

INNOVATIONS IN GOVERNANCE: A FUNCTIONAL TYPOLOGY
OF PRIVATE GOVERNANCE INSTITUTIONS

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ABSTRACT

The need to manage the environmental and social impacts of globalization has never been more pressing. Rather than turning to formal government to address these problems, communities are increasingly looking to private governance institutions to set public policy and perform regulatory activities. These institutions, rules and structures for governing without government, remain undertheorized despite an expanding literature. Questions remain about why they have arisen, what functions they serve, and whether they are effective. This article advances the literature in several ways. First, the article pulls from the political science, economics, law, and sociology scholarship to introduce the various types of private governance institutions using a conventional taxonomy, which groups these institutions based on the identity of their constituent organizations (business interests, civil society, and government entities and their hybrid permutations). The article then outlines the inherent limitations of this approach as a descriptive and analytical tool. Second, the article offers an alternative typology, viewing private governance institutions through an economic lens. The article examines what demands for governance arise at each stage of the regulatory process and what barriers keep formal government from meeting that demand. By sorting the institutions according to the kinds of barriers they address at each phase of the regulatory process, the article creates a functional typology.

This process yields a number of insights. First, a functional typology clarifies the strengths of each type of private governance institution, reveals key structures needed at each stage of the regulatory process and suggests ways that both private governance and formal government may be improved. Second, the functional typology suggests that the conventional analysis is incorrect; it is not always necessary for a single private governance institution to provide a substitute for formal government at all stages of the regulatory process to be effective. Private governance institutions may complement formal government at key junctures or they may coordinate and collaborate with each other to create regimes with the capacity to substitute for formal government entirely. In fact, collaboration may be preferred, based on considerations associated with the theory of the firm. Third, only one type of private governance institution currently attempts to substitute for formal government at all stages of the regulatory process: voluntary standards, certification and labeling systems. This marks these systems for more focused study, since they provide a unique solution to the tragedy of the commons and regulatory fragmentation and other anti-commons problems. Fourth, the functional typology reveals that funding is important. Prior efforts to analyze these institutions based on the constituents, their motives, their capacities, and their relative power within the institution had obscured the role of funding in governance. The functional typology underscores the key role that the relative allocation of the burdens and the benefits of governance plays in determining the whether an institution will be effective and survive over the long term.

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INTRODUCTION

Biodiversity loss, fishery collapse, deforestation, climate change, conflicts over natural resources, economic migration, and increasing inequality threaten economic and social stability throughout the world. Despite the economic gains it has brought much of the world, globalization is driving most of these negative externalities. Advances in communications technology have allowed communities to constitute themselves based on common interests and participation in common markets as well as by geographic proximity to act collectively to address those impacts.¹ Demands for governance may be met not just by governmental legislation or regulation, which results from the political process, but also from direct negotiations between individuals impacted by an environmental concern, advocacy groups, nonprofit organizations, corporations and other parties. Increasingly, communities are turning to private governance, rather than formal government, to address their needs.

Private governance institutions provide governance without government; they are rules and structures by which individuals, communities, firms, civic organizations and other entities govern their interests without the direct involvement of the state or its subsidiaries. Private governance institutions are limitless in their variety. The political science, sociology, law and economics literatures describe hundreds of variations in case studies of communities throughout the world that have developed their own rules for managing resources and dealing with conflicts.²

This article advances that literature in three ways. First, the article examines private governance from an economic point of view. Using the framework of supply and demand, the article examines the contexts in which private governance institutions arise. In general, private governance institutions arise to meet an unmet public demand for governance.³ Kenneth Abbott and Duncan Snidal, writing in the political science literature, indicate that there are five stages of regulatory activity, captured by the acronym “ANIME”: (1) agenda-setting, (2) negotiation of standards, (3) implementation, (4) monitoring, and (5) enforcement.⁴ This article examines each stage of regulation and argues that private governance institutions arise in response to either to government failure or market failure at one or more stages of the regulatory process. Whether undertaken by formal governments, private governance institutions, hybrids, or through intergovernmental agreements, the parties seeking to develop effective regulation must overcome

¹ See *Introduction, An Overview of the Knowledge Commons*, in UNDERSTANDING KNOWLEDGE AS A COMMONS: FROM THEORY TO PRACTICE (Charlotte Hess & Elinor Ostrom eds., MIT 2008).

² See Indiana University's Digital Library of the Commons, available at <http://dlc.dlib.indiana.edu/dlc/>.

³ Thomas P. Lyon, *Environmental Governance: An Economic Perspective*, in GOVERNANCE FOR THE ENVIRONMENT, NEW PERSPECTIVES ____ (Magali A. Delmas & Oran R. Young eds., Cambridge 2009) (suggesting, from an economic point of view, that demand for governance may arise from consumers seeking products or services from companies that have a record of fair treatment of their workers, fair payment to their agricultural suppliers or environmentally sound operations); Walter Mattli & Ngaire Woods, *In Whose Benefit? Explaining Regulatory Change in Global Politics*, in THE POLITICS OF GLOBAL REGULATION 29, 33 (Walter Mattli & Ngaire Woods eds., Princeton 2009).

⁴ Kenneth W. Abbott & Duncan Snidal, *The Governance Triangle: Regulatory Standards Institutions and the Shadow of the Law*, in THE POLITICS OF GLOBAL REGULATION 46 (Walter Mattli & Ngaire Woods eds., Princeton University Press 2009).

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a number of barriers, including information problems, collective action problems, public choice dilemmas, rent-seeking, regulatory capture risks, and the problem of funding public goods.

Second, by sorting private governance institutions based on the functions that they serve in addressing government failure or market failure, the article takes a new approach. To the extent that scholars have previously attempted to classify the diverse array of private governance institutions, they have or have grouped them according to their dominant constituents, based on whether those constituents are primarily (i) firms and business groups, (ii) nongovernmental organizations and civic participants, (iii) some hybrid involving both groups, (iv) government partnering with either or both groups, or (v) a combination of all three sectors.⁵ Using this approach, scholars have questioned the value of certain institutional structures based on the capacities⁶ or mixed or compromised motives of the dominant players within those institutions.⁷ In general, this approach obscures more than it illuminates. Formal organization may not reflect the underlying control. Participant motives may be mixed. Firms sometimes create private governance institutions to improve compliance, to avoid new regulation, and to avoid risks that they would not otherwise face if government structures such as the courts did not exist. In such cases, the lines drawn between public and business interests can blind scholars to important elements needed for effective regulation. In other words, classifying governance systems based on the composition of their constituents fails to get at the crux of the matter: predicting which private governance institutions will meet the demand for governance and which will not.

Identifying the criteria that will render private governance institutions reliable as effective regulators is a meaningful exercise for a number of reasons. Parties that generate social costs may also use private governance to avoid regulation. Private governance institutions not only complement one other and formal government to meet demands for governance; they also sometimes preempt formal regulation and compete with one another for regulatory space, participants, consumers and investors. The consequences include label dilution and consumer and investor confusion. By sorting private governance institutions according to the structures they provide to meet the demands for governance at each stage, the article identifies key structures needed at each stage to guard against the parade of public choice horrors. This exercise turns a spotlight on institutional strengths and weaknesses, revealing how private governance institutions (and formal government) may be improved. It also provides a set of criteria that the public may use to evaluate private governance institutions – whether to buy wood certified by the Forest Stewardship Council or the Sustainable Forestry Institute, for instance.

Finally, by drawing from the political science, economics, business, sociology, and legal literatures, the article provides a more comprehensive view of the scope of private governance and overcomes the silo effects that can limit analysis within each discipline. This broad approach yields two important observations relating to the availability of exit in private governance situations. First, funding is key. In the context of state regulation, the costs associated with the public's demand for governance are met through the general fisc. Tax revenues are seldom

⁵ See Graeme Auld, Steven Bernstein, & Benjamin Cashore, *The New Corporate Social Responsibility*, 33 ANN. REV. ENVTL. RESOURCE 413 (2008). See also Abbott, *supra* note 4, at 46.

⁶ See Abbott, *supra* note 4, at 46.

⁷ See Auld, *supra* note 5 at 416.

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devoted to specific regulatory activities. In contrast, private governance institutions must not only satisfy the demands of each of the five stages of regulation, but must also fund each stage of regulation. Allocation of the costs of regulation is a sensitive matter in the context of private governance because coalitions can fail if participants perceive that the relative share of the benefits and burdens of regulation are distributed unfairly. In addition, the source of funding can impact the forms the regulatory structures take, rendering them less effective.

Second, dispute resolution mechanisms are very important. One of the key distinctions between private governance and public governance is that state criminal and civil sanction are available to keep residents from opting out and refusing to comply with the law. Private governance institutions are more sensitive to change because they are maintained through the continuing agreement of their participants. At any stage, exit is an option. Consequently, private governance institutions that include dispute resolution mechanisms tend to be more stable, robust in the face of challenges and resilient to external changes that occur over time. By requiring participants to participate in dispute resolution procedures, private governance institutions allow participants to air grievances, provide a forum for changing rules over time. By reducing their members' need for and their opportunity to resort to exit, private governance institutions improve their likelihood of long-term success.

The article is organized as follows: Part I describes the various types of private governance institutions using the conventional approach, dividing the organizations based on their main constituencies: private firms, civic organizations and hybrid forms that may or may not involve formal government. It then outlines the shortfalls of this approach. Part II describes the circumstances that give rise to a demand for private governance at each of the five stages of the regulatory process and the barriers and hazards that block effective regulation. This section also organizes private governance institutions according to the functions they serve in overcoming these barriers and hazards. Part III describes the interplay between private governance institutions and formal government and among private governance institutions themselves. While Part II discusses the complementary roles private governance institutions play, Part III is devoted primarily to the conflicts that arise among private governance institutions and between private governance and formal government. The section describes the ways private governance institutions compete for regulatory space, participants, consumers and investors and the impact these interactions may have on effective regulation.

The article then draws certain conclusions from this functional typology exercise. The article identifies key characteristics or structures needed at each stage of regulation to ensure its effectiveness. The article notes that voluntary standards, certification and labeling systems are the only private governance institution to attempt to substitute for formal government at all stages of the regulatory process. It also describes how constellations of private governance institutions may collaborate to address demand for governance at all stages of the regulatory process.

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I. CONVENTIONAL TAXONOMY: SORTING BY AFFILIATION

This section divides the main private governance institutions along the lines of whether they are generated primarily by private firms, by civic organizations, by some hybrid of the two or with the involvement of formal government.

A. BUSINESS INSTITUTIONS

Efforts by firms to address environmental and other social concerns into their business activity appear to take three forms: corporate social responsibility, contractual arrangements and cooperatives. Regulations that firms impose on themselves, otherwise known as corporate social responsibility, include individual firm programs or activities, corporate codes of conduct and environmental management systems. Firms also impose social and environmental requirements upon firms other firms via contract. This need generally arises connection with merger and acquisition activities and other forms of investment, lending activities, insurance underwriting and supply chain management. In addition, individuals and firms may seek to regulate the activities of the firms with whom they do business through a cooperative structure.

1. FIRM CORPORATE SOCIAL RESPONSIBILITY

One type of voluntary regulation is characterized as corporate self-regulation or corporate social responsibility.⁸ This occurs when individual firms make a pledge to comply with standards that they have identified or trade association members have agreed to improve their performance in some area.⁹ In general, these kinds of activities are usually undertaken when the firm may increase profitability by improving efficiency and eliminating waste, or by attracting consumers who are willing to pay a premium for products or services that meet their social or environmental preferences.¹⁰

A. ENVIRONMENTAL MANAGEMENT SYSTEMS

Management systems are programs used by firms to manage the environmental impacts of their operations.¹¹ The systems help firms identify problems and build capacity for change.¹² They may include evaluation processes to determine the environmental impacts of a firm's

⁸ Lyon, *supra* note 3, at 57.

⁹ *Id.*

¹⁰ *Id.*

¹¹ The International Organization for Standardization (ISO) has developed a standardized set of guidelines that firms may follow in instituting an environmental management system, ISO 14001. ISO 14001, which was last updated in 2004, is identified as ISO 14001:2004. ISO 14001:2004 provides a general template for developing an environmental management system for use by all firms. This meets the ISO's organizational goal – to standardize systems, to increase interoperability, to reduce the cost of obtaining knowledge, and to assure those that rely on the system that the essential elements of environmental management have been considered and addressed. Because the operations of businesses differ from one another, their environmental impacts vary. For this reason, ISO has provided a general template that may be modified by each business based on their initial evaluation of their environmental impacts.

¹² Sasha Courville, *Social Accountability Audits: Challenging or Defending Democratic Governance?*, 25 L. & POL. 269, 288 (2003).

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operations, policies designed to reduce those environmental impacts, plans for allocating resources and responsibility for implementing those policies, timelines for implementation, and organizational structures and hierarchies to assign responsibility for particular aspects of the program and for evaluating and reporting compliance.¹³ The systems may, but do not necessarily, provide specific goals for the firm to accomplish, benchmarks to measure progress in meeting those goals, and timelines for meeting those benchmarks. They may also, but do not necessarily, identify performance measures and timelines that would allow the firm to determine whether and at what rate the firm is improving its environmental performance. By providing a systematic way of managing the environmental impacts of the firm and providing a structure to coordinate actions, the system is thought to be more effective and efficient.¹⁴

Environmental management systems lower the barriers to entry to environmental improvement because each firm may develop its own standards. The systems are thought to incentivize firms at all levels to improve their level of environmental performance by stressing continual improvement. This encourages firms to set standards low so that they will be able to demonstrate continual improvement over time.¹⁵ Firms also have an incentive to avoid specific requirements and benchmarks that are prescriptive in nature because compliance is costly.¹⁶ Consequently, firms may use environmental management systems to obscure the fact that the changes they are making are minor.¹⁷

Effective internal control systems ensure that the firm monitors its own performance.¹⁸ Firms may supplement their internal audits with planned and unplanned audits by external auditors.¹⁹ Environmental management systems also provide a framework for generating documentation to demonstrate compliance. This is used to provide assurance to employees, customers, and the general public about environmental risks, safety and performance. Firms sometimes also provide the documentation to investors, lenders and suppliers to confirm that the firm is conformity with their requirements, and to regulatory agencies to show that the firm is in compliance with the law. Environmental management systems may therefore reduce the costs of external monitoring by regulatory entities.²⁰ To the extent that internal auditing is used to reduce the comprehensiveness of an external audit, however, the value of the auditing process is reduced.²¹

Environmental management systems increase the rate of learning at lower cost, since firms do not have to spend significant resources developing programs and processes that have

¹³ [ISO studies]

¹⁴ [ISO studies]

¹⁵ Andrew King, Michael J. Lenox & Ann Terlaak, *The Strategic Use of Decentralized Institutions: Exploring Certification with ISO 14001 Management Standard*, 48 ACAD. MGMT J. 1091, 1101 (2005).

¹⁶ Courville, *supra* note 12, at 288–289. Prescriptive requirements might include maximum emissions during a set time frame. Procedural requirements, in contrast, might include plans to take measurements at set intervals and to report them to firm management using specific forms of communication.

¹⁷ Auld *supra* note 5, at 423.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Courville, *supra* note 12, at 288–289.

²¹ *Id.*

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already been tried, tested and distilled into best practices.²² They may also facilitate the inculcation of values and a shift in firm norms through the logic of appropriateness.²³

B. CODES OF CONDUCT

In general, codes of conduct are developed when the members of an industry share a collective reputation.²⁴ They are procedural practices designed to reduce risk in industry operations. Codes of conduct are usually set by industry without input from other stakeholders, such as regulators or the general public. Consequently, like environmental management systems, they may not contain any prescriptive requirements that would improve environmental or social outcomes. In fact, they may be even less effective as regulatory mechanisms than environmental management systems, because they do not necessarily contain requirements for implementation or procedures for enforcement. Unless there are effective mechanisms to monitor compliance, firms have an incentive to free-ride, a problem that will increase with the size of the industry and greater numbers of participants.²⁵

One well-known example of a code of conduct within the lending community is the Equator Principles.²⁶ The Equator Principles were developed in 2003 by a number of private banking firms, including Citigroup, ABN Amro, and Barclays. The project sets industry-wide social and environmental standards for project finance, applying across all industry sectors to projects with capital costs in excess of \$10 Million.²⁷ The standards are based, in part, on the performance standards on social and environmental sustainability developed by the International Finance Corporation and on the World Bank's Environmental, Health and Safety general guidelines.²⁸ Project developers are required to avoid, reduce, mitigate or provide restitution for the negative impacts of their projects on ecosystems and communities.²⁹ In July of 2010 an association was created to govern the institution; the organization is comprised of participating financial institutions that are active in public finance and have adopted the principles and associates (banking institutions that are not active in public finance).³⁰ The association obtains input from various steering committees and working groups, including three stakeholder working groups comprised of nongovernmental organizations, industry-based groups, and socially responsible investment firms.³¹ Signatories are required to report annually on their lending activities.³²

²² Auld, *supra* note 5, at 422.

²³ *Id.*

²⁴ *Id.*

²⁵ Lyon, *supra* note 3, at 59.

²⁶ Auld, *supra* note 5, at 423.

²⁷ *About the Equator Principles, Frequently Asked Questions*, available at <http://www.equator-principles.com/abouttheeps.shtml> (last modified ???).

²⁸ *About the Equator Principles, Frequently Asked Questions*, *supra* note 65.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Equator Principles: Disclosure Status Based on EP 10*, available at <http://www.equator-principles.com/reporting.shtml> (last modified ???). At times, nongovernmental organizations have raised questions about the degree to which signatory banks have enforced the Equator Principles and held project developers accountable. *See, for example*, Press Release: WWF Urges Commercial Banks Not to Fund Controversial Pipeline,

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Trade associations have sometimes developed codes of conduct in the wake of an industry disaster, with the goal of deterring government regulation.³³ For instance, following the Union Carbide disaster in Bhopal, the chemical industry developed the Responsible Care program to deflect the threat of regulation.³⁴ This effort was successful, and, following initiation of the program, Responsible Care participants showed worse environmental performance than firms that did not join program.³⁵

C. FIRM PROGRAMS

Business programs have tremendous variety and are the most common forms of corporate social responsibility.³⁶ In general, firms are seeking a win-win situation; they seek to increase efficiency and firm profits either by reducing costs and wastes, or through development of new markets through differentiation, generating premium prices.³⁷ Firms generally determine what policies they will pursue without input from other parties.³⁸ They employ their management structures to implement the policies, use their internal hierarchies to obtain feedback about policy impacts, and incentivize compliance through compensation, honors, and other perquisites.³⁹

D. EVALUATION OF CORPORATE SOCIAL RESPONSIBILITY

In general, firms have strong organizational capacities to implement corporate social responsibility programs. They have internal authority through firm hierarchies, ample resources and expertise, and strong management systems that facilitate implementation of the regulations they may impose. Compensation incentives and systems of corporate values and camaraderie are also available to ensure compliance.⁴⁰ Consequently, corporate social responsibility may have a significant impact over time because firms have shifted mores within the business community through implementation, through the learning process and through a shared logic of appropriateness.⁴¹

However, the threat of the loss of consumers and the loss of potential investors through competition are powerful forces aligned against this shift. Shareholders seek higher returns on

available at http://wwf.panda.org/wwf_news/press_releases/?9722/WWF-urges-commercial-banks-not-to-fund-controversial-pipeline (last modified ____).

³³ Auld *supra* note 5, at 423.

³⁴ *Id.* at 424.

³⁵ In general, this is interpreted as evidence that these kinds of voluntary programs only shield industry from regulation and are ineffective in improving environmental performance. However, some scholars suggest that the improved performance by firms not participating in the Responsible Care program may have resulted from increased pressure by nongovernmental organizations that shifted their attention to firms that did not take voluntary action. Lyon, *supra* note 3, at 59.

³⁶ Auld, *supra* note 5, at 417.

³⁷ *Id.* at 422.

³⁸ Abbott, *supra* note 4, at 67. *See also* David Vogel, *The Private Regulation of Global Corporate Conduct*, in *THE POLITICS OF GLOBAL REGULATION*, 159 (Walter Mattli & Ngaire Woods eds., Princeton 2009). (“business self-regulation is typically exclusively governed and controlled by firms”).

³⁹ Abbott, *supra* note 4, at 65.

⁴⁰ *Id.*

⁴¹ *Id.* at 70.

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investment; they will sell their shares and move their investment to other more profitable companies over time. Similarly, because consumers seek goods for lower prices, market competition incentivizes firms to deliver goods and services for lower prices to retain those customers. To reduce their costs, firms must either become less wasteful or shift those costs to others. When countries lack labor regulation or the means to enforce the regulation, firms may use their market power to lower wages, refuse to pay wages, pay discount wages to child laborers or extend working hours and requirements. When firms use environmental resources as sinks (such as the atmosphere or water resources) without paying for them, they externalize the costs associated their wastes to the public.

Regulation is designed to internalize these kinds of social costs into the price of the goods or services a firm is delivering. If corporate social responsibility is offered as a substitute for government regulation, its effectiveness may be judged by whether those costs actually have been internalized into the price of firm goods. If all firms share norms that recognize that these social costs should be internalized, firms have a relatively level playing field. However, managers may not be able to maintain these programs in the face of competition from firms that do not share these values, even if they would otherwise pursue a more sustainable course of action. Ultimately, firms will make choices that maximize profits to shareholders by increasing sales to the public and reducing costs to the firm.

As a structural matter, if other parties impacted by externalized costs were brought into the discussion about firm policies, the profit motive and the forces of competition might be tempered, but discussion of corporate social responsibility programs is internal to the firm. Firms are not obligated to share their policies, include those outside of the firm in policy discussions, or permit the public to know the results of any monitoring or evaluation of firm performance that may occur.⁴² The decision-making body may be limited to the firm itself with no broader representation.⁴³ When no independent third parties are involved in establishing standards or enforcing them, corporate social responsibility efforts are likely to be limited. For this reason, corporate social responsibility programs generally fail to garner legitimacy among the public.⁴⁴

2. REGULATION BY CONTRACT

Much environmental and labor regulatory compliance may be attributed to contractual arrangements between private parties.⁴⁵ Firms include environmental provisions in contracts, for instance, to allocate among themselves and their business partners the burdens associated with government regulatory requirements.⁴⁶ Private contractual arrangements are also used to allocate risk of loss that may arise from tort or other common law claims. These contracts may be in the form of acquisition and merger agreements, private equity investments, lending and credit

⁴² Abbott, *supra* note 4, at 70.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ See Michael P. Vandenberg, *The Private Life of Public Law*, 105 COLUM. L. REV. 2029, 2034 (2005).

⁴⁶ *Id.* Vandenberg notes that questions remain about how widespread these private agreements are and how they impact firm decision making and behavior.

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arrangements, insurance contracts or supply chain contracts.⁴⁷

A. EQUITY INVESTMENT AND ACQUISITION CONTRACTS

Parties to a purchase and sale agreement quantify the risks and costs associated with compliance and potential contract or tort liability during due diligence investigations; these matters are reflected in the purchase price, in post-closing agreements, in indemnity provisions, and in insurance products purchased by the parties to cover post-closing risks.⁴⁸ These kinds of agreements enhance efficiency by permitting the parties to allocate those burdens to the parties most likely to manage those costs most effectively and cheaply.⁴⁹

B. LENDING CONTRACTS

Lenders also include contractual provisions protect themselves against risks from borrowers.⁵⁰ By including provisions in their loan documents that grant the lender private rights of enforcement when environmental problems or risks such as labor strikes or work stoppages arise, lenders add themselves to the number of parties monitoring compliance.⁵¹ The additional rights that lenders exercise, such as declaring a default, accelerating the repayment of the loan, and controlling the use of loan proceeds make the threat of sanctions more immediate and credible.⁵² In general, however, these contractual provisions tend to be used in a defensive manner to give the lender a defense or a competing claim when there is a threat of tort or regulatory liability. For instance, lenders may bar the use loan funds to pay settlements or for remediation efforts.⁵³

C. SUPPLY CHAIN CONTRACTS

A number of scholars have begun to focus on supply chain contracts as a source of environmental and social regulation.⁵⁴ Supply chain contracts and operations permit anchor firms

⁴⁷ *Id.* Acquisition agreements include environmental representations, warranties, covenants, indemnities, and dispute resolution provisions. Parties may identify and limit liabilities by including or excluding items from the asset schedules. Purchasers of assets may perform environmental assessments and other due diligence activities to identify risks. The parties may also acquire insurance products to cover risks and uncertainty.

⁴⁸ Vandenberg, *supra* note 45, at 2046.

⁴⁹ *Id.* at 2050. In addition, private dispute resolution mechanisms in the contracts permit parties to preserve confidentiality and to avoid costs associated with court delays and unreliability. *Id.* at 2051.

⁵⁰ *Id.* at 2051-2056.

⁵¹ *Id.* at 2053.

⁵² *Id.* at 2055. Lenders with private rights of enforcement sometimes create more stringent standards. *Id.* at 2055-56.

⁵³ *Id.* at 2052. Note however, that lenders may include contractual provisions primarily for defensive purposes. In the event that the borrower is subject to damages, fees or fines as a result of tort liability or noncompliance, the lender retains the right to control loan proceeds and may prevent them from being used to pay those liabilities or to redress environmental impacts.

⁵⁴ See Michael P. Vandenberg, *The New Wal-Mart Effect: The Role of Private Contracting in Global Governance*, 54 UCLA L. REV. 913, 925-26 (2007); Michael P. Vandenberg & Mark A. Cohen, *Climate Change Governance: Boundaries and Leakage*, 18 N.Y.U. ENVTL. L.J. 221, 226-29 (2010); Thomas P. Lyon & Bart van Hoof, *Evaluating Mexico's Green Supply Chains Program* ___ (Sept. 2010)(unpublished paper, prepared for GSC Steering Committee Meeting), available at <http://webuser.bus.umich.edu/tplyon/Lyon%20Van%20Hoof%20GSC%20Paper%20Sep%2013%202010.pdf>.

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to transfer technology and management skills to countries where the rule of law and the regulatory apparatus are weak.⁵⁵ As an empirical matter, countries with strong supply chains tend also to have fair labor practices and improved environmental performance.⁵⁶

Firms experience pressures to control suppliers from a variety of sources, including the threat of contract or tort liability,⁵⁷ consumer demand, nongovernmental organization targeting through public information campaigns and boycotts,⁵⁸ and pressures from socially responsible investors,⁵⁹ firm managers and owners. Firms may also seek to avoid potential future regulation through preemptory self-regulation.⁶⁰

Because the largest firms can have a significant impact on the way their suppliers harvest resources, investors have also begun to pressure firms to manage their supply chain contractors in a way that ensures the long-term supply of the raw materials used in their sales or business.⁶¹ Firm requirements that suppliers implement environmental controls can have significant anti-competitive impacts; by requiring their supply chain contractors to invest in expensive technology, firms may spread the costs of their own regulatory compliance. When a firm requires its supplier to make a regulatory change, the supplier may raise the price of its goods for all of its customers; this shifts part of the burden of change to the firm's competitors.⁶² When the competitors are smaller or otherwise more sensitive to price changes on their inputs, this change in pricing may drive them out of business, revealing a potential anti-competitive motive behind the requirement.⁶³

The effectiveness of supply-chain contracting as a regulatory mechanism remains unclear.⁶⁴ To be effective the contracts must contain standards set high enough to achieve environmental objectives and suppliers must implement new management systems to meet them.⁶⁵ Some firms require only that the contractor comply with the environmental standards in their own country; these kinds of requirements may have less of an impact because the standards may be low or poorly enforced in these countries.⁶⁶ Other contracts require firms to adopt environmental management systems to monitor firm operations and to measure improvement. The effectiveness of these systems will vary based on the level at which the baselines were set initially.⁶⁷ Nevertheless, environmental performance standards are independent of the standards

⁵⁵ See Vandenberg, *supra* note 54, at 945–946 (indicating that supply-chain contracts containing environmental provisions are widespread, representing fifty percent of firms and over seventy percent of total sales in eight sectors.) Note that in general, these requirements extend only to first tier suppliers, and would have little impact on suppliers further up the manufacturing chain. *Id.*

⁵⁶ *Id.*

⁵⁷ Vandenberg, *supra* note 45, at 2031.

⁵⁸ Vandenberg, *supra* note 54, at 947.

⁵⁹ *Id.* at 948.

⁶⁰ See also *id.* at 949.

⁶¹ Vandenberg, *supra* note 54, at 949.

⁶² *Id.* at 950.

⁶³ *Id.*

⁶⁴ *Id.* at 963, 944.

⁶⁵ *Id.* at 944.

⁶⁶ *Id.* at 950, 955.

⁶⁷ *Id.* at 954-955. Note, however, that if firms implement management systems that insure compliance with existing standards, environmental performance can improve.

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of the exporting country; they therefore have the potential to create improvement in countries where environmental regulation is weak.⁶⁸

Suppliers must also implement the standards for them to be effective.⁶⁹ The extent to which this has occurred remains unclear.⁷⁰ Unless a firm has provisions and mechanisms to monitor compliance by the suppliers and sanctions with which to enforce firm contractual rights and supplier obligations, the environmental requirements will provide little traction in moving forward against environmental harms. Finally, while auditing firms and other mechanisms are available to verify whether supply chain contractors are in compliance, there has been little research on whether firms ever enforce the environmental obligations their contracts. Some scholars suggest that the enforcement of environmental and social provisions would be improved through more widespread adoption of more explicit and effective standards, and by disclosure of existing implementation and enforcement practices, possibly through a clearinghouse of environmental supply contract information.⁷¹ These changes would permit consumers and nongovernmental organizations to evaluate their performance.⁷² However, the likelihood of this occurring would appear to be slim, given that sharing the information with competitors and the public could put companies at a competitive disadvantage.

D. INSURANCE CONTRACTS

Insurance companies have also been identified as regulatory entrepreneurs.⁷³ Because insurance firms face increased exposure from higher risks, they have begun to demand additional regulation and to use their contracts to enforce existing regulation.⁷⁴ Insurance agreements generally enhance efficiency by permitting parties to spread the risks of compliance and create an economy of scale in managing the costs of remediation.⁷⁵ Insurance premium rate structures also incentivize compliance, since premiums are reduced over time if firms remain in compliance and insurers often inspect insured parties to monitor their behavior.⁷⁶ Insurance contracts may also make the payment of claims contingent on whether the insured has complied with law, leaving the firm to face a complete loss if they fail to be vigilant. For instance, in the shipping

⁶⁸ *Id.* at 950.

⁶⁹ *Id.* at 944.

⁷⁰ *Id.* at 963. As Vandenberg notes in *The Private Life of Public Law*, the goal of some of these agreements may be to avoid regulation. Vandenberg, *supra* note 45, at 2034. To the extent that the costs of environmental compliance are high and the costs of insulating a firm from the impact of these private regulatory requirements are low (by imposing an intermediate level of corporate ownership and entering into a subcontract), firms would be incentivized to fulfill the letter of the contracted environmental requirement, without addressing its intent.

⁷¹ Vandenberg, *supra* note 54, at 967.

⁷² *Id.* at 969. Vandenberg suggests that transparency and accountability would be enhanced if nongovernmental organizations had access to the requisite information to develop a clearinghouse to provide detailed information about firm supplier procurement policies, environmental provisions in the contracts, other materials about implementation and the extent of enforcement by the supply chain anchor or retailer.

⁷³ Mattli, *supra* note 3 at 33.

⁷⁴ *Id.*

⁷⁵ Vandenberg, *supra* note 45, at 2063. Policies can cover past liabilities costs associated with future requirements for compliance, and for cost overruns on projects to clean up an environmentally damaged property.

⁷⁶ *Id.*

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industry, traffic on navigable waters has risen from expanded trade and increased tanker size.⁷⁷ Consequently, the likelihood of accidents has increased, and the payouts associated with the lost cargo and the environmental and other harms to natural resources and human communities have ballooned.⁷⁸ In response to increased risk and higher payouts, insurance firms have taken a more active role in lobbying for regulation of the shipping industry⁷⁹ and in enforcing regulations through their contracts.⁸⁰

E. EVALUATION OF REGULATION BY CONTRACT

Whether private contractual provisions improve environmental and social conditions depends on the regime to which they are being compared. In their favor, they may enhance efficiency by reducing costs to the government of ensuring compliance and may permit the government to focus their enforcement activity on firms and facilities that are not usually governed by private contracts.⁸¹ Private agreements may be more cost effective because they allow parties to shift risks and costs to the parties that can avoid social costs most cheaply, and to those with greater expertise or ability to handle environmental or labor problems when they arise.⁸²

On the other hand, they also reduce transparency and accountability.⁸³ Private monitoring, private enforcement and private dispute resolution mechanisms obscure the identity of the party making decisions about compliance.⁸⁴ Private contracts may also mandate conditions that will permit the parties to avoid existing environmental standards by subcontracting to other companies, outsourcing risky behavior to companies that do not meet size or jurisdictional thresholds.⁸⁵ Because these contractual provisions do not occur in the public domain, the public is less aware of the importance and consequences of noncompliance.⁸⁶ They may also reduce the demand for regulation because enforcement is hidden from the public eye, enforcement being the typical measure of success for public regulation.⁸⁷ They may also complicate or undermine priority setting in regulation because they do not reflect public preferences in terms of the aggregate risks and costs or the distribution of those risks and costs.⁸⁸ Finally, to the extent that

⁷⁷ Samuel Barrows, *Racing to the Top . . . at Last: The Regulation of Safety in Shipping*, in *THE POLITICS OF GLOBAL REGULATION* 189, 202-206 (Walter Mattli & Ngaire Woods eds., Princeton University Press 2009).

⁷⁸ *Id.*

⁷⁹ *Id.* at 203.

⁸⁰ *Id.* at 202.

⁸¹ Thomas P. Lyon, *Introduction*, *GOOD COP, BAD COP: ENVIRONMENTAL NGOS AND THEIR STRATEGIES TOWARD BUSINESS* 10 (Thomas P. Lyon ed. RFF Press 2010).

⁸² Vandenberg, *supra* note 45, at 2050.

⁸³ *Id.* at 2068-73.

⁸⁴ *Id.* at 2070.

⁸⁵ *Id.* at 2071.

⁸⁶ *Id.* at 2072. In contrast, public disclosure requirements, such as those in Resource Conservation and Recovery Act and the Emergency Planning and Community Right-to-Know Act of 1986 and the Pollution Prevention Act of 1990, which are reported in the Toxic Release Inventory, have been effective in shifting firms to reduce their environmental impacts.

⁸⁷ *Id.* at 2071-72. Vandenberg notes however that to the extent that noncompliance is a result of the complexity of the environmental law, enforcement actions can violate norms of fairness and autonomy and also reduce compliance in the future. *Id.* at 2076.

⁸⁸ *Id.* at 2081-82.

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environmental provisions are enforced privately, there are fewer matters before the courts; this may undermine the role of the judiciary in articulating norms.⁸⁹

3. COOPERATIVES

Cooperatives are mutual benefit organizations.⁹⁰ They are formed when groups of individuals or firms voluntarily decide to work together to meet their collective needs or to share the profits from their enterprise.⁹¹ They may take the form of business organizations that are owned by employees in equal shares, such as trade cooperatives, or a business that is owned by the individuals that use its services, such as electrical utility cooperatives.⁹² While competition in a free market with full information and low transaction costs would theoretically produce the greatest social welfare for both buyers and purchasers,⁹³ exercises of market power, lack of easy access to complete information, moral hazard, and uncertainty may inhibit trade.⁹⁴ Cooperatives address problems associated with unfair competition and monopolistic use of power either upstream or downstream⁹⁵ by permitting individuals to act collectively to obtain discounts and other benefits that are granted to market actors that engage in larger and more regular transactions.⁹⁶ Those who use the enterprise control it and those rights are exercised on a one person one vote basis.⁹⁷

Cooperatives also address agency problems.⁹⁸ When an individual hires an agent to conduct business or enter into a transaction on the individual's behalf, a number of issues may arise. First, the agent may have a conflict of interest; that is, the principal may not be able to tell

⁸⁹ *Id.* at 2071.

⁹⁰ There are ___ cooperatives in the U.S. and they comprise ___ percent of business. ___. European countries have ___ cooperatives and they comprise as much as ___ of business enterprises in those countries. Henry Hansmann, *THE OWNERSHIP OF ENTERPRISE* ____ (Belknap Press of Harv. Univ. Press 2000). They are not prominent in the scholarly literature, however. Some scholars attribute this to a decline in coverage of institutions in economics textbooks which has shifted toward neoclassical economics, and the changing role of the economist as a social engineer that seeks optimal solutions. Panu Kalmi, *The Disappearance of Co-operatives from Economic Textbooks*, 31 *Cambridge J. Econ.* 625, 639 (2007).

⁹¹ Morris Altman, *History and Theory of Cooperatives*, in *INTERNATIONAL ENCYCLOPEDIA OF CIVIL SOCIETY* at 536 (Helmut K. Anheir & Stefan Toepler eds., Springer 2009).

⁹² During the Great Depression the extension of public utility services was seen to be a key factor in reducing poverty and improving employment and interstate trade. Because the costs of extending electricity to rural areas would likely exceed the benefits for many years, few local and state governments were willing to make these investments. The Rural Electrification Administration was created under the New Deal to make loans to rural electrification cooperatives so that they could build lines and other infrastructure to transmit electricity to rural residents.

⁹³ See Ronald Coase, *The Problem of Social Cost*, 3 *J. LAW & ECON.* 1 (1960). (Coase theorizes that, in the absence of transaction costs, trade will give rise to an economically efficient allocation of entitlements, regardless of how the entitlements are originally allocated. If there is no cost associated with making an exchange, parties will exchange entitlements until a Pareto optimal allocation occurs; trade will continue to occur until no one can be made better off without making another party worse off).

⁹⁴ *Id.*

⁹⁵ Michael Sykuta & Michael L. Cook, *A New Institutional Economics Approach to Contracts and Cooperatives*, 83 *Am. J. Agr. Econ.* 1271 (2001), also available as Contracting and Organizations Research Institute (Working Paper No. 2001-04), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=291408.

⁹⁶ Altman, *supra* note 91, at 564-65.

⁹⁷ Kalmi, *supra* note 90 at 627.

⁹⁸ Sykuta, *supra* note 95, at 1274.

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whether the agent is simply pursuing the agent's own interests, a "moral hazard" problem, or serving the interests of the principal.⁹⁹ Second, the agent may be withholding information that the principal would otherwise use to negotiate a fair price if he had access to the information.¹⁰⁰ Two ways that market participants using contract law frequently solve the asymmetrical information problem are to perform research before the transaction, or to monitor and enforce rules after the transaction.¹⁰¹ These solutions can be expensive. Cooperatives eliminate the agency and asymmetrical information problems by allowing market actors to be involved on both sides of the transaction.¹⁰² Additional profits to be gained from an agent succumbing to moral hazard or using asymmetrical information to the detriment of the person who hired them will accrue as a surplus not to the agent but to the cooperative as a whole.¹⁰³ Surpluses are then distributed to cooperative members in accordance with their relative contribution to that surplus.¹⁰⁴ The cooperative structure changes the incentives; if investors ultimately reap the profits from withholding information, there is little reason to withhold the information in the first place.¹⁰⁵ Cooperatives eliminate the hold-up problem by permitting value chains to integrate vertically without losing advantages associated with independent decision-making.¹⁰⁶ Finally, cooperatives often seek to achieve social goals as well as serve their members' needs, such as promoting equality, recognizing human rights, and protecting the environment.¹⁰⁷

Fair trade certification and labeling programs often have a cooperative element. Farmers that participate in the Fair-trade Labeling Organization are required to participate in cooperatives designed to assist producers in developing and accessing new markets and in building trading relationships.¹⁰⁸ The fair trade premium garnered by the program is delivered to the cooperative and the cooperative members, a joint body of workers and management, decide how it is to be used.¹⁰⁹ They may elect to remit the proceeds to the cooperative members or to use the money to make other investments that will allow the group to enhance their operations and improve their profitability.

⁹⁹ *Id.* In this hypothetical the individual would likely receive a percentage of the surplus equivalent to the amount of his investment.

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¹⁰¹ Sykuta, *supra* note 95, at 1277.

¹⁰² Altman, *supra* note 91, at ___; Sykuta, *supra* note 95, at 1277.

¹⁰³ Altman, *supra* note 91, at ___.

¹⁰⁴ A trade cooperative would reward its members according to the member's relative production, a work cooperative according to the member's labor and a purchasing cooperative according to the member's patronage.

¹⁰⁵ Sykuta, *supra* note 95, at 1279.

¹⁰⁶ Helmut M. Dietl & Martin Grossman, *The Knowledge Economics of Cooperatives*, 15-17 (2006)(SSRN Working Paper Series), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1017844. Most professional sports leagues are organized as cooperatives. Individual sports teams would lose much of their value if they did not use common rules, referees, scheduling and marketing. Refusal by any team to play according to common rules and schedules, an example of the hold-up problem, would undermine the entire league. The common market solution to hold-up, vertical integration through merger, would also undermine league value, because fans could no longer trust that the individual teams were sufficiently independent for real competition to occur. Cooperative organization permits the teams to maintain decentralized decision-making while participating in a binding structure that eliminates the uncertainty associated with hold-up. *Id.* at 17. Multi-stakeholder institutions with tripartite structures resemble cooperatives in their ability to maintain decentralized decision-making while using common rules and structures and coordinating activities.

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¹⁰⁸ Courville, *supra* note 33 at 279.

¹⁰⁹ *Id.* at 280.

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B. HYBRID GOVERNMENT / BUSINESS INSTITUTIONS

There are a variety of ways that governments interact with private firms to coordinate regulatory activity.¹¹⁰ Legislators may consult with firms during the legislative process. Government agencies may consult with private firms when they develop regulations pursuant to legislative authority.¹¹¹ Agencies may delegate certain aspects of regulatory authority to private firms.¹¹² Firms and government authorities may jointly negotiate standards and implementations processes.¹¹³ Finally, firms may self-regulate in the face of potential state intervention.¹¹⁴

Increasingly governments have begun to offer voluntary programs and negotiated agreements as new hybrid forms of regulation. Governments may decide to pursue a public voluntary program or negotiated agreement because it lacks the authority to develop a mandatory program,¹¹⁵ because it may use the program as an opportunity to test new approaches through pilot projects,¹¹⁶ because the program may reduce the costs of obtaining environmental improvement compared to traditional command-and-control regulation or because it seeks to improve relationships with business.¹¹⁷

Businesses enter into these programs for a variety of reasons, including positive publicity,¹¹⁸ the opportunity for differentiation in the market,¹¹⁹ or to have a greater opportunity to negotiate the standards and their methods and timing for implementing those standards. The actions of NGOs to hold specific companies responsible for the environmental and social impacts that result from the activities of companies in their supply chains¹²⁰ and investor pressures¹²¹ been significant drivers of participation.¹²² Firms often agree undertake hybrid approaches to governance when they are under threat of regulation.¹²³

1. NEGOTIATED AGREEMENTS

¹¹⁰ Auld supra note 5, at 420.

¹¹¹ *Id.*

¹¹² *Id.* See also Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 545-49 (2000); Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1 (1997).

¹¹³ Auld supra note 5, at 420.

¹¹⁴ *Id.*

¹¹⁵ Lyon, supra note 3, at 60-61.

¹¹⁶ *Id.* at 60.

¹¹⁷ *Id.*

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¹¹⁹ Lyon, supra note 54, at 29, citing Aberdeen, *What are the main drivers for focal companies to green their supply chains?*, in BUILDING A GREEN SUPPLY CHAIN: SOCIAL RESPONSIBILITY FOR FUN AND PROFIT (March 2008).

¹²⁰ Lyon, supra note 54, at 23.

¹²¹ Lyon, supra note 54, at 26, citing Aberdeen, *What are the main drivers for focal companies to green their supply chains?*, in BUILDING A GREEN SUPPLY CHAIN: SOCIAL RESPONSIBILITY FOR FUN AND PROFIT. at ____ (March 2008).

¹²² Lyon, supra note 54, at 23.

¹²³ Lyon, supra note 3, at 57. The choice to engage is thought to follow a nonlinear model. *Id.* at 66. Some voluntary mechanisms, such as public voluntary programs, are undertaken when the threat of regulation is weak; others, such as negotiated agreements, when the threat is stronger. *Id.* at 57. Firms would tend to pursue voluntary abatement if the threat of government regulation is low or if the threat of governmental regulation is high. *Id.* at 66. Intermediate threats of regulation would not appear to prompt firms to take action. *Id.*

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Negotiated agreements, also known as bilateral agreements, are made between governments and firms for the purpose of achieving particular environmental goals.¹²⁴ The substance of the agreements varies widely.¹²⁵ Under negotiated agreements, firms will negotiate with the government to come to a joint agreement about the specific goals to be met and the plan for implementation.¹²⁶ Firms may negotiate their own standards individually; however sometimes industries negotiate with the government as a group.¹²⁷ The industry or trade association representing the industry is then given the authority to determine how abatement responsibility and costs will be allocated among the individual members of that industry.¹²⁸ Governments may offer tax incentives or regulatory relief in exchange for the firm's agreement to meet specific pollution reduction goals within a certain timeframe.¹²⁹ Firms enter into these agreements primarily for the opportunity to influence the way they are regulated.¹³⁰ In some circumstances, a firm that commits to a more stringent compliance level may be subject to less monitoring, particularly if it has made irreversible investments in new technology.¹³¹

A commonly cited example of a public voluntary program,¹³² Project XL, was a pilot project developed by the EPA to encourage innovation by state and local governments, businesses and communities in improving environmental performance and protection of public health.¹³³ Potential participants were asked to submit projects designed to produce environmental results beyond those that would otherwise be achieved under existing and reasonably anticipated future regulations in a more cost-effective and efficient way.¹³⁴ Proposed projects were to be feasible, involve stakeholder support, give rise to lessons or data that would be useful for other projects or facilities, and include EPA-sanctioned monitoring, evaluations, and reporting.¹³⁵ In addition, community-based programs were required to involve community planning and increase economic opportunity.¹³⁶

¹²⁴ Jonathan C. Borck & Cary Coglianese, *Voluntary Environmental Assessment Programs: Assessing Their Effectiveness*, 34 ANN. REV. ENV'T. RES. 305, ____ (2009).

¹²⁵ *Id.* at 305. Negotiated agreements are more common in Europe and Japan than in the United States.

¹²⁶ Lyon, *supra* note 3, at 57.

¹²⁷ *Id.*

¹²⁸ *Id.* at 61.

¹²⁹ Borck, *supra* note 124, at 308.

¹³⁰ Lyon, *supra* note 3, at 59.

¹³¹ *Id.* Once a firm has installed new technology, which will itself reduce emissions, the government may shift its regulatory activity to other firms with higher emissions. *Id.* at 60. Lyon and his colleagues have created models to examine the dynamics associated with the regulatory process and to test the assumption that the higher the likelihood of regulation, the more likely that voluntary abatement occurs. *Id.* at 62, 66. The model suggests that first best results may be achieved when the probability of legislation is high or voluntary compliance is cheap. *Id.* at 61. The model assumes that industry and environmental lobbying groups compete for rents. Consequently, if the regulatory requirements are more stringent, the legislators may have difficulty passing the bill resulting in a higher likelihood that no legislation will be passed or that it will be passed with far less stringent standards. *Id.*

¹³² Borck, *supra* note 124, at 308.

¹³³ See U.S. Environmental Protection Agency, *What is Project XL?*, available at <http://www.epa.gov/projectxl/file2.htm> (last modified ????)

¹³⁴ See *id.*

¹³⁵ See *id.*

¹³⁶ U.S. Environmental Protection Agency, *supra* note 133. [Include additional evaluations from Dennis D. Hirsch, Project XL and the Special Case: The EPA's Untold Success Story, and Lawrence E. Susskind, The Risks and the Advantages of Agency Discretion: Evidence From EPA's Project XL]

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Benefits to the EPA from Project XL included improved relationships with firms and communities.¹³⁷ Communities near Project XL participants were given an opportunity to be involved in the regulatory process.¹³⁸ Firm participants saved substantial costs from the waiver of certain regulatory requirements.¹³⁹ To address public concerns that the Project XL allowed the EPA to effectively waive existing regulatory requirements, EPA administrators scrutinized the project proposals carefully, which lengthened the approval process and increased costs.¹⁴⁰ Finally the costs of negotiating the agreements were high, averaging \$350,000 for firms and \$110,000 for the EPA.¹⁴¹ The program required stakeholder involvement; this entailed extensive outreach and discussion.¹⁴² In general, while negotiated agreements may bring good results to the firms that participate in them, if the bar for participation is high, fewer firms will participate, which may, in turn limit the overall effectiveness of the program.¹⁴³ In addition, to the extent that negotiated agreements absorb significant agency staff time, they may pull resources away from other programs. It is costly for agencies to conduct separate negotiations for each firm participant. This may drain resources from other agency tasks, such as monitoring regulatory compliance.

2. PUBLIC VOLUNTARY PROGRAMS

Public voluntary programs differ from negotiated agreements in that they are open to any party that meets the participation criteria, though the general requirements under each of the types of programs may be the same.¹⁴⁴ Under a voluntary public program, the government will identify a set of standards or criteria to be met by any firm that falls within the eligibility parameters and agrees to make good-faith efforts to meet the criteria.¹⁴⁵ They vary widely in their goals, methods and requirements.¹⁴⁶ The firms receive technical support, and sometimes tax or other subsidies for participating.¹⁴⁷ Participating firms receive publicity for going beyond compliance.¹⁴⁸ In general the government's goals with public voluntary programs are to educate firms and share best practices and new technology.¹⁴⁹

¹³⁷ Cary Coglianese & Jennifer Nash, *Government Clubs: Theory and Evidence from Voluntary Environmental Programs*, in VOLUNTARY PROGRAMS: A CLUB THEORY APPROACH ___, 246 (Matthew Potoski & Aseem Prakash eds., MIT Press 2008).

¹³⁸ *Id.* Intel, one of the participants, was estimated to have saved millions of dollars because the waiver permitted it to change manufacturing processes without having to obtain multiple environmental permits. *See* U.S. Environmental Protection Agency, *supra* note 134.

¹³⁹ *See* U.S. Environmental Protection Agency, *supra* note 134.

¹⁴⁰ Coglianese, *supra* note 137, at 247.

¹⁴¹ *Id.* at 245-46. In general, transaction costs increase with the number of participants.

¹⁴² *Id.*

¹⁴³ *See id.* at 257. Note, however, that the stated goal of Project XL was to encourage innovation in regulation. The extent to which these innovations have been replicated or incorporated into the existing regulatory apparatus is unclear. Any cost benefit evaluation of the project would need to include the benefits of increased compliance at lower costs from implementing the innovations in other regulatory programs.

¹⁴⁴ *Id.*

¹⁴⁵ Lyon, *supra* note 3, at 60-61

¹⁴⁶ Borck, *supra* note 124, at 308.

¹⁴⁷ Lyon, *supra* note 3, at 57

¹⁴⁸ Auld *supra* note 5, at 421.

¹⁴⁹ *Id.*

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The design of many public voluntary programs may be so lax that the programs are ineffective.¹⁵⁰ One example of a public voluntary program is the 33/50 program developed by the Environment Protection Agency.¹⁵¹ The overall goal of the program was to reduce emissions of toxic chemicals by 33% within four years and 50% within seven years.¹⁵² The EPA provided public recognition to firms that agreed to reduce their emissions of specific toxic chemicals beyond the limits required by law.¹⁵³ The EPA's screening or entry requirements to participate in the 33/50 program were very low, making it easy for firms to join the program, and the EPA did not perform any evaluations or otherwise confirm that firms had followed through on their commitments afterward.¹⁵⁴ However, because so little was required, the program lacked credibility.¹⁵⁵ Environmental organizations had lobbied for firms to show that they had reduced their use of toxic chemicals, not just their releases.¹⁵⁶ They were concerned that firms would simply reduce emissions during the period of the program or switch to other toxic chemicals to garner the reputational benefits without making changes that would result in actual long-term abatement.¹⁵⁷ While the 33/50 program has been thought to have some measurable effect on environmental performance, other studies have drawn these results into question.¹⁵⁸ Some studies have suggested that firm decreases in toxic emissions during the period were not attributable to the 33/50 program, but to the mandatory Toxic Release Inventory program, which was instituted only a few years prior to the 33/50 program.¹⁵⁹

3. EVALUATION OF HYBRID GOVERNMENT / BUSINESS INSTITUTIONS

In general, as compared to a situation in which compliance is mandated by formal government, participation in these hybrid voluntary programs has been low, with only a fraction of eligible firms participating.¹⁶⁰ The programs are thought to have only modest effects on pollution levels based on the levels of participation and the degree of environmental improvement achieved for the participating firms.¹⁶¹ Studies using economic models indicate that negotiated agreements and public voluntary programs with moderate standards and a strong enforcement will likely have the greatest overall effectiveness.¹⁶² Modest standards make the programs more amenable to firms and increase the likelihood that they will participate; stringent enforcement results in some level of environmental improvement being assured.¹⁶³ Given that firms participate in voluntary environmental programs in many cases to stave off additional regulation or to obtain concessions in regulatory requirements, enforcing the modest standards

¹⁵⁰ Lyon, *supra* note 3, at 61, *citing* Darnall & Carmin. ??????

¹⁵¹ Borck, *supra* note 124, at 308.

¹⁵² *Id.*

¹⁵³ *Id.* There is also some evidence that participating firms benefited from reduced scrutiny.

¹⁵⁴ Coglianese, *supra* note 137, at 234-36.

¹⁵⁵ *Id.* at 238.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* at 236-37.

¹⁵⁹ *Id.* at 236.

¹⁶⁰ Borck, *supra* note 124, at 318.

¹⁶¹ *Id.* at 320.

¹⁶² *Id.* at 309, *citing* THE VOLUNTARY ENVIRONMENTALIST: GREEN CLUBS, ISO 14001, AND VOLUNTARY ENVIRONMENTAL REGULATIONS 24 (Aseem Prakash & Matthew Potoski eds., Cambridge 2006).

¹⁶³ *Id.*

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would be essential to demonstrate comparative improvement over a situation in which more stringent regulations are otherwise mandated. As a structural matter, however, the mere availability of voluntary programs may result in lower social welfare.¹⁶⁴ When firms shift public policy toward regulations that are less stringent, political conflict is reduced,¹⁶⁵ but there is some evidence that the possibility of entering into a negotiated agreement or public voluntary program can increase political resistance to more effective regulatory regimes.¹⁶⁶

Note, however, that in situations in which there is no clear governing authority and the barriers to creating an intergovernmental agreement are high,¹⁶⁷ any regulatory activity may improve probable outcomes over the existing situation. For instance, no single government has authority over the open seas. Even when governments have been able to come to agreement to prohibit illegal fishing, monitoring has been difficult because of the expanse of the territory to be monitored and enforcement has been ineffective because of leakage.¹⁶⁸ In addition, in regions where multiple jurisdictions could govern, often they do not, failing to address obvious problems because they are engaged in race-to-the-bottom dynamics or public choice dilemmas.¹⁶⁹

C. HYBRID CIVIC / BUSINESS INSTITUTIONS

1. AUDITS AND THIRD-PARTY ASSURANCE SERVICES

Third party auditing processes arose initially as an extension of the financial audits that accounting firms were performing.¹⁷⁰ As economies became global in scope, firms began to outsource manufacturing processes and other services to foreign firms.¹⁷¹ Products have also grown more complex. Different firms manufacture various components in different countries, making it more difficult to monitor and control quality, conformity to specifications and timely delivery.¹⁷² Because manufacturing standards, cultural practices and regulatory infrastructure differ throughout the world, firms have begun to hire third party auditors to verify whether goods being manufactured by their foreign contractors meet firm specifications.¹⁷³

In recent years third party audits have been expanded to include social parameters relating to labor standards, environmental impacts and other matters.¹⁷⁴ They have been developed primarily in response to “greenwashing,” or unsubstantiated and sometimes false

¹⁶⁴ From an economic point of view, lobbying and other activities to avoid regulation are considered to generate dead weight losses. These activities are not considered to produce anything valuable to the economy. Because capital is being used to keep social costs externalized (or to shift costs to other parties), it is being diverted from investment in productive activities.

¹⁶⁵ Lyon, *supra* note 3, at 58.

¹⁶⁶ *Id.* at 61.

¹⁶⁷ *See infra* Sections II ____.

¹⁶⁸ Any fishing vessel may simply seek registration in jurisdictions that are not parties to the treaty.

¹⁶⁹ *See infra* Sections II ____.

¹⁷⁰ Margaret M. Blair, Cynthia A. Williams, and Li-Wen Lin, *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325, 330 (2008).

¹⁷¹ *Id.* at 329, 335.

¹⁷² *Id.* at 329.

¹⁷³ *Id.* Social, cultural, and institutional differences and geographic distance reduces the frequency of interaction and information transfers. The accuracy of the information flows is reduced as well. *See* King, *supra* note 15.

¹⁷⁴ Courville, *supra* note 12, at 272; Blair, *supra* note 170, at 329, 337.

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claims that they have taken effective actions to reduce their negative environmental or social impacts.¹⁷⁵ Social audits verify whether or not a firm or facility is adhering to pledges it has made to follow certain production processes, to use certain management systems, or otherwise to meet the benchmarks or standards to which it has committed. Social audits may be aimed at firm products, facilities, services or processes.¹⁷⁶ They may include performance assessments to determine whether production standards have been met, or may simply verify whether a firm is following prescribed processes.¹⁷⁷ Companies may hire either private firms, including the accounting firms that are performing other auditing services,¹⁷⁸ civic organizations¹⁷⁹ or some hybrid of the two to perform the audits. Some institutions sets guidelines and provide training of auditors to ensure that firm performance is accurately measured.¹⁸⁰

Auditing has grown into a separate industry.¹⁸¹ Private commercial auditors have been criticized as ineffective.¹⁸² Critics have voiced concerns about inherent conflicts of interest and whether the auditors can be fair both when the party being audited pays for the audit,¹⁸³ and when the parties performing the audit are too close to the standards setting organization. Consequently, many voluntary certification and labeling systems that include monitoring or audit processes have begun to separate this body from the organization that developed the standards.¹⁸⁴

2. SOCIALLY RESPONSIBLE INVESTMENT

In recent years, investors have begun to pressure firms to manage their environmental and other risks.¹⁸⁵ While some institutional investors have weighed in to support particular governmental or intergovernmental initiatives,¹⁸⁶ others have developed programs to screen firms based on their performance across a number of social parameters, above and beyond firm profitability or return on investment. Socially responsible investment (SRI) provides information to investors about the environmental and social performance of firms, primarily publicly held

¹⁷⁵ Courville, supra note 12, at 272.

¹⁷⁶ *Id.*

¹⁷⁷ Courville, supra note 12, at 272.

¹⁷⁸ Blair, supra note 170, at 345. Major accounting firms are responsible for providing 60% of the reports where firms seek third party verification.

¹⁷⁹ Courville, supra note 12, at 272.

¹⁸⁰ *Id.* at 276-77.

¹⁸¹ Blair, supra note 170, at 342.

¹⁸² Michael J. Hiscox, Claire Schwartz, & Michael W. Toffel, *Evaluating the Impact of SA 8000 Certification*, in *SA 8000: THE FIRST DECADE* 147 (Deborah Leipziger ed. Greenleaf Pub. 2008).

¹⁸³ Courville, supra note 12, at 291. The Fairtrade Labeling Organization solves this problem in a unique way by charging the final packaging company in the supply chain a license fee to pay for the cost of the auditing process. *Id.* This allocates the audit costs to the entity in the supply chain that is closest to the consumer, the party that most values the audit. While the actual incidence of the cost of the audit may ultimately be passed forward or backward (through higher coffee prices to consumers or reduced prices for farmers) based on market dynamics, it solves the conflict of interest dilemmas that arise from producers paying directly for their own audits.

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¹⁸⁵ Robert Kagan, Neil Gunningham, & Dorothy Thornton, *Explaining Corporate Environmental Performance: How Does Regulation Matter?*, 37 L. & SOC'Y REV. 51, 82 (2003).

¹⁸⁶ See Cynthia Williams, *Civil Society Initiatives and "Soft Law" in the Oil and Gas Industry*, 36 N.Y.U. J. INT'L L. & POL. 457, 488-89 (2003) (describing the involvement of institutional investors managing \$3 Trillion in assets in the Extractive Industry Transparency Initiative, designed to require extractive industry companies to disclose amounts paid to foreign governments for rights to extract natural resources).

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firms with stocks that trade on public exchanges.¹⁸⁷ SRI research organizations may collect information by sending questionnaires to companies to self-report their activities, or they may pull information provided by initiatives such as the reporting and certification systems.¹⁸⁸ The information is seldom verified independently.¹⁸⁹ SRI firms screen companies to assemble portfolios of investments.¹⁹⁰ Different investments are selected based on investor preferences for positive firm qualities, aversions to firms with negative qualities.¹⁹¹ SRI firms may also assemble portfolios by identifying the best firms in each sector.¹⁹²

While initial participants were individual investors, recent engagement by institutional investors, such as state pension funds, universities and foundations, has increased the funds under management dramatically.¹⁹³ A number of studies have shown that SRI funds perform comparably to non-SRI mutual funds.¹⁹⁴ Some SRI funds are benchmarked against non-SRI indices, such as the S&P 500 and the Dow Jones Industrial Average, and in some instances have outperformed these standard indices.¹⁹⁵

Whether investment in socially responsible firms is producing environmentally and socially beneficial outcomes remains in question. Because there are no mechanisms in place to verify the self-reported information gathered from firms through questionnaires and through reporting initiatives, the effectiveness of the selection and screening process is unclear. Given that social and environmental performance are credence qualities, firms may not provide accurate reports of their performance unless there is a credible threat of sanction. In addition, if the firm standards are not sufficiently prescriptive or stringent they may have little impact. Even if a number of firms are employing effective standards and adhering to their commitments, SRI programs may not be effective in changing environmental or social outcomes because they are too removed from the commercial process to have an impact. Finally, as long as noncompliant businesses can receive capital from an alternate source they may gain a competitive advantage over compliant firms by continuing to externalize the social costs.

D. CIVIC INSTITUTIONS

¹⁸⁷ Courville, *supra* note 12, at 274.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ Social Investment Forum, *Performance and Socially Responsible Investments* (indicating a 424% increase in funds under management from 1995 to 2007), available at <http://www.socialinvest.org/resources/performance.cfm> (last modified) (socially responsible investing comprises over ten percent of the U.S. investment market).

¹⁹⁴ See, e.g., Meir Statman & Denys Glushkov, *The Wages of Social Responsibility*, Santa Clara University Working Paper (December 2008). See generally, Key Studies, SRIStudies.org, Center for Responsible Business, Haas School of Business, University of California, Berkeley available at: <http://www.sristudies.org/Key+Studies>

¹⁹⁵ See Social Investment Forum, *Performance and Socially Responsible Investments* (comparing the FTSE KLD 400, formerly the Domini 400 Social Index fund, to the S&P 500 for the period from the fund's inception in 1990 through December 31, 2009), available at <http://www.socialinvest.org/resources/performance.cfm> (last modified ???).

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Over the last 20 years, civic institutions have taken on new roles to address a number of environmental and social concerns.¹⁹⁶ Non-governmental entities and other civic groups have been organized to (1) inform the public about environmental, ecological or social problems and their causes, (2) organize the public to engage in protests and consumer boycotts against firms whose activities contribute to these problems or direct their consumption toward substitute goods that alleviate these problems, (3) mimic traditional governmental activities in funding and delivering public goods, and (4) mimic market enterprises to facilitate trade that addresses negative environmental or social impacts.

1. EDUCATION AND MOBILIZATION INITIATIVES

Effective oversight requires information¹⁹⁷ and gathering information can be costly.¹⁹⁸ In recent years, nongovernmental organizations have taken an entrepreneurial role and have assumed the costs associated with gathering and disseminating information about firm performance with respect to environmental and social concerns.¹⁹⁹ Since the 1980s nongovernmental organizations, churches, and other groups have developed civil society campaigns to draw into question the activities of certain high-profile firms.²⁰⁰ The groups have used media and Internet campaigns to focus on the environmental and social impacts of those activities.²⁰¹

As a result of these campaigns, targeted companies began to shift their practices to identify and reduce the negative environmental and social impacts of their firm through government-based public voluntary programs,²⁰² corporate social responsibility programs, and in other private governance institutions.²⁰³ Corporate involvement in these programs have been grounded in the desire to upgrade their image,²⁰⁴ to reduce the financial risks associated with these public campaigns, to address the concerns of their investors, and generally to restore their social license to operate.²⁰⁵

Scholars have noted that while civic institutions are effective in pointing out failures and garnering support, they have been limited in scope of what they can attain.²⁰⁶ These limits may result from the way these institutions are structured. Membership-based organizations rely on annual membership fees to cover the costs of their activities. They are therefore incentivized to focus on activities in which they may garner media attention and attract new members.²⁰⁷

¹⁹⁶ Mattli, *supra* note 3, at 28.

¹⁹⁷ Mattli, *supra* note 3, at 28.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 29 (attributing this phenomenon, in part, to the availability of the Internet, which reduced the costs of communication and information gathering).

²⁰⁰ Courville, *supra* note 12, at 271.

²⁰¹ *Id.*

²⁰² Lyon, *supra* note 3, at 23, 67.

²⁰³ Lyon, *supra* note 3, at 67.

²⁰⁴ Robert Kagan, Neil Gunningham, & Dorothy Thornton, *Explaining Corporate Environmental Performance: How Does Regulation Matter?*, 37 L. & SOC'Y REV. 51, 82,107 (2003).

²⁰⁵ Auld *supra* note 5, at 9.

²⁰⁶ Vogel, *supra* note 38, at 171.

²⁰⁷ Mattli, *supra* note 3, at 29.

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Media-worthy activities, such as exposing harmful practices, identifying bad actors, initiating educational campaigns, and setting the regulatory agenda tend to occur at the beginning of the regulatory process.²⁰⁸ Members may find it more difficult to engage later in the regulatory process, when technical expertise is required to set limits and draft statutory language.²⁰⁹ In addition, monitoring and enforcement activities are resource intensive, but seldom attract the attention of the public.²¹⁰

The Rainforest Action Network (RAN) is a well-known example of a civic organization that engages in grassroots activism and direct action focused on well-recognized leaders in industry and commerce to achieve its goals - to protect rainforests and to defend the rights of rainforest inhabitants.²¹¹ The organization derives its \$4 Million budget equally from membership dues, major donations and foundation support, a proportion the organization tries to maintain.²¹² The organization has approximately 13,000 members, 100,000 online supporters, and 1000 activists that participate regularly.²¹³ The organization engages in street protests, initiates advertising campaigns, develops shareholder resolutions, negotiates directly with corporate boards and generally tries to coordinate with other organizations that work on the same or similar issues to attack the concern from a different angle.²¹⁴

In the mid-1990s RAN initiated a campaign to stop the destruction of old growth forests by targeting companies that sold wood and paper products harvested from them.²¹⁵ When Home Depot, one of the largest suppliers of paper and wood products, refused to agree, RAN organized 600 protests at Home Depot stores and RAN members directed over 250,000 letters, postcards and email to Home Depot executives.²¹⁶ By 1999 Home Depot had agreed to phase out retail of products harvested from endangered forests and phase in sustainably harvested wood certified by Forest Stewardship Council.²¹⁷ While RAN has saved important tracts of forestland from logging, the overall impact of these campaigns has been limited; the logging industry has simply shifted to other tracts of old growth forest located elsewhere on the globe and consumption has remained unchanged.²¹⁸

2. LEARNING INITIATIVES

²⁰⁸ Mattli, *supra* note 3, at 29.

²⁰⁹ *Id.* Firms subject to regulation may effectively reduce participation and influence of NGOs in setting of actual standards delaying and dragging out the regulatory process.]

²¹⁰ *Id.*

²¹¹ Jennifer Krill, *Rainforest Action Network*, in GOOD COP, BAD COP: ENVIRONMENTAL NGOS AND THEIR STRATEGIES TOWARD BUSINESS 208, 210 (Thomas P. Lyon ed. RFF Press 2010). Factors that NGOs examine in determining which businesses they will target include the market share of the corporation, its reputation, and the distance that activists must travel to reach the corporation's headquarters. Vogel, *supra* note 38, at 268.

²¹² Krill, *supra* note 274, at 213.

²¹³ *Id.* at 213.

²¹⁴ *Id.* at 213, 217.

²¹⁵ *Id.* at 218.

²¹⁶ *Id.*

²¹⁷ *Id.* at 218.

²¹⁸ *Id.* at 211.

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Learning initiatives provide training to facilitate firm implementation of systems for social and environmental accountability, auditing and reporting.²¹⁹ Learning initiatives are designed to increase capacity within a firm to evaluate and improve social and environmental performance.²²⁰ Firms generally participate in learning initiatives to receive reputational benefits and to reduce risks associated with tort actions, labor disputes and other events that reduce firm profitability. In addition, they may seek to improve their relationships with their employees and bring their practices into alignment with the norms and values of senior management.²²¹ Firms sometimes enroll in a learning initiative to receive reputational benefits, but fail to follow through to achieve compliance.²²²

The primary non-governmental example²²³ of a learning initiative is the Ethical Trading Initiative, which targets supply chains to improve labor practices throughout the world. The organization's membership is comprised of firms, trade union organizations and nonprofit organizations or voluntary civic institutions.²²⁴ The Ethical Trading Initiative helps firms evaluate their trade performance and set benchmarks to improve their performance over time.²²⁵ The organization identifies best practices, provides training on implementation of those practices, initiates pilot projects, and brokers resolutions between companies, suppliers and workers.²²⁶ The organization also raises awareness among consumers, and provides training to firms on integrating ethical buying practices.²²⁷ Finally, the Ethical Trading Initiative requires firms to submit annual reports of their progress and conducts random validation visits to approximately 20 percent of its membership each year to validate the data and information contained in the report.²²⁸ The organization provides a disciplinary procedure for companies that fail to implement the management systems and data collection processes within the benchmarked timeframes.²²⁹ The ultimate sanction is removal from the organization's membership list.²³⁰ The organization is supported through membership fees and grants from government agencies.²³¹ Firms join the organization to benefit from the support structures and mediation processes to reduce the risk of strikes and work stoppage and to rehabilitate their reputations following adverse media exposure.²³²

²¹⁹ Courville, *supra* note 12, at 273.

²²⁰ *Id.* at 274.

²²¹ *Id.* at 271.

²²² *Id.* at 274.

²²³ An example of a governmentally funded learning initiative is the EPA's Green Suppliers Network Program, in which large manufacturers and their suppliers go through a technical review process to identify environmental and other wastes in their operations, as well as other activities that do not add value. The process identifies ways that manufacturers and their suppliers may reduce raw material costs, disposal costs, and the costs of compliance management and pollution control equipment. *See* U.S. Environmental Protection Agency, Green Suppliers' Network, available at <http://www.epa.gov/greensuppliers/> (last modified ???).

²²⁴ *See* Ethical Trading Initiative, available at <http://www.ethicaltrade.org/> (last modified ???).

²²⁵ *See id.*

²²⁶ *See id.*

²²⁷ *See id.*

²²⁸ *See id.*

²²⁹ *See id.*

²³⁰ *See id.*

²³¹ *See id.*

²³² *See id.*

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3. REPORTING INITIATIVES

Reporting initiatives prompt firms to report information about their activities across a range of social and environmental parameters. Information initiatives multiply the effects of both governmental regulation and private governance by rewarding firms that reduce impacts associated with the manufacture and distribution processes,²³³ shifting public norms, including management norms,²³⁴ facilitating environmental activism,²³⁵ and signaling investment choices for socially responsible investors and underwriting choices for insurance companies.²³⁶ By providing more information about whether firms are performing in these areas, reporting initiatives educate the public about risks, permit investors make socially conscious decisions about their investments, permit consumers to make conscious choices about their purchases, and permit regulators, insurance companies and other interested parties to compare risks between firms.²³⁷

The Global Reporting Initiative, one of the most well-known of these types of programs, is a network-based organization²³⁸ that has developed a sustainability reporting framework. The framework reduces the transaction costs firms face in gathering and reporting information relating to the environmental and social impacts of their operations. The framework helps firms determine what to report and how to gather reliable high-quality data about their operations and facilitates the compilation of credible, consistent reports that permit investors to compare firms. The Global Reporting Initiative's organizational structure is divided into three stakeholder constituencies that, along with geographic representation, are maintained over time: business (private firms), civil society (nongovernmental organizations) and mediating institutions (government). Stakeholder organizations have indirect input into decision-making through election of members of the stakeholder council, which nominates and elects the board of directors. The board of directors is responsible for decision-making within the organization;²³⁹ and the secretariat is charged with implementing the organization's decisions.

Modeling suggests that firm participation in reporting initiatives will be low compared to participation under mandatory governmental requirements, particularly among the firms that

²³³ Michael P. Vandenbergh, *Climate Change: The China Problem*, 81 So. Cal L. Rev. 905, 943 (2008).

²³⁴ *Id.* at 952.

²³⁵ *Id.* at 955.

²³⁶ *Id.* at 956.

²³⁷ One governmentally mandated reporting program, the Toxic Release Inventory, established shortly after the 1984 Union Carbide disaster in Bhopal India has been seen as particularly effective. It requires large industrial firms to disclose information to the public each year about chemical releases that have occurred at their facilities. *Id.* at 943-944. Empirical studies have shown that markets have responded to this information by penalizing the highest emitters with reductions in stock value. *Id.* As a consequence, high-emitting firms reduced their emissions more rapidly and to a greater extent than lower emitting companies, even when emissions reductions were not required by law. *Id.*

²³⁸ CERES, a nonprofit organization created following the Exxon Valdez oil spill, partnered with the United Nations Environmental Programme to develop a corporate code of conduct, the CERES principles, to be used by private investors in evaluating firm performance. These principles and their reporting requirements later developed into the Global Reporting Initiative. Philip Pattberg, *The Institutionalization of Private Governance: How Business and Nonprofit Organizations Agree on Transnational Rules*, 18 Gov. 589, 598-602 (2005).

²³⁹ The decision-making structure and processes are not described in detail on the organization's website. See GRI.org available at <http://www.globalreporting.org/Home>

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perform most poorly along the reported parameters.²⁴⁰ However, when compared to situations in which there is no clear governing authority and where governments lack the political will to act,²⁴¹ any movement by firms to address the issue would be an improvement, particularly when the risks associated with inaction are high.²⁴² For instance, in 2009 nearly 2500 of the largest corporations submitted voluntary reports on their carbon emissions to the Carbon Disclosure Project²⁴³ which provides the information to over 500 institutional investors, with over \$64 trillion in assets under management,²⁴⁴ and approximately 60 supply chain anchors, such as Wal-Mart.²⁴⁵ The Carbon Disclosure Project was developed to identify the financial risks companies face from climate change and company efforts to decrease carbon emissions,²⁴⁶ with the understanding that in the business world “what gets measured gets managed.”²⁴⁷ Nevertheless, if reporting initiatives only require firms to self-report and lack systems to verify whether the reports correctly reflect the firm environmental impacts, their usefulness to investors and consumers may be limited.

4. MODELS AND META-STANDARDS

A number of institutions have arisen to assist in the development of private governance institutions by creating model structures and outlining procedures and criteria for the development of standards. These institutions reduce the costs that firms or organizations would otherwise face in developing the rules and structures on their own or attempting to modify those from an existing organization to suit their particular needs. These institutions disseminate information about best practices and they in turn provide the locus for their members to modify rules, structures and best practices to address the needs of particular industries, sectors and stakeholders. In general these organizations tend to abide by the same rules and standards that they provide for their members. Consequently, their characteristics may diverge significantly.

For example, the ISEAL Alliance provides guidance and models for social and environmental standards systems and shares best practices to help member organizations improve their effectiveness, increase their positive impacts and maintain their credibility.²⁴⁸ ISEAL Alliance establishes process requirements by which organizations develop, structure and

²⁴⁰ Lyon, *supra* note 3, at ____ (discussing incentives for firm to disclose or to avoid disclosure).

²⁴¹ See Sections II. ____ *infra*.

²⁴² Ecological systems behave in a non-linear manner; they are frequently subject to thresholds and tipping points and collapse can occur quickly after a long period of what appears to be incremental change. Young, *supra* note 10, at ____.

²⁴³ Carbon emissions and their effects on the climate transcend national boundaries. Formal governments have the incentive to free ride on the efforts of others. Recent efforts in Copenhagen to develop an international treaty to replace the Kyoto Protocol failed.

²⁴⁴ Institutional investors seek information on carbon emissions to understand the risks associated with future regulatory activity, as well as to discern how dependent the investment is on fossil fuels.

²⁴⁵ Carbon Disclosure Project, *What We Do*, available at <https://www.cdproject.net/en-US/WhatWeDo/Pages/overview.aspx> (last modified ???). The data is also available to, policymakers, government bodies, nongovernmental organizations, universities and the general public.

²⁴⁶ Blair, *supra* note 170, at 345.

²⁴⁷ Carbon Disclosure Project, *Industry Viewpoints: What does business want from a Global Deal?*, available at <https://www.cdproject.net/en-us/WhatWeDo/Pages/Industry-viewpoints-What-does-business-want-from-a-Global-Deal.aspx> (last modified ???).

²⁴⁸ <http://www.isealliance.org/content/the-iseal-alliance-in-100-words> (last modified ???)

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revise standards that provide for the process to be open, transparent, and broadly participatory.²⁴⁹ The organization also sets standards for measuring and evaluating the social and environmental impacts of the member organizations and the effectiveness of their systems.²⁵⁰ Finally, the organization has accreditation and process requirements for the individuals or bodies that will audit and certify whether participants are in compliance with the organization's standards with a view to ensuring that they are credible and accessible.²⁵¹ ISEAL Alliance provides training, tools and technical support to its members.²⁵² Full members²⁵³ play a formal role in governing the organization,²⁵⁴ but the board of directors manages the main business of the organization, including the standards-setting process. The ISEAL Alliance follows its own guidelines and procedures in setting standards for its member organizations.²⁵⁵ The ISEAL Alliance is funded by foundations, membership fees and government grants.²⁵⁶

E. HYBRID GOVERNMENT / CIVIC INSTITUTIONS

As with other government hybrids, there is a continuum of government involvement with civic institutions. Government may simply provide a background of regulation that gives rise to needs that may be met by nongovernmental organizations or there may be an explicit partnership between government and a civic institution. The hybrid featured here is noted primarily because of its long history and prominence in undertaking a traditionally governmental function, land conservation. Land conservancies, serve a function similar to eminent domain or public condemnation processes, in that they acquire tracts or interest in land to serve as wildlife reserves, open space and wildlife habitat or other public benefit.

1. LAND CONSERVANCIES / CONSERVATION LAND TRUSTS

Land conservancies, or conservation land trusts, are nonprofit organizations that acquire rights to ecologically, environmentally, or historically important properties.²⁵⁷ Land conservancies are commonly developed to preserve open space, ranch and farmland, environmentally sensitive areas, water rights and riparian zones.²⁵⁸ They may acquire property in

²⁴⁹ <http://www.isealalliance.org/content/codes-good-practice> (last modified ???)

²⁵⁰ <http://www.isealalliance.org/content/codes-good-practice>

²⁵¹ <http://www.isealalliance.org/content/codes-good-practice>

²⁵² <http://www.isealalliance.org/content/members>

²⁵³ Members that have demonstrated that they are in compliance with all ISEAL Good Practice Codes and other relevant requirements may become full voting members. Prior to that time they are associate members and cannot vote. Other interested organizations and individuals may join as affiliates.

<http://www.isealalliance.org/content/members>

²⁵⁴ Memorandum of Association of ISEAL Alliance dated June 12, 2003.

²⁵⁵ <http://www.isealalliance.org/content/code-development> The stakeholder council, a standing body representative of stakeholders, initiates the process, the board of directors determines whether it will go forward and if so, delegates authority to a steering committee to develop the standards in consultation with technical committees. The public is entitled to review and comment to two successions of drafts, which are revised and circulated to stakeholders for their review and comment. The stakeholder council then provides a recommendation to the board of directors.

²⁵⁶ <http://www.isealalliance.org/content/partners>

²⁵⁷ Zachary Bray, *Reconciling Development and Natural Beauty, The Promise and Dilemma of Conservation Easements*, 34 HARV. ENVTL. L. REV. 119, 121-22 (2010).

²⁵⁸ *Id.*

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fee, obtain conservation easement rights, or purchase the development or resource extraction rights associated with the property.²⁵⁹ Frequently, land conservancies transfer the acquired rights to federal or state governments for management, especially if the acquired rights are to lands that are adjacent to other publicly held lands, but they may also hold the property rights in perpetuity, privately enforcing the land use restrictions in conservation easements to prevent heirs from developing property subject to the easement.²⁶⁰

The process delivers a similar outcome as eminent domain; the state or federal government acquires for fair market value the rights to property to hold in public trust. However, the acquisition process is voluntary; it avoids much of the public debate and furor over state action because the deliberations are not public, and the seller avoids the delays associated with government action and deliberation, since the conservancy can hold the land until appropriations are made for government to acquire it. In addition, selling parties may receive benefits that exceed the property's fair market value because of tax deductions that are available for donations or below-market sales to public charities.²⁶¹ Funding sources for land conservancies include donations from individuals, firms and foundations, grants from governmental entities to purchase property rights and manage them, and royalties from leases of resource extraction rights. Policy-makers are increasingly considering conservancies not only for managing ecologically sensitive and historically important lands, but for preserving the relationships with indigenous people that rely on those lands.²⁶²

The Nature Conservancy is a well-recognized land conservancy. The organization works throughout the U.S. and in 31 other countries to identify and preserve the ecological resources they identify as most important, including forests, marine and freshwater resources. The organization's conservation work includes obtaining property rights from firms and transferring them to state and federal governments for management, acquiring conservation easements over private properties, managing its own private nature preserves, performing conservation services and improving management practices for millions of acres of land and water.²⁶³ In 2009 it had \$4.6 Billion in assets and an annual operating budget of \$448 Million.²⁶⁴ It received over \$400 Million in member dues and donations and over \$300 Million in land sales and gifts that year.²⁶⁵ The organization is a tax-exempt nonprofit public charity with over one million members. The members are not allowed to vote or participate in the governance structure; the board of directors

²⁵⁹ *Id.*

²⁶⁰

²⁶¹ Bray, *supra* note 257, at 131. A number of concerns have arisen about fraudulent activity associated with valuation of the conservation easements, the value of the properties to which they are subject and the tax benefits that accrue to the individuals who participate in these transactions. There are also concerns about whether conservation easements will be enforced over time. *Id.* at 123.

²⁶² See Mary Christina Wood & Matthew O'Brien, *Tribes as Trustees* _____; Mary Christina Wood & Zachary Welcker, *Tribes as Trustees Again (Part I) The Emerging Tribal Role in the Conservation Trust Movement*, ___ HARV. L. REV. ___

Mary Christina Wood & Matthew O'Brien, *Tribes as Trustees Again (Part II): Evaluating Four Models of Tribal Participation in The Conservation Trust Movement*, 27 STAN. ENVTL L. REV. 477 (2008); Karol Bourdreaux, *A New Call of the Wild: Community-Based Resource Management in Namibia*, 20 GEO. INT'L ENVTL. L. REV. 297 (2008).

²⁶³ <http://www.nature.org/initiatives/forests/> (last modified ???).

²⁶⁴ The Nature Conservancy 2009 Annual Report, *available at* (last modified ???).

²⁶⁵ *Id.*

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manages the organization's business and delegates certain responsibilities to a number of committees comprised of board members.²⁶⁶

F. HYBRID CIVIC / BUSINESS / GOVERNMENT INSTITUTIONS

1. CERTIFICATION AND LABELING SYSTEMS

Voluntary standards, certification and labeling systems²⁶⁷ are private governance institutions that set minimum standards for firms or products to meet one or more consumer preferences, designate a process with which to verify whether the standards have been met, provide training for individuals who will inspect the goods or facilities to verify whether they are in compliance with the standards, certify the goods or firms that have met the standards, and develop labels to identify the compliant goods and firms.²⁶⁸ These institutions sometimes also market the labels and the goods and facilities that they certify to consumers. Their main proponents are non-governmental entities from civil sector. Most are governed through a tripartite structure that ensures broad representation and deters domination by one type of interest.²⁶⁹ Many of these institutions follow the guidelines developed by the ISEAL Alliance for developing standards, measuring and evaluating performance, and accrediting auditors.²⁷⁰

Voluntary standards, certification and labeling regimes use the supply chain to create financial incentives for performance.²⁷¹ Organizations may create or seek to capitalize on activist pressure directed toward supply chain anchor firms in the form of media campaigns, protests and actual or threatened boycotts.²⁷² Firms committing to become members of the certification and labeling system or committing to purchase certified goods gain relief from these pressures. The organizations may also offer positive incentives in the form of positive reputational benefits or retail price premiums on certified goods.²⁷³

Following recognition of the tragedy of the commons dynamic with respect to forests in the 1960s, many governments elected to privatize their forests.²⁷⁴ In some cases, government

²⁶⁶ *Id.*

²⁶⁷ These systems go by many names in the different literatures. Some scholars call these institutions non-state market-driven or (NMSD) systems. See Benjamin Cashore, Graeme Auld, Steven Bernstein, & Constance L. McDermott, *Can Non-state Governance 'Ratchet Up' Global Environmental Standards? Lessons from the Forest Sector*, 16 REV. EUR. COMTY & INT'L ENV. L. 158, at 162-66 (2007), also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1450435. Others have identified them as Regulatory standards setting (RSS) forms of private governance. See Abbott, *supra* note 4, at 44-45. Others, in the business world refer to all forms of private governance as "civil regulation," a term that is disconcerting for legal scholars, since in legal terminology, all governmental regulation that is not criminal regulation is "civil regulation."

²⁶⁸ Errol Meidinger, *Competitive Supragovernmental Regulation: How Could It Be Democratic?*, 8 CHICAGO J. INT'L L. 513, 515 (2008); Cashore, *supra* note 217, at 162-66.

²⁶⁹ Meidinger, *supra* note 269, at ____.

²⁷⁰ See ISEAL Alliance List of Full Members at http://www.isealalliance.org/organisation/full_members (last modified ???).

²⁷¹ Auld, *supra* note 5, at 424-25.

²⁷² *Id.*

²⁷³ *Id.* at 425.

²⁷⁴ Elinor Ostrom, *GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION* 23 (Cambridge 1990).

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ownership of the forests has not made them less susceptible to illegal logging, but more so where governments have lacked the capacity to monitor and enforce the law.²⁷⁵ In an attempt to reverse this trend, the Forest Stewardship Council has developed a system to help enforce existing national laws against illegal logging by encouraging the logging industry, forest owners, and indigenous populations to adopting sustainable forest management practices and deter illegal logging by joining the certification program.²⁷⁶ The organization certifies and labels forests, forest products and firms that sell those products. In exchange for their participation, forest owners and managers and retailers that sell certified forest products may receive a premium on products they sell.²⁷⁷

G. LIMITS OF THE CONVENTIONAL TAXONOMY

While grouping institutions according to the relative contributions and control of their dominant constituents has been used regularly,²⁷⁸ the “sectoral” approach of the conventional taxonomy is at best uneasy. First, as a descriptive matter, institutions as structures do not fit neatly into the business, civic, government, or hybrid categories. Similar institutional structures may be used by business or by purely civic institutions.²⁷⁹ Frequently, there is a continuum of involvement of the three interests in each type of private governance institution.²⁸⁰ Parties from each sector may be involved directly or indirectly, making it difficult to discern which sector is actually in control.²⁸¹ For some private governance structures, government plays a significant role even though they are not direct stakeholders or participants in the development of the institution. Many private governance institutions mimic programs developed and funded by government. In some instances it is the existence²⁸² or the threat of future government regulation that motivates the creation of private governance structures in the first place.²⁸³ Some private governance structures would not be developed without the availability of the courts to enforce contractual

²⁷⁵ *Id.*

²⁷⁶ See Forest Stewardship Council, _____, available at _____

²⁷⁷ *Id.* This market premium has not always eventuated. Michael Richards, *Certification in Complex Socio-political Settings: Looking Forward to the Next Decade*, in *Forest Trends* 26 (2004).

²⁷⁸ See Kenneth W. Abbott & Duncan Snidal, *The Governance Triangle: Regulatory Standards Institutions and the Shadow of the Law*, in *THE POLITICS OF GLOBAL REGULATION* 46-57 (Walter Mattli & Ngaire Woods eds., Princeton University Press 2009)

²⁷⁹ For instance, some socially responsible investors, such as Domini Social Investments and Pax World, are business organizations, developed to provide a return to their investors on a portfolio of investments that meet certain environmental and social criteria. Others, such as Equity Trust and the Acumen Fund are nonprofit organizations that provide no monetary return on investment to investors, but devote 100% of their net profits to further their social causes.

²⁸⁰ Abbott and Snidal develop a map that identifies the location of specific organizations within a “Governance Triangle” based on the extent to which states, firms and/or nongovernmental organizations participate directly in the development and operations of a particular organization, recognizing that while generalizations may exist they . See Abbott, *supra* note 3, at 46-57.

²⁸¹ Questions have been raised about whether institutions developed by nongovernmental organizations funded with private resources accurately represent the interests of the public or civil sector. Lyon, *supra* note 81 at 10.

²⁸² Environmental management systems are generally used to facilitate firm compliance with existing environmental laws.

²⁸³ The chemical industry, for example, developed the Responsible Care Program following the Union Carbide disaster in Bhopal with the goal of avoiding the institution of regulations upon the chemical industry, and in 1992, following the Rio Summit, the Chamber of Commerce developed a Business Charter for Sustainable Development to deflect possible global environmental regulation. Vogel, *supra* note 38, at 167-68.

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obligations or impose tort liability.²⁸⁴ In such cases it becomes more difficult to determine what interests actually dominate such structures.

Second, the sector-based taxonomy may also have limited utility as an analytical tool. For instance, in evaluating different institutions that compete with one another, some scholars have looked to the composition of the organization to predict whether the regulations will be sound. This is a form of stakeholder theory.²⁸⁵ There is some evidence that the general public is taking a similar approach in evaluating private governance institutions, particularly ecolabels.²⁸⁶

Abbott & Snidal take the stakeholder analysis up one level, arguing that for private governance institutions to regulate in the public interest, (1) the stakeholders must address all stages of the regulatory process, (2) it takes certain capacities to address the various stages of regulation (independence, representativeness, expertise and operational capacity), and (3) businesses, nongovernmental organizations and government have different capacities. They explain that “it is difficult, if not impossible” for private governance institutions to have the necessary capacities to contribute to all stages of the regulatory process and suggest that the institutions most likely to provide regulation in the public interest are those that have stakeholder participation from each sector.²⁸⁷ However, institutions may appear to be the same in terms of stakeholder composition (and capacities), but function in very different ways.

For example, Forest Stewardship Council (FSC), an organization developed with input from business, government and environmental organizations, has created a certification and labeling system for forest products and their retailers to encourage sustainable management of forests globally. The Sustainable Forestry Initiative (SFI) has developed a certification and labeling scheme for forestry products that competes with the system created by FSC. SFI’s standards are less stringent than those of FSC. Initially, the public could differentiate the standards of the two organizations based on the identity of their participants. FSC was a nonprofit organization and SFI was business firm, a subsidiary of the American Forest and Paper Association. SFI has since been converted into a tax-exempt nonprofit organization with tripartite governance that includes environmental organizations and government members as well as business and industrial interests. SFI now bears the same indicia of civic representation and the organizational structure reflects the same capacity for “representativeness” as FSC; however, the actual standards behind the two organizations remain significantly different. Here the composition of the institution is not an accurate signal as to whether the institution is undertaking voluntary regulation that will have an overall beneficial effect on the greater community. In such cases, the public cannot discern whether an institution is meeting their demand for regulation by looking at such stakeholder identify or the relative participation by nongovernmental organizations, business and government in the governing structure.

²⁸⁴ For instance, firms use contracts to control the quality of products being delivered through their supply chains. When the goods they sell are credence goods (goods for which the consumer cannot tell the quality prior to purchase), firms are motivated to monitor their supplies less by consumer demand than by the risks associated with breach of contract claims and potential tort liability.

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²⁸⁷ Abbott, *supra* note 3, at 46.

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In addition, while the rules that the constituents develop may initially be evenhanded or favor the interests of one sector or another, those rules can change over time.²⁸⁸ For instance, the Forest Stewardship Council has been criticized as compromising its standards in order to compete with SFI and increase participation by large retail firms in the United States and the European Union. Similarly, private governance institutions may also fall prey to internal conflicts of interest. For example, the Nature Conservancy has had organizational structures in place to avoid conflicts of interest for many years, including specific written policies and a broad-based board of directors; it nevertheless became entangled in scandals associated with rent-seeking by its members and trustees in 2003.²⁸⁹

Other taxonomies focus, in part on the intent, the motives of the stakeholders.²⁹⁰ However, stakeholders have a wide variety of motives in undertaking voluntary regulation. Firms undertake corporate social responsibility primarily to reduce waste, improve efficiency and increase profits,²⁹¹ differentiate themselves in the market,²⁹² adapt to shifting business norms and values,²⁹³ enhance firm reputation with investors, markets and consumers,²⁹⁴ and level the playing field.²⁹⁵ They use contract to regulate others to shift the risk of loss in transactions, reduce risks from contract and tort liability and the costs associated with labor disputes or

²⁸⁸ For instance, the Forest Stewardship Council, an organization developed with input from business, government and environmental organizations, has created a certification and labeling system for forest management and forest products to encourage sustainable harvesting. The organization has been criticized as having allowed its standards to be compromised in order to increase the participation by large retail firms in the United States and the European Union.

²⁸⁹ In 2003 the Washington Post disclosed that the organization had engaged in a number of questionable transactions with the organization's trustees and board members and had begun resource extraction activities on one of its nature preserves. See Joe Stephens & David B. Ottaway, *Charity's Deals to Be Scrutinized; Senators Send Letter to Nature Conservancy*, WASH. POST, May 10, 2003, at A02. The organization was required to submit to an audit by the Internal Revenue Service and they received Congressional requests from to attend public hearings. Joe Stephens & David B. Ottaway, *IRS Toughens Scrutiny of Land Gifts*, WASH. POST, July 1, 2004, at A01; Joe Stephens & David B. Ottaway, *Nature Conservancy Faces Panel Review*, WASH. POST, July 27, 2003, at A19. The organization responded by suspending land sales and reviewing its governing documents and practices. *Conservation Group Alters Rules After Criticism Over Its Practices*, N.Y. TIMES, Jun 15, 2003, at ____.

²⁹⁰ Auld, *supra* note 5, at ____.

²⁹¹ Auld *supra* note 5, at 415; Vogel, *supra* note 20, at 268-269 (suggesting that much of the business literature exaggerates the cost-savings or other "win/win" benefits from shifting to more sustainable practices; he indicates that studies have shown little correlation between financial performance and performance along social and environmental parameters).

²⁹² Lyon, *supra* note 3, at 29; Auld *supra* note 5, at 415; Abbott, *supra* note 4, at 70; Mattli & Woods, *supra* note 1, at 56. The need for market differentiation may arise from a disaster within the industry that has widespread negative impacts on public perception of the industry as a whole and could potentially lead to regulation. Vogel, *supra* note 20 at 268.

²⁹³ Vogel, *supra* note 20, at 269 (suggesting that changes in business mores have contributed significantly to the shift in business practices and attributes this change to an expansion of firm accountability not only to shareholders but to other communities that are impacted by their decisions); Vogel, *supra* note 38, at 170. See also Stephen Bernstein & Benjamin Cashore, *Can Non-State Global Governance Be Legitimate? An Analytical Framework*, 1 REG. & GOV. 347 (2007). *But see*, Abbott, *supra* note 4, at 70 (suggesting that while these kinds of responses to the logic of appropriateness may have long-term impacts, competition drives firms to reduce and externalize costs).

²⁹⁴ Vogel, *supra* note 38, at 169. A firm's desire to enhance its reputation may arise in response to activities by nongovernmental organizations to shame and blame the firm or the industry through media exposes, protests, and boycotts.

²⁹⁵ Vogel, *supra* note 38, at 169.

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stoppages.²⁹⁶ Firms also create and adhere to voluntary regulations to curry sufficient favor with the regulatory authorities to be included in the regulatory process,²⁹⁷ reduce the degree of monitoring that currently occurs,²⁹⁸ preempt proposed governmental regulation,²⁹⁹ and avoid negative publicity from shame and blame tactics. Intent itself will not always reflect the ultimate benefits or costs of the activity to the broader society.

Because the conventional taxonomy is limited in its descriptive capacity and analytical scope, a new paradigm for sorting and examining private governance institutions is needed. The next section formulates a new typology based the functions that private governance institutions serve at each stage of the regulatory process.

II. FUNCTIONAL TYPOLOGY: HOW PRIVATE GOVERNANCE INSTITUTIONS OVERCOME GOVERNMENT FAILURES AND MARKET FAILURES THAT OCCUR AT EACH STAGE OF REGULATION

Both the formal governmental and informal regulatory processes occur in five steps: (1) agenda-setting, (2) negotiation of standards, (3) implementation, (4) monitoring, (5) enforcement.³⁰⁰ At each stage, the process may break down, undermining the purpose for which the regulations are being promulgated. Formal governments fail to regulate successfully for a number of reasons. They may lack the authority, the resources or political will to regulate at all. They may be unable to coordinate and collaborate across jurisdictional boundaries. They may fail to generate regulation that prescribes any enforceable standards. They may also fail to monitor and enforce the standards that they have set.³⁰¹ In addition, some actors seek to divert the regulatory process at each stage to their own ends. Finally, stage must be funded; the extent of funding and the allocation of responsibility for developing, implementing, monitoring and enforcing the rules can also give rise to a breakdown in the regulatory process.

This section describes the different stages of regulation and the kinds of barriers and hazards that may prevent public regulation from occurring or cause public regulation to fail to serve the public interest at each stage. Because the demands for governance are unmet, this creates a regulatory void or gap in which private governance systems may step in. The section, therefore, also describes how private governance institutions address these governance deficits and provides specific examples of private governance institutions that have responded to that demand at each stage.

A. AGENDA-SETTING: ADDRESSING KNOWLEDGE AND COLLECTIVE ACTION PROBLEMS

²⁹⁶ David Vogel, *Private Global Business Regulation*, 11 ANN. REV. POL. SCI. 261, 268 (2008).

²⁹⁷ Lyon, *supra* note 3, at 58.

²⁹⁸ *Id.*

²⁹⁹ Lyon, *supra* note 3, at 58. An increased threat of governmental regulation will increase firm attempts at corporate self-regulation. Lyon suggests that regulatory preemption may decrease political transaction costs and leaves open the possibility that consumers will organize if preemption measures do not result of insufficient environmental improvement.

³⁰⁰ Abbott, *supra* note 4, at 46.

³⁰¹ Vogel, *supra* note 38, at 160.

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During the agenda-setting phase, a number of knowledge problems must be addressed. Often, social costs, such as those associated with environmental harm,³⁰² may not be apparent.³⁰³ Globalization has shifted manufacturing from developed to developing nations, making the social harms experienced in these countries less visible to those enjoying the lower prices that result from externalizing those costs.³⁰⁴ Proponents of regulation must identify the activities that generate negative externalities and identify the parties responsible for those social harms.³⁰⁵ While technology has advanced communication to a level that government censorship becomes less feasible on a global scale, some governments are still able to exert control over information either through limiting media access³⁰⁶ or through disinformation campaigns.³⁰⁷

Effective oversight requires information.³⁰⁸ Gathering information can be costly.³⁰⁹ Increasingly non-governmental organizations have taken an entrepreneurial role in uncovering these social costs, in communicating them to the public and in galvanizing action with respect to environmental and social concerns.³¹⁰ Nongovernmental organizations, in addition to disclosing social costs and identifying the parties that have contributed to the problem, may also communicate this information to the public in a way that will prompt action.³¹¹ They may offer a plan for action to empower the public to overcome collective action problems and call for institutional change either in the form of legislation, enforcement of existing regulations, or, if those needs will not be met by formal government, by galvanizing interest groups to develop governance institutions themselves.³¹²

Regulatory advocates that are independent of the proposed regulatory target have greater credibility.³¹³ Advocacy organizations or coalitions that are comprised of a diverse array of constituents garner more public support because they are more representative of diverse interests and the broader society.³¹⁴ The actions and policies that are taken by these organizations may be viewed as a weighted average of the preferences of their constituents.³¹⁵ Some organizations develop structures to maintain a balance of power between types of constituents to ensure that no

³⁰² For those concerned about natural resources and ecological systems, the damage suffered by these systems may be difficult to discern or estimate. Biological systems frequently behave in a non-linear ways, and are subject to thresholds and tipping points. Collapse may be imminent, but the signs may not be readily apparent. *See* Oran Young _____.

³⁰³ Occasionally, catastrophic events, such as the Bhopal disaster, coffee collapse, labor scandals or human rights scandals will bring these social costs into public attention.

³⁰⁴ Vogel, *supra* note 38, at 159.

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³⁰⁶ *See for instance* William Yong & Robert F. Worth, *Iran Clamps Down on Reporting on Protest Leaders* N.Y. TIMES, Aug. 25, 2010, at ____; Andrew Jacobs & Miguel Helft, *Google, Citing Attack, Threatens to Exit China*, N.Y. TIMES, Jan.12, 2010, at ____.

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³⁰⁸ Mattli, *supra* note 3, at 28.

³⁰⁹ *Id.*

³¹⁰ *Id.* at 29; Abbott *supra* note 2, at 74 n.45; Vogel, *supra* note 38, at 164-65.

³¹¹ Abbott, *supra* note 4, at 64; Vogel, *supra* note 38, at 168-69 (naming and shaming campaigns directed at prominent firms demonstrates corporate irresponsibility).

³¹² Abbott, *supra* note 4, at 64.

³¹³ Mattli, *supra* note 3, at 29.

³¹⁴ Abbott, *supra* note 4, at 64;

³¹⁵ Lyon, *supra* note 81, at 9;

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group dominates.³¹⁶ A tripartite structure frequently used splits membership and voting rights into three groups: (1) private firm or industry representatives, (2) government representatives and civic institutions, (3) nongovernmental organizations and other public interest groups.³¹⁷

In addition, organizations that are funded by membership dues may be more likely to take actions that align with member interests and, and therefore, the public interest, than those that receive funds from foundations or private industry.³¹⁸ Some organizations develop structures to maintain a balance of funding from various sources of support to avoid conflicts of interest that arise between their mission and the interests of those that provide significant funding.³¹⁹

When traditional state and intergovernmental organizations fail to regulate they create a space for private regulation. Sometimes this space arises because government lacks authority. At other times there is a mismatch between the jurisdiction of governments that might regulate and the jurisdiction of the population causing or experiencing the social costs of an activity, or when the boundaries of the resource system or the environmental problem do not match the jurisdiction of the governments that might otherwise govern the situation. In some instances, the conservation of certain ecosystems and the preservation of long-term productivity of certain natural resources would require all states to agree to regulate. However, even governments that recognize the negative externalities often lack the political will to coordinate.

For example, in recent years technology has permitted industry to harvest fish in the open seas at rates that are leading fisheries to collapse. No government has the authority to limit the fishing activities of all of the firms harvesting fish in the open seas. Any government that would unilaterally impose those limits on their own industrial fishing enterprises would only harm their own country's firms and have no effect on the activities of firms from other countries. Unless all countries agree to a treaty and supply funding for enforcement, any firm may relocate to a jurisdiction that is not party to their treaty and continue unsustainable fishing practices. In addition, every firm has an incentive to fish as quickly and efficiently as possible. When all firms do so, however, the rate of harvesting exceeds the rate at which the fish can replenish themselves, resulting in the "tragedy of the commons."³²⁰ The void in government authority creates an opening for private governance institutions. The Marine Stewardship Council has stepped into this void to attempt to address this problem by creating a system to encourage sustainable fishing, to label sustainably harvested fish and other marine products, the supply chains that deliver them to the public and restaurants that serve them to the public.³²¹ The system

³¹⁶ See for example Forest Stewardship Council and U.S. Green Building Council.

³¹⁷ See *id.*

³¹⁸ Lyon, *supra* note 101, at 5. However, the activities that these organizations pursue may also reflect member limitations. See Vandenbergh, *supra* note 71, at 960. To the extent that the standards setting process is technical, the nuances may be difficult to explain, complicating any advocacy role that members may play. See Mattli, *supra* note 3, at 26-27. Because implementation, monitoring and enforcement may occur where the public lacks access (because firm security bars access, geographic location) or technical skills to assist in any meaningful way, members are unlikely to be able to play any direct role. Consequently, they may not be as ready to provide funding to support endeavors when they cannot participate or see the impacts directly.

³¹⁹ Krill, *supra* note 274, at 213.

³²⁰ Garrett Hardin, *Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

³²¹ See Marine Stewardship Council, available at <http://www.msc.org/> (last modified ???).

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also educates consumers and gives them an opportunity to purchase sustainably harvested seafood.³²²

Jurisdictional mismatch also frequently prevents governments from addressing social costs. As networks become responsible for producing goods and as supply chains cross jurisdictional boundaries, collaboration problems become increasingly important.³²³ In addition, there may be a mismatch in the geography of the firms to be regulated and the jurisdiction that seeks to regulate them³²⁴ or between the individuals impacted and the authority of the governing body over the individuals or firms causing the impacts.³²⁵ One example of this phenomenon is cross-boundary pollution. When the parties being harmed from an activity are in a different jurisdiction from those causing the harm, states often find it difficult to address these kinds of conflict. When there is a mismatch between the geography of an environmental or natural resource and the jurisdiction of the governments that would seek to regulate its use,³²⁶ governments may fail to act. Because no one government has the clear authority or power to regulate, often none do.

There are a number of reasons for this dynamic. Public choice literature views government actors as self-interested agents.³²⁷ From this perspective, when authority is split, there is little incentive for any one agency to effectively regulate;³²⁸ the political rewards of action are small compared to the costs of coordination.³²⁹ Agencies must communicate and coordinate in order to regulate comprehensively.³³⁰ Regulation and enforcement are expensive. The costs of investigating, collaborating and coordinating with other states are high, while the political benefits are low.³³¹ Consequently, these types of action would be disfavored. Each state has the incentive to free ride: to benefit from the conservation efforts of others and contribute nothing to those efforts. These collective action dilemmas commonly arise because self-regulation by one state will only put that state at a disadvantage relative to other members of the group. In contrast, the political costs to states of taking *no* action are low.³³² When authority is

³²² *See id.*

³²³ Vogel, *supra* note 38, at 159.

³²⁴ William W. Buzbee, *Recognizing the Regulatory Commons: A Theory of Regulatory Gaps*, 89 IOWA L. REV. 1, at 32, 24, 25 (2003).

³²⁵ For example, when parents in the U.S. discover their children's toys manufactured in China contain lead paint, they have limited legal recourse against the Chinese tortfeasors. In response, American manufacturers have begun retailing natural non-toxic products. *See for example* _____.

³²⁶ For example, residents of the European Union and the United States may want to preserve South American rain forests to preserve unique species, maintain biodiversity, and retain them as carbon sinks, an important resource in combating global warming. The EU and the US have no jurisdiction over South American rain forests, however. Both the Forest Stewardship Council and the Rainforest Alliance have initiated VSCL systems to educate the public about the importance of these forests and provide market incentives to prevent deforestation and promote conservation.

³²⁷ Buzbee, *supra* note 350, at 33.

³²⁸ *Id.* at 32.

³²⁹ *Id.* at 33.

³³⁰ *Id.* *See also, generally*, Hardin, *supra* note 321.

³³¹ Buzbee, *supra* note 350, at 33.

³³² *Id.* at 30-32.

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vested in multiple states, no one state may be held accountable. It is much more difficult to allocate blame for a sin of omission, a failure to regulate comprehensively.³³³

In addition to the usual transaction costs associated with communication and coordination, there may be resistance to sharing information and authority; under public choice theory, governments would resist anything that would undermine authority or reduce their regulatory turf.³³⁴ Consequently, few governments would be willing to share, consolidate or cede authority in order to provide a more effective resolution of the issue at hand. To the extent that governments overcome each of these challenges, any political rewards for effective action would be split among the participating governments, and therefore, diluted.³³⁵

Furthermore, the political benefits of blocking action are high. Unless all of the relevant governments are working together, any government may hold out, refusing to come to an agreement, and undermine any affirmative resolution the group might otherwise reach.³³⁶ There is much greater political value for a state to hold-out, or undercut a collective decision, than to participate in it. By threatening to refuse to join the collective effort, a state may seek special benefits or “rents” as the price of its agreement and participation. Hold-outs also face much lower transaction costs; it is far easier to block regulation and action than it is to move forward.

Finally, institutional dynamics between different sources of authority may create disincentives to regulate.³³⁷ For instance, states, counties and municipalities frequently compete with one another to attract businesses and new residents. The problem is exacerbated when states seek benefits in the form of employment and tax revenues from a regulated industry. Where industry is mobile, it may choose to relocate rather than be subject to the regulation. Governments sometimes trade environmental goods to attract a broader tax base and to encourage economic growth in their region. This may result in a competitive “race to the bottom” as the various jurisdictions offer reduced taxes and exemptions from regulation.³³⁸ States not only act to remove regulation and other impediments to retain businesses, but provide subsidies and other incentives to attract them.

For instance, state and local governments often fail to perform regional planning. They compete for commercial, industrial and residential developments in order to expand their tax bases, resulting in a race to the bottom.³³⁹ The consequences include sprawl, traffic, loss of agricultural lands and wildlife habitat to commercial use, hollowing out of cities, urban blight

³³³ *Id.* at 47.

³³⁴ *Id.* at 50.

³³⁵ *Id.* at 32-33.

³³⁶

³³⁷ Buzbee, *supra* note 350, at 26.

³³⁸ The regional consequence is often sprawl, congestion, heat bubbles, energy spikes and loss of greenspace and agricultural lands. The U.S. Green Building Council’s Leadership in Energy and Environmental Design rating system addresses these social costs by rewarding land use planning that avoids or internalizes these social costs. *See* Sustainable Sites requirements, LEED for New Construction Rating System, *in* LEED REFERENCE GUIDE FOR GREEN BUILDING DESIGN AND CONSTRUCTION, 2009 Edition, *available at* <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=220>.

³³⁹ Buzbee, *supra* note 350, at 18.

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and brownfields, heat island effects, groundwater pollution, flooding, and exposure to sewage wastes because of failure to separate and upgrade storm water infrastructure.

In response to these social costs, members of the design, construction and development industries, environmental organizations, and urban planners have developed the U.S. Green Building Council.³⁴⁰ The organization addresses not only issues associated with poor land use planning, but also wasteful building design and construction practices. The organization has developed the Leadership in Energy and Environmental Design standards to incentivize developers and building owners to plan and build more sustainably. The system awards certification points to projects located in urban, in-fill and brownfields environments located near public transit and bars developments of raw agricultural or forest lands from certification.³⁴¹ It also provides certification points for planning neighborhoods and building infrastructure that reduces the environmental impacts that buildings create in their construction and in their use.³⁴² While the impacts from use of the LEED standards in any single building or development may be limited, the U.S. Green Building Council fulfills on its mission to transform the industry by educating not only building design and construction professionals, but the financial industry, local, state and federal governments and the general public about the social costs associated with the status quo and the measurable benefits that can be attained from shifting to more sustainable planning, design, practices and materials.³⁴³ To date

Table 1. Agenda-Setting Stage

Barrier /Hazard	Suppliers	Structure Supplied	Characteristic for Effectiveness
Information Problem: Lack of Information about Problem and Cause of Problem	NGOs Voluntary standards certification and labeling (VSCL) institutions	<ul style="list-style-type: none"> • Information about problem • Information about cause • Network for communication with the public 	<ul style="list-style-type: none"> • Independence (organizational and financial) from entity causing problem • Independence (organizational and financial) from entity causing problem •
Collective Action Problems: Lack of individual incentives to regulate (This includes anti-commons and regulatory fragmentation problems.)	Government, NGOs, Businesses, Voluntary standards certification and labeling (VSCL) institutions	<ul style="list-style-type: none"> • Convening stakeholders • Market incentives to provide incentives to regulate 	<ul style="list-style-type: none"> • Structures to permit participation by all • Sufficiently broad participation for market incentive to be created
Race to the Bottom	Voluntary	<ul style="list-style-type: none"> • Market incentives to 	<ul style="list-style-type: none"> • Sufficiently broad participation

³⁴⁰ Welcome to USGBC, available at <http://www.usgbc.org/Default.aspx> (last modified ???).

³⁴¹ See U.S. Green Building Council, LEED for New Construction, available at <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=220> (last modified ???).

³⁴² See *id.*

³⁴³ The organization’s mission statement is “To transform the way buildings and communities are designed, built and operated, enabling an environmentally and socially responsible, healthy, and prosperous environment that improves the quality of life.” See U.S. Green Building Council, About USGBC <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=124>

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Dynamics: Incentives against regulation	standards certification and labeling (VSCL) institutions	counteract	for market incentive to be created
Lack of Authority to Regulate	Public Voluntary Programs	<ul style="list-style-type: none"> Mild incentives to introduce firms to the good will and other potential benefits (green and social premiums) that may result from the voluntary regulatory process 	<ul style="list-style-type: none"> Prescriptive standards must be clearly delineated for actual performance improvements Stringency of standards must be balanced against low participation thresholds necessary to encourage opt-in Complementary monitoring and enforcement devices are needed to ensure compliance

B. NEGOTIATION OF STANDARDS: ADDRESSING GOVERNMENT VOIDS, REGULATORY CAPTURE AND THE RACE TO THE BOTTOM

In addition, private governance institutions may arise where governments have adopted laws that are contrary to the needs and desires of certain populations. Governments may fail to regulate because it would impede important policies relating to economic growth.³⁴⁴ They may also fail to regulate because there is uncertainty about the impacts of regulation.³⁴⁵ Finally, governments can be subject to capture and corruption.³⁴⁶ In the case of pollution, legislators must make a choice between two opposing entitlements: they may grant a firm the right to pollute or grant the public the right to be free of pollution. Sometimes there is uncertainty about the costs and benefits associated with regulation and failure to regulate. There may also be uncertainty about the distributional impacts of the status quo versus regulation. An incorrect or inefficient allocation of entitlements may occur because of these kinds of uncertainty.³⁴⁷

For instance, at the international level, the World Trade Organization Technical Barriers to Trade Agreement prohibits trade discrimination against “like goods.”³⁴⁸ Governments may post regulations that make distinctions based on characteristics that inhere in the goods, “product distinctions,” but they are barred from making “process distinctions” that relate to the process by which the goods are made.³⁴⁹ Process distinctions, such as whether distinctions based on labor standards, human rights conditions or the environmental impacts associated with the manufacture

³⁴⁴ Abbott, *supra* note 4, at 59.

³⁴⁵ *Id.*

³⁴⁶ Mattli, *supra* note 3, at 11; Abbott, *supra* note 4, at 59.

³⁴⁷ Legal theory suggests that if legislators are uncertain about whether a legal entitlement is worth its cost to society, they should allocate the costs to the party that will be able to avoid the social cost most cheaply (the “cheapest cost avoider”). If legislators are uncertain about which party would be the cheapest cost avoider, they should allocate the costs to the party that can most cheaply (a) locate the cheapest cost avoider and (b) pay them to avoid those costs. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability Rules: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1096-97 (1972).

³⁴⁸ Vogel, *supra* note 38, at 161, *see also* Cora Parkers, at 73-87.

³⁴⁹ Douglas A. Kysar, *Preferences for Processes: The Product / Process Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 525, 531(2004).

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and distribution of products, are not viewed as legitimate and may be challenged as non-tariff barriers to trade.³⁵⁰ If states maintain these kinds of regulatory standards in the face of a challenge, they may subject the state to retaliatory trade sanctions.³⁵¹ While the law remains somewhat uncertain,³⁵² the product/product process distinction effectively prohibits governments from imposing these kinds of regulatory standards. There are limits to the reach of the WTO Technical Barriers to Trade Agreement, however. In general, international treaties apply only to nation-states that are signatories to the agreements. They do not apply to corporate or individual actors or to multinational organizations³⁵³ or extend to the activities of private parties unless those actions may be attributed to the states.³⁵⁴ Consequently, there is an opening for private governance to meet public demand.

Private governance systems, such as voluntary standards certification and labeling systems, permit that demand for governance to be met through trade.³⁵⁵ These systems reduce transaction costs to allow parties to trade entitlements.³⁵⁶ To trade, a prospective seller or purchaser of entitlements must identify the party with whom to trade,³⁵⁷ communicate with them, and negotiate.³⁵⁸ Voluntary standards, certification and labeling systems allow consumers with preferences for processes (fair trade coffee, sustainably harvested sea food, bird friendly coffee) to overcome three challenges to trade.³⁵⁹ First they identify the cheapest cost avoiders with whom trades must be made to eliminate the negative externalities (environmental and other harms).³⁶⁰ Second, they empower consumers to make those trades.³⁶¹ No individual has sufficient wherewithal to pay the manufacturers to shift their production practices, shoulder additional transition costs, and risk unfair competition from parties conducting business under the dominant industrial practices; therefore, it is necessary to aggregate consumer interests to

³⁵⁰ Vogel, *supra* note 38, at 161.

³⁵¹ *Id.*

³⁵² World Trade Organization cases do not have precedential effect. Recent cases appear to show some tolerance for the environmental concerns of nation states, however. In addition, the WTO has granted a specific waiver from the Technical Barriers to Trade Agreement for conflict diamonds, indicating that social screening devices may be permitted under some circumstances. *See id.* at 173.

³⁵³ Williams, *supra* note 186 at 481.

³⁵⁴ Wirth, *supra* note 185, at 95.

³⁵⁵ When governments allocate rights inefficiently, consumers adjust to the increased health risks associated with pollution in a number of ways. One way is to reduce risk by reducing exposure. For air pollution this may require moving to rural areas, for water pollution, it may entail installing special water filters. If a consumer is concerned about exposing himself to chemical toxins in food produced with chemical fertilizers and pesticides, he can pay farmers to grow produce without those substances. Both governments and private governance institutions employ standards, certification and labeling mechanisms. When the government has allocated risks and costs to the public that members of the public do not want to bear, these mechanisms allow the public to pay a premium to avoid those risks.

³⁵⁶ Transaction costs are the costs of negotiating. Calabresi, *supra* note 373, at 1094-95.

³⁵⁷ *See* Guido Calabresi, *THE COST OF ACCIDENTS*, at 150-151 (Yale U. Press 1970).

³⁵⁸ As discussed above, if a large number of parties are involved on either side of the transaction, communication becomes more difficult. If many parties must be pulled together to trade an entitlement, there are collective action problems; each party individually has the incentive to free ride. If there are a large number of parties from whom entitlements must be purchased, there are coordination problems, including problems with hold-outs.

³⁵⁹ *See* Tracey Roberts, *Voluntary Standards, Certification and Labeling Systems: Enhancing Efficiency Through Trade of Entitlements*, University of Louisville Working Paper, at ____.

³⁶⁰ *Id.* at ____.

³⁶¹ *Id.* at ____.

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provide sufficient monetary incentives.³⁶² Finally, voluntary standards, certification and labeling systems negotiate those trades; they create a direct link through the supply chain and use product labeling to signal when that bribe has been made.³⁶³ Labels help consumers identify when their preferences have been met. Voluntary standards, certification and labeling mechanisms allow consumers to procure fair trade practices, fair labor practices, environmental sustainability, human rights protections, and organic farming practices when they acquire goods and services.³⁶⁴ Commodities exchanges also reduce transaction costs associated with trade. The Chicago Climate Exchange not only facilitated negotiation and trade between willing buyers and sellers of carbon offsets, but it also provided third-party verification services to ensure the buyer of the value of the good it was purchasing.³⁶⁵

While legislators on occasion may allocate entitlements inefficiently because of uncertainty, more frequently, an inefficient allocation of rights occurs because of legislative or agency capture. In these situations, legislators or bureaucrats promulgate regulations that are more favorable to targeted industries to be regulated than to the public.³⁶⁶ Regulation may also provide preferential benefits to certain members of a regulated industry, a situation known as “regulatory capture.”³⁶⁷ There are a number of reasons why this would be a common outcome. Pro-regulatory groups, such as environmental or other public interest organizations, have higher transaction costs because of the difficulty of collective action and the likelihood of free-riding.³⁶⁸ In contrast, industry has access to resources and advantages in terms of organization, hierarchy, lines of authority, and a profit motivation to lobby successfully against regulation or for lax or preferential regulation.³⁶⁹ The likelihood of capture is greater. Public regulatory capture frequently occurs because there has been a democracy deficit in the legislative process.³⁷⁰ When the process for promulgating regulations occurs in closed, exclusive fora that provide minimal transparency, the likelihood of capture is high.³⁷¹ In contrast, when structures for procedural due

³⁶² *Id.* at ____.

³⁶³ *Id.* at ____.

³⁶⁴ Another example, explored more fully in *Voluntary Standards, Certification and Labeling Systems: Enhancing Efficiency Through Trade of Entitlements*, explains the rise of organic food clothing and toxin free building materials in light of public demand to avoid toxins. The necessity of instituting voluntary standards, certification and labeling mechanisms for organic food and other items arises from the relative allocation of entitlements between the public and chemical producers under the Toxic Substances Control Act.

³⁶⁵ _____
³⁶⁶ Buzbee, *supra* note 350, at 44-45.

³⁶⁷ *Id.* (“Most significantly the path-breaking early work of Professors Stigler, Becker, and Petzman is primarily concerned with how diverse interest groups will compete for regulatory spoils. The result of this competition is typically not excessively burdensome regulation addressing social ills, but regulation favoring regulatory targets, weak regulation or no regulation at all.”). *See also* Mancur Olson, *THE LOGIC OF COLLECTIVE ACTION, PUBLIC GOODS AND THE THEORY OF GROUPS* __ (Harv. U. Press 1965).

³⁶⁸ Buzbee, *supra* note 350, at 47.

³⁶⁹ *Id.* at 18 (“Those with significant monetary stakes in environmental policy will have great incentives to succeed in markets or politics and those with possibly greater aggregate interests but lesser individual stakes will often have insufficient stakes to remedy market harms or succeed in political competition.”). *Id.* at 40 (“Mancur Olson’s classic analysis of collective action dynamics acknowledges that the very decision to form a group requires unlikely efforts overcoming free-riding proclivities. Still, those with a concentrated stake in a regulatory issue are, due to their relatively higher monetary stake and smaller numbers, more likely than dispersed citizens to overcome collective action hurdles.”).

³⁷⁰ _____ [Democracy deficit.]

³⁷¹ Mattli, *supra* note 3, at 16. *Cf.* Richard B. Stewart, *Madison’s Nightmare*, 57 U. CHI. L. REV. 335 (1990).

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process are in place, when interested participants have multiple points of access to understand what is being proposed and when all impacted have an opportunity to participate, the likelihood of generating regulation in the public interest is high.³⁷²

Private governance systems seek to avoid capture by including structures that provide for transparency, encourage inclusive and broad participation by assorted interest groups, enforce procedural due process requirements, and include substantive rules that reflect broader law and social norms.³⁷³ Many private governance institutions permit participation by any "interested party."³⁷⁴ In general these parties are included as members and stakeholders; resources may even be provided to permit low-income individuals and those representing minority interests to participate.³⁷⁵ Decentralization deters capture.³⁷⁶ To come to agreement, the parties that will be impacted by potential regulation must participate as well as those that seek to regulate.³⁷⁷ Since participation is voluntary, if the parties to be regulated are not involved in the standards setting process, they may choose not to comply.³⁷⁸ In addition, if the process for negotiating and setting the regulations is not open and fair, the public will not continue to participate in the process or, after the standards are promulgated, demand compliance.³⁷⁹

Regulation-setting may occur through a deliberative process that includes a number of familiar procedural due process protections, including transparency, public right of comment on proposed rules, and fair and consensus-based decision-making. The process for rule making may also provide for direct democracy, since rules are developed largely by consensus, with both the constituencies impacted by the matter being regulated and groups that will be impacted by the regulation negotiating the rules.³⁸⁰ Many private governance regulations themselves are based in familiar sources of law, including international treaties, United Nations documents, state laws, and the rules and regulations of academic and professional associations.³⁸¹ Private governance systems show deference for, and sometimes incorporate by reference, the public laws of the country in which they are to be applied.³⁸² In addition, some processes employ reason and refer to empirical results in deliberating appropriate rules and include structures to modify policies over time to improve performance based on these evaluations.³⁸³

³⁷² Mattli, *supra* note 3, at 17-20.

³⁷³ Meidinger, *supra* note 218, at 533. *See also* ELINOR OSTROM, UNDERSTANDING INSTITUTIONAL DIVERSITY 263-64 (Princeton 2005) (noting that when rules have been made by a local elite or a government agency, research reveals higher levels of theft and free-riding; in contrast, when those that are governed by the rules have made the rules, participants show increased cooperation).

³⁷⁴ Meidinger, *supra* note 218, at 526.

³⁷⁵ *Id.* at 526-527 (note, however, that industry-based organizations tend to strictly limit participation to select industry groups in setting regulations).

³⁷⁶ Mattli, *supra* note 3, at 11 n.11; Abbott, *supra* note 4, at 79.

³⁷⁷ Abbott, *supra* note 4, at 46.

³⁷⁸ Young, at ___; Ostrom, *supra* note 274, at 264-65 (discussing how participants who have had a hand in crafting local rules to govern common pool resources, understand the rules and why one rule was chosen over another, tend to follow the rules more than those on whom rules have been imposed from the outside).

³⁷⁹ Abbott, *supra* note 4, at 46.

³⁸⁰ Meidinger, *supra* note 218, at 529.

³⁸¹ *Id.*

³⁸² *Id.* at 530.

³⁸³ *Id.* at 529; Abbott, *supra* note 4, at 62.

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Many private governance systems use a tripartite structure that separates decision-making bodies into private sector, civic sector and government sector groups; this permits all interested parties to be included in the deliberative process but checks the power of each group to avoid regulatory capture within the institution.³⁸⁴ The greater the number of parties involved at each stage of the regulatory process, the more resistant the institution will be to capture, simply because the expense of influence increases as the number of parties involved at each stage of the regulatory process increases.³⁸⁵ Note that not every private governance institution incorporates these democratic and participatory structures.³⁸⁶ However, those systems that include these structures enjoy greater legitimacy and public support.³⁸⁷

When production and supply networks cross jurisdictional boundaries,³⁸⁸ implementing standards becomes even more difficult. As discussed in the section above, firms may prefer to flee a jurisdiction than to be subject to regulations. In a related practice, firms sometimes create subsidiaries outside of the regulating jurisdiction and execute a subcontract with that entity to outsource the offending activity.³⁸⁹ They may avoid regulatory requirements by subcontracting to other companies, outsourcing risky behavior to companies that do not meet size or jurisdictional thresholds.³⁹⁰ In addition they may enter into private contracts that mandate conditions that will permit the parties to avoid falling within the technical parameters of existing regulations.³⁹¹

Contract law has become a source of private governance to incentivize regulatory compliance from firms.³⁹² Investors and lenders perform due diligence investigations prior to investment and create financial incentives for compliance as a condition to funding. Insurance companies require compliance as a condition to issuing a policy and failure to comply may delay or scuttle a transaction.³⁹³ When nongovernmental organizations, investors, lenders, insurance companies or consumers require firms to comply with quality control or social or environmental standards, supply chain anchors cannot always rely on state regulation to ensure compliance in global trade. They have turned to third party assurance services where regulatory and enforcement structures have proven inadequate.³⁹⁴ Legal scholars have followed the expansion of demand for third-party assurance services to audit compliance with social and environmental standards.³⁹⁵ Environmental and social provisions contained in global supply chain contracts

³⁸⁴ See U.S. Green Building Council, Forest Stewardship Council.

³⁸⁵ See Vandenberg, *supra* note 45, at 2073-74.

³⁸⁶ Compare the ISO system for promulgating regulations with the system provided by the ISEAL Alliance, for example.

³⁸⁷ Young at _____. Institutions that have rules for inclusive participation, transparency and consensual agreement in setting standards tend to be more successful because they allow individuals to have a say in the institutions that govern their activities. If impacted parties do not have the right to participate, to provide input, and to witness the deliberation, communities are unlikely to perceive the process and the final governing standards as fair. Consequently, they are less likely to abide by them.

³⁸⁸ Vogel, *supra* note 38, at 159.

³⁸⁹ Vandenberg, *supra* note 45, at 2034.

³⁹⁰ *Id.* at 2088.

³⁹¹ *Id.*

³⁹² Vandenberg, *supra* note 45, at 2044.

³⁹³ Barrows, *supra* note 95, at 202-206.

³⁹⁴ Blair, *supra* note 170, at 329.

³⁹⁵ See *id.* at 329; Li-Wen Lin, *Legal Transplants Through Private Contracting: Codes of Vendor Conduct in Global Supply Chains*, 57 AM. J. COM. L. 711, 714-16 (2009).

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transplant social and environmental standards in foreign countries.³⁹⁶ While multinational corporate goals may simply be to meet investor and consumer demands, their exercise of bargaining power may be seen to benefit the residents of countries in which environmental and labor regulation may be precluded because of democracy deficits.³⁹⁷

Table 2. Negotiations Stage

Barrier /Hazard	Suppliers	Structure Supplied	Characteristic for Effectiveness
Misallocation of entitlements from uncertainty or mistake	Voluntary standards, certification and labeling institutions (VSCLs)	<ul style="list-style-type: none"> Mechanism to permit trade of entitlements 	<ul style="list-style-type: none"> Structures to address knowledge problems from credence goods (certification and labeling mechanisms) Structures to reduce transaction costs (identification of parties, negotiation of price)
Regulatory capture	NGOs, VSCLs	<ul style="list-style-type: none"> Alternative avenue for regulation 	<ul style="list-style-type: none"> Tripartite or other structures to ensure representation of different stakeholders to prevent domination by one group Open, transparent structures to provide informational access and avoid secrecy Deliberative, consensus structures for inclusive participation and to prevent capture by narrow interests

C. IMPLEMENTATION: ALTERING INCENTIVE STRUCTURES

A number of private governance institutions have arisen solely to reduce costs associated with compliance or to address market uncertainties. Public voluntary programs and negotiated agreements are favored not only because they give firms the ability to negotiate the standards that they will meet, but allow them to meet given standards with greater flexibility. Few regulatory mandates impact all firms the same way. Traditional command and control regulation lacks the flexibility to permit firms to share the costs and responsibilities of compliance. Older facilities may have higher compliance costs and may pass those costs onto the public in higher priced goods. Newer firms may be able to meet standards with minor changes at low cost, but not use these efficiencies to achieve compliance above what is specifically required of them. Public voluntary programs and negotiated agreements allow firms to innovate in determining how they will achieve industry compliance. When governments set standards but delegate to industry to resolve the allocation problem, the industry may choose to allocate responsibility for meeting standards according to a firm’s ability to comply. They may also adopt a cap-and-trade

³⁹⁶ *Id.*

³⁹⁷ *Id.* at 716. While the low levels of implementation may not yet result in substantial environmental and social benefits, their influx appears to have prompted the consideration, and in some circumstances, the adoption of certain legal reforms. *Id.* at 738.

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style allocation where the older firms may pay the newer firms to reduce their emissions to achieve the standard collectively, enhancing efficiency by reducing costs.

To the extent that firms agree to comply with regulatory requirements, they may find the process of implementing the regulations burdensome. Small firms with fewer resources may find the process prohibitively expensive. A number of private governance mechanisms have arisen to facilitate implementation and lower the costs of compliance, including model environmental management systems,³⁹⁸ meta-standards for certification and labeling systems,³⁹⁹ and learning initiatives to assist smaller firms in implementing internal controls.⁴⁰⁰ Models, such as ISO 14001, provide general templates for firms to develop environmental management systems. Meta-standards, rules for rules, such as those developed by ISEAL provide guidance to reduce the costs to certification and labeling systems in developing effective rules and structures. By reducing the costs and sharpening the learning curve associated with rule development, these models lower cost barriers to implementation and accelerate the process. In addition, to the extent that models provide guidelines for data collection and documentation, they permit those concerned with compliance to compare the records of different firms or organizations. By identifying best practices to address the needs of particular industries, sectors and stakeholders, these institutions accelerate learning and ensure effectiveness. Learning initiatives increase capacity within a firm to evaluate and improve performance.

In addition, some institutions reduce the risks and enhance the rewards associated with change. Trade associations have developed codes of conduct designed reduce the risks and the competitive disadvantage faced by a single actor. By encouraging other firms to undertake similar obligations, trade associations reduce the first mover risks to any particular firm. Socially responsible investment (SRI) firms direct investors to companies that are achieving their financial goals in a socially responsible manner. By offering early recognition and the advantages associated with expanded access to capital they provide economic incentives to firms to undertake abatement or other costs associated with meeting investor preferences.

Table 3. Implementation Stage

Barrier /Hazard	Suppliers	Structure Supplied	Characteristic for Effectiveness
Market Uncertainties	Models and metastandards	<ul style="list-style-type: none"> Reduce costs by providing templates, best practices 	<ul style="list-style-type: none"> General models have greater interoperability; particularized models have better application to specific problems Prescriptive standards must be clearly delineated Complementary monitoring and enforcement devices are needed to ensure compliance
	Learning Initiatives	<ul style="list-style-type: none"> Reduces costs by providing technical 	<ul style="list-style-type: none"> Knowledge of industry, industry practices, best practices

³⁹⁸ ISO 14001 provides a model for environmental management systems.

³⁹⁹ ISEAL provides guidelines for voluntary standards, certification and labeling mechanisms.

⁴⁰⁰ For instance, the Ethical Trading Initiative assists firms in adopting management and reporting systems associated with labor practices and facilitates dispute resolution.

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		support implementation for	<ul style="list-style-type: none"> Complementary monitoring devices are needed to verify improvement
	Environmental Management Systems	<ul style="list-style-type: none"> Systematizes implementation 	<ul style="list-style-type: none"> Prescriptive standards must be clearly delineated Complementary monitoring and enforcement devices are needed to ensure compliance
	Codes of Conduct	<ul style="list-style-type: none"> Levels the playing field for participants in industry 	<ul style="list-style-type: none"> Monitoring is necessary to prevent free-riding Prescriptive standards must be clearly delineated for actual performance improvements Complementary monitoring and enforcement devices are needed to ensure compliance
	Negotiated Agreements	<ul style="list-style-type: none"> Lowers firm cost by increasing flexibility of firm response 	<ul style="list-style-type: none"> Prescriptive standards must be clearly delineated for actual performance improvements Complementary monitoring and enforcement devices are needed to ensure compliance High transactional costs of negotiating individual agreements requires far greater resources; group leadership must have authority to bind members and shift governance costs to regulated entities
	Socially Responsible Investment	<ul style="list-style-type: none"> Supports first mover advantage and incentivizes voluntary efforts 	<ul style="list-style-type: none"> Complementary reporting initiatives needed to obtain information on firms Information needed on prescriptiveness of standards, third-party monitoring results
	Voluntary Standards Certification and Labeling Institutions	<ul style="list-style-type: none"> Provides technical assistance, management systems, and trains consultants to advise participants on program requirements and implementation; 	<ul style="list-style-type: none"> Prescriptive standards must be clearly delineated Complementary monitoring and enforcement devices are needed to ensure compliance

D. MONITORING AND ENFORCEMENT: TRADING ENTITLEMENTS AND SHIFTING MORES

If rules are to be effective, they must be enforced. This requires governments to devote resources to monitor compliance and address non-compliance. An economic model of the deterrence effect of sanctions predicts that firms will comply with regulation to the extent that the penalties for noncompliance, when multiplied by the risk of getting caught, exceed the

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benefits from cheating.⁴⁰¹ In other words, the funds a firm will invest to comply with regulations will depend on potential cost of sanctions for noncompliance, discounted by the risk of being caught, prosecuted and fined.⁴⁰² A demand for private governance institutions also arises when the policies in accord with public interest have been signed into law, but are not being enforced. This occurs when the legislation contains no requirements for monitoring and enforcement, when too few funds are allocated to develop the infrastructure required for monitoring and enforcement, and when corruption or other factors render monitoring and enforcement ineffective.

Private governance has supplied a number of innovative mechanisms to address needs for monitoring and enforcement. For instance, equity investors, lenders and insurers conduct due diligence prior to investment and release of funds. Insurers and supply chain anchors may engage third party assurance providers or may conduct audits themselves to ensure compliance. Supply chain anchors reward compliant suppliers with continued future contracts. Insurers conduct inspections and reward compliant parties with insurance contracts and, potentially, lower rates. Nongovernmental organizations investigate firm activities and employ “name and shame” tactics to alert the public to serious impacts. The threat of negative news media reports, the loss of market share and investors, the threat of government regulation, combined with the desire of firm owners, managers and employees to maintain an image of public integrity, press firms toward environmental improvement.⁴⁰³ Firms that can demonstrate that they meet or exceed the standards set by societal norms can also receive the positive attention and increased investment.⁴⁰⁴

Table 4. Monitoring

Barrier /Hazard	Suppliers	Structure Supplied	Characteristic for Effectiveness
Credence Problem: Incentives to cheat on implementation unless monitoring	Audit firms	<ul style="list-style-type: none"> Monitors whether standards have been met 	<ul style="list-style-type: none"> Training and independence needed so reports to firms, NGOs, investors, insurers, supply chain anchors, public are accurate (credence problem) Complementary reporting initiatives needed to supply

⁴⁰¹ Lyon, supra note 3, at __; Jonothan Gruber, PUBLIC FINANCE AND PUBLIC POLICY 176 (Worth Publishers 2004). From an economic point of view, firms would comply with regulations when the value to be gained from cheating is less than the amount of penalty multiplied by the risk of getting caught out of compliance. If the penalty times the risk of getting caught is greater than the value of cheating, then a firm will comply with the regulations. However, if the costs of monitoring are high, such as when there are many sources of environmental harm, then monitoring will not occur as frequently. If monitoring is done less frequently or less comprehensively, the risk of getting caught is low and firms will be incentivized to cheat.

⁴⁰² See Williams, supra note 186, at 493, citing Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968). This analysis derives from the “logic of consequences” used primarily in law, economics, and political science. Sociology would interpret compliance activities somewhat differently, from the “logic of appropriateness” where compliance activities communicate to shareholders, future investors, lenders, insurers, regulators and the general public a commitment that is inculcated through socialization into a shared culture. Abbott, supra note 4, at 63.

⁴⁰³ See Michael A. Livermore, Reviving Environmental Protection: Preference Directed Regulation and Regulatory Ossification, 25 VA. ENVTL. L. J. 311, 330-331 (2007).

⁴⁰⁴ See *id.* at 332.

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			audit information on firms to SRI investors
Credence Problem: Selection signaling	Voluntary standards certification and labeling (VSCL) institutions	<ul style="list-style-type: none"> Monitors whether standards have been met 	<ul style="list-style-type: none"> Training needed so goods accurately and consistently labeled Checks on conflicts of interest: Independence of monitors from standards setting groups, from private contractors assisting with implementation, and from participants Accessible dispute resolution mechanisms

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Common pool resources pose additional sustainability challenges. Collaboration problems, such as those that arise in maintaining common pool resources, require communities to develop rules relating to harvesting, to develop the means to monitor compliance with those rules, and to sanction and deter violations of the rules.⁴⁰⁵ For resources, such as fisheries and forests, the institution must define the boundaries of the resource and create barriers to entry.⁴⁰⁶ To the extent that an institution governing a common pool resource fails to set boundaries on the resource and limit new entrants, it will not be able, at least on the supply side of the resource, to prevent the resource from being depleted. If a community cannot enforce agreed-upon harvesting limits, either because it cannot ensure that the parties are adhering to the agreement or because it cannot control harvesting by outsiders, it will not be able to maintain the resource for the long term.⁴⁰⁷ Voluntary standards, certification and labeling systems alter incentive structures to create a market for resource protection and sustainable resource harvesting practices. These systems engage retailers and consumers who are willing to pay a premium to ensure the long-term availability of supply and sustainable practices. The institutions use those premiums to cover the costs of enhanced monitoring of the resource and enforcement of sustainable practices.

Yet these incentive systems have their own challenges. When a consumer cannot discern the quality of the good before, during or after use, those goods are known as “credence goods.”⁴⁰⁸ While most contractual activity requires parties to monitor the behavior of their business partners and to enforce their contractual rights, credence goods pose additional concerns. Asymmetric information creates an opportunity for opportunistic behavior.⁴⁰⁹ As with many environmental concerns about pollutants, consumers concerned about other social conditions cannot discern whether the goods they have purchased were manufactured under hazardous or unfair working conditions, traded under monopolistic terms or extracted at the cost of human life.⁴¹⁰ Credence goods give rise to two separate problems: selection problems and monitoring problems.⁴¹¹ Consumers and investors face selection problems in identifying the goods that meet their preferences. In addition, firms that develop systems to meet consumer and investor

⁴⁰⁵ Oran R. Young, *Building Regimes for Socioecological Systems: Institutional Diagnostics*, in *INSTITUTIONS AND ENVIRONMENTAL CHANGE: PRINCIPLE FINDINGS, APPLICATIONS AND RESEARCH FRONTIERS* ____ (Oran R. Young, Heike Schroeder & Leslie A. King eds., MIT 2008).

⁴⁰⁶ *Id.* at 127; Ostrom, *supra* note 373, at ____ Elinor Ostrom has identified eight design factors seen regularly in long-lived private governance institutions that have been developed that to govern common pool resources. One of the key design factors is that the governance system clearly defines and maintains the boundaries for the resource and establishes clear rules to identify the parties that use the resource.

⁴⁰⁷ *Id.* This comports with Ostrom’s observation that in robust regimes developed to maintain common pool resources participants often act as their own monitors or choose their own monitors. *See* Ostrom, *supra* note 373, at 265.

⁴⁰⁸ Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 *J. LAW & ECON.* 67, 68-69 (1973) (“Credence qualities are those which, although worthwhile, cannot be evaluated in normal use. Instead the assessment of their value requires additional costly information.”).

⁴⁰⁹ King, *supra* note 15, at 1092.

⁴¹⁰ Whether or not resources have been extracted as a result of exploitative practices or a product has been manufactured using slave labor and whether these items are transferred up the supply chain for less than their fair market value because of the exercise of power is not visible to the consumer. Furthermore, media coverage of human rights violations may be difficult to obtain, particularly in developing countries.

⁴¹¹ King, *supra* note 15, at 1092.

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preferences must be monitored to ensure that the systems actually deliver on what the firms have promised. In these situations consumers and investors must generally rely on the reputation or assurances of other parties.⁴¹² Voluntary standards, certification and labeling systems address compliance issues by creating structures for monitoring and using labels to signal consumers that a firm or a set of goods is in compliance and conforms to their preferences.⁴¹³ In addition, the institutions make self-restraint easier by providing and labeling an alternative, more sustainable, option to meet consumer demand.⁴¹⁴

Monitoring and enforcement of the supply of credence goods is inherently problematic. The same difficulties that institutions face in verifying that goods are legally harvested, organic, traded fairly, produced in a sustainable, ecosystem-friendly manner, investors face in discerning whether their investments are supporting their investment goals. Institutional investors that use environmental or social criteria to select potential targets for investment generally obtain information from reporting initiatives, such as the Global Reporting Initiative and the Carbon Disclosure Project, which provide information to the public, to institutional investors and to supply chain anchors about firm performance along environmental and social parameters. To the extent that any of these institutions rely on firm reports and do not include independent third party monitoring and verification, they may not achieve their goals, since the matters being reported are credence matters; without independent investigations no one can discern whether standards have been met. Chain of custody and other verification systems are also vulnerable to fraud; identifying, documenting and segregating firms or products based on social and environmental criteria is expensive.⁴¹⁵ With credence goods, there is always an incentive to cut the process short or to cheat. In addition, if the standards set by these organizations fail to be sufficiently prescriptive or include appropriate metrics,⁴¹⁶ or if the audits are not sufficiently rigorous, any certification process may be seen as simply symbolic⁴¹⁷ and will only add to the costs of doing business without procuring actual changes in social and environmental conditions.

It may be important to separate out the functions associated with different phases of regulation in order to maintain legitimacy. For example, civic organizations have expressed concern about the independence of monitoring agencies that are paid by the entities being monitored.⁴¹⁸ Firms have expressed concern that organizations setting the standards may not be sufficiently removed from their advocacy roles to provide a fair assessment of compliance.⁴¹⁹ Other institutions have separated implementation functions from monitoring functions to ensure

⁴¹² Darby, *supra* note 434, at 69.

⁴¹³ Vogel, *supra* note 38, at 183.

⁴¹⁴ For instance, the Forest Stewardship Council certifies forest products so that consumers may avoid illegally and unsustainably harvested wood and instead choose products that have been sustainably harvested. Similarly, the Marine Stewardship Council, through their certification and labeling of fish and marine products, seek to increase consumer awareness about illegal, unreported and unregulated fishing and shift consumption toward more sustainable harvesting. Unfortunately any the gains in sustainability that consumers make through self-restraint may be undermined if new markets increase demand. Unless those norms can be spread to include all parties that consume the harvest, the institution will not be effective in reducing demand.

⁴¹⁵ King, *supra* note 15, at 1092.

⁴¹⁶ Courville, *supra* note 12, at 280. Concrete performance benchmarks are important otherwise there is a lack of clarity resulting in problems with credibility. *Id.* at 283.

⁴¹⁷ King, *supra* note 15, at 1094.

⁴¹⁸ _____, at ____.

⁴¹⁹ Courville, *supra* note 12, at 283.

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that the monitors have no conflicts of interest between their role as monitors and their business interests in assisting with implementation.⁴²⁰

Another source of conflict arises when parties that are subject to monitoring or enforcement dispute the conclusions drawn by the monitor or allege that the enforcement processes are being applied unfairly or equally. Again, when these conflicts arise, the system can undergo a loss of credibility and legitimacy; this may result in participants withdrawing from the private governance scheme or increased cheating.⁴²¹ These outcomes can be avoided if the private governance institution has developed conflict resolution mechanisms that allow participants to resolve their disputes cheaply and quickly.⁴²²

Independent of the possibility of punishment, the mere existence of a known law may also influence behavior.⁴²³ In a coordination game, knowledge of the law may change behavior, even without the threat of sanctions.⁴²⁴ Under post-structuralist theory, political scientists see individuals as shaped by the ways that governments exercise power.⁴²⁵ Governments are thought to achieve their ends less by forcing people to comply with state-mandated goals than by making them confederates.⁴²⁶ In addition, governance systems and the discourses surrounding them are thought shape public perception of social or environmental problems.⁴²⁷ When the dominant discourse changes, institutional change occurs.⁴²⁸ Similarly, under sociological theory, individuals are thought to take action based on the logic of appropriateness rather than the result of a conscious cost-benefit analysis;⁴²⁹ institutions are viewed as social practices, individuals' identities are shaped by their membership in groups, and they comply with rules as a matter of habit.⁴³⁰ These theories are supported by empirical evidence. To the extent that a community's

⁴²⁰ *Id.* at 283.

⁴²¹ Young at ____; Courville, *supra* note 12, at 290.

⁴²² Ostrom, *supra* note 373, at 267-268 (noting that (1) all rules are subject to interpretation, (2) conflicts arise between participants even when they have made the rules jointly, (3) low cost conflict resolution mechanisms not only address immediate conflicts, but reduce conflicts as the community becomes aware of the way the conflicts have been resolved and the rules have been interpreted, and (4) such mechanisms also deter capture by local elites).

⁴²³ See Williams, *supra* note 186, at 482, *citing* Richard H. McAdams and Janice Nadler, *Testing the Focal Point Theory of Legal Compliance: Expressive Influence in an Experimental Hawk/Dove Game*, 2 (August 2003)(Nw. L. Legal Working Paper Series. L. and Econ. Papers, Working Paper no. 29), *available* at <http://law.bepress.com/nwwps/lep/art29>.

⁴²⁴ See Williams, *supra* note 186, at 482.

⁴²⁵ Lemos, *supra* note 8, at 84 (much of this work based in the work of Michele Foucault).

⁴²⁶ Lemos, *supra* note 8, at 84-85. These theories suggested that individuals' private lives and actions are also shaped by the way that knowledge is represented. In the process of following certain modes of thought, or "discourses," and engaging in certain practices, individuals posit themselves as subjects and take actions consistent with that subjectivity. When the dominant discourse changes, institutional change occurs. This line of inquiry is thought to be relevant particularly for market-based forms of governance that posit individuals as global citizens and consumers and that label goods for consumption and for social responsible investment and the kinds of programs that shape the information reported by firms along their investment parameters. See Young at ____.

⁴²⁷ Young terms this method of examination a "knowledge – action" perspective. Oran R. Young, *Institutions and Environmental Change: The Scientific Legacy of a Decade of IDGEC Research*, in INSTITUTIONS AND ENVIRONMENTAL CHANGE: PRINCIPLE FINDINGS, APPLICATIONS AND RESEARCH FRONTIERS, ____ (Oran R. Young, Heike Schroeder & Leslie A. King eds., MIT 2008).

⁴²⁸ Young, *supra* note 431, at 8.

⁴²⁹ *Id.* at 7.

⁴³⁰ *Id.*

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belief systems, norms, culture and sense of connectedness create a culture of compliance, it reduces the need to develop complex systems for monitoring and enforcement and reduces the costs of enforcement.⁴³¹ On the other hand, if the parties that are participating in the governance system share no common norms or share norms of noncompliance, the costs associated with enforcing the regime will be higher.⁴³²

Some private governance systems target the demand side by activating norms associated with harvesting.⁴³³ By “making externalities more visible” voluntary standards, certification and labeling systems also enhance efficiency; when consumers are put in a position to see the environmental impacts of their consumption choices and to pay a premium to internalize the externality, they may choose the good with a lower environmental or other social cost.⁴³⁴ Private governance institutions not only enable customers to express existing preferences, but also shift those preferences; by providing information, rankings, and third-party certification and labeling, they engender and strengthen norms.⁴³⁵ By educating and informing consumers about the consequences of over-harvesting, these institutions seek to engender certain values and encourage consumers to internalize boundaries on what they will and will not consume. Labeling, and the opportunity to make a choice as a consumer invites consumers to see themselves as citizen/consumers and take action through their consumption choices and purchasing power.⁴³⁶ To the extent consumers use self-restraint in their consumption, monitoring and enforcement are internalized.

Table 5. Enforcement

Barrier /Hazard	Suppliers	Structure Supplied	Characteristic for Effectiveness
Incentives to cheat on implementation	Supply Chain Anchors	<ul style="list-style-type: none"> Contractual enforcement mechanisms for breach and default: nonpayment and reduced payment; termination of contract 	<ul style="list-style-type: none"> Complementary monitoring devices and credible threat of enforcement needed
	Insurance Contracts	<ul style="list-style-type: none"> Refusal to insure after underwriting; refusal to pay claims; offer of reduced premiums for compliance; increased premiums for noncompliance 	<ul style="list-style-type: none"> Underwriting review Complementary monitoring devices and credible threat of enforcement needed

⁴³¹ *Id.* at 15; Ostrom, *supra* note 373, at 265 (noting, however, that few institutions that rely solely on trust and reciprocity endure for long periods). Regular monitoring and enforcement by local groups has a higher correlation with improved forest strength than the participants’ degree of reliance on the resource, the level of formal organization, or the degree of social capital within the group. *Id.* at 266.

⁴³² Young, *supra* note 431, at 15. *See also* Livermore, *supra* note 429, at 333.

⁴³³ Norms are internalized rules; individuals who fail to observe norms experience mental discomfort and may be shunned within their community. Livermore, *supra* note 429, at 332.

⁴³⁴ Roberts, *supra* note 121, at ___; *see also* Livermore, *supra* note 429, at 330.

⁴³⁵ Roberts, *supra* note 121, at ___; *see also* Livermore, *supra* note 429 at 326-28.

⁴³⁶ Kysar, *supra* note 375, at ___.

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	Lending Contracts	<ul style="list-style-type: none"> Refusal to loan after underwriting; loan enforcement mechanisms: stop payment, default interest rates, fines, acceleration of debt; decision making rights of use of loan proceeds; calls on collateral and cross-collateralized debt 	<ul style="list-style-type: none"> Underwriting review Due diligence review Complementary monitoring devices and credible threat of enforcement needed
	Equity Investment Contracts	<ul style="list-style-type: none"> Refusal to contract following due diligence review; enforcement of indemnification agreements; calls on private collateral 	<ul style="list-style-type: none"> Due diligence review Complementary monitoring devices and credible threat of enforcement needed
	SRI	<ul style="list-style-type: none"> Refusal to invest; divestment 	<ul style="list-style-type: none"> Complementary monitoring and reporting devices are needed
	Voluntary Standards, Certification and Labeling Mechanisms	<ul style="list-style-type: none"> Fines; sanctions; exclusion from club (remove participant from membership in label scheme) 	<ul style="list-style-type: none"> Checks on conflicts of interest: Independence of monitors from standards setting groups, from private contractors assisting with implementation, and from participants Accessible dispute resolution mechanisms

E. FUNDING GOVERNANCE, A PUBLIC GOOD

Rules and the institutions that are developed to enforce them are themselves public goods⁴³⁷ and the process of developing rules and bringing them into effect is expensive. In general, private markets will provide an insufficient amount of public goods.⁴³⁸ Public goods are by definition nonrival (if public goods are provided to anyone, everyone can enjoy their benefit without diminishing others' enjoyment of them) and non-exclusive (those who pay for the goods cannot exclude others from their enjoyment).⁴³⁹ Consequently, not everyone will pay to the extent of their enjoyment of public goods because they can rely, or free-ride, on the efforts of others. Because everyone does not pay, the private market will supply less of the public goods than it would be socially optimal.⁴⁴⁰

Formal governments regulating within their own jurisdictional boundaries have several advantages in funding the regulatory process, particularly the latter stages of the process, implementation, monitoring and enforcement. As many have noted, formal governments have the authority and the power to coerce implementation and compliance through threat of criminal

⁴³⁷ Edela Schlager, *Rationality, Cooperation and Common Pool Resources*, 45 AM. BEHAVIORAL SCIENTIST 801, 804 (2002).

⁴³⁸ Gruber, *supra* note 427, at ____.

⁴³⁹ *Id.* at 170.

⁴⁴⁰ *Id.* at 176.

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or monetary sanction.⁴⁴¹ Possibly more importantly, governments are able to use their power to tax to overcome the free rider problem and cover the costs of developing, effectuating and enforcing new rules.

Unlike governmental regulation, there is also no state authority to impose criminal sanctions or fines for non-compliance⁴⁴² and there is no general taxing authority to cover the costs of the implementation, monitoring, enforcement and conflict resolution processes. Private governance systems must cover the costs of the institutions that they develop, they must allocate those costs among those that benefit from and participate in them, and they must overcome free-rider problems.⁴⁴³ In smaller self-governing communities, Elinor Ostrom has observed that the costs and benefits associated with successful regulatory regimes tend to be proportionate for the participants.⁴⁴⁴ If participants' costs bear no relation to their benefits, they may either opt out or cheat, causing the system to unravel.⁴⁴⁵ The same dynamic is observed at the international level. States must come to an agreement that is collectively acceptable; there is no coercive power to ensure compliance.⁴⁴⁶ To the extent that certain states disproportionately bear the burdens from change and others reap the benefits, a mechanism is required to permit costs to be shared or the agreement will be unstable.⁴⁴⁷

This tension has important consequences for institutional stability. In a representative democracy, the tensions between interest groups tend to occur primarily in the initial stages, when the agenda is set, when the standards are negotiated, and when the programs are funded through the budgetary process. Firms must bear the costs of implementing the regulation or suffer government sanctions. The costs of monitoring, enforcement and conflict resolution are borne by the state and funded through tax revenues. In contrast, in private governance institutions, participants must find resources to cover costs at each of the regulatory stages; consequently, internal tensions among participating interest groups occur throughout the regulatory process.

To develop private governance institutions, most participants must accept the rules at each stage; otherwise, they may opt out. If the parties fail to reach an agreement, no institution is

⁴⁴¹ Vogel, *supra* note 38, at 153; Abbott, *supra* note 4, at __.

⁴⁴² Abbott, *supra* note 4, at 57.

⁴⁴³ Ostrom, *supra* note 373, at 262.

⁴⁴⁴ *Id.* at 262-63.

⁴⁴⁵ *Id.* at 263.

⁴⁴⁶ LOCAL COMMONS AND GLOBAL INTERDEPENDENCE: HETEROGENEITY AND COOPERATION IN TWO DOMAINS ____ (Robert O. Keohane & Elinor Ostrom eds., Sage Pub. 1995).

⁴⁴⁷ Note that this phenomenon has been observed in the common pool resource context and is the basis in part for caution against using any particular governing approach as a panacea. Following recognition of the extent to which the Earth's ecosystems were subject to a tragedy of the commons problem, many governments began to privatize forests and other natural resources, following the approach suggested by Garrett Hardin. Because many governments failed to allocate adequate resources to monitoring and enforcing restrictions on harvesting, the rate at which harvesting occurred accelerated, exacerbating the problem. In contrast, forests governed by local communities that assigned monitoring duties to individuals that would benefit directly from enforcement of the harvesting limits fared well. Ostrom, *supra* note 274, at 23.

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developed and no regulation occurs.⁴⁴⁸ If parties reach an initial agreement, but lack sufficient means or incentives to implement, the policy will not be implemented. If there are no mechanisms for monitoring and enforcement or resources to implement them, the incentives to cheat will remain unchecked. If monitoring and enforcement are not performed in a fair manner and there are no systems to permit participants to appeal decisions or resolve disputes, participants may refuse to comply with the rules. The participants in private governance institutions must find resources to fund these regulatory matters themselves, if they are to be addressed at all. Whether the participants have the resources to take on one or more of these regulatory burdens will determine whether the institutions can stand on their own as effective regulatory mechanisms over time or will require supplemental structures or the support from formal government or other private governance institutions. Furthermore, the way the costs of these burdens are allocated among the participants can have a significant impact on the effectiveness of the regulation.⁴⁴⁹

Sources of financial support may also shape the behavior of nongovernmental organizations.⁴⁵⁰ Membership organizations that rely on the financial support of members and grassroots fundraising events tend to take on media intensive activities that raise awareness and shift public debate.⁴⁵¹ In contrast, organizations funded by private foundations often undertake projects that more strongly resemble traditional government activities, such as including the monitoring and regulation of firm behavior and the truthfulness of firm claims, and funding and developing public goods, such as conservation of endangered habitat and development of public utility services.⁴⁵² They may also undertake market-enhancing activities, such as the creation of exchanges to facilitate the trade of environmental goods and or the development of new markets and branding systems to direct public attention to substitute goods that meet consumer social and environmental preferences. The kinds of projects that these institutions undertake may also simply reflect the availability of stable sources of funding; long-term, ambitious projects are less “sexy” in terms of confrontational activity and media interest, but may be more effective in addressing the social and environmental problems. On the other hand, these projects give rise to fewer conflicts with corporate interests, raising questions about whether firm interests are steering nongovernmental organizations’ activities through foundation-based funding.⁴⁵³

Table 6 below identifies the main sources of funding for the various types of private governance institutions.

Table 5. Funding Sources

Institution	Funding Sources
Business	
Firm Programs	Green and social premium; savings from increase in efficiency, lower costs

⁴⁴⁸ Oran R. Young, *Governance for Sustainable Development in a World of Rising Interdependencies*, in GOVERNANCE FOR THE ENVIRONMENT, NEW PERSPECTIVES ____ (Magali A. Delmas & Oran R. Young eds., Cambridge 2009) (on opting out).

⁴⁴⁹ See Ostrom, *supra* note 373, at 262.

⁴⁵⁰ Lyon, *supra* note 101, at 2-3.

⁴⁵¹ *Id.* at 5; Vogel, *supra* note 38, at 169.

⁴⁵² Lyon, *supra* note 101, at 5; Vogel, *supra* note 38, at 154-55.

⁴⁵³ Lyon, *supra* note 101, at 5; Vogel, *supra* note 38, at ____.

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Codes of Conduct	Reduction in competitive risk from competitors; benefits of preempting regulation
Environmental Management Systems	Cost savings from coordination within firm, increased compliance, reduced monitoring.
Acquisition and Investment Contracts	Avoidance of risk of loss from due diligence; shifting of risk of loss through contractual arrangements.
Lending Contracts	Avoidance of risk of loss from due diligence; reduction of risk of loss through contract rights
Supply Chain Contracts	Green and social premium; reduction of risk of loss from unstable supply, contract claims, tort liability.
Insurance Contracts	Avoidance of risk of loss from underwriting; shifting of risk of loss through exclusions from coverage.
Cooperatives	Reduction of risk of loss from information asymmetries and moral hazard; increased profits from increased bargaining power and economies of scale in sales and purchase
Hybrid Private / Govt	
Negotiated Agreements	Reduction in costs of compliance with increased flexibility
Public Voluntary Programs	Green and social premium; enhancement of goodwill
Civic	
NGO Education and Mobilization Initiatives	Private donations; foundation funding, grants
Learning Initiatives	Private donations; foundation funding, grants, fees for services
Reporting Initiatives	Private donations; foundation funding, grants, fees for services
Models and Meta-Standards	Private donations; foundation funding, grants, fees for services
Hybrid Private / Civic	
Audits	Fees for services
Socially Responsible Investment	Investment fees
Hybrid Civic / Govt	
Land Conservancies	Private donations; foundation funding; sales, rents, royalties from lands; tax incentives to donors
Hybrid Private / Civic / Govt	
Certification and Labeling Systems	Price premium for certified goods; membership fees; foundation funding; private donors

Voluntary standards, certification and labeling systems address a portion of the costs of governance by generating market demand to procure a price premium for goods that meet consumer preferences; these funds may be used to cover the costs of monitoring and enforcement, the certification process. Similarly, corporate social responsibility efforts are designed to generate a green premium to contribute to the costs of compliance; firms will initiate changes to the extent their efforts are repaid with returns on investment (or possibly goodwill and social capital) within a reasonable time frame. For firms seeking equity investment, loans, insurance contracts or supply contracts, compliance is simply a cost of doing business. Firms calculate the value of the first and successive contracts and perform a cost benefit analysis. Suppliers may fund the costs of compliance by requiring all buyers to pay a premium. Supply chain anchors reward compliant suppliers with continued future contracts. Insurers reward compliant parties with insurance contracts and, potentially, lower rates. The actual incidence, the distribution of these costs, has not been modeled, but with many of these mechanisms the party that ostensibly pays the costs may pass those costs forward to consumers or investors or backward to suppliers, workers or resource owners. To the extent that key participants do not perceive that they are being remunerated appropriately, they may refuse to continue to participate or to follow the rules of the institution.

III. INTERPLAY

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Part II of this article suggested that private governance systems arise when a demand for governance is not satisfied by formal government. This may occur when formal government lacks the authority to regulate, lacks the ability to overcome collective action problems, or is subject to capture or other public choice dilemmas at any one of five stages of the regulatory process. This section divides up the kinds of interplay that may occur according to the different levels of social organization at which the institutions operate.⁴⁵⁴ “Vertical interplay” describes the kinds of interactions that occur at different levels of society; this article focuses on the interactions between private governance institutions and formal governments.⁴⁵⁵ “Horizontal interplay” describes the interactions that occur between and among private governance institutions.⁴⁵⁶

A. VERTICAL INTERPLAY BETWEEN FORMAL GOVERNMENT AND PRIVATE
GOVERNANCE SYSTEMS

In Part II, the article described many of the ways that private governance systems can complement public governance - by filling gaps where formal government has failed to regulate effectively in the public interest. There are several other ways that private governance systems and formal governments interact in a positive or at least neutral way.

First, private governance may support public regulation by providing additional private enforcement mechanisms. Many private governance institutions require that participants adhere to local and state laws in addition to the rules that the institution proposes.⁴⁵⁷ Since many formal governments in developing countries lack the resources to monitor and enforce their own regulations, private governance fills an otherwise unmet need for monitoring and enforcement. The monitoring and enforcement process may itself reinforce state norms.⁴⁵⁸ Private governance institutions may also reduce the extent of bureaucratic empire building within state structures.⁴⁵⁹ Actions by private governance systems may reduce the need for government action, and may achieve higher levels of performance than delivered through government regulation alone. Firms adopting technological changes through public voluntary programs or negotiated agreements may require less monitoring and enforcement activity simply because they are no longer capable of the same levels of pollution. To the extent that the institution monitors and enforces compliance with law, it reduces the need for government to spend public funds doing so and permits government to shift their resources elsewhere.⁴⁶⁰

⁴⁵⁴ Interplay may occur between different levels of social organization, between institutions working within the same geographic area, and between institutions working on the same problem. Interplay may also result when formal and informal institutions address one or more related problems that interact in complex ways. In addition, interplay may be intentional or may arise as a de facto matter. Finally the interactions between institutions may result in conflict or they result in complementary relationships. Sometimes institutions may even work synergistically. Young, *supra* note 431, at 32.

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.*

⁴⁵⁷ Meidinger, *supra* note 218, at 528; Vogel, *supra* note 38, at 154.

⁴⁵⁸ Abbott, *supra* note 4, at 84.

⁴⁵⁹ Vandenbergh, *supra* note 45, at 2080.

⁴⁶⁰ Richards, *supra* note 228, at 17-19.

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Second, private governance may also have the effect of ratcheting up government standards; they become more stringent through a harmonization effect. In the United States certain federal regulatory regimes have given states some leeway in setting standards.⁴⁶¹ California, because of its size and dependence on automotive transportation, has repeatedly set more stringent automotive emissions standards than the rest of the nation. To ensure that they have access to the lucrative California market and to avoid manufacturing vehicles to meet two different sets of standards, manufacturers have designed all of their vehicles to meet the more stringent California standards. Consequently vehicles in all jurisdictions meet the more stringent standards, a phenomenon dubbed the “California effect.” This phenomenon has also been seen in private governance situations.⁴⁶² Some legal scholars see private governance as a means for firms to import their own legal standards.⁴⁶³ In addition, formal government can provide many forms of support to private governance institutions, including financial support, technical assistance and a level of gravitas in acknowledging the importance of the problem or concern that the institution seeks to address. Formal government has also had positive impacts on private government systems, providing support by convening initial meetings, delivering technical assistance, funding start-up operations and incorporating standards into their procurement processes.⁴⁶⁴ Government may also provide initial startup funding.⁴⁶⁵ To the extent that the programs are housed within nonprofit, tax-exempt organizations, they have the benefit of excluding donated resources and other mission-related revenues from their income. They are also subsidized through tax subsidies that permit, with some limitations, donors to deduct their charitable contributions to the organizations from their income.⁴⁶⁶ Empirically, this subsidy has been shown to have a positive effect on the value of donations received.⁴⁶⁷

⁴⁶¹ Under the Clean Air Act, states are permitted to set higher standards for themselves when they show that they would suffer disproportionately from federal standards that are not sufficiently stringent.

⁴⁶² See Vogel, *supra* note 38, at 158; Cashore (2007) at 158; Ben Cashore, Stefan Renckens, et al., *Can Non-State Governance “Ratchet-up” Global Standards? Assessing their Indirect Effects and Evolutionary Potential* 3 (Sept. 3-6, 2009) (unpublished manuscript prepared for 2009 American Political Science Association Annual Meeting), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1450435. See also Charles Sabel, Dara O’Rourke & Archon Fung, *Ratcheting Labor Standards: Regulation for Continuous Improvement in the Global Workplace*, (Colum. L. Sch. Pub. L. Research Paper 01-21 May 2, 2000)(suggesting that certification and labeling systems may also be used to improve labor standards in other countries), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=253833.

⁴⁶³ Lin, *supra* note 395, at 713; Vogel, *supra* note 38, at 185.

⁴⁶⁴ For instance, the Clinton administration convened the initial gathering of members of the apparel industry and labor activists to discuss ways to improve labor standards within the industry, leading to the formation of the Fair Labor Association. Abbott, *supra* note 4, at 84. Similarly the Green Suppliers Network in the United States provides technical support to retailers and their suppliers and intermediaries to help them reduce environmental and other wastes, resulting in environmental improvement. See U.S. Environmental Protection Agency, Green Suppliers Program, available at <http://www.epa.gov/greensuppliers/> (last modified ???). Similarly, a number of intergovernmental organizations have provided technical support to improve supply chains in Mexico. See Lyon, *supra* note 54, at ____.

⁴⁶⁵ The US Green Building Council received funds at a crucial stage in the development of the organization to cover costs associated with convening environmental organizations, urban planners, professionals within the design and construction industries, and suppliers of building materials, to develop the LEED rating standards and criteria. See David Gottfried, *GREED TO GREEN: THE TRANSFORMATION OF INDUSTRY AND LIFE*, ____ (WorldBuild Publishing 2004).

⁴⁶⁶ Abbott, *supra* note 4, at 84.

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Finally, governments have begun incorporating private governance standards into their procurement policies⁴⁶⁸ and incorporating them into their own regulatory codes either as models or in whole.⁴⁶⁹ Benjamin Cashore and Graeme Auld suggest that this path is part of the evolutionary process for certain forms of private governance, particularly non-governmental, market-driven systems, which are identified descriptively in this article as “voluntary standards, certification and labeling systems.”⁴⁷⁰ This path permits parties to side-step the hazards faced within the formal government and political processes at the first two stages of the regulatory process, the agenda-setting stage, and the negotiation and standards-setting stages. Governments may reduce their costs associated with developing regulations and permits them to build on tested standards. Government adoption would also permit proponents of privately developed rules to side-step the problem of funding the expensive monitoring and enforcement processes. To the extent that industry has not yet implemented systems to meet the private governance standards, there may be significant resistance. Firms that have been early adopters of the new systems will likely champion government mandates, since they may obtain a competitive advantage while non-adopting firms catch up. Note, however, adoption of privately developed standards by formal government may not be the hoped for panacea. Formal government with centralized authority and decision-making provides opportunities for capture that private governance decentralized decision-making may resist. The history of the transition of organic standards from private governance systems developed regionally, to state-controlled mechanisms, and ultimately to the National Organic Program within the U.S. Department of Agriculture provides a cautionary tale.⁴⁷¹

Private governance institutions may also conflict with formal governments in a number of ways. One of the key critiques leveled at private governance institutions is that they crowd out public regulation.⁴⁷² Private governance systems may prevent more effective institutions from being developed,⁴⁷³ they may pull resources away from other more significant problems, or they

⁴⁶⁸ Abbott, *supra* note 4, at 84.

⁴⁶⁹ See U.S. Green Building Council, Resources for Government, *available at* <http://www.leed.us/DisplayPage.aspx?CMSPageID=1779> (last modified ???) (indicating that “LEED initiatives including legislation, executive orders, resolutions, ordinances, policies, and incentives are found in 45 states, including 442 localities (384 cities/towns and 58 counties), 35 state governments (including the Commonwealth of Puerto Rico), 14 federal agencies or departments, and numerous public school jurisdictions and institutions of higher education across the United States.”).

⁴⁷⁰ Graeme Auld, Christina Balboa, Steven Bernstein, & Benjamin Cashore, *The Emergence of Non-state Market-driven (NMSD) Global Environmental Governance: A Cross-Sectoral Assessment*, in GOVERNANCE FOR THE ENVIRONMENT: NEW PERSPECTIVES, 153 (Magali A. Delmas & Oran R. Young eds., Cambridge 2009).

⁴⁷¹ Samuel Fromartz, ORGANIC, INC.: NATURAL FOODS AND HOW THEY GREW, ____ (Mariner Books 2007).

⁴⁷² The political science literatures appear to view private governance, particularly those that are market driven, as simply an outgrowth of neoliberal economics. They suggest that it has been exported and enforced through international structures developed following World War II to facilitate trade. They suggest that they result from neoliberal economic hegemony, and are a continuation of colonial power relations between privileged elites and local communities. Lemos, *supra* note 8, at 82, 88. See also Philipp Pattburg, *The Institutionalization of Private Governance: How Business and Nonprofit Organizations Agree on Transnational Rules*, 18 GOVERNANCE, 589, 597 (2005)(arguing that neo-Gramscian theory suggests that the shift from politics to market-oriented business-sponsored regimes is driven by business and society elites and that nongovernmental organizations become key allies to these groups in securing stability and control). The sociology literature also appears to be skeptical of the utility of turning to private governance systems for similar reasons. See Bartley _____.

⁴⁷³ Young, *supra* note 431, at 110.

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may waste the resources that they receive.⁴⁷⁴ Undergirding this claim is a counterfactual supposition that if a private governance institution had not been developed, political activity would have given rise to government action and that regulation more closely aligned with the public interest would have arisen. While there may be circumstances in which this is true, private governance institutions most often appear to arise in situations where there are institutional voids. At the international level, no single government has authority to regulate or resources to enforce regulation by itself. Therefore, collaboration between governments would be required to regulate effectively. The challenges and costs of cooperation are so high and the benefits are so low, however, that regulation often does not occur. At the state level private governance institutions arise when political actors have been unable to set, maintain or move forward with an agenda or when the regulations that have been negotiated are lax, vague or are otherwise unenforceable because there are no mechanisms, infrastructure or resources for monitoring compliance. Often, private governance systems are pursued as a second-best option when a public solution has been pursued and failed.⁴⁷⁵

A more significant threat is posed by preemption. While most of the legal literature⁴⁷⁶ focuses on both functional and political interplay and the way that private governance mechanisms may undercut regulatory institutions, the economics literature⁴⁷⁷ examines the way that firms make strategic decisions to preempt regulation or resist imposition of more stringent standards by state and federal governments.⁴⁷⁸ By adopting self-regulation, firms may demonstrate that they are taking steps to eliminate or reduce environmental or social impacts or that they are providing payments to address the distributional impacts of their activity by reimbursing the individuals being harmed by their activities.⁴⁷⁹ In doing so, they may seek to deflect regulatory scrutiny and to mollify the public. The central goal of much of this activity is to preempt government regulation. This has often been a successful strategy.⁴⁸⁰ In fact, whether or not firms enter into negotiated agreements or public voluntary agreements or undertake other actions that fall under the umbrella term “corporate social responsibility” appears to depend primarily on whether there is a credible threat of regulation.⁴⁸¹

⁴⁷⁴ *Id.* at 111. *See* Vandenberg, *supra* note 45, at 2071-72 (with respect to concerns about private contracts crowding out judicial and regulatory developments).

⁴⁷⁵ Vogel, *supra* note 38, at 166. There may also be a second level of crowding out at the enforcement level. To the extent that private governance takes up regulatory space for conflict resolution, disputed matters never come before the courts system, reducing the degree to which the judiciary has a voice and reducing the role that the courts and case law play in the governance process. *See* Vandenberg, *supra* note 53, at 2077.

⁴⁷⁶ *See* Vandenberg, *supra* note 45, at 2083 (with respect to concerns about private contracts crowding out judicial and regulatory developments).

⁴⁷⁷ The economic literature indicates states that firms adopt CSR, submit to voluntary programs and enter into negotiated agreements with the express purpose of avoiding the imposition of new regulations. *See* Lyon, at _____. There is some empirical evidence that this has occurred. For instance, Goyert reports that Australian Western Rock Lobster Fishery sought to Marine Stewardship Council certification to avoid new regulations.

⁴⁷⁸ *See also*, Lin, *supra* note 395, at 744 (indicating that China’s adoption of its own form of Corporate Social Responsibility standards may have been a defensive move to prevent the imposition of SA8000).

⁴⁷⁹ ⁴⁸⁰ *See* Abbott, *supra* note 4, at 75 (describing situations in which firms or trade associations have adopted minimally sufficient standards and have avoided public regulation altogether). [Responsible Care Program]

⁴⁸¹ Lyon, *supra* note 3, at 58.

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There is some evidence that preemption may lower social costs associated with regulatory battles but not wholly bar regulation, leaving open the possibility that regulation may occur if the outcomes of the alternate private governance activities are not good enough.⁴⁸² However, nongovernmental organizations face greater transaction costs when compared to firm costs associated with lobbying. Firms have the profit motive, capital, and individual incentives to act collectively to fight regulation; the public is dispersed, lacks hierarchical or authority structures to organize their activities and lacks any profit motive in taking action. Nongovernmental organizations must educate citizens about the risks and costs associated with inaction and persuade those individuals to provide resources to a collective effort that already failed once in procuring public regulation. While it may be possible for consumers and citizens to organize a second time over the same matter if firm preemptive measures are shown to fail, it becomes increasingly more difficult over time if citizen investment in regulation has yielded little return in previous efforts.

Private governance systems cannot easily persist in the face of persistent or catastrophic government failures. Elinor Ostrom identifies a number of threats that can undermine small-scale private governance institutions.⁴⁸³ Based on the literature evaluating various forms of private governance, two of these threats also appear to impact large-scale systems: (1) rapid changes caused by forces much greater than the private governance institutions, such as mass migration and natural or economic disasters,⁴⁸⁴ and (2) corruption and other forms of opportunistic behavior.⁴⁸⁵ As with formal governments, smaller governance systems may find it difficult to manage rapid change, whether those changes result from economic disruption, technological changes or social change. The faster change occurs the more difficult it is for institutions to adapt to new circumstances. Adaptation requires a feedback loop and the ability to change the rules to adapt to modified conditions; to the extent that either are missing, the institution may not be able to sustain itself.⁴⁸⁶ Corruption and rent-seeking also undermine private governance systems.⁴⁸⁷ Illegal logging and illegal fishing undercuts prices, making it more difficult to maintain a price premium sufficient to cover the cost of private governance.

Private government regulation may also undermine private governance systems. Government regulation sets boundaries on what private governance systems may do.⁴⁸⁸ The U.S. Federal Trade Commission has begun to regulate “green” and other claims with respect to labor

⁴⁸² *Id.* Note that pro-regulatory groups may face higher collective action costs and challenges following the resolution of an issue, even if it has not been resolved in a way that is satisfactory. Regulatory outcomes may be path dependent; political will may be more difficult to generate a second time if governmental regulation does not result during the agenda setting stage.

⁴⁸³ Ostrom, *supra* note 373, at 272.

⁴⁸⁴ Coffee study _____

⁴⁸⁵ Ostrom, *supra* note 373, at 276. [Insert information about impacts of illegal logging on FSC and other standards; impacts of illegal, unreported and unregulated fishing on MSC.]

⁴⁸⁶ *Id.* at 264-64.

⁴⁸⁷ *Id.* at 275.

⁴⁸⁸ Government intervention may also completely undermine any efforts to provide private governance. Elinor Ostrom notes that for governance institutions to remain effective over time, formal government must provide at least minimal recognition of rights of the participants to organize themselves and to set their own rules. She noted that in jurisdictions where government barred the parties from organizing and allocating rights and responsibilities, any unhappy participant could call in the formal government to disband the regime. *See* Ostrom, *supra* note 373.

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practices.⁴⁸⁹ The law may also be used strategically. For instance, the Coalition for Fair Forest Certification,⁴⁹⁰ which is comprised in large part, of members of the Sustainable Forestry Initiative, has brought suit against the Forest Stewardship Council⁴⁹¹ claiming that the organization uses unfair and deceptive trade practices in violation of the Federal Trade Commission Act and anticompetitive behavior prohibited under the Sherman Act.⁴⁹² The Coalition has also brought suit against the U.S. Green Building Council’s LEED rating system under the Clayton Act⁴⁹³ on the grounds that they have created an illegal tying mechanism because LEED awards points for sustainably harvested forest products that are certified by the Forest Stewardship Council and not by other certifiers, such as the Sustainable Forestry Initiative.⁴⁹⁴ The law may also prevent legitimate activity from occurring and have a chilling effect on speech. The U.S. Green Building Council has incorporated expansive policies to limit the kinds of discussions that take place among members, and at national and chapter organization meetings in order to avoid circumstances that might give rise to even the appearance of antitrust activity.⁴⁹⁵

B. HORIZONTAL INTERPLAY BETWEEN PRIVATE GOVERNANCE SYSTEMS

Private governance systems may complement one another and, potentially, produce synergistic effects. As noted above in Part II, each type of private governance system has something to contribute to the regulatory process. Not every institution attracts the kind of competencies needed to produce regulation that is in the public interest at every stage, however. In fact, as shown on the attached table, only voluntary standards, certification and labeling mechanisms attempt to address governance needs at every stage of the regulatory process. Table 1 identifies each stage of regulation and the types of private governance institutions that bring resources to bear at each stage.

Table 1: Private Governance Institution Supply at Each Stage of Governance

Institution	Agenda-Setting	Negotiation of Standards	Implementation	Monitoring	Enforcement
Private					

⁴⁸⁹ Insert FTC information _____.

⁴⁹⁰ See Leora Broydo Vestel, *Feud Continues Between Wood Certifiers*, N.Y. Times, Oct. 29, 2009. The Coalition describes itself as an “ad hoc coalition” comprised, in part, of major forest product and timber companies that are members of the Sustainable Forestry Initiative. On its website, the Coalition identifies itself as a “group of family forest landowners, forest product companies, trade associations, and concerned citizens.” See <http://fairforestcertification.com/index.html> (last modified??). The Coalition specifically notes that it is not a charitable organization or tax-exempt entity. See *id.* The first goal of the legal action committee is to “Promote good forest stewardship through the use of consistent, reliable forest certification standards which benefit both the environment and the marketplace for forest products.” See *id.*

⁴⁹¹ *Id.*

⁴⁹² *Id.*; 15 U.S.C. §1-2.

⁴⁹³ See Vestel, *supra* note 510. See also Chris Cheatham, *USGBC Accused of Anti-competitive Practices*, Green Building Law, available at <http://www.greenbuildinglawupdate.com/2010/01/articles/codes-and-regulations/usgbc-accused-of-anticompetitive-practices/> (last modified Jan 12, 2010). The USGBC has created a green building certification program. The program awards certification points to projects that use FSC certified wood; it does not award points to wood certified by SFI.

⁴⁹⁴ *Id.*; 15 U.S.C. § 12–27; 29 U.S.C. § 52–53.

⁴⁹⁵ See U.S. Green Building Council Antitrust policy, available at _____ (last modified??).

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Private Firm Programs			X	(X)	(X)
Codes of Conduct	X	X	X		
Environmental Management Systems			X	(X)	
Investment Contracts				(X)	X
Lending Contracts				(X)	X
Supply Chain Contracts	X				X
Insurance Contracts				(X)	X
Cooperatives	X	X	X	(X)	(X)
Hybrid Private / Govt					
Negotiated Agreements		X	X	(X)	(X)
Public Voluntary Programs			X		
Civic					
NGO Education and Mobilization Initiatives	X				X
Learning Initiatives			X		
Reporting Initiatives	X			(X)	
Models and Meta-Standards	X	(X)	X		
Hybrid Private / Civic					
Audits				X	
Socially Responsible Investment	X			(X)	X
Hybrid Civic / Govt					
Land Conservancies	X	X		(X)	X
Hybrid Private / Civic / Govt					
Certification and Labeling Systems	X	X	X	X	X

X = Provides

(X) = Varies

Combinations of private governance institutions may work together to produce effective regulation, however. Whether the regulation will be effective over the long term depends on whether all stages of the regulatory process have been addressed and whether the institutions employ key design features based on the functional roles that they serve in the regulatory process.

For instance, one possible sequence may proceed as follows: At the agenda-setting stage, nongovernmental organizations educate consumers about lead contamination in toys sold by a leading retailer. At the negotiations of standards stage, the retailer, under threat of tort litigation, sets substantive requirements for its suppliers to exclude lead and similar substances in the manufacturing of products. To implement the retailer standards, suppliers employ management systems designed to avoid the use of lead and similar substances in the manufacture and assembly of the products and require their secondary suppliers to exclude those substances in the manufacture of component parts. To monitor and enforce the contract, the retailer includes provisions for periodic inspections and hires an auditing firm to ensure that its requirements are being met. Based on the audits, the retailer sanctions suppliers that fail to adhere to its standards through contract or by withholding repeat business. The retailer funds the process though the costs may be passed forward to consumers or back to suppliers and manufacturers. Typically, in this sequence the weak link has been the auditing process. By making the audits public, retailers may reassure consumers and engage a broader group of parties in the monitoring process.

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Another possible sequence may involve additional participants. Nongovernmental organizations increase awareness about sweatshop labor conditions in apparel manufacturers Southeast Asia and identify particular companies that employ child laborers and have poor safety records. They may also engage in name and shame campaigns and institute boycotts of the products of specific companies identified. Socially responsible investment firms screen those manufacturers from their funding list and sell stock from those companies. To rehabilitate its reputation, the company becomes a member of a learning initiative and employs a management system to restore its market share. By implementing new management processes, the company improves conditions. The company employs a third party audit to confirm the improvements made to the learning initiative and the reporting initiative. The reporting initiative in turn provides information about these changes to investors, retail chain suppliers and the general public. The company covers these costs, but passes them forward in the price of its apparel. Socially responsible investment firms again include the stock of the company in their portfolios and consumers again purchase the goods following confirmation that the firm's labor practices have improved and are being monitored. Again, the key weakness in this process relates to the verity of the auditing process. Reporting initiatives may reduce fraud and strengthen demand for socially responsible firm management by requiring the firms to have the contents of their reports verified by independent third-parties.

In another potential sequence, a major mining concern seeks loans to undertake resource extraction activities in a foreign country would obtain a commitment from a private lender. The loan documents require all borrowers to meet certain social and environmental standards and to employ management systems that ensure implementation. The company seeks funding elsewhere, but finds that the major lenders providing funds at reasonable rates have similar criteria because they are operating under a collective code of conduct.⁴⁹⁶ The lenders also require that the company obtain insurance to cover its operations. The insurance companies require the company to submit to periodic inspections to reduce risks associated with its operations. When nongovernmental organizations reveal that the company's resource extraction processes are diverting slurry into public water systems, the insurer increases its rates and the lender places limits on the company's ability to draw down funds until the company demonstrates that it is implementing systems to redress these environmental impacts. In this situation the primary challenges to effective regulation relate to leakage. To the extent that firms may obtain cheap loans from other institutions, the effectiveness of the regime is reduced.

Private governance systems may also conflict with one another. First, they may compete for regulatory space and support.⁴⁹⁷ Competition has at times resulted in the ratcheting up of standards and implementation of more democratic procedures for schemes initiated originally by trade and industry associations.⁴⁹⁸ More frequently it has resulted in the more stringent standards developed by civic institutions being watered down. The Sustainable Forestry Initiative was developed in 1994 by the American Forest & Paper Association, in part, to avoid potential regulation after being targeted by environmental nonprofits for having unsustainable forestry

⁴⁹⁶ The main risks here are from leakage – companies turning to lenders, such as sovereign wealth funds, that do not require these kinds of criteria.

⁴⁹⁷ Abbott, *supra* note 4, at 78-79; Vogel, *supra* note 38, at ___.

⁴⁹⁸ Abbott, *supra* note 4, at 78-79.

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practices⁴⁹⁹ and later grew to compete with FSC to prevent its market share in the United States from being eroded by FSC's activities. In response to criticism, over time SFI has modified its structure to include more representation of environmental organizations and interests and included procedures that more closely resemble those of FSC, ratcheting their standards up.⁵⁰⁰ To garner increased industry and smallholder participation, FSC has, in turn, included greater flexibility in its standards,⁵⁰¹ leading some environmental organizations to accuse FSC of watering down its standards.⁵⁰²

Trade association and corporate social responsibility efforts may disarm nongovernmental organizations that are making a case for public or private regulation.⁵⁰³ They may undermine coalitions of nongovernmental organizations by splitting them into factions supporting greater and lesser stringencies.⁵⁰⁴ They may also divert the attention of nongovernmental organizations away from firms that would otherwise be targets for activism and toward programs that would not otherwise be primary targets for their impacts.⁵⁰⁵ Trade associations have often used the second mover advantage to develop alternate schemes that resemble stringent systems developed by civic institutions in structure, but contain only minimal requirements for compliance.⁵⁰⁶

Certification and labeling systems compete as signals to investors and labeling systems compete for consumers.⁵⁰⁷ Multiple schemes may result in investor and consumer confusion.⁵⁰⁸ To the extent there are multiple certification systems, investors may become concerned about whether the certification systems continue to signal environmental performance. Evaluations have shown that a decoupling may occur between the certification process and the practices and performance that the certification process is supposed to reflect.⁵⁰⁹ This lowers the value not only of the particular system in question but casts doubt on the integrity of all certification processes. Similarly, when labels emerge rapidly, noise may overcome the signal that labeling systems send.⁵¹⁰ The power of a particular label to signal quality along the lines of consumer preferences is diluted. To the extent that the public recognizes that there may be a difference between labels,

⁴⁹⁹ See ___ [Forestry papers]; See also Basics of SFI, available at <http://www.sfiprogram.org/sustainable-forestry-initiative/basics-of-sfi.php> (last modified ???)

⁵⁰⁰ _____ [Forestry papers]

⁵⁰¹ _____ [Forestry papers]

⁵⁰² _____ [Forestry papers]

⁵⁰³ Abbott, *supra* note 4, at 75-76. For instance, the chemical industry developed the Responsible Care Program following the Union Carbide disaster in Bhopal with the goal of avoiding the institution of regulations upon the chemical industry and in 1992, following the Rio Summit, the Chamber of Commerce developed a Business Charter for Sustainable Development to deflect possible global environmental regulation. Vogel, *supra* note 38, at 167-68.

⁵⁰⁴ Abbott, *supra* note 4, at 75-76.

⁵⁰⁵ *Id.* at 75-76. [Responsible Care Program].

⁵⁰⁶ These organizations adopt the trappings of fair regulatory processes to set standards without actually requiring compliance. See *id.* at 76, 78 (comparing SFI to FSC, FLA to WRAP).

⁵⁰⁷ Fair Labor Association versus WRAP, for instance.

⁵⁰⁸ There is some suggestion that this may be a form of intentional interplay. Creating a similar label allow us a firm to free ride on the goodwill and value associated with existing labels. This may substantiate recent moves by the Federal Trade Commission to regulate "green" claims.

⁵⁰⁹ King, *supra* note 15, at 1094.

⁵¹⁰ Abbott, *supra* note 4, 79-80.

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consumers demand more information about the labels.⁵¹¹ Efficiency declines as consumer must spend more time to investigate the labels to discern which labels are meeting their preferences. There is some evidence that consumers look to the reputation of the nongovernmental organizations supporting the labeling system to discern the value of the label.⁵¹²

Demand has grown for increased transparency and a means to evaluate the various certification and labeling programs.⁵¹³ The threat is that if labels are decoupled from the performance standards that they purport to signal, their collective power to signal anything will be destroyed.⁵¹⁴ Some institutions have begun to address label confusion by evaluating them based on the information that the private governance institutions self-report.⁵¹⁵ As with all verification processes, the effectiveness of this endeavor is limited by the truthfulness of the organizations' responses, whether the organizations are subject to having their submissions verified, and of course, the pertinence and clarity of the questions to which the organizations are asked to respond. As this article has argued, the most important questions relate to the key characteristics needed to produce effective regulation and overcome public choice and other barriers at each stage of the regulatory process. In particular, the questions should relate to the institution's funding sources, since funding is so determinative of the effectiveness and the short and long-term stability of the institution.

CONCLUSION

Voluntary standards, certification and labeling systems are singular in their attempt to substitute for government regulation at each stage of the regulatory process. They are the only institution type to provide the infrastructure to address governance needs at all five stages of the regulatory process. They activate consumer norms and use consumer markets as an enforcement tool to ensure that externalities are internalized. They create structures for developing standards through multi-stakeholder deliberation and broad participation, reducing the risk of capture. They include management and monitoring systems to ensure that participants to adhere to those standards. They address the transaction costs that consumers face in locating and negotiating with the "cheapest cost avoider" in global trade by creating structured links between those parties. They address both the information asymmetries and search costs that consumers face in purchasing credence goods by identifying conforming goods with labels. Finally, they also generate their own financial support, an important factor in maintaining their legitimacy and effectiveness over time.

Other combinations of private governance institutions may work together to achieve effective regulation, however, through collaboration, cooperation, and contractual arrangements. Each stage of regulation is subject to different hazards; private governance institutions must

⁵¹¹ Darby & Karni, *supra* note 434, at 84.

⁵¹² See _____ [PhD dissertation]

⁵¹³ See, for example, World Resources Institute Ecolabel Index, available at <http://www.ecolabelindex.com/ecolabels/> (last modified ???), see also Bibi van der Zee, *Listing the green labels, Can an international database of eco-labels help us live more ethically?*, available at <http://www.guardian.co.uk/environment/ethicallivingblog/2008/jan/31/labelgeeks> (last modified Jan. 31, 2008).

⁵¹⁴ King, *supra* note 15, at 1095.

⁵¹⁵ See, for example, World Resources Institute Ecolabel Index, *supra* note 513.

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bring different competencies or structures to each of these stages to overcome the barriers and hazards that occur at each stage. Certain design features may create more effective regulatory regimes than others based on the function that an institution plays in overcoming public choice and other obstacles to the regulatory process.

As indicated in Part II, at the agenda-setting stage, private governance institutions that are independent of their regulatory targets can bring public awareness toward social costs associated with firm activities and credibly identify the causes of social harm. If they are representative of community interests, they may be able to garner sufficient public support to induce public officials to regulate or generate interest in private governance if the hazards and barriers to legislation appear to be too high. At the negotiations stage, private governance institutions that can supply structures that make the regulatory process transparent, open and inclusive and include deliberative procedures that give stakeholders the ability to contribute in a meaningful way allow constituents to overcome the regulatory capture that increasingly clouds the process in a representative democracy. Capture becomes more difficult because the expense of influence rise as the number of parties involved at each stage of the regulatory process increases.

At the implementation stage, private governance institutions can offer flexibility, opportunities to lower costs, and level the playing field to reduce market uncertainties that arise from change. At the monitoring stage, institutions that relay to consumers and investors firm-reported information about social and environmental performance, but lack monitoring or verification systems will not enhance efficiently. Instead, they will direct consumption and investment flows to firms that are not actually meeting consumer or investor preferences, reducing utility. Private governance systems may avoid claims of bias by ensuring that monitor and auditors are financially and structurally independent of both the advocacy organizations that developed the standards and the targets being regulated and cannot gain financially from providing services that may be needed following an audit. Institutions that enlist the public in the monitoring process, such as public reporting projects and whistleblower systems can improve effectiveness of these systems. Institutions that provide cheap, accessible and credible dispute resolution mechanisms will permit conflicts to be resolved quickly. This enhances the system's credibility to participants and helps to secure their long-term involvement. Conflicts, if left untended, may exacerbate the tensions that continue to exist between parties to private governance institutions, and devolve into cheating, opting-out and finally institutional failure.

Finally, private governance institutions and the parties that subscribe to them must find funding to meet the governance needs that occur at each stage of the regulatory process. Implementation, monitoring and enforcement can be particularly costly. Therefore, if organizations through their structures can generate sufficient value to cover their costs they will be much more resilient to the outside pressures and inside tensions that occur throughout the regulatory process. Systems that include a market element, such as contractual or investment vehicles, exchanges, and voluntary standards, certification and labeling institutions, can potentially generate a premium that will cover some portion of the governance process. Other institutional forms may reduce the need for monitoring and verification processes by eliminating or reducing the incentives for agents to take advantage of their partners. Cooperatives place consumers on both sides of the economic equation; the need for third party monitoring and

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verification is reduced when the incentives to cheat are eliminated because the benefits or the costs of cheating would only accrue to the consumers themselves.