Revisiting the Application of the Administrative Procedure Act to Banking Supervision and Regulation

September 20, 2021

The Committee on Capital Markets Regulation (the "**Committee**") believes that the Administrative Procedure Act[1] (the "**APA**") fully applies to supervisory and regulatory actions by the U.S. Federal Reserve Board (the "**Fed**"). Our past work has emphasized the importance of the Fed's compliance with the APA's procedural requirements for rulemaking in connection with its annual bank stress testing and standards that the Fed and FDIC apply to banks' living wills.[2] In this statement, we review a forthcoming law review article, *Bank Supervision and Administrative Law*, by former Federal Reserve Governor and current Harvard Law School Professor, Daniel Tarullo, that asserts that the APA does not fully apply to bank supervision and regulation by the Fed.[3] The statement begins by summarizing the procedural requirements applicable to any U.S. federal agency action set forth in the APA. It then reviews Professor Tarullo's analysis of the procedural requirements that apply to Federal Reserve stress testing, highlighting his argument that certain banking statutes on capital regulation may overrule the administrative law requirements that would otherwise apply to stress testing practices. The statement concludes by reviewing case law on administrative law "exceptionalism," showing that it does not support Professor Tarullo's claim for exceptionalist treatment of banking supervision and regulation.

The Administrative Procedure Act's Requirements for Agency Action

The APA establishes uniform procedural requirements that apply to actions taken by U.S. federal agencies. The statute divides agency action into two categories—rulemakings and adjudications—and sets forth separate procedural requirements for each category.

Rulemakings include the formulation of "agency statement[s] of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[4] Rulemakings are generally subject to the requirement that agencies provide the public with notice of proposed rules and an opportunity to comment on them.[5] However, notice-and-comment procedures are *not* required if: (a) the agency policy is merely guidance; (b) the rule is only an interpretative rule of prior policy; or (c) the agency demonstrates that notice-and-comment procedures are unnecessary, impracticable, or contrary to the public interest (the "good cause" exception).[6] Although there is limited caselaw regarding the "good cause" exception, courts

[1] 5 U.S.C. ch. 5, subch. I § 500 et seq.
[2] *See, e.g.,* COMMITTEE ON CAPITAL MARKETS REGULATION, *The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency* (Sept. 2016), https://www.capmktsreg.org/wp-content/uploads/2019/05/The-Administrative-Procedure-Act-and-Federal-Reserve-Stress-Tests-Enhancing-Transparency.pdf; COMMITTEE ON CAPITAL MARKETS REGULATION, *Roadmap for Regulatory Reform* (May 2017), 23-25, https://www.capmktsreg.org/wp-content/uploads/2018/10/Roadmap-for-Regulatory-Reform.pdf.
[3] Daniel K. Tarullo, *Bank Supervision and Administrative Law*, Columbia Business Law Review (forthcoming).
[4] 5 U.S.C. § 551.
[5] *See* 5 U.S.C. § 553.
[6] 5 U.S.C. § 553(b).

applying it have considered whether notice-and-comment would defeat the rule's purpose, and should therefore not be required.[7]

In contrast, adjudications are proceedings intended to determine past and present rights and liabilities, often involving disputed facts on a case-by-case basis.[8] Formal adjudications are those that are required by statute to be determined on the record after opportunity for a hearing; the APA subjects formal adjudications to trial-type procedural requirements.[9] Informal adjudications are agency adjudications that are not required by statute to be determined on the record after an opportunity for an agency hearing; they are subject to minimal procedural requirements under the APA.[10]

The APA applies to all U.S. federal executive branch and independent agencies except for those that the statute specifically excludes.[11] The U.S. banking agencies, including the Fed, are subject to its requirements. Importantly, the APA establishes the default requirements for agency action and its judicial review, which govern in the absence of specific instructions from Congress to the contrary—the APA's text provides that "subsequent statute may not be held to supersede or modify this subchapter… except to the extent that it does so expressly."[12]

Federal Reserve Stress Testing and Professor Tarullo's Exceptionalism Argument

In his article *Bank Supervision and Administrative Law*, Professor Tarullo considers whether certain forms of bank supervisory activity taken by the U.S. banking agencies are consistent with the APA requirements for rulemakings. One of his main examples focuses on requirements that apply to the Federal Reserve Board's use of an annual stress test to set minimum capital requirements for large banks.

The annual stress test is an intensive exercise to assess whether the largest bank holding companies in the U.S. have adequate capital to continue operations during stressful economic and financial conditions.[13] To conduct the stress test, the Fed uses its own economic models to project the impact on bank losses and revenues of a hypothetical scenario of economic and financial stress. The Fed has published certain high-level information about its stress test models, but it does not

[7] *See DeRieux v. Five Smiths, Inc.*, 499 F.2d 1321 (Temp. Emerg. Ct. App. 1975); *Nader v. Sawhill*, 514 F.2d 1064, 1068 (Temp. Emerg. Ct. App. 1975).
[8] *See, e.g.*, U.S. DEP'T OF JUSTICE, *Attorney General's Manual on the Administrative Procedure Act* (1947) at I.c.; *United States v. Fla. E. Coast Rwy. Co.*, 410 U.S. 224, 245 (1973).
[9] *See* 5 U.S.C. §§ 554-557.
[10] *See* 5 U.S.C. §§ 551, 555.
[11] *See* 5 U.S.C. § 551(1); Todd Garvey, *A Brief Overview of Rulemaking and Judicial Review*, U.S. CONGRESSIONAL RESEARCH SERVICE (March 27, 2017), https://fas.org/sgp/crs/misc/R41546.pdf; FEDERAL RESERVE SYSTEM, *What specific steps does the Board take to issue a regulation?* (June 29, 2018), https://www.federalreserve.gov/faqs/steps-board-takes-to-issue-a-regulation.htm.
[12] 5 U.S.C. § 559.
[13] https://www.federalreserve.gov/supervisionreg/stress-tests-capital-planning.htm.

publicly release the models themselves.[14] It publishes the details of its baseline and stress scenarios shortly before the stress test is conducted.[15]

The results of a bank's stress test is used to calculate that bank's "stress capital buffer," which comprises an important part of the capital requirements that apply to that firm.[16] If a bank's risk-weighted capital falls below the sum of its stress capital buffer, minimum regulatory capital requirements, and other applicable buffers, then the Fed can restrict the payments that the bank makes to shareholders through dividends or stock buybacks.[17] In effect, the Fed's annual stress test is therefore used to establish the binding capital constraints for many large U.S. banks.[18]

As the Committee has stated in the past, we believe that the Fed's stress test scenarios and models are rules and not adjudication under the APA because they: (a) are generally applicable to a group of banks; (b) have future effect through their significant influence over a bank's ability to make capital distributions; and (c) establish *de facto* capital requirements.[19] As rules, the Fed's scenarios and models are required to be adopted through public notice-and-comment, unless a legal exception to the APA's rulemaking procedures applies. We find that no such exception applies to the development of the Fed's scenarios, and that they are required to receive public notice-and-comment.[20]

With respect to the models, the Fed could argue that public notice-and-comment would be "impracticable, unnecessary, or contrary to the public interest," and therefore is not legally required. Specifically, the Fed could argue that disclosing the models could enable a bank to "game" the stress test by adjusting its portfolio of assets in order to perform well under the stress test, but then alter its portfolio once the stress test is over. In our view, however, this argument

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[14] *See* Vice Chair for Supervision Randal K. Quarles, *Speech: Themistocles and the Mathematicians: The Role of Stress Testing*, FEDERAL RESERVE SYSTEM (Feb. 25, 2021), https://www.federalreserve.gov/newsevents/speech/quarles20210225a.htm; FEDERAL RESERVE SYSTEM, *Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test*, 84 FED. REG. 6784 (Feb. 28, 2019), https://www.federalregister.gov/documents/2019/02/28/2019-03505/enhanced-disclosure-of-the-models-used-in-the-federal-reserves-supervisory-stress-test.

[15] *See, e.g.*, FEDERAL RESERVE SYSTEM, *2021 Stress Test Scenarios* (Feb. 2021), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20210212a1.pdf; Tarullo at 23.

[16] FEDERAL RESERVE SYSTEM, *Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules*, 85 FED. REG. 15576 (March 18, 2020), https://www.federalregister.gov/documents/2020/03/18/2020-04838/regulations-q-y-and-yy-regulatory-capital-capital-plan-and-stress-test-rules. *See also* COMMITTEE ON CAPITAL MARKETS REGULATION, *Stress Testing During a Pandemic: Enhancing Transparency & Financial Stability*, 3-4 (Oct. 2020), https://www.capmktsreg.org/wp-content/uploads/2020/10/Stress-Testing-During-a-Pandemic-Oct-2020.pdf.

[17] 85 FED. REG. 15576, at 15577; 12 C.F.R. § 3.11(a)(4).

[18] *See* CLEARY GOTTLIEB, *Alert Memorandum: Federal Reserve Finalizes "Stress Capital Buffer"* (March 16, 2020), https://www.clearygottlieb.com/-/media/files/alert-memos-2020/federal-reserve-finalizes-stress-capital-buffer.pdf ("The Federal Reserve's supervisory stress test regime is, and almost certainly will continue to be, the binding capital constraint on most CCAR firms."). *See also* FEDERAL RESERVE SYSTEM, *Press Release: Federal Reserve Board announces individual large bank capital requirements, which will be effective on October 1* (Aug. 10. 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200810a.htm.

[19] COMMITTEE ON CAPITAL MARKETS REGULATION, *The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency* (Sept. 2016), https://www.capmktsreg.org/wp-content/uploads/2019/05/The-Administrative-Procedure-Act-and-Federal-Reserve-Stress-Tests-Enhancing-Transparency.pdf at 12.

[20] *Id.* at 17.

faces serious doubts.[21] The Committee has observed that the Fed has not produced a detailed analysis of the likelihood of the risk of "gaming" or of the consequences if the models were indeed "gamed."[22] If banks did attempt to "game" the stress tests, then they would do so by divesting assets with high projected losses and purchasing assets with low projected losses – precisely the kind of behavior that the Fed wishes to encourage, assuming it has faith in the accuracy of its own loss projections. We have also noted that, to the extent "gaming" is a legitimate concern, the Fed could address it by imposing and enforcing a good faith or anti-circumvention principle in connection with banks' participation in the stress test.[23]

Professor Tarullo disagrees with the Committee's interpretation of the APA's applicability to the Fed stress test, but acknowledges that "there will always be some room for disagreement on how general administrative law requirements should be applied to any substantive regulatory program, including stress testing."[24] But he then goes a major step further, suggesting that two statutory provisions on capital regulation—§165 of the Dodd-Frank Act and §908 of the International Lending Supervision Act of 1983 ("**ILSA**")—override the applicable APA requirements that might otherwise apply.[25]

Professor Tarullo's analysis of Dodd-Frank §165 focuses on sub-sections (a) and (b) requiring enhanced prudential standards for large bank holding companies.[26] According to Professor Tarullo, the fact that the capital measures required by these provisions are called "standards" rather than "regulations" opens the possibility that Congress contemplated more procedural flexibility in implementing those standards than would apply under the APA.[27] He continues "this inference is strengthened by the second relevant provision [of Dodd-Frank §165], which authorizes the Board to vary standards on an individual bank basis if it so desires."[28] With respect to ILSA, Professor Tarullo argues that the Fed's practice of setting capital requirements through annual stress testing can be understood as the exercise of its authority under ILSA §908 to establish minimum capital requirements that the Fed "in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the banking institution."[29] In Professor Tarullo's view, "there is a strong case to be made that these statutes entirely preclude the administrative law arguments against stress testing practices."[30]

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[21] *See* COMMITTEE ON CAPITAL MARKETS REGULATION, *The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency* (Sept. 2016), https://www.capmktsreg.org/wp-content/uploads/2019/05/The-Administrative-Procedure-Act-and-Federal-Reserve-Stress-Tests-Enhancing-Transparency.pdf at 17-19.

[22] *Id*. at 21.

[23] *See* COMMITTEE ON CAPITAL MARKETS REGULATION, *Comment Letter to the Board of Governors of the Federal Reserve System re: Docket Nos. OP-1586, OP-1587, and OP-1588*, at 6 (Jan. 19, 2018), https://www.capmktsreg.org/wp-content/uploads/2018/01/1_19_18_CCMR-FINAL_Comment_Letter_Fed-Stress-Test-Proposals.pdf.

[24] Tarullo at 28. Tarullo's two key rebuttals are: (1) each bank's stress capital buffer is the result of an informal adjudication, which is subject to negligible procedural requirements under the APA; and (2) even if the stress test models and scenarios are rules, there is reason to apply the statutory "good cause" exception ("when the agency for good cause finds…that notice and public procedure thereon are impracticable, unnecessary or contrary to the public interest." APA 553(b)(B)). Tarullo at 24-27.

[25] *See* Tarullo at 19-20, 28.

[26] *See* Tarullo at 29.

[27] Tarullo at 29.

[28] Tarullo at 29.

[29] Tarullo at 31; 12 U.S.C.§ 3907(a)(2).

[30] Tarullo at 20.

Professor Tarullo's legal argument is not persuasive. As stated above, the text of the APA provides that subsequent statute cannot modify or supersede its provisions "except to the extent that it does so expressly."[31] Nothing in the text of the Dodd-Frank Act or ILSA explicitly states that the APA procedures do not apply to the Fed's annual stress test. Moreover, the Committee staff was unable to identify any case law holding that the APA applies less-stringent requirements to the promulgation of "standards" than it does to "rules," as Professor Tarullo suggests.

Separately, although Tarullo acknowledges that the Fed has modified its stress testing regime to integrate point-in-time risk-based capital requirements through the "stress capital buffer,"[32] he neglects to address the full implications of this change. Whereas the Fed could previously characterize its stress tests as purely supervisory annual exercises, the Fed stress tests now determine each bank's stress capital buffer, which is added to the minimum capital ratio, G-SIB surcharge, and countercyclical capital buffer to determine ongoing minimum capital requirements. If the minimum capital ratio,[33] G-SIB surcharge,[34] and countercyclical capital buffer[35] all constitute "rules" subject to the APA rulemaking procedures,[36] then it is unclear on what basis the determination of the stress capital buffer becomes exempt from those same requirements.

Professor Tarullo's argument has been made before but has been strongly rejected by the courts. U.S. regulators (and sometimes those they regulate) have argued in other contexts that a particular regulatory field is "exceptional," such that general administrative law doctrine does not apply. However, these regulatory exceptionalism arguments have generally failed in the courts. The following section reviews caselaw in two regulatory fields where arguments for administrative law exceptionalism have been litigated: tax administration and the patent system, showing that Professor Tarullo's exceptionalist analysis is not supported by the law.

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[31] 5 U.S.C. § 559.
[32] Tarullo at 22.
[33] 12 C.F.R. § 3.10.
[34] 12 C.F.R. § 217.403; 12 C.F.R. § 217.404; 12 C.F.R. § 217.405.
[35] 12 C.F.R. § 217.11.
[36] *See, e.g.*, FEDERAL RESERVE SYSTEM, *Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer*, 81 FED. REG. 63682, 63684 (Sept. 16, 2016), https://www.federalregister.gov/documents/2016/09/16/2016-21970/regulatory-capital-rules-the-federal-reserve-boards-framework-for-implementing-the-us-basel-iii. *See also* FEDERAL RESERVE SYSTEM, *Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies*, 80 FED. REG. 49081, 49087 (Aug. 14, 2015), https://www.federalregister.gov/documents/2015/08/14/2015-18702/regulatory-capital-rules-implementation-of-risk-based-capital-surcharges-for-global-systemically; FEDERAL RESERVE SYSTEM, *Regulation Q; Regulatory Capital Rules: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies*, 85 FED. REG. 81923 (Dec. 17, 2020), https://www.federalregister.gov/documents/2020/12/17/2020-27591/regulation-q-regulatory-capital-rules-risk-based-capital-surcharges-for-global-systemically.

Precedent on Administrative Law Exceptionalism

Tax Exceptionalism

The Supreme Court and D.C. Circuit Court have recently heard and rejected arguments that tax administration is unique, and should therefore not be subject to general administrative law requirements. In *Mayo Foundation v. United States*,[37] for example, a taxpayer argued that the U.S. Supreme Court should apply a less deferential standard of review to a Treasury Department tax regulation relating to medical residents' employment status than the standard of review established by *Chevron v. NRDC*,[38] which the Court applies to other agencies' regulations. However, the Court rejected the taxpayer's argument, declining "to carve out an approach to administrative review good for tax law only."[39]

Shortly after the *Mayo* decision, the D.C. Circuit rejected another tax exceptionalism argument, this time advanced by the IRS, in *Cohen v. United States*.[40] In *Cohen*, taxpayers challenged an IRS "Notice" (a public announcement by the IRS that typically involves an interpretation of the Internal Revenue Code) that established a refund process for excise taxes that had been erroneously collected on phone calls.[41] In response, the IRS set out several arguments for exempting the Notice from judicial review focused on the notion that the taxpayers had not exhausted their options for obtaining a refund directly from the IRS.

The D.C. Circuit rejected the IRS arguments, holding that the judicial review provisions of the APA applied fully to the IRS Notice in question, even though there "may be good policy reasons to exempt IRS action from judicial review."[42] The court emphasized that the IRS is not special in this regard; no exception exists that shields it or the rest of the Federal government from suit under the APA.[43]

CIC Services, LLC v. IRS,[44] decided in May 2021, is the most recent example of the Supreme Court's repudiation of tax exceptionalism.[45] Here, a tax advisor (CIC Services) had filed a lawsuit challenging a particular IRS Notice because the IRS had issued it without public notice-and-comment.[46] The IRS Notice imposed reporting requirements on tax advisors, enforceable with tax penalties and criminal prosecution for noncompliance.

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[37] *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011).
[38] 467 U.S. 837.
[39] Id. at 55.
[40] Cohen v. United States, 650 F.3d 717 (D.C. Cir. 2011).
[41] NYU LAW, *Federal Tax Research: Notices* (April 21, 2021), https://nyulaw.libguides.com/c.php?g=773839&p=5551992; *Cohen*, 650 F.3d 717, at 720.
[42] *Id.* at 736.
[43] *Id.* at 723. *See also* Altera Corp. v. Commissioner, 145 TC 91 (Tax Court 2015) (holding that APA notice-and-comment requirement applies to Treasury regulations), reversed on other grounds. Altera Corp. v. Commissioner, 926 F.3d 1061 (9th Cir. 2019).
[44] Slip Op. No. 19-930 (May 17, 2021).
[45] Kristin E. Hickman, CIC Services, LLC v. IRS: *Another Blow to Tax Exceptionalism*, Yale J. Reg.: Notice and Comment (May 20, 2021), https://www.yalejreg.com/nc/cic-services-llc-v-irs-another-blow-to-tax-exceptionalism.
[46] *CIC Services* at *4-5.

Importantly, the tax advisor filed the lawsuit challenging the Notice *before* the taxpayer had paid the tax and thus before any enforcement proceeding had commenced. The Supreme Court observed that the APA establishes a general presumption in favor of pre-enforcement judicial review of agency regulations.[47] However, it also acknowledged that the Anti-Injunction Act ("**AIA**") generally requires anyone challenging the validity of a tax to pay the tax before challenging it in court.[48] In defending against the tax advisor's legal challenge, the IRS argued that the AIA precluded the lawsuit.

The Supreme Court rejected the IRS's argument. The Court held that the tax advisor's action challenged a regulatory mandate (the Notice's reporting requirement), not a tax, and that the suit did not trigger the AIA. As such, the IRS Notice was subject to pre-enforcement review as provided by the APA.

Courts have permitted the IRS to deviate from APA procedures in limited circumstances, pursuant to language in the APA providing that the APA does "not limit or repeal additional requirements… recognized by law."[49] Based on this language, courts have sometimes applied statutory procedural requirements that (a) were in place when the APA was adopted in 1946 and (b) are stricter than those set forth in the APA, instead of APA procedural requirements.[50] This APA language does not support Professor Tarullo's argument that the Fed should have procedural flexibility in its annual stress testing in light of Dodd-Frank provisions on enhanced prudential standards. Dodd-Frank was enacted after the APA, and Professor Tarullo is calling for weaker, not stricter, procedural requirements.

Courts have applied this APA language in tax cases. For example, certain courts have applied a standard of review set forth by a specific statutory scheme for the review of IRS notices of deficiency, rather than applying the APA standard of review, when those courts reviewed IRS notices of deficiency.[51] The courts applied this statutory standard of review because it was enacted

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[47] *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967).

[48] *CIC Services* at *2. *See also National Federation of Independent Business v. Sebelius*, 567 U. S. 519, 543 (2012) ("Because of the Anti-Injunction Act, taxes can ordinarily be challenged only after they are paid, by suing for a refund.").

[49] 5 U.S.C. § 559.

[50] *Wilson v. Commissioner*, 705 F.3d 980, 990 (9th Cir. 2013), https://casetext.com/case/wilson-v-commr-of-internal-revenue ("Where Congress has enacted a special statutory review process for administrative action, that process applies to the exclusion of the APA."); *Commissioner of Internal Revenue v. Neal*, 557 F.3d 1262 (11th Cir. 2009), https://casetext.com/case/commissioner-of-internal-revenue-v-neal. *See also Porter v. Commissioner*, 130 T.C. 115, 118 (2008), https://casetext.com/case/porter-v-commr-of-internal-revenue-5 ("[T]he APA does not supersede specific statutory provisions for judicial review.").

[51] *See* 26 U.S.C. § 6214. *See, e.g., Streightoff v. Comm'r*, 954 F.3d 713, 722 (5th Cir. 2020), https://casetext.com/case/streightoff-v-commr-1 ("Congress made clear that the APA's judicial review proceedings were not intended to supplant existing statutory schemes that set forth clear pre-existing procedures for review, like the deficiency statute at issue here."); *QinetiQ US Holdings, Inc. v. Comm'r*, 845 F.3d 555, 561 (4th Cir. 2017), https://casetext.com/case/qinetiq-us-holdings-inc-v-commr-of-internal-revenue-1 ("Accordingly, we hold that the APA's requirement of a reasoned explanation in support of a final agency action does not apply to a Notice of Deficiency issued by the IRS and that, therefore, the Notice of Deficiency issued to QinetiQ in this case was not subject to that APA requirement."). *But see Fisher v. Commissioner*, 45 F.3d 396 (10th Cir. 1995), https://law.justia.com/cases/federal/appellate-courts/F3/45/396/634050/ ("it is an elementary principle of administrative law that an administrative agency must provide reasons for its decisions"). *See also* Petition for a

before the APA and because it establishes *additional*, rather than weaker, requirements for the review of notices of deficiency than would be required by the APA. Importantly, these tax holdings are grounded in the APA text providing that it does not limit or repeal additional legal requirements, not on the claim of tax exceptionalism.

Patent Law Exceptionalism

Courts have also rejected arguments that general administrative law principles should not apply in certain patent law contexts. In *Dickinson v. Zurko*, decided by the Supreme Court in 1999, a patent applicant (Zurko) had sued the Patent and Trademark Office ("**PTO**") in the Federal Circuit to challenge the PTO's denial of her patent application.[52] Zurko and the PTO each argued that the Federal Circuit should apply a different standard of review in analyzing the PTO's factual finding. Zurko argued that the Federal Circuit should use a "clearly erroneous" standard of judicial review, which generally applies to appellate court review of district court fact-finding. Zurko preferred that the court review the PTO's decision with this relatively high level of scrutiny because it would increase the likelihood that the court would invalidate the PTO's decision. The PTO, on the other hand, sought greater deference to its decision. The PTO argued that the Federal Circuit should apply the less stringent standard of judicial review set forth in the APA, under which courts may set aside agency findings found to be arbitrary, capricious, an abuse of discretion, or unsupported by substantial evidence.[53]

The Federal Circuit applied the "clearly erroneous" standard rather than the APA standard, and found that the PTO's factual finding was clearly erroneous. They chose this standard in light of the language in the APA providing that the APA "does not limit or repeal additional requirements…recognized by law." According to the Federal Circuit, the "clearly erroneous" standard was appropriate because the Federal Circuit's predecessor had applied a similar standard of review before the APA was adopted, which represented an "additional requirement" that the APA could "not limit or repeal." The Federal Circuit also offered policy justifications for the heightened standard of review—they suggested, for example, that it would produce better agency fact-finding.

The Supreme Court reversed the Federal Circuit decision, holding that courts must use the framework for judicial review set forth in the APA when reviewing PTO findings of fact. The Court explained that the purpose of the APA was to bring uniformity to administrative law; only clear congressional intent (not a disputed historical practice or speculative policy arguments) can establish an exception to general APA standards.[54] Since *Zurko*, the Federal Circuit has repeatedly

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Writ of Certiorari, QinetiQ U.S. Holdings, Inc. & Subsidiaries v. Commissioner of Internal Revenue (April 4, 2017), https://www.scotusblog.com/wp-content/uploads/2017/04/16-1197-cert-petition.pdf.

[52] Dickinson v. Zurko, 527 U.S. 150 (1999), https://supreme.justia.com/cases/federal/us/527/150/#tab-opinion-1960516. The U.S. Court of Appeals for the Federal Circuit has jurisdiction to hear patent case appeals. U.S. COURT OF APPEALS FOR THE FEDERAL CIRCUIT, *Court Jurisdiction* (July 2021), http://www.cafc.uscourts.gov/the-court/court-jurisdiction.

[53] 5 U.S.C. § 706(2); Dickinson v. Zurko, 527 U.S. 150, 152 (1999).

[54] *See Dickinson v. Zurko*, 527 U.S. 150, 155 (1999), https://supreme.justia.com/cases/federal/us/527/150/#tab-opinion-1960516.

applied the APA standards governing judicial review of agency findings of fact in its review of PTO decisions.[55]

In *Merck & Cie v. Gnosis S.P.A.*, the Federal Circuit considered the applicability of the APA to judicial review of the PTO's patent decisions in a different context—"*inter partes* review proceedings" ("**IPR**").[56] IPR are special proceedings whereby patents can be challenged before the Patent Trial and Appeal Board ("**PTAB**"), an adjudicative body within the PTO.[57] Congress created IPR in the 2012 America Invents Act, in order to provide a less expensive alternative to patent litigation in federal court.

In the *Merck* case, Gnosis had successfully challenged a Merck patent claim using IPR, and Merck appealed the PTAB ruling to the Federal Circuit. The Federal Circuit reviewed the PTAB's decision using the APA standard for judicial review of agency action and upheld it. Merck then moved for a rehearing *en banc*, arguing that the "clearly erroneous" standard of review typically applied to court decisions (rather than the APA standard for review of agency action) was the appropriate standard for the Federal Circuit to apply, because Congress intended for IPR to serve as an alternative to district court litigation.

The Federal Circuit denied *en banc* review, with Judge O'Malley's concurrence noting "[b]ecause Congress failed to expressly change the standard of review employed by this court in reviewing Board decisions when it created IPR proceedings … we are not free to do so now."[58] Merck subsequently petitioned the Supreme Court for certiorari, which the Supreme Court denied. Since *Merck*, the Federal Circuit has repeatedly applied the APA to IPR.[59]

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[55] *See, e.g.*, *In re Board of Trustees of the Leland Stanford Junior University*, 991 F.3d 1245 (Fed. Cir. 2021), https://www.leagle.com/decision/infco20210325140; *Nantkwest, Inc. v. Iancu*, 898 F.3d 1177 (Fed. Cir. 2018), https://casetext.com/case/nantkwest-inc-v-iancu; *Applications in Internet Time, LLC v. RPX Corp.*, 897 F.3d 1336 (Fed. Cir. 2018), https://casetext.com/case/applications-in-internet-time-llc-v-rpx-corp; *Pride Mobility Prods. Corp. v. Permobil, Inc.*, 818 F.3d 1307 (Fed. Cir. 2016), https://casetext.com/case/pride-mobility-prods-corp-v-permobil-inc; *Alere, Inc. v. Rembrandt Diagnostics*, LP, 791 FED. APPX. 173, (Fed. Cir. 2019), https://law.justia.com/cases/federal/appellate-courts/cafc/18-1812/18-1812-2019-10-29.html/.

[56] 820 F.3d 432 (Fed. Cir. 2016), https://casetext.com/case/merck-amp-cie-v-gnosis-spa?resultsNav=false; Merck & Cie v. Gnosis, S.P.A., No. 14-1779 (Fed. Cir. 2015), https://law.justia.com/cases/federal/appellate-courts/cafc/14-1779/14-1779-2015-12-17.html; NEW ENGLAND IN-HOUSE, *Merck & Cie v. Gnosis: A more deferential standard of review for inter partes review decisions* (Feb. 1, 2017), https://newenglandinhouse.com/2017/02/01/merck-cie-v-gnosis-a-more-deferential-standard-of-review-for-inter-partes-review-decisions/.

[57] AKIN GUMP, *Inter Partes Review* (last accessed July 14, 2021), https://www.akingump.com/en/experience/practices/intellectual-property/inter-partes-review.html.

[58] *Merck & Cie v. Gnosis S.P.A.*, 820 F.3d 432, 433 (Fed. Cir. 2016), https://casetext.com/case/merck-amp-cie-v-gnosis-spa?resultsNav=false.

[59] SAS Institute, Inc. v. ComplementSoft, LLC, 825 F.3d 1341, 1351 (Fed. Cir. 2016), https://casetext.com/case/sas-inst-inc-v-complementsoft-llc-2 ("As we have noted, IPR proceedings are formal administrative adjudications subject to the procedural requirements of the Administrative Procedure Act ("APA"). *See Dell Inc. v. Acceleron, LLC*, 818 F.3d 1293, 1298 (Fed. Cir. 2016) ; *Belden Inc. v. Berk–Tek LLC* , 805 F.3d 1064, 1080 (Fed. Cir. 2015); *see also Dickinson v. Zurko* , 527 U.S. 150, 154 (1999).").

Scholars have argued that two recent Supreme Court decisions—*Microsoft Corp. v. i4i Ltd. Partnership*[60] and *Kappos v. Hyatt*[61]—embrace patent law exceptionalism.[62] But in both cases, the Supreme Court's decision was tied to a clear Congressional choice to apply standards other than those set forth in the APA in the specific types of judicial proceedings at issue.[63]

In *i4i*, the Supreme Court held that a patent invalidity defense must be proved by clear and convincing evidence; Stuart Benjamin and Arti Rai note that this evidentiary standard afforded greater deference to the PTO's decision to issue the patent than administrative law principles would have otherwise provided based on the facts of the case.[64] Critically, however, the Supreme Court held that *Congress had prescribed* the clear and convincing standard of proof.[65] According to the Court, Congress had specified the applicable burden of proof when it codified the common law presumption of patent validity in the Patent Act of 1952.[66] As such, "any recalibration of the standard of proof remains in Congress' hands."[67]

Similarly, in *Kappos v. Hyatt*, the Supreme Court referred to the express terms of Section 145 of the Patent Act to reach its decision regarding the evidentiary limits and standard of review that apply to civil actions filed under that provision. Acknowledging that judicial review of agency decisions under the APA are typically limited to the administrative record, the Court highlighted that §145 proceedings permit the district court to consider new evidence and act as a factfinder.[68] Applying a deferential standard of review to PTO decisions that could not have taken this new evidence into account would be inappropriate. Instead, "the district court must make its own findings *de novo* and does not act as the 'reviewing court' envisioned by the APA."[69]

Exceptionalism and the Banking Agencies

A review by the Committee staff of federal caselaw yielded no lawsuits that directly address claims of administrative law exceptionalism for the Fed, the Federal Deposit Insurance

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[60] *Microsoft Corp. v. i4i Ltd. Partnership*, 131 S. Ct. 2238 (2011), https://www.supremecourt.gov/opinions/10pdf/10-290.pdf (holding that, in patent infringement litigation, defendants asserting the invalidity defense must show invalidity by "clear and convincing evidence").

[61] *Kappos v. Hyatt*, 132 S. Ct. 1690 (2012), https://www.supremecourt.gov/opinions/11pdf/10-1219.pdf (holding that, in proceedings brought under 35 U.S.C. §145, the district court need not limit its review to the administrative record, but may consider new evidence and make de novo findings of fact).

[62] *See, e.g.*, Stuart Minor Benjamin & Arti K. Rai, *Administrative Power in the Era of Patent Stare Decisis*, 65 DUKE LAW JOURNAL 1563 (2016), https://dlj.law.duke.edu/article/administrative-power-in-the-era-of-patent-stare-decisis-benjamin-vol65-iss8/ ("*Zurko*… notwithstanding, recent Supreme Court opinions in the patent arena have tended to reject standard administrative law principles. These opinions have instead given precedence to a forceful reading of the Court's own pre-APA cases. … [T]he [Supreme] Court appears to have found clear pre-APA precedent that contradicts traditional principles of administrative law.").

[63] 35 U. S. C. §282; 35 U.S.C. §145.

[64] Stuart Minor Benjamin & Arti K. Rai, *Administrative Power in the Era of Patent Stare Decisis*, 65 DUKE LAW JOURNAL 1563, 1592-1593 (2016), https://dlj.law.duke.edu/article/administrative-power-in-the-era-of-patent-stare-decisis-benjamin-vol65-iss8/

[65] *Microsoft Corp. v. i4i Ltd. Partnership*, 131 S. Ct. 2238 (2011), https://www.supremecourt.gov/opinions/10pdf/10-290.pdf. *See* 35 U. S. C. §282.

[66] *Id*.

[67] *Id*. at 2241.

[68] *Kappos v. Hyatt*, 132 S. Ct. 1690 (2012), https://www.supremecourt.gov/opinions/11pdf/10-1219.pdf.

[69] *Id*. at 1696.

Corporation, or the Office of the Comptroller of the Currency. Relevant scholarly work outside of Professor Tarullo's article is similarly limited. But the principles articulated in existing tax and patent case law offer no basis for treating banking law differently.

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In conclusion, the Committee finds that claims of administrative law exceptionalism for bank supervisory actions are not supported by the law. As we have emphasized in the past, we believe that U.S. agencies' compliance with applicable APA requirements is critical for effective financial regulation.