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Rulemaking

How Government Agencies Write Law and Make Policy

4TH EDITION

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Rulemaking

To Ann, Paul, Michael, Alex, Kara, and Violet
—Cornelius M. Kerwin

For Debbie, Kyle, and Darcy Furlong
and all they do to make my life complete

and

For Neil Kerwin, my colleague, mentor, and friend,
who spurred my interest in rulemaking
—Scott R. Furlong

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Preface

In the preface to the first edition of this book, Kerwin explained the significance of rulemaking in the American system of government:

> Rulemaking is the single most important function performed by agencies of government. Some readers may find this a surprising, if not outrageous, assertion. But consider the breadth and depth of influence that rulemaking has on our lives.
>
> Rulemaking refines, and in some instances defines, the mission of every government agency. In so doing it provides direction and content for budgeting, program implementation, procurement, personnel management, dispute resolution, and other important government activities. Rules provide specific, authoritative statements of the obligations the government has assumed and the benefits it must provide. It is to rules, not to statutes or other containers of the law, that we turn most often for an understanding of what is expected of us and what we can expect from government. As a result, intense political activity surrounds the contemporary rulemaking process, and effective political action in America is no longer possible without serious attention to rulemaking.
>
> The centrality of rulemaking in our public policy system has placed it under considerable stress. The demand for rules created by hundreds of new government programs and the intense scrutiny of the process by which they are developed give rise to persistent questions from the business and academic communities about the quantity of rules, their quality, and the time it takes to write them. Whether the problems the questions address are real or perceived, the questions themselves raise doubts in the public's mind about the ability of rulemaking to play its vital role. These doubts—and the failures they sometimes reflect—often reduce the effectiveness of public programs and reverberate throughout the political system.

Since the initial publication of this book sixteen years ago, crisis has been a recurrent presence in the American experience. The third edition was

completed shortly after the attacks of September 2001 forever shattered our illusions of physical invulnerability to external threats. This edition arrives in the wake of the most dramatic economic downturn since the Great Depression, fueled by meltdowns in the housing market, exotic financial instruments often related to the mortgages that fueled the housing boom, and the collapse of previously iconic financial institutions that had become hostage to transactions whose risk they failed to fully grasp or care enough about. In between these deeply traumatic events the country experienced more mundane but still disturbing threats to the safety of our food and water, physical environment, and workplaces. The integrity of governance of private and nonprofit institutions has been called into question. The health care system continues to disappoint with high costs, insufficient coverage for some, and weaker than desired results. Similar complaints have been heard about our institutions of higher education. Throughout it all, the one constant has been the call for government action or intervention, and with that call the inevitable resort to rules developed in the complex and dynamic systems that are the topics of this book. The agenda of important issues changes constantly, and with it the cast of players in and out of government who determine the outcomes of rulemaking efforts. But rulemaking is a constant.

We write this preface just slightly more than one year into the presidency of Barack Obama, a historic administration in many respects and one for which there are few rivals in the mix of vexing problems and high expectations that greeted its arrival. If there is consensus on anything, it is that regulation will be a centerpiece of the Obama program. His election was viewed in part as a repudiation of the policies of the preceding administration. Among those policies was a fairly typical Republican skepticism about interventions into the market and the value of social regulation. Liberals see in the president a believer in government as a force for positive change across a wide range of social issues and are determined to push their causes through the use of formidable policy tools like rulemaking. Conservatives see Obama the same way, but with markedly less enthusiasm, and they have expressed fears that the country is in for another round of government intervention comparable to the era of the late 1960s and 1970s. What is yet to be determined is whether the much-anticipated rulemaking will be undertaken to implement new authorities created in a wave of landmark statutes in the areas of health, environment, labor, financial services, and food safety, or whether it will be undertaken in lieu of new statutes blocked or stalled by an uncooperative Congress. In the pages that follow, we will comment on various pieces of empirical evidence that are available to measure the frequency, complexity, and impact of rules. They paint a complex picture of a function that waxes and wanes over time. However, it is plain that without

an understanding of rulemaking our grasp of the dynamics of both American policymaking and politics is woefully incomplete. This book is our contribution to a complete education.

When a book survives to a fourth edition there are many people to thank. At American University, Kerwin remains in debt to his now coauthor, whose contributions to earlier editions were important, as well as to colleagues such as Laura Langbein, David Rosenbloom, Jeff Lubbers, Andy Popper, Bernard Ross, and James Thurber. In addition, there are the entire faculty and generations of students in American University's School of Public Affairs, who provided the type of intellectual atmosphere and high expectations that helped him grow as a scholar. Michael Kerwin provided important research and insights for earlier editions. Meg Clemmer, Shavana Gonzales, and Maria Bueno assisted with the preparation and editing of the manuscript, exhibiting both wisdom and an undeserved level of patience throughout. Furlong would also like to thank many of the School of Public Affairs faculty who encouraged his scholarship in rulemaking, particularly his coauthor, who introduced him to this area and provided a number of scholarly opportunities. He also thanks his colleagues at the University of Wisconsin–Green Bay, who have supported his efforts and career, and the students who make the teaching of rulemaking fun and exciting. Both authors would like to thank Kay Hofer of Texas State University, Glenn C. Smith of California Western School of Law, and Kelly Tzoumis of DePaul University for their many helpful comments on the manuscript.

With all this help and encouragement, errors of omission or commission are difficult to justify. But where they have happened, the fault is ours alone.

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CHAPTER 1

The Substance of Rules and the Reasons for Rulemaking

"Outcry Builds in Washington for Recovery of AIG Bonuses" read the March 17, 2009, headline in *The New York Times,* one of many that followed the recent and historic collapse of financial institutions, credit markets, and the larger economy. In a time when outrage had become commonplace, the reaction to this particular story was extraordinary. The American Insurance Group (AIG), a very large and established firm that required hundreds of billions of dollars of taxpayer money in 2008 to avoid a collapse feared to be catastrophic to the broader economy, had entered into contracts with employees that required the company to pay hundreds of millions of dollars in bonuses. When the news broke it threatened to undermine the credibility of all involved in the efforts to forestall systemic financial failure. How could people who ostensibly participated in one of the most astounding financial collapses in history and accepted unprecedented amounts of public assistance be rewarded in such a fashion? Congress had already enacted President Barack Obama's proposed framework for restoration of the American economy, the American Recovery and Reinvestment Act. With the new developments from AIG, one of the act's nonspending provisions—an amendment to the executive compensation provisions of 2008—took on new and compelling significance.

Just three months after news of the AIG bonuses was revealed the Department of the Treasury issued a set of regulations that severely restricted compensation for executives working in firms that received bailout funds from the Troubled Asset Relief Program (TARP). The rules were the direct result of the authority granted to the secretary of the Treasury through the American Recovery and Reinvestment Act.[1] They provided specificity on the new requirements essential to the affected companies, the personnel covered by the new rules, and enforcement officials in the government. The Treasury-issued rules covered the full range of compensation issues raised in the statute, including limits on salary, bonuses, and payment of "golden parachutes and so-called 'clawback' regulations that allowed the federal

government to recoup compensation awarded on the basis of"[2] materially inaccurate performance criteria. In addition, they added a number of other requirements the department viewed as important to the goals Congress intended in the legislation but not specifically included in the statute. These included mandatory reporting of "perks" over $25,000; prohibition of the practice of providing additional compensation to cover tax liability and the appointment of a special master with broad powers to review and approve the compensation structure for the executive officers and one hundred top earners in any affected firm; and the authority to negotiate repayments by firms to the Treasury for improper payments made previously to covered employees. The Treasury rules covered 123 pages in the *Federal Register* on the day they were issued, including references to earlier rules they had issued on the same topic. This compares to the four pages devoted to the executive compensation issue in the parent legislation. The rules conclude with the qualification that some would consider a warning that Treasury would issue additional rules as conditions merit.

Throughout our history, in crisis and in the normal course of the public's business, Congress deferred to the expertise, management, and administrative capabilities of an agency to carry out what they, as elected representatives, perceived to be the will of the people.

Rulemaking has been used in this case, and countless others, because as an instrument of government it is unmatched in its potential for speed, specificity, quality, and legitimacy. Rulemaking is a ubiquitous presence in virtually all government programs. For a variety of reasons Congress is unwilling or unable to write laws specific enough to be implemented by government agencies and complied with by private citizens. The crucial intermediate process of rulemaking stands between the enactment of a law by Congress and the realization of the goals that both Congress and the people it represents seek to achieve by that law. Increasingly, rulemaking defines the substance of public programs. It determines, to a very large extent, the specific legal obligations we bear as a society. Rulemaking gives precise form to the benefits we enjoy under a wide range of statutes. In the process, it fixes the actual costs we incur in meeting the ambitious objectives of our many public programs.

Rulemaking is important for many reasons. The best place to begin a discussion of those reasons is with a definition of rulemaking and an explanation of why it is crucial to our system of government.

The Definition of Rulemaking

Colin Diver, former dean of the University of Pennsylvania Law School and one of the most thoughtful observers of rules and rulemaking, defines the term in a paraphrase of the great jurist Oliver Wendell Holmes: A "rule is the

skin of a living policy . . . it hardens an inchoate normative judgment into the frozen form of words. . . . Its issuance marks the transformation of policy from the private wish to public expectation. . . . [T]he framing of a rule is the climactic act of the policy making process."[3] This definition underscores the pivotal role that rules play in our system of government, but more light must be shed on their key characteristics.

More than sixty years after its enactment into law, the Administrative Procedure Act of 1946 (referred to henceforth as the APA) still contains the best definition of *rule*. The act was written by Congress to bring regularity and predictability to the decision-making processes of government agencies, which by the mid-1940s were having a profound influence on life in this country. Rules and rulemaking were already important parts of the administrative process in 1946. Both, however, required careful definition so that the procedural requirements established in the act would be applied to the types of actions Congress intended to affect.

The APA states: "[R]ule means the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[4] At first reading this statement does not appear to reveal much. On closer examination, however, it surrenders several elements crucial to understanding contemporary rulemaking. Not the first element mentioned but a good place to start is a single word—*agency*—because it identifies the source of rules.

The Source of Rules: Agencies

We learn first from this definition that rules do not come from the major institutions created by the Constitution. They are not products of Congress or some other legislature. Rules are by-products of the deliberations and votes of our elected representatives, but they are not themselves legislation. Congress does have its own institutional rules, but they apply only to its members and committees. Under the APA definition, rules do not originate with the president or some other chief executive. As we will see, the actions of the president of the United States and chief executives at the various levels of government have a profound effect on the rulemaking process. These officials employ executive orders and directives in the course of their management responsibilities, but rarely, if ever, do they write rules of the type considered in this book.[5]

Various and sundry courts may have reason to consider rules. Their actions may result in rules being changed or eliminated. But judges do not write rules in the first instance either, except, like Congress, to establish procedures for their colleagues and the operation of the courts over which they preside.

Rules are produced by bureaucratic institutions entrusted with the implementation, management, and administration of our law and public policy. We view bureaucracies as inferior in status to the constitutional branches of government—Congress, the president, and the judiciary. We do so because the authority of these agencies is derived and patterned after and drawn from the three main branches. In one important respect, however, agencies are the equal of these institutions. The rules issued by departments, agencies, or commissions are law; they carry the same weight as congressional legislation, presidential executive orders, and judicial decisions. An important and controversial feature of our system of government is that bureaucratic institutions are vested with all three government powers established in the Constitution. Through a device called delegation of authority, government agencies perform legislative, executive, and judicial functions. Rulemaking occurs when agencies use the legislative authority granted them by Congress.

It is significant that agencies are the sources of rules, because it means that rulemaking is subjected to the external and internal influences that have been found to affect decision making in our public bureaucracies. Agencies behave differently from the constitutional branches of government. Their decisions cannot be explained simply by reference to the admittedly strong pressures they continually feel from Congress, the White House, the courts, interest groups, and the public at large. As one group of scholars put it, "Public agencies are major political actors in all phases of the policy process."[6]

The organization, division of labor, culture, professional orientation, and work routines of bureaucracies affect the way they make decisions. So too do the motives of individual bureaucrats. These themes will be developed further in the book's final chapter. We must expect the law and policy embodied in rules written by agencies to be different from what would be developed by Congress, the president, or the courts. So the very source of rules makes them immediately distinctive from other instruments of law and public policy.

Agency can mean any one of a number of organizational arrangements used to carry out law and policy. Public bureaucracies have many names. There are departments, such as the Department of Transportation; commissions, such as the Federal Trade Commission (FTC); administrations, such as the Federal Aviation Administration (FAA); and agencies, such as the Environmental Protection Agency (EPA). However organized or named, most of these bodies have the authority to issue rules and use a rulemaking process to carry it out.

The Subject Matter of Rules: Law and Policy

Having specifically identified the source of rules, the APA definition, interestingly, does not refer to subject matter other than "law" and "policy." In this respect, the definition could not be written more broadly. No area of public policy is excluded. This was not intended by the drafters of the APA as an invitation or authorization to engage in rulemaking in any area that a given agency found interesting or attractive. On the contrary, authority to issue rules can derive only from the statutes that establish the mission of agencies and set their goals and objectives. The definition simply acknowledges that rules can be developed in any area in which Congress adopts a valid statute that is signed by the president.[7] Our experience since the time this definition was framed makes it plain that the decision to put no substantive limits on the potential reach of rules was wise. Rules covered a large range of topics in 1946; in the early twenty-first century the scope is virtually limitless.

The Range of Influence of Rules over Law and Policy: Implement, Interpret, Prescribe

The definition clearly establishes an expansive relationship between rules, law, and public policy. The terms *implement, interpret,* and *prescribe* describe the fullest range of influence that a rule could have. Rules merely *implement* when law or policy has been fully developed in a statute enacted by Congress, an executive order of the president, or a judicial decision. Hence, rules need provide no additional substantive elaboration. In these cases rules give instructions to administering officials and the public in the form of procedures but add nothing else of substance to the direction already provided by Congress.

Rules *interpret* when law and policy are well established but confront unanticipated or changing circumstances. Statutory terms, clear and precise when written, may require adaptation when new business practices or technologies appear. Legislation implemented by the Federal Trade Commission, for example, seeks to eliminate improper restraints on competition. This creates tasks in the present time that are very different from those created in the era of the robber barons and the trusts. Similarly, statutes mandating air or water quality clearly require agencies to be attentive and respond to industry structure and production processes that may, in turn, alter the sources and types of pollution to be regulated. Currently, the rapid innovation in financial products such as collateralized debt obligations, interest rate swaps, and other "products" challenges the reach and grasp of regulators.

Rules *prescribe* when Congress establishes the goals of law or policy in statutes but provides few details as to how they are to be put into operation or how they are actually to be achieved. The Occupational Safety and Health Act stated its ambitious goals in this way: "to assure so far as possible every working man and woman in the Nation safe and healthy work conditions."[8] Although it provided some additional guidance, it left to the administering agency, the Occupational Safety and Health Administration (OSHA), the job of defining through rules key legal terms such as *so far as possible, safe,* and *healthy.* And once these terms were given an authoritative, legal meaning the huge task of finding the ways that health and safety could be protected was left to the agency as well. Similarly, it was not uncommon for statutes dealing with economic regulation to set agencies off in search of "the public interest" as the criterion for their actions.[9] The APA definition allows agency rulemaking to fill whatever vacuum has been left by Congress, the president, and the courts in the formation of public policy or law. The greater the demands on these institutions, the more likely that the role of rules will expand.

The Range of Circumstances Affected by Rules: General and Particular Applicability

Rules affect persons or activities in the widest possible range of circumstances. The phrase "general or particular applicability" in the APA allows rules to range from those that affect large segments of the population and economy to those that produce changes in a single individual, group, firm, or government unit. Some may find this element of the definition confusing, even troubling. We tend to think of legislative action as being concerned with general issues and problems that affect groups of people and activities. The judicial process is generally thought to be better designed for dealing with individual circumstances.[10]

So, should not a reduction in number of activities or persons affected by a government action cause an agency to shift from a quasi-legislative process to a quasi-judicial mode of decision making? Should not an agency use other delegated authority to act in a judicial capacity? The short answer is that, although the number of persons affected might influence the specific procedures used to make a decision, this characteristic alone does not determine whether an action that is contemplated is best classified as a rule. The underlying purpose of the action is a key element in this regard, and it is addressed directly in the APA definition.

The Importance of Future Effect

Rules, like legislation, attempt to structure the future. By creating new conditions, eliminating existing ones, or preventing others from coming into being,