mostly discussing discretion in enforcement.

Hawley, Ellis. *Three Facets of Hooverian Associationalism: Lumber, Aviation and Movies, 1921-30,* in REGULATION IN PERSPECTIVE (Thomas K. McCraw ed. 1981). The theory of supervised self-regulation has its roots in the efforts of Secretary of Commerce Herbert Hoover during this period. Seeking to build on the successes of organized private industry during the War, Hoover relied on what Hawley calls "corporatism," with the idea "that the resources for meeting new regulatory needs were to be found mostly in the private rather than the public sector, and would act accordingly." The push was on self-regulation, an idea which carried over even to Roosevelt's NRA.

Hed-Hofmann, Tamar. *The Maloney Act Experiment*, 6 B.C. INDUS. & COM. L. REV. 187 (1965). Review of the performance of the NASD since 1938: purported advantages of self-regulation in this area, analysis of where it has worked and failed.

HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, SECURITIES INDUSTRY STUDY, H.R. Rep. No. 1519, 92d Cong., 2d Sess. 79-99, 155-68 (1972). These two chapters of the Securities Industry Study discuss "cooperative regulation" and antitrust liability.

Husband, Warren H. Comment, *New Approaches and New Polluters: The Practical Impact of the Clean Air Act Amendments of 1990*, 19 FLA. ST. U. L. REV. 861 (1991). General review of the 1990 Act's provisions.

Jaffe, Louis L. *Lawmaking by Private Groups,* 51 HARV. L. REV. 201 (1937). Critical of the then-recent *Carter Coal* decision, Jaffe points out the myriad ways in which private decisions are given public force independent of some "standard" by which they are reviewed. Though Jaffe notes that we rely much on the abilities of professionals or groups with opposing economic interests bargaining at arms' length to produce proper results, this may be enough.

Jennings, Richard W. *Self-Regulation in the Securities Industry: The Role of the Securities and Exchange Commission,* 29 LAW & CONTEMP. PROBS. 663 (1964). Jennings examines the historical development of self-regulation and evaluates its performance in light of the assumed virtues of self-regulation (lower cost, increased flexibility and legitimacy, for example). He suggests several reforms paralleling those ultimately adopted in the Securities Acts Amendments of 1975.

Joskow, Paul L., & Roger C. Noll, *Regulation in Theory and Practice: An Overview* in STUDIES IN PUBLIC REGULATION (Gary Fromm ed. 1981). A comprehensive review of a research agenda on the economics of administrative regulation.

Jost, Timothy S. *Administrative Law Issues Involving the Medicare Utilization and Quality Control Peer Review Organization (PRO) Program: Analysis and Recommendations*, 50 OHIO ST. L.J. 1 (1989). Excellent summary of the development of the PRO program and more particularly of the problems in administration, both from a practical standpoint and from an administrative law standpoint. Makes recommendations based on policies and goals of the program as well as those of administrative law. Based on interviews of numerous participants in the system in addition to traditional research.

Jost, Timothy S. *The Joint Commission on Accreditation of Hospitals: Private Regulation of Health Care and the Public Interest*, 24 B.C. L. REV. 835 (1983). Excellent summary of the development of the JCAHO and its current role, and critiques of its operation, primarily from an antitrust perspective.

1 JULIAN C. JUERGENSMEYER & JAMES B. WADLEY, AGRICULTURAL LAW §§10.1 - 12.12 (1982 & Supp. 1985). A leading treatise discussing the laws and regulations of agricultural marketing and promotion.

KAPLIN, WILLIAM A. THE LAW OF HIGHER EDUCATION (2d ed. 1985). Chapter 8, pp. 561-80 discusses accrediting agencies, applicable cases in administrative, antitrust and defamation law, and includes an annotated bibliography.

Karmel, Roberta S. *Securities Industry Self-Regulation — Tested by the Crash,* 45 WASH. & LEE L. REV. 1297 (1988). Discusses the reforms implemented by the securities markets after the 1987 market crash, preceded by an extensive historical overview of securities market self-regulation and the benefits and disadvantages of self-regulation generally.

Krent, Harold J. *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government,* 85 NW. U. L. REV. 62 (1990). Krent supplies separation-of-powers analysis to fill the void left by lack of challenge to the remarkable variation of delegation outside the government made by Congress in recent legislation, providing useful examples and analysis of such delegation. He suggests that such legislation can survive challenge if at all only by relying on functional equivalents such as self-interest to supply the constitutional checks and balances otherwise provided by the President's appointment and removal powers in delegations within the executive branch.

Latin, Howard. *Ideal Versus Real Regulatory Efficiency: Implementation of Uniform Standards and "Fine Tuning" Regulatory Reforms,* 37 STAN. L. REV. 1267 (1985). A broad criticism of regulatory reform as largely theoretical and relying on unrealistic assumptions. The theory of "second best," argues Latin, suggests continued reliance on setting specific "command and control" standards.

Lawrence, David M. *Private Exercise of Governmental Power,* 61 IND. L.J. 647 (1986). Conceding that federal government delegation is universally approved, Lawrence examines delegations under state law. Nonetheless, he provides a good description of the conventional benefits of delegation to private groups generally, and the discussion of limits of that power, though in a state law context, points out many of the conventional disadvantages.

Levin, Harvey J. *The Limits of Self-Regulation,* 67 COLUM. L. REV. 603 (1967). Discussion of creation of industry codes and standards reviewed from an antitrust perspective. He provides an introductory discussion of the motivations for self-regulation, as well as three case studies: motor vehicle safety standards, cigarette advertising and broadcast programming.

Levin, Michael H. *Getting There: Implementing the "Bubble" Policy*, in SOCIAL REGULATION: STRATEGIES FOR REFORM 59-92 (Eugene Bardach & Robert A. Kagan eds. 1982). Case study of the development and implementation of bubble policies at EPA, focusing on how to align the industry and, more importantly, the agency, with the new approach, concluding with requirements for implementing novel regulatory techniques effectively.

Liebmann, George W. *Delegation to Private Parties in American Constitutional Law,* 50 IND. L.J. 650 (1975). Critical of the incoherence of current formulations of the nondelegation doctrine, he discusses specific applications, including the NASD and more generally delegation of "judicial" powers to existing private groups. He concludes most can be upheld if they provide for meaningful review by a government body (court, agency, legislature).

Lipton, David A. *The SEC or the Exchanges: Who Should Do What and When? A Proposal to Allocate Regulatory Responsibilities for Securities Markets,* 16 U.C. DAVIS L. REV. 527 (1983). A useful analysis of division of responsibility within an industry already governed in large part by supervised self-regulation. Lipton provides guidelines designed to maximize utility and efficiency in allocation of regulatory responsibility between the agency (use of its direct or indirect control) and the self-regulatory organizations (SROs). Guidelines include: (1) decisions requiring technical expertise should be resolved by the institution with the greatest expertise; (2) where uniformity is required, the SEC should administer the decisions of the SROs; (3) conflicts of interest among SROs should be resolved by the SEC. Lipton notes in conclusion that similar criteria could be developed to resolve whether an industry should regulate itself at all.

LIPTON, DAVID A. BROKER-DEALER REGULATION (1988 & Supp.). A comprehensive treatise, with coverage in Ch. 1 of the historical development of regulation (and self-regulation) of securities broker-dealers.

LIROFF, RICHARD A. REFORMING AIR POLLUTION REGULATION (1986). A comprehensive study focusing specifically on the EPA's "bubble" regulations and the development of the comprehensive emissions reduction credit program.

LIROFF, RICHARD A. AIR POLLUTION OFFSETS: TRADING, SELLING, AND BANKING (1980). A companion to Liroff's 1986 study, focusing on the EPA's offset and banking programs.

LITAN, ROBERT E., & WILLIAM D. NORDHAUS, REFORMING FEDERAL REGULATION (1983). Especially relevant is the typology of federal regulation in Ch. 3 (Why and How We Regulate).

6 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2787-2830 (3d ed. 1990). The authors trace the background of the use of self-regulation versus governmental regulation in the organization of the NASD and discuss the nature of the NASD-SEC relationship.

Lurie, Jonathan. *Commodities Exchanges as Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law,* 28 RUTGERS L. REV. 1107 (1975). Comprehensive review of exchange decisions regarding market designation and disciplinary actions against members, and regulation in and judicial review by states. He concludes that courts were deferential to the exchanges' decisions in both areas, creating in the process an early model of judicial review of administrative agency action.

MacAvoy, Paul W., & Dorothy M. Tella, *The Impact of Regulation on the Performance of Industry,* in JOINT ECONOMIC COMMITTEE, 96TH CONG., 2D SESS., GOVERNMENT REGULATION: ACHIEVING SOCIAL AND ECONOMIC BALANCE 176-196 (1980). Focuses primarily on the costs of regulation and the inflationary impact of those costs, but also has a useful description of the historical change in regulatory focus and the difficulties faced by the new health, safety and environmental regulatory agencies.

Markham, Jerry W. *The Commodity Exchange Monopoly — Reform is Needed,* 48 WASH. & LEE L. REV. 977 (1991). A demonstration of the failure of commodities markets to regulate their own members' conduct, suggesting that opening them to competition from other markets, more well disciplined now than in 1922 when the commodities markets were given a monopoly on trading these instruments, could improve their performance.

MARKHAM, JERRY W. COMMODITIES REGULATION: FRAUD, MANIPULATION & OTHER CLAIMS (1988 & Supp.). A treatise relating primarily to commodities trading fraud, but Ch. 26 discusses the self-regulatory environment in commodities regulation similar to that in securities regulation.

MARKHAM, JERRY W. THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION (1987). A complete narrative of the development of the markets and the federal regulation, with a complete discussion of each type of regulated financial product and details of the organization and operation of the CFTC.

MCCRAW, THOMAS K., PROPHETS OF REGULATION (1984). Case studies of four key regulators (Charles Francis Adams, Louis Brandeis, James Landis and Alfred Kahn), with helpful discussions about Landis' use of self-regulation at the SEC, and an ending discussion on the use of economic motivations in structuring effective regulation.

McCraw, Thomas K. *Regulatory Change, 1960-79, in Historical Perspective,* in JOINT ECONOMIC COMMITTEE, 96TH CONG., 2D SESS., GOVERNMENT REGULATION: ACHIEVING SOCIAL AND ECONOMIC BALANCE 1-17 (1980). Charts three periods of regulation, of which the most recent is the most confusing, due to the rise of "single-issue" politics. This resulted in new functional regulation during a period of contradictory emphasis on deregulation. Concludes that these new types of regulations will be considered valuable by society regardless of cost for several years, will require different modes of implementation, and cooperation from business.

* McGarity, Thomas O. *Regulatory Reform in the Reagan Era,* 45 MD. L. REV. 253 (1986). McGarity reviews of the history and typology of regulatory reform techniques from the 1930s, and then surveys their use by the Reagan Administration. Although he concludes that reform has had major setbacks, particularly in its legislative efforts, he believes the underlying goals and justifications for regulatory reform remain intact.

Mellette, Peter M. *The Changing Focus of Peer Review Under Medicare,* 20 U. RICH. L. REV. 315 (1986). A full historical discussion of peer review from before Medicare through the creation of the PRO program, concluding with some critiques of the PRO program.

MELNICK, R. SHEP. REGULATION AND THE COURTS: THE CASE OF THE CLEAN AIR ACT (1983). General analysis of judicial review of EPA regulations under the Act. Although exhaustive in scope, the book does not focus on emissions trading programs.

Miller, Sam S. *Self-Regulation of the Securities Markets: A Critical Examination,* 42 WASH. & LEE L. REV. 853 (1985). Miller reviews the usual concerns about self-regulation (over- or under-regulation, insulation, anticompetitive conduct, abuse of members' rights) with particular emphasis on the securities industry, and discusses the Congressional responses to these problems, most notably in the Securities Acts Amendments of 1975. He concludes that there may be over-reliance on self-regulation in the securities industry, and would restrict it more to technical areas of market operation, referring to a model developed by Lipton (discussed this bibliography).

MITNICK, BARRY M. THE POLITICAL ECONOMY OF REGULATION (1980). A full treatment of the political processes of regulation: life cycle, origins, goals and methods, and deregulation.

Moe, Ronald C. Privatization: An Overview from a Public Administration Perspective, Cong. Res. Serv. Rept. No. 88-201 (Mar. 2, 1988). Surveys rationales for choosing various levels of public intervention, discussing "market failure" theories and public choice theories.

Nachbar, Marshall J. *Contract Market Self-Regulation Under the Commodity Exchange Act*, 31 CLEV. ST. L. REV. 573 (1982). A brief history of development of commodities trading and a complete narrative review of existing CFTC requirements for commodities exchange self-regulation. He concludes that some of those requirements may, by mandating information production and storage, created more accessible information resulting in better self-regulation especially through private litigation.

NOLL, ROGER G., AND BRUCE M. OWEN, THE POLITICAL ECONOMY OF DEREGULATION(1983). The authors use the "interest group" model of regulation to describe existing regulation and the theory is applied to five specific examples, concluding with models and suggestions to make deregulation possible in an environment of regulation supported by various interest groups.

Note, *Delegation of Power to Private Parties*, 37 COLUM. L. REV. 447 (1937). Early summary of mostly state cases on delegation to "non-official" (private) groups. Severely critical of existing judicial analysis, advocating application of the same standard applied to delegations to governmental bodies as set forth in the then-recent *Schechter Poultry* and *Panama Refining* cases.

Note, *Professional Self-Regulation,* 29 ALA. L. REV. 679 (1978). Survey of licensing and regulation focused on Alabama law. The author undertakes a useful typology of regulation: (1) occupations having no relation to public welfare and not subject to regulation (mostly an empty class, analogous to substantive due process); (2) occupations related to public welfare sufficiently to justify health and safety regulation; (3) occupations related to public welfare sufficiently to justify entrance restriction; (4) "learned professions" (historically law, medicine, divinity). In category (3), the author recognizes the "welfare" justification as a facade in many cases for entry restriction to limit competition.

Oulahan, Courts. *The Legal Implications of Evaluation and Accreditation,* 7 J. L. & EDUC. 193 (1978). Critical review and collection of major cases, particularly legal arguments based on due process ("state action" question), antitrust laws, due process, and the scope of authority of the Commissioner [now Secretary] of Education.

PRIVATE ACCREDITATION IN THE REGULATORY STATE (materials prepared for conference sponsored by Am. Bar Ass'n Sec. of Admin. L. & Pract., May 21, 1993). Comprehensive summaries of self-regulatory efforts in accreditation of hospitals, other health care facilities, and colleges and universities, covering each aspect of regulation.

Ponsoldt, James F. *The Application of Sherman Act Antiboycott Law to Industry Self-Regulation: An Analysis Integrating Nonboycott Sherman Act Principles,* 55 S. CAL. L. REV. 47-52 (1981). Reconciles cases to a statement of coherent doctrine, applicable both to audited and voluntary self-regulation.

Rabin, Robert L. *Federal Regulation in Historical Perspective,* 38 STAN. L. REV. 1189 (1986). A detailed review of 100 years of regulation, including the political and social events preceding each wave of regulation or regulatory reform, and the judicial responses, connecting the politics of the regulation with the growth of the resulting administrative law.

Redish, Martin H., & Lawrence C. Marshall. *Adjudicatory Independence and the Values of Procedural Due Process*, 95 YALE L.J. 455 (1986). The authors seek to establish "core" due process requirements from the current "balancing" due process jurisprudence; they identify as such values an impartial adjudicator in all cases and notice and hearing in most cases.

REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 4, at 495-722 (1963). Chapter 12 of the Special Study focuses on the "Regulatory Pattern," discussing philosophies of self-regulation and its use in each exchange and the NASD.

Rhinelander, Laurens H. *The Bubble Concept: A Pragmatic Approach to Regulation Under the Clean Air Act*, 1 VA. J. NAT. RESOURCES L. 177 (1981). A summary of the economic theory of "bubbles," a summary of EPA's 1975 and 1979 bubble regulations and their invalidation in court. Rhinelander concludes that the use of bubbles should be increased, and proposes changes in the three EPA program areas involved.

Roberts, Marc J. *Some Problems of Implementing Marketable Pollution Rights Schemes: The Case of the Clean Air Act*, in REFORM OF ENVIRONMENTAL REGULATION 93-117 (Wesley A. Magat ed. 1982). A comprehensive review of the information and technology problems and impossibilities keeping the economist's ideal solution from any significant implementation.

Rubin, Edward L. *Due Process and the Administrative State,* 72 CAL. L. REV. 1044 (1984). Exhaustive survey of due process doctrines with a view toward formulating certain minimum standards instead of courts' current unfocused balancing tests.

Schoenbrod, David. *Goals Statutes or Rules Statutes: The Case of the Clean Air Act*, 30 UCLA L. REV. 740, 756-59 (1983). A convincing case for why the Clean Air Act was a failure, and a classical critique of "command and control" regulation, especially when done without guidance from Congress. By advocating "rules" statutes, Schoenbrod seems to suggest that "command and control" rules can work if Congress is the source of those rules.

SCHULTZE, CHARLES L. THE PUBLIC USE OF PRIVATE INTEREST (1976). Schultze exhorts regulators to consider using the market to supplant government "command-and-control" regulation wherever possible. He uses EPA and OSHA as examples. The "command and control" regulation stemmed from the early desire to limit governmental power, but is inappropriate to the new pervasive "social regulation." That type of regulation is uniquely suited to modifications of private incentives.

SELDEN, WILLIAM K. ACCREDITATION: A STRUGGLE OVER STANDARDS IN HIGHER EDUCATION (1960). Chapter 4, pp. 29-44, provides an excellent early history of accreditation efforts by colleges and universities. Chapter 5, pp. 45-54, provides an excellent early history (through 1952 legislation) of the limited federal government in accreditation.

Shapiro, Sidney A., & Thomas O. McGarity. *Reorienting OSHA: Regulatory Alternatives and Legislative Reform*, 6 YALE J. REG. 1 (1989). Comprehensive review of why OSHA has failed by a wide margin to live up to Congress' expectations in 1970. Authors undertake a detailed analysis of the industry, internal administrative and political issues involved in enforcement of the Act, and recommend several reforms from "patch and repair" to significant Congressional overhaul. Significantly, self-regulation does not figure into this scheme in an area where one might expect to see it: a large regulated body, agency lack of manpower and expertise, technical questions suitable for negotiation, for example.

Smythe, Marianne K. *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. REV. 475 (1984). Overview of the development of securities regulation, with occasional mentions of its use and benefits in other areas. Focus is then on the application of principal antitrust cases in the area, concluding that the 1975 Securities Acts Amendments provide a model for securing exemptions from antitrust laws to self-regulatory programs.

Stewart, Richard B. *Madison's Nightmare*, 57 U. CHI. L. REV. 335 (1990). Stewart describes Madison's original scheme of countervailing powers has resulted in these groups instead dividing power among themselves, so that

Congress in 1960s and 1970s was able to expand regulatory authority far beyond its supervisory ability. The solution requires a break from "command and control" regulatory strategies, much along the lines of Schultze.

Stewart, Richard B. *Reconstitutive Law,* 46 MD. L. REV. 86 (1986). Describing and extolling the title concept as a middle ground between traditional prescriptive regulation and deregulation or "delegalization."

Stewart, Richard B. *Economics, Environment, and the Limits of Legal Control*, 9 HARV. ENV. L. REV. 1 (1985). Another in Stewart's series of articles extolling the benefits of incentive regulation. Most helpful is Pt. V (20-22) explaining why this type of regulatory reform is misunderstood and currently so difficult to implement.

Sunstein, Cass R. *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407 (1990). Defining a regulatory paradox as "a self-defeating regulatory strategy," Sunstein details five, such as "overregulation produces underregulation" and so on. Nowhere mentioned is any suggestion that self-regulation leads to more direct agency regulation, but application of Sunstein's analysis might be useful.

THOMPSON, FRED, & L. R. JONES. REGULATORY POLICY AND PRACTICES: REGULATING BETTER AND REGULATING LESS (1982). A comprehensive theoretical (mostly economic) treatment of regulation: definition, extent, objectives, and alternatives for both procedural and substantive reform. Helpful in defining regulation and objectives, but no specific discussion of self-regulation beyond what can be extrapolated from general discussions.

TIETENBERG, THOMAS H. EMISSIONS TRADING (1985). An exhaustive compilation of studies on emissions trading combined with the author's own 13 years of study. The text includes in-depth sophisticated economic analysis of each aspect of emissions trading.

UNITED STATES GENERAL ACCOUNTING OFFICE, NRC'S RELATIONSHIP WITH THE INSTITUTE OF NUCLEAR POWER OPERATIONS (1991). A study upon congressional request, finding that the NRC does not rely on information supplied to it by INPO, but recommending that the NRC issue publicly-available notices even when they would duplicate INPO industry notices, which are typically not publicly-available.

* Verkuil, Paul R. *A Critical Guide to the Regulatory Flexibility Act*, 1982 DUKE L.J. 213. An initial review of the Act, comparing it with the Paperwork Reduction Act and Executive Order 12,291 (cost-benefit analysis). He predicts

the effectiveness of the Act depends almost entirely on the effort by the SBA's Office of Advocacy, and a resolution of the unclear provisions on judicial review.

Vogel, David. *The "New" Social Regulation,* in REGULATION IN PERSPECTIVE (Thomas K. McCraw ed. 1981). He defines "social" as consumer and environmental protection, and surveys the development of these regulatory agencies in the 1960s and 70s. The important differences are the cut of these regulations across industry lines and the input given to nonindustry constituencies, which makes these agencies fundamentally different from the then more typical single-industry or single-interest agencies.

Werner, Walter. *The SEC as a Market Regulator*, 70 VA. L. REV. 755 (1984). Describes the SEC's limited efforts in market regulation as opposed to disclosure regulation, and suggests that most of the SEC's inaction or inept action is due to its inability to understand the operations of the securities markets. Werner's analysis suggests some minimum standards of agency expertise are necessary before invoking supervised self-regulation.

Westwood, Howard C., & Edward G. Howard, *Self-Government in the Securities Business,* 17 LAW & CONTEMP. PROBS. 518 (1952). An early historical examination of the development of self-regulation with particular emphasis on the establishment of the National Association of Securities Dealers (NASD), its unique status, and the role of the SEC in overseeing the NASD, particularly its disciplinary actions.

WILSON, JAMES Q. BUREAUCRACY: WHAT GOVERNMENT AGENCIES DO AND WHY THEY DO IT (1989). Chapter 19, "Markets," is the most relevant. Though Wilson refers primarily to privatization or contracting for government services, the four standards he posits against which to measure alternative arrangements for supplying a publicly-funded service — efficiency, equity, accountability and authority — might well serve as useful measures for self-regulatory as well as private enterprises.

YOUNG, KENNETH E., ET AL., UNDERSTANDING ACCREDITATION (1983). A comprehensive survey of issues in accreditation of postsecondary educational institutions. Most relevant for purposes of this study are Chapters 1 (history of accreditation), 3 (accreditation discussed as part of a broader concept of self-regulation, and 13 (the federal government and accreditation).