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Congress of the United States

U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, House Small Business Committee
From: Sam Graves, Chairman
Re: Full Committee Hearing: "Reducing Federal Agency Overreach: Modernizing the Regulatory Flexibility Act"
Date: March 23, 2011

On Wednesday, March 30, 2011, at 1:00 pm in Room 2360 of the Rayburn House Office Building, the Small Business Committee will meet for the purposes of examining the Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA). Although the hearing will not focus specifically on the Regulatory Flexibility Improvements Act of 2011 (H.R. 527), that bill may be addressed in passing. The Committee expects to hold a more detailed hearing on the bill prior to markup later in the spring. The RFA requires federal agencies to assess the economic impact of their regulations on small businesses, small non-profits, and small governmental jurisdictions (collectively referred to in the RFA as "small entities") and if the impact is significant, consider alternatives that are less burdensome.

Historical Background

More than 30 major regulatory statutes were enacted during the 1970s. By the end of that decade, businesses were groaning under the weight of federal regulation. For example, the Federal Register had grown from a non-weighty publication to a 42,000 page blueprint for regulating many aspects of modern American life. The Federal Register had nearly doubled in size to more than 80,000 pages by the end of the Clinton Administration.

In a series of hearings in the late 1970s, Congress began focusing on the ever-growing burden federal regulation imposed upon small businesses. The hearings revealed two major issues: (a) small businesses were under-represented in federal regulatory proceedings; and (b) federal agency efforts to impose a Aone-size-fits-all@ body of regulation imposed disproportionate burdens on small businesses. Congress, spurred on by cries from small businesses, responded with the enactment of the Paperwork Reduction Act[1] and the Regulatory Flexibility Act (RFA). Congress expected these two

[1] The Paperwork Reduction Act is beyond the scope of this memorandum.

pieces of legislation would stem the growth of regulatory burdens on the economy in general, and on small businesses in particular.

Principles of the RFA

The basic premise of the RFA is that a Aone-size-fits-all@ regulation may impose disproportionate cost burdens on small entities. For example, if a regulation has a fixed cost of compliance of $100, then a business that produces 1000 units of a particular item will see an increase of $.10 per unit. A business that only produces 100 units of the same item will see the cost per unit increase of $1. Thus, the smaller business will be adversely affected in the marketplace in selling that item because it will have to raise its price more to recover the cost of the regulation.

Under the RFA, each agency must review its regulations to ensure that, while accomplishing its statutory mandate, the ability of small entities (the RFA applies to small businesses, small not-for profit institutions, and small governmental jurisdictions) to invent, produce, and compete is not inhibited. The RFA forces agencies to identify and account for the often excessive small entity cost consequences of federal rulemaking actions. Agencies must balance the burdens imposed by regulations against their benefits and propose alternatives to regulations which create economic disparities among different-sized entities.

The Operation of the RFA Analytical Requirements

The RFA applies to every federal rule, both proposed and final, for which an agency must provide notice and comment by ' 553(b) of the Administrative Procedure Act (APA) or some other statute, such as the Competition in Contracting Act (requiring major federal procurement regulations to be issued pursuant to notice and comment despite the fact that such regulations are not required to be issued pursuant to notice and comment under the APA).

Under the RFA, an agency has an obligation to complete a threshold analysis of the economic impact of a proposed or final rule. This preliminary assessment is used by the agency to determine whether to certify a rule or prepare a regulatory flexibility analysis. In this regard, the process is similar to that of agencies determining whether to prepare an environmental impact statement pursuant to the National Environmental Policy Act (NEPA). *Cf. National Ass'n of Home Builders v. United States Army Corps of Engineers*, 417 F.3d 1272, 1286 (D.C. Cir. 2005); *Associated Fisheries of Maine v. Daley*, 127 F.3d 104, 113 (1st Cir. 1997) (holding that parallels exist between NEPA and RFA).

If the agency determines, after completion of its threshold analysis, that a rule will not have a significant economic impact on a substantial number of small entities, then the agency head (or the person the agency head delegates) is entitled to certify to such a conclusion and need not prepare a regulatory flexibility analysis. 5 U.S.C. ' 605(b). SBREFA strengthened the RFA certification standard by mandating that the agency provide the factual and legal basis for the certification. Prior to the enactment of

SBREFA, agencies simply would make a boilerplate statement that the rule would not have a significant economic impact on a substantial number of small entities.

An agency that determines a rule will have a significant economic impact on a substantial number of small entities is required to prepare a regulatory flexibility analysis. With one major exception, there is no difference between an initial regulatory flexibility analysis prepared for a proposed rule and the final regulatory flexibility analysis to accompany the final rule. *Compare* 5 U.S.C. ' 603 *with* 5 U.S.C. ' 604.

Each regulatory flexibility analysis must contain the following: 1) a description of the reasons why action by the agency is being considered (for a proposed rule) or taken (for a final rule); 2) a succinct statement of the objectives of, and legal basis for, the rule; 3) a description of, and when feasible, an estimate of the number of small entities to which the rule will apply; 3) a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the recordkeeping or reporting requirement; 4) an identification, to the extent practicable, of all relevant federal rules which may duplicate, overlap, or conflict with the rule; and 5) alternatives to the rule that might reduce the economic impact on small entities. The final regulatory flexibility analysis (FRFA) also must describe why each alternative that would lessen economic impact was rejected. SBREFA also added the requirement that the agency must explain what steps it has taken to reduce or eliminate economic impact on small entities.

The RFA is economically neutral. An agency must prepare a regulatory flexibility analysis whether the rule will have a beneficial or negative impact. However, the agency is only required in a FRFA to explain what steps it has taken to minimize the impact on small entities, i.e., only address negative impacts.

Alternatives contemplated by the authors of the RFA may include separate reporting requirements or compliance standards to take account of the limited regulatory compliance resources of small entities. The agency may ultimately develop a tiered regulation with different requirements for entities of different sizes or a decision not to regulate small entities because they only contribute to a small portion of a problem that the agency is trying to correct.

Consideration of these alternatives does not require the adoption of any particular regulatory alternative. An agency may adopt a regulatory strategy that imposes substantial burdens on small entities as long as the agency has complied with the analytical requirements of the RFA. *Compare Strycker=s Bay Neighborhood Council v. Karlen*, 444 U.S. 223, 227-28 (1980) (holding NEPA only procedural statute not mandating a specific outcome) *with Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 625 (D.C. Cir. 2000) (RFA only a procedural statute), citing *Associated Fisheries of Maine*, 127 F.3d at 114.

Preparation of an initial regulatory flexibility analysis requires preparation of a FRFA at the final rule stage. However, a certification at the proposed rule stage does not mean that the agency is entitled to certify at the final rule stage. Data obtained during the notice and comment process may force an agency to rethink its decision to certify. If sufficient information is submitted to the agency that demonstrates a significant economic impact on a substantial number of small entities, then the agency is required to prepare a FRFA.

Affirmative Outreach Requirements

The agencies are required to undertake affirmative outreach to obtain the input of small entities when they are proposing a rule for which they would have to prepare an initial regulatory flexibility analysis. 5 U.S.C. ' 609(a). SBREFA expanded and provided further details on the requirements to perform affirmative outreach.

SBREFA singled out two agencies for special requirements with respect to affirmative outreach. When the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA) are ready to issue a proposed rule for which they would have to prepare an initial regulatory flexibility analysis, they are required to follow a formal procedure (colloquially known as the Apanel process@). The panel process requires the establishment of a panel consisting of a member of the Office of Advocacy, a member of the Office of Information and Regulatory Affairs, and a member of either EPA or OSHA depending upon which agency is writing the rule. The panel identifies small entity representatives who provide their assessment of the proposed rule and its potential impacts on small businesses to the panel. The panel drafts a report for submission to the covered agency which has the opportunity to respond prior to publication of the proposed rule. The report and the agency response must be included in the publication of the proposed rule in the Federal Register.

Loopholes and Weaknesses in the Regulatory Flexibility Act

A long line of court cases in the D.C. Circuit has held that the RFA only applies to entities directly regulated by a particular rule. For example, the Clean Air Act requires the Environmental Protection Agency (EPA) to promulgate National Ambient Air Quality Standards (NAAQS). States then develop plans for meeting those NAAQS by placing limits on air emissions by various businesses. The EPA has held (and affirmed by the federal appeals court in DC) that NAAQS rules do not directly regulate small entities but rather only regulate the states. Nevertheless, the NAAQS rules have a tremendous foreseeable indirect effect on small entities. This is only one example of such a situation. Numerous other examples of similar indirect effects that go without assessment under the RFA can be found littered throughout the Code of Federal Regulations and the Federal Register. Reasonably indirect effects on the environment, including socioeconomic effects, are required to be assessed under regulations implementing NEPA. Given the parallels between NEPA and the RFA, a similar

assessment of reasonably foreseeable indirect effects should be required of agencies when promulgating federal regulations.[2]

Currently, land management plans promulgated by the United States Forest Service and the Department of Interior's Bureau of Land Management are not considered rules that must be issued pursuant to notice and comment rulemaking and thus not subject to coverage under the RFA. These plans have significant consequences on small businesses that utilize the land and the small governmental jurisdictions in which the businesses are located. The plans are assessed under NEPA and should be assessed under the RFA.

The IRS claims that most of its interpretative rules do not require recordkeeping or reporting requirements but are imposed by statute. As a result, the IRS claims that its interpretative rules are not subject to analysis under the RFA. This interpretation of § 603 of the RFA is wrong and needs to be modified to ensure that the IRS actually complies with the RFA.

The RFA's original sponsor, Senator John Culver (D-IA), expected the RFA to be the economic equivalent of an environmental impact statement prepared pursuant to the National Environmental Policy Act (NEPA). The distinction is critical because, as the court in *Associated Fisheries of Maine* noted, a detailed statement imposes greater criteria on agency analysis than a simple statement that is mandated under the RFA. Query: Why should agencies be required to assess in greater detail the effects on the environment of their proposed actions than the effects of their proposed regulations?

One of the changes made by SBREFA was the requirement to obtain input from small entities prior to publication of the proposed rule. SBREFA required such input for proposed rules that would have a significant economic impact on a substantial number of small entities promulgated by EPA and OSHA. Based on testimony provided by the Chief Counsel for Advocacy at previous hearings of the Committee on the RFA, these procedures have proved effective in tempering EPA and OSHA regulations; yet, the agencies still achieved their regulatory objectives. It then makes sense for this process to apply to other agencies when promulgating rules that will have a significant economic impact on a substantial number of small entities.

The RFA requires federal agencies to periodically review their significant regulations (those that have a significant economic impact on a substantial number of small entities) every ten years pursuant to § 610. The current process for such review simply does not work; it is not even clear whether agencies need publish the outcomes of such reviews. This makes it impossible to ensure that agencies are actually conducting the reviews and the section needs to be rewritten *ab ovo*.

Courts have jurisdiction to hear challenges to agency compliance with the RFA (these requirements were imposed in 1996 by SBREFA). However, for certain agencies with

[2] NEPA applies to regulations so EPA prepared a socioeconomic analysis of the effects of the NAAQs rules on the economy as part of the environmental impact statement for the NAAQS rules. Thus, it would not be hard for EPA to assess the effects of the NAAQS on small businesses.

mandatory internal appeals of agency regulatory decisions (specifically the Centers for Medicare and Medicaid Services and the Agricultural Marketing Service), it is unclear whether a court would have jurisdiction to hear a case concerning compliance with the RFA until a rather long and interminable review process is completed. Since compliance with the RFA is a separate procedural matter from the substance of the rule, this loophole needs to be eliminated ensuring that small businesses challenging rules from the aforementioned agencies have the capacity to challenge compliance with the RFA in federal court.

Each agency that promulgates rules has the power to adopt its own mechanism for complying with the RFA. As a result, the interpretations of the Chief Counsel for Advocacy are not considered authoritative by the courts. Unless the Chief Counsel is required to draft regulations mandating the methods that all agencies will use in complying with the RFA, the Chief Counsel's interpretations of the RFA can be ignored by the agencies and the courts when the Chief Counsel files an amicus brief in federal court. By requiring the Chief Counsel to write government-wide guidance, the interpretations of the Chief Counsel will be considered authoritative. In addition, the ability of the Chief Counsel to draft such regulations also will resolve another difficult conundrum in implementation of the RFA – the fact that agencies use very different standards for determining the threshold decisions of whether a rule will have a "significant economic impact on a substantial number of small entities."