

HB 3430 SMALL BUSINESS IMPACT FINAL GUIDELINES

April 2008

The 80th Legislature adopted HB 3430 which, among other things, requires that, as part of the rulemaking process, state agencies must prepare an Economic Impact Statement that assesses the potential impact of a proposed rule on small businesses and a Regulatory Flexibility Analysis that considers alternative methods of achieving the purpose of the rule if the proposed rule will have an adverse economic effect on small businesses. HB 3430 also required that the Attorney General, in consultation with the Comptroller, prepare these guidelines to assist agencies in determining a proposed rule's potential adverse economic effects on small businesses and in identifying and evaluating alternative methods.

The Office of the Attorney General prepared Interim Guidelines in September 2007 and distributed them to state agencies and other interested parties for review and comment. Proposed Guidelines were prepared based on the comments received and were published in the *Texas Register* for additional public comment on February 1, 2008 (33 TexReg 985). These Final Guidelines were developed in response to the comments received.

Attached to these Guidelines are the following appendixes: Text of § 2006.002 as amended, a Sample Economic Impact Statement and Regulatory Flexibility Analysis, and a Sample Statement Regarding the Public Health, Safety, and Welfare.

I. REQUIREMENTS

The requirements for an Economic Impact Statement and Regulatory Flexibility Analysis are set forth under section 3 of HB 3430, which amends Texas Government Code § 2006.002. Section 2006.002 as amended by HB 3430 is set out in an appendix to these guidelines.

HB 3430 requires that before adopting a rule that may have an adverse economic effect on small businesses a state agency shall prepare an Economic Impact Statement that estimates the number of small businesses subject to the proposed rule, projects the economic impact of the rule on small businesses, and describes alternative methods of achieving the purpose of the proposed rule. An agency's consideration of alternative methods must be set forth in a Regulatory Flexibility Analysis (§ 2006.002(c)). The Regulatory Flexibility Analysis must consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives while minimizing adverse impacts on small businesses. The state agency must include in the analysis several proposed methods of reducing the adverse impact of a proposed rule on a small business (§ 2006.002(c-1)). Each agency must assess for itself the quality and quantity of the data needed to prepare an Economic Impact Statement for a proposed rule.

The Economic Impact Statement and Regulatory Flexibility Analysis must be included in the notice of the proposed rule (§ 2006.002(d)). Copies of the notice of the proposed rule that is submitted to the *Texas Register* must also be provided to the Senate and House standing committees that are charged with reviewing the proposed rule (§ 2006.002(d)).

Section 2006.002, as amended by HB 3430, applies only to a rule that is adopted on or after January 1, 2008. A rule adopted before that date is governed by the law in effect when the rule was adopted, and the former law is continued in effect for that purpose. In accordance with the Administrative Procedure Act, Texas Government Code Ch. 2001, the use of the word “adopted” indicates that this requirement applies to the date that a rule is actually adopted by a state agency, not to the date when an adopted rule is filed with the Secretary of State. *See* Texas Government Code § 2001.033 and § 2001.036.

II. OUTLINE OF REQUIRED STEPS

Is an Economic Impact Statement required?

- Would the proposed rule have:
 - 1) an adverse economic effect;
 - 2) on small businesses?

If the answer to both question is yes, then an Economic Impact Statement must be prepared that includes:

- An estimate of the number of small businesses subject to the proposed rule;
- A projection of the economic impact of the proposed rule on small businesses; and,
- A Regulatory Flexibility Analysis, which reflects an agency’s consideration of the alternative methods described in the Economic Impact Statement, must include:
 - Consideration of the use of regulatory methods that will achieve the purpose of the proposed rule while minimizing adverse impacts on small businesses, if consistent with the health, safety, and environmental and economic welfare of the state; and,
 - An analysis of several proposed methods of reducing the adverse impact of the proposed rule on small businesses.

Notice and Comment is required:

- Include the Economic Impact Statement and the Regulatory Flexibility Analysis in the notice of the proposed rule in the *Texas Register*
- Provide copies to the standing committees of each house of the legislature that is charged with reviewing the proposed rule
- Respond to any comments on the Economic Impact Statement and Regulatory Flexibility Analysis as required in any adoption preamble.

III. WHAT IS A SMALL BUSINESS?

As provided under § 2006.001(2), as amended by HB 3430, a small business is an entity that is:

- 1) for profit,
- 2) independently owned and operated, and
- 3) has fewer than 100 employees or less than \$6 million in annual gross receipts.

Each of these three elements should be met in order for an entity to qualify as a small business under HB 3430. A business must be operated for profit. Consequently, rules that apply exclusively to non-profit and governmental entities need not comply with HB 3430.

Independently owned and operated businesses are self-controlling entities that are not subsidiaries of other entities or otherwise subject to control by other entities and entities that are not publicly traded. To qualify as a small business, an entity must have either fewer than 100 employees or less than \$6 million in annual gross receipts. Practically, the standard of fewer than 100 employees will be the easiest to determine and implement. Data on an entity's annual gross receipts is generally not publicly available.

In some cases, individual persons licensed by an agency might be considered to be small businesses. Whether an individual licensee might be a small business will depend upon the nature of the regulated profession or trade and the governing statute. An agency should look to see if any of its licensees might practice as small businesses.

IV. ADVERSE ECONOMIC EFFECT

Section 2006.002(c) requires that "[b]efore adopting a rule that may have an adverse economic effect on small businesses, a state agency shall prepare" an Economic Impact Statement and Regulatory Flexibility Analysis. One of an agency's first inquiries should be whether a proposed rule may have an adverse economic effect on small businesses.¹

If a proposed rule will not have an adverse economic effect on small businesses, an agency should include a finding to that effect in the notice of the proposed rule. An agency is not required to prepare an Economic Impact Statement and Regulatory Flexibility Analysis if there is no adverse economic effect.² An agency should, however,

¹ Courts have not interpreted the meaning of "adverse effect" under § 2006.002. *See Unified Loans, Inc. v. Pettijohn*, 955 S.W.2d 649 (Tex. App.--Austin 1997, no pet.). WEBSTER'S DICTIONARY defines "adverse" as "1 : acting against or in a contrary direction : Hostile <hindered by ~ winds> 2 : opposed to one's interests : Unfavorable <an ~ verdict>." 59 (9th New Collegiate ed. 1990).

² *Texas Shrimp Ass'n v. Texas Parks & Wildlife Dep't*, 2005 WL 1787453, at *6 (Tex. App.—Austin 2005, no pet.) (not designated for publication) ("The requirements in section 2006.002 are not absolute,

provide a reasoned explanation in the preamble for the proposed rule as to why an Economic Impact Statement and Regulatory Flexibility Analysis is not required for a proposed rule.³

Adverse economic effects can include the costs to a small business for compliance with a proposed rule and may include a loss of business opportunities as the result of regulatory limits. What constitutes an adverse economic impact may depend upon the characteristics of a regulated industry and upon the effect of a proposed rule. However, an agency need only consider direct adverse economic effects. An agency need not consider indirect economic effects, such as impacts on small businesses that are not regulated entities.⁴ Generally, there is no need to examine the indirect effect of a proposed rule on entities outside of an agency's regulatory jurisdiction. However, an agency should carefully evaluate a proposed rule where indirect effect may be of particular concern, such as the impact of a proposed rule on other regulated entities.

Adverse economic effects need not be limited to regulatory programs. Adverse economic effects can also be associated with grant programs or other voluntary programs.

V. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS

Agencies should make a reasonable, good-faith effort to prepare an Economic Impact Statement and Regulatory Flexibility Analysis that will provide the public and the affected small businesses with information about the potential adverse effects of the proposed rule and about potentially less-burdensome alternatives.⁵ Substantial

but rather are conditioned on the adoption of 'a rule that would have an adverse economic effect on small businesses',” quoting the text of § 2006.002(c) as it existed at the time).

³ An objective of statutes such as § 2006.002 "is to afford adequate notice--to place the agency's assessment before interested persons in advance in order that (1) interested persons might comment intelligently on the proposed rules and (2) the agency might exercise intelligently its responsibilities in arriving at the contents of the rule as finally adopted, in stating reasons for and against adoption, and in formulating the required contents of the adopting order, including a 'reasoned justification' for the rule." *Unified Loans*, 955 S.W.2d at 652.

⁴ Courts have held that the federal Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, applies only to direct economic impacts. See *Mid-Tex. Elec. Coop v. FERC*, 773 F.2d 327 (D.C. Cir. 1985) (Regulations for generating utilities did not need to consider potential adverse effect on transmission utilities); *American Trucking Ass'ns v. EPA*, 175 F.3d 1027 (D.C. Cir. 1999) (EPA's national ambient air quality standards did not have a direct impact on small entities which were regulated directly through state implementation plans), *aff'd in part and rev'd in part on other grounds*, *Whitman v. American Trucking Ass'ns*, 531 U.S. 457 (2001); *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1170 (D.C. Cir. 1996) (Regulatory flexibility analysis provision applies only to small entities that are subject to the requirements of the rule and the agency had no obligation to analyze the effects on entities which it did not regulate).

⁵ See *Southern Offshore Fishing Assoc. v. Daley*, 995 F.Supp. 1411, 1437 (M.S. Fla. 1998) (interpreting the federal requirement to examine impacts on small entities). One court required that a federal agency consider comments not submitted during the formal notice and comment period because the agency's proposed rule did not properly inform the regulated industry that its interests were at stake. *Northwest Mining Assoc. v. Babbitt*, 5 F.Supp.2d 9 (D.D.C. 1998).

compliance requires that the Economic Impact Statement provide interested persons with an opportunity to comment intelligently on the basis for an agency's projected economic impact of a proposed rule on small businesses.⁶

An agency should individually analyze the impacts of each proposed rule or rule amendment. While an agency may be able to take advantage of the data and analysis compiled as part of an Economic Impact Statement for a prior rulemaking, the agency should confirm that the data is appropriate for each proposed rule.

A. Determining the Number of Small Businesses

To know whether a proposed rule affects a number of small businesses, an agency must first know how many regulated entities exist and which are small businesses. For some agencies that regulate only one industry or profession, this may require determining only how many of the businesses that the agency regulates meet the standards for small businesses. For some agencies, most of their regulated individuals and entities, if not nearly all, may qualify as small businesses.

The most readily determinable factor will be whether a business has less than 100 employees. If a business does, then it is clearly a small business and an economic impact statement and regulatory flexibility analysis should be prepared. With regard to businesses with more than 100 employees, but less than \$6 million in annual gross receipts, further information may be obtained by consulting.

The Comptroller of Public Accounts has developed a web site to assist agencies in determining a proposed rule's potential adverse economic effect on small businesses (<https://fmx.cpa.state.tx.us/fmx/legis/ecoeffect/>). Additional information on employers with fewer than 100 employees is available from the Texas Workforce Commission's TRACER web site (www.tracer2.com).⁷

An agency that regulates only one industry or profession may only need to conduct this analysis once to determine the number and/or percentage of small businesses that it regulates. That analysis can then be used in future rulemakings, however, the analysis should be reviewed and updated periodically to reflect changes in the number of regulated businesses or changes to the agency's jurisdiction.

Agencies that adopt rules affecting multiple industries will likely need to determine for each proposed rule the number of small businesses that may be affected. The first step in this analysis would be to identify the industry sectors to be regulated. In the past, many agencies used the Standard Industrial Classification (SIC) codes to categorize regulated businesses on an industry-by-industry basis. In 1999, the SIC system was replaced by the

⁶ See *Unified Loans*, 955 S.W.2d at 652-654.

⁷ Additional labor market and other information may be found at www.twc.state.tx.us/customers/rpm/rpmsub3.html.

North American Industry Classification System (NAICS), which breaks down industry sectors in much greater detail.

For a grant program or other voluntary program, an agency can develop an estimate of the number of small businesses affected by anticipating the potential number of applicants and potential number of grant recipients. The number of applicants from past years of a program could be used as examples, or the number of applicants for similar programs can be used as the basis for an estimate. An agency should strive to provide some reasoned explanation for an estimate of the number of applicants and the methodology and quality of the data used to derive the estimate.

An agency does not need to provide an exact accounting of the number of small businesses that a proposed rule may affect.⁸ The number of businesses may be reported as an approximation, such as “more than,” or in a range such as: 1-100, 101-500, 501-1000, 1001-5000, 5001-10,000, or 10,000+.

In some instances, an agency may regulate businesses that are located outside of Texas. In such a case, an agency should look to see whether any of these businesses are small businesses that should be included in the number that the proposed rule might affect. However, an agency need only assess the general adverse effect of a proposed rule on small businesses doing business in Texas; it need not perform a detailed analysis of how a proposed rule might have a different effect, if any, on small businesses that are located outside of Texas.

B. Projecting the Economic Impact

Under § 2006.002(c)(1), an agency is required to project the economic impact of a proposed rule on small businesses. Every rule is different. The level, scope, and complexity of analysis may vary significantly depending on the characteristics and composition of the industry or small-entity sectors to be regulated. The projection need only assess the potential adverse economic effects on small businesses.

Agencies are also required, under § 2006.002(f), to reduce the adverse effect of rules on micro-businesses. Under § 2006.001(1), a micro-business is defined as an entity with not more than 20 employees. Consequently, the number of micro-businesses in a regulated industry or profession is a subset of the number of small businesses. In some instances, however, a proposed rule may have a disparate effect on micro-businesses as compared to small businesses. An agency’s projection of economic impact should include an analysis as to whether a proposed rule may have an adverse effect on micro-businesses distinct from any potential adverse effect on small businesses.

⁸ See U.S. SMALL BUSINESS ADMINISTRATION, OFFICE OF ADVOCACY, STATE GUIDE TO REGULATORY FLEXIBILITY FOR SMALL BUSINESSES (March 2007) (Examining the regulatory flexibility programs of Rhode Island, South Dakota, and other states).

Examples of the costs associated with a proposed rule may include:

- recordkeeping;
- reporting;
- required professional expertise, such as lawyer, accounting, or engineering;
- capital costs for any required equipment;
- costs for modifying any existing processes and procedures;
- lost sales and profits resulting from the proposed rule;
- changes in market competition as a result of the proposed rule and its effect on the balance between specific submarkets;
- extra tax costs;
- additional employees that may need to be hired; and
- required fees.

C. Regulatory Flexibility Analysis

In preparing the Regulatory Flexibility Analysis, as required under § 2006.002(c)(2), an agency must consider alternative methods of achieving the purpose of the proposed rule. As provided under § 2006.002(c-1), the alternatives should:

- be consistent with the health, safety, and environmental and economic welfare of the state;
- accomplish the objectives of the rule; and
- minimize adverse impacts on small businesses

An agency must also include in the analysis several proposed methods of reducing the adverse impact of a proposed rule on a small business. The Regulatory Flexibility Analysis and Economic Impact Statement can be combined into a single report.

1. Exception for the Public Health, Safety, and Welfare

Under § 2006.002(c-1), an agency must “consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small business.” An agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small businesses would not be protective of the health, safety and environmental and economic welfare of the state.⁹ One common example would appear to fit within this exception. Agencies may be required to adopt as rules specific fees or specific standards and procedures under a legislative or federal mandate. In such a situation, the mandated language may be considered *per se* consistent with the health, safety, or environmental and economic welfare of the state and the agency need not consider other regulatory methods. Other situations may not be as clear, and each agency should exercise professional discretion and expertise in making this determination. It is reasonable to conclude that this *per se* exception should be narrowly applied, and it should only be applied in situations where the governing standard has left

⁹ Protection of the public health, safety, and welfare is part of the inherent power of a sovereign state. See *Barshop v. Medina County Underground Water Conservation Dist.*, 925 S.W.2d 618, 633-635 (Tex. 1996); BLACK’S LAW DICTIONARY 1178 (7th ed. 1999).

the agency with no discretion as to the standard to be applied and the method for implementing the rule.

2. Alternatives Analysis

The kinds of alternatives that are possible will vary based on the particular regulatory objective and the characteristics of the regulated industry. Examples of alternatives that an agency may identify and evaluate include:

- Establishment of different compliance or reporting requirements for small entities or timetables that take into account the resources available to small entities.
- Clarification, consolidation, or simplification of compliance and reporting requirements for small entities.
- Use of performance rather than design standards.
- Implementation of different requirements or standards for micro-businesses.
- Exemption for certain or all small entities from coverage of the rule, in whole or in part.
- Adopting different standards for the size of businesses.
- Modifying the types of equipment that are required for large and small entities.
- The effect of not adopting the proposed regulation, a “no action” alternative.

An agency must include in the analysis several methods of reducing the adverse impact of a proposed rule on a small business. A common meaning of “several” is “more than two but fewer than many,” with “many” meaning “a large number of persons or things.”

VI. REVIEW AND COMMENT ON THE ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS

Under § 2006.002(d), an agency must “include the economic impact statement and regulatory flexibility analysis as part of the notice of the proposed rule that the agency files with the secretary of state for publication in the Texas Register.” Thus, the Economic Impact Statement and Regulatory Flexibility Analysis should be included in the preamble for a proposed rule along with other required findings such as the fiscal note and note on public benefits and costs required under the Administrative Procedure Act (APA), Government Code § 2001.024(a)(4)&(5).¹⁰

Under § 2006.002(d), an agency must also provide copies of the proposed rule and preamble to the standing committee of each house of the Legislature that is charged with reviewing the proposed rule. Typically, these will be the legislative committees that have primary jurisdiction over the agency or over the area of law or the subject matter under which the rule is adopted.

¹⁰ The previous text of § 2006.002 constituted “any other statement required by law” which must be included in the notice of a proposed rule as described under § 2001.024(a)(8) of the APA. *Unified Loans*, 955 S.W.2d at 651.

While the Economic Impact Statement and Regulatory Flexibility Analysis are not required to be included in the preamble for the rule adoption, an agency should respond to any comments received regarding the Economic Impact Statement and Regulatory Flexibility Analysis as required under the APA, § 2001.029.

VII. QUESTIONS

For further information or a response to any questions that you may have regarding these guidelines, please contact:

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APPENDIX

§ 2006.002. Adoption of Rules with Adverse Economic Effect

(a) A state agency considering adoption of a rule that would have an adverse economic effect on small businesses or micro-businesses shall reduce that effect if doing so is legal and feasible considering the purpose of the statute under which the rule is to be adopted.

(b) To reduce an adverse effect on small businesses, an agency may:

- (1) establish separate compliance or reporting requirements for small businesses;
- (2) use performance standards in place of design standards for small businesses; or
- (3) exempt small businesses from all or part of the rule.

(c) Before adopting a rule that may have an adverse economic effect on small businesses, a state agency shall prepare:

- (1) an economic impact statement that estimates the number of small businesses subject to the proposed rule, projects the economic impact of the rule on small businesses, and describes alternative methods of achieving the purpose of the proposed rule; and
- (2) a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule.

(c-1) The analysis under Subsection (c) shall consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses. The state agency must include in the analysis several proposed methods of reducing the adverse impact of a proposed rule on a small business.

(d) The agency shall include the economic impact statement and regulatory flexibility analysis as part of the notice of the proposed rule that the agency files with the secretary of state for publication in the Texas Register and shall provide copies to the standing committee of each house of the legislature that is charged with reviewing the proposed rule.

(e) This section does not apply to a rule adopted under Title 2, Tax Code.

(f) To reduce an adverse effect of rules on micro-businesses, a state agency shall adopt provisions concerning micro-businesses that are uniform with those outlined in Subsections (b)-(d) for small businesses.

(g) The attorney general, in consultation with the comptroller, shall prepare guidelines to assist a state agency:

- (1) in determining a proposed rule's potential adverse economic effects on small businesses; and
- (2) in identifying and evaluating alternative methods of achieving the purpose of the proposed rule.

Example Economic Impact Statement and Regulatory Flexibility Analysis

The Board has approximately 5,000 doctor of chiropractic licensees and 3,000 registered facilities, and nearly all of these entities are small businesses and many of them are micro-businesses. The projected economic impact of this rule amendment on these small businesses will be neutral to positive for licensees and clinics in that licensees will be able to more effectively use their practice time by delegating approved tasks to qualified assistants when appropriate. In preparing this proposed rule, the Board considered several alternative methods for achieving the purposes of this rule amendment. The Board considered requiring, under proposed subsection (j), that each person performing treatments sign the patient records, but this was rejected as excessively burdensome recordkeeping. The Board considered not modifying the standards for “qualified and properly trained” in proposed subsection (d), but the Board decided that the public welfare would benefit from clearer standards. The Board considered adopting more specific standards regarding the required education, training, and skills of personnel, but the Board decided instead that it would be easier for licensees to implement the general standards included in the proposed rule under subsection (d).

Sample Statement Regarding the Public Health, Safety, and Welfare

The Agency estimates that there are approximately 7,500 widget manufacturers in Texas and that approximately nine out of ten of these manufacturers are small businesses and that three out of ten are micro-businesses. The Agency estimates that the projected economic impact of this proposed rule will be increased costs of compliance for safety training and reporting. Under § 2006(c-1), an agency is required to consider alternative regulatory methods only if the alternative methods would be consistent with the health, safety, and environmental and economic welfare of the state. The Agency has developed this proposed rule in accordance with a legislative mandate and in compliance with the requirements of the regulations of the U.S. Environmental Protection Agency. Consequently, any variance from the federal standards would not be consistent with the health, safety, and environmental and economic welfare of the state, and no alternative regulatory methods have been considered.