Testimony of

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Agency Compliance With the Regulatory Flexibility Act and The Small Business Regulatory Enforcement Fairness Act

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Mr. Chairman, Members of the Committee, my name is Shawne Carter McGibbon, Acting Director of Interagency Affairs for the Office of Advocacy. Although I have been recently elevated to this position, I have worked in the Office of Advocacy since August 1994 as Assistant Chief Counsel for Food, Drug and Health Policy. As head of Interagency Affairs, I have the privilege of supervising and working with a talented staff of lawyers and policy experts that work diligently to ensure that Federal regulatory agencies comply with the various laws that require analyses of small business impact. I would like to recognize two members of my staff at this time, Jennifer Smith, an attorney with expertise in matters that include fisheries management; and Kevin Bromberg, an

attorney with expertise in environmental law. I know they would be delighted to assist in answering any questions you may have.

Before proceeding, I would like to state that, consistent with the Office's historical independence within the SBA and the Administration, the views expressed here are my own and do not necessarily reflect the views of SBA or the Administration. I have not discussed this testimony with anyone other than the staff of the Office of Advocacy and the Committee. Nor have I cleared the testimony with anyone in the Administration.

Introduction

My office has been asked to testify about our FY 2000 report, *20 Years of the Regulatory Flexibility Act: Rulemaking in a Dynamic Economy,* which describes agency compliance with the Regulatory Flexibility Act (RFA) and the Small Business Regulatory Enforcement Fairness Act (SBREFA). I applaud the committee for holding this hearing as we recognize the 5th anniversary of SBREFA, the 20th anniversary of the RFA and the 25th anniversary of the Office of Advocacy.

By way of background, the Office of Advocacy was created by Congress in 1976 to serve as the independent voice for small business within the Federal government and to measure the costs and impacts of small business regulation. Congress realized, however, that the creation of the Office of Advocacy, in itself, was not sufficient to sensitize Federal agencies to the fact that there are differences in the scale and resources of regulated entities, and that this failure adversely affected competition, discouraged innovation, and created market entry barriers. Hence, the RFA was enacted in 1980. Finally, in 1996, Congress added "teeth" to the RFA when it passed SBREFA which,

among other things, permits judicial review of an agency's failure to comply with the RFA, and requires special small business advocacy review panels for significant EPA and OSHA regulations. The panel process has institutionalized outreach to small entities and has helped ensure that EPA and OSHA identify and consider less burdensome alternatives that still accomplish their public policy objectives. Because of the type of early access to agency deliberations created by the panel process, Advocacy, small businesses, and the covered agencies have often been able to develop better rules. Of all the amendments enacted under SBREFA, the judicial review and review panel requirements have had the greatest impact on agency compliance with the RFA and on the manner in which the agencies interact with the Office of Advocacy.

With its new tools under SBREFA, Advocacy has been able to achieve significant regulatory cost savings for small business. Industry representatives, small businesses, and the Office of Advocacy working together helped achieve regulatory cost savings estimated at nearly $12 billion from 1998 to 2000. Advocacy is particularly proud of these achievements despite our increasing workload[1] and decreasing staff.[2]

Agency Compliance with the RFA

Agency compliance with the RFA has been spotty since enactment of the RFA in 1980. The RFA requires agencies to tailor rule requirements to fit the size, resources, and relative contribution to the problem of the small entities that will be subject to the requirements. Some agencies have ignored and continue to ignore the requirements of the RFA. Agencies sometimes perceive the RFA as a mere procedural hurdle over which

[1] In FY 2000, Advocacy staff dedicated nearly 700 hours per panel on a total of seven different panels.

they must jump in order to push rules forward. This kind of thinking lends itself to a "cookie cutter" approach that yields little in identifying a rule's true impact and provides little in the way of justification. Regulatory analysis, if it is to live up to the purpose and intent of the RFA, should not be an afterthought; rather it should be an integral part of the regulatory process.

The picture is certainly not all bad, however. A number of agencies have shown marked improvement in compliance since the enactment of SBREFA. Advocacy attributes this change to several important factors, including 1) the threat of judicial review; 2) Advocacy's outreach efforts to train agencies and small businesses in compliance requirements; 3) Advocacy's efforts to coordinate review of regulations with the Office of Information and Regulatory Affairs (OIRA) at the Office of Management and Budget (OMB); and 4) increasing early intervention in the rulemaking process through the panel process for covered agencies (i.e., EPA and OSHA) and improved interagency communication with certain other agencies (e.g., FDA).

Judicial Review. Prior to the advent of judicial review, the Office of Advocacy more than once began the process of filing an appellate brief under its *amicus curiae* authority. Without direct judicial review authority, Advocacy based its intervention on the argument that non-compliance with the RFA was arbitrary and capricious under the Administrative Procedure Act (APA). For various reasons, those actions did not go forward. Moreover, the Department of Justice often vehemently objected to our attempted interventions on constitutional and other grounds.

[2] In 1995, prior to enactment of SBREFA, Advocacy's headquarters staff numbered 53. Today, that number is about 33.

Once judicial review became a reality in 1996, the landscape changed dramatically. Advocacy first exercised its *amicus curiae* authority fully by filing a brief in the case of *Northwest Mining Association v. Babbitt*, 5 F.Supp. 2d 9 (D.D.C. 1998). In that case, Advocacy challenged the Bureau of Land Management's (BLM) use of a small business size standard that was not in compliance with the size standards defined in the Small Business Act, SBA's regulations, and the RFA. The brief also raised concerns about the agency's failure to comply with the APA and the substance of the agency's economic analysis. The court held that the agency's RFA certification of no significant impact on a substantial number of small entities was a violation of the RFA. The rule was remanded to the agency.

In one other case, *Southern Offshore Fishing Association v. Daley*, 55 F.Supp. 2d 1336 (M.D. Fla. 1999), Advocacy filed a notice of intent to intervene as *amicus curiae*, but subsequently entered a notice of withdrawal when the Department of Justice stipulated that the standard of review for RFA cases should be the "arbitrary and capricious" standard. The case proceeded through the courts and, notably, Advocacy's original comments on the regulation were influential in the court's decision. The court noted that the chief counsel for advocacy was the "watchdog of the RFA," and quoted excerpts from Advocacy's comments. Unfortunately, other courts have afforded Advocacy far less deference (see *American Trucking Association v. EPA*, 175 F.3d 1027 (D.C. Cir. 1999)).

As a result of these victories, Advocacy believes that agencies began to take the RFA and the work of Advocacy more seriously. At least one agency has expressed concern regarding the potential for judicial review and a desire to comply with RFA to

avoid legal peril. The mere threat of judicial review seems to be the "big stick" that allows us to walk softly.

Outreach and Training. Within a year of SBREFA becoming law, the staff at the Office of Advocacy trained over 600 Federal employees—regulatory staff, legal staff, policy staff and economists—in RFA and SBREFA compliance. In fact, some agencies requested agency-specific training at their offices.

In addition, in 1998, Advocacy published, *The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies.* The publication is a step-by-step guide to understanding the RFA. Some degree of agency input was incorporated into early drafts of the guide and the final version was distributed widely to each regulatory agency. The guide can be found on our website, along with most of our publications.[3]

Advocacy also hosts regular, ad-hoc industry roundtables in which agency staff, industry representatives, congressional staff and small businesses are invited to participate. These informal meetings have proven to be an excellent vehicle for identifying and raising awareness of small business issues concerning industry structure, pending legislative or regulatory issues, and new legal issues/court cases arising from the RFA.

These and other efforts by Advocacy to educate agencies and small business have paid valuable dividends in increased compliance.

Coordinated Review with OMB. In a January 1995 exchange of letters, Advocacy entered into an informal agreement with OIRA at OMB. The letters discussed ways in which OIRA could assist Advocacy in monitoring agency compliance with the RFA.

[3] www.sba.gov/advo

Among other things, Advocacy agreed to bring to the attention of OIRA instances where RFA problems existed.

Over the last couple of years Advocacy staff have worked closely with OIRA on many draft regulations. In fact, an increasing percentage of Advocacy's work has occurred during the pre-proposal stage largely because of the relationship that has developed with OIRA. It is significantly easier and more productive to deal with potential RFA and other problems before a rule reaches the *Federal Register*. This has been a mutually beneficial arrangement for both parties to the agreement because Advocacy and OIRA staff are able to use their combined expertise to tackle tough issues.

The Small Business Review Panel Process. Both EPA and OSHA must convene review panels whenever a regulation is being considered that is likely to have a significant economic impact on a substantial number of small entities. The panel, which includes OIRA's administrator, Advocacy's chief counsel, agency representatives, and small entity representatives, must review the agency's proposal and produce a report outlining the small entity comments and the panel's findings on the rule's impact. The covered agency may then consider whether to modify the proposal based on the panel's findings.

Rather than viewing the panel process as an unnecessary additional burden, EPA has acknowledged the positive outcomes for the agency and small businesses that have resulted from the panel process. An EPA official has said, "In each case the panel's report has included concrete recommendations to the Administrator for her to consider in the development of the subject rule."

Regulations that have developed out of the panel process have been changed in some cases to reduce burden in response to small business concerns. In one instance, an EPA regulation on industrial laundry water pollution was withdrawn because the data demonstrated that there was no need for national regulation; the savings to small businesses totaled about $103 million annually. Even the controversial OSHA ergonomics rule was modified significantly during the panel process to reduce burden before it was eventually withdrawn by the current administration.

More Improvement Needed 20 Years Later

Although there have been substantial increases in RFA compliance since passage of SBREFA, agency performance is still not consistent. In fact, various program offices within the same agency perform differently. Not even EPA, whose Office of Science and Technology (OST) we recognized in our 20th anniversary report as an exemplary performer in RFA compliance, has a perfect record of compliance with the RFA.

Despite all of the training and outreach, some agencies still lack a basic understanding of how the RFA works; why small businesses are important to this country's economy, job creation, and innovation; why regulations have disproportionate impacts on small businesses (or why a "one-size-fits-all" approach to regulation is not appropriate); what the definition of a small business is; or what the advantage is of early consultation on a regulatory proposal.

Again, some agencies do better than others. In our 20th anniversary report, Advocacy singled out OST within EPA's Office of Water, the Center for Food Safety and

Applied Nutrition (CFSAN) at FDA, the Employee Benefits Office at Treasury, and the SEC as high performers.

OST's data analyses have been extremely comprehensive. Moreover, Advocacy has been able to work effectively with this division of EPA to generate substantial cost savings in the promulgation of at least two significant rules proposed in 2000.

CFSAN has made every effort to consult Advocacy in the earliest stages of its regulations that are likely to have an impact on small entities—often before the rule is cleared by the Secretary of HHS and prior to OMB review. This was not always the case: CFSAN published a dietary supplement regulation in the mid-1990s that contained a poor analysis and faulty data. Since that time, this division of FDA has made a conscious decision to work with Advocacy to identify and mitigate small business impact at the early stages of the rulemaking process, rather than fight Advocacy after promulgation of the rule. Clearly, it would be beneficial if all agencies changed their regulatory culture and adopted this approach.

The Employee Benefits Office was also singled out in the report for its work to resolve the issues of more flexibility for small business 401(k) plans, comparability testing for defined contribution plans, and simplification of small business pension plans.

Finally, the SEC, which has always maintained a good relationship with Advocacy, frequently works with Advocacy at the pre-proposal stage of its rulemakings to assure sensitivity to small business concerns. The SEC is also diligent in complying with the RFA's size standard requirements and has an excellent record of adhering to the statutory process for obtaining exceptions.

Several agencies received honorable mention in the report, namely, the IRS[4] and the National Marine Fisheries Service (NMFS).

Although the IRS could do a better job of analyzing the impact of interpretative regulations they deem to contain de facto recordkeeping burdens (rather than only those with explicit recordkeeping burdens), the agency has done a good job of outreach whenever a regulation is likely to be controversial or contains a high-visibility small business problem. The agency is also becoming more amenable to gathering small business input before promulgating regulations.

NMFS has made strides toward greater RFA compliance. Having suffered a defeat in the *Southern Offshore Fishing* case referenced earlier, the agency has worked with Advocacy on important issues concerning "spotter planes" and the Florida Keys sanctuary to avoid a similar fate under judicial review. Although the NMFS has more work to do, the agency has taken positive steps toward improvements by consulting with Advocacy in developing guidance for its staff on RFA compliance, hiring an economist and lawyer to work exclusively on RFA issues, and making significant attempts to increase outreach to small entities.

Finally, Advocacy included in its report four agencies in need of more improvement in RFA compliance: the Federal Communications Commission (FCC), the Health Care Financing Administration (HCFA) at HHS, the Food and Nutrition Service (FNS) at USDA, and the Food Safety and Inspection Service (FSIS) at USDA.

The FCC routinely fails to provide adequate discussion or analysis of small business impacts, relying instead on cut-and-paste RFA analyses. The FCC also violates

[4] The IRS is required to analyze under the RFA only interpretative regulations that contain recordkeeping/paperwork requirements.

statutory requirements governing size standards for small businesses under the Small Business Act, seeking approval of size standards that have already been adopted by the agency. Although there have been several RFA training sessions for the FCC, problems remain.

HCFA has a challenging congressional mandate to implement major Medicare reforms within short statutory deadlines; however, the agency could do a more thorough job of considering less burdensome alternatives and being more sensitive to the need for public notice and comment. For instance, in the past, HCFA seemed to have had a practice of publishing direct and interim final rules on significant regulations that allowed the agency to bypass normal notice and comment procedures under the Administrative Procedure Act. Similarly, the agency requested expedited OMB review of paperwork requirements, thereby shortening the time for public comment. HCFA has, however, made progress toward RFA compliance in its efforts to consult Advocacy early on some controversial regulations.

Twice in FY 2000, the FNS failed to provide a factual basis for its RFA certifications and failed to address the number of small entities potentially affected by the two rules. The agency had made no changes to its draft final rule based on Advocacy's comments submitted during the public comment period, but worked with OIRA and Advocacy to resolve some of the problems prior to publication of a final rule.

Finally, twice in 1999, FSIS issued what it called "policy changes" that adversely affected thousands of small entities. Despite the impact of the changes, the agency failed to prepare any type of analysis. In the opinion of the Office of Advocacy these changes were disguised rulemakings that were not subjected to public notice and comment. To the

credit of FSIS, its staff requested and were given a tailored presentation on RFA compliance by Advocacy staff.

Lingering Issues

Many good things can be said about the RFA as amended by SBREFA. Much has been accomplished in reducing regulatory burden and improving agency compliance. The RFA, however, is not an altogether perfect vehicle because of at least one loophole in the law. For years, Advocacy has struggled with the RFA's failure to address adequately the problem of indirect effects. The controlling legal case, *Mid-Tex Electric Co-op, Inc. v. F.E.R.C.*, 773 F.2d 327 (D.C.Cir. 1985), states that agencies doing regulatory flexibility analyses are in compliance with the RFA if they only estimate the costs to be incurred by those entities that will be directly subject to a regulation. Agencies do not have to take into account indirect costs that occur as the result of, but not mandated by, a regulation. This becomes particularly problematic where indirect costs are foreseeable and measurable, as opposed to instances in which they are not. In a fairly recent case, the EPA imposed air quality standards on states, which must in turn regulate tens of thousands of small entities. Advocacy does not have the solution to this problem, but the office certainly would not want agencies to have to analyze the impact of every possible indirect effect, only those that are measurable and foreseeable.

Another issue of concern is the timeliness and adequacy of the information received during the panel process. The small entity representatives and the panel need to learn about the small firm contribution to the environmental problem, the expected impacts on small firms, and the appropriate regulatory alternatives to make the 60-day

panel process work in an even more meaningful way. Although the four affected federal agencies (EPA, OSHA, SBA, and OMB) continue to work on this problem, it is possible that legislative improvement is warranted with respect to specific types of information that ought to be required under the panel process.

One other loophole in the RFA is that the law applies only when notice and comment are required by the APA or some other law. This means that if an agency uses the APA's notice and comment exceptions to publish an interim or direct final rule, the RFA does not apply. Often, these final rules are significant and have an impact on many small entities, but the agencies are not required to prepare an analysis of the impact under the RFA. Sometimes agencies publish a final rule within the comment period, but the effective date of the regulation generally coincides with the end of the comment period. This makes the so-called comment period appear to be nothing more than administrative window-dressing. On occasion, Advocacy's response has been to use the provision of the APA (section 553(e)) that allows any interested person to petition an agency for the amendment or repeal of a rule. Unfortunately, this approach has had very limited success. Again, Advocacy does not have the solution to this dilemma, but we do wish to make the committee aware of these problems.

Thank you again for allowing me to testify. On behalf of the Office of Advocacy, I appreciate the opportunity to showcase the work of my talented staff and our experience with the RFA. I look forward to answering any questions you may have.