

**Testimony of
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**United States House of Representatives
Committee on Small Business**

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Regulation: The Hidden Small Business Tax

Mr. Chairman and Members of Committee, I am pleased to present my views on how small businesses are impacted by federal regulation. The bulk of my testimony will actually cover how small businesses impact federal rules. Or, at least, how the Regulatory Flexibility Act is designed to ensure that small business has a voice in the process.¹

I am an attorney with the law firm of Nelson Mullins Riley & Scarborough, LLP. I represent several businesses and run the Coalition for Responsible Business Finance – a group of small businesses that are trying to educate Congress and the federal government on how non-traditional lending provides tremendous value for small businesses and the economy.² The businesses I represent are concerned with how regulation impacts their bottom-lines, whether they will be treated fairly by regulators, and whether they will have a legitimate seat at the regulatory policy table. However, I am not presenting this testimony directly on my clients' behalf. Rather, my testimony this morning is drawn from my two decades of work on small business regulatory issues and my overall desire to bolster the voice of small business in the regulatory process.

My first job in Washington was with the EPA. I served under both Administrator Bill Reilly and Administrator Carol Browner. After learning about regulatory policy development from within government, I joined the Washington office of the National Federation of Independent Business (NFIB). One of my fondest memories was working on NFIB's campaign to prevent small businesses from being sued under the Superfund law just because they sent household garbage to their local landfill. That was the story of Barbara Williams of Gettysburg, Pennsylvania who I

¹ Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164 (1980), amended by the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 857

² Coalition for Responsible Business Finance (CRBF). Accessible at: <http://www.ResponsibleFinance.com>.

was honored to be with when President George W. Bush signed the small business superfund bill on January 11, 2002.³

Later that month, I was unanimously confirmed to head the Office of Advocacy at the U.S. Small Business Administration (SBA). The Office of Advocacy is responsible for overseeing the Regulatory Flexibility Act.⁴ I served as Chief Counsel for Advocacy until October 2008. During my tenure, the Office of Advocacy issued approximately 300 public comment letters to 60 agencies (averaging 38 per year).

I have remained deeply interested in how small businesses are impacted by regulation and how small business involvement in regulatory decision-making can benefit regulatory policy. I serve as an advisor for NFIB's Small Business Legal Center and for the SBE Council's Center for Regulatory Solutions and I am trying to create the Small Business Regulation Committee for the American Bar Association's Section on Administrative Law and Regulatory Practice. I also serve on the Board of Directors for the Public Forum Institute which is involved in the Policy Dialogue on Entrepreneurship, the Global Entrepreneurship Week initiative, and the Global Entrepreneurship Congress. The most recent congress was held last month in Medellin, Colombia and I was honored to participate.

History of the Regulatory Flexibility Act

One of the top five recommendations from the 1980 White House Conference on Small Business was for a law requiring regulatory impact analysis and a regular review of regulations. That recommendation became a reality when President Jimmy Carter signed the Regulatory Flexibility Act into law on September 19, 1980.

³ *Small Business Liability Relief and Brownfields Revitalization Act*, Pub. L. No. 107-118, 115 Stat. 2356 (2002).

⁴ See <http://www.sba.gov/advocacy>.

The rationale for passage of the Regulatory Flexibility Act in 1980 still exists today. That rationale is based on the critical role small businesses play in our economy and an understanding of how small firms are disproportionately impacted by regulation (research-based proof that “one-size-does-not-fit-all”). Recent data show that small firms create almost 2/3 of the net new jobs in this country and that small businesses lead America’s innovation economy, producing 16 times more patents per employee than their larger business competitors.⁵ At the same time, research shows that the \$2.028 trillion cost of federal government regulations hits small businesses the hardest.⁶ Small businesses with fewer than 50 employees shoulder \$11,724 per employee per year to keep up with regulatory mandates.⁷ That is more than twice the cost of healthcare.⁸ Plus, the costs for small firms are 29 percent higher per employee than for firms with 100 or more employees. The disproportionate regulatory impact is even more pronounced for environmental regulations where small firms bear over 3 times the costs per employee than their larger business competitors.⁹

Those reasons led to the enactment of the Regulatory Flexibility Act in 1980. The Act directs all agencies that use notice and comment rulemaking to publicly disclose the impact of their regulatory actions on small entities and to consider less burdensome alternatives if a proposal is likely to impose a significant economic impact. The law authorizes SBA’s Chief Counsel for Advocacy to appear as amicus curiae in Regulatory Flexibility Act challenges to rulemakings and it requires SBA’s Office of Advocacy to report annually on agencies’ compliance with the Regulatory Flexibility Act.

⁵ *Frequently Asked Questions*, SBA Office of Advocacy (updated March 2014).

⁶ W. Mark Crain and Nicole V. Crain, *The Cost of Federal Regulation to the U.S. Economy, Manufacturing and Small Business* (September 10, 2014).

⁷ *Id.*, at page 2.

⁸ ASPE Research Brief, U.S. Department of Health and Human Services, *Health Insurance Marketplaces 2016: Average Premiums After Advance Premium Tax Credits in the 38 States Using the Healthcare.gov Eligibility Platform*, at table 2 (estimating costs of \$408 per month) (January 21, 2016).

⁹ Crain & Crain at page 2 (annual costs per employee for firms with under 50 employees is \$3,574 and costs per employee for firms with 100 or more employees is \$1,014).

From the time of enactment up to 1995, agency attention to the Regulatory Flexibility Act was disappointing and committees in the U.S. House of Representatives held hearings and drafted amendments to strengthen the Regulatory Flexibility Act.¹⁰ The Small Business Regulatory Enforcement Fairness Act (SBREFA) passed Congress and was signed into law by President Clinton in March of 1996.¹¹ Those amendments to the Regulatory Flexibility Act established formal procedures for the EPA and for the Occupational Safety and Health Administration (OSHA) to receive input from small entities prior to the agencies proposing rules.¹²

Early in my tenure as Chief Counsel, there was a realization that government could still do a better job incorporating small business considerations into rulemaking. We felt that in order to change the attitudes of regulators, direction had to come from the top. That led to President George W. Bush signing Executive Order 13272, Proper Consideration of Small Entities in Agency Rulemaking, in August of 2002.¹³ The Executive Order directed SBA's Office of Advocacy to train regulatory agencies on how to comply with the Regulatory Flexibility Act and further instructed agencies to consider the Office of Advocacy's comments on proposed rules. More recently, the Small Business Jobs Act codified the Executive Order's requirements for agencies to respond to the Office of Advocacy's comments in final rules.¹⁴

The latest amendments to the Regulatory Flexibility Act were authored by Senators Olympia Snowe and Mark Pryor and were adopted as part of the Dodd-Frank financial regulatory reform law. That amendment requires the Consumer Financial Protection Bureau (CFPB) to conduct a

¹⁰ See, e.g., *Strengthening the Regulatory Flexibility Act: Hearing on H.R. 9 before H. Comm. On Small Business*, 104th Cong., Serial No. 104-5 (Jan. 23, 1995); *Job Creation and Wage Enhancement Act of 1995: Hearing on H.R. 9 Before the Subcomm. On Comm. And Admin. Law of the H. Comm. On the judiciary*, 104th Cong. Serial No. 104-3 (Feb. 3 & 6, 1995).

¹¹ *Small Business Regulatory Enforcement Fairness Act of 1996*, Pub. L. No. 104-121, 110 Stat. 857 (1996).

¹² See, 5 U.S.C. sec. 609.

¹³ Executive Order 13272, *Proper Consideration of Small Entities in Agency Rulemaking*, 67 Fed. Reg. 53461 (August 16, 2002).

¹⁴ *Small Business Jobs Act of 2010*, Pub. L. No. 111-240, sec. 1601 (September 7, 2010).

small business panel process (“SBREFA panels”) when issuing rules, the same requirement that EPA and OSHA have followed since SBREFA passed in 1996.¹⁵

What is required by the Regulatory Flexibility Act

The basic spirit of the Regulatory Flexibility Act is for government agencies to analyze the effects of their regulatory actions on small entities and for those agencies to consider alternatives that would allow agencies to achieve their regulatory objectives without unduly burdening small entities.

The Regulatory Flexibility Act covers all agencies that issue rules subject to the Administrative Procedure Act (APA). The Regulatory Flexibility Act requires agencies to publish an initial regulatory flexibility analysis (IRFA) unless the promulgating agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.¹⁶ The IRFA is supposed to be a transparent small business impact analysis that includes a discussion of alternatives designed to accomplish the stated objectives of the rule while minimizing impact on small entities. In the case of EPA, OSHA, and the CFPB, the SBREFA panels aid the agencies’ analysis and discussion of alternatives. Each SBREFA panel produces a report that includes a small business economic analysis and a detailed exchange of information between the promulgating agency and small entities

The availability of an IRFA allows for a more informed notice and comment process that can guide an agency’s formulation of its final rule. Under the Regulatory Flexibility Act, an agency’s final rule must contain a final regulatory flexibility analysis (FRFA) if it published an IRFA with its proposal. The FRFA is basically a public response to issues raised in the IRFA.

¹⁵ *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. No. 111-203, sec. 1100G (July 21, 2010).

¹⁶ *See*, 5 U.S.C. sec. 605(b).

Regulatory Flexibility Act in practice.

SBA's Office of Advocacy monitors implementation of the Regulatory Flexibility Act and a full accounting of how agencies are complying with the Act is published annually.¹⁷ Every annual report contains a section on the Office of Advocacy's interaction with the EPA, which should be no surprise because of how much of the federal regulatory burden emanates from EPA. The National Association of Manufacturers study on regulatory burden reported that small manufacturers with 50 employees or less pay an estimated \$34,671 per employee to comply with federal regulation.¹⁸ Environmental regulatory costs account for \$20,361 of the total (more than half of the total costs are from environmental regulation).

Good news/bad news

The good news is that federal agencies work with SBA's Office of Advocacy and EPA, OSHA, and the CFPB utilize SBREFA panels to explore how each agency can sensitize its regulatory approach to small business. It is encouraging that EPA is willing to hold "pre-panel" sessions with small business stakeholders in order to think through issues they may not have anticipated in developing a rulemaking. It is also good that the CFPB Director generally is public about the Bureau's decision to have a SBREFA panel early on in the regulatory development process. Finally, it is good that OSHA releases its SBREFA panel reports upon their completion (instead of waiting until the agency proposes its rule (EPA and CFPB keep their SBREFA panel reports secret until they publish their proposed rules)).

The bad news is that there are still times when agency deadlines, whether they are judicial, statutory, or political, push careerists to approach the Regulatory Flexibility Act as a set of bureaucratic procedural hurdles. That concern is of utmost concern during this stage of the

¹⁷ See, Office of Advocacy annual reports on the Regulatory Flexibility Act, available at <https://www.sba.gov/advocacy>.

¹⁸ Crain & Crain at page 2.

administration, when the clock is ticking down on when federal regulations will be finalized under President Obama. The end-of-administration phenomenon to cement its legacy through regulation is not unique to the Obama presidency. There are plenty of data, research, and testimony on the subject of “Midnight Regulations.”¹⁹ One recent publication estimates 4,000 regulations making their way through the administration at a cost of more than \$100 million.²⁰

The most obvious example of an agency purposely avoiding the Regulatory Flexibility Act was EPA’s recent promulgation of the “Waters of the U.S.” rule. The EPA and the U.S. Army Corps of Engineers (the “Corps”) certified that the proposed rule would not have a significant economic impact on a substantial number of small businesses. EPA argued that their proposal would not expand jurisdiction, but would narrow the jurisdiction of the Clean Water Act.²¹ To EPA’s credit, the agency had worked with SBA’s Office of Advocacy for several years and had engaged directly with small business stakeholders. According to testimony by Charles Maresca, who heads the Office of Advocacy’s legal team, the Corps met with small entities well before issuing the proposed rule on April 21, 2014.²²

Unfortunately, EPA did not seem to listen to those small business interests and instead concocted an argument that its rule would not impose additional costs on small businesses. Mr. Maresca pointed out that EPA’s own economic analysis estimated a range of permit cost increases from \$19.8 - \$52 million dollars annually and that wetlands mitigation costs would rise between \$59.7 - \$113.5 million annually. That background suggests to me that EPA made a deliberate decision

¹⁹ See, e.g., *Midnight Regulations: Examining Executive Branch Overreach: Hearing before H. Comm. On Science, Space & Technology*, 114th Cong. (Feb. 10, 2016).

²⁰ Timothy Noah, *Obama pushing thousands of new regulations in Year 8*, *Politico* (Jan. 1, 2016). Available at: <http://www.politico.com/agenda/agenda/story/2016/1/obama-regulations-2016>.

²¹ *Definition of Waters of the United States Under the Clean Water Act*, 79, Fed. Reg. 22188 (April 21, 2014).

²² Testimony of Charles Maresca, Director of Interagency Affairs, Office of Advocacy, U.S. Small Business Administration, *An Examination of Proposed Environmental Regulation’s Impacts on America’s Small Businesses*, United States Senate Committee on Small Business and Entrepreneurship (May 19, 2015).

to avoid the transparent and constructive dialogue with small entities required by SBREFA when pushing forward with the Waters of the U.S. rulemaking.

Another set of policies that is good news is that states continue to experiment with ways to make their regulatory climate more hospitable for small business. In my home state, Governor Charlie Baker led an initiative to review all the Commonwealth's rules in a "spring cleaning" exercise designed to help small business.²³ This is akin to my work as Chief Counsel when the Office of Advocacy worked with several states to encourage the adoption of the Regulatory Flexibility Act at a state level.²⁴ It is good news that effort continues.

Unfortunately, the bad news is that states also stumble into situations where they want to help, but unintentionally harm small businesses. The Coalition of Responsible Business Finance is monitoring a situation in Illinois where the Senate Committee on Financial Institutions is considering the, "Small Business Lending Act."²⁵ While it seems as though the goals of transparency and disclosure in the bill are the same as my coalition's, the complex regulatory mandates, expansion of civil and criminal penalties, and prescriptive underwriting standards could actually prevent small businesses from responsibly accessing capital in Illinois. I am hopeful that in Springfield, and in Albany where a similar process started this week, that legislators and regulators will incorporate the views of small businesses before moving forward. That same principal is the foundation of the Regulatory Flexibility Act.

²³ Massachusetts Governor Charlie Baker, *Executive Order No. 562 To Reduce Unnecessary Regulatory Burden* (March 31, 2015).

²⁴ U.S. Small Business Administration, Office of Advocacy, *The Small Business Economy 2008, A Report to the President*, pages 262-267 (Feb. 2009). Available at: https://www.sba.gov/sites/default/files/files/sb_econ2008.pdf.

²⁵ Illinois General Assembly, *Senate Bill 2865* (Introduced Feb. 17, 2016). More information is available at: <http://goo.gl/hqAtDB>.

How can the Regulatory Flexibility Act work better?

The Regulatory Flexibility Act requires agencies to analyze the direct impact a rule will have on small entities. Unfortunately, limiting the analysis to direct impacts does not accurately portray how small entities are affected by new EPA rules. For instance, when greenhouse gas regulations impose a direct cost on an electric utility, EPA should make public how its proposal will likely affect the cost of electricity for small businesses and include that analysis as part of its work to meet the goals of the Regulatory Flexibility Act. The process works when there is a transparent and candid exchange of views between small business stakeholders and regulators. That exchange works best when small business stakeholders have as much information as possible and I believe that not including analysis of reasonably foreseeable indirect impacts harms the process.

The SBREFA amendments to the Regulatory Flexibility Act in 1996 established the SBREFA panels and have helped force a dialogue between EPA and small business stakeholders. Unfortunately, the process lacks transparency because EPA does not release the SBREFA panel report that must be completed in 60 days, until EPA issues its proposed rule. The time between a completed SBREFA panel report and EPA's proposed rule can be several months or several years. Keeping the valuable small business input secret and hiding the candid exchange of information between EPA and business stakeholders is a disservice to the development of regulatory policy that depends on a robust public exchange of information, even before the formal notice and comment period. I am not promoting the release of confidential interagency information that is a necessary part of the rulemaking process. However, once a SBREFA panel report is finished it is no longer a deliberative process document that deserves to be kept confidential. Regulators should continue to think about ways to improve their proposed regulations, all the way up to publishing their proposed rules. Hiding part of an agency's exchange with the regulated community stifles EPA's ability to gain informed insight up to the date of a proposed rule's publication. OSHA is subject to the same SBREFA panel requirements

as EPA and OSHA releases their SBREFA panel reports as soon as they are completed. I think that if EPA changes its policy to mimic OSHA's, they will benefit from a more transparent SBREFA process.

Finally, I am troubled by what happened with EPA's Waters of the U.S. rule and how its avoidance of the Regulatory Flexibility Act (certification that the rule would not significantly impact a substantial number of small entities in April 2014) could not be challenged until the rulemaking was finalized a year later. EPA's decision on whether it should conduct a full examination of small business impacts and alternatives is a critical point in the rulemaking process. The "certification" part of the Regulatory Flexibility Act is truly the fork in the road when it comes to whether EPA should listen to small businesses and tailor its regulatory approach to accommodate small firms. The Small Business Regulatory Flexibility Improvements Act, passed by this Committee, solves that problem and I am hopeful that the Senate will similarly look towards a solution.

Conclusion:

I commend this Committee's attention to the plight of small businesses that are trying to keep up with the flood of regulatory mandates emanating from our nation's capital. Agencies need to continually hear from you, from the Office of Advocacy, from small business stakeholders like my fellow panelists from the National Association of Manufacturers (NAM) and the National Federation of Independent Business (NFIB), and from small business owners themselves in order to affect positive regulatory change.