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ARTICLES

SUB S ONE CLASS OF STOCK REQUIREMENT:
RULEMAKING GONE WRONG

Carole C. Berry*

The promulgation of regulations by federal agencies is often a cumbersome and time consuming exercise. The purpose of this Article is to examine the rulemaking process and, more specifically, how that process relates to the provisions of the Internal Revenue Code (Code) that allow Subchapter S corporations to issue only one class of stock (one class of stock requirement). In the process, this Article will explore: (1) the Internal Revenue Service's (IRS) procedures for promulgating tax regulations; (2) the theory of negotiated rulemaking and its use by selected agencies; (3) the federal act that allowed those agencies to use negotiated rulemaking; and finally (4) how the IRS could have used this process effectively in formulating the Subchapter S regulations.

A brief review of the Subchapter S regulations is instructive, especially given the long and stormy history of the Subchapter S one class of stock requirement. In 1958, Congress enacted Subchapter S of the Code. Subchapter S allows certain small businesses to elect to be treated, for tax purposes, as pass-through entities. Thus, double taxation on distributed earnings is eliminated and shareholders can take advantage of corporate

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3. A detailed description of the history of Subchapter S may be found in JAMES S. EUSTICE & JOEL D. KUNTZ, FEDERAL INCOME TAXATION OF S CORPORATIONS ¶ 1 (1985).
5. I.R.C. § 1362(a) (1993); see also EUSTICE & KUNTZ, supra note 3, at ¶ 1.02[3][d] (stating that the original Subchapter S allowed a corporation's undistributed income to be taxed at the shareholder level as dividends, thereby passing through the corporation).
losses while remaining insulated from corporate liability. Consequently, many small businesses have chosen the S corporation as their preferred business form. To qualify for S corporation standing, a business cannot have: (1) more than thirty-five shareholders, (2) shareholders other than individuals, estates, or certain qualifying trusts, (3) a nonresident alien as a shareholder, or (4) more than one class of stock. If any of the four statutory requirements is violated, the corporation ceases to be an S corporation, and the entity may be forced to wait five years before it is allowed to reelect S corporation status. Of the four prerequisites for S corporation standing, the one class of stock requirement has proven to be the most difficult qualification to define. To fully appreciate the problems associated with this regulation or any other regulation, however, it is necessary to examine generally the process of rulemaking.

I. THE RULEMAKING PROCESS

For almost fifty years, the Administrative Procedure Act has set forth the procedures used by administrative agencies to promulgate rules and regulations. Remarkably, the APA has proven to be both durable and unusually impervious to change. Thus, it is not surprising that attempts to alter the mechanism for fashioning regulations have been met with some skepticism. Increased dissatisfaction with the APA rulemaking process, however, has created the potential for changes in a system.

6. See § 1363(a) (1993); see also Eustice & Kuntz, supra note 3, at ¶ 1.02[3][d] (explaining that ordinary corporate losses pass through to shareholders while capital losses do not).
9. Id. § 1362(d)(2).
10. Id. § 1362(g).
13. Id. (stating that the APA has undergone only three amendments in its 40 year existence).
15. Many groups, including academics, industry, public interest groups, the private sector, the courts, and even the agencies themselves have criticized the rulemaking process over the course of the past decade. Lawrence Susskind & Gerard McMahon, The Theory and Practice of Negotiated Rulemaking, 3 YALE J. ON REG. 133, 135 (1985). Most parties that take part in rulemaking complain about the time and expense involved in creating and implementing a regulation. Id. at 133-34; Note, Rethinking Regulation: Negotiation as an Alternative to Traditional Rulemaking, 94 HARV. L. REV. 1871, 1872-73 (1981) (explaining the complicated procedures for implementing regulations). For example, businesses claim
that "had become increasingly adjudicatory and adversarial in character since the 1960s."\footnote{16}

The APA prescribes two principal methods for promulgating regulations by federal agencies. The first is known as formal rulemaking,\footnote{17} where, in a trial-like setting, testimony and exhibits provide evidence, which is then converted into a transcript.\footnote{18} The transcript constitutes the required record for the proposal of a new rule.\footnote{19} This is a cumbersome process both from the agency standpoint and for those parties who are involved outside of the agency.\footnote{20} For example, commentators note that in applying formal rulemaking procedures, the Food and Drug Administration took almost ten years to determine whether peanut butter should be eighty-seven or ninety percent peanuts.\footnote{21}

The second method of promulgating regulations, informal rulemaking, is somewhat less time consuming and certainly less cumbersome.\footnote{22} The informal process generally provides for notice and comment procedures prior to the implementation of a regulation.\footnote{23} Under these provisions, agencies must publish a notice of the proposed rulemaking in the Federal Register.\footnote{24} The comment procedures require agencies to provide not only an opportunity for public comment, but also to consider the comments that are received.\footnote{25} Only after these conditions are satisfied can the agencies publish the final rule.\footnote{26} The rule then waits thirty days

\footnote{16. Perritt, supra note 14, at 471.}
\footnote{18. \textit{Id.; see 1 Kenneth C. Davis, Administrative Law Treatise} § 6:3, at 453-58 (2d ed. 1978) (explaining that this process, known as "rules made on the record," is required by formal rulemaking).}
\footnote{19. 5 U.S.C. §§ 556, 557; see 1 Davis, supra note 18, § 6:3, at 453.}
\footnote{20. \textit{See 1 Davis, supra} note 18, § 6:8, at 475 (noting that "judges, legislators, administrators, and practitioners" agree that formal rulemaking is "not good for making rules of general applicability").}
\footnote{22. 5 U.S.C. § 553 (1988 & Supp. V 1993); see 1 Davis, supra note 18, § 1:4, at 13 (defining informal rulemaking as rulemaking without the burdens of a trial-type hearing).}
\footnote{23. 5 U.S.C. § 553(b)-(d).}
\footnote{24. \textit{Id.} § 553(b).}
\footnote{25. \textit{Id.} § 553(c).}
\footnote{26. \textit{Id.} § 553(d).}
before it becomes effective. While this method of rulemaking is more flexible than the formal rulemaking provisions, the informal rulemaking procedures assume that parties with an interest in the outcome will use adversarial techniques to persuade the decision makers to adopt a particular position. Interested parties employ various representatives who present written data or views before the agency and occasionally even present oral arguments. In this respect, a type of sequential negotiation takes place. In other words, because different parties represent different points of view and present them one at a time to the agency, there is no time for interaction among the various interest groups.

Initially, the formal and informal rulemaking procedures appear to be routinely simplistic. However, as a result of growing concern over the exercise of agency discretion and accountability in the increasing myriad of complex regulations, the executive branch, Congress, and the courts have added significant baggage to the statute in the last several years. Specifically, Executive Orders 12,291 and 12,498 expanded the oversight function of the Office of Management and Budget to include an appraisal of the cost efficiency of proposed regulations. In addition, Congress enacted the Freedom of Information Act, the Government in the Sunshine Act, the Federal Advisory Committee Act, and amended the APA to prohibit ex parte communications during both the formal rulemaking and adjudication processes.

At the same time, the courts also have restructured informal rulemaking in a series of decisions that expanded both the duties of agencies and the role of reviewing courts. As a result of the expansion that took

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27. Id.
29. Id. at 1873 (listing “lawyers, lobbyists, and others” as examples of representatives).
30. Id. at 1874 (stating that “face-to-face negotiations among the parties themselves that characterize regulatory negotiation” do not occur).
35. Id. § 552b (requiring that agencies hold open meetings for most proceedings).
38. See DeLong, supra note 31, at 262-76 (discussing the cases that established “stringent requirements” for informal rulemaking).
place in these “‘hybrid rulemaking cases,’” informal rulemaking as envisioned by the APA has evolved “into a new kind of on-the-record proceeding.” These cases expanded both the rules of standing and the notice and comment requirements. The courts also enlarged the development and use of the factual record, while utilizing the so-called “‘hard look’” approach in reviewing agency action. As a result of these various changes, the informal rulemaking process has become increasingly adversarial in nature and procedurally formalized. It is little

39. Id. at 259 (footnote omitted).
40. Id. at 260 (footnote omitted). As noted by DeLong, these terms can be confusing because formal rulemaking requires a proceeding “‘on the record,’” as mandated by 5 U.S.C. § 556, which necessitates both a formal record and various adjudicatory rights, whereas many of the hybrid cases appear to require the term “‘on the rulemaking record,’” which “does not create the same procedural rights.” Id. at 260 n.16 (citing 1 Davis, supra note 18, §§ 6:3, at 454-55, 6:4, at 458-59).
41. See United States v. Students Challenging Regulatory Agency Procedures, 412 U.S. 669, 686 (1973) (holding that standing is not confined to only those showing “‘economic harm’”).
42. See Mobil Oil Corp. v. FPC, 483 F.2d 1238 (D.C. Cir. 1973); see also 1 Davis, supra note 18, §§ 6:19, 6:20, 6:25, 6:26.
43. See Portland Cement Ass’n v. Ruckelshaus, 486 F.2d 375, 392 (D.C. Cir. 1973), cert. denied, 417 U.S. 921 (1974). In Portland Cément, the court held that there were critical defects in the decision-making process because the Environmental Protection Agency neither provided the manufacturers with the technical information that formed the basis of the regulation in a timely fashion, nor responded adequately to the manufacturer’s comments and objections to that same technical information. Id.; see also Solite Corp. v. EPA, 952 F.2d 473, 485 (D.C. Cir. 1991) (holding that technical and scientific data must be made available to interested parties); Navistar Int’l Transp. Corp. v. EPA, 941 F.2d 1339, 1359 (6th Cir. 1991) (same); Florida Power & Light Co. v. United States, 846 F.2d 765, 771 (D.C. Cir. 1988) (same), cert. denied, 490 U.S. 1045 (1989); Connecticut Light & Power Co. v. Nuclear Regulatory Comm’n, 673 F.2d 525, 530-31 (D.C. Cir. 1982) (same), cert. denied, 459 U.S. 835 (1982); United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240, 251-52 (2d Cir. 1977) (same); Home Box Office, Inc. v. FCC, 567 F.2d 9, 35-36 (D.C. Cir.) (same), cert. denied, 434 U.S. 829 (1977); Industrial Union Dep’t v. Hodgson, 499 F.2d 467, 475-76, 488 (D.C. Cir. 1974).
44. Greater Boston Television Corp. v. FCC, 444 F.2d 841, 851 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971). The court defined the hard look approach as the necessity of agencies to “articulate with reasonable clarity its reasons for decision, and identify the significance of the crucial facts.” Id. If the agency itself has not “taken a ‘hard look’ at the salient problems, and has not genuinely engaged in reasoned decision-making,” courts, in their supervisory function, must intervene. Id. (footnote omitted). In other words, the court cannot uphold agency decisions unless the agency has used reasons and standards to address the issues. Id.
45. While these developments no doubt have led to increased agency accountability, they nevertheless also have produced increased costs, complexity, and time necessary for the promulgation of rules and regulations. With only adversarial challenges to the process, those outside the agency have made little progress in addressing policy concerns. Therefore, one must question whether agency legitimacy is achieved through the present procedures.
wonder that scholars\textsuperscript{46} and even the agencies themselves\textsuperscript{47} have made suggestions for reform.

Given the changes made by the executive branch,\textsuperscript{48} Congress,\textsuperscript{49} and the courts,\textsuperscript{50} as well as the constantly changing Internal Revenue Code, it is hardly surprising that regulation projects are far behind the Code sections that they are supposed to define. For illustrative purposes, an examination of the process through which a regulation is formulated will best exemplify the myriad of problems with the present system.

II. RULEMAKING AND THE IRS

A. Preparing Regulations for Notice and Comment

While the IRS issues various types of rules, the regulations and Department of Treasury (Treasury) decisions that are prepared by the Office of Chief Counsel are the most important to the general public.\textsuperscript{51} The \textit{Internal Revenue Service Manual} prescribes the procedure used to develop, review, and approve regulations.\textsuperscript{52} The decision to open a regulations project\textsuperscript{53} is made in collaboration with attorneys from the Treasury Department, Office of the Assistant Secretary (Tax Policy), and with representation from the Treasury Department, Office of the Assistant Secretary (Tax Policy), and with representatives from various other agencies.

\begin{footnotesize}
\footnote{46. \textsc{Stephen Breyer}, \textit{Regulation and Its Reform} 341-63 (1982). Scholars have suggested numerous ideas for reform. One such suggestion is an effort to attract "better people" into the government to handle regulatory responsibilities. \textit{id.} at 342-45. Another proposal is to make several procedural changes designed to impose strict standards and to increase legal formality to achieve fairness. \textit{id.} at 346-50. These changes would increase efficiency in both formal and informal rulemaking. Such changes also would enhance the opportunity to participate in agency decisionmaking and the ability of agency decisions to achieve a greater degree of legitimacy through judicial review. \textit{id.} at 350-54. Other reform suggestions include structural changes to set up a system of checks and balances to clarify intra-agency responsibility and increase intra-agency efficiency, changes in the relationship between agencies and the rest of government in an effort to increase supervision of performance, and finally, the creation of new institutions, such as an administrative court, technical review board, and ombudsman, designed to help overcome problems of regulation. \textit{id.} at 354-63; \textit{see also} \textsc{Alan Stone}, \textit{Regulation and Its Alternatives} 237-74 (1982) (discussing the need for reform, but failing to make a consensus recommendation about what should be done).}

\footnote{47. \textit{See infra} notes 139-214 and accompanying text (discussing agency successes and failures in using negotiated rulemaking).

\footnote{48. \textit{See supra} notes 32-33 and accompanying text.}

\footnote{49. \textit{See supra} notes 34-37 and accompanying text.}

\footnote{50. \textit{See supra} notes 38-44 and accompanying text.}

\footnote{51. Treas. Reg. $ 601.601$ (as amended in 1987). The IRS Commissioner initiates regulations and Treasury decisions, which subsequently need approval by the Secretary of Treasury or the Secretary's delegate. \textit{id.})}

\footnote{52. \textsc{Internal Revenue Service}, \textit{Internal Revenue Service Manual} ch. (39)311 (1992) [hereinafter I.R.M.].}

\footnote{53. \textit{id.} ch. (39)312(1) (stating that "[r]egulations projects are opened when it is necessary or desirable to clarify or amend existing regulations or to provide new regulations").}
sentatives of the Legislative Affairs Division of the Assistant to the Commissioner (Public Affairs).”54 If a project is opened, attorneys from the Chief Counsel’s Office (Domestic) (Domestic drafting attorney) and the Tax Legislative Counsel (TLC) are assigned to the project and meet to determine the substance of the regulations, possible joint development, and an implementation schedule.55 The Domestic drafting attorney then prepares an “Issues Memorandum,” which identifies project issues and potential solutions.56 If there are major policy issues to be addressed and resolved, a “policy memorandum” also is prepared.57 On the other hand, the Domestic attorney and the Treasury attorney usually try to resolve nonpolicy issues on an informal basis.58 If a resolution is not possible, the Assistant Chief Counsel and an appropriate Treasury official will attempt to find a solution.59

Generally, the Domestic attorney has the duty to prepare the preliminary draft of the regulations, the policy memorandum, a 4-point memorandum for the Office of Management and Budget (OMB) and other necessary documents.60 A Domestic reviewer is then responsible for a “line-by-line” review of the draft regulations.61 In addition, the Treasury attorney also will review the draft regulations along with the 4-point memorandum and any policy memoranda.62 A preliminary draft of the regulations may be circulated to other individuals or offices within the Chief Counsel (Domestic) or the IRS63 and subjected to further com-

54. Id. ch. (39)312(2). Once a project’s opening is announced, the IRS encourages and welcomes comments concerning the content of the regulations from interested parties who can do so freely, either in written or oral form. See Treas. Reg. § 601.601 (1993).
55. I.R.M. ch. (39)312(3). A reviewer must be “satisfied that the draft Issues Memorandum identifies and analyzes the issues in the project thoroughly enough” before it is finalized. Id. ch. (39)312(4).
56. Id. (39)312(4).
57. Id. (39)312(5) (stating that the policy memorandum should detail the issues and suggested resolutions).
58. Id. (39)314.1(2).
59. Id. (39)314.1(3).
60. Id. (39)314.2(2) to -(3) (stating that the Domestic Attorney may be excused from these duties only by agreement). A 4-point memorandum is required for “[a]ny regulations document that must be approved by the Assistant Secretary (Tax Policy) and is not a major legislative regulation.” Id. (39)314.2(2). It must include “(1) the identifying number and title of the project; (2) whether the document is a Treasury decision or a notice of proposed rulemaking; (3) what the document does, stated briefly; and (4) whether the regulations are major legislative regulations.” Id.
61. Id. (39)313(2).
62. Id. (39)314.5(2). The Treasury attorney also must provide written comments regarding the draft to the Domestic drafting attorney and to other persons significantly involved within 30 days. Id.
63. Id. (39)314.3(1). Specifically, the regulations provide that copies of the policy memoranda and a preliminary draft of the regulations are issued to: (1) the Treasury attor-
ments. After all parties reviewing the document have determined that all appropriate revisions have been made, the Domestic drafting attorney notifies the Assistant Chief Counsel that the project is ready for briefing. The Assistant Chief Counsel recommends which, if any, issues should be addressed at a joint briefing. The Assistant Chief Counsel then confers with other offices and individuals who have participated in the project to assess whether a joint briefing is necessary. If a joint briefing is necessary, all persons who will attend receive a policy memorandum for the regulations project and a note indicating that the project will be briefed and which issues will be briefed. After a joint briefing does occur, the Domestic drafting attorney prepares a revised policy memorandum to note changes as a result of the briefing and revises the draft regulations to reflect those changes. Next, the Treasury attorney, reviewer, and other people in the IRS or Chief Counsel's Office who participated in the review examine the revised draft of regulations and the policy memorandum to determine whether they are consistent with substantive decisions regarding the regulation.

Once the Domestic attorney, Treasury attorney, and their reviewers have informally approved the draft regulations, and the Assistant Chief Counsel has decided that no further review is necessary, the Domestic drafting attorney prepares a signature package. The signature package is then submitted to the Assistant Chief Counsel, the Associate Chief Counsel (Domestic), the Chief Counsel, and the Commissioner for signature. Thereafter, the package goes to the Treasury, where the Assistant

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64. Id. (39)314.4, (39)314.5(1). Like Treasury attorneys, other officials making comments should submit their comments to the Domestic drafting attorney within 30 days. Id. (39)314.5(1).
65. Id. (39)314.7(1).
66. Id. (39)314.7(2).
67. Id. (39)314.7(3). Individuals who would participate in a joint briefing have the option to request a briefing or to suggest any additional issues that should be briefed. Id. (39)314.8(1), 8(3).
68. Id. (39)314.8(5) (noting that any unsatisfactory drafting should be reported to the Assistant Chief Counsel) Id.
69. Id. (39)314.9(1) to -(2).
70. Id. (39)314.9(2). Chronologically, the Assistant Chief Counsel will sign the package and then forward it to the Associate Chief Counsel (Domestic) for signature; after the latter's signature is obtained, the package is then sent to the Chief Counsel, followed by the Commissioner. Id.
Secretary (Tax Policy), the General Counsel, and the Executive Secretariat must indicate their approval. After Treasury approval, the regulations finally are ready to be published in the Federal Register.

B. The Notice and Comment Procedure

The notice and comment procedure commences when the proposed regulation is published in the Federal Register. In the event that interested parties request to be heard, the IRS sets a hearing time for that purpose. Occasionally, the IRS may schedule a hearing at the same time that the regulation is submitted for publication. Pursuant to section 601.601(a)(3)(i), people who wish to make oral comments at a public hearing are directed to submit both written comments and an outline of the topics to be discussed as well as the time necessary to discuss each topic. At the hearing, the oral comments ordinarily are restricted to a discussion of or questions and answers related to the subject matter of the written comments. If time permits, however, people who are not listed on the agenda may be allowed to comment orally provided they have given prior notification. Nonetheless, the notice and comment provisions may be waived "[i]n the case of unusual circumstances or for good cause shown." With respect to general comments on proposed rules, any interested persons may respond to a notice of proposed rulemaking by submitting data, views, or arguments, but because any comments made by the public are subject to public inspection, confidential material will not be accepted.

From beginning to end, this process can be extremely time consuming and costly for both the government and those parties wishing to be heard.

72. Id. (39)314.9(4).
73. Id. (39)314.9(5). At the same time that the Domestic attorney is providing the appropriate regulations and documents for filing with the Federal Register, he or she also “will prepare and forward a diskette . . . containing the approved regulation." Id. (39)314.9(6).
75. Id. § 601.601(a)(3)(ii).
76. Id. § 601.601(a)(3)(i). For this section to apply, its rules must be “incorporated by reference in a notice of hearing with respect to a notice of proposed rulemaking." Id.
77. Id. § 601.601(a)(3)(ii) to -(iii). The total time limit allotted for oral comment by each advocate is ten minutes. Id. § 601.601 (a)(3)(iii).
78. Id. § 601.601(a)(3)(ii).
79. Id. § 601.601(a)(3)(iv). Interested persons may notify the IRS Commissioner before the hearing or inform an IRS representative present at the entrance of the hearing room either before or during the hearing. Id.
80. Id. § 601.601(a)(3)(v).
81. Id. § 601.601(b).
82. Id.
Compounding these problems is the fact that the process can result in a complete failure. This Article questions whether a better alternative procedure exists for making regulation projects more efficient and satisfactory and concludes that the concept of negotiated rulemaking may provide the answer.

III. THE THEORY OF NEGOTIATED RULEMAKING

The concept of rulemaking through negotiation, as introduced by John T. Dunlop, revolutionized traditional rulemaking by shifting the focus of promulgatory rules to those groups most interested in the outcome of agency regulation. Dunlop, who was Secretary of Labor during 1975-1976, asserted in his article, *The Limits of Legal Compulsion*, that "parties that will be affected by a set of regulations should be involved to a greater extent in developing those regulations." While the regulatory agencies did not implement his ideas in practice or by the force of law, they were not forgotten. Rather, Philip J. Harter amplified Dunlop's ideas in an article that addressed the shortcomings of traditional rulemaking. By outlining his hypotheses for surmounting these shortcomings, Harter's article formed the underlying conceptual basis for negotiated rulemaking.

83. John T. Dunlop, *The Limits of Legal Compulsion*, 27 LAB. L.J. 67, 70 (1976) (explaining that interested parties with conflicting views may extend the comment process indefinitely through petitions for clarification or review, or litigation before the agency or courts).

84. Philip J. Harter, *Negotiating Regulations: A Cure for Malaise*, 71 GEO. L.J. 1, 28-29 (1982) (discussing how the approach transcended the traditional rulemaking process, which had considered participation to be merely submitting information); see Henry H. Perritt, Jr., *Negotiated Rulemaking Before Federal Agencies: Evaluation of Recommendations by the Administrative Conference of the United States*, 74 GEO. L.J. 1625, 1630-33 (1986) (discussing the emergence of negotiated rulemaking as a distinct process, as influenced by Dunlop).


86. See Dunlop, supra note 83, at 67.

87. *Id.* at 72. Dunlop also lamented the lack of any "mechanism for the development of mutual accommodation among the conflicting interests," such that opposing interests could settle the differences between them instead of involving the government. *Id.* at 70. Arguing that "[d]irect discussions and negotiations among opposing points of view, where mutual accommodation is mutually desirable . . . forces the parties to set priorities among their demands," Dunlop concluded that this process would create an incentive for opposing interests to find common ground and foster mutual understanding. *Id.*

88. See Harter, supra note 84, at 28 (attributing the lack of interest in Dunlop's ideas as a cause for their failure to become effectively implemented).

89. See id.; see also Perritt, supra note 84, at 1634 (discussing Harter's motivation to break away from traditional rulemaking).
At the outset, Harter conceded that negotiation is not appropriate in all situations.\textsuperscript{90} Therefore, his first, and perhaps most important point, is that parties will bargain only if they believe that the negotiations will produce a result that is at least as good as that which can be reached through some other decisional process.\textsuperscript{91} This concept, called BATNA (Best Alternative to a Negotiated Agreement) developed by Roger Fisher and William Ury,\textsuperscript{92} simply assumes that rational people will only attempt to negotiate if their resulting position is better than their position without negotiating.\textsuperscript{93} Conversely, if a favorable negotiated result is questionable and a party's position is superior to what is likely to transpire in negotiation, the party will not participate in the negotiation.\textsuperscript{94} Furthermore, determination of a party's BATNA will turn on what negotiators perceive as the results that will be achieved if the agency promulgates the regulation without negotiation.\textsuperscript{95} Harter's second construct dictates that parties have a certain degree of equality insofar as the power to influence the course of the negotiation.\textsuperscript{96} In other words, there must be interdependence among negotiators, such that any one of them is constrained from acting unilaterally.\textsuperscript{97} Thus, the countervailing power among the parties balances the outcome of the conflict, puts the result in doubt, and places the onus on the parties to reconcile their differences through negotiations.\textsuperscript{98} Conversely, if one party has the power to effectively overwhelm other members of the negotiation

\textsuperscript{90} Harter, supra note 84, at 43.  
\textsuperscript{91} Id. (illustrating this point through an example depicting the resolution of a dispute between a customer and store after a discussion of the alternatives available to each).  
\textsuperscript{92} ROGER FISHER & WILLIAM URY, GETTING TO YES 104 (Bruce Patton ed., 1981).  
\textsuperscript{93} Id. (asserting that BATNA is a standard that should be used in evaluating any proposal because of its ability to protect parties from inadvertently accepting or rejecting regrettable terms).  
\textsuperscript{94} Perritt, supra note 84, at 1637 (noting that a party's BATNA is flexible because the party may reevaluate and amend its BATNA with the addition of information throughout the negotiations).  
\textsuperscript{95} Id. Of course, different representative groups may have different predictions as to the unilateral agency outcome. Id. As a result, parties will have varied BATNAs. Id. For example, a manufacturer might be interested in making a product for the least amount of money, whereas a consumer group might be interested in the safety of the product. Consequently, the parties may have different views of what might result if the agency promulgates the final regulation in the absence of negotiations.  
\textsuperscript{96} See Harter, supra note 84, at 45 (explaining that a single party may have so much influence that it would not have to compromise to attain its goals and, consequently, it would have no reason to negotiate with other parties).  
\textsuperscript{97} Id. at 45-46 (discussing the ability of one party to impose its will over other parties); see Susskind & McMahon, supra note 15, at 139.  
\textsuperscript{98} See Harter, supra note 84, at 45-46 (noting that seemingly powerless parties may compensate with threats of delay or of instituting an action with a third party whose decision may not be easily predicted).
team, those overwhelmed members will search for an alternative process or forum in which to press their claims.  

Negotiated rulemaking in a practical agency process also depends on the number of negotiators involved. Harter determined that fifteen or fewer participants should be the limit. He speculated that if more than fifteen negotiators were involved, too many interests would be represented and the process would break down. Moreover, the issues to which the negotiation is directed must be mature or "‘ripe’" for decision. Hence, if the parties have not yet formulated their interests in the issues involved in the negotiation or if the issues themselves are not sufficiently identified, the process has not reached maturity. In this formulative process, issues are not ripe because the parties are still in their organizational stages and/or the substance of the negotiations has not yet been solidified.

Harter’s fifth prerequisite to successful negotiated rulemaking is based on the degree of urgency related to a decision. If the decision on the issue “is inevitable, or even better, imminent,” negotiators are more likely to engage in the required compromises and concessions necessary to resolve the matter in an effort to avoid a decision made by others. The urgency created by the pressures of a deadline will prompt the fear that an agency will take the decision-making process away from the negotiators. This fear will ultimately induce the negotiators to engage in negotiations.

100. Harter, supra note 84, at 46.
101. Id. at 46 & n.257. Harter’s observation was driven primarily by his feeling that it would be difficult to get more than 15 people around a table. Id. at 46 n.257. He did concede, however, that more than that number have participated in negotiations. Id.: see 5 U.S.C. § 565(b) (Supp. V 1993) (limiting membership to 25 people unless the agency head determined that more was necessary).
102. See Harter, supra note 84, at 46; cf. id. at 46 n.258 (suggesting the use of caucuses as a means to represent the interests of a number of different organizations).
103. Id. at 47 (emphasizing that negotiated rulemaking seeks to resolve issues and accommodate interests, which necessarily mandates that the issues are able to be addressed).
104. Id. For negotiators, maturity means the ability to grasp the issues, the possible solutions, and the implications of potential compromises. Id.
105. Id. (distinguishing the inability of a party to participate in a negotiation from the issue not lending itself to agency consideration).
106. Id.
107. Id. In this context, inevitability means that, in the event that the negotiators do not settle on a regulation, the agency will be required to act. Id.
108. Id. at 47-48.
109. Id. at 48. The parties are motivated to concede and negotiate by their desire to retain control of the proceedings. Id.
Reiterating his first point, Harter also maintains that parties will participate in negotiations only if they believe that they will be “better off for having done so.” Negotiations that result in “zero sum games,” therefore, are unlikely to be successful because, as Harter initially pointed out, parties will be attracted to the negotiation process only if they believe that they will come away in a better position than had they not participated in the process. Thus, he notes, negotiators must believe that the dispute will result in a win-win situation.

Furthermore, when the subject matter of the negotiations involves deeply held fundamental beliefs or values, the negotiations may come to gridlock. This phenomenon holds true because parties to the process can find little or no room for compromise. Basically, the more the parties agree on the underlying fundamental principles that may have an impact on their decisions, the greater their ability to negotiate the critical issues in search of a resolution.

Another dimension of Harter’s theory dictates that a negotiation will have a greater potential for success if there is more than one issue on the table. Because parties come to a negotiation with concerns that are weighted relative to their interests, they come ready to order those interests and to determine their priorities in an effort to maximize their potential for success. In contrast, with only one issue involved in the regulation, there is virtually no room for give and take. This sets up a zero sum games result, the classic situation in which one party wins and the other loses, thus ultimately directing any negotiation to fail.

110. Id.
111. Id. Zero sum games are “situations in which one party wins only to the extent that another loses.” Id.
112. See supra notes 90-94 and accompanying text.
113. Harter, supra note 84, at 48-49. A win-win situation results when all parties are better off for having negotiated. Id. at 48.
114. Id. at 49 (noting that “[i]f fundamental issues cannot be resolved, . . . the situation may closely resemble a debate over the superiority of various religions and the parties may be unable to reach an agreement”).
115. See id.; Perritt, supra note 84, at 1645. Here, Perritt illustrates the difficulties of conflicting fundamental values in a situation where “a fundamentalist Baptist preacher and an equally committed evolutionist” would have to negotiate a public school curriculum. Perritt, supra note 84, at 1645 n.115.
116. See Harter, supra note 84, at 50.
117. Id.
118. Id. To maximize their overall interests, parties may improve higher priority issues by yielding on lower priority issues. Id.
119. Id.
120. Id. Fortunately, most regulations raise a variety of issues appropriate for negotiating, such as the extent of the problem, the manner of compliance, or the date of implementation. Id.
Harter also contends that research should not be dispositive of the negotiation\textsuperscript{121} because parties probably will not negotiate if the results of the completed research or the research to be undertaken dictate the outcome of the negotiation.\textsuperscript{122} If research does determine the outcome, there is no reason to negotiate a matter that is or would be decided based on that research,\textsuperscript{123} unless the research opens new negotiation positions and further possibilities for compromise.\textsuperscript{124}

Harter's last major point is that the parties will negotiate only if some kind of effective implementation process is possible.\textsuperscript{125} Specifically, negotiators must believe that the agency will utilize and implement the results of their agreements.\textsuperscript{126} A contrary result would defeat the notion that parties negotiate to better their position.\textsuperscript{127}

Harter’s suggestions have been emulated in a report and recommendation presented to the Administrative Conference of the United States (ACUS),\textsuperscript{128} wherein regulatory negotiation has been recognized as an alternative method of drafting regulations.\textsuperscript{129} The ACUS subsequently adopted the proposal unanimously.\textsuperscript{130} While only a recommendation, it is evident that there is discontent in the way that rules and regulations are being drafted and implemented.\textsuperscript{131}

\textsuperscript{121} Id. at 50-51.
\textsuperscript{122} Id. Professor Harter notes that “when fundamental research is necessary, the outcome is in substantial doubt, and the outcome [of that research] would dictate the regulatory result.” Id. at 51. He points out that “a party may not wish to commit itself in advance to accepting the results of such research.” Id. at 50. On the other hand, the parties may agree during negotiations that research is needed and may determine the protocol for that research. Id. at 50-51. However, the results of that research must be fairly certain or, in the alternative, they must “open up a range of regulatory alternatives.” Id. at 51. In other words, the research should not resolve issues involved in the negotiation. Id.
\textsuperscript{123} Id. at 50 (explaining that “[i]f one party controls information that bears directly on a regulation, its power to control the outcome is greatly enhanced”).
\textsuperscript{124} See supra note 122 and accompanying text.
\textsuperscript{125} Harter, supra note 84, at 51.
\textsuperscript{126} Id.
\textsuperscript{127} See supra notes 90-94 and accompanying text.
\textsuperscript{128} Procedures for Negotiating Proposed Regulations, (Recommendation No. 82-4), 1 C.F.R. § 305.82-4 (1993) [hereinafter Recommendation 82-4].
\textsuperscript{129} See Harter, supra note 84, at 112-13.
\textsuperscript{130} See Recommendation 82-4, supra note 128. In addition, Recommendation 82-4 describes the various stages of negotiation as set out by Professor Harter in his original design and offers criteria to select appropriate subjects for negotiation. Id. The stages include (1) assembling the negotiators, (2) the negotiations process, (3) achieving consensus, (4) reporting the consensus to the agency, (5) agency action, and (6) judicial review. Id.
\textsuperscript{131} See id. The introductory comments to Recommendation 82-4 discuss the increasing formalization of the rulemaking process, the institutionalizing effect on adversarial relationships among interested parties, and the resulting extensive factual records, long
IV. **Negotiated Rulemaking in Practice**

Notwithstanding ACUS's unanimous endorsement of negotiated rulemaking as an alternative means for drafting regulations, it was concerned about whether negotiated rulemaking could withstand the scrutiny of the courts.\(^\text{132}\) For example, agency delegation could be one issue questioned. According to the delegation doctrine, policy decisions ought to be made only by accountable officials;\(^\text{133}\) however, negotiated rulemaking arguably takes that power and places it in the hands of people who are not accountable.\(^\text{134}\) In addition, some opponents to negotiated rulemaking also suggest that the policy against ex parte communication would limit the effectiveness of negotiated rulemaking.\(^\text{135}\) Perhaps the strongest argument against negotiated rulemaking concerns its effect on the Federal Advisory Committee Act\(^\text{136}\) (FACA), and the many ways that it potentially contravenes FACA.\(^\text{137}\)

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132. *See id.* The introductory comments to Recommendation 82-4 suggest this concern through a seemingly prophetic assertion that the recommended procedures would "ensure that affected interests have the opportunity to participate, that the resulting rule is within the discretion delegated by Congress, and that it is not arbitrary or capricious."  

133. JOHN LOCKE, *Two Treatises of Government* 380-81 (Peter Laslett ed., 2d ed. 1970); *see also* Perritt, supra note 14, at 480-82 (discussing how negotiated rulemaking may seem to violate the delegation doctrine, but in fact does not).  

134. *See Perritt, supra* note 14, at 480 (stating that if an agency delegates its rulemaking power to private citizens, delegation problems arise because private citizens are less accountable to the public than agency officials).  

135. *See id.* at 484-88 (concluding that negotiated rulemaking potentially could contradict the policy against ex parte communication between parties and decision makers). Ex parte contacts are forbidden during the formal rulemaking process. 5 U.S.C. §§ 554(d), 557(d) (1988 & Supp. V 1993).  

136. 5 U.S.C. app. §§ 1-15 (1988 & Supp. V 1993). Congress enacted the Federal Advisory Committee Act in 1972 because of rising concerns over the use of advisory committees by administrative agencies. *See id.* app. § 2; *see also* Perritt, supra note 84, at 1703. The findings and purpose section of the statute states that Congress found that: (1) the need for advisory committees had not been reviewed adequately; (2) new committees should be established only when needed and their numbers should be kept to a minimum; (3) advisory committees should be terminated once they have fulfilled their purpose; (4) standard and uniform procedures should govern the establishment, operation, administration, and duration of advisory committees; (5) Congress and the public should be kept informed with respect to the number, purpose, membership, activities, and cost of the committees, and (6) committees should serve only in an advisory capacity. 5 U.S.C. app. § 2(b)(1)-(6).  

137. In its final form, FACA requires an advisory committee to: (1) be chartered with the appropriate government office or personnel, (2) be used only for advisory purposes, (3) have meetings that are open to the public, (4) publish a timely notice in the Federal Register revealing the committee's schedule of meetings, and (5) make detailed notes at all meetings. *Id.* app. §§ 9(c), 9(b), 10(a)(1), 10(a)(2), 10(c). In effect, FACA regulates the creation, composition, and general function of advisory committees. Clearly, the require-
Fortunately, these and other potential problems have not surfaced in the attempts at negotiated rulemaking by several agencies.\textsuperscript{138} Hence, a review of some of the triumphs and failures of negotiated rulemaking is instructive for purposes of its application to the failed Subchapter S regulation.

\section*{A. Agency Successes}

Between 1983 and 1985, three different agencies utilized negotiated rulemaking on four significant occasions.\textsuperscript{139} Three of these negotiations reached consensus, while the fourth one was adjourned. One successful use of negotiated rulemaking occurred with the Federal Aviation Administration's (FAA) revision of the flight-and-duty time regulations for airline personnel.\textsuperscript{140} At issue was the maximum number of hours or periods of service in which airmen and other employees of airlines could be engaged.\textsuperscript{141} Because old restrictive regulations failed to meet changing technology of air travel, the FAA tried on numerous occasions to use the traditional rulemaking process to develop proposed revisions.\textsuperscript{142} None of these attempts, however, succeeded in resolving the myriad of issues to the satisfaction of all parties.\textsuperscript{143} Finally, in 1983, the FAA decided to attempt negotiated rulemaking.\textsuperscript{144}

Pursuant to FACA, the agency published a notice in the Federal Register of its intent to negotiate the regulation through the use of an advisory

\begin{footnotesize}
\begin{enumerate}
\item See infra notes 139-214 and accompanying text; see also Perritt, supra note 84, at 1695-96 (noting that another difficulty perceived by opponents of negotiated rulemaking is the potential conflicts between the informality of the process and judicial review). This potential conflict is due partially to the increased growth of hybrid rulemaking and its need for a more formal evidentiary base upon which the rule is promulgated. Perritt, supra note 84, at 1696. Commentators also have suggested that there could be challenges under section 706 of the APA, which "allows a court to overturn a rule if the agency's action was 'arbitrary, capricious, and abuse of discretion.'" Id. at 1701 (quoting 5 U.S.C. § 706(2)(A) (1988)).
\item See infra notes 140-54, 155-61, 162-70, 171-214 and accompanying text.
\item Id. at 12,136.
\item Id. at 12,136, 12,137 & n.1 (reflecting that within the prior six years alone, four separate attempts to reform the rules had been made).
\item Id. at 12,136-37 (identifying the complexity and inflexibility of the existing rules as well as the change in the character and growth of the air transportation industry as factors necessitating a change in the existing rules).
\item Id. at 12,137. The FAA created an advisory committee, which met for 16 days in 1983 to discuss the major issues regarding flight-and-duty time regulations. Id.
\end{enumerate}
\end{footnotesize}
committee. The notice identified the convener/mediator for the negotiations and requested interested parties to comment on advisory committee membership, issue formulation, and procedural matters. The notice made clear that the agency intended to promulgate a rule even if the negotiation process failed and incorporated provisions for interested parties to request inclusion in the process. Ultimately, the FAA established an advisory committee, primarily consisting of various airline companies, associations, and the International Brotherhood of Teamsters.

As with any group decision, the advisory committee probably faced many stumbling points during the process but the FAA was eventually able to publish a Notice of Proposed Rulemaking (NPRM), which gave interested parties forty-five days to comment. After the FAA and the advisory committee reviewed and addressed the comments received, they successfully reached an agreement on a proposed rule in March 1984 and promulgated the final rule in July 1985.

It is important to recognize the various factors that led to the success of this negotiation. The most significant factors include: the limited number of interests (ultimately eighteen participants were involved); the absence of issues involving fundamental value questions; and the ripeness of the issues for discussion. It also was obvious to the participants that prior FAA regulations had been unacceptable; therefore, there were present and pressing incentives to negotiate.

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146. Id. at 21,339-40.
147. Id. at 21,340 (stating that “the agency would issue a new [notice for proposed rulemaking] based upon the complete regulatory record including the record of this process”).
148. Id. at 21,341. The FAA, however, limited the number of participants to 15. Id.
152. Id. (explaining that “[t]he final rule [was] the result of FAA consideration of all comments on the NPRM and of the final deliberations of the Advisory Committee”).
153. See id. Thus, the circumstances under which the FAA conducted this rulemaking met several of Harter’s criteria for success. See supra notes 100-05, 114-15 and accompanying text.
154. See supra notes 91-95 and accompanying text (stating that Harter’s most important criteria for successful negotiated rulemaking is that the parties feel they have more to gain
At about the same time, the Environmental Protection Agency (EPA) was using negotiated rulemaking in two different settings. The EPA’s first effort was in developing an NPRM on noncompliance penalties under section 206(g) of the Clean Air Act.\textsuperscript{155} Overall, the EPA established the advisory committee in basically the same manner as the FAA negotiation\textsuperscript{156} and the negotiations began in June and ended in October 1985.\textsuperscript{157} The EPA conducted the negotiations under the requisite FACA charter with notice in the Federal Register of the meeting dates and the fact that the negotiations were open to the public.\textsuperscript{158} In the end, the committee reached a consensus on the issues that had been identified for discussion and resolution, and was able to submit a proposal for rulemaking.\textsuperscript{159} Subsequently, the EPA published the proposal in the Federal Register\textsuperscript{160} accompanied by little comment and the first phase of the noncompliance penalty rules were promulgated in final form later that year.\textsuperscript{161}

The EPA’s second success with negotiated rulemaking came in the form of exemptions from pesticide regulations. Specifically, section 18 of the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) granted the EPA administrator discretionary authority to exempt a federal or state agency from the provisions of FIFRA if the agency met cer-
tain conditions. Although regulations implementing that section already existed, concerns about their use or potential misuse prompted the EPA to utilize negotiated rulemaking as the procedure to develop new regulations.

Pursuant to the normal course of events, the EPA selected a convener to handle prenegotiation operations and appointed an in-house facilitator to help the negotiation process. Consistent with its first effort under the Clean Air Act, a Federal Register notice announced the convening of the committee, identified the potential issues, and invited requests for participation. The committee began negotiations in September 1984 and by January 1985 the committee reached full consensus on the preamble and text of the NPRM, which was subsequently published in April 1985. The EPA received comments and published the final rule in 1986 with little change.

B. Agency Failure

The last of the four major negotiation efforts began in 1983 and involved the Occupational Safety and Health Administration (OSHA).

162. 7 U.S.C § 136p (1988 & Supp V 1993) (allowing exemptions in cases where, after consultation with the Secretary of Agriculture and the governor of any state, the EPA Administrator determines that an emergency warrants an exemption).


164. Proposed Rule, 50 Fed. Reg. 13,944 (1985) (to be codified at 40 C.F.R. pt. 166) (proposed Apr. 8, 1985) (stating that in its audit of these regulations, the EPA cited the regulations' complexity, inefficiency, and lack of standards to determine emergency exemptions as concerns); see also Susskind & McMahon, supra note 15, at 147 (noting that the dramatic increase in the number of exemptions requested caused concerns that states and industries were using exemptions to improperly circumvent the regulations). See generally EPA Pesticide Regulatory Program Study: Hearing Before the Subcomm. on Department Operations, Research, and Foreign Agriculture of the House Comm. on Agriculture, 97th Cong., 2d Sess. 12 (1983) (discussing congressional concern about the marked increase in the number of requests for exemptions).

165. 50 Fed. Reg. at 13,944.

166. A convener is “a person who impartially assists an agency in determining whether establishment of a negotiated rulemaking committee is feasible and appropriate in a particular rulemaking proceeding.” 5 U.S.C. § 562(3) (Supp. V 1993); see also Harter, supra note 84, at 70 (explaining that the convenor would be responsible for a “preliminary determination of the feasibility of negotiation, the interests to be represented, and the appropriate representatives of the interests”).

167. A facilitator (or mediator) is “a person who impartially aids in the discussions and negotiations among the members of a negotiated rulemaking committee to develop a proposed rule.” 5 U.S.C. § 562(4); see also Harter, supra note 84, at 79 (explaining that the facilitator should “facilitate discussions between the interested parties without taking a position”).


170. Id.
OSHA was attempting to develop a revised standard for workplace exposure to benzene.\textsuperscript{171} This task ultimately proved to be unsuccessful, due in part to the baggage brought to the negotiation as evidenced by the stormy history of the regulation.\textsuperscript{172}

In 1971, OSHA promulgated an industry-wide standard for benzene exposure.\textsuperscript{173} Nonetheless, due to growing concerns for the health risks associated with the gas, many interested parties requested a stricter standard.\textsuperscript{174} In response to those requests, OSHA issued voluntary guidelines that eventually resulted in the promulgation of an emergency temporary standard.\textsuperscript{175} The restrictive nature of the emergency standard, however, led to judicial challenges\textsuperscript{176} and, consequently, OSHA never implemented it. Although OSHA proposed this same standard again and eventually issued it in final form,\textsuperscript{177} it was similarly challenged and invalidated.\textsuperscript{178} According to the United States Court of Appeals for the Fifth Circuit, OSHA provided insufficient evidence to support its findings in the administrative record; the Supreme Court agreed.\textsuperscript{179} The controversy over benzene continued until finally, in 1983, OSHA conceded to pressure and decided to expedite the issuance of a new permanent standard.\textsuperscript{180} After considering the time frame it had set for formulating a

\footnotesize{\begin{itemize}
  \item \textsuperscript{173} The EPA implemented this standard as the Emergency Temporary Standard for Occupational Exposure to Benzene. See 50 Fed. Reg. 50,512 (1985). The Secretary of OSHA established it under power granted in section 6(a) of OSHA. 29 U.S.C. § 655(a) (1988); see 50 Fed. Reg. at 50,515.
  \item \textsuperscript{175} Id. at 22,516.
  \item \textsuperscript{176} American Petroleum Inst. v. OSHA, 581 F.2d 493, 499 (5th Cir. 1978), aff'd sub nom. Industrial Union Dep't v. American Petroleum Inst., 448 U.S. 607 (1980); see also Industrial Union Dep't v. Bingham, 570 F.2d 965, 973-74 (D.C. Cir. 1977) (discussing the filing challenge to an OSHA regulation).
  \item \textsuperscript{177} Perritt, supra note 84, at 1648.
  \item \textsuperscript{178} Industrial Union Dep't v. American Petroleum Inst., 448 U.S. 607, 639 (1980).
  \item \textsuperscript{179} American Petroleum Inst., 581 F.2d at 504-05; Industrial Union Dep't, 448 U.S. at 639-40 (adding that OSHA had the burden to show through substantial evidence that the limit was "reasonably necessary and appropriate to remedy a significant risk of material health impairment").
  \item \textsuperscript{180} See Perritt, supra note 84, at 1650 (explaining that prior to the expedited issuance of a new standard, OSHA had denied a petition for a temporary emergency one).
\end{itemize}}
regulation that was acceptable to all parties, OSHA decided to use negotiated rulemaking to issue a new permanent standard.

The negotiations began in the summer of 1983 with healthy skepticism as to the chances of a successful outcome. This skepticism was due in part to the diversity of interests present at the negotiations, many of which were in absolute conflict with one another. For example, labor favored the minimum amount of exposure for its workers, while the steel industry acknowledged that it was difficult to stay within the fairly wide parameters of the 1971 regulation. Several other contingencies favored a standard that was less restrictive than the one that had been invalidated by the Supreme Court, but more restrictive than the existing standard. In addition, speculation about benzene's actual effect on health contributed to the difficulties in reaching a consensus. In the end, OSHA discontinued the negotiations and formulated a new NPRM that it released in 1985.

The reasons for the failure of the negotiations are significant because other agencies may examine OSHA's attempt to employ negotiated rulemaking before embarking on their own experiment. Among the questions that may be asked about the negotiations, one particularly important query is whether this set of regulations was an appropriate candidate for the negotiation process. It also is important to consider what other dynamics ultimately led to the failure. Does Harter's theory of negotiated rulemaking explain or suggest a reason for the outcome both from a procedural and a social interactive standpoint? In the totality of the circumstances, was the end result probable and perhaps even predictable?

181. See Perritt, supra note 84, at 1650-51. Basically, the time frame was to "add [the] benzene standard to [OSHA's] 'regulatory agenda' by June, 1983; submit a proposed standard to the OMB by November, 1983; publish a proposed standard in the Federal Register by December, 1983; hold a fact-finding hearing by February, 1984; and publish the final standard by June, 1984." Id. at 1650 (footnote omitted).

182. Id. (stating that the parties themselves were very doubtful about the success of the negotiations).

183. Id. at 1657-58 (noting that "[m]ost of the industry participants in the benzene negotiations worked in the health and safety functions of regulated enterprises or trade associations").

184. Id. at 1651. In particular, the steel industry favored a standard that exposed workers to 10 times more benzene than the proposed standard to which labor had agreed. Id.

185. Id. The petroleum and chemical industries thought they could accept a benzene level between those favored by the steel and labor industries. Id.

186. Id. (noting the difference in opinion as to the reliability of scientific data by labor and industry).

In considering whether the OSHA regulation was an appropriate candidate for negotiation, it appears that the negatives outweighed the positives. First, as previously noted, people will come to the bargaining table only if they believe that negotiation will lead to a better result than the traditional rulemaking process. Additionally, as noted by Professor Perritt, there was a degree of skepticism as to the potential for the negotiations to move to consensus. It appears that the negotiators were willing to “try anything” because of substantial pressure from then OSHA Assistant Secretary of Labor Thorne G. Auchter to negotiate, and because of the seven years of frustration in trying to use the traditional APA rulemaking method. In short, the climate at the outset left something to be desired.

Regarding the concerns of maturity, it appears that the issues in this case were “overripe” for decision because there had been multiple attempts at promulgating a standard and numerous failures, the last of which resulted in a divided Supreme Court decision. Moreover, negotiators likely were entrenched in their positions, due in part to the numerous informational documents that OSHA had created in the course of extensive pre-negotiation activity. Consequently, the participants had to assimilate the data to effectively discuss the issues. Thus, it appears that trade-offs would have been more difficult than in a negotiation in which the participants were building a record and had more flexible positions.

Furthermore, one could argue that a benzene standard flirts with Harter’s construct regarding fundamental values because of the health implications for exposed workers. Implementation also could pose a problem in light of the Supreme Court’s unwillingness to approve a reduction of the amount of benzene in the air (10 parts benzene per million parts of air—10 ppm to 1 ppm) without a showing that the exposure limit

188. See supra notes 91-95 and accompanying text.
189. Perritt, supra note 84, at 1650. One of the major forces, the petroleum industry, doubted whether negotiation was a good idea at all. Id. at 1651.
190. Id. at 1650.
191. See supra notes 103-05 and accompanying text.
192. See supra notes 173-80 and accompanying text.
194. Perritt, supra note 84, at 1653.
195. See Harter, supra note 84, at 50 (stating that negotiations are most effective when “the parties affected by a decision can identify the issues involved, scale their respective importance, trade positions, and work out novel approaches in an effort to maximize their overall interests”).
196. See supra notes 114-15 and accompanying text.
197. See supra notes 125-27 and accompanying text.
was reasonably necessary to provide a safe workplace.\textsuperscript{198} Therefore, the possibility that judicial review would overturn the standard would make such implementation problematic at best.

A final negative factor in applying negotiated rulemaking to OSHA regulations is premised on the fact that the issues central to the negotiation were technical in nature.\textsuperscript{199} As such, the standard was influenced necessarily by objective data rather than discussion and compromise.

On the positive side, having failed to successfully apply the traditional method of rulemaking, OSHA did seek negotiated rulemaking as an avenue to forge the regulations. Also, a finite number of parties were involved in the process\textsuperscript{200} with balanced countervailing powers.\textsuperscript{201} These parties had the ability to discuss several issues, creating the potential for trade-offs.\textsuperscript{202}

In considering other dynamics of the OSHA negotiations, it is clear that the process was the product of unforeseeable happenstance and the result of poor planning. For example, midway through the negotiations, the Assistant Secretary of OSHA resigned.\textsuperscript{203} Another unforeseeable problem was the apparent change in the political climate during the negotiations period, such that a negotiated standard potentially would have appeared to favor the steel industry.\textsuperscript{204}

In retrospect, one major reason for the failure of the negotiations was OSHA's lack of participation in the process. There appears to be no explanation of the agency's failure to participate, other than members of the health staff personnel and their legal staff had little confidence that the process would be successful.\textsuperscript{205} In short, OSHA was not committed to

\textsuperscript{199} See supra notes 121-24 and accompanying text (noting that such issues often require objective data).
\textsuperscript{200} See supra notes 100-02 and accompanying text.
\textsuperscript{201} See supra notes 95-98 and accompanying text. Over the course of several prior years, labor organizations promoted a lower exposure standard, while industry, afraid that its constituents could not meet those standards, promoted a higher exposure standard. Perritt, supra note 84, at 1651. The Supreme Court found that OSHA failed to show that a lower benzene standard was reasonably necessary or appropriate, while indicating that a higher benzene standard could be upheld once OSHA made such a showing. Industrial Union Dep't, 448 U.S. at 630-38.
\textsuperscript{202} See supra notes 116-20 and accompanying text.
\textsuperscript{203} Perritt, supra note 84, at 1659. Many perceived Assistant Secretary Auchter to be the power behind the organization of the negotiation. Id. at 1662. The parties also relied upon him to ensure that OSHA would unilaterally issue a regulation if the negotiations failed. Id.
\textsuperscript{204} Id. (discussing the emergence of labor's cooperation with the Reagan administration).
\textsuperscript{205} Id. at 1655.
the process from the outset. As a result of OSHA's nonparticipation, the negotiators had little guidance as to what kind of compromise the agency would accept. Moreover, the agency's veto power left open the possibility of complete failure of the process.

Another potential problem for the negotiation was OSHA's distribution of a draft standard during the negotiations. While nothing in the draft came as a surprise, the disclosure of OSHA's position on the issues may have effectively solidified positions at a time in the negotiations when open-mindedness may have better served the parties. As previously stated, OSHA adjourned the negotiated rulemaking committee and in late 1985, published its own NPRM with respect to limiting benzene exposure in the workplace.

Despite OSHA's failure with negotiated rulemaking to set benzene standards, OSHA and other federal agencies used this process in some form since the early 1980s. Because substantial questions remained about the application of FACA and other federal statutes, Congress be-

206. Id.
207. See Harter, supra note 84, at 60. Harter stated that "[a]gency nonparticipation . . . adversely affects the definition of the boundaries of the discussions, because the parties are either insufficiently aware of the boundaries or the boundaries are too rigid." Id.
208. See Perritt, supra note 84, at 1666.
209. Id. at 1661-62. Professor Perritt, however, acknowledges his research indicated that some members of the team thought that the draft standard was helpful. Id. at 1662 n.190.
210. Id. at 1662 (explaining that the draft solidified party positions and lessened the chances of consensus).
gan to examine the possibility of codifying the process and ultimately enacted the Negotiated Rulemaking Act of 1990.

V. CODIFICATION OF NEGOTIATED RULEMAKING

On June 23, 1987, Congress first attempted to codify negotiated rulemaking with Senate Bill 1504. After the Senate passed Senate Bill 1504 on September 30, 1988, the House of Representatives began to examine the matter; however, the 100th Congress adjourned with the House taking no action on the bill. Eventually, Congress introduced Senate Bill 303 and House Bill 743 on January 31, 1989, which were considered by the Senate Government Affairs Committee and the House Judiciary Committee, respectively. Finally on November 29, 1990, the Negotiated Rulemaking Act of 1990 (Act or Negotiated Rulemaking

213. See infra notes 215-19 and accompanying text.


215. S. 1504, 100th Cong., 1st Sess. (1987). The bill itself states that its purpose is “[t]o provide for an alternative to the present adversarial rulemaking procedure by establishing a process to facilitate the formation of negotiated rulemaking committees.” Id.


218. S. 303, 101st Cong., 1st Sess. (1989). While S. 303 incorporated much of the language of its predecessor S. 1504, there were some notable changes. First, S. 303 “simplifie[d] and strengthen[ed] the language requiring agencies that sponsor negotiated rulemaking committees to comply with the Federal Advisory Committee Act.” S. Rep. No. 97, 101st Cong., 1st Sess. 7 (1989). Second, “it place[d] the key provision of the bill in Title 5 of the U.S. Code, in the chapter on administrative rulemaking.” Id. at 8. Third, it made clear that in the judicial review process, regulations promulgated by negotiation “are to be accorded no greater deference by a court than” those of other rulemaking procedures. Id. Fourth, Congress added language “requiring agencies to publish a notice in the Federal Register of an intent to establish a negotiated rulemaking committee,” and language requiring that such notice “explain how a person may apply, or nominate another person, for membership on the committee.” Id. Finally, the Governmental Affairs Committee made general revisions to correct typographical errors, to change minor words, and to clarify that the Federal Mediation and Conciliation Service had authority to assist other federal agencies conducting negotiated rulemakings. Id.

The primary purpose of the Negotiated Rulemaking Act of 1990 "is to establish a framework for the conduct of negotiated rulemaking . . . to encourage agencies to use the process when it enhances the informal rulemaking process." As noted in the report submitted by the Senate Committee on Governmental Affairs, this purpose "contains two caveats." First, the Act encourages the use of negotiated rulemaking only if it would enhance the informal rulemaking process. Second, it recognizes that one of the most valuable qualities of the process "is its flexibility and adaptability to the exigencies of particular rulemakings." Thus, the Act clarifies the procedural issues involved in negotiated rulemaking while allowing "continued experimentation with th[e] process."

In section 563, the Act states that a committee should be assembled when "the head of an agency determines that the use of the negotiated rulemaking procedure is in the public interest." To aid in this decision making, the Act provides a list of seven basic factors to consider. By establishing basic rules for the process, instead of inflexible requirements, the Act creates a framework for implementing negotiated rulemaking. The agency head must consider whether:

1. there is a need for a rule;
2. there are a limited number of identifiable interests that will be significantly affected by the rule;
3. there is a reasonable likelihood that a committee can be convened with a balanced representation of persons who—
   A. can adequately represent the interests identified under paragraph (2);
   and
   B. are willing to negotiate in good faith to reach a consensus on the proposed rule;
4. there is a reasonable likelihood that a committee will reach a consensus on the proposed rule within a fixed period of time;
Rather than attempting to be comprehensive, these considerations should
serve as a guide for the agency head in determining whether negotiated
rulemaking is suitable for a particular case. In addition to these fac-
tors, the Act also authorizes the agency to use the services of a convener
to determine whether to form a negotiated rulemaking committee. Specifically, a convener assists the agency in designating which persons
would be most affected by the rule. Through discussions with those
interested persons, the convener then examines their concerns and at-
ttempts to determine whether it is both practical and suitable to form a
negotiated rulemaking committee for a particular rulemaking exercise. Afterwards, the convener reports the findings along with recommenda-
tions on these matters to the agency. In responding to this report and
recommendations, the agency may ask the convener to locate and iden-
tify persons who would be “willing and qualified to represent the interests
that will be significantly affected by the proposed rule.” The convener,
therefore, acts as an information gatherer and soundboard for the parties
involved in the potential negotiation.

If the agency decides to form a negotiated rulemaking committee, the
agency is required to publish that decision in the Federal Register and, if
necessary, other specialized publications. By publishing a notice, an
agency ensures that all parties affected by the proposed rule will be in-

(5) the negotiated rulemaking procedure will not unreasonably delay the no-
tice of proposed rulemaking and the issuance of the final rule;
(6) the agency has adequate resources and is willing to commit such resources,
including technical assistance, to the committee; and
(7) the agency, to the maximum extent possible consistent with the legal obliga-
tions of the agency, will use the consensus of the committee with respect to the
proposed rule as the basis for the rule proposed by the agency for notice and
comment.

Id. § 563(a)(1) to (7).

228. S. REP. No. 97, at 11-12. Because negotiated rulemaking requires willing and vol-
untary participation by all affected interests, it necessitates the ability of those affected to
choose a representative to negotiate in good faith on a rule for which the agency has
agreed to find and render assistance. Id. at 12.


230. Id. § 563(b)(1)(A).

231. Id. § 563(b)(1)(B).

232. Id. § 563(b)(2). Additionally, “[t]he report and any recommendations of the con-
venor shall be made available to the public upon request.” Id.

233. Id. Interested parties may include “residents of rural areas.” Id.

234. 5 U.S.C. § 564(a)(1) to -(8) (Supp. V 1993). The notice should contain:

(1) an announcement that the agency intends to establish a negotiated
rulemaking committee to negotiate and develop a proposed rule;

(2) a description of the subject and scope of the rule to be developed, and the
issues to be considered;

(3) a list of the interests which are likely to be significantly affected by the rule;
volved in the process, thereby improving the chances of a successful negotiation.\(^{235}\)

To effectuate the goals of public notice, section 564(b) of the Act provides that persons who believe their interests have not been properly represented "may apply for, or nominate another person for, membership on the . . . committee."\(^{236}\) Furthermore, the agency must allow at least thirty calendar days for the receipt of applications or nominees as well as comments on the formation of the committee and its proposed membership.\(^{237}\)

The question of whether to establish a negotiated rulemaking committee depends upon the evaluation of the comments and applications submitted.\(^{238}\) If the agency determines that a negotiated rulemaking process is feasible and appropriate and the interests of all parties affected by the proposed rule can be properly represented by the negotiated rulemaking committee, then a committee will be appointed by the agency head.\(^{239}\)

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(4) a list of the persons proposed to represent such interests and the person or persons proposed to represent the agency;

(5) a proposed agenda and schedule for completing the work of the committee, including a target date for publication by the agency of a proposed rule for notice and comment;

(6) a description of administrative support for the committee to be provided by the agency, including technical assistance;

(7) a solicitation for comments on the proposal to establish the committee, and the proposed membership of the negotiated rulemaking committee; and

(8) an explanation of how a person may apply or nominate another person for membership on the committee, as provided under subsection (b).

\(^{235}\) S. REP. NO. 97, 101st Cong., 1st Sess. 13 (1989) (explaining that if "representation for all significantly affected interests" does not exist, "the very problems of adversarial relationships and rulemaking litigation" that negotiated rulemaking is supposed to avoid will materialize).

\(^{236}\) 5 U.S.C. § 564(b) (Supp V 1993). This section specifies that each application or nomination must include:

(1) the name of the applicant or nominee and a description of the interests such person shall represent;

(2) evidence that the applicant or nominee is authorized to represent parties related to the interests the person proposes to represent;

(3) a written commitment that the applicant or nominee shall actively participate in good faith in the development of the rule under consideration; and

(4) the reasons that the persons specified in the notice under subsection (a)(4) do not adequately represent the interests of the person submitting the application or nomination.

\(^{237}\) Id. § 564(1) to -(4).

\(^{238}\) Id. § 564(c).

\(^{239}\) Id. The Senate Committee on Governmental Affairs explained that "this determination must take into consideration all of the comments received from the public as well as
While the committee generally will be limited to twenty-five members, at least one member of the committee must represent the agency, thereby, emphasizing that the agencies must actively participate in the process rather than remaining passive and neutral. On the other hand, if the agency decides not to form a negotiated rulemaking committee, its decision and the reasons supporting it must promptly be published in the Federal Register.

Assuming a negotiated rulemaking committee is formed, the agency must comply with the FACA, "except as otherwise provided." Although prior to the enactment of the Negotiated Rulemaking Act of 1990 there had been questions concerning FACA’s applicability to negotiated rulemaking and its potential for disrupting the negotiation process, the matter has been settled in favor of FACA’s applicability. Consequently, any perceived notions that FACA may potentially interfere with the negotiated rulemaking process must be left to future negotiations.

the factors listed in Section 563.” S. REP. No. 97, at 16; see also supra note 227 (listing the section 563 factors). The decision also "should include careful consideration of any findings or recommendations made by a convener." Id.

240. 5 U.S.C. § 565(b).
244. 5 U.S.C. § 565(a)(1). The Senate Committee on Governmental Affairs stated that while negotiated rulemaking committees appear to have had little trouble complying with FACA, these committees would benefit from the two limited exceptions to FACA found in the Negotiated Rulemaking Act of 1990. S. REP. No. 97, at 17. According to the Senate committee report, the Act’s first exception “provides more flexible rules for terminating a negotiated rulemaking committee, as explained in relation to Section [567].” Id. The second exception “provides different rules for agency reimbursement of committee member expenses, as discussed in relation to Section [568].” Id. The committee report concludes that “[i]t is to accommodate these two exceptions that Section [565] requires agencies establishing negotiated rulemaking committees to comply with FACA, ‘except as otherwise provided in this subchapter.’ ” Id.

245. See supra note 137 and accompanying text (explaining that FACA’s requirements for advisory committee formation and open meetings are in conflict with some of the essential structural provisions for negotiated rulemaking).
246. See S. REP. No. 97, at 16-17 (noting that the Act states “unequivocally that negotiated rulemaking committees are subject to FACA”).
247. Id. The Committee report paints a glowing picture of the interface between FACA and the Rulemaking Act. For example, FACA’s requirement that advisory committees be balanced in viewpoint dovetails with the statute’s requirement that negotiated rulemaking committees reflect all interests that will be significantly affected by the rule. Id. The issue of open meetings is not discussed except to say that because FACA applies, negotiated rulemaking committees must observe standard operating procedures on such subjects as finances, recordkeeping, and the Government in Sunshine Act. Id. The unresolved issue is whether subgroups or caucuses within the negotiated rulemaking committee are subject to the open meeting requirement. An argument can be made that they may
C. Committee and Agency Conduct

Once formed under section 566 of the Negotiated Rulemaking Act, the negotiated rulemaking committee must consider the matter proposed by the agency and attempt to reach agreement on a corresponding rule to be proposed. Section 566 also further defines the role of the agency representative as a member of a particular negotiated rulemaking committee. Specifically, individuals representing the agency are required to participate in committee deliberations and activities and are entitled to all of the same privileges and burdens of other committee members, including the authority to fully represent the agency throughout the proceedings. Yet, despite an agency representative’s authority to represent an agency during the negotiations and discussions of the committee, the agency itself retains the right to make the final decision regarding acceptance of a proposed rule. To temper an agency’s independent decision making power, the Act also requires the agency to consider any rule arrived at through a consensus of the committee and, to the greatest extent possible, to base its proposed rule on the committee’s findings. Nevertheless, the Act does not state clearly what the outcome would be should the agency decide not to publish the rule arrived at by a consensus of the committee.

be closed based on National Anti-Hunger Coalition v. Executive Comm. of the President’s Private Sector Survey on Cost Control, 557 F. Supp. 524 (D.D.C.), aff’ed, 711 F.2d 1071 (D.C. Cir. 1983), in which the United States District Court for the District of Columbia found that subgroups formed by an advisory committee to provide information and recommendations were not themselves advisory committees. Rather, the court reasoned, they were groups to advise the advisory committee and therefore removed from the literal language of the FACA. Also, in FCC v. ITT World Communications, Inc., 466 U.S. 463 (1984), the Supreme Court ruled that meetings between a panel of the FCC and foreign officials were not subject to the Sunshine Act and therefore not open to the public. The Court viewed those meetings as informational in nature and stated that to require all meetings of this sort to be open to the public would “impair normal agency operations without achieving significant public benefit.”


249. Id. § 566(b).

250. Id.

251. The Senate committee report stated that the agency head may “accept all, part or none of the consensus proposal.” S. REP. NO. 97, at 19 (1989). Harter, supra note 84, at 65 (stating that an agency representative’s participation does not bind the agency).

252. 5 U.S.C. § 563(a)(7) (Supp. V 1993). This section specifically states that “the agency, to the maximum extent possible consistent with the legal obligations of the agency, will use the consensus of the committee with respect to the proposed rule as the basis for the rule proposed by the agency for notice and comment.” Id.; see also S. REP. NO. 97, at 19 (stating that an agency is expected to “make a good faith effort to use the consensus rule as the basis for the published rule”).
To expedite this process, the Act provides that a "facilitator" may be appointed.\textsuperscript{253} Defined as "a person who impartially aids in the discussions and negotiations among the members of a negotiated rulemaking committee," the facilitator, as a neutral party, heads the meetings, assists the committee members in discussing and negotiating the issues, and keeps the minutes and records in accordance with FACA.\textsuperscript{255}

In addition to a convener and a facilitator,\textsuperscript{256} the Act allows an agency engaging in negotiated rulemaking to utilize federal and private property and services, with or without reimbursement, so long as the owner's consent is obtained.\textsuperscript{257} Thus, an agency may take advantage of a variety of resources to achieve its goals. For example, the Act permits an agency to utilize both office space and computer time donated by private parties as well as services of a facilitator from another agency.\textsuperscript{258} Additionally, an agency may employ technical experts from other agencies or private firms in the process.\textsuperscript{259} Reimbursement for these donated services or facilities is decided on a case-by-case basis.\textsuperscript{260} One final resource available to assist the negotiated rulemaking committee is the Federal Mediation and Conciliation Service, which can furnish conveners, facilitators, or training in the negotiated rulemaking process.\textsuperscript{261}

With respect to committee procedures and operations, section 566 specifically states that the requirements of section 553 of the APA shall not

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\item \textsuperscript{253} 5 U.S.C. § 566(c) (Supp. V 1993). Section 566(c) sets out the method by which a facilitator is designated:

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\item an agency may nominate either a person from the Federal Government or a person from outside the Federal Government to serve as a facilitator for the negotiations of the committee, subject to the approval of the committee by consensus. If the committee does not approve the nominee of the agency for facilitator, the agency shall submit a substitute nomination. If a committee does not approve any nominee of the agency for facilitator, the committee shall select by consensus a person to serve as facilitator. A person designated to represent the agency in substantive issues may not serve as facilitator or otherwise chair the committee.
\end{itemize}

\textit{Id.}

\item \textsuperscript{254} 5 U.S.C. § 562(4) (Supp. V 1993).

\item \textsuperscript{255} \textit{Id.} § 566(d)(1) to -(3). Under the Freedom of Information Act, the requirement of keeping minutes and records does not encompass the release of the personal notes and materials of the committee members or the facilitator. \textit{Id.} § 566(d)(3); see Mead Data Cent., Inc. v. United States Dep't of the Air Force, 575 F.2d 932, 934-35 (D.C. Cir. 1978) (holding that predecisional conclusions are protected from public exposure).

\item \textsuperscript{256} See supra notes 229-33, 253-55 and accompanying text (discussing the roles of the convener and the facilitator, respectively).

\item \textsuperscript{257} 5 U.S.C. § 568(b) (Supp. V 1995).

\item \textsuperscript{258} S. Rep. No. 97, 101st Cong., 1st Sess. 23 (1989).

\item \textsuperscript{259} \textit{Id.}

\item \textsuperscript{260} \textit{Id.}

\item \textsuperscript{261} 5 U.S.C. § 568(b). Section 553 of the APA provides an informal rulemaking procedure. See supra notes 22-30 and accompanying text.
apply. Rather, a negotiated rulemaking committee may adopt procedures for its own operation. Section 566 also states that upon completing negotiations, if the committee reaches an agreement on a proposed rule, the committee must transmit that proposal to the agency. If no consensus on a proposed rule is achieved, the committee may submit a report to the agency identifying any issues upon which the committee reached a consensus together with "any other information, recommendations, or materials that the committee considers appropriate." Furthermore, any individual committee member may include as an addendum to the report any other information or comments that he or she would like the agency to consider. Pursuant to the FACA requirements, the committee also must submit records required under FACA sections 10(b) and (c) to the agency, including documents considered by the committee during its deliberations and the minutes of each advisory committee meeting.

D. Funding the Committee

As previously established, the Negotiated Rulemaking Act specifically requires that negotiated rulemaking committees must comply with FACA "except as otherwise provided." How and when agencies may reimburse committee members for expenses is one such exception. Mem-

263. 5 U.S.C. § 566(e). This provision provides the committee “the flexibility to address only those procedural issues that need to be resolved,” and to do so expeditiously and unhampered by the formalized procedure of the APA. S. REP. No. 97, at 20.
265. Id.
266. Id.
267. Id. § 566(g). Sections 10(b) and 10(c) of the FACA provide the following:
   (b) Subject to section 552 of title 5, United States Code, the records, reports, transcripts, minutes, appendixes, working papers, drafts, studies, agenda, or other documents which were made available to or prepared for or by each advisory committee shall be available for public inspection and copying at a single location in the offices of the advisory committee or the agency to which the advisory committee reports until the advisory committee ceases to exist.
   (c) Detailed minutes of each meeting of each advisory committee shall be kept and shall contain a record of the persons present, a complete and accurate description of matters discussed and conclusions reached, and copies of all reports received, issued, or approved by the advisory committee. The accuracy of all minutes shall be certified to by the chairman of the advisory committee.
268. See supra note 244 and accompanying text.
269. 5 U.S.C. § 568(c) (Supp. V 1993); see 5 U.S.C. app. § 7(d) (1988). Section 7(d) of FACA authorizes agencies to compensate committee members, staff members, and consultants for certain expenses. Id. FACA requires the General Services Administration to issue uniform regulations regarding the compensation that may be paid and delineates sev-
bers of negotiated rulemaking committees are responsible generally for their own expenses. If a committee member can show that he or she lacks the financial resources to participate in the committee and the agency finds that this same member’s participation is essential for representation of his or her interests, the agency may reimburse that member’s expenses. Significantly, the use of the word “may” in the Act indicates that the agency is authorized, but not necessarily required, to pay such expenses in these exceptional cases. Nevertheless, once a committee member is found eligible, the agency must pay that member’s expenses pursuant to section 7(d) of FACA, which includes “reasonable travel and per diem expenses, expenses to obtain technical assistance, and a reasonable rate of compensation.”

One particular concern that may arise when an agency reimburses a committee member who represents private interests is whether that committee member is then considered a federal employee. If so, that committee member, as a federal employee, would be subject to the criminal conflict provisions in Title 18 of the United States Code, which would bar the member from participating in any future activities related to the negotiated rule. Section 568(d) of the Negotiated Rulemaking Act, however, clearly states that under section 568(c), reimbursement to committee members does not conclusively classify that person as a fed-

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270. 5 U.S.C. § 568(c).
271. Id. § 568(c)(1) to -(2).
272. Id. As noted in the Senate committee report, there are several reasons for this provision. First, the negotiated rulemaking process “usually cost[s] more, initially, than conventional rulemaking procedures in which a few agency employees draft the proposed rule.” S. REP. No. 97, 101st Cong., 1st Sess. 24 (1989). The bulk of these costs involve “setting up meetings, providing clerical and technical assistance, and making agency officials available for extended periods of time.” Id. Consequently, if the agency, in addition to the foregoing expenses, also had to fund travel and per diem costs, the entire negotiating process could be jeopardized. Id. On the other hand, the Act recognizes that a negotiated rulemaking committee may include groups of people who are unable to fund their expenses, but who are critical to the successful function of the negotiation. Id. Thus, section 568(c) allows agency flexibility in “hold[ing] down costs while nevertheless ensuring that agencies are able to conduct negotiated rulemaking which require the participation of financially needy representatives.” Id.
273. 5 U.S.C. § 568(c).
274. S. REP. No. 97, at 25.
275. Id.
eral employee. Thus, it appears that section 568(d) has both antici-
pated and resolved this concern.

E. Termination of the Committee

Section 567 provides for the termination of a negotiated rulemaking
committee and states that, generally, a committee is dissolved once a final
rule has been promulgated. Deviations from this provision are permis-
sible when the committee’s charter contains an earlier ending date, when the agency, along with the committee, decides to terminate, or when the committee independently calls for its own dissolution.

F. The Role of the Administrative Conference of the United States

The Administrative Conference of the United States (ACUS) en-
couraged the use of negotiated rulemaking because of frustration over
the existing notice and comment procedure and hybrid rulemaking.

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276. 5 U.S.C. § 568(d).
277. 5 U.S.C. § 567 (Supp. V 1994). This section differs from FACA’s requirements for
      termination of a committee. Under FACA, an advisory committee’s charter specifies a
termination date, which can only be altered if the agency, prior to that date, determines
      that the committee should continue to function and renews its charter prior to the sched-
ule date. S. Rep. No. 97, at 21. The original termination date, however, can
      never be more than two years after the date of the committee’s charter. Id. In contrast,
      the Negotiated Rulemaking Act recognizes the need for greater flexibility in using negoti-
ated rulemaking because promulgation of a final rule potentially could take more than two
years. Id. An example of this problem is an agency that recalls a dormant committee to
give its analysis of a proposed final rule developed from committee efforts before publica-
tion. Id. Thus, reconvening the committee could take place without a renewed charter as
would be required by FACA, even if it takes place more than two years after the commit-
teer’s inception. Id.
278. 5 U.S.C. § 567. In this case, the charter could dissolve the committee on a speci-
      fied date even before a final rule is actually promulgated. S. Rep. No. 97, at 21. Addition-
ally, a charter could specify that the committee must terminate when a proposed rule
merely is issued by the agency, regardless of a final rule. Id.
279. 5 U.S.C. § 567. This provision provides the agency the authority to initiate termi-
nation of the committee. S. Rep. No. 97, at 21. Of course, this authority is not unilateral.
The agency must consult with the committee before it takes any action to disband the
committee. Id. This provision could be used in the event of an agency’s fiscal constraints
or where the committee simply fails to act after a lengthy impasse yet refuses to disband.
Id. Because the statute only requires that the agency consult with the committee before
termination, the agency retains final authority over the committee’s existence as long as
the agency does not abuse its discretion and does not act in bad faith. Id. 21-22.
280. 5 U.S.C. § 567. This provision allows the committee to dissolve itself when the
      committee’s work is finished and it chooses not to wait for a final rule or when committee
negotiations have simply failed. S. Rep. No. 97, at 22.
281. Procedures for Negotiating Proposed Regulations (Recommendation 82-4), 47
282. Id. at 30,708; see also supra notes 15-30 and accompanying text (discussing short-
      comings of traditional rulemaking).
After noting some examples of successful negotiations, ACUS made further recommendations in 1985 to address the dynamics of the negotiation process in the rulemaking setting.283 Predictably, ACUS would have a significant role in the continued use of negotiated rulemaking and Congress codified that role in the Negotiated Rulemaking Act.284

Section 569 details ACUS' role in the negotiation process, and specifically lists ACUS as a source of information for agencies that seek to form a negotiated rulemaking committee for a proposed rule.285 Agencies also are permitted to contact other persons or institutions, both private and public, for additional guidance.286 One recommended source is other government agencies that have experience in negotiated rulemaking.287

To help agencies obtain conveners and facilitators, ACUS, working with the Federal Mediation and Conciliation Service, maintains a roster of people who have experience in or an interest in serving in those capacities,288 including people from both the private and public sector.289 The agencies, however, are not precluded from utilizing individuals and organizations from both private and public sources that are not from the above-mentioned rosters.290 Furthermore, because many agencies have not used negotiated rulemaking, ACUS is charged with creating procedures whereby agencies can obtain quick access to conveners and facilitators.291 In short, ACUS' goal in creating these procedural guidelines is to minimize the "confusion and red tape" that could potentially be involved in the process of obtaining convener or facilitator services.292

Under section 569(e), ACUS also acts as a mentor by providing programs on the elements and implementation of negotiated rulemaking, which are open to agency personnel and other individuals.293 The provi-
sion also authorizes ACUS to offer this training to private individuals on a reimbursable basis and federal personnel on either a reimbursable or nonreimbursable basis.294

Because funding of a negotiated rulemaking project is an agency concern, agencies can request that ACUS provide funding to pay for all or part of the start-up costs for forming a negotiated rulemaking committee and the expenses incurred from conducting a negotiated exercise.295 ACUS is not necessarily mandated to finance the expenses incurred by an agency as a result of negotiated rulemaking.296 The Chairman of ACUS has the discretion to select the type and amount of payments that ACUS will make.297 In granting or denying funds to an agency, ACUS must consider its charge: to advance negotiated rulemaking in federal agencies.298 One last funding issue, which was inserted at ACUS' request,299 permits ACUS to further the Act's goal by accepting and applying donations and in-kind contributions for negotiated rulemaking.300 In other words, donations to ACUS may be applied not only toward expenses for conveners, facilitators, training, and the like, which are specifically listed in the statute, but also to any other expenses that may promote negotiated rulemaking.301

Furthermore, to give agencies a central source for negotiated rulemaking information and to provide Congress with a status report on the effec-

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294. 5 U.S.C. § 569(e). The Senate committee report specified that private individuals include both federal and nonfederal personnel. S. Rep. No. 97, at 27. Federal Personnel may receive training on a reimbursable or nonreimbursable basis, but nonfederal personnel may only be offered training on a reimbursable basis. Id. The report did not attempt to explain the different treatment and it did not explain under what circumstances a federal employee would reimburse ACUS for the negotiation training. See id.

295. 5 U.S.C. § 569(f). Some agencies may choose not to use negotiated rulemaking because of the initial start-up costs that are not associated with traditional rulemaking. S. Rep. No. 97, at 27. Consequently, ACUS' ability to reduce agency expenditures is intended to encourage more agencies to utilize negotiated rulemaking. Id. Examples of start-up costs include, but are not limited to, expenses for conveners and facilitators, eligible committee members, and training. See 5 U.S.C. § 569(f)(1) to -(3).


297. Id.; see also S. Rep. No. 97, at 28 (stating that any discussion to provide funding must be noted and explained in ACUS' biennial report submitted to Congress).

298. 5 U.S.C. § 569(f); see S. Rep. No. 97, at 28.


300. 5 U.S.C. § 569(g).

tiveness of the statute, ACUS must compile and maintain data related to negotiated rulemaking. To assist in this endeavor, agencies making use of negotiated rulemaking must provide ACUS with negotiated rulemaking committee reports and all other relevant information reflective of the agency's negotiation experience. ACUS must review and analyze the reports and materials, and then generate a biennial compilation which is forwarded to the Senate Committee on Governmental Affairs and the appropriate House committees. The biennial report includes suggestions for effective agency use of negotiated rulemaking and an accounting of all ACUS expenditures made to further the goals of the Act.

G. Judicial Review and Duration of the Act

Some of the primary benefits of negotiated rulemaking include the issuance of more workable rules, as well as reductions in litigation, time, and costs normally associated with the traditional rulemaking procedure. While actions taken by agencies to create, join in, or terminate a negotiated rulemaking committee are not reviewable, the Act provides for judicial review of a negotiated rule. In fact, section 570 preserves the right to challenge an agency's rule when it is the product of a negotiated rulemaking proceeding. More specifically, the APA allows challenges to this provision, such that a court could overturn a negotiated rule if it found that in promulgating the rule, the agency's actions were "arbi-

302. Id. at 26.
303. 5 U.S.C. § 569(d)(1). This information is available to aid agencies as well as parties involved in the negotiations. Id.
304. Id. § 569(d)(2).
305. Id. § 569(d)(3).
306. Id. § 569(d)(3)(A),(B). The purpose of this report is to review agency use of the negotiation process during the previous two years and to make suggestions for any necessary improvements that could be implemented through legislation. S. Rep. No. 97, at 27.
307. See Recommendation 82-4, supra note 128; S. Rep. No. 97, 101st Cong., 1st Sess. 6 (stating that negotiated rulemaking "produced more effective rules in less time, with less overall cost and less litigation" according to various agency witnesses).
308. 5 U.S.C. § 570 (Supp. V 1994). Without this provision, agency actions relating to negotiated rulemaking prior to the final rule's publication could be subject to interruption and delay due to judicial intervention. S. Rep. No. 97, at 28. This provision reflects section 704 of the APA, which says that agency action is judicially reviewable by statute or when final agency action allows for no other in-court remedy. 5 U.S.C. § 704 (1988). In contrast, agency action that is not final, but is only intermediate, preliminary, or procedural, is not reviewable until there is a final agency action. Id.
309. 5 U.S.C. § 570.
310. Id.; see S. Rep. No. 97, at 28. Section 570 states that "[n]othing in this section shall bar judicial review of a rule if such judicial review is otherwise provided by law." 5 U.S.C. § 570.
To avoid the scrutiny of judicial review, a rulemaking body must adequately inform interested parties of any pending negotiations. By doing so, the negotiated rulemaking committee ensures that all interests are represented throughout the rulemaking process. If the committee does reach a consensus, it also should examine the rule closely to determine whether it meets statutory requirements for promulgation. Similarly, the committee should examine carefully the agency's authority to formulate the particular rule since the APA clearly allows judicial review to determine whether an agency has overstepped its bounds. Finally, under section 570 of the Act, rules that are the product of negotiated rulemaking receive no greater deference from a court than a rule resulting from other rulemaking methods.

In terms of the duration of the Negotiated Rulemaking Act, concerns about the effectiveness of the negotiated rulemaking process prompted inclusion of a provision for the Act's expiration after six years. The convening agency may make exceptions to this six year period for those negotiations begun prior to the expiration date and whose continuation is deemed to be in the best interest of the parties involved.

After the codification of the negotiated rulemaking process, various agencies began exploring its use. Yet, even today, the IRS persists in

312. See Perritt, supra note 84, at 1709.
313. Id.
314. See Patricia M. Wald, Negotiation of Environmental Disputes: A New Role for the Courts?, 10 Colum. J. Envtl. L. 1, 17-25 (1985) (noting that the goal of a regulation is to serve the statute under which it is promulgated).
315. See Perritt, supra note 84, at 1702-03 (suggesting that an agency promulgating a negotiated rule should be given wide latitude for discretion because the nature of the “process ensures that the agency has taken a ‘hard look’ at relevant factors and considered alternatives” (footnote omitted)). Others note that negotiators often engage in compromises and political log rolling, thereby producing rules that are unwieldy and defective in fulfilling the goals of the statute for which they were promulgated to serve. See, Wald, supra note 314, at 17-18.
318. 5 U.S.C. § 571 (Supp. V 1993) (stating that exceptions will be allowed to continue until the negotiations naturally terminate).
319. See, e.g., Daily Labor Rep. (BNA) at A-11 (May 23, 1991) (reporting that the Department of Labor says it has begun exploring alternative rulemaking processes including negotiated rulemaking to avoid going to court to resolve its disputes); ARAC to Review EPA's Draft Rules This Month on Allowance Auctions, Util. Env't Rep., Apr. 5, 1991, at 9, available in LEXIS, Envirn Library, UER File (documenting EPA negotiations on acid rain regulations); Industry Panel to Guide Revisions of Ex Parte Rules, Gas Daily, Apr. 11,
choosing not to utilize negotiated rulemaking to solve the problems of delayed and repeatedly litigated regulations. The following section explores the ill-fated Subchapter S one class of stock requirement, which may have benefitted from the application of the negotiated rulemaking process.

VI. BACKGROUND OF THE ONE CLASS OF STOCK REQUIREMENT

The first set of regulations that dealt with the one class of stock provision, issued under former section 1371(a)(4) in 1958,320 prompted extensive litigation.321 Ultimately, the litigation led to a revision of the regulations in 1966. The revision, as applied, continued to provoke litigation until 1973, when the IRS announced that it would revise its regulations again and cease to litigate questions related to forming a second class of stock.322

Little progress occurred in this area until 1982, when Congress passed the Subchapter S Revision Act of 1982.323 The Revision Act renumbered former section 1371(a)(4) as section 1361(b)(1)(D),324 and, not unmindful of the myriad of problems regarding the one class of stock requirement as it relates to debt, added section 1361(c)(5).325


320. See Eustice & Kuntz, supra note 3, ¶ 3.07[3][a], at 3-47 (explaining that under former Treasury Regulation § 1.1371-1(g), debt instruments could be treated as stock, thus creating a second class of stock).

321. See Eustice & Kuntz, supra note 3, ¶ 3.07[3][a], at 3-47 to 3-48 (stating that the Tax Court found that the IRS misinterpreted the former regulation).

322. See Eustice & Kuntz, supra note 3, ¶ 3.07[3][a], at 3-50 (stating the IRS announced that it would not litigate the question of whether a second class of stock existed); Richard M. Lipton, The Proposed One Class of Stock Regulations: A First-Class Problem, 49 Tax Notes 695, 696 (1990) (stating the IRS "lost every case" that involved the question of whether debt constituted a second class of stock because the courts ruled that even if such debt was equity for tax purposes, it did not constitute a second class of stock).


325. Id. § 1361(c)(5).
vides that straight debt will not be treated as a second class of stock under prescribed circumstances.\textsuperscript{326} Congress also authorized the IRS under section 1361(c)(5) to draft regulations deemed "necessary or appropriate" to effectuate "the proper treatment of straight debt."\textsuperscript{327} On October 7, 1986, the IRS published proposed regulations defining S corporations;\textsuperscript{328} however, it reserved the paragraph dealing with the one class of stock requirement at that time.\textsuperscript{329} Four years later, the IRS issued proposed regulations defining one class of stock for purposes of maintaining Subchapter S corporation status.\textsuperscript{330} At that time, no one could have predicted the problems that would ensue.\textsuperscript{331}

The major concerns with the 1990 proposed regulations cited by business and academia centered on four key points. First, the proposed regulations state that a second class of stock would come into being if all outstanding shares did not confer identical distribution and liquidation rights.\textsuperscript{332} In other words, if the distributions varied in timing or amount, they would be considered nonconforming distributions regardless of how the timing or amounts were determined.\textsuperscript{333} Curiously, the regulations disregard differences in voting rights, restrictions on stock transferability, and rights under shareholder buy-sell agreements in determining stock status.\textsuperscript{334}

A second area of concern referred to the provision that any debt instrument, regardless of its classification as debt, (1) that is not subject to the straight debt safe harbor, or (2) that constitutes equity or allows the holder of the debt instrument to be classified as a stockholder under the federal tax law, would be deemed a second class of stock.\textsuperscript{335} To qualify

\textsuperscript{326} Id. The debt instrument must satisfy three tests: "(i) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors, (ii) there is no convertibility (directly or indirectly) into stock, and (iii) the creditor is an individual (other than a nonresident alien), an estate, or a trust described in paragraph (2)." Id. § 1361(c)(5)(B)(i) to -(iii).

\textsuperscript{327} Id. § 1361(c)(5)(C).


\textsuperscript{329} Id.


\textsuperscript{331} See generally Lipton, supra note 322 (discussing the problems surrounding the 1990 proposed regulations).


\textsuperscript{333} Id. A second class of stock would come into existence if the difference in rights was established pursuant to the articles of incorporation, corporate bylaws, corporate charter, "by operation of state law, by administrative action, or by agreement." Id.

\textsuperscript{334} See id.

\textsuperscript{335} See id. § 1.1361-1(l)(3)(ii), 55 Fed Reg. at 40,873.
for the debt safe harbor, the obligation must be "straight debt" that bears a reasonable interest rate. By adopting the requirement of a reasonable interest rate to qualify a debt obligation under the safe harbor limits, the proposed regulations appear to have added a fourth requirement which consequently could put the status of many S corporations at risk depending on whether their debt, when incurred, bore "reasonable" interest rates.

Equally troubling was the debt-equity controversy resulting from the IRS' interpretation of the legislative history of the Revision Act. Its interpretation assumed that Congress intended to supplant the pre-1982 case law with the straight debt safe harbor of section 1361(c)(5) of the Code. As a result, any purported debt instrument that falls outside of the safe harbor rules will be treated as a second class of stock if it constitutes equity under general principles of federal tax law. On the other hand, opponents argue that if Congress had intended the provision to be interpreted in this manner, it would have clearly and explicitly indicated that fact.

336. Id. § 1.1361-1(l)(4)(i), 55 Fed Reg. at 40,873. Straight debt is defined as a written unconditional promise to pay on demand or on a specified date a sum certain in money if (1) the interest rate and interest payment dates are not contingent on profits, the corporations discretion, or similar factors, (2) it bears an interest rate that is reasonable, (3) it is not convertible (directly or indirectly) into stock, and (4) the creditor is "an individual (other than a nonresident alien), an estate, or a trust described in section 1361(c)(2)." Id. § 1.1361-1(l)(4)(i)(A) to (D).

337. Id. § 1.1361-1(l)(4)(ii)(A), 55 Fed. Reg. at 40,874. Whether the interest rate is reasonable depends upon "all of the facts and circumstances, including the amount borrowed and the timing and amount of payments due under the obligation." Id. Two safe harbors, however, exist for satisfying the reasonable interest rate requirement. Id. § 1.1361-1(l)(4)(ii)(C). "[A]n obligation is treated as bearing a reasonable interest rate if the obligation has a yield to maturity that is at least equal to the applicable Federal rate, but not more than five percentage points above the applicable Federal rate, . . . ." Id. § 1.1361-1(l)(4)(ii)(C), 55 Fed. Reg. at 40,874. Other determinative factors are involved when dealing with obligations bearing a variable rate. Id. § 1.1361-1(l)(4)(ii)(B), 55 Fed. Reg. at 40,874.

338. Id. § 1.1361-1(l)(4)(ii)(A); see Lipton, supra note 322, at 700 (explaining that this risk results from situations where the corporation has borrowed money from shareholders at rates below the federal rate or where repayment of the debt does not follow a schedule).

339. See Lipton, supra note 322, at 699.

340. Id. (explaining that prior case law struck down the per se treatment of debt as a second class of stock if the IRS classified the debt as equity for tax purposes); see, e.g., Portage Plastics Co. v. United States, 486 F.2d 632 (7th Cir. 1973); Armory Cotton Oil Co. v. United States, 468 F.2d 1046 (5th Cir. 1972); Shores Realty Co. v. United States, 468 F.2d 572 (5th Cir. 1972).

341. See Lipton, supra note 322, at 699.

342. Id. One opponent, Richard M. Lipton, stated that "[t]he only 'hint' in the legislative history which could be viewed as support of the IRS' position is the statement that 't'he classification of an instrument outside the safe harbor rules as stock or debt will be
A third area of concern centers on call options, warrants, and similar instruments (collectively, call option). A corporation would be deemed to have a second class of stock if it is substantially certain that the call options will be exercised by the holders. Furthermore, this provision would apply regardless of whether the owner of the call option is treated as the owner of the underlying stock under the general principles of federal tax law.

The opponents of this provision claim that the call options provision would defy one of the purposes for which the one class of stock exists, which is to avoid the complex administrative procedures that are necessary in calculating losses and gains when more than one class of stock is issued by a corporation. Because such a calculation of losses and gains is not necessary with respect to call options, they argue, the inclusion of call options in the regulation violates the purpose of the one class of stock provision. Moreover, opponents contend that, assuming the call option relates to the underlying stock, that option would create no rights other than the right to purchase stock of which there is only one class.

Finally, the proposed regulations were to become effective for tax years beginning after 1982, with some provisions taking effect ninety days after the final regulations were published. As a result, shareholders of an S corporation who had relied upon previous case law and the sound advice of their tax practitioner could have had their S corporation status retroactively revoked. The proposed retroactive application of the regulations caused the greatest clamor among both practitioners and academics who made under usual tax law classification principles.
informed Congress of their views, claiming that these regulations would virtually eliminate most S corporations.\textsuperscript{351}

On December 20, 1990, the IRS set a public hearing for the one class of stock rule for February 15, 1991.\textsuperscript{352} Shortly thereafter, the IRS received letters requesting hearing time and criticizing the regulations. For example, Marshall & Poe of Elkhart, Indiana, said that “[c]haos would definitely be the result of the proposed regulations regarding ‘S’ corporations. The people who would be most hurt are those with small businesses. These regulations would throw their whole existence into chaos because of the Hitler-like restrictions being proposed. No ‘S’ corporation would survive.”\textsuperscript{353} Another private firm, Drees, Perugini & Co., of Indianapolis, Indiana urged the IRS to withdraw the regulations because they were an unreasonable way to raise tax revenues.\textsuperscript{354} Other critics included Senate Small Business Committee Chairman Bumpers and ranking minority member Kasten who urged Treasury Secretary Brady to revise the regulations.\textsuperscript{355} Various associations also commented on the proposed regulations. For example, the American Institute of Certified Public Accountants (AICPA) said that the proposed regulations were inconsistent with congressional intent and would create enormous practical problems if implemented in the present form.\textsuperscript{356} Further, the AICPA urged the IRS to withdraw the proposed regulations and convene a series of discussions for the development of new regulations.\textsuperscript{357} The National Association of Manufacturers similarly urged the withdrawal of the proposed regulations, claiming they would disrupt the status of many S corporations.\textsuperscript{358} Additionally, the National Association of Wholesalers-Distributors said that the proposed regulations go beyond the limits of the law, that the distribution rules were burdensome, and that the refer-


\textsuperscript{352} 50 Tax Notes 249 (1991).


\textsuperscript{357} Id.

ence to inadvertent terminations was ambiguous.\textsuperscript{359} Another argument made by the American Bar Association Section of Taxation suggested that disqualification of an S election should not be used as a solution to a problem where other appropriate solutions are available.\textsuperscript{360}

As a result, Treasury withdrew the proposed regulations and, at the end of July 1991, it submitted new Subchapter S one class of stock proposed regulations.\textsuperscript{361} While it generally is agreed that the 1991 version of the proposed regulations is far better than the 1990 version, problems concerning the second attempt at formulating regulations for the one class of stock requirement exist.\textsuperscript{362}

VII. THEORY INTO PRACTICE: NEGOTIATING THE SUBCHAPTER S REGULATIONS

Considering the foregoing, there can be little doubt that the regulations preceding and including the 1990 proposed regulations were basically a disaster. Consequently, even conceding that negotiation is not always the best method to formulate regulations,\textsuperscript{363} it still may be useful to examine whether the constructs of negotiated rulemaking would favor its application in the context of the failed Subchapter S one class of stock regulations.

First, as Fisher and Ury have pointed out, parties will only bargain if the negotiations are likely to produce a better result than another form of


\textsuperscript{360} 66 Comment Letters, \textit{supra} note 356, at G-5 (stating that “disqualification of an S election should not result from non-conforming distributions unless they are part of a deliberate pattern to avoid the single class of stock requirement”). Further, the ABA recommended that “the regulations should not add a reasonable interest rate requirement to the straight debt safe harbor . . . and the final regulations should not be effective retroactively except in abusive situations.” \textit{Id.}


\textsuperscript{362} \textit{Id.} (admitting that the 1991 version was an improvement over the 1990 proposed regulations but still fails to resolve all of the problems associated with the original proposal); see also Jerald D. August et al., \textit{The 'Kinder and Gentler' Proposed Single-Class-of-Stock Regulations}, 53 TAX NOTES 713, 714 (1991) (praising the revised proposed regulations as a great improvement but criticizing the new rates and the new test because they created new areas of uncertainty).

\textsuperscript{363} See Harter, \textit{supra} note 84, at 42. Harter makes the point that negotiation is not always the answer to promulgating rules any more than “it is for settling all disputes.” \textit{Id.} Furthermore, the mere fact that a process is assumed to be nonadversarial does not guarantee that people will attempt “to resolve disputes with openness and reasonableness.” \textit{Id.}
decisional action. A review of the stormy history of only a single aspect of the one class of stock issue, the debt instruments question, reveals the myriad of problems surrounding the regulation. Given the failure of the IRS to deliver an acceptable set of regulations, it would be logical to assume that parties with an interest in the one class of stock issue would view their interests as being better served by a bargaining process. Therefore, the requirement that the parties believe that they have a better chance of successfully reaching a more favorable result through negotiation would be met.

As to the equality of the participants, there was no single group that held a significant bargaining advantage. The participants included business concerns, lawyers, and accountants who regularly advise S corporations. While some groups may have had slightly different concerns with certain aspects of the regulations, generally speaking, most questions regarding them centered around a finite number of issues that most parties found problematic. Among the issues causing the most difficulty was the intractable problem of the retroactivity of the regulations. As previously noted, most parties believed that the application of the retro-

364. See FISHER & URY, supra note 92, at 20 (contending that one negotiates “to reach an agreement that satisfies his substantive interests”).

365. See Lipton, supra note 322, at 696. The one class of stock provision was a requirement for qualification for Subchapter S status under section § 1371(a)(4) of the 1954 Code. Id. Furthermore, the regulations issued pursuant to this section “provided that debt instruments could be treated as stock,” which would invalidate an entity’s S corporation status. Id. This issue was litigated in the case of Gamman v. Commissioner. 46 T.C. 1 (1966), which held that there was nothing in the legislative history, the law itself, or committee discussions to indicate that all instruments that purport to be debt, but are in fact equity capital, must be treated as a second class of stock. Id. at 8. A short time after Gamman, the IRS amended the regulation “to eliminate the per se treatment of debt as a second class of stock” and began to assert deficiencies based on the new regulation, but lost every case. Lipton, supra note 322, at 696. Specifically, one author noted that in Portage Plastics Co. v. United States, 486 F.2d 632 (7th Cir. 1973), and Shores Realty Co. v. United States, 468 F.2d 572 (5th Cir. 1972), “the courts concluded that former Reg. section 1.1371-1(g) was invalid to the extent that such regulation treated debt as a second class of stock, even if the debt was equity for tax purposes.” Lipton, supra note 322, at 696. Lipton finally noted that “[i]n 1973, the IRS threw in the towel” and refused to litigate the issue until further regulations could provide clarification. Id.

366. See supra notes 331-50 and accompanying text (discussing serious flaws in the proposed 1990 regulations).

367. See supra notes 96-98 and accompanying text.

368. See supra notes 350-59 and accompanying text.

369. See IRS Urged to Withdraw One-Class-of-Stock Rule; Terminations, Distributions Cited, Daily Tax Rep. (BNA) No. 33, at G-7, G-7 to G-8 (Feb. 19, 1991) (identifying concerns such as the retroactive application of the proposed regulations, disqualification based on nonconforming distributions, and treatment of call options as a second class of stock).

370. See supra notes 349-51 and accompanying text (detailing the problem of retroactive application).
active provision would lead to the disqualification of most S corporations.\(^{371}\) Other notable concerns included the debt-equity controversy, call options, and distribution/liquidation rights controversies.\(^{372}\) In terms of political or bargaining power, it does not appear that any of the potential participants in a negotiation would have more bargaining strength over any other participant.\(^{373}\)

Harter also notes that "[n]egotiations will clearly not work among an auditorium full of people."\(^{374}\) Relative to the Subchapter S regulations, a review of the interested parties shows that a finite number of people who could have effectively represented the concerns of all possible interested parties because the issues of greatest concern were fairly few in number.\(^{375}\) For example, those making comments or requesting hearing time on the failed 1990 regulations were primarily accounting firms,\(^{376}\) law firms, and small businesses. In addition, the American Bar Association and AICPA took a stand on withdrawal of the regulations.\(^{377}\) Trade groups, such as the National Association of Manufacturers and the National Association of Wholesalers-Distributors, also commented on the regulations.\(^{378}\) One Cincinnati, Ohio, firm suggested that the regulations be withdrawn and a new set of regulations be developed by the American Bar Association's Section on Taxation, AICPA's Tax Division, the IRS, and Treasury. Thus, it seems clear there could have been a limited number of individuals who could have represented the interests of all concerned.

A successful negotiation also requires the negotiated matter to be ripe for decision.\(^{379}\) In this instance, in view of the history of the regulations,\(^{380}\) they were not only ripe for decision, but they were likely overripe.\(^{381}\)

\(^{371}\) See supra note 350 and accompanying text.

\(^{372}\) See supra notes 331-50 and accompanying text (discussing these issues in more detail).

\(^{373}\) See Harter, supra note 84, at 46; supra notes 101-02 and accompanying text (discussing Harter's requirement that there be a small number of people negotiating).

\(^{374}\) See Harter, supra note 84, at 46; supra notes 101-02 and accompanying text (discussing Harter's requirement that there be a small number of people negotiating).

\(^{375}\) See supra notes 331-50 and accompanying text.

\(^{376}\) Four of the big six firms appear to have made requests to be heard with respect to the proposed Subchapter S regulations.

\(^{377}\) See supra notes 356-60, and accompanying text.

\(^{378}\) See supra notes 358-59 and accompanying text.

\(^{379}\) See supra notes 103-05 and accompanying text (explaining the term ripe).

\(^{380}\) See supra notes 319-30, 351-61 and accompanying text.

\(^{381}\) The history of the regulation indicates that the issues existing prior to the failed proposed 1990 regulation and the numerous complaints concerning that regulation determined the issues for the regulation that the IRS ultimately published. As previously indi-
Urgency for a resolution also contributes to a negotiation’s likelihood of success. If the parties do not see a need for the guidance and creation of a regulation, then they will not perceive a reason to engage in a dialogue. In this instance, even though the 1991 proposed regulations cured many of the deficiencies of the 1990 proposed regulations, the 1991 regulations still left a number of controversial issues unresolved. Consequently, it appears that there is still a sense of urgency for a solution to the Subchapter S one class of stock requirement.

Finally, for a negotiated rulemaking experience to be successful, the parties must believe that their efforts will be utilized. Implementation of the negotiated regulation must be a clear possibility. Based on the foregoing analysis, there is no apparent reason why the IRS, Treasury, and a finite number of interested parties would not be able to negotiate a regulation that could and likely would be implemented.

VIII. Conclusion

Based on the dismal results of the former regulation governing the one class of stock rule, it appears that potential negotiators likely would feel that they could negotiate a better result and place themselves in a better position than leaving the promulgation to the IRS. This clearly would have been the case when the proposed regulations were withdrawn in October 1990 and new regulations were proposed in August 1991, because the IRS actually incorporated into the second regulation many of the suggestions resulting from the multitudinous hours of hearings and conferences. Furthermore, given the failed 1990 regulations, one can only surmise that if the parties had a choice, they would have preferred to have negotiated the 1990 regulations with the IRS and avoided the subsequent months spent on its criticism. The results surely would have been better than the regulations that were eventually withdrawn.

Undoubtedly, problems that will prompt litigation still remain. Whether the IRS will press the amorphous issue of taxpayer circumven-

382. See supra note 362 and accompanying text.
383. See supra note 362 and accompanying text; see also supra notes 125-27 and accompanying text (explaining that if negotiators did not believe their efforts would result in a regulation, it would defeat the notion that parties negotiate to better their positions).
384. See supra notes 125-27 and accompanying text.
385. While the regulation appears to attempt to make it difficult to disqualify an S corporation based on the existence of a second class of stock, one unsettling aspect of the regulation is that “commercial contractual agreements” related to distribution and liquidation proceeds are not binding if entered into to circumvent (emphasis added) the one class of stock requirement. Treas. Reg. § 1.1361-1(f)(2)(i), (iii)(A)(1) (1992). Yet, there is no sug-
tion to avoid a second class of stock is speculative. This matter appears to be the most problematic in the new regulations.

After withdrawing one set of regulations and promulgating final regulations that still may be wrought with problems, the IRS should learn from other agencies and employ the negotiated rulemaking process. There would be little to lose in attempting to use the 1990 Rulemaking Act, considering the time and effort that all parties put into producing the potentially flawed 1991 final regulations. Quite clearly, the notice and comment method failed in this context as it has failed in other instances. It is submitted that by working together in a negotiation, there is a substantial likelihood of coming to a consensus that would protect all interests. The chances of litigation would be significantly reduced as would the time, energy, and money expended on the process.

The IRS should join the ranks of other agencies that have successfully used negotiated rulemaking. Considering that the Code is amended in some respect on an annual basis and that some of those changes are substantial, regulations to define and to guide taxpayers have fallen far behind the enactment of the new Code sections. Given the time frame involved in these regulation projects and the ensuing backlog that has been produced, experimenting with the negotiation process could prove to be useful and successful.

386 See Thomas O. McGarity, Some Thoughts on "Deossifying" the Rulemaking Process, 41 Duke L.J. 1385, 1390 (1992) (stating that the average time for an FTC proposed regulation to become final is five years, four months).