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SCOTUS Ruling on the Dept. of Veterans Affairs Regulation Has Implications for the Banking Industry and Supervisors

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For those as interested in regulatory examination and enforcement as we are at BPI, Wednesday was an important day. The Supreme Court issued a ruling in *Kisor* v. *Wilkie*, which dealt with a regulation issued by the Department of Veterans Affairs which will likely have significant implications on the weight that U.S. courts will place on banking agency guidance and other agency interpretations of regulations. You will be forgiven if you didn't immediately make the connection between this ruling and the banking agencies.

The case focused on long-standing court precedent called "*Auer* deference," (also, at times, referred to as "*Seminole Rock"* deference) *i.e.*, the deference that U.S. courts have shown to an agency's interpretation of its own regulations. In a majority opinion by Justice Kagan, the Court substantially narrowed "Auer deference" in holding that while it should be retained as a formal matter under the doctrine of *stare decisis* (i.e., the legal principle of only overturning longstanding court precedent in very limited circumstances), it was necessary to "clear up" when and how the courts should apply *Auer*. Most importantly, the Supreme Court articulated a multi-step test for courts to use before applying *Auer* deference. As Justice Gorsuch remarked in his concurrence, the *Auer* "doctrine emerges maimed and enfeebled – in truth, zombified." In short, *Kisor* is pyrrhic victory for *Auer* deference.

Previously, many courts had treated *Auer* deference as something to be automatically applied to an agency's interpretation (*e.g.*, in the context of the U.S. bank regulators, the interpretation is often in the form of agency guidance) of its own ambiguous regulations. A recent illustration of court application of *Auer* deference in the banking context was in *California Pacific Bank* v. *FDIC* (March 2018), where the U.S. Court of Appeals for the Ninth Circuit deferred to the FDIC's interpretation of the FFIEC's Bank Secrecy Act/Anti-Money Laundering Examination Manual, as a definitive statement of the regulatory requirements for satisfying BSA program obligations under applicable (and "ambiguous") law and regulations.

Importantly, Wednesday's opinion rejects the automatic application of *Auer* in favor of what amounts to a five-step test – i.e., in other words, at least five criteria (or court findings) have to be met in order for courts to apply *Auer* deference.

- *First Step*: the court determines that the regulation at issue is "genuinely ambiguous" after using all "traditional tools" of construction.

- *Second Step:* next, the court must determine that the agency's reading is "reasonable" (i.e., it must come within the "zone of ambiguity" or permissible interpretation).

- *Third Through Fifth Steps*: the court then must further determine that the "character and context of the agency's interpretation entitles it to controlling weight." This includes (but is not limited to) the following determinations:

    - the court determines that the interpretation is the "authoritative" or "official" position of the agency, rather than an *ad hoc* position (*e.g.*, the formal position of the Federal Reserve vs. informal agency interpretations or perspectives of Federal Reserve staff),

- o the court determines that the interpretation implicates the agency's substantive expertise (*e.g.*, in the case of the Federal Reserve, relates to, *e.g.*, "safety and soundness" and/or financial stability), and
- o the court determines that interpretation reflects a "fair and considered judgment," *i.e.*, it is consistent with prior agency interpretation and is not created as a *post hoc* justification or for litigation purposes.

The banking industry is being reshaped through advances in technology and changes in the marketplace. Especially in times of rapid transformation, novel interpretive issues (which at times may amount to "ambiguities" for purposes of *Kisor*) arise under banking regulations as the treatment of new or emerging technologies, processes, products and services under longstanding regulations is often uncertain. As a result of Wednesday's holding narrowing *Auer* deference to agency interpretations of regulations, U.S. banking agencies should have a greater incentive to more frequently address "ambiguous" rules through further notice and comment rulemaking rather than through guidance. In addition, we believe that the Supreme Court holding will meaningfully increase the ability of banks to challenge informal agency interpretations of regulations in court given the limitations on use of *Auer* deference described above (*e.g.,* if a bank were to seek to litigate supervisory determinations by federal banking agencies under circumstances where there has been no clear violation of a statutory provision or regulatory requirement subject to notice and comment rulemaking).

Finally, it also warrants mention that:

· Justice Kagan – in a portion of her opinion that drew 4 Justices – also addressed *Auer* on substantives grounds (not just *stare decisis*). These justices observed that "[e]ven though a court might defer to an agency's interpretation of a regulation, the agency's interpretation itself never forms the basis for an enforcement action. Rather, an agency bringing an enforcement action must always rely on a rule that went through notice and comment."

· Chief Justice Roberts concurred in preserving *Auer*, and stated, in his view, that *Auer* deference is not particularly impactful because "the cases in which *Auer* deference is warranted largely overlap with the cases in which it would be unreasonable for a court not to be persuaded by agency's interpretation of its own regulation."

· Justice Gorsuch, writing for four Justices, would have formally *abolished Auer* deference, arguing that it was contrary to the Administrative Procedure Act and the U.S. Constitution's separation of powers. He also reasoned that it was not entitled to *stare decisis* given its recent and inconsistent application.

· In separate concurring opinions, both Chief Justice Roberts and Justice Kavanaugh (joined by Justice Alito) stated that *Kisor* did not touch upon the question of *Chevron* deference, suggesting that these Justice might be open to modifications of *Chevron*, should the opportunity arise.

· The specific facts of *Kisor* involved a Marine veteran (James Kisor) who argued that the Department of Veterans Affairs owes him retroactive disability payments. A federal appeals court considered the interpretation of the Board of Veterans' Appeals of an ambiguous Dept of Veterans Affairs regulation binding under *Auer*, and ruled against Kisor. The U.S. Supreme Court vacated and remanded the federal appeals court decision.