No. 22-51124

IN THE

United States Court of Appeals for the Fifth Circuit

KEVIN CLARKE; TREVOR BOECKMANN; HARRY CRANE; CORWIN SMIDT; ARISTOTLE INTERNATIONAL, INC.; PREDICT IT, INC.; MICHAEL BEELER; MARK BORGHI; RICHARD HANANIA; JAMES D. MILLER; JOSIAH NEELEY; GRANT SCHNEIDER; AND WES SHEPHERD,

Plaintiffs-Appellants,

v.

COMMODITY FUTURES TRADING COMMISSION,

Defendant-Appellee.

On Appeal from the United States District Court for Western District of Texas (1:22-cv-00909-LY)

BRIEF OF THE NEW CIVIL LIBERTIES ALLIANCE AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFFS-APPELLANTS

Russell G. Ryan
Mark S. Chenoweth
NEW CIVIL LIBERTIES ALLIANCE
1225 19th St. NW, Suite 450
Washington, DC 20036
(202) 869-5210
Russ.Ryan@NCLA.legal

Counsel for Amicus Curiae
New Civil Liberties Alliance

CERTIFICATE OF INTERESTED PERSONS

Undersigned counsel for *amicus curiae* certifies that the following listed persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1, in addition to those listed in Appellant's Certificate of Interest Persons, have an interest in the outcome of the case. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

***Amicus*:** The New Civil Liberties Alliance is a not-for-profit corporation exempt from income tax under section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. § 501(c)(3). It does not have a parent corporation, and no publicly held company has a 10% or greater ownership in it.

***Counsel for Amicus*:** Russell G. Ryan, Senior Litigation Counsel, and Mark Chenoweth, President and General Counsel of the New Civil Liberties Alliance.

February 1, 2023

/s/ *Russell G. Ryan*
Russell G. Ryan

Counsel for Amicus Curiae
New Civil Liberties Alliance

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INTEREST OF *AMICUS CURIAE*[1]

Amicus curiae New Civil Liberties Alliance ("NCLA") is a nonpartisan, nonprofit civil-rights organization devoted to defending constitutional freedoms from administrative power. NCLA challenges constitutional defects in the modern administrative state through original litigation and *amicus curiae* briefs, because no other entity denies more rights to more Americans.

NCLA is particularly concerned when administrative agencies effectively bind private parties through regulatory "guidance," such as staff-level "no-action" letters, especially when that guidance contradicts policy positions previously articulated by the same agency without reasoned explanation for the change—a phenomenon variously referred to as regulatory "whiplash," "bait-and-switch," "flip-flop," "U-turn," "volte-face," "see-sawing," or the "surprise switcheroo." Such unexplained policy reversals are inherently arbitrary and capricious—particularly when the agency's prior policy engendered significant reliance interests on the part of regulated parties—and courts have a statutory obligation to set them aside as unlawful. The present case is a textbook example of such an arbitrary and capricious policy reversal, and NCLA urges the Court take the opportunity to underscore the need for agencies not only to explicitly consider reliance interests before reversing

[1] All parties consented to the filing of this brief. No counsel for a party authored any part of this brief. No one other than the *amicus curiae*, its members, or its counsel financed the preparation or submission of this brief.

previously articulated policies, but also to articulate a reasoned explanation for overriding those interests.

SUMMARY OF ARGUMENT

A foundational premise of administrative law is that when agencies exercise their vast discretionary powers to bind regulated parties, they must provide reasoned explanation and cannot act arbitrarily or capriciously. This premise is codified by the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), and confirmed by countless federal court decisions, *e.g.*, *Motor Vehicle Mfrs. Ass'n v. State Farm Auto Mut. Ins. Co.*, 463 U.S. 29 (1983); *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 155-61 (2012). *See generally* Todd Garvey, Cong. Rsch. Serv., R41546, A Brief Overview of Rulemaking and Judicial Review, 14-15 (2017) (citing cases).

Clearing this notoriously low bar is the least we expect from unelected administrators entrusted to promulgate and enforce the ever-expanding reams of regulation that federal agencies require private citizens and businesses to obey. Yet agencies often fail to clear even this low bar.

The present case illustrates a recurring scourge in administrative regulation: the "surprise switcheroo"[2] whereby an agency abruptly reverses prior policy without explanation, thus wreaking havoc on property and reliance interests engendered by

[2] *Wages & White Lion Invs. v. FDA*, 41 F.4th 427, 446 (5th Cir. 2022) (Jones, J., dissenting) (quoting *Env't Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005)), *reh'g granted*, No. 21-06766, 2023 WL 312977 (5th Cir. Jan. 19, 2023).

its prior policy. After assuring Plaintiffs-Appellants in 2014 that their proposed event-prediction market could operate lawfully under the Commodities Exchange Act, thus inducing them and others to invest millions of dollars and years of sweat equity to build and operate their PredictIt Market, Defendant-Appellee Commodity Futures Trading Commission ("CFTC") pulled the rug out from under Plaintiffs-Appellants in 2022 and told them to shut everything down by the apparently arbitrary date of February 15, 2023—or else. As if to flaunt the arbitrariness, *the same CFTC official* signed off on both the 2014 permission slip and the 2022 shut-down order.

So, this case offers the Court an ideal opportunity to underscore the need for agencies not only to explicitly consider reliance interests before reversing prior policy, but also to articulate a reasoned explanation for overriding those interests or not reasonably accommodating them. Here, CFTC did neither, thereby rendering its switcheroo on PredictIt Market both arbitrary and capricious.

ARGUMENT

CFTC Acted Arbitrarily and Capriciously by Reversing Course on PredictIt Market Without Considering Reliance Interests and Providing a Reasoned Explanation for Disregarding Those Interests

The Administrative Procedure Act requires courts to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). One of the most common ways an agency acts arbitrarily and capriciously is by inadequately explaining its reasons for taking

regulatory action, especially when that action reverses or rescinds a policy position previously taken by the same agency.

Whether described as regulatory "whiplash," "bait-and-switch," "flip-flop," "U-turn," "volte-face," "see-sawing," or the "surprise switcheroo,"[3] agency policy reversals demand rational explanations because they often wreak havoc on private property and reliance interests engendered by the prior policy. "Individuals and institutions operate around and build upon official representations of the law," and they "are incapable of managing the risk of legal change in a rational and effective manner, as they are unable to inoculate themselves against unforeseeable, broad swings in policy." Gary M. Bridgens, *Demystifying Reliance Interests in Judicial Review of Regulatory Change*, 29 Geo. Mason L. Rev. 411, 430 (2021). By contrast, just as *stare decisis* honors legitimate reliance interests created by judicial precedent, "[s]tability in regulation promotes efficiency [and] transparency[] and ensures accountability upon departure from the status quo." *Id*.

A seminal case in this area is *State Farm*, 463 U.S. 29, in which the Supreme Court set aside the rescission by the National Highway Traffic Safety Administration of a regulation promulgated 14 years earlier that required motor vehicles to be equipped with "passive restraints" such as airbags or automatic seatbelts. As relevant here, the Court held that the arbitrary-and-capricious standard applies to the

[3] *Wages & White Lion,* 41 F.4th at 446 (Jones, J., dissenting).

"rescission or modification" of regulatory action no less that it does to the original action and that, accordingly, an agency reversing course "is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance." *Id*. at 41-42. Although four dissenting justices would have found adequate explanation for rescinding the automatic seatbelt requirement imposed by the rescinded regulation, all nine justices agreed that the agency acted arbitrarily and capriciously when it "gave no explanation at all" for rescinding the airbag requirement. *Id*. at 58 (Rehnquist, J., concurring in part and dissenting in part).

The Court elaborated in this area in *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735 (1996), which arose from a Comptroller of the Currency regulation that allowed banks to charge late fees even to customers who resided in states that forbade such fees, a position arguably inconsistent with informal positions previously taken by the agency. Although the Court ultimately held the agency had not actually changed its position (but rather had merely resolved conflicting prior positions), Justice Scalia's opinion for the unanimous Court made clear—citing *State Farm* and other cases—that "[s]udden and unexplained change, or change that does not take account of legitimate reliance on prior interpretation, may be 'arbitrary, capricious [or] an abuse of discretion.'" *Id*. at 742 (citations omitted) (quoting 5 U.S.C. § 706(2)(A)).

The Court pushed this concept further in *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502 (2009). There, the Court upheld a regulatory order by the Federal Communications Commission that expanded the agency's prior position regarding when isolated utterances of expletives on television might be deemed actionably indecent and thus subject to enforcement under the Communications Act of 1934. In another opinion authored by Justice Scalia, the Court held that the agency's explanation for reversing course was adequately explained and "entirely rational," and therefore not arbitrary or capricious. *Id*. at 517-18. In doing so, however, the Court made clear that the agency's policy reversal would have warranted greater skepticism had the agency ignored "serious reliance interests" created by its prior interpretation of the relevant statute:

> [T]he agency need not always provide a more detailed justification than what would suffice for a new policy created on a blank slate. Sometimes it must—when, for example, … its prior policy has engendered serious reliance interests that must be taken into account. *Smiley v. Citibank (South Dakota), N. A.*, 517 U.S. 735, 742, 116 S. Ct. 1730, 135 L.Ed.2d 25 (1996). *It would be arbitrary or capricious to ignore such matters*.

Id. at 515 (emphasis added). Four dissenting justices would have gone further by insisting that *any* regulatory reversal—even those that do not undermine serious reliance interests—be supported not only by reasoned explanation, but by "a more complete explanation than would prove satisfactory were change itself not at issue." *Id*. at 549 (Breyer, J., dissenting).

In more recent cases, the Court has continued to demand reasonable explanation when agency flip-flops trample on legitimate reliance interests. For example, in *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211 (2016), the Court held that the Department of Labor acted arbitrarily and capriciously when, without meaningful explanation, it reversed its prior position on whether automobile dealerships must pay overtime to certain "service advisors" under the Fair Labor Standards Act. The Court was especially troubled by the Department's failure to consider the automobile industry's "significant reliance interests" in having operated their businesses and negotiated their labor and employment contracts based on the Department's prior interpretation of the relevant statutory provision. *Id*. at 222-23.

The Court raised similar concerns more recently when reviewing a decision by the Department of Homeland Security to rescind the Deferred Action for Childhood Arrivals program, commonly known as DACA. *DHS v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891 (2020). Among other reasons, the Court held the rescission arbitrary and capricious because the Department failed to address the substantial reliance interests of the program's beneficiaries. "[B]ecause DHS was 'not writing on a blank slate,' it *was* required to assess whether there were reliance interests, determine whether they were significant, and weigh any such interests against competing policy concerns." *Id*. at 1915 (emphasis in original) (internal quotation from dissenting opinion of Justice Thomas).

To summarize this line of Supreme Court authority: An agency acts arbitrarily and capriciously when it flip-flops on a policy position without articulating a reasoned explanation for doing so, and that explanation must specifically address any legitimate reliance interests engendered by the agency's prior position and explain why those interests were disregarded or not reasonably accommodated.[4]

In the present case, CFTC did neither. Its 2014 no-action letter induced Plaintiffs-Appellants to invest millions of dollars and years of sweat equity to create and operate their PredictIt Market, leading thousands of third-party traders to invest in prediction contracts offered on the market—some of which remain open. Yet when the agency withdrew its no-action relief in 2022 and ordered the market to shut down and unwind all pending contracts by the apparently arbitrary date of February 15, 2023, it disregarded the legitimate and substantial reliance interests of the Plaintiffs-Appellants and numerous other users of the market, offering no reasonable explanation for disregarding those interests and making no effort to accommodate them through less disruptive alternatives. The fact that the very same CFTC staff

[4] For similar reasons, courts deny agencies so-called *Auer* deference when "there is reason to suspect that the agency's interpretation [of its own rule] 'does not reflect the agency's fair and considered judgment on the matter in question,'" *Christopher*, 567 U.S. at 155 (quoting *Auer v. Robbins*, 519 U.S. 452, 462 (1997)), such as "when the agency's interpretation conflicts with a prior interpretation," *id*. (citing *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 515 (1994)).

official signed both the 2014 no-action letter and the 2022 shut-down order puts an exclamation point on the arbitrariness and capriciousness of CFTC's switcheroo.[5]

CONCLUSION

CFTC's no-action switcheroo on PredictIt Market was arbitrary and capricious, so this Court should therefore hold the agency's action unlawful and set it aside under 5 U.S.C. § 706(2)(A).

February 1, 2023

Respectfully submitted,

/s/ *Russell G. Ryan*

Russell G. Ryan
Mark S. Chenoweth
NEW CIVIL LIBERTIES ALLIANCE
1225 19th St. NW, Suite 450
Washington, DC 20036
(202) 869-5210
Russ.Ryan@NCLA.legal

Counsel for Amicus Curiae
New Civil Liberties Alliance

[5] CFTC's bald assertion that Plaintiffs-Appellants are no longer operating PredictIt Market in conformity with the 2014 no-action letter cannot justify the agency's wholesale bait-and-switch here. Even assuming CFTC's assertion of noncompliance is not pretextual, *cf. Dep't of Com. v. New York*, 139 S. Ct. 2551, 2573-76 (2019)—an issue presumably to be explored should this litigation proceed to discovery on the merits—that assertion could at most explain CFTC's about-face only with respect to those contracts and other aspects of the market that CFTC proves to be noncompliant. It could not plausibly explain CFTC's further direction disallowing even *compliant* pending and future contracts. *See, e.g*, *State Farm*, 463 U.S. at 46-51 (even if agency had adequately explained reasons for rescinding automatic seatbelt requirement, it failed to explain why it was also rescinding airbag requirement); *Regents of Univ. of Cal.*, 140 S. Ct. at 1911-14 (even if agency adequately explained why it was rescinding the authorization of benefits for DACA recipients, it failed to explain why it was also rescinding DACA's coordinate feature of forbearance from removal).

CERTIFICATE OF SERVICE

I hereby certify that on February 1, 2023, I electronically filed this *Amicus Curiae* brief with the Clerk of this Court using the CM/ECF system, which will send notice of such filing to all counsel of record.

February 1, 2023

/s/ *Russell G. Ryan*
Russell G. Ryan

Counsel for Amicus Curiae
New Civil Liberties Alliance

CERTIFICATE OF COMPLIANCE

I certify that this *Amicus Curiae* brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(iii) because this brief contains 2,106 words, excluding those portions of the brief exempted by Rule 32(f)(a)(7)(B)(iii).

This brief complies with the typeface requirements of Rule 32(a)(5) and the type-style requirements of Rule 32(a)(6) because it has been prepared using a proportionally spaced typeface using Microsoft Word in Times New Roman 14-point font.

February 1, 2023

/s/ *Russell G. Ryan*
Russell G. Ryan

Counsel for Amicus Curiae
New Civil Liberties Alliance