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Supreme Court Reconsideration of *Auer v. Robbins* Deference Could Significantly Impact BSA Enforcement

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"Auer" deference requires the federal courts to afford controlling weight to an agency's interpretation of its own ambiguous regulation—even if the agency's interpretation is not the "best" interpretation. The authors of this article discuss "Auer" deference, the U.S. Supreme Court's grant of certiorari on the question of whether the Court should overrule the Auer decision, and the implications for financial institutions.

The U.S. Supreme Court granted certiorari in *Kisor v. Wilkie*[1] limited to the question of whether the Court should overrule *Auer v. Robbins*[2] and *Bowles v. Seminole Rock & Sand Co.*[3]

As explained below, "*Auer*" deference (also known as "*Seminole Rock*" deference) requires the federal courts to afford controlling weight to an agency's interpretation of its own ambiguous regulation—even if the agency's interpretation is not the "best" interpretation. Of particular interest to financial institutions, the U.S. Court of Appeals for the Ninth Circuit recently applied *Auer* deference in the Bank Secrecy Act ("BSA") enforcement context in *California Pacific Bank v. Federal Deposit Insurance Corp*.[4] After holding that the Federal Deposit Insurance Corporation's ("FDIC's") regulation setting forth the "four pillars" of BSA compliance (12 C.F.R. § 326.8(c)) was ambiguous, the Ninth Circuit deferred to the FDIC's interpretation of that ambiguous regulation, as set forth in an interagency examination manual published by the Federal Financial Institutions Examination Council ("FFIEC"), pursuant to

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1 No. 18-15 (U.S. Dec. 10, 2018).

2 519 U.S. 452 (1997) (Scalia, J.).

3 325 U.S. 410 (1945).

4 885 F.3d 560 (9th Cir. Mar. 12, 2018).

Auer. The Ninth Circuit then upheld the FDIC's issuance of a cease-and-desist order against California Pacific Bank for alleged violations of 12 C.F.R. § 326.8(c)'s pillar requirements.

The Supreme Court's reconsideration of *Auer* thus could have important implications for BSA enforcement. Each of the other prudential federal financial regulatory agencies—the Board of Governors of the Federal Reserve System ("FRB"), the National Credit Union Administration ("NCUA"), and the Office of the Comptroller of the Currency ("OCC")—have promulgated "four pillars" regulations that are substantially identical to 12 C.F.R. § 326.8(c).[5] As such, these regulations are, like the FDIC's "four pillars" regulation, also facially ambiguous. If *Auer* is overturned by the Supreme Court, the federal courts would not be required to defer to the agencies' interpretations of the requirements of their respective, ambiguous "four pillars" regulations. As a result, the playing field would be leveled and the good faith arguments of financial institutions that their BSA compliance programs satisfy the requirements of the applicable "four pillars" regulations would be significantly strengthened.

"*AUER*" DEFERENCE

Auer deference is so powerful because it requires the federal courts to afford controlling weight to an agency's interpretation of an ambiguous regulation *even when the agency's interpretation is not "the best" reading of the regulation*.[6] Specifically, *Auer* requires the federal courts to afford controlling weight to an agency's interpretation of its ambiguous regulation unless the agency's interpretation is "plainly erroneous or inconsistent with the regulation."[7] The Supreme Court has elsewhere described this standard as requiring deference to an agency's interpretation of an ambiguous regulation "unless an 'alternative reading is *compelled* by the regulation's plain language or by other indications of the [agency's] intent at the time of the regulation's promulgation.' "[8]

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[5] *See* 12 C.F.R. § 208.63(c) (FRB); 12 C.F.R. § 748.2(c) (NCUA); 12 C.F.R. § 21.21(d) (OCC).

[6] *Decker v. Nw. Envtl. Def. Ctr.*, 568 U.S. 597, 613 (2013) ("It is well established that an agency's interpretation need not be the only possible reading of a regulation—or even the best one—to prevail. When an agency interprets its own regulation, the Court, as a general rule, defers to it 'unless that interpretation is "plainly erroneous or inconsistent with the regulation."'" (citations omitted)).

[7] *See Auer*, 519 U.S. at 461 (quoting *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 359 (1989) (quoting *Seminole Rock*, 325 U.S. at 414)).

[8] *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (emphasis added) (citation

In *Auer* itself, for example, St. Louis police sergeants sued the St. Louis police department for overtime pay under the Fair Labor Standards Act of 1938 ("FLSA").[9] The issue was whether, under regulations promulgated by the Department of Labor pursuant to the FLSA, the sergeants were exempt from the FLSA's overtime pay requirements.[10] The regulations' "salary basis test" that governed the exemption was ambiguous in that it was susceptible to both an interpretation that favored the sergeants as well as an interpretation that favored the police department.[11] After the Department of Labor filed an *amicus* brief at the Court's request clarifying the agency's interpretation of the regulations, the Court deferred to the Department of Labor's interpretation, leading to a ruling in favor of the police department.[12] In a unanimous opinion authored by Justice Scalia, the Court held that "[b]ecause the salary-basis test is a creature of the [Department of Labor]'s own regulations, [the Department's] interpretation of it is . . . controlling unless 'plainly erroneous or inconsistent with the regulation.'"[13]

Unsurprisingly, courts have rarely found that *Auer* deference did not apply to agency interpretations of ambiguous regulations because the agency interpretations were "plainly erroneous" or "inconsistent with the regulation."[14] To the contrary, *Auer* deference has been utilized by the federal courts to defer to agency interpretations of ambiguous regulations in a wide variety of regulatory contexts.[15] In *Kisor*, for example—the case currently before the Supreme Court—the U.S. Court of Appeals for the Federal Circuit deferred to the defendant Department of Veterans Affairs' ("VA's") interpretation of the ambiguous term "relevant" in a VA regulation because the VA's interpretation was not plainly erroneous or inconsistent with the regulation.[16] As a result, the

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omitted); *see also Cal. Pac. Bank*, 885 F.3d at 574 (quoting *Thomas Jefferson*, 512 U.S. at 512).

[9] *Auer*, 519 U.S. at 455.

[10] *Id.*

[11] *See id.* at 459–60.

[12] *Id.* at 461–63.

[13] *Id.* (quoting *Robertson*, 490 U.S. at 359 (quoting *Seminole Rock*, 325 U.S. at 414)).

[14] *See, e.g.*, *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1214 (2015) (Thomas, J., concurring) ("On this steady march toward deference, the [Supreme] Court only once expressly declined to apply [*Auer*] deference on the ground that the agency's interpretation was plainly erroneous.").

[15] *See, e.g.*, *id.* (summarizing the application of *Auer* deference "to regulations issued by agencies across a broad spectrum of subjects" and in surprising contexts, such as "an agency's interpretation of another agency's regulations").

[16] *Kisor v. Shulkin*, 869 F.3d 1360, 1367–68 (Fed. Cir. Sept. 7, 2017), *cert. granted in part*

Federal Circuit did not consider whether the plaintiff's interpretation of the ambiguous regulation may have been more persuasive than the interpretation advanced by the VA.[17]

Kisor thus presents the Supreme Court with a narrowly tailored case in which to consider the continuing validity of *Auer* deference. If the Supreme Court overrules the Federal Circuit's decision, it will presumably remand *Kisor* to the Federal Circuit to consider whether the VA's interpretation or the plaintiff's interpretation of the ambiguous regulation is more persuasive.

CALIFORNIA PACIFIC BANK v. FDIC—APPLYING *AUER* DEFERENCE TO BSA ENFORCEMENT

In March 2018, the Ninth Circuit applied *Auer* deference to uphold a cease-and-desist order issued by the FDIC against California Pacific Bank.[18] The FDIC's cease-and-desist order had found that California Pacific Bank had violated the BSA[19] and FDIC's implementing regulation, 12 C.F.R. § 326.8(c), which sets forth the so-called "four pillars" of BSA compliance.[20] These four pillars are:

(1) "a system of internal controls to assure ongoing compliance,"

(2) "independent testing for compliance,"

(3) "[d]esignat[ion] of an individual or individuals responsible for coordinating and monitoring day-to-day compliance," and

(4) "training for appropriate personnel."[21]

In its appeal to the Ninth Circuit, California Pacific Bank argued that the FDIC's cease-and-desist order should be set aside because the FDIC had relied

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sub nom. *Kisor v. Wilkie*, No. 18-15 (U.S. Dec. 10, 2018).

[17] *See id.* at 1368 ("Because § 3.156(c)(1) is ambiguous, the *only remaining question* is whether the [VA's] interpretation of the regulation is 'plainly erroneous or inconsistent' with the VA's regulatory framework." (emphasis added) (citation omitted)).

[18] *Cal. Pac. Bank*, 885 F.3d at 566.

[19] 31 U.S.C. § 5311 *et seq.*

[20] *See Cal. Pac. Bank*, 885 F.3d at 573 ("The FDIC Board adopted in full the ALJ's findings, which looked to the FFIEC Manual as an authority on compliance with the FDIC's four pillars regulation. The FDIC Board found that the Bank failed to comply with the four pillars of BSA compliance: adequate controls, independent testing, administration, and training."); Decision and Order to Cease and Desist, *In re: Cal. Pac. Bank, San Francisco, Cal.*, No. FDIC-13-094b (Feb. 17, 2016) (ordering bank to cease and desist from violating the pillar requirements in 12 C.F.R. § 326.8(c)).

[21] 12 C.F.R. § 326.8(c).

on the FFIEC's *Bank Secrecy Act/Anti-Money Laundering Examination Manual* ("FFIEC Manual") as an authority on compliance with the FDIC's "four pillars" regulation.[22] In other words, California Pacific Bank disputed that it was appropriate for the FDIC, which is a member of the FFIEC, to rely on the guidance and recommendations in an interagency examination manual to clarify the requirements of 12 C.F.R. § 326.8(c).[23] The FDIC, in contrast, contended that "an agency may properly rely on, and clarify regulations with, an instructional manual promulgated to provide guidance on what is required by the regulation it administers."[24] The parties' arguments were made in the context of California Pacific Bank's contention that the BSA and the FDIC's "four pillars" regulation were unconstitutionally vague because they failed to provide fair notice of the conduct required to comply with the BSA.[25]

Neither party briefed the issue of whether, if the FDIC's "four pillars" regulation was ambiguous, the FDIC's interpretation of the regulation set forth in the FFIEC Manual should receive *Auer* deference.[26] In the course of considering whether the FDIC's cease-and-desist order was supported by "substantial evidence" as required by the Administrative Procedure Act ("APA"),[27] however, the Ninth Circuit considered whether 12 C.F.R. § 326.8(c) was ambiguous, potentially triggering *Auer* deference. This was apparently a question of first impression, as the Ninth Circuit did not cite to any other court's construal of the FDIC's "four pillars" regulation—nor of any other prudential federal financial regulatory agency's "four pillars" regulation, for that matter.

In any event, the Ninth Circuit answered this first question affirmatively. It found the FDIC's "four pillars" regulation to be ambiguous because the regulation's generalized requirements are susceptible to multiple interpretations:

> The FDIC's four pillars regulation is ambiguous. The four pillars are not entirely "free from doubt," given the complexity of BSA compliance and the need for FDIC officials to conduct administrative examinations of bank BSA programs. That banks can design different

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[22] *Cal. Pac. Bank*, 885 F.3d at 573–74.

[23] *Id.*

[24] *Id.* at 574.

[25] *See e.g.*, Pet'r Cal. Pac. Bank's Opening Br. at 16–20, *Cal. Pac. Bank v. FDIC*, 885 F.3d 560 (9th Cir. Mar. 12, 2018) (No. 16-70725).

[26] *See, e.g.*, *id.*; Answering Br. of Resp't FDIC, *Cal. Pac. Bank v. FDIC*, 885 F.3d 560 (9th Cir. Mar. 12, 2018) (No. 16-70725).

[27] 5 U.S.C. § 706(2)(E).

compliance programs further demonstrates that the four pillars are "susceptible to different interpretations."[28]

Having found that 12 C.F.R. § 326.8(c) is ambiguous, the Ninth Circuit next considered whether it was required to afford *Auer* deference to the FDIC's interpretation of the regulation set forth in the FFIEC Manual. The Ninth Circuit also answered this question affirmatively. The court concluded that "[t]he FFIEC Manual is not plainly erroneous or inconsistent with the FDIC's four pillars regulation."[29] It also found that an alternative reading to the interpretation offered by the FDIC in the FFIEC Manual was not "compelled by the plain language of 12 C.F.R. § 326.8(c), given the generalized framing of the four pillars."[30] Accordingly, the Ninth Circuit held that "[t]he FFIEC Manual must receive *Auer* deference."[31]

The Ninth Circuit then went on to consider each of 12 C.F.R. § 326.8(c)'s four pillars in light of the FDIC's interpretations of the pillar requirements set forth in the FFIEC Manual.[32] Applying this deferential standard, the court concluded that there was "substantial evidence" to support the FDIC's determination that California Pacific Bank had failed to comply with each of the regulation's four pillars.[33]

The Ninth Circuit's consideration of the California Pacific Bank's compliance with the training pillar set forth in 12 C.F.R. § 326.8(c)(4), for example, illustrates the power of *Auer*'s deferential approach. The regulation simply provides that a BSA compliance program shall "[p]rovide training for appropriate personnel."[34] Because no additional information is provided regarding the quantity or quality of the training that is required in the regulation itself, the regulation's training pillar is inherently ambiguous. Various training programs could conceivably satisfy the regulation's generalized requirement that "training" be provided to "appropriate" personnel.

The FFIEC Manual purports to clarify the training pillar's ambiguity by advising, among other things, that "training should be tailored to [a] person's specific responsibilities."[35] Because the Ninth Circuit afforded *Auer* deference

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[28] *Id.* (citations omitted).

[29] *Id.* at 575.

[30] *Id.*

[31] *Id.*

[32] *Id.* at 575–80.

[33] *Id.*

[34] 12 C.F.R. § 326.8(c)(4).

[35] *See Cal. Pac. Bank*, 885 F.3d at 579 (quoting FFIEC Manual).

to the FFIEC Manual's interpretation of the pillar requirements, it held that the FDIC's determination that California Pacific Bank's training did not comply with the training pillar was supported by "substantial evidence."[36] This was because California Pacific Bank's training materials were not tailored to specific job responsibilities—*as recommended or required by the FFIEC Manual*, not by the plain language of the regulation itself.[37] In holding that there was substantial evidence to support the FDIC's determination of a training pillar violation, the Ninth Circuit rejected California Pacific Bank's arguments that the training it provided was appropriate given the bank's small size (fewer than 15 employees and approximately 200 customers) and the overlapping responsibilities of its personnel.[38]

In short, the Ninth Circuit upheld the FDIC's cease-and-desist order against California Pacific Bank based on the court's understanding that it was required to afford *Auer* deference to the FFIEC Manual's interpretation of 12 C.F.R. § 326.8(c)'s pillar requirements. It is unclear whether the Ninth Circuit would have similarly upheld the FDIC's cease-and-desist order had it not been required to follow *Auer* as controlling Supreme Court precedent.[39]

AUER'S CURRENT STANDING

Does *Auer* have a significant chance of being overturned in light of the Supreme Court's recent grant of certiorari in *Kisor*? The short answer is "yes." As explained below, *Auer*'s author, now-deceased Justice Antonin Scalia, eventually called for *Auer* to be overturned. More important, each of the Justices forming the Supreme Court's current conservative majority have questioned or criticized *Auer*.

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[36] *Id.* at 579–80.

[37] *See id.* at 580 & n.12.

[38] *Id.* at 580 & n.12.

[39] Whether the Ninth Circuit's conclusion that, under controlling precedent, *Auer* deference applied to the FDIC's interpretation of 12 C.F.R. § 326.8(c) was correct is beyond the scope of the current article. The authors note, however, that the court's consideration of *Auer* deference was *sua sponte*, leading to the possibility that the court would have benefited from briefing on this issue. *Auer* deference may not have been appropriate, for example, because 12 C.F.R. § 326.8(c) parrots the statutory pillar requirements of the BSA, 31 U.S.C. § 5318(h)(1). *See Gonzales v. Oregon*, 546 U.S. 243, 257 (2006) ("An agency does not acquire special authority to interpret its own words when, instead of using its expertise and experience to formulate a regulation, it has elected merely to paraphrase the statutory language.").

Justice Scalia called for *Auer* to be overturned in a 2015 concurrence in *Perez v. Mortgage Bankers Ass'n*.[40] In that opinion, Justice Scalia expressed concern that the judicially-created *Auer* doctrine incentivized agencies to draft ambiguous regulations that they could later supplement through interpretative rules not subject to the notice-and-comment requirements of the APA that guard against "excesses in rulemaking."[41] Justice Scalia therefore urged "restor[ing] the balance originally struck by the APA with respect to an agency's interpretation of its own regulations . . . by abandoning *Auer*."[42] Rather than deferring to an agency's interpretation of an ambiguous regulation, Justice Scalia believed that a federal court should be free to "decide—with no deference to the agency—whether that [agency] interpretation is correct."[43]

Justices Thomas and Alito also questioned the continuing validity of the *Auer* precedent in *Perez*. In a lengthy concurrence, Justice Thomas opined that *Auer* deference is constitutionally suspect because it effects a transfer of judicial power to executive agencies by requiring federal judges to defer to agency interpretations of ambiguous regulations.[44] Justice Alito, meanwhile, succinctly acknowledged that "[t]he opinions of Justice SCALIA and Justice THOMAS offer substantial reasons why the [*Auer*] doctrine may be incorrect," and stated that he "await[ed] a case in which the validity of [*Auer*] may be explored through full briefing and argument."[45]

More recently, Justice Gorsuch joined Justice Thomas in opining that "[*Auer*] deference is constitutionally suspect."[46] Justices Thomas and Gorsuch also

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[40] *Perez*, 135 S. Ct. at 1213 (Scalia, J., concurring).

[41] *Id.* at 1212–13 ("To expand [its notice-and-comment free] domain, the agency need only write substantive rules more broadly and vaguely, leaving plenty of gaps to be filled in later, using interpretive rules unchecked by notice and comment. The APA does not remotely contemplate this regime . . . . [T]here are weighty reasons to deny a lawgiver the power to write ambiguous laws and then be the judge of what the ambiguity means."); *cf. also Decker*, 568 U.S. at 620 (Scalia, J., concurring) ("*Auer* deference encourages agencies to be vague in framing regulations, with the plan of issuing 'interpretations' to create the intended new law without observance of notice and comment procedures." (internal quotation marks and citation omitted)).

[42] *Id.* at 1213.

[43] *Id.*

[44] *Id.* (Thomas, J., concurring) ("Because this doctrine effects a transfer of the judicial power to an executive agency, it raises constitutional concerns. This line of precedents undermines our obligation to provide a judicial check on the other branches, and it subjects regulated parties to precisely the abuses that the Framers sought to prevent.").

[45] *Id.* at 1210–11 (Alito, J., concurring).

[46] *Garco Constr., Inc. v. Speer*, 138 S. Ct. 1052, 1052 (2018) (Thomas, J. dissenting, joined by Gorsuch, J.).

opined that "[b]y all accounts, [*Auer*] deference is 'on its last gasp.' "[47] Chief Justice Roberts, for his part, has noted that "[i]t may be appropriate to reconsider [*Auer*] in an appropriate case," and that he "await[ed] a case in which the issue is properly raised and argued."[48] Meanwhile, the newest member of the Supreme Court, Justice Kavanaugh, considers Justice Scalia to be "a hero and a role model"[49] and has predicted that Justice Scalia's call to abandon *Auer* will eventually prevail.[50]

As the *Wall Street Journal* Editorial Board recently wrote, "with the arrival of Justices Neil Gorsuch and Brett Kavanaugh, [the] judicial reconsideration [of *Auer*] may finally be on."[51]

IMPLICATIONS FOR FINANCIAL INSTITUTIONS

Financial institutions should monitor the outcome of *Kisor* closely. Given the past criticisms of *Auer* by the Justices forming the Supreme Court's conservative majority, the probability that the Court will overrule *Auer* appears high.

Overruling *Auer* would have significant impacts across the regulatory landscape, including for BSA enforcement. The Ninth Circuit's decision in *California Pacific Bank* indicates that each of the federal financial regulatory agencies' "four pillars" regulations are inherently ambiguous, providing standards for BSA compliance that can accommodate a broad range of preferred interpretations. If federal judges are no longer required to defer to the agencies' interpretations of their respective "four pillars" regulations under *Auer*, it may be difficult for the agencies to successfully defend BSA enforcement actions that financial institutions appeal to the federal courts for review. Rather than blindly deferring to an agency's interpretation of its "four pillars" regulation, a federal court hearing an appeal of a BSA enforcement action would instead decide—without deference to the agency—whether the agency's interpretation of its

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[47] *Id.* at 1053 (citation omitted).

[48] *Decker*, 568 U.S. at 615–16 (Roberts, C.J., concurring, joined by Alito, J.).

[49] Manu Raju & Joan Biskupic, *Trump's Supreme Court pick calls Antonin Scalia a "role model" and a "judicial hero*," CNN (Aug. 13, 2018, updated 6:00 AM), https://www.cnn.com/2018/08/13/politics/brett-kavanaugh-antonin-scalia-role-model-supreme-court/index.html.

[50] Alison Frankel, *Trump DOJ faces conundrum in SCOTUS review of Auer deference*, Reuters (Dec. 11, 2018, 3:04 PM), https://www.reuters.com/article/legal-us-otc-auer/trump-doj-faces-conundrum-in-scotus-review-of-auer-deference-idUSKBN1OA2BD.

[51] Editorial Board, *Auer of Legal Reckoning: The Supreme Court tees up a big case on the administrative state*, Wall Street Journal (Dec. 10, 2018, 7:06 PM), https://www.wsj.com/articles/auer-of-legal-reckoning-1544486782.

ambiguous regulation is correct. In the long term, this would encourage the agencies to adopt regulations setting forth the "four pillars" of BSA compliance that are clearer and more detailed.

In the short term, the uncertainty over the continued validity of *Auer* may provide immediate benefits to financial institutions engaged in BSA compliance disputes with regulators. The probability that *Auer* will be overturned by the conservative Supreme Court majority should provide financial institutions with increased leverage with which to resist overreaching or unjustified interpretations of the "four pillars" regulations propounded by the federal financial regulatory agencies.