5th Circ. Ruling Will Spur Challenges To No-Action Letters

By **Gordon Todd, Brian Morrissey and Manuel Valle** (August 10, 2023)

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With potentially far-reaching implications for the "no-action" letter practice that is common at multiple federal agencies, the U.S. Court of Appeals for the Fifth Circuit ruled on July 21 that the U.S. Commodity Futures Trading Commission's decision to withdraw a no-action letter constituted a final agency action subject to judicial review.[1]

In so doing, the appeals court rejected the agency's characterization of its action as a discretionary and unreviewable staff-level decision. The court instead concluded that the CFTC's withdrawal decision had to satisfy arbitrary-and-capricious review, along with the additional Administrative Procedure Act requirements applicable to the withdrawal of an agency-issued license.

The panel acknowledged that this decision arguably splits with at least three other federal courts of appeals, which have described no-action letters as nonfinal and unreviewable. In holding otherwise, the Fifth Circuit's decision in Clarke v. CFTC challenges the common federal agency practice of establishing legal standards through subregulatory guidance and staff-level decisions.

No-action letters, in particular, have been criticized for failing to provide clear and predictable standards, and for enabling agencies to change course abruptly and without adequate warning, evading the guardrails imposed by the APA.

Going forward, Clarke will likely encourage litigation challenging such heretofore unreviewable actions. And agencies may need to adjust their subregulatory guidance procedures if they wish to avoid the exacting scrutiny applied by the court in this case.

The PredictIt Dispute

PredictIt is a futures market that allows participants to trade on the predicted outcomes of political events, such as elections or the passage of legislation. Such markets typically must register with the CFTC under the Commodity Exchange Act, or CEA.

But the CFTC's Division of Market Oversight can effectively exempt a market from registration by issuing a no-action letter, which provides that DMO staff "will not recommend enforcement action" against the market for failure to comply with the CEA.[2] These letters bind only DMO staff — not the CFTC itself — and "[o]nly the beneficiary [of the letter] may rely" on it.[3] The DMO's decision to grant or revoke such a letter is not appealable.

In 2014, PredictIt sought a no-action letter to operate its market without registering under the CEA, and informed the CFTC that it would abide by certain restrictions — e.g., capped investments and trader limits — if allowed to do so.

A few months later, the CFTC's DMO issued the requested no-action letter based on PredictIt's representation that it would abide by those restrictions. The no-action letter made clear that it did "not necessarily represent the positions or views of the Commission," and that DMO staff retained discretion to terminate the letter or restrict its terms.[4]

Almost eight years later, in August 2022, the DMO rescinded the no-action letter. The revocation notice simply stated that PredictIt had "not operated its market in compliance with the terms of" the no-action letter, without further explanation.[5] And the notice directed PredictIt that any "remaining listed contracts and positions" in its market "should be closed out and/or liquidated no later than 11:59 p.m. eastern on February 15, 2023."[6]

Parties affiliated with PredictIt promptly sued the CFTC in the U.S. District Court for the Western District of Texas, challenging the unexplained revocation as arbitrary and capricious,[7] and for unlawfully withdrawing a license.[8] The plaintiffs sought a preliminary injunction, and when the district court did not rule promptly on their motion, they appealed to the Fifth Circuit.

There, a panel majority — with U.S. Circuit Judge Kyle Duncan authoring the opinion, and U.S. Circuit Judge James Ho concurring — held that PredictIt was likely to succeed on the merits and a preliminary injunction was warranted. U.S. Circuit Judge James Graves dissented.

The Fifth Circuit's Decision

At its core, the panel held that the CFTC's no-action letter was a "license" under the APA, such that its withdrawal constituted a final agency action subject to the APA and was reviewable in federal court.

The appeals court first held that the no-action letter was agency action under the APA. The APA defines "agency action" to include the grant or denial of an agency-issued license,[9] and "license" to include any "form of permission."[10] Drawing on these definitions, the court held that because the no-action letter was a "form of permission," it qualifies as "a 'license' within the meaning of the APA, [and] its withdrawal constitutes agency action."[11]

Next, the Fifth Circuit held that the no-action letter was a reviewable final action because it (1) "mark[ed] the consummation of the agency's decisionmaking process" and (2) had "legal consequences."[12]

The court found the consummation prong satisfied because the withdrawal of the no-action letter was not "subject to further agency review" — i.e., CFTC regulations do not provide for appeals of such actions.[13] And the court held that the letter's withdrawal had legal consequences because the CFTC's regulations authorized beneficiaries to rely on such letters.[14]

The panel also rejected the CFTC's argument that no-action letters are functionally decisions not to prosecute, and as such are "committed to agency discretion" and unreviewable under the APA.[15] On this point, the court emphasized that the plaintiffs were not challenging the initial grant of the no-action letter to a third party, but rather the withdrawal of a no-action letter on which they personally had relied.[16]

Along the same lines, the court rejected the notion that only the party that granted the no-action letter could challenge its withdrawal because "the APA permits suit by anyone 'adversely affected or aggrieved by agency action.'"[17]

Having found the CFTC's action reviewable under the APA, the panel proceeded to subject it to scrutiny under the arbitrary-and-capricious standard, which requires that agency actions "be reasonable and reasonably explained."[18]

The commission's revocation action failed that standard, the court held, because it offered "no explanation whatsoever" for the revocation, nor did it consider or analyze why "less draconian" alternatives to shutting down the market were not appropriate.[19]

The CFTC attempted to stave off defeat after oral argument by issuing a letter purporting to supersede and offering more detailed reasons for the original revocation. But the court rejected this "obvious post hoc rationalization" as also insufficiently reasoned to justify the initial decision or to satisfy the APA's procedures for license revocations.[20]

Judge Ho concurred, underscoring the novelty of the panel's holding. In particular, he noted that the court's decision "admittedly conflicts with the precedents of our sister circuits" and that "no circuit has held that a no-action letter or its withdrawal is sufficient to constitute 'final agency action' under the [APA]."[21] He emphasized that the panel's analysis at the preliminary-injunction stage was not "definitive."[22]

The Dissent

In dissent, Judge Graves asserted that no-action letters are not final agency actions.[23] He first argued that such letters "do not mark the consummation of the agency's decisionmaking" because they are merely "informal and advisory, inherently staff-level statements about whether the issuing staff might (or might not) recommend" enforcement proceedings.[24]

Judge Graves also disagreed with the panel's holding that a no-action letter qualifies as a license.[25] In his view, the APA's use of the word "permission" to define the term "license" is best read to mean "formal authorization," and the no-action letter in this case did not represent the commission's "formal consent" to PredictIt's conduct.[26]

Finally, Judge Graves highlighted that "no-action letters have been regularly found to be non-binding and devoid of legal authority," pointing to three court of appeals decisions that described such letters as nonfinal and unreviewable, at least in dicta.[27]

Analysis

Clarke may have significant consequences for federal agencies' use of no-action letters and similar vehicles to regulate private conduct through subregulatory means.

Many agencies — including the U.S. Securities and Exchange Commission and the CFPB — use similar tools to establish standards of conduct through means that historically have not been subjected to the APA's procedural constraints. By treating no-action letters as reviewable final-agency actions subject to arbitrary-and-capricious review, the Fifth Circuit's decision rebukes that practice.

According to the CFTC, regulated parties will be worse off under the Fifth Circuit's rule because "requiring full-dress APA litigation on these sorts of informal letters [will] discourage the practice of giving them in the first place."[28] But that policy argument did not sway the Fifth Circuit, and its assumptions are questionable.

After all, if an agency can revoke a no-action letter without explanation — and without recourse for adversely affected parties — then the benefits of such letters are hard to discern. And, in any event, such bespoke accommodations among regulated entities and regulators would seem to undercut the transparency and uniformity of administration the APA was intended to promote.

At any rate, with Clarke on the books, those relying on agency no-action letters should monitor future developments in the case and in the regulatory litigation environment more generally.

In Clarke itself, the Fifth Circuit's preliminary injunction analysis did not conclusively determine the merits, and Judge Ho's concurrence raised the possibility that at least some aspects of the panel's analysis could be reconsidered after a full trial. That said, the panel published its decision, so it is controlling precedent for now in courts throughout the Fifth Circuit.

Separately, the panel's decision is likely to encourage future litigation involving no-action letter decisions by the CFTC and other federal agencies, especially in the Fifth Circuit, where Clarke is now the law and where arbitrary and capricious review "has serious bite."[29]

What is more, the Fifth Circuit's holding that a no-action letter is a license under the APA means that withdrawing such a letter will require agencies to comply with the APA's procedures for license revocation,[30] over and above the ordinary requirements of reasoned decision making.

Clarke may also prompt the CFTC and other federal agencies to consider adopting regulations clarifying their no-action letter procedures to avoid federal court challenges or to ensure that their procedures can survive arbitrary-and-capricious review. For instance, if the CFTC's regulations had provided for further agency review of the DMO staff's revocation decision, that would likely have altered the Fifth Circuit's finality analysis.

Likewise, agencies may seek to amend regulations specifying that parties may rely on no-action letters to downplay the legal consequences stemming from those letters. At the same time, finality is a pragmatic inquiry,[31] so courts may be skeptical of an agency's attempt to avoid judicial review by changing the form — but not the substance — of its no-action letter procedures.

The Fifth Circuit's decision in Clarke — along with the U.S. Supreme Court's recent decision in Axon Enterprise v. FTC and its forthcoming reconsideration of the Chevron doctrine — may portend a more rigorous judicial skepticism of regulatory caprice.

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should not be taken as legal advice.

[1] See Clarke v. CFTC, No. 22-51124, 2023 WL 4677542, at *4 (5th Cir. July 21, 2023).

[2] 17 C.F.R. § 140.99(a)(2).

[3] See id.

[4] Clarke, 2023 WL 4677542, at *2.

[5] Id.

[6] Id.

[7] See 5 U.S.C. § 706.

[8] See id. § 558(c).

[9] 5 U.S.C. § 551(13).

[10] Id. § 551(8).

[11] Clarke, 2023 WL 4677542, at *4 (quotations omitted).

[12] Id. at *5 (quotations omitted).

[13] Id.

[14] Id.

[15] See 5 U.S.C. § 701(a)(2).

[16] Clarke, 2023 WL 4677542, at *6.

[17] Id. at *7 (quoting 5 U.S.C. § 702).

[18] Id. at *8 (quotation omitted).

[19] Id.

[20] Id. at *9.

[21] Id. at *11.

[22] Id.

[23] Id. at *12.

[24] Id.

[25] Id. at *13.

[26] Id.

[27] Id. (citing Trinity Wall St. v. Wal-Mart Stores, Inc., 792 F.3d 323, 331 (3d Cir. 2015), Board of Trade of City of Chicago v. SEC, 883 F.2d 525, 530 (7th Cir. 1989), New York City Emps.' Ret. Sys. v. SEC, 45 F.3d 7, 12 (2d Cir. 1995)).

[28] Id. at *11.

[29] Wages & White Lion Invs., LLC v. FDA, 16 F.4th 1130, 1136 (5th Cir. 2021).

[30] See 5 U.S.C. § 558(c) (requiring notice and an opportunity to demonstrate or achieve compliance).

[31] Abbott Labs. v. Gardner, 387 U.S. 136, 149 (1967).