

7.0 Rule Analysis

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7.1 Introduction

The Administrative Procedure Act, Chapter 150B of the General Statutes, and Executive Order No. 70 establish procedural requirements for the adoption, amendment, and repeal of administrative rules. They include requirements for agency development of fiscal notes and rules to meet OSBM review, approval, and certification. Compliance with the following procedures will satisfy the minimum analysis required for OSBM review, approval, and certification under Chapter 150B, E.O. 70, and the policies of the Director of the Budget.

A fiscal note is used to anticipate and evaluate the likely consequences of rules. It provides a formal and systematic way of organizing evidence on the key effects of rules. A good analysis is designed to inform the public and other stakeholders of the effects of the proposed action. It can also demonstrate that a proposed action is reasonable and justified.

7.2 Definitions

- “Agency” means any institution, board, commission, bureau, department, division, council, or officer of the state, but does not include any agency in the legislative or judicial branch of state or local government. (See G.S. 150B-2(1a) for further description).
- “Affected parties” means those persons who bear an economic impact from the proposed rule change.
- “Approval for publication” means the requirement that the agency must receive OSBM approval before it may publish a proposed rule change in the *North Carolina Register*.
- “Baseline” means the best assessment of the way the world would look absent the proposed rule change. This assessment must account for current N.C. General Statutes and rules contained in the N.C. Administrative Code. Informal agency policies not adopted as rules in compliance with Chapter 150B must be excluded from the assessment of the baseline.
- “Certification before adoption” means the requirement that the agency must receive OSBM certification that it has complied with the principles of G.S. 150B-19.1 and Section 2 of E.O. 70, when applicable, before it may adopt a rule.
- “Certification of federal requirement” means (specifically, as required under G.S. 150B-19.1. (g)) the certification identifying:
 - The federal law that the rule is purported to implement;
 - The federal law that requires the rule or for which the rule is necessary for compliance; or

- The federal law which places conditions on the receipt of federal funds.

If all or part of the proposed rule is not required by federal law or exceeds the requirements of federal law, then the certification shall state the reasons.

- “Fiscal note” means a realistic estimate of the impact of a proposed rule change.
- “Local funds” are receipts from non-federal and non-state governmental units and public interest organizations including county and city funds, third party matching funds, and in-kind contributions.
- “Opportunity cost” is the value of benefits that could have been received from an alternative that is forgone as a result of the regulatory action. The use of any resource, including a person’s time, has an opportunity cost. That opportunity cost is equal to the net benefit the resource would have provided in the absence of the regulatory action. For example, if a regulatory action adds paperwork and reporting requirements, the opportunity cost is the value of the staff time now used to comply with the added requirements.
- “Person” means any natural person, partnership, corporation, body politic, unincorporated association, organization, or society that may sue or be sued under a common name.
- “Permanent rule” is a rule adopted in accordance with the requirements of G.S. 150B-21.2.
- “Responsible agency fiscal officer” is the person designated by the department to certify that the agency has prepared an accurate fiscal note.
- “Rule” means each agency regulation, standard, or statement of general applicability that implements or interprets laws enacted by the General Assembly or Congress, or amends or repeals a prior rule. (See G. S. 150B-2(8a) for further clarification).
- “Rule change” means the package of individual rules that are new or proposed for amendment that the agency is requesting to publish and adopt together. Collectively this package of rules is the new policy the agency is proposing to implement.
- “State funds” are any moneys, including federal funds and any funds appropriated by the General Assembly, deposited in the state treasury except moneys deposited in a trust fund or agency fund as described in G.S. 143C-1-3 (G.S. 143C-1-1).
- “Substantial economic impact” means an aggregate financial impact on all persons affected of at least five hundred thousand dollars (\$500,000) in a 12-month period. (See G.S. 150B-21.4 (b1) for further clarification). Both costs and

benefits must be included when estimating this financial impact. For example, a rule change with \$300,000 of estimated benefits and \$200,000 of estimated costs would have a substantial economic impact.

7.3 Procedures for Agencies Covered by Executive Order 70

In addition to the requirements of the Administrative Procedures Act, Cabinet agencies and all boards and commissions with rule-making powers located within the Cabinet agencies must also follow Executive Order 70. Procedures for approval for publication and certification before adoption for these agencies are covered in this section.

Procedures for agencies not covered by E.O. 70 start in section 7.4.

7.3.1 OSBM Review and Approval before Publication

Before publishing permanent rule changes in the *North Carolina Register*, an agency must obtain approval for publication from OSBM. Approval for publication includes the rule change and fiscal note as submitted to OSBM. In order to ensure adequate review time, agencies must send rule changes and fiscal notes to OSBM at least 60 days prior to the intended date of publication. To the extent a permanent rule change or fiscal note is significantly modified after approval by OSBM for publication but before publication in the *North Carolina Register*, the rule change and fiscal note must be resubmitted for OSBM review. Significant modifications would include changing the cost or benefit estimate or adding or removing policies or procedures in the rule change.

There are three types of permanent rule changes, and each requires a different level of OSBM review. Each is briefly described below:

- a) De minimis rules – Rules with little to no impact on state funds, local funds, or private entities.
- b) Non-substantial economic impact rules – Rules that have (1) an aggregate economic impact of less than five hundred thousand dollars (\$500,000) in a 12-month period; and (2) impact State or local government funds or have a significant policy impact.
- c) Substantial economic impact rules – Rules with an aggregate economic impact on all persons affected of at least five hundred thousand dollars (\$500,000) in a 12-month period.

7.3.2 Information Submitted to OSBM before Publication

A good fiscal note does not follow a strict formula or template. Different rule changes require different emphases and levels of analysis, depending on the nature and

complexity of the rule change. As a result, there are three tiers of information required in a fiscal note. The first tier is required for de minimis rule changes. The second tier is required for any non-substantial economic impact rule changes, while the third tier is reserved for substantial economic impact rule changes. The general framework for the three tiers follows.

7.3.2.1 Tier 1 - De Minimis Rules

There are many rule changes that propose minor changes to policy or have a small economic impact. These rule changes do not require nearly the same level of analysis as a larger rule change. Examples of such rule changes include technical changes, clarifications and updates to current rule language, and rules that have no impact on state or local funds and have a de minimis impact on the private sector.

For de minimis rule changes, a brief description of the rule change must be submitted to OSBM for review and approval. The brief description must include:

- The title of the rule change and North Carolina Administrative Code citation;
- The name of the agency proposing the rule and agency contact information;
- A citation to the statute authorizing the rule change or the federal law or regulation requiring the rule;
- A brief statement identifying whether or not the rule has State, local, federal government, or substantial economic impact;
- A brief description of the rule, its purpose, likely impact of costs and benefits, and how it would benefit the public interest;
- A copy of the proposed rule text; and
- The certification of federal requirement.

7.3.2.2 Tier II - Non-Substantial Economic Impact Rules

For permanent rule changes with (1) a non-substantial economic impact and (2) an impact on State or local government funds or a significant policy impact, the fiscal note must include the following information:

- a) General Information
 - The title of the rule change and North Carolina Administrative Code citation;
 - The name of the agency proposing the rule and agency contact information;
 - A citation to the statute authorizing the rule change or the federal law or regulation requiring the rule;
 - A brief statement identifying whether or not the rule has State, local, federal government, or substantial economic impact;
 - Information on the source of funds that would be used to cover new costs if the rule change requires disbursement of state funds so that OSBM can certify the existence of funds (see G.S. 150B-21.4(a));
 - A copy of the proposed rule; and
 - The certification of federal requirement.

b) Summary of the Proposed Regulation

- Description of the change – Given the broad intended audience for this analysis, this discussion must be clear, concise, and avoid technical jargon.
- Purpose of the rule change – Describe the need for the proposed action, including a clear description of the problem or issue a rule change is intended to address. Discuss any expected improvements in public health, safety, or welfare.

c) Economic Analysis – This section is the heart of the fiscal note and must describe how the agency estimated the impact of the rule change. The depth of the fiscal note must correspond to the complexity and impact of the rule. Below are some general considerations that must be taken into account when evaluating the economic impact of the proposed rule change:

- Scope of Analysis –The appropriate time frame for analysis is dependent on the nature of a specific rule change and must cover a period long enough to encompass the important costs and benefits likely to result from the rule change. For many rule changes, a per year estimate may be sufficient. For others, such as a rule change with phased implementation over a number of years, the appropriate time frame may be much longer.
- Baseline – The impacts identified must be measured against a baseline. This baseline must be the best assessment of the way the world would look if the rule change is not adopted. This assessment must account for effective N.C. General Statutes and rules contained in the N.C. Administrative Code. Informal agency policies not adopted as rules in compliance with G.S. 150B must be excluded from the assessment of the baseline.
- Cost Estimates – The economic impact of the rule change is the incremental difference between the baseline and the future condition expected after implementation of the regulation. Direct costs as well as opportunity costs must be included. How is the rule change expected to change the current state? What costs are associated with these changes? Agencies must include tables and schedules of the cost estimates. Cost estimates must be monetized to the greatest extent possible. Where costs are not quantified in dollars, they must be listed and described.
- Benefit Estimates – Explain how the actions required by the rule change are linked to the expected benefits. Benefit estimates must be quantified in dollars to the greatest extent possible. Where benefits are not quantified, they must be listed and described.
- Transparency and Reproducibility – A good fiscal note must clearly set out the basic assumptions, methods, and data used, enabling the reader to understand how conclusions were reached.

- d) Persons Affected – The fiscal note must identify the persons affected by the rule change within the categories listed below. Within each category, describe the number of different entities impacted by the rule change and briefly summarize how these units will be affected. In some cases, it may be useful to organize the discussion by type of entity affected, depending on the complexity of the rule change.
- State government entities,
 - Local government entities,
 - Federal government entities, and
 - Private sector entities.

7.3.2.3 Tier III - Substantial Economic Impact Rules

A rule change is considered to have a substantial economic impact if the aggregate impact on all persons affected is of at least \$500,000 in a 12-month period. For example, a rule change with \$300,000 in estimated benefits and \$200,000 in estimated costs would have a substantial economic impact.

For rule changes with substantial economic impact, the agency must send OSBM the following:

- The information required for non-substantial economic impact rules.
- Alternatives – Agencies must identify at least two alternatives deserving consideration, evaluate their impacts to the extent possible, and state reasons for which they were rejected. The alternatives may have been identified by the agency or by members of the public. When there is a “continuum” of alternatives to address a particular problem, an agency must examine a preferred option, a more expensive or stringent option, and a less expensive or stringent option. Agencies must also consider alternatives involving economic incentives, information disclosure requirements, performance standards, and other actions that do not require rule-making. When the status-quo is a possible alternative, it may be used as one of the two required alternatives. (See G.S. 150B-21.4(b2)).
- Time Value of Money – Benefits and costs do not always take place in the same time period. When they do not, an agency may not simply add up all of the expected benefits or costs without accounting for when the impacts occur. Benefits or costs that occur sooner are generally more valuable. Given this preference, a discount factor of 7.0% must be used to adjust future benefits and costs when appropriate. At the discretion of OSBM, other discount rates may be used in addition to 7.0% for comparative purposes. Agencies must include a summary table of annualized costs and benefits. In constructing this summary table, it may be helpful to organize annual costs and benefits by rule provision and affected party. (See G.S. 150B-21.4(b1) and the U.S. Office of Management and Budget’s Circular A-4 on Regulatory Analysis.)

- Risk Analysis – A risk is a factor or possible event that may jeopardize anticipated benefits or increase the cost of a rule change. The agency must evaluate possible risks for their likelihood of occurrence and the impact of the occurrence. The impact must be described in terms of the costs and/or benefits it would affect. The risk analysis must tie into the assumptions and parameters used in the analysis of benefits and costs. Each significant risk must be listed and described. Given the uncertainty of various estimates, it may also be useful to provide a sensitivity analysis to reveal whether, and to what extent, the results of the analysis are sensitive to possible changes in key assumptions.

7.3.3 Certification before Adoption for Cabinet Agencies

G.S. 150B-21.4 requires OSBM to determine and certify that an agency adhered to the principles set forth in G.S. 150B-19.1 if state funds are affected. Additionally, E.O. 70 requires OSBM to ensure that an agency adheres to the principles outlined in Section 2 of the order. The principles must be followed through the process of adopting the rule according to G.S. 150B-21.2 and E.O. 70. As a result, agencies shall not adopt a rule change until OSBM has certified compliance with the principles. OSBM will not certify an agency has complied with the principles of G.S. 150B-19.1 or the E.O. until after publication and any public comments have been received, but prior to adoption. The procedures in 7.3.3.2 shall be followed to receive certification.

7.3.3.1 Scope of Review

OSBM certification after publication but before adoption is required to ensure that the conditions under which the rule change and fiscal note were approved for publication have not changed. For instance, if the agency receives public comments on the proposed rule change, new information is introduced that could change the assumptions made in the fiscal note and the policies that underlie the rule change. The certification review will ensure that any new information is taken into account and that the rule change and fiscal note are properly updated before adoption.

7.3.3.2 Certification Procedures

If an agency receives public comment after publication that raises significant concerns about whether the rule change complies with the principles discussed in 7.3.3. or the basis or validity of the fiscal note, it must resubmit the rule change and any updates, the fiscal note and any updates, and any public comments received to OSBM for certification review. After the public comment period, the agency must discuss the comments with OSBM. If OSBM and the agency find that no public comments were received that meet the above criteria and no significant modifications are made to the fiscal note or the rule change that was approved for publication, then OSBM will certify the rule change and the agency may adopt the rule change.

7.4 Procedures for all other Agencies

Agencies that are not in the Cabinet or boards and commission with rule-making powers not located in Cabinet agencies are not required to follow E.O. 70. However, these agencies are still subject to review, approval and, as applicable, certification by OSBM for the development of fiscal notes and rule changes as required by the Administrative Procedures Act. Section 7.4 lists the requirements for these agencies.

7.4.1 Rule Changes Requiring OSBM Approval

The following are the categories of rule changes with fiscal notes that must be submitted to OSBM for approval before publication.

- State impact – Permanent rules that require the expenditure or distribution of state funds. “Expenditure of funds” includes new agency activities required to be implemented by state employees or other agents of the state (contractors, temporary employees, etc.) paid with state funds. These activities must be included even if other agency activities are eliminated to offset the impact of the new activities. In addition, any new agency costs must be included, even if additional receipts may offset the cost. “Distribution of state funds” includes funds paid out by the state or reallocation of funds across agencies or divisions. In short, a rule change that causes any additional costs to the state or that moves funds requires OSBM approval. See G.S. 150B-21.4 (a).
- Substantial economic impact – Permanent rule changes with a substantial economic impact require OSBM approval.

7.4.2 Rule Changes Requiring OSBM Review

Permanent rules with any impact on local funds require OSBM review. This impact can be either expenditures or revenue. (See G.S. 150B-21.4 (b) and G.S. 150B-21.26).

7.4.3 Information to Submit to OSBM for Publication Approval

If a rule change from a non-Cabinet agency requires OSBM approval or review, than before publishing permanent rule changes in the *North Carolina Register*, an agency must obtain approval for publication from OSBM. Agencies must submit the rule changes and the fiscal note to OSBM for review and approval. The information the agency must submit to OSBM is the same information as required of Cabinet agencies and is outlined in 7.3.2 above.

7.4.4 Certification before Adoption for non-Cabinet Agencies

G.S. 150B-21.4 requires OSBM to determine and certify that the agency adhered to the principles set forth in G.S. 150B-19.1 if state funds are affected. In addition, the principles must be followed through the process of adopting the rule according to G.S. 150B-21.2. As a result, OSBM will not certify an agency has complied with the principles of G.S. 150B-19.1 until after publication and any public comments have been received, but prior to adoption. The procedures in 7.4.4.2 shall be followed to receive certification.

7.4.4.1 Scope of Review

OSBM certification after publication but before adoption will ensure that the conditions under which the rule change and fiscal note were approved for publication have not changed. For instance, if the agency receives public comments on the proposed rule change, new information is introduced that could change the assumptions made in the fiscal note and the policies that underlie the rule change. The certification review will ensure that any new information is taken into account and that the rule change and fiscal note are properly updated before adoption.

7.4.4.2 Certification Procedures

If an agency receives public comment after publication that raises significant concerns about whether the rule change complies with the principles discussed in 7.4.4., it must resubmit the rule change and any updates, the fiscal note and any updates, and any public comments received to OSBM for certification review. After the public comment period, the agency must discuss the comments with OSBM. If OSBM and agency find that no public comments were received that meet the above criteria and no significant modifications are made to the fiscal note or the rule change that was approved for publication, then OSBM will certify the rule and the agency may adopt the rule change.

7.4.5 Other Required OSBM Approval after Rule Publication

Besides certification as discussed in 7.4.4, there are three other circumstances when an agency must get OSBM approval after it has published the text of a proposed rule change and possibly already had the rule change approved.

1. If an agency must publish the text of a proposed rule in the *North Carolina Register* that differs substantially from the text of a previous version of the proposed rule published in the *North Carolina Register*, as outlined by G.S. 150B-21.2 (g), and if the previous version of the proposed rule change required a fiscal note, then the agency must have an amended fiscal note and rule change approved by OSBM before it publishes the text.
2. If an agency must publish the text of a proposed rule in the *North Carolina Register* that differs substantially from the text of a previous version of the

proposed rule published in the *North Carolina Register*, as outlined by G.S. 150B-21.2 (g), and if the proposed rule would cause the rule change to require a fiscal note, then the agency must have a fiscal note and rule change approved by OSBM before it publishes the text.

3. If the Rules Review Commission objects to the proposed rule change and additional or revised data are requested and prepared for presentation that changes the fiscal note, the fiscal note must be reviewed and approved again by OSBM.

An amended fiscal note should incorporate the new circumstances created by the proposed different rule and be submitted according to the procedures outlined above. If a new fiscal note is required, it should follow the procedures outlined above.

7.5 Administrative Processes

All required submissions of rule information to OSBM must be sent electronically to osbmruleanalysis@osbm.nc.gov. Faxes and paper submittals of information will not be accepted and will not constitute the submittal of a proposed rule change and supporting fiscal note.

Once OSBM has approved the proposed rule change and fiscal note for publication (7.3.1 and 7.4.3 above), the agency will be notified and OSBM will post the fiscal note, title of rule change, and the OSBM approval date on the OSBM website. The agency is responsible for submitting the OSBM approved rule change to the Office of Administrative Hearings for publication or adoption in the *North Carolina Register*.

Once OSBM has granted certification (7.3.3 and 7.4.4 above), the agency will be notified and the entry on the OSBM website will be marked as certified. If the fiscal note is modified prior to adoption, OSBM will post the final, fiscal note on the OSBM website.