DECEMBER 2019

Better economic analysis can reduce regulators' litigation risks

Jerry Ellig
Research Professor, George Washington University Regulatory Studies Center

This report is available online at: https://www.brookings.edu

Economic Studies at BROOKINGS

The Brookings Economic Studies program analyzes current and emerging economic issues facing the United States and the world, focusing on ideas to achieve broad-based economic growth, a strong labor market, sound fiscal and monetary policy, and economic opportunity and social mobility. The research aims to increase understanding of how the economy works and what can be done to make it work better.

Contents

About the Author 3

Statement of Independence 3

Introduction 4

Interviews with agency officials on economic analysis and litigation risk 5

Federal court of appeals decisions that examine regulatory agency economic analysis 7

Economic analysis matters when the agency claims to use it 11

Conclusion 11

ABOUT THE AUTHOR

Jerry Ellig is a research professor in the Regulatory Studies Center at The George Washington University.

STATEMENT OF INDEPENDENCE

The author did not receive financial support from any firm or person for this article or from any firm or person with a financial or political interest in this article. Part of this article is based on interviews conducted by Dr. Ellig for a separate report commissioned by the Administrative Conference of the United States (ACUS), and the opinions, views, and recommendations expressed by the author are those of the author and do not necessarily reflect those of ACUS or its members. Dr. Ellig is not currently an officer, director, or board member of any organization with a financial or political interest in this article.

Introduction

Legal scholars such as Cass Sunstein, Jonathan Masur, and Eric Posner argue that federal regulatory agencies will face increasing pressure from courts in the coming years to produce high-quality economic analysis to inform decisions about regulations. While some are concerned about courts' capability to review economic analysis, the fact is that courts are already doing it. Several recent research projects shed light on the relationship between the quality of an agency's economic analysis and the risk that a regulation will be overturned in court.

The various projects employ different research methods that each have their own limitations. They include interviews with agency staff who work on regulations, analysis of cases in which courts have reviewed agency economic analysis, and econometric analysis of factors that influence the quality of economic analysis and court decisions to overturn or uphold regulations. Taken together, the research tells a largely consistent story: the quality of an agency's economic analysis can affect litigation risk if the agency says it used that analysis to guide decisions. High-quality analysis raises the odds that a regulation will be upheld in court, and low-quality analysis reduce the odds that a regulation will be upheld in court.

In 2019, the Administrative Conference of the United States commissioned a report to explore the potential relationship between the organization and management of economists in regulatory agencies and the quality and consideration of economic analysis in regulatory design. The report included interviews of 15 senior economists and 10 senior non-economists in regulatory agencies. One interview question asked how the quality of the agency's economic analysis affected litigation risk.

The responses reveal several helpful insights about the role economic analysis might play in litigation involving regulations in the future. Many respondents believed that the quality of economic analysis could affect litigation risk; a minority thought it made little difference. They said economic analysis is more likely to have an effect if the statute authorizing the regulation requires the agency to consider economic factors. Respondents suggested that a high-quality analysis reduces litigation risk and a low-quality analysis increases litigation risk. In their view, assessment of alternatives and calculation of costs are topics to which courts might be especially sensitive.

The second cluster of research consists of multiple law review articles that examine a substantial sample of federal appeals court decisions in which the court evaluated the quality of the economic analysis accompanying a regulation. These articles find that the quality of an agency's economic analysis can affect the likelihood that a regulation will be upheld in court; an agency's analysis is vulnerable if it ignores a significant aspect of the problem, alternatives, benefits, or costs; and the depth of court scrutiny varies widely, but courts are more likely to examine an analysis carefully if the underlying statute specifies benefits and costs the agency is expected to consider or specifies how the results of the analysis should affect decisions.

The final piece of research is a paper presented at the Southern Economic Association's annual conference in November 2019. It examines econometrically whether there is a correlation between the quality of the regulatory impact analysis (RIA) accompanying a regulation and the likelihood that the regulation will be overturned in court. The empirical results suggest that the effect of the economic analysis depends on the quality of the analysis, but only if the agency explained how it used any part of the analysis in decisions.

Interviews with agency officials on economic analysis and litigation risk

As part of the Administrative Conference report, I interviewed 15 senior economists and 10 senior non-economists who work on regulations in six Cabinet departments and two independent agencies. One question asked respondents how they thought their agency's regulatory impact analysis or equivalent economic analysis affected litigation risk.[1] Because the interviews revealed no significant differences in responses to this question based on how economists were organized and managed in the agency, this question is discussed only briefly in my ACUS report (pp. 40-41). A substantial number of interviewees thought that a high-quality economic analysis can help a regulation survive court challenge. The most common response was that a good RIA helps show that the agency's decisions are not arbitrary or capricious. One noted, "The more transparent you are and the more data you collect, the more likely it will hold up in court." A non-economist said that the RIA requirement is the best way to get agencies to explain the effects of what they are doing. A few mentioned that the analysis could have mixed effects: a more extensive analysis could give stakeholders more to dispute, but a high-quality analysis also makes it easier to uphold the

. . .

1. The research addresses both the RIAs produced by Cabinet agencies and similar economic analyses produced by independent agencies to inform the development of new regulations. Executive Order 12866 requires Cabinet agencies to prepare an RIA for regulations that have annual economic impacts of $100 million or greater or certain other adverse economic impacts. Independent agencies sometimes conduct similar economic analysis, either because they are required by statute or simply because they believe the analysis helps them make better decisions.

regulation. One suggested that there is no generally right answer; it depends on the circumstances.

In similar vein, many respondents suggested that a low-quality analysis could jeopardize the regulation in court. One commented, "The one time we lost due to the RIA was because it wasn't thorough enough and didn't explain how the results were reached." Another cautioned that agency attorneys can increase risk associated with the RIA by changing the analysis and the court sees the RIA as flawed as a result. One mentioned that an economic analysis can create litigation risk if it strays into extraneous issues it does not need to cover to address the consequences of the regulation.

Two analytical areas that respondents specifically mentioned as adding litigation risk were inadequate consideration of alternatives and costs. One interviewee said that agency economists sometimes work "backward" to get results that justify the regulatory direction the agency wants to take, and they may feel they have to invent some alternatives in the RIA that were not really considered. A court could be more likely to overturn a regulation if the alternatives in the RIA look like "fig leaves" rather than alternatives the agency seriously analyzed and considered. Several hinted that failure to analyze costs adequately definitely increases litigation risk. One individual located in an agency that is permitted to consider costs said that the agency would definitely get sued if it did not include a discussion of costs. This comment appeared to be based on the agency's past experience, not just this individual's interpretation of *Michigan v. EPA* (discussed more below).

Not all interviewees thought the quality of their agency's economic analysis makes a significant difference in court. Several said their agencies usually get sued for reasons other than the quality or results of the economic analysis. "We'll get sued regardless [of the analysis], because someone's ox will be gored [by the regulation]," one declared. They thought that the major reasons regulations get challenged in court include how controversial the regulation is and how it affects stakeholders. Others added that challenges tend to be based on legal process issues more than on problems with the economic analysis.

Several respondents specifically brought up the role of statutory requirements for benefit-cost analysis or other kinds of economic analysis. If the statute expressly requires that the agency conduct economic analysis or consider economic factors, they said, the risk is in not doing this analysis well enough. For this reason, they said, a well-done analysis can reduce litigation risk. On the other hand, they thought that the economic analysis will be less important in court if there is no statutory requirement.

The discussions revealed two reasons that economic analysis may become more important in court in the future: diminishing marginal returns to regulation, and the Supreme Court's decision in *Michigan v. EPA*.

First, one respondent opined that lawsuits based on the substance of a new or revised regulation have increased in recent years because there are diminishing marginal returns to additional regulatory changes. This individual opined that in some policy areas, the easy steps that yield big benefits at low cost have already been taken, and so additional regulation will require more careful economic analysis to ensure that it does not do more harm than good.

Multiple respondents suggested that *Michigan v. EPA* may have opened new grounds for litigation based on the RIA. In that case, all of the justices agreed that cost is a factor one would normally expect an agency to consider in some way, at some point in the process, unless a statute prevents the agency from considering costs. Consequently, stakeholders will likely pursue more legal challenges to agencies' cost analyses.

Five primary perceptions emerge from these interviews:

1. Economic analysis can affect litigation risk, but not always.
2. High-quality analysis is especially important when the statute requires the agency to consider economic factors.
3. When it has an effect, good analysis reduces litigation risk; poor analysis increases litigation risk.
4. Assessment of alternatives and calculation of costs are parts of the RIA where an agency may be especially vulnerable if it did not do a good job.
5. Economic analysis may become more important in the future.

Federal court of appeals decisions that examine regulatory agency economic analysis

Several law review articles published in the last few years shed additional light on the points above by examining federal appeals court decisions that evaluated the agency's economic analysis. Caroline Cecot and Kip Viscusi published the first article to examine a large set of court cases involving economic analysis rather than a few individual cases.[2] Cecot and

. . .

2. Most of the cases involve court review of RIAs or of economic analysis conducted by independent agencies addressing issues similar to those covered in RIAs. A few involve economic aspects of environmental impact statements. All occurred after the Supreme Court's 1983 decision in *Motor Vehicle Manufacturers*

Viscusi found that courts review an agency's economic analysis when the agency relied on it to make or support decisions – either because the agency was required to do so by statute or because the agency chose to do so within its legal discretion. When appeals courts offered an opinion on the validity of the agency's economic analysis, they upheld the agency's analysis completely in about 60 percent of these cases. In the other 40 percent, courts found the following types of problems:

- Failure to consider an important or statutorily mandated aspect of the problem
- Failure to consider important benefits (such as reduced greenhouse gas emissions), costs (such as increased use of dangerous substances in place of asbestos), or alternatives (such as regulatory options in between no new regulation and a complete ban on a hazardous substance)
- Assumptions or conclusions that were clearly contradicted by the best available scientific evidence
- Multiple significant methodological flaws, such as failure to use the same discount rates for benefits and costs, use of unrealistic time frames, or double-counting of benefits or costs
- Failure to disclose adequately the methodology, models or assumptions used in the analysis

That said, Cecot and Viscusi note that judicial review is often highly deferential, generally not probing into the analysis at all, and there is great inconsistency in the depth at which courts scrutinize the analysis when they do. Finally, they suggest that courts in the future will consider agency benefit-cost analysis more frequently, simply because agencies are relying on benefit-cost analysis more to guide decisions.

Reeve Bull and I conducted some additional analysis of the Cecot-Viscusi case sample. We found that courts tend to examine the agency's economic analysis very carefully when the underlying statute specifies how benefits and costs are supposed to influence agency decisions. Courts employ widely varying degrees of scrutiny when the statute includes less specific requirements, such as a mandate to "consider" benefits and costs or economic feasibility without further statutory guidance. Finally, courts are very deferential when the statute does not direct the agency to consider benefits, costs, or other economic factors.

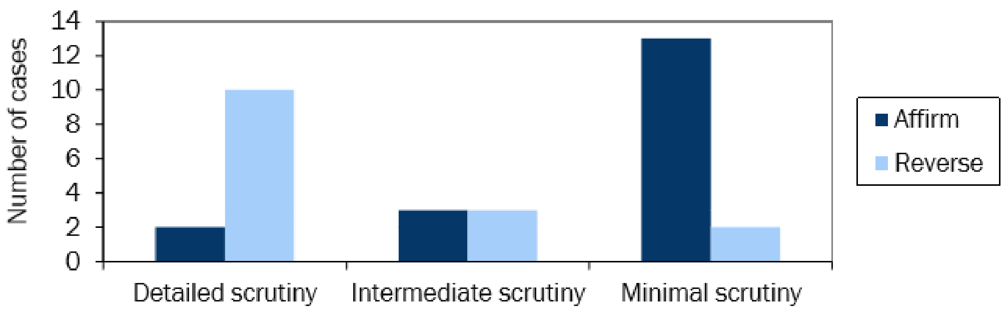
We found that courts are much more likely to reverse a regulation when they conduct detailed scrutiny of the economic analysis, and vice versa. As Figure 1 shows, in 10 of the 12 cases (83 percent) where courts evaluated the economic analysis in depth, the regulation

. . .

Association v. State Farm Mutual Automobile Insurance Co. articulated the contemporary "hard look" standard of review.

was reversed. In 13 of the 15 cases (87 percent) where the economic analysis received only minimal scrutiny, the court affirmed the regulation. Of the small number of cases where the economic analysis received an intermediate level of scrutiny, courts affirmed three times and reversed three times. The direction of causality is not clear. Perhaps courts are more prone to overturn a regulation when they examine an agency's economic analysis more closely. Or perhaps courts feel a need to provide an extensive critique of the agency's economic analysis when they find an analytical shortcoming large enough to lead them to reverse the regulation.

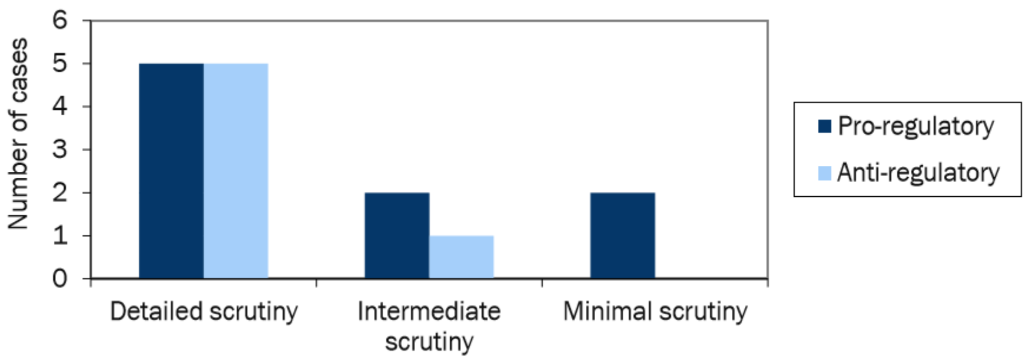
Figure 1: Appeals court decisions vary with extent of court's scrutiny of agency's economic analysis



Source: Author's calculations based on description of cases in Bull and Ellig (2018) Appendix.

Figure 2 focuses on the cases where courts reversed some part of a regulation. It divides the cases based on whether the appellant was seeking more regulation or less regulation. When courts engaged in detailed scrutiny of the agency's economic analysis, they sided with appellants who sought more regulation the same number of times they sided with appellants who sought less regulation. In the handful of cases where courts reversed a regulation based on the economic analysis but did not examine the analysis in detail, they usually sided with appellants seeking more regulation. If one can reach any conclusion at all based on this small number of cases, it appears that careful court scrutiny of agency economic analysis is not biased against regulation.

Figure 2: Scrutiny of economic analysis when courts reversed a regulation



Source: Author's calculations based on classification of cases in Bull and Ellig (2017) and description of cases in Bull and Ellig (2018) Appendix.

In a second paper, we found that agencies appear to respond both to statutory instructions and to courts. Agencies tend to produce more thorough RIAs and more extensive explanations of how the RIA influenced their decisions when the statute requires consideration of benefits and costs or when a federal appeals court has previously examined the agency's RIA for a similar regulations promulgated under the same or a predecessor statute. RIAs include less thorough analysis of costs and alternatives when the statute specifies non-economic factors, such as technological feasibility. When the agency is prohibited from considering costs, it tends to produce less thorough analysis of costs and less thorough explanations of how the analysis influenced decisions, but more thorough analysis of the underlying problem and the benefits of the regulation.

Five insights emerge from these law review articles that closely parallel the insights from interviews with agency officials:

1. The quality of an agency's economic analysis can affect whether a regulation is affirmed or reversed in court.
2. Courts will scrutinize an agency's economic analysis when the agency relied on it in making decisions, especially if the statute indicates economic factors the agency is expected to consider.
3. Agencies tend to produce more thorough analysis when the statute is more specific about the economic factors they are expected to consider, or when a court has previously examined the agency's analysis for a similar regulation.
4. An agency's analysis is vulnerable if it ignores a significant aspect of the problem, alternatives, benefits, or costs.
5. Economic analysis may become more important in the future.

Economic analysis matters when the agency claims to use it

The interviews with agency officials and law review analyses of cases described above both suggest that high-quality economic analysis can increase the odds that a regulation will survive court challenge, but courts are most likely to examine the agency's economic analysis when the agency relied on the analysis to inform decisions. Chris Carrigan, Zhoudan Xie and I recently conducted an empirical study that seeks to test these theories.

Our data set consists of 126 economically significant, prescriptive regulations for which OIRA review was concluded between 2008 and 2013. Scores evaluating the quality of the agency's RIA are taken from the Regulatory Report Card project. That project also identified whether the agency claimed to rely on any aspect of the RIA to make decisions about the regulation; agencies claimed to use the RIA for only about 40 percent of the regulations. Our dependent variable is a binary variable indicating whether any portion of the regulation was later overturned by a court.

After controlling for a variety of other factors that might influence the result, we find that neither the quality of analysis nor the agency's claim to use the analysis is correlated with the likelihood that the regulation will be overturned in court. Therefore, the quality of the RIA does not always affect court outcomes, and neither does the agency's claim to use the analysis.

But those results change when we add a variable that interacts the RIA's quality score with the agency's claim that it used the analysis. That variable indicates that a regulation is less likely to be overturned in court when the quality of the RIA is higher, *if* the agency claims that it relied on the RIA in any decisions about the regulation. The possible scores for the quality of RIAs in our sample range from 0 to 20 points. Holding other variables constant, a 1-point increase in the RIA's quality score is associated with a 3.7 percentage point reduction in the likelihood that a regulation will be overturned in court. An analysis with above-average quality is more likely to help uphold the regulation in court than to undermine it.

Conclusion

The new empirical analysis summarized above confirms the impressions of agency officials and legal literature assessing appeals court cases involving economic analysis. The quality of an agency's economic analysis is positively associated with the likelihood that the regulation will be upheld in court – but not always. If the agency says it relied on the economic analysis to make decisions, that puts the analysis "in play," and then the analysis could make a difference in the court's decision. A high-quality analysis is more likely to help than to hurt the agency's case in court. And many agency analysts and legal scholars also agree that economic analysis will likely become more important to courts in the future. Given these results, it behooves agencies to do their economic analysis well and use it to guide decisions.

Economic Studies at BROOKINGS

The Brookings Economic Studies program analyzes current and emerging economic issues facing the United States and the world, focusing on ideas to achieve broad-based economic growth, a strong labor market, sound fiscal and monetary policy, and economic opportunity and social mobility. The research aims to increase understanding of how the economy works and what can be done to make it work better.