The New Gatekeepers: Private Firms as Public Enforcers

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PRIVATE FIRMS AS PUBLIC ENFORCERS

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The world’s largest businesses must routinely police other businesses. By public mandate, Facebook monitors app developers’ privacy safeguards, Citibank audits call centers for deceptive sales practices, and Exxon reviews offshore oil platforms’ environmental standards. Scholars have devoted significant attention to how policy makers deploy other private sector enforcers, such as certification bodies, accountants, lawyers, and other periphery “gatekeepers.” However, the literature has yet to explore the emerging regulatory conscription of large firms at the center of the economy. This Article examines the rise of the enforcer-firm through case studies of the industries that are home to the most valuable companies, in technology, banking, oil, and pharmaceuticals. Over the past two decades, administrative agencies have used legal rules, guidance documents, and court orders to mandate that private firms in these and other industries perform the duties of a public regulator. More specifically, firms must write rules in their contracts that reserve the right to inspect third parties. When they find violations, they must pressure or punish the wrongdoer. This form of governance has important intellectual and policy implications. It imposes more of a public duty on the firm, alters corporate governance, and may even reshape business organizations. It also gives resource-strapped regulators promising tools. If designed poorly, however, the enforcer-firm will create an expansive area of unaccountable authority. Any comprehensive account of the firm or regulation must give a prominent role to the administrative state’s newest gatekeepers.

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INTRODUCTION

In 2018, Facebook Chairman and CEO Mark Zuckerberg faced senators on national television regarding conduct that prompted the Federal Trade Commission (FTC) to seek its largest ever fine. The main issue was not what Facebook did directly to its users. Instead, the hearing focused on the social network’s failure to restrain third parties. Most notably, the political consulting firm Cambridge Analytica accessed millions of users’ accounts in an effort to support election candidates. Before Zuckerberg’s Senate testimony, the FTC had already sued Google and Amazon to force them to monitor third parties for privacy violations and in-app video game purchases by children that sometimes reached in the thousands of dollars. In other words, the FTC is requiring large

1 Cecilia Kang, A Facebook Settlement With the F.T.C. Could Run Into the Billions, N.Y. Times, Feb. 15, 2019, at B6.
technology companies to act in ways traditionally associated with public regulators—by policing other businesses for legal violations.

Over time policy makers have enlisted a large array of private actors in their quest for optimal regulatory design. Scholarship on the private role in public governance has focused on third-party enforcers whose main function is to provide a support service. Those enforcers include self-regulatory organizations formed by industry and independent auditors mandated by regulators. The corporate law strand of this enforcement literature emphasizes a network of “gatekeepers,” such as lawyers, accountants, and certifiers who guard against compliance and governance failures. For instance, before releasing annual reports a publicly traded company must obtain the signoff of a certified accountant. In these more familiar private enforcement contexts, the private


7 15 U.S.C. § 78m(a) (2018) (“Every issuer of a security . . . shall file with the Commission . . . such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants . . . .”)}
“cops on the beat” are ancillary actors rather than core market participants.\(^8\)

This Article demonstrates how policymakers have enlisted a new class of more powerful third-party enforcers: the businesses at the heart of the economy. The ten largest American companies by valuation operate in information technology, finance, oil, and pharmaceuticals.\(^9\) A regulator has put leading firms in each of these industries on notice about their responsibilities for third-party oversight.\(^10\) In addition to the FTC, the Environmental Protection Agency (EPA)—along with the Department of Justice (DOJ)—requires BP Oil and other energy companies to audit offshore oil platform operators for environmental compliance.\(^11\) The Food and Drug Administration (FDA) expects Pfizer and other drug companies to ensure suppliers and third-party labs follow the agency’s health and safety guidelines.\(^12\) The Consumer Financial Protection Bureau (CFPB) orders financial institutions, such as American Express, to monitor independent debt collectors and call centers for deceptive practices.\(^13\)

\(^8\) Kraakman, supra note 6, at 53 n.1 (attributing to Jeremy Bentham the “cop on the beat” metaphor and using it to describe gatekeepers).

\(^9\) The literature has also extensively analyzed self-regulation as part of a broader new governance that arose in recent decades. Administrative agencies now pursue collaborative and responsive models of public governance designed to encourage the business sector to self-regulate. See, e.g., Ian Ayres & John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (1992); Jody Freeman, Collaborative Governance in the Administrative State, 45 UCLA L. Rev. 1, 4 (1997). Additionally, large businesses have dramatically grown their compliance departments to police the firm from within. See, e.g., Sean J. Griffith, Corporate Governance in an Era of Compliance, 57 WM. & Mary L. Rev. 2075, 2077 (2016); Kimberly D. Krawiec, Organizational Misconduct: Beyond the Principal-Agent Model, 32 Fla. St. U. L. Rev. 571, 572 (2005); Veronica Root, Coordinating Compliance Incentives, 102 Cornell L. Rev. 1003, 1004 (2017) . This important and nascent literature on corporate compliance has remained focused on the firm’s role in overseeing internal operations, or on traditional gatekeepers doing so.


\(^11\) See infra Part II

\(^12\) Consent Decree Among Defendant BP Exploration & Production Inc., the United States of America, and the States of Alabama, Florida, Louisiana, Mississippi, and Texas, at 32–33, In re Oil Spill by the Oil Rig “Deepwater Horizon” in the Gulf of Mexico, on April 20, 2010, MDL No. 2179 (E.D. La. Oct. 5, 2015).


\(^14\) Joint Consent Order, In the Matter of Am. Express Centurion Bank, No. FDIC-12-315b,
The widespread conscription of businesses as enforcers—also called “enforcer-firms” below—shares characteristics with but differs meaningfully from prior iterations of third-party regulation. For instance, the FTC’s original court order required Facebook to hire a third-party auditor—an example of the old gatekeeper model—to certify Facebook’s compliance.\(^\text{15}\) In that arrangement, refusing to sign off on Facebook’s biennial reports to the FTC constituted the auditor’s main sanction.\(^\text{16}\) Facebook could, however, respond to that sanction by bringing its business elsewhere.\(^\text{17}\) That ability to retaliate weakens traditional gatekeepers’ power and independence.\(^\text{18}\)

In contrast, the enforcer-firm is usually the client—or at least a crucial business partner—to the third parties it regulates. Its main sanction is to cease doing business with those third parties, which can prove devastating.\(^\text{19}\) The client relationship that weakens traditional gatekeepers thus strengthens the enforcer-firm. In short, policymakers have begun relying on third-party enforcement by the real gatekeepers of the economy: the firms who control access to core product markets.\(^\text{20}\)

In highlighting a new enforcement model, this Article builds on the literature scrutinizing the increasingly narrow divide between private businesses and the administrative state.\(^\text{21}\) Although that scholarship has yet to examine the enforcer-firm in any sustained manner,\(^\text{22}\) mandated third-party governance raises similar

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\(^\text{16}\) See id at 6.

\(^\text{17}\) The consent order does not prevent such a response. See id.

\(^\text{18}\) See Joel S. Demski, Corporate Conflicts of Interest, 17 J. Econ. Persp. 51, 57 (2003).

\(^\text{19}\) See infra Part IV.A.

\(^\text{20}\) A diversified firm may play both a new and traditional gatekeeper role. For instance, by allowing a company to serve as both a commercial bank and investment bank, the law enabled large financial institutions to operate as both traditional gatekeepers—overseeing their clients by underwriting securities, prompted by liability avoidance under the Securities Act of 1933—and as new gatekeepers, being the clients who hire third party businesses. See infra Part II.A.; Kraakman, supra note 6, at 83.

\(^\text{21}\) To the extent scholars have discussed mandated third-party governance it has been in passing or in narrower contexts such as in criminal or international law. See, e.g., Larry Catá Backer, Surveillance and Control: Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley, 2004 Mich. St. L. Rev. 327, 433–34 (2004) (referencing how the Bank Secrecy Act causes a larger number of businesses to become “part of the network of the state’s eyes and ears.”); John Braithwaite, Responsive Regulation and Developing Economies, 34 World Dev. 884, 889–90 (2006) (exploring how domestic firms can serve as a means of reaching foreign actors); Stavros Gadinis & Colby Mangels, Collaborative Gatekeepers, 73 Wash. & Lee L. Rev. 797, 910 (2016) (focusing on money laundering); Itai Grinberg, The Battle over Taxing Offshore
accountability issues as previous generations of third-party enforcement. In particular, as a new area of quasi-regulatory activity unlikely to be overturned by judicial review, conscripted enforcement lacks transparency and traditional measures of public involvement, such as notice and comment rulemaking.\(^\text{23}\)

However, if designed well, the enforcer-firm offers some hope for improving upon prior regulatory models’ accountability. Because enforcer-firms often sell directly to consumers they may prove more responsive to public concerns when compared to traditional gatekeepers, which interact most closely with regulated entities.\(^\text{24}\) And because the enforcer-firm is itself a prime target of public regulation, it would be easier for an administrative agency to oversee it than to add a whole new category of firms as required for oversight of traditional gatekeepers.\(^\text{25}\) The conscription of businesses has proved crucial in other unwieldy administrative contexts, facilitating the transformation of the U.S. fiscal system to reliance on a previously unadministrable income tax on individuals.\(^\text{26}\) The enforcer-firm could, by analogy, enable the regulatory state to bring dispersed business actors into compliance.

None of this should be taken as an endorsement of the enforcer-firm, which is too new and understudied to yield strong normative conclusions. However, an openness to the upsides of the enforcer-firm responds to the critique that administrative law scholars have too often portrayed private actors as an intrusion into legitimacy, which prevents “imagining the means by which private actors might contribute to accountability.”\(^\text{27}\)

Mandated third-party governance also speaks to vibrant corporate law inquiries. Scholars have paid considerable attention to the duties of directors and officers, personal liability for corporate wrongdoing, and organizational structure.\(^\text{28}\) Conscripted enforcement shapes each of these areas and pushes

Accounts, 60 UCLA L. Rev. 304 (2012) (referencing a “growing consensus that financial institutions should act as cross-border tax intermediaries”). For other ways that scholars have recognized that businesses regulate other firms, see infra Part I.


\(^\text{24}\) See, e.g., Coffee, supra note 6, at 13–18 (describing gatekeeper shortcomings).

\(^\text{25}\) See infra Part IV.B.


\(^\text{27}\) Freeman, supra note 4, at 675. Numerous scholars have taken up this call in other contexts. See, e.g., Sarah Light, The Law of the Corporation as Environmental Law, 71 Stan. L. Rev. 137, 139–41 (2019) (calling for a holistic view of corporations’ role in promoting environmental goals).

\(^\text{28}\) See generally Nicolai J. Foss et al., The Theory of the Firm, in Encyclopedia of Law &
against depictions of the firm emphasizing its private nature. Those depictions are rooted in the influential metaphor—sometimes described as the most dominant theory of the firm—that the firm is a “nexus of contracts” among owners, managers, laborers, suppliers, and customers.\footnote{29} The firm remains exceedingly private. But by directing businesses to write enforcement-oriented contract clauses and monitor external relationships for legal violations, as a descriptive matter the state is pushing the firm toward a larger public role.\footnote{30}

That insight is relevant beyond theory and institutional design. In the highest legislative circles and corporate boardrooms, debates are unfolding about what duties corporations owe to society, with some taking particular aim at the idea that shareholders should come above all other stakeholders.\footnote{31} Conscripted enforcement marks a significant uptick in federal regulatory involvement in the firm by imposing more of an affirmative public duty to act.\footnote{32} Cast against the backdrop of the firm as public enforcer, calls for business leaders to do more for society appear less disconnected from reality than would be the case under a largely private conception of the firm.\footnote{33}

The Article is structured as follows. Part I provides an overview of the well-studied ways that private entities serve as enforcers. Part II offers four case studies of how regulators have implemented mandated enforcement of third parties in some of the largest U.S. industries: the FTC and technology, the CFPB and banking, the EPA and oil, and the FDA and pharmaceuticals. Part III examines how mandated enforcement alters the firm’s contracts, relationships, and governance. It also explores shifts in liability at the personal and entity level, which could influence organizational structure. Part IV concludes by considering implications for the effectiveness and accountability of the administrative state.

\begin{footnotes}

\footnote{30}{Infra Part III.A.}


\footnote{32}{Infra Part III.D.}

\footnote{33}{There is arguably a gap between rhetoric and reality. See Marcel Kahan & Edward Rock, Symbolic Corporate Governance Politics, 94 B.U. L. Rev. 1997, 2042 (2014).}
\end{footnotes}
I. TRADITIONAL FORMS OF THIRD-PARTY ENFORCEMENT

A decades-long debate in both corporate and administrative law scholarship concerns “how best to tap the private interests of enterprise participants to serve the public interest.” Historically, the starting point was the hope that firms would self-regulate—if not for market incentives, then to avoid legal punishment for wrongdoing. Although scholars recognize the heterogeneity of external private enforcers, they have stopped short of examining the emerging importance of how large firms are required to oversee third parties. I now turn to those prior narratives of third-party private regulation.

A. Independent Enforcement

The origins of businesses influencing other businesses for the public benefit lie in markets, rather than government. To see the public-private connection, it is instructive to first consider how the administrative state functions. Regulators have significant discretion in choosing which policymaking tools to deploy. Their most prominent tools include writing legal rules and filing lawsuits. However, as I have shown elsewhere, public regulators devote fewer resources to these legal functions than to monitoring businesses through on-site inspections and remote information collection. When monitoring activities detect wrongdoing, the monitors—EPA inspectors, bank examiners, and others—can respond in many ways outside the court system. Responses range from informally requesting that businesses change behavior to mandating the suspension of business activities. Private third-party enforcement has analogs to each of these main policymaking functions, but especially to monitoring.

Independent of any legal influence, firms monitor other firms solely out of self-interest. For instance, when land is the collateral for a loan, banks may inspect the property periodically to ensure that the borrowing firm is not releasing hazardous chemicals or otherwise damaging that collateral. Insurance companies also monitor the businesses that they insure to prevent legal violations that would cause the insurer to make large payouts under the

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35 See Kraakman, supra note 6 at 56.
36 See, e.g., Freeman, supra note 37.
38 Id. at 1384 (providing an overview of policy tools).
40 Id. at 373–75.
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The prospect of reducing costs motivates such monitoring, but the monitoring advances public interest. These financial interests can push external parties to “constrain fundamental managerial decisions even in the ordinary course of business.”

Another type of private enforcer is the self-regulatory organization, which has been described as the new “fifth branch” of government but originates in industry. Workers or companies in a given industry come together to form self-regulatory organizations. Traders formed the New York Stock Exchange (NYSE), for instance, “to improve their business by excluding unreliable, uncreditworthy, and unscrupulous brokers.”

In recent decades, private entities increasingly regulated to advance social causes for reasons beyond protecting their direct investments or members. For example, Walmart imposes recycling and energy conservation requirements on its vendors, and Nike and Apple audit their manufacturing facilities to prevent child labor and other abuses. Although businesses originally developed these types of programs mostly in response to negative publicity, firms are becoming more proactive: “Firms are not merely the objects of activist boycotts. They are becoming activists themselves.”

A final category of market-oriented constraints involves certification schemes. Organizations offer logos that tell grocery shoppers whether coffee, fruit, and other products meet fair-trade and environmentally sustainable standards. Logos leverage the consumers’ desire to motivate companies to adhere to better standards. Solely out of private initiative, businesses monitor other businesses in diverse ways.


43 See Frederick Tung, Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance, 57 UCLA L. Rev. 115, 120 (2009).


45 Id.


48 See, e.g., Light, supra note 27, at 139 (footnote omitted).

B. Encouraged Enforcement

Although one motivation for voluntary regulation is to forestall public oversight, the examples thus far cover situations in which private regulation occurs independent of existing legal influence. Policymakers sometimes wish to intervene but are reluctant to act paternalistically by forcing a private party to act. Without mandating private enforcement, policymakers can still influence private parties to regulate voluntarily. For instance, if the law imposes vicarious liability on the pharmaceutical company for violations by its ingredient supplier, the pharmaceutical company may be motivated to audit the supplier’s production process even though auditing is not required.

Another straightforward application of encouraged enforcement is requiring companies to release product information in digital form so that intermediaries can use that data to help consumers. Travel websites such as Expedia and Travelocity benefitted from government mandates that airlines release flight prices and times online. These intermediaries help to regulate by enabling a marketplace filled with informed consumers, thereby deterring undesirable business practices. Although legal authority made the information available, it did not require any private actor to use that information to regulate.

Private parties can also voluntarily serve as enforcers by bringing lawsuits or alerting authorities to legal violations. Private attorney general statutes in many fields give citizens the right to sue to enforce public laws. These statutes may offer the plaintiff monetary incentives to file the suit, by awarding them a portion of any penalties paid by the offending company.

Rather than filing the lawsuit, citizens and nonprofits may instead serve as informants. Environmental watchdog groups patrol natural habitats to find evidence of pollution, a practice that has increased with the availability of powerful monitoring technologies. Whistleblower statutes serve a related function by providing legal protections or monetary incentives for employees or.

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50 See, e.g., Birdthistle & Henderson, supra note 44, at 14–15 (discussing the NYSE).
54 See id.
55 See Van Loo, supra note 53, at 1269.
57 See, e.g., id. at 216. Attorneys have monetary incentives to initiate lawsuits as well, which plays an important role in some enforcement areas. See Stephen J. Choi & A.C. Pritchard, SEC Investigations and Securities Class Actions: An Empirical Comparison, 13 J. Empirical Legal Stud. 27, 28 (2016).
third parties who come forward with information about wrongdoing.\textsuperscript{59}

Scholars have also highlighted the instrumental role that contracts play in voluntary enforcement.\textsuperscript{60} In particular, businesses enter into second-order agreements voluntarily in response to or in the absence of regulation.\textsuperscript{61} Those agreements result from private bargaining and serve to limit a firm’s risks of incurring legal liability, such as from common law torts.\textsuperscript{62} Discretionary inspections help not only to minimize legal violations, but also to receive lower penalties per federal organizational sentencing guidelines.\textsuperscript{63} Without directly mandating enforcement, policymakers have many options to motivate businesses to monitor other businesses.

C. Mandated Enforcement

The law can require private enforcers rather than merely encouraging them. “Corporate governance is often about gatekeeping,”\textsuperscript{64} which Reiner Kraakman defines as situations in which a corporation must obtain the support of attorneys, accountants, and others before taking certain actions.\textsuperscript{65} Instead of allowing an oil company to decide whether to hire a third-party inspection service, for instance, the regulator may instead write a rule requiring certification from an accredited third-party inspector.\textsuperscript{66} Thereafter, oil companies would no longer have the option of lowering costs by refusing to hire a third party. Statutes and court orders compel businesses in diverse industries to hire third-party monitors.\textsuperscript{67} Scholars believe that more of this “regulation by third-party verification” could help to solve the problem of under-resourced public regulators.\textsuperscript{68}

It is important to note that any individual gatekeeper may have only partial


\textsuperscript{61} Vandenbergh, supra note 41, at 2030-31. But see Lipson, supra note x, at 1110.

\textsuperscript{62} Id. at 2033 & n.14.


\textsuperscript{64} Mark J. Roe, Delaware's Competition, 117 Harv. L. Rev. 588, 622 (2003).


\textsuperscript{67} See id. at 17?Root, supra note 5, at 529–30.

\textsuperscript{68} McAllister, supra note 23, at 5.
ability to prevent wrongdoing. A private auditor might refuse to provide the necessary approval for a fraudulent securities transaction, thus driving away one potential buyer who sees the non-approval as a “red flag.”\textsuperscript{69} However, without a requirement that the auditor disclose its findings, the securities seller may go to another auditor and attempt to obtain approval anew.\textsuperscript{70}

To illustrate further, for most of American history stock exchanges were not gatekeepers. In the nineteenth century, the NYSE accounted for only a fraction of the trades even in New York, because most deals unfolded “in brokers’ offices, in coffee houses, and in the street.”\textsuperscript{71} Reforms throughout the 1900s gradually made the exchanges more attractive through licensing and other regulation, and encouraged enforcement, but it was not until 1983 that a federal law required every broker to register.\textsuperscript{72} The old gatekeepers’ influence depends on the extent of the exclusion mechanism that the law provides.\textsuperscript{73}

In light of gatekeepers’ prominent regulatory role, many scholars have explored how the law should hold them accountable.\textsuperscript{74} In 2001, this issue resurfaced when Enron, believed to be one of the most successful U.S. companies, suddenly collapsed, destroying billions of dollars in shareholder value and costing thousands of employees their retirement savings.\textsuperscript{75} The swift downfall “stunned Wall Street” because Enron executives, alongside Arthur Andersen, one of the leading auditing firms, made hundreds of millions of dollars in losses look like a multibillion-dollar profit.\textsuperscript{76}

Despite an academic consensus that insufficient gatekeeper liability contributed to this incident of securities fraud, Congress’s main response, the Sarbanes-Oxley Act, did little to address that issue.\textsuperscript{77} Instead, the Act instructed the SEC to write rules overseeing auditors.\textsuperscript{78} It nonetheless required auditors to “attest to, and report on, the assessment made by . . . management” of the

\textsuperscript{69} Kraakman, supra note 6, at 58.
\textsuperscript{70} Id.
\textsuperscript{71} Stuart Banner, Anglo-American Securities Regulation, Cultural and Political Roots, 1690-1860 256 (1998).
\textsuperscript{74} See Hamdani, supra note 6, at 107–08.
\textsuperscript{75} See, e.g., Kathleen F. Bricker, From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley, 81 Wash. U. L.Q. 357 (2003).
\textsuperscript{76} Id. at 357, 369.
company’s internal controls. The Act thus made auditors into mandated whistleblower-gatekeeper hybrids to increase the likelihood that a public regulator will learn of wrongdoing.

These diverse private actors—whether independent, encouraged, or mandated—operate in parallel not only to one another, but also to business self-regulation and public regulatory oversight. For this reason, regulation should be thought of in aggregate terms, in light of the mix of public and private actors. These actors form a regulatory ecosystem, sometimes called “nodal governance,” with many players supporting and monitoring one another.

D. What Is Missing

Despite widespread recognition of the pervasiveness and heterogeneity of private enforcement, missing from these discussions is an examination of mandates that explicitly direct regulated entities to serve as enforcers. Instead, the focus has been on encouraging or mandating that other private parties help enforce the law against regulated entities. In the rare instances when scholars mention mandated third-party governance by the largest firms, it is in passing or in narrower contexts, such as criminal statutory requirements that banks identify money laundering transactions.

As a result, although a rich literature on third-party enforcement spans corporate and administrative law, scholars have yet to connect the firm’s growing regulatory role to theories of the firm and debates about its proper place in society. Monitoring in corporate law usually refers to internal contexts, such as the board of directors ensuring that officers exercise their duties or that the corporation obeys the law. Corporate law scholars have nonetheless contributed valuable foundations, particularly by illuminating the centrality of gatekeepers to corporate regulation.

Administrative law scholarship also provides valuable foundations by showing the evolution and growth of public-private collaboration. The expansion of private enforcement from second-order to first-order firms not only raises the accountability stakes identified in that literature but also creates new dynamics. With more formal external oversight roles, the world’s most valuable companies have the potential to profoundly shape governance, markets, and

79 Id. at § 404(b), 116 Stat. at 789.
80 Freeman, supra note 4, at 549.
82 See supra note 22.
84 See supra notes 37–41 and accompanying text.
85 See infra Part IV.
II. CASE STUDIES

The ten largest companies operate in four main industries: information technology, banking, pharmaceuticals, and oil. This Part considers how regulators handle the largest companies in each industry. The industries with the ten largest companies were chosen because their power and reach enable them to exert influence on a broader swath of the economy than would smaller companies. Additionally, when a prominent company is subject to an enforcement action, its competitors adjust accordingly. These case studies demonstrate how administrative agencies, after receiving authority from Congress, have delegated some of that authority to the largest regulated entities.

A. The FTC and Big Tech

The FTC issued third-party oversight orders against Amazon, Facebook, and Google, as well as other large technology companies such as Lenovo. The greatest amount of detail available relates to the agency’s actions against Facebook, the subject of two rounds of investigations. In 2012, the FTC finished its original investigation of Facebook for violation of the Federal Trade Commission Act’s prohibition on unfair and deceptive acts, concluding that the social network had “deceived consumers by telling them they could keep their information on Facebook private, and then repeatedly allowing it to be shared and made public.” One of the FTC’s main concerns was how Facebook had verified the security practices of third-party service providers.

The enforcement order left Facebook’s responsibilities vague, but required the submission of auditor reports. However, in the 2018 report, its auditor, PricewaterhouseCoopers, summarized Facebook’s requirements imposed on app developers by referring to Facebook’s publicly available policies. Facebook also submitted to the FTC a mandatory follow-up report on what it

86 See Fortune 500 List, supra note 10.
87 Griffith, supra note 9, at 2090.
90 In the Matter of Facebook, Inc., supra note 15, at 5–6. Facebook has treated app developers as similar to service providers. See infra note 97 and accompanying text. Additionally, the FTC’s other agreements have signaled a broader expectation for regulated entities’ oversight of third parties. See, e.g., In the Matter of Lenovo Inc., supra note 88.
91 Id. 15
had done to comply with each part of the commitment. The report detailed an apparently extensive oversight program for third parties. Facebook might send questionnaires to service providers to determine their security and privacy practices. Depending on the answers to those questions, or merely the nature of the data shared, Facebook would initiate more targeted security audits. Those audits, which are sometimes conducted by Facebook and sometimes by a security firm, “assess [ ] compliance with Facebook’s security guidelines.” Facebook uses these audits to determine, for instance, whether an app developer complied with users’ requests to delete their personal data.

After Cambridge Analytica accessed millions of users’ Facebook data to promote Donald Trump’s election campaign, the FTC began investigating Facebook to determine whether that incident involved violations of the 2012 settlement. Zuckerberg admitted that Facebook needed to better police app developers, stating in his opening testimony to Congress, “It’s not enough to just give people control over their information. We need to make sure that the developers they share it with protect their information, too.”

The FTC’s enforcement actions against Amazon demonstrate a different gatekeeper approach. Amazon operates an app store populated with products created and owned by third-party operators. These apps enable people on Android phones or Kindle to play games, among other activities. While using these apps, consumers buy products, for which the third-party app developers set the prices and receive 70% of the payment. The developers control the interface while consumers use the app, including the in-app purchases at the heart of the FTC’s investigation. Amazon thus had little direct involvement in the communications surrounding the disputed transactions.

Although Amazon does not operate the apps, induce consumers to make the purchasing decision, or set the prices, and only keeps 30% of the payment, the FTC treated the company as responsible for those purchases. It did so by

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94 Id.
95 Id.
96 Id. at 10.
97 Facebook Platform Policy, supra note 89. App developers may be subject to Facebook audits of their apps, systems, and records. Id.
98 See Steinmetz, supra note 2.
101 Id.
102 Id.
103 Id. at *1, *11.
focusing on two points of contact between Amazon and consumers. First, Amazon operates the online store through which consumers purchase the apps.104 With respect to this original purchase, Amazon did not make it clear enough that in-app purchases would be possible.105 Amazon’s description of the apps, available below the purchase button, included such information.106 However, Amazon imbedded the information in a long description of the app below the purchase button and displayed it in smaller font.107 A federal court agreed with the FTC that the notice of in-app purchases “was not conspicuous.”108

Amazon’s second point of contact was the interface for making the purchase. For many months, upon pressing a button that led to a purchase, Amazon required no additional approval.109 The customer simply received a follow-up email confirming the purchase.110 Amazon later displayed a prompt that asked for a confirmation, sometimes requiring password entry, but only for purchases over $20.111 Even the updated confirmation settings allowed children, in the course of playing a video game, to make many purchases that individually were under $20, but collectively produced large bills.112

Unlike the Facebook case, the FTC never reached a settlement with Amazon.113 In 2017, the parties withdrew their appeals and announced a refund program for injured consumers.114 The press release gave no indication that the FTC would mandate ongoing oversight.115 That omission may reflect a new approach under the Trump Administration, or possibly suggests that privacy concerns command greater regulatory scrutiny of third parties than do monetary harms. Regardless, to lessen the risk of future liability, Amazon must ensure that third-party apps on its platforms do not deceive consumers.

B. The CFPB and Big Banks

Like banking regulators focused on financial stability, the CFPB could

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104 Id. at *1.
105 Id. at *1–*2.
106 Id. at *2.
107 Id. at *2–*3, *10.
108 Id. at *10.
109 Id. at *2.
110 Id. at *4–5.
111 Id. at *2.
112 Id. at *2, *4.
114 Id.
115 Id.
pursue its consumer protection mission by bringing enforcement actions directly against third-party service providers.\(^{116}\) Instead, it has required banks to govern third parties, including call centers, debt collectors, software developers, and real estate lawyers.\(^{117}\) Tools for overseeing third parties are likely to become even more important given the regulatory challenges created by the rise of nonbank fintechs offering digital consumer financial services, typically in partnership with traditional banks.\(^{118}\) The agency has brought third-party actions against each of the four largest banks—JP Morgan Chase, Wells Fargo, Bank of America, and Citibank.\(^{119}\)

The bureau’s third-party enforcement policy began with its first enforcement action. Capital One, one of the largest credit card issuers, contracted with an independent call center which routed card holders with low credit scores—also known as subprime borrowers—to different sales representatives when they called Capital One.\(^{120}\) Those representatives talking with subprime cardholders had a Capital One script for how to sell additional payment protection products, but they frequently veered from the script.\(^{121}\) Some representatives inaccurately described the add-on products as free, even though consumers collectively paid about $140 million over a two-year period for the products.\(^{122}\) They also often implied that the products were not optional.\(^{123}\)

The CFPB found that the call center’s employees engaged in deceptive acts

\(^{116}\) 12 U.S.C. §§ 1863, 1867(c) (2012) (granting third-party oversight to the Federal Reserve, the Federal Deposit Insurance Corporation, and other prudential regulators over third-party services, such as accounting and computation, that a bank “causes to be performed for itself”); 12 U.S.C. § 5514(e) (granting similar oversight authority to the CFPB over institutions offering consumer financial services).


\(^{121}\) Id. at 4.

\(^{122}\) Id. at 5–6.

\(^{123}\) Id.
and practices in violation of federal law.\textsuperscript{124} Although the bureau found no fault with the script Capital One provided to the call center, it argued that “the Bank’s compliance monitoring, service provider management and quality assurance resulted in ineffective oversight which failed to prevent, identify, or correct the improper sales practices.”\textsuperscript{125} The settlement required Capital One to submit to the CFPB for pre-approval a written internal policy for implementing heightened third-party oversight.\textsuperscript{126} Among other requirements, Capital One would conduct “periodic onsite audit reviews … of the Bank Service Provider’s controls, performance, and information systems” and retain the right to exit the contract in the face of service provider noncompliance.\textsuperscript{127} Capital One also paid $25 million in penalties, but was “prohibited from seeking or accepting indemnification … from any third party.”\textsuperscript{128} These indemnification-piercing stipulations provide greater motivation for the enforcer-firm to do a thorough job of monitoring and addresses the problem that many firms merely “window-dress” their compliance efforts without making a true effort.\textsuperscript{129}

In its various cases and policy guidance, the CFPB has reinforced and clarified these initial expectations for third-party governance. Not long after its action against Capital one, the CFPB fined American Express for deceptively collecting debts, charging excessive late fees, and discriminating based on age.\textsuperscript{130} Third-party service providers committed all but one of the violations.\textsuperscript{131} Nonetheless, the agency explicitly faulted the board and senior management of American Express for ineffective compliance management, “particularly” their oversight of third-party service providers.\textsuperscript{132}

Similar to the Capital One consent order, the enforcement action required American Express to develop policies for monitoring its service providers’ compliance with consumer protection laws.\textsuperscript{133} But American Express also agreed to have its compliance department submit quarterly reports to the board on “whether Service Providers are in compliance” with all contracts, and the consent order stipulated that “[t]he Board shall be responsible for ensuring that corrective actions are taken….\textsuperscript{134} The American Express consent decree thus

\begin{flushleft}
\textsuperscript{124} Id. at 8.
\textsuperscript{125} Id. at 4.
\textsuperscript{126} Id. at 22–23 (requiring also that any subsequent changes to this policy must obtain CFPB approval).
\textsuperscript{127} Id.
\textsuperscript{128} Id. at 21.
\textsuperscript{130} American Express Consent Order, supra note 14, at 3–4(alleging misrepresentation related to credit scores
\textsuperscript{131} Id. at 5.
\textsuperscript{132} Id. at 4.
\textsuperscript{133} Id. at 17–19 (requiring consumer protection compliance review).
\textsuperscript{134} Id. at 19.
\end{flushleft}
helped to put the industry on notice that the CFPB would expect the board of directors to engage actively in the oversight of third parties.

Several years later, the CFPB went after a bigger target for its failure to oversee third parties: Citibank, one of the four largest U.S. banks. Presumably aware of the Capital One enforcement action, Citibank went further than simply providing a script by also reviewing recorded telemarketer calls. The telemarketing firm knew, however, which calls would be later reviewed for legal compliance and used a misleading sales script only for unmonitored calls. The CFPB ordered Citibank to adopt third-party oversight reforms and pay a $35 million penalty. The Citibank action illustrates how having an oversight system in place is not enough—the oversight must produce results.

A rare case that went to trial produced more details about third-party governance setups. The court order required the British multi-national bank HSBC to audit samples of contracts between third-party service providers and customers, to ensure that those documents comply with the law and that “only fees and costs that are lawful, reasonable and actually incurred are charged to borrowers.” Banks are also expected to oversee the processes and compliance departments of third-parties.

After four years of these enforcement actions, the CFPB issued a guidance bulletin summarizing its expectations for third-party oversight. The bulletin offers many details, including that the financial institution’s contracts and compliance management system must include ongoing monitoring of third parties.

The CFPB’s settlements contain more detail than the FTC’s, since the FTC did not specify which parties within Facebook—whether the compliance department or the board of directors—must become involved. The CFPB also plays a more active role in the implementation of such settlement requirements by reviewing third-party governance policies before and after they are implemented. Both agencies nonetheless rely on mandated enforcement by

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137 CFPB-Citibank Consent Order, supra note 119, at 12-13. It hired a private third party to monitor compliance. Id.
138 Id. at 26–30, 45.
139 Id. at 26–30, 45.
141 Id.
explicitly requiring large businesses to monitor for wrongdoing by third parties.

C. The EPA and Big Oil

The 2010 Deepwater Horizon oil spill, which discharged billions of gallons of oil into the Gulf of Mexico in one of the worst environmental disasters in U.S. history, heavily shaped offshore oil regulation.144 BP Oil owned much of the rights to the well’s oil, but in a straightforward sense, the problem began with the Deepwater Horizon offshore drilling platform, owned by Transocean, a Swiss company.145 As the platform began to sink, it ruptured the pipe connecting it to the well below, thereby causing the oil to discharge from the well thousands of feet underwater at the ocean floor.146

If environmental regulators had applied the CFPB’s approach, they might have brought an enforcement action against BP alone and mandated that it monitor the other businesses it hired, such as Transocean. After all, BP Oil is one of the ten largest companies in the world and hired the smaller Transocean as a contractor, just as Citibank hired smaller independent call centers to perform sales.147 Like Transocean, the call centers controlled the specific violations.148

The EPA and the DOJ instead brought enforcement actions against both BP and Transocean.149 However, pursuing Transocean is arguably different from pursuing call centers and app developers directly. Unlike call center operators and many app developers, Transocean is not a small company.150 It is one of the


145 The ownership rights came in the form of a lease, and two other companies also had lessee ownership rights in the well, Anadarko and MOEX. Id. at 94.


147 See Deepwater Report, supra note 144, at 2; Global 500, Fortune, https://fortune.com/global500/2019; supra notes 135 to 139 and accompanying text.

148 Supra notes 135 to 138 and accompanying text (discussing Citibank).


world’s largest operators of offshore oil rigs and as recently as 2017 was ranked one of the 1,300 most valuable companies in the world.\textsuperscript{151} Thus, multinational third-party oil contractors cannot escape regulatory scrutiny simply by working with an oil producer that is considerably larger.

Nonetheless, the EPA and the underlying law still placed the bulk of the responsibility on BP, which wound up paying close to $20 billion in regulatory enforcement actions, compared to $1.4 billion for Transocean.\textsuperscript{152} Policy foundations for this allocation can be seen in an early judicial opinion on Deepwater Horizon liability. Finding the Clean Water Act’s specific liability language to be unclear, the court relied on larger policy purpose, saying it was “designed to place[] a major part of the financial burden for achieving and maintaining clean water upon those who would profit by the use of our navigable waters and adjacent areas and who pollute same . . . .”\textsuperscript{153} Those who profit most are more likely to be valuable companies, giving them more resources to devote to monitoring.

Environmental regulators do not only rely on the imposition of liability, which by itself has led to extensive voluntary monitoring of firms by firms.\textsuperscript{154} Following the Deepwater Horizon incident, new regulations required offshore oil operators to ensure that their contractors comply with environmental standards.\textsuperscript{155} Regulators have expanded on those basic requirements through lawsuits. In its Deepwater Horizon settlement, BP agreed to extensive improvement of its third-party oversight, “including provisions related to contractor oversight.”\textsuperscript{156} Those stipulated provisions include the creation of Contract Governance Boards for both drilling and cementing operations, as well as audits of contractors.\textsuperscript{157} The settlement required the BP board to oversee those


\textsuperscript{152} See EPA Enforcement Actions, supra note 149.


\textsuperscript{154} See Vandenbergh, supra note 41, at 2041 (showing pervasive second-order agreements).


\textsuperscript{157} Id. at app. 4, at 25.
improvements, as well as their ongoing execution. These BP oversight measures are separate from the various audits that private third parties other than BP must also undertake of BP’s contracts. It is BP’s responsibility to ensure that its contractors complete those independent audits.

Transocean’s settlement imposed no explicit ongoing third-party monitoring responsibilities on Transocean. The settlement referenced regulations imposing broad safety management responsibilities, which include evaluation of all contractors to ensure they operate according to safety environmental management systems. But the referenced regulations have numerous other requirements unrelated to third parties, and thus it would be a stretch to see the settlement as mandating third-party monitoring. Still, the existence of those regulations means that Transocean must, like BP, oversee all third parties with which it contracts.

For oil refineries located on land, the EPA imposes similar oversight duties. In a 2005 case, the EPA found that Exxon routinely emitted hazardous pollutants, in violation of the Clean Air Act, in Illinois, Louisiana, and Montana oil refineries. Among other stipulations, Exxon committed to an annual “review of each contractor’s monitoring data which shall include, but not be limited to, a review of: (i) the number of components monitored per technician; (ii) the time between monitoring events; and (iii) abnormal data patterns.” The EPA is not always so explicit about third-party oversight expectations. In another Clean Air Act case, regarding similar violations in a manufacturing facility in Texas, the EPA did not specify exactly how Exxon should monitor its contractors. Instead, it stipulated that moving forward Exxon “will not raise as a defense the failure by any of its officers, directors, employees, agents, or contractors to take any actions necessary to comply with the provisions of this

158 See id.
159 Id. at app. 6, p. 6–7.
160 See id.
162 Id. at 16 (requiring a management system that “complies with Operators’ Safety and Environmental Management System (‘SEMS’)).”); 30 C.F.R. § 250.1914(c)(1) (2013).
165 Id. at 110.
166 The settlement did, however, order Exxon’s contractors to take affirmative actions, such as preserving records. See Consent Decree at 80, United States v. Exxon Mobil Corp., No. 4:17-cv-3302 (S.D. Tex. June 6, 2018) [hereinafter 2018 Exxon Mobil Consent Decree], https://www.epa.gov/sites/production/files/2018-06/documents/exxonmobilcorp-cd.pdf.
Consent Decree.” Exxon is also assumed to know everything that its contractors and agents “knew or should have known.”

Even when the EPA is less directive, as it was with Exxon, once the agreement is in place imposing such clear responsibility for the acts of third parties, government inspectors can fault the company if its contractor oversight capabilities are found to be insufficient. Additionally, companies generally look to the larger body of a regulator’s enforcement actions in deciding how to implement internal systems. Thus, by mandating regular oversight of third parties in some cases explicitly, the EPA can create industry-wide standards. Either way, the largest oil companies—including their biggest contractors—have been subject to direct mandates to oversee third parties involved in both onshore and offshore oil activities.

D. The FDA and Big Pharma

Pharmaceutical companies manufacture drugs but contract with other companies for “processing, packaging, holding, or testing.” The FDA has the most explicit third-party monitoring expectations of the four case studies. Rulemaking, guidance statements, and warning letters have communicated its policy.

One FDA rule states that in every pharmaceutical company there “shall be a quality control unit . . . responsible for approving or rejecting drug products manufactured, processed, packed, or held under contract by another company.” Monitoring the output is not, however, enough. The company must also directly monitor inputs used by the contractor, including ingredients and materials. After specifying the contractor’s internal compliance systems, the manufacturer should conduct audits. Thus, the pharmaceutical company must oversee contractors’ organizational processes, inputs and outputs.

The FDA places responsibility for third-party activities at the top of the regulated entity. In its formal rules on liability for tainted products, the agency states that it “regards extramural facilities as an extension of the manufacturer’s...
own facility.”

It reiterated this point in its post-inspection warning letters. In other words, the pharmaceutical company is responsible for the third-party contractor’s activities as if they were one company. In guidance documents, the agency clarified that it was addressing “the relationship between owners and contract facilities.”

Contractual arrangements cannot shield pharmaceutical companies from liability. In one warning letter, the FDA told Pfizer, the largest pharmaceutical company in the world, “You are responsible for the quality of combination products you produce as a contract facility, regardless of agreements in place with [your customer] or with any of your suppliers.”

The FDA does not, however, rely solely on Pfizer to regulate the company’s independent contractors. The FDA still routinely inspects and brings enforcement actions directly against those third parties. For instance, in one warning letter to an independent manufacturer, the FDA wrote, “You and your customer, Pfizer, have a quality agreement regarding the manufacture of drug products. You are responsible for the quality of drugs you produce as a contract facility, regardless of agreements in place . . . .”

Pfizer implemented the FDA’s organizational advice into its internal processes. It routinely monitors suppliers through audits, inspections, and review of systems. Supplier agreements reflect these review procedures, and when Pfizer recognizes a violation, it can de-list the offender from its list of “qualified” suppliers or can report violations to the FDA.

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175 21 C.F.R. § 200.10(b) (2019).
177 FDA Drug Contract Guidance, supra note 171, at 2.
182 Id. at 12.
E. Summary of Case Studies

Federal regulators have established an expectation that today’s largest companies regulate independent contractual parties for legal violations. Through direct enforcement actions or industry-wide mandates, the FTC, CFPB, EPA, and FDA have required the most valuable companies to monitor and punish third-party business wrongdoers. They serve as a new breed of gatekeepers because the regulated entities must now decide whether to give the third parties market access based on regulatory considerations. Sometimes this private regulation benefits a specific party that will be contracting with one of the businesses, such as a consumer, but other times the beneficiary is more general, as in the case of environmental protection or financial stability.

The variations in approaches indicate design choices for new gatekeeper governance. In the case of wrongdoing, should the regulator prosecute only the enforcer-firm, or also the third party? How detailed of a gatekeeper mandate should the regulator provide, and how closely should the regulator oversee the enforcer-firm’s gatekeeping? And should the regulator develop the gatekeeper governance model in a piecemeal manner through cases, or through more explicit means, such as guidance documents and formal rulemaking?

Though focused on a subset of industries and companies to manage scope, these case studies are part of a broader sphere of regulatory activity. These four regulators alone have jurisdiction over other large parts of the economy. The FTC, for instance, oversees retailers and other industries in addition to big technology, and the FDA regulates food and supplement manufacturers. Additionally, other regulators deploy third-party mandated governance beyond these four industries. The Interstate Commerce Commission, for instance, obligates trucking operators to monitor contractual parties for roadway safety compliance. A number of other federal and state laws similarly require companies to play some regulatory oversight role with respect to third-party businesses, including health care providers ensuring business associates safeguard health data. Even if the regulatory state conscripted only the five largest companies it would mean a substantial extension of regulatory resources. But mandated enforcement is widespread enough to prompt a broader inquiry into the implications for the firm’s evolving place in society.

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183 On the prior iterations of gatekeepers, see Kraakman, supra note 6, at 54.
185 The Interstate Commerce Commission, for instance, mandates that companies inspect leased equipment. 49 C.F.R. § 376.11 (2018).
187 See infra Section IV.A.
III. EXPANDING THE PUBLIC INFLUENCE ON THE FIRM

This Article aims primarily to illuminate the rise of mandated enforcement, both its form and scope. Once recognized, however, this development implicates prominent conversations and policy debates. By redrawing the lines between public and private, mandated enforcement adds a new layer to some of the most fundamental corporate law questions: How should the firm be conceptualized? And what duties does it owe to society?

The firm has a decidedly private core, as implicated by its prominent description as a nexus of contracts. Because the firm’s contractual foundations are necessarily incomplete, corporate law fills in the gaps to reflect the parties’ intents. Some scholars have proposed giving greater weight in corporate governance to a broader set of social issues, including employee rights or a cleaner environment, and demonstrated how managers have discretion under the business judgment rule to pursue these goals. Nonetheless, most commentators and judges see the primary goal of corporate law as advancing shareholder value.

By some accounts, the depiction of the firm as a contractually-based private entity helped advance the notion that government intervention in those private agreements is “unnatural.” That line of reasoning views the firm’s “market-oriented nature” as serving “to dismiss the notion that the corporation owes anything to the state.” Of course, the firm and its directors cannot pursue profit illegally. Under Delaware law, for instance, the firm’s articles of incorporation

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188 Supra note 29 and accompanying text.


cannot limit a director’s personal liability when the director commits a “knowing violation of law.” Thus, the firm is private at its core, but public statutes define the limits. The rest of this Part illustrates how mandated governance constitutes a considerable expansion of that public side.

A. Conscripting the Firm as Regulator

Two of the most fundamental functions of administrative agencies are writing and enforcing rules. Firms now perform each of these functions for the public good. They do not undertake these activities voluntarily in response to laws or market incentives, but by direct public mandate.

1. Writing Rules

Mandated enforcement puts the firm in a rulemaking role by compelling it to write regulatory contractual clauses. Firms’ written contracts serve as a principal vehicle for implementing third-party governance. For example, in its FTC settlement, Facebook agreed to require “service providers, by contract, to implement and maintain appropriate privacy protections” for any data obtained from Facebook. When the company later submitted its required compliance report, Facebook explained that it had implemented its third-party oversight through its contracts. In particular, it developed a “Contract Policy” so that agreements with third parties operate through Facebook’s “pre-approved standard contract templates.” Facebook’s legal department “reviews contracts that deviate from the pre-approved templates to help ensure that contracts with applicable service providers contain the required privacy protections.”

The case of Facebook embodies a broader theme of regulator-mandated contract clauses.

Consumer finance, pharma, and oil regulators also explicitly mention contractual requirements. A CFPB guidance bulletin states that all financial institutions should include “in the contract with the service provider clear expectations about compliance, as well as appropriate and enforceable consequences for violating any compliance-related responsibilities.” The FDA expects pharmaceutical companies to detail in their contracts the shape of

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195 By analogy, Congress delegates to agencies. Bamberger, supra note 4, at 381.
198 Id.
199 Id.
third-party suppliers’ compliance systems, and to reserve the right to audit these systems.\textsuperscript{201} The EPA required BP Oil to include certain provisions in any new contract with a drilling rig, including requiring the rig to join an industry safety group.\textsuperscript{202} The firm’s contracts no longer contain only voluntary second-order regulatory components made in response to regulation, but now also include first-order clauses mandated by law.\textsuperscript{203}

These mandated contractual clauses presumably become legally enforceable against the smaller companies agreeing to them.\textsuperscript{204} Even if the counterparties do not expect the contract to ever reach a courtroom, however, their terms can define the contours of the ongoing relationship.\textsuperscript{205} Businesses refer to their contracts for guidance as to their respective rights.\textsuperscript{206} Through their inclusion in contracts, third-party enforcement clauses can influence many of the firm’s relationships with external parties.\textsuperscript{207}

More to the point, these mandates infuse a more significant public obligation into the firm’s contracts. Motivated solely by profit and without any legal influence, businesses have long inserted contract clauses that incidentally advance the interests of consumers, the environment, or health.\textsuperscript{208} Even second-order contractual clauses, inserted voluntarily in response to laws, still retain the autonomy of contracting parties and therefore a heavy private component.\textsuperscript{209} Conversely, conscripted enforcement contracts impose more thoroughly public obligations because businesses do not write them voluntarily.

Do contractual third-party governance clauses differ from other contractual mandates? Various statutes influence the shape of particular contracts by requiring them to include certain information. For instance, credit card companies must prominently communicate the annual percentage rate, under the Truth in Lending Act.\textsuperscript{210} The Uniform Commercial Code provides a default warranty of merchantability and imposes a duty to act in good faith.\textsuperscript{211} Legislative limits on freedom of contract are neither new nor unusual.

Conscribed enforcement clauses need not differ from other contractual mandates to mark a significant expansion of public influence on the firm’s

\textsuperscript{201} FDA Drug Contract Guidance, supra note 171, at 4.
\textsuperscript{202} BP Consent Decree, supra note 156, at App. 6-8.
\textsuperscript{203} On second-order voluntary contracts, see Vandenbergh, supra note 41.
\textsuperscript{204} This assumes, of course, that the contract is valid, and a meaningful remedy is crucial for any legal enforcement.
\textsuperscript{205} See Lisa Bernstein, Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts, 7 J. Legal Analysis 561, 562 (2015).
\textsuperscript{206} See id. at 563–65 (providing results on how businesses use contracts).
\textsuperscript{207} See id. at 566 (describing the nature of remedies for firms’ contractual schemes).
\textsuperscript{208} See supra Section I.A.
\textsuperscript{209} See Vandenbergh, supra note 41.
\textsuperscript{211} U.C.C. §§ 1-203, 2-314 (Am. Law Inst. & Unif. Law Comm’n 1978).
contracts. However, those traditional mandates do, in fact, differ because their most immediate beneficiary is one of the contracting parties. Arguably, these restraints advance freedom of contract, in that they help one of the parties to come to the agreement they would have wanted if both were economically rational and informed.212 Disclosures, for instance, give information that both parties would want entering into the transaction about the nature of what they are receiving—such as the full cost of a loan, including fees.213 Those laws may ultimately benefit the public by improving welfare through more efficient market transactions, but they remain more clearly internal-to-the-contract in terms of their direct beneficiary—one of the contracting parties.214

In contrast, mandated enforcement can benefit parties not involved in the contract. These mandates require Facebook, Citibank, and Pfizer to protect consumers by governing service providers and suppliers.215 Exxon and BP must ensure that contractors safeguard the environment for the benefit of the public.216 Granted, one or both of the contractual parties also arguably benefit from these requirements, by preserving their reputation and strengthening industry standards.217 Also, consumer-oriented protections benefit a party that will ultimately contract with the enforcer-firm—Facebook’s users, or Citibank’s customers.218 The benefits to the contracting parties are less immediate and less definite, however—nor do they motivate the clause.

Congress regularly passes laws that require some administrative agency with rulemaking. Following the financial crisis of 2008, for instance, Congress tasked the CFPB with writing numerous consumer protection rules.219 By analogy, in the case of third-party governance, regulators arguably delegate some of the rulemaking authority they receive from Congress to firms. Regulators could write the specific third-party governance clauses that they want firms to include in their contracts, but they do not. This non-directive approach reflects regulators’ broader strategy of delegating complex decisions to private parties due to limited information and resources.220

Instead, regulators provide general guidance regarding what the firm should

214 See, e.g., id (providing an example of disclosure).
215 Supra Part II.
216 Supra Section II.C.
218 See supra Sections II.A–B.
220 See Bamberger, supra note 4, at 380–81 (identifying regulatory limits and complexity).
include, such as instructing Google to require “service providers by contract to implement and maintain appropriate privacy protections.”

Although companies do not normally release the text of their contracts, Facebook’s terms state to app developers, “We or an independent auditor acting on our behalf may audit your app, systems, and records to ensure your use of Platform and data you receive from us is safe . . . .” Regulators thus, to varying degrees, let the firm determine how best to write that clause. In short, by writing contract clauses governing other private parties, businesses play a rulemaking role analogous to what Congress expects of administrative agencies.

2. Enforcing Law

Mandated third-party governance also compels large firms to enforce the law. In his testimony in front of the Senate, Zuckerberg was asked by one senator why the company had not more closely monitored app developers and held them accountable for violating Facebook’s privacy policies. Zuckerberg responded, “Before, we’d thought that when developers told us that they weren’t going to sell data, [that was] a good representation. But one of the big lessons that we’ve learned here is that clearly, we cannot just take developers’ word for it. We need to go and enforce them.”

As mentioned above, federal regulators use ongoing monitoring as their main enforcement tool, rather than simply bringing formal lawsuits. The FDA and EPA conduct routine on-site inspections of laboratories and manufacturing facilities, for instance, and the CFPB visits banks to examine their records. When the federal monitors—typically called inspectors or examiners—detect wrongdoing, they often handle the problem directly without involving lawyers.

Mandated enforcement also emphasizes monitoring. Facebook “audits” app developers as part of its consent order. Capital One must conduct “periodic onsite audit reviews” of service providers. Pharmaceutical companies are expected to reserve the right “to audit its contractor’s facilities for compliance . . . .” Exxon is required by court order to review subcontractor

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222 Facebook Platform Policy, supra note 92.
224 See supra Section I.A; see also Van Loo, supra note 39, at 412.
225 See, e.g., Van Loo, supra note 39, at 382, 391 n.138, 411.
226 Id.
227 Facebook Platform Policy, supra note 97; Facebook Compliance Report, supra note x.
228 Capital One Bank, supra note 120, at 23.
monitoring data.\textsuperscript{230} Thus, by public mandate firms must undertake one of the core functions of the modern public regulator.

In implementing regulatory monitoring, private firms face similar challenges as public regulators long have. For instance, Volkswagen fooled regulators for years into thinking its cars met emissions standards through software that recognized when an emissions test was occurring and hid actual emissions levels.\textsuperscript{231} Similarly, Citibank had an oversight regime that included reviewing call centers’ phone conversations, but call center employees figured out which calls would be audited and only veered from the mandated script on unmonitored calls.\textsuperscript{232} Businesses now have incentives to evade the enforcer-firm’s detection as they long have had for public regulatory policing.

In monitoring third parties, large firms also look for similar things as do public regulators. A “critical component” of modern regulation is to move beyond the identification of specific violations to ensure that companies have “a robust and effective compliance management system.”\textsuperscript{233} This means scrutinizing a company’s procedures to ensure a meaningful compliance system.\textsuperscript{234} The enforcer-firm must also look for more than violations. As one example, when Facebook monitors app developers for privacy, they examine developers’ data security procedures.\textsuperscript{235}

Enforcement must come with some kind of sanction. One pervasive regulatory sanction is the ability to block access to the market, often through the revocation of a permit or license.\textsuperscript{236} This gives regulators a potentially ruinous enforcement sanction, even if they rarely use it.

Big businesses are expected to enforce using a similar gatekeeper function by blocking access to markets. In one consent decree, the Comptroller of Currency and other governmental entities required HSBC to “perform appropriate due diligence” of “Third-Party Provider qualifications, expertise, capacity, reputation, complaints, information security, document custody practices, business continuity, and financial viability . . . .”\textsuperscript{237} These factors reflect what bank regulators consider in extending bank charters.\textsuperscript{238} More broadly, regulators may require firms to screen third-party qualifications at the

\begin{itemize}
\item \textsuperscript{230} Exxon Mobil, supra note 164, at 110.
\item \textsuperscript{231} Jack Ewing, Inside VW’s Campaign of Trickery, N.Y. Times, May 7, 2017, at BU1, 5.
\item \textsuperscript{232} CFPB-Citibank Consent Order, supra note 119, at 12–13.
\item \textsuperscript{233} CFPB, Supervisory Highlights: Fall 2012 4 (2012).
\item \textsuperscript{234} See Griffith, supra note 9, at 2089.
\item \textsuperscript{235} See FTC-Facebook Consent Decree, supra note 15, at 5–6.
\item \textsuperscript{236} Eric Biber & J.B. Ruhl, The Permit Power Revisited: The Theory and Practice of Regulatory Permits in the Administrative State, 64 Duke L.J. 133, 137, 209 (2014).
\item \textsuperscript{237} Consent Order at 11, HSBC Bank USA, N.A. (Off. of the Comptroller of the Currency Apr. 13, 2011) (No. AA-EC-11-14).
\item \textsuperscript{238} In awarding a bank charter, the OCC considers factors such as the reputation of the board members, the business plan, and the financial profile. See Barr et al., supra note 8, at 165.
\end{itemize}
outset, and then to reserve the right to end the contract in the event of misconduct.  

Like public regulators, large private firms wield powerful blocking sanctions.  

Despite their private foundations, corporations increasingly must play a role similar to the public regulator—both by writing rules for the benefit of the public into their contracts with third parties and by actively monitoring and enforcing those rules. This new role not only changes the descriptive account of the firm, but promises to reshape corporate governance, liability, and structure.

B. Shaping Corporate Governance

Much of corporate law addresses the duties owed by officers and directors. In public corporations, the shareholders do not exert day-to-day control, but rely instead on the board of directors and the officers of the corporation to run the business. Fiduciary law is one of the main ways that shareholders can hold officers and directors liable if they manage the corporation in a way contrary to shareholders’ interests. Other civil lawsuits may also be brought against business leaders. This section looks at the implications of third-party mandates for personal liability and the corporate governance principles that such liability seeks to promote.

In In re Caremark, the Delaware Chancery Court observed that “a director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may . . . render a director liable for losses . . . ” Subsequent rulings have reinforced directors’ fiduciary duty to ensure the corporation has reporting systems and controls that enable them to monitor risks. But the bar is high for such liability. Directors do not violate their fiduciary duty simply by overseeing a company with objectively poor compliance systems, unless plaintiffs show that the directors’ oversight of

240 For more on the sanction effect and its variability among enforcer-firms, see infra Section IV.A.
243 Id. § 10:1.
244 In re Caremark Int’l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).
those systems was subjectively reckless or grossly negligent.\footnote{Stone, 911 A.2d at 369, 372–73.}

How does third-party mandated governance alter board members’ duties to shareholders? Shareholders tested that issue through a suit against Capital One.\footnote{In re Capital One Derivative S’holder Litig., 952 F. Supp. 2d 770 (E.D. Va. 2013).} Pointing to the CFPB’s aforementioned enforcement action, shareholders first alleged that the board inadequately monitored the call centers.\footnote{Id. at 785.} The court noted that, under Delaware law, to establish a breach of fiduciary duty in monitoring third parties plaintiffs must show that the board operated in bad faith.\footnote{Id. (citing Stone, 911 A.2d at 369–70) (internal quotations omitted).} Because Capital One had controls in place for call centers, the court found that the plaintiffs did not plead sufficient facts to show “a sustained or systematic failure of [the] board to exercise oversight’ or that ‘the board utterly failed to implement any reporting or information system or controls.”\footnote{Id. (quoting Stone, 911 A.2d at 369–70).} The court ultimately dismissed the suit on summary judgment because the plaintiffs did not put forth facts showing that the directors “consciously chose not to remedy the misconduct.”\footnote{In re Capital One Derivative S’holder Litig., 979 F. Supp. 2d 682, 701 (E.D. Va. 2013).}

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Despite the lack of a strong influence on directors’ state law liability, mandated third-party regulation could still alter corporate governance. By specifying actions the board must take in the wake of settlements, administrative agencies are dictating concrete board duties. In its settlement with Citibank, for instance, the CFPB required the board to form a sub-committee focused on compliance, and for that sub-committee to meet monthly, take minutes, and submit quarterly reports to the CFPB’s regional director on the bank’s progress overseeing third parties.\footnote{CFPB-Citibank Consent Order, supra note 119, at 32–34.} Regulators’ detailed instructions put responsibility at the top of the corporation for the ongoing oversight of third parties, leaving little room for the board to claim ignorance.\footnote{See, e.g., Consent Decree Among Defendant BP Exploration & Production Inc., the United States of America, and the States of Alabama, Florida, Louisiana, Mississippi, and Texas at app. 4–020 to –023, In re: Oil Spill by the Oil Rig “Deepwater Horizon” in the Gulf of Mexico, on Apr. 20, 2010, 2179 (E.D. La. Oct. 5, 2013).}

Although regulators are unlikely to prosecute officers and directors for third-party mandates, and insurance would normally shield many from paying anyway,\footnote{Kraakman, supra note 34, at 859.} the mandates move business leaders toward personal liability for the...
acts of third parties under various statutes. For example, the Federal Trade Commission Act holds individuals liable for a corporation’s deceptive acts if the individual possessed authority to control the acts and knew or should have known about them.257 Since many settlement agreements and guidance documents require the board of directors or officers to oversee third-party compliance and to receive reports,258 regulators are essentially ordering them to have control and knowledge. Some regulators, including the CFPB and FTC, have pursued actions against individuals for failed supervision of third parties.259 Individuals within the firm thus may in the future face greater personal liability for the acts of third parties as a result of current mandates to monitor and influence those third parties.260

More broadly, the mandates may still influence board members’ conduct even if personal sanctions are unlikely. Enforcement actions against firms drove the explosion in many large corporations’ compliance departments, which now often rival the legal department in size and influence. Those large compliance departments often retain some formal relationship with the board.261 The emergence of specific requirements for third-party oversight could similarly shape industry norms for the board’s oversight of other external companies.262

Put differently, regulators are moving the bar set by corporate law’s compliance duties imposed on boards for third-party oversight. By requiring the firm to oversee third parties for legal compliance, regulators inevitably implicate those ultimately responsible for running the firm, including owners, board members, and managers. Regulators’ specific requirements for board conduct, reaching details such as minutes and compliance plan approval, mean that even boards that have yet to be subject to enforcement actions operate in reference to them in managing their compliance programs. Mandated enforcement may overcome the formidable shield from liability that the state law business judgment rule, and other waivers,263 have provided to the board of directors.

C. Altering Entity Liability and Structure

258 See supra note 254 and accompanying text.
260 Cf. Stavros Gadinis & Amelia Miazad, The Hidden Power of Compliance, 103 Minn. L. Rev. 2135, 2137 (2019) (showing how compliance officers can change the board’s liability).
262 Directors and officers liability insurers could also exert pressure on individuals to engage in certain third-party governance practices to be eligible for coverage, thereby influencing without imposing personal liability.
Legal liability plays a prominent role in corporate law. By some leading accounts, the limitation of liability is the defining characteristic of the corporation and has driven its structural evolution. Regulators’ approach to third-party regulation has increased the firm’s liability for the acts of other businesses. That shift in liability implicates the firm’s entity-level liability, which could alter the corporate structure in ways that policymakers did not intend.

Mandated third-party governance could change large companies’ organizational structures. In recent decades, many businesses have outsourced activities previously conducted in-house. Diverse considerations drive the decision to outsource, including cost savings and an enhanced ability to monitor remote parties, but some scholars have concluded that one goal as lessening the risks of legal liability. Regardless of the motivation for the original outsourcing, the third-party service provider typically contractually shields the outsourcing firm from lawsuits. For instance, a debt collector indemnified cell phone carrier Sprint from “all claims, damages, losses, liabilities, costs, expenses and reasonable attorney’s fees” related to its collection services.

Third-party mandates could make outsourcing less attractive if they remove some of these legal protections. As discussed above, this governance shift already prevents many of the largest companies from delegating away liability for public prosecution. That fact alone presumably makes outsourcing less

264 See, e.g., Hansmann & Kraakman, supra note 191, at 439–40.
265 See supra Part II.
269 Penncro Assocs., Inc., 499 F.3d at 1156 (indemnifying Sprint against claims for work performed by the service provider).
270 The FDA, for instance, states in its guidance document on third-party contracts, “It is important to note that quality agreements cannot be used to delegate statutory or regulatory responsibilities to comply with [Current Good Manufacturing Practice].” See Drug Contract Guidance, supra note 171, at 6. Environmental and consumer financial protection laws have
Outsourcing would become even less attractive if it stopped insulating the firm from private lawsuits. Agency law provides a primary avenue for private parties holding firms liable for the acts of third parties. The more a business controls the acts of another, the more likely courts will find the business to be the principal liable for an agent’s acts. Various other statutes also provide a private right of action against companies for acts by third parties they control, such as for unfair and deceptive acts committed against consumers. The more Verizon controls the acts of the telemarketer, for instance, the easier it is for a customer harmed by the telemarketer to sue Verizon, rather than the telemarketer. Outsourcing may provide less protection from liability in private lawsuits if third-party mandates closely map those considered by courts in determining control. In analyzing whether a third party, such as a telemarketer, is an agent, courts cite activities such as monitoring and editing the script used by telemarketers as demonstrating control. Yet regulators often mandate third-party monitoring and explicitly require the implementation of “controls” over third parties. It follows that conscripted enforcement may move the firm into a position of control sufficient for courts to hold the firm liable for the acts of third parties. In other words, the new gatekeepers may prompt a resurgence of respondeat superior liability.

The additional risk of liability possibly imposed by third-party mandates might change the outsourcing calculus. Purchasing the service provider would not necessarily impose more liability. In United States v. Bestfoods, the EPA sued a parent company under common law liability for the cleanup costs of hazardous waste disposed of by a subsidiary. The Court reasoned that something more than ownership control was needed to hold the parent liable under the common law. Direct involvement by the parent company in the wrongdoing is needed.

Although purchasing a subsidiary thus would not necessarily increase liability for the wrongdoing of the subsidiary, it could facilitate monitoring. As an independent company, the service provider would be reluctant to share

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277 Id. at 61–62.
278 Northbound Grp., Inc. v. Norvax, Inc., 795 F.3d 647, 651 (7th Cir. 2015).
private information with its client. Companies generally guard private information closely, and if the client later used a different service provider, oversharing information could reduce the original service provider’s competitive advantage. When the service provider is a subsidiary, however, the need for secrecy diminishes.

Thus, mandated third-party governance may cause businesses to either purchase the third-party service provider or develop a new service provider as a subsidiary to facilitate more effective monitoring. This assumes that the firm believes more effective monitoring would decrease the likelihood that the service provider will engage in wrongdoing. If so, pervasive mandated enforcement could thereby influence firms’ organizational structures.

D. Strengthening the Public Duty

Conscripted enforcement informs debates about what duties businesses owe to society. Firms must refrain from violating laws, but they usually do not need to take any particular action to benefit the public.279 A strong norm discourages “unwarranted ‘social’ obligations on private enterprise.”280

Industry-specific exceptions do exist, however. Utilities and common carriers must offer cable, Internet, electricity, and gas services at comparable prices even to unprofitable customers, such as inhabitants of rural communities.281 Under the Community Reinvestment Act, banks must extend credit in underserved neighborhoods.282 Disparate state and federal laws oblige hospitals not to exclude patients.283

Unlike banks’ and utilities’ requirements to help some sector of the public, third-party mandated governance is not limited to companies offering essential services or serving as common carriers.284 It thus reaches a broader swath of the economy.285 Additionally, those essential services providers can fulfill the mandated public act by offering their core product—even for compensation.286 In contrast, conscripted enforcement requires a public action other than offering

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279 See Cox & Hazen, supra note 242, at § 10:1.
285 Supra Part II.
286 To satisfy the Community Reinvestment Act, for instance, banks can make loans to small businesses. See, e.g., Michael S. Barr, Credit Where It Counts: The Community Reinvestment Act and Its Critics, 80 N.Y.U. L. Rev. 513, 523–26 (2005).
the firm’s core product, and without compensation, thus bringing the firm further outside its sphere of private enterprise.

Third-party mandates differ from the drastic growth in mandated internal compliance. Compliance departments have until now largely been seen as internally focused. Conversely, third-party mandates are externally focused. That distinction matters because mandating internally focused compliance departments can be seen as merely a new mechanism for requiring the firm to do what it was always expected to do—regulate itself.

Although different in fundamental ways, conscripted enforcement is part of a broader shift that includes compliance departments, community reinvestment requirements, and the SEC’s expanded substantive corporate law authority through the Sarbanes-Oxley Act. These and related developments have over time marked greater federal intervention into corporate governance and operations.

Conscripted governance adds a substantial new layer by allowing a large number of federal agencies beyond the SEC to shape the firm’s relationships, contracts, board activities, and liability. In debates about what duties the firm owes to society, appeals to the private nature of the firm are less persuasive in light of this extensive public influence. Other arguments against government overstepping, such as the efficiency implications of regulatory burden, retain their force and underscore the importance of weighing broader economic tradeoffs in designing corporate governance interventions. However, as a descriptive matter, policymakers are proceeding as though the firm has a duty to act affirmatively in the public good.

IV. EXPANDING THE PRIVATE BRANCH OF THE REGULATORY STATE

The central preoccupation of administrative law is the accountability of unelected bureaucrats. The effectiveness of administrative decisions is also

287 See, e.g., Griffith, supra note 9, at 2082, 2108 (portraying compliance department as “internal” and “intrafirm”); Krawiec, supra note 9, at 572 (discussing “internal compliance structures”); Root, supra note 9, at 1004–05 (describing compliance departments as focusing on the firms within which they sit).


289 See Barkow, Rachel E., The Prosecutor as Regulatory Agency, in Prosecutors in the Boardroom: Using Criminal Law To Regulate Corporate Conduct 177, 177 (Anthony S. Barkow & Rachel E. Barkow eds., 2011); Coglianese & Lazer, supra note 4, at 691; Griffith, supra note 9, at 2088–89; Roe, supra note 64, at 591; Vandenbergh, supra note 46, at 916. Broadening this class of activities to include enforcing laws against individuals and criminal and national security law would expand the array of examples. See supra note 22.

290 See, e.g., Bainbridge, supra note 83, at 591–92; Romano, supra note 288, at 1529.

crucial to administrative law. Scholars have already extended those projects to the growth in private governance. This Part begins to map the normative path forward for integrating the enforcer-firm into the regulatory state.

A. Effectiveness of the Enforcer-Firm

A central question in business regulation is what set of incentives would optimally deter wrongdoing. The law can influence deterrence chiefly by adjusting the severity of the penalty or the likelihood of detection. Studies of optimal deterrence have produced inconclusive results. That indeterminacy will undermine any efforts to draw firm conclusions about the attractiveness of the enforcer-firm. Nonetheless, since the enforcer-firm is a new tool for deterrence, it is necessary to consider when to deploy it.

One straightforward reason for use of the enforcer-firm is inadequate regulatory resources. The firm’s compliance department plays a major role in enforcement. In many public corporations today, the compliance group has grown to rival the legal department in size and influence. At Goldman Sachs, the number of people in compliance more than tripled between 2004 and 2016, to about 950. But the CFPB has only 416 personnel in its monitoring group to conduct examinations of Goldman Sachs, Citibank, and many other large banks. As another example, Facebook recently hired thousands of new compliance reviewers, while its main regulator, the FTC, has only 1,100 employees total.

By conscripting even a fraction of large companies’ compliance departments to enforce, policymakers can dramatically expand the

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292 See, e.g., Elena Kagan, Presidential Administration, 114 Harv. L. Rev. 2245, 2331–46 (2001). Effectiveness can be seen as part of accountability, in that one of the goals in holding agencies accountable is to ensure they are effective.

293 See, e.g., Ayres & Braithwaite, supra note 9, at 101–32; Freeman, supra note 9, at 2.


296 Part II provided several examples of this. See, e.g., supra note 125 and accompanying text.

297 Griffith, supra note 9, at 2077.

298 Sean J. Griffith et al., The Changing Face of Corporate Compliance and Corporate Governance, 21 Fordham J. Corp. & Fin. L. 1, 37 (2016). Other large financial institutions have seen similar growth. Id. at 36–37, 39.

299 Van Loo, supra note 37, at app.A at 436.

administrative state’s regulatory workforce. In deciding whether that expansion is beneficial, observers will come to differing conclusions depending, in part, on whether they view current public regulatory resource levels as adequate.

Putting the question of adequate resources aside, there remain other tradeoffs in determining when it would be ideal to regulate directly rather than through the enforcer-firm. A sensible signal for when the enforcer-firm might prove more effective at regulating than a government entity is the presence of superior information or sophistication. A major concern about regulation is that bureaucrats have insufficient skills or information to keep up with the private sector.301 Observers mention regulators’ predicted inability to understand complex algorithms, for instance, as a counterpoint to calls for public regulation of Amazon, Facebook, and other tech giants.302 Additionally, since traditional gatekeepers do not produce the product subject to regulation, they are less familiar with the intricacies of fast-moving, technical industries.

Most enforcer-firms already have greater access to information about their counterparties, through the regular course of business, than would regulators. This informational criterion also suggests that the enforcer-firm fits best with the types of activities already related to its interactions with the third party, or that “touch and concern” it.303

To be clear, the firm is not necessarily an expert in all that the service provider does—indeed, a lack of expertise sometimes motivates a firm to outsource.304 For instance, banks have found the task of monitoring third-party vendors extremely difficult, particularly fintechs and others providing complex artificially intelligent services, such as chatbots, credit monitoring, and fraud detection.305 Nonetheless, regulatory understanding exists along a spectrum. Given large firms’ resources, talent, information access, and expertise, they will in many contexts deliver a monitor better situated to keep pace.

The informational advantages speak not only to the ability to detect wrongdoing, but also the cost of doing so. A chief criticism of regulation is that it increases transaction costs.306 In highly fragmented industries, the regulator

303 A familiar common law property term, touch and concern is used in other areas, such as the Alien Tort Statute. Kiobel v. Royal Dutch Petroleum Co. 133 S. Ct. 1659 (2013).
304 See, e.g., Samuelson & Nordhaus, supra note 267, at 32.
306 On the importance of transaction costs in regulatory analyses, see, e.g., Freeman, supra note 4, at 573 n.108; Sidney A. Shapiro, Outsourcing Government Regulation, 53 Duke L.J. 389, 390 (2003).
faces greater difficulty monitoring all entities than in a concentrated industry with a small number of large businesses. 307 It requires expenditures to establish communications, travel to the site of so many businesses, and understand institutional idiosyncrasies. Unlike administrative agencies and third-party inspectors, the enforcer-firm already is in contact with its counterparties and already has a high baseline level of expertise, meaning that it can spend less to collect information and develop expertise. 308 The regulated third party also then spends less on transferring and explaining information. The enforcer-firm can thereby lower the cost of regulation.

Regulatory informational savings are only part of the efficiency analysis. Efficiency would be improved if new gatekeeper governance caused the enforcer-firm to better internalize the full costs of its business activities. But if enforcer-firms responded by bringing external services in-house, it could either increase or decrease efficiency. If cost savings or other business advantages would otherwise drive the firm to rely on external service providers in the first place, then those losses from insourcing would need to be compared to the gains from increased compliance and regulatory informational savings. If instead the avoidance of liability is the sole reason for the firm to use some specific external services, then insourcing in response to new gatekeeper governance would not necessarily prove inefficient. 309

A further efficiency complication arises because some of the compliance information needed may be competitively sensitive. Amazon is notorious for hiring outside businesses—whether cloud computing providers, small clothing manufacturers, or shipping companies—and then ultimately deciding to take those products or services in-house after having had the chance to study them closely. 310 By forcing the sharing of sensitive information, gatekeeper governance could facilitate anticompetitive displacement or takeover of service providers, and even encourage enforcer-firms to become inefficiently large.

In the alternative, the sensitivity of information may cause service providers to avoid sharing crucial monitoring information with the enforcer-firm. If the monitor is instead an administrative agency or private inspection firm, the risks

308 Cf. Judge, supra note 41, at 1262 (discussing the informational advantages that bank have in influencing risk-taking by other banks).
309 There is disagreement about whether liability concerns drive a small or large amount of outsourcing. See Geis, supra note 267; Hansmann & Kraakmann, supra note 268, at 1881.
are less concerning because the monitor would not be a potential competitor.\textsuperscript{311} Information is the “lifeblood” of effective governance.\textsuperscript{312} When sensitive information is necessary for monitoring compliance, a public option or third-party monitor may prove more effective or at least necessary as a complement to the enforcer-firm.

Another risk is that dispersed regulators create problems with overlapping jurisdiction. There is evidence that administrative agencies with overlapping jurisdiction are less likely to act, partly because each feels less pressure.\textsuperscript{313} By analogy, the public regulator, the firm, and the service provider have overlapping jurisdiction. As a result, each may assume someone else is paying adequate attention. Strategic shirking is also possible, since the multiple businesses working with any given service provider may realize they can benefit from other businesses’ monitoring of that same service provider without incurring the costs of rigorous monitoring.\textsuperscript{314}

The possibility of shirking reflects a broader concern that the enforcer-firm’s monitoring may serve merely a “cosmetic” function—allowing the firm to show regulators that it is doing something, and thereby defend itself from regulatory liability, without actually exerting considerable influence.\textsuperscript{315} One FTC lawsuit uncovered email evidence that a health care industry company’s written reprimands of third-party telemarketer misconduct may have been all about appearances.\textsuperscript{316} The company’s representative assured the telemarketer after sending compliance emails, “I just have to cover all bases so nobody can say that I never told them lol.”\textsuperscript{317}

This concern about shirking indicates that the regulatory cost savings and sophistication advantages in using the enforcer-firm should be adjusted for any public resources needed to oversee the enforcer-firm. Still, administrative agency oversight represents another area in which the enforcer-firm has inherent advantages over traditional gatekeepers. With private inspectors, accountants, self-regulatory organizations, or auditors, agency oversight of the private enforcer would require interacting with additional entities. Those interactions would necessitate devoting agency resources to communicating with,

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\item Grant, competitors of the service provider could still hire government employees who had gained knowledge from monitoring. See, e.g., David Zaring, Against Being Against the Revolving Door, 2013 U. Ill. L. Rev. 507, 511–12 (2013).
\item On multiple clients per service provider, see Brown & Wilson, supra note 268, at 47.
\item Krawiec, supra note 129, at 487 (discussing compliance department window-dressing).
\item Id.
\end{itemize}
understanding, and prosecuting new institutions. In contrast, the agency already oversees the enforcer-firm, and could merely add gatekeeper-related oversight. Public accountability of the enforcer-firm is thus lower cost and more likely to occur than for many traditional gatekeepers.\(^{318}\)

A final drawback is that the enforcer-firm’s sanctions are more limited than that of an administrative agency. The enforcer-firm’s main sanction is exit: if the third party is in violation, the firm can stop doing business with the service provider. That punishment is far narrower than those available to the public regulator, and still allows the third party to do business with other firms. Over time, the typical enforcer-firm may wield more substantial sanction power as industries become more concentrated.\(^{319}\) But when the service provider serves a large number of clients, as many do, exit becomes less harmful.\(^{320}\)

This limitation on the enforcer-firm raises questions about its potential use in peer-to-peer settings. Often two large companies work closely together and surely have informational advantages—thus providing the possibility of cost savings by relying on them to police one another. Facebook, for instance, allows Amazon, Netflix, and Microsoft to access user data, including the ability to read private messages.\(^{321}\) The expansion of the enforcer-firm to oversee peers could, in theory, decrease the resource and information gap between regulator and regulated entity even further.\(^{322}\) Peer-to-peer gatekeepers may still have a regulatory role to play, but such relationships depend on gatekeepers with less relative power. Overall, regulators may need to be more involved as the enforcer-firm’s market power diminishes with respect to the counterparty.\(^{323}\)

Part of the problem with assessing these diverse costs and benefits is that the largest firms remain untested as external regulators. In contrast, research demonstrates that public regulators’ monitoring promotes compliance. In one study, increasing the frequency of EPA inspections lowered pollution from factories by about three percent.\(^{324}\) Policymakers would benefit from similar research on the enforcer-firm’s benefits and which of the diverse institutional design models, outlined above, are most effective. But there are sufficient examples of public regulators, private third-party monitors, and self-regulation

\(^{318}\) On the net of traditional gatekeepers typically involved, see Andrew F. Tuch, Multiple Gatekeepers, 96 Va. L. Rev. 1583, 1585 (2010).


\(^{320}\) Brown & Wilson, supra note 268, at 47.


\(^{322}\) For a proposal to leverage interbank discipline, see Judge, supra note 41, at 1321–22.

\(^{323}\) This is about more than size. Some service providers have greater power in indemnity negotiations. See Jason D. Krieser et al., Outsourcing Law and Business § 11.02(3)(e) (2019).

A crucial variable in any such analysis is the potentially substantial costs imposed on the enforcer-firm and its counterparties. In short, the question of whether the enforcer-firm is better than other regulators will hinge on factors that include information access, the sensitivity of the regulatory information needed, the power that the enforcer-firm has over its counterparty, the organizational efficiency of outsourcing, and the societal gains from increased compliance. In theory, in the absence of direct empirical study, large firms’ greater information and sophistication should make them more cost-effective than a public regulator or new class of private third-party regulators performing the same function.

Difficult design questions remain about which party should be incentivized to what degree—the enforcer-firm or its counterparties. Another fundamental choice is whether explicit governance mandates for the enforcer-firm are needed beyond leveraging indirect liability, vicarious liability, and strict liability. Also, legal reforms could address some of the enforcer-firm’s downsides. To increase sanctions, the law could give it a private right of action against the third-party for noncompliance. Or the law might require the enforcer-firm to report violations. Greater antitrust attention to the enforcer-firm would help ensure it did not abuse its position and any access to sensitive information.

In assessing the enforcer-firm, it is important to be realistic about the alternatives. The practical choice may not be between public monitors and enforcer-firm, or between the enforcer-firm and the old gatekeepers. Industry lobbying may block congressional allocation of adequate public resources to oversee a large universe of smaller third-party firms. Given these resource constraints, the real-world question may simply be whether the enforcer-firm, despite its imperfections, is better than no direct oversight of dispersed third parties. Assuming that greater compliance with those laws is desirable, the enforcer-firm offers a promising avenue for more effective regulation.

B. Accountability of the Enforcer-Firm

A central administrative law concern about prior generations of privatization is that they “insulate” the government from accountability because the public has limited visibility or interaction with the private entity. The delegation of regulatory responsibilities to the enforcer-firm can further insulate from accountability. It is therefore worthwhile to consider how the public can ensure that enforcer-firms are promoting compliance. Three potential responses would


\[326\] See, e.g., Gadinis & Mangels, supra note x, at 910 (proposing reporting requirements).


\[328\] See Freeman, supra note 60, at 175–76.
be through courts, private actors, and administrative agencies.\textsuperscript{329}

Judicial review provides a check against industry capture of bureaucrats. Enforcer-firms can write monitoring contracts or make enforcement decisions free from accountability mechanisms that apply only to government, such as the Administrative Procedure Act\textsuperscript{330} and the Freedom of Information Act.\textsuperscript{331} A concern would be that by delegating regulation to the enforcer-firm, the state allows large firms to write and enforce rules to cement or further concentrate existing market shares, thereby harming smaller firms and new entrants. In the absence of a clear statutory mechanism for review, one existing proposal would have courts hold delegations unconstitutional if the agency imposes inadequate constraints on the private actor.\textsuperscript{332}

Overall, solutions relying on the nondelegation doctrine seem unlikely. Congress must only provide “an intelligible principle” within lawful bounds\textsuperscript{333} a lenient standard that has traditionally proved highly tolerant of government delegations to private parties.\textsuperscript{334} However, courts have occasionally indicated hostility for “empowering private parties to wield regulatory authority”\textsuperscript{335} and indicated the need “to subject private delegations to a more searching scrutiny than their public counterparts.”\textsuperscript{336} Most prominently, in \textit{Department of Transportation v. Association of American Railroads} the Supreme Court avoided ruling on the nondelegation issue by holding that Amtrak was a government actor, but in a concurring opinion Justice Alito observed that “handing off regulatory power to a private entity is legislative delegation in its most obnoxious form.”\textsuperscript{337} It is thus not inconceivable that the nondelegation doctrine might at some point gain relevance to the enforcer-firm.

Others have explored imposing constitutional constraints on businesses as state actors under the Due Process Clause of the Fourteenth Amendment.\textsuperscript{338} The most relevant tests for a state actor seem immediately applicable to the enforcer-firm—“joint participation” sufficient for interdependence, a sufficient “nexus”

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\textsuperscript{332} On agency reliance on private actors as delegation, see Metzger, supra note 4, at 1370.
\textsuperscript{333} See Hampton & Co. v. United States, 276 U.S. 394, 409 (1928).
\textsuperscript{334} See Freeman, supra note 4, at 589–90 (reviewing cases upholding privatization).
\textsuperscript{335} See Ass’n of Am. Railroads v. U.S. Dep’t of Transp., 721 F.3d 666, 671 (D.C. Cir. 2013), vacated and remanded sub nom, Dep’t of Transp. v. Ass’n of Am. Railroads, 135 S. Ct. 1225 (2015).
\textsuperscript{336} See Tex. Boll Weevil Eradication Found., Inc. v. Lewellen, 952 S.W.2d 454, 469 (Tex. 1997) (“[C]ourts should subject private delegations to a more searching scrutiny. . . .”).
\end{flushright}
between the private and public actor, and performance of a “public function” traditionally exclusively reserved for the state.\(^{339}\) But courts have consistently found that private companies failed these tests, even when involved in activities with a heavy public component, such as operating electric utilities and nursing homes.\(^{340}\) Self-regulatory organizations like the Financial Industry Regulatory Authority (FINRA), which is congressionally authorized to protect investors, present a closer case but courts still do not usually see them as state actors.\(^{341}\)

It is worth considering whether it matters that—unlike utilities and nursing homes—the enforcer-firm is engaging in a public service outside of its normal business operations.\(^{342}\) While that distinction could be relevant, and deserves a more extensive analysis, the “protections courts afford those affected by private decisions, and the scope of judicial review they provide, remain minimal.”\(^{343}\) If the enforcer-firm produces similar judicial outcomes as other private enforcers, the administrative state has another large area of governance that will likely proceed unconstrained by judicial review.

Private actors present another possibility for holding the enforcer-firm accountable. For some perspective, it is instructive to consider again how the regulatory architecture differs between enforcer-firms and more traditional private enforcement models. When lawyers, accountants, and auditors serve as gatekeepers, the entity they are regulating is the one paying their bills.\(^{344}\) That client relationship makes it easier for the firm to capture the gatekeeper—in the sense of influencing it to enforce lightly—because the gatekeeper has financial interests in keeping the client happy.\(^{345}\) With the enforcer-firm, however, the gatekeeper pays the service provider’s bills—perhaps indirectly, as in the case of Amazon and Facebook, by providing some crucial access to users.\(^{346}\) If “the client is king,”\(^{347}\) the old gatekeepers are subjects, while the new gatekeepers are royals. Enforcer-firms should thus prove inherently more resistant to capture, and more independent, than hired monitors.


\(^{340}\) See id. at 358 (finding that a public utility with a monopoly is not a public actor); Blum v. Yaretsky, 457 U.S. 991, 1010-12 (1982) (holding that nursing home decision to provide Medicaid patients with less care was not a state action despite heavy regulations).


\(^{342}\) See supra Part III.D. (distinguishing the enforcer-firm from utilities).

\(^{343}\) See Freeman, supra note 4, at 591.

\(^{344}\) See Kraakman, supra note 6, at 892 (discussing gatekeepers’ profit motives).

\(^{345}\) Cf. Root, supra note 5, at 531 (describing court-ordered monitor relationships).

\(^{346}\) See supra Part II.

\(^{347}\) Wilson Hunter, Independent or Adrift at Sea: How the Concept of Independence Has Warped American Legal Ethics, 34 J. Leg. Prof. 367, 367 (2010).
Moreover, in contrast to the old gatekeepers, the enforcer-firm deals directly with consumers. As a result, some enforcer-firms’ employees will have more of a natural affinity for consumers, and thus potentially some of the groups needing protection from the laws to be enforced. Also, consumers have a means of directly affecting most enforcer-firms, by taking their business elsewhere. That direct relationship enables advocacy, such as consumer boycotts, that has pushed businesses toward compliance in other contexts.\(^{348}\) It also at least partly addresses some of the concerns in the literature that the old gatekeepers “are biased away from the public interest simply because close affinity with the client renders the desired independence psychologically impossible.”\(^{349}\)

There are many shortcomings with relying on markets to hold private firms accountable. A customer can easily choose another coffee shop or store, but it is harder for a consumer to switch banks or social networks.\(^{350}\) There may not be many other options for digital products, and if there are it would take time to learn a new interface and all of one’s pictures, posts, and contacts may not be readily portable to the new system.\(^{351}\) Indeed, when consumers have little choice the enforcer-firm may care less than traditional gatekeepers about reputation, and thus worry less about the public shaming aspect of violations.\(^{352}\) Thus, one consideration for whether to mandate enforcement may simply be the ease of exit: the more easily consumers can switch to competitors, the greater the accountability enforcer-firms face.\(^{353}\)

Moreover, for consumers to hold the enforcer-firm directly accountable, they must have both visibility into the firm’s enforcement and the ability to assess its efficacy. Visibility implicates one of the primary mechanisms for administrative accountability: transparency.\(^{354}\) Greater transparency into the firm’s role as enforcer could come in any of the forms used currently for administrative agencies, such as annual reports on enforcement activities.\(^{355}\) Many firms would likely not release such information voluntarily, however. Public transparency for the enforcer-firm would depend on mandates, or alternatively on public regulators releasing summaries of enforcer-firms’ activities.

\(^{348}\) See, e.g., Vanderbergh, supra note 46, at 917.

\(^{349}\) See Demski, supra note 18, at 57.


\(^{352}\) On shaming, see Sharon Yadin, Regulatory Shaming, 49 Envtl. L. 407 (2019).


For the public to hold the conscripted enforcer accountable based on that information, however, people must also be able to assess its efficacy, which may prove difficult except in cases of extreme failure. Behavioral law and economics has demonstrated how consumers ineffectively weigh various shrouded attributes in a product, such as the warranty or fees. It cannot be ruled out that some kind of independent grading scale, akin to restaurant health scores, could facilitate consumer-driven accountability. Still, in many industries, including banking and technology, consumers rarely switch because of the time and costs of doing so. Given challenges related to information, decision making, and switching, consumer spending and advocacy likely provide only a limited additional layer of accountability for the enforcer-firm.

These legal and nongovernmental shortcomings underscore the importance of active administrative agency oversight of the enforcer-firm. The CFPB provides one such model because it routinely checks whether financial institutions are overseeing third parties. For instance, as part of its routine examinations the CFPB found that credit reporting agencies engaged in “insufficient ongoing monitoring, or re-vetting” of third-party furnishers of credit data. With that message delivered industry-wide, credit agencies adjusted their internal processes enough that two years later the CFPB concluded, “In recent follow-up reviews, we determined that these policies and procedures have improved.” Improvements included “monitoring for furnishers that do not comply” and enforcement mechanisms such as “ceasing to accept data from furnishers.” The CFPB thus not only examines enforcer-firms’ monitoring, but also communicates some of its findings to the public.

This Part’s discussion is not meant to be an exhaustive list of the factors influencing the enforcer-firm’s effectiveness and accountability. Additional risks include the possibility that the state relies too much on self-serving firms to regulate, thereby diminishing agencies’ expertise or prompting Congress to allocate suboptimal resources. Another risk is perverse incentive for regulators to prefer concentrated industries with large companies because they facilitate regulation and wield more powerful sanctions, thus putting mandated enforcement even further in tension with antitrust.

More broadly, expanding the state’s ability to coopt businesses implicates

359 Id.
360 Id.
361 Anticompetitive enforcer-firm purchases of counterparties is another possible result.
more universal governance problems, such as how to prevent regulatory arbitrage and how to control a nefarious government wielding additional power. Those problems help motivate many existing checks on the administrative state. It may be necessary to extend analogous checks to enforcer-firms, such as requiring the inspector general to investigate them. These and other effectiveness and accountability implications are ripe for systematic study.

Overall, as a regulatory tool, conscripted regulators offer a number of potential advantages over prior privatization models. They present the possibility of greater efficiency, expertise, and responsiveness to consumers. Designed poorly, however, they risk creating a vast sphere of regulatory arbitrage out of public sight and judicial review. A crucial feature is ensuring that an administrative agency watches the new gatekeepers.

CONCLUSION

The public role of the firm and the private reach of the administrative state expand farther than is commonly understood. With large companies’ immense resources at their disposal, administrative agencies now direct a large shadow regulatory workforce. That development offers some promise of filling in the regulatory policing gap left by resource-deprived and technologically less sophisticated administrative agencies.

Conscripted enforcement marks one of the federal government’s boldest encroachments into the firm by shaping its contracts, relationships, structure, and governance. Moreover, as a descriptive matter, the world’s largest firms now have affirmative duties to act for the public benefit. Policymakers may have thereby strengthened the case of those calling on firms to do more for society, at least in the sense of providing a breathtaking precedent for the state enlisting businesses into its service.

Shareholders remain the greatest beneficiary of the firm, and administrative agencies are still the most important regulators. However, any account of either the firm or regulation is incomplete without recognizing that the frontier of enforcement is policed by large businesses serving as gatekeepers for some of society’s most important laws.

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