

1-2024

## The Professional Employer Organization Regulatory Regime

Ursula Ramsey

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### Recommended Citation

Ursula Ramsey, *The Professional Employer Organization Regulatory Regime*, 20 Hastings Bus. L.J. 95 (2024).

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# THE PROFESSIONAL EMPLOYER ORGANIZATION REGULATORY REGIME

*Ursula Ramsey\**

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## INTRODUCTION

Employment taxes constitute over thirty percent of the revenue collected by the Internal Revenue Service (“IRS”).<sup>1</sup> For fiscal year 2022, the IRS’s employment tax collections totaled over 1.3 billion dollars.<sup>2</sup> Over the past few decades, a new industry has emerged that provides payroll, human resources,

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1. INTERNAL REVENUE SERVICE, 2022 INTERNAL REVENUE SERVICE DATA BOOK 3 (2023) (“For fiscal year 2022, employment taxes represented 31.7 percent of net collections”).

2. *Id.* (“For fiscal year 2022, net collections totaled \$1,349,938,254”).

and employment tax services to its small to mid-sized business clients.to its small to mid-sized business clients payroll, human resources, and employment tax services.<sup>3</sup> On behalf of business clients, these professional employer organizations (“PEOs”) remit the employment taxes associated with 216 billion dollars in worksite employee wages.<sup>4</sup> This number represents the wages of four million worksite employees.<sup>5</sup> Though there are 487 PEOs operating in the United States with over 170,000 client companies,<sup>6</sup> the industry has received little scholarly study.<sup>7</sup> Beyond the government’s interest in the efficient collection of employment taxes, regulation in the PEO industry warrants attention to ensure that those 170,000 small businesses receive the services for which they contract. Additionally, regulation in the industry warrants attention to ensure that those four million workers receive the protections to which they are entitled by law.<sup>8</sup>

At present, the PEO industry is regulated by a mix of state licensure and regulation, voluntary membership in private industry organizations, and the IRS’s voluntary certification program.<sup>9</sup> This article is about the effectiveness of the current PEO regulatory regime. It argues that the current regime fails to achieve its potential and uses new governance theory to propose changes to enhance the effectiveness of modern PEO regulation. Part I explains the PEO model and incorporates case law to illustrate the relationship between a PEO, its client company, and workers. Part II traces the development of both the PEO industry and its regulatory regime. In Part III, the article provides an overview of new governance theory. From there, Part IV applies new governance principles to five illustrations from the current PEO regulatory regime to highlight opportunities for improved governance.

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3. *Industry Statistics*, NAPEO, <https://www.napeo.org/what-is-a-peo/about-the-peo-industry/industry-statistics> (last visited Aug. 17, 2023).

4. *Id.*

5. *Id.*

6. *Id.*; see also Laurie Bassi & Dan McMurrer, *An Economic Analysis: The PEO Industry Footprint*, NAPEO (Sept. 2015), at 2 [https://www.napeo.org/docs/default-source/white-papers/napeo-white-paper-3-sept-2015-final0daf50ac2ab0647c9e4ff00004fd204.pdf?sfvrsn=2d1e34d4\\_2](https://www.napeo.org/docs/default-source/white-papers/napeo-white-paper-3-sept-2015-final0daf50ac2ab0647c9e4ff00004fd204.pdf?sfvrsn=2d1e34d4_2) (noting that there is some difficulty in determining the exact size of the PEO industry due to the way that different sources, such as the U.S. Bureau of Labor Statistics, define PEOs).

7. See, e.g., H. Lane Dennard, Jr. & Herbert R. Northrup, *Leased Employment: Character, Numbers, and Labor Law Problems*, 28 GA. L. REV. 683 (1994); Britton Lombardi & Yukako Ono, *Professional Employer Organizations: What are they, who uses them, and why should we care?*, ECONOMIC PERSPECTIVES, Nov. 2, 2008, at 2; Natalya Shmitser, *“Professional” Employers and the Transformation of Workplace Benefits*, 39 YALE J. ON REG. BULL. 99, 106 (2021).

8. NAPEO, *Industry Statistics*, *supra* note 4.

9. *Guidelines for Choosing a PEO*, NAPEO, <https://www.napeo.org/what-is-a-peo/selecting-a-peo/guidelines-for-choosing-a-peo> (last visited Oct. 11, 2023).

## I. AN OVERVIEW OF THE RELATIONSHIP BETWEEN PROFESSIONAL EMPLOYER ORGANIZATIONS, WORKERS, AND CLIENT COMPANIES

PEOs are companies that provide human resources, payroll, and employment tax services to small businesses.<sup>10</sup> PEOs pitch their services as a way for a small business to focus on its core business while, in turn, allowing the PEO to focus on its core business: issuing payroll; remitting employment tax payments; administering employee benefits; administering workers' compensation; recruiting, hiring, and onboarding workers; and, in general, maintaining compliance with employment laws.<sup>11</sup> Thus, PEOs submit that a client company can either maintain a barebones human resources infrastructure or eliminate completely its in-house human resources infrastructure and rely solely on its PEO.<sup>12</sup>

A small business and its PEO structure their relationship via a client service agreement.<sup>13</sup> That agreement will specify how the small business and the PEO will delineate the employer's responsibilities and liabilities over the small business's workers.<sup>14</sup> Within the industry, this relationship structure between the PEO and its client company is termed "co-employment" and reflects that both the PEO and the client company fulfill some aspect of the employer role.<sup>15</sup> While the co-employment concept may pass muster for PEOs administering benefits on behalf of workers, the IRS has a decidedly dubious view of the concept of co-employment in the context of employment tax withholding and payment.<sup>16</sup> Instead of a co-employer, the IRS views a PEO, generally, as a third-party payer to whom payroll and employment tax duties are outsourced by the client company. However, in the IRS's view, the client company, with limited exception such as those PEOs who have achieved IRS certification via its CPEO program, bears sole responsibility for paying taxes on behalf of its workers as their common law employer.<sup>17</sup>

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10. *Selecting a PEO*, NAPEO, <https://www.napeo.org/what-is-a-peo/selecting-a-peo> (last visited Aug. 17, 2023) [hereinafter NAPEO, *Selecting a PEO*]. NAPEO, the industry association for the PEO industry, reports that, for those PEOs who are NAPEO members, the average client company has nineteen employees. *Id.* Further, NAPEO reports that companies utilizing the services of a PEO include accounting firms, small manufacturers, doctors, mechanics, and retailers. *Id.*

11. *Id.*; *What is a PEO? What are Its Advantages and Disadvantages?*, SOC'Y FOR HUM. RES. MGMT., <https://www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/whatisapeoanditsadvantagesanddisadvantages.aspx> (last visited Aug. 17, 2023).

12. NAPEO, *Selecting a PEO*, *supra* note 10.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Third Party Payer Arrangements - Professional Employer Organizations*, IRS (Dec. 13, 2022), <https://www.irs.gov/government-entities/third-party-payer-arrangements-professional-employer-organizations>; NAPEO, *Selecting a PEO*, *supra* note 10; *But see About the Voluntary Certification Program for Professional Employer Organizations (CPEOs)*, IRS (Sept. 29, 2023), [www.irs.gov/tax-professionals/about-certified-professional-employer-organization](https://www.irs.gov/tax-professionals/about-certified-professional-employer-organization) (describing the IRS's voluntary certified professional employer organization program). For detailed analysis of the IRS's CPEO program, see Katherine S. Goodner & Ursula Ramsey, *Certified Professional Employer Organizations and Tax Liability Shifting: Assessing the First Two Years of the IRS Certification Program*, 16 BERKELEY BUS. L.J. 571 (2019).

17. IRS, *supra* note 16.

A review of some recent court decisions concerning PEOs can help to provide context for the relationship between a PEO, its client company, and the workers who are co-employed by the PEO and the client company. Furthermore, the following cases highlight the trust that is placed in the PEO by the client company and demonstrate why a well-functioning and well-regulated relationship between the PEO, its client company, and workers can benefit both small businesses and their workers.

In *People v. Gaspar*, a California appellate court considered an appeal in a criminal case in which a jury convicted a PEO owner and manager of one count of conducting an unlawful insurance business transaction.<sup>18</sup> The underlying facts describe a typical PEO that managed its clients' payroll, remitted taxes on behalf of its clients, and, central to the case, obtained workers' compensation insurance for its clients.<sup>19</sup> Notably, the court specifically included three times in its opinion names of the small business owners whose companies were clients of the PEO: the clients included a transportation business owned by Sandra Ward; a décor business owned by Marguerite Scomazzon; a family horse ranch owned by Mary Hilvers; and several staffing companies owned separately by Carlos Gutierrez, Alvaro Ayala, and Beatriz Campos.<sup>20</sup> This helps to provide some picture of who might contract for the services of a PEO. The issue giving rise to the case centered on the invalidity of the workers' compensation insurance certificates provided to the client companies.<sup>21</sup> In this case, the prosecution focused on an injury to one particular worker for one of the PEO's client companies.<sup>22</sup> While the PEO approved surgery and temporary disability payments for the injured worker Linda Wiseheart, Ms. Wiseheart's medical bills were not paid and she did not receive workers' compensation.<sup>23</sup> The opinion notes that "[a]lthough a representative from [the PEO] repeatedly insisted the situation would be resolved, it never was."<sup>24</sup> Instead, an 80-count information charged the PEO's owner with the following offenses: three counts of workers' compensation fraud, 69 counts of forgery, seven counts of grand theft, and one count of engaging in an unlawful insurance business transaction.<sup>25</sup> Notably, the information alleged that the PEO owner "took, damaged, and destroyed property of a value exceeding \$3.2 million."<sup>26</sup>

The PEO owner's first criminal trial resulted in a mistrial after the jury could not reach a verdict.<sup>27</sup> In the second trial, the jury heard evidence that the PEO used an insurance broker to obtain workers' compensation coverage for

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18. *People v. Gaspar*, No. B316236, 2023 WL 2365339, at \*1 (Cal. Ct. App. Mar. 6, 2023).

19. *Id.* at \*3.

20. *Id.* at \*3, \*14, n.9.

21. *Id.* at \*5.

22. *Id.* at \*4-5.

23. *Id.*

24. *Id.*

25. *Id.* at \*1.

26. *Id.*

27. *Id.*

the PEO's client companies.<sup>28</sup> As the State and the PEO owner agreed, this insurance was invalid.<sup>29</sup> At trial, the defense called a forensic analyst to testify that the PEO had, in fact, paid to the insurance broker over two million dollars for its clients' workers' compensation premiums.<sup>30</sup> That forensic analyst testified that the insurance broker then sent to the PEO falsified bank records; thus, as the PEO owner testified, she believed that the clients had workers' compensation coverage when, in fact, they did not.<sup>31</sup> The appellate court noted that the second "jury evidently believed Gaspar, acquitting her of allegations that she had forged the certificates, knowingly perpetrated fraud, and stolen from the named businesses."<sup>32</sup> Instead, the jury convicted her of only one count of conducting an unlawful insurance business transaction without a license.<sup>33</sup> Because the PEO owner was not licensed to engage in workers' compensation insurance transactions, she could not administer claims such as Ms. Wiseheart's.<sup>34</sup>

The trial court ordered the PEO owner to pay restitution in the amount of \$2,825,414, reflecting payments to Sergio Noches, Alvaro Ayala, Mary Hilvers, Marguerite Scomazzon, Carlos Gutierrez, Saundra Ward, and Beatriz Campos, owners of the PEO's client companies.<sup>35</sup> In addition, because it found the victims "particularly vulnerable," the trial court denied probation and sentenced the PEO owner "to an upper term of three years in the county jail, suspended execution of sentence, gave her credit for time served, and placed her on mandatory supervision for the remaining 103 weeks of her term."<sup>36</sup> The trial court explained its reasoning for imposing the upper term, noting "the manner in which the crime was carried out indicated planning, sophistication, and professionalism; the crime involved a large monetary loss to the victim and the defendant took advantage of the trust and confidence of the victims to commit the crime."<sup>37</sup>

On appeal, the PEO owner argued, among other arguments, she should be resentenced due to California laws passed after her original sentencing.<sup>38</sup> The court agreed.<sup>39</sup> The PEO owner also argued the amount of restitution ordered by the trial court was improper because it was restitution for alleged crimes for which she had been acquitted.<sup>40</sup> Specifically, she claimed, at most, she should pay \$20,000 as restitution, reflecting the deductibles paid out by

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28. *Id.* at \*2.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at \*6.

33. *Id.* at \*1.

34. *Id.* at \*2.

35. *Id.* at \*6, \*6 n.9.

36. *Id.* at \*6.

37. *Id.* at \*8.

38. *Id.* at \*1.

39. *Id.*

40. *Id.*

the client companies.<sup>41</sup> The prosecution's argument for \$2,825,114 as restitution reflected workers' compensation insurance premiums paid by the client companies to the PEO, as well as losses to the client companies due to unpaid medical bills, salaries, and legal fees resulting from the lack of workers' compensation coverage.<sup>42</sup> The court agreed with the PEO owner that the trial court had ordered her to pay restitution for crimes of which the jury had acquitted her and ordered her restitution vacated.<sup>43</sup>

Although the appellate court vacated the trial court's order for restitution, the trial court's assessment that the victims – the small businesses – were “particularly vulnerable” is important for understanding the expertise for which the small business client contracts with its PEO.<sup>44</sup> And, to that point, the trial court's opinion specifically highlighted the trust and confidence placed by the clients in the PEO.<sup>45</sup>

The facts of a 2023 Florida case, *Libardi v. Pavimento, Inc.*, also describe the trust that a client company places in its PEO.<sup>46</sup> In that case, the facts describe the termination of an employee by a PEO and its client company after the employee lost a leg in a car accident.<sup>47</sup> According to the facts, Tara Libardi, the employee, worked at Pavimento, Inc. (the “client company”) on assignment from Encore Peo, Inc. (the “PEO”), at the time of the automobile accident.<sup>48</sup> As a result of her injuries and loss of her leg, Ms. Libardi was away from work for a month.<sup>49</sup> Upon her return to work, she used a wheelchair.<sup>50</sup> However, the facts describe that the client company terminated her employment only one or two days after she returned to work.<sup>51</sup> After her termination from the client company, Ms. Libardi received a letter from the PEO stating that she, likewise, was no longer an employee of the PEO.<sup>52</sup> The PEO's letter explained that Ms. Libardi had seventy-two hours from receipt of the letter in which to contact the PEO for reassignment to a different job.<sup>53</sup> Although Ms. Libardi complied with the instructions and reached out to the PEO, “she was told that she could not be placed anywhere because of her disability and that [the PEO] had no potential referral that could accommodate her wheelchair.”<sup>54</sup> The PEO's vice president testified that the PEO attempted to find a role for Ms. Libardi at the PEO itself without

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41. *Id.* at \*6.

42. *Id.*

43. *Id.* at \*6, \*8.

44. *Id.*

45. *Id.* at \*8.

46. *Libardi v. Pavimento, Inc.*, 362 So. 3d 296 (Fla. Dist. Ct. App. 2023).

47. *Id.* at 297-99.

48. *Id.* at 297-98.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.* at 300.

success.<sup>55</sup> Due to her termination, Ms. Libardi sued the PEO and the client company under the Americans with Disabilities Act and the Florida Civil Rights Act.<sup>56</sup>

The circuit court granted summary judgment in favor of the PEO, stating the PEO was not Ms. Libardi's employer.<sup>57</sup> Instead, the circuit court reasoned that the PEO simply signed paychecks without any additional control of her employment, and, furthermore, only learned of Ms. Libardi's leg amputation after the client company terminated her employment.<sup>58</sup> As the appellate court noted, however, this basis "was directly contrary" to the evidence in the record and reversed the grant of summary judgment.<sup>59</sup> Whether the PEO is liable turns on the level of control that the PEO had over Ms. Libardi's employment; in this case, the court found that a question of fact existed on that point.<sup>60</sup>

To that question, the court provided some additional context. In a deposition, the owner of the client company explained that the PEO helped to hire all of its workers and, in fact, "testified that [the PEO] was [the client company's] human resources department."<sup>61</sup> To punctuate that point, the client company's owner's deposition testimony provided that "[h]e could think of no instance in which [the client company] did not follow [the PEO's] guidance regarding compliance with employment laws."<sup>62</sup> Regarding Ms. Libardi's circumstances, the owner testified that he consulted an account manager at the PEO before she returned to work and before terminating her employment.<sup>63</sup> A PEO vice president disputed the latter assertion.<sup>64</sup>

Regardless of the ultimate resolution of the question of fact, the client company's owner's deposition testimony emphasizes just how important of a partner the PEO is to its client company. As the client company owner stated, the PEO functioned as the company's human resources department.<sup>65</sup> As such, the client company's owner testified under oath that the company unwaveringly followed the PEO's guidance regarding employment law compliance.<sup>66</sup> Again, the client company places a great deal of trust in its PEO. Ensuring, then, that PEOs are well-regulated benefits these small businesses who rely on a PEO's services. Beyond that, however, as both cases show, a PEO's actions directly impact the client company's workers. For that reason, responsible regulation of PEOs is essential.

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55. *Id.*

56. *Id.* at 298.

57. *Id.*

58. *Id.*

59. *Id.* at 300.

60. *Id.* at 298, 300.

61. *Id.* at 299.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*



## II. THE DEVELOPMENT OF THE PEO REGULATORY REGIME

At the outset, it is helpful to trace the development of the modern PEO regulatory regime to determine the forces that have motivated its development. Specifically, this part highlights efforts within the industry to self-regulate. To put the current PEO regulatory environment into context, it is helpful, likewise, to trace a brief history of the industry's development. While the employee leasing industry, the precursor to the modern PEO industry, existed prior to the 1970s, the industry functioned, at that time, largely as a means of taking advantage of certain tax benefits related to pension planning.<sup>67</sup> In essence, to receive the favorable tax treatment related to pension plans, the law required that the employer treat its employees comparably, regardless of the employees' level of compensation or status as an officer.<sup>68</sup> Employee leasing provided a workaround.<sup>69</sup> In the historic iteration of an employee leasing model (an iteration that has since evolved), a client company would terminate its employees, and the employee leasing company immediately hired the workers en masse.<sup>70</sup> From those origins, businesses began to see that employee leasing had benefits beyond just creating separate pension plans.<sup>71</sup>

By the mid-1980s, the United States had approximately 200 PEOs.<sup>72</sup> As the industry gained its footing, it did so in an environment in which few controls existed.<sup>73</sup> The lack of regulation resulted in a few unscrupulous PEOs failing to capitalize their businesses adequately, fund clients' benefit plans, or remit tax payments on behalf of their clients.<sup>74</sup> In response, other industry

67. Sheldon S. Cohen, *Employee Leasing: Industry in a Time of Change*, 20 FORUM 657, 657 (1984); see also FAQs, NAPEO, <https://www.napeo.org/what-is-a-peo/selecting-a-peo/faqs> (last visited Jan. 4, 2023) (explaining the difference between the employee leasing and PEO model because some states statutes continue to use the term "employee leasing" instead of "professional employer organization").

68. Cohen, *supra* note 67, at 657-58.

69. *Id.* at 658.

70. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, GUIDELINES 1950: GUIDELINES FOR REGULATIONS AND LEGISLATION ON WORKERS' COMPENSATION COVERAGE FOR PROFESSIONAL EMPLOYER ORGANIZATIONS ARRANGEMENTS (2010), <https://naic.soutrounglobal.net/Portal/Public/en-US/RecordView/Index/25382> [hereinafter NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, GUIDELINE 1950].

71. Goodner & Ramsey, *supra* note 16, at 576-77; see also Eric Gelman & Richard Sandza, NEWSWEEK, May 14, 1984, at 55 (describing the general manager of a Texas employee leasing company's "estimate[e] that only 15 percent of his clients are motivated by the desire to skirt pension regulations.").

72. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, REPORT ON EMPLOYEE LEASING AND PROFESSIONAL EMPLOYER ORGANIZATIONS (2003), <https://naic.soutrounglobal.net/Portal/Public/en-US/RecordView/Index/6998> [hereinafter NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS].

73. Louis Basso, *Why the IRS' Voluntary Certification Program for Professional Employer Organizations Matters*, THE TJB AM. BUS. MAG. (Apr. 16, 2018), <https://www.americanbusinessmag.com/2018/04/why-the-irs-voluntary-certification-program-for-professional-employer-organizations-matters/>.

74. Michael J. Album & Philip M. Berkowitz, *Industry Model for Professional Employer Organizations - New NY Law Outlines Responsibilities for PEOs and Their Clients*, 30 EMP. REL. TODAY 65, 65 (2003); see *The History of the Florida Association of Professional Employer Organizations*, FAPEO, [www.fapeo.org/history/](http://www.fapeo.org/history/) (last visited May 12, 2023); see also Louis Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, 79 N.Y. ST. B.J. 42, 43 (2007) [hereinafter Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*].

members felt the industry needed regulation to address and prevent these abuses.<sup>75</sup> Furthermore, the industry sought regulation because that would lend credibility to entice investors.<sup>76</sup>

In addition, the industry sought regulation because being proactive would allow the industry to have more of a say regarding how regulation took place (for instance, whether a Department of Insurance was the proper entity to regulate the PEO industry or whether another regulatory entity could be more preferable).<sup>77</sup> Thus, a great deal of the impetus for regulating the PEO industry came from within the industry.<sup>78</sup> This desire for regulation is a theme still seen today within the PEO industry.

To trace the beginnings of self-regulation within the PEO industry is largely to trace the beginnings of regulation in the Florida PEO industry.<sup>79</sup> Early PEO industry leaders in Florida formed the non-profit Florida Association of Employee Leasing in 1986, which later became the Florida Employee Leasing Association in 1990.<sup>80</sup> Industry leaders in Florida decided that the best path forward for the industry was to pursue state licensure.<sup>81</sup> In 1991, Florida became the first state to license PEOs and served as a model for other states.<sup>82</sup> In 1993, the Texas legislature followed suit and passed the Texas PEO Act.<sup>83</sup> The 1990s witnessed significant growth of the PEO industry: the industry grew 386% from 1992 to 2002.<sup>84</sup> In the early 1990s, the industry also rebranded by

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75. See *The History of the Florida Association of Professional Employer Organizations*, FAPEO, [www.fapeo.org/history/](http://www.fapeo.org/history/) (last visited May 12, 2023).

76. *Id.*

77. *Id.* See NORTH DAKOTA LEGISLATIVE COUNCIL, REPORT OF THE NORTH DAKOTA LEGISLATIVE COUNCIL 252 (2007) (PEOs have been regulated by insurance departments, as well as “labor departments, regulatory and licensing departments, workers’ compensation agencies, commerce departments, and secretaries of state.”); see also *supra* note 74, at 65-66 (In 1999, NAPEO launched its Millennium Project as an effort to encourage a more uniform approach to state legislation. Album & Berkowitz); see also NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, GUIDELINE 1950, *supra* note 70, at 3 (In particular, especially in the earlier years of the employee leasing industry, insurance regulators had an interest in bringing the employee leasing industry under its umbrella because of the impact that employee leasing had on the experience rating system. At that time, some employee leasing companies would argue that their workers’ compensation premiums should not reflect any accidents that occurred when their employees worked as employees for client companies (before the employee leasing company and client company entered into a business relationship). Insurance regulators did not agree with that interpretation. Another concern for insurance regulators at the time was that some employee leasing companies told client companies that they were covered under a workers’ compensation policy, but they simply were not).

78. See Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, *supra* note 74, at 43.

79. FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75 (noting that the organization became known as the Florida Association of Professional Employer Organizations in 1995).

80. *Id.*

81. *Id.*

82. *Id.*

83. Garry Bradford, *Testimony on behalf of NAPEO* (Dec. 7, 2020), [https://www.sunset.texas.gov/public/uploads/Bradford\\_G\\_NAPEO\\_12-21-20.pdf](https://www.sunset.texas.gov/public/uploads/Bradford_G_NAPEO_12-21-20.pdf) [hereinafter Garry Bradford Letter].

84. Lombardi & Ono, *supra* note 7, at 2.

distancing itself from the term “employee leasing” and transitioning to the term “professional employer organization.”<sup>85</sup> Correspondingly, the industry’s national trade association changed its name from the National Staff Leasing Association to the National Association of Professional Employer Organizations (“NAPEO”).<sup>86</sup> By the mid-1990s, the PEO industry was more firmly established.<sup>87</sup>

From there, at the state level, the PEO industry continued to push for its preferred regulatory model.<sup>88</sup> For instance, in 1999, the industry trade association NAPEO began pursuing its Millennium Project to promote state law uniformity.<sup>89</sup> At the federal level, a key legislative development occurred in 2014 with the enactment of the Tax Increase Prevention Act of 2014.<sup>90</sup> This legislation called for the development by the IRS of a voluntary certification program for professional employer organizations (the “CPEO Program”).<sup>91</sup>

### III. AN OVERVIEW OF NEW GOVERNANCE THEORY

In this section, the goal is to provide a high-level, orienting view of new governance theory before presenting specific illustrations of how new governance theory could inform aspects of the PEO regulatory regime. To provide some context for the new governance model, it helps to have some understanding first of the New Deal regulatory model, a model to which new governance is, at least to some extent, a reaction. The New Deal model championed centralization.<sup>92</sup> With the backdrop of the Great Depression and two world wars, the New Deal era witnessed a boom in the creation of regulatory agencies.<sup>93</sup> The mindset was that a national crisis needed a response at the national level.<sup>94</sup> To provide that response, the New Deal model championed experts: “[t]he central proposition of the New Deal regulatory model was that a few well-educated, specially trained, and publicly appointed professionals could make the best decisions about national policies.”<sup>95</sup> Because of the confidence placed in these experts, the New Deal model did not champion participation in governance by industry (as that could bring the taint

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85. Ted N. Kazaglis, Managing Principal Jackson Lewis P.C., Expert Q&A on Impact of New Federal PEO Legislation, *in* PRACTICAL LAW LABOR AND EMPLOYMENT, Feb. 2015, [https://content.next.westlaw.com/7-600-4201?\\_lrTS=20201212020106767&transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://content.next.westlaw.com/7-600-4201?_lrTS=20201212020106767&transitionType=Default&contextData=(sc.Default)&firstPage=true).

86. FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75.

87. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, *supra* note 72, at 5.

88. Album & Berkowitz, *supra* note 74, at 66.

89. *Id.*; Louis Basso & Barry Shorten, *PEO Industry’s Growing Voice Advances New Regulations and Guidelines*, ACCOUNTING TODAY, July 8, 2013.

90. IRS, *Voluntary Certification Program for Professional Employer Organizations (CPEOs)*, <https://www.irs.gov/tax-professionals/certified-professional-employer-organization> (last visited Jan. 1, 2023).

91. *Id.*

92. Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 381 (2004) [hereinafter Lobel, *The Renew Deal*].

93. *Id.* at 351-52.

94. *See id.* at 381.

95. *Id.* at 371.

of self-interest).<sup>96</sup> Instead, citizens, industry, or trade associations had as their recourse the right to contest the agency's policy through the administrative process or through the courts; however, the New Deal model did not invite participation by these stakeholders in crafting regulation.<sup>97</sup>

The new governance model takes a markedly different approach: a hallmark of the new governance model is decentralized, cooperative governance.<sup>98</sup> In a 1996 article by R.A.W. Rhodes, the first article to reference the term "new governance,"<sup>99</sup> Rhodes set the tone for the new model, providing a definition of governance as "self-organizing, interorganizational networks."<sup>100</sup> A change had arrived. Then, in 2004, Orly Lobel presented a fully fleshed-out model of new governance.<sup>101</sup> In reviewing from there scholars' attempts to define concisely the concept of new governance, one scholar described that the common formula explained the model as a type of regulation followed by a list of attributes.<sup>102</sup> As those adjectives recur throughout the new governance literature, however, those adjectives are again presented here: new governance is decentralized, participatory, collaborative, and experimental.<sup>103</sup>

As opposed to the New Deal model's top-down flow, the New Governance model is participatory.<sup>104</sup> Those private actors participating in governance include industry associations, nonprofits, private standard-setting bodies, public interest organizations, and individual firms.<sup>105</sup> The methods by which these private actors participate in governance include legislative functions such as standard-setting and negotiated rulemaking as well as adjudicative roles such as accreditation, audited self-regulation, and disclosure practices.<sup>106</sup> Thus, as opposed to the New Deal model's top-down flow, the new governance model is decentralized.<sup>107</sup> However, new governance

96. *Id.* at 373.

97. Douglas Nejaime, *When New Governance Fails*, 70 OHIO ST. L.J. 323, 331 (2009).

98. Lobel, *The Renew Deal*, *supra* note 92, at 377.

99. Karen Bradshaw Schulz, *New Governance and Industry Culture*, 88 NOTRE DAME L. REV. 2515, 2516 n.6 (2013).

100. R.A.W. Rhodes, *The New Governance: Governing without Government*, 44 POL. STUD. 652, 660 (1996).

101. Lobel, *The Renew Deal*, *supra* note 92; *see also* Bradley C. Karkkainen, "New Governance" in *Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping*, 89 MINN. L. REV. 471, 472 (2004) (refining Lobel's word choice of "governance model" and "Renew Deal" by suggesting use of the term "New Governance" instead).

102. Jason M. Solomon, *New Governance, Preemptive Self-Regulation, and the Blurring of Boundaries in Regulatory Theory and Practice*, 2010 WIS. L. REV. 591, 594 (2010).

103. Lobel, *The Renew Deal*, *supra* note 92, at 382.

104. Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 547 (2000) [hereinafter Freeman, *The Private Role in Public Governance*].

105. *Id.*; Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L.J. 1, 59 (2008).

106. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 547; Lobel, *The Renew Deal*, *supra* note 92, at 345, 374-75; *see also* Catherine E. Rudder, *Private Governance as Public Policy: A Paradigmatic Shift*, 70 THE J. OF POL. 899, 906 n.38 (2008) (noting that the nomenclature's lack standardization).

107. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 548, 571.

maintains a role for the government actor.<sup>108</sup> In a new governance model, the government actor functions as facilitator, pooling and communicating information from industry to then allow for peer learning and development by industry actors of industry norms.<sup>109</sup> While the government actor may set policy guidelines and goals,<sup>110</sup> the benefit of this stakeholder participation is that regulation is crafted with those who have the greatest depth of knowledge of the problem, any potential solutions, and any impacts those solutions may have on the industry or on consumers.<sup>111</sup> While some might argue that industry could be self-serving when it comes to self-regulation,<sup>112</sup> the role of the government actor in the new governance model (the “backdrop of the state,”<sup>113</sup> as some scholars have described it) is to help facilitate the promotion of best practices within the industry.<sup>114</sup> Though the industry may develop norms and standards from within, the government actor’s presence serves as a ballast.

#### IV. OPPORTUNITIES FOR NEW GOVERNANCE TO INFLUENCE THE PEO REGULATORY REGIME

##### A. *Illustration: The State of Florida’s Board of Employee Leasing Companies*

The first illustration by which to use new governance theory to inform the regulatory construct comes from the State of Florida’s regulation of PEOs. As some context, in Fiscal Year 2018-2019, Florida PEOs co-employed over 570,000 workers.<sup>115</sup> For that same year, Florida PEOs handled 24.6 billion dollars in employee wages.<sup>116</sup> The Florida PEO industry is a sizable industry requiring an effective regulatory regime. To provide regulation, the State of Florida tasks the Department of Business and Professional Regulation with licensing and regulating Florida PEOs.<sup>117</sup> The Board of Employee Leasing Companies sits under the umbrella of the Department of Business and

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108. Ford, *supra* note 105, at 30-31; Lobel, *The Renew Deal*, *supra* note 92, at 377, 400; Nejaime, *supra* note 97, at 334.

109. *Id.*

110. Ford, *supra* note 105, at 27-28.

111. *Id.*; Freeman, *The Private Role in Public Governance*, *supra* note 104, at 641.

112. John Braithwaite, *Responsive Business Regulatory Institutions*, in BUS., ETHICS & THE L. 83, 83 (C.A.J. Coady & C.J.G. Sampford eds., 1993).

113. Schulz, *supra* note 99, at 2515.

114. Ford, *supra* note 105, at 41.

115. OFFICE OF PROGRAM POL’Y ANALYSIS & GOV’T ACCOUNTABILITY, REP. NO. 21-04, REVIEW OF PROFESSIONAL EMPLOYER ORGANIZATIONS AND WORKERS’ COMPENSATION 7 (Fl. 2021), <https://oppaga.fl.gov/Documents/Reports/21-04.pdf>. This report notes that, as of March 2020, 760 PEOs operated in Florida. *Id.* This number differs from the total count of 487 PEOs operating in the United States that industry trade association NAPEO reported. LAURIE BASSI & DAN MCMURRER, THE PEO INDUSTRY FOOTPRINT 2021 8 (2021). Likely, this difference is caused by the Florida government agency counting related entities as separate PEOs in its tally. *Id.* In NAPEO’s tally, PEOs that are related entities are counted only as one PEO. *Id.*

116. OFFICE OF PROGRAM POL’Y ANALYSIS & GOV’T ACCOUNTABILITY, *supra* note 115, at 7.

117. *Id.* at 3.

Professional Regulation.<sup>118</sup> The Florida Governor appoints and the Florida Senate confirms the Board's seven members for four-year terms.<sup>119</sup>

Florida's state statutes specify the Board's composition.<sup>120</sup> Five board members must be licensed members of Florida's employee leasing industry.<sup>121</sup> The statute further specifies that one of those five members must represent a small PEO, specifically providing that "[o]ne of the licensed members must be in an employee leasing company that has an annual gross Florida payroll for its leased employees which is among the smallest 20 percent of licensed employee leasing companies in the state...."<sup>122</sup> The statute also provides that two board members must be Florida residents with no connection (current or former) to the PEO industry.<sup>123</sup>

On its face, the structure of the Florida Board of Employee Leasing Companies would seem to exemplify public-private governance. Participation is a core new governance principle.<sup>124</sup> And, increased participation encourages a broader range of perspectives at the governing table.<sup>125</sup> In the governance of Florida PEOs, the Florida state statutes call for the perspective of industry members, including those representing large and small PEOs, as well as the perspective of industry outsiders.<sup>126</sup> The Board's composition allows for the benefit of industry insiders' deep knowledge (a benefit acknowledged by new governance scholars that a purely public actor may not have),<sup>127</sup> but also promotes accountability by balancing the industry perspective with that of two industry outsiders. This example would seem to bring to life that which scholar Orly Lobel writes of in stating, "the governance model offers a framework that enables us to view the different sectors—state, market, and civil society—as part of one comprehensive, interlocking system."<sup>128</sup>

There is, however, a caveat. And this caveat presents an opportunity to improve the effectiveness of this aspect of the PEO regulatory regime. A 2021 report by the Office of Program Policy Analysis and Government Accountability ("OPPAGA") revealed that "[s]ince Fiscal Year 2010-11, the Board of ELCs had full membership during one fiscal year. In 3 of the last 10 fiscal years, the board has lacked any resident member representation. During the 10-year period, the number of board members ranged from two to seven."<sup>129</sup> While the Department of Business and Professional Regulation

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118. FLA. STAT. § 468.521(1) (2023).

119. *Id.*; FLA. STAT. § 468.521(3) (2023).

120. FLA. STAT. § 468.521(2) (2023).

121. *Id.*

122. *Id.*

123. *Id.*

124. Lobel, *The Renew Deal*, *supra* note 92, at 382.

125. Ford, *supra* note 105, at 59.

126. FLA. STAT. § 468.521(2) (2023).

127. Jody Freeman, *Private Parties, Public Functions and The New Administrative Law*, 52 ADMIN. L. REV. 813, 836 (2000) [hereinafter Freeman, *Private Parties, Public Functions and The New Administrative Law*].

128. Lobel, *The Renew Deal*, *supra* note 92, at 375.

129. OFFICE OF PROGRAM POL'Y ANALYSIS & GOV'T ACCOUNTABILITY, *supra* note 115, at 4.

reports that the Board's empty seats did not impact its ability to conduct business,<sup>130</sup> new governance theorists would note that the regulatory regime is failing to achieve its potential. One way in which the regime fails to achieve its potential is that the resident member functions as a check on any potential self-interest that could occur, a check that cannot happen if that seat sits vacant.<sup>131</sup> Another way in which the regime fails to achieve its potential is that new governance espouses collaboration, and fewer perspectives render that collaboration less meaningful.<sup>132</sup> OPPAGA has suggested that the Board add members from the insurance industry and other business communities, and implementation of this suggestion would foster the new governance principle of collaboration (while also working to maintain accountability).<sup>133</sup> Regardless of whether that fine suggestion is taken, it is imperative for the Board's actual composition to follow the composition called for in the Florida state statutes.

### B. *Illustration: An Openness to Self-Regulation within the PEO Industry*

This second illustration explores factors that led to the development of a self-regulatory mindset within the PEO industry. A specific application of new governance is industry self-regulation.<sup>134</sup> Though the term itself is simple enough, the language used by scholars in this area lacks standardization.<sup>135</sup> Some refer to self-regulation, while others refer to self-governance; some use the term private regulation, while others reference hybrid governance.<sup>136</sup> However, a key working definition of self-regulation is "a regime of collective rulemaking, whereby an industry-level entity develops and enforces rules and standards governing behavior of all industry members."<sup>137</sup> The industry-level actor could be a trade association, for instance, or could be a professional society within the industry.<sup>138</sup> An example of self-regulation from the legal industry would be the American Bar Association's creation of the *Model Rules of Professional Conduct*.<sup>139</sup>

If a continuum existed with New Deal-style, government-mandated regulation on one end and market forces regulating behavior on the other,

130. *Id.*

131. See Lobel, *The Renew Deal*, *supra* note 92, at 373 (explaining that the threat of self-interest made New Deal theorists wary of industry participation in governance).

132. *Id.* at 382, 498.

133. OFFICE OF PROGRAM POL'Y ANALYSIS & GOV'T ACCOUNTABILITY, *supra* note 115, at 24; see also Saule T. Omarova, *Wall Street as a Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 482 (2011) (discussing the value of a third-party stakeholder in regulating the financial services industry).

134. Lobel, *The Renew Deal*, *supra* note 92, at 374-75; Schulz, *supra* note 99, at 2520.

135. Omarova, *supra* note 133, at 423-24; Rudder, *supra* note 106, at 906 n.38.

136. *Id.*

137. Omarova, *supra* note 133, at 421.

138. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 646; Anil K. Gupta & Lawrence J. Lad, *Industry Self-Regulation: An Economic, Organizational, and Political Analysis*, 8 ACAD. OF MGMT. REV. 416, 417 (1983).

139. Raymond H. Brescia, *Regulating the Sharing Economy: New and Old Insights into an Oversight Regime for the Peer-to-Peer Economy*, 95 NEB. L. REV. 87, 113 (2016).

self-regulation would not fall at either extreme.<sup>140</sup> Scholars are clear that self-regulation is a *form* of regulation; self-regulation is not synonymous with deregulation.<sup>141</sup> If government-mandated regulation works on the basis of deterrence via negative sanctions,<sup>142</sup> self-regulation relies on cooperation from industry members, education, and social pressure to achieve the same means.<sup>143</sup> To be clear, self-regulation also works because of the inherent threat of the government stepping-in to regulate if the industry fails to self-regulate well,<sup>144</sup> a reality described by one scholar in this way: “cooperation only takes place in the shadow of the law.”<sup>145</sup> Furthermore, the role of government in a self-regulatory regime can also function as that of enforcer of the rules that the industry creates.<sup>146</sup>

As opposed to top-down government regulation, however, industry self-regulation can be less transparent.<sup>147</sup> This lack of transparency can lead to accountability concerns.<sup>148</sup> Indeed, the individuals and firms most impacted by the regulation could have no opportunity to provide input into how that regulation is crafted.<sup>149</sup> Although certain statutes and Constitutional provisions may apply to government regulators, those same requirements do not necessarily apply to industry self-regulation.<sup>150</sup> While one check on self-regulation is the threat of government regulation<sup>151</sup> and another check is the potential emergence of a new private industry regulator to replace an ill-performing private industry regulator,<sup>152</sup> there are some best practices to consider for self-regulation. First, in crafting industry self-regulation, industry members should try to incorporate the same democratic principles of openness and fairness required of government regulation.<sup>153</sup> Second, the process of self-regulation should try to ensure balanced representation from

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140. Gupta & Lad, *supra* note 138, at 417-18; Omarova, *supra* note 133, at 422; Rudder, *supra* note 106, at 899; Schulz, *supra* note 99, at 2519; Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 L. & POL’Y 529, 541 (1997).

141. Orly Lobel, *The Slipperiness of Stability: Contracting for Flexible and Triangular Employment Relationships in the New Economy*, 10 TEX. WESLEYAN L. REV. 109, 111 (2003) [hereinafter Lobel, *The Slipperiness of Stability*]; Omarova, *supra* note 133, at 425.

142. Sinclair, *supra* note 140, at 534.

143. *Id.*

144. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 666; see also Onnig H. Dombalagian, *Self and Self-Regulation; Resolving the SRO Identity Crisis*, 1 BROOK. J. CORP. FIN. & COM. L. 317, 323 (2007).

145. Sinclair, *supra* note 140, at 536.

146. Rudder, *supra* note 106, at 901 n.8.

147. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 647.

148. *Id.*

149. Rudder, *supra* note 106, at 900.

150. Harold I. Abramson, *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 HASTINGS CONST. L.Q. 165, 180-82 (1989).

151. *Id.*

152. *Id.* at 186.

153. See Rudder, *supra* note 106, at 903 n.17 (explaining that “[t]he degree of openness in private standard setting varies substantially across groups.”); see also Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions*, 84 N.C. L. REV. 397, 432-34 (2006) (describing due process in the standard setting context).



the industry itself.<sup>154</sup> Third, industry relationships and expertise are essential.<sup>155</sup> Fourth, industry self-regulation works well when the industry has established norms.<sup>156</sup> In addition, self-regulation can be particularly successful when the industry views itself as a “community of fate,” meaning that the industry views the individual firms’ boats as tied together, and whether they sink or sail depends on any individual firm’s ability to follow collective rules.<sup>157</sup> To illustrate the use of that term, one scholar described ensuing self-regulation in the nuclear power industry after the Three Mile Island disaster—a disaster so severe that nuclear power plants faced the possibility of closure.<sup>158</sup>

Evidence from the early years of the PEO industry demonstrates this same community of fate mentality and provides the first example of new governance-style self-regulation appearing in the PEO industry.<sup>159</sup> Essentially, to quote one early PEO industry player, “[t]he industry had a really black eye.”<sup>160</sup> Some unscrupulous actors within the industry caused this “black eye” by taking clients’ money and subsequently failing to remit tax payments, failing to pay workers’ compensation claims, or failing to pay health insurance claims.<sup>161</sup> Damaging newspaper coverage and close attention from regulators followed.<sup>162</sup> As one industry pioneer noted,

We had every single government agency on our back, from unemployment insurance to insurance commissioners all over the place. They wanted to shut us down because they were convinced that we were nothing but a scheme to break down employment systems, from unemployment to collection of the withholding taxes to insurance issues.<sup>163</sup>

Another industry pioneer described the environment in this way, “[w]e were all like comrades then. We were competing against each other, but we were more competing against the forces that were threatening our survival.”<sup>164</sup> Thus, the industry was ripe for self-regulation. Indeed, this is a great example of the forces that would lead to the “preemptive self-regulation” described by Jason Solomon.<sup>165</sup>

Because of the regulatory headwinds, the industry leveraged the relationships between industry members and sought state regulation as a

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154. Dombalagian, *supra* note 144, at 329.

155. *Id.* at 347; Freeman, *The Private Role in Public Governance*, *supra* note 104, at 644.

156. Schulz, *supra* note 99, at 2550.

157. Omarova, *supra* note 133, at 446.

158. *Id.* at 451-52.

159. *Id.* at 446.

160. FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75.

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. Solomon, *supra* note 102, at 598.

collective.<sup>166</sup> Specifically, the Florida PEO industry “chose a model of self-regulation, which was incredibly attractive because the board was made up of a majority of industry members....”<sup>167</sup> The early years of the Florida PEO industry demonstrate the cooperation that took place between industry members to survive as individual firms and as an industry.<sup>168</sup> Indeed, the actions of those unscrupulous industry members helped to create the pressure necessary for the industry to develop a regulatory scheme from within in the face of the threat of government regulation and, potentially, the elimination of the industry.<sup>169</sup>

### C. Illustration: The PEO Industry’s Self-Regulatory Organization

While the PEO industry pushed for the inclusion of self-regulation within the state statutory scheme, the PEO industry also pushed for developing an independent self-regulatory organization for the industry.<sup>170</sup> The Employer Services Assurance Corporation (ESAC) illustrates new governance influences at work in the PEO industry.<sup>171</sup> ESAC, organized at the behest of the industry trade association NAPEO,<sup>172</sup> “is an independent nonprofit corporation that is the official accreditation and financial assurance organization for the PEO industry.”<sup>173</sup> As a key industry self-regulatory body, ESAC sets ethical, operational, and financial standards for PEOs under its mission of “build[ing] integrity and trust and provid[ing] assurance to the PEO industry, so the industry can reach its full potential in support of America’s small businesses.”<sup>174</sup> Specifically, ESAC established forty best practice standards against which a PEO is measured and evaluates quarterly whether an accredited PEO

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166. Dombalagian, *supra* note 144, at 347; Freeman, *The Private Role in Public Governance*, *supra* note 104, at 644; FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75. To be clear, not all jurisdictions within the United States follow this preferred regulatory model. Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, *supra* note 74, at 42 (discussing the various regulatory schemes in place at the time of the article’s drafting).’

167. FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75. As discussed in the previous section, the Florida Board of Employee Leasing Companies’ balanced representation (if realized) can lead to effective self-regulation. *See* FLA. STAT. § 468.521(2) (2023); Dombalagian, *supra* note 144, at 329. Scholar Harold Abramson categorized private regulators as one of three types. Abramson, *supra* note 150, at 169. On one end of the spectrum existed purely private regulators (such as the Better Business Bureau), and on the other end of the spectrum existed private actors who the government “deputized” as public regulators (such as professional licensing boards). *Id.* at 169-70. Of the deputized private regulators category, the category under which the Florida Board of Employee Leasing Companies would fall, Abramson wrote that the “category encompasses the least obvious cases of private regulation...,” but it is private regulation, nonetheless. *Id.* at 169.

168. FLORIDA ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, *supra* note 75.

169. *Id.*

170. Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, *supra* note 74, at 42-43.

171. ESAC, <https://www.esac.org> (last visited Dec. 30, 2022).

172. Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, *supra* note 74, at 43.

173. *About US*, ESAC (Oct. 10, 2023, 12:38 PM), <https://www.esac.org/About/about-esac>.

174. *Id.*

complies with its tax, insurance, and retirement plan responsibilities.<sup>175</sup> Achieving ESAC accreditation is considered the PEO industry's "Gold Standard" and, at present, is reserved for fewer than five percent of the PEO industry.<sup>176</sup>

On its website, ESAC states that "[p]artnering with an accredited PEO is the only practical way for business owners to confirm proven reliability of their service provider."<sup>177</sup> Given the just-cited statistic of less than five percent of the industry having achieved this accreditation,<sup>178</sup> this raises governance concerns for the remaining ninety-five percent of the industry. Key questions are how this five percent is measured and whether it refers to five percent of PEOs by market share or five percent of PEOs out of the 487 PEOs identified by NAPEO.<sup>179</sup> It is also important to note that PEOs vary in the number of worksite employees that they co-employ;<sup>180</sup> thus, the number of co-employees protected by an ESAC-accredited PEO, and the number of client companies protected by an ESAC-accredited PEO is not readily ascertainable by that statistic without additional information. While industry members have analogized ESAC to the Federal Deposit Insurance Corporation (FDIC) or Securities Investor Protection Corporation (SIPC),<sup>181</sup> an opportunity for the PEO regulatory regime exists to expand the reach of this self-regulatory organization. Certainly, the standards that ESAC sets can benefit all PEOs (an aspect that the next section explores). However, considering how ESAC accreditation could be expanded, especially to smaller PEOs who may have less financial ability to pay the costs of ESAC accreditation, could strengthen the overall regulatory regime in compliance with new governance principles.<sup>182</sup>

#### D. Illustration: Standard-Setting within the PEO Industry

New governance is participatory and collaborative, and standard-setting—a specific branch of new governance's promotion of self-regulation—exemplifies this. By referring to standards, the literature is referring to "voluntary best-practice rules."<sup>183</sup> An example could be an industrial code

175. *Choosing the Right PEO*, ESAC (Oct. 10, 2023, 2:19 PM), <https://www.esac.org/Business/selecting-a-peo>. [hereinafter *Choosing the Right PEO*, ESAC].

176. ESAC, <https://www.esac.org> (last visited Dec. 30, 2022); *Choosing the Right PEO*, ESAC, *supra* note 175 (stating that "[l]ess than five percent of the industry has achieved this proven level of reliability").

177. *Choosing the Right PEO*, ESAC, *supra* note 175.

178. *Id.*

179. *What is a PEO?*, NAPEO, <https://www.napeo.org/what-is-a-peo/about-the-peo-industry/industry-statistics> (last visited Jan. 2, 2023).

180. See, e.g., Lorraine Lee & Ursula Ramsey, *Certified Professional Employer Organizations: The First Four Years*, J. OF ACCOUNTANCY 4 (July 1, 2021) <https://www.journalofaccountancy.com/issues/2021/jul/certified-professional-employer-organizations.html>.

181. Basso, *Heightened Regulations and Licensing Requirements Raise the Bar for PEOs*, *supra* note 74, at 43.

182. See Garry Bradford Letter, *supra* note 83 ("[T]here are significant costs associated with PEOs that choose to be accredited by the ESAC or certified through the IRS, especially for smaller PEOs...").

183. Dieter Kerwer, *Rules that Many Use: Standards and Global Regulation*, 18 GOVERNANCE: AN INT'L J. OF POL'Y, ADMIN., AND INSTITUTIONS 611, 611 (2005).

developed by a trade association, a model law, or a statement of principles.<sup>184</sup> While the New Deal model presented the industry with only the choice of whether to comply with regulations or skirt compliance, the new governance model invites the industry to participate in developing its own governing rules.<sup>185</sup> The basis, then, of the authority for these stakeholder-set rules rests in the expertise of these stakeholders.<sup>186</sup> The idea is that the expertise of the standards' crafters results in better solutions because it relies on the deep industry knowledge that private industry stakeholders have.<sup>187</sup> With industry stakeholders participating in the development of standards, the industry may also experience an easier effort in implementing the rules, as "[e]mpirical evidence suggests that the more involved people are in making rules and consenting to them, the stronger their sense of obligation to abide by them."<sup>188</sup>

Agency adoption of privately-crafted standards highlights the cooperative nature of the new governance model.<sup>189</sup> However, while this may routinely occur,<sup>190</sup> it is important to remember that industry stakeholders are neither elected officials, nor are they tasked by their role in government with a mission of public service.<sup>191</sup> To promote accountability, procedural rules within the standard-setting organization are critical.<sup>192</sup> In other words, due process has a place within these private standard-setting bodies.<sup>193</sup> These private standard-setting bodies should promote open deliberations and provide transparency regarding those who participated in the standard-setting process.<sup>194</sup> Regarding participation, these standard-setting bodies should evaluate whether their membership is diverse and consider how to incorporate the interests of smaller firms—not just the interests of large industry players—and consumers.<sup>195</sup>

Within the PEO industry, the presence of participatory governance is evident, as references to private-standard setting organizations appear in various PEO regulations.<sup>196</sup> An example comes from Chapter 61G7 of

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184. *Id.* at 617; Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 817 n.10.

185. Lobel, *The Renew Deal*, *supra* note 92, at 377-79.

186. Kerwer, *supra* note 183, at 618.

187. *Id.* at 615-16; Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 836.

188. Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 848, 848 n.103.

189. *Id.* at 830.

190. Freeman, *The Private Role in Public Governance*, *supra* note 104, at 638.

191. Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 818.

192. Verkuil, *supra* note 153, at 434.

193. *Id.*

194. *Id.*

195. Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 828, 854.

196. See PEOs, ESAC, <https://www.esac.org/PEO/> (last visited Dec. 30, 2022) (highlighting as a benefit of ESAC accreditation state acceptance of ESAC accreditation as a substitute for state licensure requirements). For instance, the North Carolina Professional Employer Organization Act provides that the Commissioner will accept an assurance organization's affidavit certifying a PEO's compliance with the state PEO licensure requirements. N.C. GEN. STAT. § 58-89A-76 (2023). Likewise, the State of Indiana allows

Florida's Administrative Code.<sup>197</sup> That chapter contains regulations related to Florida's Board of Employee Leasing Companies.<sup>198</sup> Within a section entitled "Reporting Requirements," the Board of Employee Leasing Companies mandates information that employee leasing companies must provide.<sup>199</sup> In the first and third quarters, the company must provide evidence of workers' compensation coverage, as well as evidence (in the form of a balance sheet and income statement) that the company can meet its payroll, employment tax, and insurance obligations.<sup>200</sup> In the second and fourth quarter, the company must provide evidence of its workers' compensation coverage and its quarterly report.<sup>201</sup> In addition, each company shall provide year-end financial statements.<sup>202</sup> As an alternative to the aforementioned requirements, however, a Florida PEO can show proof of accreditation in good standing by ESAC.<sup>203</sup> The process for that alternative provides that ESAC would certify compliance by the PEO to the Department of Business and Professional Regulation.<sup>204</sup> Then, ESAC would allow the Department to access the documentation referenced in the reporting requirements of the Florida regulation (that the PEO had previously provided to ESAC).<sup>205</sup> If ESAC finds that the PEO has failed to meet the requirements of Florida statutes and regulations for PEOs, ESAC is required by this regulation to disclose that information to the Board of Employee Leasing Companies and the Department of Business and Professional Regulation.<sup>206</sup>

This provides an illustration of new governance principles at work in the PEO regulatory regime. As noted, the inclusion of ESAC, a private standard-setting body, directly into the State of Florida's regulations, highlights the harnessing of this private industry expertise and using it to better the overall regulatory regime.<sup>207</sup> A potential drawback of incorporating standards set by private actors is that private actors are not subject to the same democratic requirements of due process and service to the electorate that a government actor would be; however, the lack of compulsion need not dictate a lack of

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for PEO certification by an independent organization. 760 IND. ADMIN. CODE 1-73-5 (2023). The certifying organization must meet a list of requirements set out in the Code and must be included on the Commissioner's approved listing. *Id.* As another example, the State of Maine has approved ESAC as an independent assurance organization. Letter from William N. Lund, Superintendent, State of Maine Department of Professional and Financial Regulation Bureau of Consumer Credit Protection, to All Maine Registered Employee Leasing Companies (May 9, 2018). This means that a PEO can have ESAC submit registration information on its behalf. *Id.*

197. FLA. ADMIN. CODE ANN. r. 61G7 (2023).

198. *Id.*

199. FLA. ADMIN. CODE ANN. r. 61G7-10.001(1)(a) (2023).

200. *Id.*

201. FLA. ADMIN. CODE ANN. r. 61G7-10.001(1)(b) (2023).

202. FLA. ADMIN. CODE ANN. r. 61G7-10.0011 (2023).

203. FLA. ADMIN. CODE ANN. r. 61G7-10.0015 (2023).

204. *Id.*

205. *Id.*

206. *Id.*

207. Freeman, *Private Parties, Public Functions and The New Administrative Law*, *supra* note 127, at 836; Kerwer, *supra* note 183, at 615-16, 618.

due process or lack of commitment to diverse membership.<sup>208</sup> Instead, the solution is for private standard-setting groups, such as ESAC, to keep these best practices in mind. For instance, ESAC is governed by a board of directors with deep industry experience.<sup>209</sup> That experience can result in better standards and a better overall regulatory regime. However, it is important to note that a final accreditation decision regarding a PEO is made by ESAC's independent directors.<sup>210</sup> This exemplifies a review that can promote confidence in the standard-setting body.

E. *Illustration: The State of Texas's Attempt to Deregulate the PEO Industry*

Recently, the State of Texas attempted to deregulate the state's PEO industry.<sup>211</sup> This effort, and an aspect of Texas's rationale behind its decision to deregulate the industry, comports neither with new governance theory nor with common sense.<sup>212</sup> To evaluate the State of Texas's deregulatory efforts, some theoretical background is helpful. There exists a common divide where business actors are viewed as either ethically able to regulate their own practices or as unable to self-regulate, requiring some coercion to act ethically.<sup>213</sup> So, too, within the legal community, there exists differing schools of thought regarding the need to regulate or the need to deregulate with limited middle ground.<sup>214</sup> A new governance perspective mediates this dispute and "show[s] that the best policy solutions frequently cannot be easily categorized as either regulation or deregulation."<sup>215</sup> William Simon illustrates this principle with the aid of two competing perspectives: hierarchical and horizontal.<sup>216</sup> The hierarchical perspective imagines a government desiring to implement a solution, but the government needs the help of those closest to the problem to develop that solution.<sup>217</sup> This could look like a government supporting the work of a private organization in lieu of an exclusively governmental solution.<sup>218</sup> The horizontal perspective has in mind industry members, for instance,

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208. Verkuil, *supra* note 153, at 432-34.

209. *About ESAC*, ESAC, <https://www.esac.org/About/about-esac> (last visited Oct. 10, 2023).

210. *Id.* (providing a listing of ESAC's independent directors, including, for instance, former state insurance commissioners).

211. See SUNSET ADVISORY COMM., STAFF REPORT - TEXAS DEPARTMENT OF LICENSING AND REGULATION 3 (2020), 26, [https://www.sunset.texas.gov/public/uploads/files/reports/Texas%20Department%20of%20Licensing%20and%20Regulation%20Staff%20Report\\_6-4-20.pdf](https://www.sunset.texas.gov/public/uploads/files/reports/Texas%20Department%20of%20Licensing%20and%20Regulation%20Staff%20Report_6-4-20.pdf) [hereinafter SUNSET ADVISORY COMMISSION STAFF REPORT].

212. *Id.* at 26-27.

213. Braithwaite, *supra* note 112, at 83.

214. Orly Lobel, *Setting the Agenda for New Governance Research*, 89 MINN. L. REV. 498, 499, 501 (2004) [hereinafter Lobel, *Setting the Agenda for New Governance Research*].

215. *Id.* at 499.

216. William H. Simon, *Afterward—Part II: New Governance Anxieties: A Deweyan Response*, 2010 WIS. L. REV. 727, 729-30 (2010).

217. *Id.*

218. *Id.*

wishing to dictate norms but needing a structure by which to do so.<sup>219</sup> In either perspective, there is no stark choice between regulation and deregulation. As Orly Lobel writes in her surreply to Bradley Karkkainen's reply, "Karkkainen accurately warns against the equation of governance approaches with merely voluntary guidance"<sup>220</sup>; thus, a role in governance remains for the state and for the regulated entity.<sup>221</sup>

This recent example regarding the PEO industry in Texas presents this push and pull of efforts to regulate and to deregulate.<sup>222</sup> In 2020, Texas's Sunset Advisory Commission's initial Sunset Staff Report identified the PEO industry as an industry no longer in need of state licensure.<sup>223</sup> (Notably, as background, Texas was one of the first states to pass PEO legislation in the early 1990s and is one of the states with the highest number of PEOs headquartered in it).<sup>224</sup> In the first version of the Sunset Staff Report published in June 2020, the Report recommended that state PEO licensure end in Texas on September 1, 2021.<sup>225</sup> State PEO licensure involved an annual audit by the Texas Department of Licensing and Regulation to ensure that the PEO could meet its financial obligations.<sup>226</sup>

The initial Sunset Staff Report explained two key justifications for its recommendation.<sup>227</sup> First, the PEO industry serves businesses, not the general public.<sup>228</sup> Moreover, the report noted receipt of only five consumer complaints in 2019 and only two disciplinary actions against PEOs in the entire program history.<sup>229</sup> To put these numbers into context, the Texas Department of Licensing and Regulation licensed PEOs (either fully or on a limited license) whose client companies employed nearly 360,000 workers.<sup>230</sup> As discussed in

219. *Id.*

220. Lobel, *Setting the Agenda for New Governance Research*, *supra* note 212, at 499, 506.

221. *Id.* at 499, 506.

222. *See* SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 3 (explaining the reasoning behind its suggestion to eliminate PEO licensure).

223. SUNSET ADVISORY COMMISSION, STAFF REPORT WITH COMMISSION DECISIONS - TEXAS DEPARTMENT OF LICENSING AND REGULATION 3 (2021), at 26, <https://www.sunset.texas.gov/public/uploads/files/reports/Texas%20Department%20of%20Licensing%20and%20Regulation%20Staff%20Report%20with%20Commission%20Decisions.pdf> [hereinafter SUNSET ADVISORY COMMISSION STAFF REPORT WITH COMMISSION DECISIONS]; *see also id.* at iv (explaining that "[f]or each agency that undergoes a Sunset review, the Sunset Advisory Commission publishes three versions of its staff report on the agency." The first version is the Sunset Staff Report, the second version is the Sunset Staff Report with Commission Decisions, and the third version is the Sunset Staff Report with Final Results.).

224. *See also* BASSI & MCMURRER, *supra* note 6, at 3 (noting that Texas, California, Florida, Michigan, and New York are the states with the highest number of PEO headquartered in them); Garry Bradford Letter, *supra* note 83, at 2.

225. SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 33.

226. *Id.* at 26.

227. *Id.*

228. *Id.*

229. *Id.*

230. *Id.*; *cf.* Garry Bradford Letter, *supra* note 83 (finding that the Texas Department of Licensing and Regulation licensed 396 entities). That letter also adds that "PEOs in Texas handle over \$18 billion in

the report, these facts indicated to the Sunset Advisory Commission that elimination of PEO licensure would pose minimal risk to the public.<sup>231</sup>

Furthermore, the initial Sunset Staff Report explained a second reason behind the recommendation: other means of oversight existed.<sup>232</sup> Specifically, the Sunset Staff Report pointed to accreditation by ESAC and to certification by the IRS via its CPEO Program as alternative means of oversight.<sup>233</sup> It noted, in comparison to the standards for state licensure in Texas, that ESAC had more stringent standards and that the IRS's CPEO Program had fairly similar standards.<sup>234</sup> The report noted that one-third of Texas PEOs had obtained ESAC accreditation.<sup>235</sup> The report also cited that sixty percent of employees in Texas who were co-employed by a PEO were covered by a PEO that had either ESAC accreditation, CPEO Program certification, or both.<sup>236</sup> While the report discussed the need for state licensure during the PEO industry's infancy, the report found state licensure "as an indicator of quality redundant and unnecessary" at this juncture.<sup>237</sup> Furthermore, while the report recommended eliminating licensure, it also suggested keeping state statutes that governed PEO contracts by defining the co-employment relationship amongst the PEO, its client, and those who worked for the client company and statutes that providing for oversight by other government agencies such as the Texas Department of Insurance and Texas Workforce Commission.<sup>238</sup>

In response, NAEPO and the NAEPO Texas Leadership Council submitted a letter in December 2020 to the members of the Sunset Commission asking for continued licensure of PEOs in Texas.<sup>239</sup> Among other points, that letter addressed the suggestion that CPEO Program certification or ESAC accreditation could substitute for state licensure by noting that both programs are voluntary.<sup>240</sup> Also, that letter interpreted the low number of enforcement actions as proof that licensure was achieving its intended purpose.<sup>241</sup>

In January 2021, the Sunset Staff Report with Commission Decisions was issued.<sup>242</sup> In it, the Commission did not adopt the recommendation to

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worksite employees' wages." *Id.* at 2. This helps to highlight the size of the Texas PEO industry and the need for it to function effectively. *Id.*

231. SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 3.

232. *Id.* at 26.

233. *Id.* at 26-27.

234. *Id.* at 27.

235. *Id.*

236. *Id.* The Report did not address PEOs who may not have either CPEO Program certification or ESAC accreditation, *id.* at 26-27. Instead, the Report seemed to rely on market forces by stating that "[t]wo other mechanisms [ESAC certification and CPEO Program certification] currently exist to help potential client businesses make an informed choice when seeking to engage a PEO's services...." *Id.* at 26.

237. *Id.*

238. *Id.* at 26, 34.

239. Garry Bradford Letter, *supra* note 83.

240. *Id.*

241. *Id.*

242. SUNSET ADVISORY COMMISSION STAFF REPORT WITH COMMISSION DECISIONS, *supra* note 223.



eliminate PEO licensure and provided no explanation for its decision.<sup>243</sup> In other words, the Texas Department of Licensing and Regulation will continue to license PEOs for now.<sup>244</sup>

At the outset, it is important to clarify what the report says and what it does not say. The Sunset Committee's report noted that, at that time, one-third of Texas PEOs had obtained ESAC accreditation and, at that time, ten Texas PEOs had obtained certification under the IRS's CPEO Program.<sup>245</sup> The report also noted that sixty percent of the workers co-employed by a PEO in Texas were co-employed by a PEO that had either ESAC accreditation, CPEO Program certification, or both.<sup>246</sup> Thus, the Sunshine Committee suggested voluntary ESAC accreditation and voluntary certification by the IRS as substitutes for state licensure.<sup>247</sup> The report, however, glaringly fails to address the means of oversight for roughly forty percent of the 360,000 workers in Texas that are co-employed by a PEO with neither ESAC accreditation nor IRS certification.<sup>248</sup> Furthermore, the report states that only ten Texas PEOs have IRS certification.<sup>249</sup> Thus, a significant number of Texas PEOs are not subject to IRS oversight via its CPEO program of Texas.<sup>250</sup> This simply leaves too significant a lacuna to be workable.

It is also important to address another aspect of the Commission's rationale in suggesting deregulation: the Commission noted that the PEO industry serves businesses instead of serving the general public.<sup>251</sup> While PEOs do contract with small businesses, it is critical to remember that those small businesses and their PEOs co-employ those who work at the small business. If the PEO falls short in its responsibilities to obtain workers' compensation coverage, remit payroll, or interpret employment laws, those workers can bear the cost.

While the issue is tabled in Texas for now, the PEO industry and Texas could draw on two new governance principles should the issue arise again. First, it is important to remember that there are many tools available with which to craft a regulatory regime beyond just the stark choices of regulation and deregulation.<sup>252</sup> In that regard, the State of Texas is right to look to self-regulatory organizations such as ESAC. The question for the industry is how

243. *Id.* at A2.

244. *Id.*; see also SUNSET ADVISORY COMM'N, FINAL RESULTS OF SUNSET REVIEWS 2020-21, (June 2021), <https://www.sunset.texas.gov/public/uploads/files/reports/Final%20Results%20of%20Sunset%20Reviews%202020-2021.pdf> (reporting final results regarding changes to the Texas Department of Licensing and Regulation).

245. SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 27.

246. *Id.*

247. Garry Bradford Letter, *supra* note 83.

248. SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 27.

249. *Id.*

250. *Id.*

251. SUNSET ADVISORY COMMISSION STAFF REPORT, *supra* note 211, at 26.

252. Lobel, *Setting the Agenda for New Governance Research*, *supra* note 212, at 499.

to expand that organization's reach.<sup>253</sup> Private certifications could provide another option.<sup>254</sup> Second, the PEO industry and the State must remember that there is a role for the government actor in the regulatory regime. In that regard, the letter drafted by the NAPEO Texas Leadership Council does align with new governance principles when it notes that a purely voluntary system of regulation is not preferable.<sup>255</sup> As Karkkainen cautions, a new governance approach may be unconvincing beyond those who have already espoused its tenets.<sup>256</sup> Still, the PEO industry and public actors should consider entirely removing the blinders of the traditional command-and-control approach and see government regulation's place within a broader set of regulatory tools.

### CONCLUSION

Two decades ago, scholar Orly Lobel noted the development of new, flexible employment arrangements, including PEOs, and warned that workers within those emerging arrangements needed the protection from an adequate regulatory structure.<sup>257</sup> Indeed, the structure of the PEO regulatory regime required attention and innovation then and still does today. Currently, over 170,000 small businesses place a great deal of trust in their PEOs.<sup>258</sup> Ensuring that this trust is well-placed matters to those small businesses and to their four million worksite employees.<sup>259</sup> An effective regulatory regime protects those interests. The PEO regulatory regime then must bring to bear those new governance principles of participation, collaboration, decentralization, and experimentation on the regime's existing resources to achieve its full potential.<sup>260</sup>

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253. Garry Bradford Letter, *supra* note 83, at 2. As the letter points out, one issue is cost, especially for smaller PEOs. *Id.*

254. Schulz, *supra* note 99, at 2525-26 (discussing sustainability certifications within the forest industry). The author explains that certification programs administered by private industry groups or NGOs can exemplify New Governance. *Id.*

255. Garry Bradford Letter, *supra* note 83, at 4.

256. Karkkainen, *supra* note 101, at 477.

257. Lobel, *The Slipperiness of Stability*, *supra* note 141, at 111.

258. NAPEO, *Industry Statistics*, *supra* note 4.

259. *Id.*

260. Lobel, *The Renew Deal*, *supra* note 92, at 382, 498.

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