Nothing but the Facts: The Regulatory Reform Process

The Committee on Capital Markets Regulation supports a transparent process for enacting regulatory reforms that would enhance the competitiveness of the U.S. financial markets and could survive a judicial challenge. Regulatory reform is important today, because as we describe throughout this Nothing but the Facts ("**NBTF**") statement, agencies can make meaningful reforms even without legislative changes.

The Administrative Procedure Act of 1946 (the "**APA**") sets forth the legal process for regulatory reform.[1] This NBTF statement first describes agency discretion in enforcing existing regulations. It will then describe the legal process for reversing agency adjudications, which are agency actions that resolve facts on a case-by-case basis.[2] Third, we will describe the more complex legal process for repealing and replacing agency rulemakings, which are agency actions that have future effect and relate to policy considerations. Finally, we describe how the Congressional Review Act can be used to repeal regulations that were finalized after May 2016.

We hope that this NBTF statement will assist policymakers seeking to enhance the regulations that cover the U.S. financial markets.

Agency Enforcement Discretion

Agencies may generally exercise discretion in how and when they choose to enforce existing regulations, including determining not to bring enforcement actions for certain actions that violate existing rules. In *Heckler v. Chaney*, the Supreme Court held that an agency's decision "not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion," and is not reviewable.[3] The Court explained that agencies have this discretion because an agency must assess not only "whether a violation has occurred, but whether agency resources are best spent on this violation or another," as well as whether the agency is likely to succeed in the action and whether the enforcement action would fit the agency's overall policies.[4]

Congress, however, "may limit an agency's exercise of enforcement power if it wishes."[5] For example, a statutory provision can provide that an agency *must* bring an enforcement action if certain conditions are met, and, in such an instance, a party with standing could seek judicial review of an agency's failure to bring an action.[6] For example, Section 619 of the Dodd-Frank Act requires the relevant agencies to enforce its provisions, stating that if an agency "has reasonable cause to believe" restrictions of the statutory provision are being violated it "shall

[1] 5 U.S.C. §§ 551-559, 701-706, 1305, 3344, 5372, 7521.
[2] The Supreme Court has turned to the Attorney General's Manual to assist it in interpreting the APA. *See Bowen v. Georgetown Univ. Hosp.* 488 U.S. 204, 218 (1988) (Scalia, J., concurring) (describing the 1947 Attorney General's Manual as "the Government's own most authoritative interpretation of the APA," which the Supreme Court has given "great weight").
[3] *Heckler v. Chaney*, 470 U.S. 821, 831 (1985).
[4] *Id.*
[5] *Id.* at 833.
[6] *Id.* at 833-34.

order" the regulated entity to "terminate the activity."[7] However, if the rule implementing that statute fails to specify or is unclear about what actions constitute a violation, then agencies would retain some discretion in determining whether a violation occurred and thus whether to bring an enforcement action.

An agency can also alter enforcement priorities by, for example, amending or rescinding and replacing related guidance, such as interpretations of rules, internal policies and manuals. These actions are not subject to the APA's lengthy rulemaking process.[8]

Adjudications

Adjudications are not subject to the APA's rulemaking process, so agencies can quickly issue adjudications, including reversals of prior adjudications. However, adjudications must satisfy the APA's "arbitrary and capricious" standard. If a federal court determines that an adjudication has violated that standard then it may overturn the agency's decision.[9]

In order to ensure that an action is not "arbitrary and capricious," a government agency must have a rational basis for its adjudication. Specifically, the Supreme Court has stated that in applying the arbitrary and capricious standard, a court will examine whether the agency has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[10] In other words, a reviewing court will "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."[11] The Supreme Court has listed a number of factors that are to be considered in applying the arbitrary and capricious standard, including the following:

1. Did the agency rely on factors Congress has not intended it to consider?
2. Did the agency fail to consider an important aspect of the problem?
3. Did the agency offer an explanation that runs counter to evidence before the agency?
4. Is the agency's action so implausible that it cannot be ascribed to be a product of agency expertise?[12]

This analysis helps ensure the agency's adjudication is rationally connected to the facts before it. By way of example, when the Financial Stability Oversight Council rescinded its designation of GE Capital Global Holdings LLC ("**GE**") as a systemically important non-bank it made significant efforts to establish a record demonstrating the rational basis for its action. It did so by releasing a 20-page order that explained the basis for rescission, including the fact that

[7] Pub. L. 111-203, § 619(e), 124 Stat. 1376, 1627 (2010).
[8] *See* 5 U.S.C. § 553(b); *Perez v. Mortgage Banker's Ass'n*, 135 S. Ct. 1199, 1206 (2015).
[9] *Id.*
[10] *Motor Vehicle Mfr. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks and citations omitted).
[11] *Id.*
[12] *Id.*

GE's total assets had declined by more than 50%, GE had shifted away from short-term funding, and GE no longer owned any depository institutions.[13]

Rulemakings

In order to amend, rescind, or replace existing rules, agencies must generally comply with the APA's procedural requirements for rulemakings and the requirement that its actions not be arbitrary and capricious.[14]

The APA's procedural requirements are that that the agency: (1) publish notice of a proposed rulemaking in the Federal Register; (2) give an opportunity to the public to comment on the proposal; (3) issue publication of a concise general statement of the rule's basis and purpose in the final rule; and (4) publish the final rule at least 30 days before it becomes effective.[15]

Of course, the APA's rulemaking process has been interpreted by the courts to include certain affirmative obligations. For example, in order to effectively provide an opportunity for the public to provide comments, the agency must: (a) disclose the relevant information on which the agency based its decision; and (b) address the vital questions raised by comments that are "of cogent materiality."[16] To satisfy (b), an agency does not need to address every comment it receives, however, it must respond to comments that "cast doubt on the reasonableness of the rule the agency adopts."[17]

To satisfy the requirement that the agency adopt a concise general statement of the basis of the rule and its purpose, the agency must "provide an adequate account of how the rule serves the objectives set out in the governing statute."[18] This means that the agency "is not free to substitute new goals in place of the statutory objectives without explaining how [the] actions are consistent with [the agency's] authority under the statute."[19]

Even if the procedural requirements of the APA are met, courts can still overturn a rule if the agency violated the APA's arbitrary and capricious standard.[20] Common factors that the

---

[13] Financial Stability Oversight Council, Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding GE Capital Global Holdings, LLC (June 28, 2016), *available at* https://www.treasury.gov/initiatives/fsoc/designations/Documents/GE%20Capital%20Public%20Rescission%20Basis.pdf.

[14] 5 U.S.C. § 551(5) (defining a rulemaking to include "formulating, amending, or repealing a rule); *id.* § 553(b) (establishing rulemaking procedures); *see, e.g.*, *Motor Vehicles Mfrs. Ass'n v. State Farm Ins. Co*., 463 U.S. 29 (1983) (Court reviewing changes to existing rules under the APA)); 5 U.S.C. § 706.

[15] 5 U.S.C. § 553(b), (c), (d).

[16] *United States v Nova Scotia Food Prods. Corp*., 568 F.2d 240, 252(2d Cir. 1977).

[17] *Balt. Gas & Elec. Co. v. U.S.*, 817 F.2d 108, 116 (D.C. Cir. 1987).

[18] *Independent U.S. Tanker Owners Committee v. Dole*, 809 F.2d 847, 849 (D.C. Cir. 1987).

[19] *Id.* at 854.

[20] *See* 5 U.S.C. § 706.

courts consider in applying the arbitrary and capricious standard are set forth in the adjudication section of this statement. The Supreme Court has also set forth specific requirements for how the arbitrary and capricious standard will be applied to the rescission or replacement of existing rules.

In *Motor Vehicles Manufacturers Association v. State Farm Insurance Co.*,[21] the U.S. Supreme Court stated that an agency that changes course by rescinding a rule must supply a reasoned analysis for the change or else it will have violated the arbitrary and capricious standard. In that case, the Supreme Court further provided that agencies must consider alternatives to the revised rule.[22]

In its 2009 *FCC v. Fox Television Stations* decision, the Supreme Court held that to change a position an agency needs to acknowledge that it is changing its position and "show that there are good reasons for the new policy."[23] The agency does not, however, need to "demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one."[24] Instead, "it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better."[25] Where the prior policy engendered reliance interests, those interests must be taken into account in the agency's stated rationale for the new policy.[26]

The D.C. Circuit has also held that a rulemaking will be invalid if a challenger, who has standing, can show by clear and convincing evidence that the agency head or commissioners had an "unalterably closed mind". This inquiry focuses on the agency member's prejudgment, not on a failure to weigh the issues fairly.[27] Thus, agency officials will need to be careful not to make statements that they are not open to input from the public on proposals to amend or repeal and replace existing rules.

Congressional Review Act

Congress and the newly-elected President can also employ an infrequently used tool to override a rule adopted in the final months of the outgoing administration. The Congressional Review Act ("**CRA**")[28] allows for the House and Senate to adopt a joint resolution "disapproving" of a newly adopted regulation.[29] The CRA has been successfully used only once since it became law in 1996[30], when it was used at the beginning of the George W. Bush administration to invalidate a rule on ergonomics standards promulgated at the end of the Clinton

[21] 463 U.S. 29 (1983).
[22] *Id.* at 43.
[23] 129 S. Ct. 1800, 1811 (2009).
[24] *Id.*
[25] *Id.*
[26] *Encino Motorcars, LLC. v. Navarro*, 579 U.S. ___ (2016), slip op. at 9-10.
[27] *C&W Fish Co. v. Fox*, 931 F.2d 1556, 1565-66 (D.C. Cir. 1991).
[28] 5 U.S.C. §§ 801-808.
[29] *Id.* § 802.
[30] Small Business Regulatory Enforcement Fairness Act of 1996, § 251, Pub. L. 104-121.

administration.[31]

Specifically, the CRA requires, among other things, that an agency provide Congress with a copy of new rules before they can become effective.[32] Generally, the House and Senate then have 60 days to adopt a joint resolution of disapproval for any reason.[33] However, the CRA also allows a newly-elected Congress to reject a rule under a similar 60-day timeframe if the rule was provided to the outgoing Congress less than 60 days before that Congress adjourned.[34] Based on estimates of when Congress will adjourn its current session, the Congressional Research Service estimates that the CRA will likely be an available tool to Congress for rules finalized after May 2016.[35] The CRA outlines procedures that allow the Senate to avoid a filibuster of a joint resolution brought before the chamber under the CRA.[36] A joint resolution that is adopted by both chambers can be signed or vetoed by the President.[37]

A rule that is "disapproved" under the CRA mechanism will not take effect, or will cease to continue if previously in effect.[38] Importantly, any rule overridden in this manner cannot be reissued in substantially the same form unless the new or reissued rule is specifically authorized by a law enacted after that date of the joint resolution disapproving of the original rule.[39] Moreover, the CRA provides that no action taken by Congress to disapprove of a rule is subject to judicial review.[40]

****

Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), or its Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

[31] Yuka Hayashi, *Republican Lawmakers Eye Freeze on Obama Regulations*, Wall St. J. (Nov. 18, 2016), http://www.wsj.com/articles/republican-lawmakers-eye-freeze-on-obama-regulations-1479489099?mg=id-wsj.
[32] *Id.* § 801(a).
[33] *Id.* § 802.
[34] *Id.* § 801(d).
[35] Christopher M. Davis & Richard S. Beth, CRS Insight IN10437, *Agency Final Rules Submitted After May 30, 2016, May Be Subject to Disapproval in 2017 Under the Congressional Review Act*, https://www.fas.org/sgp/crs/misc/IN10437.pdf.
[36] 5 U.S.C. § 802(c), (d).
[37] *See id.* § 801(a)(3)(B).
[38] *Id.* § 801(b)(2).
[39] *Id.*
[40] *Id.* § 805.