Testimony of David E. Frulla
Before the Subcommittee on Commercial and Administrative Law
House of Representatives Committee on the Judiciary

July 20, 2006

Mr. Chairman and Members of the Subcommittee on Commercial and Administrative Law, I appreciate the opportunity to testify before the Subcommittee's July 20, 2006, legislative hearing on H.R. 682, the Regulatory Flexibility Improvements Act. This legislation should help ensure that the Regulatory Flexibility Act ("RFA"), as amended in 1996 by the Small Business Regulatory Enforcement and Fairness Act ("SBREFA"), is an effective and enforceable tool to require Federal agencies tailor their regulations to the scope and scale of small businesses and other small entities. H.R. 682 shows that its sponsors have been listening to the needs and concerns of small entities, with respect to RFA compliance.

EXECUTIVE SUMMARY

SBREFA made many salutary changes to the RFA, not the least of which are its judicial review provisions. As the Subcommittee knows, SBREFA added these judicial review provisions, at 5 U. S. C. § 611, to ensure federal agencies do more than pay "lip service" to the RFA. *See* 142 CONG. REC. S3242, S3245 (*daily ed.*, Mar. 29, 1996).

We have extensive experience litigating SBREFA cases.[1] That said, I am appearing before the Subcommittee today in my personal capacity, and not on behalf of

[1] In fact, I believe that I may have litigated as many RFA cases as anyone in the country since SBREFA was enacted. I have been involved in over a dozen RFA cases against six different agencies: the Department of Commerce (regarding various fisheries regulations), the Department of Health and Human Services (regarding the "interim payment" system for home health agency Medicare reimbursement), the Army Corps of Engineers (regarding modification of its Clean Water Act Nationwide Permit System), the Environmental Protection Agency (regarding its Lead Rule), the Federal Communications Commission (regarding its intermodal telephone number porting requirements), and the Food and Nutrition Service (as a friend of the court, regarding its cost-reduction program for so-called "WIC-only" vendors).

any client. In summary, the decade-long crucible of the litigation process has demonstrated both strengths and weaknesses in the RFA's structure and processes. Congress should now use this experience to improve the RFA and ensure it serves its intended purposes. H.R. 682 addresses many important issues but more needs to be done.

I will first address important changes to the RFA that H.R. 682 would make. Then I will identify an important situation where H.R. 682 addressed an issue, but may not have gone far enough. Finally, I will identify a few issues that H.R. 682 did not address, but that Congress should address, whether in this legislation or elsewhere (for instance, in the appropriations process).

I. H.R. 682 ADDRESSES CERTAIN CHRONIC RFA/SBREFA IMPLEMENTATION PROBLEMS VERY WELL

First, Section 8 of H.R. 682 would clarify a jurisdictional and timing issue that we confronted in *Nat'l Ass'n of Homebuilders v. U.S. Army Corps of Engineers*, 417 F.3d 1272 (D.C. Cir. 2005), *reversing* 297 F. Supp. 2d 74 (D.D.C. 2003). I represented the National Federation of Independent Business Legal Foundation and a small business homebuilder in their RFA challenge to a major Army Corps of Engineers Clean Water Act rulemaking that implemented new nationwide permits and supporting terms and conditions. The Army Corps had completely and, as the D.C. Circuit held, erroneously disclaimed its obligation to comply with the RFA, by baldly claiming that it was not issuing "regulations." More specifically, *NAHB* reversed a lower court decision which had dismissed RFA and APA claims on the ground that the Army Corps' issuance of these nationwide permits and their terms and conditions did not represent "final agency action." The RFA uses the term "final agency action" in its jurisdictional provisions, 5 U.S.C. § 611(a).

We were able to argue successfully at the appellate level in *NAHB* that the Army Corps' actions relating to the RFA were complete when the agency concluded its rulemaking proceedings and that no set of facts (such as the application of the nationwide permit standards in the context of an actual permit application), could or would make the RFA claim any more ready for review. By changing the finality standard in Section 611 from "final agency action" to "publication of the final rule," Section 8(c) of H.R. 682 would remove this point of confusion on jurisdiction and the timing of judicial review.

The clarity H.R. 682 would provide represents a real benefit to the small business community. We filed suit in *NAHB* in 2000, and it was not until 2005 that the appeals court made its decision. And we are still awaiting a final order from the district court effecting the settlement of the case that followed from the D.C. Circuit ruling. Meanwhile, the Army Corps is gearing up for a new permit rulemaking as these nationwide permits are only valid for five years.

Second, H.R. 682 would significantly enhance the Small Business Administration Office of Advocacy's coordinating role for Federal Government-wide RFA compliance. For instance, Section 10(a) of H.R. 682, proposing to enact a new RFA section, 5 U.S.C. § 613, would authorize the Office of Advocacy to develop omnibus RFA implementing regulations that all other agencies would be required to follow, absent approval from the Office of Advocacy. Currently, there are almost as many sets of agency RFA implementing regulations as there are Federal agencies. This is not constructive.

For instance, the Environmental Protection Agency's RFA implementing guidelines authorize the agency to conduct RFA economic impact analyses based on small businesses' revenues, rather than their profitability. While any fair assessment of a

regulation's economic impact ought to be measured against profits (and thus the entity's ability to pay for the regulation), a district court in Washington, D.C. recently deferred to the EPA guidelines. *Ad Hoc Metals Coalition v. Johnson*, 1:01cv0766 (PLF) (D.D.C., Jan. 20, 2006), *slip op.*, at 12-13.[2] Uniform Office of Advocacy regulations consistent with its Guide for Government Agencies would have changed the deference calculus.

More generally, the caselaw is mixed regarding the level of deference accorded to the Office of Advocacy in its efforts to ensure RFA compliance. Certain cases are very respectful of positions and submissions from the Chief Counsel. *See, e.g., Southern Offshore Fishing Ass'n v. Daley*, 995 F. Supp. 1411, 1435 (M.D. Fla. 1998) (*SOFA I*) (terming the Office of Advocacy as the Federal Government's RFA "watch dog"). However, other cases are not deferential. *American Trucking Ass'ns v. EPA*, 175 F.3d 1027, 1044 (D.C. Cir. 1999) (no deference owed to either EPA's or SBA's RFA interpretations), *modified on other grounds*, 195 F.3d 4 (D.C. Cir. 1999), *aff'd in part and rev'd in part on other grounds, sub nom., Whitman v. American Trucking Ass'ns*, 531 U.S. 457 (2001).

Deference ought to be accorded to the Office of Advocacy. The Chief Counsel and his experienced staff have a detailed familiarity with the RFA and its requirements, small entities' ability to accommodate regulations, and the benefit of an overall perspective on the many and varied ways that rulemaking agencies attempt to avoid or defeat their RFA obligations. By law and Executive Order, the Office of Advocacy has been an RFA teacher. In granting the Office of Advocacy an explicit regulation-writing

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[2] The court explained, "The RFA does not define 'significant impact on a substantial number of small entities,' grants neither authority nor responsibility to any entity to develop a uniform definition of SEISNSE, and provides no guidance as to how certification decisions are made. Instead, the RFA grants federal agencies broad discretion regarding how key terms in the act should be defined and how certification decisions should be made." *Id.*, *slip op.*, at 12.

role, H.R. 682 should not only promote more consistent RFA application and compliance across the government, but also confirm that the primacy of the expert Chief Counsel for Advocacy on the RFA issues within his ken. In addition, by extending the Chief Counsel's authority to comment and intervene to Administrative Procedure Act issues more generally (*see* H.R. 682, § 10(c)), the legislation recognizes the integral links between RFA compliance and APA standards.[3]

Section 4(b)(3) of H.R. 682 also requires rulemaking agencies to address specifically to Office of Advocacy comments in response to a proposed rule. This measure should help the small business community, and the courts, identify when rulemaking agencies are acting in the face of, or even inconsistent with, conclusions and guidance from expert agency.

For its part, Section 8(d) of H.R. 682 constructively clarifies the Chief Counsel's authority to intervene in actions under the RFA against Federal agencies, by specifically delineating that authority as coextensive with the scope of RFA judicial review. The SBA can have a unique role to play in RFA litigation, especially given the RFA's unique and tailored remedial provisions.

For instance, in *United States Telecom Ass'n v. FCC*, 400 F.3d 29 (D.C. Cir. 2005), in my prior law firm, we represented small, generally rural wireline telephone carriers in their challenge to a Federal Communications Commission order requiring all wireline carriers to develop and maintain the infrastructure to permit their customers to transfer, or "port," their phone numbers to their wireless phones even if these customers moved from one physical location to another. In that case, the FCC had disclaimed its

[3] For instance, the RFA's applicability is principally tied to the APA's standards for notice and comment rulemaking under 5 U.S.C. § 553. See 5 U.S.C. §§ 601(2) (defining a "rule" under the RFA); 604 (initial regulatory flexibility analysis standards); and 605 (final regulatory flexibility analysis standards).

RFA obligations, arguing that it had merely issued an interpretative ruling in response to a petition for rulemaking, which it also likened to adjudication. The D.C. Circuit disagreed, and held the agency had developed a "legislative rule" requiring RFA compliance. 400 F.3d at 40-41. The court enjoined the FCC from enforcing the rule against small entities until the agency had complied with the RFA. *Id.* at 43-44. While the injunction came approximately fifteen months after the rulemaking, with the SBA Office of Advocacy's assistance, our clients were still able to preserve enough of the *status quo* for the injunction to be effective.

More specifically, during the pendency of the case, state utility commissions had employed their limited authority to grant "waivers" to petitioning companies that were subject to the FCC's porting order. The FCC Bureau that developed the rule had preemptively informed these state commissions that they should not grant any of the waiver requests. Whether or not these state commissions would have complied with the bureau's edict, FCC Chairman Michael Powell ultimately countermanded it. He did so as part of a settlement with the SBA Office of Advocacy to resolve the SBA's intervention in our case, on the eve of the SBA's filing its *amicus* brief supporting our position. SBA's litigation role, even stopping short of briefing and argument, served an important and creative function in the overall arc of the litigation.

Third, H.R. 682 addresses another long-standing problem relating to what are called "indirect" regulatory impacts. More specifically, agencies often claim, based on a long-standing line of cases, that the impacts of their regulations should not be counted for RFA purposes if they do not directly impact small entities, or else they design their regulatory schemes to impact indirectly small entities, perhaps in part to avoid or limit

RFA requirements. *See, e.g., Nat'l Women, Infants, and Children Grocers Ass'n v. Food and Nutrition Svc.*, 416 F. Supp.2d 92, 109-10 (D.D.C. 2006) (rejecting RFA challenge because the interim final rule imposed its requirements on state agencies administering the WIC program even though small business WIC-only grocery stores were the professed "targets" of the rule). This case relied on *Cement Kiln Recycling Coalition v. EPA*, 255 F.3d 855, 869 (D.C. Cir. 2001), which held that "application of the RFA does not turn on whether particular entities are the 'targets' of a given rule." The origins of this narrowing construction of the RFA's scope are sketchy, and non-statutory, and H.R. 682 should correct this matter.[4]

Section 3(b) of H.R. 682 would constructively address this situation by extending the term "economic impact" under the RFA to "any indirect economic effect on small entities which is reasonably foreseeable and results from such rule . . . "

II. H.R. 682 COULD DO MORE TO ENSURE COURTS RECOGNIZE THEIR AUTHORITY TO REQUIRE THAT AGENCIES UNDERTAKE DETAILED, CAREFUL RFA ANALYSES

H.R. 682's findings, set forth in Section 2, state clearly that rulemaking agencies need to do more to understand the impacts their proposed regulations have on small entities, undertake outreach to small entities in the regulated community, and develop ameliorative alternatives.[5] To address these shortcomings in agency RFA analyses, the

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[4] These RFA "indirect regulation" cases stem from *Mid-Tex Elec. Coop. v. FERC*, 773 F.2d 327, 432 (D.C. Cir. 1985). *See, e.g., Cement Kiln*, 255 F.3d at 869. For its part, *Mid-Tex* derived the standard from the RFA's preamble, rather than its operative terms. *See* 773 F.2d at 341. A statute's operative terms should control over its preamble, *Ass'n of American Railroads v. Costle*, 562 F.2d 1310, 1316 (D.C. Cir. 1977); *Yazoo and Miss. Valley R.R. Co. v. Thomas*, 132 U.S. 174, 188 (1889), particularly when the operative language establishes a specific "definition which declares what a term 'means' [and] is binding upon the court," *Nat'l City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122, 1133-34 (8th Cir. 1982), *relying on Colautti v. Franklin*, 439 U.S. 379, 392-93 n.10 (1979).

[5] RFA applicability and Section 605(b) certifications have been the subject of much SBREFA litigation to date, but they are only threshold issues; ultimately, to be truly effective, as the findings

bill, in the main, imposes more detailed analytical requirements on agencies in Section 4. Section 4(a) also constructively requires agencies to affirmatively collect information to estimate the number and type of small entities to which a proposed rule would apply, rather than allowing an agency to excuse shoddy outreach and investigation based on 5 U.S.C. § 603(b)(4)'s current "feasib[ility]" limitation.[6] The legislation would also promote more relevant RFA analyses by requiring an agency to consider the cumulative impacts of its regulations on small businesses, by adding a new sub-section (b)(6) to Section 603.

Simply requiring agencies to undertake more analyses may not, however, solve the problem that H.R. 682's Findings correctly identify. H.R. 682 does not, but should, ensure adequate enforcement authority for these new requirements. We have had success in RFA litigation when a court carefully considers an agency RFA's analyses under the APA's "arbitrary and capricious" standard. But in our experience, not all courts conduct sufficiently careful reviews of agencies' RFA analyses.

On the positive side of the ledger, in *SOFA I*, the Federal court in Tampa, Florida was able to recognize from personal, real world experience that a 50% shark fishing quota reduction would have a significant economic impact on a substantial number of small business shark fishermen, 995 F. Supp. at 1436, notwithstanding the Commerce

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recognize, RFA requirements and attendant litigation must evolve to address whether agencies are conducting adequate regulatory flexibility analyses and effectively developing ameliorative alternatives.

[6] Such an obligation has been created in certain contexts under the National Environmental Policy Act. "In general, NEPA imposes a duty on federal agencies to gather information and do independent research when missing information is 'important,' 'significant,' or 'essential' to a reasoned choice among alternatives." *Oregon Environmental Council v. Kunzman*, 817 F.2d 484,495 (9th Cir. 1987) (citations omitted). Certain courts have already found that NEPA's substantive requirements are analogous to duties imposed on resource agencies under the RFA. *See Associated Fisheries of Maine, Inc. v. Daley*, 127 F.3d 104, 114 (1st Cir. 1997).

Department's repeated rationalizations and diversionary arguments to support its flawed Section 605(b) no significant impact certification. *Id.* at 1433-37. *See also Nat'l Ass'n of Psychiatric Health Sys. v. Shalala*, 120 F. Supp.2d 32, 43-44 (D.D.C. 2000) (carefully reviewing cursory, hedged, and contradictory Section 605(b) certification and granting relief).

In so doing, *SOFA I* applied the APA's "arbitrary and capricious standard" and rejected application of the more deferential "without observance of procedure" standard of review. 995 F. Supp. at 1425.[7] This decision is consistent with SBREFA's legislative history[8]; for its part, the RFA currently states more generally that courts are to review agency RFA compliance under Administrative Procedure Act standards. *See* 5 U.S.C. § 611(a)(1). The SBA Chief Counsel for Advocacy had intervened in *SOFA I* on this point, recognizing the hollowness of the "without observance of procedure" standard of review.

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[7] The court's commitment to ensuring the Commerce Department complied with the RFA made *SOFA* a seminal case – and one that provided effective relief. In November 2000, after repeated, failed agency efforts to rationalize its original Section 605(b) "no significant impact" certification, two stern reported decisions and a special master finding that the agency had acted in bad faith with respect to the plaintiffs' RFA claims, the shark fishermen and the Department of Commerce settled the case. *See Southern Offshore Fishing Ass'n v. Mineta*, 2000 WL 33171005 (M.D. Fla., Dec. 7, 2000) (prior proceedings reported sub nom. at *SOFA I, supra,* and *Southern Offshore Fishing Ass'n v. Daley*, 55 F. Supp.2d 1336 (M.D. Fla. 1999) (*SOFA II*)). As part of the settlement, the parties agreed to an independent scientific review of the scientific data and analyses used by the Government to set these quotas. That independent review did not support the Commerce Department's scientific justifications for the quota reductions. The Committee should note that the Court lacked the expertise (and maybe the authority under the APA) to address the flaws in relevant agency scientific analyses that were so evident to the scientific review panel convened as a result of the settlement. *See SOFA I*, 995 F. Supp. at 1432-33.

[8] According to SBREFA's legislative history: "[I]f the court finds that a final agency action was arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law, the court may set aside the rule or order the agency to take other corrective action." 142 CONG. REC. S3245 (daily ed. Mar. 29, 1996) (statement of Sen. Bond). Similarly, SBREFA's main drafter confirmed sub-section 611(a)(1) & (2)'s express terms, stating:

> ... Review under these sections is not limited to the agency's compliance with the procedural aspects of the RFA; final agency actions under these sections will be subject to the normal judicial review standards of Chapter 7 of Title 5.

142 CONG. REC. E571-01, E574 (daily ed. Apr. 19, 1996) (remarks of Rep. Hyde). Chairman Hyde further specifically stated that the "normal" standards include the "arbitrary and capricious" standard. *Id.*

However, the standard of review for RFA analyses in certain cases is verging on this latter-referenced, essentially toothless standard. For instance, *Nat'l Women, Infants, and Children Grocers Ass'n* concluded that, "Agencies need only engage in a 'reasonable' and 'good faith effort' to carry out the mandate of the RFA . . . . Further, the RFA is a purely procedural, as opposed to a substantive, mandate; RFA 'requires nothing more than that the agency file a final regulatory flexibility analysis demonstrating a reasonable good-faith effort to carry out the RFA's mandate." 416 F. Supp.2d at 108 (*quoting Alenco Communs. Inc. v. FCC*, 201 F.3d 608, 625 (5th Cir. 2000), and *United Cellular Corp. v. FCC*, 254 F.3d 78, 88 (D.C. Cir. 2001)) (citations omitted).

I am concerned that, under these latter cases, especially with the new provisions in Section 4 of H.R. 682, if it is enacted, an agency would be tempted to substitute bulk for quality in its analyses, expecting a court would consider the development of voluminous analyses to equate with a good faith effort, notwithstanding the quality of conclusions contained in the analyses. Recognizing courts are loath to tackle reams of data and analyses, some agencies are already on occasion, if not as a *modus operandi*, filling the RFA decision-making record with impenetrable layers of economic information, but failing to take the important, subsequent step of distilling and analyzing this information, so as to assist the decision-makers and the public to develop flexible regulatory alternatives.

H.R. 682 should thus amend Section 611 of the RFA to clarify the applicable standard of review: Agency decisions regarding whether the RFA applies and whether a an agency's authority to promulgate a rule under a statute permits regulatory flexibility[9]

[9] Agencies often claim (sometimes, we believe, inappropriately) that their general statutory grants of authority do not accord them any flexibility regarding small entities as to the voluminous details of the

represent questions of law that a reviewing court should consider *de novo*. Subsequent agency analyses contained in Section 605(b) certifications and regulatory flexibility analyses should be subject to the APA's "arbitrary and capricious" standard of review.

Congress should also consider clarifying the RFA to state that agencies need to complete a full RFA analysis if there is a doubt. The RFA's legislative history makes this point. After reviewing the RFA's legislative history, a district court has explained "that '[t]he legislation is intended to be as inclusive as possible, and doubts about its applicability should be resolved in favor of complying with the provisions of the Act.'" *NAHC,* 135 F. Supp. 2d at 168 (*quoting* 126 CONG. REC. H24589 (Sep. 8, 1980) (House Statement of RFA Issues) (alteration in original)). Accordingly, "[t]he statement's context clearly shows that Congress intended that agencies err on the side of caution in determining whether to perform regulatory flexibility analyses." *Id.* However, the import of this important section of legislative history can be blunted, if not negated entirely, by the good faith review standard, under which certain agencies are back-stopping questionable Section 605(b) certification with cursory and flimsy regulatory flexibility analyses.

III. ADDITIONAL MATTERS THAT CONGRESS SHOULD ADDRESS

I would now like to offer some constructive, discrete steps that Congress can take to provide tools for those of us who sometimes need to secure agency RFA compliance through litigation.

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regulations they implement. For instance, in *National Association for Home Care v. Shalala*, 135 F. Supp.2d 161(D.D.C. 2001) (*NAHC*), the Health Care Financing Administration claimed that one page of statutory language in the Balanced Budget Act of 1997 accorded it essentially no flexibility in how it developed and implemented forty-seven Federal Register pages of regulatory analyses and requirements imposed on small home health care providers. *See also Greater Dallas Home Care Alliance v. United States*, 36 F. Supp.2d 765 (N.D. Tex. 1999).

First, Congress should explicitly provide for expedited judicial review regarding whether the RFA applies. Agencies are still claiming that binding, widely-applicable actions are not legislative rules subject to the RFA. *USTA* and *NAHB*, discussed above, are notable examples. In fact, in *NAHB*, we have been alternatively litigating and waiting since we filed suit in June 2000 for a final decision that the Army Corps should have applied the RFA. Indeed, we waited for well over three years for the district court to (erroneously) dismiss the case for lack of jurisdiction.

Second, the RFA's judicial review provisions should be amended to provide for attorneys' fees under the EAJA whenever a small entity prevails on an RFA/SBREFA claim. Small entities and associations representing them often lack the funds to sustain RFA litigation, pa rticularly once it reaches the often-protracted remedy phase. RFA litigation and compliance efforts should not become a war of attrition for these often economically marginal entities and associations representing them. *See, e.g.*, *United States Telecom Ass'n v. FCC*, 2005 U.S. App. LEXIS 18599 (D.C. Cir., Aug. 25, 2005) (denying EAJA award to prevailing small business associations).

Finally, Congress should recognize that the Office of Advocacy will likely require more resources, especially if H.R. 682 is to expand its regulatory and oversight role. Such a public investment in RFA compliance pays dividends in terms of "more just application of the laws and more equitable distribution of economic costs, which will ultimately serve both the society's and the government's best interests." *See* 126 Cong. Rec. H24589 (Sep. 8, 1980).

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I appreciate the opportunity to testify before the Subcommittee on Commercial and Administrative Law, and hope that the Committee on Judiciary and the Congress as a whole will act promptly and decisively to make the SBREFA-improved RFA even stronger and better.