Relational Contracts in the Privatization of Social Welfare: The Case of Housing

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INTRODUCTION

Privatization has become a permanent and increasingly significant fixture on the landscape of contemporary public policy. Federal, state, and local governments now turn to the private sector for everything from collecting neighborhood garbage to assisting in the occupation of Iraq. As Martha Minow recently noted, "a sea change is at work," with "[p]rivate and market-style mechanisms . . . increasingly employed to provide what government had taken as duties."[1] Nowhere is this trend more pronounced, and contested, than in the privatization of social welfare. In that arena, privatization's potential to harness the experience, efficiency, and diversity of the private sector sharply clashes with the risk to accountability raised by private-sector provision of public services.

Commentators concerned with capturing privatization's benefits and muting its potential harms often call for additional government control of private providers through their contractual agreements, specifying in ever-more-careful terms the scope of the engagement and monitoring providers with ever-greater oversight. In this view, privatization is best approached through contracts that are "clear, thorough, accurate, and unambiguous."[2] These prescriptions reflect an adversarial model of privatization analogous to classical discrete contracting in private law. The model presumes that the parties to the agreement are one-time players, bargaining outside the larger legal and social context in which their interaction occurs, and capable of capturing the key variables of their engagement in relatively complete terms.

Conceptualizing privatization through this discrete-contracting lens, however, understates the fundamentally relational nature of many of the

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1. MARTHA MINOW, PARTNERS, NOT RIVALS: PRIVATIZATION AND THE PUBLIC GOOD 3 (2002).
2. E.S. SAVAS, PRIVATIZATION AND PUBLIC-PRIVATE PARTNERSHIPS 188 (2000).

agreements that define public-private partnerships. In many forms of privatization, the long-term and repeat nature of the interactions between the parties shape their agreements, reflecting the inherent uncertainties that accompany a complex and intertwined relationship that can last for decades. Recognizing privatization as a relational phenomenon shifts the locus of efficiency and accountability efforts from contractual specificity and enforcement to encouraging flexibility and fostering mutual responsibility for program goals.

To explore this relational phenomenon and its implications, this Article examines the contracts and other modes of control that shape the relationship between the government and private providers in a collection of important affordable rental housing programs. Subsidized housing provides a fertile field of examination because policymakers, program managers, and private providers have been tinkering with the structures of privatization in that context for decades, yielding a number of insights into how structures of interaction have emerged.

A close study of those programs reveals a core of relational contracting features that discredit models of privatization predicated on conceptions of discrete contracting. The agreements recognize in myriad ways the long-term and inherently uncertain nature of the public-private interaction, and they accordingly often frame critical provisions in flexible terms with mechanisms for the parties to adjust to changing conditions on an ongoing basis. These agreements, however, often take a limited approach to relational norms, in that they respond to uncertainty not by sharing risk and providing for the mutual adjustment of terms over time, but rather by reserving discretion to the government.

Recognizing the relational, yet at times imbalanced, nature of these agreements yields prescriptions that seek to foster reciprocity and solidarity on the part of private providers. Tempering some measure of governmental discretion, or creating mechanisms to balance the parties' adjustments over time, may enhance the benefits of engaging the private sector in service provision, and may also provide alternative means to address threats to accountability. By rewarding fidelity on the part of private actors to the public values involved in services traditionally provided by the government, a relational approach can harness private incentives in the long run in a way that reinforces, rather than undermines, important public law norms. In various contexts other than privatization, relational contracts scholars have recognized the value that strategies of mutual commitment can bring to the long-term governance of contractual relations. These insights have direct relevance to the theory and practice of privatization.

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This Article proceeds as follows. Part I reviews current trends in privatization, outlining concerns of efficiency and accountability at the core of contemporary discussions of privatization. Part I then examines prescriptions for increased contractual control of private providers, arguing that such prescriptions overstate the extent to which privatization may reflect a discrete, rather than relational, contracting paradigm. Part II then turns to subsidized housing to illustrate the alternative paradigm of relational contracting, discussing common contractual and regulatory mechanisms that frame public-private interactions in that context. Turning from the descriptive to the prescriptive, Part III argues that there are advantages that a more relational approach might bring to privatization. Part III concludes with notes of caution about a relational contracting approach to privatization and suggests some responses to these concerns.

Ultimately, this Article seeks to make two contributions to the literature on privatization. First, it uncovers the relational features that can be found throughout agreements that shape government-provider interactions in one significant area of social welfare policy. Second, on a normative level, the Article argues that shifting the focus in privatization from discrete contracting to collaborative governing norms can improve the quality and responsiveness of the privatized service, while providing an alternative approach to preserving public values.[3] Examining in depth what Jody Freeman calls the

3. Arguments for collaborative approaches to governance are increasingly appearing in the public law scholarship. *See, e.g.*, Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 364-65 (2004) (arguing that long-dominant regulatory models are giving way to a broad-based "governance" model that seeks to transform legal control into a "dynamic, reflexive, and flexible regime"); Jerry L. Mashaw, *Structuring a "Dense Complexity": Accountability and the Project of Administrative Law*, *in* ISSUES IN LEGAL SCHOLARSHIP: THE REFORMATION OF AMERICAN ADMINISTRATIVE LAW 1, 6-8 (Philip P. Frickey & John F. Manning eds., 2005), *available at* http://www.bepress.com/ils/iss6/art4/ (discussing contemporary scholarship focused on decentering hierarchical, state-based processes of accountability). Variations on the general argument that cooperation may have advantages over strict contractual control in privatization have been made in the public management literature. *See, e.g.*, Peter Frumkin, *After Partnership: Rethinking Public-Nonprofit Relations*, *in* WHO WILL PROVIDE?: THE CHANGING ROLE OF RELIGION IN AMERICAN SOCIAL WELFARE 198, 198 (Mary Jo Bane et al. eds., 2000) (arguing that "[r]ather than working toward tighter oversight and more programmatic control . . . public management should move . . . toward strategies that promote more sectoral autonomy"); *see also* KIERON WALSH, PUBLIC SERVICES AND MARKET MECHANISMS: COMPETITION, CONTRACTING AND THE NEW PUBLIC MANAGEMENT 40-44 (1995) (discussing relational contracts in privatization). Urban economist Elliott Sclar has argued for relational contracting in privatization from an economics perspective, focusing generally (and skeptically) on municipal services. *See* ELLIOTT D. SCLAR, YOU DON'T ALWAYS GET WHAT YOU PAY FOR: THE ECONOMICS OF PRIVATIZATION 121-28, 130-50 (2000). As applied to privatization, however, the embrace by some public law scholars of alternatives to traditional command-and-control approaches has yet to incorporate in depth the insights of relational contracts theorists who have long explored the dynamics of long-term, intertwined interactions. Similarly, the public management and economics literature has not explored in detail the formal and informal mechanisms through which a relational approach to privatization might occur, particularly in social welfare policy. This Article begins to fill those gaps.

"uncomfortable interface of public law norms and private law principles"[4] thus clarifies our theoretical understanding of privatization and sheds important light on improving its practice.[5]

I. PRIVATIZATION AND GOVERNANCE

Privatization, a hearty policy and scholarly perennial, is currently enjoying a significant resurgence of attention. This Part describes this trend, particularly in social welfare policy, and reviews concerns of efficiency and accountability that drive current debates about privatization. Examining the argument that careful contractual crafting is a critical tool to promote privatization's benefits and mitigate its risks, this Part argues that such claims overemphasize a discrete-contracting framework. It concludes with the theoretical case for an alternative framework grounded in relational contracting.

A. *The Promise and Peril of Privatization*

1. *The Rise of Governing by Network*

"Privatization" holds a number of conceptually distinct meanings. At the highest level of generality, the term encompasses any devolution of public responsibility to private parties,[6] and internationally it often refers to the sale of state-owned enterprises.[7] In the United States, however, privatization generally refers to private-sector provision of traditionally publicly provided goods and services.[8]

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4. Jody Freeman, *The Contracting State*, 28 FLA. ST. U. L. REV. 155, 207 (2000).

5. *See* Jody Freeman, *Private Parties, Public Functions and the New Administrative Law*, *in* RECRAFTING THE RULE OF LAW: THE LIMITS OF LEGAL ORDER 331, 368 (David Dyzenhaus ed., 1999); Edward L. Rubin, *The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1437 (1996) ("By debating and analyzing how competing norms—specifically, the norms of efficiency and social justice—are instantiated in legal institutions, legal scholarship can advance our collective understanding about how these institutions function, how they create and implement the law, and what they mean for our society in a way that no other discipline can duplicate."); *see also* Janna J. Hansen, Note, *Limits of Competition: Accountability in Government Contracting*, 112 YALE L.J. 2465, 2469 (2003). As to the focus of this Article—long-term contractual and regulatory relationships between government agencies and private service providers—the literature is meager. *Cf.* JOEL F. HANDLER, DOWN FROM BUREAUCRACY: THE AMBIGUITY OF PRIVATIZATION AND EMPOWERMENT 90 (1996) (stating that privatization "has exploded, but research and evaluation studies are still quite scarce").

6. *See* Ronald A. Cass, *Privatization: Politics, Law, and Theory*, 71 MARQ. L. REV. 449, 456-62 (1988) (providing a typology of variations on the meaning of privatization); *see also* SAVAS, *supra* note 2, at 104-05 (providing a hierarchy of privatization arrangements, from "most privatized" to direct governmental provision).

7. *See* Clayton P. Gillette, *The Private Provision of Public Goods: Principles and Implications*, *in* A FOURTH WAY? PRIVATIZATION, PROPERTY, AND THE EMERGENCE OF NEW MARKET ECONOMIES 95 (Gregory S. Alexander & Grazyna Skapska eds., 1995). Privatization as divestiture is operative to some extent in the United States, but less so than in many other countries given the lack of a domestic tradition of nationalization.

8. John Donahue distinguishes this prosaic form of privatization—changing the type of entity

All levels of government are increasingly employing private entities to undertake functions traditionally performed by the public sector.[9] Contracting out and close variants have become important policy tools in everything from the delivery of municipal services[10] to international military operations and foreign aid.[11] As Paul Verkuil points out with concern, it is becoming increasingly challenging to identify core government functions that cannot be performed by private parties.[12]

While by no means a new phenomenon,[13] privatization has accelerated in recent years.[14] As it is emerging, privatization reflects what Stephen Goldsmith and William Eggers recently described as "governing by network,"[15] with governments replacing traditional core management structures with networks of public and private organizations.[16] At the federal level, for example, those employed through grants and contracts outnumber civil servants by at least four to one.[17]

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delivering a public good or service—from the arguably broader shift from public to private financing. *See* JOHN D. DONAHUE, THE PRIVATIZATION DECISION: PUBLIC ENDS, PRIVATE MEANS 7 (1989). Donahue argues that the combination of public financing and public sector delivery encompasses much of what has traditionally constituted governmental action, while private finance and private delivery constitute much of what traditionally constituted the private sector. Privatization as a phenomenon can include shifting delivery, financing, or both to the private sector. *Id.*

9. *See* Steven J. Kelman, *Contracting*, *in* THE TOOLS OF GOVERNMENT: A GUIDE TO THE NEW GOVERNANCE 282, 287-88 (Lester M. Salamon ed., 2002) (noting that contracting has been a part of government since the beginning of the Republic, and that contracting has increased apace with the growth of government); DONAHUE, *supra* note 8, at 4-5.

10. *See* DONAHUE, *supra* note 8, at 131-33.

11. *See* Laura Dickinson, *Government for Hire: Privatizing Foreign Affairs and the Problem of Accountability Under International Law*, 47 WM. & MARY L. REV. 135 (2005); Jon D. Michaels, *Beyond Accountability: The Constitutional, Democratic, and Strategic Problems with Privatizing War*, 82 WASH. U. L.Q. 1001 (2004).

12. *See* Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions*, 84 N.C. L. REV. 397, 420-21 (2006); *see also* Clayton P. Gillette & Paul B. Stephan III, *Constitutional Limits on Privatization*, 46 AM. J. COMP. L. (SUPP.) 481, 482 (1998) ("It is hard to identify any function that, as a constitutional matter, has been characterized as inherently public.").

13. *See* Daniel Guttman, *Public Purpose and Private Service: The Twentieth Century Culture of Contracting Out and the Evolving Law of Diffused Sovereignty*, 52 ADMIN. L. REV. 859, 863-90 (2000) (discussing the twentieth century history of privatization at the federal level).

14. *See* Freeman, *supra* note 4, at 161-63.

15. STEPHEN GOLDSMITH & WILLIAM D. EGGERS, GOVERNING BY NETWORK: THE NEW SHAPE OF THE PUBLIC SECTOR 6-7 (2004); *see also* H. Brinton Milward & Keith G. Provan, *Governing the Hollow State*, 5 J. PUB. ADMIN. RES. & THEORY 1, 3-4 (2003), *available at* http://jpart.oxfordjournals.org/cgi/reprint/10/2/359 (discussing the network metaphor for public administration in social services privatization). Goldsmith and Eggers's discussion of public management is part of the literature on the New Public Management movement, an important aspect of which is managing private providers. *See generally* SAVAS, *supra* note 2, at 318-20 (discussing the New Public Management movement and the role of privatization in the collection of reforms that generally fall under that heading); E.S. Savas, *Privatization and the New Public Management*, 28 FORDHAM URB. L.J. 1731, 1736 (2001).

16. *See* GOLDSMITH & EGGERS, *supra* note 15, at 9-14.

17. *See* Guttman, *supra* note 13, at 863 (citing PAUL LIGHT, THE TRUE SIZE OF GOVERNMENT 1 (1999)); *see also* John J. Dilulio, Jr., Response, *Government by Proxy: A Faithful Overview*, 116 HARV. L. REV. 1271, 1273 (2003) (noting that for every federal civil servant, there are more than six workers employed in the "proxy" government—state and local governments administering federal programs as well as for-profit and nonprofit entities).

Nowhere is this trend more pronounced than in social welfare policy. The private sector has long played an important role in providing health care, education, welfare, job training, housing, and other social services.[18] As early as the late nineteenth century, local governments were contracting with private entities to supply social services, in some cases for the bulk of their poverty-relief efforts.[19] And most significant federal social welfare programs have included some measure of public-private partnering—sometimes a great deal.[20]

As with government services more generally, privatization in social welfare is increasing in prevalence.[21] Social services privatization has been a hallmark of welfare policy since the 1996 Welfare Reform Act[22] and the concomitant shift at the state level to private providers.[23] States are likewise turning to vouchers for education,[24] and privatization is at the heart of the current administration's focus on bringing religious institutions to the forefront of social service delivery.[25] This surge in privatization has brought renewed attention to the practice and increasingly urgent calls for responding to the threats that some see in the trend.

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18. *See* Arnold Gurin, *Governmental Responsibility and Privatization: Examples from Four Social Services*, *in* PRIVATIZATION AND THE WELFARE STATE 179, 179-84 (Sheila B. Kamerman & Alfred J. Kahn eds., 1989); Ruth Hoogland DeHoog & Lester M. Salamon, *Purchase-of-Service Contracting*, *in* TOOLS OF GOVERNMENT, *supra* note 9, at 323. The nonprofit sector, in particular, has long played a central role in the provision of social services. *See* LESTER M. SALAMON, PARTNERS IN PUBLIC SERVICE: GOVERNMENT-NONPROFIT RELATIONS IN THE MODERN WELFARE STATE 34 (1995) (noting that "in a number of human service fields . . . nonprofit organizations actually deliver a larger share of the services government finances than do government agencies themselves"); *see also* Frumkin, *supra* note 3, at 199 (noting that "the nonprofit sector had become by the late 1970s the principal vehicle for the delivery of government financed human services"); Michele Estrin Gilman, *Legal Accountability in an Era of Privatized Welfare*, 89 CAL. L. REV. 569, 581-91 (2001) (discussing the historical pendulum swings in public and private provision of welfare services).

19. *See* DeHoog & Salamon, *supra* note 18, at 323.

20. *See* GOLDSMITH & EGGERS, *supra* note 15, at 10 (quoting DONALD KETTL, SHARING POWER: PUBLIC GOVERNANCE AND PRIVATE MARKETS 4 (1993)); Guttman, *supra* note 13, at 875.

21. *See* DeHoog & Salamon, *supra* note 18, at 319-20; *see also* Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1380-94 (2003) (surveying recent trends in privatization and noting that the trend toward privatization has been "particularly pronounced in social welfare programs and in government-run institutions").

22. Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 1936.

23. *See* Gilman, *supra* note 18, at 591-94 (discussing privatization following passage of the Personal Responsibility and Work Opportunity Act of 1996); Sheila S. Kennedy, *When Is Private Public? State Action in the Era of Privatization and Public-Private Partnerships*, 11 GEO. MASON U. CIV. RTS. L.J. 203 (2001) (discussing privatization in the wake of welfare reform); Jon Michaels, *Deforming Welfare: How the Dominant Narratives of Devolution and Privatization Subverted Federal Welfare Reform*, 34 SETON HALL L. REV. 573 (2004).

24. *See generally* Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1230 (2003).

25. *See* DiIulio, *supra* note 17, at 1278 (discussing the current promotion of social services delivery by religious entities); *see also* Matthew Diller, *Form and Substance in the Privatization of Poverty Programs*, 49 UCLA L. REV. 1739, 1758 (2002) (discussing the Bush administration's push toward privatizing poverty programs).

2. *Efficiency and Accountability in Privatization*

Despite its ubiquity, privatization remains contentious. Some scholars and advocates approach privatization from ideological perspectives that cast doubt on *any* private provision of public services, or that alternatively assume a blanket preference for such provision.[26] But commentators are increasingly accepting the reality of privatization and analyzing the practice from a more neutral starting point.[27] This pragmatic approach eschews sweeping generalizations and instead focuses on potential determinants of its success or failure as a policy tool in practice.[28] Within this pragmatic literature, lines of discussion have coalesced largely around concerns of efficiency and accountability.[29]

Exploring these concerns serves two functions in this Article. First, it provides an evaluative framework through which to examine the government-provider relationship. Any governance mechanism—discrete contracting, relational contracting, or otherwise—must answer to these two different and at times competing goals. Second, and perhaps more fundamentally, understanding the current terms of the privatization debate underscores why commentators tend to prescribe solutions to privatization's challenges that may be too sanguine about contractual specificity and oversight.

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26. For proponents, arguments in favor of privatization can be fueled by a commitment to reducing the role of government, and privatization becomes another ground for general opposition to state intervention in modern life. *See* Paul Starr, *The Meaning of Privatization*, *in* PRIVATIZATION AND THE WELFARE STATE, *supra* note 18, at 15, 37. Regardless of its particulars, the argument goes, privatization is a salutary way to shift ever-increasing responsibility for the traditional public realm to the private sector. The countervailing view holds that private provision of public services creates an irremediable conflict threatening to hollow government and undermine the rule of law. Under this view, privatization inherently compromises the public sphere, reducing the deliberative values of government and destroying citizens' roles in shaping public policy. *See generally* Mark H. Moore, *Introduction* to *Symposium: Public Values in an Era of Privatization*, 116 HARV. L. REV. 1212, 1212-13 (2003). While these arguments help conceptualize the proper spheres of public and private governance, this Article begins with the fact of privatization and explores privatization given that practical reality.

27. *See* Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 631 n.368 (2000).

28. *Cf.* Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. 1285, 1295-98 (2003) (focusing on the pragmatics of privatization). Professor Freeman notes that scholars focused on the efficiency aspects of privatization, generally from an economics perspective, tend to ignore the legal and democratic accountability concerns that occupy public law scholars, while the latter tend not to focus on the cost and quality of the privatized services. *Id.* at 1290.

29. Matthew Diller argues that for poverty programs, privatization can be described by three basic accounts: privatization as technocratic advancement (an argument from improved public management); privatization as a qualitative improvement in the delivery of services (an argument from the nature of private providers); and privatization as "stealth big government" (an argument that privatization facilitates increased public support for anti-poverty programs despite conservative opposition). *See* Diller, *supra* note 25, at 1743-51. In my typology, the first two of these arguments are efficiency-related arguments, while the third is an argument that falls outside of the internal debate about privatization, representing a variation on the anti-government strain of privatization advocacy.

a. The Efficiency Case for Privatization

The primary pragmatic argument in favor of privatization rests on private providers' purported comparative advantages over public entities and consequent potential to deliver higher-quality services at lower cost.[30] Although discussions of these potential gains use various labels, for present purposes we can call this set of arguments the efficiency case for privatization.

In somewhat reductionist terms, the efficiency case begins with the perception that private providers are more nimble, better able to respond to changing conditions, and free from the constraints of supposedly rigid public bureaucracies.[31] Market mechanisms, in this view, discipline wayward private firms and create an incentive structure for the private sector that is impossible to replicate for public entities.[32] The public nature of government actors thus tends to yield rigid rules and procedures, without the discipline to perform optimally.[33] A separate line of argument emphasizes the potential benefits of fostering community involvement and drawing on the diversity of perspectives and experiences available in the private sector.[34]

The efficiency case for privatization, however, is not without its critics.[35]

30. *See* Cass, *supra* note 6, at 485-86; Michael J. Trebilcock & Edward M. Iacobucci, *Privatization and Accountability*, 116 HARV. L. REV. 1422, 1423 (2003). In discussions about privatization, the term efficiency is often used in its productive rather than allocative sense. In other words, "efficiency" in this context generally focuses on the immediate comparative advantages that private parties bring to bear, and less on the macroeconomic advantages of a wholesale shift to private provision. The concept of efficiency, it bears noting, is not without normative overtones. *See* JANICE GROSS STEIN, THE CULT OF EFFICIENCY 68-69 (2002). This Article focuses on efficiency in the sense of delivering the same or better service with the same or less public funding. *Id.*

31. *See, e.g.*, SAVAS, *supra* note 2, at 111-12; *see also* DAVID OSBORNE & TED GAEBLER, REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR 250-79 (1992) (contrasting centralized and decentralized public management structures).

32. *See* Trebilcock & Iacobucci, *supra* note 30, at 1424-26. Thus, the argument goes, the fact that public agencies are not subject to extinction or acquisition creates the "special peril" of "chronic inefficiency." DONAHUE, *supra* note 8, at 51; *see also* Trebilcock & Iacobucci, *supra* note 30, at 1428.

33. DONAHUE, *supra* note 8, at 51 (citing ANTHONY DOWNS, INSIDE BUREAUCRACY 24-25 (1967)).

34. *See* Minow, *supra* note 24, at 1244-46; *see also* DeHoog & Salamon, *supra* note 18, at 336 (discussing the possibility of increased equity and responsiveness in servicing clients, given the ability of private—nonprofit—providers to tailor services to client needs and to provide services in the community); Matthew Diller, *The Revolution in Welfare Administration: Rules, Discretion and Entrepreneurial Government*, 75 N.Y.U. L. REV. 1121, 1209 (2000) (noting the account of privatization—particularly with community-based nonprofits—as enhancing responsiveness to local conditions).

35. Perhaps reflecting the unsettled theoretical case for the comparative efficiency of private providers, little consensus has emerged on the empirical determinants of efficiency gains in privatization as a general matter. Some scholars have made sweeping claims about the empirical evidence as to the comparative advantages of private entities in the delivery of public goods. *See, e.g.*, Gillette, *supra* note 7, at 106 (citing DENNIS C. MUELLER, PUBLIC CHOICE II 261-66 (1989)) (summarizing approximately fifty empirical studies and concluding that in over forty of the studies public entities were found to be "significantly less efficient than private firms supplying the same service"); *see also* SAVAS, *supra* note 2, at 167 (reviewing empirical studies of municipal garbage collection, and concluding that contracting out was more efficient than public provision); *cf.* Trebilcock & Iacobucci, *supra* note 30, at 1429 (noting that a review of the empirical evidence on the privatization of state-owned enterprises "confirmed that private actors economically outperform public agents in the provision of goods and services" (citing

Assumptions about comparative incentives and organizational form that underlie the efficiency case, for example, may be missing key elements of privatization in practice.[36] Examining municipal services, Elliott Sclar has argued that in evaluating privatization, one must recognize that market information is generally incomplete, competition is often lacking, and market participants are complex organizations instead of the paradigmatic wealth-maximizing individuals of the traditional microeconomic story.[37] And because the standard efficiency case for privatization generally rests on the ability of the government to return to the market—to re-bid at regular intervals—the rationale may break down where there are barriers to market development or to the ability of participants to evaluate the costs of contract formation and oversight.[38] For Sclar, whether privatization yields efficiency gains turns on the information available to the government about the service to be rendered and the government's ability to put that knowledge into operation.[39]

Sclar's argument has clear relevance to many areas of social welfare privatization. Providers of many social services have no clear analogue in the private sector and operate in markets where re-bidding poses serious practical challenges.[40] The tasks they are called upon to perform are often hard (if not impossible) to reduce to clear commands, the implementation of which could be assessed on narrow price and quality terms. Many social service providers, although by no means all, are motivated by more than profits alone. And in social services, the public-private relationship can be long-lasting, with termination often reserved for the most extreme circumstances, reflecting (depending on your point of view) the capture of agencies or a benign

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William L. Megginson & Jeffrey M. Netter, *From State to Market: A Survey of Empirical Studies on Privatization*, 39 J. ECON. LIT. 321, 356 (2001))). There is significant reason, however, to doubt the validity of such sweeping claims. John Donahue's review of the empirical literature, for example, concludes that the record is decidedly mixed. *See* DONAHUE, *supra* note 8, at 57-78. Donahue finds that private provision may or may not yield efficiency gains depending largely on the nature of the service contracted out, the relevant organizational structure involved (regardless of whether that structure is public or private), and market determinants such as the potential for collusion, information costs, and availability of alternative providers. *Id.* Similarly, Professor Sclar's review of leading empirical studies of privatization of municipal services identified a number of methodological and conceptual gaps. *See* SCLAR, *supra* note 3, at 48-49. Sclar's work casts doubts on the proposition that privatization necessarily improves service provision, and highlights the importance of context and implementation.

36. *See* SCLAR, *supra* note 3, at 97.

37. *See id.* at 47.

38. *See id.* at 19. Sclar argues that many publicly provided services may have apparent analogues in the private sector, but given the nature of positive and negative externalities (that is, effects that publicly provided services have beyond the direct beneficiaries), the comparisons are not perfect. Sclar gives the example of the U.S. Postal Service and a company like FedEx, arguing that the "service" each provides is distinct, with the former reflecting public policy goals such as serving rural communities at low costs. *Id.* at 22-23. For these reasons, Sclar argues, one cannot simply open the yellow pages and assume that the market for similar services will necessarily match what is needed for the given public service. *Id.* at 29, 32.

39. *See id.* at 91.

40. *Id.* at 125.

embodiment of a long-term commitment.[41] All of this limits the value of exit over voice as a means of control.[42]

These conditions challenge the assumptions of the standard case for efficiency gains in privatization. Prescriptions for achieving the benefits attendant to private-sector provision therefore have to take a cautious approach to modes of control that rely on the standard market model. As an evaluative matter, any approach to the management of privatization should recognize the particular contours of the efficiency case as it applies in social welfare.[43]

b. The Risk to Accountability from Privatization

Mirroring efficiency arguments in favor of privatization is a concern, voiced primarily by public law scholars, that privatization threatens government accountability to core public law norms.[44] Accountability is a notoriously slippery concept, serving as what Jerry Mashaw has called a "placeholder for multiple contemporary anxieties."[45] In the context of privatization, the threat to accountability arguably derives from the very comparative advantages that private parties are thought to bring to service provision—freedom from the constraints of governmental action.

Accountability can invoke multiple frames of responsibility. Public officials, for example, are accountable to the general public, although difficult and subtle questions can arise as to the relevant "public" to which officials must respond.[46] Within the government, separation of powers and federalism are accountability mechanisms pitting one branch or layer of government against another. And within any government organization, there are frames of accountability focused on the organization's mission, which in the social services arena includes accountability to recipients. These multiple frames often lead to significant confusion in discussions of accountability.

Accountability, moreover, can be grounded in different institutional arrangements. While public law scholars tend to think about accountability in terms of controlling the discretion of public actors, market mechanisms might

41. *See* Diller, *supra* note 34, at 1210 n.454 (quoting HANDLER, *supra* note 5, at 217).

42. *See generally* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970) (discussing means of influencing institutions); Minow, *supra* note 24, at 1266-67 (discussing exit, voice, and loyalty in privatization).

43. *See* SCLAR, *supra* note 3, at 130-50; *see also* OSBORNE & GAEBLER, *supra* note 31; Diller, *supra* note 34, at 1173-76 (describing the public administration literature on entrepreneurial government).

44. *See* MINOW, *supra* note 1; *see also* Barbara L. Bezdek, *Contractual Welfare: Non-Accountability and Diminished Democracy in Local Government Contracts for Welfare-to-Work Services*, 28 FORDHAM URB. L.J. 1559, 1560 (2001) ("Accountability problems multiply because familiar rules of administrative law do not clearly constrain the new regime of the Contractual State.").

45. *See* Mashaw, *supra* note 3, at 15.

46. *See* Paul L. Posner, *Accountability Challenges of Third-Party Government*, *in* TOOLS OF GOVERNMENT, *supra* note 9, at 523, 524.

provide an alternative approach to accountability.[47] Market accountability operates both through the relationship that managers and employees in a firm have with the owners of that firm, and through the relationship between the firm and its customers.[48] Some commentators object to conceptualizing market pressures—to owners (as a function of capital markets) and to customers—as accountability mechanisms analogous to the constraints of public law,[49] but these pressures at the very least force responsiveness to notions of public responsibility.[50]

Finally, as Mashaw points out, the inherent responsibility to others that arises in social networks is a third framework for conceptualizing accountability.[51] Accountability through social networks arises from what Mashaw calls "community and culture," with individuals and private organizations responding to the demands and often unspoken strictures of norms generated by social institutions largely in lieu of state governance.[52]

All of these frames of accountability are implicated to some extent any time the government employs a private party to deliver goods or services to the public.[53] The primary concern that public law scholars evince when considering privatization, however, is the shift away from the tools of public accountability available when public actors deliver public services.[54] While this Article focuses primarily on the relationship between government entities and their private intermediaries, other mechanisms of accountability inform the extent to which such fears will bear out.[55]

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47. *See* Moore, *supra* note 26, at 1225; Mashaw, *supra* note 3, at 21-24. For an argument that private actors' comparative advantages (in terms of market discipline and ability to incentivize agents) are themselves a form of accountability, see Trebilcock & Iacobucci, *supra* note 30, at 1422-23.

48. *See* Moore, *supra* note 26, at 1225-26; Trebilcock & Iacobucci, *supra* note 30, at 1423.

49. *See* Mashaw, *supra* note 3, at 22-23 (citing Richard Mulgan, *Contracting Out and Accountability*, AUSTL. J. PUB. ADMIN., Dec. 1997, at 106).

50. *See id.* at 23. To the extent that the critique of market forces as mechanisms of accountability is grounded in a normative evaluation of the values to which market actors are held accountable—profit maximization, for example—it is valid to draw a hard line between public governance and market approaches to accountability. But it is conceptually possible to harness market-like forces to achieve public goals, and that shift from the structure to the content of the accountability regime lies at the heart of alternative approaches to accountability in privatization.

51. *See id.* at 24-26.

52. *See id.* at 25.

53. *See* DONAHUE, *supra* note 8, at 38-39, 43-54; SCLAR, *supra* note 3, at 96-101. Public law scholars tend to focus on the public governance frame as the most responsive to public values, but the choice is rarely so singular. David Riemer, Director of Administration for the City of Milwaukee, has argued that market models of accountability work best when the task to be performed is complex, focuses on holistic problems, implicates public disagreements about approach, and is amenable to variations in approach. *See* David R. Reimer, *Government as Administrator vs. Government as Purchaser: Do Rules or Markets Create Greater Accountability in Serving the Poor?*, 28 FORDHAM URB. L.J. 1715, 1725 (2001). While one can quibble with Reimer's criteria, the important point is that various mechanisms may work better or worse in specific contexts, and easy generalization must be avoided.

54. *See* Freeman, *supra* note 28, at 1302-06 (discussing public law perspectives); Moore, *supra* note 26, at 1212.

55. *See* Freeman, *supra* note 27, at 664-73 (discussing aggregate modes of ensuring accountability).

Turning, then, to the government-provider relationship, Martha Minow has usefully outlined the accountability threat potentially posed by private-sector delivery of public services. First, privatization may undermine legal protections grounded in norms of equality and freedom that attach to state action.[56] Minow has acknowledged that defining the precise content of applicable public law norms can be a ground of significant contention.[57] Whatever the specific contours of the relevant values, however, using private actors not subject to traditional state action constraints challenges the public's ability to protect such values.[58]

Second, privatization raises a potential structural mismatch between private incentives (particularly where for-profit entities are involved) and public goals.[59] Thus, for Minow, certain public goods, such as education, are fundamentally resistant to the information feedback mechanism of the market lauded by advocates of privatization, and determinants of success and failure are beyond the scope of direct competition.[60] A variation on this concern with incentives is the argument that privatization can at best lead to agency capture and at worst be a directly corrupting influence on the public sector, as public actors are exposed to the temptations of private gain.[61]

Finally, turning to private forces to deliver public goods "risks diminishing experiences of commonality and fomenting tension and distrust across groups already experiencing religious or ethnic tension."[62] Ultimately, this carries the potential to create a de-legitimized "hollow state,"[63] as greater involvement by private parties in the provision of social services undermines our collective capacity "to imagine and participate in a public realm."[64]

Although privatization has the potential to raise these normative concerns

56. *See* Minow, *supra* note 24, at 1246.

57. *See* MINOW, *supra* note 1, at 144.

58. Minow's proposals for core public values include individual freedom of belief and expression, government neutrality toward religion, freedom from discrimination, provision for basic human needs, respecting pluralism, and democracy. *See id.* at 146-50. As Minow acknowledges, any list at this level of generality is "contestable both as generally articulated and as interpreted in particular contexts." *Id.* at 146. However the political and legal process arrives at the appropriate set of governing norms, in this view, such norms are threatened when private parties are the instrument of providing government services.

59. *See* Minow, *supra* note 24, at 1249. Some commentators have framed this concern in terms of the incentives that the private sector has to manipulate the terms of contracts to privilege profit over services. *See, e.g.*, Michaels, *supra* note 23, at 631-33.

60. Minow, *supra* note 24, at 1249-53.

61. *See, e.g.*, Dickinson, *supra* note 11, at 164.

62. *See* Minow, *supra* note 24, at 1253.

63. For an extensive review of the arguments that privatization has the potential to undermine the legitimacy of the state, see Milward & Provan, *supra* note 15.

64. Minow, *supra* note 24, at 1254. Paul Verkuil focuses on the closely related concern that the increasing prevalence of privatization threatens the legitimacy of the public sector given the unique role that government employees play in upholding public values (by, for example, swearing to uphold the Constitution, following conflict-of-interest rules, and working for more than simply material gain). *See* Verkuil, *supra* note 12, at 459.

across the entire spectrum of government action, concerns about the threat to public values are particularly sharp in social welfare.[65] Where services such as housing, welfare, and education are concerned, distributional and other non-efficiency based instrumental concerns are a critical aspect of service delivery. In other words, if the government service is explicitly designed to alleviate inequality or serve some other larger societal goal, program design may be less readily justified solely in market terms. Conversely, given the vulnerability of populations to be served, concerns about public law norms such as due process and equality take on particular urgency when the services at issue focus on combating poverty.[66]

Concerns about accountability and the reach of public law norms, however, are not necessarily a one-way street. Just as privatization has the potential to improve the delivery of services under the appropriate conditions, it also carries the potential to enhance rather than diminish accountability. As Jody Freeman and others have argued, privatization carries the potential to bring public law norms to traditionally private realms, a process Freeman calls "publicization."[67] Private actors are increasingly taking on the hue of public entities as the "price of access" to opportunities to provide public services.[68] For Freeman, the extent to which privatization should include the imposition of public values turns on the ease of specifying public goals, the extent of the provider's discretion, the potential impact on the consumer of the relevant service, and the government's motivation for privatizing.[69] Thus government should seek to impose public values on private providers where programs are hard to define contractually, involve the exercise of discretion, are value-laden, and serve vulnerable populations.[70]

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65. *See* Freeman, *supra* note 28, at 1349-50.

66. Within the range of social services, just as there are significant operational differences, concerns about public values may take on different casts depending upon the context. Housing, for example, requires careful attention to aspects of equality and fairness in housing location (which has too often yielded to exclusionary pressures at the local level), the selection of and long-term relations with tenants, and the transparency of the use of public funds, among others. Given the long-term and relatively intimate relationship between provider and tenant, housing also requires attention to a more ineffable quality of *respect*, a value hard to capture in clear contractual terms regardless of whether a provider is a public or private entity.

Other areas of social welfare might raise different operational and normative concerns. Substance abuse and counseling services, for example, or benefits eligibility in welfare and health care raise variations of concerns about equality, fairness, and transparency, although perhaps as a difference in degree rather than in kind. And prison privatization, another contentious area of privatization, involves particularly significant aspects of social control and state power over inmates. *See* Ahmed A. White, *Rule of Law and the Limits of Sovereignty: The Private Prison in Jurisprudential Perspective*, 38 AM. CRIM. L. REV. 111, 145-46 (2001).

67. *See* Freeman, *supra* note 28, at 1314-29; *cf.* Jack M. Beermann, *Administrative-Law-Like Obligations on Private[ized] Entities*, 49 UCLA L. REV. 1717, 1729-34 (2002).

68. Freeman, *supra* note 28, at 1285.

69. *Id.* at 1343-50.

70. *Id.* at 1349. Freeman also argues that imposing public norms in privatizing public services is a tool for responding to the potential for governmental avoidance of public law protections, and should be less of a factor when privatization is more focused on pragmatic goals. *Id.*

Any inquiry into whether privatization is a force for eroding or extending public law norms, then, must focus on the details of privatization in practice. There are grounds to be skeptical about an inherent conflict between efficiency and accountability, and it is important to examine instances of privatization in practice at the level of program implementation.

3. *Contractual Control in the Efficiency/Accountability Debate*

If privatization carries the promise of harnessing the creativity and discipline of the private sector, but risks eroding the core values that define and constrain public action, identifying the appropriate mechanisms for controlling private providers becomes a critical question. This is a basic principal-agent problem, and as John Donahue points out, a government entity's decision to employ private actors is only one strategy that can be employed to respond to the potential mismatch between the goals of the principal and the incentives that shape the actions of the agent.[71] If the government decides to contract out, however, there are a number of mechanisms generally available to respond to potential principal-agent problems, including regulation, contracting, increasing the potential for non-contractual liability (tort or public law-based), and less formal means of aligning agents' incentives.[72] While all of these tools are important, and none operate in isolation, it is the contract that sets the terms of the relationship between the government and private providers.[73]

One might ask why the government would choose to define core aspects of the relationship with private providers through contract even in a minimal way, rather than reserving all discretion to administrative oversight of grantees.[74] Government entities (or the legislators that mandate contractual obligations by statute) may simply be seeking the additional remedies that are available when an obligation is imposed by contract and the ability to tailor an agreement to the particulars of a given relationship.[75] And having a contract in place creates an

71. *See* DONAHUE, *supra* note 8, at 38-39. Directly employing agents is another strategy to lessen this tension, but privatization reflects a decision (for whatever reason) to employ a contractual strategy. *Id.; see also* Kelman, *supra* note 9, at 305 (discussing contracting versus employment as two alternative strategies to reduce principal-agent problems).

72. For an overview of various tools in the context of welfare reform, see Gilman, *supra* note 18.

73. *See, e.g.*, Minow, *supra* note 24, at 1266-67 (discussing contractual mechanisms for ensuring accountability to public values in the context of privatization).

74. *Cf.* Lester M. Salamon, *The New Governance and the Tools of Public Action: An Introduction*, *in* TOOLS OF GOVERNMENT, *supra* note 9, at 1, 1-6 (discussing alternative approaches to structuring public-private interaction). Certainly in the housing arena, as with other areas of privatization, significant obligations are imposed on private providers as a condition of receiving funding, and there is no inherent reason why subsidies could not be delivered through administrative, rather than contractual means.

75. *Cf.* Gilman, *supra* note 18, at 635 (discussing contractual remedies). Courts appear increasingly inclined to hold governmental entities to the essence of the bargain they enter into, absent clear authority to modify terms. *See* United States v. Winstar Corp., 518 U.S. 839 (1996); Cienega Gardens v. United States, 331 F.3d 1319 (Fed. Cir. 2003).

incentive for private providers to make capital and other investments, giving the government some measure of influence over the types of entities likely to bid for subsidies.[76]

Given that contracts are a central mechanism of controlling private providers, both efficiency advocates and public law scholars frequently prescribe ever-greater specificity in contract design, as well as increased attention by public officials to the minutiae of contract monitoring.[77] In this view, greater contractual clarity holds the potential for ever-more-careful calibration of governmental goals and public oversight.[78] As noted at the outset, E.S. Savas, a leading proponent of privatization, succinctly summarized this view with the argument that government contracts "will achieve their intended purpose only if the terms are clear, thorough, accurate, and unambiguous."[79] This view is widely shared.[80]

Prescriptions for contractual control are driven by a certain logic. If one accepts a role for the private sector in social welfare, but remains concerned that principal-agent disconnect might undermine efficiency or threaten public law norms, then it is important to have a clear metric for translating public goals into a discernable framework of delegation, as well as effective means to ensure that those goals are being met.[81] As Mark Moore has stated, "a necessary condition for success [in privatizing social services] is a form of accountability that allows a collective to define its purposes and then to develop

76. On the provider side, contracts provide certainty. The greater the number of variables in the relationship with the government that can be stipulated by contract, and the greater the capital investment by the private entity, the greater the ability of the provider to manage the risks inherent in accepting the subsidy. In housing, as discussed below in Part II, there are a variety of risks associated with becoming the intermediary of government subsidies, including increased scrutiny of operations, tenant obligations unmatched in the private sector, and even the potential for criminal liability that attends receipt of public funds. One important risk that providers seek to manage, however, is the possibility that the government might, through its regulatory or legislative authority, alter the "bargain" to disadvantage the provider. *See infra* text accompanying notes 211-212.

77. *See* Freeman, *supra* note 28, at 1350-51 (arguing that "there might be considerable agreement between the economic and public law views about the importance of clear and enforceable contractual terms to the success of privatization"); *cf.* MINOW, *supra* note 1, at 33 ("As drafter of the contracts, and the piper calling the tune, the government can set extensive and detailed public requirements.").

78. *See* DONAHUE, *supra* note 8, at 43-45.

79. SAVAS, *supra* note 2, at 188; *see id.* at 188-94 (discussing contractual structures for privatized services).

80. Elliott Sclar has observed that the "typical reaction to the concept of privatization is the attempt to modify the arrangement to work more like a classical contract," with ever-clearer terms and ever-greater enforcement mechanisms. SCLAR, *supra* note 3, at 121-22.

81. *Cf.* Judith Welch Wegner, *Utopian Visions: Cooperation Without Conflicts in Public/Private Ventures*, 31 SANTA CLARA L. REV. 313, 342-43 (1991) ("Clear standards for defining obligations and measuring compliance are especially important to provide an adequate benchmark in the event of financial or political downturns [in public/private ventures]. An effort should be made to anticipate future problems or changes in circumstances in order to specify at the outset that both current and future public health and welfare concerns will be addressed. Finally, ample remedies for noncompliance should be included in the interest of both parties . . . . These remedies would ensure that government judgment remains free and independent in the event of noncompliance and that private expectations are fairly treated in the event of changing political tides.").

the technical means for determining the degree to which those purposes have been achieved."[82]

However logical these widespread prescriptions might seem, they are misguided in important respects. First, they assume that the terms of engagement in privatization can be reduced to clear contractual commands that capture the essence of the outputs desired by government (whether in terms of the actual services or in terms of the public values through which those services are delivered).[83] Given the nature of the services at issue in social welfare policy, however, many aspects of services provided are extremely difficult to specify in clear output-driven terms.[84] Public law norms such as rationality and equality, for example, involve complex value judgments in operation that will elude detailed specification, no matter how prescient or creative the drafter of the contract.

This view, moreover, looks to the moment of contracting as the critical juncture in defining the public-private relationship and assumes that the contingencies that might shape that relationship can be accounted for at the time of contracting. As a temporal matter, however, the needs of both parties often cannot be foreseen or specified at the time of contracting, and the external environment (market, policy, or otherwise) in which services are to be provided is likely to shift, perhaps significantly, in the long run.

Finally, prescriptions that focus on clearer contractual control assume that the relationship between the government and the private provider is an essentially arm's-length transaction, amenable to termination as an important (if not the most important) remedy for noncompliance. As noted, however, the relationships that develop in this arena often involve significant investment in the relationship, long-term subsidies, and significant limitations on the extent to which deviations from contract terms may be amenable to traditional

82. Moore, *supra* note 26, at 1225. Likewise, for example, Martha Minow's account of contractual regimes for accountability depends heavily on the ability of the government both to define the terms of engagement in a way that does not undermine constitutional or legislative commitments and to enforce those terms strictly, ultimately with termination. *See* Minow, *supra* note 24, at 1267.

83. Moreover, the spiral of contractual specificity and oversight mechanisms creates increasing costs with ever-diminishing returns. Elliott Sclar described this "contract-fattening" process in the prison-privatization context:

> After each . . . malfunction, such as escapes, brutality, or deaths among prisoners, public officials step in to write a lengthier contract . . . to avoid repetition of the specific abuse that caused public embarrassment in the first place. Of course, each time more information and performance standards are demanded, the cost of the contract increases.

SCLAR, *supra* note 3, at 122.

84. Imposing a contractual obligation that tracks, for example, Fair Housing Act requirements can draw in the entire range of judicial and administrative interpretations that have evolved to clarify the nature of such obligations. *See* Henry Korman, *Underwriting for Fair Housing? Achieving Civil Rights Goals in Affordable Housing Programs*, 14 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 292, 295-97 (2005). And some public law norms, such as tenant procedural rights prior to lease termination, may be captured in relatively straight-forward terms. But many public law norms are more open-ended and must be applied in the myriad day-to-day interactions between providers and the public.

contractual remedies.[85]

In sum, the assumptions underlying prescriptions for tighter contractual control form what contract theorists would describe as a paradigm of "discrete" contracts. As we shall see, however, these assumptions do not necessarily hold, and privatization can generate agreements that are anything but on-off, discrete, and complete.

B. *Relational Contracting as an Alternative Paradigm*

Contracts for easily identifiable and measurable goods to be delivered in the short term may be amenable to relative clarity, but the practical challenges to achieving contractual clarity in more complex and long-term interactions are well documented.[86] The longer the term of the "transaction" captured by the contract and the more amorphous the "output" to be captured by the contracting parties, the more challenging the drafting becomes. The recognition of these conditions has spawned a vast literature on what contracts scholars call relational contracts.[87] Relational contract theory draws a contrast to so-called "discrete" exchange—paradigmatically negotiated at arm's length between strangers, in a spot market, with little or no focus on mechanisms to adjust contractual relations over time.[88] Discrete contracts attempt to allocate risks clearly, define reciprocal obligations narrowly, and leave sanctions for breach

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85. In the housing context, for example, terminating a subsidy contract may have significant detrimental effects on the residents of the housing being provided. Agencies do, of course, in extreme circumstances, sever relations with providers, but the decision to terminate can complicated by the costs of transition, the impact on beneficiaries, and the investments made by the government in the initial development of the good or service (in housing, the construction or rehabilitation).

86. *See* DONAHUE, *supra* note 8, at 115-18 (discussing, in the context of defense procurement, contractual complexity arising out ambiguous measures of value, difficulties in assessing need over time, and conflicting governmental goals (such as secrecy)); *see also* Steven Cohen & William Eimicke, Managing Privatization: The Tools, Skills, Goals and Ethics of Contracting (Mar. 10, 2001) (unpublished conference paper presented to the 62nd Annual Meeting of the American Society for Public Administration), http://www.columbia.edu/~sc32/managingprivataspa.pdf (outlining challenges to effective government contracting in privatization).

87. The literature on relational contracts is voluminous, stretching back to the pioneering work of Macaulay, *see* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963), and Macneil, *see* Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978) [hereinafter Macneil, *Contracts*]; Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691 (1974). *See* Richard E. Speidel, *The Characteristics and Challenges of Relational Contracts*, 94 NW. U. L. REV. 823, 823-24 (2000) (collecting sources). Contracts scholars dispute the extent to which relational contracting is a separate and distinct body of law. *See id.* at 824. Few scholars, however, would disagree that a relational lens has independent conceptual value in both positive and normative terms. *See* Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 852 (2000); *cf.* Randy E. Barnett, *Conflicting Visions: A Critique of Ian Macneil's Relational Theory of Contract*, 78 VA. L. REV. 1175, 1200 (1992) ("To a significant degree, we are all 'relationists' now.").

88. *See* Macneil, *Contracts*, *supra* note 87, at 862-65. Macneil contrasts relational contracts with discrete contracts, which he situates in the realm of classical contract doctrine. Neoclassical contract law, in Macneil's account, incorporates relational features and begins to shift toward mechanisms of planning and flexibility in adjusting to change. *Id.* at 884-85.

as the primary response to changed circumstances.[89] Discrete contracting typically arises in the realm of low-frequency transactions, with a low level of asset specificity, and relative clarity in the product or service that is the subject of the contract.[90]

Relational contracts challenge each of these predicates. Providing a single, coherent account of such agreements in the private-law context is a task that continues to elude legal scholars,[91] but several relevant themes have emerged in the literature. As Richard Speidel notes, relational contract theory has both descriptive and normative dimensions.[92] As a descriptive matter, relational contracts characteristically tend to extend over a longer period of time than discrete or classical contracts, involving either repeat interactions between parties or a single long-lasting agreement.[93] The durational aspect of relational contracts, although not singularly defining,[94] creates "patterns of interaction and expectation" that transcend the terms of any given exchange.[95]

Relational contracts, moreover, can be distinguished from discrete contracts in that the former tend to be more "incomplete" and the latter more "complete."[96] The terms of classical or discrete contracts tend to capture contingencies with relative clarity—perhaps because the subject of the contract is relatively simple or the transaction relatively brief.[97] By contrast, the more

89. *See* Jay M. Feinman, *Relational Contract Theory in Context*, 94 NW. U. L. REV. 737, 739-40 (2000) (discussing the relational-discrete continuum).

90. *See* SCLAR, *supra* note 3, at 102. Asset specificity refers to the extent to which investments specific to a relationship can be transferred to other contexts, a factor that influences the ability of parties to terminate. In housing, the government makes an investment in subsidizing a specific project, as does the private provider who builds it; both are reluctant to abandon the project. Providers have some ability to transfer investments in subsidized assets into market-rate housing, an important problem in contemporary housing policy, but the transition is by no means cost-free.

91. *See* Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 NW. U. L. REV. 877 (2000) (surveying uncertainty in relational contract theory); *see also* Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483.

92. *See* Speidel, *supra* note 87, at 827-28.

93. *Id.*

94. *See* Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1091 (1981) (noting that "long-term contracts are more likely than short-term agreements" to be relational, but "temporal extension per se is not the defining characteristic").

95. Speidel, *supra* note 87, at 828.

96. *See* OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 36-37 (1996). Relational contracts are a form of incomplete contracting, characterized by uncertainty, a high-degree of relation-specific investment, and repeat transactions, but relational contracts and incomplete contracts, theoretically, can diverge at the juncture of governance mechanisms. *See* SCLAR, *supra* note 3, at 123. Sclar draws a distinction between incomplete contracts, which he argues focus on replicating market governance, and relational contracts, which he argues build on the recognition of the interdependence of the parties. *Id.*

97. *See* SCLAR, *supra* note 3, at 102. One view of the difference between discrete contracts and relational contracts in terms of mechanisms of adjustment could track long-standing distinctions between rules and standards in law more generally. *See* Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1685-87 (1976); *see also* Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 384-90, 427-29 (1985) (criticizing the rules-standards dialectic). On this view, discrete contracts tend toward rules, while relational contracts tend toward standards, although the fit is not entirely perfect. *Cf.* William C. Whitford, *Relational Contracts and the New Formalism*,

complex or long-standing the interaction that is the subject of the contract, the more incomplete the terms will likely be.[98]

Thus, rather than attempting to define and allocate all risks and obligations at the outset, relational contracts tend to focus on planning and governance mechanisms, often through open terms and the allocation of discretion with respect to potential contingencies to one party or the other, within a framework of mutual obligation.[99] This lack of specification can be a function of the transaction costs of memorializing the full range of potential contingencies, the more so the longer the potential interaction. It can also be a function of the inherent difficulty—no matter how great the resources for negotiation at the outset—of anticipating all possible changes over time.[100] "Parties to a relational contract, then, are likely to view the exchange as an ongoing integration of behavior which will grow and vary with events in a largely unforeseeable future."[101]

The terms of relational contracts reflect inherent contingencies and the inability of contractual specificity to capture accurately the intended allocation of risk, giving rise to mechanisms of cooperation and the division of the benefits and burdens of the ongoing relationship.[102] In other words, conflict resolution in relational contracts, most theorists would agree, tends to minimize formal judicial enforcement in favor of various means of self-enforcement.[103]

Turning to the normative level, relational contract theorists argue that if the interaction between contracting parties involves long-term commitments and inherent uncertainties deeply imbedded within a shared social context, then the contract law that emerges should promote norms of solidarity, reciprocity, and role integrity.[104] Relational contracts, in this view, are grounded in the recognition that formally structuring incentives to overcome principal-agent problems is inadequate to manage long-term relations, and engaging the parties' mutual self interest is an alternative strategy for responding to the inevitability of change and uncertainty over time.[105] In other words, on an

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2004 WIS. L. REV. 631, 639 (discussing rules and standards in the context of relational contracts).

98. *See* WILLIAMSON, *supra* note 96, at 37.

99. *See id.*

100. Individualization of contractual terms, in contexts where one or both parties are repeat players, also takes resources.

101. Speidel, *supra* note 87, at 828.

102. *See id.*

103. *See* Donald James Smythe, *The Role of Contractual Enforcement and Excuse in the Governance of Relational Agreements: An Economic Analysis*, 2 GLOBAL JURIST FRONTIERS 3, 5 (2002) (citing WILLIAMSON, *supra* note 96; Goetz & Scott, *supra* note 94; and Macneil, *Contracts*, *supra* note 87), http://www.bepress.com/gj/frontiers/vol2/iss2/art3.

104. *See* Speidel, *supra* note 87, at 827. Drawing from Macneil's work, these are norms that Speidel identifies as holding a long-term relationship together. Similarly, contract law in this account can reinforce norms that develop over time, such as "supporting cooperation, risk sharing, and preserving the relationship." *Id.*

105. *See* SCLAR, *supra* note 3, at 123; Christopher Grandy, *Can Government Be Trusted To Keep Its Part of the Social Contract?: New Jersey and the Railroads, 1825-1888*, 5 J.L. ECON. & ORG. 249,

instrumental level, there are advantages to governing relational contracts in a way that rewards commitment to the relationship, deters defection, and fosters collaboration.[106]

A greater elaboration of the relevance of relational contract theory to privatization will benefit from context.[107] As others have noted in discussing privatization more generally, relational contracting norms hold promise,[108] but the ground-level means of embodying that promise, particularly in the realm of social welfare policy, remain largely unexplored. It is to such details that we now turn.

II. RELATIONAL CONTRACTING IN AFFORDABLE HOUSING

Moving from the abstract to the concrete, affordable housing policy provides insights into what a relational contracting approach to privatization might look like.[109] Affordable housing policy in the United States maps the full

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249-50 (1989).

106. Although these norms are generally targeted toward the relationship-specific investments that characterize private exchange, they may also apply to more abstract terms in privatization that relate to accountability—e.g., fealty on the part of private providers to public law norms.

107. *Cf.* Joel F. Handler, *Continuing Relationships and the Administrative Process: Social Welfare*, 1985 WIS. L. REV. 687, 691-99 (drawing on Macaulay's work on long-term relationships to posit a cooperative decisionmaking model of social welfare policy).

108. *See* SCLAR, *supra* note 3, at 130-50; Freeman, *supra* note 4, at 171 (noting that "[n]o contract can be specific enough to anticipate any and all situations that a private provider might encounter," and recognizing that "contractual vagueness may be desirable in some circumstances, as, for example, when the parties are familiar with each other, have been repeat players, and have established trust"); *see also* DeHoog & Salamon, *supra* note 18, at 321 (noting that in the social services arena, because "[t]he relationships established between the contractors and the government are critical," social welfare often involves "relational contracting").

109. The legal literature on the privatization of low-income housing focuses on specific policy concerns, often in the context of privatization through divestiture. *See, e.g.*, Michael H. Schill, *Privatizing Federal Low Income Housing Assistance: The Case of Public Housing*, 75 CORNELL L. REV. 878, 884-86 (1990) (discussing the sale of public housing to residents); Note, *When HOPE Falls Short: HOPE VI, Accountability, and the Privatization of Public Housing*, 116 HARV. L. REV. 1477 (2003) [hereinafter Note, *HOPE VI*]. For an excellent overview of privatization strategies and their consequences in affordable housing policy, see Peter W. Salsich, Jr., *Solutions to the Affordable Housing Crisis: Perspectives on Privatization*, 28 J. MARSHALL L. REV. 263 (1995). While housing privatization has not generated much attention in the legal literature, the topic has long been a staple of economic, political science, and public policy scholarship on government involvement in the market for housing. For prominent examples, see HOWARD HUSOCK, AMERICA'S TRILLION-DOLLAR HOUSING MISTAKE 13-29 (2003) (arguing broadly against government subsidies for affordable housing); JOHN C. WEICHER, PRIVATIZING SUBSIDIZED HOUSING (1997); and Peter D. Linneman & Isaac F. Megbolugbe, *Privatisation and Housing Policy*, 31 URB. STUD. 635, 639 (1994). Perhaps the most important policy concern raised in analyzing housing privatization is a recurring debate about the merits of tenant-based versus project-based subsidies. *See, e.g.*, Kirk McClure, *Housing Vouchers Versus Housing Production: Assessing Long-Term Costs*, 9 HOUSING POL'Y DEBATE 355 (1998), *available at* http://fanniemaefoundation.org/programs/hpd/pdf/hpd_0902_mcclure.pdf (arguing that the perception of a cost premium for project-based strategies overstates the differential by focusing on start-up, rather than life-cycle, costs); Mark Schroder & Arthur Reiger, *Vouchers Versus Production Revisited*, 11 J. HOUSING RES. 91 (2000) (criticizing McClure's study); Amy Ellen Schwartz et al., *The External Effects of Place-Based Subsidized Housing* (NYU Law Sch. Law & Econ. Research Paper Series, Working Paper No. 05-05, 2005), *available at* http://ssrn.com/abstract=720103 (arguing that the economic literature has ignored significant and sustained external benefits of project-based housing). This Article

taxonomy of privatization.[110] Over the past fifty years, public housing has yielded to divestiture,[111] supply-side subsidies, vouchers, and deregulation.[112] This Article focuses on programs that subsidize privately owned housing because the long-term institutional mechanisms that develop between public entities and private providers stand out in stark contrast in that context.[113]

This Part provides a framework for understanding the spectrum of approaches in affordable housing, detailing the public-private interface in a group of important subsidized housing programs. It argues that clear patterns of relational contracting can be found at the heart of the public-private interface in many important housing subsidy programs.

A. *Subsidized Housing in the Public-Private Spectrum*

In response to persistent, if not unchallenged,[114] perceptions of fundamental failure in the market for housing,[115] policymakers have sought for the better part of the last century to remedy problems of housing availability, price, and quality.[116] Direct regulatory approaches include housing codes, zoning, rent

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does not address the relative merits of tenant-based versus project-based subsidies, but instead focuses on implementation of the latter form of subsidy as a representative form of privatization.

110. *See* Cass, *supra* note 6, at 456.

111. The sale of government assets (Cass's "divestiture," Cass, *supra* note 6, at 457 & n.28) is an aspect of the move away from large-scale public housing in a program called HOPE VI. In HOPE VI developments, government owned and operated housing can be redeveloped in partnership with private developers (or, more accurately, torn down by the government owner and replaced, in part, by privately developed housing). *See* Note, *HOPE VI*, *supra* note 109, at 1478-79. This is different, of course, from the classic divestiture strategy of directly selling a government-owned business to a private party, in that in HOPE VI, the government generally continues some involvement in the resulting ownership entity and provides some form of subsidy to the private provider. Divestiture is also a part of the programs that involve the donation or sale at reduced prices of government-owned housing to private parties, as in the U.S. Department of Housing and Urban Development's ("HUD") Officer Next Door/Teacher Next Door/Firefighter-Emergency Medical Technician Next Door programs.

112. The recurring movement in housing policy to lower "regulatory barriers" to housing can be seen as a species of privatization. *See* U.S. DEP'T OF HOUS. & URBAN DEV., "WHY NOT IN OUR COMMUNITY?" REMOVING BARRIERS TO AFFORDABLE HOUSING (2005), *available at* http://www.huduser.org/Publications/pdf/wnioc.pdf.

113. Subsidized housing stands at the midpoint of the public-private spectrum in housing policy and involves the most direct and ongoing interaction between public and private entities. This Article focuses on these programs because they represent more than forty years of practical experience with the long-term interactions that can form in privatizing social services, providing fertile ground for examining the assumptions underlying conceptions of privatization. Reflections of the themes explored in this Article can be seen in other housing privatization strategies, but are clearest where the government and private providers mutually commit to long-term, project-based subsidies.

114. *See, e.g.*, HUSOCK, *supra* note 109; *see also* RICHARD K. GREEN & STEPHEN MALPEZZI, A PRIMER ON U.S. HOUSING MARKETS AND HOUSING POLICY 135-40 (2003) (noting debates about the nature of housing market failures with respect to affordability).

115. Typical rationales for public intervention in the housing market include remedying supply problems that reflect short-term inelasticity (arising from costs associated with site selection, financing, and construction); restrictions on supply arising from regulations including land use, health and safety, and tenure protections; remedying the externalities that arise from substandard housing; and non-economic factors that arise from public preferences for certain fundamental goods. *See* Schill, *supra* note 109, at 888-93.

116. *See* GREEN & MALPEZZI, *supra* note 114, at 85-133; William G. Grigsby & Steven C.

control, and similar policies that impose minimal housing standards, cap prices, and regulate other aspects of the private housing market.[117] On the other end of a spectrum of private to public approaches is direct government provision. The U.S. Housing Act of 1937[118] initiated a national program of public housing, using federal funds to build (and later to operate) housing generally owned by local government agencies.[119]

Between the (regulated) market and public ownership stand a number of hybrid public-private policies.[120] On the supply side,[121] the federal government began subsidizing privately owned and operated housing in the late 1950s with a first wave of mortgage subsidy and other programs,[122] followed by programs that included rent subsidies and direct construction support.[123] In the 1980s, construction and rehabilitation subsidies largely shifted from these older U.S. Department of Housing and Urban Development ("HUD") programs to tax-based incentives, primarily the Low Income Housing Tax Credit ("LIHTC")

Bourassa, *Trying To Understand Low-Income Housing Subsidies: Lessons from the United States*, 40 URB. STUD. 973, 975 (2003); *see also* MILLENNIAL HOUS. COMM'N, MEETING OUR NATION'S HOUSING CHALLENGES 22-25 (2002), *available at* http://govinfo.library.unt.edu/mhc/MHCReport.pdf; John M. Quigley, *A Decent Home: Housing Policy in Perspective* 3-27 (Berkeley Program on Hous. & Urban Policy Working Paper Series, Paper No. W99-007, 1999), *available at* http://repositories.cdlib.org/iber/bphup/working_papers/W99-007/. Broadly speaking, housing policy encompasses for-sale housing (with the single largest federal subsidy coming in the form of the deduction from federal income taxes for mortgage interest payments and local property taxes), rental housing, mortgage lending, and other aspects of the market for shelter. *Id.* at 24. This Article focuses on subsidies for multifamily rental housing, a relatively narrow slice of the overall market for shelter, but a central focus of modern policy in responding to the failure of the market to provide decent and affordable shelter for the poor.

117. *See* Mary K. Nenno, *Changes and Challenges in Affordable Housing and Urban Development*, *in* AFFORDABLE HOUSING AND URBAN REDEVELOPMENT IN THE UNITED STATES 1, 10-11 (Willem Van Vliet ed., 1997). Remedying discrimination in housing markets is also a critical component of the direct regulatory approach.

118. Pub. L. 93-383, 88 Stat. 653 (codified as amended at 42 U.S.C. § 1437 (2000)).

119. *See* Lynn E. Cunningham, *A Structural Analysis of Housing Subsidy Delivery Systems: Public Housing Authorities' Part in Solving the Housing Crisis*, 13 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 95, 112-16 (2003). The current stock of public housing is approximately 1.3 million units. *See* MILLENNIAL HOUS. COMM'N, *supra* note 116, at 24.

120. *See generally* Rochelle E. Lento, *Federal Sources of Financing*, *in* THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT 215 (Tim Iglesias & Rochelle E. Lento eds., 2005); Charles J. Orlebeke, *The Evolution of Low-Income Housing Policy, 1949-1999*, 11 HOUSING POL'Y DEBATE 489 (2000), *available at* http://www.fanniemaefoundation.org/ programs/hpd/pdf/hpd_1102_orlebeke.pdf.

121. On the demand side, starting in the early 1970s the federal government has subsidized rent with programs structured generally as a commitment by the government to pay a portion of rents up to a local fair-market rent, as set by HUD. Federal tenant-based subsidies began in 1974 with a certificate program (which capped the allowable rent level of eligible housing), adding a voucher program in 1983. *See* WEICHER, *supra* note 109, at 5. In 1998, Congress, in the Quality Housing and Work Responsibility Act of 1998, Pub. L. 105-276, 112 Stat. 2518, mandated that these programs be consolidated into a single program.

122. *See* Orlebeke, *supra* note 120, at 494; Quigley, *supra* note 116, at 14. The two primary mortgage subsidy programs of this era are known as Section 221(d)(3) and Section 236, after the respective sections of the National Housing Act of 1961, Pub. L. No. 87-70, 75 Stat. 175 (codified as amended at 12 U.S.C. §§ 1715*l*(d)(3), 1715z-1 (2000)). While these programs are no longer funding new production, there remains a significant inventory of existing 221(d)(3), 236, and other stock.

123. The programs include project-based Section 8 and Section 202/811 programs. *See infra* notes 127-128.

and tax-exempt bonds.[124] The stock of privately owned housing subsidized on a project basis currently has at least 1.9 million units.[125]

These supply-side public-private programs variously involve up-front grants, direct operating subsidies, and indirect tax-based subsidies.[126] Grant programs can involve "capital advances" (essentially loans that do not have to be repaid if the housing continues to meet program requirements), and are often coupled with ongoing rent subsidies.[127] Subsidies designed to induce construction or rehabilitation can also focus entirely on lowering operating costs through rent[128] or mortgage subsidies.[129] Finally, the LIHTC provides a

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124. Quigley, *supra* note 116, at 25-26. The LIHTC was enacted as part of the Tax Reform Act of 1986, one goal of which was to eliminate real estate-based tax shelters that Congress felt had given rise to abuses in the early 1980s. *See* GREEN & MALPEZZI, *supra* note 114, at 110. Recognizing the potential impact on affordable housing production that closing those loopholes might have, Congress opted to experiment with an explicit tax subsidy instead. In 1993, Congress made the LIHTC program permanent. *See* Sagit Leviner, *Affordable Housing and the Role of the Low Income Housing Tax Credit Program: A Contemporary Assessment*, 57 TAX LAW. 869, 869 (2004).

125. *See* MILLENNIAL HOUS. COMM'N, *supra* note 116, at 24. Other current supply-side subsidy programs include the HOME Investment Partnership program, 42 U.S.C. §§ 12701-12713 (2000), subsidizing new construction, *see* 24 C.F.R. § 92.205 (2004), state and local housing trust funds, *see* MARY E. BROOKS, HOUSING TRUST FUND PROGRESS REPORT 2002: LOCAL RESPONSES TO AMERICA'S HOUSING NEEDS (2002), *available at* http://www.communitychange.org/shared/publications/downloads/HousingSurvey2002.pdf, as well as other state sources of financing, *see* Peter Salsich, *State Sources of Housing Finance*, *in* THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT, *supra* note 120, at 259. Property-tax exemption is another subsidy strategy at the local level, and, in some markets, makes the difference between viable and non-viable financing structures. *See* Willard S. Moore, *Tax-Exempt Bond Financing for New York City Rental Housing*, 500 PLI/REAL 601, 605 (2004). For an evaluation of current federal subsidies, see GEN. ACCOUNTING OFFICE, FEDERAL HOUSING ASSISTANCE: COMPARING THE CHARACTERISTICS AND COSTS OF HOUSING PROGRAMS (2002), *available at* http://www.gao.gov/new.items/d0276.pdf.

126. Many privately owned subsidized housing developments participate in more than one program. It is common, for example, to have projects receive loans derived from tax-exempt bonds and tax-credit subsidized private equity, as well as direct subsidies through project-based Section 8. It is also not uncommon for different tenants at the same project to be supported by different subsidies. *See, e.g.*, Rubaneko v. Martinez, 2002 WL 2008107 (E.D. Cal. Aug. 11, 2002) (describing a building served by a Section 236 mortgage subsidy as well as a Housing Assistance Payment contract and vouchers).

127. While a number of federal, state, and local programs directly subsidize the construction of affordable housing, Section 202 (Supportive Housing for the Elderly) and Section 811 (Supportive Housing for Persons with Disabilities) are among the most significant programs still in operation on the federal level. Section 202 and Section 811 are named after the relevant portions of the Housing Act of 1959, Pub. L. No. 86-372, 73 Stat. 654, *amended by* Cranston-Gonzalez National Affordable Housing Act, Pub. L. No. 101-625, 104 Stat. 4079 (1990) (codified as amended at 12 U.S.C. § 1701q and 42 U.S.C. § 8013 (2000)). Long-term support covers the difference between approved project operating costs and a mandatory minimum tenant rent contribution, with tenants contributing the greater of thirty percent of their adjusted monthly income, ten percent of unadjusted monthly income, or certain qualified housing assistance. 12 U.S.C. § 1701q(c)(3) (2000); 42 U.S.C. § 8013(d)(3) (2000). This rental assistance is provided through a "project rental assistance contract" that lasts at least twenty years, *see* 12 U.S.C. § 1701q(d)(2) (2000); 42 U.S.C. § 8013(e)(2) (2000), or through Section 8.

128. Project-based Section 8, for example, provides ongoing rent subsidies to private owners pegged to the difference between what eligible renters are required to contribute and rent levels that HUD has approved for the community. Although project-based Section 8 is a form of operating subsidy, the operating subsidy served as an incentive for initial development. Project-based Section 8 is no longer available for projects not already under subsidy (except for a variation under the tenant-based voucher program, *see* 24 C.F.R. § 983 (2005); 70 Fed. Reg. 59892 (2005)), but the program represents a significant portion of the current assisted portfolio.

129. Programs such as Section 221(d)(3) and (4), *see* 12 U.S.C. § 1715*l* (2000); 24 C.F.R. § 221

federal income tax credit in exchange for an equity investment in affordable housing,[130] and bond financing, both private activity volume-cap bonds and 501(c)(3) bonds, is generally used to generate subsidized loans for construction or rehabilitation.[131]

In most of these programs, providers tend to compete for limited subsidies, and these subsidies are often over-subscribed.[132] Once engaged, providers—for whom, in some instances, a given subsidy represents a fraction of overall financing—tend to remain within the program for as long as the subsidy lasts.[133] Private providers accordingly typically make large-scale, relationship-

(2005), and Section 236, *see* 12 U.S.C. § 1715z-1 (2000), create incentives for construction (or substantial rehabilitation) by lowering operating costs through mortgage subsidies. Under Section 221(d)(3) and (4), HUD insures privately provided multifamily mortgages, while under Section 236, HUD provides payments representing the difference between relevant mortgage-payments (principal, interest and mortgage insurance premiums) and payments that would be required on a hypothetical one percent interest-rate loan. *See* 12 U.S.C. § 1715z-1(c) (2000). Section 236 is no longer subsidizing new construction, but given the long-term nature of the subsidy represents a significant number of projects still under subsidy.

130. 42 U.S.C. §§ 3601-3619 (2000), enacted as part of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 42 U.S.C.). Under the LIHTC, state housing agencies allocate available tax credits to private parties for the acquisition and rehabilitation or new construction of qualifying properties. To qualify, rental projects must reserve at least twenty percent of the units rent-restricted and occupied by renters whose income is no more than fifty percent of the area median or forty percent of the units for renters whose income is no more than sixty percent of the area median. *See* Leviner, *supra* note 124, at 871. The credit is then awarded based on the qualified basis of a project, discounted by the percentage of the project devoted to affordable housing, and taken over a ten-year period. *Id.* at 871-72. In many LIHTC transactions, developers take awarded credits and reach the capital markets through syndicators who operate as intermediaries to investors. The LIHTC currently generates roughly $6 billion in equity investment, subsidizing about 90,000 new units per year. *See* OFFICE OF POLICY DEV. & RESEARCH, U.S. DEP'T OF HOUS. & URBAN DEV., UPDATING THE LOW INCOME HOUSING TAX CREDIT (LIHTC) DATABASE: PROJECTS PLACED IN SERVICE THROUGH 2002, at vii (2004), *available at* http://www.huduser.org/intercept.asp?loc=/Publications/pdf/updtlihtc.pdf; Ted M. Handel & David C. Nahas, *Leveraging the Low-Income Housing Tax Credit Program*, L.A. LAW., Jan. 26, 2004, at 23.

131. *See* Elise K. Traynum, *Subsidized Housing (80/20) Programs: Low-Income Housing Tax Credit and Tax-Exempt Housing Bonds*, 489 PLI/REAL 139, 152 (2003). Volume-cap refers to the total amount of private-activity bonds that may be issued every year by all eligible issuers in a state. However, 501(c)(3) bonds are not subject to this volume cap, but are limited to qualifying uses. Essential function bonds, for projects owned by public bodies, are also used for tax-exempt bond financing in affordable housing. *Id.* While a number of specific state and local bond programs target housing, the general parameters of the subsidy are set by federal tax law. *See* 26 U.S.C. §§ 103, 141-50 (2000); *see* Moore, *supra* note 125, at 605; Traynum, *supra*, at 152. In the typical bond program used in affordable housing, a governmental entity sells bonds on the market, and then loans the proceeds to qualified private entities, with the resulting development used to secure repayment. *See* Traynum, *supra*, at 152.

132. The limited nature of the subsidies available in some measure shapes a part of the asymmetry between the government and providers. The fact that only a small fraction of those eligible for subsidized housing are actually served by the programs in operation shapes the incentives of the government to ensure private participation. If the government had an obligation to serve all eligible beneficiaries, the government might have more incentive in structuring the public/private relationship to maximize participation.

133. As noted below, *see infra* text accompanying notes 161-165, one area of significant controversy in housing policy in recent years has been the ability of providers to exit programs, either before the subsidy ends or at the completion of the original term of the subsidy. That fact reflects the incentive to take housing to market rates that many subsidized landlords face when conditions change, but the point here is that providers tend to remain as long as they are required to.

specific investments in reliance on the subsidy.[134] In other words, where a provider receives government subsidies and decides to produce housing, that housing represents a significant investment and one that is explicitly contemplated to last for a significant period of time. Conversely, the subsidy mechanisms, even if short-term, represent a form of long-term commitment by the government. These market realities shape the nature of the issues that are addressed by contract and regulation, and the practical implementation of the programs.

Housing is therefore one of the more capital-intensive social services, requiring significant investment in assets specific to the service. Private providers can, and do, switch from the affordable stock to market-rate housing, within the confines of their affordability commitments, but the initial decision to build or rehabilitate the housing entails significant start-up cost. This level of capital intensity impacts the length of the subsidy and requires commitment on both sides of the public-private relationship to preserve the asset over the long run.[135]

B. *The Government-Provider Interface*

In each of the subsidy programs just described, the reciprocal obligations of government entities and private providers derive from a mix of statutory, regulatory, and less formal pronouncements, generally embodied in some form of explicit contract.[136] Scholars of privatization have given relatively little attention to the ground-level mechanisms that frame the relationship between the government and private providers, but such mechanisms demonstrate important relational features.[137]

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134. *See* GREEN & MALPEZZI, *supra* note 114, at 86 (discussing public and private roles in the housing market).

135. This is a ground on which the housing context may not fully translate to other areas of social welfare policy, but any private delivery of services requires at least some relationship-specific capital investment.

136. In these programs, projects exist in a web of documentation and regulation that involves multiple parties—not just a single governmental agency and service provider—and raises issues beyond the core contractual and regulatory terms under examination here. Indeed, one recurring problem for private providers involves meeting sometimes inconsistent requirements by multiple funding agencies involved in any single project. *See supra* note 126; *cf.* John W. Daniels, Jr. & Elizabeth G. Nowakowski, *Managing the Legal Risks of Providing Both Debt and Equity in Section 42 Low-Income Housing Tax Credit Transactions*, 8 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 81 (1998); Handel & Nahas, *supra* note 130, at 25-27 (discussing the prevalence of leveraging of financing sources for affordable housing development); Peter W. Salsich, *Saving Our Cities: What Role Should the Federal Government Play?*, 36 URB. LAW. 475, 504 (2004) (discussing the layering of financing for affordable housing). This Article approaches the programs at issue through the somewhat stylized lens of the single governmental entity-provider relationship in order to explore the core of that relationship.

137. In all of these programs, the volume of project documents tends to be significant, covering financing (notes, mortgages, security agreements, etc.), construction or rehabilitation (architectural agreements, design standards, construction contracting), property management, asset management, entity formation and form, and myriad tenant-related documents (tenant-selection plans, lease forms, etc.). This Article focuses on the agreements that form the center of the "bargain" between the

1. *Flexibility and Discretion in Long-Term Commitments*

Contracts at the heart of the government-provider relationship for most privately owned subsidized housing—generally on standard government forms[138]—undergird a hierarchy of authority that includes mechanisms for providing informal guidance on provider obligations, non-binding and binding guidance, and formal notice-and-comment regulation.[139] Beyond this program-specific hierarchy, obligations on private parties often attach to government financing that can be government-wide[140] or tied to a general area of policy, but not to a specific program.[141] The relevant contractual forms—though differing significantly in their details—share some broad characteristics, and consistent patterns emerge in terms of how obligations and future contingencies are addressed.[142]

As a threshold matter, provisions appear in several of the program agreements that allow the government to modify terms over time by changing background regulations. These provisions give the government explicit authority to amend agreements, deem agreements automatically amended,[143]

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government and the provider—defining the scope of a project, the terms of affordability, the terms of the subsidy and the like. Other documents are important, and in practice project agreements interact to frame a transaction in complex ways, but it is possible to narrow the analysis to core agreements as a representative sample.

138. Contracts are built on standard forms promulgated by HUD, state housing finance agencies, and similar entities, subject in some instances to modest negotiation but rarely wholesale change. In the HUD programs at issue, the key contractual documents include Housing Assistance Payments contracts ("HAP contracts"), regulatory agreements, and other variations. Except as noted, relevant HUD forms discussed in this Article are available at http://www.hudclips.org/sub_nonhud/html/forms.htm. LIHTC and bond projects typically involve use or regulatory agreements, which, while not as extensive a recitation of mutual obligations as HAP contracts, are important nonetheless. *See, e.g.*, 26 U.S.C. § 42(g)(2), (h)(6), (i)(1) (2000). The actual forms of agreement—what the statute calls the "extended use agreement"—vary from state to state and are promulgated by state agencies implementing the program.

139. There can be overlap in issues addressed at each level of this hierarchy. For example, fair housing obligations are typically required by statute, reinforced by regulation, and then made the subject of contractual obligation on the part of a provider.

140. Examples include the non-discrimination requirements of Title VI of the Civil Rights Act, *see* 42 U.S.C. § 2000d (2000) (prohibiting exclusion from participation in, denial of benefits of, and discrimination under federally assisted programs on grounds of race, color, or national origin), and Drug-Free Workplace obligations, *see* 41 U.S.C. § 701 (2000) (requiring a drug-free workplace for federal contractors).

141. Davis-Bacon prevailing wage obligations, for example, are imposed by law in several housing programs, although not uniformly. *See* Davis-Bacon Act, 40 U.S.C. §§ 3141-3148 (2000); 24 C.F.R. § 965.101 (2005) (determining wage rates for HUD purposes).

142. Addressing these broad themes should not obscure the proposition that certain provisions are clearly more important to each party than others. That is to say, the relative weight that a provider will give to, for example, the right to exit a program may be significantly different from the weight that provider might give to provisions that govern more ancillary aspects of long-term ownership. Conversely, the government may place greater weight on a core of affordability, quality, and soundness provisions.

143. *See, e.g.*, Fla. Hous. Fin. Corp., Extended Low-Income Housing Agreement § 11 (Sept. 18, 2001), http://www.nhlp.org/html/lihtc/documents/2b1FL_EUA.pdf [hereinafter Florida Agreement] (providing that amendments required by the Code and "any final or temporary Treasury Regulations or Revenue Rulings" are deemed automatically to apply).

cross-reference legal requirements "as amended,"[144] or require compliance with regulations in effect at some future point in time.[145] In the LIHTC context, clauses that require compliance with section 42 of the Code and the accompanying regulations are common,[146] suggesting compliance with current and future statutory and regulatory obligations. These provisions, however worded, memorialize broad ongoing discretion retained by the government to change background terms over time.

Similarly, recognizing the difficulty of anticipating all contingencies that might befall a project in the long run, program agreements generally condition owner discretion over various events in the life cycle of the project on agency approval. These functionally critical issues can include conveyance, transfer, or encumbrance of the project or interests in the entity owning the project,[147]

144. *See, e.g.*, Cal. Tax Credit Allocation Comm., Regulatory Agreement: Federal Credits § 13 (Aug. 1, 1997), http://www.nhlp.org/html/lihtc/documents/2c1%20CA%20TCAC%20Reg%20Agmt%20FEDREG%202000.doc [hereinafter California Regulatory Agreement]; Ind. Hous. Fin. Auth., Declaration of Extended Rental Housing Commitment § 5 (u), (v) (2005), http://www.nhlp.org/html/lihtc/documents/2c2%20IN%20QAP%202005%20Form%20P%20Decl.doc [hereinafter Indiana Declaration]. *Compare* U.S. Dep't of Hous. & Urban Dev., Form HUD-52522B, Housing Assistance Payments Contract (Aug. 1980) [hereinafter New HAP Contract] (for project-based Section 8 New Construction or Substantial Rehabilitation projects starting in 1980), *and id.* § 1.1(g) (referencing the applicability of regulations beyond the scope of the agreement), *with* U.S. Dep't of Hous. & Urban Dev., Form HUD-52582A, Housing Assistance Payments Contract (June 1976) [hereinafter Old HAP Contract] (for project-based Section 8 New Construction projects prior to 1980), *and id.* § 1.1(g) (stating that the contract constitutes the entire agreement between the owner and HUD and that "neither party is bound by any . . . agreements of any kind except as contained herein or except agreements entered into in writing which are not inconsistent with this Contract").

145. *See, e.g.*, New HAP Contract, *supra* note 144, § 2.9 (mandating that an owner not terminate any tenancy or assistance on behalf of any family "except in accordance with all HUD regulations and other requirements in effect at the time of the termination"); U.S. Dep't of Hous. & Urban Dev., Form HUD-52539A, Housing Assistance Payments Contract, pt. 1 (Feb. 1991), http://www.hudclips.org/sub_nonhud/html/pdfforms/52539-a.pdf [hereinafter MR HAP Contract Part I] (for project-based Section 8 Moderate Rehabilitation projects); *id.* § 1.4(A) ("The Owner must comply with applicable HUD requirements, including any amendments of HUD requirements."); U.S. Dep't of Hous. & Urban Dev., Form HUD-90173-B-CA, Project Rental Assistance Contract, pt. 2 (Apr. 1992), http://www.hudclips.org/sub_nonhud/html/pdfforms/90173bca.pdf [hereinafter 202 PRAC Agreement] (defining the terms of rent subsidies for the Section 202 and Section 811 Capital Advance programs); *id.* § 2.9 (following MR HAP Contract); Indiana Declaration, *supra* note 144, § 5(h) ("Developer shall strictly obey, comply with and observe all laws, rules, regulations and executive orders of all federal, state and local governments and regulatory bodies, as from time to time amended, which are applicable to the Development or the Credits available to the Development."); Mass. Dep't of Hous. & Cmty. Dev., 2002 Tax Credit Regulatory Agreement and Declaration of Restrictive Covenants § 8, http://www.nhlp.org/html/lihtc/documents/2b2%20MA%20LIHTC%20Restr%20Cov.pdf [hereinafter Massachusetts Regulatory Agreement] ("The Owner agrees to comply with any monitoring plan, guidelines, procedures, or requirements as may be adopted or amended from time to time by [the Department of Housing and Community Development] in accordance with requirements of the Code or regulations promulgated thereunder by the U.S. Dept. of Treasury . . . .").

146. *See, e.g.*, Wis. Hous. & Econ. Dev. Auth., Land Use Restriction Agreement for Low Income Housing Tax Credit § 2(d) (Oct. 2000), http://www.nhlp.org/html/lihtc/documents/2b3%20WI%20LURAEXH-1.pdf [hereinafter Wisconsin Agreement].

147. *See, e.g.*, U.S. Dep't of Hous. & Urban Dev., Form HUD-92465, Regulatory Agreement for Insured Multi-Family Housing Projects § 8(a), (c) (June 1977), http://www.hudclips.org/sub_nonhud/html/pdfforms/92465.pdf [hereinafter FHA Insured Regulatory Agreement]; New HAP Contract, *supra* note 144, § 2.20 (prohibiting sale, assignment, conveyance or transfer without the prior written consent of HUD); 202 PRAC Agreement, *supra* note 145, § 2.22 (same). In the LIHTC context, transfer can be

refinancing or restructuring finances, or remodeling, reconstructing or demolishing any part of the project.[148]

Another variable on the government side that is often the subject of a more flexible approach is housing quality. Here agreements tend to provide fairly open-ended mandates that owners provide housing that, for example, is "decent, safe and sanitary,"[149] meets minimum property requirements,[150] or is of quality comparable to non-subsidized units.[151] Agreements also impose prophylactic measures about property and asset management to ensure that adequate resources are devoted to the project, or at least facilitating government oversight over the adequacy of those resources.[152]

In exchange for affordability restrictions, contracts generally make explicit the government's obligation to provide the given subsidy and the terms of that subsidy.[153] For some operational-subsidy programs,[154] however, agreements can provide for adjusting subsidies over time in response to changing conditions.[155] These provisions arguably make the most important aspect of the

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conditioned upon notification and the obligation of the new owner to assume contractual obligations. *See, e.g.*, California Regulatory Agreement, *supra* note 144, § 14; Florida Agreement, *supra* note 143, § 4(a).

148. *See, e.g.*, FHA Insured Regulatory Agreement, *supra* note 147, § 8(d). These operative provisions are then complemented by ongoing oversight mechanisms, such as annual reporting obligations, *see, e.g.*, New HAP Contract, *supra* note 144, § 2.6(a) (annual financial reports); 202 PRAC Agreement, *supra* note 145, § 2.6(a) (same), agency rights to conduct inspections, *see, e.g.*, California Regulatory Agreement, *supra* note 144, § 6 (compliance monitoring); Wisconsin Agreement, *supra* note 146, § 5(a), (b) (inspection rights), as well as an elaboration of third-party enforcement rights. LIHTC extended use agreements, for example, are required by statute to allow third-party enforcement. *See* 26 U.S.C. § 42(h)(6)(B)(ii) (2000).

149. *See, e.g.*, New HAP Contract, *supra* note 144, § 2.5(a); 202 PRAC Agreement, *supra* note 145, § 2.5(a).

150. *See, e.g.*, California Regulatory Agreement, *supra* note 144, app. A (outlining mandatory physical features).

151. *See, e.g.*, Indiana Declaration, *supra* note 144, § 5(n); Wisconsin Agreement, *supra* note 146, § 2(i).

152. *See, e.g.*, FHA Insured Regulatory Agreement, *supra* note 147, § 2 (requiring a reserve fund for replacements); *id.* § 12(g) (regulating the deposit of rents and other project receipts); New HAP Contract, *supra* note 144, § 2.6(b) (regulating the use of project funds).

153. *See, e.g.*, New HAP Contract, *supra* note 144, § 1.3 (stating that execution of the contract by HUD is an assurance that the "faith of the United States is solemnly pledged to the payment" of the housing assistance under the contract and that HUD has obligated funds for such payments); *id.* § 2.4(a)(1) (providing that the amount of housing assistance payments constitutes the difference between rents set by the contract and "that portion of the rent payable by the [tenant] as determined in accordance with the HUD-established schedules and criteria," subject to any change by HUD to program rules); *id.* § 2.7(b)(1) (providing for adjustment of "contract rent" pursuant to 24 C.F.R. § 888 (2005)); *see also* 42 U.S.C. § 1437f(c)(1) (2000) (providing that contracts under the program shall establish maximum monthly rent pursuant to HUD regulation); *cf.* Katz v. Cisneros, 16 F.3d 1204, 1206-07 (Fed. Cir. 1994) (describing mechanisms for adjusting rent in one project-based Section 8 program).

154. As distinguished from programs such as Section 236, LIHTC, and tax-exempt bond financing, which set the level of subsidy at the outset.

155. *See, e.g.*, 202 PRAC Agreement, *supra* note 145, § 2.5(a); FHA Insured Regulatory Agreement, *supra* note 147, § 4(c); MR HAP Contract Part I, *supra* note 145, § 1.8; New HAP Contract, *supra* note 144, § 2.7(a) (describing rent adjustments as subject to the maximum housing assistance authorized by the agreement).

relationship—the amount of the subsidy—subject to periodic revision.

Some obligations, of course, are spelled out in relatively clear-cut terms. Program contracts, for example, tend to memorialize and elaborate on program restrictions on populations to be served and rent restrictions in less flexible terms.[156] In some instances, the contracts embody choices left to providers as to the nature of the subsidy,[157] while in other cases contracts specify the number of units, income levels, and other details tied to the level of subsidy.[158] Contracts imposing obligations on owners with respect to verification of tenant eligibility (vesting primary responsibility with owners to ensure that target populations are actually served) are likewise generally less flexible, reflecting that these core obligations are amenable to clear-cut provisions and are unlikely to change over time.[159]

How long a project's affordability restrictions are to last might be thought of as sufficiently clear and unlikely to change as to warrant straightforward memorialization. And, in some cases, this is how the term of the restrictions is treated, simply reciting the relevant period.[160] However, the owners' right to terminate restrictions by prepaying subsidized mortgages or "opting out" of the Section 8 program at the expiration of the subsidy contract opens up an area where the long-term expectations of the parties at the outset have arguably shifted over time, and has been a significant source of litigation and legislation.

While the Section 221(d)(3) and Section 236 programs contemplated subsidy periods reflecting the term of the relevant loan (up to forty years), for-profit owners were granted the right to exit the program and terminate affordability restrictions by pre-paying their loans twenty years after the final endorsement.[161] In the mid-1980s, Congress began to confront the loss of thousands of subsidized units by passing a series of statutes that sought to keep the units in the subsidized portfolio by restricting the right to prepay.[162] These

156. *See, e.g.*, U.S. Dep't of Hous. & Urban Dev., Form HUD-90163-CA, Capital Advance Program Use Agreement § 3 (June 2003), http://www.hudclips.org/ sub_nonhud/cgi/pdfforms/90163-ca.pdf ("The Project shall be used solely as rental housing for very-low income elderly or disabled persons."); New HAP Contract, *supra* note 144, § 2.2(a) (specifying population to be served, cross-referenced to HUD regulatory definitions).

157. For instance, developers in the LIHTC program can choose to reserve at least forty percent of the units for individuals whose income is sixty percent of the area median or twenty percent of the units at fifty percent of the area median, *see* 26 U.S.C. § 42(g)(1) (2000), and that choice is then reflected in the operative agreement.

158. *See, e.g.*, MR HAP Contract Part I, *supra* note 145, § 1.3 Exhibit A (listing of contract units, including number and size and applicable initial rents).

159. *See, e.g.*, New HAP Contract, *supra* note 144, § 2.8(c); Florida Agreement, *supra* note 143, § 3(d).

160. *See, e.g.*, New HAP Contract, *supra* note 144, § 1.2(a).

161. *See* Richard B. Peiser, *The Fallout from Federal Low-Income Housing Preservation Programs: A Case Study in Estimating Damages*, 10 HOUSING POL'Y DEBATE 371, 373-75 (1999), *available at* http://fanniemaefoundation.org/ programs/hpd/pdf/hpd_1002_peiser.pdf; Henry A. Herman, Comment, *Privity: How HUD Avoided Contract Liability Under ELIHPA and LIHPRHA*, 30 SW. U. L. REV. 323, 324 (2001).

162. The Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA), Pub. L. No. 100-

statutes generated significant litigation from owners challenging Congress's right to restrict prepayment rights, culminating in a series of decisions in the *Cienega Gardens* litigation, first finding no contractual liability for HUD,[163] but later holding HUD liable on Fifth Amendment Takings grounds.[164] Congress eventually reversed course and reinstated the right to prepay, creating instead a voluntary incentive regime designed to keep owners in a number of programs with long-term affordability provisions.[165]

For LIHTC projects, there has been less controversy over the term of providers' obligations, but agreements required by state housing finance agencies do in some instances extend affordability restrictions beyond what is statutorily required. Despite the fact that the tax subsidy runs for a ten-year period, by statute the use agreement's restrictions must remain in place for at least thirty years,[166] and some states require or create incentives for longer periods.[167] For bond programs, regulatory agreements are required to impose affordability and other restrictions during the "qualified project period," which under the Code must be at least fifteen years from the date that at least half the residential units are occupied.[168] Bond-related regulatory agreements tend to track the statutory requirement.

Public norms-related obligations that program agreements embody, particularly in terms of equality and due-process-grounded fairness norms, vary

242, 101 Stat. 1877 (codified as amended at 12 U.S.C. § 1715*l* (2000)), placed a two-year moratorium on prepayments without HUD approval, and the Low-Income Housing Preservation and Resident Homeownership Act of 1990, Pub. L. No. 101-625, § 601, 104 Stat. 4079, 4249 (codified at 12 U.S.C. §§ 4101-4125 (2000)), made the moratorium permanent, giving HUD authority to create incentives for owners to remain in the programs. *See* Herman, *supra* note 161, at 330-31.

163. Cienega Gardens v. United States, 194 F.3d 1231, 1242 (Fed. Cir. 1998) (finding no "privity of contract" between owners and HUD as to prepayment rights contained in mortgage notes and riders).

164. Cienega Gardens v. United States, 331 F.3d 1319, 1337 (Fed. Cir. 2003). *Cf.* Franconia Assocs. v. United States, 536 U.S. 129, 142-43 (2002) (finding that enactment of ELIHPA constituted repudiation of loan agreements in a Farmer's Home Administration loan program).

165. *See* Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA), Pub. L. 105-65, §§ 501-579, 111 Stat. 1344, 1384 (codified at 42 U.S.C. § 1437f (2000)). The mark-to-market program created by MAHRA gives providers at the end of their contract period various options to restructure and refinance projects to encourage owners not to opt out.

166. 26 U.S.C. § 42(h)(6) (2000). The LIHTC compliance period was originally fifteen years, but has now been extended to a minimum of thirty. *See* Leviner, *supra* note 124, at 873.

167. *See, e.g.*, Massachusetts Regulatory Agreement, *supra* note 145, § 6 (setting the term of the regulatory agreement to ninety-nine years); *see also* Idaho Hous. & Fin. Ass'n, 2006 Low-Income Housing Tax Credit Program Allocation Plan for the State of Idaho 14 (Dec. 15, 2005), http://www.ihfa.org/pdfs/2006LIHTCQualifiedAllocationPlan.pdf (requiring that certain nonprofit set-aside projects be "perpetually affordable," defined as lasting for the life of the property without major rehabilitation or forty years); Md. Dep't of Hous. & Cmty. Dev., Maryland Low Income Housing Tax Credit Program: Qualified Allocation Plan 1-2 (Jan. 2, 2004), http://www.dhcd.state.md.us/Website/programs/rhf/document/2004qap.pdf (granting additional points in the allocation to developers agreeing to an additional forty years on the use period). *See generally* Daniels & Nowakowski, *supra* note 136, at 83.

168. 26 U.S.C. § 142(d)(2)(A)(i) (2000); *see* Moore, *supra* note 125, at 616 (discussing LIHTC "compliance periods" versus tax-exempt bond "qualified project period" requirements).

from the general and open-ended[169] to the fine-grained and detailed.[170] Program contracts can cover both overarching public policy goals beyond simply providing housing, from the sweeping—such as affirmatively furthering fair housing[171]—to the micro-level—such as complying with relocation assistance requirements,[172] undertaking affirmative action to employ lower-income persons,[173] utilizing minority and women's business enterprises,[174] and prohibiting lobbying.[175]

A fairly clear picture thus emerges of the contingencies government entities tend to address in these core agreements. Agency-drafted contracts frequently specify general obligations on the part of the owner, and often in open-ended terms that provide a measure of flexibility in operation. The primary reciprocal obligation—that government entities provide the relevant subsidy—is likewise at times accompanied by mechanisms of adjustment over time. In the broadest sense, then, these agreements function as an acknowledgment on the part of the private provider that it will be subject to regulation, that a number of key obligations can only be captured in general, flexible terms, and that there are contingencies in the long run that neither party can fully anticipate.[176]

2. *Retained Discretion and the Gap-Filling Function*

If program agreements function in many ways as an acknowledgment of regulatory oversight, a number of implementation issues can arise over the life-

169. In some instances, obligations imposed by contract are arguably broader than applicable statutory provisions. *See, e.g.*, MR HAP Contract Part I, *supra* note 145, § 1.24.B (prohibiting discrimination against "[u]nwed mothers" and "recipients of public assistance").

170. *See, e.g.*, Old HAP Contract, *supra* note 144, § 1.9(b) (providing a formula for determining tenants' security deposits); *cf.* Office of Pub. & Indian Hous., U.S. Dep't of Hous. & Urban Dev., Form HUD-52530A, Project-Based Assistance Housing Choice Voucher Program—Housing Assistance Payments Contract—New Construction or Rehabilitation § 11.a (June 2001) (requiring leases that follow "word-for-word" provisions required by HUD).

171. Old HAP Contract, *supra* note 144, § 2.1.b ("The Owner shall comply with all requirements imposed by Title VIII of the Civil Rights Act of 1968, and any rules and regulations pursuant thereto.").

172. *See* U.S. Dep't of Hous. & Urban Dev., Form HUD-52524-B, Section 202 Project Assistance Contract, pt. 2, § 2.16 (July 1990), http://ptp.hud.gov/reqdirect/ddsimage/3715.pdf [hereinafter 202 PAC] (citing the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, 42 U.S.C. § 4601 (1988), among other relevant statutory obligations).

173. U.S. Dep't of Hous. & Urban Dev., Form HUD-52539B, Housing Assistance Payments Contract: Moderate Rehabilitation, pt. 2, § 2.1 (July 1984), http://www.hudclips.org/sub_nonhud/html/pdfforms/52539-b.pdf [hereinafter MR HAP Contract Part II].

174. MR HAP Contract Part I, *supra* note 145, § 1.24.E (contractually obligating entities receiving HUD subsidies to comply with Executive Orders Nos. 11625, 12138, and 12432).

175. *Id.* § 1.26; *see also* 202 PAC, *supra* note 172, § 2.18. HUD Handbooks can elaborate even further. *See, e.g.*, U.S. Dep't of Hous. & Urban Dev., Handbook 4350.1 Rev-1 ch. 12 (Jan. 23, 1996), http://www.hudclips.org/sub_nonhud/cgi/hudclips.cgi#handnot (select "all Handbooks," then search by document number) (requiring certain projects to have and follow Energy Conservation Plans); *see also id.* at 32-1 (elaborating on prohibitions against discrimination on the basis that tenants or their family members own or keep a "common household pet").

176. Indeed, some agreements state this explicitly. *See, e.g.*, Wisconsin Agreement, *supra* note 146, at 2 (noting that the owner "by entering into this Agreement, consent[s] to be regulated by the Authority").

cycle of a subsidized development that are not explicitly addressed or made subject to general reservations of government discretion.[177] For private contracts, contractual ambiguity is resolved generally by mutual agreement, judicial decision, or some form of alternative dispute resolution.[178] In agreements with private parties, however, government entities retain significant authority to define the terms of the relationship that exist outside of the express and implied terms of the contract. In other words, program contracts often implicitly leave many important long-term details to the exercise of agency discretion.[179]

In many instances, as noted, the relevant contracts reference the authority granted to the government to define key terms, such as allowable rent levels, or to approve or disapprove critical actions that owners might undertake with respect to the project. Beyond that, in many ways, an equally if not more important aspect of the contractual relationship is the authority to regulate contingencies not contemplated or embodied in the formal agreement.[180]

While administrative law scholars tend to focus on the link between formality, agency power, and judicial deference,[181] these concerns have had relatively little practical impact in the implementation of subsidized housing programs.[182] Indeed, a significant percentage of agency pronouncements on

177. The extent to which agencies can use their governmental authority to *redefine* the terms of their agreements (absent an explicit reservation of authority to do so) is significantly constrained by the Contract Clause (on the state and local level) and by *United States v. Winstar*, 518 U.S. 839 (1996), on the federal level. *See* Freeman, *supra* note 4, at 209-10.

178. At least at the level of the "paper deal"—the formal terms embodied in the contract. In any ongoing private contractual relationship, there will often also be the kind of informal mutual adjustment that does not amount to renegotiation of the initial agreement. *See* Stewart Macaulay, *The Real Deal and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Simple Rules*, 66 MOD. L. REV. 44, 45-47 (2003).

179. In this sense, these agreements can be seen to deviate from some accounts of relational contracts in the private sector. *Cf.* Scott, *supra* note 87, at 849-51 (describing various private-sector approaches to the enforcement of relational contracts). Government contracts leave relatively little room for negotiation at the outset as to the scope of subsequent government authority to regulate contingencies. While private parties clearly signal their willingness to agree to the allocation of risks proffered by the government as a condition of the contract, this aspect of the public-private bargain varies from the self-conscious, if constrained, negotiations presumed at the outset of private relational contracts.

180. These contingencies can relate to anything from asset management (questions over the permissible use of project funds), to tenant relations, to legal requirements that might arise outside of the agency-provider relationship (such as rent control). The only certainty in a relationship that can last decades is that questions will arise that cannot be anticipated at the time of initial contracting.

181. In other words, scholars tend to focus on the extent to which agencies can bind private parties with pronouncements that are not the subject of notice-and-comment rulemaking or similar formality. *See, e.g.*, John Manning, *Nonlegislative Rules*, 72 GEO. WASH. L. REV. 893, 937-39 (2004) (discussing agency formality and judicial deference). The Supreme Court recently made clear that the absence of notice-and-comment rulemaking, formal adjudication, or other indicia of agency formality downgraded such agency pronouncements from *Chevron* deference to non-binding *Skidmore* deference, suggesting that some degree of formality is required to bind private parties. *See* United States v. Mead Corp., 533 U.S. 218, 226-35 (2001); *see also* Richard W. Murphy, *A "New" Counter-*Marbury*: Reconciling* Skidmore *Deference and Agency Interpretive Freedom*, 56 ADMIN. L. REV. 1, 17-18 (2004).

182. While conflicts can be resolved by judicial determinations of the binding nature of various

which the private subsidized rental housing industry operates come not through notice-and-comment rulemaking or other relatively formal processes, but instead involve informal guidance.

For HUD programs, the agency operates under a bookshelf of handbooks, which HUD and its private partners at times treat as functionally binding, even if such guidance is not issued with any clear formality.[183] The agency supplements this guidance with a fairly regular stream of general counsel and program staff directives.[184] Likewise, although the IRS regulations governing the LIHTC program are detailed,[185] the IRS is frequently asked by members of the LIHTC bar to clarify programmatic details through technical advisory memoranda and private letter rulings.[186] Unanticipated contingencies are often resolved in this realm of informal guidance, vesting significant authority in the government to redefine the expectations of the parties in the long run.

3. *Operational Norms and Intermediate Sanctions*

Beyond informal agency guidance, another critical mechanism for defining the long-term relationship between the government and providers can be found in the implicit norms that guide day-to-day interactions not governed by the explicit terms of the relevant agreements or gap-filling agency pronouncements.[187] These informal contacts match what relational contract theorists would describe as typical means of resolving conflicts in long-term

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agency pronouncements, the infrequency of such challenges is notable.

183. This is not to suggest that conflicts over the binding nature of HUD and other agency guidance never arise. The point is simply that given the number of projects under subsidy and the breadth of public-private contacts such a portfolio engenders, one might expect much more friction over questions of agency authority than seems to be the industry practice.

184. Just under the heading of "Housing," which covers multifamily programs such as project-based Section 8, HUD's handbooks include thirteen volumes on topics ranging from the details of program oversight to project-specific concerns including acceptable property insurance, tenant selection, and management standards.

185. *See generally* 26 C.F.R. §§ 1.42-0 to -17 (2005) (describing credits allowable under Sections 30-45D); *id.* §§ 301.6401-1 to .6407-1 (describing procedures in general for abatements, credits, and refunds).

186. To cite a recent high-profile example, the IRS in 2000 released five technical advisory memoranda in connection with the audit of several LIHTC projects that clarified the agency's position with respect to whether certain land preparation costs, construction loan and bond issuance costs, local impact fees, and developer fees may properly be included in the eligible basis of a project, a critical determinant of the level of the tax subsidy. *See* Jeffrey R. Pankratz & Craig Emden, Comment, *Heard from the IRS: IRS Rulings May Significantly Reduce Eligible Basis in Tax Credit Transactions*, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 99 (2001). The rulings, though informal, roiled the industry, leading to calls for legislative revision and state agency oversight revisions. *Id.* at 99-100. While this is an example of up-front tax treatment of costs not addressed by statute or regulation, the need for clarification arose during field audits, *id.* at 100, and similar issues often arise during the auditing process. Note that in the LIHTC and bond-finance context, the federal government and state agencies share implementation, and there is an ongoing interaction between the IRS, state housing agencies, and private participants.

187. On the relationship between norms and formal law, see generally ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991).

intertwined agreements.[188]

On the provider side, the primary recipients of public subsidies (or their agents)[189] often maintain contacts with their government counterparts.[190] They do so both because of regular reporting and auditing requirements, and to raise day-to-day management and operations questions that do not require formal guidance. Over time, these contacts can establish patterns of governance in the interstices between the agency pronouncements and the agreements that formally define the relationship. If a question arises about issues such as the permissible uses of a reserve fund, tenant qualifications, permissible management agents, or other day-to-day operational aspects of project ownership and management that are not defined ex ante, consultation can provide a first line of response.[191]

The development of the "rules" that govern the ongoing relationship between government entities and providers in the subsidized housing context can thus be driven by transaction-specific concerns arising from providers. As new financing structures, changing market conditions, or developments in other areas of the law raise questions about permissible courses of action not previously addressed, the parties to development or preservation transactions seek guidance from relevant government agencies, which are then called upon to make formal or informal pronouncements on a case-by-case basis.[192] The resulting "common law" of program implementation is then spread through networks of affordable housing developers, lenders, syndicators, investors, and

188. *See supra* text accompanying notes 102–103.

189. In the LIHTC and similar subsidy mechanisms, the entity or individual receiving tax benefits rarely (except in the case of what is called "recapture") interacts directly with the IRS or any state agencies about the program. Instead, the point of contact is often the developer who applies for allocations of tax-credit authority that are then syndicated to investors.

190. There are reasons why providers might avoid entering into a dialogue with the government, and there are certainly implementation issues in the interstices of clear obligations that providers resolve without resort to consultation. The point here is simply that ambiguities and the reality that contracts and the backdrop of the statutes and regulations against which they operate—in addition to regular contacts through audits and the like—create an inevitable dialogue in the long run between providers and the government.

191. In the HUD context, the Inspector General can also play a role in defining operational norms, given the relatively broad authority granted to the Inspector General to investigate HUD programs. For a general discussion of monitoring and oversight for both HUD subsidized and LIHTC projects, see Deborah Kenn, *Monitoring and Enforcement of Regulatory Agreements*, *in* THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT, *supra* note 120, at 363.

192. To cite one example, the relatively recent phenomenon of using limited liability companies as ownership entities for private affordable housing projects, *cf.* J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES § 1.5, at 3 (1994) (detailing the history of enactment of LLC legislation), raises practical questions given that most applicable statutes and regulations contemplated individual, corporate or partnership forms of ownership (and often explicitly cite specific ownership types). This has played out, among other areas, in HUD's process for determining previous participation—the "2530 process," *see infra* text accompanying notes 196–200—which nowhere mentions limited liability companies, causing confusion at a time when deal structures in the industry are increasingly moving toward the use of LLCs. *See* Memorandum from Monica Hilton Sussman & Richard Michael Price to Stillman D. Knight, Deputy Assistant Sec'y for Multifamily Hous. Programs (Mar. 26, 2004), *available at* http://library.findlaw.com/2004/Apr/26/133420.html.

their counsel.[193] Again, this kind of informal interchange between contracting parties is paradigmatically relational.[194]

4. *Repeat Players and Feedback Mechanisms*

Contractual obligations and non-contractual contacts in the subsidized housing context operate against a background of repeat interactions that tend to bring the same parties into subsidy programs. On the government side, agencies such as HUD, recognizing that many providers are repeat players, have created feedback mechanisms that reinforce fealty to agency goals by conditioning future participation.[195] The so-called "2530" process (named after the relevant HUD form)[196] requires potential recipients of many forms of HUD subsidy to list all past involvement in affordable housing (involving any type of subsidy at any level of government), and to indicate whether, for example, the applicant has ever defaulted on a loan or violated program requirements.[197]

While aimed at giving HUD the opportunity to screen for bad actors—a genuine risk given the potential for individuals to mask previous participation behind shifting entity structures—the 2530 process creates a practical day-to-day feedback loop in the ownership and management of affordable housing.[198] Providers who wish to be repeat players with HUD may exercise caution at the margins to avoid a 2530 "red flag,"[199] which is difficult to remove—and which, in any event, can slow the process of working with HUD in the future.[200]

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193. In practice, private entities interact with the government in ways more subtle and complex than this Article's focus on the bilateral agency-provider relationship suggests. For example, if HUD makes a decision or sets policy to the detriment of a provider, that provider can seek redress elsewhere in the executive branch (to the Office of Management and Budget, for example, which plays a role in policy-making at HUD), as well as to Congress in its oversight capacity.

194. Similarly paradigmatic of relational contracting is the IRS and HUD's usage of penalties short of termination (or the equivalent) to manage private providers. For example, under 26 U.S.C. § 4958(a)(1)-(2) (2000), the IRS has the power, in dealing with nonprofits, to issue intermediate sanctions rather than terminate their tax-exempt status in cases involving private benefits, a situation that can arise in the housing context.

195. From a "relational" perspective, the federal government also has the ability to suspend or even debar providers from participating in federal subsidy and other programs. *See* Kenn, *supra* note 191, at 369.

196. U.S. Dep't of Hous. & Urban Dev., Form HUD-2530, Previous Participation Certification (May 2001), http://www.hudclips.org/sub_nonhud/cgi/pdfforms/2530.pdf.

197. *See* Instructions to HUD Form 2530. *See generally* U.S. Dep't of Hous. & Urban Dev., Handbook 4065.1 Rev-1, Previous Participation Handbook (Sept. 21, 1994), http://www.hudclips.org/sub_nonhud/cgi/hudclips.cgi#handnot (select "all Handbooks," then search by document number) (explaining the procedures for processing Form 2530).

198. The 2530 process is controversial in the housing industry, in part reflecting changes in the structure of ownership from small partnerships and family members to large institutional investors. *See* Memorandum from Monica Hilton Sussman & Richard Michael Price, *supra* note 192.

199. *See* 24 C.F.R. § 200.219 (2005) (on "red flags"); *see also* 24 C.F.R. §§ 200.210 to .245 (2005).

200. For example, a provider may be facing a risk of foreclosure on an insured mortgage; rather than "breach" (e.g., allow the project to fail, take the loss, and move on), providers have an incentive to avoid the 2530 "red flag" that would accompany such a decision. Thus, interest in future subsidies—common in the subsidized multifamily industry where there are numerous repeat players (indeed, where

5. *Background Legal Constraints*

Finally, to complete the description of the mechanisms that shape the government-provider relationship in subsidized housing, it is important to note that in practice, private providers operate under a host of legal constraints that mirror public law obligations.[201] For owners of multifamily housing, whether or not they receive public subsidies, the role of landlord has famously taken on an almost quasi-public tint, constraining the price (primarily through rent control) and quality (through building codes, housing codes, and common-law doctrines of the implied warranty of habitability) of the housing, and granting to tenants rights unavailable at common law.[202]

The "revolution" in landlord-tenant law demonstrates the importation in the private context (through both judicial and legislative action) of constraints that would not be unfamiliar to government entities,[203] although the overlay is by no means perfect.[204] Housing providers, moreover, are also subject to tort liability and the ability of tenants to create obligations in leases, however tenuous that ability might be in the markets in which subsidized housing tends to operate. In short, over the duration of the contracts and other modes of control that shape

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repeat players are often the only practical recipients of some of the more complex forms of government subsidy, given the expertise required on the private side)—coupled with a formal mechanism to self-report "bad actions" broadly speaking, can police actions that would be difficult to control through formal contract.

201. In reviewing privatization as a general matter, Jack Beermann has argued with much force that private-sector legal mechanisms restrain private actors in ways that parallel traditional governmental restraints. Beermann cites judicial review of corporate management, the transparency-forcing consequences of the regulation of public capital markets, and state oversight of nonprofit organizations as examples of regulations that attempt in the private sector to give principals control of their agents' behavior similar to administrative law's control over public entities. *See* Beermann, *supra* note 67, at 1720-29.

202. *See* Edward H. Rabin, *The Revolution in Residential Landlord-Tenant Law: Causes and Consequences*, 69 CORNELL L. REV. 517, 522-23 (1984). For examples of extensive commentary on these developments in residential landlord-tenant law, see Lawrence M. Friedman, *Comments on Edward H. Rabin*, The Revolution in Residential Landlord-Tenant Law: Causes and Consequences, 69 CORNELL L. REV 585, 585 (1984); Mary Ann Glendon, *The Transformation of American Landlord-Tenant Law*, 23 B.C. L. REV. 503, 503-05 (1982). *See also* Gerald Korngold, *Whatever Happened to Landlord-Tenant Law?*, 77 NEB. L. REV. 703, 705-07 (1998).

203. For example, one of the central battlegrounds in the development of "new property" due process protections was in the arena of tenants' rights. *See* Karl Manheim, *Tenant Eviction Protection and the Takings Clause*, 1989 WIS. L. REV. 925, 928. A parallel hallmark of the revolution in landlord-tenant law in the 1960s and 1970s was increasing constraints on the ability of private landlords to evict tenants. *See* Rabin, *supra* note 202, at 521.

204. On the other hand, because public housing authority officials can in some circumstances claim sovereign immunity, *see, e.g.*, Evans v. Hous. Auth. of Raleigh, 602 S.E.2d 668 (N.C. 2004), tenants in private subsidized housing may have stronger remedies available than do tenants in government-owned housing for harms arising from the ordinary incidents of residential life. In many cases, public housing authorities are found to have waived their sovereign or governmental immunity, at least for ordinary torts, *see, e.g.*, *id.* (remanding for a determination of possible waiver), but such immunity poses at least an initial barrier for tenants seeking relief. *Cf.* Beermann, *supra* note 67, at 1729-34; *id.* at 1733 (noting the limits on imposing antidiscrimination norms on public actors and concluding that "privatization may enhance the reach" of such norms by employing private actors more amenable to legal remedies than public actors).

the relationship between governments and private providers in subsidized housing, providers are governed by a number of significant legal constraints not directly imposed in connection with the subsidy.[205]

C. *Subsidized Housing as a Species of Relational Contracting*

1. *Mapping Relational Patterns*

In the paradigmatic privatization-as-discrete-contract case, a public entity crafts a request for proposals, obtains bids from a relatively competitive market of potential providers, sets out and negotiates the terms of the contract, and then turns the private entity loose, subject to periodic monitoring and the threat of potential termination.[206] This discrete-contracting vision of privatization focuses largely on clearly defining terms up front and then deciding whether a breach has occurred, often with short-term consequences (primarily termination).

As a descriptive matter, the subsidized housing programs examined above bear little resemblance to this vision. Although there is an element of discrete contracting in the initial process of granting a subsidy in the programs discussed above, in practice the "exchange" extends over numerous interactions, bringing government agencies and their intermediaries into repeated contact and raising the long-term need for fairly regular adjustment of the terms of engagement. This interaction exemplifies key aspects of relational contracting, explicitly recognizing the difficulty of embodying critical long-term obligations in clear-cut and inflexible terms, and creating mechanisms for supporting the contractual relationship with a superstructure of formal and informal interactions that fill gaps in the initial contracts. As noted, the terms of the agreements tend to be relatively open-ended with respect to significant life-cycle events, or even subject to explicit change.[207]

As with relational contracts in the private sector, moreover, incentives to breach are limited on both sides by significant sunk costs and incentives to repeat the interaction.[208] As a result, informal mechanisms have developed to

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205. In this regard, housing as an area of policy can be distinguished from some areas of social welfare, such as benefits eligibility determinations, substance abuse treatment, and others in which public law norms may be less prevalent in the private-sector analogues of public sector service providers.

206. Joel Handler outlines the traditional model of contracting out. Handler's chronology begins with requesting bids, selecting firms, and drafting, negotiating, and processing contracts; moves through contract monitoring; and concludes with renewal (and, rarely, termination). *See* HANDLER, *supra* note 5, at 90-93. Although Handler recognizes (and criticizes) the interdependency of government agencies and the private providers they use, Handler's paradigm stages of contracting reflect an adversarial, arm's-length relationship that contemplates a fairly classical, discrete agreement.

207. *See supra* text accompanying notes 147-148.

208. Government entities are invested because they need private parties to provide housing; providers are invested because that is their business or the mission of their nonprofit.

resolve conflict, however imperfectly, and reinforce solidarity.[209] The "2530" process is a prime example of an overarching mechanism that builds on the fact that many housing providers are repeat players in subsidy programs, creating incentives to meet program goals without explicitly mandating them. Even the process of regulatory and informal agency-action gap filling—the common-law-like development of governing rules—reflects relational contracting by building a process of adjustment internal to the relationship over time.

2. *Balancing Flexibility and Certainty*

A relational contract lens brings to the fore the question of which aspects of the government-provider relationship could best employ flexibility and which aspects are best approached through more rigid terms. In the housing context, some core aspects of the "service" can be memorialized in fairly concrete terms, such as the number of units to be subsidized, the income limits of the tenants who will occupy those units, and the amount of the tenant contribution to rent. These basic determinants of the service are not likely to change over time and can frame the broad contours of the transaction between the government and the provider.[210]

On the other hand, there are myriad aspects of the government-provider relationship in the housing context that agencies have tended to memorialize in more flexible terms, including, as noted, terms relating to subsidy level, housing quality, and various life-cycle events. These mechanisms for flexibility recognize that as conditions change, both parties need to adjust. To the extent that contractual obligations also track relevant public law norms, contracts take approaches that vacillate between specificity and flexibility.

It is difficult to make generalizations about where the current balance between flexibility and certainty might be adjusted, given that program requirements vary significantly even within the confines of the programs this Article has examined. Speaking broadly, one must account for the likelihood of changing market conditions (both at the macro level and also in the local area of a given project), the uncertainty of property conditions over the long run, and the role that any one property may play in a larger portfolio of properties. Balancing certainty and discretion must also take account of factors such as the relative information to which providers and the government have access (and each has distinct advantages in this regard), as well as the many practical details of property ownership and management that translate program goals into actual service.

209. *See supra* text accompanying notes 196-200.

210. Accordingly, flexibility is less useful as a tool in the original bidding for such basic terms.

3. *Reserved Discretion in Operation*

On one level, the agreements that frame the public-private interaction in subsidized housing only imperfectly reflect relational norms. Were resources available to anticipate and clearly articulate the allocation of risk for all future contingencies, it would be theoretically possible to substitute the kinds of mechanisms of governance described above with clear obligations. However, given the practical fact that flexibility is necessary, an alternative response to uncertainty over time as well as to the difficulty of capturing requirements in precise terms is to implement mechanisms that foster mutual commitment and a concomitant sharing of risks.

In subsidized housing, however, agreements frequently respond to change and the vague nature of many requirements by functionally reserving unilateral discretion to the government to approve significant adjustments and to fill gaps left open by the four corners of the agreement. This phenomenon of government retention of the ability to resolve ambiguity and decide issues not covered by the stated terms of agreement, as well as some larger (however limited) measure of authority to change the basic bargain, presents the risk that the government will unilaterally change the "rules of the game."[211] In housing, as with most areas of policy, political conditions and programmatic goals inexorably shift, sometimes dramatically, over time. This raises a particular concern in housing policy, where public-private relationships might last thirty or forty years or more.[212]

One might suggest that if flexibility is necessary in the long run, a logical response would be to allocate responsibility to one side or the other to resolve inevitable ambiguities. Retaining unilateral discretion might not be a dysfunctional response, but rather a simple way to provide for conflict resolution in the long run. Only if the government exercises that discretion improvidently, the argument would continue, is provider commitment undermined.[213] And, if discretion is retained by the sovereign partner in the relationship, evolving public policy norms can be incorporated into the service provision, rather than locked in at the time of contracting.

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211. In the private-bargain context, there are a number of frameworks that might be employed for resolving issues not controlled by the four corners of a written agreement, including efficiency, the hypothetical bargain, and community norms. In privatization, the policy goals underlying the relevant program theoretically provide a source of gap-filling principles. In other words, where contingencies arise that are not covered by agreement or regulation, the remedial public purpose can supply a principle for resolution—gap-filling rules that account for the policy being implemented.

212. Some of the central subsidy programs in the housing arena have evolved as legislative and administrative priorities change. The example of Congress's decision to revisit the right to prepay mortgages and hence remove affordability restrictions in the Section 221(d)(3) and Section 236 context is perhaps the starkest example, *see supra* text accompanying notes 161-165, but housing policy constantly evolves. This leads to shifts, both subtle and significant, in the governance of most programs.

213. In other words, discretion in the government provides a framework, and in theory, governmental entities have every incentive to exercise that discretion appropriately.

Asymmetrical discretion, however, is not without cost. For one thing, the uncertainty this generates in the long-term relationship can reinforce an adversarial relationship between the government and providers, requiring providers to bear a significant measure of the risk of change over time.[214] This retained discretion, moreover, coupled with the open-ended terms of many provisions in the governing contract, requires providers to seek approval for even relatively mundane (but hard-to-predict) new conditions. This can undermine the advantages in terms of responsiveness, creativity, and experience that providers might bring to responding to front-line conditions that are hard, if not impossible, to capture at the outset of the life of the project. Recognizing these shortcomings, however, suggests strategies for improving the relational aspects of privatization.

III. EMBRACING RELATIONAL CONTRACTING IN PRIVATIZATION

If the emerging paradigm in public administration is "governing by network,"[215] then the structural backbone of that network can be thought of as the formal and informal agreements that define the relationship between government entities and their private-sector counterparts. Arguments for contractual clarity—essentially seeking to tighten that structure—are grounded in a vision of government contracting that supposes a relatively discrete transaction, focused largely on the initial act of provider selection, followed by extensive contract oversight. However, as the examination of the subsidized housing programs in Part II shows, government-provider contracts can emerge that are better described as relational.

Thus far, the analysis has focused on uncovering the essentially relational nature of the agreements that drive privatization in housing, a characteristic of agreements in privatization that has been given relatively little attention in the literature. This descriptive project, however, brings to the fore aspects of the relational agreements that can be described as inchoate in terms of their one-sided response to uncertainty. There is therefore a prescriptive element to this analysis as well. One might fairly ask, if the current structure of housing subsidies represents only a limited relational approach, why the response might not be to scale back, limiting flexibility and eschewing collaboration in favor of tighter control. This Part argues, however, that fostering mechanisms for long-term collaboration through strategies of mutual commitment, while perhaps entailing the loss of some governmental discretion at the margins, could foster

214. The government also bears some measure of risk over time, no matter how much discretion it retains to set the terms of long-term governance in a public-private relationship. As the opt-out crisis involving Section 8 illustrates, *see supra* text accompanying notes 161-165, changing conditions can create incentives for providers to exit subsidy programs. Moreover, the asset-specific investment made by the government is a limiting factor in the exercise of its discretion as much as it is an element of risk for the provider.

215. *See* GOLDSMITH & EGGERS, *supra* note 15, at 6-7.

a greater sense of solidarity to program goals on the part of private providers.

Returning to the evaluative framework set out in Part I, then, this Part argues that more fully embracing a relational contracting approach has the potential to enhance efficiency while providing an alternative response to the risk that privatization poses to public law norms. It concludes with notes of caution regarding relational contracting in privatization, and suggests responses to such concerns.

A. *Strategies of Mutual Responsibility*

Relational contracts reflect the inherent difficulty of capturing all contingencies in a long-term relationship. Notions such as a duty to fulfill a contract's terms in good faith—which is generally imposed on the government in traditional procurement, at least at the federal level[216]—show that muting the risk of opportunism can reinforce the stability and vitality of the contractual relationship, enhancing the gains to both parties to a long-term agreement. Such notions at the core of relational contract theory suggest that government entities have much to gain from giving up some measure of control in favor of fostering the relational aspects of their oversight role.

1. *Credible Commitments*

Oliver Williamson has argued persuasively that when parties engage in long-term contractual relationships, particularly those defined by significant investments in relationship-specific assets, mechanisms of mutual commitment can temper the risk that the other party will exploit those investments.[217] For Williamson, "credible commitments" to the contractual relationship foster "more durable and specialized investments," yielding "superior" terms.[218] This suggests that for privatization, tempering or moderating governmental discretion may yield greater private commitment.[219]

Adopting a strategy of fostering provider commitment by the government entails a willingness to forego some measure of retained discretion. In the pre-payment context,[220] for example, although the problem of allowing owners to opt out is a serious one, the uncertainty and cost introduced into the industry by a change in policy that arguably changed one of the basic elements of the

216. *See* 64 AM. JUR. 2D *Public Works and Contracts* § 107 (2005).

217. *See* WILLIAMSON, *supra* note 96, at 61.

218. *Id.* at 91. By credible commitments, Williamson means strategies such as reciprocal trading that binds parties to a bilateral exchange more closely. The analogy in privatization would be governmental approaches that change the incentive structure for private providers, given the risk that the government might take advantage of providers' previous investments.

219. *Id.* at 268 ("Fewer degrees of freedom (rules) can have advantages over more (discretion) because added credible commitments can obtain in this way.").

220. *See supra* text accompanying notes 161-165.

"bargain" between the government and providers introduces an element of instability in the relationship that makes it more difficult for the government to induce future partnerships.

Equally important, seeking to foster mutual responsibility would require a commitment by agencies in the long run to exercise the significant amount of discretion they will inevitably retain with an eye toward reinforcing private providers' ability to respond to conditions as they develop. Private intermediaries might, for example, be empowered to participate in the process of filling gaps left in agreements, with contractual provisions that provided means of mutually adjusting terms in response to change over time.[221]

From a relational contracts perspective, norms of reciprocity could fill the gap left open by balancing the exercise of discretion. Foregoing discretion, of course, has practical consequences on the government side. But the gains from reducing government opportunism may preserve the private sector's ability to respond flexibly to changing conditions while providing an alternative mechanism to achieve the goals that the public partner seeks.[222]

There may be instances, conversely, where it makes sense to increase the discretion granted to the government. If, as William Kovacic has noted, relational features inhere in all government contracts to some extent, the key to realizing the potential of such relational features may be found in increasing governmental flexibility to forego formal contracting requirements.[223] For Kovacic, who is concerned primarily about regulatory mismatch,[224] enhancing the ability of regulators and procurement officials to "bend formal commands" would provide them a tool to make regulatory regimes more efficient.[225] Kovacic acknowledges the potential for capture and fraud, but argues the ability of agency officials to tailor private obligations in the face of potentially over-inclusive nominal standards, like the exercise of prosecutorial discretion in law enforcement, would allow agencies to minimize efficiency losses by targeting regulation to the specific context.[226]

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221. These mechanisms would seek to foster cooperation, the sharing of risk, and preservation of the relationship. *See* Speidel, *supra* note 87, at 829; *see also* Thomas J. Stipanowich, *Reconstructing Construction Law: Reality and Reform in a Transactional System*, 1998 WIS. L. REV. 463, 535 (arguing that relational contract "realities" in the construction industry argue in favor of promoting agreement and good faith as primary contracting rules).

222. This is not to argue that agency officials have incentives to manipulate or exploit the private providers with whom they interact, or to suggest that in practice they do so. Scandals in housing, as in many other areas, tend to create an unfortunate public perception of corruption in an area of policy in which literally millions of units have been provided with no taint of fraud or abuse.

223. *See generally* William E. Kovacic, *Law, Economics, and the Reinvention of Public Administration: Using Relational Agreements To Reduce the Cost of Procurement Regulation and Other Forms of Government Intervention in the Economy*, 50 ADMIN. L. REV. 141 (1998).

224. Regulatory mismatch, according to Kovacic, is the proposition that regulation reduces economic efficiency because of legislative and regulatory failures that lead to both regulatory over- and under-inclusiveness. *Id.* at 149.

225. *Id.*

226. *See id.*

In the context of social services, there are relatively few substantive constraints on government power to shape the relationship with private providers, as courts generally defer to agencies in the broad choices that go into the structure of discretionary spending programs.[227] There is a role for judicial review in the implementation of any privatized service, and a rich literature is developing on the grounds for such challenges,[228] but institutional design questions have largely been left to agency discretion.[229]

Government entities possess some measure of authority to tailor program requirements to conditions as they arise, although a relational approach would seek to increase that flexibility. Agencies can use that flexibility to harness more effectively the expertise and perspective of private providers, while inculcating and reinforcing dedication to program goals. Private providers, in turn, can gain (or perhaps retain) the ability to adjust to conditions on the ground.[230] In short, a relational approach can enhance the service and responsiveness that obtains from engaging with the private sector.[231]

2. *Accountability as Mutual Gain*

Shifting from potential efficiency gains to concerns about preserving accountability, a relational contracting perspective provides an alternative

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227. *See* Cass, *supra* note 6, at 522 (noting that while the "law plainly offers a great many avenues for possible challenge to privatization schemes," current legal doctrine, in general, "offers strikingly few serious judicial obstacles to government disinvolvement, at least as long as accomplished through the normal political processes"); Freeman, *supra* note 28, at 1305-06 (noting that "the implementation of federal grants and run-of-the-mill discretionary funding decisions are not governed by the procurement process and generally receive considerable judicial deference," and that the "bulk of privatization also remains beyond the reach of the subconstitutional discretion-constraining and accountability-forcing mechanisms of administrative law").

228. *See, e.g.*, Gilman, *supra* note 18, at 626-40.

229. Paul Verkuil has recently explored in depth the internal structures the federal government has established to guide outsourcing decisions, noting that administrative challenges to agency decisions to contract out rarely succeed and judicial review (at least under the principal applicable public law constraints, the Federal Activities Reform Act, Pub. L. No. 105-270, 112 Stat. 2382 (1998) (codified at 31 U.S.C. § 501 note (2000)), and the Office of Management and Budget's Circular A-76) has not been a factor. *See* Verkuil, *supra* note 12, at 455-69. *Cf.* Paul R. Verkuil, *The Nondelegable Duty To Govern* (Cardozo Legal Studies Research Paper No. 149, 2005), *available at* http://ssrn.com/abstract=871455.

230. There is a role for courts to play in reinforcing the relational aspects of the agreements that frame privatization. Courts could, for example, give the parties room to develop the internal norms of the relationship over time—for example, by allowing flexibility where relational norms should take primacy, such as in the interpretation of regulations or of contractual provisions. Courts could also bolster governmental strategies of commitment by holding the government to the broad terms of the original bargain. In other words, reversing the normal deference granted to agencies at the margins under an analysis similar to that the Supreme Court employed in *United States v. Winstar*, 518 U.S. 839 (1996), courts could temper governmental discretion to alter the basic bargain while at the same time increasing the tools available to public and private partners to adjust the "details" over time.

231. This is not to make the empirical assertion that in all situations or under all conditions, introducing balanced and flexible mechanisms will necessarily enhance the services provided—here, more and better housing at less cost. Rather, with recognition of the significant empirical debate about the efficiency of potential privatization writ large, *see supra* note 35, my aim here is to argue more modestly that there is sufficient promise in the approach that it is worth exploring further in practice.

framework for preserving public law norms in service provision. In terms of mechanisms of accountability situated in the government-provider interface, a discrete-contracting approach yields prescriptions for contractual specificity and vigilant monitoring in order to exercise the sanction of termination in the event private providers do not fulfill the public norms underlying the program.

A relational approach, however, recognizes that public law norms are inherently difficult to capture in contractual terms and likewise that the risk of shirking—doing what is minimally required by contract—is ever-present.[232] In response, a relational approach would seek to inculcate public values in the private partners the government employs, not as much through ever-increasing contractual specificity (or other tools that have been suggested for making private parties more "government-like"[233]) as through formally and informally encouraging reciprocity and private-party solidarity to public values.

In the process of selecting providers, in the ensuing contracts, and in the interactions that follow, public officials could reorient their approach to make fidelity to core public values as important an aspect of private conduct as any "hard" output. This reorientation—from focusing on oversight to focusing on strategies of mutual commitment—can shift the basis of that interaction from an adversarial posture to one of mutual problem-solving.[234]

The advantages that this shift would bring in terms of efficiency make intuitive sense—to the extent that private-sector actors have advantages in the provision of services, engaging them collaboratively should facilitate the engagement with those advantages. But recognizing the value of flexibility and long-term collaboration has the potential as well to reorient frames of accountability.[235] Rather than continue to conceive of accountability as the ability of an agency to impose requirements on private parties (which will always be necessary for practical aspects of the service provision and, for more open-ended public law norms, in the marginal case as well), accountability in this context can be thought of as the mutual responsibility of government and

232. *See* SCLAR, *supra* note 3, at 122; *see also id.* at 128 (noting that if agencies focus too heavily on specifications, "they stand a good chance of getting precisely what they [seek] regardless of whether it is what the situation truly warrants").

233. Other tools to make private providers more "government-like" include increased liability and reduced immunity. *See* Freeman, *supra* note 28, at 1315-28; *see also* Freeman, *supra* note 27, at 574-91 (describing four traditional constraints advocated by administrative law scholars to constrain private parties performing governmental functions: treating private parties as "state actors"; enforcing non-delegation or due process constraints on the involvement of private parties; extending procedural controls to private actors; and infusing private law with public law norms).

234. *Cf.* Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1, 24 (2000) (discussing the advantages of collaboration to the regulatory process, and noting that sustained interaction is "likely to ameliorate the adversarialism of stakeholder relationships," which can be instrumental in fostering "trust and good faith").

235. *Cf.* Korman, *supra* note 84, at 294 ("[A] housing provider that is attentive to civil rights concerns has substantial discretion in choosing the methods deemed necessary to fulfill the responsibility to further fair housing.").

provider.[236]

Ensuring that a private agent's interests are aligned with the public partner is a significant challenge. Shirking on the part of the private party in the face of overly narrow commands, the reality of ever-more limited oversight resources, and the practical challenges in memorializing the full range of potential contingencies in long-term relationships all suggest that preserving accountability through ever-greater contractual clarity may simply not be feasible. Focusing instead on increasing provider commitment to public ends, while leaving that private party greater discretion to experiment with appropriate means for reaching those ends, can accomplish both goals.[237]

Shifting from the incentives to operate within the constraints of public norms to the content of those norms, a relational perspective could also provide a filter through which to assess which public law norms to impose in the first place.[238] A relational perspective can sharpen administrative and legislative decisions about the range of public law norms that should be operative, a process that currently occurs largely in a piecemeal fashion. Resisting the loss

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236. *Cf.* Freeman, *supra* note 234, at 30 ("A collaborative regime challenges existing assumptions about what constitutes public or private roles in governance because the most collaborative arrangements will often involve sharing responsibilities and mutual accountability that crosses the public-private divide.").

237. Reaching a similar conclusion from a different direction, Henry Korman has argued forcefully for what he calls an "underwriting" approach to the civil rights aspects of the public values involved in providing affordable housing, making fair housing duties an aspect of the provider's orientation at every stage of the development and management process, in the same way that agencies now underwrite for financial obligations. *See* Korman, *supra* note 84, at 313. For Korman, placing what could be called the "civil rights risk" on a par with financial and management risks would incentivize private providers and other relevant stakeholders to develop and operate housing with greater sensitivity to these public values, while drawing on the "substantial latitude" that providers have "to determine the nature and scope of appropriate action." *Id.*

238. It might be argued that the appropriate locus of responsibility for deciding the relevant public values to be imposed on any private provision of public services is the recipient of that service, as reinforced by judicial remedies in the case of recalcitrant providers. In other words, private providers should be subject to the full range of remedies by program participants that public providers would be. As noted above, *supra* note 204, private actors in certain circumstances may be more amenable to the type of accountability represented by liability to recipients.

There is, however, a deeper concern here. There may be instances in which the definition of relevant public values that results from the political process—that is, imposed by public entities on private providers as a matter of contract, regulation, or other law—varies from the public values that recipients might choose. *Cf.* Moore, *supra* note 26, at 1220 ("If a collective defines public purposes by acting through political, legislative, executive, and judicial means, then values, purposes, and goals defined in these processes become a different standard for judging what is publicly valuable than the simple aggregation of the welfare of those affected by the public policies."). Residents, for example, might have a different view than public officials about the appropriate balance between tenant screening mechanisms and tenant security. A controversial variation on this conflict recently played out with respect to permissible grounds for eviction in public housing. *See* HUD v. Rucker, 535 U.S. 125 (2002). Without taking a position on whether the HUD policy upheld in *Rucker* went too far on the side of security, the case illustrates the potential for a rift between visions of appropriate operating norms that the government might choose and that some clients might choose. It is beyond the scope of this Article to evaluate fully the specific public values at play in subsidized housing, let alone the privatization of social welfare writ large. But it is important to acknowledge the potential gap between collectively defined public values and recipient-derived public values.

of public values while strengthening appropriate public norms in privatization risks a series of question-begging exercises, and the tradeoff between efficiency and accountability cannot be evaluated in a vacuum.[239]

As noted above, in the housing programs at issue, "publicization" reflects both sweeping obligations (such as equality- and due-process-grounded protections for tenants) and more particular obligations.[240] Deciding which of these obligations best enhances the ultimate provision of service, and reinforces the private providers' incentives to deliver the "best" service (defined as the optimal mix of constraints, cost, and quality), can be focused through a relational contract lens.[241]

From an accountability standpoint, in sum, relevant public law norms—such as anti-discrimination provisions and notions of rationality in the selection and retention of tenants—are appropriately imposed in open-ended terms. The ability of any contract (or regulatory) drafter to provide a complete normative program is inherently limited given the variety of case-specific and often novel applications in which such norms must apply over the life of a project. In a public policy environment of severely limited resources, therefore, strategies that extend the reach of public law norms while not transforming the public-private relationship into one that essentially replicates public provision deserve serious consideration.

3. *Mechanisms of Collaboration*

What might a more collaborative approach look like in practice? Because this Article has focused on a collection of specific housing programs, and because operational details are critical and vary greatly from program to program, it is appropriate to limit this inquiry to the subsidized housing context.

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239. Freeman argues that imposing public law norms might turn on the extent to which a program involves value-laden judgments in implementation. *See* Freeman, *supra* note 28, at 1349-50. An examination of subsidized housing suggests that that line might be a difficult one to discern in practice. Deciding which tenants to accept into government-funded housing, for example, is arguably as value-laden as any exercise of discretion over the decision to extend or deny a governmental benefit, but the myriad details of HUD and IRS program guidance focus as well on pragmatic concerns like housing quality, conditions of secondary financing, approval for transfer and the like.

240. *See supra* text accompanying notes 169-175.

241. A relational contracting approach to privatization might also blunt the concern that attempting to inculcate public values—particularly non-discrimination norms and tolerance for individual beliefs—in religious entities who act as social service providers itself undermines the unique nature of such entities. Kathleen Sullivan, for example, has argued that just as the freedoms of speech, association, and religious practice limit the government's ability to impose certain norms on religious entities directly, so too should the concerns animating those constitutional protections limit government's ability instead to "bribe" those entities though vouchers and contracts. *See* Kathleen M. Sullivan, *The New Religion and the Constitution*, 116 HARV. L. REV. 1397, 1397, 1420-21 (2003). While the substance of the "strings" that might accompany public funding in a relational approach might look little different than the substance that could be attached through a more discrete-contracting model, the larger social and institutional framework in which the collaboration between private (religious) and public entities occurs could provide greater sensitivity to the distinctive nature of religious entities and help temper some of the potential excesses that injecting religion into social service provision risks.

Collaborative mechanisms that embrace a relational contracting perspective likely apply in other areas of social welfare policy, but the exploration of such mechanisms must be sensitive to context.

To begin, under a relational contracting approach, public-private agreements could share the burden of decisionmaking over time. When providers seek approval from government entities in response to changing conditions on the ground—say, for the need for additional financing or to attempt a creative approach to marketing in response to new population needs—they could be provided with some assurance of a response by government entities in a timely manner and perhaps a shift in the burden of proof. Currently, for those issues where discretion is retained by the government, the exercise of that discretion is often triggered by provider input and the burden remains on providers to show why a given course of action should be allowed. Even if an agency can be convinced, the need to do the convincing may deter creativity and responsiveness. If providers knew the range of likely outcomes, or had some confidence that balanced mechanisms existed to resolve disputes, then that would encourage providers to take initiative in the first place.

A relational contracting approach, moreover, could reallocate some measure of the risk of change over time to the government, giving providers a greater measure of certainty at the time of contracting as to what the rules of the game would be over the lifetime of the public-private partnership. This might involve explicit contractual provisions that lock in some set of core governing rules—say, the regulations in place at a given time—or that place some burden on the government's ability to change those rules. Alternatively, if policy shifts and providers are to be subject to new requirements, then some offsetting benefit might be granted to induce providers to incorporate those new norms.[242]

Another governance mechanism to reinforce provider solidarity in the face of inherent uncertainty is for agencies to focus resources on non-contractual measures that reward the internalization of public law norms by providers. The 2530 process, for example, was designed to screen "bad actors" but has had the secondary effect of deterring undesirable behavior by the repeat players that populate the industry. Similar mechanisms could formally reward good behavior. Examples could include giving points or other advantages in competitions for subsidies to providers who demonstrate commitment to program goals,[243] or providing other concrete incentives to providers to pay

242. This is essentially the approach that Congress has reached in the pre-payment context, after years of conflict, *see supra* note 165. Despite the genuine threat of losing the subsidized portfolio, the current collaborative approach has met with much success.

243. HUD, for example, conducts surveys of some residents to assess satisfaction with issues such as the level of maintenance, repair, and appearance of developments, as well as communications, safety, and services provided. *See* U.S. Dep't of Hous. & Urban Dev., Customer Satisfaction Survey (Mar. 14,

attention to delivering housing in ways that go beyond the level minimally required.[244]

These examples are just that—speculations as to appropriate governance mechanisms that might advance the public-private collaboration in light of the relational nature of the interaction. They must be tested on the ground and in practice and undoubtedly there are many other appropriate mechanisms that agencies and providers could develop. The important point is to firmly plant the focus of governance on best responding to uncertainty, creating mutual responsibility, and incentivizing private providers to advance public goals.

B. *Notes of Caution*

If viewing at least some forms of privatization as creating a species of relational contract has the potential to yield efficiency gains while providing an alternative set of approaches to preserving accountability to public law norms, why is the model not more prevalent in practice? Several barriers to long-term relational collaboration are evident in the context of subsidized housing, and may have wider application. First, the ever-present risk of capture and corruption, certainly no stranger to the world of affordable housing, suggests caution. Next, the fact that a government entity frames and largely controls the interaction underscores the inherent imbalance of the contracting parties, potentially undermining relational norms. And the mismatch in incentives between public and private actors may likewise undermine the ability of the parties to commit to shared responsibility. Finally, any effort to work more collaboratively may stretch scarce agency resources. All of these concerns deserve attention, but ultimately should not undermine the promise that a relational contract approach holds.

1. *Fear of Capture and Corruption*

Perhaps the most significant impediment to collaborative models of public-private partnerships is the potential for capture and the risk of public corruption.[245] If the government foregoes discretion and commits to collaboration that is genuinely mutual, such loss of control might invite abuse

2006), http://www.hud.gov/offices/reac/products/prodrass.cfm. HUD could modify this type of feedback into broader instruments to track sensitivity to the norms that the agency decides are most important and use that information when selecting providers to subsidize.

244. There are a variety of tools that one can envision serving a similar feedback-loop function. The right, for example, to get certain levels of development fees might be conditioned on the uses to which those fees are put, and a sliding scale could be employed to encourage reinvestment in affordable housing. Or eligibility for relief from "exit taxes"—potential capital gains and depreciation recapture that accompany the sale of many older buildings—might likewise be conditioned on commitments to preserve such housing. *See* MILLENNIAL HOUS. COMM'N, *supra* note 116, at 34 (endorsing a form of this proposal).

245. *See* Kovacic, *supra* note 223, at 148-49.

by private partners. Likewise, the absence of any pre-defined and publicly announced standard to be applied may undermine the public's ability to detect and deter fraud. In other words, the lack of transparency that inheres in relational exchanges shifting over time raises the risk of outright corruption: The less clear (and clearly enforced) the norms that govern the public-private relationship, the greater the risk of fraud.

HUD's track record with capture and fraud in privatization is certainly not without its unfortunate blemishes,[246] leaving a legacy of heightened concerns about corruption.[247] The government, however, retains a significant array of tools to deal with "waste, fraud and abuse," and extra-contractual enforcement mechanisms pervade even the most detailed contractual relationship.[248] The HUD Inspector General, for example, has broad investigative and remedial authority[249] and has rarely been hesitant in exercising that authority.[250] Likewise, the IRS audits LIHTC projects regularly, and compliance monitoring for tax-credit projects has spawned an industry of consultants.

One could argue that clear benchmarks and the limitation of discretion will tend to be more effective than ex-post mechanisms to minimize the risk of fraud. As long as relational practices are grounded within the broad confines of acceptable agency discretion and are subject to review through ordinary agency oversight, the risk of shifting to ex-post enforcement should not stand as an insuperable barrier to effective public-private collaboration. In short, collaboration need not mean corruption: While capture and fraud are always risks in the private provision of public services, those risks alone should not obscure the potential for embracing flexibility and creativity in long-term contractual relations.

2. *Inherent Imbalance*

Another barrier to shifting to a relational contracting model for privatization is the inherent imbalance between contracting parties. Some degree of a disparity is theoretically present in all contracts, but it is more pronounced when a sovereign is on one side of the bargaining table.[251] Scholars

246. *See* Michael Allen Wolf, *HUD and Housing in the 1990s: Crises in Affordability and Accountability*, 18 FORDHAM URB. L.J. 545 (1991).

247. Following a series of scandals at HUD during the Reagan administration, Congress passed the Department of Housing and Urban Development Reform Act of 1989, Pub. L. No. 101-235, 103 Stat. 1987 (codified at 42 U.S.C. § 3531 note (2000)), containing a number of provisions aimed at reforming HUD's ethics and management.

248. *See* Kovacic, *supra* note 223, at 150-51.

249. *See* Inspector General Act of 1978, 5 U.S.C. app. at 12 (2000).

250. *See, e.g.*, OFFICE OF THE INSPECTOR GEN., U.S. DEP'T OF HOUS. & URBAN DEV., SEMIANNUAL REPORT TO CONGRESS: OCTOBER 1, 2004 THROUGH MARCH 31, 2005 (2005), *available at* http://www.hud.gov/offices/oig/sar53.pdf (detailing the work of the HUD Inspector General's Office).

251. In many instances, of course, private parties have informational advantages over public entities that can skew the negotiation of a public-private contract. *See* SCLAR, *supra* note 3, at 121

focused on the intersection between relational contracts and the government have generally been concerned with the risk of opportunism that arises where one party to the bargain—the government—is also the institution charged with enforcing the contract.[252] Opportunism, even if reflecting a benign reaction on the part of the government to shifting public policy priorities, can threaten the confidence of private parties that the terms of the engagement will remain stable over time, undermining incentives to do more than what is minimally required by contract.

Moreover, relational norms may be hard to inculcate in a relationship where the government, as it must, retains an array of regulatory and other means to reinforce its control.[253] Incentivizing private parties to embrace program goals not strictly required by contract may be challenging.[254] Government entities—at least outside of procurement, which is much more tightly regulated than many of the contexts in which social services privatization such as subsidized housing occurs[255]—have authority to temper their own prosecutorial discretion and target limited resources on resolving problems cooperatively before they become the subject of enforcement actions.

In a relational contracting paradigm, while government entities would not give up their ability to sanction private intermediaries, they might see some value in reserving enforcement for situations in which cooperation had broken down. Of course, clear violations of law should merit enforcement, but in the day-to-day operations of many privatized public services, there are significant gray areas and room for the exercise of government discretion.

("Even the most conscientious public officials are almost always systematically on the short end of informational asymmetry inequality."). This may be less so in an area of privatization such as housing, where there are constraints on the ability of housing providers to manipulate information advantages, given that subsidies are only a part of most projects (and hence other stakeholders, such as lenders and investors, can police construction and management costs).

252. *See, e.g.*, Victor P. Goldberg, *Relational Exchange*, 23 AM. BEHAV. SCI. 337 (1980); Todd S. Lowry, *Bargain and Contract Theory in Law and Economics*, 10 J. ECON. ISSUES 1 (1976). For an extended case study in state opportunism, and the argument that political and economic forces make governments problematic participants in relational contracts, see Grandy, *supra* note 105.

253. Some HUD contracts, for example, include warnings about potential criminal liability arising out of false statements. *See, e.g.*, Housing Assistance Payments (HAP) Contract, Section 8 Housing Assistance Payments Program: Additional Assistance Program for Projects with HUD-Insured and HUD-Held Mortgages, § IV (June 1992) (citing monetary penalties and potential imprisonment for violations of 18 U.S.C. § 1001), *in* U.S. Dep't of Hous. & Urban Dev., Handbook 4350.2 Rev-1, app. 15 (Aug. 20, 1993), http://www.hudclips.org/sub_nonhud/cgi/hudclips.cgi#handnot (select "all Handbooks," then search by document number); MR HAP Contract Part I, *supra* note 145, at 21 (invoking 18 U.S.C. § 1001 (2000)).

254. Put starkly, "[s]o long as one partner to the relationship has the ability to imprison employees of the other partner and insists on deputizing the employees of the other partner [through qui tam suits] to monitor deviations from various rules, reliance on relational commitments is likely to be reduced." Kovacic, *supra* note 223, at 154.

255. *Cf.* Freeman, *supra* note 4, at 160 n.18 (noting that "the law governing traditional government procurement of goods and services addresses only a narrow subset of government contracts," and is "either imperfect or wholly unsuitable for responding to the more widespread use of contract to deliver services or perform arguably public functions").

The flip side of relaxing these structural barriers is the risk that applying the kind of flexibility that characterizes relational contracts unfairly bends the rules. If the government adjusts the relationship on a relational basis—issues a waiver of some requirement, for example—then the failure to provide a similar waiver in like cases raises serious questions.

As a practical matter, HUD and other agencies already possess authority to waive some program requirements,[256] and are certainly called upon to exercise that discretion already. What a relational contract perspective would suggest, however, is that exercising such authority more judiciously might enhance the incentives that private parties have to innovate within the framework of program goals.

3. *Skewed Incentives*

The structural impediment to relational contracting arising from the imbalance between the partners also arises in the incentives of the contracting parties. Principals and agents always face a potential mismatch in incentives; but providing complex and highly contextual services over a period of decades, while advancing sometimes abstract public values, poses particularly sharp challenges. The longer the term of the contractual relationship, the more risk that initially aligned interests will grow apart. Private providers—both for-profits and, to a lesser extent, non-profits—rarely place the advancement of public values at the center of their incentive structure, undermining the ability of the parties to commit to increasing solidarity to achieve such values.[257] In the commercial context, the underlying goal of all parties is relatively clear and translatable (in some form) into financial terms. In the public sector, at least where social services are concerned, the need to be sensitive to public values and the essentially redistributive nature of social welfare make the mutual gains of the parties potentially incommensurate.[258]

An answer to this challenge may lay in the long-term and repeat nature of the interaction between the parties in privatization. As discussed above, the government in some instances has created mechanisms that have the effect of incentivizing providers to avoid the reputational and practical burdens of undesirable behavior. Programs could conversely structure the public-private relationship affirmatively to reward actions that reflect the government's goals.

256. *See, e.g.*, 24 C.F.R § 5.110 (2005) (HUD waiver authority).

257. *Cf.* Minow, *supra* note 24, at 1249.

258. It is also important to note that while this discussion has generally focused on mechanisms for enhancing efficiency while providing an alternative way to think about promoting accountability, the discussion has assumed as a baseline that *government* fealty to public law norms can be assumed. Particularly in the social welfare context, elected officials in different administrations, at least at the federal level, may take different views of the value of certain public goals. That can raise a type of mismatch not generally considered above, where the private provider is taking what might be considered a more public-oriented view than the government.

Indeed, with for-profit private partners, recognizing that the profit motive is central to the private party's goals may lead to mechanisms that harness that profit motive for public gain. The government could build on the kinds of feedback mechanisms currently in place to create incentives for repeat players to undertake the myriad daily operational decisions that make up service provision in a way that demonstrates, in the long run, commitment to the public goals at issue.

Another response can be found in the selection and screening mechanisms that governments employ to decide with whom to enter into the kinds of long-term collaborations at issue. Mission-driven nonprofit entities, for example, may have distinct advantages in this regard over for-profit entities, although even within the for-profit sector there are entities that are likely to be more appropriate long-term partners. Laura Dickinson has argued in this vein that third-party accreditation can provide an effective tool to enhance norms of accountability internal to a given industry.[259] A similar mechanism in the housing privatization context—an industry set of clear best practices for the development and operation of affordable housing, with an accompanying accreditation mechanism—could provide a tool through which the government could filter participation.[260]

4. *Resource Constraints*

Finally, it could be argued that a relational approach would require government entities to devote more of their extremely limited resources to managing relationships outside of a framework of standardized contractual control.[261] With limited staff and significant portfolios to monitor, it might be better to focus on standard forms and audit triggers that ease administration and reduce transaction costs compared to more flexible mutual engagement.[262]

A relational approach, however, need not necessarily entail greater public costs. It is at least plausible that the expenditure of resources to create structures of governance that incentivize private providers to pursue public goals would be less expensive in the long run. This is an empirical question

259. *See* Dickinson, *supra* note 11, at 175-76. I thank Laura Dickinson for this suggestion.

260. The longer the relationship to which the government is committing, the more important is the selection of the contracting partner in the first place.

261. *Cf.* Verkuil, *supra* note 12, at 439 (discussing concerns with the capacity of governmental entities to ensure that their contracts are properly enforced).

262. In this view, to husband scarce resources, agencies that subsidize housing should essentially be reactive. After setting up the initial conditions under which private providers are to operate, agencies should intervene only to correct material deviations from such conditions. However, given the likelihood that the management of a typical private housing project will require government approval or consent (for issues such as changes in management agencies, distributions, dispositions, and many other turning points in the life-cycle of the asset), *see supra* text accompanying notes 147-148, agencies already interact on a fairly active basis with the projects they oversee. The question is how to approach that interaction.

beyond the scope of this Article, but the long-term, intertwined nature of the public-private relationship suggests that any structure successfully aligning interests rather than imposing requirements at least carries the potential for reducing costs.[263]

CONCLUSION

Privatization has become a permanent public policy fixture. The practice is only going to accelerate, as governments at all levels stretch increasingly thin resources to meet vital public needs. It is thus imperative to explore how to make the promise of privatization real while mitigating the potential risk to public values. Given the limits of contractual specificity and enforcement in long-term, complex public-private partnerships, shifting to a collaborative model that privileges mutual responsibility is well worth exploring. If enlisting the creativity and experience of private providers to solve problems in the implementation of social welfare policy can enhance the capacity of government entities to provide critical services, then the kinds of incipient relational norms evident in subsidized housing deserve greater recognition.

This is not to say that embracing a relational model requires unilateral disarmament on the part of the government. Government entities must retain critical enforcement authority, and private providers will always operate in a web of accountability mechanisms. But government entities can craft and manage agreements that enhance the positive role that private providers can play as long-term partners. A more balanced approach would foster reciprocal commitment on the part of private providers to promote public ends.

Context, of course, is critical. This Article has focused on one set of housing programs, representing one approach to privatization, and a particular set of normative and practical conditions. No doubt some of the relational aspects of the agreements examined in this Article are unique to this area of

263. Beyond the structural and other barriers to embracing a relational contracting model, there is an independent set of concerns that might arise in terms of the risk to the private sector of ever-increasing public involvement. This concern is often for nonprofit entities that, by this account, have to mold their structure and goals to meet governmental expectations, warping the independence of the private provider and diminishing the social capital that such independence brings. *See, e.g.*, Frumkin, *supra* note 3, at 198.

This is far from a trivial concern. Shifting from a discrete-contract paradigm, with its emphasis on contractual specificity and focus on government remedial control, to a relational contract paradigm that seeks to inculcate public values on the part of the private party may actually preserve more independence for those entities that choose to enter into public-private partnerships. While the goal of a relational contract perspective is to align incentives and reinforce the private parties' fidelity to public goals, the *means* through which public goals can be reached would be left to a greater extent to the private side of partnership. For entities that choose to provide governmental services, retaining a relatively greater scope of operational control may shore up independence. In other words, many of the more onerous oversight provisions that raise concerns about co-opting the private sector spring from the fear of a mismatch between public and private goals. The greater the potential disconnect, the more control the government seeks to assert. If alternative means of creating incentives for private parties to achieve public goals were brought to the fore, independence could be enhanced.

policy and the market in which it operates. But given the practical challenges that contractual control poses and the long-term nature of many public-private partnerships, it is well worth examining—and, with appropriate caution, embracing—the relational features that might be found in government's engagement with the private sector.