Office of Advocacy

A Voice for Small Business

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U.S. House of Representatives
Committee on Small Business

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Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. The Chief Counsel for Advocacy, who is appointed by the President and confirmed by the U.S. Senate, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Issues are identified through economic research, policy analyses, and small business outreach. The Chief Counsel's efforts are supported by offices in Washington, D.C., and by Regional Advocates. For more information about the Office of Advocacy, visit ***http://www.sba.gov/advo****, or call (202) 205-6533*

Chairman Manzullo, Ranking Member Velazquez, Members of the Committee, good afternoon and thank you for the opportunity to appear before you today to address H.R.2345, the Regulatory Flexibility Improvements Act. My name is Thomas M. Sullivan and I am Chief Counsel for the Office of Advocacy at the U.S. Small Business Administration. As Chief Counsel for Advocacy, I am charged with monitoring federal agencies' compliance with the Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA). Because my office is independent, these views are my own and do not necessarily reflect the views of the Administration or the U.S. Small Business Administration.

Success of the Small Business Regulatory Enforcement Fairness Act

Congress enacted the RFA in 1980 after determining that uniform federal regulations produced a disproportionate adverse economic hardship on small entities. In an attempt to minimize the burden of regulations on small entities, the RFA mandated federal agencies to consider the potential economic impact of federal regulations on small entities and to examine regulatory alternatives that achieve the agencies' public policy goals while minimizing small entity impacts.

Agency compliance with the RFA, however, was not judicially reviewable. Therefore, agencies could not be held legally accountable for their noncompliance with the statute. Consequently, many agencies ignored the RFA and did not conduct full regulatory flexibility analyses in conjunction with their rulemakings. In response to the widespread agency indifference, Congress amended the RFA in 1996 by enacting the

SBREFA, which reshaped the requirements of the RFA and provided for judicial review of agencies' final decisions under the RFA.

The RFA requires agencies to prepare and publish an initial regulatory flexibility analysis (IRFA), when proposing a regulation, and a final regulatory flexibility analysis (FRFA) when issuing a final rule for each rule that may have a significant economic impact on a substantial number of small entities. The analysis is prepared to ensure that the agency has considered the economic impact of the regulation on small entities and that the agency has considered all significant regulatory alternatives that would minimize the rule's economic impact on affected small entities. The RFA allows an agency to certify a rule in lieu of preparing a regulatory flexibility analysis if the head of the agency "certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." Pursuant to SBREFA, the agency must provide a factual basis for the certification.

SBREFA has been successful. In general, agencies have paid closer attention to their RFA obligations and implemented less costly regulations. Some agencies submit their draft regulations to Advocacy early in the process to obtain feedback on their RFA compliance and small business impact. Early intervention and improved agency compliance with the RFA have led to less burdensome regulations. For example, in FY 2001, involvement by the Office of Advocacy in agency rulemakings helped save small businesses an estimated $4.4 billion in new regulatory compliance costs.[1] Similarly, in FY 2002, the Office of Advocacy's efforts to improve agency compliance with the RFA

[1] The annual reports on the RFA can be found on the Office of Advocacy's website at http://www.sba.gov/advo/laws/flex/.

on behalf of small entities secured more than $21 billion in first-year cost savings, with an additional $10 billion in annually recurring cost savings.[2] Most recently, in FY 2003, Advocacy achieved more than $6.3 billion in regulatory cost savings and more than $5.7 billion in recurring annual savings on behalf of small entities.

Executive Order 13272

Even with the additional requirements under SBREFA and the threat of judicial review, some agencies were not complying with the requirements of the RFA. On March 19, 2002, President George W. Bush announced his Small Business Agenda, which included the goal of "tearing down the regulatory barriers to job creation for small businesses and giv[ing] small business owners a voice in the complex and confusing federal regulatory process." To accomplish this goal, the President sought to strengthen the Office of Advocacy by enhancing its relationship with the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) and creating an executive order that would direct agencies to work closely with the Office of Advocacy and properly consider the impact of their regulations on small entities. To further this goal, on August 13, 2002, the President signed Executive Order (E.O.) 13272, titled "Proper Consideration of Small Entities in Agency Rulemaking."[3]

E.O. 13272 enhances Advocacy's RFA mandate by directing Federal agencies to implement written procedures and policies for measuring the economic impact of their

[2] It should be noted that revisions made by the Environmental Protection Agency (EPA) to its Cross Media Electronic Reporting and Record-Keeping rule produced an estimated savings of $18 billion. Without that rule, Advocacy's interventions in FY 2002 resulted in more than $3 billion in first year cost savings.
[3] E.O. 13272 can be found on the Office of Advocacy's website at http://www.sba.gov/advo/laws/eo13272.pdf.

regulatory proposals on small entities. It also requires agencies to notify Advocacy of draft rules that are expected to have a significant economic impact on a substantial number of small entities and to give every appropriate consideration to any comments provided by Advocacy, including publishing a response to Advocacy's comments in the Federal Register. The Office of Advocacy must provide periodic notification, as well as training to all federal agencies on how to comply with the RFA.

As a result of E.O. 13272, all Cabinet-level departments, except the Department of State and the newly formed Department of Homeland Security, have developed written plans in compliance with E.O. 13272. The performance of the independent agencies, however, was not as stellar. Of the 75 independent regulatory agencies, only 16 responded to the requirements of the E.O. Of those 16, only eight provided written procedures, six claimed that they did not regulate small entities, and two claimed to be exempt from the E.O.. In terms of training, Advocacy has trained 19 agencies and is planning to train 30 agencies before the end of this year. More importantly, several agencies have actively sought ways to improve their compliance either through involving Advocacy early in the rulemaking process or reaching out to small entities.

The Construction and Development Water Quality (C&D) rule considered by the U.S. Environmental Protection Agency (EPA) is indicative of the type of success that can be achieved through interagency cooperation and agency compliance with the dictates of the RFA and E.O. 13272. The original draft proposed rule carried a price tag of almost $4 billion per year. The rule contained new requirements that overlapped with existing storm water programs. Fortunately, small business had a voice in the rulemaking process

because of the panel process that was enacted as part of SBREFA. The panel requirements apply to EPA and the Occupational Safety and Health Administration (OSHA) and require those agencies to formally consult with small businesses prior to issuing a proposed rule. Small businesses provided information about the potential impact of EPA's C&D rule and offered other options. After reviewing the information, the SBREFA panel concluded that the C&D requirements would add substantial complexity and cost to current storm water requirements without a corresponding benefit to water quality. The panel recommended that EPA not impose the C & D requirements, and focus instead on improving public outreach and education about existing storm water rules. On March 31, 2004, EPA announced that it would not impose new duplicative, costly, and complex requirements for construction sites.[4]

H.R. 2345

Even though the last few years have yielded a number of successes, there are certain loopholes in the RFA that were not addressed through the E.O. or SBREFA. H.R. 2345 would amend the RFA to address many of the gaps or problem areas. Since Advocacy takes its guidance from small entities, Advocacy met with small entity representatives to discuss the most important issues in H.R. 2345. The most prevalent issues are:

1) direct v. indirect economic impacts;
2) inclusion of the Internal Revenue Service's (IRS) interpretative rules;
3) the importance of analyzing cumulative impacts;
4) the importance of analyzing beneficial impacts; and
5) the expansion of the panel process to more agencies.

[4] A press release on the C&D rule can be found at http://www.sba.gov/advo/press/04-11.html.

Direct v. Indirect Economic Impacts

Of all the issues, the most prevalent concern of the small business community is the lack of inclusion of indirect impacts in the current version of the RFA. Pursuant to sections 603, 604 and 605(b) of the RFA, agencies are required to consider the economic impact of an action on small entities. Although the RFA does not define economic impact, the committee report for the RFA suggested that agencies should consider direct and indirect impacts of the proposed regulation. The courts, however, have interpreted the RFA differently.

The primary case on the consideration of direct versus indirect impacts for RFA purposes in promulgating regulations is Mid-Tex Electric Co-op Inc. v. F.E.R.C., 249 U.S. App. D.C. 64, 773 F.2d 327 (1985) (hereinafter Mid-Tex). Mid-Tex addressed a FERC ruled that electric utility companies could include in their rate bases amounts equal to 50% of their investments in construction work in progress (CWIP). In promulgating the rule, FERC certified that the rule would not have a significant economic impact on a substantial number of small entities. The basis of the certification was that virtually all of the utilities did not fall within the meaning of the term small entities as defined by the RFA. Plaintiffs argued that FERC's certification was insufficient because it should have considered the impact on wholesale customers of the utilities as well as the regulated utilities. The court dismissed the plaintiffs' argument. The court concluded that the agency did not have to consider the economic impact of the rule on small entities that did not have to directly comply with the requirements of the rule.[5]

[5] Id. at 342.

Post-SBREFA, the U.S. Court of Appeals for the District of Columbia applied the holding of the Mid-Tex case to American Trucking Associations, Inc. v. U.S. E.P.A., 175 F.3d 1027, 336 U.S.App.D.C.16 (D.C.Cir., May 14, 1999) (hereinafter ATA). In the ATA case, EPA established primary national ambient air quality standards (NAAQS) for ozone and particulate matter. At the time of the rulemaking, EPA certified the rule pursuant to 5 USC § 605(b). The basis of the certification was that EPA had concluded that small entities were not subject to the rule because the NAAQS regulated small entities indirectly through the state implementation plans (SIPs). Although the court remanded the rule to the agency, the court found that EPA had complied with the requirements of the RFA. Specifically, the court found that since the states, not EPA, had the direct authority to impose the burden on small entities, EPA's regulation did not directly impact small entities.[6] The court also found that since the states would have broad discretion in obtaining compliance with the NAAQS, small entities were only indirectly affected by the standards.[7]

In Mid-Tex, compliance with FERC's regulation by the utilities was expected to have a ripple effect on customers of the small utilities. There were several unknown factors in the decisionmaking process that were beyond FERC's control such as whether utility companies had investments, the number of investments, costs of the investments, the decision of what would be recouped, who would the utilities pass the investment costs on to, etc. Unfortunately, the idea of the RFA not applying to indirect economic impacts is now being used by agencies in cases where the impact is reasonably foreseeable, which usurps the spirit of the RFA.

[6] Id.
[7] Id.

The 2002 Immigration and Naturalization Service's (INS) rule on B nonimmigrant alien visas illustrates the importance of having reasonably foreseeable indirect impacts analyzed under the RFA in the rulemaking process. On April 12, 2002, the Immigration and Naturalization Service (INS) published a proposed rule on *Limiting the Period of Admission for B Nonimmigrant Aliens.* The proposal eliminated the minimum six (6) months admission period of B-2 visitors for pleasure and placed the onus of explaining the amount of time for the length of stay on the foreign visitor. If the length of stay could not be determined, the INS agent would issue a visa for thirty (30) days. Although it was foreseeable that small businesses in the travel industry could lose approximately $2 billion as a result of the proposal, INS certified that the proposal would not have a significant economic impact on a substantial number of small entities. The basis for the certification was that the proposal applied only to nonimmigrant aliens visiting the United States as visitors for business or pleasure. Because the courts have interpreted the RFA as only requiring agencies to consider the economic impact of the proposal on the entities that the proposal will directly impact, the certification was not technically erroneous. Advocacy asserted that from the standpoint of good public policy, the agency had a duty to perform a regulatory flexibility analysis and to consider less burdensome alternatives for achieving their goal when the potential impact of a regulation was foreseeable and economically devastating to a particular industry.[8] Advocacy reiterated this position at a hearing before the Small Business Committee in June 2002.[9] Representatives from the travel industry also testified at that hearing about

[8] The Office of Advocacy's comment letter is located at http://www.sba.gov/advo/laws/comments/ins02_0513.html.
[9] The Office of Advocacy's testimony is located at http://www.sba.gov/advo/laws/test02_0619.html.

the potential economic impacts that their businesses would have experienced as a result of INS's actions.

Because of the potentially devastating effect that not considering indirect impacts may have on small entities, Advocacy strongly supports section 3(b) of H.R. 2345, which defines economic impact to include foreseeable indirect economic impacts. Requiring agencies to perform a regulatory flexibility analysis would provide the public with information about the potential economic impact of an agency's proposed action. More important, it would require agencies to consider less costly alternatives that would help create an environment where entrepreneurship can flourish.

Inclusion of Certain Interpretative Rules Involving the IRS

Section 3(f) of H.R. 2345 expands the scope of applicability of the RFA to IRS actions that impose a recordkeeping requirement without regard to whether the requirement is imposed by statute or regulation. Traditionally, the IRS's compliance with the RFA has been marginal. The IRS implements changes that are resource-intensive for small entities. However, it often usurps the RFA by asserting that the particular action is not a legislative rulemaking. Small entities, therefore, are often subjected to burdensome and costly actions without the benefit of an analysis or the consideration of less costly alternatives. Section 3(f) of H.R. 2345 addresses that problem by requiring the IRS to prepare an IRFA for all recordkeeping requirements. Advocacy strongly supports section 3(f).

Cumulative Impacts

Another issue that small business representatives feel strongly about is the consideration of cumulative impacts. Unlike the National Environmental Policy Act (NEPA), the RFA does not require agencies to consider the cumulative economic impacts of their regulatory actions. Therefore, it is possible for an agency to institute a series of regulatory changes that individually may not have a significant economic impact but may be cumulatively devastating when a small business has to comply with two or more of them.

An example of cumulative impacts can be found in the regulations that were implemented by the Department of Health and Human Services under the Medicare anti-fraud reforms that came out of the Balanced Budget Act of 1997. The statute affected every type of business in the health care industry. If we single out the home health industry, the Medicare reforms resulted in multiple regulations, each burdensome in their own right. These regulations included an interim payment system for home health agencies, surety bonds for home health agencies, a prospective payment system for home health agencies, and OASIS (outcome and assessment information set) patient assessment reporting. The cumulative impact of these rules was devastating to the home health care industry, but since the different segments of the rule were implemented at different times, the agency did not consider the cumulative impact of its actions.

Section 4 of H.R. 2345 addresses this problem by requiring agencies to estimate the cumulative economic impact of a proposed rule on small entities. For the reasons stated above, Advocacy supports this amendment to the RFA.

Beneficial Impacts

H.R. 2345 also amends the RFA to require agencies to consider the beneficial impacts of regulatory actions on small entities. Currently, the RFA is silent as to whether agencies need to consider beneficial impacts. However, the legislative history of the RFA indicates that Congress considered the term "significant" to be neutral with respect to whether the economic impact is beneficial or harmful to small businesses. It states that:

> Agencies may undertake initiatives which would directly benefit such small entities. Thus, the term 'significant economic impact' is neutral with respect to whether such impact is beneficial or adverse. The statute is designed not only to avoid harm to small entities but also to promote the growth and well-being of such entities.[10]

Although Advocacy has consistently maintained that agencies should analyze the beneficial impacts of the RFA, most agencies do not perform such an analysis. From Advocacy's standpoint this is unfortunate. By analyzing the beneficial impacts, the agency would be providing the public with important information about its assumptions in the rulemaking process. Amending the RFA to include beneficial impacts would clarify the original congressional intent and increase the transparency of the rulemaking process for small entities.

Suggested Improvements to H.R. 2345

Expansion of the Panel Process

Advocacy supports the expansion of the SBREFA panel process to better sensitize CMS, IRS and the Federal Communications Commission (FCC) to small business

[10] 126 Cong. Rec. H8,468 (daily ed. Sept. 8, 1980).

concerns. However, Advocacy is concerned about the changes that H.R. 2345 makes to the panel process. The panel process described in section 6 of H.R. 2345 provides Advocacy with responsibility for drafting the panel report. The current process produces a consensus report negotiated between Advocacy, OMB, and EPA or OSHA. Because it is a consensus document, agencies typically follow the recommendations. Moreover, Advocacy has developed a productive panel process with EPA and OSHA that may be jeopardized if the process is statutorily restructured at this time. Advocacy, therefore, recommends that H.R. 2345 expand the panel process to CMS, IRS and the FCC but make it consistent with the panel process that is currently in place.

Establishment and Approval of Small Business Size Standards by Chief Counsel for Advocacy

Currently, section 601(3) of the RFA provides that the term "small business" has the same meaning as the term "small business concern" under section 3 of the Small Business Act, unless an agency, after consulting with the Office of Advocacy of the Small Business Administration and after an opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes the definition in the Federal Register. The law assumes that the SBA size standard is appropriate unless the agency pursues a different one.

Section 9 of H.R. 2345 amends the Small Business Act to allow the Chief Counsel for Advocacy to specify small business size definitions or standards for the purposes of any Act other than the Small Business Act or the Small Business Investment Act of 1958. Advocacy is concerned that vesting the authority to determine size standards to the Chief Counsel for Advocacy may cause confusion over which SBA

office determines size standards. The SBA's Office of Size Standards has the necessary expertise and resources to make appropriate decisions regarding industry size determinations. I do not believe that the proposed section 9 of HR 2345 will benefit small entities.

Requiring Agencies to Address Advocacy's Written Comments

Although section 4(b)(3) of H.R. 2345 requires agencies to respond to Advocacy's comments if an agency prepares a FRFA, it does not provide for Advocacy's comments to be addressed if the agency certifies the rule at the final stage of the rulemaking. This is particularly important since in FY 2003, 11.7% of Advocacy comments were on improper certifications and 15.5% of Advocacy comments were on inadequate or missing IRFAs.[11] Under H.R. 2345, therefore, anywhere from 11% to 26% of Advocacy's comments could go unaddressed, if agencies decide to certify final rules in lieu of preparing a FRFA. Advocacy suggests that H.R. 2345 be amended to require agencies to provide written responses to all comments submitted by Advocacy, regardless of whether the agency prepares a FRFA or a certification for the final rule. H.R. 2345 in this way sets into law a key component of E.O. 13272 and would provide further assurance that small business has a voice in the rulemaking process.

610 Periodic Review

Section 610 of the RFA requires agencies to periodically review all rules that have or will have a significant economic impact on a substantial number of small entities. The purpose of the review is to determine whether such rules should be continued

[11] See, Report on the Regulatory Flexibility Act, FY 2002, page 14.

without change, or should be amended or rescinded, consistent with the stated objectives of applicable statutes. Section 7 of H.R. 2345 amends the RFA to require an agency to submit an annual report on the result of its plan to Congress and OIRA. I recommend that H.R. 2345 be amended to include the Chief Counsel for Advocacy as a recipient of the agencies reports at the same time they are submitted to Congress.

Conclusion

Advocacy believes that H.R. 2345 makes several needed improvements to the RFA. The amendments will further federal agency understanding of RFA obligations. H.R. 2345 will improve the RFA to allow for a more thorough analysis, foster the consideration of alternatives that will reduce the regulatory burden on small entities, and improve the transparency in the rulemaking process.

Thank you for allowing me to present these views. I would be happy to answer any questions.