THE LENDING-LIMIT COMBINATION RULES: REGULATION BY ENFORCEMENT AT THE OCC

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An agency cannot merely flit serendipitously from case to case, like a bee buzzing from flower to flower, making up the rules as it goes along.

– Judge Bruce M. Selya[1]

ABSTRACT

The regulation-by-enforcement critique has made an impact at the Securities and Exchange Commission, and scholars are beginning to turn this critique against other agencies. Using this critique, this Note demonstrates that the federal combination rules for the lending-limit law should be rewritten. Under the lending-limit law, national banking associations may lend only a certain percentage of their unimpaired capital and unimpaired surplus to any one borrower. Although the combination rules include several per se rules pursuant to which loans made to two borrowers will be aggregated, they also grant the Office of the Comptroller of the Currency (OCC) the power to determine ad hoc whether to aggregate two loans. This power to determine on an ad hoc and even on a post hoc basis whether a violation of the law has occurred is an affront to the rule of law and is unfair to the industry. The combination rules should be amended to remove the OCC's power to make ad hoc determinations.

INTRODUCTION

In the wake of the 2008 financial crisis, scholars,[2] the media,[3] and legislators turned their focus to banking regulators and how they

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1. Henry v. INS, 74 F.3d 1, 6 (1st Cir. 1996).

regulate the banking industry.[4] As Comptroller of the Currency Thomas Curry has explained, the "mission of ensuring the safety and soundness of America's national banks and federal savings associations has never been more important or more challenging."[5] This Note focuses on one of the ways in which the Office of the Comptroller of the Currency (OCC) ensures the safety and soundness of financial institutions—namely, by preventing financial institutions from lending too much money to any one borrower.[6] Because loans made to two technically distinct borrowers may carry the same risk as loans made to one borrower, the OCC has established combination rules to define when two borrowers should be treated as one.[7] As explained in Part II, these combination rules do not inform banks whether a given loan would exceed a bank's capital requirements because the OCC may aggregate loans to two borrowers whenever "the facts and circumstances" warrant such action.[8]

Political theory has long held the rule of law in high esteem. Aristotle wrote that "the law must govern, and not individuals,"[9] and that "the rule of the law is preferable to that of any individual."[10] When a rulemaker has the power to determine whether past conduct violated some heretofore unstated law, the rule of law is rendered

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2. *See, e.g.*, Julie Andersen Hill, *Bank Capital Regulation by Enforcement: An Empirical Study*, 87 IND. L.J. 645, 706 (2012) (discussing "the appropriate balance between capital regulation by rule and capital regulation by enforcement").

3. *See, e.g.*, Binyamin Appelbaum, *Dodd-Frank Backers Clash with Regulator*, N.Y. TIMES, July 23, 2011, at B1.

4. *See, e.g.*, Press Release, Office of Sen. Jack Reed, Reed Urges a "Fundamental Rethink" of Leadership at the OCC (June 22, 2011), *available at* http://reed.senate.gov/press/release/reed-urges-a-fundamental-rethink-of-leadership-at-the-occ (expressing "extreme[] concern[] about the lack of prudent leadership at the Office of the Comptroller of the Currency").

5. Press Release, Office of the Comptroller of the Currency, Thomas J. Curry Takes Office as the 30th Comptroller of the Currency (Apr. 9, 2012), *available at* http://www.occ.gov/news-issuances/news-releases/2012/nr-occ-2012-58.html.

6. 12 U.S.C. § 84 (2006 & Supp. V 2012); *see also* 12 C.F.R. § 32.1(b) (2013) (establishing that one of the purposes of regulations issued pursuant to 12 U.S.C. § 84 is to "protect the safety and soundness of national banks and savings associations by preventing excessive loans to one person").

7. 12 C.F.R. § 32.5.

8. *See infra* Part II.

9. ARISTOTLE, POLITICS bk. IV, at 160 (Benjamin Jowett trans., Clarendon Press ed. 1908) (c. 350 B.C.E.).

10. *Id.* bk. III, at 139.

obsolete.[11] An industry should be able to know what the law is by examining the applicable laws and regulations. When the law is unclear, it is unfair for an agency to hold people accountable for violating that law.

This idea is at the heart of the regulation-by-enforcement critique. Regulation by enforcement occurs when an agency creates a piecemeal rule via enforcement actions or interpretive letters, bypassing the normal rulemaking process.[12] The regulation-by-enforcement critique has historically been applied to the Securities and Exchange Commission (SEC), but in recent years scholars have extended this critique to other agencies.[13] This Note further extends the regulation-by-enforcement critique to the OCC, an agency historically less visible than the SEC,[14] but no less important. Part I of this Note describes the regulation-by-enforcement critique. Part II explains the lending-limit law and the combination rules. Part III explains why the OCC should not rely on regulation by enforcement in the context of the combination rules.

The combination rules provide one particularly egregious example of regulation by enforcement in the field of banking regulation. With the combination rules, the OCC has established multiple per se tests according to which the OCC will aggregate loans made to two related borrowers, but the OCC has also granted itself the discretion to determine whether to aggregate loans. This grant of discretion undermines the purpose of having per se rules at all: there is little point to having the per se rules if the OCC can aggregate loans whenever it deems fit. A grant of this much discretion undermines

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11. *See* Neil MacCormick, *Natural Law and the Separation of Law and Morals*, *in* NATURAL LAW THEORY: CONTEMPORARY ESSAYS 105, 123 (Robert P. George ed., 1994) (defining the rule of law as "treating people with formal fairness, that is, in a rational and predictable way, setting public standards for citizens' conduct and officials' responses thereto, standards by which one can judge one's compliance or non-compliance, rather than leaving everything to discretionary and potentially arbitrary decision").

12. *See infra* Part I.

13. *See infra* Part I.A.

14. *Compare* Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149, 155 (1990) ("Unlike many of its sister agencies, the SEC consistently has maintained a vigorous, highly-visible, and largely successful enforcement profile."), *with* COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 66 (2006), *available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf ("By contrast [to the SEC], bank regulators, concentrating on the 'safety and soundness' of the financial system, take a prudential approach to supervision and generally do not broadly publicize their enforcement actions.").

rule-of-law values. The OCC should amend its combination rules so that the law is apparent from the text of the rules.

I. THE REGULATION-BY-ENFORCEMENT CRITIQUE

In creating law, agencies have three main options available to them: formal rulemaking, notice-and-comment rulemaking, and regulation by enforcement. Formal rulemaking is used, for instance, in some food-additive and ratemaking proceedings.[15] It is, however, a "seldom used" option[16] because it is triggered only when a statute other than the Administrative Procedure Act (APA)[17] requires a rule to be made on the record after opportunity for an agency hearing.[18] In contrast, notice-and-comment rulemaking occurs when an agency makes a rule pursuant to the APA.[19] The APA requires that agencies (1) publish a notice of proposed rulemaking, (2) provide an opportunity for public participation in the rulemaking by the submission of written comments, and (3) publish a final rule and an accompanying statement of basis and purpose not less than thirty days before the rule's effective date.[20] Notice-and-comment rulemaking is the most common way that agencies establish rules.[21]

Agencies sometimes bypass formal rulemaking and notice-and-comment rulemaking, opting instead for regulation by enforcement and for making policy through enforcement actions and interpretive letters.[22] Regulation by enforcement occurs not when an agency issues

15. JEFFREY S. LUBBERS, A GUIDE TO FEDERAL AGENCY RULEMAKING 5 (5th ed. 2012).

16. *Id.*

17. Administrative Procedure Act, 5 U.S.C. §§ 551–559, 701–706 (2006).

18. LUBBERS, *supra* note 15, at 5.

19. *Id.*

20. 5 U.S.C. § 553 (2006). The APA imposes three general requirements on the administrative process:

> First, it requires that various governmental actions be publicized, or made available to public scrutiny. . . . Second, the APA imposes various procedural requirements on rulemaking and adjudication. . . . Third, the APA grants aggrieved parties the opportunity to challenge agency action in court on the grounds that it violates the Constitution or federal statutory law, including . . . the procedural requirements of the APA.

Edward Rubin, *It's Time To Make the Administrative Process Administrative*, 89 CORNELL L. REV. 95, 100–01 (2003) (footnotes omitted).

21. LUBBERS, *supra* note 15, at 5.

22. James J. Park, *The Competing Paradigms of Securities Regulation*, 57 DUKE L.J. 625, 635–36 (2007). Interpretive letters are letters in which an agency responds to a request for guidance on the applicability of a particular regulation. Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed*

an interpretive letter to clarify a vague rule, but rather when the agency uses interpretive letters to create a rule that does not otherwise exist.[23] It is this use of interpretive letters which offends the Aristotelian ideal of the rule of law.

A. Defining Regulation by Enforcement

Since at least 1982, the SEC has received criticism for bypassing the rulemaking process and instead making policy through enforcement actions and no-action letters[24]—in other words, for regulation by enforcement.[25] Professor Roberta Karmel first articulated the regulation-by-enforcement-critique in her influential book, *Regulation by Prosecution*.[26]

Professor Karmel, a former commissioner of the SEC, wrote *Regulation by Prosecution* as "an act of self-justification, an effort to explain why and how the relationship between government and business—and more specifically, federal securities regulation—must be changed."[27] Professor Karmel was "disturbed by the spectacle of a government prosecutor failing to justify its policies and programs under its enabling legislation."[28] She argued that the SEC had been unnecessarily antagonistic toward business, pursuing certain cases without adequate authority.[29] Using examples such as SEC enforcement actions against companies for paying bribes abroad, she shows how the SEC has failed to lay out its rules so that those it has taken enforcement actions against could know what those rules were.[30]

Framework, 83 CORNELL L. REV. 921, 937 (1998). For a discussion on the often blurred distinction between interpretive letters and no-action letters, see *id.* at 937–38.

23. *See* Park, *supra* note 22, at 637 ("The 'Regulation by Enforcement' critique reflects a general sense that norms are best initiated by rulemaking whereas enforcement actions should merely enact previously defined rules.").

24. *See* ROBERTA S. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA 95 (1982) ("The evils of combining prosecutorial and adjudicative functions have been exacerbated by the [SEC's] predilection for formulating regulatory policy through the prosecution of enforcement cases.").

25. *See supra* notes 22–23 and accompanying text.

26. KARMEL, *supra* note 24.

27. *Id.* at 15.

28. *Id.* at 151.

29. *Id.* at 151–55. For a brief summary of Professor Karmel's work, see Park, *supra* note 22, at 635.

30. *See* KARMEL, *supra* note 24, at 155.

Professor Karmel's regulation-by-enforcement critique begins with a simple assertion: "Lack of corporate accountability may be troubling, but lack of accountability on the part of government is far more dangerous."[31] But the SEC, instead of taking formal action to create rules, has at times chosen to rely on case-by-case enforcement actions to develop policy.[32] For instance, in the 1970s the SEC sought to encourage publicly held corporations to use independent auditors.[33] The SEC requested the American Institute of Certified Public Accountants (AICPA) to take the position that independent auditors needed to deal with a publicly held corporation through an audit committee of independent directors, rather than through the corporation's full board of directors.[34] When the AICPA refused to do so, the SEC then brought enforcement actions against corporations that had failed to implement such a policy, without first proposing such a rule and without a congressional mandate.[35] To Professor Karmel, the SEC's regulation by enforcement did not square with the American value of governmental transparency. The rule of law requires government agencies not to operate on a case-by-case basis.

Scholars have continued to level the regulation-by-enforcement critique at the SEC.[36] Historically, however, scholars have not extended this critique to other agencies, perhaps because most agencies have not maintained an enforcement profile as "vigorous, highly-visible, and . . . successful" as has the SEC.[37] But the SEC is not unique. Like the SEC, the OCC and other banking regulators rely "on a mix of regulation by rule and regulation by enforcement."[38] The former Secretary of the Treasury, Timothy Geithner, showed his willingness to rely on regulation by enforcement, arguing that "it is imperative that regulatory capital requirements be able to adapt quickly to innovation and to changes in accounting standards and

31. *Id.* at 151.
32. *Id.* at 153.
33. *Id.* at 152–53.
34. *Id.* at 153.
35. *Id.*
36. *See generally, e.g.*, Nagy, *supra* note 22; Park, *supra* note 22; Pitt & Shapiro, *supra* note 14.
37. Pitt & Shapiro, *supra* note 14, at 155.
38. Hill, *supra* note 2, at 707.

other regulations."[39] The alternative, Secretary Geithner argued, would "produce an ossified safety and soundness framework that is unable to evolve to keep pace with change and to prevent regulatory arbitrage."[40]

Two examples in which banking regulators rely on regulation by enforcement are capital requirements and the lending-limit combination rules. Professor Julie Andersen Hill has provided a thorough discussion of the former,[41] and this Note discusses the latter. As Professor Hill explains, bank regulators have created ad hoc capital requirements for the banks, and these requirements have not been consistent from bank to bank or from regulator to regulator.[42] Capital is the difference between a bank's assets and its deposits and other liabilities.[43] A bank's capital divided by its total assets must generally equal at least 4 percent.[44] But the regulations governing bank capital requirements provide significant discretion for regulators to set capital requirements for each bank.[45] For instance, the OCC's regulations provide that the factors to be considered in determining capital requirements "vary in each case"[46] and that the OCC may consider the "overall condition, management strength, and future prospects of the bank" in making that determination.[47] The OCC has used this discretion to require banks to hold much more capital than what the 4 percent threshold would seem to require.[48] By relying on their discretionary power, bank regulators have foregone rulemaking, which would have been "less costly, more transparent, and more likely to consider macroeconomic concerns," in their quest for greater discretion.[49] It may well be that bank regulators should require banks

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39. Letter from Timothy F. Geithner, U.S. Sec'y of the Treasury, to Keith Ellison, U.S. Representative (Jan. 11, 2010), *available at* http://ellison.house.gov/images/stories/Documents/2010/01-11-10_Treasury_Letter.pdf.

40. *Id.*

41. Hill, *supra* note 2.

42. *Id.* at 648.

43. DARRYL E. GETTER, CONG. RESEARCH SERV., R42744, U.S. IMPLEMENTATION OF THE BASEL CAPITAL REGULATORY FRAMEWORK 2 (2012).

44. RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF BANKING AND FINANCIAL INSTITUTIONS 256 (4th ed. 2009).

45. Hill, *supra* note 2, at 656.

46. 12 C.F.R. § 3.11 (2013).

47. *Id.* § 3.11(c).

48. *See* Hill, *supra* note 2, at 648 ("Through discretionary capital increases implemented on a bank-by-bank basis, bank regulators are creating ad hoc capital requirements that are, in some cases, much higher than capital requirements published in regulations.").

49. *Id.* at 708.

to hold more capital as a policy matter because banks that hold more capital are better able to withstand bank runs,[50] but according to Professor Hill, the regulators should do so openly and by means of a clear rule.[51]

Like its rules for capital requirements, the OCC's combination rules for the lending-limit law grant the OCC near limitless discretion to determine when the loans made to two borrowers should be aggregated and treated as if they were made to a single borrower.[52] Because the combination rules obscure when two borrowers qualify as a single borrower, these rules obscure when a financial institution violates Congress's lending-limit law. A fuller discussion of these rules appears in Part II.

B. Why Regulation by Enforcement is Objectionable

The critics of regulation by enforcement argue that it sidesteps the rulemaking process, fails to take advantage of the expert input that comes from the rulemaking process, and unfairly surprises industry by failing to provide guidance regarding what is illegal.[53] The SEC has acknowledged that it "ha[s] been criticized for attempting to 'make new law' in an uncertain area by means of enforcement action."[54] At times, the SEC has accepted the validity of this critique and has opted instead to make policy through notice-and-comment rulemaking.[55] Yet regulation by enforcement is sometimes the only

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50. *See generally* ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT (2013) (arguing that banks should raise more capital and carry less debt). *But see* GETTER, *supra* note 43, at 7 (raising the possibility that "[i]nvestors could possibly interpret a bank's decision to raise capital as a sign that its default or funding risks may be increasing," which could lead investors to sell their stock and ironically increase the risk of bank failure). For a review of ADMATI & HELLWIG, *supra*, see John H. Cochrane, *Running on Empty*, WALL ST. J., Mar. 2, 2013, at C5.

51. Hill, *supra* note 2, at 706 (arguing that clear rulemaking "should be the preferred method of setting capital requirements").

52. *See* 12 C.F.R. § 32.5(c)(4) (stating that a common enterprise will be deemed to exist "[w]hen the [OCC] determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists").

53. Park, *supra* note 22, at 632.

54. Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 243, 249 (2012)).

55. *Id.*

option available to the SEC, in which case this method may be appropriate as a "last resort."[56]

By allowing an agency greater discretion, regulation by enforcement may have certain advantages for the agency,[57] but it adds ambiguity to the law.[58] All too often, as Professor Karmel and other scholars have explained,[59] the result of regulation by enforcement is nothing but "confusion and distrust."[60] When rules are deficient, agencies should change them and release new rules. They should not short-circuit the rulemaking process by relying on enforcement actions or interpretive letters.[61] Regulation by enforcement is unfairly surprising to industry.[62] It may cause significant economic disruption.[63] And it sidesteps the administrative scheme and the benefits it provides of expert input and deliberation.[64] Although some degree of uncertainty in the law is always to be expected,[65] regulation by enforcement takes this uncertainty to an extreme. As Professor

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56. Pitt & Shapiro, *supra* note 14, at 167; *see also id.* ("In a proper context, an administrative agency should define normative standards first, offer interpretive guidance second (to the extent feasible), and compel obedience to those standards as a last resort, when it is clear that those standards have been well publicized and comprehended, but disregarded.").

57. *See, e.g.*, Hill, *supra* note 2, at 694 ("The traditional justification for allowing regulators discretion to adjust individual bank capital requirements is that mechanically determined numerical capital requirements are insufficient to safeguard deposits in a dynamic and complex banking industry.").

58. *Id.* at 700.

59. *See, e.g.*, KARMEL, *supra* note 24, at 95 ("[The SEC enforcement] program can be attacked as creating uncertainty, leading to an unwarranted accretion of the SEC's jurisdiction, and discriminating unfairly against prosecutorial targets with interesting or novel violations."); James J. Park, *Rules, Principles, and the Competition To Enforce the Securities Laws*, 100 CALIF. L. REV. 115, 152 (2012) ("[Critics] argued that principle-enforcement did not give the industry enough notice as to what conduct was prohibited."); Park, *supra* note 22, at 635–37 ("'Regulation by Enforcement' raises concerns in that 'notions of due process require ample, advance notification of precisely what types of conduct will be prohibited, before any person may be civilly or criminally prosecuted for a violation of those standards.'" (quoting Pitt & Shapiro, *supra* note 14, at 167)).

60. COMM. ON CAPITAL MKTS. REGULATION, *supra* note 14, at 66 ("When new standards are introduced through specific enforcement actions and only later codified as explicit rules, confusion and distrust are likely to be the consequences.").

61. *Id.* at 67.

62. Park, *supra* note 22, at 632.

63. *Id.*

64. *Id.*

65. *Cf.* Grayned v. City of Rockford, 408 U.S. 104, 110 (1972) ("Condemned to the use of words, we can never expect mathematical certainty from our language.").

Karmel explains, it "transform[s]" an agency's enforcement program "into a policy-making and, therefore, highly political tool."[66]

By arguing that the regulation-by-enforcement critique applies to banking regulators just as it applies to the SEC, this Note does not deny that banks are, in certain aspects, fundamentally different from other companies. As the Supreme Court has recognized, "[b]anking is one of the longest regulated and most closely supervised of public callings."[67] At least since the introduction of deposit insurance by the Banking Act of 1933,[68] banking regulators have had a vital role to play in protecting the safety and soundness of banks.[69] This special status means that banks should indeed be subject to heavy regulation.[70] But heavy regulation can still come in the form of clear rules;[71] it need not come in the form of unfettered discretion.

66. KARMEL, *supra* note 24, at 336.

67. Fahey v. Mallonee, 332 U.S. 245, 250 (1947); *see also* Lawrence G. Baxter, *Judicial Responses to the Recent Enforcement Activities of the Federal Banking Regulators*, 59 FORDHAM L. REV. S193, S195–96 (1991) (describing the long history and relationship between banks and regulators).

68. Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.). For a history of deposit insurance in America, see generally FED. DEPOSIT INS. CORP., A BRIEF HISTORY OF DEPOSIT INSURANCE IN THE UNITED STATES (1998), *available at* http://www.fdic.gov/bank/historical/brief/brhist.pdf.

69. *See* Lawrence G. Baxter, *The Rule of Too Much Law? The New Safety/Soundness Rulemaking Responsibilities of the Federal Banking Agencies*, 47 CONSUMER FIN. L.Q. REP. 210, 211 (1993) ("From the very inception of the federal insurance system in 1933, safety and soundness has been a principal concern driving a 'cradle to grave' regime of tight regulation; it is a corollary of the federal insurance safety net upon which rests the constitutional and prudential justification for federal regulation of even state chartered depository institutions (whenever those institutions elect to become federally insured)." (citations omitted) (quoting People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311, 316 (S.D. Cal. 1951))).

70. *See* Jonathan R. Macey, *Commercial Banking and Democracy: The Illusive Quest for Deregulation*, 23 YALE J. ON REG. 1, 2–3 (2006) (arguing that regulation of banks is necessary "in heavy doses" because of banks' special characteristics). For a critique of Professor Macey's article, see Peter J. Wallison, *Banking Regulation's Illusive Quest*, 30 REGULATION, Spring 2007, at 18.

71. Granted, heavy rule-based regulation will result in regulations that span page after page. A proposed version of the Volcker Rule, for instance, covers 127 pages of the *Federal Register*. *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846, 68,846–68,972 (Nov. 7, 2011). The proposed Volcker Rule has continued to expand and, considering how many exceptions it now contains, might not be the best example of heavy bank regulation. *See* Jesse Eisinger, *The Volcker Rule, Made Bloated and Weak* N.Y. TIMES DEALBOOK BLOG (Feb. 22, 2012, 12:04 PM) http://dealbook.nytimes.com/2012/02/22/the-volcker-rule-made-bloated-and-weak (observing that the proposed Volcker Rule has become "a 530-page monstrosity of hopeless complexity and vagueness").

Many scholars have enumerated regulation by enforcement's faults. This Note focuses on five specific criticisms of regulation by enforcement levied by Professor Donna Nagy.[72] First, regulation by enforcement "produces a dearth of authoritative pronouncements on which the public and, by extension, courts, can rely for guidance."[73] After receiving an interpretive letter from the OCC, for instance, a bank may know how the OCC will act toward it, but other banks do not know how the OCC would act if presented with a slightly different fact pattern.

Second, regulation by enforcement is "an inefficient method of law making"[74] that is "time-consuming and cumbersome."[75] For instance, when capital requirements are established through regulation by enforcement, as opposed to by clear statute or regulation, banks cannot assess ex ante the amount of capital necessary to satisfy their controlling statute or regulation.[76] When regulators set capital requirements through formal or informal capital-enforcement actions, banks have a difficult time assessing the amount of capital that their regulators might require. As Professor Hill has explained, "[t]his can be costly not only for a bank receiving an enforcement action, but also for the economy as a whole."[77]

Third, regulation by enforcement "increases the likelihood of agency capture and special-interest decisionmaking," given that an interpretive letter is the result of a discussion between the regulator and the individual regulated entity requesting the letter.[78] The APA states that an agency cannot adopt a rule until all regulated entities and other interested parties have received notice and have had an opportunity to comment.[79] This broad participative process helps to prevent the agency from overlooking any considerations that ought to influence its opinion.[80] The participative process leads to better rules because it allows agencies to learn more about the subject of regulation and because it helps offset any biases that may arise during

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72. Nagy, *supra* note 22, at 957–61.

73. *Id.* at 957.

74. *Id.* at 958.

75. 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 19 (3d ed. 1995).

76. Hill, *supra* note 2, at 700.

77. *Id.*

78. Nagy, *supra* note 22, at 959 (footnote omitted).

79. 5 U.S.C. § 553(b)–(c) (2006).

80. Park, *supra* note 22, at 665–66.

the one-on-one discussion that occurs while preparing an interpretive letter.[81] Even though the participative process is not altogether immune from these biases,[82] it may weaken them.[83]

Fourth, the piecemeal nature of interpretive letters "may lead to regulatory interpretations that are inconsistent with each other or with the broader statutory framework."[84] Courts have taken notice of how inconsistent agency letters can be.[85] Historically, inconsistencies have riddled agency letters,[86] and the problem of inconsistency persists.[87] The OCC is not immune to this problem, and it has faced criticism for perceived inconsistencies between some of its interpretive letters in the past.[88]

Lastly, an agency's reliance on interpretive letters "contravenes the spirit, and arguably the letter, of the APA's notice and comment provisions."[89] Although the APA exempts "interpretive rules and statements of policy" from the notice-and-comment requirement,[90] an agency should not misuse this exemption "to accomplish indirectly

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81. Michael Asimow, *Public Participation in the Adoption of Interpretive Rules and Policy Statements*, 75 MICH. L. REV. 520, 574 (1977).

82. *See, e.g.*, Kimberly D. Krawiec, *Don't "Screw Joe the Plummer": The Sausage-Making of Financial Reform*, 55 ARIZ. L. REV. (forthcoming 2013) (manuscript at 8), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1925431 ("[T]he powerful interest groups most affected by Dodd-Frank did not waste the opportunities provided by the Volcker Rule's gaps and ambiguities. Instead, as evidenced by both public comment letters and meeting logs, they actively lobbied agencies to adopt favorable definitions, interpretations, and exemptions . . . .").

83. *See* Nagy, *supra* note 22, at 959 (contrasting the public comment process with "policymaking through the no-action letter process," which "substantially increases the likelihood of agency capture").

84. *Id.* at 960.

85. *See* Am. Fed'n of State, Cnty. & Mun. Emps. v. Am. Int'l Grp., Inc., 462 F.3d 121, 123 (2d Cir. 2006) ("[T]he group within the SEC that handles investor disclosure matters and issues no-action letters[] continued to apply this interpretation consistently for fifteen years until 1990, when it began applying a different interpretation, although at first in an ad hoc and inconsistent manner." (footnote omitted)).

86. *See generally* Lewis D. Lowenfels, *SEC No-Action Letters: Conflicts with Existing Statutes, Cases, and Commission Releases*, 59 VA. L. REV. 303 (1973) (discussing how SEC no-action letters have caused inconsistencies in a number of fields).

87. *See* Kab Lae Kim, *A Study on Rule 145 of the Securities Act of 1933: How To Provide Clarity and Predictability in Rule 145 Transactions*, 40 AKRON L. REV. 131, 169 (2007) (deriding the "excessive and inconsistent 'no-action letters'" issued by the SEC on Rule 145, 17 C.F.R. § 230.145 (2006)).

88. *See, e.g.*, Chase Manhattan Bank, N.A., OCC Interpretive Letter, 1988 OCC Ltr. LEXIS 266, at *48–50 (Aug. 8, 1988) (defending against the criticism that its "[d]ecision is inconsistent with previous OCC statements"); *see also infra* text accompanying note 104.

89. Nagy, *supra* note 22, at 960.

90. 5 U.S.C. § 553(d) (2006).

what the APA forbids it to accomplish directly" by "announc[ing] in no-action letters what are, in effect, new regulatory requirements or obligations without providing prior notice or the opportunity for public comments."[91]

Because of the harm caused by regulation by enforcement, an agency should rely on regulation by enforcement only "as a last resort."[92] Unfortunately, as is explained in Part II, the OCC has not evidenced this restraint in crafting its combination rules.

II. AN OVERVIEW OF THE COMBINATION RULES

The OCC is a bureau located within the Department of the Treasury.[93] It is one of three—formerly four[94]—agencies in charge of regulating the financial industry.[95] Its purpose is to "assur[e] the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers by, the institutions and other persons subject to its jurisdiction."[96] In addition to overall capital requirements,[97] banks also have separate risk-lowering lending limitations, which cap the amount of capital that a bank can lend to any single borrower.[98] Since the enactment of the first federal lending-limit law during the Civil War,[99] the law governing lending limits has undergone significant changes.[100] As

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91. Nagy, *supra* note 22, at 962 (criticizing SEC regulation by enforcement via no-action letters).

92. *See supra* note 56 and accompanying text.

93. 12 U.S.C. § 1(a) (2006 & Supp. V 2012).

94. The Office of Thrift Supervision (OTS) previously supervised federally insured savings banks and thrifts. Functions and Responsibilities of the Director of the Office of Thrift Supervision, 12 C.F.R. § 500.1 (2009). The OTS's role in the financial crisis led to it being labeled "the worst federal regulator on the block." Mary Kane, *Agency at Forefront of Mortgage Crisis Making a Comeback*, WASH. INDEP. (Jan. 9, 2009), http://washingtonindependent.com/24782/insurance-firms-aim-for-tarp-money-less-oversight (quoting Professor Patricia McCoy). In response, Congress eliminated the OTS. S. REP. NO. 111-176, at 25–26 (2010).

95. Hill, *supra* note 2, at 650.

96. 12 U.S.C. § 1(a).

97. *See supra* Part I.A.

98. 12 U.S.C. § 84 (2006 & Supp. V 2012).

99. Currency Act, § 47, ch. 58, 12 Stat. 665, 679 (1863) (codified as amended at 12 U.S.C. § 84); *see also* Donald E. Frechette, *National Bank Lending Limits and the Attribution Rules of 12 U.S.C. § 84: Congress and the Comptroller Cover the Bases*, 2 U. MIAMI BUS. L.J. 1, 2–4 (1991) (describing the history of the federal lending-limit law).

100. *Compare* Currency Act § 47, 12 Stat at 679 (mandating that "the total liabilities of any person, or of any company or firm . . . shall at no time exceed one third . . . of the amount of the capital stock"), *with* 12 U.S.C. § 84(a)(1) (prohibiting loans to a single borrower from "exceed[ing] 15 per centum of the [bank's] unimpaired capital and unimpaired surplus").

World War I drew to a close in 1918, Congress amended the federal lending-limit law by empowering the comptroller of the currency to develop rules regulating lending limits and to determine when loans made to two borrowers should be treated as if they were made to a single borrower.[101]

Originally, the comptroller of the currency exercised this power by means of "general rules."[102] These general rules evolved and gained some degree of specificity via administrative practice and interpretive letters, but they evolved on a case-by-case basis, without the benefit of further written rules.[103] The OCC eventually recognized that the combination rules were "inconsistently applied" and "overly complicated."[104] The 1982 passage of the Garn-St. Germain Depository Institutions Act[105] finally propelled the OCC to delineate its combination rules more clearly. At the time, the OCC stated that it needed to provide clear combination rules and that the alternative—the combination of loans on a *post hoc* basis—was "wholly undesirable."[106] The OCC noted two reasons why this alternative was so undesirable. First, "if combination of loans were to be done only on a post hoc basis, banks would have little, if any, certainty as to how to operate to avoid violations of Section 84 and the attendant possibility of directors' liability."[107] Second, "[t]he [OCC], in turn, would find itself faced with an endless stream of requests for opinion letters from banks wishing to operate cautiously; examiners would be equally overburdened in their attempts to judge each set of circumstances on its facts."[108] Unfortunately, the OCC has stopped short in its commitment to clear rules.

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101. Supplement to Second Liberty Bond Act, § 6, ch. 176, 40 Stat. 965, 967 (1918).

102. National Bank Lending Limits, 47 Fed. Reg. 56,862, 56,863 (Dec. 21, 1982) (codified in scattered sections of 12 C.F.R.).

103. National Bank Lending Limits, 48 Fed. Reg. 15,844, 15,846 (Apr. 12, 1983) (codified in scattered sections of 12 C.F.R.). An "interpretive letter" in the OCC context is the same as a "no-action letter" in the SEC context. *See* Joshua E. Broaded, *A Survey of Regulations Applicable to Investment Advisers*, 12 DUQ. BUS. L.J. 27, 31 (2009) ("These public letters, which are often called 'no-action letters' or 'interpretive letters,' can then be considered by other[s] . . . grappling with similar questions.").

104. National Bank Lending Limits, 48 Fed. Reg. at 15,846.

105. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat 1469, (codified as amended in scattered sections of 12 U.S.C.).

106. National Bank Lending Limits, 48 Fed. Reg. at 15,846.

107. *Id.*

108. *Id.*

A. The Current Law

Section 84 of Title 12 of the United States Code sets the federal lending limit for national banks. A national bank is a bank chartered under federal, not state, law.[109] A national bank may not loan more than 15 percent of its unimpaired capital and unimpaired surplus to any one borrower, if not fully secured by collateral with a market value at least equal to the amount of the loan.[110] A national bank may, however, issue an additional fully secured loan to a maxed-out borrower if the loan does not exceed 10 percent of the bank's unimpaired capital and unimpaired surplus.[111] The law also authorizes the OCC to adopt rules governing "when a loan putatively made to a person shall for purposes of this section be attributed to another person."[112]

Section 32.5 of Title 12 of the Code of Federal Regulations, adopted pursuant to Section 84, prescribes that two borrowers will be combined and deemed to be one borrower "[w]hen proceeds of a loan . . . are to be used for the direct benefit of the other person . . . or . . . [w]hen a common enterprise is deemed to exist between the persons."[113] It also contains specialized rules for the aggregation of loans (1) to a "corporate group";[114] (2) to foreign governments, their agencies, and their instrumentalities;[115] and (3) to partnerships, joint ventures, and associations.[116]

109. Eliot C. Schaefer, Comment, *The Credit Card Act of 2009 Was Not Enough: A National Usury Rate Would Provide Consumers with the Protection They Need*, 41 U. BALT. L. REV. 741, 747 n.65 (2012).

110. 12 U.S.C. § 84(a)(1) (2006).

111. *Id.* § 84(a)(2).

112. *Id.* § 84(d)(2).

113. 12 C.F.R. § 32.5(a) (2013).

114. *Id.* § 32.5(d)(1). A loan to a corporate group may not exceed 50 percent of a bank's capital and surplus. *Id.* A "corporate group" is defined as "a person and all of its subsidiaries," and a person's "subsidiary" is defined as a corporation or a limited liability company for which the person "owns or beneficially owns directly or indirectly more than 50 percent of [its] voting securities or voting interests." *Id.*

115. *Id.* § 32.5(f). Loans to foreign governments, their agencies, and their instrumentalities are aggregated with one another only if the loans fail to satisfy one of two tests: either (1) "the borrower has resources or revenue of its own sufficient to service" the loan, or (2) the purpose of the loan "is consistent with the purposes of the borrower's general business." *Id.* § 32.5(f)(1).

116. *Id.* § 32.5(e). A loan to a partnership, joint venture, or association is deemed to be a loan to each member of the partnership, joint venture, or association so long as the member is liable for the loan, but a loan to a member of a partnership, joint venture, or association is not attributed to the partnership, joint venture, or association unless the loan satisfies the direct-benefit or common-enterprise test. *Id.*

Section 32.5 attempts to provide further guidance by defining what constitutes a "direct benefit" or a "common enterprise."[117] Under the direct-benefit test, the proceeds of a loan will be attributed to another person "when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction."[118] One example of the OCC's reliance on the direct-benefit test arises from the OCC's enforcement action against Texas National Bank.[119] The bank issued loans to (1) a wealthy individual with an estimated net worth of several hundred million dollars, (2) his spouse, (3) twenty corporations owned by the family, and (4) their children.[120] The family created the twenty corporations to hold shopping-center properties that the family already personally owned.[121] The purported purpose of the loans to the corporations was to finance the borrowers' "purchases" of the shopping-center properties.[122] After the so-called purchases, proceeds of the loans were either paid in cash to the family or were "used to pay off any outstanding mortgages on the properties transferred."[123] Subsequently, the children received a majority interest in each of the twenty corporations.[124] Thus, "the entire matter was motivated by estate planning considerations."[125] Because the proceeds of the loans were used for "an intra-family restructuring of assets," rather than for a "bona fide commercial transaction," the loans were all for the direct benefit of the family; therefore, the OCC aggregated the loans.[126]

The direct-benefit test is not the only test at the OCC's disposal. The common-enterprise tests allow the OCC to aggregate loans when the connection between the borrowers is less direct. The OCC's regulations include three per se common-enterprise tests and one catch-all test.[127] Unlike the catch-all test, the regulation's three per se

117. *Id.* § 32.5(b)–(c).

118. *Id.* § 32.5(b).

119. Tex. Nat'l Bank Baytown, Tex., No. OCC-AA-EC-92-88, 1994 OCC Enf. Dec. LEXIS 272 (Apr. 20, 1994).

120. *Id.* at *4–5.

121. *Id.*

122. *Id.* at *5–6.

123. *Id.* at *6.

124. *Id.* at *10.

125. *Id.* at *11–12.

126. *Id.* at *12.

127. *See* 12 C.F.R. § 32.5(c) (2013).

common-enterprise tests provide guidance to national banks trying to abide by the lending-limit law.

The first per se common-enterprise test declares a common enterprise to exist when the expected source of repayment for two loans "is the same for each borrower and neither borrower has another source of income from which the loan . . . may be fully repaid."[128] For instance, Corporation A and Corporation B both have loans from the same bank.[129] Corporation A derives all of its income from the production of sausage, and each year it sells all of its sausage to Corporation B. In turn, the income of corporation B is 100 percent derived from the retail marketing of Corporation A's sausage; Corporation B does not receive any sausage from any other corporation. The expected source of repayment for both loans is effectively the same, and neither borrower has another source of income with which to repay the loans; therefore, the loans are for a common enterprise, and the OCC would aggregate them.[130]

The second per se common-enterprise test declares a common enterprise to exist when loans are made "[t]o borrowers who are related directly or indirectly through common control," provided that "50 percent or more of one borrower's gross receipts or gross expenditures . . . are derived from transactions with the other borrower."[131] For instance, a bank makes loans both to a Subchapter S corporation and to the 100 percent owner of that corporation.[132] Seventy-two percent of the owner's gross receipts come from that corporation.[133] Pursuant to the second per se common-enterprise test, the owner and the corporation are related through common control, and substantial financial interdependence exists between them; therefore, the OCC would aggregate these loans.[134]

The third per se test declares a common enterprise to exist when the borrowers' purpose in obtaining the loans is "to acquire a

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128. *Id.* § 32.5(c)(1).

129. The example used here is based on an example in the Missouri Code of State Regulations. *See* MO. CODE REGS. ANN. tit. 20, § 1140-2.080(3)(A) (2013).

130. *See* 12 C.F.R. § 32.5(c)(1) (deeming a common enterprise to exist "[w]hen the expected source of repayment for each loan or extension of credit is the same for each borrower and neither borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid").

131. *Id.* § 32.5(c)(2).

132. [Redacted], OCC Interpretive Letter No. 938, O.C.C. Q.J., Dec. 2002, at 31, 33 (Jan. 18, 2001).

133. *Id.* at 33 n.10.

134. *Id.* at 32–33 (citing 12 C.F.R. § 32.5(c)(2) (2000)).

business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests."[135] For instance, a bank makes loans to six individual borrowers, each of whom uses the loans to invest in a new limited liability company.[136] Combined, the six borrowers hold 100 percent of the membership interests in that company.[137] Even if each borrower were a longstanding bank customer with significant net worth, the OCC would aggregate the loans pursuant to the third per se common-enterprise test because all loan proceeds were used "to invest in and acquire more than 50 percent of a business enterprise."[138]

In contrast to these per se common-enterprise tests, the OCC has promulgated a catch-all test. The OCC deems a common enterprise to exist "[w]hen [it] determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists."[139] The presence of this unfettered discretion should cause concern to any bank that is trying to decipher the OCC's rules. To determine whether the OCC will aggregate certain loans pursuant to the catch-all provision, banks have no other option but to spend time and money requesting an interpretive letter from the OCC, which the OCC has acknowledged may flood the OCC "with an endless stream of requests for opinion letters" regarding the scope of the catch-all test.[140]

The OCC has cited thirteen factors as having some bearing on whether the OCC will determine that a common enterprise exists, but it has not attempted to establish any additional per se rules based on these factors. These thirteen factors are as follows:

(1) engaging in supporting lines of business;
(2) interchange of goods and services;
(3) common ownership of assets;
(4) common management;
(5) use of common facilities;
(6) commingling of assets and liabilities;

135. 12 C.F.R. § 32.5(c)(3) (2012).

136. [Redacted] Nat'l Bank, OCC Interpretive Letter No. 863, O.C.C. Q.J., Dec. 1999, at 49, 49 (July 22, 1999).

137. *Id.*

138. *Id.* at 4.

139. 12 C.F.R. § 32.5(c)(4).

140. National Bank Lending Limits, 48 Fed. Reg. 15,844, 15,846 (Apr. 12, 1983) (codified in scattered sections of 12 C.F.R.).

(7) closely related business activities;
(8) similarity in structure, financing and holding;
(9) use of same business address;
(10) centralized cash management program;
(11) likelihood that a financially troubled member of the group would receive financial aid from other members of the group;
(12) family relationships among the borrowers; and
(13) pledging of assets to support another person's loans.[141]

The OCC has provided no guidance as to how these thirteen factors are to be weighed against one another, or how many factors are required to warrant combination.

Notwithstanding its pro-industry reputation,[142] the OCC has expressed its willingness to rely on the facts-and-circumstances provision of the combination rules,[143] which grants the OCC the authority to deem a common enterprise to exist ad hoc.[144] In an interpretive letter, the OCC has explicitly rebuked the notion that this provision is "merely a prefatory statement."[145] The OCC has recognized the concern about "the extent to which this regulation grants to examiners discretion to judge when a common enterprise exists."[146] It has rejected the notion "that the facts and circumstances provision must be directly, substantially, and demonstrably tied to the three *per se* tests which follow," even if "otherwise the provision becomes an ambiguous standard that can only be applied on a *post hoc* basis during the examination process."[147] The facts and circumstances provision "is indeed a stand alone provision,"[148] and,

141. [Redacted], OCC Interpretive Letter No. 938, O.C.C. Q.J., Dec. 2002, at 31, 33 (Jan. 18, 2001); *accord* [Redacted], OCC Interpretive Letter No. 925, O.C.C. Q.J., June 2002, at 65, 66 (Apr. 12, 2001).

142. *See* Elizabeth Warren, *Redesigning Regulation: A Case Study from the Consumer Credit Market*, *in* GOVERNMENT AND MARKETS: TOWARD A NEW THEORY OF REGULATION 391, 410 (Edward J. Balleisen & David A. Moss eds., 2010) ("But the[] main mission [of the OCC and other banking regulators] is to protect the financial stability of banks and other financial institutions, not to protect consumers. As a result, they focus intently on bank profitability and the maintenance of sufficient capital reserves relative to outstanding loans, and far less on the financial impact that many of the products sold by the banks will have on consumers.").

143. *See supra* note 139 and accompanying text.

144. 12 C.F.R. § 32.5(c)(4).

145. [Redacted], OCC Interpretive Letter No. 563, 11-1 O.C.C. Q.J., Mar. 1992, at 71, 71 (Sept. 6, 1991).

146. *Id.*

147. *Id.*

148. *Id.*

with it, the OCC has "reserve[d] the ability to attribute loans under the general rule even when none of the specific rules is directly applicable."[149]

The OCC "believe[s] that instances where the facts and circumstances test will apply to the exclusion of the *per se* rules will be rare."[150] But this may not always be the case. Considering the increasing negative press against the OCC in the wake of the 2008 recession,[151] the OCC's moderation might not continue. Senators Jack Reed and Carl Levin have advocated for President Obama "to fundamentally re-think the OCC's leadership" after comments by John Walsh, the former acting comptroller of the currency, that warned against the danger of excessive financial regulation.[152]

To determine whether the OCC will aggregate certain loans pursuant to the catch-all provision, banks may write to the OCC and request an interpretive letter.[153] The ability to request an interpretive letter and inquire into whether the OCC will aggregate loans to two borrowers mitigates the sympathy that a court or the public may have for a bank that falls victim to the regulation's facts-and-circumstances provision.[154] Nevertheless, the regulation-by-enforcement critique, which argues that agencies should establish readily understandable per se rules, counsels against the OCC's reliance on interpretive letters if the law could be made clear without them.[155]

149. *Id.* at 72 (quoting National Bank Lending Limit, 54 Fed. Reg. 43,398, 43,402 (Oct. 24, 1989) (codified at 12 C.F.R. pt. 7, 32)).

150. *Id.* at 73.

151. *See, e.g.*, Appelbaum, *supra* note 3 ("'The O.C.C. is acting as if there was never a financial crisis,' said Dennis Kelleher, president of Better Markets, a nonprofit group that advocates for increased regulation of the financial industry. 'It's just an utterly indefensible abdication of its responsibility to the American people.'").

152. Press Release, Office of Sen. Jack Reed, *supra* note 4; *see also* John Walsh, Comptroller of the Currency, Remarks Before the Centre for the Study of Financial Innovation (June 21, 2011), *available at* http://www.occ.treas.gov/news-issuances/speeches/2011/pub-speech-2011-78.pdf (advocating for "*caution* regarding the cumulative effects" of increased banking regulation).

153. *Cf.* National Bank Lending Limits, 48 Fed. Reg. 15,844, 15,846 (Apr. 12, 1983) (codified in scattered sections of 12 C.F.R.) (noting that cautious banks may flood the OCC "with an endless stream of requests for opinion letters" regarding the scope of § 32.5).

154. *See* Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1982) ("[E]conomic regulation is subject to a less strict vagueness test because [inter alia] . . . the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry . . . .").

155. *See supra* Part I.

Even the OCC has recognized that the combination rules would ideally consist of per se rules: when amending the combination rules, the OCC has attempted to "set[] forth clear rules which were internally consistent and were logical from both a legal and financial perspective."[156] For instance, in 1995, the OCC amended the combination rules to remove a second facts-and-circumstances catch-all provision from the direct-benefit test.[157] In making this change, the OCC declared that its purpose was "to improve certainty regarding the application of the test."[158] Thus, despite maintaining the facts-and-circumstances provision of the common-enterprise test,[159] the OCC conceded the desirability of crafting clear combination rules.

Following the federal government's lead, many states have enacted statutes or regulations that mirror the federal scheme and that permit their states' banking regulators to make similar ad hoc determinations.[160] Despite the pervasive mimicry of the federal

156. National Bank Lending Limits, 48 Fed. Reg. at 15,846.

157. Lending Limits, 60 Fed. Reg. (Feb. 15, 1995) (codified at 12 C.F.R. pt. 32).

158. *Id.*

159. *Id.*

160. *See, e.g.*, CONN. GEN. STAT. ANN. § 36a-262(b)(4) (West 2011) (aggregating loans "[w]hen the commissioner determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists"); IDAHO CODE ANN. § 26-705(5)(b)(iv) (Supp. 2012) (aggregating loans "[w]hen the director determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists"); IOWA CODE § 524.904(6)(e) (2011) (aggregating loans "[w]hen the superintendent determines the interests of a group of more than one borrower, or any combination of the members of the group, are so interrelated that they should be considered a unit"); KAN. STAT. ANN. § 9-1104(f)(6) (2001) ("[T]he commissioner may determine, based upon an evaluation of the facts and circumstances of a particular transaction, that a loan to one borrower may be attributed to another borrower."); COLO. CODE REGS. § 701-101.64(H)(3)(d) (2013) (aggregating loans when "[t]he Banking Board determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists"); GA. COMP. R. & REGS. 80-1-5.11(3)(d) (2012) (aggregating loans when "the Department determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exi[s]ts"); NEV. ADMIN. CODE § 662.008(3)(b)(3) (2011) (aggregating loans when "[a]ny other circumstances exist which indicate that one or more persons acting in concert directly or indirectly exercises a controlling influence over the management of policies of another person"); N.Y. COMP. CODES R. & REGS. tit. 3, § 77.3 (2013) (authorizing "the Banking Department [to] criticize such undue concentration of credit [among multiple borrowers] and [to] take such other supervisory action with respect thereto as may be deemed necessary or appropriate," even if a bank's loans do not otherwise fall within the regulation's combination rules); OHIO ADMIN. CODE 1301:1-3-01(D)(3)(d) (2013) (aggregating loans when "the superintendent determines, based upon an evaluation of the facts and circumstances or particular transactions, that a common enterprise exists"); OKLA. ADMIN. CODE § 85:10-11-10(b)(2)(A) (2012) (noting that "[w]hether two or more persons are engaged in a 'common enterprise' will depend upon a realistic evaluation of the facts and circumstances of particular

scheme, some states, including Delaware, Alaska, and Montana, have refrained from granting an agency the ability to make ad hoc determinations, choosing instead to use only per se rules to determine whether to aggregate certain loans for state banks.[161] In these states, state banks can turn to the respective combination rules and understand them without needing to request an interpretive letter.

Interestingly, these three states—Delaware, Alaska, and Montana—have not suffered a single bank failure between October 1, 2000 (when the FDIC's data begins) and April 5, 2013, although more than five hundred banks in other states have failed during this period.[162] Although the successes of these states cannot be attributed to their clearly delineated per se combination rules, they do provide evidence that regulation by enforcement is not a categorical necessity for combination rules. The OCC should learn from these states, which serve as "social laboratories" from which other states and the federal government might learn.[163]

B. The Penalty for a Violation

Violating the lending-limit law may lead to a substantial penalty, and, under the facts-and-circumstances provision, a person may violate the law unknowingly. The federal lending-limit law conditions punishment on the commission of a knowing violation of the law,

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transactions"); OR. ADMIN. R. 441-505-3080(4) (2013) (aggregating loans when "the Director determines, based upon an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists"); 7 TEX. ADMIN. CODE § 12.9(a)(4) (2012) (aggregating loans when "the banking commissioner determines that a loan should be attributed to another person"); WASH. ADMIN. CODE § 208-512-260(2) (2013) (noting that "whether a 'common enterprise' exists depends upon a realistic evaluation of the facts and circumstances of the particular transaction"); W. VA. CODE R. § 106-9-4.2(a) (2013) (noting that "[w]hether two . . . or more persons are engaged in a common enterprise depends upon a realistic evaluation of the facts and circumstances of particular transactions").

161. *See, e.g.*, DEL. CODE. ANN. tit. 5, § 909(c) (2001) (excluding any mention of "common enterprise"); ALASKA ADMIN. CODE tit. 3, § 02.125(c) (2008) (roughly tracking 12 C.F.R. § 32.5 but not including a "facts and circumstances" provision); MONT. ADMIN. R. 2.59.108 (2013) (largely replicating 12 C.F.R. § 32.5 but not including a "facts and circumstances" provision).

162. *See Failed Bank List*, FED. DEPOSIT INS. CORP. (Apr. 5, 2013), http://www.fdic.gov/bank/individual/failed/banklist.html. Faring equally well were Maine, North Dakota, Rhode Island, and Vermont. *See id.* The relatively small populations of these seven states may in part explain why these states had no bank failures.

163. *See, e.g.*, Chandler v. Florida, 449 U.S. 560, 579 (1981) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." (quoting New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting))).

thereby protecting directors who negligently violate the law.[164] Yet the word "knowingly" does not excuse a defendant who knowingly engages in certain conduct but who is ignorant that the law prohibits such conduct.[165] A legal mistake is generally irrelevant to the courts.[166] Although some states have written a fair-notice requirement into their respective lending-limit laws or regulations,[167] the federal scheme does not require fair notice.[168] Granted, courts may nevertheless read the OCC's regulations to contain a fair-notice requirement, as they have in other contexts.[169] However, courts rarely do so.[170] Therefore, if

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164. 12 U.S.C. § 93(a) (2006). The Supreme Court has discussed in detail the mens rea requirement for a lending-limit violation:

> [I]t must appear not only that the liabilities of a person, company, firm, etc., to the [b]ank for money borrowed were permitted to exceed the prescribed limit, but that [the bank director] . . . participated in or assented to the excessive loan or loans not through mere negligence but knowingly and in effect intentionally, with this qualification, that if he deliberately refrained from investigating that which it was his duty to investigate, any resulting violation of the statute must be regarded as "in effect intentional."

Corsicana Nat'l Bank of Corsicana v. Johnson, 251 U.S. 68, 71–72 (1919) (quoting Yates v. Jones Nat'l Bank, 206 U.S. 158, 180 (1907)) (applying the law that preceded 12 U.S.C. § 84 (2006 & Supp. V 2012)).

165. *See, e.g.*, Hamling v. United States, 418 U.S. 87, 123–24 (1974) ("To require proof of a defendant's knowledge of the legal status of the [conduct committed] would permit the defendant to avoid prosecution by simply claiming that he had not brushed up on the law. Such a formulation of the scienter requirement is [not] required . . . .").

166. *See, e.g.*, United States v. Wilson, 133 F.3d 251, 264 (4th Cir. 1997) ("[T]he government need prove only that the defendant knew the operative facts which make his action illegal. The government need not prove that the defendants understood the legal consequences of those facts or were even aware of the existence of the law granting them significance."); *see also* 21 AM. JUR. 2D *Criminal Law* § 137 (2011) ("[I]t is a deeply rooted common-law principle that ignorance or mistake of law provides no defense or excuse for a crime.").

167. *See, e.g.*, IOWA CODE § 524.904(6)(e) (2011) (giving banks an opportunity to cure a violation of the Iowa lending-limit law after Iowa's superintendent of banking has deemed a violation to exist); MINN. STAT. § 48.24(8) (2012 & Supp. 2013) (requiring a willful violation, as opposed to a knowing violation, before an officer or employee of the bank becomes "personally liable to the bank for the amount of the loan in excess of the statutory limit"); OKLA. ADMIN. CODE § 85:10-11-10(d)(7) (2012) (giving banks an opportunity to cure an "inadvertent" violation).

168. 12 U.S.C. § 93 (2006).

169. *See, e.g.*, Beaver Plant Operations, Inc. v. Herman, 223 F.3d 25, 31 (1st Cir. 2000) (establishing that in the absence of a clearly articulated standard, the Occupational Safety and Health Administration (OSHA) could not demonstrate a violation without showing "fair notice of its interpretation of the cited standard"); Upton v. SEC, 75 F.3d 92, 98 (2d Cir. 1996) (explaining that the court would violate due process by deferring to the SEC's interpretation of its own rules if "doing so would penalize an individual who has not received fair notice of a regulatory violation"); Gen. Elec. Co. v. EPA, 53 F.3d 1324, 1333–34 (D.C. Cir. 1995) (holding, in light of unclear EPA policies, that "where the agency itself struggles to provide a definitive reading of the regulatory requirements, a regulated party is not 'on notice' of the agency's ultimate interpretation of the regulations, and may not be punished"); Phelps Dodge Corp. v.

the OCC exercises its right under the combination rules to decide ad hoc that it will aggregate two loans, then a bank and its directors may violate the lending-limit law, even if they had no reason to know that the OCC would aggregate the two loans.

The penalty for a knowing violation of the federal lending-limit law may include the forfeiture of "all the rights, privileges, and franchises of the [national banking] association."[171] For example, after the directors of a California bank exceeded that bank's lending limit and attempted to game the combination rules, the OCC issued an order "prohibiting [them] from further participation in the banking industry."[172] In addition, the order stated that every director of a bank "who participated in or assented to [a violation] shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation."[173] After another California bank exceeded its lending limit, its directors were held personally liable for the difference between the bank's actual lending limit and the amount of money it lost on its defaulted, excessive loans.[174] A civil penalty, in certain situations, may also be assessed against an infracting bank in

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Fed. Mine Safety & Health Review Comm'n, 681 F.2d 1189, 1193 (9th Cir. 1982) (holding that unclear Mine Safety and Health Review Commission regulations cannot form the basis of civil and criminal penalties); Kent Nowlin Constr. Co. v. Occupational Safety & Health Review Comm'n, 593 F.2d 368, 371 (10th Cir. 1979) (explaining that "an employer is not required to assume the burden of guessing what the Secretary [of OSHA] intended the safety regulations to mean"); Diebold, Inc. v. Marshall, 585 F.2d 1327, 1335 (6th Cir. 1978) (identifying "adequate warning of what [statutes and regulations] command or forbid" as "fundamental" to due process); Diamond Roofing Co. v. Occupational Safety & Health Review Comm'n, 528 F.2d 645, 650 (5th Cir. 1976) (refusing to construe regulations liberally and noting that "the Secretary [of OSHA] has the responsibility to state with ascertainable certainty what is meant by the standards he has promulgated").

170. Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1982) ("The degree of vagueness that the Constitution tolerates—as well as the relative importance of fair notice and fair enforcement—depends in part on the nature of the enactment. Thus, economic regulation is subject to a less strict vagueness test because its subject matter is often more narrow, and because businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action. Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process." (footnotes omitted)); *see also* John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 COLUM. L. REV. 612, 670–71 n.282 (1996) ("[T]he [Supreme] Court has never held that an agency interpretation of a regulation was invalid because of a lack of fair notice.").

171. 12 U.S.C. § 93(a) (2006).

172. Ulrich, No. AA-EC-00-40, 2003 OCC Ltr. LEXIS 82, at *77–78 (Jan. 31, 2003).

173. 12 U.S.C. § 93(a).

174. Del Junco v. Conover, 682 F.2d 1338, 1342–43 (9th Cir. 1982).

an amount up to $1,000,000, although more modest civil penalties are usually assessed.[175] For instance, the OCC assessed a penalty of only $5,000 against the president of a Texas bank after that bank exceeded its lending limit by over $1 million.[176] The OCC has assessed penalties as high as $100,000.[177] Thus, the penalties for a violation of the lending-limit law may be substantial, and, under the facts-and-circumstances provision, a person may violate the law even though no per se rule proscribes the person's conduct.

III. APPLYING THE REGULATION-BY-ENFORCEMENT CRITIQUE TO THE OCC'S COMBINATION RULES

In light of these stiff penalties, the regulation-by-enforcement critique weighs particularly heavy on the combination rules. Thus, before applying the regulation-by-enforcement critique, it is crucial to understand why the OCC would use regulation by enforcement in this context. This Part explains why the OCC has rejected the notion "that the facts and circumstances provision must be directly, substantially, and demonstrably tied to the three *per se* tests which follow," even when "otherwise the provision becomes an ambiguous standard that can only be applied on a *post hoc* basis during the examination process."[178]

A. An Attempt at Justifying the Facts and Circumstances Provision

The primary reason for the OCC's decision to rely on regulation by enforcement is to thwart those who would endeavor to find loopholes around the combination rules. The OCC has declared that it crafted the combination rules with an eye to "attempt[ing] to eliminate many of the[] loopholes" that had previously permitted banks and borrowers to circumvent the rule.[179] The OCC sought to prevent the combination rules from being underinclusive, as notice-

175. 12 U.S.C. § 93(b)(4).

176. Jordan, No. 2009-064, 2009 OCC Enf. Dec. LEXIS 68, at *1–4 (2009).

177. [Redacted], No. OCC AA-EC-88-17, 1989 OCC Enf. Dec. LEXIS 26, at *1 (1989).

178. [Redacted], OCC Interpretive Letter No. 563, O.C.C. Q.J., Mar. 1992, at 71, 71 (Sept. 6, 1991).

179. National Bank Lending Limits, 48 Fed. Reg. 15,844, 15,847 (Apr. 12, 1983) (codified in scattered sections of 12 C.F.R.).

and-comment rulemaking may be too slow to respond to those who would exploit loopholes in the combination rules.[180]

The avoidance of loopholes is a legitimate concern.[181] Would-be lawbreakers are creative,[182] and neither a legislative body nor an administrative agency can outsmart them quickly enough.[183] Regulations generally do not apply retroactively,[184] and rulemaking is a slow process.[185] Even though courts often look with disfavor upon crafty would-be lawbreakers,[186] the OCC may fear that these lawbreakers could find ways to avoid the per se combination rules and thereby avoid punishment.[187]

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180. *See* Pitt & Shapiro, *supra* note 14, at 156 ("[T]here are administrative benefits to . . . regulation by enforcement. Among other things . . . the agency is able to react to specific facts[] and tailor its responses to each new situation; [and] the agency is not required to conform its actions to procedures that can . . . delay the articulation of new legal standards . . . .").

181. *See, e.g.*, Freeman United Coal Mining Co. v. Fed. Mine Safety & Health Review Comm'n, 108 F.3d 358, 362 (D.C. Cir. 1997) ("[B]y requiring regulations to be too specific [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation." (second alteration in original) (quoting Ray Evers Welding Co. v. Occupational Safety & Health Review Comm'n, 625 F.2d 726, 730 (6th Cir. 1980))); State v. Wilchinski, 700 A.2d 1, 6 (Conn. 1997) ("[I]t is apparent that in many instances the uncertainty [in a statute] is merely attributable to a desire not to nullify the purpose of the legislation by the use of specific terms which would afford loopholes through which many could escape." (quoting WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., CRIMINAL LAW 84–85 (1972)) (quotation marks omitted)).

182. *See, e.g.*, Judith Yates Borger, *High Drama in the Courts: Bar Owners Try To Skirt State's Smoking Ban*, MINN. POST (Apr. 28, 2008), http://www.minnpost.com/stories/2008/04/28/1585/high_drama_in_the_courts_bar_owners_try_to_skirt_states_smoking_ban (describing various attempts by bar owners to utilize loopholes in state smoking laws, including a Minnesota bar's attempt to label its patrons as actors to take advantage of an exception to a smoking ban for theatrical performances).

183. *See* Dan M. Kahan, *Ignorance of Law Is an Excuse—But Only for the Virtuous*, 96 MICH. L. REV. 127, 138 (1997) ("Because the means by which bad people can invade the rights of others are infinitely numerous and diverse, any attempt to specify them all by statute is bound to be incomplete.").

184. *See* Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988) ("Retroactivity is not favored in the law. Thus . . . administrative rules will not be construed to have retroactive effect unless their language requires this result.").

185. Park, *supra* note 22, at 668.

186. When a court must rule either for someone who is sincerely trying to enforce a law or someone who is deliberately and mischievously trying to circumvent the law, the court is unlikely to rule for the latter. *See, e.g.*, Taverns for Tots, Inc. v. City of Toledo, 307 F. Supp. 2d 933, 940–42 (N.D. Ohio 2004) (recognizing that the plaintiff, "a sham corporation," ostensibly qualified under an exemption to the Toledo smoking ordinance and that the court could not in this case pierce the corporate veil, but nevertheless refusing to allow the plaintiff to benefit from the exemption, "despite [the sham corporation's] putative or even partially eleemosynary purposes").

187. *See* Albert C. Lin, *Refining Fair Notice Doctrine: What Notice Is Required of Civil Regulations?*, 55 BAYLOR L. REV. 991, 1024 (2003) ("Writing a rule with greater specificity

Due to the threat posed by loopholes, some regulations arguably require regulation by enforcement to be successful.[188] For instance, Congress and the SEC have purposefully refused to codify a definition of insider trading.[189] When more than half of traders are willing to admit that they would act upon an illegal tip if they could avoid detection,[190] the SEC's use of regulation by enforcement to prevent insider trading is "not astonishing" because it is trying to attack an almost existential problem.[191] For insider trading, regulation by enforcement may arguably be necessary to deter traders who are determined to find ways to circumvent the law.[192] However, insider trading is a special case. Whether regulation by enforcement is appropriate for insider trading has little bearing on whether regulation by enforcement is appropriate for the OCC.

B. Why Regulation by Enforcement Is Inappropriate for the Combination Rules

At times, regulation by enforcement can perhaps be an appropriate means of preventing the exploitation of loopholes, but it must be fair to the regulated industry. For regulation by enforcement to be fair, two characteristics must be present. First, the result of the agency's ad hoc decision must be based on an overarching principle

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increases the risk of 'loopholing,' as regulated entities seek creative ways to skirt the law's edges without violating it. Regulatory vagueness, by making the outer edges of the law uncertain, discourages regulated entities' efforts to find loopholes in the law." (footnotes omitted)).

188. *See* Park, *supra* note 22, at 681–88 (discussing when regulation by enforcement is warranted).

189. *See* Ted Kamman & Rory T. Hood, *With the Spotlight on the Financial Crisis, Regulatory Loopholes, and Hedge Funds, How Should Hedge Funds Comply with the Insider Trading Laws?*, 2009 COLUM. BUS. L. REV. 357, 398 ("The SEC, as well as Congress, seem to have concluded that the definition of insider trading is better developed through the common law approach of case-by-case decisions rather than through codification."); *Enactment of Insider Trading Bill Unlikely This Year, SEC Official Says*, 20 Sec. Reg. & L. Rep. (BNA) 323, 324 (1988) ("[House Energy and Commerce Committee Chairman] Dingell opposes legislation to define insider trading because he believes it would narrow the SEC's ability to bring enforcement actions . . . .").

190. *See* Roger Lowenstein, *The Greed Police*, N.Y. TIMES MAG., Sept. 25, 2011, at 36, 38 ("In a survey of 2,500 traders taken in 2007, more than half said they would take advantage of an illegal tip if they were assured they wouldn't be caught.").

191. Kamman & Hood, *supra* note 189, at 398.

192. *See* Lowenstein, *supra* note 190, at 38 ("Though lawmakers have proposed legislation codifying insider trading in the statutes, the S.E.C. seems to prefer a common-law approach, on the theory that it will be a less fixed—thus a more worrisome—deterrent."). *But see generally* Pitt & Shapiro, *supra* note 14 (criticizing the SEC for relying on regulation by enforcement for insider-trading cases).

that is well-established so that the regulated industry may effectively have had fair notice that it should not have pursued a given course of action.[193] Second, to justify regulation by enforcement, the public must face significant harm as a result of the misconduct.[194]

If the overarching principle motivating the combination rules is not well-established, then regulation by enforcement is not justified, because the regulated industry could not intuit that it should not have issued the loans that it issued.[195] The OCC has given scant guidance on when it will deem a common enterprise to exist based on the facts and circumstances of a given situation, and the motivating principle behind the application of the facts-and-circumstances test is neither intuitive nor well-established. The OCC's only guidance has come in the form of a thirteen-factor list—factors which may contribute toward such a finding.[196] These thirteen factors are broad and include "engaging in supporting lines of business, interchange of goods and services, . . . use of common facilities, . . . closely related business activities, similarity in structure, . . . likelihood that a financially troubled [borrower] would receive financial aid from [the other borrower], [and] family relationships."[197] Due to these factors' breadth, a bank can know whether the OCC will utilize the catch-all provision only if it first requests an interpretive letter. So long as none of the three per se common-enterprise tests are met, a bank cannot expect that a common enterprise exists. Because the principle behind the facts-and-circumstances test is not well-established, the OCC should not utilize regulation by enforcement.

Even if such a principle were well-established, the OCC should not utilize regulation by enforcement because of the mismatch between the public harm—the costs of bank failure—and the proscribed violation—lending too much money to interrelated borrowers. The express purpose of the lending-limit law is "to protect the safety and soundness of national banks and savings associations by preventing excessive loans to one person, or to related persons

193. Park, *supra* note 22, at 681.

194. *Id.* at 682.

195. *See id.* at 681–82 ("If the principle is novel, then fair notice concerns become more significant and the conduct may be less likely to violate values on which there is societal consensus. . . . If the misconduct causes significant public harm, the case for confronting such wrongdoing with a principles-based enforcement action is stronger.").

196. *See supra* note 141 and accompanying text.

197. [Redacted], OCC Interpretive Letter No. 938, O.C.C. Q.J., Dec. 2002, at 31, 33 (Jan. 18, 2001).

that are financially dependent, and to promote diversification of loans and equitable access to banking services."[198] The lending-limit law serves to diminish the risk that a bank may need to absorb a substantial loan default, which could cause the bank to become insolvent.[199] The harm to the public from a bank violating the lending-limit law is trivial unless the bank becomes insolvent as a result of the excessive loans. If a bank has issued loans exceeding its lending limit, but the borrowers have repaid those loans, then no harm has occurred. Although the safety and soundness of the bank may have been in jeopardy, the risk did not materialize. In contrast, if a bank has issued loans exceeding its lending limit and the borrowers have defaulted on those loans, then the bank must absorb the cost.[200] Bankers, not wishing for their banks to go insolvent, establish reserves to absorb potential losses.[201] These reserves typically exceed bank equity by ten to fifteen times.[202] Although a default on a loan that exceeds a bank's lending limit may consume a bank's reserves and render the bank insolvent,[203] the bank's reserves can provide a cushion to prevent insolvency. If, despite this cushion, a bank does become insolvent, then the cost to the government may be several millions of dollars,[204] as the government generally insures deposits up

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198. 12 C.F.R. § 32.1(b) (2012). Although the goal of "diversification of loans and equitable access" may sound like an equality concern, the OCC has made clear that it is concerned only with the safety and soundness of the banks. *See* Lending Limits, 60 Fed. Reg. (Feb. 15, 1995) ("The final rule . . . refocuses the lending limit rules on the areas of greatest safety and soundness concern. The new rule enhances the ability of national banks to lend while protecting against situations where excessive loans to a borrower or related borrowers present safety and soundness concerns.").

199. *See* Heidi Mandanis Schooner, *Private Enforcement of Systemic Risk Regulation*, 43 CREIGHTON L. REV. 993, 1010 (2010) ("Difficulty establishing a private cause of action stems from the fact that limitations on lending were established to protect the solvency of the bank rather than to protect an individual borrower.").

200. Gay Hatfield & Carol Lancaster, *The Signalling Effects of Bank Loan-Loss Reserve Additions*, J. FIN. & STRATEGIC DECISIONS, Spring 2000, at 57, 57.

201. *Id.*; *see also* OFFICE OF THE COMPTROLLER OF CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED. DEPOSIT INS. CORP., NAT'L CREDIT UNION ADMIN. OFFICE OF THRIFT SUPERVISION, INTERAGENCY POLICY STATEMENT ON THE ALLOWANCE FOR LOAN AND LEASE LOSSES, 5–15, *available at* http://www.federalreserve.gov/boarddocs/srletters/2006/SR0617a1.pdf (describing how much capital a bank should have in its reserves).

202. James M. Wahlen, *The Nature of Information in Commercial Bank Loan Loss Disclosures*, 69 ACCT. REV. 455, 455 (1994); *see also* Hatfield & Lancaster, *supra* note 200, at 57 (citing Wahlen, *supra*, at 455).

203. *E.g.*, [Redacted], No. OCC AA-EC-88-17, 1989 OCC Enf. Dec. LEXIS 26, at *13–14 (1989).

204. *Id.*

to $250,000 in the event of a bank collapse.[205] Thus, lending-limit violations can still spell insolvency for a bank, and that risk should not be discounted.[206] The financial harm to the public can be significant.[207]

Yet regulation by enforcement is not the only way to prevent banks from violating the spirit of the combination rules. The OCC could draft more comprehensive combination rules by including additional per se rules. The OCC has already announced the thirteen factors that it considers to be relevant to an inquiry of whether the facts and circumstances indicate that a common enterprise exists between two borrowers.[208] The OCC could transform some of these factors into additional rules. For instance, the OCC could add a rule that would aggregate loans made to spouses.[209] The OCC could also add a rule that would aggregate loans made to two borrowers who share a centralized cash management system.[210] Any such rule would lessen the ability of banks to issue excessively risky loans without the OCC needing to rely upon enforcement via the catch-all facts and circumstances provision.

The OCC may have decided that the upfront costs necessary to craft a more comprehensive regulation were not worth the expense,[211]

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205. 12 U.S.C. § 1821(a)(1)(E) (Supp. V 2012).

206. In 2007–2012, the estimated loss caused by all bank failures totaled almost $90 million. *Failures and Assistance Transactions*, FED. DEPOSIT INS. CORP., http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30 (last visited Mar. 28, 2013) (select "United States" and "Other Areas" in the "State" field, "2007" and "2012" in the "Effective Date(s) field, and "Detail" in the "Type of Report" field; then click "Produce Report"). The estimated loss is the difference between the amount the FDIC disbursed from the Deposit Insurance Fund to cover obligations to insured depositors and the amount estimated to be recovered or recoverable from liquidating the receivership estate. *Historical Statistics on Banking Help*, FED. DEPOSIT INS. CORP., http://www2.fdic.gov/hsob/help.asp#BF1EC (last visited Mar. 28, 2013).

207. The bailouts in the wake of the 2008 financial crisis led the U.S. government to spend $2.5 trillion and to make $12.2 trillion in commitments to various institutions. *Adding up the Government's Total Bailout Tab*, N.Y. TIMES, July 24, 2011, http://www.nytimes.com/interactive/2009/02/04/business/20090205-bailout-totals-graphic.html.

208. *See supra* note 141 and accompanying text.

209. *Cf. supra* note 141 and accompanying text (listing thirteen factors relevant to the "facts and circumstances" provision).

210. *See* [Redacted], OCC Interpretive Letter No. 938, O.C.C. Q.J., Dec. 2002, at 31, 33 (Jan. 18, 2001) (listing the presence of a centralized cash-management program as a factor in finding that the facts and circumstances warrant deeming a common enterprise to exist). A cash-management system is a cash depository that acts as a netting center and repository of surplus funds, pooling the excess cash from each person and paying it to the other persons when they experience a cash shortage. THUMMULURI SIDDAIAH, INTERNATIONAL FINANCIAL MANAGEMENT 313 (2010).

211. *See* Lin, *supra* note 187, at 1025 ("[S]ome vagueness in the law is tolerable because the costs of eliminating vagueness may simply be too high. These costs include the direct cost

especially considering how rarely the OCC uses the catch-all provision.[212] Yet rule-of-law values should not be sacrificed so easily. Moreover, although drafting a more comprehensive regulation requires additional time and effort,[213] more comprehensive regulations may actually reduce enforcement costs for an agency by decreasing the number of requests for interpretive letters that the agency receives.[214] Each interpretive letter that explains whether the OCC will aggregate particular loans under the facts-and-circumstances provision costs the OCC time and money—costs that it could largely have avoided incurring. The OCC has already revised the combination rules five times in the past thirty years.[215] Whatever costs the OCC may incur in revising the combination rules do not warrant the OCC's decision to turn to regulation by enforcement as a first resort. The OCC should take the time to identify what the law is.

CONCLUSION

Because of the facts-and-circumstances provision,[216] banks are unable to ascertain from a reading of the federal combination rules whether the OCC will aggregate loans made to certain related borrowers. Instead, they must either request an interpretive letter from the OCC or risk the OCC later deciding to aggregate the loans. As the regulation-by-enforcement critique shows, this ad hoc "rulemaking" conflicts with rule-of-law values.[217]

Regulation by enforcement is best reserved as an agency's "last resort."[218] The facts-and-circumstances provision is not justified by the

involved in formulating more detailed rules without uncertainty . . . ." (footnote omitted)); *see also* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 591 (1992) (discussing why an agency may craft a vague regulation).

212. *See* [Redacted], OCC Interpretive Letter No. 563, O.C.C. Q.J., Mar. 1992, at 71, 72 (Sept. 6, 1991) ("[W]e believe that instances where the facts and circumstances test will apply to the exclusion of *per se* rules will be rare.").

213. *See supra* note 211.

214. *See* Lin, *supra* note 187, at 1023 ("Clear rules reduce an agency's enforcement costs by making it easier for a regulated party to comply and for the agency to prove noncompliance.").

215. Lending Limits, 60 Fed. Reg. (Feb. 15, 1995) (codified at 12 C.F.R. § 32.5) (2013); National Banks' Lending Limit, 55 Fed. Reg. 854, 857 (Jan. 10, 1990) (codified at 12 C.F.R. § 32.5); OMB Control Numbers, 49 Fed. Reg. 11,824, 11,826 (Mar. 28, 1984) (codified in scattered sections of 12 C.F.R.); National Bank Lending Limits, 48 Fed. Reg. 27,224, 27,225 (June 14, 1983) (codified at 12 C.F.R. § 32.5); National Bank Lending Limits, 48 Fed. Reg. 15,844, 15,846 (Apr. 12, 1983) (codified at 12 C.F.R. § 32.5).

216. 12 C.F.R. § 32.5(c)(4) (2012).

217. *See supra* Part III.B.

218. *See supra* note 56 and accompanying text.

need to ensure the safety and soundness of banks; nevertheless, the OCC has reserved for itself the ability "to flit serendipitously from case to case, like a bee buzzing from flower to flower, making up the rules as it goes along."[219] In the wake of the 2008 financial crisis, sound regulation of financial institutions is perhaps more needed than ever, but the OCC has opted to treat lending limits like Calvinball, "making up new rules on the fly to justify whatever [it], for some reason, want[s]."[220]

The OCC has already recognized once before, when it removed the facts-and-circumstances provision from the direct-benefit test, that it should use per se rules.[221] The OCC should do so again by removing the analogous facts-and-circumstances provision from the common-enterprise test. If the OCC finds that the remaining per se tests are insufficient to cover every situation in which loans should be aggregated, then the OCC should add more per se tests.

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219. *Cf. supra* note 1 and accompanying text.

220. Paul Krugman, *Monetary Calvinball*, N.Y. TIMES PAUL KRUGMAN BLOG (June 10, 2011, 12:17 PM), http://krugman.blogs.nytimes.com/2011/06/10/monetary-calvinball.

221. *See supra* notes 156–159 and accompanying text.