

Podcast: Demystifying Agency Rulemaking, Ep.1: Navigating the Administrative Procedures Act to Safeguard Against Overreaching Regulations

August 18, 2023

When a Federal agency alleges that an individual or business has violated one of its rules, the immediate response usually is to argue that the agency rule was not violated. That immediate response skips over a fundamental issue. That fundamental issue is whether the agency rule is legally valid. Did the agency overstep its authority in promulgating the rule? If it did not overstep its authority? Did the agency follow the proper procedures when it promulgated its rules? In this two-part series, we will explore the process by which Federal agencies promulgate their rules and how individuals and businesses have challenged agency rules.

Douglas Charnas: Welcome to our podcast on Agency Rulemaking, Part I. I'm Douglas Charnas, Member in McGlinchey's Washington DC office. I practice corporate and tax law. I'm joined today by my colleagues Michael Blumenthal and David Waxman, who are both located in McGlinchey's Cleveland, Ohio office. Michael represents clients in environmental due diligence in real estate transactions, mergers and acquisitions, environmental compliance permitting, and multimedia auditing. David represents clients on matters pertaining to real estate, acquisitions, development, redevelopment, construction, contracts and transactions, environmental compliance and insurance financing, opportunity zone transactions, leasing, and business acquisitions and divestitures.

David Waxman: Well, we talk about the law, but what is the law? Is it just the statutes that congress and state legislative bodies pass?

The purposes of the APA when enacted were to ensure that agencies keep the public informed of their organization, procedures, and rules; to provide public participation in the rulemaking process; to prescribe uniform standards for the conduct of formal rulemaking and adjudicatory proceedings; and restate the law of judicial review.

Michael Blumenthal: It's not always easy to know what is the law and what is not. We have statutory law. This is what we most commonly think of as law. Congress and state legislatures make law, as well as local governments when they enact statutes. Then we have common law. Courts make common law through judicial precedent. We also have administrative law. Government agencies make law through notices, regulations, or other forms of published guidance. Some administrative rules have the force and effect of law and others do not.

David Waxman: Administrative law is a significant component of the law.

Douglas Charnas: I have a copy of the Internal Revenue Code in my office. It's one volume, albeit very thin paper and small print. I also have a copy of the tax regulations. They are eight volumes, also very thin paper and very small print.

We often hear about the burden imposed by government regulations. The whole idea of government regulations is a political hot potato. Is this because government agencies can write whatever they want?

Michael Blumenthal: Not exactly. The Administrative Procedure Act, which was enacted in 1946, serves to police improper agency behavior, protect public safety, and secure proper entitlements. The APA governs all three main Federal agency functions: rulemakings, adjudications, and licensing.

The APA was a product of concern about the rapid increase in the number of powerful federal agencies in the first half of the 20th century, particularly during the administration of President Franklin D. Roosevelt, who created a number of agencies to implement his New Deal social and economic programs.

Interpretive rules are generally contrasted with legislative rules. Interpretive rules articulate what an agency thinks a statute means or reminds parties of preexisting duties. Interpretive rules merely advise the public on an agency's construction of the statute it's administering. Legislative rules impose new rights or duties and change the legal status of regulated parties. Unlike interpretative rules, legislative rules have the force and effect of law.

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The APA describes a particular rulemaking process with which agencies are required to comply. Typically, the agency must give a notice of a proposed rulemaking, published in the Federal Register. The notice must include the date the rule will come into effect, the legal authority under which the agency has proposed a rule, and the substance of the rule.

After notice is given, the agency is required to solicit and accept public comments on the rule. There is no minimum period specified for the comment period to remain open, and it often varies with the complexity of

the rule. Most comment periods last between 30 and 60 days, and some are reopened if the agency believes that there was insufficient time for the public to respond or that the agency did not receive as much feedback as it would like. The agency must then consider all the comments that are submitted in passing the final rule.

David Waxman: Does every pronouncement by a Federal agency need to go through the notice and comment rulemaking process?

Michael Blumenthal: No. The APA also describes certain cases in which the notice and comment rulemaking process is not required, including two general exceptions and two specific exceptions. The first general exception is that the rule involves a military or foreign affairs function of the government. The second general exception is that the rule involves a matter relating to agency management or personnel or to public property loans, grants, benefits, or contracts. The first specific exception is in cases of interpretive rules, general statements of policy, or rules of agency organizations' procedure or practice. The second specific exception is when the agency finds for good cause that the notice and comment process is impractical, unnecessary, or contrary to the public interest.

Now, you might be asking the question, "what happens if a Federal agency fails to comply with the APA in promulgating a rule?" If the validity of that agency rule is challenged because the agency failed to comply with the APA, it is likely that a court will hold the rule invalid.

David Waxman: Okay, so under the first specific exception, an interpretive rule is not subject to the notice and comment process. What's an interpretive rule versus some other type of rule?

Douglas Charnas: Interpretive rules are generally contrasted with legislative rules. Interpretive rules articulate what an agency thinks a statute means or reminds parties of preexisting duties. Interpretive rules merely advise the public on an agency's construction of the statute it's administering. Legislative rules impose new rights or duties and change the legal status of regulated parties. Unlike interpretative rules, legislative rules have the force and effect of law.

David Waxman: So if a Federal agency issues a regulation as an interpretive rule, the agency does not have to follow the notice and comment rulemaking process.

Douglas Charnas: Yes, that's correct, but agencies generally follow the notice and comment rulemaking process for interpretative and legislative regulations. Having said that, sometimes the regulations need to be issued immediately. In this case, the agency may issue temporary regulations and proposed regulations at the same time. The temporary regulations fall under the second specific exception to the notice and comment rulemaking process.

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David Waxman: It seems to me that when a Federal agency takes the position that a company has failed to comply with one of its rules, a company's blush reaction is often to demonstrate that it complied with the agency's rules. But it sounds like the company should also look at challenging the validity of the rule.

Michael Blumenthal: Yes, absolutely, and in this regard, the first challenge is whether the agency complied with the APA. One, is the rule an interpretive rule or a legislative rule? Two, if the rule is a legislative rule, did the agency comply with the notice and comment rulemaking process? In addition to challenging whether the agency complied with the APA, does the rule come within the so-called major question doctrine or should the agency's interpretation be given deference?

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David Waxman: Doug, I understand that there's a relatively recent U.S. Tax Court decision, in which the full Court, with concurring and dissenting opinions, invalidate an Internal Revenue Service (IRS) notice, not a regulation, for Treasury's failure to comply with the APA when it issued the rule.

Douglas Charnas: That is correct. *Green Valley Investors* is an important case. It is a reviewed opinion. This means that the Chief Judge directed, after reviewing the draft opinion, that the draft opinion should be considered by the full Court. When the full Court considers an opinion, it is referred to as a reviewed opinion. In practice, a draft opinion will be considered by the full court if it proposes to invalidate an agency's rule or overturn Tax Court precedent.

At issue in *Green Valley Investors* was an IRS Notice that identified certain syndicated conservation easement transactions as tax avoidance transactions and provided that such transactions are so-called listed transactions. Taxpayers that participate in listed transactions are required to disclose to the IRS their participation in those transactions. Harsh penalties apply if taxpayers fail to disclose their participation in a listed transaction, even if such participation does not result in a tax deficiency. It is the failure to disclose that triggers the penalty, not the underpayment of the tax.

Green Valley participated in a transaction that was later identified as a listed transaction and the IRS asserted the penalty against Green Valley for failing to identify its participation in the listed transaction within 90 calendar days once it was identified as such by the IRS, as required by the regulations. Green Valley argued that it was not liable for the penalty for not disclosing its investment in the listed transaction on two grounds. First, the IRS Notice listed the transaction *after* Green Valley had made its investment and this resulted in a prohibited retroactive assessment of tax. Second, the issuance of the Notice failed to comply with the notice and comment rulemaking procedures of the APA.

The tax court did not agree with Green Valley's first argument. With respect to the second argument, the court first addressed whether the Notice constituted a legislative rule. It found that the act of identifying a transaction as a listed transaction is, by its very nature, a substantive, that is, legislative rule, and not merely an interpretative rule. The Court then addressed whether the Notice was exempt from the notice and comment rulemaking procedures of the APA. It noted that the APA provides that an agency may depart from normal notice and common procedures for good cause, but the IRS did not invoke this exception. Rather, the IRS argued that when Congress enacted the statute dealing with tax transactions like listed transactions, it expressly authorized the IRS to identify transactions as listed transactions.

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The court noted that the APA limits the ability of a subsequent statute to modify or supersede its procedures except to the extent that the statute does so expressly. After analyzing the legislative history, the court concluded that the statute did not expressly modify or supersede the APA to allow the IRS to identify a transaction as a listed transaction without complying with the notice and comment rulemaking procedures. Because the IRS failed to do so, when it issued the Notice, the court held the Notice to be invalid and the penalties for failure to report the listed transaction not to apply.

The interesting point is that *Green Valley* acknowledged that it invested in a listed transaction and it did not report it, but nevertheless escaped the penalties because the IRS failed to comply with the APA when it issued the Notice. 10 judges joined the opinion, four judges concurred with the result, but provided separate opinions, and two judges dissented.

David Waxman: Michael, early last year, the Supreme Court handed the Environmental Protection Agency a defeat in *West Virginia v. EPA*. The case also involved the challenge to an agency rule in this case, an EPA rule.

Michael Blumenthal: Yes, that is correct; however, the rule was not challenged on the basis of EPA's failure to comply with the APA, but on the basis that the rule addressed an issue of major national significance and EPA failed to demonstrate that the rule was supported by clear statutory authorization. The case involved the so-called major questions doctrine.

I will not get into the specifics of the EPA rule involved in the *West Virginia* case, but it involved regulating greenhouse gas emissions for existing power plants through shifting electricity generation at the grid level from the higher-emitting to lower-emitting producers. An objective of the rule was to shift electricity generation from coal to natural gas and renewables, primarily wind and solar sources. The Supreme Court noted that such a sector-wide shift in electricity generation from coal to natural gas and renewables required by the rule would result in billions of dollars in compliance costs paid in the form of higher energy prices, retirement of dozens of coal-fired plants, and elimination of tens of thousands of jobs across the various sectors.

The Supreme Court has traditionally treated the major questions doctrine as an exception to the Chevron doctrine, but the relationship between the two is a bit unclear. As noted, the Chevron doctrine governs judicial review of an agency's interpretation of a statute it administers. If Chevron applies, a court will typically engage in a two-step analysis to determine if it must defer to an agency's statutory interpretation.

Michael Blumenthal: Relying on the "major questions" doctrine, the Court found that a "clear statement" from Congress is necessary for a court to conclude that Congress intended to delegate authority to EPA to establish a rule with such "vast economic and political significance," and EPA failed to do so. In requiring an agency to point to a clear "textual commitment of authority" to regulate issues involving major questions, the Supreme Court

has explained that “Congress ...does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions. It does not, one might say, hide elephants in mouse holes.”

David Waxman: Congress frequently delegates authority to agencies to regulate particular aspects of society in general or broad terms. Courts generally have deferred to an agency’s interpretations of statute that it administers under the so-called *Chevron* doctrine. Michael, how do you reconcile the *Chevron* doctrine with the major question doctrine?

Michael Blumenthal: David, that’s a great question, and in honestly, I’m not sure they can be reconciled. Rather, the Supreme Court has traditionally treated the major questions doctrine as an exception to the *Chevron* doctrine, but the relationship between the two is a bit unclear. As noted, the *Chevron* doctrine governs judicial review of an agency’s interpretation of a statute it administers. If *Chevron* applies, a court will typically engage in a two-step analysis to determine if it must defer to an agency’s statutory interpretation. Step one, the court asks whether the statute directly addresses the precise issue before the court or if the statute is ambiguous or silent. In that respect, the court must proceed to step two. Step two instructs the court generally to defer to the agency’s reasonable interpretation. However, when an agency’s interpretation of an ambiguous statute concerns an issue of vast economic and political significance, the court has at times invoked the major questions doctrine to deny the agency the deference traditionally accorded under *Chevron*.

Michael Blumenthal: What creates some uncertainty between the two doctrines is when the Supreme Court applies the major questions doctrine as an exception to the *Chevron* doctrine. The Court has applied the major questions doctrine at step one of *Chevron*, concluding that Congress did not give the agency authority to regulate the major question at issue. The court has also invoked the major questions doctrine at step two, determining that the agency’s interpretation was unreasonable because Congress did not clearly give it such authority. The Court has even used a doctrine as a reason to reject engaging in the *Chevron* two-step analysis altogether.

When considering whether an agency rule applies, we need to consider the procedural aspects of the rule. First, is it a legislative or interpretive rule? Second, if it’s a legislative rule, did the agency follow the notice and comment rulemaking procedure? Third, if not, is there an exception to the notice-and-comment procedural rule? Fourth, if the notice and comment rulemaking procedure was followed, does the rule involve the major questions doctrine? Was there a clear statement from Congress that it had intended to delegate authority to the agency to promulgate the rule? Finally, should the agency rule be given deference under the *Chevron* doctrine?

While the Supreme Court continues to apply the *Chevron* doctrine analysis when interpreting agency rules, even though it may not mention *Chevron*, a case last summer, *American Hospital Association v. Becerra*, suggests that the court may require a significant level of ambiguity before accepting the agency’s interpretation.

It is also important to note that on May 1, the Supreme Court granted certiorari in *Loper Bright Enterprises v. Raimondo*. The issue before the Supreme Court in the *Loper Bright* case is whether the *Chevron* deference should be overruled or clarified.

Douglas Charnas: Michael, Congress is addressing the *Chevron* doctrine and the major question doctrine. Legislation has been introduced that would direct courts to conduct their own interpretation of laws when

reviewing administrative actions without deferring to the agencies' legal conclusions. The proposed legislation also would require Congress to approve major administrative rules, including those with an annual cost of \$100 million or more, before they could take effect. Whether these provisions get enacted is to be seen, but it is clear that the *Chevron* doctrine and the major question are facing serious challenges.

David Waxman: Well, this is a lot to digest. So let me take a shot at summarizing what we've discussed. When considering whether an agency rule applies, we need to consider the procedural aspects of the rule. First, is it a legislative or interpretive rule? Second, if it's a legislative rule, did the agency follow the notice and comment rulemaking procedure? Third, if not, is there an exception to the notice-and-comment procedural rule? Fourth, if the notice and comment rulemaking procedure was followed, does the rule involve the major questions doctrine? Was there a clear statement from Congress that it had intended to delegate authority to the agency to promulgate the rule? Finally, should the agency rule be given deference under the *Chevron* doctrine? Michael, what's your take from this?

When an agency is contending that your company or client has not complied with one of its rules, do not just focus on whether there was compliance with the substance of the rule. Challenge the rule itself. Was the rule validly issued, and if so, should the court give it any deference?

Michael Blumenthal: My take is when an agency is contending that your company or client has not complied with one of its rules, do not just focus on whether there was compliance with the substance of the rule. Challenge the rule itself. Was the rule validly issued, and if so, should the court give it any deference?

David Waxman: Compliance with the APA is essential for Federal agencies promulgating rules, but there are other aspects to rulemaking that we'll discuss in the second part of this series. These include the Paperwork Reduction Act, the Regulatory Flexibility Act, the Office of Information and Regulatory Affairs, the Office of Management and Budget, and certain Executive Orders. We will also discuss the importance of participating in the rulemaking process and how you can do that. Thank you for joining us today, and please join us in the second part of this series.

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