Issues in Regulation

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Letter from the Editor

We are pleased to bring our readers this special series on issues in regulation. Thanks to the hard work and efforts of Ronald Cass, a longtime friend and volunteer leader of the Federalist Society, several eminent scholars have contributed to this series. We hope our readers will appreciate the original information and incisive analysis that they will find in these pages.

As always, we encourage readers to send us any responses or feedback at info@fedsoc.org.

Sincerely,

Katie McClendon

September 2015

Editor
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Issues in Regulation

Introduction

*By Ronald A. Cass**

These papers look at a variety of issues related to administrative regulation. This project and the papers it generated came out of the realization that, with the coming presidential election, there will be renewed opportunity for discussion of the successes and failures of federal regulatory initiatives. Each candidate, of course, routinely assembles a team of experts, receives advice on the most important issues to address, and proposes particular solutions to the problems identified as significant for that candidate. Still, those of us who conceived of this project thought there was an opportunity to focus attention on a few specific areas in which regulation, procedures associated with regulation, and the legal structure that has important implications for regulation may be especially problematic or especially in need of attention.

With that in mind, we have asked a group of leading experts in administrative law and regulatory policy to address distinct areas, describe the regulatory regime in place, identify the most significant issue, and opine on the sort of considerations that incoming government officials should bear in mind when crafting solutions to the problems or when approaching the regulatory issues. These papers are not intended to provide specific policy proposals; instead, they are designed to provide background for those who are interested, to offer guidance for those who share broad concerns about personal liberty and economic opportunity, and to give a starting point for people interested in governance of the federal administrative apparatus. That includes both outside observers and government officials—notably those in charge of the Executive Branch, though in some instances the discussion may also focus on considerations applicable to legislators or judges.

Together, the papers call out regulatory programs that have been the subject of public debate from time to time because some view them as excessively costly, insufficiently attentive to corrective market forces, at odds with incentives for beneficial investment, or difficult to reconcile with constitutional values—a combination of problems that fall under headings of overregulation, regulatory misfit, and structural deficiencies. These issues obviously emphasize the negative aspects of regulation. That is by design, since our goal is not to provide an overall assessment of regulation's costs and benefits, but rather to expose issues that should receive attention precisely because there have been serious arguments about whether something has gone wrong. The emphasis on places where things have gone wrong, however, should not be mistaken for a skewed perspective on regulation; the analyses are dispassionate, careful, and thoughtful.

Furthermore, while the electoral cycle provided the impetus for this project, the project's output—the descriptions of regulatory programs, the analyses of regulatory problems, options, and opportunities, and the suggestions of principles that those who design regulatory policies and processes should keep in mind—are not so narrowly focused or time limited. The issues identified are not all of recent origin, and solutions will not likely be implemented for all of them before the next election cycle is upon us. We commend these papers to readers who want to understand where federal regulation may be off track, the reasons for concern about those instances of regulatory mishap, and the sorts of considerations that should be kept in mind by those who seek to get particular regulatory programs back on track.

** Honorable Ronald A. Cass, is Dean Emeritus of Boston University School of Law, Chairman of the Center for the Rule of Law, and President of Cass & Associates, PC. A former Commissioner and Vice-Chairman of the US International Trade Commission, Dean Cass also is a member of the governing council of the Administrative Conference of the United States, co-author of a leading text on Administrative Law, and author of more than 125 scholarly works on government regulation and other topics.*

Agency Taxation

*By Christopher DeMuth Sr.**

In recent years Congress has delegated its taxing and appropriating powers to regulatory agencies under several guises. The new "agency taxation" is distinct from the economic transfers implicit in many regulatory programs and also from agency fees-for-service. Traditional electricity and telephone regulation has required cross-subsidized rate structures, with above-cost rates for urban and business customers and below-cost rates for rural and residential customers. Environmental, health, and safety regulations impose compliance costs that are paid by firms and their customers for the benefit of customers or the general public. And agencies have long charged fees for particular services and transactions, ranging from admission fees at national parks to FCC license fees and FDA and Patent Office filing fees. The subject of this paper, in contrast, is broad-based taxes unrelated to any transactions with the agencies, used to fund the agencies' budgets and grant programs.

I. Taxation by Delegation

The FCC Universal Service Program. The first recent instance of agency taxation is in the Telecommunications Act of 1996, which authorizes the FCC to set and collect taxes for promoting "universal service" and gives the Commission wide discretion to determine whom to tax and at what rate and how to spend the revenues.

Currently, the FCC collects the tax (which it calls a "contribution") on the interstate and international revenues of landline and wireless telecommunications companies, cable companies that provide voice service, and paging service companies. It is a substantial tax—much higher than the 3-percent statutory federal excise tax on telephone service—and the Commission adjusts it each quarter to keep pace with its program spending. Recently the tax rate has been 15.7 percent (3Q-2014), 16.1 percent (4Q-2014), 16.8 percent (1Q-2015), and 17.4 percent (2Q-2015).

The FCC spends the revenues, which come to about $8.8 billion per year, on grant programs for landline, wireless, broadband, and Wi-Fi equipment and services for schools, libraries, and rural health care facilities, and on rate-subsidies for low-income and rural customers. Thus the Commission's "Lifeline" program currently provides a free basic wireless phone or landline installation and free basic telephone service (250 minutes per month) to about 12 million low-income customers, at a cost of $1.6 billion annually. In May 2015, FCC Chairman Tom Wheeler announced plans to expand the Lifeline program to cover Internet broadband as well as telephone service.

The universal service program is a delegation not only of Congress's taxing power (Article I, Section 8: "The Congress shall have power to lay and collect taxes … to … provide for the … general welfare of the United States") but also of its appropriations power (Article I, Section 9: "No money shall be drawn from the treasury, but in consequence of appropriations made by law"). The FCC's annual operating budget of about $500 million is covered entirely by the Commission's licensing and other fees and a share of the net proceeds from its spectrum auction programs—but the expenditures are nonetheless subject to annual appropriations by Congress in response to FCC budget requests. The universal service program, in contrast, is administered for the FCC by a subsidiary not-for-profit corporation, the Universal Service Administrative Company, whose revenues and expenditures are independent of annual budget requests and congressional appropriations.

The Public Company Accounting Oversight Board. The Sarbanes-Oxley Act of 2002 established the PCAOB to regulate accounting firms that audit "public companies" (those that issue publicly-traded stock) and broker/dealers in public stocks. The PCAOB's annual budget of about $250 million is funded almost entirely by its own tax (which it calls an "accounting support fee") on the equity capital or net asset value of public companies and broker/dealers. The Board establishes its operating budget for the year, subtracts a small sum from annual fees it collects from the accounting firms it regulates (about $1.6 million), and allocates the remainder among public companies and broker/dealers according to their size as measured by equity capital or net asset value. (The Board exempts smaller public companies from its tax, and it typically funds part of each year's budget from carryover tax and fee revenues from prior years.)

The PCAOB, like the FCC's Universal Service Administrative Company, is a 501(c)(3) subsidiary of a regulatory agency—for the PCAOB, the parent is the SEC. Its annual budget must be approved by the SEC, but is entirely independent of congressional appropriations. The Sarbanes-Oxley Act contains several provisions emphasizing that the PCAOB is independent of Congress and that its tax revenues are not "monies of the United States." But the Board's taxes (as well of course as its accounting regulations) are federally enforced legal obligations.

The Consumer Financial Protection Bureau. The CFPB, established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, enjoys a different form of agency self-financing. The Bureau is funded, not by its own tax, but rather by a draw (up to a statutory cap) from the profits of the Federal Reserve Banks. Those profits—revenues from fees and earnings from open market operations, minus the Federal Reserve's own operating expenses—were previously remitted to the Treasury as general revenue. Guaranteeing the CFPB a portion that would otherwise support other, discretionary government programs is a new entitlement program like Social Security or Medicare—an entitlement for a regulatory agency rather than citizens. Federal Reserve profits are currently more than $100 billion, while its own operating costs are about $6 billion and the CFPB's expenses are about $500 million. The Bureau's budget, like that of the Federal Reserve, is entirely independent of congressional appropriations.

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II. Constitutional Questions

The case law is adverse to a constitutional challenge to the delegation of taxation and appropriations in the FCC, PCAOB, and CFPB programs. The Supreme Court held in *Skinner v. Mid-American Pipeline Co.* that the nondelegation doctrine, which is extremely lenient, does not apply differently to Congress's taxing powers than to its other enumerated powers.[1] Lower courts have upheld aspects of the financing mechanisms of both the FCC universal service program and the CFPB against constitutional challenge.[2]

A well-crafted constitutional challenge to the universal service program and PCAOB could, however, have substantially greater prospects than this (rather thin) case law might suggest. The agencies' delegated powers go far beyond anything that has been considered by the Supreme Court. *Skinner* involved pipeline user fees limited to funding Transportation Department regulation of pipeline safety, and the Court noted that the fee revenues were subject to congressional appropriations (the arrangement was akin to the FCC's operating budget). *Texas Office of Public Utility Counsel v. FCC* formally considered only a poorly argued challenge to the universal service program on Origination Clause grounds (the circuit court also spurned a Taxing Clause argument in a footnote, but cursorily and as dicta because the issue had not been properly briefed). The Supreme Court's decision on the constitutionality of the PCAOB did not consider the Board's taxing and appropriating powers at all.[3]

Recently, moreover, Congress's increasingly bold delegation of regulatory discretion, and several Executive Branch actions going beyond statutory delegations, have prompted some reconsideration of whether the nondelegation doctrine is really as dead as had been supposed. During the past two Supreme Court terms, three justices have issued striking invitations to relitigate nondelegation.[4] Justice Thomas's opinion in *Department of Transportation v. Association of American Railroads* includes an impressive analysis of how "intelligible principles" might be specified to distinguish permissible from impermissible delegations. He does not touch on taxing and appropriations powers, but the features of the universal service program and PCAOB discussed here—wholesale delegation of discretion to determine whom is to be taxed and at what tax rates, and to collect and spend tax revenues without congressional appropriation—would fit well with a new effort to define constitutionally clear, judicially workable principles.

The CFPB presents issues separate from those of the universal service program and the PCAOB. The Bureau does not possess autonomous taxing power, and its independence of appropriations is part of the broader independence of the Federal Reserve System, which occupies a special place among federal institutions. It is worth noting, however, that the Fed's special status dates from a time when its primary function was to manage the money supply, which was thought to necessitate extraordinary independence from short-term political pressures. But in recent years the Fed has acquired many new regulatory powers of its own (in addition to those of the CFPB), through the Dodd-Frank Act and other statutes. The Fed's and the CFPB's regulatory policies are often highly costly and controversial, and they do not involve the considerations that motivated special independence for monetary policy. The transformation of the Fed's responsibilities and the grafting on of CFPB regulation invite a reconsideration of its freedom from congressional appropriations.

III. Policy and Political Questions—and Guiding Principles

Regardless of the constitutional status of the universal service program, PCAOB, and CFPB under prevailing or prospective Supreme Court doctrines, they raise profound questions about separation of powers and national policy that ought to be of keen interest to the president, Congress, and the general public.

The text of the Constitution indicates that the framers regarded the taxing power as particularly sensitive; they went out of their way to require that revenue measures originate in the House, the people's chamber whose members face the voters every two years. The universal service and PCAOB taxes, along with the implicit tax in the CFPB's financing mechanism, do not loom large among federal revenue raisers. They are, however, recent initiatives adopted in the context of routine deficit spending and high political controversy over taxes. They are properly viewed as ingenious means of evading accountability for taxes, which if allowed to stand could encourage a trend toward a system where Congress takes the credit for new programs but does not bear the responsibility of paying for them. It is worth notice that the annual profits of the Federal Reserve Banks could finance numerous additional "entitlement agencies" on the model of the CFPB—whose automatic budgets, siphoned from funds that would otherwise go to the Treasury as general revenues, would in effect be deficit financed. *Presidents ought to resist statutory arrangements that give executive agencies responsibility to impose taxes and spend the revenue while restricting the president's ability to supervise either.*

The appropriations power is the lynchpin of congressional control over federal spending and much else. It is also a key mechanism for countering—through "appropriations riders"—executive actions opposed by congressional majorities. But Congress's "power of the purse" has been falling into disuse, and the statutes discussed in this paper are part of a broader trend. This was dramatically illustrated in late 2014 when President Obama unilaterally revised statutory immigration policies in ways that many in Congress opposed on constitutional or policy grounds or both. Shortly after the president announced his policy changes, Republican opponents in Congress responded that they would halt them with a rider to the appropriations of the U.S. Customs and Immigration Service. Then, a few days later, came an embarrassed follow-up: staffers had discovered that USCIS is not only self-funded by its own fees, but also (unlike the FCC's operating budget) exempt from congressional appropriations. Regardless of the merits of President Obama's immigration policies, *Congress's confusion over which agencies are and are not dependent on it should be worrisome to those who believe that robust inter-branch competition is an important feature of our system of government.* Foremost among the worriers should be members of Congress themselves.

Finally, combining regulation, taxation, and appropriation in a single executive agency is a concentration of power conducive to *both abuse and bad policy.* The CFPB has been notably imperious concerning its regulatory powers and independence from the rest of the federal government. The chairman of the PCAOB draws a salary of $672,676 and the other Board members $546,891—they are by far the highest paid political officials in the federal government. The FCC's Lifeline program has been infamously beset by fraud and abuse.[5] More generally, regulatory agencies already possess tremendous power to impose costs and dispense benefits by rulemaking (as in the examples mentioned at the beginning of this paper), which in the nature of the case is independent of taxation, appropriation, and budgeting.

All single-purpose, mission-driven agencies tend to pursue their missions to excess—but regulatory agencies, unlike spending agencies, lack the conventional constraints of public finance that oblige trade-offs among competing public goods. To compensate for this problem, presidents from Ronald Reagan to Barack Obama have required regulatory agencies to follow a cost-benefit standard for their new rules. Congressional reform proposals would go further with such devices as a judicially reviewable cost-benefit standard, a "regulatory budget," and "regulatory pay-go" procedures. Giving regulatory agencies additional, highly discretionary authority to tax and subsidize the firms and individuals they regulate is a large step backwards from these mainstream, bipartisan reform initiatives. *Better policy requires greater institutional discipline, but the arrangements discussed in this paper relax institutional discipline to an unprecedented degree.*

The FCC's universal service program, the PCAOB, and the CFPB are signal innovations in government. With comprehensive taxing, spending, and regulatory powers, they are, in effect, autonomous special-purpose national governments, independent of elected officials so long as their enabling statutes remain on the books. They are innovations that friends of our constitutional order, and of sound and honest public policy, should seek to counter and reverse.

Endnotes

1 490 U.S. 212 (1989).

2 *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999); *CFPB v. Morgan Drexen Inc.,* – F. Supp. 3d –, No. SACV 13-1267-JLS, 2014 WL 5785615 (C.D. Cal., Jan. 10, 2014).

3 *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010).

4 *City of Arlington v. FCC*, 133 S. Ct. 1863, 1879 (2013) (Roberts, C.J., dissenting); *Department of Transportation v. Association of American Railroads*, Docket No. 13-1080, March 9, 2015 (Alito, J., concurring, and Thomas, J., concurring in the judgment).

5 A 2013 review of the Lifeline subscribers of the top telephone service providers found that 41 percent of more than six million subscribers receiving free or subsidized services either could not demonstrate their eligibility or failed to respond to requests for certification. *See* Spencer E. Ante, "Millions Improperly Claimed U.S. Phone Subsidies," *Wall Street Journal*, Feb. 12, 2013. Lifeline service is widely marketed as "Free Obama Phones," and one service provider has advertised for phone distributors under the headline, "Get Paid to Pass Out Free Government Cellphones." *See* Charles C.W. Cooke, "Life, Liberty, and a Free Phone," *National Review*, March 11, 2013.

EPA's Use of Co-Benefits

*By C. Boyden Gray**

Note from the Editor:

This article is about environmental regulation and the EPA's questionable practice of using co-benefits to justify its regulations. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the author. Generally, the Federalist Society refrains from publishing pieces that advocate for or against particular policies. When we do so, as here, we will offer links to other perspectives on the issue, including ones in opposition to the arguments put forth in the article. We also invite responses from our readers. To join the debate, please e-mail us at info@fedsoc.org.

• Alan Neuhauser, *EPA Power Plant Rule 'Modestly' Lowers Rates, Carbon Emissions*, U.S. News & World Report (May 22, 2015), http://www.usnews.com/news/articles/2015/05/22/epa-power-plant-rule-modestly-lowers-rates-carbon-emissions.

• Adam Liptak and Coral Davenport, *Supreme Court Blocks Obama's Limits on Power Plants*, New York Times (June 29, 2015), http://www.nytimes.com/2015/06/30/us/supreme-court-blocks-obamas-limits-on-power-plants.html?_r=2.

• Benjamin Zycher, *President Obama's Clean Power Plan: All Cost, No Benefit*, American Enterprise Institute (August 14, 2015), https://www.aei.org/publication/president-obamas-clean-power-plan-all-cost-no-benefit/.

I. Cost-Benefit Analysis in Environmental Regulation

In keeping with longstanding Executive Orders and guidance from the Office of Management and Budget (OMB), EPA must subject its proposed major rules to cost-benefit analysis in an effort to demonstrate that the regulations will protect Americans' "health, safety, environment, and well-being" and bolster "the performance of the economy," but "without imposing unacceptable or unreasonable costs on society." This practice is consistent with the primary purpose of the Clean Air Act: "to protect and enhance the quality of the Nation's air resources"—not for their own sake—but "so as to promote the public health and welfare and the productive capacity of [the U.S.] population." A regulation that achieved cleaner air at a net cost to national health, welfare, and productive capacity would be inconsistent with this congressional purpose.

II. The Increasing Costs of Environmental Regulation

Thanks to technological advances, our environment is dramatically cleaner today than it was in the early days of EPA. In sector after sector of the American economy, the low-hanging fruit of environmental regulation has largely been picked. An unfortunate result of EPA's early success is a larger and larger EPA making smaller and smaller marginal improvements in the air we breathe, at greater and greater cost to the U.S. economy.

Take two examples of these high costs. First, EPA's proposed Clean Power Plan for regulating greenhouse gas emissions from existing power plants comes with an annual cost of $5.5 billion by 2020 and $7.3 billion by 2030, according to the Agency's own estimates. Second, the proposed revision to the National Ambient Air Quality Standard (NAAQS) for ozone will carry an annual price tag of between $3.9 billion and $15 billion by 2025, depending on the stringency of the standard EPA finalizes. As shown below, the corresponding benefits represent a small fraction of these costs.

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III. The Co-Benefits Temptation

Faced with the staggering costs of regulation and the requirement of cost-benefit analysis, EPA is under considerable pressure to identify corresponding benefits to outweigh the costs. That is where co-benefits come in. Often a rule designed to reduce emissions of one pollutant claims most of its benefits from incidental reductions of secondary pollutants. Those incidental reductions are known as "co-benefits."

One such co-benefit has proven particularly useful to EPA's costly regulatory agenda. Estimated reductions of particulate matter ($PM_{2.5}$) and ozone have become a staple of EPA's regulation, with monetized benefits from $PM_{2.5}$ reduction representing the majority of all federal regulatory benefits (not just EPA's) for the past decade. As OMB reported to Congress in 2012, "It is important to emphasize that the large estimated benefits of EPA rules are mostly attributable to the reduction in public exposure to a single air pollutant: fine particulate matter." The vast majority of $PM_{2.5}$ co-benefits (about 98%) come from estimated reductions of premature mortality associated with $PM_{2.5}$ exposure based on EPA's estimated "value per statistical life," which takes no account of the age of the persons whose premature mortality is supposedly avoided. This metric is questionable in itself since, as OMB reported, "significant uncertainty remains" concerning "the reduction of premature deaths associated with reduction in particulate matter and . . . the monetary value of reducing mortality risk."

IV. EPA's Mercury Rule

For example, although no cost-benefit analysis was required, EPA's recent rule governing mercury emissions from power plants predicted benefits of up to $90 billion per year, including the avoidance of up 11,000 premature deaths annually, even though only a tiny proportion of those benefits came from reducing mercury emissions. More than 99% of the anticipated benefits were attributable to incidental reductions of $PM_{2.5}$.

This stark imbalance prompted Chief Justice Roberts to suggest in oral argument that EPA was using its authority to regulate mercury "to get at the criteria pollutants [including

$PM_{2.5}$] that you otherwise would have to go through a much more difficult process to regulate." The Chief Justice questioned whether EPA "ought to consider only the benefits of regulating that" targeted pollutant, rather than "bootstrapp[ing]" a "disproportionate amount of benefit that would normally be addressed under" a separate statutory authority.

V. EPA's Clean Power Plan

But despite these sensible questions, there is no end in sight for EPA's reliance on $PM_{2.5}$ and ozone co-benefits. Most of the projected benefits that EPA used to justify its proposed regulation of carbon emissions from power plants have nothing to do with climate change—the purported aim of the regulation. Out of $48 billion in total domestic benefits projected for 2030, for example, $45 billion (94%) are attributed to ancillary $PM_{2.5}$ and ozone reduction. Only $3 billion are associated with the climate change benefits of achieving the mandated carbon reductions—an amount far below the rule's annual compliance costs of $9 billion.

EPA's reliance on co-benefits to justify its new carbon rule is especially problematic because the statutory authority for that rule—section 111(d) of the Clean Air Act—*expressly prohibits* EPA from regulating $PM_{2.5}$, ozone, and other "criteria pollutants" under that provision. Because sources of air pollution inevitably emit multiple pollutants indiscriminately, air pollution regulations necessarily affect multiple pollutants. The only meaningful way to enforce the prohibition on regulating criteria pollutants through Section 111(d), therefore, is to prohibit EPA from counting $PM_{2.5}$, ozone, and other NAAQS pollutants as benefits of carbon regulation under that section.

VI. Double Counting

Particulate matter and ozone seem to offer EPA an inexhaustible well of regulatory co-benefits. But $PM_{2.5}$ and ozone are both already directly regulated by EPA's NAAQS to a level "requisite to protect the public health" with "an adequate margin of safety." Thus, whenever EPA counts $PM_{2.5}$ or ozone reductions in its cost-benefit analysis for other rules, it is double-counting reductions already mandated by the NAAQS.

For example, EPA admits that its proposed Clean Power Plan's benefit "estimates include health co-benefits from reducing fine particles in areas with varied concentrations of $PM_{2.5}$, including both areas that do not meet the fine particle standard and those areas that are in attainment, down to the lowest modeled concentrations." And it counts every ton of $PM_{2.5}$ reduction equally, regardless of where it is found.

This is double-counting, plain and simple. As Michael A. Livermore and Richard L. Revesz explained in the N.Y.U. Law Review last year, "[t]o guard against double counting the ancillary benefits, one needs to make sure that after each regulation is promulgated, a new baseline level of pollution is computed. Then, the further benefits from subsequent regulations need to be determined by reference to this baseline." EPA regularly flouts this basic principle of sound regulation by ignoring the $PM_{2.5}$ and ozone reductions it has already mandated, and counting those reductions again as benefits in new rules. The same ton of pollutant thus serves to justify multiple rules, even though the pollution can only be prevented once.

VII. Inflated Benefits

In regions that have already attained EPA's $PM_{2.5}$ and ozone NAAQS, counting reductions of those pollutants as co-benefits presents a different problem. EPA's NAAQS represent the level of pollution control that the Agency deems "requisite to protect the public health" with "an adequate margin of safety." Reducing $PM_{2.5}$ and ozone emission even further is not "requisite to protect the public health," and therefore cannot possibly produce the health benefits that the proposed rule claims. As a former Chairman of the Texas Commission on Environmental Quality has explained, "[i]f reducing particulate matter had the enormous benefits that EPA's analysis claims, it has a legal responsibility to lower the national ambient standard to a level that is actually protective of human health. The fact that it has not done so suggests that the EPA does not really believe its own numbers."

EPA can only accomplish this sleight of hand by jettisoning the very same evidence, assumptions, and models that it used to justify the $PM_{2.5}$ and ozone standards. In support of its proposed Clean Power Plan, EPA "assumes that the health impact function for fine particles is log-linear without a threshold" and counts $PM_{2.5}$ mortality benefits all the way down to the lowest measured level. But in its 2013 $PM_{2.5}$ NAAQS, EPA explicitly considered and rejected proposals to mandate a more stringent $PM_{2.5}$ standard, because such a standard "would not be warranted to provide requisite protection that is neither more nor less than needed to provide an adequate margin of safety." EPA declared that it was "not appropriate to focus on" the "uncertain" and "suggestive" evidence of health effects from $PM_{2.5}$ exposure below the mandated level. The proposed rule ignores these conclusions and treats all emissions reductions alike, whether or not they occur below the NAAQS level. Without any explanation for contradicting the assumptions on which it based its own $PM_{2.5}$ rule, EPA declares in the Clean Power Plan that it is "unable to estimate the percentage of premature mortality associated with the emission reductions at each $PM_{2.5}$ concentration, as we have done for previous rules with air quality modeling," and admits that it is "less confident in the risk we estimate from simulated $PM_{2.5}$ concentrations that fall below the bulk of the observed data in the [relevant] studies." Yet it is on the basis of these supposed benefits that EPA is justifying a path-breaking greenhouse gas regulation to the American people. The EPA's inflation of its purported regulated benefits appears to be a perfect example of what former OIRA Administrator Susan Dudley describes as the agencies' habit of "perpetuating puffery" in their benefit-cost analyses.

VIII. Nondelegation Implications

EPA's misuse of co-benefits to justify costly regulations is more than just bad policy; it violates the constitutional separation of powers. As I explained in an article in the George Mason Law Review earlier this year, the Supreme Court and D.C. Circuit have repeatedly recognized that statutes must not be construed to allow the agency to impose substantial regulations without evidence that such regulation is actually necessary to prevent "significant" risk of harm. To allow otherwise would be to "make such a 'sweeping declaration of legislative power' that it might be unconstitutional under" the Court's nondelegation precedents, as Justice Stevens' plurality opinion in the *Benzene Cases* explained. "A construction of the statute that avoids this kind of open-ended grant should certainly be favored," he and his colleagues stressed.

The Court reiterated this approach in *Whitman v. American Trucking Associations*, where it narrowly construed the Clean Air Act's Section 109(b)(1). That statute provides for the establishment of air quality standards that are "requisite" to protect public health. The Court, at Solicitor General Waxman's urging, construed this as authorizing EPA to set standards that are "sufficient, but not more than necessary," to protect public health.

EPA utterly ignores such limits in its counting of $PM_{2.5}$ co-benefits in the Clean Power Plan. Just two years ago, when EPA updated its NAAQS for $PM_{2.5}$, the agency specifically found that the "requisite" level of protection was 12 micrograms per cubic meter; beyond that level, EPA could not show significant health impacts. But now, when calculating the supposed co-benefits that the Clean Power Plan would achieve by collaterally reducing $PM_{2.5}$, the EPA jettisons that conclusion without any justification, and simply claims co-benefits for any $PM_{2.5}$ reductions that might be obtained, even beyond the aforementioned 12 micrograms level, all the way down to the zero level. In other words, EPA now interprets the Clean Air Act as allowing it to regulate $PM_{2.5}$ emissions reductions beyond 12 micrograms, all the way down to zero, even though they have not shown any significant health risks being eliminated by such extreme reductions. EPA is treating the Clean Air Act as a completely open-ended grant of power, precisely as the Supreme Court forbids.

IX. Foreign Co-Benefits

Perhaps EPA's most egregious use of co-benefits is its reliance on the projected global benefits of its regulations. The cost-benefit analysis supporting EPA's Clean Power Plan and other carbon regulations is predicated on an apples-to-oranges comparison of domestic costs and global benefits. This will be a hallmark of all subsequent carbon regulation, thanks to the global "social cost of carbon" (SCC) at the heart of EPA's analysis. Although all of the costs of reducing carbon emissions will be borne by U.S. entities, EPA offsets those costs against a global valuation of the benefit of reducing a ton of carbon. Never mind that the United States' share is only 7 to 10 percent of the global SCC.

EPA's reliance on foreign benefits violates the Clean Air Act, whose purpose is "to protect and enhance the quality of the *Nation's* air resources so as to promote the public health and welfare and the productive capacity of *its* population." Despite EPA's past acknowledgement of "the [Clean Air Act's] stated purpose of protecting the health and welfare of *this* nation's population" in the context of the Agency's greenhouse gas endangerment finding, the Agency now gives equal weight to foreign benefits, without regard to whether they have any measurable impact on the United States.

EPA's use of a global social cost of carbon also violates OMB guidance, which requires a regulatory impact analysis to "focus on benefits and costs that accrue *to citizens and residents of the United States*." The Interagency Working Group that produced the SCC noted OMB's guidance, and acknowledged that using a global estimate "represents a departure from past practices, which tended to put greater emphasis on a domestic measure of SCC." Nevertheless, the Working Group—and EPA—expressly declined to follow OMB's instructions.

EPA attempts to justify its reliance on foreign benefits by the observation that "we expect other governments to consider the global consequences of their greenhouse gas emissions when setting their own domestic policies." But of course EPA has no power to control whether foreign countries regulate greenhouse gas emissions at all, much less how they calculate the benefits of their own regulation. As former Administrator of OIRA, Susan Dudley, has explained, "In the absence of . . . reciprocal action by other nations, . . . the global benefits in the SCC cannot be regarded as a legitimate entry in the benefit-cost ledger."

The global SCC has also been defended on the ground that climate change involves global externalities. But all significant U.S. regulations have international externalities, and the global benefits of adopting policies designed to benefit the world at large would invariably outweigh their cost to U.S. citizens. As economists Ted Gayer and Kip Viscusi have observed, the use of global benefits to justify domestic regulations "represents a dramatic shift in policy, and if applied broadly to all policies, would substantially shift the allocation of societal resources." Of course, if Congress wanted EPA to consider global benefits, it could pass a law requiring EPA to do so. But that is a policy judgment only Congress can make.

X. Guiding Principles for the Future

1. *Maintain Coherence Across Regulations.* In cost-benefit analysis of proposed regulations, EPA should not double-count pollution-related benefits that have already been used to justify prior regulations. Nor should agencies be allowed to count reductions of pollutants in areas where they appear below the national standard EPA has already set for those pollutants. EPA should use the best available data and models for calculating the health effects of reducing a given pollutant across all regulations.

2. *Compare Apples to Apples.* The costs of complying with a given regulation should be compared against the social goods that that regulation is authorized to achieve—not incidental co-benefits, especially the reduction of pollutants that are already regulated by separate rules. By the same token, domestic costs should be compared against domestic benefits.

3. *Justify Regulations Based on American—Not Global—Benefits.* Consistent with the Clean Air Act's purpose of improving national air quality and OMB's guidance requiring agencies to focus on domestic benefits, EPA should be prohibited from justifying costs to domestic industry with estimated benefits to the world at large.

Environmental Regulation

*By James Huffman**

Although opinion polling generally indicates that the environment is low on the list of public concerns, environmental and natural resource policies have a very significant impact on the economy and therefore on the day to day lives of ordinary Americans. Any pro-growth agenda will benefit from attention to environmental regulations and federal natural resource management.

I. Challenges Facing Federal Departments and Agencies with Environmental Responsibilities

Numerous federal departments and agencies have regulatory and management responsibilities relating to the environment and natural resources including, but not limited to, the following: Council on Environmental Quality, Environmental Protection Agency, Department of Interior (Bureau of Land Management, Bureau of Reclamation, National Park Service, U.S. Fish and Wildlife Service), Department of Agriculture (Forest Service, Natural Resources Conservation Service, Office of Environmental Markets), Department of Energy, and Department of Commerce (National Oceanic and Atmospheric Administration).

Federal laws and administrative actions have created a complex array of environment-related regulations and directives that affect virtually every aspect of private and public life. While most environmental regulations have important and legitimate purposes, the monitoring and compliance costs often exceed the public benefits and, like all regulations, those relating to environmental protection and natural resources conservation can be manipulated for the benefit of special interests rather than the public welfare.

Two challenges facing every presidential administration are to achieve the maximum possible coordination and consistency among the many federal agencies and to assure that the private and public costs of regulatory compliance are justified by the resulting public benefits. Given the many agencies involved and the broad range of statutes they are responsible to administer, it is not possible to meet these challenges with top-down policy directives from the White House. Thus, the only realistic approach is to integrate a common set of basic policy principles across the full range of environmental and natural resources agencies–principles that can have application to the regulation of pollution from private industrial sources as well as to the management of publicly owned resources, the control of greenhouse gas emissions, and the preservation of endangered species and natural areas.

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II. The Most Important Environmental and Natural Resources Issues Facing the Next Administration

Several concrete issues are likely to provide the opportunity for a coordinated and coherent approach to environmental protection and natural resource conservation. Continued pressure from environmental groups combined with independent action by state and local governments will require the federal government to act where matters within the scope of federal responsibility are at issue. Foremost among those issues requiring federal action will be climate change, energy, water, federal public lands, and endangered species.

Climate change has become the dominant concern of most mainstream environmental groups, including those with relatively narrow missions like wildlife and wilderness protection. Their concern is that climate change has the potential to alter or destroy whatever environmental amenities and natural resources it is their mission to protect. Climate change has also surfaced as a top priority of the current administration. On June 1 of this year, the Environmental Protection Agency (EPA) promulgated rules implementing its Clean Power Plan. Those rules have been challenged as beyond EPA authority, but if upheld they will have dramatic consequences for the American economy.

Inextricably related to climate change policy is *energy*. Carbon dioxide constitutes over 80 percent of greenhouse gas (GHG) emissions, and nearly 80 percent of those emissions derive from electricity generation, transportation, and industry. Thus, significant reductions in GHG emissions are dependent on rapid and widespread substitution of low carbon for high carbon fuels and on the development of alternative energy sources. There has been growing pressure from environmental groups to close coal-fired generating facilities, and the recent history of subsidized alternative energy sources has created influential interest groups lobbying for the extension and expansion of those subsidies. A growing movement on college campuses is pressuring for disinvestment in companies engaged in carbon related industries.

Also linked to concerns over climate change is *water policy.* Environmental activists attribute the ongoing drought in California and the Southwest and flooding in other parts of the country to climate change. Whether or not climate change has anything to do with these and other weather patterns, the allocation of scarce water resources will be an ever more pressing challenge, and the next administration will be faced with defining the federal role and collaborating with the states in the allocation and management of the nation's water resources.

In the western states, the use and management of the vast *federal public lands*, which constitute on average 50 percent of the land between the Rocky Mountains and the Pacific Ocean, is likely to reemerge as an issue for the next administration. Agricultural and natural resource interests in much of the rural West are pressuring state legislatures to follow the state of Utah's lead and enact legislation calling on the federal government to transfer control of federal lands to state governments. While there appears to be little likelihood that states will succeed in claiming legal title to federal lands, the effort does evidence a widespread concern in the rural West over the use and management of lands in federal ownership. Because these lands contain significant timber, mineral, water, and grazing resources, there are significant opportunities to stimulate rural economies through improved management.

Directly related to the water and public lands challenges are existing policies relating to the protection of *endangered species*. The Endangered Species Act (ESA) has proven to be a powerful tool for the imposition of constraints on land and resource use with obvious implications for economic development. Because the ESA increasingly constrains alternative energy development and curtails water diversions by large urban areas affecting millions of inhabitants, there are likely to be growing pressures to amend the ESA.

III. Discussion

Political debates over climate change policy usually degenerate into name-calling, with one side labeled extremists and the other deniers. The next administration will have the opportunity to elevate the discussion in the interest of developing a realistic and affordable set of policies to cope with whatever climate change may occur, without regard for whether it is human caused. To the extent reduced reliance on carbon-based fuels and a shift from more carbon-intensive to less carbon-intensive fuels will be cost-effective and beneficial to Americans, measures should be taken to encourage such actions. But it makes little sense to incur enormous taxpayer and social costs where the returns in mitigated climate change will be minimal. The better approach is to prepare for the possible impacts of climate change with strategies for adaptation if and when changes occur, and with an understanding that the predictions are based on models that necessarily simplify extremely complex natural processes.

Because most climate change mitigation strategies that have been proposed would dramatically affect the cost of energy, and because energy costs are a significant factor for virtually all businesses, climate change policies must account for economic effects including innovation, investment, employment, compensation, and the quality of goods and services. Recent innovations in the technology of petroleum extraction ('fracking' and directional drilling) demonstrate that private innovation can have significant environmental benefits (reduced carbon emissions from the substitution of natural gas for coal, for example) as well economic benefits (lower energy costs and new jobs, for example). Although the federal government can play an important role in energy innovation by providing support for basic research, experience suggests that direct federal intervention in the energy market with subsidies and tax breaks only serves to divert private investment into uneconomic energy development. It should also be clear that the best and perhaps only existing large-scale alternative to carbon-based energy fuels is nuclear. Modern nuclear technology has advanced dramatically over the past decade and now has enormous potential for safe electricity generation with minimal environmental harm and zero carbon emissions. Still, existing federal regulations make the costs of new nuclear development prohibitive.

Because water is essential to life and because water sources are usually parts of complex systems of transient and integrated ground and surface waters, the tendency over the last half-century has been to resort to public planning and management of water resources. This tendency has given rise in nearly every region of the country to political struggles over water and a diminished role for the private rights systems that have long existed in all of the states. While there is a necessary role for federal involvement in the allocation of interstate waters, it is important to recognize that historic government policies have contributed to some of the nation's most serious environmental problems, and that private water markets can make an important contribution to the efficient use of water resources.

Federal public land resources have also suffered from a lack of market discipline. Pursuant to various federal laws, vast areas of the public lands have been effectively withdrawn from productive use in favor of environmental preservation and species protection. The impact on rural communities of the West has been devastating. The 1964 Multiple Use Act and the subsequent planning legislation has had the perverse effect of removing economic considerations from management decisions while tying the hands of the government officials with management responsibilities. The Endangered Species Act further constrains land managers by functioning as an effective trump on all other considerations. Efficient use of whatever public land resources are made available for economic use does not require private title, but it does require private rights of use sufficient to justify investment and long-term management.

IV. Unifying Themes

Although the foregoing issues are related to one another (as explained above), they will also seem quite distinct from a political perspective. Different regions of the country will tend to see some issues as more important than others and each of the political interest groups active in these arenas will have a particular policy focus that views the problems and solutions in a given area as unique. But there are unifying themes that should be reflected in the environmental and natural resource policies of the next administration.

1. *Remember that resource scarcity requires trade-offs.* All of the foregoing issues rise to political significance because of resource scarcity. Whether we are talking about water for residents of Los Angeles, timber for mills in Idaho, coal not mined in Pennsylvania, or carbon pollution from New Jersey industries, the challenge exists because resources are limited. Water delivered to Los Angeles is water not available to farmers as distant as Colorado. Trees harvested on public lands to supply mills in Idaho are trees no longer providing habitat for birds and shade for hikers. Coal left in the ground in Pennsylvania denies employment to local miners and requires reliance on other energy sources. Carbon emitted in New Jersey is the byproduct of both jobs and useful products. There are tradeoffs everywhere because resources are scarce and therefore valuable. To the extent federal law requires federal officials to make resource allocation decisions, these tradeoffs must be taken into account. But government policy at all levels must also recognize that central planners cannot possibly account for all of the literally millions of factors affecting supply and demand.

2. *Rely on market forces to make needed trade-offs wherever possible.* Scarce resources could be allocated on a first come first served basis, but the result of that is what Garrett Hardin labeled the "tragedy of the commons"–everyone has incentives to consume what they can and no one has incentives to conserve and manage for the future. The alternatives to this tragedy are only two: we can allocate resources through a political process of some sort, or we can allocate them through market exchanges between willing buyers and sellers. The former requires a distribution of political power; the latter requires a system of private property and contract rights. Environmental harm is evidence that a purely market system will have unacceptable third party impacts. A half century of environmental regulation and over a century of public lands resource management demonstrate that public officials lack the information required for efficient resource allocation and that the processes put in place to acquire information end up creating obstacles to timely decision making. Thus, the allocation of scarce resources requires some combination of political and market approaches.

3. *Be aware of regulations' links to rent-seeking.* To the extent we rely on the political methods of regulation, subsidy (including tax breaks), and public management, rent-seeking will be a persistent reality. Private interests and self-proclaimed public interest advocates will seek political solutions that benefit them. All will insist that they have only the public interest in mind, but pursuit of private advantage is an inevitable aspect of public resource management. The same is true of the resource managers who have careers to think about and their own agendas. Measures can be taken to limit opportunities for private benefit, but the reality is that rent-seeking is pervasive, expensive, and often disruptive of the public purposes that justify public action in the first place.

4. *Focus on incentive effects.* Achieving the right balance between public action and private markets is difficult, to say the least, but a good guiding principle should be to get the incentives right in relation to our public objectives. Getting the most benefit from any given amount of a scarce resource is surely an objective that is widely shared. Markets are demonstrably superior for getting the incentives right in this respect. For markets to work, resources must be effectively owned and ownership must be transferable. To the extent that the resulting resource uses impose unacceptable costs on third parties (like air and water pollution), regulation is necessary and appropriate. But consistent with the theme of getting the incentives right, regulators should rely on market incentives like tradable emissions permits for pollution control, congestion pricing for traffic management, competitive bidding for the allocation of public land resources, and user fees for the provision of public goods and services.

The Consumer Financial Protection Bureau and the Return of Paternalistic Command-and-Control Regulation

*By Todd J. Zywicki**

Note from the Editor:

This article examines and critiques the regulatory strategies employed by the Consumer Financial Protection Bureau. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the author. Generally, the Federalist Society refrains from publishing pieces that advocate for or against particular policies. However, when we do, as here, we will offer links to other perspectives on the issue, including ones in opposition to the arguments put forth in the article. We also invite responses from our readers. To join the debate, please e-mail us at info@fedsoc.org.

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I. The Return of Command-and-Control Regulation at the Consumer Financial Protection Bureau

A centerpiece of the Dodd-Frank financial reform legislation was the establishment of the Consumer Financial Protection Bureau (CFPB), a new consumer protection super-regulator with the power to control the terms and offerings of every consumer financial product in America, from expensive complex mortgages offered by trillion-dollar international banks to short-term small-dollar loans by local payday lenders and routine debt collection. Moreover, because many small and start-up businesses are funded by the entrepreneur's personal credit, the CFPB has effectively become the regulator of much of the economy's small business credit as well. The White House press release issued contemporaneously with the CFPB's March 2015 announcement of plans for new stringent regulations on payday lending summed up: "One of the most critical components of the Wall Street Reform bill passed by Congress in 2010 and signed by the President was the creation of the Consumer Financial Protection Bureau (CFPB), a dedicated, independent cop on the beat with the single goal of protecting consumers from threats like abusive practices of unscrupulous lenders or the fraudulent practices of debt collectors."[1]

II. Agency Rules and Approach

According to its own materials, the CFPB touts itself as a "21st century, data-driven agency,"[2] and its proponents argue that it will take a "market-based approach" to regulation, seeking to make markets work better instead of replacing markets, through product bans, substantive regulation of specific terms of contracts, and the like.[3] In practice, however, the CFPB has quickly evolved into an old-fashioned command-and-control paternalistic regulator. Moreover, as a result of the combination of the CFPB's extremely broad authority and a lack of accountability from traditional oversight by the President or Congress, the CFPB's archaic regulatory approach holds potential for extreme harm to consumers and the economy. Its adoption of discredited command-and-control regulatory strategies is especially tragic in that, prior to Dodd-Frank, the federal system of consumer financial protection was in dire need of reform. Consumer financial regulation should have been systematized and modernized in light of sound economics and a more institutionally streamlined and coherent regulatory approach that could not only unify federal consumer financial protection policy, but also encourage federal and state policies to work together more effectively for the benefit of consumers. Instead, the CFPB's approach resembles a Nixon-era regulatory dinosaur frozen in ice and thawed out to try to regulate our 21st century economy.

III. Context: Consumer Financial Protection Regulation: Old and New Approaches

While legal rules governing the U.S. economy broadly support freedom of contract, the CFPB's command-and-control approach is more consistent with the historical approach of consumer financial protection law, which was defined by substantive regulation of terms and conditions of consumer financial products. Most notably, regulators around much of the world long regulated the maximum allowable interest rates for consumer credit products under "usury" laws that prohibited rates of interest regulators deemed excessive, purportedly to protect low-income and improvident borrowers from excessive costs and use of credit.[4] Following Jeremy Bentham's criticism of price controls on interest rates in the eighteenth century, however, a consensus emerged among economists that price controls on interest rates harmed consumers by forcing lenders to adjust other terms of the contract (such as requiring larger

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down-payments or larger loan amounts), by distorting the consumer credit market (favoring retailers that could increase prices of goods to offset credit losses), and by reducing credit availability to higher-risk borrowers (which increased their dependence on loan sharks and lower-quality credit products such as pawn shops). Apart from their inefficiency, usury ceilings' ill effects fall hardest on their supposed beneficiaries—low-income consumers—who are the first to lose credit choices when regulation tightens access to credit. Economic analysis has stressed that the distorting effects of command-and-control regulation of terms applies not just to regulation of interest rates but to restraints on any freely-bargained term of a consumer credit contract.

This recognition of the failure of command-and-control regulation led to a movement in the 1960s and 1970s toward disclosure requirements in place of substantive restrictions on products and terms, best exemplified by the enactment of the Truth in Lending Act. Disclosure regulation rests on the presumption that, rather than dictating terms and conditions of credit, regulators should try to work within the market structure by providing standardized disclosure formats and similar tools that will enable consumers to comparison shop among different providers of credit. This vision of disclosure regulation, however, fell victim to litigation, regulatory excess, and a preference for disclosure rules intended to shape consumer behavior rather than disclosure requirements that enable informed consumer choice.

The CFPB's resuscitation of a command-and-control approach to regulation is a self-conscious return to the regulatory approach of the past. The CFPB, as proposed by now-Senator Elizabeth Warren and others, was modeled on the Consumer Products Safety Commission, which has the power to ban and recall consumer products deemed to be "unsafe." Indeed, in advocating for the new agency, Warren once expressly analogized the regulation of subprime mortgages to unsafe toasters that explode when used, oblivious to the obvious differences between the products.[5]

Although the CFPB is expressly barred by Dodd-Frank from setting interest rate ceilings, its archaic approach to consumer financial protection is seen in a variety of other substantive areas. For example, its "Qualified Mortgages" and "Ability-To-Repay" rules essentially dictate the mortgage terms and borrower conditions which it deems to be "safe" mortgages for consumers. Yet at the same time, the rules do nothing to address the primary cause of the foreclosure crisis—the prevalence of underwater mortgages that provided consumers with an incentive to default when their homes fell in price—such as by requiring larger down payments, limiting cash-out refinancing, or recognizing the effects of state anti-deficiency laws that limit a borrower's personal liability upon mortgage default. The CFPB is also proposing rules on payday loans, auto title loans, installment loans, and other products that would force lenders to assess a borrower's ability to repay small-dollar loans before extending them, essentially eliminating (or sharply curtailing) those products from the marketplace.[6] With respect to auto loans issued by auto dealers, the CFPB is using its leverage over banks to try to restrict the opportunity for borrowers to negotiate over loan terms, because bargaining ability may result in pricing differences that have disparate impact on borrowers. Although enacted prior to Dodd-Frank, the Credit CARD Act of 2009 similarly regulates the terms of credit card accounts, such as limiting the size and incidence of certain behavior-based fees and limiting the ability of issuers to reprice interest rates when consumers' credit risks change.

The CFPB also appears prepared to take steps that would nullify pre-dispute arbitration clauses in consumer credit contracts, thereby opening the market to increased class action litigation. The "Durbin Amendment" to the Dodd-Frank financial reform legislation places price controls on the interchange fees of debit cards issued by banks with over $10 billion in assets, cutting those fees approximately in half and reducing bank revenues by an estimated $6-$8 billion annually. Finally, although the CFPB is barred from fixing interest rate ceilings, the Department of Defense has been authorized to do so with respect to members of the military, and it has extended the terms of the Military Lending Act to apply its 36% interest rate ceiling to virtually every consumer credit product used by military members.

IV. Effects of Command-and-Control Regulation for American Consumers

The effects of the command-and-control approach to consumer financial protection have been disastrous for consumers. For example, studies have found that implementation of the CARD Act accelerated interest rate increases on all credit card accounts and reduced access to credit cards (which has since fallen by 11 percent among low-income households). The Qualified Mortgages rule slowed recovery of the housing market by creating a massive layer of regulatory red-tape and liability risk for banks. And, despite the CFPB's pledge to examine the cost and availability of alternative sources of short-term credit for consumers before imposing new restrictions on payday loans, the CFPB appears ready to force these products out of the market without any evident replacement for the millions of Americans who rely on them to make ends meet. The problems visited on consumers are not entirely attributable to administrative decisions; for instance, large banks facing massive revenue losses from the Durbin Amendment have compensated with more and higher bank fees on consumers—free checking accounts have shrunk from 76% of all bank accounts to only 38%, and fees on bank accounts, such as monthly fees and overdraft fees, have risen substantially. This loss of access to free checking has been particularly problematic for low-income consumers who cannot afford the higher fees or the higher minimum balances necessary to avoid those fees. According to the FDIC, the number of unbanked American consumers rose by 1 million from 2009-2011, and the number of underbanked consumers rose even more, in part because of their loss of access to mainstream financial products as a result of the Durbin Amendment, the CARD Act, and various regulations.

In addition, the regulatory weight of the CFPB has tilted retail banking markets against smaller banks that cannot afford the new regulatory compliance costs associated with its many regulations and litigation risk. A study by the Mercatus Center at George Mason University found that 71% of small banks stated that the CFPB has affected their business activities.[7] Sixty-four percent of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank, and 15% said that they had either exited or were considering exiting residential mortgage markets entirely. Nearly 60% of small banks reported that the CFPB and/or the Qualified Mortgages rule had a "significant negative impact" on their mortgage operations. More than 60% said that changes in mortgage regulations had a significant negative effect on bank earnings. Driving smaller banks from the market reduces competition and consumer choice, hurting all consumers; moreover, community banks serve a particularly crucial role in smaller, rural communities, making their loss particularly painful for those consumers and small businesses.

This kind of regulation also stifles innovation and creativity. For example, the Qualified Mortgages rule forces all mortgages into a one-size-fits-all set of underwriting criteria. In so doing, the rule has deprived community banks of their one competitive advantage against megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers and to tailor loans to the needs of their customers. Similarly, the Durbin Amendment applies to prepaid cards issued by covered banks if those cards provide a level of functionality comparable to bank accounts; this shadow of the Durbin Amendment has deterred the largest banks from developing low-cost, no-frills prepaid and mobile bank products that could provide an alternative to expensive bank accounts for lower-income consumers.

V. What Should Be Done

America's consumer financial protection regime was in need of an overhaul prior to Dodd-Frank. Instead of updating the regime, the CFPB is attempting to impose 19th century regulatory approaches on a 21st century consumer credit economy. Consumers today have unprecedented choice, flexibility, and information about the products and services that they use. Consumer credit is no exception.

A modern regulatory strategy would begin with understanding the success of market economies, especially that of the United States, identifying the particular market failure the regulator seeks to address, and then designing crisply tailored regulation that addresses the problem with a minimum of unintended consequences. Many prior bases for regulation have been obviated or reduced in the modern world. For example, there are multiple credit card comparison websites (such as cardhub.com) that compile and assess the various terms of credit card offers and enable consumers to shop for cards according to the terms that they find most valuable, including interest rates, rewards, and even particular terms like fees on foreign transactions. Credit card issuers recognize the vast heterogeneity of credit card customers and tailor their products to the needs of consumers. These comparison websites have arisen to help consumers find the particular card offerings that they want. In this context, heavy-handed regulation is both unnecessary and detrimental.

For products such as payday loans, concern about vulnerable consumers with limited options are understandable, but regulatory solutions that further deprive these consumers of choices often harm those consumers that the regulations are purportedly intended to help. Surveys of payday loan customers reveal that they fully understand the terms and price of their choices; there is no compelling evidence that users of these products would be better off without such loans. Although the evidence is mixed, studies suggest that banning payday loans leads to more bounced checks and greater use of overdraft protection (which is often more expensive than payday loans) and may lead to more evictions and utility terminations.

The centerpiece of a modern consumer financial protection regime should be focused on encouraging competition, consumer choice, and innovation. Command-and-control regulation of consumer financial products, from the Durbin Amendment to new proposed regulations on payday loans, will have the opposite effect—reducing choice, competition, and innovation. Perhaps most tragically, these regulations typically fall hardest on the most vulnerable American consumers, taking away choices from those consumers who already face limited choices as a result of their situations in life. Ill-considered regulations are driving mainstream financial products such as credit cards and bank accounts out of the reach of low-income consumers, pushing those consumers into the alternative financial sector of check cashers, pawn shops, and payday lenders. As has happened so often in the past, paternalistic regulations intended to help consumers end up hurting them.

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International Trade: New Initiatives

By Ronald A. Cass & C. Boyden Gray***

Note from the Editor:

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I. International Trade

International trade is not often thought of in the context of regulatory overreach—which is the primary focus of the series that includes this paper—but the sort of trade agreements that nations enter into, the manner in which trade accords are arrived at and made binding on signatory nations, and the ways in which they are implemented have enormous implications for national economies and also for the scope and impact of domestic regulation in each nation. Trade agreements can bolster inefficient regulatory approaches by "harmonizing" regulations in ways that reduce some inputs to competition among firms' production in different nations. Conversely, trade agreements can reduce barriers to competition across borders, at least indirectly increasing pressure on regulators to adopt more efficient approaches. Choosing the right approach can make a significant difference to domestic economies and to the degree of liberty enjoyed in trading nations.

II. New Trade Initiatives: TPP and TTIP

After a series of global trade initiatives from the 1940s to the 1990s lowered trade barriers, especially tariffs on traded goods, efforts to advance further global multi-lateral agreements—notably, the World Trade Organization's (WTO) Doha Round—have stalled. Many nations (including the U.S.) have turned to arrangements between smaller groups of nations as vehicles for reducing trade barriers and expanding trade.

The two initiatives currently at the forefront of trade expansion hopes and fears are the Trans-Pacific Partnership agreement (TPP) and the Transatlantic Trade and Investment Partnership agreement (TTIP); both are still being negotiated, though they are substantially far along in the process. The TPP would provide lower trade barriers and agreed rules on trade-related issues for 12 Pacific Rim nations, while the TTIP would do similar (but not identical) things for the U.S. and the 28-nation European Union (EU).

Opponents complain that the agreements would reduce U.S. ability to secure American consumers' and workers' interests and to protect taxpayers against claims from foreign companies that feel disadvantaged, and that both agreements ultimately would hurt the U.S. economy and its most vulnerable workers—almost exactly the opposite of arguments made in favor of the accords. While our interest is primarily in the relationship between these potential agreements and regulation, we will touch on other arguments as well.

III. The New Trade Agreements: What is at Stake?

TPP negotiations have concentrated mostly on relatively traditional forms of trade opening, particularly lowering tariffs and reducing non-tariff barriers, although the negotiations also have included protections for investment and intellectual property rights as well as other issues that are either directly affected by trade or can be most efficiently addressed in the trade context. *Regulatory coherence*—a term used to connote promotion of more effective and transparent mechanisms for scrutinizing regulatory initiatives and for preventing regulations that (by design or not) unduly restrict trade—has not been a primary focus, but it has been added to the negotiating agenda.

Much of the work done by promotion of regulatory coherence also can be done within the TPP framework by restricting non-tariff barriers. Concerns over such barriers have been on the negotiating table under the rubric of agreements over *technical barriers to trade* and *sanitary and phytosanitary (health and food related) measures*. The goal for each of those parts of the agreement is to design rules that constrain protectionist regulations that lack substantial scientific support (for instance, a documented connection between a product and a health risk) and that especially limit competition by imports.

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In comparison, a greater part of the TTIP negotiation aims at *regulatory cooperation*—coordination of different regulatory approaches to assure that the U.S. and EU regulations, even if different, do not pose cumulative hurdles to product development and sales—as well as *regulatory coherence*. TTIP also endeavors to lower tariff and other trade barriers (including on agricultural products, a long-running source of U.S.-EU trade frictions), but the greater focus on regulatory impediments reflects the fact that other barriers to U.S.-EU trade are already lower.

Further, as both the U.S. and EU have highly developed regulatory structures with extensive sanitary and phytosanitary rules, as well as technical regulations covering almost every imaginable industry and product class, it is likely that differences in approach or in standards may pose trade barriers that serve no significant public interest. In other words, differences may exist simply by virtue of the fact that different bodies have adopted the rules, even though there are many equally good approaches to protecting public interests and rules used on both sides of the Atlantic will be effective. While good faith differences will exist, there also is substantial opportunity for manipulation of the rule-creation and rule-administration processes to achieve protectionist ends—not all differences will be the result strictly of separate, good faith efforts.

At the simplest level, different rules and regulations, specifying different inputs to products or different certification procedures to assure compliance with regulators' concerns, frequently pose substantial, and unproductive, impediments to business. Two researchers looking at issues to be addressed in the TTIP negotiations gave one example that aptly illustrates the problem:

> According to one U.S. trade association, a U.S.-based producer of light trucks found that a popular U.S. model the manufacturer wanted to sell in Europe required 100 unique parts, an additional $42 million in design and development costs, incremental testing of 33 vehicle systems, and 133 additional people to develop—all without any performance differences in terms of safety or emissions. EU manufacturers face similar issues in reverse when selling an EU-designed model in the United States.[1]

The problems of regulatory differences between the U.S. and EU also have been brought up by representatives of numerous other industries, each with its own horror story about needless costs and delays in selling into countries that have comparable protections for the public but incompatible regulatory standards.

While these complaints generally are advanced by businesses that face barriers to competition in other markets, the barriers to trade also affect broader national interests. Estimates of gains to GDP in the U.S. and EU from eliminating such barriers range from just under 1 percent of GDP to as much as 13 percent of GDP (an estimate taking account of dynamic gains in the economy from greater freedom to compete in many markets more efficiently, as well as from the direct gains from eliminating special design changes and redundant regulatory permitting). Given the combined GDPs of the U.S. and EU, even at the lower end of the spectrum, gains would amount to tens of billions of dollars of gain annually, and higher estimates would equate to 3-4 trillion dollars of benefit each year.

IV. Analyzing, Forging, and Implementing Trade Accords

One set of arguments about trade policy has to do with international relations, including security concerns; a second set, which tends to dominate domestic debates in the U.S., focuses on economic issues. The short version of the international relations argument is that trade agreements help knit countries together: global trade accords facilitate and encourage trade across all borders, making nations more interdependent and less antagonistic, more likely to cooperate, less likely to fight.

There is doubtless some truth to this proposition (famously captured in the assertion that nations with Starbucks and McDonald's do not go to war against each other). But the evidence is less than compelling that the proportion of business done in trade is directly related to peaceful relations. Nations that fought in the first World War had economies far more integrated with fellow combatants than many that were on the sidelines. Still, at times conclusion of a preferential trade agreement signals—especially to those in less powerful, less populous, and less economically advanced nations—a degree of affiliation among the parties that can encourage better relations, facilitate more helpful accommodation on non-economic issues, and even tilt political debates in some of the partner-nations in a more favorable direction.

While national security and international political effects are important considerations, and increasing bonds are important likely byproducts of preferential trade agreements in particular (agreements of less than global reach, including TPP and TTIP), our focus is primarily on the economic effects of these accords, most of all on regulatory matters. Academic theorists for decades have developed analyses showing that reducing trade barriers does not always yield a "first best" economic result for each nation. This is true in special cases, but it almost always produces the best practical result, providing more goods and services of more quality options at better prices than more trade-restrictive alternatives. That insight is the same reason that we don't all make our own clothes, grow our own food, or build our own homes—or limit our effective options to products made by our friends and neighbors. Competition is economically beneficial, and competition among more potential creators and producers tends to expand the benefits to consumers and to nations.

Regulations can also be beneficial. They can limit opportunities for self-interested behavior that generates negative spillover effects, such as pollution that harms neighbors, acid rain that falls downwind, or water pollution that harms fish and ecosystems downstream. At the same time, regulations can be inefficient or ineffective; they can impose costs enormously in excess of their benefits; they can frustrate competition and reduce the range, quality, and affordability of products. Regulatory coherence should improve the way in which regulations are adopted, scrutinized, and justified. And regulatory cooperation should provide means of eliminating needless frictions among regulations that ostensibly serve the same ends.

To the extent that happens, competitive forces will push jurisdictions to reduce regulatory costs, as these will make products from jurisdictions with higher regulatory costs (from rules that fail to produce better outcomes) less competitive. And lower regulatory drag also will increase the freedom of individuals and enterprises to research, design, produce, and distribute goods in the ways they think most conducive to success. Some observers worry that regulatory cooperation will reduce protections for consumers and punish producers in jurisdictions that are more responsible—those that police against harmful spillover effects, for example. The key consideration in treaties like TTIP is to reduce needless friction while keeping mutually agreed recognition of standards that enhance public health, safety, and well-being—without making it easy for less competitive businesses to use standards that advantage them (that rely on inputs others wouldn't use or specific product configurations that are peculiar to a particular location) as means of raising barriers to more globally successful rivals. Concentration on mutual recognition, rather than a single, agreed rule generally will better serve that end.

V. Guiding Principles for the Future

1. Support Expanding Open Trade. Because open trade tends to be politically, economically, and philosophically beneficial, administrations should start with the presumption that trade accords encouraging lower trade barriers should be favored.

2. Reduce Regulatory Frictions. Nations such as the U.S. and those comprising at least the core of the EU share broad commitments to similar goals, such as protection of the public against products that are dangerous for health and safety in ways that make it particularly efficient for well-conceived regulations to protect public interests rather than relying on individuals to protect themselves. Yet different regulatory approaches aimed at the same broad ends reduce competition, raise costs, and frequently make little or no difference in public health or safety. Input specifications and related standards should be eliminated where possible or their competition-reducing effects addressed. Primary attention should be devoted to this end.

3. Support Mutual Recognition. Administrations should prefer accords that allow different approaches to exist but that rely on agreed testing for compliance with standards by other national authorities or on mutually recognized certifications of compliance with similar regulatory requirements as sufficient. These approaches allow regulatory cooperation without the need for costly and often fruitless efforts to arrive at a single, jointly-approved regulatory approach.

4. Favor Dynamic Gains Over Static Gains. Approaches that generate more freedom over time for businesses to innovate, to find new and better ways of meeting concerns about public health and safety, and to compete as openly as possible—in as many markets and settings with as little risk of multiple, overlapping administrative requirements to gain entry into markets—should be favored over narrower agreements focused on approval of a specific, limited set of mutually accepted requirements. Narrower agreements may provide necessary starting points, but broader arrangements that allow reduced regulatory cost and more competitive engagement over time should be preferred. These will tend to promote newer and better ways of accomplishing agreed-on ends, more efficient and effective regulatory regimes, and greater welfare for all partner-nations over the longer term.

Endnotes

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Labor Rules: Union Walk Around Rule and Broadened Joint Employer Standard

*By Karen Harned**

Note from the Editor:

This article is about new labor rules, including the so-called union walk around rule and the broadened joint employer standard. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the author. Generally, the Federalist Society refrains from publishing pieces that advocate for or against particular policies. However, when we do, as here, we will offer links to other perspectives on the issue, including ones in opposition to the arguments put forth in the article. We also invite responses from our readers. To join the debate, please e-mail us at info@fedsoc.org.

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I. Labor Regulation by the Occupational Safety and Health Administration and the National Labor Relations Board

One cabinet level agency and two independent agencies regulate the majority of issues relating to the American worker. The Department of Labor houses various administrations, including the Wage and Hour Administration, which ensures that workers are paid a fair wage, and the Occupational Safety and Health Administration (OSHA), which ensures that working conditions are safe. The National Labor Relations Board (NLRB) serves as the arbiter of conflicts between labor and management and protects workers' right to organize. Finally, the Equal Employment and Opportunity Administration protects workers against illegal discrimination.

Examples of executive overreach can be found within each of these agencies, but two recent examples stand out as especially egregious. OSHA's "Union Walk Around Rule" and NLRB's pursuit of a much broader "joint employer standard" have the potential to impact a great number of employers and workers, along with the vitality of the American economy.

Both OSHA and NLRB are arguably acting outside the scope of their statutory authority in pursuing these policies. In addition, neither agency provided an opportunity for public comment as envisioned under the Administrative Procedure Act prior to proposing or implementing these changes.

II. OSHA's Underground "Union Walk Around Rule"

a. OSHA's Rule

On Feburary 21, 2013, Former Deputy Assistant Secretary for OSHA, Richard Fairfax, announced OSHA's "union walk around rule" in a controversial opinion letter responding to a union official.[1] The so-called "Fairfax Memo" concludes that an employee may ask that a union official accompany OSHA officials during safety inspections of a worksite, regardless of whether the company is unionized or has a collective bargaining agreement in place. Accordingly, the Fairfax Memo provides that a union representative may accompany an OSHA inspector as an employee's "personal representative," provided that the employee has requested the union official's presence and the OSHA inspector agrees to allow it.[2] The employer has no say in the arrangement. Under the Fairfax Memo, employers must allow union officials to walk around the worksite with OSHA inspectors.

b. The Rule's Context

Under the Occupational Safety and Health Administration Act, employees are permitted to have a "personal representative" present during OSHA inspections.[3] But the "union walk around rule" stretches the text of the Act quite liberally. A plain reading of the pertinent statutory language would not suggest that a non-employee union official should be considered a personal representative:

> The representative(s) authorized by employees shall be an employee(s) of the employer. However, if in the judgment of the Compliance Safety and Health Officer, good cause has been shown why accompaniment by a third party who is not an employee of the employer . . . is reasonably necessary to the conduct of an effective and thorough physical inspection of the workplace, such third party may accompany the Compliance Safety and Health Officer during the inspection.[4]

This seems to require a showing of "good cause" on an individualized basis for any third party to be present in an OSHA inspection.[5] The Fairfax Memo's blanket conclusion that union representatives may be present without such a showing runs contrary to the text of the regulation and OSHA's interpretation of the statute, regulations, and Field Manual.[6] Indeed, it makes little sense to assume that the presence of a union official will necessarily do anything to facilitate a proper inspection or be deemed "necessary" for "an effective and thorough physical

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inspection." Furthermore, this significant change of longstanding OSHA policy was implemented without any notice to the public or opportunity to comment, both of which are required by the Administrative Procedure Act. Finally, the Fairfax Memo raises constitutional concerns since it requires business owners to allow physical invasions of their property by parties who are not essential to an administrative inspection.[7]

III. NLRB's Proposed Change to the Joint Employer Standard

a. NLRB's Proposed Change

On August 27, 2015, in *Browning-Ferris Industries of California, Inc.*, NLRB overturned the existing joint employer standard, which had been in place since 1984.[8] Under the old standard, an entity was a joint employer if it exercised *direct and immediate control* over another business' employees by, for example, having the ability to hire, fire, discipline, supervise, or direct individual employees. Entities were joint employers only when they shared that *direct control* over the terms and conditions of employment for the same employees. Under the previous standard, franchisors, franchisees (independent businesses), and subcontractors operate as separate businesses.

In May 2014, NLRB announced that it would treat McDonald's USA LLC (McDonald's) and its franchisees as joint employers.[9] Then, in December 2014, NLRB filed 13 complaints asserting that McDonald's and its franchisees should be held jointly liable for numerous alleged violations of labor law stemming from alleged misconduct on the part of McDonald's franchisees.[10] There is a serious question as to whether McDonald's may be held liable, as a franchisor, for the actions of its franchisees.

The decision to treat McDonald's as a joint employer is highly controversial. With this move, NLRB effectively announced new rules that will have far-reaching implications for businesses working with independent companies. As one business owner put it, NLRB's newly announced rule throws "a hand-grenade in the middle of the [franchising] business model."[11] NLRB's new approach treats franchisors as joint employers with franchisees, or other independent contracting firms, so long as they exert "significant control" over the same employees—a standard that NLRB now argues can be satisfied simply by demonstrating that a franchisor has exerted signifiant control over every-day business operations, without regard to whether the franchisor has exercised any control over personnel decisions.[12] This not only jeopardizes the entire franchisor-franchisee model, but it contravenes 30 years of case law establishing that a franchisor is not a joint employer unless the franchisor actively exerts control over employment decisions, such as by setting wages or administering discipline.[13]

b. The Change in Context

NLRB first advanced this new rule in an amicus brief filing before an Administrative Law Judge (ALJ) in June 2014.[14] In the case of *Browning-Ferris Industries of California, Inc.*, NLRB argued that the ALJ should change the 30-year-old joint employer rule because today's franchising practices demonstrate the need for a change in order to promote "meaningful collective bargaining . . . [because] . . . some franchisors effectively control [] wages 'by controlling every other variable in the business except wages . . . .'"[15] Accordingly, *Browning-Ferris* may well pave the way for NLRB's enforcement actions against McDonald's. The case also could result in other "fishered" industries—like staffing companies—to be considered joint employers under the new rule.

The new rule imposes regulatory burdens, including expanded liabilities, on businesses throughout the country. In addition, NLRB's position would cause major disruptions for thousands of companies across the nation, as franchisors would be forced to take a more hands-on role in the franchisee's employment decisions, and an independent business would need permission from the franchisor to hire, fire, or discipline its employees.

IV. Discussion of OSHA's and NLRB's Rationales for the Rules

There has been a precipitous decline in union membership over the last thirty years. Many believe that the practical effect of both of these rules will be to help increase union membership. The OSHA rule could incentivize unions to use OSHA complaints as an organizing tactic. Through an OSHA inspection, union officials could gain access to non-union employees and begin laying the groundwork for a unionization campaign.[16]

The NLRB rule also promises a significant increase in union membership. The new broader standard will make it easier for unions to gain access to a larger company. By organizing a subcontractor first, the union can say that the company who uses the subcontractor should also be unionized. Similarly, in the franchising model, unions will no longer need to fight unionization campaigns on a piecemeal basis in every franchisee location. Instead, unions can seek to unionize all non-corporate franchisees in one election.[17]

V. Guiding Principles Going Forward

OSHA's union walk around rule and NLRB's recent decision to broaden the joint employer standard completely overturn decades of labor and employment law upon which businesses and workers have relied. Absent significant evidence that such fundamental legal changes are necessary, the executive should not change the law. If evidence suggests that such legal changes should be made, Congress—not unelected agency officials—should propose and consider them. Executive agencies should not be permitted to change decades of law for millions of businesses and workers through a memorandum or enforcement position. That is the constitutional system America's founders envisioned and upon which America's job creators rely.

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Net Neutrality and the Rule of Law

By Richard Wiley & Brett Shumate***

Note from the Editor:

This article is about the Federal Communications Commission's net neutrality rules. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the authors. Generally, the Federalist Society refrains from publishing pieces that advocate for or against particular policies. However, in some cases, such as with this article, we will do so because of some aspect of the specific issue. In the spirit of debate, whenever we do that we will offer links to other perspectives on the issue, including ones in opposition to the arguments put forth in the article. We also invite responses from our readers. To join the debate, please e-mail us at info@fedsoc.org.

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I. Internet Regulation by the FCC

The Federal Communications Commission (FCC) was created for "the purpose of regulating interstate and foreign commerce in communication by wire and radio." While Congress has expanded the FCC's regulatory mandate over time to embrace new communications technologies, it has never granted the FCC open-ended regulatory authority over communications. Instead, the Commission has been given express regulatory power with respect to specific types of communications. In the Communications Act of 1934, as amended by the Telecommunications Act of 1996, Congress charged the FCC with regulating telecommunications services in Title II of the Act; broadcast television, radio, and commercial mobile radio service in Title III; and cable television in Title VI. The degree to which the FCC can stretch the bounds of its statutory mandate has critical implications for federal power to control communications.

II. Net Neutrality Rules

Probably the most controversial issue in the communications arena today is the FCC's ongoing effort to regulate the Internet to promote "net neutrality." Despite the absence of express authority to regulate the Internet, the FCC has sought for nearly a decade to impose "net neutrality" requirements on Internet service providers (ISPs)—companies like AT&T, Verizon, and Comcast as well as small and rural providers. The FCC's previous two regulatory attempts in this regard were overturned in court. Earlier this year, the Commission imposed strict net neutrality rules and, in the process, classified broadband Internet access service as a telecommunications service subject to the requirements of Title II of the Act.

III. Net Neutrality in Context

Net neutrality represents the concept that ISPs should treat all Internet traffic equally—not blocking or degrading some content and not speeding up or slowing down content based on its source. Net neutrality supporters fear that ISPs will use their control over the Internet connection they provide to their customers to extract fees from content providers or otherwise disadvantage unaffiliated content. For this reason, public interest groups and many Internet content companies (sometimes referred to as "edge providers") favor net neutrality rules. On the other hand, ISPs believe that they should be able to control their own networks and that the competitive marketplace will prevent them from engaging in misconduct of the sort net neutrality advocates invoke, noting also that other laws already exist (including antitrust laws) to address such misconduct in the unlikely event of a market failure.

Nearly everyone supports the central ideal at the core of net neutrality, including the ISPs. The heart of the debate is whether the FCC has the authority to impose net neutrality requirements through regulation. From 1998 to 2015, the FCC—under both Republican and Democrat administrations—treated Internet access as an unregulated information service under Title I of the Communications Act. The Supreme Court upheld this policy in *NCTA v. Brand X Internet Services*.[1]

After *Brand X*, the FCC issued an Internet Policy Statement adopting four principles that, according to the Commission, would "encourage broadband deployment, preserve and promote the open and interconnected nature of the public Internet," and entitle consumers to: (1) access lawful Internet content of their choice; (2) run applications and use services as desired, subject to the needs of law enforcement; (3) connect their choice of legal devices that do not harm the network; and (4) enjoy the benefit of "competition among network providers, application and service providers, and content providers."

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While not legally binding, these principles were endorsed by the largest ISPs.

The debate about net neutrality has been largely theoretical. There has been little evidence that ISPs have unfairly blocked access to websites or online services. The most high-profile incident to date involved allegations that Comcast was using network management techniques to address congestion from file sharing services such as BitTorrent, which can use up to 60 percent of the bandwidth of an ISP's network. The FCC found that Comcast's network management practices violated federal Internet policy. Comcast appealed, and the D.C. Circuit held that the Commission had not demonstrated statutory authority to regulate ISPs' network management practices.[2]

The FCC responded in 2010 by adopting net neutrality regulations under several statutory provisions, including Section 706 of the Telecommunications Act, which directs the Commission to encourage the deployment of broadband infrastructure.[3] Specifically, the FCC adopted: (1) a transparency rule requiring broadband providers to disclose their network management practices; (2) rules prohibiting wireline broadband providers from blocking access to lawful content and wireless providers from blocking access to lawful websites and competing applications; and (3) a nondiscrimination rule prohibiting wireline broadband providers from taking steps to slow or degrade Internet traffic.

The D.C. Circuit indicated that Section 706 authorized the FCC to adopt some net neutrality rules.[4] However, the court held that the no-blocking and nondiscrimination rules in particular were unlawful because they treated ISPs as common carriers in violation of the Communications Act. Because Title II common carrier regulation is reserved for telecommunications carriers, the Communications Act prohibits the FCC from regulating information service providers as common carriers. The court concluded that the no blocking and nondiscrimination rules required ISPs to give all content providers nondiscriminatory access to their subscribers—the same duty applicable to common carriers under Title II of the Act.

In response to the Verizon case, the Commission initially proposed to adopt new net neutrality rules under Section 706. However, net neutrality supporters urged the FCC to instead change the regulatory treatment of Internet access service. Specifically, they argued that the Commission should classify Internet access as a telecommunications service under Title II—the same regulatory classification of basic telephone service, which traditionally has been heavily regulated—rather than an unregulated information service under Title I. According to these advocates, treating Internet access as a telecommunications service would provide the most defensible legal foundation for net neutrality rules, allow the FCC to prohibit any "discrimination" against Internet content, and thereby prevent broadband providers from prioritizing certain content. In November 2014, President Obama weighed in on the net neutrality debate, urging the agency to adopt strict rules and reclassify Internet access as a telecommunications service subject to regulation under Title II of the Act.

On February 26, 2015, the FCC adopted President Obama's plan to regulate the Internet, reversing more than a decade of precedent treating Internet access as an unregulated information service. The Commission adopted new net neutrality rules applicable to both fixed and mobile ISPs that prohibit blocking, throttling, and paid prioritization, and require enhanced transparency. In addition, the FCC adopted a catch-all prohibition against practices that "unreasonably interfere with or unreasonably disadvantage the ability of consumers to reach the Internet content, services, and applications of their choosing or of edge providers to access consumers using the Internet." The FCC also reclassified Internet access as a telecommunications service under Title II of the Act and further declared mobile Internet access to be a commercial mobile service. Although the FCC granted forbearance from certain provisions of Title II, ISPs will be subject to various Title II obligations, the precise scope of which the agency has yet to define.

IV. Discussion of the FCC's Approach to Net Neutrality

According to the FCC, net neutrality rules are necessary to promote a "virtuous cycle" of edge provider innovation, end user demand, and ISP investment. As the Commission has explained, net neutrality rules will spur content providers to innovate, which will incent end user demand and which, in turn, will motivate ISPs to invest in their networks. Thus, in the FCC's view, net neutrality rules encourage broadband deployment as directed by Congress in Section 706 of the Telecommunications Act of 1996. And by classifying broadband Internet access as a telecommunications service under Title II of the Act, the agency believes it can ground net neutrality rules in the strongest legal authority.

The main criticism of the FCC's approach is that net neutrality is a solution in search of a problem. As indicated, nearly all ISPs openly support the concept of net neutrality, and there is no real record of ISPs blocking or degrading Internet traffic. Although the FCC found that ISPs have the incentive and ability to interfere with the Internet's openness, it has been able to identify only a handful of supposed instances of bad behavior. Instead of examining whether ISPs have market power, the Commission has acted on the belief that ISPs are gatekeepers to edge providers seeking to reach end users, and the agency has discounted evidence that subscribers are ready and willing to switch ISPs in the unlikely event they engage in misconduct.

The FCC's decision to regulate ISPs under Title II has drawn a firestorm of criticism. Title II was designed to regulate the monopoly-era telephone companies of the 1930s. By classifying broadband Internet access as a Title II telecommunications service, the FCC attempted to unlock the power to regulate the Internet in the same way it regulated telephone wires in the past. Title II gives the FCC the authority to control nearly every aspect of a telecommunications carrier's business, including the rates that the company can charge its customers. It also authorizes the Commission to impose new taxes on customer bills to support universal service. Title II regulation has long been the goal of net neutrality supporters because it puts the Internet on par with such public utilities as water and electricity, providing a rationale for broad regulatory oversight.

Many fear that regulating the Internet under Title II will harm the vitality of the Internet. ISPs spend billions of dollars to build and maintain the broadband facilities that consumers use to access the World Wide Web. The concern is that these companies may be less inclined to invest in expanding capacity and reaching unserved areas if they are subjected to extensive government oversight under Title II. And if ISPs choose not to continue such investment—or if their sources of private capital diminish because of excessive regulation—broadband deployment in this country might stagnate and the future growth of the Internet could be threatened.

V. Guiding Principles for the Future

1. Ensuring Political Accountability. The political branches of our government must decide whether—and to what extent—the Internet should be regulated. This is a question of overriding national importance that should not be decided by an administrative agency. Delegating such a key issue to a single regulatory body undermines political accountability.

2. Promoting Investment. The Internet has flourished because the FCC's deregulatory policies heretofore have encouraged ISPs to expend billions of dollars to build ubiquitous networks throughout the country. These providers may not invest at the same pace if their services are subject to excessive government regulation. A light-touch regulatory framework will incentivize continued investment by ISPs in faster and more ubiquitous networks to the benefit of all Americans.

3. Maintaining Government Impartiality. The government should not pick winners and losers on the Internet. Using a heavy bureaucratic hand to skew the competitive playing field in favor of one preferred group over another entrenches existing business models and suppresses innovation. Instead, the market should decide which businesses succeed and which new services develop without the government tipping the scales in one direction.

4. Encouraging Innovation. The Internet has been one of the greatest developments of our time. Innovation, which is occurring both on the network and at its edges, is highly desirable and essential to maximize consumer choice. Government policy should seek to promote such innovation through continuing bipartisan support of a deregulatory approach to the Internet.

Endnotes

1 545 U.S. 967 (2005).

2 Comcast Corp. v. FCC, 600 F.3d 642 (D.C. Cir. 2010).

3 47 U.S.C. § 1302.

4 Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014).