Research

2010: The Year in Regulation

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2010 was a boom for federal regulators. At the same time as near-record high unemployment, federal agencies proposed a record number of regulations, and at a record cost for the U.S. economy. While the political story of last year was the midterm elections, the legislative measures passed and their subsequent implementation will continue to dominate the regulatory environment. New Dodd-Frank regulations, Net Neutrality, and the EPA's CO_2 framework kept federal regulators busy in 2010, and 2011 will be no different.

Adding it up, the *Federal Register* published 82,590 pages in 2010, an historic high. This figure was an 18.5 percent increase from 2009, and up almost 11 percent since 2007.

The number of pages doesn't tell the whole story of the impact regulations have on businesses and consumers. For example, according to the U.S. Small Business Administration, the total regulatory burden in 2008 was $1.75 trillion, or roughly 12 percent of the nation's total economic output.

In 2010, the federal government promulgated 2,401 proposed rules, 3,562 new rules, of which 673 were considered significant. According to the Office of Management and Budget, there are 137 major rules (generally costing at least $100 million per rule) currently under review. Calculating the total cost of these regulations can prove difficult even for the individual agencies, as they routinely request comment from industry experts.

The Heritage Foundation has also conducted research on Fiscal Year 2010 regulations. According to their calculations, the total cost of enacted federal regulations was $26.5 billion, the highest ever recorded. The EPA's onerous new rules on carbon regulation, among many others, accounted for the lion's share of the total, $23.2 billion.

The EPA was not alone, however. 2010 was marred by several regulatory overreaches in

Congress and among the various administrative agencies. The FCC's unilateral, and likely illegal, attempt to impose Net Neutrality will go down as a lowlight in 2010, as legal challenges will make it almost impossible to implement fully in 2011. Finally, the passage of Dodd-Frank and its initial implementation will also put regulatory pressure on businesses and consumers in 2011.

EPA Takes the Baton from Congress

Although the U.S. House was able to muster 219 votes to pass Cap-and-Trade, a proposal that would gradually place higher prices on carbon output, the U.S. Senate never formally took up the legislation and it died in the 111th Congress. That didn't stop the EPA from beginning to implement what Congress couldn't pass.

Aided by a favorable 2007 U.S. Supreme Court ruling, the EPA was charged with determining whether it could regulate carbon under the Clean Air Act (CAA). Not surprisingly, federal regulators decided that they did have the power to regulate carbon dioxide and other greenhouse gases (GHG) as pollutants under the CAA.

One of the opening salvos on the regulation of GHG occurred on April 2, 2010, when EPA Administrator Lisa Jackson issued a final rule codifying the EPA's power to issue federal permits for GHG emissions. This "Jackson Memo" arrived at a time when businesses and some experts presumed that the EPA was intent on regulating all sources of GHG, including small businesses like restaurants and office buildings.

In June, the EPA issued its final "Tailoring Rule" to limit regulation to major GHG emission sources. The EPA created a phased system for regulating carbon, and promised that no source with emissions below 50,000 tons per year (tpy) would be subject to regulation, until at least 2016. Without the Tailoring Rule, sources with emissions as low as 100 tpy (thousands of small businesses) would fall under the CAA. (The average *per person* carbon footprint is roughly 20 tpy.)

Finally, on September 2, 2010, the EPA announced that stationary sources (primarily power plants) that emit GHG will be subject to the CAA beginning on January 2, 2011. The EPA and local governments will issue permits that require compliance and routine inspections. In 2011, the industry and consumers will witness the first two phases of the EPA's version of Cap-and-Trade.

The first phase began on January 2; stationary sources that already obtain CAA permits for non-GHG must follow new requirements if they increase emissions by at least 75,000 tpy of GHG. This phase would only apply to existing sources.

The second phase begins in July and includes all facilities emitting more than 100,000 tpy of emissions. Facilities making changes that would increase GHG by at least 75,000 tpy will be required to obtain construction permits that regulate emissions. By July, all sources that emit at least 100,000 tpy must obtain operating permits from the EPA or state agencies.

These regulations will hit the coal industry the hardest, a major emitter of GHG. Not surprisingly, even the prospect of EPA regulation has halted construction on coal-fired power plants for the past two years. Contrast this paucity of construction with the previous eight years of the decade, when 19 plants were constructed.

In conclusion, although legal challenges are pending in an attempt to stop the regulations, without legislation from Congress, it will be difficult to curb EPA action. In the coming months, little stands between new energy jobs and EPA regulators.

Higher MPG or More Ethanol? EPA Chooses Both

American politicians have been addicted to ethanol for several decades. According to the Congressional Budget Office (CBO), federal ethanol subsidies cost American taxpayers more than $6 billion a year. This is combined with a 54-cent tariff on imported ethanol, reducing foreign ethanol to an insignificant market participant in the U.S. To add insult to injury, the federal government mandates more than 11.5 billion gallons of ethanol consumption, jumping to 20.5 billion by 2015, and 36 billion gallons by 2022.

In order to meet the 2015 requirement alone, the CBO estimated that the U.S. would have to plant or replant more than 31 million acres of corn, or roughly the entire land area of North Carolina. These federal mandates impose tremendous costs on U.S. taxpayers, the environment, and even the automotive industry, which must continue to upgrade technology to handle higher ethanol contents.

A burden is also imposed on the EPA. Due to the higher ethanol consumption mandates, the EPA is required to address the so-called blending wall. Currently, passenger cars and even older Model Years (MY) are able to process E10 (a blend of ten percent ethanol and 90 percent gasoline). Higher ethanol requirements in the future, however, require the EPA to examine raising the wall, to E15.

The EPA took action to raise the blending requirement to E15 in November, 2010. Only newer cars were initially included because ethanol, in spite of its fervent backing from industry lobbyists, is a poor transportation fuel and can damage the catalytic converters of older vehicles.

It contains only two-thirds the energy content (BTU's) of one gallon of gasoline, reducing

miles-per-gallon (MPG) performance by approximately 3-4 percent for E10, and up to 30 percent for E85. Thus, Congress is forcing the EPA to push a fuel that has a dubious environmental record and actually reduces MPG performance.

Contrast this to the action the EPA took in May, 2010 when it issued its final rule for light-duty vehicles in an effort to reduce GHG emissions. The new rule calls for a dramatic increase in fuel standards for light-duty vehicles. Automotive manufacturers will be required to increase fuel efficiency to 35.5 MPG by 2016, a 57 percent hike from the current rate. The 405-page rule details a long list of benefits, but says little of the projected costs for such a dramatic increase. According to the EPA and the National Highway Traffic Safety Administration, the higher MPG requirements will cost $51.8 billion, with net benefits exceeding $94 billion.

Adding to the burden on auto manufacturers, in November the Obama Administration released fuel efficiency standards for medium-and-heavy-duty engines. The 305-page proposed regulation is the first of its kind. The Administration estimates that the new regulations would cost $7.7 billion.

In an absurd twist of dueling federal mandates, the U.S. auto industry must adapt its technology to use ethanol, which reduces MPG, while at the same time develop expensive new technology to increase MPG performance. According to current federal policy, why implement one onerous regulation when you can implement two at twice the cost?

The FCC: If it Moves, Regulate It

The Federal Communications Commission's (FCC) action to unilaterally impose so-called Net Neutrality rules grabbed regulatory headlines in 2010. Not surprisingly, on the darkest day of the year, December 21, the FCC finalized its rule, "In the Matter of Preserving the Open Internet." The FCC arrived at this Orwellian rule in a circuitous and highly litigated manner, and the prospects for implementation will doubtless be marred by legal challenges.

The FCC began its Net Neutrality push in 2009, issuing a proposed rule that received a torrent of public comments, both in favor, and in opposition. The Commission received more than114,000 comments in response to its broad framework to regulate the broadband decisions of private Internet service providers. This backlash delayed implementation of a final rule. Then, Congress and the courts intervened.

Under hornbook administrative law, federal agencies do not make law; they simply implement Congressional legislation, which carries the force of law. Yet, Congress has passed no legislation authorizing Net Neutrality and there is no equivalent language in the

seven titles of the Communications Act. In fact, even the U.S. Court of Appeals for the District of Columbia agreed that the FCC lacks the power to unilaterally impose Net Neutrality.

The FCC's actions look even more brazen when examined in light of federal precedent. On April 6, 2010, a unanimous D.C. Circuit Court found that the FCC lacked authority under section 706 of the Communications Act to impose Net Neutrality rules on Comcast. The Court found that the FCC needed a grant from Congress to act, not mere policy statements.

Judge David Tatel wrote, "The Commission has failed to make [its] showing. It relies principally on several Congressional statements of policy but under Supreme Court and D.C. Circuit case law statements of policy, by themselves, do not create 'statutorily mandated responsibilities.'" Approximately 300 Members of Congress agreed, asking the FCC to allow Congress, as it should, to address Net Neutrality.

The FCC was undeterred, and instead of abiding by the *Comcast* decision and acting in response to Congressional needs, it became petulant, raising the specter of onerous Title II regulation, again without Congressional or court approval. The rebuke from Congress and industry leaders was quick, and the Commission soon scuttled the idea.

Then, just before the November elections, Chairman of House Energy and Commerce, Henry Waxman, leaked details of a possible legislative compromise, ensuring any FCC implementation would likely be upheld by the courts. This proposed legislation died, however, and never received a vote.

The FCC and Chairman Julius Genachowski (a law school classmate of President Obama) had one option remaining: pass a regulatory version of the Waxman compromise and present several questionable legal rationales.

Lowlights of new rule include:

- Transparency for both fixed and wireless broadband. What constitutes disclosure must be "sufficient for consumers to make informed choices regarding use of such services and for content, application, service, and device providers to develop, market and maintain Internet offerings." According to the FCC, disclosure must contain information about network management practices, performance characteristics, and pricing terms.
- Blocking of lawful content for fixed broadband is banned. For wireless providers, they are prohibited from blocking websites and content and applications that compete with their services.

- For fixed broadband only, discrimination is banned, subject to "reasonable network management," a term that is still undefined. The FCC has hinted, however, that "pay for priority" would likely be unreasonable, and thus illegal. Wireless providers are exempt from this section.
- Legal rationale: the FCC repeated its argumen
  ts under Section 706 of the Communications Act and general Congressional policy to expand broadband access, the same rationale rejected by the D.C. Circuit. In addition, the FCC relied on other tenuous legal grounds, including sections 4(k), 201, 218, 230, 251, 254, 616, 628, and Titles III and IV.

Strangely, the D.C. Circuit Court ruled that the FCC must have some express delegation of authority by Congress. If the authority to impose Net Neutrality is legal, as the FCC claims, then why does the Commission need to explicate a dozen different statutory bases? If Congressional delegation was explicit, the FCC would need only one citation, not 12.

Dodd-Frank Marches Forward

On July 15, 2010, the U.S. Senate approved the final Conference Report to the "Dodd-Frank Wall Street Reform and Consumer Protection Act." The President signed the bill into law six days later and the regulatory fervor has not stopped.

Dodd-Frank will produce approximately 243 regulations and cost the U.S. economy hundreds of millions of dollars, according to the CBO's conservative estimate. Already, the Commodity Futures Trading Commission (CFTC) has promulgated 32 proposed rules, four advanced notices, two interim final rules, and one final rule. The Securities and Exchange Commission has joint rule-making authority, and has published 12 proposed rules and two final rules related to Dodd-Frank.

Initial cost estimates are fairly conservative, listing mainly the administrative and recordkeeping burdens for the private sector. The final rule requiring reporting of security-based swap transaction data will cost the industry $56 million. Thus far, the total estimated filing and recordkeeping costs are $490 million.

The CFTC alone has identified 30 rulemaking areas that it will need to address in the future, so the full regulatory implementation of Dodd-Frank is years away.

2011: Looking Forward

The biggest regulatory stories in 2011 will be the EPA regulations and the likely repeal of the 1099 requirement. There is widespread bipartisan support for repeal of the 1099

provision that was buried in President Obama's health care legislation last year. In addition, the heightened EPA regulations that are slated to begin in July should also grab headlines.

Even President Obama has acknowledged that the looming 2011 regulatory environment has proved intimidating to businesses. In a January *Wall Street Journal* op-ed, President Obama argued that past regulations have placed "unreasonable burdens on business." The President vowed to remove outdated regulations that stifle innovation, namely, eliminating saccharin as a dangerous chemical.

However, saccharin regulations are no barrier to innovation and job creation. The saccharin regulations mentioned by President Obama were considered neither a "significant regulatory action," nor a major rule under the Congressional Review Act. They are a joke, a political smoke screen devised to convince the public that the Administration now understands that federal actions can impede job growth.

The problem with job creation is not saccharin, it's devising entirely new regulatory regimes that impose onerous new filing requirements (1099 regulation), regulate broadband companies (Net Neutrality), and impose Cap-and-Trade through regulatory fiat (new EPA regulations).

Looking forward, if the Administration doesn't take the lead in delaying or canceling some of these expensive new regulations, Congress should force the President's hand. When a bill to cancel billions in new regulatory costs is on the President's desk, only then will businesses know whether he's serious about reform.