

February 1, 2006

Via Facsimile and Electronic Mail

Julie MacDonald
Deputy Assistant Secretary for Fish,
Wildlife and Parks
U.S. Department of Interior
1849 C Street, N.W.
Room 3156
Washington, DC 20240

Re: Endangered and Threatened Wildlife and Plants; Revised Proposed Designation of Critical Habitat for the California Red-Legged Frog (*Rana aurora draytonii*) (70 Fed. Reg. 66,906).

Dear Deputy Assistant Secretary MacDonald:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits these comments on the U.S. Fish and Wildlife Service's (FWS) proposed rule, *Endangered and Threatened Wildlife and Plants; Revised Proposed Designation of Critical Habitat for the California Red-Legged Frog (*Rana aurora draytonii*)*.¹ Advocacy believes that the Regulatory Flexibility Act (RFA) requires FWS to complete an initial and final regulatory flexibility analysis for this rulemaking, as the evidence indicates the rule will have a significant economic impact on a substantial number of small entities. Advocacy also recommends the consideration of regulatory alternatives to minimize unnecessary small business regulatory burdens. Further, Advocacy concludes that under the RFA, FWS should not deny the public an opportunity for meaningful participation by deferring its small business impact determinations until after publication of proposed rules, as it has done in this case.

Congress established Advocacy in 1976 under Pub. L. No. 94-305 to represent the views and interests of small business within the Federal government.² Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the

¹ *Endangered and Threatened Wildlife and Plants; Revised Proposed Designation of Critical Habitat for the California Red-Legged Frog (*Rana aurora draytonii*)*, 70 Fed. Reg. 66906 (Nov. 3, 2005).

² Pub. L. No. 94-305, 90 Stat. 663, §§ 201 et seq. (codified at 15 U.S.C. §§ 634a-g).

Administration. Further, Advocacy has a statutory duty to monitor and report to Congress on FWS' compliance with the RFA.³

On August 14, 2002, President George W. Bush signed Executive Order 13272, requiring Federal agencies to implement policies protecting small businesses when writing new rules and regulations.⁴ This Executive Order authorizes Advocacy to provide comment on draft rules to the agency that has proposed or intends to propose the rules and to the Office of Information and Regulatory Affairs of the Office of Management and Budget.⁵ It also requires agencies to give every appropriate consideration to any comments provided by Advocacy regarding a draft rule.

I. The Economic Analysis Provided by FWS and the Makeup of the Home Building Industry Indicate the Rule Will Have a Significant Economic Impact on a Substantial Number of Small Entities, and the Rule Should be Accompanied by Regulatory Flexibility Analyses.

FWS has concluded in its draft economic analysis that:

Critical habitat is not expected to result in significant small business impacts since revenue losses are less than one percent of total small business revenues in affected areas. From permit data, it appears that large businesses greatly dominate Greenfield development. It is estimated that no more than a single small business will be affected annually as a consequence of designation.
Draft Economic Analysis, at 3 (I.7 Small Business Impacts).

However, this conclusion does not appear to be based on a sufficient factual basis to support a decision to certify this rulemaking as not having a significant economic impact on a substantial number of small entities. After reviewing the agency's materials provided in support of this rulemaking, Advocacy concludes that: (1) FWS appears to have significantly underestimated the number of affected small entities, and (2) FWS has improperly found the rule's impacts to be insignificant.

The assumptions underlying FWS' certification of no significant economic impact on regulated small entities appear to be incorrect. Advocacy recommends that FWS complete an initial regulatory flexibility analysis for the proposed rule and provide this analysis to the public for comment.

A. The Rule is Likely to Have a Significant Economic Impact on a Substantial Number of Small Entities.

Contrary to FWS' apparent conclusion that the rule is not likely to impose significant economic impacts on a substantial number of small entities, the draft economic analysis provided by FWS indicates that the rule will have a significant economic impact on a

³ 5 U.S.C. § 612.

⁴ Exec. Order. No. 13272, at § 1, 67 Fed. Reg. 53,461 (2002).

⁵ *Id.* at § 2(c).

substantial number of small entities. Also, small entity representatives have contacted Advocacy and commented that the rule will impose significant economic impacts.

1. *Substantial number of small entities.*

The draft economic analysis conducted by FWS and input from small entities support the conclusion that this rule will impact a substantial number of small entities. Advocacy believes that any factual basis for certification under the RFA or estimate of the affected small entities in an initial regulatory flexibility analysis must contain, at the minimum, a clear explanation of what type and how many small entities will be affected, as well as basic information allowing the public to determine how the agency arrived at such conclusions. FWS's draft economic analysis does not include any information with respect to the delineation of small entities within the regulated industry.

Based on our discussions with small entity representatives, FWS appears to have underestimated greatly the number of small entities in the home building industry this rulemaking would impact. According to FWS' draft economic analysis, this rule will only affect one or less small entity builders in each of the six counties for which the rule is projected to impose the most impacts.⁶ However, this conclusion appears to be based on an analysis of building permit data, which includes only the number of home *developers*, rather than *builders*.⁷ If it is indeed the case that FWS is using builders and developers interchangeably, FWS needs to revise its analysis and ensure that the conclusions reached at the NPRM stage still hold. This is a significant problem, as any statistical information that FWS relies on using the incorrect NAICS code will lead to incorrect conclusions as to the makeup and impacts to small home builders.

Advocacy has discussed the home building market with the primary trade association representing small home builders in Northern California, the Home Builders Association of Northern California. They informed Advocacy that when a building permit is granted to a developer, that developer then subcontracts the building project to a number of

⁶ FWS, *Economic Effects of Critical Habitat Designation for the Red-Legged Frog in 23 California Counties*, at 71 (Oct. 19, 2005) (*Draft Economic Analysis*) (available online at <http://www.fws.gov/sacramento/ea/Documents/Red-Legged%20Frog%20DEA%2010-19-05.pdf>).

⁷ FWS does not state anywhere in its analysis whether it is measuring impacts to home builders or developers, two distinctly different sets of businesses. However, the agency repeatedly references "developers," leaving Advocacy with the impression that its estimates do not pertain to home builders, but developers. Developers appear to be covered by NAICS code 237210, whereas new, single-family home builders are classified under NAICS code 236115. See U.S. Census Bureau, *North American Industry Classification System, Revisions for 2002* (available online at <http://www.census.gov/epcd/naics02/>). County level census business statistics report using these NAICS codes, meaning that substitution of these codes would be a fatal error to any small business impacts analysis. In what appears to be a related error, FWS also concluded in part that impacts would be insignificant because home builders would be able to substitute home remodeling for home building. Advocacy notes that residential home remodeling is not included within NAICS code 236115 (single-family home construction), but rather 236118 (residential remodelers).

builders who each build a handful of individual units.⁸ For example, in the case of an average new home development, one permit may cover 30-40 small home builders. FWS, in its economic analysis, concluded that only 22% of projects involve small builders.⁹ That percentage appears to be incredibly low considering the information in Note 8.

Based on FWS' analysis and discussions with the representatives of small home builders, Advocacy believes that the number of small home builders affected by this rule is many orders greater than indicated by FWS. Advocacy believes this to represent a substantial number of small entities.

2. *Significant economic impacts.*

The draft economic analysis provided by FWS for this critical habitat designation does not support the conclusion that the rule's economic impacts will not be significant to regulated small entities. FWS does not state in its draft economic analysis the actual costs it plans to impose per small business home builder; however, FWS does provide some estimate of the number of affected small developers (this number does not include home builders) and a total impact from the rule over 20 years.¹⁰

Absent impact data on small home builders, and given that FWS may have underestimated the total number of small home builders affected by the rule, the conclusion that the impact on small home builders is not significant needs to be substantiated further in the factual basis. Home builder trade representatives have unambiguously declared the impact significant. Advocacy suggests that FWS substantiate its conclusions through an initial regulatory flexibility analysis.¹¹

Advocacy notes that FWS has apparently discounted the significance of these economic impacts using a test for a rule's significance under the RFA which has been previously held by a Federal court to be improper.¹² On page 3 of the draft economic analysis, the agency states that the rule "is not expected to result in significant small business impacts

⁸ Telephone Interview with Paul Campos, General Counsel and Vice President for Government Affairs, Home Builders Association of Northern California (Jan. 27, 2006). It is worth noting that about 99 percent of businesses engaged in residential building construction are small and they employ 77.1 percent of the workforce in the industry. (2002 data, Office of Advocacy, U.S. Small Business administration, from data provided by the U.S. Census Bureau, Statistics of U.S. Business).

⁹ *Draft Economic Analysis*, at 67 ("Table VI-2: Small Business Impacts from Residential Construction").

¹⁰ *Draft Economic Analysis*, at 4 (Table I-1: Summary of Economic Effects of Critical Habitat Designation).

¹¹ For illustrative purposes, consider San Luis Obispo County. FWS concludes that the county will incur approximately \$4 million in annual revenue impacts due to the rule. *Id.* at 70 (Table VII-1). FWS also estimates that 1.1 small entities per year will incur these losses. *Id.* at 71 (Table VII-3). Advocacy believes that \$4 million is a significant economic impact to a small entity. Also, even if Advocacy is correct in its conclusion that FWS has greatly underestimated the number of small entities likely to be affected by the rule, it is likely that the impacts could amount to hundreds of thousands of dollars per firm, an amount that Advocacy would also believe to be significant.

¹² *North Carolina Fisheries Ass'n. v. Daley*, 27 F. Supp. 2d 650, 659 (E.D. Va. 1998).

since revenue losses are less than one percent of total small business revenues in affected areas.”¹³ This indicates that FWS may have divided the rule’s total impacts into the total revenues for all small business home builders for affected counties—whether those small entities were regulated or not—to conclude that the rule would reduce all small entities’ revenues by less than one percent. However, this test does not measure the impact of the rule to those small entities that are regulated, as the RFA requires. As the court found in *North Carolina Fisheries Ass’n. v. Daley*, when an agency measures the significance of a rule under the RFA, it must measure the significance to regulated small entities—without diluting that measure of significance by dividing it among entities which are not being regulated.¹⁴ In light of judicial precedent and the economic impact data reflected elsewhere in the economic analysis, Advocacy recommends that FWS remove this analysis and change its conclusion that the rule’s impacts to regulated small entities will not be significant for purposes of RFA analysis.

B. The Rule Should Be Accompanied by an Initial Regulatory Flexibility Analysis.

Since the evidence indicates that the rule will impose significant economic impacts on a substantial number of small entities, Advocacy recommends that FWS complete an initial regulatory flexibility analysis. Whenever an agency finds that a rule required to be promulgated through notice and comment rulemaking will have significant economic impacts on a substantial number of small entities, that agency is required to complete an initial regulatory flexibility analysis.¹⁵ The initial regulatory flexibility analysis must be published in the *Federal Register* for public comment, and must include an estimate of the number of small entities to which the rule will apply and “a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities.”¹⁶ Advocacy recommends that FWS publish an initial regulatory flexibility analysis with at least 60 days for the public to comment, the amount of time the agency provided for non-economic comments.

II. Recommended Small Business Alternatives.

Advocacy recommends that FWS consider regulatory alternatives which could reduce this rule’s impacts to small entities, including the exclusion of areas that FWS has identified as most likely to impose regulatory burdens to small home builders.

The ESA orders FWS to designate critical habitat, “after taking into consideration the economic impact” of such designation.¹⁷ Advocacy believes that the ESA invests

¹³ Draft Economic Analysis, at 3.

¹⁴ *North Carolina Fisheries Ass’n*, 27 F. Supp. at 658-660 (holding improper a test that divided the total economic impact into the total number of small entities, whether those small entities were being harmed by the rule or not).

¹⁵ 5 U.S.C. §§ 605(b) (certification), 603 (initial regulatory flexibility analysis).

¹⁶ 5 U.S.C. § 603.

¹⁷ 16 U.S.C. § 1533(b)(2).

considerable discretion in FWS in designating critical habitat, as the statute states that:

The Secretary may exclude any area from critical habitat if he determines that the benefits of such exclusion outweigh the benefits of specifying such area as part of the critical habitat, unless he determines, based on the best scientific and commercial data available, that the failure to designate such area as critical habitat will result in the extinction of the species concerned.
16 U.S.C. § 1533(b)(2).

The RFA requires agencies to publish with their final rules a final regulatory flexibility analysis, which includes, among other things:

[A] description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.
5 U.S.C. § 604(a)(5).

Thus, Advocacy believes that FWS should analyze regulatory alternatives to reduce small entity burdens to satisfy both the ESA's requirement to consider economic costs of designating critical habitat and the RFA's requirement to consider regulatory alternatives which minimize unnecessary economic impacts to small entities.

In this rule, it appears there are a number of geographical areas which could be excluded, and that FWS has not yet presented an explanation of concrete species benefits or asserted that the exclusion of these areas from a final critical habitat designation would result in species extinction. According to FWS' draft economic analysis, approximately 91% of the rule's impacts will be felt in eight counties; San Luis Obispo, Contra Costa, Santa Barbara, Ventura, Alameda, Riverside, Los Angeles, and Monterey. These eight counties account for \$10,457,818 of the \$11,484,407 in annual costs FWS projects the rule will have to home construction.¹⁸ FWS has conducted housing market analyses for these counties that identifies the geographic areas where home building may occur.¹⁹ Advocacy recommends that FWS consider excluding these areas from its designation, and provide the public with either a certification statement providing a factual basis to how the areas' exclusion causes the rule to not have significant economic impacts on a substantial number of small entities, or complete the required regulatory flexibility analyses.

III. FWS May Not Defer its Responsibilities Under the RFA Until After Publication of Proposed Rules.

It has been a pattern at FWS to issue a proposed rule, delay the RFA analysis pending further study, then certify that the rule will have no significant economic impact on a substantial number of small entities when the analysis is completed. Advocacy believes that deferring the small business impact and alternatives analysis until late in the

¹⁸ Id. at 70 (Table VII-1: Impact of CHD on New Home Construction Revenue).

¹⁹ Id. at 52-57.

rulemaking process does not give appropriate consideration to the requirements of the RFA. These delays in conducting the necessary RFA analysis thwart the ability of affected small entities to provide meaningful comment on the proposal's impact. Advocacy believes there are a number of small entities likely to face harm from this proposal, and they deserve an adequate opportunity to review the agency's RFA analysis.²⁰

IV. Conclusion.

Advocacy believes that there is insufficient factual basis for the certification of this rulemaking as not having a significant economic impact on a substantial number of small entities; and accordingly, that the agency should conduct regulatory flexibility analyses required by the RFA. Advocacy recommends the consideration of exclusion of certain areas from the final rule to minimize small entity regulatory burdens. Also, Advocacy also urges FWS to provide for meaningful public participation in its rulemaking process by including with proposed rules the determinations and regulatory analysis required by the RFA. Thank you for your consideration and please do not hesitate to contact Michael See with any further questions at (202) 619-0312 or Michael.See@sba.gov.

Sincerely,

/s

Thomas M. Sullivan
Chief Counsel for Advocacy

/s

Michael R. See
Assistant Chief Counsel

cc: The Honorable Dale Hall, Director, U.S. Fish and Wildlife Service

²⁰ FWS has not based its delays on the RFA's emergency rulemaking provision in this case. As Advocacy commented previously in another rulemaking:

The RFA requires agencies to publish a certification or [initial regulatory flexibility analysis] at the same time as the publication of their proposed rules. Should FWS find itself unable to comply with the RFA due to an emergency which would prevent the agency from timely compliance, the RFA provides for delayed compliance through specific mechanisms. However, FWS has not declared an emergency under the RFA. Advocacy believes that FWS is not entitled to delay its statutory obligations routinely, as such delays could deny the public an opportunity to participate in FWS rulemakings meaningfully.

Letter from Thomas M. Sullivan, Chief Counsel for Advocacy, to the Honorable Craig Manson, Assistant Secretary for Fish, Wildlife, and Parks, U.S. Department of the Interior, at 6 (March 29, 2005) (citations omitted).