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Are OCC's Reserve-Based Lending Guidelines Enforceable?

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Two years ago, right after crude oil prices hit rock bottom in the middle of the worst downturn for U.S. producers since the 1980s, the Office of the Comptroller of the Currency revised its Handbook for Examination of Oil and Gas Exploration and Production Lending (E&P handbook). The E&P Handbook introduced new metrics by which bank examiners were supposed to evaluate the repayment risks on banks' loans secured by oil and gas reserves, or RBLs. The changes announced by the OCC added to the angst and consternation among energy lenders and their oil and gas borrowers.

A few years before the E&P Handbook was issued, the OCC, along with other agencies responsible for oversight of national banks, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corp., issued a similar guidance for the evaluation of leveraged loans under the Interagency Guidance on Leveraged Lending (leveraged lending guidance). The agencies issued their guidance without first submitting it to Congress for review and approval under the Congressional Review Act, or CRA.

Last fall, following an inquiry by Sen. Pat Toomey, R-Pa., the Government Accountability Office reviewed whether the agencies' action complied with the CRA and concluded that it did not. Following the GAO's decision, officials at the Fed and the OCC have publicly stepped back from enforceability of the leverage lending guidelines. Although the GAO's decision related to the leveraged lending guidance, the same analysis should apply to the E&P handbook because it is similar to the leveraged lending guidance when it comes to scope, purpose and effect on banks. Because the OCC also failed to submit the E&P handbook for review under the CRA, it would appear that, if properly challenged, the binding nature of the E&P handbook should be similarly questioned.

Discussion

Scope of Review Under the Congressional Review Act

The CRA was enacted in 1996 to "create a special mechanism for Congress to review new rules issued by federal agencies … before they go into effect and to disapprove any rule to which Congress objects."[1] The CRA requires all federal agencies to submit to the GAO and Congress new rules before they can become effective.[2] From its enactment in 1996 through 2016, the CRA was invoked only once to invalidate an agency rule.[3] However, since President Donald Trump's inauguration in 2017, 15 rules have been overturned by joint congressional resolution under the CRA.[4]

The threshold question of whether the CRA applies to an agency publication is whether or not such pronouncement is considered a "rule."[5] The CRA adopted the Administrative Procedure Act's broad definition of a "rule."[6] The APA defines a rule as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency."[7] This definition encompasses all types of agency pronouncements, including notice-and-comment procedures, regulations not requiring such procedures, agency interpretive rules, and, of particular significance, general statements of policy.[8]

Once a rule has been submitted to Congress under the CRA, members of Congress have a limited period of time to initiate the formal review process. To successfully invalidate a rule, both houses of Congress must pass

an identical joint resolution of disapproval to be submitted to the president for signature or veto. The disapproval of any rule under the CRA is retroactive to the date such rule is issued. The CRA provides, "If the agency rule is already in effect when the joint resolution of disapproval is enacted, the rule 'shall be treated as though it had never taken effect.'"[9] Furthermore, "once a rule is invalidated under the CRA, the agency may not reissue the rule 'in substantially the same form,' and may not issue a new rule 'that is substantially the same' without specific legislative authorization."[10] These provisions of the CRA are helpful when an agency properly submits the rule for congressional review, but, as discussed below, the CRA does not say what the effect a "rule" has where it has not been submitted for congressional review.

The CRA and Leveraged Lending Guidance

This brings us back to the issue raised by Toomey. When the leveraged lending guidance was issued, the agencies took the position that it was not a "rule" and therefore not subject to CRA congressional review. Toomey asked the GAO whether it agreed with the agencies' position. While the GAO acknowledged that deference should be giving to an agency's characterization, "an agency's own label ... is not dispositive."[11]

The agencies issued the leveraged lending guidance to assist banks providing guidance on how the agencies evaluate prudent underwriting standards for leveraged lending.[12] More specifically, the leveraged lending guidance "outlines the Agencies' minimum expectations on a wide range of topics related to leveraged lending, including underwriting standards, valuation standards, the risk of leveraged loans, and problem credit management."[13] For example, the guidance sets forth criteria that banks can use to define leveraged loans, such as, "Transactions where the borrower's Total Debt divided by EBITDA (earnings before interest, taxes, depreciation, and amortization) or Senior Debt divided by EBITDA, exceed 4.0X EBITDA or 3.0X EBITDA, respectively."[14] The guidance further describes certain actions by banks that might cause the agencies to initiate further review over such banks, which could require an independent finding that unsafe or unsound action has occurred.[15]

The GAO concluded that the leveraged lending guidance was a general statement of policy.[16] In reaching such a conclusion, the GAO relied on a definition used by the U.S. Supreme Court to define a general statement of policy as "statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power."[17] The leveraged lending guidance "provides information on the manner in which the Agencies will exercise their enforcement authority regarding leveraged lending activities, ... [and] expresses the regulators' expectations regarding the sound risk management of leveraged lending activities."[18] The GAO noted that although there were exceptions where policy statements would not constitute a "rule," the leveraged lending guidance fell squarely within with the CRA.[19]

Handbook on Oil and Gas Exploration and Production Lending

Two years after the leveraged lending guidance was issued, the OCC published a revised E&P handbook[20] replacing its 2014 handbook. Similar to the agencies' actions, the OCC did not submit the E&P handbook for review under the CRA. The revised E&P handbook significantly altered the way in which the risk of repayment for oil and gas reserve-based loans, or RBLs, would be assessed by energy lenders and subsequently evaluated by bank examiners.[21] Significantly, the revised E&P handbook instructed bank examiners to review not only their RBL debt, but to look at the borrower's total committed debt (whether or not fully drawn), including second-lien debt and unsecured debt, when risk-rating repayment of the senior loans.

The change in field examination metrics announced in the E&P handbook occurred during the depth of the oil and gas commodity price downturn, when many E&P borrowers were laboring under the weight of heavy debt loads consisting of not only senior bank RBLs but also second-lien debt and unsecured debt. By March 2016,

when the E&P handbook was issued, the price of oil had fallen from above $100 per barrel in the summer of 2014 down to below $30 per barrel by January 2016. Although senior energy bankers were generally sanguine regarding their borrowers' ability to repay their senior secured loans, there was less optimism that junior secured and unsecured lenders would emerge unscathed.

Since January 2015 through March 2018, almost 150 producers filed for bankruptcy, involving total aggregate debt of over $90 billion. Bloodletting affected many second-lien lenders and unsecured lenders who received pennies on the dollar or exchanged their debt for equity in reorganized producers as they emerged from bankruptcy. A few of the senior bank loans also suffered losses, but on balance, losses attributable to RBLs were very low, in large part because the junior debt acted as heat shield that protected the first-lien RBL banks from the meteoric collapse in energy prices. Nevertheless, once the E&P handbook was issued, energy lenders began to apply the new metrics and many loans that were likely to be repaid in full were nevertheless downgraded based on the new "total debt" analysis. One analysis at the time of 58 publicly reporting E&P companies revealed that only five would pass the strict guidelines under the E&P handbook.[22]

Similar to the leverage lending guidelines, the E&P handbook "addresses the risks associated with lending to upstream oil and gas exploration and production companies and provides examiner guidance on prudent risk management of this lending activity."[23] This language tracks very closely to the stated purpose of the leveraged lending guidance.[24] It also indicates that the E&P handbook, like the leveraged lending guidance, is intended to provide criteria for the bank examiners to look for in evaluating reserve-based lending.[25] Accordingly, it is highly likely the E&P handbook, if properly challenged, will also be considered a "statement issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power," i.e., a general statement of policy.[26] If such challenge is made and conclusion is reached, the E&P handbook also should have been submitted to the GAO and Congress pursuant to the CRA.[27]

Where Do the OCC RBL "Rules" Stand Today?

The CRA does not explicitly state what happens to rules that should be, but are not, submitted for congressional review. The CRA states, "Before a rule can take effect, the Federal agency promulgating such rule shall submit to each House of Congress and to the Comptroller General a report."[28] Some argue the opening phrase to the CRA indicates rules that have not been submitted to Congress have not "take[n] effect."[29]

However, the CRA also defines the joint resolution used to disapprove a rule as follows: "For purposes of this section, the term 'joint resolution' means only a joint resolution introduced in the period beginning on the date on which the report … is received by Congress and ending 60 days thereafter."[30] This suggests the process by which Congress may overrule an agency action does not begin until the agency submits the rule for review.[31] Congress has on a couple of occasions commenced the CRA review process after the GAO determined that an agency statement that had not been submitted to Congress was a rule subject to the CRA.[32] However, in each case, Congress upheld the rules and therefore there is no precedent for Congress invalidating a rule under CRA that an agency has not proffered for review.

Following the GAO's determination regarding the leveraged lending guidance, a banking industry association reported that the GAO would meet with the Senate parliamentarian to require the agencies to submit the leveraged lending guidance to Congress at which time Congress would have 60 days to decide whether or not to pass a resolution disapproving the rule for presidential signature.[33] To date it does not appear that the agencies have submitted the leveraged lending guidance to Congress.

Some market participants, including current Comptroller of the Currency Joseph Otting, believe the leveraged lending guidelines are unlikely to be repealed entirely, but will remain in effect for the time being, meaning regulators will continue monitoring the leveraged lending activities of banks while also reminding them the leveraged lending guidance is merely a guideline to be observed when conducting such activities.[34] Under this regime, banks may occasionally operate outside of the parameters found in the leveraged lending guidance so long as their actions comport with the ordinary safety and soundness standards to which they are subject under federal statutory law.[35] The result of this approach, therefore, is to provide more flexibility and require greater examiner judgment, which, in turn, may provide less predictability and uniformity than a bright-line rule like those in the leverage lending guidelines.[36] It was reported that the comptroller's statement "prompt[ed] several bankers to say they have already begun pushing their credit risk officers to allow more aggressive deals."[37]

On the other hand, Federal Reserve Board Chairman Jerome Powell has indicated the agencies might consider simply abandoning the leverage loan guidelines altogether in favor of an alternative approach.[38] Powell testified before the House Financial Services Committee on Feb. 27, 2018, in response to a question during the hearing, that, "in the case of the leveraged lending guidance, we do accept and understand that that's nonbinding guidance."[39] Powell also noted that since the GAO's ruling, the board has "made it a point to go out and make sure that that message is getting out to supervisors of banks" regarding the nonbinding nature of the guidelines.[40] He concluded his response by indicating the board is also considering other ways in which it can underscore this message, "perhaps by putting it out for further comment."[41]

Conclusion

To our knowledge, there has been no discussion about the effect of applying the GAO's analysis to the OCC's E&P handbook. However, if the GAO is tasked with determining the effectiveness of the E&P handbook, as it was the leveraged lending guidance, it is most likely that the same conclusion would be reached, because the E&P handbook is also a general statement of policy subject to the requirements of the CRA and should be submitted to Congress for review. Since these procedures were not followed, just as in the case of the leveraged lending guidance, the E&P handbook, too, may be considered ineffective. Rescinding the E&P handbook guidelines would not change the outcome for the many stakeholders impacted by the E&P bankruptcies that have been filed. Nor would energy bankers necessarily ignore entirely the metrics that the OCC included in their handbook. But, as with the leveraged lending guidance, clarity to the bank examiners and the regulated banks that the "rules" outlined in the E&P handbook are examples and that the banks and their examiners can and should, where appropriate, consider exceptions to the guidelines, could provide some needed flexibility for properly risking E&P RBLs.

Other bankers believe that "written correctly," the E&P guidelines could serve as clear guideposts to both prevent examiners from conservatively overplaying their "discretion" and at the same time keeping more aggressive energy lenders from leading all banks into foul territory by loosening their underwriting parameters in an effort to gain market share. Human nature and self-interest in job preservation would indicate that a field examiner exercising discretion will err on the side of conservatively reviewing and rating E&P loans. And, therefore, any perceived flexibility from the E&P handbook as "nonbinding" could be more constraining and less accommodating. On the other hand, some bankers confidentially express concern, in spite of the recent spate of producer bankruptcies, that if there are no bright underwriting parameters, some of their brethren could become more aggressive in underwriting loans in order to grow market share, forcing competing banks to relax their standards in order to maintain market share. Therefore, it may be best for the regulated and regulators alike to find common ground on underwriting guidelines for RBLs, which can then be properly reviewed by Congress under the CRA.

For example, based on RBL bankers' experience in the recent E&P bankruptcies, some bankers believe that the "total debt" leverage covenants should be more appropriately tied to "total secured debt" and exclude from the ratio unsecured debt given the different bargaining position of the secured versus unsecured lenders. In connection with an open review and comment process in issuing revised guidelines, other refinements might also be discovered.

The various stakeholders affected by the leveraged lending guidance seem to be pushing for a resolution to this unfortunate twilight zone in which they find themselves. They may soon have as additional company energy bankers and their E&P borrowers. Although uncertainty exists regarding whether Congress may act unilaterally to overrule a final agency action that has not been brought before it, it is not hard to imagine, if given the opportunity, that the Republican-led Congress sitting today would be willing to wield its power afforded under the CRA to overturn both the leveraged lending guidance and the E&P handbook. And regulators such as the OCC may be better-served, rather than waiting to see if Congress unilaterally takes up a review process under the CRA, to instead work with their regulated banks and industry organizations to find guidelines that better address the needs of oil and gas producers and the RBLs that provide them necessary credit.

Until some definitive action occurs, for energy lenders and their borrowers, their next stop is the "Twilight Zone":

> There is a fifth dimension beyond that which is known to man. It is a dimension as vast as space and as timeless as infinity. It is the middle ground between light and shadow, between science and superstition, and it lies between the pit of man's fears and the summit of his knowledge. It is an area which we call the Twilight Zone.
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> —Rod Serling

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[1] The Congressional Review Act and the Leveraged Lending Guidelines: Questions and Answers, The Loan Syndications and Trading Association (May 23, 2017) [hereinafter LSTA Q&A].

[2] See id.

[3] See id.

[4] See U.S. General Accounting Office Congressional Review Act FAQs (June 21, 2018).

[5] See Peter Weinstock and Marysia Laskowski, "If it Walks Like a Duck ...": The Demise of the Guidance Masquerade, 135 The Banking Law Journal 215, 217 (April 2018).

[6] See id.

[7] Id.; see also Congressional Review Act, 5 U.S.C. § 804(3) (citing Administrative Procedure Act, 5 U.S.C. § 551(4)).

[8] See Weinstock, supra note 12, at 218-19.

[9] LSTA Q&A, supra note 7, at 5 (quoting 5 U.S.C. § 801(f), a portion of the CRA), and at 7 (quoting Congressional Research Service, Disapproval of Regulations by Congress: Procedure Under the Congressional Review Act (Oct. 10, 2001)).

[10] LSTA Q&A, supra note 7, at 5 (quoting 5 U.S.C. § 801(b)(2), a portion of the CRA).

[11] Susan A. Poling, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation — Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending, U.S. Government Accountability Office, B-329272 (Oct. 19, 2017) [hereinafter GAO Determination], at 3 (quoting *Chamber of Commerce v. OSHA,* 636 F. 2d. 464, 468 (D.C. Cir. 1980)).

[12] See Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17,766 (Mar. 22, 2013) (hereinafter Guidance).

[13] See GAO Determination, supra note 11, at 2.

[14] Guidance, supra note 12, at 17771. See also, GAO Determination, supra note 11, at 3.

[15] See GAO Determination, supra note 11, at 3.

[16] See id. at 4.

[17] Id.

[18] Id.

[19] See id at 5 (citing 5 U.S.C. Sections 552(a)(1)(D) and (a)(2)(B)).

[20] See Oil and Gas Exploration and Production Lending, Office of the Comptroller of the Currency, OCC Bulletin 2016-9 (Mar. 16, 2016). (Hereinafter E&P Handbook).

[21] See Buddy Clark, et al., New OCC Oil and Gas Loan Review Guidelines, Haynes and Boone LLP, Energy Alert (Mar. 28, 2016).

[22] E&P Companies Continuing to Stumble Under the SNC Review, Aug. 26, 2016, by Laura S. Martone and Jeff Nichols.

[23] E&P Handbook, supra note 4, at 1.

[24] See Guidance, supra note 1 (“This guidance outlines for agency-supervised institutions high-level principles related to safe-and-sound leveraged lending activities, including underwriting considerations, assessing and documenting enterprise value, risk management expectations for credits awaiting distribution, stress-testing expectations, pipeline portfolio management, and risk management expectations for exposures held by the institution.”).

[25] See GAO Determination; supra note 2, at 4.

[26] Id. at 4.

[27] See id. at 7.

[28] 5 U.S.C. § 801(a)(1)(A) (emphasis added).

[29] See Weinstock, supra note 12, at 221.

[30] 5 U.S.C. § 802(a).

[31] See Weinstock, supra note 12, at 221.

[32] LSTA Q&A, supra note 1, at 4.

[33] Will the Leveraged Lending Guidance GAO Away? The Loan Syndications and Trading Association (May 7, 2018).

[34] See Jonathan Schwarzberg, OCC head says leveraged lending guidance needs no revisions, Reuters (May 24, 2018, 4:31 p.m.).

[35] See id.; see also Safety and Soundness Standards, 12 C.F.R. pt. 30.

[36] Eric Leicht et al., Banking Regulators Signal Movement Away from Leveraged Lending Guidance, White & Case (Mar. 15, 2018).

[37] "OCC Head Says Banks Not Bound by Lending Guidelines, Expects Leverage to Increase," Debtwire (Feb. 27, 2018).

[38] See Leicht, supra note 36.

[39] Monetary Policy and the Economy, hearing before the House Fin. Serv.'s Comm., 115th Cong. (2018), (statement of Federal Reserve Chair Jerome Powell).

[40] Id.

[41] Id.