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REVIEWING INDEPENDENT AGENCY RULEMAKING

HEARING

BEFORE THE

SUBCOMMITTEE ON
REGULATORY AFFAIRS AND FEDERAL
MANAGEMENT

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

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REVIEWING INDEPENDENT AGENCY RULEMAKING

THURSDAY, SEPTEMBER 8, 2016

U.S. SENATE,
SUBCOMMITTEE ON REGULATORY,
AFFAIRS AND FEDERAL MANAGEMENT,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:02 a.m., in room 342, Dirksen Senate Office Building, Hon. James Lankford, chairman of the Subcommittee, presiding.

Present: Senators Lankford, Portman, Ernst and Heitkamp.

OPENING STATEMENT OF SENATOR LANKFORD

Senator LANKFORD. Good morning. Welcome to today's Subcommittee hearing entitled "Reviewing Independent Agency Rulemaking." This is the 13th hearing in the regulatory process that this Subcommittee has held during this Congress. All our prior hearings the Subcommittee has reviewed the regulatory actions of executive branch agencies. Today we turn to the rulemaking record of independent regulatory agencies.

First of all, I want to recognize Senator Portman for his work on this topic, and as the Subcommittee moves toward addressing shortcomings independent agencies regulate, we have Senator Portman to thank for his tireless work in this area and the foundation he has laid regarding common sense solutions to fixing problems associated with independent agency rulemaking.

Independent regulatory agencies were conceived to accomplish varied missions, but they have one thing in common. They were structured to be somewhat independent from the influence of the President, the Administration, or originally, the Judiciary. However, independent agencies should not be exempt from oversight. When an agency is independent of the executive branch, it does not require that they are also independent of Congress and the American people. Congress created each independent agency and Congress still has the authority to oversee the agency they created. No public entity should be exempt from oversight.

Independent agencies take regulatory action just like their executive branch counterparts. They promulgate rules, issue guidance, take enforcement actions. Accordingly, independent regulatory agencies should be held to the same procedural standards as executive branch agencies. I would actually argue that independent regulatory agencies require a heightened level of oversight over their regulatory regimes because the Executive Orders (EO) that have structured every aspect of the rulemaking process for executive branch agencies, and have been endorsed by both Democrat and Republican administrations for decades, do not apply to independent regulatory agencies.

Part of the question we will have today is why not? According to the Office of Management and Budget (OMB's) 2015 Report to Congress on the benefits and costs of Federal regulations from 2005 through 2014, Federal agencies issued 549 major rules. Independent regulatory agencies were responsible for 141 of these rules, which equates to roughly 25 percent of rulemaking.

There is cause for concern when it comes to the analysis to support those rules. In the same report, OMB found that in 2014, only 10 of the 16 major rules issued by independent agencies provided some information on the benefits of the cost of regulation and that independent agencies continue to struggle in providing monetized estimates of benefits of cost and regulation.

Another study published by the independent well-respected Administrative Conference of the United States in 2013 found that no major rule issued by an independent agency in 2012 contained a complete cost benefit analysis. Many of these rules that are issued without a cost benefit analysis are financial regulations issued by the Consumer Financial Protection Bureau (CFPB), the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC) and have a direct impact on the smaller community banks that small business owners and farmers depend on.

Take for example the CFPB's qualified mortgage rule. CFPB designed this in an attempt to extend credit only to those who can afford to repay a mortgage, preventing another mortgage crisis. Instead, the agency failed to monetize any of the costs and benefits and issued a one-size-fits-all rule that has crippled the ability of community banks to issue mortgages. Rules like this show that when agencies are not required to conduct a full cost benefit analysis before issuing a regulation, unintended consequences were likely to follow, such as uncertainty among community banks that limits their ability to issue credit to farmers and small businesses. Although community banks account for only 22 percent of all current loans, they hold three-quarters of all agricultural loans and half of all small business loans. Uncertainty for community banks means uncertainty for job creation.

This Administration has made efforts to urge independent regulatory agencies to improve some of their regulatory processes. In July 2011, the President issued Executive Order 13579, which urged independent regulatory agencies to comply with the analytical requirements that applied to executive branch agencies. Requiring independent regulatory agencies to follow the analytical requirements of Executive Order 12866 and 13563 would be a reasonable and significant step toward achieving transparency and predictability for regulatory entities.

We are pleased to have three witnesses today, and I look forward to hearing from each of you and what Congress can and should do to ensure that all agencies work for and hold accountable these independent agencies for the American people. With that, I recognize Ranking Member Heitkamp for her opening remarks.

OPENING STATEMENT OF SENATOR HEITKAMP

Senator HEITKAMP. Thank you, Mr. Chairman. Today's hearing builds on the Subcommittee's thorough investigation of the current State of Federal rulemaking. Together, we have explored virtually every aspect of the rulemaking process in a comprehensive and, I believe, bipartisan way. We have sought out views and opinions from individuals across the political spectrum in order to identify sensible steps Congress should be able to agree upon to make needed improvements to the regulatory system.

Our focus today is independent agencies which occupy a unique position in our national government. They were deliberately, deliberately established by Congress to operate independent of the President. Among other things, they are charged with vital public health and safety functions, ensuring economic and financial stability and serving as stewards and guardians of fairness and equity on a wide range of public policy issues. These are critical responsibilities and those responsibilities will certainly require independent agencies to issue regulations when authorized or required by statute.

What I want to explore today is how Congress can ensure such rulemaking is of the highest quality. I remain committed to making the Nation's regulatory system more transparent, efficient, effective and certainly accountable. First, Congress cannot lessen its own authority through inaction on critical issues by blurring the lines between legislative, judicial and executive functions. In some cases though, excessive delegation to agencies, I think Congress has ceded their responsibility. I do not think there is any doubt about it.

The clearest example that I can provide is Waters of the United States, where clearly over decades of litigation and decades of rulemaking there is not a clear answer. One would imagine in that factual situation Congress would see the important role of stepping in and providing the guidelines that need to be provided, the laws that need to be provided. But yet we do not do it because we would rather pound the table and complain about regulatory agencies.

Simply stated, Congress must pass good laws by taking full responsibility for clearly articulating priorities and goals in legislation. If our statutory directives are unambiguous, we will not see as many claims of agency overreach. Second, while rulemaking is often mandated by statute, we must continue to understand the benefits and costs of regulation. That means that Congress must fulfill its obligation to the American people through oversight of the regulatory process and this has to include independent agencies whose rules in many cases have more impact on today's business world and today's health and safety world.

To be clear, independent agencies face significant challenges in quantifying costs and benefit in the same manner as executive agencies. Nevertheless, in my opinion, their regulatory decisions should be based upon good regulatory analysis. It is not always easy to quantify cost and benefits. Decades of scholarship have revealed that it is often far easier to tabulate costs for regulation and much harder to capture benefits and quantify benefits.

That just means that there will always be a role for quantifying cost and benefits in the regulatory analysis. We should be wary of imposing a one-size-fits-all requirement which would have serious unintended consequences. We must also be mindful of the regulatory resources if we expect agencies to compete and complete regulations in a timely fashion.

Today I want to hear from our witnesses, all enormously gifted and knowledgeable in this area, on how to improve the regulatory process for independent agencies, with a focus on how best to improve congressional oversight. I look forward to continuing my work with Senator Lankford and the rest of my colleagues on these important issues, and I look forward to the testimony today and our continuing dialogue. Thank you, Mr. Chairman.

Senator LANKFORD. Thank you. At this time, we will proceed with testimony from our witnesses. Robert Gasaway is of Counsel at Kirkland & Ellis, specializing in appellate litigation, where he represents clients before the Federal and State court and administrative agencies. He clerked for Judge James Buckley of the U.S. Court of Appeals for the D.C. Circuit. He has twice been recognized as one of the top lawyers in the country by the Legal 500.

Adam White is a fellow at the Hoover Institution, adjunct professor at George Mason's Scalia Law School, and of counsel at Boyden Gray & Associates. He serves on the leadership council of the American Bar Association (ABA), of the Administrative Law and Regulatory Practice, and on the executive committee of the Federalist Society's Administrative Law and Regulatory Practice Group. He clerked for Judge David Sentelle; is that correct?

Mr. WHITE. Sentelle.

Senator LANKFORD. Sentelle, of the U.S. Court of Appeals to the D.C. Circuit. Cary Coglianese is the Edward Shils Professor of Law and professor of political science at the University of Pennsylvania, where he serves as the director of the Penn Program on regulation. He specializes in the study of regulation and regulatory process with an emphasis on the empirical evaluation of alternative regulatory strategies and the role of public participation, negotiation and business and government relations and policymaking. He holds an M.P.P., J.D. and Ph.D. from the University of Michigan.

I would like to thank all of our witnesses for not only your preparation, your written testimony, but also being here personally for your oral testimony as well. It is the custom of this Subcommittee to be able to swear in all witnesses that appear before us. I would like you to please stand, raise your right hand so you can be sworn in for your testimony.

Raise your right hand, please. Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth and nothing but the truth, so help you, God?

Mr. GASAWAY. I do.

Mr. WHITE. I do.

Mr. COGLIANESE. I do.

Senator LANKFORD. Thank you. You may be seated. Let the record reflect all witnesses answered in the affirmative.

We are using a timing system today. You will see it in front of you with a 5-minute countdown to it. We will be somewhat lenient on that, merciful, maybe 4 or 5 seconds or so past. But we are trying to stick as close as we can so we can have a lot of questions and dialogue. The goal of this conversation will be not only receiving your testimony, your input, which has been excellent for all three of you, but it is also for us to have an open dialogue on some of these issues.

So with that, Mr. Gasaway, we would be honored to be able to receive your oral testimony first.

TESTIMONY OF ROBERT R. GASAWAY,[1] OF COUNSEL, KIRKLAND & ELLIS, LLP

Mr. GASAWAY. Thank you very much, Chairman Lankford. And Senator Heitkamp, thank you as well. I am going to try to be very brief and give an overview and pick up on the statements that we just heard, both from you Senator Lankford and Senator Heitkamp. These are incredibly important hearings. We have a number of different issues in the administrative state. Some of them are chronic syndromes and some of them are breaks and sprains.

We are going to talk a little bit about breaks and sprains in the independent agencies, some of the specific issues that go to them. And these are very critical issues and they need to be addressed, but I think there are easy issues and easy things that can be done to address them. But I think you also have to look at the harder issues, the chronic syndromes. They are particularly acute in the administrative agencies for reasons that Senator Heitkamp referred to. They are independent of the executive branch, largely the Congressional Branch, and political accountability.

And then we have to tie that back in, as Senator Heitkamp said, to the larger issues of this hearing. So see if I can do that with the remaining 4 minutes. First of all, the issue extending the Executive Orders 12866 and 13563, I think that is on the level of a no-brainer. More information is better information. I think it would clearly make a difference in agency decisionmaking. I do not think there is any good reason for exempting them. Their independence can be preserved through a carve-out, as has been effected in other statutes, and I do think it would make a difference.

The American Equity Investment Life Insurance Company case is one, where as you know, under Section 2(b) of the Exchange Act, economic analyses are required because there was no Office of Information and Regulatory Affairs (OIRA) review, because there were no standards at that time at the SEC. They committed a very remarkable error of failing to measure the effects of their program against the existing legal baseline of State regulation. I think those are exactly the kinds of mistakes that would not happen if the Executive Orders were extended by statute.

And again, there have been carve-outs in other statutes to preserve independence. I think that could be done. There are technical issues to be sure, and Professor Coglianese has looked at some of them. What is the threshold? Do you use cost or benefits? I like costs because they are more measurable. Is it adjusted for infla-

[1] The prepared statement of Mr. Gasaway appears in the Appendix on page 34.

tion? What is an independent agency? But those are all technical issues.

The no-brainer is you should go ahead and do it. OIRA has an extraordinary wealth of capability. There would be an extraordinarily greater degree of coordination and the technical issues can be overcome.

Now segueing briefly, I think that you also have to look at wider issues of actually bringing them under congressional control. And I stated briefly in my written testimony that I think an adaptation of the Red Tape Act that Senator Sullivan has introduced could function that way. I think, obviously, there are some challenges and there is a discussion that needs to be made. But the key point there is you overcome this cultural problem—and I will come back to that—that you see in Professor Coglianese's testimony. He says retrospective review is not part of the culture of agencies. We want to push our agencies forward.

The great thing about the Red Tape Act, the one-in, one-out, is that retrospective review is bound up with the prospective review, right? You have to take regulatory costs off the table to move it forward. So now everybody's pushing together. And that division that we see reflected in Professor Coglianese's testimony becomes unified. Looking at old regulations, doing new regulations all become one. So I would greatly encourage all the Members of the Committee to take a hard look at how that legislation could be adapted.

And then third, I do have to go back very briefly within my time to the issues that you have been struggling with, the mega issues of over-delegation, and I will just hit on them briefly there. The "Chevron" issue and over-delegation, Non-Delegation Doctrine in the Supreme Court is one of the challenges of this Congress and of our time. I am extraordinarily impressed with the testimony the Committee has received. I have tried to summarize that testimony in a new way and crystalize it in a new way, and I would urge the Committee to go back to previous witnesses and see if I have that right. Because if I do, "Chevron" is extraordinarily vulnerable and candidly more vulnerable than I expected when I first came to this Committee record.

Second, very briefly, I emphasize that Congress does have to get back into the game. I put a couple novel proposals on there for using fast track administrative processes, just like you have fast track processes in the trade area.

And then finally, I want to return to that word "culture." Professor Herz gave testimony that it was a quote "completely infelicitous phrase, a completely infelicitous choice of language in 'Chevron' to say administrators are freed unless Congress has quote, 'spoken to precise issues.'"

He is absolutely correct about that. It has had pervasive cultural effects in independent agencies and executive agencies alike, and I would urge the Committee to return attention to that issue. Thank you.

Senator LANKFORD. Thank you. Mr. White.

TESTIMONY OF ADAM WHITE,[1] FELLOW, HOOVER INSTITUTION

Mr. WHITE. Chairman Lankford, Ranking Member Heitkamp, and other Members of the Subcommittee, thank you for inviting me to testify today. In my written statement, I try to make three basic points. First, I recognize that so-called independent agencies have a long and varied history in American government. Nevertheless, the justifications for their independence from the President reflect largely a bygone era.

Today, the rules of most independent agencies are largely indistinguishable from those of executive agencies, whose major rules are subject to full cost benefit analysis under OIRA's oversight. 35 years ago, the Reagan Administration made a prudential choice not to subject independent agencies to OIRA oversight because those agencies were at the time relatively unimportant.

Today the regulatory world is completely different, with independent agencies like the Federal Reserve Board (FRB) of Governors, the SEC, the CFPB, the Federal Communications Commission (FCC) and even the Federal Energy Regulatory Commission (FERC), making immensely consequential policy decisions. Independent agencies issued at least 17 major rules from October 2013 through September 2014, according to OIRA and the Government Accountability Office (GAO). It is time for the Congress and the President to take down the artificial and increasingly arbitrary wall that insulates independent agencies from OIRA's review, as both the American Bar Association Section on Administrative Law and the Administrative Council of the United States have both long urged.

My second point, we now see clearly what happens when independent agencies' cost benefit analyses do not face meaningful review or interagency coordination. As to meaningful review, I cite criticism of the Government Accountability Office, the CFTC's Inspector General (IG), the D.C. Circuit, and others who have found independent agencies' analyses woefully lacking.

This week my wife and I are sending our kids back to school, and just as our schools do not trust students to grade their own homework, we should not leave the independent agencies free to grade their own homework. This is not intended to cast aspersion on the agencies motives or their dedication, but only to point out a basic fact of human nature: We do our best work when we know that someone else will eventually grade it.

And as to interagency coordination, this is perhaps the most important role that OIRA plays, even more than cost benefit analysis. The OIRA framework facilitates an interagency dialogue that helps to coordinate agency policies, but also to ensure that each agency is getting the best possible expertise and advise from its sister agencies in the context of White House, OIRA oversight. Independent agencies should be fully incorporated into the OIRA framework for precisely this reason.

The third point that I make in my testimony, as you focus on subjecting independent agencies to greater OIRA oversight perhaps, I urge you to subject independent agencies to greater con-

[1] The prepared statement of Mr. White appears in the Appendix on page 48.

gressional oversight, and not just in terms of oversight hearings, but more importantly, in terms of the way that you structure independent agencies and fund them. I think right now the trend is in the wrong direction in terms of giving independent agencies too much independence, not just from the President but also structurally and financially from Congress.

If I may add just one final note to reemphasize the basic point of my testimony and what I see to be the crux of the issue before the Subcommittee. Cost benefit analysis and interagency coordination are not simply ends in and of themselves. The point of cost benefit analysis, as I see it, is not to come up with some precise, absolutely correct numerical answer. As Senator Heitkamp noted in her opening remarks, I doubt that is even possible. I doubt the cost benefit analysis could even accomplish this, even if we wanted it to.

And I think there is risk in putting too much faith in seemingly objective economic analysis. Rather, the point of cost benefit analysis, as I see it, is the process. It creates a framework for agencies to think through these issues rigorously, think through the impacts of their decisions, and just as importantly, to look back at their analyses years down the road to see where their previous assumptions were right and where they were wrong.

That is the retrospective reviews that my fellow witnesses have mentioned. This process should teach agencies and all of us to be more modest in our predictions and our arguments and to be more accountable to the public. Thank you.

Senator LANKFORD. Dr. Coglianese.

TESTIMONY OF CARY COGLIANESE, PH.D.,[1] EDWARD B. SHILS PROFESSOR OF LAW AND PROFESSOR OF POLITICAL SCIENCE, DIRECTOR, PENN PROGRAM ON REGULATION, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

Mr. COGLIANESE. Chairman Lankford, Ranking Member Heitkamp, and other Members of the Subcommittee, thank you for the opportunity to be here today. And let me also thank you for your service to the Nation. I am pleased to talk about ways that Congress might help encourage independent agencies to engage in smarter regulation. Smarter regulation requires sound analysis, both upfront before rules are adopted prospectively as well as rigorous research after rules are adopted, to find out how well they are working, or retrospective analysis.

With respect to prospective analysis, as has already been indicated, one option would be for Congress legislatively to codify the outline of and requirements in Executive Order 12866 and apply them to independent agencies. This would have the advantage of making symmetrical the analytical requirements between independent and executive agencies, but it would mark a major shift in the norms of independent decisionmaking by independent agencies. That is because Executive Order 12866 not only contains requirements for prospective analysis, but also establishes an institutional structure that places the President, and the president's staff, in a more central role in regulatory decisions.

[1] The prepared statement of Mr. Coglianese appears in the Appendix on page 69.

This option would also require a major increase in funding and staffing for OIRA.

Let me suggest an alternative to that, which would have a similar advantage of creating symmetry in regulatory analysis requirements between independent and executive agencies, but would not bring with it the kinds of institutional changes and challenges that would accompany the first option. The alternative would be to eliminate the exemption in the Unfunded Mandates Reform Act (UMRA) for independent agencies. The Unfunded Mandates Reform Act simply imposes a requirement that all agencies, for certain rules, apply benefit-cost analysis to them, and that requirement is something that is enforceable through judicial review.

The courts can make sure that the agencies have done that analysis, and then the quality of that analysis would form part of the standard arbitrary and capricious review that courts would give.

If Congress should go forward with either of these options and apply a new mandate to independent agencies, it obviously should keep in mind that effectively implementing any such mandate will require resources by independent agencies, and even with these resources and the stronger incentives that a mandate would bring, regulatory analysis will always remain somewhat provisional. A mandate should not expect agencies always to be able to monetize costs and benefits, or at least all costs and all benefits, for every regulation.

Let me turn in my remaining time briefly to retrospective analysis and possible steps to be taken to improve agencies study of their rules after they are adopted. Such analysis is absolutely vital to inform prospective analysis and it is something that is underproduced by both executive agencies and independent agencies.

The Obama Administration's Look Back Initiative has been a good move forward in this regard. And Congress, I think, could help by codifying a model like that Initiative and applying it to independent agencies, which have been exempt from the regular status reporting that executive agencies have had to make on their retrospective reviews.

I would also suggest that requiring all agencies to develop some kind of structural evaluation plans at the time they adopt new rules would help shape their thinking about evaluation early on in the process, as well as form a basis for more rigorous review after the fact. The very frameworks that are called for in the Smarter Regs Act of 2015, for example, strike me as quite useful.

Finally, as with prospective analysis, of course, ensuring high quality retrospective analysis requires resources, and Congress would need to allocate those as well. In these various ways, and for the reasons I have elaborated in my written testimony, Congress has an opportunity to strengthen the capacity for smarter regulatory decisions by the Nation's independent agencies, by both encouraging better prospective and better retrospective analysis.

Thank you very much for your time and dedication to these issues.

Senator LANKFORD. Thank you, all three of you. The ranking member and I are going to defer our questions to the end, and I recognize Senator Ernst.

OPENING STATEMENT OF SENATOR ERNST

Senator ERNST. Thank you very much. I appreciate that. And thank you, gentlemen, for appearing before us today. I am going to take just a moment and kind of set the stage, walk you through an issue that I have seen, and then certainly get your feedback on it.

As you may know, in February, the FCC published its Notice of Proposed Rulemaking on the Set-Top Boxes that are now required. And I have received several letters from small cable companies in my State that are very concerned, serious concerns about what this rule means for the vitality of their business, some of which have been family owned for many decades.

According to the Small Business Administration (SBA's) Office of Advocacy, the FCC published an Initial Regulatory Flexibility Analysis (IRFA), with its notice of proposed rulemaking (NPRM). However, the FCC did not attempt to quantify or describe the economic impact that its proposed regulation might have on small entities. SBA goes on to say that the FCC's analysis "Simply describes compliance requirements without making any attempt to explain what kinds of costs small multi channel video programming distributor (MVPDs) might incur in order to comply, and without any discussion of how those costs might be disproportionately burdensome for small entities."

So my questions to you are two-fold. Can either of you, Mr. White or Mr. Gasaway, comment on the FCC ruling and the quality control of that economic analysis, and with your experience and background, would you believe further defining what an economic analysis should entail from the Regulatory Flexibility Act side and how it could improve economic analysis of those independent agencies? How can we do better, if you would please?

Mr. GASAWAY. Well, I will take a crack at that. Senators, first of all, let me say that I am aware that that rule is out there. I have not studied it and so it is hard for me to talk, but I am a lawyer, so I will talk at length.

Senator ERNST. Thank you. Of course.

Mr. GASAWAY. It is hard for me to talk about. I would be surprised if there was a quality Small Business Regulatory Enforcement Fairness Act (SBREFA) analysis. It could well be that that is the case. But unless there is a reason for doing a quality SBREFA analysis, often times it gets lost in the fact that there are limited resources at agencies, and I think the empirical work at independent agencies shows that many times they cut short those types of analyses.

So I would not be at all surprised if in fact it was cut short. I do think the types of steps that we are talking about today can help. One of them, obviously, is subjecting SBREFA type analysis or other type of analysis to either the Small Business Administration Office of Advocate or Counsel of Revenue. It would be tying that more closely, tying it more closely to OIRA.

But I would again say that there is not going to be better decisionmaking until there is some sort of fundamental reform. Now, one reform that people often think about is just making SBREFA judicially enforceable. And if you had only one card in your deck that might do it there. And I always support positive incremental reforms. But without spinning out of control, I do think that it shows the larger problems of administrative agencies and the larger problems this Committee has been dealing with.

Remember, the FCC or any other agency is going to be thinking, I have a programmatic mandate, and my programmatic mandate is not to promote small businesses; it is to promote good telecommunications. And promoting good telecommunications requires the small Set-Top Box rule. So the SBREFA requirements are always going to be the caboose, and what I was trying to suggest with some of my broader reforms in my testimony is if you are going to change that culture, that word that I appropriated from my fellow witness, you are going to have to think very seriously about one of these other proposals that are on the table and these larger issues.

I do not think there is a clear answer to that, but I do see the problem.

Senator ERNST. Very good. And Mr. White, I cannot help but notice those Iowa Hawkeye cufflinks. They are glaring at me. This is a Cy-Hawk weekend, right?

Mr. WHITE. I know, Senator. Thank you, and thank you very much for bringing the Committee to my hometown of Dubuque, Iowa last month. Thank you very much.

If I may just add very briefly to what my friend just said.

Senator ERNST. Absolutely. Thank you.

Mr. WHITE. I think the key word, if I heard it correctly from the SBA, was the FCC did not attempt an economic analysis. And that is key. It is not even that they did it and did it poorly. It is that they did not even attempt it, which I think goes to the cultural, the regulatory culture issue that Mr. Gasaway mentioned.

I read a recent report by an economist named Hal Singer—I am sorry. I do not have it off the top of my head, but I would be happy to submit it for the record[1]—focusing on the broader problems of the lack of economic analysis at the FCC. The FCC's former chief economist called the recent Open Internet Order, he quipped that it was an economics free zone. And I think that is from the FCC's own former chief economist. I think the same could be said for a lot of what the FCC is doing.

Senator ERNST. OK. Thank you, gentlemen, very much. Thank you.

Senator LANKFORD. Senator Portman.

OPENING STATEMENT OF SENATOR PORTMAN

Senator PORTMAN. Well, first of all, thank you very much for holding the hearing. I mentioned to Senator Heitkamp a moment ago, I hold these two up as my model at other hearings. I chair the PSI Subcommittee, saying that they allow Members to come and ask their questions and leave, because our lives are all so crazy and busy rather than monopolize the microphone. So thank you for letting me ask a question. I did just get here, so I missed some of your opening remarks. I did have a chance to look through your testimonies.

[1] The report submitted by Mr. White appears in the Appendix on page 87.

Senator LANKFORD. You missed all my kind remarks about all your work for independent agencies. We talked about you positively even when you were not here.

Senator HEITKAMP. Major moment of suck up.

Senator PORTMAN. I missed it, but exactly, I heard about it, and I was not going to suck up again, as you—no, no. Seriously, thank you for mentioning that. And look, we have been working this a long time. Senator Warner deserves a lot of credit too, and I know some of you have disagreements with us in the way in which we make these agencies accountable, but give me a break. I mean, the American people are shocked to learn that independent agencies who play a bigger and bigger role in all of our lives do not have to go through a basic cost benefit analysis. I mean, they are shocked by that. And we have to figure this out.

I am looking at some of these comments about how independent agencies are not subject to any influence from the White House. That is just not true. I mean, I would point you to April, when President Obama publicly announced his support for the FCC Set-Top Box proposal. I mean, Homeland Security Committee, this Committee, issued a report finding that the White House had duly influenced the FCC's decisions to reclassify broadband Internet under Title II.

I mean, there is influence. I wish there was not that kind of influence, but there is. So this notion that they are somehow not subject to any kind of political pressure, unfortunately they are, but they do not have the same accountability. And I just think people really are ready to come up with some way. We can look, do the benefits outweigh the costs or not? And I think that is the least we should be asking for.

So the way Senator Warner and I approach it is, as you know, is to have the independent agencies at least provide information to OIRA and have OIRA play an advisory role. There are various ways to do this, but I hope you will work with us on this. The President said that he is for it. All we really want to do is codify what the President has said through his Executive Order, and it has to be done legislatively because these are independent agencies.

OMB found that 10 of the 16 major rules issued by independent agencies in 2014, which is the last year we have data for, included some information. That means six contained no information on cost or benefits and zero included a full analysis of the type of analysis required by executive agencies, zero.

So I think we have a real problem here, and this Subcommittee has been terrific at focusing on it. We had hoped to get this Independent Agency Regulatory Analysis Act as part of a broader package on maybe six or seven bills. It seemed to have some bipartisan consensus. We were not able to get that done. Senator Heitkamp was helpful in trying to get that done, by the way, as were other Democrats, but there were others who just could not go along with the broader package. But I hope this is something that this Subcommittee can continue to work on and push on so we can get it done.

I guess, Mr. White, if I could just ask you a couple questions, I would appreciate it. You have been at this for a while. I read your testimony. I thought it was very informative, very well done. I think our legislation is pretty modest. It does not go as far as maybe you would like us to go and some others would.

The American Bar Association, the Justice Department under President Reagan and President Clinton, the Administrative Conference of the United States, legal scholars across the spectrum, including Cass Sunstein, who all of you know, have said that the President, as head of the executive branch, has the authority to bring independent agencies under the same regulatory analysis and review framework that applies to executive agencies.

And as you said, agencies currently are able to grade their own homework. Can you explain what you see as the benefits of having an outside entity review an independent agencies cost benefit analysis in terms of how it increases the quality of their work, and perhaps tell us the problems that come from a lack of accountability.

Mr. WHITE. Sure. Well, with respect to the benefits, I think that oversight, while it provides an accountability mechanism for the people, I think it also helps make the agencies the best version of themselves when they know that they will have to explain and justify their analysis to a superior authority, whether it is in the White House or a Federal court, not to be micro-managed by the White House or the court, but just have someone kicking the tires seriously on their analysis and questioning their assumptions. I think that will spur the agencies to do better work.

The Set-Top Box example, which again, I am not an expert on, but I have heard a lot about, is a worrisome example. The Open Internet Order, which I am involved in in litigation, I should make clear, is another example where everybody from the dissenting commissioner, Ajit Pai, to the dissenting judge, Judge Steve Williams of the D.C. Circuit, who is a former regulatory scholar himself, all had serious, serious criticism of the assumptions and often self-contradictions within the meager economic analysis that the FCC undertook. I think it is a glaring example of the need for serious accountability and cost benefit analysis before these rules are imposed on the public.

Senator PORTMAN. Thank you. I do not want to overindulge you guys. Thank you for letting me come and ask the question, and I look forward to hearing more from you guys with other questions. And thank you, Mr. Chairman.

Senator LANKFORD. Senator Heitkamp.

Senator HEITKAMP. Thanks so much. We have covered kind of the whole watershed here from regulatory analysis to where that needs to be done all the way through judicial review and "Chevron." I want to focus on independent agencies, because of all of the things that we have worked on, taking Senator Portman, and Senator Warner's bill, trying to sell it in a political sense, has been a lot tougher than I ever thought it would be, because it seems so common sense to me that if you have a major rule that is being promulgated, no matter who is promulgating it, all the rules should be the same for major rules, and that is not what we have.

And so I am going to offer you some of the criticisms that we have heard from the independent agencies about that concept and ask you to kind of help me work through—if we are going to do a full frontal attack, right, and say we are going to do this no matter what, and it is going to go to OIRA, then we are going to lose politically, I can tell you that.

We have already been—I know it is hard to imagine, because when you look at it and you look at the history of this, it has been very bipartisan. But it has been very difficult. And so let us walk through some of the criticism that we have received. First off, OIRA is an agency, a sub agency of OMB and under the control of the President, and simply giving regulatory review to OIRA under this procedure would in fact interject and interfere with independence.

Now, what we have tried to do in response to that is look at another agency, whether it is the IGs, whether it is GAO, take a look at some other place where we could put that kind of regulatory analysis. Because I agree with you, Mr. White, I mean, none of this is ever going to be perfect, but if there is no level of scrutiny or analysis, work can be pretty sloppy, right? Your dog ate your homework every day, right?

So how do we overcome, or how do we respond to an argument that OIRA is a sub-agency of the President and interference would be—Mr. Gasaway?

Mr. GASAWAY. With the Paperwork Reduction Act (PRA) precedent. You just say this is for analysis purposes only. There is a carve-out. It has to go to the expert agency within the Federal Government on regulatory analysis for their comments.

Senator HEITKAMP. That makes a lot of sense. However, the bill is very modest in terms of—I mean, it does not say they can stop the regulation.

Mr. GASAWAY. Non-binding.

Senator HEITKAMP. Yes, it is not binding. There is nothing in this legislation that would give OIRA any authority to stop the regulation. It just would give them review authority. And we still hear the argument that it is over-burdensome and attacks the independents.

Mr. GASAWAY. Well, then I would say this is like sending a medical question to the experts at the National Institutes of Health (NIH), or something like that, for non-binding review. The greatest repository of medical information in our government, I think, is at NIH. And maybe somebody is taking a policy decision and they need medical input. You do not have to do what they say, but you have to ask the question.

OIRA is a terrific agency with a terrific bipartisan level of competence. And obviously, Professor Sunstein is great, but many of his predecessors are. And it is absolutely inconceivable to me, if I were the United States senator, which I am not, that I would want independent agencies to avail themselves of that expertise. And that is what I would say. Do you really just want them to not avail themselves of that expertise?

Senator HEITKAMP. I am looking for an alternative word, because we have said all these things. That is not the problem. The problem is not that we are not graded arguing our position. The problem is that we have reached this impasse that we need to somehow get over. And Mr. White, I am curious, I forget which witness talked about the need for coordination. I think it was you. Obviously, OIRA has a much better handle on all of the agency major rulemaking and probably is the best place to balance, what is the Department of Commerce doing against what, the Consumer Finance Protection Bureau might be doing.

So it is dangerous to take it out of OIRA, but yet we need to get this kind of review. We need to change the culture of, I should not say lack of accountability, but kind of this, we have our own funding stream, we have our own—once we get an appointment and confirmation, which is getting tougher to get because of these issues, in my opinion, so now hands off, we are in charge.

And so we are trying to get beyond that. How do we find a mechanism or find a way to do a work-around that would accommodate what we all here believe needs to happen?

Mr. WHITE. Well, if I may, I want to make clear, I do not mean to focus on OIRA to the exclusion of anything else. Whether it is accountability to the executive branch or to Congress, either through existing mechanisms or some new congressional office of regulatory review, or through the courts, at the end of the day, for me the most important point is there being a measure of accountability and oversight, not one particular branch doing it.

And so I am open-minded on all these proposals.

Senator HEITKAMP. One of the concerns that I have about leaving this up to judicial review, and I am not being critical, and maybe I am, but you will hear agency heads saying, we are going to implement this rule. If the court does not issue a stay on the rule, then the rule is going to take effect even though the rule was bad. So it is not a process that provides for immediate reaction or some kind of contemporary analysis. And so it fails. Judicial review fails and should be a last resort. That is my position.

The Chairman and I have had long debates about reform of judicial review, but I am looking for some way to get this concept over the finish line in a way that we have legitimacy to the argument that we are not imposing Presidential review on an independent agency.

Mr. WHITE. If I may just add on that point, at the end of the day, like I said, this is about accountability, not just to Congress, but to the people. In the last few years, especially in the aftermath of Dodd-Frank, where independent agencies on financial policy have had ever greater power, you see so many of these regulations. No matter what they say in terms of marketing them as anti-Wall Street, ultimately these regulations benefit the biggest banks and the biggest companies first and foremost, whether it is because of the compliance burdens that the community banks and other small entities face, whether it is through the Financial Stability Oversight Council and others seeming to place a too big to fail stamp on the biggest players.

At the end of the day, if an agency is truly independent and not accountable to the people, there is the greater risk that the biggest, most influential corporate players will have a disproportionate voice on policymaking, and whether it is through the President or Congress or through the courts, if the people do not have a real means of accountability for these agencies, at the end of the day, they will have a disproportionately quieter voice relative to the bigger players.

Senator HEITKAMP. I would like your thoughts.

Mr. COGLIANESE. Yes. Well, first, let me just say that from a constitutional structure point of view, if a president wanted to apply OIRA review just to a single agency——

Senator HEITKAMP. He could.

Mr. COGLIANESE [continuing]. He could, right. The Executive Order is the president's prerogative to design however he or she would like. The fact is that there is one piece of legislation that requires agencies to provide statements of cost and benefits of major rules, a piece of legislation that Congress has expressly exempted independent agencies from.

So one way of making a cultural change might be for the Congress to say fundamentally, in what we have required of all other agencies, we are going to require of independent agencies as well. That would be a step forward. And it would address something that one reads time and again in responses by general counsel or others at independent agencies on these issues that, "oh, we are not required, we have no legal obligation". Amending the Unfunded Mandates Reform Act would, at least for those rules that pass that threshold, eliminate the ability to make that excuse.

So that is one step, I think, that could be taken by the Congress that would also avoid the kinds of political issues that you have talked about, Senator Heitkamp. There are obviously limitations, right? I mean, this is not maybe providing the optimal level of oversight, peer review, and so forth. But the possibility exists for there to be judicial review, and the ex-post threat of judicial review does offer some ex-ante incentive for agencies upfront to do their homework.

With respect to homework, I think the way I would characterize this is, yes, it would be great to get feedback from a teacher, but what is different about Executive Order 12866 is it involves not just a grade from the teacher, but also permission to graduate to the next grade. So there is this lever, the hammer that hangs over it, and that is causing the kind of constraints and responses that you are talking about, Senator Heitkamp.

One other possible approach, and it is not mutually exclusive, might be for Congress to impose on, quite frankly, all agencies, something along the lines of the peer-review guidelines that OIRA has in place already for various scientific analyses that agencies are conducting. This would bolster the Information Quality or Data Quality Act provisions where agencies could in real time get that kind of feedback through a peer-review process.

Maybe that peer review could come from other agencies. Maybe it could come from outside experts, but at least there would be some process of someone reviewing, providing feedback if indeed the option of having analysis reviewed by the White House staff is not politically feasible or wise for other reasons.

Senator LANKFORD. I want to open this up and I want to open it up for the full dais to be able to talk about questions, be able to interact, but I want to give you a broad philosophical question that you are going to think I am kidding, but I am not. Independent of who? They are an independent agency. Independent of who?

Mr. GASAWAY. I will give the answer. I think it is not independent of who but independent for what? To exercise independent judgment. And I think the key word there is judgment and I think the key thought is in Adam's testimony. They are originally thought of as kind of specialized courts, not as specialized legislatures. And I think unless you go back to that model of more an independent court with more circumscribed jurisdiction, I think you are going to have problems.

Senator LANKFORD. I ask that question because the common question here is we cannot impose 12866 on them, we cannot put them in UMRA, we cannot put them in all these things because they are independent of the executive agencies and independent of Congress, and it is always they are independent of who. I think we have lost the why they were created, because they were supposed to be non-political, supposed to give faster judgments with greater expertise than what the Federal courts could do or other entities.

They were going to be specialized in their area to be able to get faster, non-political responses, and now we have independents like the FCC where it is really a five-member board, that three members are selected by the president's party and by the president, and so they are not non-political, they are not faster, and they are not cheaper.

And so we are back to the same issue. We still have these independent entities that Congress seems to argue about who are they independent from and we have lost the why that they ever existed as an independent. And I think the argument really boils down to a philosophical argument of if we are going to determine what to do with the agencies that are creating billions of dollars in regulatory schemes and giving answers to people based on statutes that we are at a loss to figure out where it connected actually to statutes, then we have to figure out if they are really independent.

Independent of who? Is it independent of Congress, independent of the executive branch, independent of the Judicial Branch, independent of the American people? Who are they independent of, and then how are they going to actually be formed? I know that may be a bigger philosophical argument, but we have not resolved that basic question, quite frankly, as a Congress, and if we can ever resolve that issue, I think it is going to go to the next step.

Do we need agents to have better independent agencies anymore, and if we do, how do we reform them? Because they are not functioning as apolitical bodies any more. They very much seem to have a political agenda in their timing and their cost seems to be equated to other Federal benches. Mr. White.

Mr. WHITE. I agree with all of that. And if I may add a further point, as I said earlier, I think the trend line is in the wrong direction with respect to independence from Congress. Independence from the president raises a whole host of questions in and of itself, but independence from Congress should not be a question at all. These agencies should be accountable.

But in recent years, from Sarbanes-Oxley to the Affordable Care Act to Dodd-Frank, the move has been to make these agencies structurally independent from Congress, and that is very dangerous, and not just for these particular agencies but going forward. The New Deal era agencies and the ones before, from the Federal Trade Commission (FTC), the FCC and so on, they basically set the paradigm for the next 60 years or more. That defined what the benchmark for independent agencies would be. And if Congress does not take steps to correct the structural mistakes that it made, with all due respect, in the Sarbanes-Oxley Act, the Affordable Care Act, and Dodd-Frank in making these agencies even more independent, that will become the paradigm for independent agencies going forward. The next independent agencies will not be modeled on the FTC. They were modeled on, for example, the CFPB. I think that is very dangerous.

Senator LANKFORD. And the CFPB, as of now in Oklahoma, 24 percent of our commercial banks no longer do home mortgages strictly based on the issues that Consumer Financial Protection Bureau created these set of regulations. There is so much liability now, they walked away from doing mortgages. 24 percent of our banks in Oklahoma. It is becoming more and difficult, especially in rural areas of my State, to be able to get a home loan because the banks have walked away from doing that because people have seasonal income, because their income does not come in every month in a predictable format that CFBP wants. It comes in when the crops come in or when there is a sale. So that seasonal income not consistent, too much risk. Those are things that should have been determined in a cost benefit analysis that should have oversight, and CFPB, as we all know extremely well, has no oversight.

So I am back to the same issue. How do we get to a set of independents, that there is a sense that they are not independent of the American people? Congress created them. They are not independent of Congress' oversight by far. If Congress created them, Congress can turn it off as well. But there has to be some level of oversight. All of us have oversight, and if there is an entity that has no oversight, that is more independent than our Constitution ever conceived of in any mindset.

Does anyone want to make a quick comment on that, just——

Mr. COGLIANESE. You have asked a great question, and one of the reasons it is challenging, just to pick up on your last point about the Constitution, it really speaks to the independence from factions, if we go back to Madison. Both factional influences through political branches of government and through influence by private interests, through, say, regulatory capture— both of those speak to the type of independence that is reflected in the concern that motivates independence for agencies.

I think that the formal structures are not always fully aligned with actual independence. It was mentioned before—I think Chairman Lankford you mentioned the comments by a president reflecting a policy preference for what action the FCC might take, and the FCC then pursuing that action. There are opportunities for influence, I agree, Senator Portman, for influence by members of either Article I institutions or Article II institutions to influence independent agencies.

And there are also some executive branch agencies that operate with a great deal of actual practical autonomy. I think ultimately it is a challenging question because we are looking for something where there is at least independence on factual determinations, expert judgment. We want that to be pure and based on sound scientific assessment. We do not want that to be influenced. But on the other hand, we are a democracy and agencies must make value choices. The fundamental values that are reflected in policy choices that independent agencies make should indeed reflect those of the Congress and the elected officials.

Senator LANKFORD. So should we assume that executive agencies then will not have bipartisan or will not have non-political answers that are based on sound science and only independence can do that? Or should we assume that for both?

Mr. COGLIANESE. No, I think that is not the implication—I mean, the Food and Drug Administration (FDA) has historically had a very strong reputation for operational independence on making those kinds of scientific judgments.

Senator LANKFORD. So I am back to the same issue. Where we have evolved at this point in the structure of independent agencies and what has happened, whether it be Mr. White in all of your very good analysis just on the history and what happened in the Reagan Administration and opting out from OIRA at that time and some of the decisions that have been made and then the acceleration since then, is there a reason that we should have independent agencies separate from executive agencies, that they have two different structures due to operations?

Because as all three of you noted in your written testimony, it is tough to get even a definition of what an independent agency is. I mean, there is the 19 that are listed, but operationally, it is "can the president fire the head of it without cause just to fire the head of it", and "are they under OIRA review" are the basics of it. But even that has some breakdown in some of the agencies that are called independents.

So the issue is at this point, why do we have some entities now under current operation that are called independent and some are called an executive and have two sets of rules under them when they are all processing the same regulations? Mr. White.

Mr. WHITE. While we are talking now about rulemaking, it is important to keep in mind that independent agencies do a lot of adjudication. The FTC and some of the other agencies do a lot of case by case adjudication. That really was in the core function of independent agencies at their origin, and I do think some measure of independence, a limited measure of independence is important for those functions.

And another word——

Senator LANKFORD. But independent from who at that point?

Mr. WHITE. Right. Again, at that point, it is independent from direct control and decision by the president, or at least insulation from it. And I am not saying that the president is constitutionally barred from getting involved in that. I am just saying I understand why that is a specific subset of agency action that might justify some measures——

Senator LANKFORD. Because it is more judicial?

Mr. WHITE. It is more judicial. As they used to say, it is quasi-judicial, which was the whole justification for their independence, and the Humphrey's Executor case that recognized agency independence. And I will say with the independent commissions, when you have a multi-member structure, that does help build in an internal check and balance, right? At the very least, when the FCC makes a decision, you might have two dissenting commissioners who, like judges on a court, are going to have dissenting opinions and in some limited ways, force a dialogue within the agency.

I think that is a very important and very good aspect of independent regulatory commissions, that they have that multi-member body. And so that is a useful function, especially in that quasi-judicial context.

Senator LANKFORD. So how are they functioning different than an administrative law judge, which is also quasi-judicial, but they are in executive agencies?

Mr. WHITE. Well, that is a very fair point. I might say in the independent agencies, it is like the difference between a court of appeals and district court judge. An administrative law judge (ALJ) makes an independent decision and then it goes on to the multimember head. But you are right, in the executive agencies, that is a very good question why that should go directly to an executive branch official.

Senator LANKFORD. Other thoughts?

Mr. GASAWAY. I will just say that I think you are hitting the nail right on the head, and I think these are very, very complicated and critical issues and I do not have a blithe answer to them other than just to say that I do worry about giving too much in legislation and trying to extend this, because if you extend it only in a way that preserves too much independence, you are in a sense sending a signal that they really are independent.

Senator LANKFORD. Yes, and that is really the concern for me, is that we are creating more and more sense that they really are truly independent of everyone, and with no accountability, we have a big issue. When you get to CFPB, that their funding does not connect to Congress, their oversight is not here, there is no oversight in the presidency, no board even to be able to check a single member of that same leader, you really have created a fourth branch of government in some ways that has very little to no restrictions around them. And even if they want to reinterpret some of their own originating statute, they have the opportunity to be able to do that, and that is a big concern for me.

One quick question. Let me open this up for broader conversation, because I do not want to hog all the conversation. Does any of the three of you have an issue with codifying 12866 for both executive entities and for independent agencies, that that would move from being an Executive Order to being codified?

Mr. WHITE. I do not. I would welcome it.

Senator LANKFORD. OK. All right. Let me open this up. I do not want to hog the time, because I know several others that may have questions and thoughts.

Senator PORTMAN. I think it is a very interesting conversation about what constitutes independence, and obviously, CFPB is sort of one end of the spectrum without having the board or commission that Mr. White talked about and not only that, having no appropriations. So, the congressional purse strings are not attached.

Again, I think the reforms that we are talking about are pretty modest. One we have talked about with CFPB is how about an inspector general? I mean, they do not have an IG that relates to them and their work. It seems to me that is kind of a minimum thing that we should be requiring that would allow them to continue their independence, but to have some check on their work.

But let us get back to this issue of OK, without calling into question the whole notion of independent agencies, the fact is having some sort of a way to look at the cost and benefits everyone seems to agree on. The question is who should do it? I like what Mr. Gasaway said, that there is expertise actually in the Federal Government to do this. Unfortunately, it is not at GAO, it is not at the Congressional Budget Office (CBO). It is not at the IGs now. It could be created. It would be another expense to the taxpayer, and the question is whether you get the kind of smart career people that are at OIRA, who I used to have the honor of working with, to be able to do this.

And we are not talking about a lot of rules. I mean, again, this is a modest proposal. We are talking about over $100 million per year in impact. It is roughly 12 to 15 rules per year. And it is advisory. And Senator Heitkamp is actually right on that; it is non-binding. But the agency does have to respond to it. So when OIRA takes this on, they have a short period of time, 90 days max, to do it.

And this notion that it is going to slow everything down, it is just not accurate. I mean, there is a deadline and, we do this with the executive agencies every day. But when they do get a non-binding analysis back, there has to be a response from the agency, which is part of this accountability we are talking about, and it is transparent. So as taxpayers, my constituents get to see it. As Members of Congress, we get to see it. As experts, you get to see it. I do think that it would have a very positive effect on coming up with some standards that are, viewed as reasonable in terms of looking at a cost versus a benefit.

There is another criticism that we have seen out there, which is that somehow the individual statutes that have cost benefit within them would be overridden. We wrote the language explicitly to avoid that problem. It states that, and I quote, "The president may by Executive Order require an independent agency to comply, to the extent permitted by law, with regulatory analysis requirements applicable at other agencies."

This mirrors the qualifying language that is in President Clinton's Executive Order, the 12866 we talked about. And everybody, including by the way, Elena Kagan, when she was a professor explained that to the extent permitted, a relevant statute means that, you would not be overriding those statutes.

So again, kind of to Senator Heitkamp's point, we have sort of gone through them. We have answered all these questions, and yet there just seems to be this concern out there that somehow these independent agencies should be able to be out on their own freelancing, and whatever we come up with, there seems to be some concern. So again, but I think we have responded to very specifically.

One of the issues that is broadly talked about is that the accountability of independent agencies would somehow be reduced. To me that is also crazy. I mean, this adds more accountability. And I guess the argument there is that there would be less accountability to Congress and more to OIRA, more to the executive branch. Congress needs to take its role seriously, which this Subcommittee does, to do the oversight, and it should have, I think, the obvious intent of this, to have more accountability. And again, we would know then what the analysis was and how it was not meeting what OIRA does for all the executive branch agencies.

So again, I thank you guys for being here. I hope that you will continue to work with us on this and help us to be able to get the word out broadly. I do think Senator Heitkamp is right. We sort of make all these arguments, we are not succeeding. But part of it is maybe we are not making the arguments as effectively as we could and not doing it to the American people, who I think would be shocked to understand that there is this, lack of analysis at a time when so many of our businesses back home tell us the regulatory burden is making it difficult for them to add a job, to expand plant and equipment. We have an economy growing at 1.5 percent. We have flat wages. We have a middle class squeeze that is very real out there, and the regulatory burden is part of it.

You mentioned the banks in Oklahoma, they are no longer offering mortgages. I would like to say that the community banks in Ohio are consolidating. What does that mean? That means there are fewer loans being available at the local level for smaller businesses. Where there is a personal relationship, there is less involvement in the community, and this is a function of regulations.

They tell me that with very specific numbers this is what they had to put aside for compliance 5 years ago, his is what they are doing today. And they simply cannot be competitive with these levels of compliance and the regulatory burden, that sometimes it is more than one regulator, particularly with CFPB being involved.

So thank you very much for coming in. I appreciate you guys having this hearing, and I hope we can get this legislation moving in the new Congress on a bipartisan basis.

Senator HEITKAMP. I do too. The luxury that we have on this Committee is that we are trying to design a highway. We are not putting the cars on the highway. We are trying to design a highway that is safe, secure and accountable for agencies so everybody knows the rules.

The problem that we have is we get mired down in analyzing this rule that someone does not like or that rule that someone does not like, and all of a sudden, this turns into a discussion about this agency or that agency. And we have not had a lot of good luck in saying, imagine that the president is of a different political party than yours. What do you want the rules to be? What do you want the accountability to be?

Because this is not about partisan politics. This is about accountability on how we interact with the American people as the Federal Government. And it is enormously frustrating to keep—you see this very modest proposal somehow getting painted even in “The New York Times” as a huge giveaway, to some big corporate interest that will result in financial mayhem in 2 weeks if we do it.

And so we are in this highly hyper-partisan exaggerated world trying to make common sense rules about how we move forward, and no one, if they really sat down like we do on this Committee and analyzed the rules, analyze the growth of what is happening with independent agencies, would ever think that they should not be subject to the same kind of rules or regulations of other executive agencies.

I mean, this just does not make a lot of common sense, but yet we have created this culture that somehow, as the chairman has said, that to have any kind of influence eliminates independence. And everybody loves independence because we all know what that means, independent from politics. Well, there is nothing in this town that is independent from politics. Get in the real world.

We have to have rules that prevent overbroad political opinions from basically being embedded in so many of these rules. And so, we need to—the idea of regulatory reform has become so politicized that the common sense aspects of regulatory reform, whether it is a look back, we are working on a number of retroactive provisions, a number of look-back provisions, whether it is a cost benefit analysis which has progressed. From my days in law school in the 1970s, when we first started talking about cost benefit analysis, it was like this magic world.

I think it has become much more professional. We have a whole society that is dedicated to improving the quality of cost benefit or benefit cost analysis. However, we want to structure that. So we just have not made the factual argument very well, it seems to me, because we keep running into the political argument. We keep running into the hyper argument.

When we can sit down, Mr. White, and you and I nod our heads in total agreement about kind of where we are, recognizing that we may not agree on everything as a matter of politics, we know that we have some fertile ground here to actually get something done. But we are not going to get it done if we have the constant sniping at this, as this is just a way to shut down this agency or shut down that agency or restrict that agency.

We are not trying to shut down, restrict, or do any of that. What we are trying to do is say, justify to us the decision that you made and the analysis that you did. And we do not want just you, to say do not worry, I got it. We want there to be someone who is changing the culture that—we all know that when we have accountability, we perform better, we make better decisions.

And so that is the problem that we have, is that this enormously modest proposal was at the heart of really an op-ed in "The New York Times" before we even got the proposal off the ground. And, shame on us that we did not anticipate that this would be this controversial. It should not be controversial, because I just keep asking my colleagues, you could have a president that is not a Democrat. What oversight, what accountability do you want for the decisions that are going to be made in that case?

And when you can answer that question, then we can get to common ground. But we need people to really help us kind of bridge these gaps and create some momentum without having a package that has become so highly politicized. I think we have the elements of a pretty good regulatory reform package that would in fact amend the APA, would in fact do the things that I think any—80 percent of people who live in the common sense world that we live in, and places like North Dakota would say, well that should be a no-brainer.

We have 80 percent of the no-brainer stuff, but we cannot get political consensus here to get it done, and it is enormously frustrating. And I think it is because, I guess my family taught me that if I am failing, I should look at what I need to do differently. And so it is not just about these people cannot agree with me. It is how do I get this done in the face of this opposition?

And so we are really in need of a broader kind of academic consensus out there that these are the five things. No matter which side of the political aisle you are on, how you view the world, these are five really good reform packages. And I guess that is what we are kind of asking, is how do we build that kind of consensus within a broad spectrum of political thought on what change should look like in terms of regulatory reform?

And I cannot leave it without saying this because I think I say it at every one of these hearings: Congress needs to start doing its job. When we have things that are in litigation for 30 years on definitional provisions of the Clean Water Act (CWA), maybe it is time for Congress to actually do its job and provide the lane or the framework for what constitutes things like Waters of the United States.

And until we figure out how to do our job here, we are going to continue to over-delegate responsibility, I think, to executive and independent agencies. And then it is just a lot more comfortable for us to beat up on the agencies than to turn the finger pointing back at us to say, well, I guess we were not very clear in what we said. Maybe we ought to change that, because that is a lot of hard work. So much for my rant.

Mr. COGLIANESE. May I make a comment?

Senator LANKFORD. I am going to take up an offering after that.

Mr. COGLIANESE. May I make a comment? If I could just add to the virtues that have been mentioned for the approach that Senator Portman was discussing. In addition to the modesty of that approach, as you said, Senator Heitkamp. There is another virtue that I think should go noted here, and it does address Chairman Lankford's question earlier about whether it would be appropriate to adopt wholesale Executive Order 12866. I think that that approach would be problematic in some of the institutional aspects or design aspects of 12866. In particular, I am just not sure how practical the conflict resolution mechanism would work with multi-member commissions, if 12866 were to become binding legislation imposed on those commissions. Just as a practical matter, it is hard to see the commissions going back and forth.

So one of the virtues of the approach that Senator Portman was taking, where an OIRA review would lead to an advisory statement that then would need to be responded to, is that there is time for that, and you avoid the practical challenges that would be associated with a back and forth, which is how the Executive Order is really structured, but which is not going to work as well. It would be much more cumbersome with the multi-member commissions, and commissions by the way that are headed by individuals who in many cases cannot be removed at will by the president.

Senator LANKFORD. But are often partisan placements.

Mr. COGLIANESE. In some ways, one of the ironies of all of this is that with multi-member commissions, particularly where there are bipartisan requirements, but even without that, in any multimember body, when you have multiple people who have to vote on something, that becomes a bit like a mini-legislative process. And there is a tension here that should not go unnoticed between setting up agencies that have that kind of collective decisionmaking structure and analysis which is supposed to be expert and non-political.

So there is a deeper tension here as well. Again, that is why, if nothing else, I think it is important for Congress to go on the record in saying, if we are requiring cost benefit analysis in UMRA of executive agencies we could eliminate that exemption for independent agencies.

Senator LANKFORD. I would have no issue eliminating that for Unfunded Mandates Reform Act because again, that was a compromise that was made years ago that has proved to be an error, because it does exempt out a whole group of folks that think the rule does not apply to them. Really, I think that was a compromise at that moment that should not have been done.

It goes back to the same issue with the Reagan Administration not including OIRA connection to the executive branch, to those independent agencies. They could have at that moment. I wish they would have. But now we have several decades of history to be able to overcome, and I believe in some of the agency culture that they are independent of everyone, and they are not a fourth branch of government.

We are incredibly grateful—and this is something we have talked about often. These are experts in the field in decisions that have to be made, that Congress is not the expert, the Federal courts are not the expert, and different agency folks are not the expert. These folks are, and we are grateful they are serving the American people in that spot. But there is a need to have accountability in every part of that, and I think that is the issue. You cannot be independent of everyone. There has to be a built-in accountability structure.

Senator HEITKAMP. And it is not even accountability. It is transparency.

Senator LANKFORD. True.

Senator HEITKAMP. So who knew? I mean, how do you even have accountability when you do not know the rationality or the rationale—why they made decisions that they made.

Senator LANKFORD. And that is the lowest tier on the judicial review.

Senator HEITKAMP. Right.

Senator LANKFORD. It is just "did you do everything you said you were going to do"? Not even do we agree or disagree with it. Did you check the boxes to actually work through to be able to get the information? Can we see the homework?

Senator HEITKAMP. It just seems to me that we are in a hyperpartisan environment dealing with an issue that should be, very bipartisan and very clear what rules we want to guarantee, that all sides have an opportunity to be heard and that we actually have a foundation in which to judge the decisionmaking that went into, in many cases, very expensive determination. And we just cannot get there because we get mired down in individual cases that then become, oh, you do not like this agency or you do not like that person, that is why you wanted to change the rule.

That is not why I want to do any of this. It is not because I do not trust anyone or I do not like anyone. It is that I believe that we have a responsibility in the U.S. Senate and in this Congress and in this government to hold agencies and government decisions accountable and to understand why they decided what they decided. And I think they will, Mr. White, make much better decisions when they know that there is someone who is going to have the ability to judge the judgers, and that is the challenge we have.

Mr. GASAWAY. OK, now I will try to give you a practical solution. I gave you my political solution. The only thing I can think of would be to have it take effect some years in the future, if you say, I do not know who is going to control Congress the next day, I do not know who is going to be president. All I know, next date I want this to be the rule, because whoever is in those positions now.

Senator HEITKAMP. So then it does not become personal.

Mr. GASAWAY. So it does not become personal. It does not become partisan. If people say you are taking a shot at my former colleague Rich Cordray, you say, I do not know what Rich is going to be doing the next date. This is not about Rich. This is not about anybody else. So that is my only practical suggestions, Senator.

Senator HEITKAMP. Yes.

Mr. WHITE. It is about the third time in this hearing that Rob has beaten me to the punch on a good idea. I would like to reiterate that, that independent agencies are doing a lot right now and they will be doing a lot in coming years. If the legislation even said we are not going to go into effect for eight, 12 years, I will still take that. I think that would be a great improvement, because it gets around this problem of the immediate political ramifications.

But one other point, Senator Heitkamp, that you raised a little bit ago, and I really do not want to let it go by, where you said about Congress doing its job. So much of Congress' relationship to the issue of independent agencies and the administrative state in general comes back to appropriations. I ended my written statement with a quote from Madison, Federalist 58, the power of the purse. It is hard for me to go through any one of these, writing a testimony like this without quoting that. It is so important, the power of the purse.

And I think meaningful regulatory reform requires not just reforming the Administrative Procedure Act requirements. It is about seriously rethinking the way that appropriations work with the agencies. And now we are obviously biting off something even bigger than just administrative law. But the appropriations process right now, this annual sort of race for a single vote on a budget, almost a cliff scenario of solving the funding for agencies that really does complicate even more the problems of Congress' oversight of agencies.

And when there comes a day when Congress is appropriating the agencies in a much more iterative process, much more tied to legislation and oversight, I think that is important, because at the end of the day, Congress' job involves legislation and the appointments process and the appropriations process, and all three of those are crucial in Congress doing its job.

Senator LANKFORD. By the way, there are some proposals that are floating around now that a group of us have floated on reforming the budget process. If anyone is keeping score on this, it has been 20 years since Congress has passed a budget without a CR before it. Since 1974, when the Budget Act was passed, the Budget Act has only worked four times since 1974. So at some point, Congress has to admit that post-Watergate process that was created did not work as they hoped it would, and it does have to be reformed.

But that is a different hearing for a different day.

Senator HEITKAMP. The Budget and Impoundment Act, we are going to repeal it?

Senator LANKFORD. We can fix it.

Mr. COGLIANESE. One other, if I may, outside the box suggestion that I think is feasible to consider, but it is a long-term strategy as well, and that is to foster research. Let us just not there are just very clear research limitations well at issue in getting better analysis at these agencies. And I know that we have been talking here about legal structures and organizational structures that might encourage agencies to produce that work themselves.

But there is another way of thinking about this, not mutually exclusive, but another way, that would say let us also, at the same time we are thinking about institutional structures, think about other ways of resolving some of the fundamental research questions that need to be answered in order to do good prospective analysis of financial regulation.

Now, there is a big debate right now in the academic literature about whether financial regulation can be subjected to meaningful benefit cost analysis, whether we can actually get good estimates or not. And there is one side that sort of says "no, it is just not even possible", and there is another side that says, "yes, it is feasible".

I think even the side that says it is feasible would agree that we are not anywhere near the level of sophistication or rigor in understanding the implications of financial regulations and how they affect financial markets to be able to make reliable forecasts as often as we would need to in order to get analysis to a level where some of the best executive agencies have it.

I know from having taught environmental law that in the early days, in the 1970s, there were lots of analytical questions that were unanswered, and we just did not know a lot. Part of the reason why today we have much better consensus about how to estimate the benefits and costs of environmental regulations, is in part because of work that agencies have done, but it is also in part of funding and studies that have been done by the National Academies of Sciences and funding through the National Science Foundation. And to the extent that those institutional avenues could help. I do not think they should be neglected. They could be used to bring up the level of the state-of-the-art thinking about these issues. Then it will be harder for agencies to say, well, we just do not know how to do this.

And part of what they are saying today is "we are not required to do it", but "we do not know how to do it", "there is not enough time", "we do not have the tools yet". Let us build a collective knowledge base then. That is something that could be done wholly apart from administrative law reforms through targeted and strategic funding initiatives through other scientific enterprises.

Senator LANKFORD. I think you could also accomplish some of those same things with advanced Notice of Proposed Rulemaking and get more people at the table earlier and so that they actually receive input from people that are affected. If you get the people that are affected at the table, they can give you a pretty good estimate of how it is going to actually—I cannot even begin to tell you the number of times I have talked to someone in business that said, X, Y, Z Agency estimated it would cost this much, just our business, it will cost three times that, just for our business not counting everyone else.

And so when you do not get all the people at the table early with advanced Notice of Proposed Rulemaking, then you get a best guess from academics rather than from practitioners.

Mr. COGLIANESE. Some of the questions might though take years to resolve. So I mean, one issue in the environmental context, how do you value the benefits of reducing air pollution over the Grand Canyon? There is not a market that one could refer to; you would normally like to use market values to input into a benefit analysis there.

So there have been years of study of what are called contingent valuation techniques and a consensus emerging over that. And similar questions arise in other areas of regulation that need answers, and there are opportunities, I think, to make progress in those areas, as well.

Senator HEITKAMP. But there also is an opportunity for everybody to recognize that some benefits cannot be monetized. And so, I think that everybody thinks that we are trying to put monetary values on things like a view shed, what does that mean that we can still see the Grand Canyon as a country? That has value. That is not easily monetized, but we can all agree it has intangible value, right?

Mr. COGLIANESE. Oh, absolutely. And this is one of the things, in going forward legislatively that I would urge you to think about retaining in 12866 and in UMRA, which is a recognition that it is not always possible to get good estimates of these things, and that benefits should justify the cost, but that does not necessarily mean that we always have fully monetized benefits that outweigh fully monetized costs. There are sometimes going to be decisions that regulators have to make in the face of uncertainty.

Senator LANKFORD. So quick comment on that, then I want to be able to wrap this up. We are at 11:30 and I appreciate everyone's time.

Cost benefit analysis, as several of you have brought up, is to inform rather than to check the box and to justify. It should not be the we want to do this regulation and so we are going to create a cost benefit analysis that then benefits the regulation that we want to create. It should inform to say we are thinking about this. We go and check it and say, you know what, that is not a good option. Let us look for other options, and I think we are missing that.

And some of the conversation and some entities, it seems to be a justification to do what they want to do rather than informing the best solution. The intent of it was, is this the best option. If we go down this track and the cost is so high and the benefit does not seem to do it, then let us find other alternatives to do it.

So at some point, I hope we can get back to that, where it is an educational experience and a targeting different options rather than a justification to be able to do what we want to do. There are some pieces of common ground that I heard today from all of us in this conversation. There are things that I hope that we can continue to build on on these issues.

Let me open this up to final comments that anyone wants to be able to have on some of the issues. Mr. Gasaway, I just want you to know, I showed my absolute best restraint not to drift into a "Chevron" deference conversation when you had a significant part of your written testimony dealing with "Chevron," which we will reserve for another day. But I do appreciate your comments in your written testimony adding to it and referring to other things. We appreciate that as an unresolved issue. But again, another conversation for another day.

Any other comments? Mr. White.

Mr. WHITE. Just on your last point, I think it is very important, like you said, that on the one end, it cannot just be a box-checking exercise. That 2011 CFTC inspector general report I cite is just devastating, where the CFTC repeatedly treats economic analysis as a caboose on the process, run by lawyers more than economists.

At the other end, it is important that the economist not get so fixated on technical precision that they lose sight of the bigger picture. I studied economics in college and the old joke was an economist is someone who knows the price of everything but the value of nothing. And I think that that is important here, that at the end of the day, cost benefit analysis, the numbers are important, but the most important thing is the process and the exercise of thinking through these things rigorously to inform the value judgments.

Mr. COGLIANESE. And if I may add also one thought about that, which I agree completely. The goal of the analysis should be learning and informing and making better decisions. That is just another factor that would weigh in favor of an approach that would have less of a hammer behind it, rather than more of a hammer. That is, if you want agency officials really to internalize and take seriously and act earnestly to use analysis to learn, they have to own it. And there is a risk, and we know this from a variety of research on performance measurement in organizations, that once you put high stakes associated with measurement, then you create incentives for gaming and box checking and not doing what, Chairman Lankford, you so rightly said, taking it seriously to make better decisions, to learn and not just to cover up and paper over decisions you already want to make.

Senator HEITKAMP. Just one more observation, and I think when you get down to it, this is not an exact science. And if people want to kind of say, you missed the boat. But the other piece of this that is so critical, and it goes back to the other pieces we are trying to pull together, is the retrospective review. And so we have a bill that received unanimous approval in the Committee that would require every new major rule have a provision in it that was noticed.

That would require retrospective review within the provisions of that new rule.

We have to deal with the body of work that is out there, but if we do not have retrospective review, we do not learn about the mistakes that we made in the last cost benefit analysis, and so we do not improve the quality of that work overall, because there is never a look back or a judgment.

And so these are—we keep trying to compartmentalize these, but the package itself is what is going to get us where we need to be. And we laugh because the one area where we probably have some of the most interesting discussions between the chairman and the ranking member is "Chevron." So just to give you a little insight.

Senator LANKFORD. Just needs to be fixed, that is all it is. Just one little word change.

Senator HEITKAMP. I guess we all agree with you, right?

Senator LANKFORD. How about just switching it judicially to "probable construction". Just that would probably fix this. But that is a whole different conversation.

On the OIRA conversation as well and the cost benefit, the benefit of going through OIRA with everybody is cumulative effects. If independents are independent, we cannot get cumulative effects, and everyone says all these regs came down at different times, different deadlines, different authorities. Nothing seems to be coordinated. It is one of the many reasons independents need to go through OIRA, so someone can check cumulative effects. And it is very helpful to have somebody just talk and say, great, what other options did you look at, and how did the cost benefit work on the other options. That is a tremendous benefit just to have that conversation that currently we do not get.

But hopefully in the days ahead we can, because as I remind everyone, independents are not independent of the American people. They are still all a part of us and we are grateful that they serve the way they do, but we have to all be connected and get on the plane together.

So with that, thank you very much for your testimony and your preparation. I look forward to an ongoing conversation in the days ahead. I hope you will maintain the ongoing relationship you have with us and with our staff so we can get a chance to gather your ideas in the days ahead.

Let me do a final closing statement. I think I have to get some deadlines in here. The next time that we are together as a subcommittee is the 22d of September. We will continue our examination of agency use of regulatory guidance in a hearing titled "Continued Review of Agency Regulatory Guidance, Part 3." At the upcoming hearing, it will be the Department of Education, Department of Labor, and the Office of Information Regulatory Affairs, which we have discussed at length today.

That concludes today's hearing. I would like to thank all of our witnesses. The hearing record will remain open for 15 days, to the close of business on September 23rd for the submission of statements and questions for the record. This hearing is adjourned.

[Whereupon, at 11:38 a.m., the Subcommittee was adjourned.]

APPENDIX

UNITED STATE SENATE COMMITTEE ON
HOMELAND SECURITY
& GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON REGULATORY AFFAIRS
AND FEDERAL MANAGEMENT

SENATOR JAMES LANKFORD, CHAIRMAN SENATOR HEIDI HEITKAMP, RANKING MEMBER

Opening Statement
Hearing before the Regulatory Affairs and
Federal Management Subcommittee,
Thursday September 8th at 10 AM
"Reviewing Independent Agency Rulemaking"

Good morning and welcome to today's Subcommittee hearing titled "Reviewing Independent Agency Rulemaking." This is the 13th hearing on the regulatory process that this Subcommittee has held this Congress. In all of our prior hearings this subcommittee has reviewed the regulatory actions of executive branch agencies, but today we turn to the rulemaking record of independent regulatory agencies.

First, I want to recognize Senator Portman for his work on this topic and as this subcommittee moves toward addressing shortcomings in how independent agencies regulate, we have Senator Portman to thank for his tireless work in this area and the foundation he has laid regarding common sense solutions to fixing problems associated with independent agency rulemaking.

Independent regulatory agencies were conceived to accomplish varied missions, but have one thing in common – they were structured to be somewhat independent from the influence of the President and the Administration.

However, Independent Agencies should not be exempt from oversight. When an agency is independent of the Executive Branch it does not require that they are also independent of Congress and the American people. Congress created each Independent Agency and Congress still has the authority to oversee the agency they created. No public entity should be exempt from oversight.

Independent agencies take regulatory action just like their Executive Branch counterparts. They promulgate rules, issue guidance, and take enforcement actions. Accordingly, independent regulatory agencies should be held to the same procedural standards as executive branch agencies.

I would actually argue that Independent regulatory agencies require a heightened level of oversight over their regulatory regimes because the Executive orders that have structured every aspect of the rulemaking process for Executive Branch agencies, and have been endorsed by both Democrat and Republican administrations for decades, do not apply to independent regulatory agencies.

According to OMB's 2015 Report to Congress on the Benefits and Costs of Federal Regulations, from 2005 through 2014 federal agencies issued 549 major rules, independent regulatory agencies were responsible for 141 of these rules which equates to roughly 25 percent of rulemakings.

There is cause for concern when it comes to the analysis to support those rules. In the same report, OMB found that in 2014 only "Ten of the sixteen major rules issued by independent agencies provided some information on the benefits and costs of the regulation," and that, "independent agencies continue to struggle in providing monetized estimates of benefits and costs of regulation."

Another study published by the independent and well-respected Administrative Conference of the United States in 2013 found that no major rule issued by an independent agency in 2012 contained a complete cost-benefit analysis.

Many of these rules that are issued without a cost-benefit analysis are financial regulations issued by the CFPB, CFTC, SEC, and FDIC and have a direct impact on the small and community banks that small business owners and farmers depend.

Take, for example, the CFPB's Qualified Mortgages rule. CFPB designed this in an attempt to extend credit only to those who can afford to repay a mortgage, preventing another mortgage crisis. Instead, the agency failed to monetize any costs and benefits and issued a one-size-fits-all rule that has crippled the ability of community banks to issue mortgages.

Rules like this show that when agencies are not required to conduct a full cost-benefit analysis before issuing a regulation, unintended consequences are likely to follow such as uncertainty among community banks that limits their ability to issue credit to farmers and small businesses.

Although community banks account for only 22 percent of all current loans, they hold three-quarters of all agricultural loans and half of all small business loans. Uncertainty for community banks means uncertainty for job creation.

This Administration has made efforts to urge independent regulatory agencies to improve some of their regulatory processes. In July 2011, the President issued Executive Order 13579, which urged independent regulatory agencies to comply with the analytical requirements that apply to Executive Branch agencies.

Requiring independent regulatory agencies to follow the analytical requirements of Executive Order 12866 and 13563 would be a reasonable and significant step toward achieving transparency and predictability for regulated entities.

We are pleased to have three witnesses today and I look forward to hearing from each of you what Congress can and should do to ensure that all agencies work for and are held accountable to the American people.

With that, I recognize Ranking Member Heitkamp for her opening remarks.

Opening Statement of Ranking Member Heidi Heitkamp
RAFM Hearing: "Reviewing Independent Agency Rulemaking"
September 8, 2016

Thank you Mr. Chairman. Today's hearing builds upon our Subcommittee's thorough examination of the current state of Federal rulemaking. Together, we have explored virtually every aspect of the regulatory process in a comprehensive and bipartisan way. We have sought out views and opinions from individuals across the political spectrum in order to identify sensible steps Congress should be able to agree upon to make needed improvements to the regulatory system.

Our focus today is independent agencies -- which occupy a unique position in our national government. They were deliberately established by Congress to operate independently of the President. Among other things, they are charged with vital public health and safety functions, ensuring economic and financial stability, and serving as stewards and guardians of fairness and equity on a wide range of other public policies. Those are critical responsibilities – and those responsibilities will certainly require independent agencies to issue regulations when authorized or required by statute.

What I want to explore today is how Congress can ensure such rulemaking is of the highest quality. I remain committed to making the nation's regulatory system more transparent, efficient, effective, and accountable. First, Congress cannot lessen its own authority through inaction on critical issues or by blurring the lines between legislative, judicial and executive. In some cases, through excessive delegation to the agencies, we have ceded power to create and define law. Simply stated, Congress must pass good laws by taking full responsibility for clearly articulating priorities and goals in legislation. If our statutory directives are unambiguous, we won't see as many claims of agencies overreach. Second, while rulemaking is often mandated by statute, we must continue to understand the benefits and costs of regulation. That means that Congress must fulfill its obligation to the American people through oversight of the regulatory process. And this includes independent agencies whose rules are just as impactful as those coming from a traditional federal agency.

To be clear, independent agencies face significant challenges in quantifying costs and benefits in the same manner as Executive agencies. Nevertheless, in my opinion, their regulatory decisions should be based upon good regulatory analyses. It is not always easy to quantify costs and benefits. Decades of scholarship have revealed that it's often far easier to tabulate costs for a regulation, but much harder to capture and quantify benefits. That just means that there will always be a role for qualitative costs and benefits in regulatory analysis. We should be wary of imposing one-size-fits-all requirements which often have serious unintended consequences. And we must also be mindful about regulatory resources if we expect agencies to complete regulations in a timely fashion.

Today, I want to hear from our witnesses about how to improve the regulatory process for independent agencies with a focus on how best to improve congressional oversight. I look forward to continuing to work with Sen. Lankford and the rest of my colleagues on these important issues.

WRITTEN STATEMENT OF ROBERT R. GASAWAY

Kirkland & Ellis LLP

REVIEWING INDEPENDENT AGENCY RULEMAKING

HEARING BEFORE THE

COMMITTEE ON HOMELAND SECURITY & GOVERNMENTAL AFFAIRS,

SUBCOMMITTEE ON REGULATORY AFFAIRS & FEDERAL MANAGEMENT,

UNITED STATES SENATE

September 8, 2016

Washington, D.C.

WRITTEN STATEMENT OF ROBERT R. GASAWAY

Chairman Lankford, Ranking member Heitkamp, members of the Committee:

Thank you for the opportunity to discuss issues surrounding the position of independent agencies within the administrative state; in particular, these agencies' compliance with statutory requirements, their compliance with Executive Orders 12866 and 13563, and my suggestions for improvements.

Before delving into specifics, I begin with the observation that today's problems of the administrative state and rule of law are deeply rooted. They are rooted so deeply, in my view, that they can be resolved only through advances in constitutional understandings. An implication is that legislative proposals for addressing today's administrative–law discontents may be grouped in two sets — proposals that aim at reform (ameliorants that leave current understandings intact) and ones that aim at an administrative–law reformation resting on sturdier constitutional foundations. My prediction is that in time, perhaps a very long time, a liberal, rule–of–law–based reformation will occur and today's discontents will be dispelled.

INTRODUCTION AND SUMMARY OF ANALYSIS

My background and perspective are those of a practicing lawyer with 23 years of experience at Kirkland & Ellis LLP. (Naturally, these comments reflect my views, not those of my firm or its clients.) Before attending law school, I worked as a management consultant and financial planning specialist and studied intellectual history and political theory at the Yale Graduate School. Since beginning practice, I've been blessed with diverse experiences and successes in the United States Supreme Court, federal trial courts, state legislatures, and other forums. Drawing on graduate–school training, I've contributed writings to scholarly publications and participated in conferences in China, Europe, and this country.

My takeaways from these experiences include the following:

- The related problems of deference and delegation are at root of today's administrative–law discontents, and it is much easier to detect these problems than to solve them. In particular, the *Chevron* doctrine is unconstitutional and must, eventually, be uprooted. That said, *Chevron* has been a great success on its own terms and extreme care should be taken in uprooting it.

- Competent economic analysis is a useful aid to decisionmaking; hence, independent agencies, like executive agencies, should be required to perform it. That said, the former consensus as to how best to perform economic analyses has fractured, making more difficult reliance on economic analysis as an aid to judicial review.

- To the extent Congress intends to try to solve, as opposed to ameliorate, today's administrative-law discontents, it will need, very delicately, to repudiate *Chevron* and then couple that repudiation with additional enactments.

  - Congress should consider legislation that classifies administrative proceedings in conformity with constitutional categories, thus easing the way to improving the Supreme Court's non-delegation test.

  - Congress should consider changing its internal rules to grant legislative agenda-setting power to the President.

ANALYSIS

The Committee has before it a number of viewpoints and proposals going to the reform or reformation of the administrative state. This testimony offers my perspectives on these exceptionally complex problems.

I. Chevron Should Be Uprooted, But Care Should Be Taken in Uprooting It.

The Committee is familiar with the *Chevron* test, and the case for and against repudiating it. Because the *Chevron* debate informs practically every issue the Committee has under consideration, I begin by briefly summarizing, commenting on, and extending perspectives found in previous testimony.

The constitutional case against *Chevron* is straightforward. To the extent *Chevron* requires judicial "deference" to executive–branch legal interpretations, *Chevron* violates Article III and the *Marbury* principle that it is the province and duty of judges to say what the law is.[1] To the extent *Chevron* says Congress may delegate administrative authority that permits agencies to change the terms of the law itself, depending on which reasonable interpretation is administratively adopted from time to time, the case violates the principle of the *Chadha* decision, which holds that the making, unmaking, and remaking of laws may occur only through Article I, section 7's constitutionally prescribed means.[2]

Put succinctly, either the law "changes" in the process of administrative interpretation or it doesn't. If not, then *Chevron* is a doctrine of judicial "deference" to the Executive's view of a fixed body of law, *Chevron U.S.A. v. NRDC, Inc.*, 467 U.S. 837, 844 (1984), in which case *Chevron* violates Article III and *Marbury*. On the other hand, if laws do "change" (within boundaries) in execution, then *Chevron* is a doctrine of implied legislative "delegation," *id.*, and it violates Article I, section 7. Whichever way you look at it, *Chevron* appears constitutionally insupportable.[3] Add in that *Chevron* was implanted in law "heedless of the original design of the APA"[4] and that it appears *Chevron* misinterpreted the precedent on which it relied,[5] and the case against *Chevron* begins to appear overwhelming.

Here, let me pause and say that I'm convinced by the arguments just sketched. At the same time, I recognize that the Committee has received Professor Herz's testimony and other testimony defending *Chevron*'s constitutionality.[6] For me, Professor Herz's response to the Article III objection just outlined underscores *Chevron*'s infirmities. Professor Herz contends that under *Chevron* courts retain "primacy in *interpretation*" and that "the agency's views matter but are not dispositive and thus the judicial power has not been ceded to another branch."[7] One rejoinder is that mere judicial primacy (as opposed to a judicial autonomy that includes interpretive independence) is not enough for Article III purposes.[8] But more fundamentally, "the agency's views" are in fact dispositive under *Chevron* in each and every case where they make a difference; namely, all *Chevron* Step–2 cases in which the agency adopts an interpretation that differs from the interpretation a reviewing court would have adopted in the absence of *Chevron* deference.

Finally, while Professor Herz rightly notes, in discussing the "non–delegation" objection to *Chevron*, that Justice Thomas's recently articulated non–delegation views have, as yet, found expressed support from "no other Supreme Court Justice, current or past,"[9] the important point is that those views are not directly relevant to *Chevron*'s constitutionality. The rejoinder to the legislative prong of the argument in favor of *Chevron* rests on the settled proposition, under *Chadha* and progeny, that there is "no provision in the Constitution" that authorizes the President or other officials "to enact, to amend, or to repeal statutes."[10] It is this principle, not Justice Thomas's recent non–delegation opinions, that undermines the "implied delegation" defense of *Chevron*.

That said, there are good reasons for taking greatest care in uprooting *Chevron*. For one thing, my impressionistic assessment is that *Chevron* has worked quite well as a curb on judicial activism in administrative–law cases — the core of *Chevron*'s original justification. For another, there are vexing problems of draftsmanship involved in overturning via legislation any sweeping, judicially–crafted review doctrine, much less one as deeply rooted as *Chevron*.[11]

Above all, there is the question, what follows? As noted, Justice Thomas's recent opinions are not directly relevant to whether *Chevron* can be squared with the Constitution. But those opinions are highly relevant to what would replace *Chevron* in the event it were uprooted.[12] I turn to such questions below, in Part III of this testimony.

II. Independent Agencies' Should Be Required to Perform Economic Analysis Along Lines of That Required by Executive Orders 12866 and 13563.

Three traditional approaches to judicial review of agency decisionmaking correspond to various sub–provisions of section 706 of the Administrative Procedure Act.[13] These approaches include review under *Chevron* and related doctrines to ensure compliance with statutory directives,[14] step–by–step review of the agency's reasoning,[15] and substantive review of the agency's various decisions.[16] Questions of applying orders requiring economic analysis, such as Executive Orders 12866 and 13563, fall under this third type of review.

The advantages and drawbacks of requiring economic analysis in connection with regulatory decisionmaking have been debated extensively in the context of environmental regulation. In that context, Mr. Frank Ackerman and Professor Lisa Heinzerling have strongly resisted almost any consideration of cost–benefit analysis.[17] Among their more fundamental contentions are objections that "voting is different from buying" (hence, we should not judge policies based on a cost–benefit calculus that views people as individuals, as opposed to community members) and that cost–benefit analysis is necessarily subjective and non–transparent (because, in their view, it "relies on a byzantine array of approximations, simplifications, and counterfactual hypotheses").[18]

Opposing such views, Edward Warren and Gary Marchant have encouraged broad use of cost–benefit analysis in environmental and other regulatory contexts.[19] Messrs. Warren and Marchant emphasize the ancient and common–sensical roots of the idea that one should do more good than harm; that idea's embodiment in a variety of legal doctrines; and the failure, in their view, of "unfocused," "ineffectual" judicial review that looks "almost exclusively at agencies' decisionmaking processes" as opposed to "whether an agency had reached a principled end result." Messrs. Warren and Marchant maintain that cost–benefit analysis provides a sensible, flexible, omnipresent, "presumptive" baseline against which Congress can legislate.

I endorse requiring independent agencies to perform cost–benefit analysis, such as those required by 12866 and 13563. While mindful of the Ackerman/Heinzerling point of view,[20] it seems to me that more information is a good thing and that fears of harm from such a step are easily dispelled by the experience of the agencies already required to perform these analyses.

A more complicated question is the wisdom of reforms that would require agencies (independent or not) to employ economic analysis as a cornerstone of the rulemaking process and then subject agencies' compliance with economic-analysis requirements to judicial review. This question is complicated in part because the former consensus as to how economic analyses should be performed has significantly fractured,[21] and, as a result, agencies often manipulate economic analyses in ways that are difficult to detect and address on review. Still, it may make sense to pursue such reforms. If pursued, the best approaches are those that simplify and make transparent the relevant economic calculus by employing a regulatory budgeting approach, or, what is much the same, requiring agencies to couple the promulgation of new regulations with equivalent revisions to (or repeals of) old regulations so that overall compliance costs remain stable.[22] A good starting point for this type of reform is S. 1944, the RED ("Regulations Endanger Democracy") Tape Act of 2015, sponsored by Senator Sullivan.[23]

III. Any Repudiation of *Chevron* Should Be Delicately Executed and Coupled with Steps for Implementing or Encouraging Improvements in Constitutional Understandings, Administrative Doctrines, and Legislative Procedures.

Today's administrative-law doctrines cover a bewildering array of agencies engaging in a bewildering variety of activities. Told there are problems with agencies being faithful, regular, and transparent in carrying out their responsibilities, and that today's doctrines appear unequal to the task of bringing them to heel, lawyers incline toward one or more items on the familiar menu of reform possibilities. Some suggest breaking the problem into parts and crafting better rules for specific agencies, agency activities, or substantive areas of law. Others support broad-based, high-level, substantive rules (such as cost–benefit analysis) or procedural innovations (such as the REINS Act).

In my view, conventional regulatory–reform initiatives, if well framed, can help ameliorate, but they cannot definitely resolve, the problems bedeviling our administrative state. The debate over judicial deference to agency interpretations of law, whether under *Chevron* or other doctrines, has been engaged continuously for decades. That debate has seen remarkable turnabouts, including Justice Scalia's repudiation of his unanimous opinion in *Auer* and his coming to the verge of repudiating the Court's unanimous *Chevron* opinion, which Justice Scalia had zealously championed for almost his full Supreme Court tenure.

As the Committee's questions adumbrate, such oscillations are in one sense inevitable. Foundational issues of administrative law in general, and questions concerning *Chevron* in particular, are often framed in terms of trade-offs between effectively constraining lower federal courts (which *Chevron* does well) and effectively constraining administrative agencies (which it does poorly). Views on the proper balancing of such trade–offs predictably vary, across time and person, together with assessments of the relative magnitude the two dangers. My approach seeks to break free from this cycle and minimize these trade-offs. It is built on a suite of proposed improvements in constitutional understandings, administrative doctrines, and congressional procedures.

Improved Constitutional Understandings. Contrary to what is sometimes thought, the Constitution's separation–of–powers principles are not a barrier for constraining the size of government. They are a means of improving government at any scale, by furthering both administrative efficiency and administrative integrity. Administrative law is at bottom constitutional law, and republican governmental accountability, not generalized ideas about republican liberty, is its organizing principle. In thinking about this sub-species of constitutional law, several points have sometimes been overlooked by lawyers.

First, administrative law is grounded in the Constitution's separation-of-governmental-powers principle and that principle is in turn embodied, not in plain constitutional text — as was done in the influential Massachusetts constitution of 1781 — but in the logical relationships between and among the Constitution's three Vesting Clauses. ("All legislative Powers herein granted shall be vested in a Congress of the United States ...; "The executive Power shall be vested in a President of the United States of America"; The judicial Power of the United States shall be vested in one Supreme Court and such inferior courts as Congress may from time to time ordain and establish.") The beginning of all administrative law wisdom is found in these relationships, and, apart from an understanding of the relationships, there can be no escaping the indeterminateness of what otherwise seem like "majestic" constitutional generalities.[24]

Second, for better or worse, the logical relationships between and among the Vesting Clauses — the foundations of administrative law — are in part European, as well as British, in origin.[25] Although one school of American jurisprudence harbors suspicions about European theorists and their American admirers, at least this one line of continental thought is, like it or not, essential to the logical derivation of administrative law.

Third, administrative law doctrines can in fact be elicited from the Constitution, just as doctrines governing relations between the courts and Congress (as declared in cases such as *Marbury v. Madison* and *Plaut v. Spendthrift Farms*) have been elicited from constitutional structure and logic, not solely from text.[26] Contrary to what administrative-law academics sometimes believe, there is no basis for fears that our Founders failed to provide for an administrative state.

Fourth, administrative law, including the law of judicial review of agency action, matters and matters greatly. It has been contended that agency win–loss records in court remain relatively unaffected by variations in standards of review.[27] I do not think that this is the case. But even if it were the case, it would remain true that the fidelity of administrative agencies to governing law is greatly affected by courts' framing of, and explanations for, the standards used in judicial review of their actions. As Professor Herz emphasizes, *Chevron* employs a "completely infelicitous phrase" when it asks reviewing courts to "determine if Congress had an intent on 'the precise question at issue.'"[28] This phraseology sometimes propels administrators into flights of *Chevronist* post–modernism — that giddy, unjustifiable regulatory over-confidence rooted in the syllogism that says all language is ambiguous; law is written in language; hence all laws are ambiguous and under *Chevron* enlightened regulators may do as they please.

Finally, it is unfair for courts and lawyers to put all blame for today's discontents on Congress. It is emphatically true that "Administrative Law without Congress" cannot work.[29] But it is equally true, as former Senator James L. Buckley reminds us, that congressmen and Senators are human.[30] Exhortations for Congress to do a better job are always welcome, and in any event always present. But Congress can actually begin to do its job only with co-operation from the courts, in the form of doctrinal improvements, and only with cooperation from the executive, in the form of non–adversarial collaboration in carrying out legislative improvements of the type outlined below.

Improved Administrative Doctrines. Our inherited administrative regime — elegant, sophisticated, worthy in its way — is neither totally implausible nor totally unworkable. Under current doctrine, courts review administrative decisions by performing a deferential double-checking of each aspect of an agency's decision-making. In an archetypal instance, a court will deferentially analyze an administrative action, not only for adherence to proper procedures, but also for proper fact-finding,[31] policy-selection,[32] legal interpretation,[33] and explanation of "choices made."[34] Such thorough but deferential review often produces unpredictable outcomes and bewildered lawyers.

A better alternative would call for independent judicial interpretation of applicable laws coupled with sliding-scale scrutiny of overall judgments according to the constitutional context in which the administrative action was taken.[35] Under this approach, courts would make their own legal determinations without deference to an agency's reading of the law. But courts would largely decline to retrace the administrative assessments underlying the various aspects of applying the law to individual circumstances. Instead, courts would assess the lawfulness of overall administrative actions, just as appellate courts review overall jury verdicts. Crucially, the intensity of judicial scrutiny would vary from one administrative context to the next according to constitutionally grounded distinctions.

Notably, administrative-law scholars have intuited many of the principles supporting such a rule-of-law reformation. Scholars already employ the concept administrative constitutional law.[36] And they have emphasized the importance of agency accountability, fidelity to statutory directives, and regularity in implementing those directives. What's mainly missing is appreciation that administrative proceedings can be classified according to constitutional distinctions and that these classifications can be employed to improve doctrines like *Chevron* deference and the tests used to assess the constitutionality of legislative delegations to the executive.

Improved Legislative Procedures. A resolution of today's discontents will almost certainly require some rearrangement of the practical workings of Congress. Again, "Administrative Law Without Congress" does not work.[37] But getting Congress back into the lawmaking business will require more than exhortations. I propose, respectfully, that Congress bind itself to taking legislative action (even if the action is an affirmative decision not to act) in certain administrative law contexts. For instance, Congress might give "fast-track" legislative preference — ensuring prompt up-or-down votes and limited opportunities for amendments — to agency-submitted proposals to modify rules governing exercises of discretion within an agency's existing jurisdiction to confer private rights or issue regulatory licenses. Likewise, Congress might give "fast-track" preference to executive proposals for responding to Supreme Court decisions holding statutes unconstitutional on non-delegation grounds.[38]

* * * * *

The challenges posed by today's administrative state are daunting. Any proposed ameliorants for administrative practices quickly confront the sheer scope, scale, diversity, and complexity of the substantive determinations that federal administrators make day in and day out in discharging their responsibilities. Improved administrative–law doctrines must work smoothly and without bias in agency Model T factories and agency Faberge Egg workshops. They must be robust enough to withstand challenges by those with personal, financial, and ideological commitments to skewing what is right and fair and achieving what is advantageous and unjust. They must be rigorously adhered to, even though issues of procedure will be seen as secondary in practically every context in which they arise.

These hearings make clear the difficulty and depth of our challenges. Moreover, if you believe, as I do, that administrative law should guide but not fetter administration, problems entailed by any attempt to improve such a wide, deep, diverse, and law-encrusted body of practices multiply to the point where one might get discouraged. I appreciate the opportunity to offer encouragement for the Committee's efforts — and my thoughts about how today's challenges should be confronted and perhaps even overcome.

[1] *Marbury v. Madison*, 1 Cranch 137, 5 U.S. 137 (1803).

[2] *I.N.S. v. Chadha*, 462 U.S. 919 (1983).

[3] The Supreme Court employed a similar analysis in invalidating a congressional "Board of Review" in *Metropolitan Washington Airports Authority v. Citizens for the Abatement of Aircraft Noise*, 501 U.S. 252 (1991). There, the Court reasoned that if the Board of Review's power "is executive, the Constitution does not permit an agent of congress exercise it. If the power is legislative, Congress must exercise it in conformity with the bicameralism and presentment requirements of Art. I § 7." *Id.* at 276. So too here; if executive officials' *Chevron* discretion is "judicial" in nature, the Constitution does not permit executive agents to exercise the power. And if *Chevron* discretion is "legislative," then Congress "must exercise it in conformity with the bicameralism and presentment requirements of Art. I, §7."

[4] *Examining Agency Use of Deference, Part II: Hearing Before the Subcomm. on Regulatory Affairs & Fed. Management of the S. Comm. of Homeland Security & Governmental Affairs*, 114th Cong. 10 (Mar. 17, 2016) (prepared testimony of Charles J. Cooper); *see Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1211 (2015) (Scalia, J., concurring) (noting that the Supreme Court has been "[h]eedless of the original design of the APA" in developing an "elaborate law of deference to agencies' interpretations of statutes and regulations"); *see also* Charles J. Cooper, *Confronting the Administrative State*, National Affairs (Fall 2015).

[5] Aditya Bamzai, *The Origins of Judicial Deference to Executive Interpretation*, forthcoming in Yale Law Journal, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2649445.

[6] *Examining Agency Use of Deference, Part II: Hearing Before the Subcomm. on Regulatory Affairs & Fed. Management of the S. Comm. of Homeland Security & Governmental Affairs*, 114th Cong. 4-5 (Mar. 17, 2016) (prepared testimony of Michael Herz).

[7] *Id.* at 5

[8] *See* U.S. Const. Art. III § 1 (promoting judges' independence of judgment by stipulating that federal judges shall "hold their Offices during good Behavior" and be protected against salary diminishment); *see also Hechinger v. Metropolitan Washington Airports Authority*, 36 F.3d 97 (1994) (invalidating Board of Review composed predominately of members of Congress because Board was authorized "to interfere impermissibly" with other officials' "performance of their *independent* responsibilities") (Buckley, J.) (emphasis added).

[9] Although they may be finding support from other distinguished judges. *See Gutierrez–Brizuela v. Lynch*, No. 14—9585, 2015 WL 4436309 (10th Cir. Aug. 23, 2016) (Gorsuch, J., concurring) ("There's an elephant in the room with us today. We have studiously attempted to work our way around it and even left it unremarked. But the fact is *Chevron* and *Brand X* permit

executive bureaucracies to swallow huge amounts of core judicial and legislative power and concentrate federal power in a way that seems more than a little difficult to square with the Constitution of the framers' design. Maybe the time has come to face the behemoth.")

[10] *Clinton v. City of New York*, 524 U.S. 417. 438 (1998).

[11] *Examining the Proper Role of Judicial Review: Hearing Before the Subcomm. on Regulatory Affairs & Fed. Management of the S. Comm. of Homeland Security & Governmental Affairs*, 114th Cong. 6-7 (Apr. 28, 2015) (prepared testimony of Ronald M. Levin). *Separation of Powers Restoration Act of 2016: Hearing on H.R. 4768 Before the Subcomm. on Regulatory Reform and Antitrust Law of the H. Comm. of the Judiciary*, 114th Cong. 3 (May 17, 2016) (prepared testimony of Jeffrey Bossert Clark, Sr.) (explaining problems with saying that anti-*Chevron* legislation now under consideration "modifies" the scope of judicial review of agency action).

[12] *See Examining Agency Use of Deference, Part II: Hearing Before the Subcomm. on Regulatory Affairs & Fed. Management of the S. Comm. of Homeland Security & Governmental Affairs*, 114th Cong. 3-9 (Mar. 17, 2016) (prepared testimony of Neomi Rao).

[13] *See generally* Edward W. Warren and Gary E. Marchant, *"More Good Than Harm": A First Principle for Environmental Agencies and Reviewing Courts*, 20 Ecology L.Q. 379, 395 n.92 (1993).

[14] 5 U.S.C. § 706(2)(D).

[15] *Id.* § 706(2)(C).

[16] *Id* § 706(2)(A).

[17] *See* Frank Ackerman and Lisa Heinzerling, *Pricing the Priceless: Cost–Benefit Analysis of Environmental Protection*, 150 U. Pa. L. Rev. 1553 (2002).

[18] *Id.* at 1576.

[19] *See* Warren & Marchant, *supra* note 11, at 379 n.1 ("While this article is limited to the regulation of environmental and safety risks, the principle that regulation should do more good than harm good can appropriately be generalized to all regulatory contexts.").

[20] *See* Ackerman & Heizerling, *supra* note 15, at 1583 ("Nor is it useful to keep cost–benefit analysis around as a kind of regulatory tag–along, providing information that regulators may find interesting even if not decisive.").

[21] Note in this regard the bi–partisan array of luminaries, including Cass Sunstein, Robert Crandall, and Christopher DeMuth, who reviewed and commented on the Warren/Marchant article before publication. *See* Warren & Marchant, *supra* note xii, at 1 n.aa1.

[22] These approaches are simpler than standard cost–benefit analysis because they eliminate the need to quantify benefits. They are more transparent than standard cost–benefit analysis because on the cost side of the equation what matters most is the relative costs of one

regulatory program compared to other programs and because the final decisions about regulatory priorities are made by human officials, not an economic calculus.

[23] Note that agencies might attempt to evade such requirements by employing regulatory means other than notice–and–comment rulemaking, such as agency adjudications and regulation through interpretive rules and informal guidance documents.

[24] *Fay v. New York*, 332 U.S. 261, 282 (1947) (Jackson, J.). If polled, I suspect a majority of administrative lawyers and professors would agree with Professor Herz's doubts about the Article III arguments against *Chevron*'s constitutionality, not my embrace of those arguments. Part of the reason, I further suspect, is that I find definitive meaning in constitutional text, structure, and logic, while others perceive "majestic generalities."

[25] Justice Scalia repudiated his *Auer* opinion once he realized that he had overlooked Founding–era thinking rooted in Montesquieu. *See Decker v. Northwest Envtl. Defense Ctr.*, 133 S. Ct. 1326, 1341 (2013) (Scalia, J., concurring in part and dissenting in part); *see generally* John F. Manning, *Constitutional Structure and Judicial Defense to Agency Intrepretations of Agency Rules*, 96 COLUM. L. REV. 612 (1996); THE FEDERALIST No. 47, at 250-251 (Madison) (Carey & McClellan, eds., 2001) (quoting Montesquieu, "'There can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates, or, 'if the power of judging be not separated from the legislative and executive powers.'")

[26] *Marbury v. Madison*, *supra* note 1; *Plaut v. Spendthrift Farm, Inc.*, 511 U.S. 211 (1995); *see also* THE FEDERALIST Nos. 78, at 404-05 (Hamilton) (Carey & McClellan, eds., 2001); and *id.* at No. 81, at 419-20 (Hamilton).

[27] *See* Kent Barnett & Christopher J. Walker, Chevron *in the Circuit Courts*, 115 MICH. L. REV. __ (2017) (forthcoming). In this study, the authors analyzed 1561 circuit-court decisions involving judicial review of agency interpretations of law handed down between 2003 through 2013. They found that agency interpretations were more likely to prevail under *Chevron* (77.3%) than *Skidmore* (56.0%) than *de novo* review (38.5%). In other words, deference doctrines greatly matter in the circuit courts, whereas an earlier study by Eskridge and Baer concludes that deference doctrines do not matter very much in the Supreme Court (76.2% / 73.5% / 66.0%). *See id.* at nn. 10 & 21 (citing William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretation from Chevron to Hamdan*, 96 GEO. L.J. 1083, 1124–25 (2008)). Memorably, Barnett and Walker refer to "Chevron Supreme" and "Chevron Regular" to denote that the application of *Chevron* matters much more to outcomes in federal appellate courts than in the Supreme Court.

[28] Herz, *supra* note 5, at 10

[29] Michael S. Greve and Ashley C. Parrish, *Administrate Law without Congress: Of Rewrites, Shell Games, and Big Waivers*, 22 Geo. Mason L. Rev. 501 (2015) (discussing problems of

administrative law doctrines that are based on the notion that Congress can be expected to police instances of overreach by Executive Branch agencies).

[30] JAMES L. BUCKLEY, SAVING CONGRESS FROM ITSELF: EMANCIPATING THE STATES AND EMPOWERING THEIR PEOPLE 48-50 (2014).

[31] *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951).

[32] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut Auto. Ins. Co.*, 463 U.S. 29 (1983).

[33] *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)

[34] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut Auto. Ins. Co.*, 463 U.S. 29 (1983).

[35] Explaining the workings of such sliding-scale scrutiny is a main focus of an article I have co-authored with Ashley C. Parrish. *See Administrative Law in Flux: An Opportunity for Constitutional Reassessment* GEO. MASON L. REV. (forthcoming).

[36] Mila Sohoni, *The Administrative Constitution in Exile*, 57 WM. & MARY L. REV. 923, 931–34 (2016).

[37] Greve and Parrish, *supra* note 28.

[38] For an extended discussion of a more far–reaching proposal along these lines, *see* WILLIAM G. HOWELL & TERRY M. MOE, RELIC: HOW OUR CONSTITUTION UNDERMINES EFFECTIVE GOVERNMENT–AND WHY WE NEED A MORE POWERFUL PRESIDENCY (2016).

"REVIEWING INDEPENDENT AGENCY RULEMAKING"

Testimony of
Adam J. White
The Hoover Institution[1]

Before the United States Senate,
Committee on Homeland Security and Government Affairs,
Subcommittee on Regulatory Affairs and Federal Management

SEPTEMBER 8, 2016

Chairman Lankford, Ranking Member Heitkamp, and other members of the Subcommittee, thank you for inviting me to testify today. Much of my legal and academic career has been spent studying, working with, or litigating against independent regulatory agencies, and so it is an honor and pleasure to appear before the Subcommittee to discuss independent agencies' increasingly important role in American government.

I. Independent Agencies: A Brief Overview and Historical Background.

A. *Defining "Independent Agencies"*

At the outset it must be noted that there is no single, authoritative definition or list of "independent" agencies. Perhaps the most familiar definition is found at

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44 U.S.C. § 3502(5), which defines "independent regulatory agency" as a nonexhaustive list of nineteen such agencies, ranging from the Federal Reserve Board of Governors to the Postal Regulatory Commission.[2] This list is incorporated by reference in Executive Order 12866, which excludes those agencies from review by "OIRA," the Office of Information and Regulatory Affairs.[3]

But that list is not exhaustive; Congress has designated other agencies as "independent" even though they do not appear in Section 3502(5)'s list. For example, the National Credit Union Administration is "an independent agency," even though it does not appear on that list.[4]

Taking a more functional approach, the courts tend to consider an agency "independent" if Congress has limited the President's ability to fire the agency's head.[5] Congress drafts such statutory protections in a variety of terms. Members of the Federal Trade Commission, for example, can be removed only "for inefficiency, neglect of duty, or malfeasance in office."[6] Members of the Federal Reserve's Board

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[2] One of the listed agencies, the Interstate Commerce Commission (ICC), no longer exists. It was abolished in 1995, in the suitably named ICC Termination Act of 1995, Pub. L. 104-88, 109 Stat. 803 (1995). The ICC was replaced in part by the Surface Transportation Board, which itself enjoys a measure of independence from the President. 49 U.S.C. § 701(b).

[3] *See* E.O. 12866 §3(b).

[4] 12 U.S.C. § 1752a(a).

[5] *See, e.g., Free Enter. Fund v. PCAOB*, 561 U.S. 477, 483 (2010) ("Congress can, under certain circumstances, create independent agencies run by principal officers appointed by the President, whom the President may not remove at will but only for good cause").

[6] 15 U.S.C. § 41.

of Governors, by contrast, can be removed only "for cause."[7] Then again, some regulatory commissions are generally considered "independent" even though their statute contains *no* explicit protection against removal at will, such as the Securities and Exchange Commission (SEC) and the Federal Communications Commission (FCC).[8] Yet even in the absence of explicit protection, a court may hold that Congress implicitly made an agency independent, based on the nature of the agency's structure and functions.[9]

Furthermore, in at least one case an agency has been designated "independent" even though its head enjoys *no* removal protection: Congress lists the Office of the Comptroller of the Currency as an "independent agency,"[10] even though

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7 12 U.S.C. § 242.

8 *See* 15 U.S.C. §78(d) (each SEC "commissioner shall hold office for a term of five years"); 47 U.S.C. § 154(c) (FCC "commissioners shall be appointed for terms of five years"); *SEC v. Blinder, Robinson, & Co.*, 855 F.2d 677, 681 (10th Cir. 1988) (observing that although the statute does not expressly give the SEC independence, "it is commonly understood that the President may remove a commissioner only for 'inefficiency, neglect of duty or malfeasance in office'"); *Free Enter. Fund, supra*, 561 U.S. at 487 ("The parties agree that the [SEC] Commissioners cannot themselves be removed by the President except under the *Humphrey's Executor* standard of 'inefficiency, neglect of duty, or malfeasance in office'"). It is worth noting that the SEC's and FCC's statutes were enacted in the brief period after the Court cast doubt on the constitutionality of agency "independence" in *Myers v. U.S.*, 272 U.S. 52 (1926), before the Court affirmed independence in *Humphrey's Executor v. U.S.*, 295 U.S. 602 (1935).

9 *Wiener v. U.S.*, 357 U.S. 349, 353-56 (1958).

10 44 U.S.C. § 3502(5).

the President is free to remove the Comptroller at will, upon communicating his reason to the Senate.[11]

Independent agencies are generally multi-member commissions, such as the Federal Energy Regulatory Commission or the Federal Reserve's Board of Governors. But not always: the Consumer Financial Protection Bureau (CFPB) is an independent agency headed by a single officer.[12] So is the Federal Housing Finance Agency (FHFA).[13]

And to confuse matters still further, sometimes Congress disregards the usual dichotomy between "independent" agencies and non-independent "executive agencies," by designating an agency as both "independent" and "executive." As I noted, Congress established the CFPB as an "independent" agency led by a Director with express protection against removal at will.[14] But Congress elsewhere refers to the CFPB as "an *Executive* agency."[15]

I am not trying to be pedantic; rather, I am simply trying to illustrate that when we speak of "independent agencies," we are not speaking of a single, easily defined class of agencies. That said, for present purposes I think it is fair to say that

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[11] 12 U.S.C. § 2.

[12] 12 U.S.C. § 5491 (creating the CFPB as an "independent bureau" led by a single Director); 44 U.S.C. § 3502(5) (listing the CFPB as an "independent agency").

[13] 12 U.S.C. § 4511 (creating the FHFA as an "independent agency"); *id.* § 4512 (providing that the FHFA will be led by a single Director); 44 U.S.C. § 3502(5) (listing the FHFA as an "independent agency").

[14] 12 U.S.C. § 5491.

[15] *Id.* § 5491(a) (emphasis added).

we are generally speaking of agencies which, whether headed by a single director or a multi-member body, enjoy some measure of explicit or implicit congressional protection against removal by the president, and which are exempt from OIRA's review of their regulations.

B. *Changing Views of Independent Agencies, from 1887 to FDR to Reagan*

While today's independent agencies seem materially identical to executive agencies, in terms of their role in modern government, it is important to acknowledge the historical roots of independent agencies, to understand why they historically were treated differently from executive agencies.[16]

The first independent agencies—or, as they once were known, independent regulatory commissions—were created by Congress to handle relatively specific corners of industrial policymaking. But, crucially, the first independent agencies were largely created to supplant not executive agencies, but *courts*. Beginning first with the Steamboat Inspection Service in 1852,[17] and then the much more famous Interstate Commerce Commission in 1887,[18] Congress created these agencies to replace courts as the primary lawmakers for purposes of common-carrier regulation

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[16] Portions of this section of my testimony are adapted from my chapter in a forthcoming collection of essays on "the Imperial Presidency," from the American Enterprise Institute.

[17] *See* Jerry L. Mashaw, *Creating the Administrative Constitution* 189 (2012)

[18] *See, e.g.*, Robert E. Cushman, *The Independent Regulatory Commissions* 40-41 (1941); Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877-1920*, p. 138 (1982); John G. Burke, *Bursting Boilers and the Federal Power*, 7 Technology and Culture 1, 23 (1966);

and the definition of negligence. While today we tend to think of independent agencies in terms of their relationship to the *executive* branch, at the outset they were most controversial for their relationship to the *judicial* branch.[19]

That is why the independence of ICC Commissioners was so uncontroversial when the Commission was created in 1887—which was, coincidentally, the very same year that Congress repealed the controversial Tenure of Office Act,[20] the post-Civil-War law by which congressional Republicans had attempted to prevent President Johnson from removing Secretary of War Edwin Stanton and other members of the late President Lincoln's cabinet. Simply put, the ICC was not seen as an "executive" agency, and restrictions on the President power to remove ICC commissioners was not seen as a restraint on "executive" power; it was exercising "quasi-legislative" ratemaking powers and "quasi-judicial" adjudicatory power—but not "executive" power.

The ICC became the benchmark for the regulatory commissions that followed: the Federal Trade Commission (1914),[21] Federal Power Commission (1920),[22] and the Federal Communications Commission (1934).[23] In these statutes,

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[19] Skowronek at 154; *see also* Cushman at 58-59; Thomas W. Merrill, *Article III, Agency Adjudication, and the Origins of the Appellate Review Model of Administrative Law*, 111 Colum. L. Rev. 939, 953-55 (2011).

[20] Act of Mar. 3, 1887, 24 Stat. 500 (repealing Tenure of Office Act).

[21] *See* Cushman at 188 ("A controlling force moving legislative leaders to create the independent Federal Trade Commission was the model of the Interstate Commerce Commission.").

[22] *Id.* at 281.

[23] *Id.* at 322.

Congress and the President were creating an administrative state separate from the President's executive-branch departments, and vesting those independent regulatory commissions with discretion to make law and policy outside of the direct oversight of the President.

Only under President Roosevelt and the New Deal did advocates of executive power begin to reframe the debate over independent regulatory commissions into one of *executive* power. In *Humphrey's Executor v. United States*, the FDR Administration argued that the distinction between "executive" agencies and "independent" commissions was phony: although the FTC had been created as an "independent" regulatory commission exercising "so-called quasi-judicial functions," those functions were "not different from those regularly committed to the executive departments."[24] Accordingly, the FDR Administration argued, statutory restraints on the President's power to fire FTC Commissioners would constitute "a substantial interference with the constitutional duty of the President to 'take care that the laws be faithfully executed.'"[25]

And even if the FTC, ICC, and other independent regulatory commissions were meaningfully distinct from executive agencies in decades past, the passage of time had erased such distinctions, the FDR Administration argued. "To ignore the extent to which these functions have been conferred upon the regular executive

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[24] Br. for the United States, *Rathburn as Ex'r of the Estate of Humphrey v. United States*, No. 667, Oct. Term 1934, at p. 26 (filed Apr. 6, 1935).

[25] *Id.* at 23.

departments is to ignore much of the development of administrative law in this country."[26]

The FDR Administration's arguments did not succeed in winning the *Humphrey's Executor* battle: the Supreme Court ruled unanimously in favor of the former FTC Commissioner who (posthumously) challenged FDR's decision to remove him without cause.[27] But the FDR Administration's arguments won a much longer war: a half-century later, the Reagan Administration adopted wholeheartedly FDR's position that independent agencies exercise "executive" power, not "quasi-legislative" or "quasi-judicial" power.[28] This is the theory of the "unitary executive," under which Presidents have full constitutional power to control not just executive agencies, but also *independent* agencies, because the Constitution vests the President alone with "the executive power"[29] and because the it obliges the President to "take Care that the Laws be faithfully executed."[30]

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[26] *Id.* at 26.

[27] 295 U.S. at 624-28.

[28] For example, when Attorney General Meese addressed the Federal Bar Association in 1985, he pressed firmly against *Humphrey's Executor*, urging—in rhetoric indistinguishable from the FDR Administration's briefs—that "federal agencies performing executive functions are themselves properly agents of the executive. They are not 'quasi' this or 'independent' that. In the tripartite scheme of government a body with enforcement powers is part of the executive branch of government. Power granted by Congress should properly be understood as power granted *to the Executive*."

[29] U.S. Const. Art. II, § 1, cl. 1.

[30] U.S. Const. Art. II, § 3, cl. 5.

II. Today's Independent Agencies Need OIRA's Oversight.

A. *Independent Agencies Were Exempted From OIRA Oversight for Reasons that No Longer Hold Today*

Given that the Reagan Administration adopted unflinchingly the FDR Administration's view that the President has full constitutional authority to control "independent" agencies, one may wonder why the Reagan Administration *excluded* independent agencies from OIRA's centralized regulatory review process established by Executive Order 12291, the predecessor to today's Executive Order 12866.

In fact, the exemption for independent agencies had nothing to do with any doubts about the President's constitutional power. The Reagan Justice Department had *no* doubt that the Constitution empowered the President to include independent agencies in the OIRA process, if the President chose to include them. In the Reagan Administration's first weeks, Larry Simms, the Office of Legal Counsel's acting chief, sent a memorandum to Office of Management and Budget Director David Stockman, making clear that the forthcoming executive order on regulatory review could lawfully include independent agencies.[31]

Rather, the Reagan Administration excluded independent agencies from the OIRA review process for prudential political reasons. As C. Boyden Gray, a co-director of President Reagan's Regulatory Task Force and counsel to Vice President

[31] *See* Memorandum from Larry L. Simms to David Stockman, *Proposed Executive Order on Federal Regulation* (Feb. 12, 1981), *reprinted in* "Role of OMB in Regulation," H.R. Rep. No. 70, 97th Cong., 1st. Sess. 152 (1981), *available at* http://njlaw.rutgers.edu/collections/gdoc/hearings/8/82601518/82601518_1.pdf.

Bush, explained in a 1981 hearing, President Reagan exempted independent agencies simply because their relatively small role in regulatory affairs of 1981 did not justify picking a political fight:

> The EO, by its terms, does not cover the independent agencies. This is not so much that we thought we lacked certain legal authority to do certain things, since I think we could have extended the EO and might still in the future. We chose not to do it really because of policy reasons that we had our plate more than full with the Executive Branch Agencies which do impose by far the greatest percentage of capital costs burdens that we think were issues during the campaign. We just didn't want to spread ourselves too thin. If we can get the main regulatory problems under control, we'll actually focus at that point more on the independents, but we'll wait and see how much progress we make with the Executive Branch.[32]

Those reasons may have justified independent agencies' exemptions from OIRA in 1981, but they no longer hold today. Independent agencies play a much more significant role in the federal government today—especially after the Dodd-Frank Act,[33] which not only creates the new Consumer Financial Protection Bureau but also expands significantly the powers of existing independent agencies such as the SEC, the CFTC, and the Federal Reserve Board of Governors.

And financial policy is not the only area where independent agencies have taken on dramatically greater power since 1981. The FCC, for example, recently asserted unprecedented authority to assert the immense burdens of "common

[32] *Id.* at 94 (quoting Gray's remarks at the Chamber of Commerce, April 10, 1980).

[33] Pub. L. 111-203, 124 Stat. 1376 (2010). As noted in footnote 1, I am of counsel to Boyden Gray & Associates, and in that capacity I am co-counsel for plaintiffs challenging the CFPB's constitutionality.

carrier" regulation on broadband Internet access service, without a legislative authorization from Congress.[34] And the Federal Energy Regulatory Commission has played a major role in furthering the Obama Administration's energy and environmental policies.[35]

Simply put, independent agencies are no longer the sleepy regulatory ratemakers and adjudicators that they once were. They now play a central role in modern regulatory policymaking, largely indistinguishable from executive agencies in terms of the regulations that they produce. Their exclusion from OIRA's review authority reflects a regulatory world that no longer exists.

Given these modern realities, it is no surprise that the American Bar Association's Administrative Law Section has supported OIRA review of independent agencies since 1986, as the ABA most recently explained to this committee in its July 23, 2015 letter in support of S. 1607, the "Independent Agency Regulatory Analysis Act of 2015."[36] Similarly, the Administrative Conference of the United States has supported OIRA review of independent agencies since 1988.[37]

[34] *See* 80 Fed. Reg. 19737 (Apr. 13, 2015). As noted in footnote 1, I am of counsel to Boyden Gray & Associates, and in that capacity I am co-counsel for a coalition of intervenors challenging the FCC's rules in the D.C. Circuit.

[35] *See* 76 Fed. Reg. 16658 (Mar. 24, 2011), *aff'd*, *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760 (2016).

[36] *See* Ltr. From ABA to Sen. Homeland Security & Governmental Affairs Comm. (July 23, 2015), *at* http://www.americanbar.org/content/dam/aba/uncategorized/GAO/2015july23_independentagencyreg_l.authcheckdam.pdf.

[37] ACUS Recommendation No. 88-9, "Presidential Review of Agency Rulemaking" (Dec. 8, 1988), *at* https://www.acus.gov/recommendation/presidential-review-agency-rulemaking.

B. *OIRA Oversight Would Improve Independent Agencies' Cost-Benefit Analyses*

With students returning to school this week, the need for OIRA review of independent agencies might best be put this way: *independent agencies should not be allowed to grade their own homework.* When independent agencies know that their cost-benefit analyses will not be reviewed by OIRA, they have too little incentive to do their best possible work. If those agencies were instead required to submit their major rules to OIRA for review of costs and benefits, the agencies' own work would certainly improve. To say this is not to cast aspersions upon independent agencies, but rather to recognize a basic fact of human nature—a trait that is not necessarily improved in independent-agency bureaucracies.

OIRA would be among the first to point this out. In its annual report to Congress this year, it stressed that "for the purposes of informing the public and obtaining a full accounting, it would be highly desirable to obtain better information on the benefits and costs of the rules issued by independent agencies. *The absence of such information is a continued obstacle to transparency, and it might also have adverse effects on public policy.* Consideration of costs and benefits is a pragmatic instrument for ensuring that regulations will improve social welfare; *an absence of information on costs and benefits can lead to inferior decisions.*"[38]

[38] OIRA, *2015 Report to Congress on the Benefits and Costs of Federal Regulations and Agency Compliance with the Unfunded Mandates Reform Act*, p. 32 (Mar. 10, 2016) (emphasis added), *at* https://www.whitehouse.gov/sites/default/files/omb/inforeg/2015_cb/2015-cost-benefit-report.pdf.

Studies justify OIRA's concerns. Perhaps the most exhaustive examination of independent agencies' cost-benefit analyses was produced by Curtis Copeland, a researcher at the Congressional Research Service, for the Administrative Conference of the United States.[39] His report illustrates the inconsistent and often unrigorous approaches that various independent agencies employ in evaluating their major rules' costs and benefits:

> Examination of the 22 major rules issued by independent regulatory agencies during FY2012 indicates a somewhat similar pattern. Only one rule contained any quantitative benefit information, but 18 of the 22 rules contained at least some quantitative or monetized information about expected costs. Although paperwork costs were most commonly quantified and monetized, some of the rules were primarily about reporting and recordkeeping, so most of their costs appeared to be paperwork related. Some agency officials noted that their agencies are not required to prepare cost-benefit analyses, and said that data on costs and benefits are often not available, particularly when they are required to regulate in new areas with tight statutory deadlines.[40]

The Government Accountability Office (GAO) has been even blunter, with respect to the independent agencies administering the Dodd-Frank laws. In a 2012 report, GAO reviewed 54 rulemakings promulgated by Dodd-Frank agencies, and found that "[w]hile most financial regulators said that they attempt to follow OMB's guidance in principle or spirit, we found that they did not consistently follow key

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[39] *See* Curtis W. Copeland, *Economic Analysis and Independent Regulatory Agencies* (Apr. 30, 2013), *at* http://bit.ly/2cvAfn9.

[40] *Id.* at 4.

elements of the guidance in their regulatory analyses."[41] Too often, the agencies failed to attempt to quantify costs and benefits,[42] or failed to amass data for such analyses,[43] or failed to compare their rules' costs and benefits to those of alternative possible regulatory approaches.[44]

Similar criticisms can be found in the report of the Inspector General for the Commodity Futures Trading Commission (CFTC), which published a scathing indictment of that agency's cost-benefit analyses in 2011.[45] The Inspector General reviewed cost-benefit analyses and found that the process was driven by lawyers, not economists, in service of the agency's policy decisions:

> [I]t is clear that the Commission staff viewed section 15(a) compliance to constitute a legal issue more than an economic one, and *the views of the Office of General Counsel therefore trumped those expressed by the Office of Chief Economist*, at least for the four rules we reviewed. *We do not believe this approach enhanced the economic analysis* performed under section 15(a) for the four rules.[46]

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[41] GAO, *Dodd-Frank Act: Agencies' Efforts to Analyze and Coordinate Their Rules,* p. 10 (Dec. 2012), *at* http://www.gao.gov/assets/660/650947.pdf.

[42] *Id.* at 14.

[43] *Id.* at 16.

[44] *Id.* at 16–17.

[45] Office of the Inspector General, CFTC, *An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act* (April 15, 2011), *at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/oig_investigation_041511.pdf.

[46] *Id.* at 22 (emphasis added).

Indeed, the CFTC's staff called cost-benefit analysis the "caboose," riding along on a train driven by other forces: "The cost-benefit analysis, [Paperwork Reduction Act] discussion, and Regulatory Flexibility Act discussion was referred to by team members as the regulation's 'caboose.'"[47] The Inspector General did not hesitate to draw the obvious conclusion: "This treatment of the cost-benefit analysis discussion might have given the impression that *it was merely an administrative task associated with the rulemaking, rather than a substantive analysis of the rule*."[48]

Shortly after the Inspector General published his report on the CFTC, the U.S. Court of Appeals for the D.C. Circuit issued a similarly negative verdict on the SEC's own cost-benefit analysis. In *Business Roundtable v. SEC*, the D.C. Circuit held that the SEC failed to satisfy its own obligation to review the costs and benefits of a major rule, the controversial "Proxy Access Rule," pursuant to SEC-specific statutory requirements (15 U.S.C. §§ 78c(f), 78w(a)(2), 80a–2(c)). Specifically, the court held that the SEC "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters."[49]

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47 *Id.* at 15.

48 *Id.* (emphasis added).

49 647 F.3d 1144, 1149 (D.C. Cir. 2011).

The D.C. Circuit's decision spurred many reactions (mostly overheated and overstated), but for this Subcommittee's purposes the most important reaction came from the regulators themselves: recognizing that their cost-benefit analyses in other rulemakings might not pass muster, agencies returned to the drawing boards and *improved* their work before finalizing the next wave of rules. SEC Chairman Mary Jo Schapiro told *Bloomberg* that "[w]e are clearly taking more time on cost-benefit analysis."[50] When critics bemoaned the momentary delay in agencies finalizing these major rules, they missed the point: if these rules were worth doing, they were worth doing *right*.

In sum: those Dodd-Frank agencies did not take their own cost-benefit analyses seriously enough until they recognized that a superior authority might someday grade their homework. In this case, the superior authority was federal judges, acting pursuant to a limited number of agency-specific statutes. We would expect to see similarly salutary results if OIRA asserted similar review authority over *all* independent agencies—either pursuant to a new executive order or, better still, pursuant to legislation by Congress.

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[50] Jesse Hamilton, "Dodd-Frank Rules Slow at SEC After Court Cost-Benefit Challenge," *Bloomberg* (Mar. 6, 2012), *at* http://www.bloomberg.com/news/articles/2012-03-06/dodd-frank-rules-slow-at-sec-after-court-cost-benefit-challenge; *see also* Steven Sloan, "Cost-Benefit Analysis Puts the Brakes on Dodd-Frank," *Bloomberg* (May 7, 2012), *at* http://www.bloomberg.com/news/articles/2012-05-07/cost-benefit-analysis-puts-the-brakes-on-dodd-frank.

C. *OIRA Oversight Would Improve Independent Agencies' Collaboration With Other Agencies*

Subjecting independent agencies to OIRA's ordinary review authority would have a second salutary effect: it would promote dialogue and collaboration between the independent agency in question and *other* agencies.

As former OIRA Administrator Cass Sunstein stressed in his recent *Harvard Law Review* essay on OIRA's crucial role in federal government, OIRA's most important job is not overseeing cost-benefit analysis, but overseeing the interagency process to ensure that all relevant federal agencies have an opportunity to weigh in on a particular agency's proposed rule, and to ensure that the administration's top lawyers vet the most important legal questions raised by a rule:

> [M]ost of OIRA's day-to-day work is usually spent not on costs and benefits, but on working through interagency concerns, promoting receipt of public comments (for proposed rules), ensuring discussion of alternatives, and promoting consideration of public comments (for final rules). OIRA also engages lawyers throughout the executive branch to help resolve questions of law, including questions of administrative procedure. As noted, OIRA considers itself a guardian of appropriate procedure, and much of its role is associated with that guardianship (including the promotion of public comments).[51]

Independent agencies do not benefit from this OIRA-facilitated interagency collaboration. To be fair, the independent financial regulatory agencies sometimes collaborate (sometimes pursuant to statutory requirements), on an *ad hoc* basis

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[51] Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 Harv. L. Rev. 1838, 1842–43 (2013).

sometimes involving semiformal "memoranda of understanding."[52] These efforts are laudable but insufficient. Independent agencies should coordinate with other agencies on *all* of their major rules, not just on the ones that trigger scattered statutory coordination requirements. And they should undertake this coordination pursuant to OIRA's oversight, and not on a disjointed, *ad hoc* basis.

One notable episode highlights the need for such interagency collaboration. In 2011, as the Dodd-Frank agencies were pressing forward with their immense rulemakings, Federal Reserve Chairman Bernanke spoke at a public event, where JPMorgan Chase's chief executive, Jamie Dimon, asked him whether all of the agencies' complicated and overlapping rulemakings might interact in counterproductive ways.

"Has anybody done a comprehensive analysis of the impact on credit? I can't pretend that anybody really has," Chairman Bernanke answered. "You know, it's just too complicated. We don't really have the quantitative tools to do that."[53]

I do not mean to imply that financial regulation is not complicated, or that a rule's future impacts can be easily predicted by an agency—even when the agency is the Federal Reserve Board of Governors, to whom Congress and the American people commit immense power, discretion, and responsibility. But I *do* believe that such analysis would be improved significantly if it were undertaken in the context

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[52] *See generally* GAO, *Dodd-Frank Regulations: Agencies Conducted Regulatory Analyses and Coordinated but Could Benefit from Additional Guidance on Major Rules* (Dec. 2013), *at* http://www.gao.gov/assets/660/659586.pdf.

[53] Dealbook, "What Dimon Told Bernanke," *N.Y. Times* (June 8, 2011), *at* http://dealbook.nytimes.com/2011/06/08/what-dimon-told-bernanke.

of a collaborative, interagency process under OIRA's guidance. The Federal Reserve Board of Governors may not have the tools to singlehandedly perform these analyses, but they do not need to do it alone; they can and should benefit from the expertise and experience of other agencies, informed by public comments.

III. Independent Agencies Need More Congressional Oversight, Not Less.

Let me offer a brief note in closing. As I have explained throughout this written statement, independent agencies need much greater oversight by OIRA, either pursuant to a new executive order replacing E.O. 12866, or—*ideally*—pursuant to legislation from Congress. But as Congress considers whether to subject independent agencies to greater White House oversight, I hope that it also recognizes the need to subject agencies to greater *congressional* oversight.

Unfortunately, in some respects the trend may be moving in the opposite direction. In Dodd-Frank, Congress created a new independent agency that enjoys a dangerous combination of independence from both the President *and* Congress. The CFPB enjoys total freedom from Congress's "power of the purse," because it is able to fund itself entirely with non-appropriated funds from the Federal Reserve.[54] In FY 2017 alone, this independent funding will total *$646.2 million*.[55] As the CFPB

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[54] 12 U.S.C. § 5497(a).

[55] CFPB, *The CFPB Strategic Plan, Budget, and Performance Plan and Report*, p. 9 (Feb. 2016), *at* http://files.consumerfinance.gov/f/201602_cfpb_report_strategic-plan-budget-and-performance-plan_FY2016.pdf.

has boasted in public reports, this un-appropriated source of funding "ensure[s] that the CFPB enjoys "*full independence*" from Congress.[56]

As much as the CFPB enjoys this arrangement, it gets our constitutional design precisely backwards.[57] The Constitution commits the "power of the purse" to Congress precisely in order to ensure that the other parts of government are held accountable to the people. As James Madison stressed in *Federalist 58*, "[t]his power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance," to protect the people against "all the overgrown prerogatives of the other branches of the government." Madison would be entirely unsurprised by the ramifications of granting such financial independence to an agency—such as the agency's director rebuffing a congresswoman's questions about the agency's controversial expenditures of hundreds of millions of dollars by asking her, defiantly, "why does that matter to *you*?"[58]

I hope that Congress's decision to free the CFPB from truly meaningful oversight power proves to be a temporary mistake, and not a harbinger of things to

56 CFPB, *Consumer Financial Protection Bureau Strategic Plan: FY2013–FY2017*, t p. 36 (Apr. 2013) (emphasis added), *at* http://files.consumerfinance.gov/f/strategic-plan.pdf.

57 Again, as disclosed above, I am also co-counsel to plaintiffs challenging the CFPB's constitutionality. Nevertheless, I express these views strictly in my own capacity, and not on behalf of any other organizations or parties.

58 CFPB Director Cordray told this to Rep. Ann Wagner at a 2015 hearing of the House Financial Services Committee. The video clip is available at https://www.youtube.com/watch?v=5IxSfJ638cs.

come. While independent agencies' regulatory actions will be improved significantly by increased White House oversight and interagency coordination, such reforms must be a complement to—not a replacement for—increased oversight by *Congress*.[59]

Thank you for inviting me to testify today.

[59] On the need to improve Congress's oversight capabilities, *see, e.g.*, Kevin R. Kosar, "How to Strengthen Congress," *Nat'l Affairs* (Fall 2015), *at* http://www.nationalaffairs.com/publications/detail/how-to-strengthen-congress; Neomi Rao, *Administrative Collusion: How Delegation Diminishes the Collective Congress*, 90 N.Y.U. L. Rev. 1463 (2015).

Testimony of Cary Coglianese
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Before the
U.S. Senate Committee on Homeland Security and Government Affairs
Subcommittee on Regulatory Affairs and Federal Management

Hearing on "Reviewing Independent Agency Rulemaking"

September 8, 2016

Chairman Lankford, Ranking Member Heitkamp, and Members of the Subcommittee, I appreciate your invitation to appear before you today to testify about potential improvements to the regulatory process at independent agencies. By way of background, I am the Edward B. Shils Professor of Law and Professor of Political Science at the University of Pennsylvania, where I also serve as the founding Director of the Penn Program on Regulation. I am currently a public member of the Administrative Conference of the United States as well as a member of the Committee on Performance-Based Safety Regulation of the National Academies of Sciences, Engineering, and Medicine. The focus of my research and teaching throughout my career has been on issues of administrative law and government regulation, with a particular emphasis on the empirical study of regulatory policymaking. In addition to authoring or co-authoring over a hundred scholarly articles or book chapters related to regulation, I have edited or co-edited seven books, including most recently *Achieving Regulatory Excellence* (forthcoming 2016), *Does Regulation Kill Jobs?* (2013), and *Regulatory Breakdown: The Crisis of Confidence in U.S. Regulation* (2012).[1]

Analysis and Agencies

> *"Analysis is both a tool for making important decisions – 'thinking ahead' – and crucially a way of 'looking back' to see whether decisions made in the past have been good ones."*[2]

Two types of analysis inform regulatory decision-making: one type, prospective analysis, takes place before new regulations are adopted and informs how they are designed; the other type, retrospective evaluation, takes place afterwards and measures what impacts they have had. These two types of analysis are interrelated. Prospective analysis clarifies the goals of a new regulation and identifies expected outcomes; this in turn informs the subsequent process of retrospective evaluation by identifying benchmarks against which the regulation's actual effects

[1] I testify in my individual capacity and not on behalf of any organization with which I am or have been affiliated.
[2] Coglianese (2013a).

can be assessed. Conversely, when retrospective evaluation shows how well a regulation has (or has not) worked in actuality, it informs prospective analysis of whether to retain or modify that regulation, as well as how to design other regulations. Both types of analysis – prospective and retrospective – are essential ingredients for smart decision making about how to deliver high-quality regulatory outcomes (Coglianese & Bennear 2005; Coglianese 2013a).

All agencies can improve both kinds of analysis. Particular concern has emerged recently about so-called independent agencies producing weak or insufficient analysis. This concern coincides with a number of major independent agencies pursuing more active and consequential regulatory agendas in recent years, whether it is the Federal Communications Commission adopting its recent Open Internet regulation or the Securities and Exchange Commission and the Commodity Futures Trading Commission promulgating major new regulations under the 2010 Dodd-Frank financial reform legislation. Litigants, as well as some judges and commentators, have criticized independent regulators for failing to produce adequate prospective analysis in support of their regulations.[3] Similar concerns about independent agencies' retrospective analyses would not generally be actionable in court, so they are less salient, but there seems little reason to think that independent agencies are doing better than other agencies when it comes to evaluating their rules after the fact.

What constitutes an "independent agency" can itself be open to discussion. Although independence has long been understood in terms of structural features related to the appointment of agency heads – for-cause removal restrictions, fixed terms, and, with multi-member agencies, bipartisan distribution requirements (Verkuil 1988) – researchers have more recently treated structural independence as a matter of degree, rather than as a binary characteristic (Datla & Revesz 2013; Lewis & Selin 2015; Carrigan & Poole 2015). For present purposes, I will assume a simple binary definition of an independent agency: namely, any of 19 agencies specifically listed in the Paperwork Reduction Act's (PRA) definition of an "independent regulatory agency."[4] All other agencies I will call "executive agencies." The independent agencies listed in the PRA do not uniformly share the same structural features. Most have agency heads protected by for-cause removal limitations, for example, but some do not (Office of the Comptroller of the Currency, Office of Financial Research). Moreover, some agencies headed by administrators

[3] For recent litigation raising challenges to independent financial regulators' analyses – challenges that have not always proven successful – see Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005); Chamber of Commerce v. SEC, 443 F.3d 890 (D.C. Cir. 2006); American Equity Inv. Life Ins. Co. v. SEC, 572 F.3d 923 (D.C. Cir. 2009); Business Roundtable and Chamber of Commerce v. SEC, 647 F.3d 1144 (D.C. Cir. 2011); Int'l Swaps & Derivatives Ass'n v. CFTC, 2012 U.S. App. LEXIS 1282 (D.C. Cir. Jan. 20, 2012) (per curiam); Inv. Co. Inst. v. CFTC, 891 F. Supp.2d 162, 190 (D.D.C. 2012), aff'd, 720 F.3d 370 (D.C. Cir. 2013); Sec. Indus. & Fin. Mkts. Ass'n v. United States CFTC, 67 F.Supp. 3d 373, 384, 390, 437–38, (D.D.C. Sept. 16, 2014). Similar objections were raised, unsuccessfully, in litigation challenging the FCC's Open Internet decision-making, arguing that, as Crovitz (2016) has put it, "the FCC skipped the economic analysis."

[4] 44 U.S.C. 3502(5). These agencies are: "the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Consumer Product Safety Commission, the Federal Communications Commission, the Federal Deposit Insurance Corporation, the Federal Energy Regulatory Commission, the Federal Housing Finance Agency, the Federal Maritime Commission, the Federal Trade Commission, the Interstate Commerce Commission, the Mine Enforcement Safety and Health Review Commission, the National Labor Relations Board, the Nuclear Regulatory Commission, the Occupational Safety and Health Review Commission, the Postal Regulatory Commission, the Securities and Exchange Commission, the Bureau of Consumer Financial Protection, the Office of Financial Research, Office of the Comptroller of the Currency."

who do enjoy for-cause removal protection are not included in the PRA's list (Social Security Administration).[5] Still, the congressionally-approved definition in the PRA is highly relevant to the subject of prospective and retrospective regulatory analysis, as the main executive orders that require the preparation of certain analyses or reports apply to executive agencies but not to agencies listed as independent in the PRA.

I now turn to a consideration of what we can infer about the state of prospective and retrospective analysis at independent agencies. It is harder than it might seem to say definitively how deficient are the analyses at these agencies, as a general matter. However, one can reasonably assume they are far from optimal, and thus I then turn to considerations related to possible legislative action that might help agencies improve their analysis. I begin with prospective analysis, considering what we can infer about its general quality at independent agencies and then discussing reform issues. I follow with a similar treatment of retrospective analysis.

Prospective Analysis

> *"[W]ith businesses rapidly advancing in precision and analytic sophistication, government will only be able to fulfill its responsibilities by becoming more optimizing itself."*[6]

Although administrative law scholars sometimes pine for a bygone era when so-called informal rulemaking was truly informal (if such a day ever truly existed), the process of making new regulations today involves numerous procedural steps and the building of what can sometimes be an extensive administrative record (Seidenfeld 2000). New rules are always susceptible to judicial review under the Administrative Procedure Act's arbitrary and capricious standard, which effectively compels agencies to justify their rules based on evidence and reasoning.[7]

For major new rules, administrative procedures demand that agency officials define the problem they seek to solve, offer justifications for their new regulations, consider alternatives, and estimate the anticipated benefits and costs of both their preferred actions as well as other alternatives. The Unfunded Mandates Reform Act (UMRA)[8] and Executive Order 12,866[9] impose these sorts of analytical requirements when agencies plan to issue rules having certain kinds of annual economic effects in excess of $100 million (or higher for UMRA, due to inflation adjustments). Under Executive Order 12,866, agencies must clear their benefit-cost analyses of new rules through the White House Office of Information and Regulatory Affairs (OIRA). The executive order further states that, "recognizing that some costs and benefits are

[5] Admittedly, the PRA's enumerated list is not intended to be exclusive; it can encompass "any other similar agency designated by statute as a Federal independent regulatory agency or commission." 44 U.S.C. §3502(5). What is "similar" is hardly self-evident, though, given that the 19 agencies are not identical in their structural features.
[6] Coglianese (2016).
[7] 5 U.S.C. § 706(2)(A). See *Motor Vehicle Manufacturers Association v. State Farm Insurance*, 463 U.S. 29 (1983)
[8] 2 U.S.C. § 1532.
[9] As reaffirmed by Executive Order 13,563.

difficult to quantify," each agency shall "propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs."

Additional analytical requirements can be found in other statutes. The Regulatory Flexibility Act requires analysis when rules are expected to impose substantial impacts on small businesses.[10] The Paperwork Reduction Act calls for estimates of costs and time associated with any paperwork requirements found in new regulations.[11] The National Environmental Policy Act demands that federal agencies analyze the environmental impacts of major actions that will affect the environment.[12] The Congressional Review Act requires agencies to report to Congress and the Comptroller General on new rules that would have an annual economic effect above the $100 million threshold and to provide a copy of any benefit-cost analysis prepared for those rules.[13]

Procedural requirements such as these sensibly call for agencies to engage in analysis before adopting new rules. Just as it is true for other consequential endeavors, it is better for regulators to "look before they leap" (Partnoy 2012:243). Conducting prospective analysis can help reduce the possibility of mistakes, unintended consequences, and wasted resources.

Most, but not all, of the analytical requirements applicable to new rulemaking must be followed by *all* regulatory agencies. However, the main analytical requirements calling for agencies to conduct benefit-cost analyses of major rules do not apply to independent agencies. The definition of an agency under UMRA "does not include independent regulatory agencies,"[14] and, as indicated earlier, the terms of Executive Order 12,866 do not apply to agencies listed as independent regulatory agencies under the Paperwork Reduction Act.[15]

As a result, it should not be surprising that independent regulatory agencies have lately come in for considerable criticism for failing to conduct extensive benefit-cost analyses of many of their rules. As Copeland (2013:4) notes in a report prepared for the Administrative Conference of the United States, "studies indicate that independent regulatory agencies often do not quantify or monetize regulatory benefits, and often quantify and monetize only paperwork costs." Revesz (2016:14) observes that when it comes to producing cost-benefit analyses of their rules, executive agencies are "more proficient," and "[t]he less successful agencies are independent and outside the purview of OIRA review." The evidence supporting such claims typically derives from the reports that independent agencies submit to the Comptroller General pursuant to the Congressional Review Act about their major rules and underlying analyses. For example, Copeland (2013:4) reported that, of 22 major rules issued by independent agencies in 2012, "[o]nly one rule contained any quantitative benefit information." OIRA compiles this information in its annual reports to Congress and, as it has noted in its latest such report,

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[10] 5 U.S.C. § 601 et seq.
[11] 44 U.S.C. § 3501 et seq.
[12] 42 U.S.C. § 4321 et seq.
[13] 5 U.S.C. § 801 et seq.
[14] 2 U.S.C. § 1502.
[15] Section 3 (b) of the Order states: "'Agency,' unless otherwise indicated, means any authority of the United States that is an 'agency' under 44 U.S.C. 3502(1), other than those considered to be independent regulatory agencies, as defined in 44 U.S.C. 3502(10)." The provisions of the Paperwork Reduction Act have been re-numbered, so that the definition of independent regulatory agencies is now found at 44 U.S.C. § 3502(5).

"[i]ndependent agencies still have challenges in providing monetized estimates of benefits and costs of regulation" (OIRA 2015). Other commentators have reached much the same conclusion on the basis of similar evidence (e.g., Fraas & Lutter 2011a; Ellig & Fike 2013).

Despite this consensus about independent agencies' analytical deficiencies, it is difficult to assess exactly how well or poorly independent agencies are doing in analyzing their rules, at least judging simply from the mere fact that these agencies fail to report to the Comptroller General that some – or even many – of their rulemakings do not include quantified or monetized estimates of benefits or costs. When researchers have looked in-depth at the specific materials prepared by independent agencies in individual rulemakings, they have sometimes found that agencies have given more considerable attention to the benefits or costs of their rules than the summaries they share with the Comptroller General might suggest (e.g., Fraas & Lutter 2011b; Copeland 2013). More importantly, there is lacking any clear benchmark against which to measure the quantity and quality of benefit-cost analyses produced by any regulator. For how many rules exactly is it reasonable to expect independent agencies to have produced monetized estimates of benefits and costs? Comparisons with the level of quantification or monetization in analyses produced by executive agencies may not be appropriate, as what constitutes quality analysis will be specific to the problem a regulator is addressing and the relevant data available. It is well recognized that quantification or monetization of regulatory impacts is not always possible due to a lack of underlying data or other research that could be used to support such estimates. Estimating the benefits of homeland security regulations, for example, has proven more difficult than for other regulations. Executive Order 12,866 expressly "recogniz[es] that some costs and benefits are difficult to quantify," and a few scholars have even argued that it is much more difficult to quantify the effects of financial regulation (Coates 2014; Gordon 2014), a domain dominated by independent regulators.[16] In addition, research indicates that agencies produce less thorough analysis for rules that must be completed under tight statutory deadlines (McLaughlin & Ellig 2011), and we know that many of the rules that independent regulators have issued recently under the Dodd-Frank Act have faced such deadlines (Copeland 2013: 110). Without controlling for factors such as these, comparisons of independent agencies' analyses with those of other agencies will be, at best, incomplete and, at worst, misleading.

Still, it seems reasonable to assume that independent agencies could do a better job in analyzing the benefits and costs of their new regulations. As Bubb (2015:50) has suggested, it may be that benefit-cost analysis "plays little role in financial regulation not because it is especially challenging but rather because institutional structures do not produce incentives for financial regulators to develop and employ" such analysis. If this is correct, then what steps might Congress be able to take to change those institutional structures so that independent agencies would have more of an incentive to improve their prospective regulatory analysis? Three main options could be considered and are discussed below:[17]

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[16] Other scholars have contested the view that benefit-cost analysis of financial regulation is more difficult (e.g., Posner & Weyl 2013; Revesz 2016).

[17] The options discussed below all contemplate general changes to administrative procedures. It bears noting that, if Congress wished to take a more incremental approach, it could always target just one or more individual agencies. To some extent, the organic statutes of individual agencies already vary in that they direct some agencies to consider – and others not to consider – costs when making regulatory decisions (Copeland 2013).

1. *Make no legislative changes, at least for now.*

   Due to the process of judicial review, as well as the heightened salience today to the need for independent agencies to improve their regulatory analysis, independent regulators appear to be taking some steps to improve their institutional capacity for producing quality analysis. The Securities and Exchange Commission, for example, has taken some notable strides to strengthen its economic staff in the wake of the *Business Roundtable* decision (Kraus & Raso 2013). The disadvantage of waiting longer, of course, is that independent agencies are continuing to implement rules now, rules that will have important consequences for the economy and could be in place for a long time.

2. *Codify the requirements of Executive Order 12,866 for independent agencies.*

   Fascinating debates have surrounded the question of whether Presidents can legally apply the requirements in Executive Order 12,866 to independent agencies. For more than thirty years, Presidents have been reluctant to assert oversight over the regulatory actions of independent agencies. By contrast, Congress would face no similar legal questions if it were to codify the requirements of Executive Order 12,866 and apply them to independent agencies.

   This option would have the advantage of creating symmetry in the analytical requirements for regulation by both executive agencies and independent agencies. As regulations affect the public and the economy regardless of whether they are issued by executive or independent agencies, it has been anomalous that benefit-cost analysis requirements have applied only to rules issued by executive agencies. Legislatively imposing those requirements on independent agencies would cure that anomaly, providing independent agencies with the same institutional structures and incentives for producing quality prospective analysis as executive agencies.

   Although subjecting independent agencies to the same requirements for producing regulatory analysis as executive agencies could be easily justified on the grounds of sound regulatory management, applying the entirety of Executive Order 12,866 to independent agencies would make a significant alteration in the policy autonomy that has long been afforded to these agencies. Executive Order 12,866 does not merely call for agencies to conduct prospective analysis; it creates an institutional review process that gives the OIRA Administrator, and ultimately the President, oversight and gate-keeping influence over agencies' regulatory decisions. As Executive Order 12,866 expressly states in numerous places, the regulatory review process is one that aims at ensuring regulation will be consistent with the "President's priorities." In addition, under Section 6(a)(3)(A) of the order, the OIRA Administrator can ultimately determine which rules will be deemed significant and thus subjected to the regulatory analysis and review provisions of the order. In addition, Section 8 of the order precludes an agency from publishing a rule while it is still under review at

OIRA, and Section 7 establishes a process through which conflicts between OIRA and the agency can be elevated to the President for resolution.

Legislatively applying the entirety of Executive Order 12,866 to independent agencies would thus also apply these institutional provisions, making for a major shift in the norms and practices of autonomy that have long prevailed for regulatory decision making by independent agencies. To the extent that this operational autonomy remains valued, Congress should not apply wholesale to independent agencies the institutional mechanisms in Executive Order 12,866. One alternative approach could be to follow the model of the Paperwork Reduction Act, which does subject independent agencies to OIRA oversight of their information collection efforts but which also expressly allows independent agencies to override OIRA's decisions.

Even with such a change, Congress should also consider the institutional capacity of OIRA to handle the additional oversight that this option would entail. OIRA possesses a very tiny staff compared with the many executive agencies it oversees. Legislation that would thrust responsibility on OIRA for overseeing the regulatory actions of at least another 19 independent agencies on the office would necessitate a substantial increase in the funding for and size of OIRA.

3. *Eliminate UMRA's exemption for independent agencies.*

Another opportunity to remove an asymmetry in analytical requirements imposed on independent agencies vis-à-vis executive agencies would be to remove the exemption contained in UMRA. This option would have the distinct advantage of avoiding questions about intruding on independent agencies' policy autonomy raised by the possibility of legislatively imposing Executive Order 12,866 on these agencies. UMRA simply imposes a legal obligation on agencies to produce a statement of costs and benefits of rules covered by the Act; this obligation to produce such a statement is judicially enforceable, but the Act precludes courts from ruling on the *adequacy* of the agencies' analysis.

One small potential downside might be that UMRA's analytic requirements do not apply to as many rules as the Executive Order 12,866. UMRA's threshold applies to rules that impose $100 million or more in annual *costs*, rather than economic *effects* (costs and benefits). Plus, the $100 million amount in UMRA adjusts over time for inflation, so today the threshold is much higher. Still, if UMRA's scope were a concern, Congress could adjust the threshold to make it comparable to the one in Executive Order 12,866.

Perhaps the larger concern about eliminating UMRA's exemption for independent agencies would be whether it would provide enough of an institutional incentive for agencies to produce quality analysis. Although this option lacks the institutional "peer review" role of OIRA, agencies' benefit-cost analyses prepared under the Act would still be included as part of the agency record and thus reviewable under the general arbitrary and capricious standard in the Administrative Procedure Act. A further advantage of this approach would be that independent agencies could no longer claim that benefit-cost analysis is not required of them, which could help in shifting organizational norms within these agencies about the value of producing quality prospective regulatory analysis.

In contemplating which step to take, members of Congress should focus on what will promote improvements in prospective analysis and regulatory decision making, taking into account the values that Congress has long recognized in institutional autonomy for regulators in certain policy domains such as financial regulation. In addition to overarching consideration of the values served by both analysis and autonomy, members of Congress should also keep in mind several other considerations when deliberating about how to improve regulatory impact analysis at independent agencies:

- *Continue to recognize practical limits associated with conducting benefit-cost analysis.* Currently, Executive Order 12,866 and UMRA recognize that full quantification and monetization of benefits and costs will not be always feasible for all regulations. Any further legislative action should similarly recognize these feasibility concerns and continue to allow agencies the discretion to adopt appropriate regulations even if all impacts cannot be quantified or monetized.

- *Take into account specific legislative mandates applicable to individual agencies.* Some agencies' organic statutes preclude them from considering costs when making certain regulatory decisions. Congress should approach any new legislation imposing general analytic requirements mindful of any implications such action might have for these individual statutory requirements.

- *Recognize that conducting quality analysis demands resources.* As Shelley Metzenbaum and Gaurav Vasisht (2017) write in a forthcoming book of mine on regulatory excellence, "[f]unding adequacy has a direct and profound impact on whether a regulator can be effective." If Congress takes steps to mandate additional analysis, it should also ensure that agencies have the resources needed to fulfill any such mandate effectively.

- *Do not expect perfection.* Even with mandates, regulatory analysis will not always be completed well nor will it always influence regulatory decisions to the extent that it should. Despite OIRA's oversight of executive agencies, there remains substantial variation in these agencies' compliance with best practices of economic analysis of regulations. What I wrote over a dozen years ago remains true today: "The available empirical research indicates that simply mandating analysis does not eliminate inefficiency, and it may not even significantly reduce it" (Coglianese 2002).

The Administrative Conference of the United States has reinforced several of these considerations, recommending to Congress, should it impose new requirements on independent agencies, that "it should recognize that agencies need (a) the flexibility to scale the analyses to the significance of the rules and (b) the resources to satisfy such requirements" (ACUS 2013).

Retrospective Evaluation

> *"[A]ny policy process that takes analysis and deliberation seriously* before *decisions are made should also take seriously the need for research* after *decisions are made."*[18]

Over the last five years, the Obama Administration has taken a number of steps to build a "culture of retrospective review and analysis throughout the executive branch" (Sunstein 2011a). In early 2011, President Obama issued Executive Order 13,563 proclaiming that the nation's regulatory system "must measure, and seek to improve, the actual results of regulatory requirements." That order directed executive agencies to develop a plan for "periodic[] review [of] existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome." In response, over the last five years, executive agencies have reportedly undertaken more than 800 retrospective reviews and eliminated over 70 "regulatory provisions" (Shelanski 2016). According to OIRA Administrator Howard Shelanski (2016), these efforts have "achieved an estimated $37 billion in cost savings, reduced paperwork, and other benefits for Americans over five years."[19] Examples of such cost-savings all stem from executive agencies (e.g., Shelanski 2013; 2014; 2015; 2016; Sunstein 2012; 2013), such as the now-famous EPA "spilled milk" regulation which effectively exempted certain milk storage containers from particular EPA oil spill rules (Coglianese 2012).

But what have *independent* regulatory agencies accomplished in terms of retrospective review? In July 2011, President Obama issued Executive Order 13,579 stating, among other things, that "each independent regulatory agency should develop and release to the public a plan" for retrospective review of its existing significant regulations. The Council of Economic Advisors (CEA) (2012) reported that, as of November 2011, a total of 21 independent agencies had developed retrospective review plans. This included all the major regulatory agencies designated as independent under the Paperwork Reduction Act. CEA claimed that these plans reflected "substantial efforts to reduce burdens" by independent agencies, highlighting in particular review efforts taken or currently underway at seven independent agencies (CFTC, FTC, Fed, FERC, OCC, FDIC, and FCC). Although most of the efforts at these seven agencies were described as still at an early stage, the CEA report indicated that the FCC had "eliminated 190 rules, many of which are no longer needed as a result of technological advances" (Ibid.:10).[20]

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[18] Coglianese & Bennear (2005:247).

[19] A review of the Administration's lookback initiative commissioned by the Administrative Conference of the United States suggests that many of these cost-savings came in the form of administrative changes, such as switching to electronic filings, rather than making substantive regulatory changes (Aldy 2014:52). I asked a research associate to review a random sample of fifty retrospective reviews completed as of July 2015, and in slightly more than three-fourths of the reviews that resulted in changes, the changes were of an administrative or paperwork variety. Reducing unnecessary paperwork burdens is no doubt to be applauded, but streamlining administrative processes seems not as squarely centered on improving "the actual results of regulatory requirements" (Executive Order 13,563).

[20] Undoubtedly this sounds like a major achievement in regulatory reduction, but it is hard to imagine that the FCC's actions could be attributable to any serious retrospective review conducted in just the four months following the

The rigor and depth of agencies' analytic efforts in these retrospective reviews, whether conducted by executive or independent agencies, was generally quite limited. According to a report commissioned by the Administrative Conference of the United States, "[t]he vast majority" of executive agencies' efforts lacked "formal retrospective analysis, such as ex post estimates of benefits, costs, or efficacy" (Aldy 2014:52). What we know about the independent agencies' efforts makes them look still less substantial. Most of the plans submitted by independent agencies basically described existing, routine practices of consulting with the public and keeping abreast of developments in the regulated industry. The Nuclear Regulatory Commission (NRC), for example, took two and a half years to approve a final retrospective review "plan" that compiled existing principles and practices that guide NRC rulemaking activities.[21] Much as with the executive agencies, few, if any, of the independent agency plans could be said to contain truly robust "formal retrospective analysis."

It is also difficult to assess independent agencies' progress over time. Anyone who is interested in executive agencies' progress can go to the White House website and find status reports submitted twice each year. But no such repository exists of the status or accomplishments at independent agencies. Indeed, it is not even clear if these agencies have followed through at all on their initial plans. Executive Order 13,563 – the one that Executive Order 13,579 imposed on independent agencies – only called for agencies to produce an initial plan. Regular progress reports were called for only in a subsequent memorandum from the OIRA Administrator as well as a subsequent presidential order (Executive Order 13,610), both of which were directed just to executive agencies.

The Obama Administration's regulatory lookback initiative aimed, laudably, to build a culture of retrospective review through the "continuing process of scrutiny of existing rules" fostered by the presidential requirement of regular progress reports (Sunstein 2011b). It remains to be seen, of course, to what extent the Administration's lookback initiative has contributed to any enduring cultural shift at any agency. Whatever positive, lasting change the initiative has had, though, presumably such effect has been most attenuated at independent regulatory agencies.

Much more could be done to foster a governmental culture that takes retrospective analysis of regulations seriously at independent agencies – and at executive agencies. One desirable cultural shift would entail refocusing and broadening the rationale for retrospective review. As Aldy (2014:34) aptly notes, burden reduction has been a "common theme" of the Obama Administration's lookback initiative, as well as similar efforts in earlier administrations. Instead of just focusing on reducing regulatory costs or burdens, retrospective review can help agencies overall create better-designed and better-implemented regulations (Coglianese & Bennear 2005). Smarter regulations not only can be more cost-effective but also can deliver greater overall benefits.

signing of Executive Order 13,579. The timing of the FCC's actions suggests that either these revocations were already in progress before that order was issued, or that the rules that were eliminated were so obviously outmoded that removing them was an inconsequential housekeeping matter.

[21] See U.S. Nuclear Regulatory Commission, Final Plan for Retrospective Analysis of Existing Rules, http://www.nrc.gov/docs/ML1400/ML14002A441.pdf.

Retrospective review can provide valuable information that can be used to inform future regulatory decisions. Multiple regulatory agencies, executive and independent, face similar challenges, whether it is in regulating to promote private security efforts to protect key infrastructure or to foster a "safety culture" within high-hazard industrial operations. Such common challenges could be fruitfully illuminated by regulatory impact evaluation of rules implemented by regulators working in related areas. Learning how different types of regulatory strategies – such as market-based instruments, management-based regulation, behavioral nudges, or performance standards – have performed in one regulatory domain can be useful in designing regulations in other, similar domains. Furthermore, by comparing the results of rigorous retrospective evaluations of individual rules' costs and benefits with the prospective estimates that agencies make of these costs and benefits, agencies and their analysts can learn how to improve the regulatory impact analysis that takes place when new rules are being designed (Coglianese & Bennear 2005).

What concrete steps might Congress take to help agencies better realize retrospective review's full potential for deepening regulatory knowledge and improving regulatory decision-making? Three possibilities merit consideration with respect to both executive and independent agencies:

1. *Codify and extend requirements for agencies to report regularly on plans and progress with respect to strategically focused retrospective reviews.*

   The practices that have emerged over the last five years for executive agencies under Executive Orders 13,563 and 13,610 provide a sustained foundation upon which agencies could be encouraged to build during the next administration and beyond. To ensure continuation of these practices, Congress could productively codify similar planning and progress reporting requirements – and extend them to independent regulatory agencies – so as to ensure that regular, strategic efforts of regulatory evaluation remain implemented.

   If Congress were to take any such action, it should broaden the purpose of retrospective review beyond the worthwhile objectives of streamlining and burden reduction, which have almost exclusively characterized retrospective review efforts in the past. In the Regulatory Flexibility Act, Congress has already required both executive and independent agencies to undertake mandatory periodic reviews of all rules imposing significant economic impacts on small businesses. The purpose of such reviews is quite narrowly "to minimize any significant economic impact of the rules upon a substantial number of such small entities."[22] Instead of focusing only on burden reduction, as important as that can be, new legislation could encourage retrospective analysis that promotes smarter, more strategic regulatory decisions – ones that measure and potentially increase benefits in addition to finding cost reductions. In other words, the purpose should be, as in Executive Order 12,866, to support a better system of regulation "that protects and improves ... health, safety, and well-being and improves the performance of the economy without imposing unacceptable or unreasonable costs on society."

[22] 5 U.S.C. § 610.

Presumably any legislation codifying the current practice under Executive Order 13,563 would give agencies both the discretion and responsibility to determine what rules to review, along with when and how to review them, as these decisions will depend on each agency's overall priorities and available resources.[23] Although Executive Order 13,563 seeks to "promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome," any legislation should approach retrospective review less narrowly and encourage agencies to review other types of rules when doing so would advance legislative and administrative priorities. For example, agencies might appropriately analyze rules that were issued under conditions of high uncertainty about their costs or benefits, or rules that rely on common assumptions or present common problems of interest to regulators (Coglianese 2013b).[24]

Maintaining OIRA's current role in simply overseeing agency reporting about retrospective review would make sense for several reasons. First, it could help ensure that OIRA staff can benefit from the knowledge generated from agencies' backward looks. Second, since OIRA coordinates the Paperwork Reduction Act, keeping its staff apprised of agencies' data needs may streamline any information requests that are needed to evaluate existing rules. Third, OIRA could incorporate overall progress and key findings from agencies' retrospective reviews into its annual reports to Congress on the benefits and costs of regulation. (Currently, these reports only provide *estimated* or *forecasted* benefits and costs of regulation.) Finally, OIRA could be encouraged or authorized to issue non-binding "evaluation prompts" to agencies, identifying specific rules that would benefit from careful retrospective study (Coglianese 2013b). OIRA is especially well-positioned to identify rules or issues where evaluation findings could help improve prospective regulatory impact analysis, and making suggestions to independent agencies about evaluations to undertake would not intrude on such agencies' core policy autonomy.

2. *Require agencies to include a structured evaluation plan as part of their* Federal Register *notices when promulgating new major final rules.*

   In principle, a well-developed RIA could provide some of the information evaluators would need to piece together an evaluation strategy at a later date, but, as noted, RIAs are not always of uniform quality. Moreover, the exercise of completing even a brief, standardized evaluation plan at the time of a rule's establishment can discipline and sharpen decision-makers' thinking.

   Such required plans need not be onerous (Coglianese 2013b). At a minimum, they simply need to include: (a) a description of concrete criteria, indicators, or proxies of

[23] If Congress seeks to direct an agency to evaluate a specific regulation or set of regulations, it always can do so through other legislation, as it already does from time to time. In such cases, Congress may also need to consider appropriating additional funding to support the desired evaluation research.
[24] As a CEA (2012) report has noted, "[r]etrospective analysis is an important complement to prospective analysis. In some cases, prospective analysis of costs and benefits will be highly uncertain; retrospective analysis can provide valuable additional information and ultimately lead to better regulations." ACUS (2014:9-10) contains a further list of helpful considerations that agencies may take into account when prioritizing retrospective analysis.

regulatory impacts (benefits as well as costs); (b) known existing data that could be used to measure the rule's impacts, or a statement of the type of new data that would be needed to measure the rule's impacts; (c) an estimated time period after which the rule's impacts should begin to be observable and evaluation would be appropriate; and (d) sources of variation and possible research strategies or designs, whether experimental or quasi-experimental, that could take advantage, at the appropriate time, of that variation to try to draw inferences of the rule's impacts. OIRA could establish guidelines for appropriate research designs and other plan features (Coglianese 2013b).

The "framework" requirement found in S. 1817, the Smarter Regs Act of 2015, operationalizes this proposal well. Whether or not agencies are required to conduct evaluations or follow their plans precisely, the process of developing such plans at the outset of a rulemaking process would help to reinforce an evaluation mindset with agency regulators, as well as to provide guidance for future evaluation of the rule by outside evaluators and the public.[25]

3. *Invest in regulatory evaluation and related research in behavioral and regulatory sciences.*

Taking retrospective review seriously demands resources: time, personnel, and funding. And when it comes to resources, there are always tradeoffs. Over the past five years, the Obama Administration's lookback initiative took retrospective review seriously by generally favoring breadth (number of rules reviewed) over depth (the empirical rigor and sophistication of the underlying reviews). The average executive branch agency undertook about 30 reviews, or about 6 per year, although a few agencies reviewed over one hundred rules, or more than 20 per year. To reach these numbers in such a period of time, many reviews appear to have relied mainly on expert judgments, impressions, and assumptions; few, if any, reviews involved in-depth empirical evaluation of the kind needed to draw valid inferences about what impacts the regulation under review actually caused.

There is nothing intrinsically wrong with reviews taking a back-of-the-envelope form, nor in building a portfolio of reviews that seeks breadth. One presumably does not need a randomized controlled experiment, after all, to surmise that replacing paper filings with electronic filings will save processing time and money. Yet a retrospective review portfolio devoid of any in-depth evaluation studies misses something vital: the ability to draw a causal connection between the regulation and various benefits and costs. To make such a causal inference requires comparing the world with the regulation to a counter-factual world without the regulation. Since the counterfactual cannot be directly observed, the evaluator must estimate it using careful research designs, such as randomized controlled experiments, or various statistical techniques that effectively approximate randomized controls (Coglianese 2011).

[25] The idea of planning for evaluation at the outset also seems consistent with the Evidence-Based Policymaking Commission Act's goal of finding ways "to incorporate outcomes measurement ... and rigorous impact analysis into program design."

Such research can take some more time and effort to design and conduct. As a result, regulatory officials need to make choices based on available resources. Not every rule will necessarily require rigorous, in-depth evaluation. Banning the use of lead as an additive in gasoline, for example, might not demand a sophisticated evaluation to validate that such a rule caused observed declines in air concentrations of lead, especially if few or no other major sources of lead emissions exist.[26] In many instances, though, it will be important to determine what the actual benefits and costs of a rule have been. Those benefits and costs, if properly monetized, represent the value of the negative and positive impacts that the rule *has caused.* Axiomatically, the only way to know what difference a regulation is making – for good or for ill – is to conduct a careful, causally-oriented evaluation (Coglianese 2015).

Such rigorous evaluations require adequate resources. When these evaluations are targeted at major regulations, the needed resources will amount to only a tiny fraction of overall estimated costs and benefits of the rules themselves; thus, from the standpoint of overall social welfare, investing in evaluation is worthwhile if it can provide decision makers with options to lessen costs or increase benefits even modestly. Still, for government agencies, these costs can be quite palpable and constraining; Congress will need to ensure agencies have appropriate resources.

Congress could consider ways that resources available for other institutions – whether, for example, at the National Academies of Sciences, Engineering, and Medicine or through the National Science Foundation – might be dedicated to supporting regulatory evaluation. Other institutions can undertake or fund such research directly, or they could provide more fundamental research in behavioral sciences that indirectly helps to inform evaluation and improve regulatory decisions by enhancing our understanding of how and why different regulations have the effects they do.

Conclusion

The persistent challenge in the field of regulation is to improve the quality of regulatory decisions in order to enhance the public value they provide and minimize any unnecessary burdens that they may impose on economic activity. Through improved regulatory analysis, agency decision makers can make smarter decisions that improve outcomes for society. Improving regulatory analysis requires enhancing the incentives for regulatory decision makers to look carefully before they leap, as well as to ensure that they look backward after they have acted to find out how well their regulations are working. Improving regulation by independent agencies depends on improving their practice and use of both prospective and retrospective analysis.

[26] Even if there were other sources, the pathways from fuel combustion to air levels of lead may be sufficiently well-understood and the adverse health effects of lead so significant that even a modest reduction from the air would still dwarf any adverse effects of a ban. Gaining an understanding of those adverse effects better, however, could still necessitate causally-directed evaluation, such as if it were thought meaningful to know how the ban affected vehicle engines and their performance, as these outcomes are affected by many other factors.

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HOOVER INSTITUTION
Ideas Defining A Free Society

September 8, 2016

Via Email and Mail

Hon. James Lankford, *Chairman*
Hon. Heidi Heitkamp, *Ranking Member*
United States Senate
Committee on Homeland Security
and Government Affairs
Subcommittee on Regulatory Affairs
and Federal Management
340 Dirksen Senate Office Building
Washington, DC, 20510

Re: Submission for the Record

Dear Senators Lankford and Heitkamp,

During today's hearing, "Reviewing Independent Agency Rulemaking," there was discussion of economic analysis and the Federal Communications Commission (FCC), with respect to the recently proposed "Set-Top Box" rule and the "Open Internet Order." I referred briefly to a recent study criticizing the FCC for becoming an "economics-free" agency.

I am submitting a copy of that study for the record: Gerald R. Faulhaber & Hal J. Singer, *The Curious Absence of Economic Analysis at the Federal Communications Commission: An Agency in Search of a Mission* (2016). It is also available online at http://www.calinnovates.org/curious-absence-economic-analysis-federal-communications-commission-agency-search-mission.

Thank you, again, for the opportunity to testify.

Sincerely,

Adam White
Research Fellow
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The Curious Absence of Economic Analysis at the Federal Communications Commission: An Agency in Search of a Mission

by

Gerald R. Faulhaber[1] and Hal J. Singer[2]

Abstract

By counseling a very judicious use of regulation, including forbearance where appropriate, regulations informed by economic analysis at the Federal Communications Commission (FCC) have positively affected the U.S. economy. From freeing up long-distance telephone from regulation and subjecting it to competition, to enabling the proliferation of enhanced data Internet services, and spurring the growth of new wireless markets, the world has been changed for the better by wise application of regulations informed by economic principles. The failure of the FCC to ground its regulations in economic reasoning in the last few years, however, has led to inefficient policies and proposals that threaten to eviscerate prior benefits. The FCC has made no effort to subject its pending privacy or set-top-box proposals to cost-benefits analysis. The resolution of the FCC's 2015 Open Internet Order illuminates the quagmire for policymakers. Given the D.C. Circuit's willingness to defer to the FCC's expertise in policy, and given the FCC's willingness to eschew econometric evidence and economic theory as it considers new regulations, the most direct way to re-inject economics into FCC policymaking is via a Congressional mandate for the agency to perform cost-benefit analysis, subject to OIRA or judicial review. There is no reason why the Department of Labor, the Environmental Protection Agency, the Consumer Financial Protection Bureau, and a host of other agencies should be required to perform cost-benefit analysis, while the FCC is free to embrace populism as its guiding principle. The tech industries under the FCC's domain are equally if not more important to the U.S. economy and deserve regulations based on rigorous economic analysis.

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2. Senior Fellow, George Washington School of Public Policy; Adjunct Professor, Georgetown's McDonough School of Business; Principal, Economists Incorporated. The authors would like to thank CALinnovates for funding, and Augustus Urschel for research assistance. The views here are those of the authors only, and do not reflect the views of their affiliated institutions.

I. Introduction

Upon leaving the Federal Communications Commission (FCC) in January 2016, outgoing chief economist Tim Brennan remarked that his former agency was operating, with respect to the issue of net neutrality, in an "economics-free" zone.[3] Professor Brennan offers an insider's view of how economics has been marginalized in the FCC's decision-making process. Even casual observers of recent FCC rulemaking can sense that economics has taken a backseat to politics. In announcing its decision to reclassify Internet service providers as "common carriers" in February 2015, a majority of FCC commissioners routinely cited the four million comments the agency received in favor of net neutrality.[4] The voices—no matter how disconnected from the ultimate policy outcome—trumped whatever the economists had to say.

To an economist with an allegiance to cost-benefit analysis, even 40 million comments could not justify regulatory action that harms the Internet ecosystem on net: What matters is (1) whether there exists a market failure that warrants sector-specific intervention; and if so (2) whether the expected benefits of the intervention (approximated by increase in investment in the "edges" of the network) exceed the expected costs (approximated by the decrease in investment at the "core"); and (3) even if the net benefits are positive, whether there exists a less-restrictive alternative that would achieve even greater net benefits. But the FCC did not perform a rigorous cost-benefit analysis in the proceeding; instead, it released a two-page statement in March 2015 purporting to show annual *gross* benefits of $100 million in edge investment. The perfunctory statement noted that "the Commission is not required to prepare a cost benefit analysis,"[5] which would entail estimating the *net* benefits of the rule. Economists warned that failure to incorporate economic analysis into the agency's decision-making could lead to increased uncertainty due to litigation risk, which in turn could discourage innovation.[6]

In the 2015 *Open Internet Order* ("*2015 OIO*") itself, rather than rely on econometric analysis proffered in the proceeding,[7] the FCC credited the casual empiricism of a consumer advocacy group, which purported to show that common-carrier regulation of DSL providers in the late 1990s and early aughts was the cause of higher telecom investment relative to later

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3. *See, e.g.*, Gordon Crovitz, *Economics-Free Obamanet*, WALL STREET JOURNAL, Jan. 31, 2016, *available at* http://www.wsj.com/articles/economics-free-obamanet-1454282427#:OXpja3_mPAWUoA.

4. *See, e.g.*, Statement of Commissioner Jessica Rosenwercel, Re: Protecting and Promoting the Open Internet, GN Dkt. No. 14-28 ("This is a big deal. What is also a big deal is 4 million voices. Four million Americans wrote this agency to make known their ideas, thoughts, and deeply-held opinions about Internet openness."), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-24A4.pdf. Statement of Mignon Clyburn, Re: Protecting and Promoting the Open Internet, GN Dkt. No. 14-28 ("I also believe that they never envisioned a government that would include the input and leadership of women, people of color, and immigrants, or that there would be such an open process that would enable more than four million citizens to have a direct conversation with their government."), available at https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-24A3.pdf. Statement of Tom Wheeler, Re: Protecting and Promoting the Open Internet, GN Dkt. No. 14-28 ("Most significantly of all, we heard from nearly four million Americans, who overwhelmingly spoke in favor of preserving a free and open Internet.").

5. Congressional Review Act Abstract, WG Dkt. No. 14-28, FCC 15-24 (Mar. 12, 2015), *available at* http://www.progressivepolicy.org/wp-content/uploads/2015/04/20150403-CRA-Abstract-Open-Internet-Order.pdf.

6. Gerald Faulhaber, *What Hath the FCC Wrought?*, REGULATION (Summer 2015), *available at* http://object.cato.org/sites/cato.org/files/serials/files/regulation/2015/6/regulation-v38n2-1.pdf.

7. Kevin A. Hassett & Robert J. Shapiro, The Impact of Title II Regulation of Internet Providers On Their Capital Investments, SONECON (Nov. 2014), *available at* http://www.sonecon.com/docs/studies/Impact_of_Title_II_Reg_on_Investment- Hassett-Shapiro-Nov-14-2014.pdf.

periods, when DSL was classified as an information service.[8] Never mind that the capital expenditure (capex) of cable modem providers, which were not subject to common-carrier rules and thus serve as a near-perfect control group for DSL providers, grew at a faster rate than telco capex during the period of asymmetric regulation,[9] casting doubt on the FCC's causal inference. Rigorous economic analysis would immediately uncover the fallacy in this naïve reasoning. Yet the *2015 OIO* contained no such economic evidence, only simple-minded (and false) conclusions. Although the *OIO* was upheld on a 2-1 vote by the D.C. Circuit in June 2016,[10] Judge Williams' dissent (discussed in detail below) vindicated the concerns of many economists, including three former chief economists of the FCC.

2015 marks the nadir of economic influence at the agency. In the prior five years (2010 to 2014), the Commission's Office of Strategic Planning and Policy Analysis hosted an average of 16 economic seminars at the agency per year.[11] In 2015, the FCC conducted just four. Assuming that economic analysis is currently held in low esteem at the FCC, how did we get there? And what are the implications of removing economic analysis from agency rulemakings that impact several critical sectors of the U.S. economy? This paper seeks to answer those questions, by studying the role of economics at the FCC over time, and by seeking to identify what caused the FCC to abandon the dismal science. We hypothesize that the waning influence of economic analysis is correlated to the politicization of the agency and its search for a new mandate. If true, this insight offers crisp policy prescriptions to reinsert dispassionate economic analysis into decision-making at the FCC.

Other researchers have taken notice of the diminution in the *quality* of economic analysis at the FCC, which is a proxy for the *influence* of economics at the agency. For example, Delp and Mayo (2016) find that while the concept of "effective competition" is central to policy formation at the FCC, the Commission's own applications of "effective competition" are inconsistently applied.[12] In the case of video distribution, they explain that "the FCC has alternatively defined 'effective competition' to be a number of competitors greater than or equal to three, six, or two."[13] Hahn, Faulhaber and Singer (2012) similarly take issue with the FCC's shifting standard for assessing competition in mobile telephony.[14] Based on a review of FCC's merger conditions involving spectrum transfers, Manne et al. (2013) find that "the agency's standard of review for spectrum transfers, its use of conditions, as well as the scope of its

8. In the Matter of Protecting and Promoting Open Internet, GN Dkt. No 14-28, Report and Order on Remand, Declaratory Ruling, and Order, ¶414 n. 1210 (citing Free Press submission) (released Mar. 12, 2015) (hereinafter *2015 OIO*).

9. Brief for Georgetown Center for Business and Public Policy and Thirteen Prominent Economists, USTA v. FCC, Aug. 6, 2015, at 14, *available at* https://www.ustelecom.org/sites/default/files/documents/15-1063%20Georgetown%20Center%20and%20Economists%20Amicus%20Brief%20080615.pdf.

10. U.S. Telecom Ass'n. et al. v. FCC, No. 15-1063 (D.C. Cir. 2016).

11. Economic Seminars, Office of Strategic Planning & Policy Analysis, *available at* https://www.fcc.gov/general/economic-seminars-office-strategic-planning-policy-analysis.

12. Amanda Delp & John Mayo, The Evolution of Competition: Lessons for 21st Century Telecommunications Policy, Georgetown Working Paper (Apr. 2016).

13. *Id.* at 12.

14. Gerald Faulhaber, Robert Hahn, & Hal Singer, *Assessing Competition in U.S. Wireless Markets: Review of the FCC's Competition Reports*, 64(2) FEDERAL COMM. L. J., 319-370 (2012).

transaction reviews exceed legal limits, impede efficient markets for spectrum, and deter welfare-increasing transactions and investment."[15] They explain how the FCC's reliance on concentration of spectrum as a surrogate for anticompetitive effects conflicts with the approach of the FTC/DOJ *Horizontal Merger Guidelines*.[16]

This is particularly unfortunate because the economics staff at the FCC is of high quality and no doubt the best in Washington in their understanding of the economics of telecommunications and the Internet. The low quality of economic analysis currently going on at the FCC could indicate that the agency is not allocating the appropriate resources for the discipline, or more likely, that the Commission is simply ignoring the analysis they are receiving from their own economists.

This paper, which to our knowledge is the first to characterize the influence of economic analysis at the FCC over time,[17] is organized as follows: In Part II, we chart the rise and fall of economic analysis at the FCC. Our brief history begins with the early years, in which broadband licenses were allocated pursuant to beauty contests—a period of minimal economic influence. Often at the behest of the D.C. Circuit, economics starts to take hold in the 1960s and 1970s, as seen through important FCC rulemakings, including *Carterfone*, *MCI*, and the *Computer Inquiries*. Economic analysis arguably reached its apex at the Commission in the 1990s, with an embrace of auctions to allocate spectrum to mobile carriers, as well as an embrace of antitrust principles to guide regulatory intervention in areas such as wireless telephony and the nascent Internet. The aughts saw a continuation of a light-touch approach guided by economics, with a key decision to unwind the "common carrier" classification scheme for DSL providers in 2005, and to forbear from rate regulation of next-generation broadband access technologies such as fiber to the home.

This streak of economic import was suddenly broken under the leadership of Tom Wheeler, which has been marked by several decisions devoid of economic analysis. The 2015 *Open Internet Order* rejected the original rationale for embracing case-by-case review of "paid prioritization" arrangements—that is, payments by edge providers to Internet service providers (ISPs) for enhanced quality of service—and instead imposed a *per se* ban on the conduct. In 2010, the Commission recognized that case-by-case review was the appropriate rubric for dealing with paid prioritization (or any vertical restraint for that matter) that could be motivated for procompetitive reasons.[18] Indeed, the 2010 *Open Internet Order* relied on economic models of two-sided platforms, which showed that zero-pricing rules (that banned paid prioritization) had ambiguous investment and welfare effects.[19] Accordingly, it was decided that blanket bans would impose certain error costs (denying arrangements that are output-expanding and welfare-

15. Geoffrey Manne, Will Rinehart, Ben Sperry, Matt Starr & Berin Szoka, The Law and Economics of the FCC's Transaction Review Process, at 2, *available at*: http://ssrn.com/abstract=2242681.

16. *Id.* at 3.

17. Extant FCC economists have written on the influence of economics during their tenure. *See e.g.*, Jonathan B. Baker, Mark Bykowsky, Patrick DeGraba, Paul LaFontaine, Eric Ralph, and William Sharkey, The Year in Economics at the FCC, 2010-11: Protecting Competition Online Federal Communications Commission.

18. In the Matter of Preserving the Open Internet, Report and Order (released Dec. 23, 2010), ¶ 76 n. 299.

19. 2010 *Open Internet Order*, ¶ 28 n. 80.

increasing), and would make sense only if those error costs were zero. Some economists (and ultimately the D.C. Circuit) objected to the presumption the FCC embraced in its 2010 *Open Internet Order*—namely, that any paid prioritization was presumptively in violation of the Commission's non-discrimination principle—which inefficiently placed the burden of proof on the ISP rather than the excluded content provider. Despite this perceived infirmity, the 2010 *Open Internet Order* was a reasonable *political* compromise that at least respected certain economic considerations. The 2015 *Open Internet Order* however, did no such thing. Part II concludes with a brief review of other decisions in the Wheeler era that were also devoid of economic content.

In Part III, we explain why populism may be preferred to economic analysis in the modern era. In short, we find that the mandate of the 1996 Telecom Act leaves the FCC with a very narrow role. Although the Act expands the FCC's ambit with respect to access lines for voice services, it severely limits the FCC's jurisdiction when it comes to broadband service. The few times the FCC has tried to impose regulation on broadband, the D.C. Circuit has limited the agency's influence even further. As a result, the core business subject to FCC oversight has evaporated, minimizing the agency's relevancy in the Internet Age. Understood in this light, the FCC's embrace of Title II regulation based on populist sloganeering gives the agency a new lease on life as a regulator of a portion of the Internet.

Part IV describes the new battleground for economics-free regulation. Untethered from its customary respect for cost-benefit principles, the FCC moved quickly from reclassification to unbundling video content, regulating the price for business broadband, and imposing marketing restrictions on ISPs (but not on edge providers) in the name of privacy. To launch its campaign for set-top box reform, the FCC issued a "Fact Sheet" that again relied on the economic findings of a consumer advocacy group to suggest (erroneously) that set-top box prices had increased by 185 percent over the past decade.[20] Repeating a coordinated marketing campaign from the Open Internet proceeding, the White House released a video and a policy memo in favor of the FCC's set-top box proposal.[21] Armed with new powers from reclassification, the FCC next intervened to usurp the Federal Trade Commission's privacy enforcement over ISPs. Since the FCC is proposing a set of restrictions unique to ISPs, but is eschewing applying those same restrictions to other market participants that have access to the same and more consumer information, the FCC's foray into privacy has been viewed as protectionism for a politically preferred class of providers.

In Part V, we explore the implications of the FCC's economics-free regulatory agenda on the tech sector. Picking up on the privacy example, asymmetric regulation on only one set of

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20. FCC Chairman Proposal to Unlock the Set-Top Box: Creating Choice and Innovation, Jan. 27, 2016, *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db0127/DOC-337449A1.pdf. The statistic can be traced to a January 20, 2016 letter by Consumer Federal of America and Public Knowledge to the FCC, *available at* https://www.publicknowledge.org/documents/pk-and-mark-cooper-set-top-box-letter-to-fcc.

21. Jason Furman & Jeffrey Zients, Thinking Outside the Cable Box: How More Competition Gets You a Better Deal, Apr. 15, 2016, *available at* https://www.whitehouse.gov/blog/2016/04/15/ending-rotary-rental-phones-thinking-outside-cable-box. We are not aware of other occasions in which the White House has openly campaigned for an FCC proposal.

market participants could permit incumbent platform providers (such as Google or Facebook) to raise advertising prices (above the rates that would have prevailed with ISP entry), resulting in less online advertising and inferior information for online shoppers. Subjecting Ethernet prices to price-cap regulation for the first time could result in fewer buildings being wired for fiber, along with forgone spillover benefits of faster broadband. As with the *Open Internet Order* and the FCC's privacy proposal, which impose no restrictions on edge providers, the FCC's set-top box proposal similarly would constrain one set of market participants (MVPDs) and not others (device makers), thereby skewing the competitive landscape. These are straightforward considerations that an economist would have recognized and taken into consideration when evaluating the FCC's regulatory proposals—had she enjoyed a seat at the FCC's table.

The paper ends by asking how economic analysis could be reinserted into the policy debate. Assuming that the waning influence of economic analysis flows from the politicization of the agency and its search for a new mandate, the solution likely involves Congress. Based on this diagnosis, we advocate that Congress (1) shield the technocrats from political pressure of the kind we observed in net neutrality and set-top boxes proceedings, and (2) clarify the FCC's role over broadband Internet in an update to the Act. With respect to the second policy, Congress could solve the jurisdictional issue regarding net neutrality by giving the FCC the statutory power to regulate blocking and paid prioritization (as well as other forms of preference such as zero-rating) along the lines the agency sought in the 2010 *Open Internet Order*, but without recourse to heavy-handed Title II authority. Perhaps the most important mandate that Congress could give the FCC is to direct the Commission to explicitly include identification of market failure and careful cost-benefit analysis as a necessary condition before imposing *any* regulation.

The failure of the FCC in recent orders to use cost-benefit analysis and economic reasoning leads to inefficient policies that have real-world consequences. Proper use of economics has the intended impact of informing regulatory policy, but the unintended impacts of an economically minded agency are also important—it can lead to the FCC pulling back from regulation (especially Title II regulation) when such regulation is unnecessary. For example, the decision to stand down on regulating the Internet back in the 1990s has been widely recognized as a key reason for the explosive growth of the Internet and concomitant Internet innovation and investment. This growth would simply be impossible in the monopoly-regulated world of the Bell System. As then-Chairman Kennard explained, forbearing from regulation was a deliberate and highly successful policy decision. Without this decision, there would be no commercial Internet as we know it today.

Minimal and informed regulation has also given rise to the second great trend of the past several decades: wireless telecommunications. From the earliest incarnation of wireless in the 1980s to today, the cell phone and smartphone have been subject to minimal regulation and have led to explosive growth. There are more cell phones in the United States than there are people, far outstripping other consumer goods such as the telephone or television. These technologies are prime examples of regulatory successes, where judicious use of regulation, including forbearance where appropriate, has made a huge impact on our country and the world. From freeing up long-distance telephone from regulation to competition, enhanced data Internet services, and new wireless markets, the world has been changed by a wise application of economic principles.

II. The Rise and Fall of Economic Influence at the FCC

The FCC's use of economic theory, thought, and analysis can be broken into three general periods of history. From its inception in the early 1900s to the 1950s, economic consideration was largely absent from Commission policymaking and regulation. This era ends around the time Nobel Laureate Ronald Coase informed the Commission that its "zero-price" spectrum policy was inefficient. Starting in the 1960s we begin to see the Commission use economic theory, if not outright economic analysis, to shape its policies and regulatory reach. The 1990s and early 2000s mark the economic zenith of the FCC, when both theory and analysis play a major role in regulatory decision-making. By the 2010s, populism had reemerged as the primary driver of FCC policy, demonstrated by the agency's embrace of zero-priced (as opposed to paid) priority and interconnection.

A. The Early Years (1910s-1950s)

The FCC's early spectrum allocations were wholly devoid of economics. Licenses were given out for free to whomever could claim the "public interest." Spectrum reallocations created winners and losers based on lobbying and purely technical analysis. Calls to shape practices around economic theory were rejected. The Commission suffered from a degree of regulatory capture, working hand-in-hand with the incumbent interests of the day.

1. FRA and the First Spectrum Reallocation (1927)

From 1912 until 1926, regulation of the airwaves was overseen by the Commerce Department,[22] where broadcasting regulation was largely developed in concert with private enterprise.[23] When Commerce's legal jurisdiction for the growing technology became too thin, the FCC was born as the Federal Radio Commission (FRC) in 1927. Its mandate was to reallocate the chaotic spectrum mess created by a period of regulatory anarchy, following the dissolution of Commerce's mandate.

Critically, the 1912 Radio Act held no specific provision on the way to allocate station licenses. The FRC's mandate was to issue licenses if it "determine[d] that public interest, convenience, or necessity would be served by the granting thereof."[24] The discretion of what the public interest was, or who would be serving it, was left up to the regulators.

The solution to the allocation problem was decidedly noneconomic. The FRA first endeavored to grandfather all existing 733 stations across 90 frequencies.[25] For allocating new

22. FCC, *Annual Report of the Federal Radio Commission to the Congress of the United States,* at 1 (1927), *available at* https://transition.fcc.gov/Reports/ar1927.pdf

23. ROBERT W. MCCHESNEY, TELECOMMUNICATIONS, MASS MEDIA, AND DEMOCRACY 3 (Oxford University Press 1994).

24. *The Radio Act of 1927,* §11, 69th Congress (1927), *available at* http://www.americanradiohistory.com/Archive-FCC/Federal%20Radio%20Act%201927.pdf

25. MCCHESNEY, *supra*, 20.

licenses, the FRC decided to interpret the "public interest" mandate as allocating licenses to the broadcaster that could provide the "best possible broadcasting conditions"—meaning the broadcaster with the best equipment.[26] Given out at a zero-price, these licenses largely went to commercial broadcasters, owing to their better equipment.[27] The FRC eventually came to rule that a "general public service broadcaster" had preference over a "propaganda station," or any nonprofit station with a policy position.[28]

Accordingly, the FRC's *ad hoc* allocation was mostly to the benefit of existing commercial networks, which descended on Washington to participate in a series of hearings about the future of radio. Meetings were generally private and closed to the press and public, and there was a revolving door between the employment at the FRC and its main beneficiaries.[29] Of the 25 "clear" (national) channels created, 23 were owned by the National Broadcasting Company (NBC).[30] Although it had not done so intentionally, the FRC admitted in later years that its initial allocation technique effectively cleared the airwaves of noncommercial radio.[31] By 1934, nonprofit broadcasting accounted for only two percent of all air time.[32]

2. FCC and the Second Spectrum Reallocation (1945)

The Communications Act of 1934 rolled the FRC into a reformed FCC. The FCC was given the broader mandate of "regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States... a rapid, efficient, Nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[33]

The second major spectrum conflict arose in 1945 over the band of VHF spectrum occupied by FM radio stations. The Radio Corporation of America (RCA), one of the largest manufactures of black-and-white televisions, desired that band of spectrum for its TV sets. RCA's competitor and upstart manufacturer, CBS, wanted television allocations to rest on the UHF band, which could support its color broadcasting.[34]

Faced with these competing interests, the FCC split the differences in an ultimately harmful way. TV was allocated 12 channels within the black-and-white VHF band, and FM had its allocation moved up from the 42-50 MHz to 88-108 MHz band. However, the 12 TV channels soon became congested. The FCC put a freeze on issuing TV licenses in 1948, until it allocated

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26. *Id.* at 25.
27. *Id.* at 26.
28. *Id.* at 28.
29. McChesney, Telecommunications, Mass Media, and Democracy, 22.
30. *Id.* at 20.
31. Sherille Ismail, *Transformative Choices: A Review of 70 Years of FCC Decisions*, 3, FCC Staff Working Paper 1 (2010), *available at* https://www.fcc.gov/reports-research/working-papers/transformative-choices-review-70-years-fcc-decisions
32. *Id. at* 30-31.
33. *Communications Act of 1934,* §1 73rd Congress (1934), *available at* https://transition.fcc.gov/Reports/1934new.pdf.
34. Ismail, *supra*, at 5.

additional 70 channels in the UHF band years later. This fragmentation between two different areas of spectrum led to headaches for TV broadcasters in the coming decades, as UHF channels struggled to compete against their incumbent VHF competition.[35]

The FCC made these decisions "based on the testimony and data before it," but the Commissions reasoning was again devoid of economics.[36] Instead of economic analysis, the matter was decided by hearings and commentary. The major vested interests came to Washington to plead their case. A total of 231 witnesses testified, generating some "4,559 pages of testimony" and "543 exhibits."[37] Part of the FCC's rationale for moving the spectrum was based on a faulty technical analysis of the FM band.[38]

Although the FCC commissioned statistical studies of the telephone and telegraph industries and their associated rates and tariffs, there is no evidence of any economic analysis of the TV versus FM Radio question. Accordingly, the reallocation of FM radio spectrum rendered obsolete nearly 500,000 FM radio sets. This shock to the industry effectively arrested FM radio growth for over a decade.[39]

3. The FCC Hears an Economic Critique of Zero-Price Spectrum Licenses (1959)

In this early period, licenses were awarded in what could pleasantly be described as "spectrum beauty pageants." The FCC simply distributed spectrum licenses for free if there were no competing requests. In the event that there were two applicants for the same spectrum, the FCC would set up "comparative hearings," where the competing applicants used "a quasi-judicial forum in which to argue why they should be awarded a license over competitors, and allowed other interested parties to argue for or against an applicant."[40] Instead of being informed by economics, this process was wholly based on rhetoric. For example, in the first grant of cellular service licenses, 30 licenses generated 200 requests with each request being over 1,000 pages of argument.[41] Congress reformed the system into a lottery in 1981, but this did not address the underlying issue of inefficiency.[42]

In his landmark 1959 paper "The Federal Communications Commission," Nobel Laureate Ronald Coase argued that giving out valuable spectrum for free was incredibly wasteful.[43] He was not the first to notice this: There had been at least eight different instances

35. *Id.*
36. FCC, *Eleventh Annual Report of the Federal Communications Commission,* 20 (1945), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-308662A1.pdf.
37. *Id.*
38. Ismail, *supra*, at 6.
39. *Id.* at 8.
40. FCC, *The FCC Report to Congress on Spectrum Auctions,* 6 (1997), *available at* http://wireless.fcc.gov/auctions/data/papersAndStudies/fc970353.pdf
41. *Id.*
42. *Id.* at 7.
43. See Ronald H. Coase, *The Federal Communications Commission,* The Journal of Law & Economics, Vol 2, pp1-40 (1959).

between 1927 and 1959 where the FCC's zero-price policy had been questioned.[44] Coase's paper was prompted in part by a feeble rejoinder by former FCC chief economist Dallas Smythe against a previous proposal to sell spectrum to the highest bidder.[45] When Coase presented his analysis to the FCC, one commissioner asked, "Are you spoofing us? Is this all a big joke?"[46]

Why did the FCC resist economics in these early years? One theory is that the FCC's initial policies were "not merely inefficient but illogical, error-prone, [and] a mere accident of history."[47] Another is that this was not a naïve mistake in undervaluing spectrum, but a deliberate *quid pro quo* between regulators and incumbent radio broadcasters.[48] Regardless of the cause, the evidence of any economic thinking in the FCC prior to the 1960s is scant. Although the organization managed to bring order to the airwaves, it did so in a bureaucratic, cabal-like manner, where winners were chosen upon nebulous public-interest grounds and persuasive presentations in Washington conference rooms.

B. The Rise of Economic Analysis in the 1960s and 70s

The FCC's non-economic doctrines did not break down of their own accord. Lacking any internal pressure to economically liberalize its policies, the FCC would require external stimulus to reform. Outside of Congressional action, this came in the form of "court-assisted liberalizations," which had the effect of pushing the FCC towards using economic theory as a principal of regulation. The decisions helped shape the FCC's treatment of the growing computer services industry in a series of decisions called the "Computer Inquiries."

1. The Hush-A-Phone Decision (1956)

The first real evidence of economic thinking at the FCC was the reluctant acknowledgement of consumers benefiting from third-party phone attachments. Prior to 1968, the FCC had routinely suppressed peripheral devices that attached to AT&T-owned phones or to the telecommunications networks themselves. At the time, only AT&T equipment could be attached to AT&T's networks, leading to a *de facto* monopoly in telecom equipment.[49] The FCC took the suppression of third-party devices to "ridiculous extremes," banning add-on devices that

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44. Thomas W. Hazlett, *Assigning Property Rights To Radio Spectrum Users: Why Did FCC License Auctions Take 67 Years?*, 534, The Journal of Law & Economics, Vol XLI (1998).

45. Dallas W. Smythe, *Facing Facts about the Broadcast Business*, 20 U. CHICAGO L. REV. 100 (1952) ("Surely it is not seriously intended that the noncommercial radio users (such as police), the nonbroadcast common carriers (such as radio-telegraph) and the nonbroadcast commercial users (such as the oil industry) should compete with dollar bids against the broadcast users for channel allocations."), *available at* http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2752&context=uclrev

46. Thomas W. Hazlett, *Economic Analysis at the Federal Communications Commission*, 13 Prepared for an RFF Conference (April 7, 2011), *available at* http://www.rff.org/files/sharepoint/WorkImages/Download/RFF-DP-11-23.pdf

47. Thomas Hazlett, *Assigning Property Rights To Radio Spectrum Users: Why Did FCC License Auctions Take 67 Years?* 41 J. LAW & ECON. 569 (1998).

48. *Id.* at 541.

49. PETER HUBER, MARK KELLOGG & JOHN THORNE, 2 FEDERAL TELECOMMUNICATIONS LAW 664 (Aspen Law & Business 1991).

had no demonstrable harm to the telephone network.[50] This was the case with an automatic rotary dialing device invented in 1940, and a prototype answering machine named the "Jordaphone."[51]

The largely unfounded rationale for these bans was that "the unrestricted use of foreign attachments... may result in impairment to the quality and efficiency of telephone service, damage to telephone plants and facilities, or injury to telephone company personnel."[52] As a result, all third-party devices would have to be analyzed one case at a time.[53] This blanket ban was anathema to innovation, as it curtailed the ability of private entities to innovate with the existing technology without explicit permission of the owning company.

The pivotal change occurred in November 1956, when the Court of Appeals for the District of Columbia Circuit (D.C. Circuit) reversed the FCC's decision on Hush-A-Phone. The product was a metal device attached to the receiver of a phone, which effectively functioned in a similar manner to cupping a hand to a receiver for the purposes of speaking privately. The FCC had argued that use of this attachment would, somehow, negatively influence "the whole 'telephone system,'" but the appeals court saw no evidence of this outlandish claim.[54] Critically, the ban on Hush-A-Phone was found to be an "unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental."[55] Although it may not have been intentional, the D.C. Circuit had set a new standard of analysis for the FCC.

With the court's decision rendered, the FCC revised its policy and directed AT&T to allow customers to use any device that "does not injure [AT&T's] employees or facilities, the public in its use of [AT&T's] services, or impair the operation of the telephone system."[56] Although AT&T still had the monopoly on the phones themselves, third-party equipment could be attached. This crack in the dam was practically insignificant in the near term, but it affected the FCC's monopoly logic in the coming years.

2. The Carterfone Decision (1968)

This economic liberalization was made plain in 1968, when the FCC permitted non-telephone devices (though not third-party telephones themselves) to be connected to the network.[57] The cause for this change was the Carterfone, a two-way radio device that used the existing phone line to connect to other Carterfone owners. AT&T had banned the use of the

50. *Id.* at 665.
51. *Id.*
52. *Id.* at 665-66.
53. *Id.*
54. *Hush-A-Phone Corporation and Harry C. Tuttle, Petitioners, v. United States of America and Federal Communications Commission, Respondents, American Telephone and Telegraph Company et al., and United States Independent Telephone Association, Intervenors,* 99 U.S. App. D.C. 190; 238 F.2d 266 (1956).
55. *Id.*
56. Huber, Kellogg, & Thorne, Federal Telecommunications Law, Issue 2; 667.
57. Ismail, *Transformative Choices: A Review of 70 Years of FCC Decisions,* 17.

Carterfone, calling it a "prohibited interconnecting device."[58] The FCC found that "Carterfone fills a need and that it does not adversely affect the telephone system."[59]

This was an important shift from the Commission's earlier policy. The decision was in part based on *Hush-A-Phone*, but it also contained nods to economic reasoning. The FCC concluded that a private manufacturer of devices could connect to the telephone system, provided that they met reasonable network standards.[60] In the long run, this opening would eventually enable the development of modems and the Internet.[61] For the moment, though, it meant that the FCC was open to competition in ancillary markets that functioned alongside the monopoly network.

3. The FCC Gives MCI Authority To Offer Long Distance Services in Select Markets (1977)

Final evidence of court-assisted liberalization can be seen in the 1977 opinion in *MCI v. FCC*. Microwave Communications, Inc. (MCI) had operated a point-to-point microwave-based long-distance telephone service starting in 1972. (It had taken ten years for the FCC to allow such a service).[62] Local users of this private "point-to-point" service could dial an MCI facility using a local phone, enter an access number to reach a foreign facility, and be connected to a local telephone on the other side.[63]

Concerned that this new service was posing a threat to their traditional long-distance telephone monopoly, AT&T first informally[64] and then formally complained to the FCC that MCI was offering long-distance telephone service under the guise of their "Execunet" point-to-point microwave service.[65] Within a few months, the FCC suspended MCI's tariff "without holding a hearing or even disclosing the details of AT&T's arguments concerning the

58. FCC, *In The Matter of Use of the Carterfone Device in Message Toll Telephone Service; In the Matter of Thomas F. Carter and Carter Electronics Corp., Dallas, Tex. (Complainants), v. American Telephone and Telegraph Co., Associated Bell System Companies, Southwestern Bell Telephone Co., and General Telephone Co. of the Southwest (Defendants).* Docket No. 16942; Docket No. 17073, 13 F.C.C.2d 420 (1968); 13 Rad. Reg. 2d (P & F) 597.

59. *Id.*

60. *Id.*

61. Ismail, *supra*, at 14.

62. Kagami, Tsuji, & Giovannetti, Information Technology Policy and the Digital Divide: Lessons for Developing Countries, 72 (Edward Elgar Publishing Limited 2004)

63. *Id.* at 72.

64. An important anecdote from the court ruling illustrates the incredible regulatory capture AT&T had within the FCC. See MCI v. FCC below: "AT&T... complained orally to the Commission that MCI was offering interstate long distance message telephone service (MTS) under the guise of Execunet and that no such service could properly be tariffed by MCI. *Apparently AT&T representatives approached individual commissioners and various Commission staff personnel with this complaint and even held a demonstration of Execunet in the Commission's offices*. Subsequent to the ex parte complaints, AT&T filed with the Commission a letter which repeated the allegations previously made."

65. *MCI Telecommunications Corporation, Microwave Communications, Inc., and N-Triple-C Inc., Petitioners, v. Federal Communications Commission and the United States of America, Respondents, American Telephone and Telegraph Company, United States Independent Telephone Association, Data Transmission Company (DATRAN), and Southern Pacific Communications Company, Intervenors.* 561 F.2d 365 (D.C. Cir. 1977).

unlawfulness of Execunet."[66] MCI sought for a legal stay of the order, and the issue eventually went to the D.C. Circuit.

Once again the D.C. Circuit forced the FCC to abandon its monopolistic tendencies. The court found that there was no mandate suggesting that "that every time a carrier seeks to start a new service over existing facilities it must petition the Commission," and that there was "no affirmative determination of public interest need for restrictions."[67] Much like *Hush-a-Phone* and *Carterfone*, *MCI v. FCC* reinforced the notion that a "mother may I" policy towards innovating within the FCC's area of jurisdiction was inappropriate.

The court poignantly explained that it was troubled with the FCC's implicit notion that AT&T was a monopoly to be protected:

> As a final and somewhat collateral point, we are concerned with a thread running through the Commission's analysis that the Specialized Carrier decision granted AT&T a de jure monopoly ... which would be undermined were MCI allowed to provide Execunet because any such assertion is plainly incorrect and may have influenced the Commission's disposition of the instant case.
>
> ...The question whether AT&T should be granted a de jure monopoly was not among those proposed to be decided in Specialized Carriers, and nowhere in that decision can justification be found for continuing or propagating a monopoly... Of course, there may be very good reasons for according AT&T de jure freedom from competition in certain fields; however, one such reason is not simply that AT&T got there first.[68]

It is important to note that this decision in 1977 came in the midst of United States v. AT&T, which had been filed by the Department of Justice in 1974 and would eventually lead to the structural divestiture of AT&T's equipment and long-distance arms in 1984 (mandated in 1982). In *MCI v. FCC*, we can see the evolving concern of a publicly sanctioned monopoly on telecom.

What were the effects of these three decisions on the FCC's economic leanings? Prior to *Hush-a-Phone*, the FCC effectively functioned as a monopoly-sanctioning agency rather than a regulator of free commerce, working hand-in-hand with incumbents to support the industry standard. The court-mandated liberalization of the FCC's rigid monopoly polices forced the Commission to acknowledge that a moderate deregulation of control could lead to positive consumer benefits.

The FCC was still not at a point of using explicit economic theory to reach their conclusions for these matters. In the following years, there would be some evidence of an economic-oriented mindset at the agency. These decisions, coupled with the breakup of AT&T, likely changed the FCC's attitude towards economic analysis.

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66. *Id.*
67. *Id.*
68. *Id.*

4. Computer Inquiry I (1970)

Perhaps the most notable example of the agency's early use of economic analysis to inform its policy was the FCC's treatment of the emerging technology of computer networking. By 1966, mainframe computers were an American reality. Not only were computers being used to process data in previously impossible ways, but they were also being used to support the telecom network. Complications began to arise when it became clear that computers could perform both functions simultaneously, and the FCC needed to understand where regulation of these devices and services would fall.

There were two main problems: The first was that the computers performed an unregulated function similar to an existing regulated service: telegrams. The telegram network would operate in a fashion similar to modern-day servers. Living operators, upon receiving a message, would pass along the message to the next node until finally reaching its destination. Mostly provided by Western Union, the FCC had regulated this service since the Communications Act of 1934.[69] Mainframe computers, which could be connected to the ends of existing telephone lines, could do this automatically using the existing phone-line infrastructure.

The second problem was how to regulate common carriers, which often had excess computing power from computers normally used to support their telecom networks. Naturally, these carriers desired to sell this surplus as a service. Under normal circumstances, this would be a non-issue to the FCC, but AT&T was a protected monopoly under their jurisdiction. The FCC had to address public concerns that common carriers could "subsidize their data processing operations with revenues and resources available from their regulated services."[70]

As in previous scenarios, the FCC called for public commentary on the matter. Instead of relying solely on public commentary, as it had in the past, the FCC additionally commissioned the Stanford Research Institute (SRI) to study the problem in detail from an economic and technical perspective.[71] After reviewing the public commentary, SRI conducted their own economic analysis of the issues and presented their findings to the FCC in a series of seven reports. They reached three conclusions: (1) That "data communication services" were rapidly growing and FCC action may not be required (but should be studied further); (2) that data processing services would benefit from free entry and unregulated competition by non-carriers; and (3) that allowing common carriers to enter the data processing field could be problematic.[72]

SRI's economic analysis of the emerging markets was critically important, because the FCC's policy prescriptions were based on the market in which each service was perceived to

69. Robert Cannon, *The Legacy of the Federal Communications Commission's Computer Inquiries*, 55(2) FED. COMM. L. J. 170 (2003).

70. *Id.* ¶25.

71. *In the Matter of Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities, Tentative Decision,* ¶3 (Computer I, Tentative) (1970), *available at* http://hdl.handle.net/2027/msu.31293012269308.

72. *See* Donald Dunn, *Policy Issues Presented by the Interdependence of Computer and Communications Services,* __ LAW & CONTEM. PROBLEMS 369-88 (1969), *available at* http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3248&context=lcp.

exist. Largely following the SRI report's recommendations, the FCC concluded "that the offering of data processing services is essentially competitive and that... there is no public interest requirement for regulation by government of such activities."[73] Computer services were to be put into two categories: "Pure communication" and "pure data processing." The former was where a message was transmitted over the network with no change in content or form, while the latter involved computers that stored, retrieved, sorted, merged, and calculated data.[74] The FCC was unsure what to do with marginal cases, where there was "an offering of service which combines Remote Access data processing and message-switching to form a single integrated service."[75] To address this ambiguity, they created a "hybrid" category that they would evaluate on a case-by-case basis. This grey area eventually consumed the rule and lead to Computer Inquiry II.

On the issue of common carriers competing in the data processing market, the FCC reasoned it was within their powers to bar AT&T from competing in a non-regulated market, but elected not to do so. The agency instead required that a common carrier could offer data processing only under a fully separate subsidiary.[76]

Computer Inquiry I is thus a clear example of the FCC calling for an impartial economic analysis of a technical situation, and then basing policy on the estimated costs and benefits of intervening in a market. Their economic reasoning was also outlined in a statement of principles within the *Inquiry*:

> In this country, we rely upon the 'free enterprise' system with the maximum possible latitude for individual initiative to enter into any given enterprise and compete for the available business... Government intervention and regulation are limited to those areas where there is a natural monopoly, where economies of scale are of such magnitude as to dictate the need for a regulated monopoly, or where such other factors are present to require governmental intervention to protect the public interest because of a potential for unfair practices exists.[77]

We can see an intriguing rationalization at play: Based on the SRI reports, the FCC concluded that computers had no natural monopoly, although they were predicated on the existence of a telecom network. This meant that they were outside the ambit of the FCC. However, the network itself was still a natural monopoly under AT&T, and thus needed the FCC's guiding hand.

5. Computer Inquiry II and the Office of Plans and Policy (1980)

Perhaps the most significant indicator of the growing popularity of economic analysis at the FCC was a staffing change that would shape *Computer Inquiry II* and all policy that followed it. Under the direction of FCC Chairman Charles Ferris, the Commission officially embraced economics by retooling the Office of Plans and Policy (OPP) to be the in-house, economic think-

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73. Computer I, Tentative ¶20
74. *Id.* at 174.
75. *Id.* ¶15.
76. Cannon, *supra*, 178.
77. Computer I, Tentative ¶19

tank of the FCC, which previously had no real internal economic division. Derthick and Quirk (1985) describe the economic enlightenment as follows:

> [Ferris] enlarged the functions of the FCC's Office of Plans and Policy and naming an economist to head it. Both this economist, Nina W. Cornell, and Ferris's general counsel, Robert R. Bruce, were strongly critical of traditional public utility regulation; as such, they exemplified the 'latest and best thinking.' ... When Cornell and Bruce, as generalist in favor of procompetitive deregulation were joined by a Common Carrier Bureau chief who shared that objective, the way was prepared for the outcome of the Computer II inquiry in the spring of 1980. This outcome represented a sweeping retreat from traditional public utility regulation, with its focus on rate setting, and the embrace instead of a structural approach to preventing predatory conduct..."[78]

OPP was a major contributing force to the FCC's shift to embracing economic analysis. OPP immediately set to work and began production of the FCC's 46 economic working papers—a practice that continued until 2012 (a potential end of economics at the FCC).[79] In its first year of operation under its new mandate, OPP produced four working papers alone that centered on the themes of deregulation, competition, and analyzing telecom policy from an economic standpoint.[80] OPP would form the economic core of the FCC, and would produce economic analysis until 2003, when it would be rebranded as the Office of Strategic Planning and Policy Analysis.[81]

Meanwhile, the "hybrid" cases outlined in *Computer Inquiry I* had become a problem for the FCC. Not only were there a multitude of services that fell into this category, but the cost of computer equipment began to plummet as its complexity exploded. Microcomputers began to appear in consumer phones. The first demonstrations of what ultimately would become the Internet were debuted to the public in 1972. A new framework was needed.[82]

The FCC responded by redefining the market into two categories: Basic and Enhanced Services. Basic transmission services were defined as those that were "limited to the common

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78. MARTHA DERTHICK & PAUL QUIRK, THE POLITICS OF DEREGULATIONS 79 (Brookings Institution Press 1985).

79. *See the FCC's Repository of Working Papers, available at* https://www.fcc.gov/reports-research/working-papers

80. *See* Cornell, Kelly & Greenhalgh, *Social Objectives and Competition in Common Carrier Communication: Incompatible or Inseparable?*, FCC OSP Working Paper 1 (1980); Douglas Webbinick, *Frequency Spectrum Deregulation Alternatives*, FCC OSP Working Paper 2 (1980); Duvall & Pelcovits, *Reforming Regulatory Policy for Private Line Telecommunications Services: Implications for Market Performance*, FCC OSP Working Paper 4 (1980); Brown & Gordon, *Economics and Telecommunications Privacy: A Framework for Analysis*, FCC OSP Working Paper 5 (1980)

81. *See FCC 2002 Annual Program Performance Report* and *FCC 2003 Annual Program Performance Report*, available at https://transition.fcc.gov/Reports/ar2002.pdf and https://transition.fcc.gov/Reports/ar2003.pdf

82. In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Tentative Decision and Further Notice of Inquiry and Rulemaking ¶10-12 (Computer II, Tentative) (1979), in Federal Communications Commission Reports, Volumes 72 Second Series 358 (1979), available at http://hdl.handle.net/2027/msu.31293012269761

carrier offering of transmission capacity for the movement of information."[83] In other words, "the direct analog or digital transmission of voice, data, video, etc."[84] Storage or alteration of data was only appropriate to facilitate the reliable movement of the information. Anything that offered more than that basic service was considered to be an enhanced service.[85]

As before, basic services would fall under the regulation of the FCC, whereas enhanced services would not. Enhanced services were thought to be competitive, as they occupied the same "truly competitive" market as "data processing" did in *Computer Inquiry I*.[86] The FCC also doubled down on its treatment of common carriers in the data-processing market. If AT&T and GTE wished to offer enhanced services, they were required to establish a subsidiary as before.[87] This "relatively clear-cut" line between basic and enhanced services was intended to end any regulatory ambiguity associated with *Computer Inquiry I*'s hybrid cases.[88]

The FCC reached this decision "based on the voluminous records compiled in this proceeding."[89] Although it did not directly commission an analysis as it did in *Computer Inquiry I*, the FCC did rely on economic theory for its major decisions. The Commission routinely cited economist Alfred Kahn, "one of our country's leading authorities in regulatory economics," for his work *The Economics of Regulation* (1971), which examined how competition affected innovation.[90] The FCC also cited academic literature on predatory-pricing practices,[91] other economic papers on monopoly and innovation,[92] and on how bundling restricts the choices of consumers.[93]

6. Computer Inquiry III (1986)

A similar, if less revolutionary, economic approach was used for *Computer Inquiry III*. Following a settlement with the Department of Justice, by 1984, AT&T had divested its local service operations, forming the Regional Bell Operating Companies (RBOCs). The Domain Name System (DNS) was introduced in 1985, and the Internet was on the cusp of becoming a reality.

The problem this time was not the definition of services, but the inability of the newly formed RBOCs and other carriers to enter the enhanced services market. *Computer Inquiry II* required the structural separation of AT&T and GTE from any enhanced services. Originally the

83. In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry). Final Decision, ¶93 (Computer II, Final) (1980), in Federal Communications Commission Reports, Volumes 77 Second Series 384 (1980), *available at* http://hdl.handle.net/2027/msu.31293000344147
84. *Id.*
85. *Id.*
86. *Id.* ¶128
87. Cannon, *supra*, 184.
88. Computer II, Final ¶97
89. *Id.* ¶5
90. Computer II, Final ¶212
91. Computer II, Final ¶153
92. Computer II, Final ¶212, n. 84, 85.
93. Computer II, Final ¶149, n. 55.

FCC had applied this policy to the RBOCs, but the Commission "found that the costs of those requirements in lost innovation, inefficiency, and delay outweigh their benefits."[94] The FCC also sought to prove more "competition-oriented" regulation, which would allow dominant carriers to offer enhanced services. The short term solution to this was to allow the RBOCs to offer services, but only if they provided a "Comparatively Efficient Interconnection (CEI) of third party enhanced service option to the customer.[95] The longer-term solution was the implementation of "Open Network Architecture" (ONA), which would require the RBOCs to unbundle their basic service offerings for all enhanced service providers.[96]

All of these decisions were based on a practical cost-benefit analysis of maintaining structural separation, a reflection of economics' newfound influence at the Commission. The FCC not only investigated the costs and benefits of structural separation,[97] but it also used economic analysis to investigate alternative regulatory approaches and their potential effects.[98] Although several of the Commission's decisions in *Computer Inquiry III*, including the ONA ruling, faced legal hurdles in the Ninth Circuit Court of Appeals, and the ONA ruling was eventually sent back to the FCC, the Commission maintained its overall deregulatory thrust.[99]

C. Peak of Economic Analysis in the 1990s and Aughts

The 1990s were the high water mark of economics at the FCC. Through Congressional action, the standard method of assigning radio spectrum licenses by regulatory fiat (often with strong political influence) gave way to allocating spectrum by auction, as suggested by FCC economists Evan Kwerel and Alex Felker[100] (based on earlier work by Ronald Coase). The FCC adopted a light-touch regulation of rapidly growing wireless service and held fast to the strict separation between regulated basic service (voice telephony and pure data transmission) and unregulated "enhanced" services (data processing, especially Internet), established by the earlier *Computer Inquiry I, II*, and *III*. This economic mindset was built into the Telecommunications Act of 1996, which was designed to create a procompetitive deregulatory framework intended to encourage private-sector competition by opening all markets to competition and relying on market forces instead of regulation wherever possible.[101]

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94. FCC, *In the Matters of Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, ¶2 (Computer III) (1986), in Federal Communications Commission Reports, Volumes 104 Second Series 958 (1986), *available at* http://hdl.handle.net/2027/inu.30000038968941.

95. *Id.*

96. Cannon, *supra*, at 201.

97. Computer III, ¶80-99.

98. Computer III, ¶102.

99. Cannon, *supra*, at 202

100. Evan Kwerel & Alex Felker, *Using Auctions to Select FCC Licensees* (1985), FCC OSP Working Paper #16, *available at* https://www.fcc.gov/reports-research/working-papers/using-auctions-select-fcc-licensees.

101. At this time, only voice access line service was arguably a monopoly; most other voice services were substantially competitive (or getting there). Hence, the emphasis in the Telecommunications Act on voice access line policy.

1. Auctions Replace Beauty Pageants (1993)

Economic influence at the Commission would mark the end of zero-price spectrum. The key to arriving at the right price was auction design. Not only had economists steered the FCC toward the efficient policy, the implementation of that policy also required the input of economists. Although the FCC's lotteries technically satisfied the Coase Theorem—in which an improperly allocated good can eventually end up in the hands of the entity that values it the most if transaction costs are low—it took years for the secondary markets to distribute these licenses accordingly.[102] One paper estimated that the "ten year delay in cellular licensing cost the U.S. economy the equivalent of two percent of Gross National Product."[103]

In 1993, Congress amended the Communications Act of 1934 to require the FCC to award spectrum based on competitive bidding.[104] Congress specifically required the FCC to design the allocations in a way to fulfill its objectives of "promoting economic opportunity and competition and ensuring that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants."[105] The Commission developed a simultaneous multiple-round bidding system, which successfully fulfilled the new mandate.[106] This would allow firms to intelligently shift their bids to other areas of spectrum if their first choice became untenable.[107] The new system was widely considered a success and is used today.

The first auction took place in 1994, and concerned nationwide licenses for narrowband personal communications services such as paging; six bidders won ten licenses, and auction receipts totaled $650 million.[108] One indication of the program's success is the decline of the secondary market transactions. Between 1994 and 1996, only 12 licenses were resold, compared to 75 resales in the 1991 cellular license lottery.[109] Another sign of success is that between 1994 and 1997, over half of all spectrum licenses went to small business and new entrants to the telecommunications markets.[110]

It is important to remember that while the FCC was given the mandate to shift to an auction system by the legislature, the system was largely based on the work of the OPP economists who called for an auction system in previous years.

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102. *Id.*

103. *See* Jeffrey Rohlfs, Charles Jackson & Tracey Kelley, Estimate of the Loss to the United States Caused by the FCC's 14 Year Delay in Licensing Cellular Telecommunications, National Economic Associates, Inc. (1991).

104. H.R. 2264 §6002 (a) ("If mutually exclusive applications are accepted for filing for any initial license or construction permit which will involve a use of the electromagnetic spectrum described in paragraph (2), then the Commission shall have the authority, subject to paragraph (10), to grant such license or permit to a qualified applicant through the use of a system of competitive bidding that meets the requirements of this subsection").

105. *Id.*

106. *The FCC Report to Congress on Spectrum Auctions*, at 3 (1997) (hereinafter *FCC Spectrum Report*).

107. *Id.* at 25.

108. FCC, Auction 1: Nationwide Narrowband (PCS), *available at* http://wireless.fcc.gov/auctions/default.htm?job=auction_summary&id=1.

109. *FCC Spectrum Report*, at 23.

110. *Id.*

2. The Telecom Act of 1996 Places Competition on the Pedestal

The passage of the 1996 Telecommunications Act fundamentally reshaped the way the FCC approached regulation. The Act had a single goal: "To promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[111] The word "competition" and its derivatives appear 61 times throughout the 106 page document. To implement these objectives, the FCC would be forced to incorporate economics into the heart of its decision-making.

The Act noted specifically that "The Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum of government regulation," and charged the FCC with a number of objectives in promoting the deployment of "advanced telecommunications" across the United States"[112] The FCC's new mandate was to promote policies favoring "vigorous economic competition, technological advancement, and promotion of the public interest, convenience, and necessity."[113]

3. Regulatory Humility Part 1: Hands Off the Internet

The unregulated treatment of the Internet was not an accident. It stemmed from the view developed from the Computer Inquiries that the "the Internet" in composite was a collection of enhanced services, based upon the physical structure of regulated basic services. In 1999, OPP economist Jason Oxman published a working paper to identify what the agency had done right.[114] Oxman noted that the Internet owed much of its success to the FCC's consistent refusal to regulate any part of it. He presciently noted that there would be pressures in the future to regulate:

> Although the FCC has a long tradition of encouraging the growth and development of the Internet by nonregulation, deregulation, and certain affirmative market-opening policies, there are frequent calls from many sources for the FCC to become more heavily involved in Internet regulation. ...The challenge to the FCC... is to ... further the Commission's longstanding goal of promoting competition, not regulation, in the marketplace.[115]

There are a few concrete examples of the FCC taking direct "un-regulatory" action. Before Internet Service Providers (ISPs) were a reality, the FCC decided in 1983 to exempt "enhanced service providers" from usage-based access chargers, so that access to the network would not face charges similar to long distance calls. Because the FCC decided that these

111. 47 U.S.C.Preamble.

112. *Id.* §706 (c)

113. *Id.* §257 (b)

114. Jason Oxman, *The FCC and the Unregulation of the Internet*, FCC OPP Working Paper #31 (July 1999), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp31.pdf.

115. *Id.* at 21.

providers were not common carriers, they did not warrant the same per-minute pricing treatment, and instead mandated essentially a flat end-user rate.[116]

Another example occurred in 1997, when the FCC decided that ISPs were not required to make contributions to the Universal Service Fund USF, a public-works program to bring physical telecommunication lines to rural areas. This reinforced the notion that ISPs were to remain unregulated.[117]

Most importantly, the FCC decided that it would not regulate the deployment of cable modem services as common carriers.[118] (Alas, telco-based DSL services were not so fortunate.) This decision would have profound implications for the growth and development for cable-based Internet services. This would have a profound effect on investment. Between 1998 and 1999, cable modem connections had grown from 100,000 to 750,000.[119] Following a legal battle culminating in 2005, the FCC would extend this deregulation to DSL services, bringing it on equal footing as the "Commission's light regulatory treatment of cable modem service."[120]

As final testament to the FCC's un-regulatory policy towards the Internet, in 1999, then-Chairman William Kennard declared:

> The best decision government ever made with respect to the Internet was the decision that the FCC made 15 years ago NOT to impose regulation on it. This was not a dodge; it was a decision NOT to act. It was intentional restraint born of humility. Humility that we can't predict where this market is going. [121]

This sentiment is in concert with Oxman, who concludes that part of the success of the Internet was thanks to the FCC's policy of free competition. This decision to un-regulate was based on the economic philosophy that flowed from a number of factors, including *Carterfone*, *Hush-A-Phone*, and *Computer Inquiries*.

4. Regulatory Humility Part 2: Wireless

A similar un-regulation story played out in the nascent wireless industry. In the 1970s, the FCC had no notion of how popular wireless telephony would become. The Commission had initially planned to license only one cellular telephone service, which would be operated by the

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116. *See* FCC, In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (1983), in Federal Communications Commission Reports, Volumes 97 Second Series 682 (1983), available at http://hdl.handle.net/2027/msu.31293106457686

117. *Id.* at 18.

118. *Id.* at 21.

119. William E. Kennard, *The Road Not Taken: Building a Broadband Future for America*, remarks at the National Cable Television Association, (June 15 1999), *available at* https://transition.fcc.gov/Speeches/Kennard/spwek921.html

120. *FCC Eliminates Mandated Sharing Requirement on Incumbents' Wireline Broadband Internet Access Services*, FCC News (August 5, 2005), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-260433A1.pdf

121. *Id.*

local telephone company. To "promote competition" in their monopoly market, in 1981, the FCC increased the number of licenses allocated to two—adding a completely unaffiliated company in addition to the local one.[122]

Unsurprisingly, this intervention did not yield competitive outcomes. Later, the FCC somewhat humorously noted that "The duopoly nature of cellular service made it less than fully competitive."[123] In 1995, the Commission awarded new licenses by auction.[124] They allocated enough spectrum to ensure "at least three, and possibly as many as six" new competitors in each market.[125]

In addition to this measure, the FCC systematically removed regulatory barriers to wireless deployment. Similar to the deployment of cable (and later broadband), the FCC decided not to regulate cellular service under Title II, and pre-empted state regulation of entry and rates.[126] This was a part of the FCC-wide trend towards reduced regulation.

The results were tremendous. In the FCC's first Commercial Mobile Services Report to Congress in 1995, there were 25 million cellular subscribers.[127] By the fifth report in 2000, that number was over 86 million.[128] The 2000 report also noted that the cellular industry was not only competitive, but that prices to consumers had fallen by 10 to 20 percent from the previous year.[129]

This decision was reached on clear economic grounds. The 1995 Memorandum and Order on wireless reads like an economic report. After an executive summary of the technology, market, and decision, the paper launches into a technical and economic study of the markets of each wireless category. In the discussion of competition, the report incorporates analyses of prices, tax returns, volumes, cash flows, and even regression analysis on estimated rates of returns.[130] It is clear from this document that the justification for the liberalization of the wireless markets was based on a pragmatic economic analysis of competition.

5. The TELRIC Quagmire (1996-2005)

122. In the Matter of Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services (First Report), 1 (1995), *available at* http://wireless.fcc.gov/auctions/data/papersAndStudies/fc95317.pdf.

123. Id. ¶4.

124. *Id.*

125. *Id.*

126. *Id.* ¶5.

127. *Id.*

128. In the Matter of Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services (Fifth Report), 87 (2000), *available at* http://wireless.fcc.gov/auctions/data/papersAndStudies/fc000289.pdf

129. *Id.* at 4-5.

130. In the Matter of Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services (First Report) (1995).

One provision of the 1996 Act was the unbundling of local carriers' networks, requiring carriers to offer competitors access to its network elements, who in turn could resell access under their own brand name and price.[131] This provision required the FCC to develop a pricing method that approximated competitive outcomes, which the FCC interpreted to mean prices that approximated the incumbent local exchange carrier's total element long-run incremental cost (TELRIC). Homogeneous-product competition among resellers was intended to drive retail prices down to the TELRIC rate.

To induce an incumbent to voluntarily cede a retail customer to a rival, the access price would have to make the incumbent indifferent between serving as a wholesaler and serving as a retailer. Mathematically, the access price must be set equal to the incumbent's forgone retail margin. While the FCC could compel a local carrier to set its access price below its forgone retail margin—that is, below the market-determined access price—doing so would dampen incentives on all parties (access provider and access seeker) to innovate and invest.[132] Forcing the resale of network at below-market rates necessarily means there is less of an incentive to develop networks for the future, in addition to other negative consequences.[133]

The FCC's initial report developed national TELRIC pricing principals as a methodology that each state could adjust for its specific use.[134] Notwithstanding the potential dynamic efficiency losses from unbundled access, we see the clear influence of economics in the rate-setting process. Section VII of the FCC's document, which is dedicated to the pricing methodology of TELRIC, draws from a wide range of commentary and economic literature to inform its methodology.[135] In particular, the Commission took into account a host of cost variables, including forward-looking common costs, reasonable returns on investment, and profit.[136] The model they developed included price ceilings for each state,[137] and specifically listed the resale-pricing standard.[138]

In 1999, this unbundling regime was expanded to require local exchange carriers (LECs) to share a portion of their lines with resellers of DSL service at regulated rates ("line sharing"). Although DSL was not reclassified as an information service until August 2005, the appeals courts largely disemboweled the FCC's common-carrier regime well before 2005. The D.C. Circuit vacated the FCC's *Line Sharing Order* in May 2002,[139] and the FCC eliminated line

131. Tom Jorde, Gregory Sidak & David Teece, *Innovation, Investment, and Unbundling*, 2 YALE J. ON REG. 1-37 (2000) *available at* http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1283&context=facpubs.

132. *Id.* at 4-5.

133. *See* Robert S. Pindyk, *Mandatory Unbundling and Irreversible Investment in Telecom Networks*, (2003), MIT Sloan School of Management Working Paper 4452-03, *available at* http://digilander.libero.it/vergalli/pdf/19.pdf.

134. In the Matter of Implementation of the Local Competition Provisions in the Telecommunications act of 1996, Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, First Report and Order, ¶¶6, ¶625 (1996), *available at* https://transition.fcc.gov/Bureaus/Common_Carrier/Orders/1996/fcc96325.pdf.

135. *Id.* ¶618.

136. *Id.*

137. *Id.* Tables A, D.

138. *Id.* §51.609.

139. US Telecom Ass'n v. FCC, 290 F. 3d. 554, 585 (D.C. Cir. 2004).

sharing as an unbundled network element in August 2003.[140] Other portions of the FCC's unbundling rules were vacated even earlier. While TELRIC was ultimately a legal and regulatory quagmire brought on by provisions of the 1996 Act, the FCC can be credited with attempting to determine mandated prices in an economically coherent way.

6. The Brewing War Over Net Neutrality (2005-10)

As Oxman predicted, the FCC was constantly showered during the aughts with recommendations from self-styled consumer interest groups. Around the turn of the century, the burning issue was "Open Access"—establishing rules that cable systems had to open up their facilities to virtual ISPs, similar to how mandated unbundling at regulated rates opened telephone access lines (including DSL service) to competitive local exchange carriers.[141] One author (Faulhaber) recalls his time as Chief Economist at the FCC (in 2000), when he found a television crew filming a group of about fifteen young people parading around the FCC's front door with signs and placards demanding the FCC mandate Open Access. Upon questioning, group members had only a hazy understanding of the issues, admitting they were students at local universities who had been hired by a consumer group (again, hazy on the name) to parade around with said signs. The television crew soon packed up and left, and the protestors left soon afterwards. At the time, such pressure was routine, but if there were no supporting economic data to back up the demands, the FCC gave those efforts short shrift.

Fast forward five years, and "Open Access" had morphed into "Network Neutrality," largely based on the seminal article by Wu.[142] Under Chairman Michael Powell, the FCC published four principles of net neutrality[143] under the agency's Title I authority. The first net neutrality case involved the Madison River Telephone Company, which had blocked a provider of voice telephony over the Internet in its North Carolina operations. The FCC resolved the issue quickly, with a fine and commitment from the firm not to engage in further blocking. A second case, involving Comcast blocking BitTorrent (a peer-to-peer video file sharing application) was much more prominent in the news in 2007-08. Comcast voluntarily agreed to change its network management practice, but the Commission nonetheless proceeded months later to find Comcast's practice to be unlawful.

Comcast sued the FCC, arguing that the four "principles" it had adopted earlier did not have the force of regulation. The D.C. Circuit did not reach that conclusion but agreed with Comcast that the FCC had not established legal authority to regulate Internet practices,[144] much to the chagrin of consumer groups who had lobbied hard for network neutrality regulation. The FCC understood that an actual regulation was required to put network neutrality in place, and

140. Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338 et al., FCC 03- 36, 18 FCC Rcd 16978 (Aug. 21, 2003) (Triennial Review Order), ¶199.

141. The requirement that telephone companies had to unbundle and resell DSL service was eventually rescinded. However, most European countries mandate resale of broadband facilities (often a state-owned monopoly) to virtual ISPs.

142. Tim Wu, *Network Neutrality, Broadband Discrimination*, 2 J. TELECOM. & HIGH TECH. 141 (2003).

143. In brief, the principles were: Transparency, No blocking or unreasonable discrimination, reasonable network management, and lighter rules for mobile.

144. Comcast v. FCC, ___ F.3d ___ (D.C. Cir. 2010).

opened the Open Internet proceeding, to satisfy the Court's requirement that an actual regulation, as opposed to an informal statement of principle, was needed for enforcement purposes.

The FCC responded to this loss with a curt and curious statement: "Today's court decision invalidated the prior Commission's approach to preserving an open Internet. But the Court in no way disagreed with the importance of preserving a free and open Internet; nor did it close the door to other methods for achieving this important end."[145] In other words, the FCC was committed to its position. It would find a way to enforce its version of net neutrality, one way or another.

The 2010 *Open Internet Order* (*2010 OIO*) was the FCC's codified rulemaking on the matter. After seeking a public commentary period in which "100,000 commenters have provided written input," the Commission stated that their "economic analysis demonstrate, however, that the openness of the Internet cannot be taken for granted, and that it faces real threats."[146]

What were these threats? In the FCC's initial inquiry, the Commission cited developments in network technology that allowed providers to "offer different qualities of service to different traffic (service differentiation), which enables charging different prices for different traffic (price differentiation)."[147] Such disparate treatment would allow ISPs to prioritize packets either based on origin or on class. The example given was Skype, which required low latency and reliable delivery.

There was general concern that, "absent appropriate oversight, broadband Internet access service providers could make the Internet less useful for some users or applications by differentiating traffic based upon the user, the application provider, or the type of traffic."[148] Critically, these potential problems were not realized. For example, in the *2010 OIO*, the FCC wrote that "the record in this proceeding reveals that broadband providers potentially face at least three types of incentives to reduce the current openness of the Internet."[149] These claims were not grounded in economic analysis done by the Commission or any economist, but instead were based on the comments of DISH, Google, Netflix, Skype, and other vested interest groups.[150] Critics of the Commission's approach pointed to the fact there was no evidence of this practice adversely affecting users; they asserted that net neutrality is "a solution in search of a problem."[151]

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145. FCC Statement on Comcast v. FCC Decision (April 6, 2010), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-297355A1.pdf.

146. In the Matter of Preserving the Open Internet Broadband Industry Practices, Report and Order (hereinafter *2010 OIO*), ¶4 (2010), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-10-201A1_Rcd.pdf

147. FCC, *In the Matter of Preserving the Open Internet Broadband Industry Practices, Notice of Proposed Rulemaking* (2010 Open Internet Order Proposed Rulemaking), ¶57 (2009)

148. *Id.* ¶60.

149. *2010 OIO* ¶21 (emphasis added).

150. *Id.* n.11-21

151. *Id.* See Dissenting Statement of Commissioner Meredith Attwell Baker at 193.

Lacking evidence of harm, the Commission nonetheless determined that the benefits of pursuing an "Open Internet" policy exceeded the costs. Harkening back to the FCC's early years, the issue was settled on public commentary of non-economic, vested entities. No economic analysis of the situation took place. Of the 24 citations the Commission lists in its "cost and benefit analysis" in the *2010 OIO*, not a single citation links to any economically rigorous study of the situation.[152] The Commission's analysis rested on the basis of casual logic and the court of public opinion.

Despite its flaws, one redeeming quality of the *2010 OIO* was its treatment of "reasonable discrimination." The Order did not flat-out ban network shaping, so long as the broadband provider was transparent and gave the end-user some control over this shaping.[153] In addition, the Commission did not prevent tiered or usage-based pricing packages, so that lighter users of Internet services would not subsidize heavy ones.[154] In sum, the Commission offered a discrimination policy of "reasonableness" based on "achieving a legitimate network management purpose."[155] This reluctance to ban practices that might be motivated for pro-competitive reasons would melt away in the FCC's subsequent populist period.

III. The Stripping of Economics from FCC Decision-Making

When it comes to regulating broadband, the Telecom Act's mandate leaves the FCC with a narrow role. The Act could not be clearer regarding regulation of the Internet: "The Internet and other interactive computer services have flourished, to the benefit of all Americans, *with a minimum of government regulation.*"[156] In light of this finding, the Act declares the policy of the United States is "to preserve the vibrant and competitive free market ... for the Internet and other interactive computer services *unfettered by Federal or State regulation.*"[157] Congress also made clear that information services are among the interactive computer services that should remain free from regulation, and that services that "provide[] access to the Internet" are information services.[158]

The focus of the Act was regulating wireline voice services, once the centerpiece of communications but now a dying industry. Soon after the Act's passage, landline connections began to be displaced by wireless ones.[159] Even voice over wireless is being replaced with VoIP, text messages, emails, and direct messaging through social media sites. This shift in the way we communicate severely limits the FCC's jurisdiction and thus its reason for being. Put differently, the evaporation of the core businesses subject to FCC oversight minimizes the relevancy of the FCC in the Internet era. Without a new mandate from Congress, the agency chose in its 2015

152. *Id.* at 23-27.
153. *Id.* at 40.
154. *Id.*
155. *Id.* ¶82.
156. 47 U.S.C. § 230(a)(4)(1996) (emphasis added).
157. 47 U.S.C. § 230(b)(2)(1996) (emphasis added).
158. 47 U.S.C. § 230(e)(2)(1996).
159. Kevin Caves, *Quantifying Price-Driven Wireless Substitution in Telephony*, 35 TELECOM. POL'Y 984-998 (2011).

Open Internet Order to embrace populism, grounding its newfound "authority" in the will of the people.

A. The Shunning of Cost-Benefit Analysis in the Wheeler Era

Economics guides regulators to act only when confronted with an empirically demonstrated market failure (such as monopoly or an externality). If there is no market failure to correct, then there can be no benefit to any new regulation, only costs, and the regulator should stay out. After identifying a perceived market failure and proposing a remedy to address it, economics teaches us that the proposed remedy must pass a cost-benefit test. A regulatory agency may fail a cost-benefit test in three ways. First, the agency can overstate the benefits of its proposed remedy. Second, the agency can understate the costs of its proposed remedy. Third, and a bit less obvious, the agency can ignore a less-restrictive alternative that would generate the same purported benefits but at a lower cost, thereby rendering its proposed remedy inefficient. For example, if the net benefits of a proposed remedy are $10 million per year, but a less-restrictive alternative generates net benefits of $15 million, then the proposal fails a cost-benefit test, even though the proposed remedy would have generated benefits in excess of costs.

Eschewing the lessons of cost-benefit analysis in particular and economics generally, the FCC has steered towards a new era of populism during the Wheeler administration. Three decisions from 2013-15 make clear that economics has been all but removed from the FCC's decision-making process. We briefly review those decisions, contrasting the policies implied by economic reasoning to those adopted by the FCC.

1. The *2015 Open Internet Order*

Paid prioritization arrangements, which involve a payment by an edge provider to an ISP for special handling, could be beneficial for all parties, including end users, so long as edge rivals that forgo such offers are not worse off in *absolute* terms; by design, edge rivals that forgo paid prioritization are worse off in *relative* terms. This recognition puts the lie to the "zero-sum hypothesis" peddled by net neutrality proponents—namely, that any priority arrangement must come at the expense of non-prioritized traffic.[160] Paid prioritization has existed in other portions of the network, and can be readily engineered to keep others whole.[161]

There are four options to dealing with paid prioritization arrangements: (1) no sector-specific regulation, with a reliance instead on antitrust; (2) case-by-case adjudication, with a presumption against any such deals; (3) case-by-case adjudication, with a presumption in favor of any such deals; and (4) a blanket prohibition on all paid prioritization deals. Assuming the case for regulation were satisfied, an economist would tend to favor case-by-case treatment over blanket bans, as paid prioritization arrangements can be motivated for legitimate business

160. For an accessible technical explanation of how priority on the Internet works, see George Ou, Oct. 11, 2014, available at https://plus.google.com/+GeorgeOu/posts.

161. *See*, e.g., Peter Rysavy remarks, at 26:40, *available at* http://www.c-span.org/video/?322383-1/discussion-mobile-telephony-regulation.

reasons. By extinguishing procompetitive arrangements—the proverbial tossing the baby with the bathwater—a blanket ban would generate an intolerably high number of errors (alongside the associated error costs). With respect to the optimal setting of the presumption, antitrust dictates that the presumption should be in favor of vertical arrangements, with the burden of proof on some outside party (typically, an excluded rival). Economics dictates that the burden (and hence the proper presumption) should fall on the party in the most efficient position to gather the evidence. From this vantage point, an edge provider claiming that its packets were degraded (in an absolute sense) as a result of not taking a paid-priority offer, would be in the best position to prove it.

From this list of policy options, the FCC's *2010 OIO* elected option (3), by rejecting a blanket prohibition in favor of case-by-case treatment,[162] but declaring that paid prioritization deals "would raise significant cause for concern" and were "unlikely [to] satisfy the no-reasonable-discrimination standard."[163] This presumption, among other part of the *2010 OIO*, was appealed by Verizon. In *Verizon v. FCC*, the D.C. Circuit ruled that such a presumption effectively barred pay-for-priority deals and was tantamount to common carriage: "If the Commission will likely bar broadband providers from charging edge providers for using their service, thus forcing them to sell this service to all who ask at a price of $0, we see no room at all for 'individualized bargaining.'"[164]

Critically, the D.C. Circuit laid out a legal path for the FCC to regulate pay-for-priority deals without resort to common carriage:

> Given these principles, we concluded that the data roaming rule imposed no per se common carriage requirements because it left "substantial room for individualized bargaining and discrimination in terms." The rule "expressly permit[ted] providers to adapt roaming agreements to 'individualized circumstances without having to hold themselves out to serve all comers indiscriminately on the same or standardized terms.'" Id. That said, we cautioned that were the Commission to apply the "commercially reasonable" standard in a restrictive manner, essentially elevating it to the traditional common carrier "just and reasonable" standard, see 47 U.S.C. § 201(b), the rule might impose obligations that amounted to common carriage per se, a claim that could be brought in an "as applied" challenge.[165]

So long as broadband providers were free to bargain individually with edge providers, the court signaled, these arrangements could be regulated under the FCC's 706 authority along the lines of

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162. *2010 Open Internet Order*, ¶76 n. 229 ("The Open Internet NPRM proposed a flat ban on discrimination and interpreted that requirement to prohibit broadband providers from "charg[ing] a content, application, or service provider for enhanced or prioritized access to the subscribers of the broadband Internet access service provider." Open Internet NPRM, 24 FCC Rcd at 13104–05, paras. 104, 106. In the context of a "no unreasonable discrimination" rule that leaves interpretation to a case-by-case process, we instead adopt the approach to pay for priority described in this paragraph.").

163. *2010 Open Internet Order*, ¶76.

164. Verizon v. FCC, 740 F.3d ___ (D.C. Cir. 2014) [[at 59-60]]

165. *Id.* at ___ (citing Cellco, 700 F.3d at 548–49).

Cellco, a case distinguished by the D.C. Circuit from common carriage in 2012.[166]

How can such freedom be established? By flipping the presumption around, so that priority deals are reasonable until a complaining edge provider can prove otherwise. One can envision two types of complaints arising under this case-by-case framework: (1) an edge provider was denied a priority offering that was extended to its rival, or (2) an edge provider who declined priority from a broadband provider suffered an absolute degradation in its quality of service. After a complaining edge provider demonstrates discrimination or degraded service, the burden should shift back to the broadband provider, thereby sparing the edge provider of significant legal expense.

Quarantined from political forces, smart lawyers at the FCC set about drafting rules that would thread this needle—again, without resort to Title II reclassification. The agency released a Notice of Proposed Rulemaking (NPRM) in May 2014, a few months after the D.C. Circuit's ruling, which explained that pay-for-priority deals would be subjected to a "commercially reasonable" standard, and "prohibited under that rule if they harm Internet openness."[167] In other words, such deals were presumed to be commercially reasonable unless an edge provider could prove otherwise. The NPRM also proposed to adopt a rebuttable presumption that a broadband provider's exclusive pay-for-priority deal would be commercially unreasonable. From an economic perspective, those two strokes were brilliant, as they efficiently placed the burden on the appropriate party.

Not so, said John Oliver[168] and millions of angry letters ostensibly submitted to the FCC. (Given the esoteric language of those letters, which invoked Title II authority, a great many likely were form letters generated by public-interest groups clamoring for Title II-based solutions. In November 2014, President Obama called on the FCC to take up the "strongest possible rules to protect net neutrality."[169] Ever since that political groundswell, Wheeler backpedaled from the elegant, light-touch solution of the NPRM, and instead imposed a blanket ban on paid prioritization.[170]

By banning paid prioritization, the FCC violated the standards of cost-benefit analysis in its *2015 OIO* in several ways. First, the *2015 OIO* fails to provide an empirically supported finding of market failure. Second, the *2015 OIO* overstates the benefits of the ban. The *2015 OIO* fails to consider that the profitability of (and thus the incentive to engage in) discriminatory conduct vis-à-vis content providers depends on whether the Internet service provider (ISP) could generate higher profits from the promoted (affiliated) products to cover the lost margins from

166. Cellco Partnership v. FCC, 700 F.3d (D.C. Cir. 2012).

167. See Protecting and Promoting the Open Internet, GN Docket No. 14-28, Notice of Proposed Rulemaking, 29 FCC Rcd ____ (2014) [¶97] (hereinafter *2014 Open Internet NPRM*).

168. *See, e.g*, Ben Brody, *How John Oliver Transformed the Net Neutrality Debate Once and For All*, BLOOMBERG POLITICS, Feb. 26, 2015, *available at* http://www.bloomberg.com/politics/articles/2015-02-26/how-john-oliver-transformed-the-net-neutrality-debate-once-and-for-all.

169. Net Neutrality: President Obama's Plan for a Free and Open Internet, *available at* https://www.whitehouse.gov/net-neutrality.

170. *2015 OIO, supra.*

departing broadband customers. The anticompetitive behavior feared by the Commission has simply not come to pass, which explains why the *2015 OIO* is hard-pressed to cite any recent examples of consumer harm. A very limited number of service disruptions or degradations have actually occurred—among literally millions of opportunities for such behavior—and many of these have been dealt with expeditiously through private negotiations.[171]

Third, the *2015 OIO* understates the costs of the ban. The *2015 OIO* ignores or dismisses the economic evidence of the impact of Title II on investment in the late 1990s and early 2000s, and thereby dismisses the real threat to ISP investment. Rather than ground its findings on economic scholarship, the *2015 OIO* relies instead on the casual empiricism of an advocacy group that operates outside of the constraints of academic reputations, to reach the extraordinary conclusion that telco investment was "55 percent higher under the period of Title II's application" than in the later period.[172] These results hinge on which years are included in the Title II era: If one includes the years 1999 and 2000 as part of the pre-2005 period, then removal of Title II appears to have caused a decline in Bell investment.[173] But those early years are associated with the dot.com boom and long-haul fiber glut, and it is difficult to remove Bell investments in backbone infrastructure from the capex figures.

Fourth, the *2015 OIO* casually dismisses a less-restrictive alternative for handling paid prioritization disputes—namely, case-by-case enforcement—as being too "cumbersome"[174] to enforce, despite the fact that: (1) the *2015 OIO* itself embraces case-by-case review to address interconnection disputes[175] and other conduct such as zero-rating;[176] (2) the *2010 OIO* embraced case-by-case to address paid prioritization disputes; (3) the FCC's May 2014 Notice of Proposed Rulemaking would have permitted ISPs and content providers to engage in "individualized bargaining" subject to ex post review; and (4) the FCC relies upon case-by-case to adjudicate discrimination complaints against traditional video distributors. Why is this form of mild preference different from any other favoritism?

Recognizing this disparate treatment of paid prioritization and interconnection, the *2015 OIO* argues that case-by-case enforcement "is an appropriate vehicle for enforcement where

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171. *See, e.g*, Hal Singer, Mandatory Interconnection: Should the FCC Serve as Internet Traffic Cop?, PPI Policy Brief, May 2014, *available at* http://www.progressivepolicy.org/wp-content/uploads/2014/05/2014.05-Singer_Mandatory-Interconnection_Should-the-FCC-Serve-as-Internet-Traffic-Cop.pdf.

172. *2015 OIO*, ¶414 n. 1210 (citing Free Press Comments).

173. *See, e.g.*, Hal Singer, Three Ways The FCC's Open Internet Order Will Harm Innovation, PPI Policy Brief, May 2015, *available at* http://www.progressivepolicy.org/publications/policy-memo/three-ways-the-fccs-open-internet-order-will-harm-innovation/ (hereinafter *Three Ways*).

174. *2015 Open Internet Order*, ¶19.

175. *Id.* ¶29 ("As a result, commercial arrangements for the exchange of traffic with a broadband Internet access provider are within the scope of Title II, and the Commission will be available to hear disputes raised under sections 201 and 202 on a case-by-case basis: an appropriate vehicle for enforcement where disputes are primarily over commercial terms and that involve some very large corporations, including companies like transit providers and Content Delivery Networks (CDNs), that act on behalf of smaller edge providers.").

176. *Id.* ¶108 ("This no-unreasonable interference/disadvantage standard will operate on a case-by-case basis and is designed to evaluate other current or future broadband Internet access provider policies or practices—not covered by the bright-line rules— and prohibit those that harm the open Internet.").

disputes are primarily over commercial terms and that involve some very large corporations. . ."[177] But interconnection disputes can involve small content providers as well. And if the concern is an asymmetry in litigation resources, the case-by-case regime can level the playing field by shifting evidentiary burdens and providing interim relief. Interestingly, FCC staff economists opined in 2015 that leaving interconnection to market forces could raise or lower welfare, which supports the case-by-case approach.[178] This same logic would apply equally to the case of paid prioritization. But it did not.

The *2015 OIO*'s embrace of a ban presumably pushed the FCC towards its dreaded reclassification decision. Logic dictates that a ban could not be sustained under section 706 of the Communications Act so long as case-by-case with a presumption against such deals could not be sustained under section 706, as indicated by *Verizon*. This dramatic policy reversal begs the question: What happened in the intervening five years that caused the Commission to lose confidence in case-by-case adjudication for paid prioritization? The *2015 OIO* does not give an answer.

It would seem that an overt and pronounced shift in regulatory policy would necessitate a clear and confident finding that such an alternative policy approach toward the Internet would produce better results—more innovation, more investment, and more consumer benefits. When viewed with an economic lens, the *2015 OIO* fails a basic cost-benefit analysis.

Although the *Order* was upheld in a 2-1 opinion by the D.C. Circuit in July 2016,[179] Judge Williams' dissent vindicated our concerns relating to the absence of serious economic analysis. The majority of three-judge panel refused to question the *OIO* on policy grounds or on the economics:

> Critically, we do not inquire as to whether the agency's decision is wise as a policy matter; indeed, we are forbidden from substituting our judgment for that of the agency." Nor do we inquire whether "some or many economists would disapprove of the [agency's] approach" because "we do not sit as a panel of referees on a professional economics journal, but as a panel of generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority."[180]

With economic considerations off the table, the majority narrowly focused on whether the FCC had the legal authority to subject ISPs to common-carrier rules under *Brand X* and *Chevron*.

177. *2015 Open Internet Order,* ¶29 ("As a result, commercial arrangements for the exchange of traffic with a broadband Internet access provider are within the scope of Title II, and the Commission will be available to hear disputes raised under sections 201 and 202 on a case-by-case basis: an appropriate vehicle for enforcement where disputes are primarily over commercial terms and that involve some very large corporations, including companies like transit providers and Content Delivery Networks (CDNs), that act on behalf of smaller edge providers.").

178. D. Bring, et al., *Year in Economics at the FCC: 2014-15*, 47 REV. IND. ORG. 437-62, 404 (2015) ("Going forward, the Commission could choose to allow the interconnection market to work freely, with the possible benefit of lower broadband access rates for consumers, but also the possibility of anti-competitive interconnection rates charged by ISPs due to excessive market power.").

179. U.S. Telecom Ass'n. et al. v. FCC, No. 15-1063 (D.C. Cir. 2016).

180. *Id.* at 23 (citations omitted).

In another show of deference to the expert agency, the D.C. Circuit declined to criticize the FCC's findings on likely investment effects, asserting that "we ask not whether [the FCC's predictions] 'are correct or are the ones that we would the ones that we would reach on our own, but only whether they are reasonable.'"[181] The majority further noted that such "predictive judgments about areas that are within the agency's field of discretion and expertise are entitled to *particularly deferential review*, as long as they are reasonable."[182]

Judge Stephen Williams offered a blistering 69-page dissent, filled with citations to the economics literature, which might prove pivotal in any future challenge by the ISPs. The dissent forcefully explained why a blanket ban on paid prioritization cannot be legally sustained even under Title II, and why such a ban makes no economic sense, particularly when paid peering arrangements were treated by the Order under a "wait-and-see" approach:

> The Commission's disparate treatment of two types of prioritization [paid peering versus paid prioritization] that appear economically indistinguishable suggests either that it is ambivalent about the ban itself or that it has not considered the economics of the various relevant classes of transactions. Or perhaps the Commission is drawn to its present stance because it enables it to *revel in populist rhetorical flourishes* without a serious risk of disrupting the net.[183]

Economists recognize that some and perhaps most episodes of paid prioritization could improve the lots of ISPs (more revenues), edge providers with applications that need quality of service to function properly (more revenues), and broadband customers (greater quality of service). A ban denies those benefits. If the FCC is permitted to ignore the teachings of economics, then populism—the antithesis of economics—will fill the void.

Judge Williams lamented how the *OIO* gave three of its former chief economists "the silent treatment."[184] He noted that two of those (Michael Katz and Tim Brennan) offered less-restrictive alternatives to the ban on paid prioritization, but that the FCC casually dismissed those alternatives.[185] The FCC offered no serious explanations as to why case-by-case treatment (offered by Dr. Katz) or a requirement that ISPs meet minimum-quality standards (offered by Dr. Brennan) were inferior to the ban.

Any economist tasked with assessing whether a blanket ban on payments from edge providers to ISPs would appeal to the economics literature on two-sided markets in justifying their policy prescription. Yet as Judge Williams remarked, "[t]wo-sided markets are barely discussed at all, with the only mentions of any sort in the Order"[186] relegated to three footnotes. The Commission "nowhere develops any particular consequences from that classification or taps

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181. *Id.* at 44.
182. *Id.* (emphasis in original).
183. Dissent at 50 (emphasis added).
184. *Id.* at 43.
185. *Id.* at 39.
186. *Id.* at 20.

Post-Hearing Questions for the Record
Submitted to Adam White
Fellow, Hoover Institution
From Ranking Member Heidi Heitkamp

"Reviewing Independent Agency Rulemaking"
September 8, 2016

United States Senate, Subcommittee on Regulatory Affairs and Federal Management
Committee on Homeland Security and Governmental Affairs

1. In your written testimony, you assert "independent agencies are no longer the sleepy regulatory ratemakers and adjudicators that they once were. They now play a central role in modern regulatory policymaking, largely indistinguishable from executive agencies in terms of the regulations that they produce. Their exclusion from OIRA's review authority reflects a regulatory world that no longer exists."

    - Historically speaking, when would you say independent agencies ceased to be functionally indiscernible from Executive agencies? Can you provide any empirical evidence to support this claim?

    Answer: As I noted in my prepared testimony (p. 5), "today's independent agencies seem materially identical to executive agencies, in terms of their role in modern government." By this I meant that independent agencies now carry out many of the same functions as executive agencies, in terms of both rulemaking and adjudication, setting broad national policies.

    Originally, independent commissions were seen in large part as quasi-adjudicatory bodies that would set rates and terms of service for railroads, pipelines, and other natural monopolies on a case-by-case basis (pp. 5–8). But over time, independent commissions began to do more and more through broad rulemakings, setting national policy in the same way that executive agencies do. The convergence is illustrated by considering subjects where executive and independent agencies collaborate: the Treasury and Federal Reserve on financial regulation; the EPA and FERC on energy policy; the Energy Department and NRC on nuclear policy.

    While there is no bright line demarcating one era from the other, scholars sometimes trace the convergence to the 1960s and 1970s. This includes Paul Verkuil, recent chairman of the Administrative Conference of the United States.[1] Then again, as I noted

[1] *See, e.g.*, Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 Duke L.J. 257, 264–65 (1988) ("Over the years, however, rulemaking and policy formulation have captured an increasing percentage of agency resources. Partially this was due to the realization at agencies such as the FTC and Federal Power Commission (FPC) that rules were a more efficient method of controlling regulated entities than the incremental, time-consuming adjudicatory approach. This 'more bang for the buck' theory of the 1960s and 1970s transformed many regulatory agencies from adjudicators to policymakers. While some independent agencies, such as the National Labor Relations Board (NLRB), still preferred to proceed on a case-by-case basis, the prevailing mode of administration became rule-oriented once the power to proceed 'informally' became accepted. . . . [I]n the 1970s several agencies began to utilize the rulemaking process to launch wide-ranging inquiries into social and business

in my testimony (p. 7), the Roosevelt Administration argued as early as the 1930s that all agencies were effectively exercising "executive" power, even if they were nominally "independent."

- You also noted how Congress has blurred the lines between independent and executive agencies. Are there any steps that Congress could take to reaffirm which agencies are in fact independent?

  Answer: To be clear, Congress has taken at least one step to "affirm" which agencies are nominally "independent": in the Paperwork Reduction Act, there is a list of "independent regulatory agenc[ies]," ranging from the Federal Reserve Board of Governors to the Office of the Comptroller of the Currency, and "any other similar agency designated by statute as a Federal independent regulatory agency or commission." *See* 44 U.S.C. §3502(5). As I noted in my written testimony (p. 4), various agency-specific statutes often describe specific agencies as "independent." And, as I further explained in my written testimony (pp. 2–3), the basic hallmark of agency "independence" is statutory protection for the agency's head, against at-will removal by the President. Those are all the work of Congress.

  If Congress wants to draw further distinctions between executive and independent agencies in terms of the agencies' functions, Congress could specifically prohibit independent agencies from undertaking certain activities, such as rulemakings. But to be clear, my position is that executive and independent agencies both deserve more executive oversight (and more congressional oversight), not less.

2. You and the other witnesses all agree with the idea of requiring independent agencies to perform regulatory economic analyses in accordance with the principles enumerated in Executive Orders 12866 and 13563.

   - What do you think the practical impact of subjecting independent agencies to the requirements of the EO's will be on OIRA-- on individual independent agencies?

     Answer: Subjecting independent agencies to the authority of OIRA will create more work for OIRA—an office that already suffers from significant financial constraints and understaffing.[2] Congress should take care to provide OIRA with the resources it needs, regardless of whether it adds independent agencies to OIRA's workload.

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behavior that were not supplemented by underlying adjudicative investigations. . . . The popularity of the rulemaking technique by independent agencies raises an issue central to this essay. Rulemaking challenges the organizational theory behind the independent agency itself. These agencies can become policy knight-errants outside the framework of the executive branch.") (footnotes omitted); *see also Consumer Energy Council of Am. v. FERC*, 673 F.2d 425, 472 (D.C. Cir. 1982) ("There has been a general breakdown in any distinction between the functions of the two types of agency"); Tracey A. Hardin, *Rethinking Independence: The Lack of Effective Remedy for Improper For-Cause Removals*, 50 Vand. L. Rev. 197, 234–35 (1997) (explaining that classical functional distinctions between executive and independent agencies do "not hold true in light of the current functions of independent agencies," because "[a]ny distinction between the functions of independent and executive agencies has largely been eradicated") (collecting examples).

[2] *See, e.g.*, Robin Bravender & Emile Yehle, "Wonks in embattled regulatory office are mysterious—but 'not nefarious'," *Greenwire* (Feb. 18, 2014), *at* http://www.eenews.net/greenwire/2014/02/18/stories/1059994711.

As I argued in my written testimony (pp. 12–16), I believe that OIRA review of independent agency rulemakings would improve the quality of those rulemakings, in terms of cost-benefit analysis and inter-agency collaboration. To be fair, it might also create an incentive for independent agencies to avoid OIRA by making policy more often through adjudications (which are not subject to OIRA review) instead of through rulemaking, but that is speculative and would depend on myriad practical considerations and constraints.

Furthermore, I agree with the scholars at Resources for the Future, who contend that OIRA oversight of independent agencies would also improve *Congress's* ability to oversee the agencies: "[E]conomic analysis of executive branch regulations has served to promote accountability by allowing Congress and the public to get information about the likely effects of regulations, at least as estimated by the agencies issuing those regulations. Extending the practice of such analysis to independent regulatory commissions would similarly constitute a step toward allowing Congress and the public to understand the effects of regulatory decisions by these agencies."[3]

- Do you have any concerns that doing so will protract or elongate the rulemaking process, or encourage premature or precipitous court challenges?

Answer: It may elongate the rulemaking process slightly, while OIRA carries out its review. But the effect would be no more onerous than it currently is for executive agencies. And as former OIRA Administrator Cass Sunstein explains, delays caused by the OIRA process usually owe to concerns that *other agencies* have about a proposed rule. Cass Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 Harv. L. Rev. 1838, 1842 (2013) ("is usually because significant interagency concerns have yet to be addressed"). In other words, the extra time is well invested in allowing other agencies to bring their own expertise and legal responsibilities to bear on the given agency's rulemaking proposal.

I do not believe that subjecting independent agencies to OIRA review would encourage premature or precipitous court challenges. If the Executive Branch were to unilaterally subject independent agencies to OIRA review, then it certainly would not affect judicial review, because the current OIRA framework is not the subject of judicial review. *See* Exec. Order 12866 § 10. If Congress decides to subject the independent agencies to OIRA review through legislation, it can tailor the timing and scope of judicial review as it sees fit.

- What additional resources if any, do you believe OIRA and the independent agencies would need to comply with a statutory requirement for more thorough cost-benefit analysis (CBA) in significant rulemakings?

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[3] Arthur Fraas & Randall Lutter, *On the Economic Analysis of Regulations at Independent Regulatory Commissions*, RFF Discussion Paper 11-16 (Apr. 2011), *at* http://www.rff.org/files/sharepoint/WorkImages/Download/RFF-DP-11-16_final.pdf.

Answer: I believe that OIRA needs more funding and personnel, given reports that OIRA is underfunded and understaffed.[4]

The independent agencies would not need significantly more resources or personnel, since OIRA review would simply require the agency to analyze and explain the rule. To the extent that more resources or personnel are required, it would be a sound investment by Congress in the improvement of federal regulations and accountability.

- Other than OIRA, is there any other entity that could review independent agency rulemaking to evaluate regulatory analyses and promote greater accountability?

  Answer: As I explained in my written testimony (pp. 15–16), courts can help to promote accountability, by subjecting agencies' cost-benefit analyses to judicial review. But this is possible only when Congress requires the agencies to do cost-benefit analysis and allows for judicial review, as in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

  Furthermore, as two experts from the Brookings Institution and R Street Institute explain in a new article, Congress could establish a "Congressional Regulation Office" analogous to the Congressional Budget Office, to oversee regulatory matters. *See* Philip Wallach & Kevin R. Kosar, "The Case for a Congressional Regulation Office," *National Affairs* (Fall 2016), *at* http://www.nationalaffairs.com/publications/detail/the-case-for-a-congressional-regulation-office.

3. You and the other witnesses argue convincingly that independent agencies should perform more rigorous CBA for major rulemakings. However, there appears to be some consensus that independent agencies are sometimes hamstrung by practical and legal limits on obtaining the type of data needed to do so.

   - How might independent agencies overcome the challenges they encounter in seeking to better quantify costs and benefits? For example, would you compel regulated industries to furnish proprietary data outside the limits of the Paperwork Reduction Act?

     Answer: Congress need not compel regulated industries to furnish proprietary data outside the limits of the Paperwork Reduction Act. Rather, Congress should allow the "adversarial process" of rulemakings to create the incentives for companies, individuals, and organizations to submit data for the record.

     If an agency publishes a sufficiently thorough and precise Notice of Proposed Rulemaking—or, even better, if it precedes the NPRM with a substantive Advanced Notice of Proposed Rulemaking)—then all interested parties will be on notice and can submit data for the public record. Such parties know or should know that the rule will ultimately be analyzed on the bases of material in the record, and thus they have a

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[4] *See, e.g.*, Robin Bravender & Emile Yehle, "Wonks in embattled regulatory office are mysterious—but 'not nefarious'," *Greenwire* (Feb. 18, 2014), *at* http://www.eenews.net/greenwire/2014/02/18/stories/1059994711.

strong incentive to submit the best possible data and other facts for the record. The agency can then make its decision based on the record.

4. In some cases, organic authorizing statutes for independent agencies prohibit or otherwise limit, use or consideration of costs and benefits in certain rulemakings. This would likely lead to conflicts if the agencies are subject to the EO's and OIRA oversight.

   - Do you have any recommendations on balancing such competing statutory mandates or structuring a legislative requirement that takes into account such disparities? Who ultimately decides what constitutes an adequate CBA for each agency?

     Answer: OIRA oversight of independent agencies need not lead to conflicts among statutory mandates. The executive order governing OIRA expressly *limits* the cost-benefit analysis requirement, make it apply only "to the extent permitted by law" and not where "prohibited by law." *See generally* Exec. Order 12866. This is consistent with the basic rule, long recognized by the Supreme Court, that an agency need not (indeed, *must* not) subject its rule to cost-benefit analysis where the statute prohibits it. *See, e.g., Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 464–471 (2001).

     If Congress chooses to subject independent agencies to OIRA oversight, it can include a similar caveat to the cost-benefit analysis requirement. But Congress should take the opportunity to consider whether particular issue-specific statutes preventing cost-benefit analysis should be revised to remove that limitation.

     I thank the Subcommittee, again, for allowing me to testify on these crucially important matters.

Post-Hearing Questions for the Record
Submitted to Cary Coglianese
Edward B Shils Professor of Law and Professor of Political Science
Director, Penn Program on Regulation
University of Pennsylvania Law School
From Ranking Member Heidi Heitkamp

"Reviewing Independent Agency Rulemaking"
September 8, 2016

United States Senate, Subcommittee on Regulatory Affairs and Federal Management
Committee on Homeland Security and Governmental Affairs

1. Your testimony was helpful in underscoring the need for better regulatory analysis, both prospective and retrospective, as well as the need for sufficient regulatory resources to satisfy the imposition of additional substantive procedural rulemaking requirements on independent agencies. Your suggestion that independent agencies possibly not be exempted from the analytical requirements of the Unfunded Mandates Reform Act is an interesting one.

   - Is it accurate to say under that scenario courts could not rule on the adequacy of an agency's regulatory analysis even though a cost-benefit analysis (CBA) would be part of the agency record, but at the same time a court could issue a ruling with respect to the arbitrary and capricious standard in the Administrative Procedure Act?

   Yes, this is accurate. Under §1571(a)(2) of the Unfunded Mandates Reform Act, if an agency fails to complete a required "statement" of costs and benefits for a qualifying rule, "a court may compel the agency to prepare such written statement." However, §1571(a)(3) states that "the inadequacy or failure to prepare such statement...shall not be used as a basis for staying, enjoining, invalidating or otherwise affecting such agency rule." In other words, UMRA authorizes the courts to compel the preparation of a cost-benefit analysis, but they cannot, on the basis of UMRA, remand a rule because the agency failed to prepare such an analysis or because the court finds the agency's analysis to be inadequate. However, §1571(a)(4) provides further that "[a]ny *information* generated [in developing a cost-benefit analysis statement under UMRA] that is part of the rulemaking record for judicial review under the provisions of any other Federal law may be considered as part of the record for judicial review conducted under such other provisions of Federal law" (emphasis added). Thus, although courts cannot pass on the adequacy of an agency's "statement" under UMRA, they can review the underlying "information" upon which the statement is based when reviewing agency rules under 5 U.S.C. §706(2)(A), the arbitrary and capricious standard in the Administrative Procedure Act.

2. You and the other witnesses all agree with the idea of requiring independent agencies to perform regulatory economic analyses in accordance with the principles enumerated in Executive Orders 12866 and 13563.

I do agree with the idea that independent agencies should "perform economic analyses in accordance with the principles enumerated in Executive Orders 12866 and 13563." The principles reflected in these executive orders encapsulate well-accepted understandings of sound regulatory policy; independent agencies should by all means be expected to conduct analysis consistent with these principles and thereby aim toward the achievement of smarter regulatory decisions.

Codifying Executive Order 12866 wholesale, and then applying it to independent agencies, is another matter, though. As I stated in both my written and oral testimony, such a change would mark a significant shift in prevailing conventions related to the President's role in shaping decisions at independent agencies. As I further stated in my oral testimony before the Subcommittee, the wholesale application of Executive Order 12866 to independent agencies headed by multimember bodies would be problematic because the procedures in Executive Order 12866 are drafted to apply to "the agency head." That is, the Order's procedures are intended for agencies headed by a single administrator. A multimember body could not engage in the kind of back-and-forth contemplated by, and that often characterizes the practice of, regulatory review under Executive Order 12866.

- What do you think the practical impact of subjecting independent agencies to the requirements of the EO's will be on OIRA-- individual independent agencies?

As noted above, "subjecting independent agencies to the requirements of the EOs" is different than compelling them to comply with the *principles* contained in the Executive Orders. As I just indicated above, one practical impact of applying the requirements would be that the OIRA Administrator would not know who or what exactly constitutes "the agency head" with whom to interact in accordance with the procedures contained in Executive Order 12866. If the entire multimember body constitutes the agency "head," then the normal White House review process would become rather cumbersome. Presumably the independent agency would need to convene meetings with all of its commission members, and comply each time with various Government in Sunshine Act requirements, simply to determine an agency position on feedback from OIRA over the adequacy of the agency's regulatory impact analysis. Normally, the OIRA review process involves a working interchange or dialogue between an agency head (or designee) and the OIRA administrator (or designee), a process which would not practically fit well with multimember bodies.

Even if we were to assume that these kinds of practical obstacles could be satisfactorily addressed, applying Executive Order 12866 to independent agencies would still impose additional work on OIRA and its staff. As I stated in my written testimony, "OIRA possesses a very tiny staff compared with the many executive agencies it oversees. Legislation that would thrust responsibility on OIRA for overseeing the regulatory actions of at least another 19 independent agencies would necessitate a substantial increase in the funding for and size of OIRA." Moreover, the types of rules these independent agencies issue – particularly those related to the financial sector – would likely necessitate the development of new expertise within OIRA, as well as present novel analytic challenges more generally.

- Do you have any concerns that doing so will protract or elongate the rulemaking process, or encourage premature or precipitous court challenges?

It can be expected that, if agencies must conduct additional analysis in response to the application of requirements like those in Executive Order 12866, this will require additional resources and staff hours. Yet, for several reasons, I am not very concerned about unduly protracting or elongating the rulemaking process, nor about encouraging lawsuits or judicial reversals.

Let me address the issue of litigation first. Section 10 of Executive Order 12866 makes clear that the Order's procedural requirements and other provisions cannot form the basis for any judicial review. Assuming that any legislation imposing regulatory analysis requirements on independent agencies contained a similar provision, such legislation would provide no additional grounds for litigation. Also, although litigation might plausibly arise were a President to apply the Executive Order's requirements to independent agencies, if Congress were to do so it would not trigger plausible separation-of-power concerns.

In terms of a general delay to the rulemaking process, delay itself is not necessarily a valid, inherent concern about procedural reform to the regulatory process. The question is overall public value. If a lengthening in time occurs but leads to better regulatory outcomes, that additional time could be well justified. The question about delay would be better understood as whether rulemaking will be *unduly* or *unjustifiably* protracted or elongated.

In this case, there are good reasons to question whether rulemaking would unduly delayed – indeed, whether it would be appreciably slowed down at all by the application of regulatory analysis requirements to independent agencies. Even when additional person-hours are needed to conduct better analysis, this does not necessarily translate into protracted regulatory processes. Agencies can manage through the assistance of outside contractors or by reassigning staff in order to be able to keep rulemaking moving apace. By and large, this appears to be what the empirical evidence on the rulemaking process suggests.

Despite repeated claims through the years that the application of OIRA review (and other procedural reforms) significantly slow down the regulatory process, the *Federal Register* continues to be published each day, filled with rules issued by agencies across the federal government. Moreover, study after study has failed to find any overall slowdown in the pace of rulemaking. As I have written elsewhere, "[a]lthough it might seem intuitive that OMB review would increase the time and expense of issuing new rules, researchers have not found systematic evidence that OMB review imposes any significant delay on the regulatory process, notwithstanding careful analysis of both large-sample datasets and matched case studies." Cary Coglianese, "The Rhetoric and Reality of Regulatory Reform," 25 *Yale Journal on Regulation* 85-95 (2008). One peer-reviewed study has actually found that rules subjected to OIRA review tend on average to proceed more quickly through the regulatory process. Jason Webb Yackee and Susan Webb Yackee, "Administrative Procedures and Bureaucratic Performance: Is Federal Rule-making 'Ossified'?", 20 *Journal of Public Administration Research & Theory* 261-282 (2009).

3. You and the other witnesses argue convincingly that independent agencies should perform more rigorous CBA for major rulemakings. However, there appears to be some consensus that independent agencies are sometimes hamstrung by practical and legal limits on obtaining the type of data needed to do so.

   - How should independent agencies overcome the challenges they encounter in seeking to better quantify costs and benefits? For example, would you compel regulated industries to furnish proprietary data outside the limits of the Paperwork Reduction Act?

   As noted in my oral testimony, agencies in other fields of regulation have struggled with data needs and analytic methods in their earliest rulemakings. But over time, these uncertainties have been reduced through investment in applied research and the building of expert capacity, both within government agencies and in the academy. Even relatively modest levels of research funding, whether committed by agencies themselves or through entities such as the National Science Foundation, can be of great assistance in building a body of empirical knowledge and developing expert consensus around analytic techniques.

   The Paperwork Reduction Act's requirements do stand in tension with efforts to produce evidence-based policy decisions, whether through better prospective or retrospective analysis. Legislative amendments to the PRA, or simply better efforts to implement the law, may be needed to ensure that legitimate concerns about excessive paperwork do not stand in the way of making better informed policy decisions. In some cases, this could mean that Congress should expressly authorize data collection efforts that require the production of proprietary data or that are exempt from the PRA. Various agencies already demonstrate well the ability to keep sensitive personal and commercial information confidential, and similar protections could be implemented at independent agencies where proprietary information is needed.

4. In some cases, organic authorizing statutes for independent agencies prohibit, or otherwise limit use or consideration of costs and benefits in certain rulemakings. This would likely lead to conflicts if the agencies are subject to the EO's and OIRA oversight.

   - Do you have any recommendations on balancing such competing statutory mandates, or structuring a legislative requirement that takes into account such disparities? Who ultimately decides what constitutes an adequate CBA for each agency?

   It is possible for new legislation to require the production of benefit-cost analysis without amending existing authorizing statutes that prohibit specific agencies, usually in specific contexts, from taking certain costs or benefits into account in their regulatory decisionmaking. Executive Order 12866 effectively achieves this same end already through the use of language such as "to the extent permitted by law," "unless prohibited by law," or "unless a statute requires another regulatory approach." Thus, even when an agency like the Environmental Protection Agency is precluded by statute from taking costs into account in making certain decisions, such as in setting ambient air quality standards under the Clean Air Act, the agency's staff members still produce an analysis of costs and benefits; they simply do not share that analysis with the agency administrator and she does not rely on it explicitly as a basis of her decisionmaking. In similar circumstances, independent agencies' staffs could still be required to produce benefit-cost analyses and make the results public, all while still affording the commissioners the ability to ignore these analyses in making their decisions. Such an approach would preserve whatever values underlie any prior legislative preclusion of costs or benefits, while still advancing the accountability that can be advanced through regulatory impact analysis and its public disclosure.

In terms of who determines what constitutes adequate analysis, in the first instance that responsibility should be borne by the agency and its officials. As I stated in my oral testimony, agency leaders need to take ownership of their process of producing rigorous analysis if it is to have a meaningful impact on policy decisionmaking. Other governmental actors such as the President, White House officials, members of Congress, and judges can reinforce the importance of sound analysis and provide oversight, which by necessity will entail their making judgments about the adequacy of agency analysis. Such analysis should also be publicly disclosed, which ultimately affords members of the public an opportunity to make their own judgments about the adequacy of an agency's regulatory analysis and decisions.