Perspectives

on current developments

A Truce in the Takeover Wars?

To a casual observer, hostile corporate takeovers may seem as pointless and destructive a form of modern warfare as the Iran/Iraq conflict. "Raiders" strike with bear hugs, junk bonds, and two-tier tender offers. Incumbent managers respond with poison pills, greenmail payments, shark repellents, and golden parachutes. Congress is wearying of the strife, and may soon impose a cease-fire on the combatants —but to whose benefit?

Last term, Representative Timothy Wirth (Democrat, Colorado) introduced H.R. 5693, the "Tender Offer Reform Act of 1984," which would have made a number of changes in the law governing takeovers:

- Once a buyer had acquired 5 percent of a target firm it would have to cease acquiring stock for two days, unless the Securities and Exchange Commission gave an earlier go-ahead. It would also have to file a public notice with the SEC—and thereby alert the target's management—within twenty-four hours of the purchase. (Currently the Williams Act allows ten days to file such a notice.) If it proceeded to seek control of the target through a tender offer, it would have to keep the offer open for forty calendar days (current regulation requires twenty business days).
- Furthermore, a buyer would have to notify the SEC in a public filing of its intentions "to make any major change which would affect the communities in which [the target] operates . . . [or] which would substantially affect its management, labor organizations, or employees." Existing law requires the buyer to notify the SEC of its background, of whether it intends to acquire control of the business, and of many other factors, but does not require the filing of a "community impact statement."
- The bill would also restrict a variety of defensive tactics by target management. During tender offers, target companies would be forbidden from issuing "golden parachutes," which provide big severance payments to executives displaced by a hostile acquirer. And takeover targets would not be allowed either to issue major new blocks of voting securities (so as to dilute the value of the offeror's shares) or buy back chunks of shares (so as to keep them away from the offeror) without the approval of a majority shareholder vote. Companies would also be prohibited from making "greenmail" payments to raiders (buying out their holdings at a substantial premium to get them to go away) without affirmative shareholder approval. Such repurchases have angered stockholders who do not share in the greenmail premiums, and who often see the value of their shares decline sharply when the greenmail recipient withdraws from the bidding.

H.R. 5693 was sent to the floor by the House Energy and Commerce Committee, but was withdrawn in the closing days of the session. Similar proposals were introduced in the Senate, and are likely to be introduced again this term. Reaction has been mixed. Last year the SEC supported restrictions on many takeover tactics, but it now seems to have stepped back from any endorsement of further federal tinkering. The Treasury Department broadly warns against restricting takeovers "in the name of fairness to shareholders, [when] those same shareholders are the ones who benefit from such activities," and says it finds "no systematic evidence that takeover activity has done anything other than increase national wealth and improve efficient allocation of corporate resources."

Some critics of takeovers decry them as part of a trend toward "paper entrepreneurism." Recent scholarship, however, suggests that they serve a productive purpose. A 1983 article in the *Journal of Financial Economics*, surveying economic studies of the market for corporate control, concluded that both bidders and targets realize positive returns from successful takeovers. That shareholders of the target firm earn a profit is no surprise, since raiders invariably offer a premium for the shares they buy. Even the threat of a takeover may spur existing managers to work harder to increase the value of their stockholders' shares. To some, perhaps, more surprisingly, the shareholders of the raider also benefit in the long run. Takeovers allow worse managers to be replaced by better, and generate the other sorts of productive efficiencies associated with mergers. So why the sudden rush to regulate?

The House committee report on H.R. 5693 recognizes that takeovers can produce economic benefits, but says they may also "result in the loss of jobs, cause management to focus upon short-term stock performance instead of long-term prospects, and reduce the amount of credit available for other productive purposes." These complaints are familiar. The spectre of job loss (and its related spectre of disruption to communities) is also invoked to argue against mergers and foreign imports; in both cases the prospect of reduced labor inputs looks suspiciously like the flip side of the opportunity for greater efficiency (and more jobs in other communities or businesses). As for the effect of takeovers on credit demand, it is wrong to imagine that a takeover will cause a "lump of credit" to vanish forever from the capital market; when shareholders of the target firm are paid off, the capital will flow back into the market. Takeovers may tie up small amounts of capital for a few weeks, but the banks and other financing parties appear to consider this more productive than the alternative uses they might have for the money. And the fear that takeovers trap management into "short-term thinking" assumes that by maximizing reported short-term profits, management succeeds in deceiving shareholders as to the long-run prospects of the company. If shareholders are well informed, after all, they will discount and capitalize poor long-term prospects in the current price of the stock, which will promptly penalize management for short-sighted decisions. The fear of takeover gives management an incentive to improve reported results in deceptive ways, but so do many other pressures.

A different line of argument holds that while takeovers in general may be efficient, it is abusive for different groups of stockholders to receive different prices for their stock. This would imply banning not only "greenmail" but also "two-tier" tender offers, in which the acquirer offers a high price (or cash) for a controlling block of stock, and a low price (or securities) for the remaining minority shares. These offers, it is said, can stampede shareholders into accepting inferior offers for fear of being locked into a minority position. But an SEC study suggests that banning two-tier offers might actually harm target shareholders by reducing the overall number of tender offers. Although shareholders might in theory get higher premiums when single-tier offers were made, fewer offers would be made—and fewer premiums paid—in the first place.

Robert Reich has argued that managers are distracted from business affairs when they concentrate on fending off a hostile invader. But managers are never forced to defend their incumbency; they can simply stand aside and let the shareholders decide. To be sure, takeover offers sometimes provoke incumbent managers into taking "poison pills" whose effect is almost certainly to harm shareholders. The remedy that suggests itself, however, is to put restrictions on the incumbents, not the raiders.

But although a stronger case might be made for restricting defensive tactics, here too there are doubts that a legislative solution would work. Treasury points out that it would be hard to draft a law that restricted abusive defensive tactics without interfering with perfectly legitimate business activity. The SEC has suggested that if filing a tender offer were to trigger sweeping restraints on target management, raiders might have a better blackmail tool than ever: threatening to tie up the targets' operations with below-market offers. Federal Trade Commission Chairman James C. Miller III has said that although he supports the principle of a law to control abusive defensive tactics, he would prefer simply to even the playing field by removing existing restraints on bidders.

Another consequence of the congressional proposals to restrict defensive tactics, and further to restrict takeovers, would be to extend federal law into areas traditionally left to state and marketplace regulation. State courts (and federal courts interpreting state law) decide corporate governance issues through case-by-case adjudication. The "business judgment rule," under which courts will not second-guess management decisions that can be attributed

In Brief–

Crackdown on Low Prices. Despite the widespread view that railroads and truckers are being deregulated, the Interstate Commerce Commission continues to pester carriers and shippers for agreeing to excessively low rates. In March the commission acted to resolve a complaint from its enforcement arm seeking treble damages against two railroads and a shipper for an alleged undercharge.

At issue was what happens when a railroad ships hazardous materials to a customer that is not yet ready to unload them. "For obvious reasons," as commissioner Frederic Andre says, "railroads prefer not to hold such cars in their switching yards any longer than necessary." Thus the railroad shunts the cars to a side track on the receiver's property until the customer is prepared to unload them. ICC officials had long given informal assurances that since the railroad conducts the shunting movement for its own benefit, it does not have to charge the customer an extra fee to cover the separate movement.

The commission's enforcement arm, which is whimsically named the Office of Compliance and Consumer Assistance, sought to overturn this practice in its complaint. In March the full commission agreed with the railroads and shippers that the practice could continue, but OCCA continues to question alleged undercharges elsewhere. "It is little wonder that the Interstate Commerce Commission is sometimes perceived as anti-shipper," wrote Commissioner Andre, "when our enforcement agents are spending a substantial portion of their budget to harass shippers for allegedly paying too little for transportation, even when both shipper and railroad have agreed that the correct charges were paid."

Goodbye, Mr. Chips. A key element of the ICC's retreat from deregulatory activism, according to commission insiders, has been its gradual but systematic elimination of reformers' staff positions. The agency's Office of Transportation Analysis, a one-time hotbed of procompetition advocacy, has come under particular pressure. It would be cut from forty-one to thirty positions if the Senate adopts the recommendation of its Appropriations Committee. "Though this office might serve to inform the Congress and the public about the implications of deregulation and the current economic status of the various activities monitored by the Commission, it has rather served to promote further deregulation by administrative fiat," says the report by the subcommittee that oversees ICC funding—which is headed by Senator Mark Andrews (North Dakota), a Republican who has been critical of deregulation.

Twinkle, Twinkle. In one of the more unusual ventures in the commercialization of outer space, entrepreneurs are planning to launch human ashes into orbit. The promoters hope to use shiny spacecraft so that bereaved earthlings could more easily view the departed.

In a letter to the editor of *Science,* Jan Beyea of the National Audubon Society warns that this is "the beginning of a new visual form of pollution, the cosmic equivalent of billboards on highways." A resourceful advertiser, Beyea sug-

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to any rational business purpose, has traditionally afforded corporate managers virtual carte blanche, absent a showing of self-dealing. To some, this suggests that the competition among states like Delaware and Nevada to supply corporate law has led to a "race to the bottom" in providing shareholder protection. To others, it suggests that the market has fixed on better ways to control managerial self-interest or incompetence than judicial oversight, whether through provisions in corporate charters, contracts with managers (including stock options and other incentive arrangements), or simply the discipline of stock pricing.

In a recent decision (*Norlin Corp.* v. *Rooney Pace, Inc.* 1984), the U.S. Court of Appeals for the Second Circuit suggested that management decisions about the use of defensive tactics in takeovers will be scrutinized more closely than in other contexts. This parallels the heightened judicial scrutiny that is traditional in other areas where executives have a conflict of interest or self-dealing is likely. The committee report on H.R. 5693 hailed the *Norlin* decision, but warned that "it will continue to monitor this area of law carefully to determine whether legislation is warranted," and in fact Wirth has filed preemptive federal legislation (H.R. 5695) to alter the business judgment rule.

However, the lobbying for restraints on raiders is stronger than for restraints on targets, with business executives leading the charge against the hostile takeovers that so often cost them their jobs. In an August 1984 Louis Harris survey, about two-thirds of senior corporate executives polled said that hostile takeovers were bad for the economy (but nonhostile acquisitions good), and 70 percent thought that the bidder has "the advantage," presumably an unfair one, in a takeover battle. A majority of the executives would ban two-tier gests, could launch dozens of reflective objects arranged so as to form letters or words. "Twenty years from now, will we walk out at night to see the word "Coke" emblazoned in the sky?"

Not if the regulators can be mobilized in time. "Congress should extend the authority it has given the Department of Transportation to regulate private launches and allow it to limit the brightness of private space payloads—a 'Space Beautification' addition to the Commercial Space Transportation Act."

All Quiet on the Pork-Barrel Front. Last year the Pentagon spent almost $75 million to buy and ship American coal to U.S. bases in Europe—mostly anthracite, the type of "hard coal" whose use has been in long-term decline. Members of Congress from Pennsylvania have succeeded in passing appropriations riders requiring the Defense Department to pass up cheaper European suppliers in favor of the U.S. product. Recently, Congress directed the Pentagon to build up an unwanted one-year stockpile of U.S. coal in Europe.

The army would prefer to hook up to German utility systems for its heating needs, but anthracite industry spokesmen have argued that switching "would make our bases dependent on German municipalities," in the words of a report in *Common Cause* magazine. Unfortunately, such dependence will not go away no matter where the coal comes from: the coal boilers themselves need water and electricity to operate, and municipal German utilities are the sole suppliers of both.

Prometheus Unbound. There are signs of a "new-found aggressiveness" at General Motors, our number one auto maker, according to a *Wall Street Journal* article. Since taking office in 1980, Chairman Roger B. Smith "has transformed GM from a shrinking, bureaucratic giant into an organization in which the only constant is change." The company has begun expanding in nonautomotive areas and experimenting with sophisticated new production techniques.

"Mr. Smith portrayed himself as making changes his immediate predecessors couldn't because they had to direct their executives' energies toward solving problems imposed by government regulations, particularly those relating to safety, fuel economy and pollution control," the *Journal* account says. "Now that most of those regulatory problems have been solved and deregulation is in vogue, Mr. Smith believes he can focus his subordinates' efforts on expanding GM's business."

For many businesses, the freeing of executives' creative energies must be the single most important benefit from deregulation. Unfortunately, it is a benefit that is nearly impossible to quantify in regulatory impact or cost-benefit analyses.

Man Bites Dog. It finally happened. A government decided to remove the beam from its own eye before complaining about its neighbor's mote.

Prime Minister Brian Mulroney of Canada said February 1 that he would restrain his criticism of U.S. inaction on acid rain until Canada "cleans up its own act." Mulroney added that "we have to stop blaming them exclusively" and that "in point of fact we are behind the Americans in emission control in many significant areas." Policy observers are now on the lookout for such unexpected events as a month of Sundays, a blue moon, and the freezing over of Hell.

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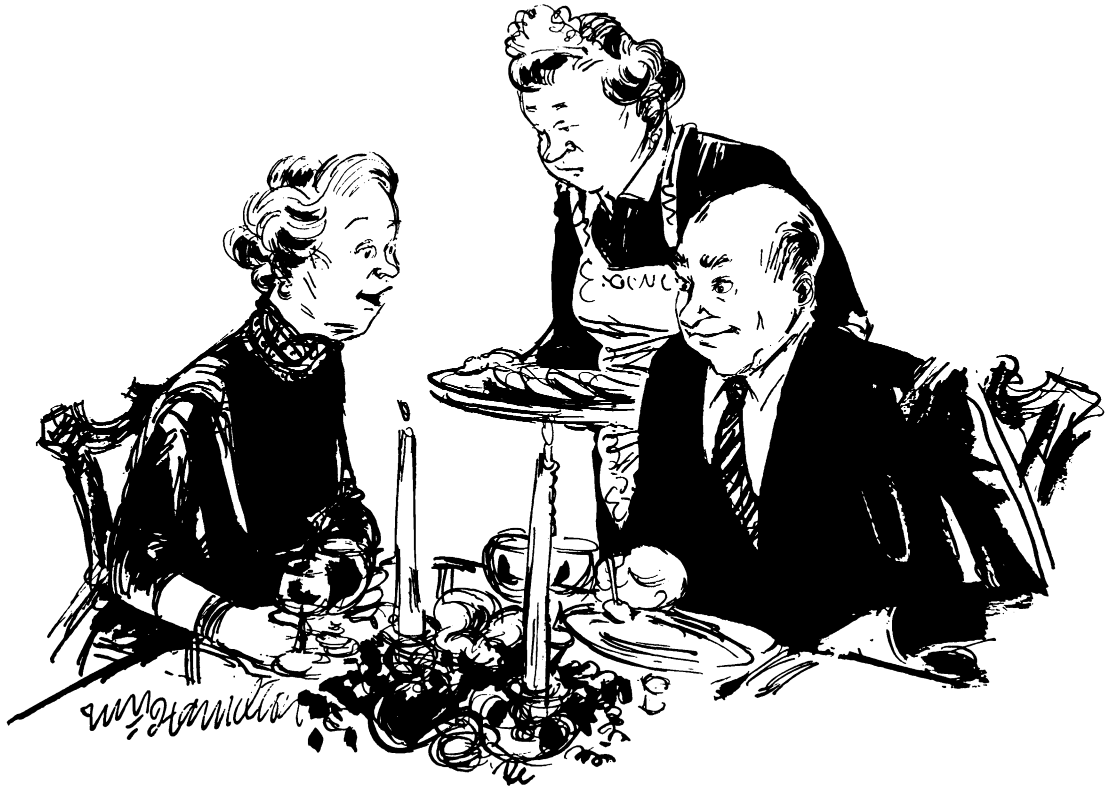
tender offers and greenmail, require 5 percent buyers to inform the target management immediately, and require 20 percent holders to make a tender offer for the remaining shares. Not surprisingly, these numbers are reversed when restraints on target management are at issue. Over two-thirds of the executives oppose restricting the amount of its own stock a target company can reacquire to block takeovers, over half oppose outlawing golden parachutes, and a plurality reject restrictions on stock dilution by targets. Harris sums it up: "What executives really want is for the acquirer to be hemmed in, but not themselves."

Interestingly, 80 percent of the executives agreed that ordinary shareholders do "very" or "moderately" well in both friendly and hostile takeovers. On average, target company shareholders appear to earn premiums in excess of 30 percent. No poll has been taken on whether shareholders are eager to give up these gains.

Even if the agreed-on aim were genuine neutrality between bidders and targets, it is doubtful that new federal legislation could achieve that goal. Consider the history of past federal forays into corporate regulation—all of which have resulted in controls on bidders, not incumbent managements. The Williams Act was intended to be neutral, but in practice it brought about an immediate and substantial reduction in the number of tender offers (a 40 percent reduction in the year after passage), which did not return to previous levels for nine years. This is hardly surprising: one key to a successful takeover attempt is to strike quickly, before the incumbent management can mobilize a defense, and the Williams Act delays the process.

The Williams Act did not restrict open market purchases of stock, which became increasingly popular as a takeover tool. By the mid-1970s, the traditional tender offer looked so unattractive by comparison that some were



"I knew it! Whenever you absorb a company, you get so perky!"

predicting large-scale shifts to open market purchases as the favored takeover method. Then the Hart-Scott-Rodino Antitrust Improvements Act of 1976 came along, imposing "waiting periods" on large stock purchasers that were longer than those the Williams Act imposed on tender offerors. The stated intent of the 1976 law was to give the FTC and Justice Department time to decide whether to challenge major acquisitions on antitrust grounds. But by taking away the advantage of open market purchases over tender offers, it may have unintentionally prevented a dramatic evolution in takeover tactics.

In the end, however, the decisive issue in the current debate may have nothing to do with the offensive/defensive balance. Underlying many takeover discussions—sometimes openly, sometimes not—is the question of merger policy. Corporate takeovers often, though not always, lead to corporate mergers—whether the target firm falls to the "raider" or the "white knight." The activities of T. Boone Pickens, for example, led to two of the largest mergers in history by driving Gulf Oil into the arms of Chevron and Cities Service into the arms of Occidental Petroleum. Although government policy and academic opinion have both shifted dramatically toward a more favorable view of mergers in recent years, old-fashioned trustbusters remain unconvinced. (A piquant irony is that the "bust-up artist," who specializes in splitting his targets into smaller companies, is universally despised even though he accomplishes deconcentration at a profit.)

The drive to regulate takeovers may afford the opponents of industrial concentration a chance to regain through regulation of the securities market the ground they have lost in antitrust policy. The Hart-Scott-Rodino Act sought to regulate mergers and wound up regulating takeovers. It would not be unprecedented for takeover legislation—by intention or not—to wind up effecting significant changes in merger policy.

Regulation and the 1986 Budget

The books have now been closed on four years of Reagan administration budget policy in the regulatory area, and we can therefore assess how things have changed, if at all, in the course of the 1981–84 period. In brief, the Reagan budgets to date show a trend toward a different allocation of spending among federal regulatory agencies, but not a lower overall amount. That may change in the future, as the administration appears ready to revive once again its push to cut spending by federal regulators.

The summary figures shown here are adapted from the annual roundup of regulatory agency budgets and staffs prepared by the Center for the Study of American Business at Washington University in St. Louis. They include final regulatory budget figures for the past two fiscal years, together with the administration's projections for 1985 and budget proposals for fiscal 1986. It should be noted that this year's figures from the CSAB are not comparable to those summarized in this space in earlier years. The main difference is that the dollar figures now cover obligations rather than outlays.

The explosive growth in spending by the federal regulatory bureaucracy during the 1970s has been contained. But it has not been reversed. From the last year of the Carter presidency to the last year of Reagan's first term, total federal employment by regulatory agencies has declined significantly, by about 14 percent overall. Apparently this reduction in employment has been more or less offset by increases in outside contracting or by in-house cost inflation, however, because total spending measured in constant dollars has not changed much.

This apparently level trend over a four-year interval in fact masks a V-shaped pattern in between. Spending dropped precipitately in the first full Reagan budget (for 1982), but in the succeeding three years it inched steadily back up to the 1980 levels. If current estimates hold, federal regulatory spending in 1985, the last budget year in Reagan's first term, will almost exactly match real-dollar regulatory spending for 1981, the last budget year from the Carter administration.

There have, however, been some significant shifts in where the federal regulatory dollar is being spent. In constant dollars, expenditures for "social regulation"—such areas as consumer and occupational safety and health, energy, and the environment—fell about 6 percent between 1980 and 1984. In the same period, expenditures for "economic regulation"—finance and banking, regulation in such specific industries as communications and commodities, and general business regulation in such areas as securities and patents—rose about 10 percent. This shift in regulatory priorities appears to be continuing in 1985, with the budget fraction allocated to economic regulation creeping up from about 18 to about 19 percent of the total.

For 1986 the administration has announced its intention to stop shuffling the regulatory deck and begin cutting it once again. It plans no significant further shift in spending from social to economic regulation, but does propose cuts in overall spending. In nominal dollars, the 1986 budget for federal regulation amounts to something just under a freeze: total expenditures are slated to decline, overall, by about 0.3 percent. In constant dollars, however, the budget represents a cut roughly equal to the rate of

EXPENDITURES ON FIFTY-SIX REGULATORY AGENCIES
Selected Fiscal Years, 1970–86

Area	1970	1980	1983	1984	1985 (est.)	1986 (est.)
	EXPENDITURES ($ billions)					
Social Regulation						
Consumer Safety & Health	$ 0.9	2.8	2.9	3.1	3.3	3.1
Job Safety & Other Working Conditions	$ 0.1	0.8	0.8	0.8	0.9	0.8
Energy & the Environment	$ 0.3	2.2	2.3	2.7	3.1	3.2
	$ 1.3	5.7	6.0	6.6	7.2	7.2
Economic Regulation						
Finance & Banking	$ 0.1	0.4	0.5	0.8	0.9	0.8
Other Industry-Specific	$ 0.1	0.3	0.3	0.3	0.3	0.3
General Business	$ 0.1	0.4	0.4	0.5	0.5	0.5
	$ 0.3	1.1	1.3	1.5	1.7	1.7
TOTAL	$ 1.6	6.8	7.3	8.2	8.9	8.9
TOTAL IN 1972 DOLLARS*	$ 1.7	3.8	3.4	3.7	3.8	3.7
PERMANENT FULL-TIME POSITIONS (thousands)						
Social Regulation	65.5	103.6	88.6	87.8	88.4	86.8
Economic Regulation	19.9	27.8	25.4	25.6	25.3	25.5
TOTAL	85.4	131.5	114.0	113.3	113.6	112.3

*Adjusted by GNP deflator (actual and, for later years, estimated in budget).
Source: Adapted from figures of the Center for the Study of American Business.

CHANGE IN EMPLOYMENT FOR TWENTY-EIGHT REGULATORY AGENCIES

Agency	Permanent Full-Time Positions 1984	1985 (est.)	1986 (est.)	Percent Increase (Decrease) 1984–86
Consumer Product Safety Commission	558	567	549	(1.6)
Food & Drug Administration	7,168	7,084	6,893	(3.8)
National Highway Traffic Safety Administration	640	640	705	10.2
Bureau of Alcohol, Tobacco & Firearms	3,038	3,038	3,016	(0.7)
TOTAL, *Consumer Safety & Health*	11,404	11,329	11,163	(2.1)
Mine Safety & Health Administration	3,271	3,107	2,977	(9.0)
Occupational Safety & Health Administration	2,355	2,323	2,280	(3.2)
Equal Employment Opportunity Commission	3,125	3,125	3,125	—
National Labor Relations Board	3,213	3,000	3,000	(6.6)
TOTAL, *Job Safety & Other Working Conditions*	11,964	11,555	11,382	(4.9)
Economic Regulatory Administration	377	325	310	(17.8)
Office of Surface Mining	849	906	898	5.8
Environmental Protection Agency	10,141	11,473	12,042	18.7
Nuclear Regulatory Commission	3,332	3,351	3,351	0.6
TOTAL, *Energy and the Environment*	14,699	16,055	16,601	12.9
Comptroller of the Currency	3,250	3,250	3,250	—
Federal Deposit Insurance Corporation	3,554	3,554	3,554	—
Federal Home Loan Bank Board	1,327	1,335	1,330	0.2
National Credit Union Administration	384	386	392	2.1
TOTAL, *Finance and Banking*	8,515	8,525	8,526	0.1
Civil Aeronautics Board*	363	—	—	(100.0)
Commodity Futures Trading Commission	557	567	567	1.8
Federal Communications Commission	1,976	1,822	1,849	(6.4)
Federal Energy Regulatory Commission	1,564	1,662	1,587	1.5
Federal Maritime Commission	232	240	215	(7.3)
Interstate Commerce Commission	1,023	844	894	(12.6)
TOTAL, *Industry-Specific Regulation*	5,715	5,135	5,112	(10.6)
International Trade Commission	1,023	844	894	(12.6)
Patent & Trademark Office	3,286	3,438	3,408	3.7
Antitrust Division**	704	649	649	(7.8)
Federal Election Commission	225	232	230	2.2
Federal Trade Commission	1,160	1,145	1,101	(5.1)
Securities & Exchange Commission	2,021	2,046	2,060	1.9
TOTAL, *General Business*	8,419	8,354	8,342	0.8
TOTAL, TWENTY-EIGHT AGENCIES	60,716	60,953	61,126	0.7

*Abolished in 1984.
**Included in earlier years under the heading "Social Regulation."
Source: Adapted from selected figures of the Center for the Study of American Business.

inflation—about 4 percent. This is not as large a drop as the 10 percent cut in fiscal 1982, Reagan's first budget, but it is a bigger drop than has been seen before or since.

Some of the more notable losers for 1986 include the Federal Railroad Administration, down 18 percent; petroleum regulation in the Department of Energy, down 17 percent; the Office of Surface Mining Reclamation and Enforcement, down 17 percent; the Animal and Plant Health Inspection Service, down 12 percent; and the Civil Aeronautics Board, down and out at zero. Among the winners are the Drug Enforcement Administration, up 64 percent; the International Trade Administration, up 29 percent; and the Environmental Protection Agency, up 12 percent. (All percentages are calculated from nominal dollar figures.) Losers outnumber winners almost two to one, but the gains of a few big winners (most especially the $2 billion Environmental Protection Agency) manage to hold the overall regulatory market fairly steady at just under $9 billion.

And what of the *real* market outside Washington? No one truly knows. For industries vetted by agencies such as the Occupational Safety and Health Administration (down 4 percent) or the Consumer Product Safety Commission (down 6 percent), a smaller agency budget will presumably mean fewer inspections or recalls, fewer new standards—in short, less regulation. But for industries whose activities are screened by agencies that license new products and technologies—agencies such as the Nuclear Regulatory Commission (down 6 percent) or the Food and Drug Administration (down 5 percent)—a smaller regulatory budget may in fact mean either more or less regulation, depending on where the cuts come from. The agency could react to the cuts in ways that slow down approval, leaving the licensing more clogged and impenetrable than ever, or it could take down some of the hurdles that keep its examiners busy. In the end, the true "regulatory budget" depends little on how much is spent directly by Washington regulators. What matters is how much the rest of the country spends in trying to appease them—and what, if anything, the country gains in return.

Bumpers to Bumpers in Court

Veterans of the last decade's regulatory debates will recall the Bumpers amendment as a perennial passenger on the omnibus of congressional regulatory reform. The amendment had to do with how judges should behave when they scrutinize regulatory activity. Now, confusingly, along comes the bumpers *decision*, which deals with some of the same issues of judicial review of regulation. This time "bumpers" refers not to the senator from Arkansas but to the small-"b" kind on automobiles.

Congress may have abandoned its search for an omnibus regulatory reform package as irrelevant or politically unachievable, but the underlying controversies persist: how complete a factual basis must agencies establish before they regulate? Can the White House interfere with agency actions? What can Congress do to make its wishes known? How deferential should judges be toward the agency when the controversy winds up in their laps? And should the standards differ when deregulation—the repeal or revision of existing rules—is at issue? The Supreme Court's landmark air-bag case last year addressed each of these questions, and the appeals court's bumpers decision this January carries the analysis along another step.

In 1971 the National Highway Traffic Safety Administration, relying on a 1966 law, issued a rule requiring that automobile bumpers be built to withstand an impact of five miles per hour in front and two-and-a-half mph in back without damage to the vehicle's "safety systems"—its lighting, fuel, exhaust, cooling, or latching components. Another part of the standard effectively required bumpers to be built at a standard height. The idea was to prevent damage to head and tail lights during collisions and also "bumper interlocks," which could tie up traffic and force drivers to dart into traffic to disentangle them.

As time went on NHTSA added elaborations to the rule, especially after a 1972 law (the Cost Savings Act) gave it new powers to combat economic losses to consumers as well as injuries. The standard for rear bumpers was increased step-wise until by the 1973 model year they too had to survive a five mph crash. Then the agency began requiring that the bumper be strong enough to protect all the rest of the vehicle from damage in five mph crashes. Eventually even the bumper was permitted to incur only minimal damage.

When the agency first issued the rule, it simply assumed that protecting the integrity of a car's safety systems in minor accidents would help prevent subsequent accidents. Not until later did it begin conducting tests and developing empirical evidence to test this hypothesis. A 1979 analysis concluded that the five mph standard gave consumers a net benefit of $39 compared with the two-and-a-half mph standard. But that report came under criticism, and the numbers were later reduced to a range of $11–29. And a long-term study released by the agency in 1981 indicated that the five mph front standard was of only borderline cost-effectiveness, and the five mph rear standard clearly was not cost-effective.

Not long after taking office, the Reagan administration announced that as part of its promise to help the auto industry out of its financial morass NHTSA would propose a modification of the bumper standard. The agency proceeded to issue a new rule reducing the standard at both ends from 5.0 to 2.5 mph, lowering the crash velocity that the corners of a car had to withstand, and eliminating the requirement that the bumper itself not suffer damage in minimal collisions.

The usual plaintiffs—insurance companies and their allied associations, along with the Nader-founded Center for Auto Safety—went to court to challenge the rollback. On January 5 of this year a three-judge panel of the U.S. Court of Appeals for the District of Columbia upheld the agency by a two-to-one majority (*Center for Auto Safety* v. *Peck.*) The court has just denied a rehearing *en banc.*

The majority and the dissent agreed that the correct standard of review to apply was that enunciated by the Supreme Court in the air-bag case (*Motor Vehicle Manufacturers Association* v. *State Farm Mutual,* 1983). There the Court rejected the argument advanced in this space that an agency should have wider latitude in pruning back or eliminating old regulations than in adopting new ones (see "Active Judges and Passive Restraints," Perspectives, *Regulation,* July/August 1982). The Court acknowledged that agencies need to adapt their regulations to changing circumstances, but reasoned that

> the forces of change do not always or necessarily point in the direction of deregulation. In the abstract, there is no more reason to presume that changing circumstances require the rescission of prior action, instead of a revision in or even the extension of current regulation. If Congress established a presumption from which judicial review should start, that presumption . . . is not *against* safety regulation, but *against* changes in current policy that are not justified by the rulemaking record. [Emphasis in original.]

In short, regulations are like numbers in algebra: there are positive and negative varieties but the applicable operations are the same. The presumption of the Administrative Procedure Act is not in favor of citizen autonomy, but in favor of the status quo—whether unregulated or regulated.

If that were all there were to it, the inquiry would have been done. But there is more to the story.

Under the general principles of administrative law, an agency's choices in issuing a regulation are bounded by the statute under which it operates and the record developed during the rulemaking proceeding. The agency must examine the relevant data on the record and articulate an adequate explanation for its action that includes a "rational connection between the facts found and the choice made," as the Court put it in the air-bag case. But since the statute and the record rarely converge to permit of only one possible interpretation, the agency normally retains a range of discretion. The choice of a particular regulation within that range belongs to the agency and is governed by politics, not law.

The first major question in the bumpers case was what the relationship is between the range of discretion in the first proceeding and the range of discretion in the second. Are the two ranges coextensive, or does the agency's choice in the first proceeding constrain its choice in the second—and if so, how?

To the appellants, and possibly the dissent (the interpretation is unclear), the agency's first decision strongly constrained its second. To abandon its first policy, the agency had to muster outright proof that the change would not reduce safety. It was not clear that NHTSA had shouldered this burden. Its own data, along with that submitted during the rulemaking proceeding, did not convince the agency that there was any measurable difference in the accident rate between the two standards. (A vice-president of one of the appellants admitted that it was an area where you "have to put some judgment on.") But, of course, failing to uncover evidence of harm is not the same thing as proving no harm.

The major importance of the decision lies in the court's finding that although the agency had to justify the change, it did not have to sustain the burden of proof. The decision held that the agency's

> justification need not consist of affirmative demonstration that the status quo is wrong; it may also consist of demonstration, on the basis of careful study, that there is no cause to believe that the status quo is right, so that the existing rule has no rational basis to support it.

Applying the principle of the "hard look," in which the court delves deeply into the record to determine whether the agency's choice was arbitrary or capricious—that is, outside the range of available discretion—the court examined the record in minute detail and found that the agency had carried out that demonstration.

At first glance, the court's principle would seem to create an asymmetry between regulation and deregulation. After all, an agency must marshal affirmative evidence to justify an original regulation. Doubt is not enough. The Occupational Safety and Health Administration surely could not announce that since it had no reason to believe that a given chemical was safe, it was going to ban it.

The asymmetry, however, is only apparent. Revision or repeal, unlike the original regula-

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tion, does not take place *ab initio;* it occurs in the context of the record established in the original rulemaking. To measure rationality only from the date at which revision began and not from the time the original record was assembled is to throw away useful information and ignore the APA's requirement that a court assess an agency's actions in the light of all the information on the record. An agency's actions should be judged in their entirety.

This does not legalize repeal on demand. Since there is a general principle that agencies should explain changes in policy, the agency may have to give a somewhat fuller explanation of its reasons for the change than it gave for the rule. In addition, the deregulating agency must consider the experience derived from the regulation. If a tentatively adopted regulation has proved undeniably successful, overturning it may no longer fall within the agency's range of discretion, even though failing to enact it would have.

The second major issue in the case was how much detail an agency has to put forward to support its conclusions. Some regulatory reformers have long complained that judges are too deferential to the putative expertise of the agencies. (Recall that the Bumpers amendment would have removed the statutory presumption of agency expertise.) The bumpers court accepted some challenged assumptions that the agency acknowledged were based on the engineering judgment of its staff. The reason is straightforward. Generalist judges cannot uncover glitches in these technical agency assumptions; they must rely on the parties, which presumably have both the access to technical expertise and the will to challenge agency assumptions, to do so for them during the proceeding.

This does not signal an attitude of blind judicial deference, since the court accepted the assumptions only after making sure that the parties had had a chance to object to them during the rulemaking. It does mean that intervenors must bring forth their best arguments in the public rulemaking, rather than holding them back for a court appearance.

The appellants also argued that many congressional sponsors of the Cost Savings Act were on record as indicating that they expected the statute to justify a five mph standard. This legislative history, the appellants maintained, should be a controlling sign of congressional intent. The court found this argument "luminescently invalid."

The legislative veto case made it clear that Congress can act only by passing legislation. Thus, if comments by individual members of Congress can have any effect, it must be because they illuminate what Congress as a whole meant by the text of the legislation it passed, not because they indicate how the individual legislators would like the agency to administer the legislation. The first bears on legislation; the second bears on the execution of legislation, which belongs squarely in the executive branch. To be sure, the agency will want to consider the will of members of Congress as part of its *political* deliberations, since members of Congress can influence executive policy through oversight hearings and in many other ways. But Congress's opinions on executive policy lack the force of law that attaches to congressional enactments.

Much of what passes as "legislative history" suffers from the same practical and constitutional infirmities that inhered in the legislative veto: it is easily manipulated by subgroups within Congress as well as by outsiders interested in the outcome, and it tends to blur if not subvert the separation of powers. By limiting legislative history to its proper role of politically pertinent advice, the court follows the thrust of the "bubble case" last year (see "The Bubble Upheld," Perspectives, *Regulation,* May/June 1984).

Finally, the court rejected the charge that the White House had exerted undue political influence over the agency's actions. It noted that in choosing within the range of discretion defined by the statute and the record, the agency is free to consult political factors. So long as the White House does not attempt to push the agency outside those boundaries, its involvement is not only acceptable, the court found, but indeed the way "the system is supposed to work." (In any case, the court noted, it was NHTSA's existing intent to take action that drove the White House announcement rather than the other way around.) Politics—or, if you prefer, voter influence—in regulatory policy making is no longer taboo.