

## THE REGULATORY FLEXIBILITY ACT AT 25: IS THE LAW ACHIEVING ITS GOAL?

By Keith W. Holman\*

### I. INTRODUCTION

The Regulatory Flexibility Act (RFA),<sup>1</sup> which marked its twenty-fifth anniversary in September 2005, was designed to “level the playing field” for small businesses competing against larger, more sophisticated, and more politically powerful businesses. Recognizing the importance of small businesses in the U.S. economy, Congress enacted the RFA in 1980 to ensure that federal agencies consider the needs of small business and other small entities<sup>2</sup> when new regulations are written. At a basic level, the RFA requires federal regulatory agencies to satisfy certain procedural requirements when they plan new regulations, including: (1) identifying the small entities that will be affected, (2) analyzing and understanding the economic impacts that will be imposed on those entities, and (3) considering alternative ways to achieve their regulatory goal while reducing the economic burden on those entities. Although the RFA does not require federal agencies to choose the regulatory approach that is the least burdensome to small entities, the overarching goal of the RFA has always been to shift the culture within federal regulatory agencies towards an ap-

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1. Pub. L. No. 96-354, 94 Stat. 1164 (1981), *amended by* Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 857 (1996) (codified as amended at 5 U.S.C. §§ 601-612 (2000)).

2. The RFA applies to three types of small entities: small businesses, small organizations, and small governmental jurisdictions. Small businesses are defined according to size standards published by the Small Business Administration at 13 C.F.R. § 121.201. Small organizations are not-for-profit enterprises that are independently owned and operated and are not dominant in their field (e.g., private hospitals, private schools). Pub. L. No. 96-354, 94 Stat. 1165 (1980), *amended by* 5 U.S.C. § 601(4) (1996). Small governmental jurisdictions are governments of cities, towns, villages, school districts, or special districts having a population of less than 50,000. Pub. L. No. 96-354, 94 Stat. 1165 (1980), *amended by* 5 U.S.C. § 601(5) (1996). The overwhelming majority of RFA compliance issues relate to regulatory impact on small businesses.

preciation of the value of small entities and to instill within them a desire to act accordingly. As viewed today, after twenty-five years of implementing the RFA, is the law succeeding in this goal?

Section II of this Article explains why small businesses need the RFA. Section III provides a brief overview of the 1980 RFA, the 1996 amendments to the RFA, and Executive Order 13,272, signed in 2002, which was designed to further internalize the RFA's procedures within federal agencies. Section IV discusses recent successes of the RFA. Section V considers remaining weaknesses in the current RFA. Section VI suggests further targeted legislative improvements to the RFA. The Article concludes that in the wake of Executive Order 13,272, the RFA is succeeding in spurring most federal regulatory agencies to improve their treatment of small entities. While some agencies have not yet fully embraced the RFA and made it part of their agency culture, small entities and the American public have greatly benefited from the law.

## **II. WHY SMALL BUSINESS NEEDS THE REGULATORY FLEXIBILITY ACT**

### **A. Small Businesses Are an Important Part of the U.S. Economy**

Small businesses have long been a critical part of the U.S. economy. Using data from preceding years, the U.S. Small Business Administration reported in 1982 that small businesses employed about half of the American labor force, produced almost half of the nation's goods and services, and, according to one study, generated over eighty percent of new jobs.<sup>3</sup> Small businesses also tended to innovate at a higher rate than medium or large businesses.<sup>4</sup> Twenty-five years later, small businesses are still an important driving force in the American economy. Small businesses comprise 99.7 percent of all employer firms in the U.S., they employ half of all the private sector workers, and have generated sixty percent to eighty percent of the net new jobs annually over the last decade.<sup>5</sup> These small firms pay forty-five percent of the total U.S. private payroll, and create more than half of the non-farm private

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3. U.S. SMALL BUS. ADMIN., THE STATE OF SMALL BUSINESS: A REPORT OF THE PRESIDENT 4-5 (1982) (citing research by the Massachusetts Institute of Technology for the period 1969-1976).

4. *Id.*

5. Office of Advocacy, U.S. Small Bus. Admin., Frequently Asked Questions 1 (2005), <http://www.sba.gov/advo/stats/sbfaq.pdf>.

gross domestic product (GDP).<sup>6</sup> Small firms continue to innovate more than large firms, producing thirteen to fourteen times more patents per employee than larger firms.<sup>7</sup> These small firm patents are more likely to be driven by leading-edge technology than large firm patents are.<sup>8</sup> Moreover, during economic downturns, small businesses often fare better than large businesses; increases in small business employment and self-employment often serve to lead the economy out of recession.<sup>9</sup>

### B. Small Businesses Have Been Inundated By Federal Regulations

The 1970s witnessed a flood of new federal agencies and ambitious new regulatory programs. New agencies were created with sweeping remedial missions, including the Environmental Protection Agency (EPA),<sup>10</sup> the Occupational Safety and Health Administration (OSHA),<sup>11</sup> and the National Highway Traffic Safety Administration (NHTSA)<sup>12</sup>. Agencies were equipped with powerful new statutory authorities such as the Clean Air Act<sup>13</sup>, the Clean Water Act,<sup>14</sup> the Endangered Species Act,<sup>15</sup> the Resource Conservation and Recovery Act,<sup>16</sup> the Occupational Safety and Health

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6. *Id.*

7. CHI RESEARCH, INC., SMALL SERIAL INNOVATORS: THE SMALL FIRM CONTRIBUTION TO TECHNICAL CHANGE 3 (2003) (written for the Office of Advocacy, U.S. Small Business Administration), available at <http://www.sba.gov/advo/research/rs225tot.pdf>.

8. *Id.*

9. It has been suggested, based on self-employment data from the U.S. Bureau of Labor Statistics, that the rate of self-employment tends to increase during business downturns. See generally DAVID AUDRETSCH ET AL., DOES ENTREPRENEURSHIP REDUCE UNEMPLOYMENT? (Max Planck Inst., Discussion Paper No. 0705, 2001). The “refugee effect” could mean that unemployed workers from larger companies who choose to start small businesses help the economy weather downturns. *Id.*

10. National Environmental Policy Act (NEPA) of 1969, Pub. L. No. 91-190, 83 Stat. 852 (codified as amended at 42 U.S.C. §§ 4331-4335 (2006)).

11. Occupational Safety and Health Act (OSHA) of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (codified as amended at 29 U.S.C. §§ 651- 678 (2006)).

12. Highway Safety Act of 1970, Pub. L. No. 91-605, 84 Stat. 1739 (codified as amended in scattered sections of 23 U.S.C.).

13. Clean Air Amendments of 1970, Pub. L. No. 91-604, 84 Stat. 1676 (codified as amended in scattered sections of 42 U.S.C.).

14. Clean Water Act of 1977, Pub. L. No. 95-217, 91 Stat. 1566 (codified as amended at 33 U.S.C. §§ 1294-1297, 1281(a)).

15. Endangered Species Act (ESA) of 1973, Pub. L. No. 93-205, 87 Stat. 884 (codified as amended at 16 U.S.C. §§ 1531-1544).

16. Resource conservation and Recovery Act (RCRA) of 1976, Pub. L. No. 94-580, 90 Stat. 2795.

Act,<sup>17</sup> the Employee Retirement Income Security Act,<sup>18</sup> and many others. By the end of the 1970s, scores of agencies had issued thousands of regulations, and small businesses were complaining about the rapidly growing volume and complexity of regulations. As one observer noted, “it was a regulatory Wild West.”<sup>19</sup> Agencies were intent on promulgating rules as quickly as possible to meet statutory deadlines, with little coordination or practical guidance on how to comply with new requirements. Also, agencies often failed to distinguish between small businesses and larger businesses when they developed rules, believing that a “one-size-fits-all” regulatory solution was adequate. Thus, small businesses, which often were not significant contributors to the problem an agency sought to address, were heavily and unnecessarily burdened by new regulatory requirements.

The tide of rules issued by federal agencies did not ebb after the 1970s. Agencies have continued to issue thousands of new regulations each year. In 2004, for example, agencies promulgated over 4,100 final rules, down slightly from the total in 2003.<sup>20</sup> Every year, the EPA alone lists more than 400 new rules that it plans to issue; EPA listed 416 such rules in 2004.<sup>21</sup> Similarly, the 2004 *Federal Register* contained 75,676 pages.<sup>22</sup>

### C. Small Businesses Are Disproportionately Impacted by Regulations

By the early 1980s it became clear that small businesses bear a greater burden in complying with regulations than their larger counterparts. In the first “State of Small Business” report, the U.S. Small Business Administration observed that:

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17. Occupational Safety and Health Act (OSHA) of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (codified as amended at 29 U.S.C. §§ 651-678).

18. Employee Retirement Income Security Act (ERISA) of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 29 U.S.C.).

19. James Morrison, *The RFA at 25: Some Reflections*, SMALL BUS. ADVOCATE (Office of Advocacy, Washington, D.C.), Sept. 2005, at 2, available at <http://www.sba.gov/advo/septnewsletter05.pdf>.

20. See CLYDE WAYNE CREWS, COMPETITIVE ENTER. INST., TEN THOUSAND COMMANDMENTS: AN ANNUAL SNAPSHOT OF THE FEDERAL REGULATORY STATE 1 (2005), available at <http://www.cei.org/gencon/030,04645.cfm>. The 2004 final rule tally was one percent below the 2003 tally.

21. *Id.* at 20 (citing OFFICE OF THE FED. REGISTER, THE REGULATORY PLAN AND THE UNIFIED AGENDA OF FEDERAL REGULATORY AND DEREGULATORY ACTIONS (2004)).

22. *Id.* at 1.

Most [federal] regulations have stipulated the same compliance requirements for small business as for large corporations. The relative burden is much greater, however, because compliance costs cannot be spread out over larger quantities of output. In short, small business has found itself at a competitive disadvantage because of the existence of efficiencies of scale in regulatory compliance.<sup>23</sup>

Subsequent economic research has confirmed that America's smallest firms bear a disproportionately large share of regulatory costs. The most recent study indicates that firms with fewer than twenty employees spend \$7,647 per employee each year to comply with federal rules, while companies with 500 or more employees spend \$5,282 per employee.<sup>24</sup> This research, which updates similar 1995 and 2001 reports, suggests that small business shoulder a forty-five percent greater regulatory burden per employee than their large business competitors.<sup>25</sup>

#### **D. Small Businesses Are Often Poorly Represented in the Regulatory Process**

Given the overwhelming number of rules being developed by the federal agencies each year, it can be very difficult for small businesses to understand how they will be affected and how they can have a voice in the rulemaking process. Most small business owners do not regularly read the *Federal Register* and cannot afford to hire a regulatory attorney to represent them in the rule development process. The key to persuading federal agencies to consider less burdensome regulatory alternatives is to suggest those alternatives early in the rulemaking process. Too often, small businesses only find out about a forthcoming regulation at the end of the rulemaking process, when it is too late to get the agency to consider alternatives. One account of this situation, written in 1964, still happens today:

Often businessmen come down to Washington when they are almost purple with apoplexy. A particular piece of legislation or an administrative ruling has been either passed or under consideration for weeks, months, or perhaps even a year. When it is about to be finalized—or even after it has been passed—the

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23. U.S. SMALL BUS. ADMIN., *THE STATE OF SMALL BUSINESS: A REPORT OF THE PRESIDENT* 13 (1982).

24. W. MARK CRAIN, *THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS* 5 (2005), available at <http://www.sba.gov/advo/research/rs264tot.pdf> (written for the Office of Advocacy, U.S. Small Business Administration).

25. *Id.*

businessman shows up in Washington for a ‘last-ditch effort.’ He must necessarily be aggressive and antagonistic, in conflict with a policy or program whose cement has virtually hardened.<sup>26</sup>

Unless the concerns of the small business are presented to the regulatory agency early in the rulemaking process, the “cement will harden” and the agency will often not address the concerns. To make matters worse, small entities must vie against larger businesses for the attention of regulators, and their objectives are often in conflict. Large companies with full-time regulatory compliance staffs may actually welcome new rules as a means to disadvantage and perhaps eliminate their small business competitors. While trade associations can be helpful to small businesses, many associations are controlled by large companies, leaving small businesses without a clear voice.

### **III. A BRIEF OVERVIEW OF THE 1980 REGULATORY FLEXIBILITY ACT, THE 1996 SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT, AND EXECUTIVE ORDER 13,272**

Faced with the problems discussed above, by the late 1970s small business asked Congress for a new law to “level the playing field” with large businesses.<sup>27</sup> The model for the 1980 Regulatory Flexibility Act was the National Environmental Policy Act of 1969 (NEPA),<sup>28</sup> the landmark environmental statute. NEPA requires federal policymakers to consider the environmental impacts of

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26. WILLIAM RUDER & RAYMOND NATHAN, *THE BUSINESSMAN’S GUIDE TO WASHINGTON* 3 (1964).

27. One account of the genesis of the Regulatory Flexibility Act observed that:

Both Houses [of Congress] built, in a number of hearings over 10 years, a conclusive record of disillusionment and discontent among the regulated. Small businesses and small entities repeatedly claimed that uniform application of the same regulations to them and to larger entities produced economic injustice. Four congressional committees (the Senate and House Small Business and Judiciary Committees), among others, heard damage reports from small businesses, small cities and towns, and small non-profit associations. Federal regulations, it was argued, imposed a disproportionate economic burden of compliance on them. In the business sector, there is considerable evidence that uniform application of regulatory requirements increases the minimum size of firms that can compete effectively in that regulated market.

OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., *THE REGULATORY FLEXIBILITY ACT: BETTER FEDERAL TREATMENT FOR SMALL ENTITIES* 5 (1980).

28. 42 U.S.C. §§ 4321-4345 (2000).

their actions.<sup>29</sup> Under NEPA, agencies must first decide whether their proposed actions are likely to significantly impact the environment.<sup>30</sup> If there will be no significant impact, the agency can issue a “Finding of No Significant Impact,” thus concluding the environmental review.<sup>31</sup> Conversely, if the agency anticipates a significant environmental impact, the agency must prepare an Environmental Impact Statement (EIS) containing a detailed assessment of the environmental impacts and potential alternatives to their proposed action.<sup>32</sup> Early in NEPA’s history, the courts were faced with the question of whether agencies were compelled by the statute to adopt the most environmentally sound alternative. In 1978, the Supreme Court held that NEPA sets a mandate for federal agencies that is essentially only procedural, and does not mandate any particular substantive outcome from an environmental review.<sup>33</sup>

The RFA’s regulatory flexibility review process is similar to NEPA’s environmental review process. The RFA requires each federal agency to review its proposed and final rules that are subject to notice and comment rulemaking under section 553 of the Administrative Procedure Act (APA)<sup>34</sup> or another statute to determine if the rules will have a “significant economic impact on a substantial number of small entities.”<sup>35</sup> Unless the head of the agency can certify that a proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities,<sup>36</sup> the agency must prepare an initial regulatory flexibility analysis (IRFA) and make it available for public review and comment.<sup>37</sup> The IRFA must describe the anticipated economic impacts of the proposed rule on small entities, and evaluate whether alternative actions that would minimize the rule’s impact on small entities would achieve the regulatory purpose.<sup>38</sup> When the agency issues the final rule, and cannot certify that the rule will not have a

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29. See § 4331 (declaring the Congressional purposes of this statute to encourage “harmony between man and his environment”).

30. § 4332(2)(C).

31. 40 C.F.R. § 1508.13 (2000).

32. 42 U.S.C. § 4332(2)(C).

33. *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council*, 435 U.S. 519, 548 (1978); *see also Strycker’s Bay Neighborhood Council, Inc. v. Karlen*, 444 U.S. 223, 227 (1980).

34. 5 U.S.C. § 553 (2000).

35. § 605(b).

36. *Id.*

37. § 603(a).

38. § 603(c).

significant economic impact on a substantial number of small entities, it must also prepare a final regulatory flexibility analysis (FRFA).<sup>39</sup> The FRFA must summarize any issues raised by public commenters, describe the steps taken by the agency to minimize burdens on small entities, and explain why the agency selected the final regulatory action it did, and why other alternatives were rejected.<sup>40</sup> The RFA does not require agencies to select the alternative that is the least burdensome for small entities.<sup>41</sup>

Problems inherent in the 1980 RFA became clear within a few years. The first problem was that agencies routinely certified their proposed rules with perfunctory boilerplate language that lacked any factual basis. The certification provision of section 605(b) had been intended as a way for agencies who could be certain that their proposed rules would have no significant small entity impacts to be excused from having to conduct a full-blown impacts analysis.<sup>42</sup> Instead, agencies improperly used certifications to evade the RFA regulatory flexibility analysis requirement altogether.<sup>43</sup> The second problem was that the RFA did not provide authority for affected small entities to challenge an agency's noncompliance with the law.<sup>44</sup> Concerned that RFA lawsuits could paralyze ongoing agency rulemakings in the same way that NEPA EIS challenges

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39. § 604(a).

40. *Id.*

41. *Id.*

42. *See* § 605(b).

43. As the Chief Counsel for Advocacy, Frank S. Swain, observed in 1989, “[t]he initial decision to certify a rule is the threshold question that triggers any further analysis by an agency. Without an adequate means to challenge an agency’s certification decision, the RFA has been viewed by some agencies as an unenforceable administrative procedure with which they need not comply. The absence of meaningful judicial review has created a checkered compliance record, dependent on each agency’s essentially voluntary commitment to sound rulemaking practices or upon its responsiveness to pressures for fair regulatory treatment.” Doris S. Freedman et al., *The Regulatory Flexibility Act: Orienting Federal Regulation to Small Business*, 93 *DICK. L. REV.* 439, 463 (1989). In 1995, for example, Advocacy’s annual RFA compliance report noted several agencies that had improperly certified proposed rules without any analysis or factual basis, including the Department of Energy (renewable energy production incentive program), EPA (storm water discharge permit program), the Department of Agriculture (almond marketing orders), and OSHA (indoor air quality rule). OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT, CALENDAR YEAR 1994 6-10, 13-14 (1995). The annual report concluded that “[i]t is hoped that the threat of judicial review would serve to influence agencies to take seriously their obligations under the RFA. Agencies would have a disincentive to dismiss RFA responsibilities through boilerplate certifications or insufficient analysis.” *Id.* at 24.

44. Pub. L. No. 96-354, § 611, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 611 (1982)).

had, Congress narrowly limited judicial review under the RFA.<sup>45</sup> An alleged RFA violation could only be considered as a factor in a larger APA challenge, which made challenges more difficult.<sup>46</sup> As a result, agencies knew that they could issue improper certifications or otherwise abuse the RFA process with few practical consequences.<sup>47</sup> The third problem was that a number of agencies simply ignored the RFA, including the Internal Revenue Service, the Department of Agriculture, and the Department of Interior.<sup>48</sup>

To address these problems, Congress amended the RFA by enacting the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).<sup>49</sup> SBREFA amended section 611 of the RFA to allow small entities to obtain judicial review of an agency's non-compliance with sections 601 (definitions of small entities), 604 (FRFAs), 605(b) (certifications), 608(b) (waiver of FRFAs) and 610 (periodic review of existing rules) of the Act.<sup>50</sup> SBREFA also tightened the requirement for certifications so that an agency must provide the factual basis that supports the certification statement.<sup>51</sup> SBREFA also requires OSHA and the EPA to convene small business review panels whenever their planned rules are likely to have a significant economic impact on a substantial number of small en-

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(a) [A]ny determination by an agency concerning the applicability of any of the provisions of this chapter to any action of the agency shall not be subject to judicial review.

(b) Any regulatory flexibility analysis prepared under sections 603 and 604 of this title and the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review.

45. *Id.*

46. *Id.* (“(b) . . . When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review.”); see *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 539 (D.C. Cir. 1983)

[A] reviewing court . . . may . . . strike down a rule because of a defect in the flexibility analysis. . . . EPA should have analyzed that option in its regulatory flexibility analysis as well, but its failure to do so is a purely technical flaw that does not affect the reasonableness of the final rule.

47. See *supra* note 43.

48. See *The Impact of Regulation on Small Business, Joint Hearing Before the S. Comm. on Small Business and the H. Comm. on Small Business*, 104th Cong. 13 (1995) (statement of Jere W. Glover, Chief Counsel for Advocacy, U.S. Small Bus. Admin.).

49. Pub. L. No. 104-121, 110 Stat. 847 (1996) (current version at 5 U.S.C. §§ 601-612 (2000)).

50. 5 U.S.C. § 611(a) (2000). SBREFA also gave the Office of Advocacy authority to file amicus briefs in appeals brought by small entities from final agency actions. § 612(b).

51. § 605(b).

ties.<sup>52</sup> The SBREFA panels include representatives from the Small Business Administration's Office of Advocacy (Advocacy), the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA), and the agency proposing the rule.<sup>53</sup> Small entity representatives who will be affected by the rule advise the panel members on probable real-world impacts and potential regulatory alternatives.<sup>54</sup> The panel prepares a report containing recommended alternatives to the agency planning the rule and the panel's recommendations are usually incorporated into the proposed rule.<sup>55</sup> From 1996 through 2005, EPA convened thirty SBREFA panels and OSHA has convened seven panels.<sup>56</sup>

The RFA was further strengthened on August 13, 2002, when President Bush signed Executive Order 13,272.<sup>57</sup> The Executive Order requires federal agencies to establish written agency policies on how they measure their regulatory impacts on small entities.<sup>58</sup> Agencies are also required to notify Advocacy of draft rules that are expected to have a significant economic impact on a substantial number of small entities.<sup>59</sup> Advocacy established an e-mail address to expedite agency notifications of these draft rules, [notify.advocacy@sba.gov](mailto:notify.advocacy@sba.gov).<sup>60</sup> Executive Order 13,272 requires agencies to consider Advocacy's written comments on proposed rules and include a response to those comments in the final rule.<sup>61</sup> Advocacy is also responsible for providing training to the federal regulatory agencies on how to comply with the RFA.<sup>62</sup> Since training sessions began in mid-2003, Advocacy has conducted more than fifty RFA

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52. §§ 609(b), (d).

53. *Id.*

54. For information about these SBREFA panels, see [http://www.sba.gov/advo/laws/is\\_epanel.html](http://www.sba.gov/advo/laws/is_epanel.html) and [http://www.sba.gov/advo/laws/is\\_oshanel.html](http://www.sba.gov/advo/laws/is_oshanel.html).

55. *Id.*

56. *Id.*

57. Exec. Order No. 13,272, 67 Fed. Reg. 53,461 (Aug. 13, 2002).

58. *See id.* § 3(a), at 53,461.

59. *See id.* § 3(b), at 53,461-62.

60. Memorandum from Thomas M. Sullivan, Chief Counsel for Advocacy, Small Business Administration, on Federal Agency Requirements under Executive Order 13,272 to Heads of Executive Agencies, General Counsels, and Agency Regulatory Staff (May 1, 2003), *available at* [http://www.sba.gov/advo/laws/memoeo03\\_0501.pdf](http://www.sba.gov/advo/laws/memoeo03_0501.pdf) [hereinafter Memorandum from Thomas M. Sullivan].

61. Exec. Order No. 13,272, 67 Fed. Reg. 53,461, § 3(c) (Aug. 13, 2002).

62. *See* OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., *HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT: A GUIDE FOR GOVERNMENT AGENCIES* 111 (2003), *available at* <http://www.sba.gov/advo/laws/rfaguide.pdf>.

compliance training sessions for a total of forty-five federal agencies.<sup>63</sup>

#### **IV. RECENT SUCCESSES OF THE REGULATORY FLEXIBILITY ACT**

##### **A. Federal Agency Compliance with the RFA is Generally Improving**

Available evidence strongly suggests that federal agency compliance with the RFA is improving as agencies are learning to implement Executive Order 13,272.<sup>64</sup> Every Cabinet-level department except the Department of State has submitted written plans to Advocacy.<sup>65</sup> A number of independent regulatory agencies that issue regulations have also adopted written policies on how they will comply with the RFA.<sup>66</sup> The Office of Advocacy now receives early drafts of proposed rules from many agencies via [notify.advocacy@sba.gov](mailto:notify.advocacy@sba.gov), enabling earlier consideration of potential small entity impacts and alternatives.<sup>67</sup> Moreover, as a result of receiving Advocacy's RFA compliance training, agency rule writers are consulting with Advocacy staff much earlier in the rule development process to discuss potential small entity impacts.<sup>68</sup> Agencies are also responding to Advocacy's written comments on

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63. The author is a member of the Office of Advocacy's RFA Training group, and has conducted or otherwise been involved in fifty-three RFA training sessions.

64. See OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 13,272, at 8 (2005), available at <http://www.sba.gov/advo/laws/flex/04regflx.pdf>.

65. *Id.*

66. *Id.* Some independent agencies take the position that Executive Order 13,272 does not bind them, since they are independent of the Executive Branch. Advocacy is particularly concerned that eight independent agencies who heavily regulate small entities failed to submit written RFA compliance procedures: the Export-Import Bank of the U.S., the Farm Credit Administration, the Federal Communications Commission, the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Federal Maritime Commission, the Federal Reserve System, and the Securities and Exchange Commission. *Id.*

67. See Memorandum from Thomas M. Sullivan, *supra* note 60. In the author's experience, in the past, agencies simply mailed copies of certifications and IRFAs to the Office of Advocacy. Mail addressed to federal agencies in the Washington, D.C. area began to be subjected to special handling, including irradiation, in 2002. Accordingly, it can take weeks for Advocacy to receive documents mailed by another agency. With these delays, a proposal was often already published in the *Federal Register* before Advocacy knew of it.

68. In 2005, the author had several such conversations with federal agency personnel and contractors concerning planned environmental and energy rules. Such early communications were less common in prior years.

proposed rules when they publish their final rules in the *Federal Register*.<sup>69</sup> Furthermore, federal agency personnel are attending more informal meetings with small businesses, such as roundtable discussions, as a way to become better informed about the potential impacts of their rules. Finally, many agencies have now established small business offices that work to help small businesses navigate the regulatory seas.<sup>70</sup>

### **B. The RFA Process is Enabling Agencies to Write Better Rules**

A major benefit of the RFA's regulatory flexibility analysis is that the process puts the real-world concerns of small business directly in front of agency officials. The same is true of SBREFA panels convened by OSHA or the EPA. With direct feedback and insight from affected small entities, agencies tend to write rules that are better tailored to address a particular regulatory problem. In recent years, the RFA has enabled small entity representatives, including the Office of Advocacy, to become involved early in the rulemaking process and suggest improvements to planned rules.

Regulations have been modified, given additional consideration, or even withdrawn by agencies on the basis of real-world concerns voiced by small businesses. In 2005, for example, the National Archives and Records Administration (NARA) finalized new structural and safety design standards for records storage facilities that house federal records.<sup>71</sup> NARA issued this rule largely in response to small business concerns, voiced through the regulatory flexibility process, that NARA's pre-2005 facility design requirements were unnecessarily stringent and costly. The final rule still achieves the regulatory objective of protecting and preserving federal records, while reducing the regulatory burden on small firms

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69. See, e.g., U.S. EPA, Control of Emissions of Air Pollution from Nonroad Diesel Engines and Fuel, 69 Fed. Reg. 38,958, 39,156 (June 29, 2004); U.S. EPA, Standards of Performance for New Stationary Sources and Emission Guidelines for Existing Sources: Other Solid Waste Incineration Units, 70 Fed. Reg. 74,870, 74,890 (Dec. 16, 2005).

70. The EPA, the Department of Agriculture, and the Department of Labor, for example, have each established an office or division dedicated to providing small business assistance. EPA's Small Business Ombudsman operates as an advocate for small business within the Small Business Division in the Office of the Administrator. See <http://www.epa.gov/sbo>. The Department of Agriculture's Office of Small and Disadvantaged Business Utilization can be accessed at <http://www.usda.gov/osdbu>. The Department of Labor's Office of Small Business Programs can be accessed at <http://www.dol.gov/osbp/sbrefa/main.htm>.

71. 70 Fed. Reg. 50,980 (Aug. 29, 2005).

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*REGULATORY FLEXIBILITY ACT*

1131

that are in the business of constructing records facilities. In another example, the Securities and Exchange Commission (SEC) delayed the compliance deadline for small public companies to comply with section 404 of the Sarbanes-Oxley Act of 2002.<sup>72</sup> Part of the rationale for the delayed compliance is to allow more time for the Commission to fully consider whether the reporting framework that has been established for large public companies also makes sense for small public companies.<sup>73</sup> As a further example, in 2004, small businesses persuaded the EPA that a proposed rule that would impose new storm water management and other water quality requirements for construction and development activities was a costly and potentially disruptive duplication of existing regulations that adequately protect water quality. As a consequence, EPA withdrew the proposed rule.<sup>74</sup>

In each of these cases, small entity feedback to the agency made possible by the RFA enabled the agency to make a better regulatory decision and resulted in a better regulatory outcome. By giving agencies the information they need to avoid imposing needless regulatory burdens on small entities, the RFA can help these small firms unleash their productive energies to fuel further economic growth.

**C. Over the Past Five Years, the RFA Has Helped Small Entities Avoid Over Seventy Billion Dollars in Unnecessary Regulatory Costs**

Beginning in 2001, the Office of Advocacy started calculating the regulatory costs saved when agencies modify their regulatory plans pursuant to the RFA and thereby reduce the economic impacts on small entities. These cost savings are calculated both as one-time savings (such as from the avoided capital cost of purchasing new equipment), and as recurring annual savings (such as from avoided yearly operating and maintenance costs). From 2001 to 2005, these one-time cost savings have totaled \$54.1 billion, while the recurring annual savings now total more than \$20 billion.<sup>75</sup> These cost sav-

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72. 70 Fed. Reg. 56,827 (Sept. 29, 2005).

73. *Id.*

74. 69 Fed. Reg. 22,472 (Apr. 26, 2004).

75. In Fiscal Year 2001 there was \$3 billion in one-time savings and \$1.4 million in recurring annual savings. OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2001 13 (2002), available at <http://www.sba.gov/advo/laws/flex/01regflx.pdf>. In Fiscal Year 2002 there was \$21.1 billion in one-time savings and \$10.2 billion in recurring annual savings. OFFICE OF ADVOCACY,

ings represent instances where agencies were able to find an alternative that addresses the regulatory goal without imposing unnecessary costs on small entities. The savings also demonstrate that the RFA is succeeding in persuading many agencies to take actions which reduce the regulatory burden on small entities.<sup>76</sup>

## V. REMAINING WEAKNESSES OF THE REGULATORY FLEXIBILITY ACT

Despite the 1996 Amendments to the RFA and the signing of Executive Order 13,272 in 2002, some weaknesses remain in the RFA and its implementation by federal agencies.

### A. Small Entity Impacts that are Foreseeable but “Indirect” are Ignored

Courts have interpreted the RFA to require agencies to perform a regulatory flexibility analysis only where the rule in question will directly regulate small entities.<sup>77</sup> Situations often arise where a planned rule will have significant foreseeable economic impacts on specified small entities, but because the small businesses themselves are not actually regulated by the rule, the RFA does not require consideration of their impacts or potential alternatives. For example, a Federal Aviation Administration (FAA) rule that

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U.S. SMALL BUS. ADMIN., ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2002 22 (2003), *available at* <http://www.sba.gov/advo/laws/flex/02regflx.pdf>. In Fiscal Year 2003 there was \$6.3 billion in one-time savings and \$5.7 billion in recurring annual savings. OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., REPORT ON THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2003 25 (2004), *available at* <http://www.sba.gov/advo/laws/flex/03regflx.pdf>. In Fiscal Year 2004 there was \$17.1 billion in one-time savings and \$2.8 billion in recurring annual savings. OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., REPORT ON THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2004 22 (2005), *available at* <http://www.sba.gov/advo/laws/flex/04regflx.pdf>. In Fiscal Year 2005 there was \$6.6 billion in one-time savings and \$970 million in recurring annual savings. OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., REPORT ON THE REGULATORY FLEXIBILITY ACT, FISCAL YEAR 2005 24 (2006), *available at* <http://www.sba.gov/advo/laws/flex/05regflx.pdf>. The \$20 billion recurring annual savings estimate represents a lower bound; the total recurring annual savings over the six years, adjusted by a net present value figure, would be larger.

76. Interestingly, it is likely that these cost savings will actually decline in future years as federal agencies incorporate a greater sensitivity to small entity concerns into their agency cultures. When an agency fully considers and provides for small entities from the very start of the rule development process, there are no “cost savings,” but the overarching goal of the RFA is achieved.

77. *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457 (2001); *Am. Trucking Ass'ns v. EPA*, 175 F.3d 1027, 1043 (D.C. Cir. 1985); *Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 340 (D.C. Cir. 1985).

mandates fewer daily flights in and out of an airport will have a foreseeable negative economic impact on shops and restaurants in the airport that depend on airline passengers as customers. Yet, because the FAA rule only regulates airlines, not businesses in airports, the impact on shops and restaurants is outside the scope of the RFA. Many rules that clearly impact small businesses never go through the RFA's regulatory flexibility analysis because their impacts are "indirect."

**B. Agencies Avoid the RFA by Regulating Through Guidance Documents and Through Enforcement Initiative Consent Agreements**

Because the RFA only applies to notice and comment rulemakings conducted under section 553 of the APA<sup>78</sup> (or any other law requiring notice and comment procedures), agency actions that are exempt from section 553 are also exempt from the RFA. Guidance documents issued by federal agencies are exempt from notice and comment rulemaking. There has been concern in recent years that agencies issue guidance documents as a way to expand the scope of their regulatory programs while evading the public participation requirements of the APA and the RFA. It is clear that federal agencies must follow notice and comment rulemaking procedures, and related requirements such as an RFA regulatory flexibility analysis, whenever they impose new legally binding regulatory requirements.<sup>79</sup> Another area of concern is in situations where federal agencies use enforcement initiatives to compel regulated entities in a particular industry to "voluntarily" accept a new substantive regulatory requirement. Because legal agreements that resolve enforcement actions do not typically require full notice and comment rulemaking, they are not subject to the RFA. Yet many enforcement initiatives are settled with 'global' consent agreements that force small entity signatories to agree to meet new industry-

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78. 5 U.S.C. § 553 (2000).

79. *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1028 (D.C. Cir. 2000) (agency guidance document imposed new substantive Clean Air Act requirements on facilities that necessitated notice and comment rulemaking under section 553 of the Administrative Procedure Act); *see also* *Chamber of Commerce v. Dep't of Labor*, 174 F.3d 206, 213 (D.C. Cir. 1999) (OSHA directive held to be a rule requiring notice and comment rulemaking); *U.S. Telecom Assoc. & Century Tel. Inc. v. FCC*, 400 F.3d 29, 40 (D.C. Cir. 2005) (FCC "clarification" held to be a substantive change in the agency's rules requiring notice and comment rulemaking); Office of Management and Budget, Proposed Bulletin for Good Guidance Practices, 70 Fed. Reg. 71,866 (Nov. 30, 2005) (OMB Bulletin would establish agency standards for the release of "significant" guidance documents).

wide standards.<sup>80</sup> Even though these new standards can have significant economic impacts on small entities, these agency actions never undergo RFA review.

### C. The RFA's Mechanism to Consider the Cumulative Impact of Regulations on Small Entities Works Poorly

Small businesses often complain about the difficulties in dealing with the layers of regulations that agencies issue over time. Although a single proposed rule may not impose a significant economic impact on a substantial number of small entities, that rule, when added to numerous current rules, may cumulatively impose a crippling burden. This is the regulatory version of the “death by a thousand cuts.” While section 610 of the RFA requires federal agencies to review existing rules periodically and to consider eliminating unnecessary requirements to reduce the overall regulatory burden on small entities,<sup>81</sup> agency compliance with this requirement has historically been minimal at best.<sup>82</sup> Most often federal agencies ignore the requirement altogether, or issue boilerplate language to the effect that an existing rule has been reviewed and the rule remains useful.<sup>83</sup> Apart from section 610, the RFA contains no practical mechanism to periodically evaluate and address the cumulative regulatory burden on small entities. Each new regulatory proposal is evaluated under the RFA independent of existing regulatory burdens. By contrast, the NEPA review process allows some assessment of cumulative impacts.<sup>84</sup> The RFA also considers sequential phases of a regulatory program on a piecemeal basis, rather than as an integrated whole. EPA's Clean Air Act program to reduce air emissions from non-road diesel engines,

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80. See, e.g., Animal Feeding Operations Consent Agreement and Final Order, 70 Fed. Reg. 4958 (Jan. 31, 2005). This EPA voluntary consent agreement concerning air emissions from poultry buildings requires signatories to fund air monitoring studies to support air standards. *Id.* While the agency solicited public comment on the consent agreement, the agreement was not subject to notice and comment procedures, nor to analysis under the RFA. *Id.*

81. 5 U.S.C. § 610 (2000).

82. See Michael See, *Willful Blindness: Federal Agencies' Failure to Comply with the Regulatory Flexibility Act's Periodic Review Requirement—and Current Proposals to Invigorate the Act*, 33 FORDHAM URB. L.J. 1199 (2006).

83. *Id.* at 1200.

84. See, e.g., *Natural Res. Def. Council v. Callaway*, 524 F.2d 79, 87 (2d Cir. 1975) (U.S. Navy's Environmental Impact Statement on ocean dumping must consider pending proposals by other agencies to dump in the same area); *Citizens for Responsible Area Growth v. Adams*, 477 F. Supp. 994, 1001-02 (D.N.H. 1979) (requiring agency to consider impact of all contemplated federal projects on airport and related industrial park).

for example, was implemented in four distinct “tiers.”<sup>85</sup> The tiers were reviewed in two completely separate SBREFA panels and IRFA/FRFAs, despite the fact that small businesses would ultimately have to bear the burden of all four tiers of requirements. This contrasts somewhat with the NEPA concept of a “programmatic” impacts review, under which the impact of the four tiers could have been evaluated together.<sup>86</sup> In general, federal agencies have some incentive to “piecemeal” their regulatory programs into a series of smaller rules. Not only does this piecemealing make it easier for agencies to certify each of the smaller rules under the RFA, it also helps them avoid having their proposal classified as “economically significant” by the Office of Management and Budget and subjected to regulatory review under Executive Order 12,866.<sup>87</sup>

## VI. RECOMMENDED LEGISLATIVE IMPROVEMENTS TO THE RFA.

To address the remaining weaknesses in the RFA discussed above, the following targeted legislative revisions would be beneficial:

- CODIFY EXECUTIVE ORDER 13,272

Executive Order 13,272 is working well to persuade agencies to adhere to the RFA’s required flexibility analysis process. As is the case with all executive orders, however, Executive Order 13,272 could be weakened or eliminated by a subsequent administration. Also, many independent federal agencies assert that they are not subject to the executive order and they make no effort to comply with it. Codifying the executive order into statutory law will enable small entities to be confident that agencies will continue to

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85. Control of Emissions of Air Pollution from Nonroad Diesel Engines, 63 Fed. Reg. 56,968 (Oct. 23, 1998) (defining Tiers I and II); Control of Emissions of Air Pollution from Nonroad Diesel Engines and Fuel, 69 Fed. Reg. 38,958 (June 29, 2004) (defining Tiers III and IV).

86. *See, e.g.*, Indian Lookout Alliance v. Volpe, 345 F. Supp. 1167, 1172 (S.D. Iowa 1972). The court held that a programmatic impact statement was required on a small, fourteen-mile highway segment, because building this small segment would establish the approximate route of the remaining segments of highway and preclude alternative routes. *Id.*

87. Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993). This Executive Order subjects any “significant regulatory action”—which generally means a rule that will have an annual effect on the economy of \$100 million or more—to review by the OIRA. *Id.* The Executive Order requires the agency to select the regulatory alternative that imposes the least burden on society consistent with maintaining an agency’s regulatory objectives. *Id.*

have their “feet held to the fire,” and that independent agencies will also be required to comply.

- REQUIRE FEDERAL AGENCIES TO ANALYZE FORESEEABLE INDIRECT IMPACTS AND CUMULATIVE IMPACTS

The RFA should be amended to require agencies to consider foreseeable “indirect” impacts within a reasonable degree of a planned regulatory action. The RFA should also require agencies to acknowledge and analyze, to the extent possible, the existing cumulative burden on regulated small entities. Taken together, these two revisions would yield far more useful and enlightening flexibility analyses than are available under the current RFA.

- STRENGTHEN SECTION 610 OF THE RFA

The RFA should be amended to strengthen the requirement that agencies review their existing rules every ten years. The scope of this review should include all rules issued by an agency, not just the rules an agency originally determined to have a significant economic impact on a substantial number of small entities. Moreover, when an agency has completed the required periodic review of a rule, the agency’s conclusion about the continued need for the rule—or the need to revise the rule—should be subjected to notice and comment in the *Federal Register*.<sup>88</sup> The RFA should also specify a timetable for the completion of periodic reviews.

## VII. CONCLUSION

The Regulatory Flexibility Act has always had two complementary objectives. The first is to ensure that federal agencies follow specific procedures to assess the economic impacts of their regulatory actions on small entities, and then consider regulatory alternatives that would reduce those impacts. The second, broader objective is to change the culture within federal agencies so that they appreciate the importance of small entities and reflect this appreciation in their regulatory actions. For many years, the RFA, as a tool for regulatory reform, seemed to be doing poorly at both objectives. Agencies either essentially ignored the RFA or conducted perfunctory regulatory flexibility analyses. This situation improved after 1996, when, for the first time, small entities could seek judicial review of an agency’s failure to comply with the RFA. The situation has further improved since 2002, when President Bush signed Executive Order 13,272. In general, federal regulatory agencies are now doing a better job of conducting flexibility

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88. See *supra* note 82, at 1240.

2006]                    *REGULATORY FLEXIBILITY ACT*                    1137

analyses and finding ways to reduce regulatory burdens on small entities. While most agencies have not yet fully embraced the RFA and made it part of their agency culture, great progress has been made since 1980. It is clear that the RFA has benefited small entities and the American public by improving the quality of federal rulemaking and reducing needless regulatory burden.

