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Privatization is often promoted as a cure for many of the problems of government. In this Article, Professor Beermann argues that the effect of privatization is likely to be muted by the fact that several related phenomena have, in recent years, reduced the differences between government and the private sector, especially when privatization is involved. First, private entities are often compelled to make public or provide to government a great deal of information about themselves, much as the Freedom of Information Act and related statutes require transparency in government. Second, discovery in litigation subjects a great deal of private information to disclosure, a fact that has become more important in recent years as the bases of potential liability have increased. Third, the amount of regulation of private entities has increased markedly, which subjects a great deal of previously private activity to government scrutiny and examination in litigation. Fourth, regulation is often enhanced when privatization is involved. Privatization and deregulation usually come with strings attached under which private entities are required to comply with governmentally prescribed standards of various forms and degrees of stringency. The lesson Professor Beermann urges to be drawn from these factors is that absent significant across-the-board deregulation, privatization is unlikely to achieve the significant effects promised by its advocates.

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INTRODUCTION

Government provision and procurement of goods and services[1] are plagued by many problems. Some of these problems are caused by the lack of effective discipline on government agencies. Other problems arise from the opposite problem, that government agencies function within a legal regime that is overly restrictive, rendering government unable to meet the challenges of dynamic social needs. Privatization is often thought of as a cure for many of the problems associated with government provision and procurement of goods or services, both because private entities are freed from restrictions placed only on government, and because private entities are subject to market discipline, which makes them better able to respond to changes in the social environment.

What may sometimes be overlooked is that many similar problems and restrictions exist with respect to private entities, especially those performing functions that were previously performed by government, which I call "privatized." On the discipline side, many of the issues in corporate law and organization, arising both out of the separation of ownership and control and the problem of accurately gauging the efficiency of production within a large firm, revolve around agency cost issues similar to those that affect government agencies. Government's extreme separation of ownership and control combined with government's coercive power make it highly amenable to corruption in the form of favoritism based on factors that agents should not consider, such as political support and the potential for private gain by government officials (for example in post-government careers). Similar problems also exist in private entities in which ownership and control are fragmented. Restrictive regulation is also common in the private and privatized sectors, and there are strong parallels between the regulation of private entities and the regulatory environment within which government agencies operate.

This Article examines two related phenomena relevant to privatization, both of which tend to reduce the differences between the public and private sectors. Taken together, these phenomena mean that privatization is unlikely to be more than a palliative in terms of solving the problems it is often

1. By "goods and services" I mean both goods and services that are commonly available from both governmental and private sources, such as recreation, housing, education, energy, and transportation, and also goods and services that, while not exclusively governmental, are more commonly considered governmental functions, such as regulation, regulatory enforcement, police protection, highway layout, and traffic regulation. The category of "pure" or exclusive government activity may actually be quite small, because private analogs can usually be found to government activity. Privatization, on the other hand, is much more common in areas in which the particular goods or services have always been commonly available from both governmental and private sources.

aimed at addressing, unless it is accompanied by significant across-the-board deregulation. The first phenomenon is that the law places administrative-law-like obligations on private and privatized entities, perhaps as a mechanism for maintaining political accountability over private sector activities that are related to government.

The second phenomenon is that privatization often involves enhanced regulation of the private or privatized entities that perform what were or might have been government functions. While it is obvious that many forms of privatization shield formerly public activities from at least some measure of political supervision, in an earlier article[2] I observed that some forms of privatization may actually enhance political accountability. Among the several ways in which accountability can be enhanced or at least preserved in privatization is that privatized entities are likely to be subject to a great deal of government supervision in terms of monitoring the private entities for observance of performance standards of various degrees of strictness. In some situations, there may be increased suspicion in privatization, and monitoring may actually increase despite the usual existence of superior mechanisms for monitoring the behavior of government entities.

While all private entities are subject to an enormous level of scrutiny in the contemporary administrative state, privatization is likely to entail increased regulation and scrutiny of privatized entities. While the degree of supervision may be less with some privatized entities than if or when the entity was part of government, in many areas it is likely to be substantial. This observation should not be surprising because there must have been some perceived public policy basis or politically powerful constituency behind the level of government control that existed prior to privatization. It would be more surprising if an entity or function suddenly went from government ownership or control to complete deregulation. Boiled down to their essentials, both points mean that absent a significant movement toward deregulation, legal and therefore political control is likely to remain extensive with regard to private and privatized institutions.

This Article elaborates these points as follows. In Part I, I compare the regulation of private entities to administrative law and other norms that traditionally are thought of as applying to the public sector. In the course of this comparison, I look more specifically at the availability of information in both the public and private sectors, at the way that the review of corporate management resembles judicial review of administrative agency action and at the mechanisms employed for monitoring privatized institutions generally. In Part II, I illustrate the way in which regulation of privatized entities is

2. *See* Jack M. Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L.J. 1507, 1507–57 (2001).

enhanced through the example of the application of antidiscrimination norms in privatization. In Part III, I consider why the phenomena addressed by this Article occur, that is, why it is that privatization so often involves increased government regulation and scrutiny of the private actors involved in privatization.

Some may take my argument—that privatization is unlikely to result in significant social change unless accompanied by massive deregulation—as an argument against privatization on the basis that given this understanding, it is not worth taking the trouble to privatize. Others who see great potential in privatization might view this reality as an argument in favor of deregulation so the potential of privatization can be realized. I do not mean to take sides on this matter. Rather, I point out the effect and conclude that some privatization measures might be worth taking anyway.

I. THE ANALOGY BETWEEN ADMINISTRATIVE LAW AND REGULATION OF PRIVATE ENTITIES

At the outset, it is important to consider the analogy between administrative law and the regulation of private entities. Gerald Frug's 1984 article *The Ideology of Bureaucracy in American Law*,[3] explored the commonalities between corporate law and administrative law in great detail, from the point of view of how bureaucracy affects life and law and how discretion within bureaucracy is controlled. Frug stressed the similarities of the various normative bases for legal acceptance of the bureaucratic, hierarchical form of social organization embodied in the administrative agency and the corporation, and then rejected each one of them as insufficient to justify the nondemocratic forms of social organization they represent.[4]

The importance of Frug's article for present purposes is its recognition that private law and administrative law present similar issues regarding controlling and channeling the behavior of fiduciaries, agents who are supposed to be acting on behalf of a principal or principals. The parallels between the public and private sectors extend beyond corporate and administrative law and even beyond the boundaries of what is conceived of as a fiduciary relationship. There are many areas in which the law regulates a person or entity's conduct because the subject of the regulation's power implicates the interests of third parties in situations not evidencing the traditional indicia of a fiduciary relationship. For example, many tort claims and civil rights actions arise in nonfiduciary settings.

3. Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1984).

4. *See id.* at 1286–97.

The desirability of the degree of regulation of everyday private activity that exists in contemporary society is often a source of disagreement. I hope it is safe to say that regardless of one's perspective on the normative question, as a positive matter there is a great deal of government regulation of both economic and social activity in the private sector. Deregulation, in fact, is often considered a category of privatization because its aim is to move decisionmaking out of government and into the private sector, either by way of the market in the case of economic activity, or by way of the individual, the family, or other social units in the case of noneconomic activity.[5] There is a great deal of regulation that would have to be eliminated to move from the current situation to complete privatization.

A. Information in the Public and Private Sectors

One of the hallmarks of the public sector is the stress on transparency. Especially since the open government movement of the last several decades, the proceedings and records of government entities are presumed to be open and available to the public. Most fundamentally, agencies must give advance notice when they are contemplating action that may affect members of the public, either individually or collectively, and agency rules are not binding unless they are published or the subject of the rule receives actual notice.[6] Further, a related group of statutes guarantees open government, including the Government in the Sunshine Act[7] and the Freedom of Information Act (FOIA).[8] The Government in the Sunshine Act requires, subject to certain exceptions, that meetings of multimember agencies be open to the public. FOIA makes agency records, again subject to enumerated exceptions, open to public inspection and copying.

In conceptualizing the differences between the public and private sectors, it is tempting to point to the stress on transparency in the public sector as distinguishing it from the private sector. However, the private sector is not as private as one might think, or at least as it might once have been. While meetings of corporate directors are not required to be open to the public, securities laws and the general functioning of capital markets place a great deal of information about private corporations in the public domain. With regard to publicly traded corporations, it is not hyperbole to state that nearly as much information about them is easily accessible to the public as is

5. *See* Beermann, *supra* note 2, at 1528–41; Ronald A. Cass, *Privatization: Politics, Law and Theory*, 71 MARQ. L. REV. 449, 459–60 (1988).

6. *See* 5 U.S.C. §§ 552–553 (2000). For convenience, this discussion focuses on federal law, although state law in most if not all states contains similar requirements.

7. Pub. L. No. 94-409, 90 Stat. 1241 (1976) (codified at 5 U.S.C. §§ 551–553, 556–557, 39 U.S.C. § 410).

8. 5 U.S.C. §552(a)–(g) (2000).

available about the workings of many administrative agencies. The steady flow of Securities Exchange Commission (SEC) filings, the market's demand for information when earnings or other major items are reported, and the structure of corporate governance all contribute to the widespread availability of information.

Publicly traded corporations cannot make major decisions out of the public eye. Rather, in the many areas in which shareholder approval is required, even if shareholders rarely dissent, the formality of a shareholder vote means that proposals and supporting materials become matters of public record for all to see. In the rare case of a real debate over the direction a private corporation should take, a proxy fight places even more information about the inner workings and prospects of the company in the public view.

There are other sorts of private entities that find it impossible to keep their information private as well. The investment industry is subject to disclosure requirements that result in the production of massive amounts of information. Even absent legal requirements, prudent investors would demand disclosure of a great deal of information. Insurance companies likewise must disclose information to gain the confidence of their customers, especially in areas such as life insurance, in which customers are almost as interested in the long-term well-being of the company as in their own long-term health. State[9] and federal[10] regulation of charitable corporations results in extensive government supervision of the activities of nonprofit corporations and, in some circumstances, public access to information concerning nonprofit groups.[11]

9. States typically regulate the governance and activities of charitable corporations and trusts:

> In most states, the attorney general has responsibility for overseeing and supervising charitable corporations and trusts. . . . State attorneys general can bring civil actions to remove directors and officers for self-dealing, waste, diversion of a charitable organization's assets, or other breach of fiduciary duty. They can also attempt to cause an accounting by a nonprofit organization of its assets or to dissolve a charitable corporation for ultra vires acts. However, they do not have the power to manage the daily affairs of a charitable organization.

Nina J. Crimm, *Why All Is Not Quiet on the "Home Front" for Charitable Organizations*, 29 N.M. L. REV. 1, 2 n.3 (1999) (citations omitted).

10. Nonprofit corporations must meet detailed statutory and regulatory standards to retain their tax-exempt status under I.R.C. § 501(c)(3). *See* 26 U.S.C. § 501(c)(3) (2000); 26 C.F.R. § 1-501(c)(3) (2001).

11. An interesting example of government regulation of the activities of charitable organizations is the Massachusetts Attorney General's intervention in the sale of the Boston Red Sox baseball team. A large share of the Red Sox was owned by a charitable trust and, under threat of litigation, the Massachusetts Attorney General forced the parties to the transaction to increase the amount that would be realized by the beneficiaries of the trust before he would approve the sale. *See* Meg Vaillancourt & Gordon Edes, *Baseball Ok's Red Sox Sale: Henry Gets Team After Charities' Funding Boosted*, BOSTON GLOBE, Jan. 17, 2002, at A1.

There are many industries that are so heavily regulated that vital information concerning their products and services is subject to disclosure to the government, and sometimes to the public generally. Food and drug manufacturers are obvious examples of entities that cannot keep the ingredients of their products secret.[12] Pesticide manufacturers must disclose their formulae to the government, and they cannot even prevent their competitors from using that information to develop and win regulatory approval for competing products.[13] While the internal operations of private companies are not generally open to the public, the amount of information in the public domain concerning private entities is staggering. The private sector is far from private.

In fact, even those areas in which records are private, in the sense that they are in the possession of private entities with no general obligation to make records public, there are many situations in which ostensibly private material may become public. When litigation occurs, for example, liberal discovery rules can function like a more focused version of FOIA, opening a great deal of private information to access by opponents in civil actions, which in turn may lead to public disclosure of that information. In fact, discovery is not limited to the parties of a particular action, but rather may be utilized against nonparties who have information relevant to the litigation.[14] The Federal Rules of Civil Procedure[15] on discovery make available "any matter, not privileged, that is relevant to the claim or defense of any party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things."[16] While this may be narrower than the previous version of the rule, which allowed discovery of "any matter, not privileged, which is relevant to the subject matter

12. *See generally* The Federal Food, Drug and Cosmetic Act, 21 U.S.C. § 301–399 (2000).

13. *See generally* The Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. § 136 (2000). Under § 136h(d), the Environmental Protection Agency (EPA) must disclose all health, safety, and environmental data regarding registered pesticides to certain competitors who might use the information to support registering a competing pesticide. The U.S. Supreme Court has held that the original registrant may not enjoin disclosure of any trade secrets, but that compensation must be provided under the Takings Clause. *See* Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1016–19 (1984). In *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 582–94 (1985), the Supreme Court upheld a compensation system under which the subsequent user of any information disclosed is required to negotiate with the original registrant over the value of the information, subject to binding arbitration if the negotiations fail. *See* 7 U.S.C. § 136a(c)(1)(F)(iii) (2000).

14. A nonparty must be served with a subpoena in order to be compelled to submit to discovery. *See* FED. R. CIV. P. 34(c).

15. Again for convenience, I focus on federal law. State rules of civil procedure tend to be similar to federal rules.

16. FED. R. CIV. P. 26(b)(1).

involved in the pending action,"[17] it still allows for broad access to the records of private entities involved in federal court litigation.

Both discovery and FOIA have exceptions that can protect material from disclosure. Privileges can exempt some material from discovery. Further, discovery may be conducted subject to a protective order that precludes disclosure of material beyond the parties, and sensitive material can be redacted before matter is turned over to the other party. FOIA has similar provisions. Both are subject to exceptions and adjustments in order to meet legitimate claims for nondisclosure. Both systems, however, illustrate my point that a designation of information as "private" is far from absolute.

FOIA and discovery share an interesting similarity in that the scope of each is affected greatly by the degree of regulation. The more regulation there is, the more records agencies will create, and thus the more material will be subject to FOIA disclosure. This is also true of discovery. The range of conduct that can give rise to a meritorious civil action has increased greatly in recent decades. This means that more and more private conduct is subject to judicial scrutiny, and therefore more and more private information is subject to disclosure through discovery. The combination of extensive administrative regulation and broad civil liability makes private entities' personnel practices, manufacturing methods, disciplinary policies in educational institutions, and even the reasons for the temperature of coffee served in a private restaurant potentially subject to public disclosure as embodied in an agency record or in a response to discovery.

B. Review of Corporate Management

With regard to corporations, litigation may add substantially to the ability of the public to obtain information about corporations, and to the ability of the law to supervise corporate decisionmaking. Shareholders upset with corporate losses can obtain judicial review of corporate decisions under the business judgment rule. While such review is probably more deferential than most judicial review of agency action, there are parallels between review of business judgment and review of agency action.

A leading treatise on the business judgment rule details the elements of the rule as a business decision made by disinterested, independent directors exercising due care and acting in good faith and absent an abuse of discretion.[18] These elements of the business judgment rule for present purposes constitute a somewhat more deferential version of the U.S. Supreme Court's elaboration of the standard of review of agency action, the "arbitrary and

17. FED. R. CIV. P. 26(b)(1) (1999) (repealed 2000).

18. *See* DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 39–89 (5th ed. 1998).

capricious" standard, which requires consideration of "relevant factors" and no "clear error in judgment."[19]

"Due care" under the business judgment rule is not the "reasonable person" standard of negligence commonly used in tort litigation; rather it requires that corporate decisionmakers be "reasonably informed" before making a decision.[20] This is similar to the administrative law requirement that all relevant factors be considered: A decisionmaker is not reasonably informed if he or she is unaware of relevant factors. The business judgment rule's good faith element is violated by "conscious doing of a wrong because of dishonest purpose."[21] However, it has also been stated that "[b]ad faith may be inferred where 'the decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.'"[22] This bears some resemblance to the Supreme Court's statement that an agency decision may be arbitrary or capricious when it is "so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[23] The abuse-of-discretion element of the business judgment rule even more directly parallels judicial review of agency action, by allowing courts to engage in their own analysis of the reasonableness of a business judgment to ensure that directors have not abused their discretion.[24] This is very similar to the "no clear error in judgment" standard applied by courts reviewing agency decisions.

Another interesting parallel between judicial review under corporate law and under administrative law exists with regard to the presumption that an agency's decision not to seek enforcement is unreviewable.[25] The business judgment rule is at its most deferential in shareholder derivative litigation, in which a shareholder sues to compel the corporation to assert claims the corporation may have against a third party, which the corporation has chosen not to assert. In both situations, the limits on judicial review may be overcome. On the corporate side, the litigation will go forward if the disinterested directors are unable to articulate a rational basis for the corporation's refusal to assert the claim.[26] On the administrative side, the

19. Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42–43 (1983); Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

20. Block et al., *supra* note 18, at 74.

21. *Id.* at 80 (quoting Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P., 624 A.2d 1199, 1208 n.16 (Del. 1993) (internal quotes omitted)).

22. Block et al., *supra* note 18, at 82 (quoting *In Re*. J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780–81 (Del. Ch. 1988)).

23. *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

24. The abuse-of-discretion element has apparently not been adopted by the key state of Delaware. *See* Block et al., *supra* note 18, at 85–86.

25. *See* Heckler v. Chaney, 470 U.S. 821, 831 (1985).

26. *See* Block et al., *supra* note 18, at 1702–44 (discussing various standards of judicial review of the decision to terminate derivative litigation).

presumption against review of an agency's decision not to bring an enforcement action can be rebutted if a statute or rule articulates mandatory standards for agency enforcement.[27] The decision is then reviewable for compliance with the applicable standards under the arbitrary or capricious standard.

Although judicial scrutiny of agency decisions is perhaps more stringent, courts perform a similar analysis when reviewing corporate decisions. Just as courts scrutinize and sometimes set aside agency action for going beyond the bounds of law or reason, so too can courts, at the instance of disappointed shareholders, set aside the action of corporate managers for acting beyond the bounds of their power or contrary to all reason.

C. Privatization and Public Monitoring of Institutions

Privatization of important government functions is likely to entail extensive public monitoring of the private institutions involved.

The following part's discussion of antidiscrimination norms[28] that were applied first to government contractors illustrates that government scrutiny of entities involved in privatization is likely to be extensive. Private entities taking over government institutions, such as private prison operators, private companies hired to run public schools, and private companies operating social services agencies, are likely to be subject to the greatest scrutiny, but even companies providing goods and services to the government in "contracting out" forms of privatization are likely to be more heavily regulated than other private businesses.

To get a sense of the way in which government regulates private entities, I looked at Tennessee's and Texas's statutes regarding private prisons. While my sample is not scientific and therefore only anecdotal, I have no reason to believe that scientific study would undermine the representative nature of the two states I studied. Further, while prisons are likely to be more heavily regulated than other privatized entities, it remains worthwhile to look at this form of privatization as a highly visible example of what is likely to be a general tendency. In Tennessee and Texas, private prisons are subject to a very high level of scrutiny.[29] A state bureaucracy monitors the performance of private prisons and the private prison operators are expected to operate within parameters established by the state. In Tennessee, reports to a legislative committee are required, and if that committee determines that the prison is not performing up to state standards, the contract may not

27. *Heckler*, 470 U.S. at 833–35 (discussing Dunlop v. Bachowski, 421 U.S. 560 (1975)).

28. *See infra* Part II.

29. *See* TENN. CODE ANN. §§ 41-24-101 to 24-115 (1997); TEX. GOV'T CODE ANN. §§ 495.001–.008 (Vernon Supp. 2002).

be renewed.[30] Also in Tennessee, private prison contractors must provide audited financial statements to be eligible to enter into a contract with the state, and the contractor must purchase insurance pursuant to a state standard. Further, in both states, the contractor is statutorily precluded from raising the defense of sovereign immunity in defense of any suit arising out of the operation of a private prison.[31]

Insofar as liability is a form of monitoring, privatization may not eliminate government-like style liability and may, in fact, enhance it. In numerous cases, private parties have been held to be state actors subject to constitutional constraints when they conspire with or otherwise act in concert with state officials.[32] Privatization of some state institutions may result in "state actor" treatment for the operators of the privatized facility. The best example of this is the prison context, in which prisoners in state custody are actually housed in privately owned facilities under contract with the state. Although the Supreme Court has not decided this precise issue, it is very likely that private prisons will be held to be state actors for the purposes of litigation over conditions of confinement, including claims of unconstitutionally excessive force by prison guards.

Although private persons may be considered state actors for the purposes of constitutional tort litigation, they are not treated as state actors for all purposes. In fact, in one respect, the Court has made the operators of private prisons, and by analogy other private institutions in privatization contexts, somewhat worse off than their governmental counterparts. In line with its prior refusal to grant immunities to private actors sued for civil rights violations,[33] the Court held that private prison guards do not have the qualified immunity from damages that state-employed guards enjoy.[34] Under the immunity, state officials such as prison guards cannot be sued for damages unless their conduct violated clearly established constitutional rights of which a reasonable official should have known.[35] Guards in private prisons are subject to damages liability even for newly recognized rights. This means that in this particular privatization context, and perhaps in analogous situations, public law obligations are enforced more strenuously on the private actors in a privatized institution than on their public official counterparts.

30. *See* TENN. CODE ANN. § 41-24-105 (1997); *see also* TEX. GOV'T CODE ANN. § 495.008 (Vernon Supp. 2002) (requiring the Department of Corrections to audit and monitor the performance of private prison contractors).

31. *See* TENN. CODE ANN. § 41-24-107(b) (1997); TEX. GOV'T CODE ANN. § 495.005 (Vernon 1998).

32. *See, e.g.*, Dennis v. Sparks, 449 U.S. 24, 27 (1980).

33. *See* Wyatt v. Cole, 504 U.S. 158, 168–69 (1992).

34. *See* Richardson v. McKnight, 521 U.S. 399, 412 (1997).

35. *See* Harlow v. Fitzgerald, 457 U.S. 800, 818 (1982).

The private prison example also illustrates another feature in the application of public law rules in the privatization context—administrative-law-like and other public law obligations apply only selectively in the privatization context. While constitutional restrictions such as the Eighth Amendment's ban on cruel and unusual punishment may apply to the privatized institution, private prisons are unlikely to be subject to civil service rules regarding their employment practices, and a corporation that owns private prisons is not likely to be subject to open records and to open meetings requirements. On the other hand, there is no doubt that private prison operators are subject to a great deal of government oversight to ensure that they operate according to the conditions imposed in contracts with the government, and the extensive government regulation of private entities discussed elsewhere in this Article will apply with full force.

The charter school movement also helps illustrate that privatization often comes with increased monitoring. Charter schools are sometimes characterized as a form of privatization, although they are actually better conceptualized as government reform. In Massachusetts, and I suspect in many other states, charter schools are not private but are actually alternative public schools, taken out of the local school board structure, but supported by public funds and required to follow a strict state-mandated structure. Charter schools are thus distinct from tuition voucher programs through which parents can send their children to private schools. The only similarity between charter schools and a voucher system is that the traditional public schools are forced to compete for students and public funds that are often based, at least in part, on enrollment. Charter schools are an attempt to introduce this competition without privatizing.

In fact, charter schools may actually be more heavily regulated in some respects than traditional public schools in that they can be abolished for failing to meet performance standards much more easily than traditional public schools. In Massachusetts, there is at least one recent case of a charter school not getting a renewal of its charter for failing to meet state performance and other regulatory standards.[36] The board of directors of a charter school may be more private than the elected or appointed school boards that are in charge of traditional public schools, but the composition of the board may be heavily regulated. Another difference between the charter school board and a traditional school board is that the charter school board is unlikely to have a political constituency akin to that of a traditional public school board. Because charter schools are chartered by the state, regulation of them is more centralized, with supervision at the state level rather

36. *See* Ed Hayward, *Ed Board Dissolves Lynn Charter School*, BOSTON HERALD, Feb. 27, 2002, at 14.

than the local level. In fact, the charter school movement could be viewed partially as a move by state education regulators to gain some control away from local school boards.

II. Regulation in Privatization— Antidiscrimination Norms

As part of privatization, private businesses performing what previously were government functions may find themselves subject to legal norms more stringent than those applicable to the private sector generally. Government may view these businesses as extensions of government when they are performing what were government functions. Further, even if government does recognize the public/private distinction, it may not be respected. Government may wish to retain a strong measure of political accountability over the activities of the private entities it deals with. Further, it may appear illegitimate to avoid governmental obligations by simply privatizing an area. For these and probably additional reasons, privatization is likely to come with strings attached.

A. Business Affected with the Public Interest

The best historical example of this phenomenon is in the area of antidiscrimination norms. Once upon a time, the strongest antidiscrimination norms in our legal system applied to privately owned businesses that were in a special category of businesses "affected with the public interest." These businesses, such as inns and common carriers, were deprived of one of the central elements of freedom of contract, the right to refuse to enter into a contract with a prospective customer. Rather, these businesses were required to accept all customers on an equal basis. For example, anyone arriving at an inn and willing to pay the posted rate was entitled to a room, and anyone wishing to ship goods on the conveyance of a common carrier and willing to pay the posted rate was entitled to do so.[37] Other businesses, by contrast, were allowed to discriminate among potential customers on any basis they chose. Further, there was no general prohibition on employment discrimination. The narrowness of the exception to the usual norms of free contract is perhaps best illustrated by the fact that it did not extend even to the practice of medicine. A doctor was free to refuse service to a dying patient, even within a legal regime that required inns and common carriers to accept all prospective customers, and even though doctors were licensed

37. *See generally* Joseph William Singer, *No Right to Exclude: Public Accommodations and Private Property*, 90 Nw. U. L. Rev. 1283, 1401–08 (1996). Singer argues that the duty to refrain from discrimination extended beyond the narrow category traditionally identified as "affected with the public interest." *Id.* at 1400 (citation omitted).

by the state.[38] The theory underlying this branch of the law was that businesses affected with the public interest were analogous to state actors.[39]

B. Antidiscrimination Norms and Government Contractors

The norm of equal employment opportunity in private employment made its first significant legal inroad through its application to the "contracting out" privatization vehicle. Since the adoption of the Fourteenth Amendment, a strong antidiscrimination norm has applied to government.[40] However, the Supreme Court resisted applying that norm to private businesses, even businesses "affected with a public interest."[41] Developments highly relevant to privatization, beginning during the Second World War, provoked the wider application of antidiscrimination norms in the private sector. In 1941, President Franklin Roosevelt issued an executive order banning discrimination in "defense industries" and "government" based on "race, creed, color or national origin."[42] Then, in 1943, President Roosevelt extended the antidiscrimination provision to all government contractors, effectively extending the government's obligation not to discriminate to the vast area of the economy doing business with the federal government.[43]

From the standpoint of privatization, the importance of President Roosevelt's executive orders, and those of his successors, is clear. It is a measure of the strength of the norm against discrimination by government that government reached out to prohibit those with whom it did business from discriminating. In light of this understanding, privatization is unlikely to provide a method for escaping the reach of important norms that constrain government more than the private sector generally.

After Roosevelt's series of orders, president after president issued executive orders restating and expanding the obligation of government contractors to refrain from discrimination. Obligations were increased and enforcement was enhanced. Phrases such as "equal employment opportunity" and "affirmative action" first made their way into the legal vernacular as part of presidential orders directed at government contractors.[44] President

38. *See* Hurley v. Eddingfield, 156 Ind. 416, 417 (1901) (explicitly contrasting doctors, who have no duty to serve the public, with "innkeepers, common carriers, and the like").

39. For an interesting discussion of this, see The Civil Rights Cases, 109 U.S. 3, 37–43 (1883) (Harlan, J., dissenting).

40. U.S. CONST. amend. XIV.

41. *The Civil Rights Cases*, 109 U.S. at 37–43 (Harlan, J., dissenting) (arguing that businesses covered by the Civil Rights Act of 1875 were of a public nature and that the U.S. Congress thus had power to reach them in legislation enforcing the Fourteenth Amendment).

42. Exec. Order No. 8802, 3 C.F.R. 957 (1938–1943).

43. *See* Exec. Order No. 9346, 3 C.F.R. 1280 (1938–1943).

44. *See* Michael H. LeRoy, *Presidential Regulation of Private Employment: Constitutionality of Executive Order 12,954 Debarment of Contractors Who Hire Permanent Striker Replacements*, 37 B.C. L. REV. 229, 256, 258–59 (1996).

John F. Kennedy's order, the last issued before the passage of the Civil Rights Act of 1964, proclaimed that "discrimination because of race, creed, color, or national origin is contrary to the Constitutional principles and policies of the United States."[45] Given that the U.S. Congress had not yet enacted legislation banning such discrimination in private employment, President Kennedy's statement was forward-looking. Imposing antidiscrimination norms on private government contractors proved to be a convenient device to help move practices in the direction favored by President Kennedy and his administration.

C. Antidiscrimination Law in the Private Sector

The executive orders discussed above became somewhat less important after the passage of the Civil Rights Act of 1964, which together with state law counterparts, prohibits discrimination on the basis of race, religion, gender, and national origin in virtually all private employment in the United States. However, government contractors are still subject to enhanced reporting requirements, and the technique of expanding legal obligations on private companies based on their status as government contractors has not been lost on subsequent administrations. More recently, President Bill Clinton, in Executive Order Number 12,954, prohibited government contractors from hiring permanent replacements for striking workers.[46] Labor laws applicable to most private employers allow the hiring of permanent replacements for many strikers, and in light of this, the U.S. Court of Appeals for the D.C. Circuit held that President Clinton's order was preempted by the National Labor Relations Act.[47] While President Clinton's attempt failed, it is likely that government will continue to use the privatization connection to extend government regulation.

The expansion of antidiscrimination norms as applied to private employers, private businesses, and other entities has greatly deprivatized large areas of society. The membership practices of large membership organizations are subject to government scrutiny,[48] as are the admissions practices of schools and universities.[49] Another important development is the expansion of the prohibited bases of discrimination. In addition to race, gender, religion, and national origin, various laws now attack discrimination based on age, disability, pregnancy, and marital status, to name a few. Government

45. Exec. Order No. 10,925, 3 C.F.R. 448 (1959–1963).

46. *See* Exec. Order No. 12,954, 3 C.F.R. 329 (1995).

47. *See* Chamber of Commerce of the United States v. Reich, 74 F.3d 1322, 1332–39 (D.C. Cir. 1996).

48. *See* Bd. of Dirs. of Rotary Int'l v. Rotary Club of Duarte, 481 U.S. 537, 546 (1987); Roberts v. United States Jaycees, 468 U.S. 609, 621 (1984).

49. *See* Bob Jones Univ. v. United States, 461 U.S. 574, 596–99 (1983); Runyon v. McCrary, 427 U.S. 160, 172–79 (1976).

scrutiny of employment and other business practices has expanded greatly in recent decades.

While the reach of antidiscrimination law began with a core of standards applicable to government and government contractors, recent Supreme Court decisions have made it easier to enforce some of these norms against private entities than against government. In a series of cases, the Court has held that sovereign immunity limits Congress's power to enforce antidiscrimination and other laws against state government in cases in which the law at issue attacks forms of discrimination or other conduct without a strong Fourteenth Amendment pedigree. For example, the Court has stated that states cannot be held liable in damages for discrimination based on age or disability.[50] The Court's decisions do not appear to affect the enforceability of laws aimed at traditionally suspect classifications such as race or sex, but they do limit the enforceability of bans on discrimination based on nonsuspect classifications such as age or disability.

The Court has not stated that these laws are wholly without effect with regard to state government discrimination. In its decision against state liability for damages based on disability discrimination, the Supreme Court stated in a footnote that injunctions are still available against state violations of the Americans with Disabilities Act.[51] At least one lower court has accepted this dictum as authoritative and consistent with prior Supreme Court decisions.[52] In its decision denying Congress the power to make states liable in money damages for age discrimination, the Court was silent on whether injunctions were authorized, but the logic of its statement in the disability case would seem to apply equally.

In my view, despite the Supreme Court's dictum, there is reason to question whether injunctive suits forcing states to comply with federal laws proscribing disability and age discrimination will survive. Because these statutes are unauthorized by the Fourteenth Amendment, the question boils down to whether Congress has the power to prescribe injunctive remedies against states for violations of laws passed pursuant to the Commerce Clause. The Court's dictum relies on *Ex Parte Young*,[53] which authorizes injunctions against state officials acting in their official capacity when they violate the U.S. Constitution, on the theory that the state cannot authorize such viola-

50. *See* Bd. of Trs. of the Univ. of Ala. v. Garrett, 531 U.S. 356, 374 (2000) (holding that Congress lacks the power to provide for a damages remedy against a state or state agency for discrimination against handicapped individuals); Kimel v. Fla. Bd. of Regents, 528 U.S. 62, 88–91 (2000) (holding that Congress lacks the power to provide for a damages remedy against a state or state agency for age discrimination).

51. Pub. L. No. 101-336, 104 Stat. 327 (1990) (codified in scattered sections of 42 U.S.C.); *see Garrett*, 531 U.S. at 374 n.9.

52. *See* Gibson v. Ark. Dep't of Corr., 265 F.3d 718, 720 (8th Cir. 2001).

53. 209 U.S. 123 (1908).

tions.[54] In effect, the injunction against the state official is an injunction against the state, just not in name. In the course of an opinion denying federal courts the power to issue injunctions against state officials based on violations of *state* law, the Court stressed that "a suit challenging the constitutionality of a state official's action is not one against the State."[55] Later in the opinion, the Court referred more generally to violations of federal law as the basis for an *Ex Parte Young* injunction, but the Court has not focused on the precise issue of whether *Ex Parte Young* authorizes injunctions based on nonconstitutional federal law. There is at least some suggestion in opinions construing the doctrine that injunctions are justified only when founded upon constitutional violations.

The irony here is that privatization may enhance the reach of the antidiscrimination norms that the Court has stated cannot be enforced against state government. As a simple example, suppose a state university engages in age discrimination in the hiring and firing of its employees by requiring tenured professors to retire at the age of seventy. Although this practice is clearly illegal, under the Supreme Court's decisions, a federal court cannot issue a judgment for money damages against the university for this discrimination. If the university were privatized, however, the new private institution would be fully subject to federal age discrimination laws, and damages would be available in a challenge to its discriminatory retirement policy. This is contrary to the usual pattern in which antidiscrimination norms that initially applied most strongly against government bleed over into the private sector.

The analysis above may overstate the importance of the Supreme Court's recent decisions because federal law prohibiting race and gender discrimination is still fully operative against states and because state law also limits the ability of state entities to discriminate on many of the bases attacked by federal law. The Supreme Court has referred to this latter fact in its decisions limiting the reach of federal law.[56] Nevertheless, state policymakers are free to impose norms that are less strict than federal law, and in some areas, states may have powerful incentives to do so.

Thus, I find it very unlikely that many instances of privatization would reduce the effectiveness of antidiscrimination norms. If anything, increased sensitivity coupled with the enhanced amenability of private entities to traditional legal remedies means that antidiscrimination norms will apply more strongly after privatization than before. It seems to me unrealistic to

54. *See id.* at 155–56, 159.

55. Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 102 (1984).

56. *See Kimel v. Fla. Bd. Of Regents*, 528 U.S. 62, 91 (2000) ("State employees are protected by state age discrimination statutes, and may recover money damages from their state employers, in almost every State of the Union." (footnote omitted)).

imagine that a private party entering a government contract or assuming what was previously a government function will be more able to discriminate than the government entity itself.

III. WHY?

Assume that I am correct that privatization is likely to be accompanied by a great deal of regulation and scrutiny of the conduct of the private entities performing what had been government functions and even private entities in the contracting-out situation. Why is this so? In what follows, I speculate about possible reasons for this phenomenon.

The fact that privatization is likely to be politically controversial means that its effects are likely to be muted with close scrutiny of privatized entities and strong demands for increased regulation or deprivatization if serious failures occur. Public employees, their unions, and other people who are generally supportive of government regulation will oppose privatization, as will politicians who draw their support from such people and groups. The forces in favor of privatization are unlikely to have the political power to ignore completely the naysayers whose constituencies are suspicious of privatization. Whatever constituency supported the previous regulatory structure is not going to be happy with an ineffective, poorly run program, whether the entity running the program is public or private. Compromise in favor of controlled privatization may result. For example, a private firm might operate a public school, but only if it complies with strict standards, it is constantly monitored, and the contract is easily terminable. Elected officials may worry about the wrath of voters and other supporters if a privatized firm turns out to have advanced its own interest in profits at the expense of the public or the people the agency was supposed to serve, or if the privatized firm turns out to be just plain incompetent.

Similar issues arise when one considers privatization of government functions like bank deposit insurance or environmental protection. If the Federal Deposit Insurance Corporation (FDIC), for example, were sold to a private company, or if the insurance the FDIC provides were put out for bids, it is likely that any private entity assuming this function would be held to strict legal standards. Moreover, even if the FDIC were privatized, the banks covered by the deposit insurance would likely remain subject to the incredibly complicated capital and reporting requirements currently in existence. If FDIC insurance were eliminated and banks started to fail, there would be a swift and powerful demand both for the government to provide disaster relief for those affected by the failures and for government insurance or some other form of regulation to be reinstituted. Likewise, if the Environmental Protection Agency (EPA) were privatized, and if pollution worsened, demands for re-regulation would certainly follow in short order.

There is a parallel here with the pervasive use of the spending power by the federal government to impose performance standards on state agencies.[57] The federal government provides a great deal of funding for many matters of local concern, including welfare, highway construction, and the operation of educational institutions and prisons, to name a few. Just as the federal government attaches strings, in the form of federal standards, to the money it provides to state and local governments, so too is government likely to attach strings to the government money that ends up in the hands of privatized entities. While there is some variation in the degree of federal supervision of state programs supported by federal money, the federal government's reluctance to abandon supervision of state programs receiving federal funds is similar to the government's general reluctance to abandon close regulation of private institutions involved in privatization.

In fact, unless an area is so thoroughly privatized and deregulated that the program or activity is no longer associated with government at all, government is likely to remain very concerned with how the privatization is working out. When government pays a private entity to carry out a government function, or awards a large contract to a private entity to supply goods or services to or on behalf of government, it is natural to expect close supervision by government. An indictment of a private contractor for fraud, or the removal of a private contractor for waste or mismanagement, is likely to be accompanied by damage to or the end of careers in government. Government accountability remains, and with it government regulation.

That is not to say that all of the government supervision is genuine. Government may be dominated by pro-privatization forces who favor strong deregulation as part of an effective privatization program. The political environment may force these people to engage in supervision for show, with a wink and a nod. In contracting-out situations, cozy relationships between private contractors and the government agents charged with monitoring them may help explain waste and mismanagement. Politicians may be able to deceive their constituents into believing they are doing their best in supervising privatized entities when in actuality they are not.

The communications market provides a good example of how difficult it is to determine whether government supervision of private entities is un-

57. Under article I, section 8, clause 1 of the U.S. Constitution, referred to as the Spending Clause, Congress has the power to "provide for the common Defence and general Welfare of the United States." U.S. CONST. art. I, § 8, cl. 1. In exercising this power, Congress often allocates money to state and local governments, subject to conditions with which recipients must comply in order to obtain the funds. The Supreme Court has been fairly liberal in allowing Congress to attach conditions to the receipt of federal funds. *See, e.g.*, South Dakota v. Dole, 483 U.S. 203, 211–12 (1987) (approving a provision under which the U.S. Secretary of Transportation must withhold a percentage of federal highway funds from states where the drinking age is less than twenty-one).

dertaken with the public interest in mind. Satisfaction seems to be very high in two areas with the least regulation and most competition—long distance telephone service and internet service. Surprisingly, the Federal Communications Commission thought the best regulatory strategy in long distance service would be to virtually eliminate for most carriers even the most rudimentary form of regulation, tariff filing, but the Supreme Court rebuffed this as inconsistent with the fundamentals of the applicable regulatory scheme.[58] It should be noted that the positive developments in the long distance area are due at least in part to careful regulatory structuring of what has become a well-functioning market. In the more highly regulated cable television arena, there seems to be greater consumer dissatisfaction, although it is unclear whether the regulators are to blame. There are still regulations such as must-carry rules for cable providers and restrictions on what satellite providers may transmit that frustrate the ability of consumers to get what they want. This example illustrates that once you have regulation, interest group lobbying and rent extraction are sure to follow.[59] This illustrates what I think is the real issue underlying a great deal of this discussion. Privatization is less likely to have a tremendously positive effect if it is carried out in the context of a highly regulated society with big government taken for granted as a feature of the society. The social effect of privatization is likely to be muted unless accompanied by radically reduced regulation. So long as big government is there to exercise coercive power, private entities will look to government for results that they could not achieve in the private market, and government will feel compelled by political reality to at least appear to be closely monitoring the performance of private entities. For privatization to entail really significant social change, it would have to be accompanied by a higher degree of deregulation than has occurred up to now.

CONCLUSION

In theory, extensive privatization could lead to substantial social changes in the form of greater private ordering. However, in the current political climate, this seems unlikely. Rather, privatization is likely to be accompanied by significant regulation in the form of performance standards,

58. *See* MCI Telecomms. Corp. v. AT & T, 512 U.S. 218, 229–34 (1994).

59. For a fascinating example, consider Fred McChesney's examination of Federal Trade Commission (FTC) regulation of the funeral industry. *See generally* Fred S. McChesney, *Consumer Ignorance and Consumer Protection Law: Empirical Evidence from the FTC Funeral Rule*, 7 J.L. & POL'Y 1 (1990). McChesney concludes that "cremators and other sellers not subject to the Rule" benefited from the FTC's rule, not consumers. *Id.* at 4; *see also* Jonathan R. Macey, *Promoting Public Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223 (1986); Fred S. McChesney, *Rent Extraction and Interest-Group Organization in a Coasean Model of Regulation*, 20 J. LEGAL STUD. 73 (1991); Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 (1987).

monitoring by government and the imposition of norms not directly related to the privatization. In fact, the generally higher regulatory burden felt by all private entities today means that private firms generally may find themselves living in a much more restrictive regulatory environment than is implicit in the appellation "private." This is not to say that privatization is not worth the trouble. Privatization may result in significant cost reduction and improved performance as compared to government agencies that lack a strong incentive to perform well. However, the realities of our regulatory structure should provide a cautionary tale against unrealistic expectations.