

Florida State University Law Review

Volume 33 | Issue 3

Article 13

2006

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Recommended Citation

J.B. Ruhl, *Default Rule Opt-Outs and Interest Group Shut-Outs: Citizen Participation and Contractarian Innovation in Environmental Law*, 33 Fla. St. U. L. Rev. (2006).
<http://ir.law.fsu.edu/lr/vol33/iss3/13>

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FLORIDA STATE UNIVERSITY LAW REVIEW



DEFAULT RULE OPT-OUTS AND INTEREST GROUP SHUT-OUTS: CITIZEN PARTICIPATION AND CONTRACTARIAN INNOVATION IN ENVIRONMENTAL LAW

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VOLUME 33

SPRING 2006

NUMBER 3

Recommended citation: J.B. Ruhl, *Default Rule Opt-Outs and Interest Group Shut-Outs: Citizen Participation and Contractarian Innovation in Environmental Law*, 33 FLA. ST. U. L. REV. 903 (2006).

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SHUT-OUTS: CITIZEN PARTICIPATION AND
CONTRACTARIAN INNOVATION IN
ENVIRONMENTAL LAW

J.B. RUHL*

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I. INTRODUCTION

Confidence in the so-called command-and-control model of environmental policy has eroded substantially over the past decade under the belief that prescriptive regulation, while effective at addressing the low-hanging fruit of environmental policy concerns, will be inefficient and inept in dealing with the complex challenges that lie ahead, such as climate change, invasive species, and endangered species.¹ Under the banners of “reinvention,” “regulatory innovation,” and “next generation” regulation, many new regulatory instruments have been proposed, tested, and by now widely used to adjust and, in some cases, supplant the blunt edge of environmental regulation.² Most of these new tools fall into one of three categories: market-based instruments that influence behavior through economic incentives; information-based instruments that influence behavior by improving the quantity, quality, and accessibility of information; and contract-based models that afford regulatory authorities and regulated parties room to negotiate context-specific standards and conditions.³ Although environmental law remains dominated by prescriptive regu-

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1. By the mid-1990s, “virtually everyone . . . agree[d] that our historical command-and-control approach [wa]s inefficient and inadequate by itself to carry us to where we still need to go.” Barton H. Thompson, Jr., *Foreword: The Search for Regulatory Alternatives*, 15 STAN. ENVTL. L.J., at viii, viii (1996).

2. See Dennis D. Hirsch, *Symposium Introduction: Second Generation Policy and the New Economy*, 29 CAP. U. L. REV. 1 (2001).

3. Law professors Richard B. Stewart of New York University and Dennis D. Hirsch of Capital University have charted this evolution of environmental law. See Dennis D. Hirsch, *Lean and Green? Environmental Law and Policy and the Flexible Production Economy*, 79 INDIANA L.J. 611 (2004); Hirsch, *supra* note 2; Richard B. Stewart, *Administrative Law in the Twenty-First Century*, 78 N.Y.U. L. REV. 437 (2003); Richard B. Stewart, *A New Generation of Environmental Regulation?*, 29 CAP. U. L. REV. 21 (2001).

lations, it is fair to say that most new fronts of environmental regulation are focused, first and foremost, on exploring how the new set of tools can be employed.

In his contribution to this Symposium, Professor Bradley Karkkainen measures examples of these emerging instruments of environmental regulation under the theoretical framework of “penalty defaults.”⁴ As he explains, penalty default theory focuses on the nature of private contract law as a source of “gap-filling” rules for interpreting incompletely specified contracts.⁵ These rules act as harsh default positions for the parties unless they deliberately contract to reach specific terms to supplant the default outcomes. In this sense, the default positions are penalties designed to encourage parties to opt out of the default by bargaining in the open on important issues, thus facilitating greater information symmetry between the parties.⁶

It is insightful of Professor Karkkainen to transport this theoretical model from the law of contracts to the dynamic world of environmental law. He does so in order to examine the mechanisms by which the emerging set of regulatory innovation instruments may similarly produce information-forcing incentives, leading to greater parity of information between regulators and the regulated. To me, the most compelling analogue between private contract and public regulation in this respect is the case of the contract-based instruments. Since penalty default theory arose in the context of private contracts, it makes sense to consider its utility in understanding the effects of greater reliance on the “contractarian” model of regulatory innovation. Indeed, as Professor Karkkainen suggests, the fit seems good: the penalty default in the public law context is the harsh regulatory prescription; the penalty nature of the default encourages the regulated party to access the contract-based program to achieve a more equitable regulatory burden; and to engage in the negotiation, the regulator and regulated parties must divulge information to each other.⁷ The result, as in private contracting, is greater information parity between the parties.

There is one hitch, however, though it is not one that reveals a flaw in Professor Karkkainen’s project by any means but rather demonstrates the value of his exercise. It has to do with the simple fact that only the parties to a private contract have direct participation rights in the negotiation. The potentially many other persons with an interest in the outcome of the private contract negotiations have no third-party participation rights. In environmental law, by contrast, we conven-

4. See Bradley C. Karkkainen, *Information-Forcing Environmental Regulation*, 33 FLA. ST. U. L. REV. 861 (2006).

5. *Id.* at 868.

6. *Id.* at 869-70.

7. *Id.*

tionally have treated *the public* as having just as much interest in regulatory outcomes as the regulators and the regulated and, thus, have long afforded interested third parties some degree of participatory rights in environmental decisionmaking.⁸ This makes all the difference in terms of how we evaluate the effects of using contract-based instruments as the penalty default opt-out mechanism.

II. THE RISE OF OPT-OUTS

In private contract default rules, the two parties control the outcome. Except in the case where no negotiated or default rule resolution exists, the decision to negotiate or not does not change the basic dynamics of the issue resolution process as a two-party, arms-length negotiation. Although third parties may have an interest in the outcome of the contract negotiations, their participatory role, if any, is not altered by the contracting parties' decision to opt out.

In the regulatory setting, the default rule is the prescribed regulatory outcome, with negotiated "contractarian" processes being offered as alternatives serving various policy objectives such as flexibility, efficiency, and innovation. However, unlike private contract negotiations, the decision by the regulator and regulated parties whether to negotiate or not *does* change the basic dynamics of the issue resolution process. The conventional permitting process, using default regulatory rules for *substantive* outcomes, carries with it a set of default regulatory *procedures* that afford participation rights for interest groups. By contrast, the contractarian opt-out alternatives generally diminish the participation rights of third-party interest groups and thus increase control of the regulator-regulated two-party dynamic over the *substantive* outcome.

With this departure from the default procedures, the opt-out becomes a bit of a slippery slope toward shutting out public participation. In the setting of an applicant for an agency permit, for example, the applicant seeks substantive flexibility, procedural efficiency, and in general, a process closer to the more familiar territory of private contract negotiations. Thus, relaxing the procedures—that is keeping the transaction costs of the opt-out lower than those of the default regulatory position—is an essential requirement for fulfilling the success of the contractarian objective of promoting flexible, efficient, innovative, and substantive outcomes. Indeed, this may become such an attraction to applicants that they flock to the opt-out mechanism in droves.

8. See Jim Rossi, *Participation Run Amok: The Costs of Mass Participation for Deliberative Agency Decisionmaking*, 92 NW. U. L. REV. 173 (1997); Mark Seidenfeld, *Empowering Stakeholders: Limits on Collaboration as the Basis for Flexible Regulation*, 41 WM. & MARY L. REV. 411 (2000).

But what about the third parties interested in the outcome? Interest groups fearing diminished participation rights in contract-based frameworks are likely to pressure the agency to duplicate those rights in the contractarian setting. If they are not duplicated, the agency may face relentless citizen suit litigation over procedural and substantive claims or appeals to other means of challenging the contractarian outcome through exercise of what Professor Karkkainen refers to aptly as their “destabilization rights.”⁹ And, in general, some agencies may, for a variety of policy reasons, wish to ensure liberal public participation. But yielding to this pressure by imposing procedural requirements in the contractarian setting similar to the default procedures of conventional permitting is likely to impose transaction costs that deter applicants from using the contractarian approaches.

The result, therefore, may be that agencies wishing to experiment with contract-based instruments find themselves in a pickle. The success of the contract-based approach depends in large part not only on its substantive advantage for regulated parties, but also its procedural advantage. But the procedural advantage for the regulated party often equates to a procedural disadvantage for interest groups wishing to influence the outcome. Because public law recognizes that third parties bear an interest in regulatory outcomes greater than that provided in private contract settings, the agency cannot ignore the interest groups’ dissatisfaction with the new contractarian procedures. Adjusting to their demands, however, makes the contract-based approach less attractive as an opt-out from the penalty default rule for the regulated parties. In the end, the agency is likely to make all sides unhappy, so why bother experimenting with contract-based approaches in the first place?

III. THE RESPONSE OF SHUT-OUTS

To give some meat to the bones of this concern, I offer the Endangered Species Act (ESA)¹⁰ example of the Habitat Conservation Plan (HCP) program.¹¹ Section 9 of the ESA generally prohibits any act

9. Karkkainen, *supra* note 4, at 893-97.

10. Endangered Species Act of 1973, 16 U.S.C. §§ 1531-1544 (2000). This Article is not intended to provide a comprehensive overview of the ESA. For comprehensive treatments of the ESA, several of which are referred to *infra*, see MICHAEL J. BEAN & MELANIE J. ROWLAND, *THE EVOLUTION OF NATIONAL WILDLIFE LAW* (3d ed. 1997); ENDANGERED SPECIES ACT: LAW, POLICY, AND PERSPECTIVES (Donald C. Baur & Wm. Robert Irvin eds., 2002) [hereinafter *LAW, POLICY, AND PERSPECTIVES*]; LAWRENCE R. LIEBESMAN & RAFFAEL PETERSEN, *ENDANGERED SPECIES DESKBOOK* (2003); STANFORD ENVIRONMENTAL LAW SOCIETY, *THE ENDANGERED SPECIES ACT* (2001); TONY A. SULLINS, *ENDANGERED SPECIES ACT* (2001).

11. 16 U.S.C. § 1539(a)(1). This Article also is not intended to provide a comprehensive overview of the ESA’s HCP program. For a more complete description of the mechanics of the HCP program, see J.B. Ruhl, *How to Kill Endangered Species, Legally: The Nuts and Bolts of Endangered Species Act “HCP” Permits for Real Estate Development*, 5 *ENVTL. L.* 345 (1999).

that would injure or kill an animal that is of a species designated as in danger of extinction by the federal government.¹² The U.S. Fish and Wildlife Service (FWS), which administers the ESA for terrestrial and freshwater species, has interpreted section 9 to extend to any habitat modification that leads to actual death or injury of an endangered species.¹³ The effect of that interpretation is that many land development projects around the nation would violate section 9, *except* that section 10 of the ESA provides authority for FWS to issue permits for “incidental take” of protected species—that is, take which is incidental to an otherwise lawful activity.¹⁴ To obtain such a permit, an applicant prepares a “conservation plan,” which has come to be known as a habitat conservation plan (and thus HCP), demonstrating compliance with a variety of criteria.¹⁵

The HCP program was a late bloomer, having been added to the ESA in 1982,¹⁶ but used only infrequently until the mid-1990s.¹⁷ During the 1990s, Bruce Babbitt, then-Secretary of the Interior with responsibility for implementing the ESA through the FWS, seized on the HCP program as a means of quieting unrest in Congress over the “pit bull” qualities of the ESA’s regulatory force. The history and precise details of how Babbitt transformed the HCP program need not

12. See 16 U.S.C. § 1538(a)(1)(C). For a description of the cases developing the legal standards for what constitutes “take,” see Gina Guy, *Take Prohibitions and Section 9*, in LAW, POLICY, AND PERSPECTIVES, *supra* note 10, at 191; LIEBESMAN & PETERSEN, *supra* note 10, at 39-46; Steven P. Quarles & Thomas R. Lundquist, *When Do Land Use Activities “Take” Listed Wildlife Under ESA Section 9 and the “Harm” Regulation?*, in LAW, POLICY, AND PERSPECTIVES, *supra* note 10, at 207; STANFORD ENVIRONMENTAL LAW SOCIETY, *supra* note 10, at 104-12; SULLINS, *supra* note 10, at 44-54; Alan M. Glen & Craig M. Douglas, *Taking Species: Difficult Questions of Proximity and Degree*, 16 NAT. RESOURCES & ENV’T 65 (2001). For a description of the process for identifying, or “listing,” species as endangered or threatened, see LIEBESMAN & PETERSEN, *supra* note 10, at 15-20; J.B. Ruhl, *Section 4 of the ESA: The Keystone of Species Protection Law*, in LAW, POLICY, AND PERSPECTIVES, *supra* note 10, at 19; STANFORD ENVIRONMENTAL LAW SOCIETY, *supra* note 10, at 38-58; SULLINS, *supra* note 10, at 11-25.

13. See 50 C.F.R. § 17.3 (2004).

14. See 16 U.S.C. § 1539(a)(1)(B).

15. See *id.* § 1339(a)(2)(A).

16. Endangered Species Act Amendments of 1982, Pub. L. No. 97-304, 96 Stat. 1411 (1982).

17. By 1992, for example, the FWS had issued only twelve HCP permits, whereas it had issued approximately 225 by October 1, 1997. LAURA C. HOOD, DEFENDERS OF WILDLIFE, FRAYED SAFETY NETS: CONSERVATION PLANNING UNDER THE ENDANGERED SPECIES ACT, at vi-xiii (1998), available at <http://www.defenders.org/pubs/hcp02.html>. For background on these developments and the HCP program in general, see Shi-Ling Hsu, *The Potential and the Pitfalls of Habitat Conservation Planning Under the Endangered Species Act*, 29 ENVTL. L. REP. 10,592 (1999); Albert C. Lin, *Participants’ Experiences with Habitat Conservation Plans and Suggestions for Streamlining the Process*, 23 ECOLOGY L.Q. 369 (1996); Barton H. Thompson, Jr., *The Endangered Species Act: A Case Study in Takings & Incentives*, 49 STAN. L. REV. 305 (1997); Robert D. Thornton, *Habitat Conservation Plans: Frayed Safety Nets or Creative Partnerships?*, 16 NAT. RESOURCES & ENV’T 94 (2001); Eric Fisher, Comment, *Habitat Conservation Planning Under the Endangered Species Act: No Surprises & the Quest for Certainty*, 67 U. COLO. L. REV. 371 (1996).

be repeated here.¹⁸ What matters is that HCPs became exactly what Professor Karkkainen suggests generally of regulatory innovation instruments—a contract-based opt-out mechanism for landowners to avoid the penalty default of the section 9 take prohibition. As I have previously described the program:

The features of HCP permitting . . . establish the regulatory parameters within which the process unfolds. But those parameters leave much of the details of the HCP to the HCP development phase, in which negotiation between applicant and agency shapes the final HCP design. For good reason, however, neither the ESA, the agencies' regulations, nor the *HCP Handbook* contains "recipes" for determining what is really at the heart of the HCP permit—the quality and quantity of take that will result and the mitigation required in return. Given the particularities of species, their habitats, and the impacts of a project on each in particular locations, defining take and mitigation becomes a project-specific topic of negotiation. . . . In the end, the context within which an HCP is sought resembles a structured negotiation in which many issues are open for negotiation, but the overall process is encompassed in a regulatory "box" that cannot be ignored or violated.¹⁹

Many practitioners and academics have examined and applauded the HCP program innovation as the poster child of contract-based reform.²⁰ Indeed, based on the success of the HCP program, Babbitt's Department of the Interior adopted the Candidate Conservation Agreement mechanism to provide incentives to landowners to conserve habitat of candidate species²¹ and developed the Safe Harbor mechanism to provide incentives to promote the introduction of habitat of species already listed.²² Yet, in every case, interest groups have objected to the procedural flexibility inherent in negotiated processes and their diminished role therein compared to conventional permit-

18. For a more thorough account of the political factors that set the stage, see John D. Leshy, *The Babbitt Legacy at the Department of the Interior: A Preliminary View*, 31 ENVTL. L. 199, 208-12 (2001).

19. Ruhl, *supra* note 11, at 391, 376-77.

20. See Daniel A. Farber, *A Tale of Two Cases*, 20 VA. ENVTL. L.J. 33, 44 (2001); Hsu, *supra* note 17, at 10,594-600; Jean O. Melious & Robert D. Thornton, *Contractual Ecosystem Management Under the Endangered Species Act: Can Federal Agencies Make Enforceable Commitments?*, 26 ECOLOGY L.Q. 489, 493 (1999).

21. See Announcement of Final Policy for Candidate Conservation Agreements with Assurances, 64 Fed. Reg. 32,726, 32,727 (June 17, 1999) (illustrating how Candidate Conservation Agreements allow a landowner to take conservation steps on behalf of species that are candidates for listing in return for an assurance that, if the species is later listed, the landowner has in place the necessary incidental take authorization to allow continuation of land uses covered under the agreement).

22. See Announcement of Final Safe Harbor Policy, 64 Fed. Reg. 32,717, 32,718 (June 17, 1999) (showing how Safe Harbor agreements allow a landowner to foster conditions suitable for listed species for determined periods of time in return for an assurance that later development will be allowed on the property to a level that returns the species to its "baseline" conditions existing on the property at the time of the agreement).

ting models, and the agency has responded by adding procedural burdens to the contractarian opt-out.

Consider, for example, the following complaint from an environmental advocacy interest group based on its evaluation of a group of HCPs:

Citizens from various stakeholder groups have no formal role in the HCP process except through the public comment period and, for some plans, through the National Environmental Policy Act (NEPA) or requirements of state or local law. Often, by the time public meetings occur or official drafts are released for comment, however, both the regulated interests and the services have invested so much money and time in plan development that they are unlikely to change course. . . . [C]itizens (including those representing the environmental community) generally have not had a seat at the negotiating table in many major recent negotiations despite the fact that conservationists (in addition to FWS) represent the public's interest in protecting endangered species. . . .

For the vast majority of plans . . . public participation was not adequate, given the plans' large effects on public resources. The most glaring examples are large-scale, single-landowner plans that significantly affect public resources While those plans did have public meetings and/or formal comment periods, the conservation strategies resulted from private negotiations with largely token attempts at listening to the public's concerns. In addition, numerous small-scale HCPs reviewed here involved exclusive negotiations between the landowner and FWS This lack of public participation has resulted from an absence of formal requirements to involve the public and the limited leverage of citizens who do not have a direct financial stake in negotiations.²³

As predicted, the agency responded to such pressure by loading up the contractarian mechanisms with conventional regulatory review and analysis steps that diminish its procedural efficiency. Consider the following evaluation of the Safe Harbor and Candidate Conservation programs by a leading environmental advocacy interest group representative:

Despite . . . impressive initial indications, it is hard to avoid the conclusion that the record of accomplishment with these new conservation tools may be no more inspiring than the record with the old tools unless a number of self-imposed obstacles to success are removed. Those obstacles . . . are self-imposed because they do not inhere in the law itself, but are instead the product of an unimaginative, process-preoccupied, and ultimately self-defeating imple-

23. HOOD, *supra* note 17, at 43-44; *see also* Holly Doremus, *Preserving Citizen Participation in the Era of Reinvention: The Endangered Species Act Example*, 25 *ECOLOGY L.Q.* 707 (1999), available at <http://www.defenders.org/pubs/hcp10.html> (examining the growing tension between the HCP and other ESA reform programs and public participation values).

mentation that discourages and deters opportunities for tangible, on-the-ground improvement. These debilitating constraints have no partisan or ideological provenance. . . .

Successful conservation efforts between landowners and the government are built on a foundation of trust. That foundation is eroded by the all-too-frequent practice, after the terms of a Safe Harbor or Candidate Conservation Agreement are worked out between a landowner and the Service field office, of asking the landowner to agree to changes recommended by the regional office or by the recovery coordinator for the species covered by the agreement. Such changes have been recommended both before an agreement is put out for public comment, and afterwards. Multiple and successive layers of Service review may be appropriate in other contexts, but they are poison in the context of voluntary undertakings by landowners to implement beneficial management actions for rare species. It is hard for a landowner to avoid the conclusion that the Service is less interested in getting something useful done on the ground than in getting a second and third bite at the apple in its dealings with the landowner.

Remedying this problem is entirely within the ability of the Service. The field office biologist negotiating a Safe Harbor Agreement ought to have the responsibility to solicit the views of the regional office and of the recovery coordinator *before* concluding a draft agreement with a landowner. Public comments received thereafter might identify other desirable changes, but they should not be regarded by the Service as a license to reopen the entire agreement.²⁴

To be sure, these are isolated evaluations of a set of related regulatory programs, albeit one of the most prominent with respect to contract-based regulatory innovation. But they do suggest that attention must be paid to the procedural impact of regulatory penalty default rules and their opt-out mechanisms. Professor Karkkainen has done an excellent job of overlaying the penalty default model on environmental regulation innovation and revealing its information-forcing potential. At the same time, that overlay exercise also pinpoints what is different about the penalty default model in its home private contract context versus in its alien regulatory law context—the procedural entitlements of third parties.

IV. CONCLUSION

My sense, then, is that one of the most difficult challenges for regulatory innovation in general, if it is to yield the promised eco-

24. Michael J. Bean, *Challenges to Making Second Generation Approaches Work*, 11 A.B.A. SEC. ENV'T ENERGY RES. 1, 2, 7 (Oct. 8-12, 2003) (proceedings of the ABA's Section of Environment, Energy, and Resources' 11th Section Fall Meeting).

conomic and information efficiencies, will be managing the fallout that builds as interest groups find the penalty default rule opt-outs leave them participatory shut-outs. The penalty default rule model, as Professor Karkkainen demonstrates, not only reveals why contract-based innovations in regulatory instruments may improve information parity between regulator and regulated parties but why they might also reduce information parity between the principal parties to the negotiated regulatory outcome and third-party interest groups. I have suggested there is evidence of likely resistance to any such trend, which is not surprising given the long-followed conventions of public participation under command-and-control models of environmental regulation. But the innovation instruments simply will not work if the solution takes the quick-fix approach of grafting first-generation command-and-control procedures onto the second-generation regulatory innovation tools. The work ahead for regulatory innovation, therefore, is in finding new means for keeping procedural rights, such as public participation, meaningfully intact while still tapping into the desired benefits of innovation.