



# Reforming Regulation

## Policies to Counteract Capture and Improve the Regulatory Process

By Ganesh Sitaraman    November 1, 2016

The debate over federal regulation has long been at the center of political contests. But surprisingly, the degree of agreement about regulation is considerable. No serious commentator denies that regulation is essential to ensuring well-functioning markets; protecting the health and safety of workers and families; and preventing fraud, corruption, and theft. Smart regulation is what makes cars safe to drive, lakes and rivers safe to swim in, and food safe to eat. At the same time, every serious commentator recognizes that poorly designed regulations can be detrimental; they can stack the deck in favor of special interests, prevent competition, and inhibit innovation.

Ordinarily, the regulatory process is designed to balance a variety of important values: expertise, democratic accountability, efficacy, and public involvement. Especially when compared with the U.S. Congress and the courts, federal agencies are composed primarily of subject-matter experts, who use science, data, and technical reasoning to craft regulations. Agencies are held accountable to the president through appointment of senior officials and through the Office of Management and Budget, or OMB; to Congress through Senate confirmation of officials, appropriation of funds, and oversight efforts; and to courts through judicial review of their actions. Federal agencies also have a mandatory process that they must follow—known as notice and comment—in which they must give the public notice of proposed regulations, allow an opportunity for public comment on the proposal, and then respond to public comments.<sup>1</sup> Courts review agencies' actions, in part to ensure that agencies have considered the public's comments seriously. Furthermore, most agencies are required by executive order to consider the costs and benefits of any regulation and to focus on maximizing net benefits so that regulations enhance the public welfare.<sup>2</sup>

Despite this sensible structure, however, the U.S. regulatory system has room for improvement. In particular, there are two areas that deserve greater attention. First, despite its many procedural protections, the regulatory process is in practice skewed in favor of industry interests. Second, regulators are often delayed in meeting their statu-

tory obligations. Improving the regulatory process will require strategies to reduce delays and inaction and to counteract what is termed regulatory capture—when regulation is skewed toward regulated industry to the detriment of the public interest.

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## Regulatory capture

One of the central challenges for regulation today is that the regulatory process is too often tilted in favor of special interests. This does not mean that regulations in the public interest are never possible but only that when looked at in the aggregate, the system leans in a direction that tends to help powerful special interests rather than the public interest. Political scientists and legal scholars call this problem capture. Regulatory capture exists when regulation is consistently directed toward the interests of regulated industry and away from the public interest.<sup>3</sup> Capture is not necessarily as crass and direct as bribery. Nor does it necessarily operate through political campaign finance channels, such as industry influence over congressional committees that oversee agencies.

Regulatory capture today is far less overt. Scholars and commentators have identified a number of sources of capture:

- **Revolving-door capture** exists when regulators come from or depart to regulated industry. These regulators might be more likely to support industry interests over the public interest either because they seek out a job within industry after government service or because their experiences in industry color their views—meaning that they are less likely to see the other side of arguments.
- **Cultural capture** extends even to those individuals who are not coming from or going to industry. People often adopt the views of those with whom they interact frequently—their social networks, friends, colleagues, and others similar to them. This is the familiar idea of groupthink or social conformism. Regulators can suffer from this same bias.<sup>4</sup>
- **Informational capture** exists when most of the people from whom regulators receive information have the same perspective. For example, if regulators only hear from industry, they will naturally be more likely to believe industry, even if there are other arguments. The marketplace of ideas does not work if there is only one set of ideas in circulation. Regulation is particularly susceptible to informational capture in technically complex sectors, in which industry holds most of the information about the practices and processes to be regulated.<sup>5</sup> In such cases, regulators often acquire much of their information from regulated industry, creating an outsized opportunity for industry to skew regulators' perspectives in their favor.

These forms of capture are not just theoretical. Some examples of revolving-door and cultural capture are well-known in the political arena. Take the extraordinary revolving door between the banking industry and top economic policy jobs in the government. As Sen. Elizabeth Warren (D-MA) has pointed out on numerous occasions, three of the past four secretaries of the U.S. Department of the Treasury under Democratic administrations were affiliated with the financial services giant Citigroup either before or after their time in government, and the fourth declined a top job at Citigroup—and those are just connections to a single firm.<sup>6</sup>

Empirical studies confirm that the regulatory process itself is also skewed in favor of special interest groups. Start with the notice and comment process: In a study of 30 rules and nearly 1,700 comments during the period from 1994 to 2001, political scientists found that business interests submitted more than 57 percent of the comments, compared with 6 percent from public interest groups.<sup>7</sup> The study's analysis showed that while business commenters have influence over the substance of final rules, nonbusiness commenters do not. Further, the more business commenters there are, the greater their influence. Another study looked at the Environmental Protection Agency's, or EPA's, rulemakings on air toxics emission standards for more than 100 industries. It found that industry provided 81 percent of comments, compared with 4 percent from public interest groups.<sup>8</sup> Business commenters also have more meetings with regulators than public interest groups do. A study of rulemaking on the Dodd-Frank Wall Street Reform and Consumer Protection Act's Volcker Rule found that regulators met with financial institutions 351 times, trade associations 33 times, and law firms representing industry interests 35 times—amounting to 93.1 percent of all meetings with regulators. Public interest groups had 19 meetings, and other reform-oriented people had 12 meetings with regulators—accounting for 6.9 percent of meetings.<sup>9</sup> When the public does engage in rulemaking, more often than not, its comments come in form letters rather than technically sophisticated comments on the proposed rule. The Volcker Rule study found that of the 8,000 comments received, 91 percent were form letters.<sup>10</sup>

Industry influence also occurs even before a regulatory proposal is unveiled and often informs the process during which a proposed rule is first written. Studies have shown that ex parte contacts between agencies and industry groups shape agencies' pre-proposal agendas.<sup>11</sup> In the Volcker Rule context, for example, powerful financial institutions JPMorgan Chase & Co., Goldman Sachs, and Morgan Stanley met with federal agencies 27 times, 22 times, and 19 times, respectively—all prior to the rule even being proposed.<sup>12</sup> Similarly, a study of the EPA's rulemakings on air toxics found that industry had an average of 84 communications with the EPA before each rule was proposed, compared with an average of 0.7 communications with public interest groups.<sup>13</sup>

Once any significant rule gets through an executive branch agency—as opposed to an independent agency—it goes to the Office of Management and Budget. There, the Office of Information and Regulatory Affairs, or OIRA, assesses the rule, including addressing any interagency concerns. OIRA review is another opportunity for industry influence. One study of 6,194 separate OIRA reviews of regulatory proposals and final rules between 2001 and 2011 showed that OIRA officials met 1,080 times with a total of 5,759 participants, and 65 percent of those participants represented industry.<sup>14</sup> In an important recent study of more than 1,500 regulations, political scientists have shown that lobbying during OIRA review is associated with change in regulations. When only business groups lobby, rule changes are more likely; this is not the case when public interest groups lobby.<sup>15</sup>

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## Regulatory delay and inaction

A second problem is that agencies frequently miss congressionally mandated deadlines to promulgate regulations. Delays and inaction mean that the public goes unprotected—even though Congress has passed laws requiring agency action. Six years after Dodd-Frank was passed into law, agencies had still not finalized 30 percent of the mandated rules to safeguard the financial system.<sup>16</sup> Deadlines have come and gone under the Affordable Care Act as well.<sup>17</sup> One of the more notable delays is related to coal ash regulation. In 2008, a ruptured dam in Kingston, Tennessee, flooded surrounding areas with coal ash sludge, coating hundreds of acres, inundating homes, and polluting water. In response, the EPA resolved to issue regulations on the hazardous material. But five years later, the regulations were still not finalized, even as another coal ash spill in North Carolina coated the Dan River with sludge for 70 miles.<sup>18</sup> The Occupational Safety and Health Administration takes an average of 12.5 years to complete economically significant rules—rules that have a \$100 million impact on the economy. What is more, one rule dealing with unsafe exposure to silica dust took 19 years to finalize.<sup>19</sup>

These are not isolated examples. One study of 159 public health and safety regulations with statutory deadlines found that 78 percent were delayed.<sup>20</sup> Another study of 1,400 regulatory deadlines between 1995 and 2014 showed that agencies failed to meet their target issuance date 50 percent of the time.<sup>21</sup> In a comprehensive study of regulations over a 20-year period, the consumer rights advocacy group Public Citizen calculated the average time for an economically significant regulation to be finalized. According to the study, rules issued in 2015 took an average of 3.4 years to complete; so far in 2016, the average has been 3.8 years. This means that most regulations take a full presidential term from start to finish—and the averages are only increasing over time.<sup>22</sup>

The sources of regulatory delays and inaction are varied. The law requires that agencies follow a number of extensive procedures—from notice and comment periods to consideration of the rules’ regulatory, paperwork, small business, and federalism impacts to review by OIRA.<sup>23</sup> In addition, delays and inaction can be a function of fierce lobbying from industry groups and political gamesmanship, particularly in multimember commissions that are divided along partisan lines. Regardless of the cause, regulatory delay and inaction means that agencies are not complying with their legal obligations, and consequently, the public is not protected.

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## Counteracting capture and improving the regulatory process

Given the problems of regulatory capture, delay, and inaction, there is a need for a regulatory reform agenda that is designed to counteract industry capture and improve the regulatory process. Reforms fit into three categories: increasing the voice of the people; facilitating agency action; and fostering effective, faithful agencies.

### Increasing the voice of the people

The first way to improve the regulatory process is to level the playing field between special interests and the general public by increasing the voice of the people. Public advocates, an amicus brief system for agencies, and preproposal consultation can all help ensure balance in regulatory decision-making.

#### *Create and empower existing public advocates*

Given that industry groups often participate more in developing regulatory proposals and commenting on proposed rules, there needs to be a countervailing voice representing the public interest with technical sophistication. Some scholars have analogized this model to the public defender in the courts—a sort of “regulatory public defender” to ensure representation for the public interest.<sup>24</sup> This model has already been adopted in a variety of settings. Texas has the Office of Public Insurance Counsel, and the Internal Revenue Service has a taxpayer advocate, both of which act as ombudsmen tasked with advocating for members of the public. California has a Public Participation Plan, through which public interest groups get reimbursed for helpful participation in regulatory proceedings.<sup>25</sup> States, cities, and some federal agencies also have ombudsmen or public advocates that serve these purposes. In each case, the goal is to ensure that there is a voice representing the public in the regulatory process.

Congress could create a standing public advocate position, rooted either in the Executive Office of the President or within each federal agency, tasked with the mission of assessing and commenting on regulations from a public interest position. The public advocate could be empowered to participate either in all regulatory proceedings or only in regulatory proceedings in which public interest groups have not participated or where participation is skewed significantly in favor of industry.

In some sectors, there are already existing public advocate offices that could be further empowered. The U.S. Securities and Exchange Commission, for example, has the Office of the Investor Advocate.<sup>26</sup> In other sectors, although the law mandates the creation of a public advocate, the agency has failed to fulfill its duty to create the position. For example, the Federal Energy Regulatory Commission, or FERC, has been required by statute to create an Office of Public Participation since 1978, with the goal of assisting the public with participation in FERC's often complex regulatory proceedings on the electric industry. However, the commission has yet to create this position.<sup>27</sup>

#### *Encourage the use of an amicus agency*

When the U.S. Supreme Court faces an issue that neither party in a case is arguing, it will appoint a lawyer as a “friend of the court” to argue the orphaned position.<sup>28</sup> The friend—or amicus—takes on the position that no other party has assumed and is obligated to advocate robustly for that position.

By executive order, the president could require or strongly advise that agencies request public interest groups or advocates to serve as an amicus agency, or friend of the agency, to take the public interest position in rulemakings in which public interest participation is limited or nonexistent. Where agencies already have a public advocate, the advocate could be charged with playing this role or with identifying an amicus agency. Currently, Executive Order 13,563 requires agencies to ensure there is a meaningful opportunity for public participation and to seek the views of those who would likely be affected. But it does not encourage or require agencies to request participation in cases where the public interest might not have an advocate.<sup>29</sup>

Even without an executive order, the agencies themselves could request participation in the comment process from public interest groups or advocates. To encourage this practice, the president and senators could ask agency nominees to commit to seeking out sophisticated public advocates in rulemakings in which industry is likely to dominate due to the technical nature of the subject or the low public salience of the topic.

The amicus agency's role would fit into the regulatory process without any revisions to that process. The amicus would participate in the notice and comment process during the ordinary comment period, and the agency would evaluate these comments as they would any other comment. Courts, in turn, would consider these comments as they would any other comment during arbitrary and capricious review.

### *Engage the public in preproposal consultation*

If agencies only engage regulated businesses, trade associations, and organized interest groups when developing an initial regulatory proposal, the proposal is likely to be based on incomplete information. It may not account for differences between large and small businesses, different views between trade association leaders and their members, or the real-world experiences of ordinary people. While some of these defects can be addressed in the notice and comment process, a better approach would be to engage the public prior to drafting the proposed regulation.

Some agencies already do this with great success. In 2013, for example, the Consumer Financial Protection Bureau, or CFPB, issued a request for information in the Federal Register that asked members of the public—including colleges and universities, lenders, students, and families—to give their views on a variety of questions related to student loan repayment.<sup>30</sup> The CFPB received 28,000 comments and published them online in a searchable database.<sup>31</sup> The agency has even accepted comments via YouTube.<sup>32</sup>

The president could issue a presidential memorandum or executive order encouraging agencies to engage the public in these kinds of preproposal forms of consultation in order to expand the input on the development of a regulatory proposal. Alternatively, entrepreneurial agencies could also take this initiative on their own.

### Facilitating agency action

Agencies that fail to act defy the will—and laws—of Congress. Agency inaction has many causes, but facilitating the adoption of best practices around the country, increasing transparency around compliance and enforcement, and adopting fail-safes that operate even in the absence of regulatory action can all help facilitate agency action.

### *A learning-from-states executive order*

Executive Order 13,132 currently requires agencies to consider federalism and the role and authority of the states when making regulations.<sup>33</sup> One of the most important benefits of a federal system is that the national government can learn from actions taking place in the states. States are famously deemed “laboratories of democracy.”<sup>34</sup> In some cases, federal agencies issue regulations that set a regulatory floor and allow states to go above and beyond the federal standard to protect the public interest. A revision to the federalism executive order could help spread best practices from the states to the nation. When enough states—a plurality, majority, or supermajority—have adopted a policy that is above the federal regulatory floor, the federal agency could be required to consider whether the higher standard should be adopted nationally. The agency would not be required to adopt the higher standard, as there might be good reasons to preserve diversity among the states. But with many states all trending in the same direction, the agency should at least consider increasing the federal standard to align with the best practices of the states.

A recent example of this phenomenon are the standards to gain certification for using harmful and restricted pesticides. The existing rules for commercial applicators of restricted pesticides do not require any certification based on the method of application, such as aerial application, soil fumigation, and nonsoil fumigation. They only require certification for certain types of pest control. However, states have recognized that there are serious risks depending on the method of applying pesticides and have required certification for people using these methods in order to protect public health and safety. Sixteen states require certification for commercial soil fumigation, 32 states require certification for aerial application, and 41 states require certification for nonsoil fumigation.<sup>35</sup> The EPA, learning from these states and in cooperation and communication with the states, has proposed method-specific certification for restricted pesticides. While the EPA's proposal is narrow—it involves setting basic certification standards, not substantive standards—it illustrates the broader principle. Federalism is a valuable policy not simply because it enables local diversity but also because it encourages the federal government to learn from the states before acting.

#### *A regulatory compliance and enforcement executive order*

It is simply not enough to make rules; there must also be compliance with and enforcement of rules.<sup>36</sup> Agencies have a wide range of options for encouraging compliance, from periodic inspections to monetary fines and from deferred and nonprosecution agreements to criminal prosecution. In 2011, President Barack Obama's administration issued an important presidential memorandum asking agencies to develop plans for making information on regulatory compliance and enforcement activities public. The memo also tasked the chief information officer and chief technology officer with helping agencies make this information available online.<sup>37</sup> Some agencies have developed extensive websites with this information.<sup>38</sup>

A new executive order could build on the important steps the Obama administration has taken. First, the executive order should require each agency to submit its past year's compliance and enforcement activities alongside its regulatory plan for the coming year.<sup>39</sup> This reporting requirement would help assist executive branch agencies as they engage in retrospective reviews of regulations.<sup>40</sup> It would allow the president and the general public to understand agencies' compliance and enforcement priorities and ensure that the laws are being enforced. And it would help Congress and the public consider where new regulatory or enforcement tools might be necessary. Second, the executive order should create a compliance and enforcement cross-agency working group that would issue a report outlining agency best practices and identifying challenges to compliance and enforcement that can be redressed through executive or congressional action.

#### *Statutory fail-safes*

Regulatory delays and inaction are often in the interest of industry. If industry can delay agency action, it prevents itself from being regulated—even though Congress has passed laws trying to protect people and regulate the industry. One answer to this problem is

for Congress to use statutory fail-safes in their legislation. A statute would empower the agency to promulgate regulations by a certain date. But it would also specify that if the agency has not promulgated regulations by that date, then statutorily specified restrictions immediately take effect. Because Congress would draft the fail-safe instead of the agency, it would likely be simpler and more restrictive; agency regulations are better able to address complexity within industry because the agency has greater expertise. And because the fail-safe would be simple, restrictive, and immediately effective, it would force industry to compromise on workable regulations, rather than delaying rules in the hopes of getting something more permissive.

Statutory fail-safes are not unheard of. The Hazardous and Solid Waste Amendments, or HSWA, to the Resource Conservation and Recovery Act of 1976 included a fail-safe. The HSWA required the EPA to promulgate regulations for waste disposal on land. But if the EPA had failed to meet its statutory deadline to issue the regulations, then any waste disposal would be banned altogether.<sup>41</sup> The threat of a total ban pushed the waste management industry to cooperate with the EPA, reversed the incentive for industry to litigate the rules, and guaranteed that regulations were issued on time. It also provided nonindustry groups with greater bargaining power.<sup>42</sup> The Clean Air Act, or CAA, also has a statutory fail-safe. The CAA requires the EPA to issue regulations for categories of air toxics that meet the standard of maximum achievable control technology, or MACT. But if the EPA fails to issue these standards on time, then the CAA mandates that pollution sources get permits and meet a case-by-case MACT standard.<sup>43</sup>

### Fostering effective, faithful agencies

Agency effectiveness rests partly on having personnel who seek to advance the public good rather than private interests and budgets that are sufficient to undertake their tasks. Ensuring that agency personnel come from diverse backgrounds, reducing revolving-door conflicts of interest, and issuing a “true effectiveness” budget can all help foster effective, faithful agencies.

#### *Ensure diverse backgrounds in agency appointees*

The problem of cultural capture—and, in particular, capture based on so-called group-think and the revolving door—can be mitigated by appointing a diverse set of regulators. The president and senators should therefore ensure that they appoint and confirm regulators who have diverse professional experiences and backgrounds. If all regulators come from a single industry or firm or are all economists or lawyers, they will bring a set of biases to their work.<sup>44</sup> Regulators should instead be drawn from a variety of backgrounds—from industry, public interest groups, governments, and academia. They should also bring a variety of methodologies: legal, financial, economic, scientific, and even psychological and anthropological backgrounds might be relevant depending on the agency. Presidents have great flexibility in who they choose as political appointees, and they can use this flexibility to reduce the risk of cultural capture.

### *Reduce revolving-door conflicts of interest*

The Project on Government Oversight has found that many big businesses offer special compensation to executives who leave to work for the government.<sup>45</sup> These policies encourage members of industry to enter government—likely into positions related to the oversight of the industry—not solely out of patriotic duty, but because of financial interest. People with industry knowledge can and should work in government, but they should do so out of civic interest rather than financial gain. The latter risks industry members who enter government being more interested in ensuring future industry success than appropriate regulation in the public interest. Congress could pass the Financial Services Conflict of Interest Act, introduced by Rep. Elijah Cummings (D-MD), which would crack down on these incentives. In the absence of legislation, the president should require that any agency nominee agree to forgo such incentives as a condition of their nomination.<sup>46</sup>

### *Issue a true agency effectiveness budget*

Sometimes federal agency rules are delayed, incomplete, or insufficient because the agency lacks the appropriate resources to act. Agencies that are starved for resources cannot do their jobs effectively. To make clear what resources agencies actually need, the president should require agencies to issue what one scholar has called a “true-up” budget: a budget that shows how much the agency would need to effectively and fully execute its statutory obligations.<sup>47</sup> The true agency effectiveness budget would set a baseline from which to measure the adequacy or inadequacy of agency resources—rather than the artificial baseline of current appropriations, which may have little to do with effective policymaking.

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## Conclusion

The U.S. regulatory system has room for improvement. Despite its many procedural protections, research shows that the regulatory process is skewed in favor of industry interests. In addition, regulators are often delayed in meeting their statutory obligations. By increasing the voice of the people; facilitating agency action; and fostering effective, faithful agencies, policymakers can counteract capture and improve the regulatory process.

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## Endnotes

- 1 *Administrative Procedure Act*, 5 U.S.C. § 553.
- 2 Executive Order no. 12,866, *Code of Federal Regulations*, sec. 1 (1993).
- 3 Some include an intent requirement on the part of industry. See Daniel Carpenter and David A. Moss, "Introduction." In Daniel Carpenter and David A. Moss, eds., *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (New York: Cambridge University Press, 2014).
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- 19 Public Citizen, "Unsafe Delays: An Empirical Analysis Shows That Federal Rulemakings to Protect the Public Are Taking Longer Than Ever" (2016), available at <http://www.citizen.org/documents/Unsafe-Delays-Report.pdf>.
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- 22 Public Citizen, "Unsafe Delays."
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- 34 For the origin of this phrase, see *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (Brandeis, J., dissenting), noting that a "courageous state" can "serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."
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- 36 For a recent analysis of enforcement issues, see Kate Andrias, "The President's Enforcement Power," *New York University Law Review* 88 (4) (2013): 1031–1125.
- 37 The White House Office of the Press Secretary, "Presidential Memoranda - Regulatory Compliance," Press release, January 18, 2011, available at <https://www.whitehouse.gov/the-press-office/2011/01/18/presidential-memoranda-regulatory-compliance>.
- 38 U.S. Department of Labor, "Data Enforcement," available at <http://ogesdw.dol.gov/homePage.php> (last accessed August 2016).
- 39 Executive Order no. 12,866, *Code of Federal Regulations*, sec. 4(c) (1993).
- 40 Executive Order no. 13,563, *Code of Federal Regulations*, sec. 6 (2011).
- 41 Laurence Tai, "Harnessing Industry Influence," *Administrative Law Review* 68 (1) (2016): 1–59.
- 42 Ibid.
- 43 *Clean Air Act*, §112(g)(2) and §112(j). For a brief summary referring to the "MACT hammer," see David P. Novello, "The Air Toxics Program at the Crossroads: From MACT to Residual Risk," *Natural Resources & Environment* 18 (3) (2004): 57–61.
- 44 Kwak, "Cultural Capture and the Financial Crisis"; Luigi Zingales, "Preventing Economists' Capture." In Carpenter and Moss, *Preventing Regulatory Capture*; Geoffrey P. Miller and Gerald Rosenfeld, "Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008," *Harvard Journal of Law & Public Policy* 33 (2) (2010): 807–840.
- 45 Michael Smallberg, "Big Business Offer Revolving Door Rewards," Project on Government Oversight, March 21, 2013, available at <http://www.pogo.org/our-work/reports/2013/big-businesses-offer-revolving-door-rewards.html>.
- 46 *The Financial Services Conflict of Interest Act*, H.Rept. 3065, 114th Cong., 1 sess. (Introduced July 15, 2015).
- 47 Sidney Shapiro, "Shining Light on Regulatory Capture: Four Proposals," Center for Progressive Reform Blog, March 11, 2016, available at <http://www.progressivereform.org/CPR-Blog.cfm?idBlog=F6F80B7B-0155-0B60-8B1BFF2C9401310>.