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Supreme Court Issues Opinion Addressing Interplay Between APA Procedural Compliance and Chevron Deference

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In ***Encino Motorcars, LLC v. Navarro***, Sup. Ct. No. 15-415 (June 20, 2016), the ***Supreme Court*** of the United States invalidated a regulation issued by the ***US Department of Labor (DOL***) under the ***Fair Labor Standards Act (FLSA***). In doing so, it affirmed long-standing precedent regarding the procedural requirements of the ***Administrative Procedures Act (APA)*** and addressed the effect of noncompliance with those requirements on the deference, if any, courts must afford agency pronouncements. Thus, even though it is not a tax case, it is likely to have an effect on cases in which taxpayers argue that a treasury regulation is invalid.

The Court's holding here is based upon an agency's unexplained change in a long-standing position. The FLSA requires employers to pay overtime compensation to covered employees who work more than 40 hours in a given week. It exempts from this requirement "any salesman, partman, or mechanic primarily engaged in selling or servicing automobiles" at a covered dealership. From 1978 to 2011, the DOL's position was that such employees were exempt from the overtime-pay rule. This position was set forth in a number of published pronouncements, including proposed regulations in 2008. However, when the regulations were finalized in 2011, the DOL took the opposite position. In a suit brought by a number of service advisors against a dealership for overtime pay, the US Court of Appeals for the Ninth Circuit resolved the matter by giving *Chevron* deference to the DOL's interpretation embodied in the 2011 regulations, holding for the plaintiff employees. The Supreme Court majority denied *Chevron* deference and remanded the case to the Ninth Circuit for further proceedings on the meaning of the underlying statutory language.

In doing so, the Court wrote that "*Chevron* deference is not warranted where the regulation is 'procedurally defective.'" Majority op. at 8. In determining whether the regulation at issue was "procedurally defective," the Court relied on the so-called *State Farm* standard: "where the agency has failed to provide even [a] minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law." *Id*. at 9. Specifically, where an agency changes an established position, it "must at least 'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'" *Id*. The Court noted that "[i]n promulgating the 2011 regulation, the Department offered barely any explanation. … [it] did not analyze or explain why the statute should be interpreted to exempt dealership employees who sell vehicles but not dealership employees who sell services … ." *Id*. at 10–11.

In addition to joining the majority opinion, Justice Ruth Bader Ginsburg wrote separately “to stress that nothing in today’s opinion disturbs well-established law.” Concurring opinion at 2. Justice Sonia Sotomayor joined both the majority opinion and this concurring opinion. Justice Clarence Thomas, joined by Justice Samuel Alito, wrote in dissent, “I agree with the majority’s conclusion that we owe no *Chevron* deference to the Department’s position because ‘deference is not warranted where [a] regulation is “procedurally defective.”’” Dissent at 1. Justices Thomas and Alito called for a “plain meaning” reading of the statute, which, they maintained, clearly exempts the plaintiffs from the overtime-pay rules.

Thus, although the opinion appears to be 6-2, it is actually unanimous on the question of how compliance with APA procedures affects *Chevron* deference. Justices Thomas and Alito’s dissent was to the fact that, having decided that the DOL regulation was invalid, the majority declined to interpret the relevant statutory provision, remanding to the Ninth Circuit instead.

This opinion has important implications for arguments regarding the validity of a treasury regulation. It is based on long-standing precedent (i.e., *State Farm*), which it plainly says still applies. Moreover, in a real sense, it confirms the Tax Court’s proposition in *Altera* that compliance with the APA’s procedural rules and eligibility for *Chevron* deference go hand-in-hand.

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