

**Testimony of Jeffrey R. Holmstead**  
**Before the**  
**Subcommittee on Courts, Commercial and Administrative Law of the**  
**House Judiciary Committee**  
**U.S. House of Representatives**  
**Wednesday, May 4, 2011**

My name is Jeff Holmstead. I am a partner in the law firm of Bracewell and Giuliani and the head of the firm's Environmental Strategies Group. This afternoon, however, I am not appearing on behalf of my law firm or any of my firm's clients. I am here as a former official in both the Environmental Protection Agency (EPA) and the White House who has spent more than 20 years working on the development of federal regulations.

I served as the head of EPA's Air Office for more than four years (from 2001 to 2005) and as an Associate Counsel to the President for almost four years (from 1989 to 2003). During my time in the White House, I was very involved in the regulatory review process. I have also been an environmental attorney in private practice for many years. In both government and the private sector, I have spent many years thinking about and dealing with cost-benefit analysis as both a conceptual and practical matter. Thank you for the opportunity to address the subcommittee on the important issue of presidential and judicial review of regulations and the role that should be played by cost-benefit analysis (CBA), which is sometimes referred as benefits-cost analysis (BCA). Both terms (and both acronyms) mean the same thing.

It is increasingly clear that we are in an age of unprecedented federal regulation over many aspects of the Nation's economy. I am most familiar with the regulations that EPA has issued over the last two years, but Susan Dudley, the former head of the White House Office of Information and Regulatory Affairs ("OIRA"), has noted that the Obama Administration has issued a total of 132 "economically significant" rules (i.e. rules whose costs or benefits exceed \$100 million per year) in the two years it has been in office. To put this total in perspective, this total is approximately 40 percent higher than the annual rate under Presidents Bill Clinton and George W. Bush.

While it is tempting to draw conclusions by simply looking at these totals, each rule or set of rules that affect the same entities should be evaluated by looking at its costs and the benefits it provides to society – and how these costs and benefits are distributed. Everyone agrees that many of these rules will impose very substantial costs, but the rules may still be justified if they provide even greater benefits to our society. On the other hand, if the cost of a rule exceeds its benefits, our economy suffers the consequences. Proponents of greater regulation often pretend that the costs are simply imposed on industry or "big business," but they also affect – sometimes quite substantially – workers, consumers, ratepayers, and all Americans who have privately-funded pension plans or are otherwise invested in stocks, bonds, or mutual funds.

I can say from my own experience that many career officials at EPA take cost-benefit analysis seriously and try to use it as much as possible to make regulatory decisions. Other federal agencies also do CBA, but perhaps to a lesser extent. I have also seen, however, that federal

agencies sometimes do not use CBA to *inform* their regulatory decision, but rather to *justify* actions they may want to take for other reasons. CBA is simply an analytical tool that can be used properly or poorly or even misused. For this reason, it is important to have appropriate oversight of the analysis conducted by regulatory agencies – to ensure that regulatory decisions are consistent with the principles of CBA and with the underlying statutory scheme created by Congress.

I support this Subcommittee's efforts to consider legislation that will ensure proper presidential and judicial review of the justification underlying Federal regulations. To further your efforts, I would like to focus attention on three key issues relating to problems with the current system of cost-benefit analysis and areas of focus for any potential solution.

## Background

Before evaluating the current use (or misuse) of cost-benefit analyses and the need for legislative action, it may be helpful to briefly review the mandates placed upon all Federal agencies when issuing regulations. First, under Executive Order 12866, issued by President Clinton in 1993, when an agency determines that a regulation is the best method of achieving a regulatory objective it must, among other things:

- (1) "design its regulations in *the most cost-effective manner* to achieve the regulatory objective;"
- (2) "propose or *adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs*;"
- (3) "*identify and assess alternative forms of regulation* and...specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities adopt;"
- (4) "tailor its regulations to impose the *least burden on society*...taking into account...the *costs of cumulative regulations*."

In Executive Order 13563, issued on January 18, 2011, President Obama reaffirmed these regulatory principles under an overarching instruction to Federal agencies to protect public health and our environment "while promoting economic growth, innovation, competitiveness, and job creation."

## Misuse of Cost-Benefit Analyses

Having spent many years looking at the benefits of different environmental regulations, I agree with the many researchers who believe that reducing levels of fine particles in the air is the most important and beneficial thing that the federal government can do in the environmental arena. The vast majority of the benefits that EPA has ever achieved under all the federal environmental statutes come from reducing ambient levels of fine particles, which are often referred to as PM2.5.

There are two major areas of uncertainty about the benefits of reducing PM2.5: (1) whether all the different components in PM2.5 should be regulated equally; and (2) whether there are

benefits of reducing such pollution in areas where levels are already low. I believe that the EPA and other agencies should pay more attention to addressing these areas of uncertainty, but I will not discuss them here.

My concern is that, rather than using cost-benefit analysis to develop the most effective way to reduce PM2.5, some EPA officials have come to view CBA – and the benefits of reducing PM2.5 – as a way to justify virtually anything that they may want to do. All too often in recent years, EPA has understood the instruction to issue the "most" cost-effective regulation to mean that it may issue "any" regulation where it can show benefits exceeding costs. Unfortunately, this is a serious misuse of the type of cost-benefit assessment that is required by Executive Orders 12866 and 13563. Proper CBA should identify the most effective way to regulate – and not be used simply to justify any regulation that can be claimed to provide benefits that exceed costs.

### **A Case Study: The Proposed Utility MACT**

EPA has recently issued a proposed rule to reduce emissions of so-called “hazardous air pollutants” (or HAPs) from coal- and oil-fired power plants. This rule is generally referred to as the Utility MACT because it was developed under a section of the Clean Air Act that calls for EPA to develop standards based on the “maximum achievable control technology” (MACT) that can be used to control HAP emissions from different type of industrial facilities.

As proposed, the Utility MACT would be the most expensive rule in EPA history. Some experts believe that EPA has actually understated its likely costs, but even EPA acknowledges that it would impose costs of about \$11 billion a year on the U.S. economy. Yet EPA has also gone to great lengths to argue that the benefits of this rule will greatly exceed the costs. Under the requirements of the two Executive Orders cited above, EPA prepared a cost-benefit analysis which suggests that annual benefits will be in the range of \$48 to \$130 billion. If the annual costs of the rule are only \$11 billion, then "the benefits of the proposed [Utility MACT] far outweigh the costs," as EPA argues.

The Agency’s sole basis for issuing this proposal is a regulatory determination that then-EPA-Administrator Carol Browner made in December 2000 that it was “appropriate and necessary” to regulate certain HAPs from power plants. This determination was based almost entirely on the Administrator’s concern about mercury emissions from coal-fired power plants. Not surprisingly, the majority of the proposed rule deals with mercury reduction requirements for coal-fired power plants.

It stands to reason that the vast majority of benefits claimed by EPA to justify the proposed rule must be the result of reductions in mercury emissions. But the Agency’s cost-benefit analysis tells a very different story. According to EPA, the benefits to society of the mercury-reduction requirements are in the range of \$500,000 to a *maximum* of \$6.1 *million* in total (i.e. not even annual) benefits. In other words, in a rule estimated by EPA to cost \$11 *billion* annually, the maximum total benefit of reducing emissions of mercury—the emissions of which serve as the primary basis for the rule—is \$6.1 *million*.

EPA asserts, however, that it's proposal is justified based on cost-benefit analysis because the rule will provide benefits of up to \$130 billion ever year. Yet virtually all these benefits come from reducing PM2.5.

Although mercury is the Agency's legal justification for the Utility MACT, EPA argues that it must also regulate non-mercury HAPs such as certain metals (e.g. nickel, selenium, etc.) emitted in trace amounts and acid gases (e.g. hydrogen chloride and hydrogen fluoride) that, according to EPA, do not pose a meaningful risk to public health. While some health risks from emissions of non-mercury HAPs are discussed in the proposed rule and the CBA (presumably implying health benefits from reducing such emissions), EPA does not make any attempt to evaluate the benefits that will be achieved by reducing these emissions. What is discussed at some length is that control technologies for non-mercury HAPs included in the proposed MACT standard result in reductions of emissions of PM2.5 and SO2. In fact, EPA's analysis admits that virtually all (i.e. 99+ percent) of the estimated \$42 to \$130 billion in annual benefits are due to reductions in PM 2.5.

Nowhere does EPA explain whether there is a less costly way to achieve these benefits, which is puzzling because Congress has created a whole separate program to regulate PM2.5 – and it is very different from the MACT approach that EPA is now proposing. Although EPA is aggressively implementing the program that Congress created to regulate PM2.5, this program is much more flexible than the MACT program and would be a much more cost-effective way of regulating PM2.5 from power plants.

Why should this matter to the public? I have explained part of the answer above: EPA is mandated to find the most cost-effective solution for the regulatory priority (here: controlling mercury emissions from power plants) How can the Agency possibly conclude that it is a good deal for society to impose an annual cost of \$10.9 billion to achieve benefits of \$6.1 million?

The other reason this type of analysis matters is that EPA has *already* controlled emissions of PM2.5 by setting a national ambient air quality standard ("NAAQS") under section 108 of the Clean Air Act. In doing so, EPA has set a level of PM2.5 that it has found to be sufficient to public health and welfare with an adequate margin of safety. Areas of the country that already have attained this level of PM2.5 (i.e., that are in "attainment") are presumably therefore already safe from any health risks; Other areas that have not yet reached this level (i.e. are in "non-attainment") are *already* required to implement market-wide reductions in PM2.5 to get into attainment.

In explaining how it developed the baseline for its benefits analysis, EPA's RIA states that "EPA did not consider actions states may take in the future to implement the existing ozone and PM2.5 NAAQS standards[.]" Of course, as it did for the Utility MACT, EPA's proposed NAAQS for PM2.5 contained an estimated analysis of the benefits of PM2.5 reductions. By not including these benefits in the baseline of the Utility MACT, EPA is essentially claiming these same benefits a second time to justify another regulation. Put a different way, the only way EPA can possibly claim more benefits from reductions in PM2.5 is to go beyond the controls it has already put in place under the PM2.5 NAAQS. Doing so, however, is completely contrary to

Congress' intent to regulate PM<sub>2.5</sub> under a different section of the Clean Air Act and contrary to EPA's own claims that the PM<sub>2.5</sub> NAAQS is sufficient to protect public health and welfare.

### Using “Friendly” Lawsuits to Avoid Oversight

Currently, the only check on an agency's use of cost-benefits principles to make regulatory decisions is the interagency review process overseen by OIRA, which is part of the White House Office of Management and Budget (OMB). I have great respect for OIRA officials and staff, who are seasoned and dedicated economists and analysts with years of experience analyzing the costs and benefits of innumerable types of regulations. Unfortunately, OIRA officials are often unable to perform effective oversight due to factors outside of their control. EPA's proposed Utility MACT is, once again, a useful illustration.

In April 2009, after being sued by several environmental organizations for its failure to issue emission standards for HAPs from power plants, EPA *voluntarily* agreed to a consent decree. Under this consent decree, EPA agreed to an extraordinarily ambitious schedule that almost guarantees that there will not be enough time to do serious regulatory analysis. The consent decree requires EPA to issue the proposed Utility MACT by March 16, 2011 (which it has already done) and then to issue a final rule by November 16, 2011. It is not clear that the environmental organizations had a valid legal claim that EPA was required to issue the Utility MACT on any particular schedule, but there was certainly no legal justification for a schedule like this one. Some observers have suggested that EPA may have wanted to be “required” to issue the rule well in advance of the next presidential election.

To gather data for the proposed rule, EPA issued an information collection request (“ICR”) to utility companies in December 2009. This ICR required these companies to conduct extensive testing and analysis that cost almost \$200 million to produce. This data was not even available until late 2010, so neither EPA nor any other interested party had more than four months to review it before the proposed rule was issued. Putting aside the question of whether four months is an adequate timeframe in which to perform the required technical and cost-benefit analyses, EPA only submitted its proposed Utility MACT to OMB for the regulatory review process on February 19, 2011. Accordingly, OIRA and OMB officials, as well as officials at other affected agencies, had a total of *thirty* days to review, analyze, submit and resolve comments on the 946-page rule and the 496-page cost-benefit analysis before EPA was required to publish the proposed rule. It goes without saying that thirty days to perform the type of careful analysis and provide the meaningful input intended by the Executive Orders is beyond the skills of even the most dedicated and hard-working public officials.

This is just one example (a particularly glaring one, to be sure) of a consent decree having the effect, if not the intention, of cutting off meaningful regulatory review. But it highlights the need for Congress to ensure that agencies cannot make voluntary arrangements with outside entities which result in an end-run around the regulatory review process. I urge the Subcommittee to develop a legal, enforceable mechanism to ensure that there is sufficient time for meaningful interagency review.

## **Ensuring Proper Review and Analysis of Guidance Documents**

I also recommend that the Subcommittee go beyond just rules and regulations to require that significant guidance documents are subject to analysis and interagency review. Informal guidance is a very important part of the regulatory and compliance process, and it would be a mistake to do anything that would prevent agencies from developing guidance that is helpful to outside parties. But some guidance documents can have major impacts on regulated entities, even though they are not formally designated as “rules” that must go through the normal rulemaking procedures and interagency review. The Subcommittee should expand the scope of its inquiry to ensure that such guidance is analyzed and reviewed like rules that have the same practical effect on regulated parties as a regulation.

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It has been widely accepted for many years that cost-benefit analysis should play an important role in federal rulemaking. Although OMB and some other federal agencies have used CBA as an important tool in regulatory development, this requirement is not always done well. Congress should build on the work that has been done over the last 30 years to ensure that agencies do not avoid or misuse this type of analysis.