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Underground Regulations: Fighting Against Government by Decree

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It is often said that "ours is a government of laws, not of people." We accept and obey lawfully-enacted statutes and regulations whether we like them or not. So long as a law is properly created, we will agree on the law's legitimacy, even if we may disagree about its desirability.

There are two common methods for enacting laws. The most well known is by passing a bill in the Legislature. Bills are proposed laws, which, if passed, become state statutes.

enacting laws is through the adoption of regulations by state government agencies. When a state agency believes that a rule is necessary to "implement, interpret, or make specific" a statute that the agency administers, California law allows the agency to adopt a regulation to do so. A lawfully adopted regulation has the same legal force as a statute enacted by the Legislature.

There are precise procedures that state bureaucracies must follow to adopt lawful regulations. These procedures are contained in the California Administrative Procedure Act, commonly called the APA (California Government Code Sections 11340 - 11365). The APA ensures that agencies adopting regulations do so openly and that members of the public have an opportunity to review and comment upon the regulations under consideration.

Regulations are only legal if they are somehow authorized by statute. Authority to adopt regulations may be "implied," but unless an agency is implementing a statute, it cannot legally adopt a regulation. But government agencies do not always enact their regulations lawfully. Sometimes agencies will issue decrees even though they have no statutory authority to do so. Even if they are acting within their statutory power, they will sometimes issue decrees instead of going through APA rulemaking procedures. The APA has a name for this - "underground regulation." When an agency imposes a regulation without going through APA procedures, it creates an underground regulation. Under the APA, an underground regulation is void (California Government Code Section 11340.5).

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Underground regulations can take many forms. Agencies may attempt to impose rules by issuing letters, bulletins, guidelines, legal opinions, or even decisions resulting from administrative adjudication. The form does not matter. If the purported rule satisfies the statutory definition of "regulation" and it is not subject to an express statutory exemption from APA rulemaking requirements, it is an illegal underground regulation.

In 2009, the California Insurance Commissioner issued a decree to all insurers instructing that investments in certain specific companies could not be counted by the insurers in reporting their financial status. The companies on this list were those that the Commissioner concluded had business ties with Iran. The Commissioner called this the "Iran Investments Initiative." Insurers objected to it, arguing both that there is no statute allowing the Commissioner to pursue foreign policy objectives, and that even if there was a statute allowing this, the decree must be adopted by APA procedures in order to be legal.

The Iran Investments Initiative was the poster child of underground regulation. It was a regulation adopted by a state agency, which was both without any statutory authority and which was imposed in complete disregard for the rulemaking requirements of the APA.

Somebody who objects to an underground regulation has a couple of legal options to challenge it. To begin with, an underground regulation is legally "void" (*Tidewater Marine Western v. Bradshaw*, 14 Cal. 4th 557). As far as the law is concerned, an underground regulation does not exist and never did exist. A person or business subject to the underground regulation, therefore, may lawfully ignore it. In the case of the Iran Investments Initiative, about 300 different insurers have ignored some or all of the Commissioner's decrees.

Ignoring an underground regulation, however, can be a high-risk strategy. Even when a rule is an illegal underground regulation, the agency that issued the decree will certainly assert that its action is lawful. The Insurance Commissioner has consistently asserted that the Iran Investments Initiative is legal. Merely ignoring an underground regulation may cause the agency that issued the rule to take action to enforce it. Although the person subjected to this enforcement action may ultimately win, it can still mean a fight and nobody likes to fight with a regulator. Ignoring an underground regulation is only a good idea when you are very sure that the rule, in fact, violates the APA.

There are two ways to obtain a formal legal declaration that a particular rule is an illegal underground regulation. The quickest and least expensive is to petition the California Office of Administrative Law (OAL) for a determination under Section 11340.5. OAL has the legal power to examine state agency actions and to issue a determination as to whether or not the action establishes an underground regulation. Any person may petition for an OAL determination, but the decision to accept or decline the petition is entirely one of OAL's discretion. The benefits of obtaining an OAL determination are real but they are also limited.

An OAL determination that an agency action is an underground regulation is not legally enforceable against the agency. OAL has the power to issue its judgment, but it does not have any power to order the offending agency to cease attempts to enforce the underground regulation. If an agency action is ultimately challenged in court, the OAL determination will be given great weight (*Grier v. Kizer*, 219 Cal.App.3d 422) by the court, but the court has the power to overrule OAL and conclude that an agency action is not an illegal underground regulation in spite of a contrary OAL determination. Any determination by OAL may be appealed to the courts.

In other words, an OAL determination that a rule is an illegal underground regulation will help make the case against the rule. It will support a decision to ignore the illegal rule, but by itself it probably will not finally resolve the issue. OAL has no power to enforce its determination.

In the case of the Iran Investment Initiative, the insurance industry sought an OAL determination that the effort was an underground regulation. On Oct. 11, 2010, OAL issued its determination that the Insurance Commissioner's Iran Investment Initiative was, in fact, an illegal underground regulation.

The Insurance Commissioner has appealed the OAL determination to the courts. The trial court proceeding should be completed this year. Both OAL and the insurance groups that petitioned for the determination are defending against the Commissioner's lawsuit. Although predicting court action is always chancy, there is good reason to believe that if this action proceeds to conclusion, there will be a judicial ruling that the Iran Investment Initiative is an illegal underground regulation, and therefore void from its inception.

When the state government acts by decree; when it ignores the rules governing the lawful adoption of regulations, members of the regulated public must understand that they have options. They are not required to roll over and play dead merely because a state government bureaucrat has issued a decree. Even at the level of regulations adopted by state agencies, there are rules giving meaning to the axiom that ours is a government of laws, not of people.

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