Developments in Judicial Deference of Administrative Agency Actions

04.22.2015

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In my post of April 2, Divided Supreme Court Restricts Provider Challenges to State Medicaid Rates, I wrote about the March 31st Supreme Court decision that providers may not sue in federal court over the adequacy of state Medicaid rates (See Armstrong v. Exceptional Child Ctr., Inc. (“Exceptional Child Center”). In that post I commented that Justice Breyer, in a concurring opinion, saw the case through the lens of administrative law principles, citing to the deference principles in Chevron U. S. A. Inc. v. Natural Resources Defense Council (“Chevron”). I promised to follow-up, which I do today, to discuss a March 9th Supreme Court decision, Perez v. Mortgage Bankers Association, (“Perez”), in which three conservative Justices (Scalia, Thomas and Alito) filed separate concurring opinions revisiting various principles of judicial deference under the Administrative Procedures Act (“APA”). These concurring opinions provide important clues to the direction in which each of these Justices may wish to move the full Court in reconsidering bedrock deference principles, and perhaps even laying the groundwork ultimately to reconsider Chevron.

Chevron holds that, where Congress has “not directly spoken to the precise question at issue,” i.e., where a statute is ambiguous (the so-called first prong), courts are to uphold an agency’s reasonable or “permissible constructions of [a] statute” (the so-called second prong). The application of Chevron, and which prong will be determinative, is one of the main legal issues at play in King v. Burwell, the case addressing whether, under the Affordable Care Act (“ACA”), tax subsidies are available to consumers who buy health insurance through federally established exchanges. The Perez case encompassed the issue of deference to an agency’s interpretation of its own rules, not the underlying statute. But the approaches to this aspect of deference taken by the three Justices in their concurring opinions in Perez may provide some hint as to what their positions will be on Chevron in King v. Burwell later this Term.

Judicial deference is based on judge-made rules to determine how courts decide whether administrative regulations and interpretations properly follow authorizing legislation. The issue before the Court in Perez was whether the Department of Labor was required to proceed by notice-and-comment rulemaking under the APA when it reversed its own interpretation of its regulations in 2010 and decided that mortgage loan officers were subject to the Department’s overtime pay regulations.

The Mortgage Bankers Association (“MBA”) brought suit, and, on appeal, the United States Circuit Court for the District of Columbia sided with the MBA based on its 1997 decision in Paralyzed Veterans of Am. v. D.C. Arena. That case held that, when federal agencies change their interpretations of their own regulations, they must implement such changes through notice-and-comment rulemaking. The Department of Labor appealed, and a unanimous Supreme Court reversed, holding that requiring notice-and-comment rulemaking in reversing an interpretation of a regulation is inconsistent with the plain language of the APA, which exempts “interpretive rules” from the formal notice-and-comment rulemaking requirements of other parts of the APA. (Inexplicably, it was not until MBA’s brief to the Supreme Court that it borrowed a tactic from many health care provider challenges to interpretive rules, and argued that the interpretation at its core was substantively not an interpretive rule, but rather a legally binding legislative rule. The Supreme Court found that the MBA waived this argument.)

Writing for the Court, Justice Sotomayor found that a long line of cases hold that interpretive rules do not bind parties and therefore do not have the force and effect of law as do formal or “legislative” rules. Notably, the
Court, citing to earlier precedent, also found that interpretive rules “are not accorded that weight in the adjudicatory process.”

In their concurring opinions, while agreeing with the holding, each of Justices Scalia, Thomas and Alito employed approaches to the analysis of deference to be given to the administrative agencies’ interpretation of their own regulations that took aim at traditional principles of deference. Those “traditional” principles derived from a 1945 Supreme Court decision, which predated the enactment of the APA, Bowles v. Seminole Rock & Sand Co., (“Seminole Rock”), and the Court’s 1997 decision in Auer v. Robbins. These cases are discussed in the context of the concurring opinions below.

A third approach, the Skidmore Deference, is not directly cited in Justice Sotomayor’s opinion, but is of importance to understand the outcome. Skidmore v. Swift, a 1944 Supreme Court decision, held that interpretations and opinions of a department are not controlling. The Court set out the factors to be afforded the agency in giving weight or deference in such circumstances: “the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.” As Skidmore deference has been interpreted over the years by other courts, the reality in practice is that interpretive guidance gets little or no deference at all, and so it is not surprising that the Court in Perez simply announced that agencies’ interpretive rules are typically not afforded any deference.

Justice Scalia and Auer Deference. Justice Scalia, elaborating on his concern that the Court has “developed an elaborate law of deference to agencies’ interpretations of statutes and regulations,” focused his opinion on the reality that courts, in his view, give agencies’ interpretive rules the force-and-effect of law and do bind regulated parties to such rules. Of concern to Scalia was the Court’s 1997 decision in Auer v. Robbins, from which derives the “Auer deference” principle that an agency’s interpretation of its own regulations is “controlling unless plainly erroneous or inconsistent with the regulation.” In concluding his Perez concurrence — and without mentioning he authored the unanimous opinion in Auer — Scalia argues for the abandonment of Auer and simply “applying [statutes] as written.” An agency, he continues, “is free to interpret its own regulations — with or without notice and comment rulemaking, but courts will decide —with no deference to the agency — whether that interpretation is correct.” Or as he put it in Exceptional Child Center, courts should avoid a rule of construction “that denies statutory text its fairest reading.”

Justice Thomas and Seminole Rock Deference. Thomas’s Perez concurrence took direct aim at Seminole Rock. In a scholarly, provocative 23 page opinion, nearly twice as long as Justice Sotomayor’s opinion for the Court, he relied on English 17th Century sources and the Constitution’s founding documents, such as the Federalist Papers, to make two fundamental constitutional challenges: Seminole Rock deference “represents a transfer of judicial power to the Executive Branch, and amounts to an erosion of the judicial obligation to serve as a ‘check’ on the political branches.”

In Thomas’s mind, the doctrine of judicial deference “has taken on a life of its own.” A case of particular concern to him was a 1994 5-4 decision in Thomas Jefferson Univ. v. Shalala (“TJU”), in which Justice Kennedy, writing for the majority, was joined by Chief Justice Rehnquist and Justices Blackmun, Scalia and Souter, with Justice Thomas writing in dissent, joined by Justices Stevens, O’Connor and Ginsburg — clearly a non-ideologically based coalition.

TJU, although now over 20 years old, provides helpful insights into the real-world consequences for health care providers when faced with too much judicial deference. In brief, the case involves graduate medical education (“GME”) reimbursement requests for direct salary costs under Medicare’s GME regulation from TJU’s affiliate, Thomas Jefferson University Hospital. After incurring GME salary costs for several years, either directly or through the medical school, in 1974 the Hospital first sought Medicare reimbursement on its cost report. The intermediary denied the expenses as violating the GME regulation’s “anti-redistribution” and “community support” principles. The Provider Reimbursement Review board reinstated the reimbursement, but the Secretary reversed, a decision upheld by the District Court, Appeals Court and the Supreme Court.

Among the reasons supporting the majority opinion in TJU majority was the view that deference to an agency’s interpretation of its own regulations was particularly important in areas requiring “significant expertise” of the
agency. But the minority, led by Thomas, dug a bit deeper into the record without deference to HHS’s interpretation of its own regulation and came to a very different view. First, the minority found the section of the GME regulation in question to be “cast in vague aspirational terms. . . [that] appears to be nothing more than a precatory statement of purpose that imposes no substantive restrictions” such that it may be used to deny reimbursement. Second, the minority found that HHS for the first twenty years of the Medicare program never gave substantive effect to the provision by denying reimbursement to any provider under the “anti-redistribution” and “community support” principles. Finally, the minority found it fundamentally unfair to deny GME reimbursement in this case, when the Hospital had previously incurred these costs but voluntarily declined to seek Medicare reimbursement until after a few years had passed.

Thomas’s minority opinion in Perez carried forward and reframed his conclusion in TJU in reaching the constitutional conclusions regarding deference, described above, regarding the relationship between the judiciary and the executive branches.

Justice Alito: Justice Alito wrote a brief opinion largely supporting the concurring opinions of Justices Scalia and Thomas. Of special significance, he noted that one of his concerns was “the exploitation by agencies of the uncertain boundary between legislative and interpretative rules.” This is an understandable concern. I have found often that the distinction that courts draw between these two types of rules is results-driven. In particular, it has often been unclear in a close reading of the facts of these cases how interpretive rules don’t bind parties. This confusion becomes more apparent in the handful of court decisions that have held that False Claims Act (“FCA”) liability can attach to providers’ knowing violations of sub-regulatory “interpretive” guidance from the Department of Health and Human Services (“HHS”), for example, agency manuals. It is hard to understand how a party could not be more bound legally than to face enormous fines and penalties under the FCA.

Future Implications

So where do we think Justice’s Alito, Scalia and Thomas are seeking to take their deference concerns, given they each fully recognized that Mortgage Bankers was not the case that presented these issues for resolution? First, there can be little doubt that Justices Scalia and Thomas are looking over the horizon for opportunities to reconsider Chevron deference to reasonable agency interpretations of ambiguous statutes that authorize the issuance of regulations. Thomas’s reasoning in Mortgage Bankers, which addresses the somewhat separate question of judicial deference to an agency’s interpretations of its own regulations, largely applies to Chevron deference as well. It is precisely because, in Thomas’s view, agency interpretative rules in effect have the force of law that they should be subject to full judicial review. Thomas does not directly say that this is the same question courts face in interpreting the validity of regulations themselves. Justice Scalia was more forthcoming, however, stating: “The problem is bad enough, and perhaps insoluble if Chevron is not to be uprooted, with respect to interpretative rules setting forth agency interpretation of statutes.”

I leave for another day any comments as to whether adjustments to Chevron are warranted. I only note here that for health care providers it is almost axiomatic that once a court has decided that HHS should be afforded deference, HHS has won the case.

But one’s desire for deference can cut both ways. For example, how Chevron deference plays out will be critical in the upcoming Court decision in King v. Burwell, in which the Court will decide whether tax subsidies are available to consumers who buy health insurance through federally established exchanges. Although the Court will likely focus on the so-called first prong of Chevron — whether the ACA is clear on its face (i.e., statutory text that appears to suggest that tax subsidies are only available for state established exchanges) — I suspect that, as with the experience of health care providers, if the Court gets past this first prong and applies the second prong, using Chevron deference grounds, the agency, in this case the IRS, will win.

I close with a modest suggestion for providers and counsel to pursue — one that is reinforced in Mortgage Bankers and consistent with other precedent. As emphasized by Justice Sotomayor, it is because interpretative rules are not seen as binding regulated parties that they do not have the force and effect of law, and therefore do not require formal notice and comment rulemaking. But that is not necessarily reality, as is borne out regularly by the experience of health care providers challenging interpretative rules, or more recently facing FCA liability: all too often rules that are characterized as “interpretive” in reality do bind the parties. The choices should be, then,
that rules that bind parties should be treated like legislative rules requiring formal notice and comment
rulemaking, among other protections; or they should be subject to judicial challenge in which, following the
Alito/Scalia/Thomas line of reasoning in Perez, they should be given no deference whatsoever.

If you have any questions about this topic, please contact the author(s) or your principal Mintz Levin attorney.

1 To digress from the deference discussion, it is noteworthy that on the same day as Mortgage Bankers was
issued, the Court on March 9th issued a unanimous opinion that Amtrak is a public agency (see Department Of
Transportation v. Association of American Railroads) in which Justice Thomas filed a concurring opinion largely
citing to his Mortgage Bankers concurrence. In his Ass’n of American Railroads concurrence, he argued that the
Separation of Powers clause does not authorize Congress to delegate to Executive agencies the power to
“formulate generally applicable rules of private conduct,” suggesting that agencies are not authorized to issue
binding legislative rules – a theory that Harvard Law School Professor Cass R. Sunstein dismissed in a March
16th Bloomberg article as “eccentric” and “radical stuff.”

2 It is possible that the case may not turn on Chevron after all, but on an issue raised by Justice Kennedy in oral
argument that there are constitutional equal protection issues in denying tax subsidies to residents of states that
did not implement their own state exchanges.