2-1-1976

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NOTES

Administrative Law—The Legislative-Interpretative Distinction: Semantical Feinting with an Exception to Rulemaking Procedures

One of the major concerns of administrative law is the identification of administrative action that requires prior notice and a public hearing. Section 553 of the Administrative Procedure Act allows exemption from such rulemaking procedures when the administrative agency is promulgating an “interpretative” rule. While courts have generally determined the applicability of this exemption by distinguishing an action that is based on the administrator’s interpretative power from one that is based on his legislative power, this distinction may not adequately protect the due process policies underlying the notice and hearing requirement of administrative law.

Eastern Kentucky Welfare Rights Organization v. Simon, in which a divided District of Columbia Circuit Court of Appeals held a Revenue Ruling interpretative on the basis of the legislative-interpretative distinction, reveals that the efficacy of the distinction may depend upon the manner in which it is judicially applied and explores an alternative judicial approach for which there is growing support.

In 1956 the IRS issued Revenue Ruling 56-1851 which required hospitals to “accept patients in need of hospital care who cannot pay for

1. 5 U.S.C. §§ 553(b)-(c) (1970) provides:
   (b) General notice of proposed rule making shall be published . . . . [T]his subsection does not apply—(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or (B) when . . . notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest. (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation.

2. See text accompanying notes 19-28 infra.

3. See text accompanying notes 66-72 infra.

4. 506 F.2d 1278 (D.C. Cir. 1974).

5. See text accompanying notes 35-40 infra.


such services" in order to qualify for a charitable exemption.\textsuperscript{8} This requirement was eliminated by the IRS in 1969 through Revenue Ruling 69-545.\textsuperscript{9} A group of health and welfare organizations and indigent persons in Eastern Kentucky persuaded a federal district court to invalidate Revenue Ruling 69-545 and enjoin its enforcement by the IRS.\textsuperscript{10} The appellate court, however, disagreed and in a two-to-one decision refused to invalidate the ruling.\textsuperscript{11}

The court resolved the question of the need for rulemaking procedures on the basis of the legislative-interpretative distinction. Revenue Ruling 69-545 was held to be an interpretative rule, a statement of the administrator's opinion as to the meaning of a statute or regulation, and not a legislative rule which creates law by implementing the statutory powers of the agency\textsuperscript{12} and is subject to section 553 proceedings. A government admission that the ruling had no binding effect and that the court was free to review its substantive validity supported the view that the rule had no force of law. The contradiction of the old ruling by the new was found to be of no consequence since there was an intervening Treasury Regulation\textsuperscript{13} that adopted a broader concept of "charitable." The Treasury Regulation had been adopted pursuant to notice and a public hearing, and Ruling 69-545 conformed the definition of "charitable hospital" to that regulation.\textsuperscript{14}

After concluding that the interpretative nature of the rule precluded the necessity for section 553 procedures and therefore permitted a
judicial judgment as to its propriety, the court refused to hear evidence from the parties in making that judgment. They reasoned that Ruling 69-545 contained two specific requirements substantially benefitting the poor and was consistent with the Treasury Regulation, and that the changed status of health care in the country justified a new definition. These judicial facts satisfied a finding of no abuse of discretion in the agency's determination.

The legal framework within which Eastern Kentucky was decided is provided by federal statute and cases decided thereunder. Section 553 of the Federal Administrative Procedure Act requires notice and hearing by an agency promulgating a rule that does not satisfy one of the statutory exceptions. Interpretative rules, one of these exceptions, have been defined as statements of the administrative officer as to what he thinks a statute means, and are distinguished from non-interpretative or legislative rules which are based on a congressional delegation of power to make regulations legislative in character.

Legislative rules derive a status of the force of law from their authority, while interpretative rules are not binding on the courts. The force of law status limits the review of legislative rules to questions of statutory authority, reasonableness, and procedure of adoption. By holding the required hearings for these rules, the administrative agency carries out the policy-making functions, and, because the function is legislatively delegated, the courts are reluctant to interfere. Interpretative rules, however, are viewed as nonauthoritative and the court is free to substitute its judgment as to the desirability or wisdom of the regulation. It has been held that the factors the court will consider in making this judgment are: (1) the thoroughness of the rule's considera-

15. Id. at 1290.
16. See generally note 54 infra.
17. The court reasoned that Medicare, Medicaid, and other government programs have "greatly reduced the number of poor people requiring free or below cost hospital services." Thus the rationale supporting Ruling 56-185 had disappeared. 506 F.2d at 1288-89.
18. Id. at 1291.
19. See note 1 supra.
22. DAVIS, supra note 21, § 5.03, at 299.
23. Id. § 5.05, at 315.
tion, (2) the validity of its reasoning, (3) its consistency with earlier and later pronouncements, and (4) all factors giving it power to persuade. These factors have not, however, been consistently applied. Some cases have held that interpretative rules are subject to little judicial scrutiny, while others have held that the reasonableness of the administrator’s interpretation is to be tested closely. Tax administrative rules have not escaped these variations. Although Revenue Rulings are generally held to be neither binding nor controlling as precedents, courts have also said that the “administrative interpretations of the IRS... should be followed unless clearly inconsistent with the statute.”

This inconsistency as to the authoritativeness of interpretative rules probably results from the variety and relative persuasiveness of factors considered in judicial review of administrative rulemaking. The expertise of the agency is one such factor. In highly technical areas the agency’s expert judgment will give the ruling a presumed validity or decisive weight. Agency expertise has satisfied this standard in the tax area, but judicial knowledge of tax law and policy will frequently override this expertise.

25. Interpretative regulations have been held to have “the force and effect of law if not contrary to statute.” Maryland Cas. Co. v. United States, 251 U.S. 342, 349 (1920). They should “not be disturbed except for weighty reasons.” Brewster v. Gage, 280 U.S. 327, 336 (1930).
26. See Permian Basin Area Rate Cases, 390 U.S. 747, 791-92 (1968); FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944); Shell Oil Co. v. FPC, 491 F.2d 82, 88 (5th Cir. 1974).
28. Cf. Commissioner v. O. Liquidating Corp., 292 F.2d 225 (3d Cir. 1961). This case actually dealt with a Treasury Regulation. To understand the differences in Treasury Regulations and Revenue Rulings see generally Rogovin, supra note 6. Administrative Rulings of the Treasury Department, which are consistent with the statute and have been consistently unchallenged, should not be overturned “except for very cogent reasons.” Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 229 (N.D. Iowa 1949).
29. One commentator has expressed the opinion that of these factors, the most important may be judicial agreement or disagreement with the rule. Davis, supra note 21, § 5.05, at 317.
31. Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944); Kern v. Granquist, 291 F.2d 29, 31-32 (9th Cir. 1961). Although the court in Kern recognized a logical and more equitable interpretation of the statute, the majority chose to defer to the weight of the Treasury Regulation.
32. United States v. Eddy Bros., 291 F.2d 529 (8th Cir. 1961) (the Revenue Ruling was held contrary to statute); Kern v. Granquist, 291 F.2d 29, 33 (9th Cir. 1961) (dissenting opinion); United States v. Bennett, 186 F.2d 407, 410-11 (5th Cir. 1951).
Another factor used in determining the validity of the interpretative rule is the implied congressional sanction of the rule through reenactment of the statute under which the rule is promulgated. The sanction is based on assumed legislative knowledge of how the agency is applying that law. This incorporation of the rule into law does not, however, apply against the agency. So that Congress will not have to change the statute every time there is a correction to be made in interpretation, the administrative agency must be allowed to change a rule through its rulemaking powers regardless of congressional reenactment.

In the midst of this body of law dealing with the manner of review of administrative rulings, there has developed a new method of determining whether or not a rule is subject to section 553 procedure. Originating in the context of rulings alleged to be exempt as procedural, this method was designed to satisfy the section 553 objectives of exposing "proposed agency action . . . to the test of prior examination and comment by the affected parties." Under this new approach the basis for exemption from rulemaking proceedings is not the facile semantic distinctions of the definitions of "procedural" and "interpretative," but is instead the rule's importance to those regulated and to the public. To determine if a rule is sufficiently important (has a substantial effect), there are four considerations: (1) the complexity and pervasiveness of the rules issued, (2) the degree of departure from former practices resulting from the rule (termed by courts as "drastic changes affected"), (3) the degree of retroactivity of the rule, and (4) the confusion and controversy engendered by practical difficulties of compliance with the new rule. This analysis does not look to what the agency says it is

33. Cammarano v. United States, 358 U.S. 498, 510 (1959); Commissioner v. Flowers, 326 U.S. 465, 469 (1946). On the other hand it has been said that this is a fiction if the point sanctioned never occurred to Congress in the reenactment. Western Union v. Lenroot, 323 U.S. 490, 508 (1945). Validity of Treasury Rulings through reenactment has been considered a nullity as the statutes are no longer periodically renewed. L. Wright, COMPARATIVE CONFLICT RESOLUTION PROCEDURES IN TAXATION 65 (1968); Popkin, A Critique of the Rule-Making Process in Federal Income Tax Law with Special Reference to Conglomerate Acquisitions, 45 IND. L.J. 453, 511 (1970).

34. Safe Harbor Water Power Corp. v. United States, 303 F.2d 928, 934 (Ct. Cl. 1962).

35. National Motor Freight Traffic Ass'n v. United States, 268 F. Supp. 90, 96 (D.D.C. 1967) (Burger, C.J., then a circuit judge, joined in an opinion by McGowan, J.), aff'd mem., 393 U.S. 18 (1968). See also Pharmaceuticals Mfrs. Ass'n v. Finch, 307 F. Supp. 858 (D. Del. 1970). In dealing with an FDA regulation, the court said that the policy of section 553 mandated the availability of prior comment if the rule "has a substantial impact on . . . the members or the products of that industry . . . ." Id. at 863.

doing, but instead examines the actual effect of the rule. A "substantial effect" on rights and obligations necessitating rulemaking procedures has been found in regulations that nullified a student exemption from a labor certificate required for immigrant status,\(^3\) established new qualifications for parole,\(^3\) established an evidentiary standard that may have stopped the marketing of thousands of drugs,\(^3\) and allowed airlines to use X-rays to guard against hijacking and thus created a health risk for airlines' employees and travellers.\(^4\) Although prior notice and hearing was essential in the adoption of these rules, such procedures are unnecessary if the due process standards are satisfied in another proceeding. American Bancorporation, Inc. v. Board of Governors of Federal Reserve System\(^4\) illustrates two possible manners in which another proceeding may substitute.

At issue in American Banco was a rule promulgated by the Federal Reserve Board to substantially expand permissible banking activities. Although it had serious public and business implications and was issued without prior notice and hearing, an attempt to invalidate the rule failed. The rule was a narrower version of another rule that had been recently adopted after notice and hearing; at that hearing the agency had heard discussion of the banking activities permitted by the new rule.\(^4\) A second basis for allowing the exclusion of section 553 proceedings was found in the passive status of the rule. Before a bank could enter the activities allowed by the rule, it had to obtain Federal Reserve Board approval preceded by a hearing with public participation.\(^4\) Despite the absence of rulemaking procedures the agency was educated before the rule became effective.\(^4\) Participation at some stage by those affected is clearly critical. If affected parties cannot participate, there is serious danger that the administrative agency will view the rule in light of its

\(509\ F.2d\ 29, 33\ (8th\ Cir.\ 1974);\ Continental\ Oil\ Co.\ v.\ Burns, 317\ F.\ Supp.\ 194, 197\ (D.\ Del.\ 1970).\)

41. 509 F.2d 29 (8th Cir. 1974).
42. This first hearing was held one year before the latter rule was adopted. The hearing considered allowing bank holding companies to participate in multiple activities. The former rule adopted a general policy statement which was limited by the contested rule to five specific activities. Id. at 33-34.
43. The fact that a later hearing may be had does not, however, protect parties where an administrative ruling creates legal consequences in advance of hearings. See CBS v. United States, 316 U.S. 407, 417-20 (1942).
44. 509 F.2d at 35.
narrow purpose and ignore the broader implications of the action.\textsuperscript{45} Such implications were admittedly ignored by the IRS in promulgating the rule that was the subject of litigation in \textit{Gibson Wine Co. v. Snyder}.\textsuperscript{46}

Pursuant to the Federal Alcohol Administrative Act the IRS issued a ruling requiring that wine made from the boysenberry variety of blackberry be labelled as boysenberry wine. Challenged in \textit{Gibson Wine}, the rule was found to be exempt from notice and hearing requirements. In basing its holding on the legislative-interpretative distinction, the court noted that although it was necessary to inform the consumer, this rule could be working an injustice. The boysenberry was only one of several varieties of blackberry, all of which had a different flavor. By creating a name foreign to the consumer, this rule would cause the producers of boysenberry wine to maintain a more than modest expense to develop a new market. To satisfy the consumer and protect the business interests, the court, after hearing from all parties to the dispute, recommended a possible judicious alternative label of “Blackberry Wine of the Boysenberry Variety.”\textsuperscript{47} Subsequent IRS adoption of the judicially proposed alternative indicates that better administrative action results from participation by affected parties.\textsuperscript{48}

If regulations merely adopting a definition of “a type of grape”\textsuperscript{49} could be found to create inequities justifying modification, a de novo hearing in \textit{Eastern Kentucky} may have similarly produced influential evidence.\textsuperscript{50} Holding that Revenue Ruling 69-545 was interpretative and not subject to rulemaking procedures, the majority in \textit{Eastern Kentucky} noted that the ruling “had no independent binding effect and that the courts . . . [may or may not] choose to accept it as proper.”\textsuperscript{51} Although the majority recognized that they were free to insert their judgment as to the wisdom of the rule before accepting its reasoning, the dissent claimed that there was not a proper hearing to determine the

\textsuperscript{45} See generally text accompanying and cases cited notes 35-39 supra.
\textsuperscript{46} 194 F.2d 329 (D.C. Cir. 1952).
\textsuperscript{47} \textit{Id.} at 336. The consumer would know the fruit of his wine, and the boysenberry wine producers do not bear an additional expense for the promotion of their product.
\textsuperscript{49} This was the phrase used by Judge Bazelon in distinguishing rules held interpretative from Revenue Ruling 69-545. Ironically he found definitions of “a type of grape” in \textit{Gibson Wine} to be justifiably interpretative on the basis of its insignificance. 306 F.2d at 1292 n.1 (Bazelon, J., dissenting).
\textsuperscript{50} See \textit{id.} at 1292-93.
\textsuperscript{51} \textit{Id.} at 1290.
The court considered all the elements suggested to be used in reviewing a nonauthoritative ruling with the possible exception of "all factors giving (the rule) power to persuade." While the dismissal of the alleged lack of consideration of the needs of the poor was based on the elements of Ruling 69-545 assumed to benefit the poor, use of these superficial assumptions as representative of "all persuading factors" omits consideration of authorities and data that might prove these assumptions incorrect. The IRS in Eastern Kentucky, as in Gibson Wine, had issued the ruling in the shelter of their bureaucracy. Unlike Gibson Wine, however, the lack of participation by the affected parties at the administrative level was not corrected at the judicial level. Although the alleged injustice to the indigent may not exist or may conflict with more important aims of the Revenue Ruling, these issues are indeterminable until the scope of the alleged adverse effect is defined.

The conclusion that affected parties should be heard does not necessarily negate the possibility that due process considerations were not satisfied at a prior proceeding. In holding the ruling to be interpretative, the majority in Eastern Kentucky found support in Treasury Regulations adopted in 1959 after notice and hearing. Ten years after adoption of the regulations, Ruling 69-545 conformed the definition of "charitable hospital" to the concept of "charitable" adopted by the earlier Regulation. Although a public hearing for a prior rule was justification for holding a rule to be interpretative in American Banco, the previous hearing had included consideration of the activities accepted three years later in the contested rule. The hearings for the 1959

52. Id. at 1292-93.
53. See generally text accompanying note 24 supra. The court examined the rule's consideration, its reasoning, and its consistency with other pronouncements in upholding the legislative validity. 506 F.2d at 1286-90.
54. This assumption was based on the fact that the Revenue Ruling had allowed exemption for a hospital which gave emergency service for indigents and accepted patients with third party payment plans. The court further felt that "Ruling 69-545 may be of greater benefit to the poor than its predecessor Ruling 56-185." 506 F.2d at 1289. Part of this belief that the rule benefitted the poor was based on the majority's opinion that Ruling 56-185 permitted a hospital operating at a deficit to qualify for charitable exemption with no obligations to the poor. Id. at 1289 n.26. However, this selective quote by the court omits the qualification that the hospital "must not, however, refuse to accept patients in need of hospital care who cannot pay for such services." Rev. Rul. 185, 1956-1 CUM. BULL. 202, 203.
56. 506 F.2d at 1290.
57. 509 F.2d at 33-34. The former ruling had authorized a broad scope of banking activities, and in making the new ruling, the Board had narrowed the former ruling to
Treasury Regulation in *Eastern Kentucky* apparently did not weigh the implications of "charitable" as applied to hospitals. This fact in combination with the time span between the hearings and adoption of the Revenue Ruling indicate that it was not truly subject to examination by affected parties.

The conclusion that a conflict may be competently resolved only after a hearing does not, however, lead automatically to the further conclusion that the hearing should have been in the administrative body, as the dissenter's claim, rather than in the courts. The finding that the ruling was interpretative, which allows public input to occur in the courts, is supported by strong precedent. By using the origin of the agency's rulemaking power to determine the rule's authoritative status (and thus the necessity for hearings prior to promulgation), Revenue Rulings are clearly interpretative. But even if the applicability of rulemaking procedure was determined by the substantial effect test, the Revenue Ruling might be interpretative. The question would be whether the rule has a substantial effect through the new rights and obligations it creates. Of the considerations suggested for this determination, only the drastic changes affected are at issue. In support of the majority it can be argued that the ruling will not actually cause indigents to be turned away from hospitals in great numbers, and the reverse presumption supports the dissent of Judge Wright. The fact that the new ruling merely clarified the Treasury Regulation implies a

allow only five explicit activities. Under either rule the activities in question were permissible.

8. 506 F.2d at 1286-90.
9. Compare the effect of Revenue Ruling 69-545 on Revenue Ruling 56-185, notes 7, 9 supra, with the effect of the amended regulation in *American Banco*, note 57 supra.
60. 501 F.2d at 1291-93.
61. Submissions by interested parties on all rules promulgated by an administrative agency might be justified on the basis of the relatively efficient procedures of the administrative body in comparison to those of the courts. In the interest of due process considerations, such submissions have been proposed in the issuance of Revenue Rulings. Where the submissions justify modifications there would be elimination of otherwise needed judicial review. Where the IRS feels suggested modifications inappropriate, judicial review should be discouraged by the likelihood of failure of a second challenge on the basis of the same contention. See generally L. Wright, *Needed Changes in Internal Revenue Service Conflict Resolution Procedures* 67-68 (1970).
63. 506 F.2d at 1291.
64. See text accompanying note 36 supra. The other considerations may be summarily dismissed. The rules are on their face not complex and generally have no retroactive effect. See note 70 infra. Compliance with the ruling would not involve any difficulties as it increases eligibility for charitable exemptions and adds no new requirements.
less drastic change. On the other hand the revocation of the old ruling and the long-standing administrative precedent seems severe.

While the action of the administrative agency in Eastern Kentucky was arguably justifiable, the negative aspects of the legislative-interpretative distinction have been illuminated above. Although the primary purpose of section 553 is the provision of an opportunity for affected parties to voice concerns, thus contributing to the education of the agency promulgating rules of significant consequence, courts generally ignore this purpose and instead base the distinction on the existence of statutory authority. This nearly exclusive emphasis upon the existence of statutory authority frequently leads to judicial failure to examine the irreversible impact exerted by the rule before judicial review. For example, Revenue Rulings, which are generally found to have no express statutory authority, are given prospective effect by the IRS. Until the ruling is judicially, administratively, or legislatively reversed, this prospective effect guarantees IRS agents and taxpayers that meeting the standard set by the rule is sufficient. Although courts are allowed to treat the rulings as nonbinding, IRS policy has had a permanent impact in the intermediate period. Basing exemptions on statutory authority has the additional problem of judicial confusion. Examination of the cases illustrates ambiguities in both the understanding of what constitutes statutory authority and the type of review warranted. When the issues examined by the court fail to focus on the purposes of the act, the natural result is confusion.

The substantial effect rule apparently concentrates on the underlying policy of section 553. All of the factors to be considered look to the application of the rule; the need for notice and hearing is based on the importance of that application. The question is “Does the rule have a substantial impact?” Although there is the danger of semantical feint-
Constitutional Law—Mortmain Statutes—A Blow to an Old and Ailing Statute

Mortmain statutes, which restrict charitable bequests in wills executed within a specified period before the testator's death, were incorporated from the Georgian Statute of Mortmain into the constitu-

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73. "Substantial impact," like "interpretative rule," could be analyzed in terms of its meaning rather than its underlying purpose of ferreting out the need for notice and hearing prior to the rule's promulgation.

74. See cases cited notes 35-41 supra.

75. See text accompanying note 36 supra. While the coordination of these considerations is complex, each illuminates a factor of importance. A complex and pervasive rule indicates a greater likelihood of agency error that might be discovered through public participation. Drastic changes, retroactivity, and difficulty in compliance with the rule all indicate that there are persons with a direct interest in the rule. That there are those injured is probably indicative of the rule's importance.

1. E.g., Pa. Stat. Ann. tit. 20, § 2507(1) (Spec. Pamphlet 1975) states, in relevant part: "Any bequest or devise for religious or charitable purposes included in a will or codicil executed within 30 days of the death of the testator shall be invalid to the extent that someone who would benefit by its invalidity objects: Provided, That the Commonwealth shall not have the right so to object . . . ."

2. Some statutes only limit the bequest, e.g., Idaho Code § 15-2-615 (Supp. 1972) allows an unlimited bequest to charity provided the first $100,000 of the testator's estate goes to his lineal descendants.

3. Pennsylvania, for example, invalidates certain inter vivos transfers to charitable organizations made within thirty days of death. Joslin, Legal Restrictions on Gifts to Charities, 21 Tenn. L. Rev. 761, 764 & n.19 (1951).

4. The prohibited period ranges from thirty days to one year before death. 1 W. Bowe & D. Parker, Page on Wills § 3.16 (1960).