LLS:MF:bb

cc: Simms
Foy
Shane
Retrieval
Sudol
Files

United States Department of Justice
Washington, D.C. 20530

ASSISTANT ATTORNEY GENERAL
OFFICE OF LEGAL COUNSEL

MAR 19 1981

MEMORANDUM FOR MICHAEL J. HOROWITZ
Counsel to the Director
Office of Management and Budget

Re: Amendment of SBA Disaster Loan Program

You have requested the views of this Office on three additional questions presented by the proposed amendment to the regulations that govern the disaster loan program administered by the Small Business Administration (SBA). See 13 CFR § 123. Your questions are as follows:

(1) Would the proposed amendment be lawful as to persons whose loan applications are now pending, notwithstanding the fact that similar victims of the same disaster have already received more loan funds than will be available under the amended regulation to present applicants?

(2) Must the Administration follow any formal procedures prior to reaching the factual and policy determinations upon which the regulation is based?

(3) Does the SBA have the authority to make its amended regulation effective on an immediate basis, without notice and comment, and can it do so now?

We address and answer your first question in part I, below. We address and answer your second and third questions in part II.

I. Application of Amendment to Victims of Previous Disasters

The SBA proposes to make the amendment effective immediately and to apply the new loan standards to new loan applications as well as to old applications that are still pending for approval or disapproval. By applying the amendment in this way, the SBA would tighten loan criteria for future disaster victims and for many victims of previous disasters who have not yet received loans or filed applications. Moreover, by applying the

amendment in this way, the SBA would limit disaster relief for some disaster victims whose economic or personal situations may be indistinguishable from those of others who have already received loans on more favorable terms. Given this state of affairs, you have asked whether there is any legal bar that would prevent the SBA from applying the proposed amendment to pending loan applications and, presumably, to new applications arising out of old disasters.

Your question raises three different legal issues. Two are "substantive" in nature. The third is "procedural." They are as follows:

(A) Is there any constitutional or statutory limitation that would prevent the SBA from modifying loan criteria for disaster victims who have already sustained disaster losses but have not yet filed loan applications, or have filed applications but have not yet received disaster loans? For the sake of brevity, we will refer to this question as the "retroactivity" question in the discussion below.

(B) Is there any constitutional or statutory limitation that would prevent the SBA from modifying loan criteria for present or future applicants, given the fact that the SBA has already made loans on more favorable terms to other victims who may be similarly situated?

(C) If there is no substantive bar to the application of the amendment to the victims of old disasters, is there any procedural limitation, contained in any constitutional provision, statute, or regulation, that would require the SBA to give victims of old disasters notice of the proposed change and an opportunity for comment on it before the change is applied to their pending or future loan applications?

We shall consider each of these issues in turn. We shall discuss the last issue, the procedural issue, in connection with our discussion of the two more general procedural questions that you have asked us to address. See part II.

A. "Retroactivity"

In our view, there is no constitutional or statutory principle that would prevent the SBA, as a matter of substantive law, from modifying loan criteria for disaster victims who have already sustained losses but have not yet received disaster loans. Insofar as the Constitution is concerned, the relevant provision is the due process clause of the Fifth Amendment -- in particular, that aspect of the due process clause which imposes substantive limitations upon legislative power. In

general, in the economic realm, "substantive due process" does not prevent legislative authority from altering the civil consequences of prior transactions. Substantive due process comes into play only when an alternation would produce "harsh and oppressive" results or when the "retroactive" aspect of the change would be wholly arbitrary and would not promote an otherwise permissible governmental objective. See generally United States Trust Co. v. New Jersey, 431 U.S. 1 (1977); Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1977). What Congress may do by statute under these cases the Small Business Administration may do to the extent of its statutory authorization.

It is clear, in our opinion, that the proposed modification of the existing regulations governing disaster loans and the application of that modification to persons who have already sustained disaster losses would not be "harsh and oppressive" in the constitutional sense. */ Moreover, in our view, the application of the modification to pending and future loan applications is a rational way of promoting the very objective that requires the modification in the first instance. By applying the amendment in this way, the SBA will spread the financial shortfall among a larger class of disaster victims, minimize the burden in individual cases, and help to bring the loan program into compliance with the constraints of the budget.

We should add that the substantive due process analysis is not altered by the fact that we are dealing here, not with a police regulation, but with a remedial loan program designed to provide disaster relief to disaster victims. Even if the existing regulations could be read to create in disaster victims some expectation of disaster relief on terms no less favorable than those now permitted by the regulation, substantive due process would not, for the reasons we have given, prevent those regulations from being changed in a procedurally regular way. In fact, the regulations themselves state that they are subject to change as exigencies arise. We will discuss the procedural point in part II, below.

Just as we find no substantive constitutional limitation here, we find no statutory limitation; and, indeed, we believe there is statutory authority for the agency to take this action.

---

*/ We note in passing that, at worst, the modification would impose a 60% loan ceiling and require some recourse to private resources.

In its relevant parts, the statute does not create in any disaster victim a vested legal right to borrow money. The statute does nothing more than authorize the SBA to make "such loans" as the agency deems "necessary" or "appropriate" in the circumstances. There is no suggestion in this language that the SBA may not, after a disaster has occurred, modify its view of what kinds of loans may be "necessary" or "appropriate" in the circumstances. Indeed, as the agency's own regulations make clear, the circumstances that bear upon the necessity or appropriateness of relief in a given case cannot be assessed until the disaster has occurred. In our opinion, if there is some post-disaster development or determination that makes it necessary or appropriate, in the agency's view, for the relevant loan criteria to be altered, the better to accomplish the purposes of the statute, we think the relevant statutory language authorizes the agency to make that alteration effective with respect to any application arising out of that disaster at any time prior to settlement of the loan.

B. Different Treatment of Disaster Victims Similarly Situated

As we noted at the outset, the application of the proposed amendment to victims of old disasters may produce uneven results. Some victims of old disasters have already received loans under the old regulations. Other victims of the same disasters may have applications pending or may not yet have filed applications. You have asked whether the proposed amendment can be made effective as to the latter class, given the more favorable treatment that has already been accorded their neighbors.

As a constitutional matter, we believe there is no "one-disaster" rule lurking in the due process clause of the Fifth Amendment. The relevant question is whether the discrimination between these classes of applicants is rational and whether it advances some permissible governmental purpose. See generally Dandridge v. Williams, 397 U.S. 471 (1970). We alluded to that test in our previous memorandum.

In our opinion, the proposal to apply the amended loan criteria to pending applications and to future applications arising out of old disasters meets the constitutional test. It is clearly rational, and it is clearly in furtherance of a permissible governmental purpose. That purpose is to ration financial resources that are no longer adequate to fund the program in its present form. Indeed, it seems to us that a far more serious question of discrimination and arbitrariness would have been presented if the agency had proposed that it should continue to process pending applications under the existing standards and that it should apply the new standards

only to new applications arising out of new disasters. That course would have provided relief for the early comers, but it would have penalized persons whose only fault was to suffer disaster late in the fiscal year; and it might have left some late comers with nothing at all.

In other words, we think that the application of the amendment to victims of old disasters is permissible under the Constitution. For the same reason, we think that it is consistent with the general principle of administrative law that forbids arbitrary administrative action. The application of the amendment to pending applications and to future applications arising out of old disasters will not be arbitrary. As we have said, it will spread the relative scarcity over a larger class of disaster victims, it will minimize the burden of the scarcity in individual cases, and it will help to avoid a collision between the program and the budget.

III. Procedure

You have asked two procedural questions: (1) whether the SBA must follow any formal procedures prior to reaching the factual or policy determinations upon which the amendment will be based, and (2) whether the amendment can be made effective immediately, without notice and comment. We will answer these questions in reverse order. The first is dependent upon the second.

The Administrative Procedure Act requires notice and comment procedures to be followed in many kinds of agency rulemaking, but it contains an explicit exception for matters relating to agency loans. 5 U.S.C. § 553(a)(2). Consequently, the APA does not subject SBA's rules for the disaster loan program to any mandatory procedures. Nor does the SBA's own statute appear to do so, for it simply authorizes the agency to make regulations deemed necessary to carry out agency functions, without requiring any special procedures. 15 U.S.C. § 634(b)(6). By regulation, however, SBA has bound itself to follow the APA's rulemaking procedures. 13 CFR § 101.9. Such a regulation is binding on an agency until revoked or amended. United States ex rel. Accardi v. Shaughnessy, 347 U.S. 260 (1964).

Both the APA and the SBA's regulation adopting APA procedures contain a "good cause" exception to notice and comment procedures that allows the immediate promulgation of final rules where notice and comment would be "impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(B); 13 CFR § 101.9. To take advantage of that exception, the agency must, according to the statute, make a finding that good cause exists, and incorporate the finding and a brief statement of

reasons for it in the rules to be issued. SBA's regulations promise that this exception will be used "sparingly," but they warn in two places that emergencies may dictate its use. 13 CFR §§ 101.9, 123.0(a)-(b). The latter provision is found at the beginning of the rules for the disaster loan program. Thus, we conclude that the SBA may omit notice and comment procedures in the promulgation of this amendment if the SBA makes the finding required by § 553(b)(B) of the APA, as incorporated by § 101.9 of its own regulations.

Regarding the question of the procedures to be followed by the SBA in making the substantive factual and policy determinations upon which the amendment is to be based, we observe simply that if the emergency exception to notice and comment rulemaking is properly invoked, the Acting Administrator may make whatever factual or policy determinations are required of him, through informal consultation, direct or indirect, with his staff, in reliance on the accumulated experience of the agency, except where a more formal process is mandated by statute. No such formal process is mandated by 5 U.S.C. § 553 or by any other statute.

Larry L. Simms
Acting Assistant Attorney General
Office of Legal Counsel