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Chenery's Contemporaneous Rationale Principle and *Chenery* Cheating

"Although, when I [Judge Henry Friendly] began my labors [to understand *Chenery*], I had the hope of discovering a bright shaft of light that would furnish a sure guide to decision in every case, the grail has eluded me; indeed I have come to doubt that it exists."

— Henry J. Friendly, Chenery *Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 DUKE L. J. 199-200 (1969)

In some contexts, where a court reviews another decisionmaker's action, the court inquires whether the decisionmaker *could* have reasonably justified the action. For instance, when reviewing a jury verdict in response to a motion for judgment as a matter of law, a court checks whether a reasonable jury *could* have reached the verdict in question. What the jurors actually thought is generally irrelevant. As a default, courts reviewing whether legislation comports with due process check whether a reasonable legislature *could* have justified the law in question. Courts do not attempt to examine the actual reasoning processes of the legislators.

In 1935's *Pacific States Box & Basket Co. v. White*, 296 U.S. 176, the Supreme Court applied this same generous approach to review of a rule promulgated by an Oregon state agency requiring the use of hallocks—rectangular wood boxes with straight sides and a raised bottom—with certain dimensions for packing berries. In response to a due process challenge from a manufacturer of non-complying containers, Justice Brandeis explained, "where [a] regulation is within the scope of authority legally delegated, the presumption of the existence of facts justifying its specific exercise attaches alike to statutes, to municipal ordinances, and to orders of administrative bodies." Applying this presumption, the Court upheld the hallocks rule because it was able to imagine plausible reasons why it might be a good idea—for instance, "the berries may conceivably be better stowed where the fruit basket has the bottom set-up peculiar to the hallock, than if it had the flat bottom of the plaintiff's metal rim cup."

But this extremely forgiving approach to review of agency action was not to last. Eight years later, in *SEC v. Chenery*, Justice Frankfurter, writing for the majority, intoned, "an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained." 318 U.S. 80 (1943) (*Chenery I*). Thus, at least where an agency's action is not compelled by law but instead implicates its judgment and discretion, the validity of that action does not, *contra Pacific States Box,* depend on whether the agency *could* have had a reasonable justification at the time it acted. Rather, the validity of the action depends on whether the agency's contemporaneous rationale was, in fact, legal and reasonable. Where the agency's contemporaneous rationale is defective, the court should vacate and remand—even if agency counsel is able during judicial review to produce a wonderfully reasonable and persuasive post hoc rationale that the agency, if only it had thought a bit harder, might have adopted in time.

The *Chenery* litigation arose out of efforts by officers and directors of the Federal Water Service Company and related companies (Federal), to preserve their control of these entities while complying with the Public Utility Holding Company Act of 1935 (the Act). Congress had passed this statute in response to the collapse of utilities in the aftermath of the Great Depression. It required public utility holding companies to submit ownership reorganization plans to the Securities and Exchange Commission (Commission). Section 7 of the Act required the Commission to reject a reorganization plan if its adoption would result in an "unfair or inequitable distribution of voting power" among securities holders or would be "otherwise detrimental to the public interest or the interest of investors or consumers." Also, section 11(e) required that any reorganization plan be "fair and equitable to the persons affected [and] appropriate to effectuate" the Act.

Federal's management submitted a series of reorganization plans that the Commission rejected. In the

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meanwhile, the *Chenery* respondents purchased preferred stock in Federal on the over-the-counter market. They did not try to hide these purchases but instead reported them to the Commission. The fourth reorganization plan submitted for Federal would have aided the respondents' efforts to continue their corporate control by converting preferred stock into new common stock. The Commission concluded that these purchases were not tainted by fraud or the improper use of inside knowledge. It also concluded, however, that, during the pendency of reorganization, the *Chenery* respondents, as managers of Federal, owed fiduciary duties to all security holders that might be affected. Permitting the respondents' preferred shares to participate at parity in the reorganized entity would violate this duty, rendering the fourth proposed reorganization plan "detrimental to the interests of investors" and "unfair and inequitable" within the meaning of the Act. The Commission addressed this problem by approving the plan subject to the condition that the *Chenery* respondents surrender the preferred stock they had purchased for costs, dividends, and interest.

"Chenery's contemporaneous rationale principle . . . can exalt form over substance and waste the time of all concerned by requiring vacation of an action that an agency plainly wishes to take, has the power to take, and will presumably repeat on remand."

Justice Frankfurter's majority opinion vacated the Commission's action because the Commission had gotten the law of fiduciary duty wrong—the judicial precedents on which the Commission had expressly relied did not, in the Court's view, bar the purchase of the preferred stock at issue. Admittedly, the Commission had the power to develop "standards expressing a more sensitive regard for what is right and what is wrong" for the purpose of enforcing the Act than these judicial precedents. This authority could not save the Commission's decision, however, for the simple reason that the Commission had not invoked it, instead purporting to apply the same law as a court of equity. The Commission's misapprehension of the law of fiduciaries therefore doomed its decision, because "[t]he grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based."

Calling to mind parents telling their children that a punishment is really for their own good, the Court insisted that it had to vacate the Commission's preferred action in order to avoid infringing on the Commission's discretionary authority. The logic here runs like this: Suppose, for the sake of argument, that the Commission did not regard the *Chenery* respondents' purchases as problematic from a policy perspective but nonetheless determined that judicial precedents governing fiduciaries required that the Commission block the reorganization plan as proposed. In that case, were a court to affirm the Commission's decision on alternative, post hoc grounds, it would deprive the Commission of a chance to act on its policy preferences unhindered by an incorrect understanding of the law. In addition to invoking this separation-of-powers justification, the Court also emphasized that reviewing agency decisions based on their contemporaneous rationales was necessary for the "orderly functioning of the process of review."

On remand, the Commission demonstrated that it had learned its lesson. It again imposed the condition that the *Chenery* respondents had to give up their preferred shares, but, rather than rely on judicial precedents regarding fiduciary duty, the Commission instead invoked its administrative "experience," explaining that this step was necessary to prevent the reorganization from being unfair and inequitable within the meaning of the Act. The case made its way to the Supreme Court a second time, and the Court, over an outraged dissent from Justice Jackson (joined by Justice Frankfurter), affirmed the Commission, holding that this time the agency had understood and invoked its authority properly. *SEC v. Chenery Corp.*, 332 U.S. 194 (1947) (*Chenery II*). (In *Chenery II*, the Court also announced the other major principle of administrative law for which this litigation is known—that the choice between rulemaking and adjudication as a means of forming policy lies within the informed discretion of the agency.)

Remarkably, Justice Frankfurter in his *Chenery I* opinion nowhere mentioned *Pacific States Box*, which just eight years earlier had insisted that courts should presume the existence of facts necessary to sustain an agency rule against a charge of arbitrariness. This apparent contradiction can be attributed at least in part to the different types of agency action involved. *Pacific States Box* involved what we would now call informal rulemaking—a variant of legislation. The plaintiff in the

case contended that the rule was void due to a lack of supporting "special findings," but neither constitutional principles nor the agency's enabling act required such findings, and the Court therefore did not demand them. The *Chenery* litigation, by contrast, involved what we would now call formal adjudication—a context where explanation is expected and required. Where an agency has, as in *Chenery,* actually provided an official and contemporaneous explanation for its action, it is a short step to requiring, as Justice Frankfurter did, that the validity of the agency's action should depend on that explanation. Ultimately, as courts in later decades embraced "hard look" review of agency discretionary action, the *Chenery* contemporaneous rationale principle would expand its domain from the context of formal proceedings to control review of informal adjudication, *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971), and notice-and-comment rulemaking. *Motor Vehicles Mfgs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983).

The most glaring problem with *Chenery*'s contemporaneous rationale principle is that it can exalt form over substance and waste the time of all concerned by requiring vacation of an action that an agency plainly wishes to take, has the power to take, and will presumably repeat on remand. Indeed, one can make a decent argument that this sequence of events is precisely what occurred in the *Chenery* litigation itself. Courts sometimes get around this problem with what, for the sake of alliteration, we must call a bit of *Chenery* cheating.

One way around *Chenery* is simply to fail to recognize a *Chenery* problem. For instance, in 1944's *Federal Power Commission v. Hope Natural Gas Co.*, the Court, without mentioning its *Chenery I* decision of the year before, carved an exception for ratemaking cases. 320 U.S. 591. The basic problem was that ratemaking cases are so notoriously complex that insisting on perfect agency rationales uninfected by error would be a recipe for an endless cycle of decision, vacation, and remand. The Court obviated this problem by holding that, where a court reviews a rate to determine if it is "just and reasonable," "it is the result reached not the method employed which is controlling."

Courts also sometimes play the harmless error card to evade *Chenery*'s contemporaneous rationale principle. Justice Fortas' plurality opinion in another chestnut from

More *Chenery*

Those who find that this short overview has whetted a ravenous appetite to learn more about *Chenery* and its relatives might wish to consult:

Nicholas Bagley, *Remedial Restraint in Administrative Law*, 117 Colum. L. Rev. 253 (2017) (discussing courts' use of the harmless error doctrine to evade *Chenery*'s "apparent absolutism").

Richard Murphy, Chenery *Unmasked: Reasonable Limits on the Duty to Give Reasons*, 80 U. Cin. L. Rev. 817 (2012) (contending that *Chenery* should be understood as a framework for guiding discretion rather than as a categorical rule; discussing *Chenery* cheating).

Thomas W. Merrill, *Article III, Agency Adjudication, and the Origins of the Appellate Model of Administrative Law*, 111 Colum. L. Rev. 939 (2011) (explaining how courts early in the twentieth century adopted a model of judicial review of agency action based on appellate review of trial court decisions in civil litigation).

Secretariat (2010) (yes—the Disney movie about the horse—but it turns out that Chenery owned Secretariat).

Note, Rationalizing Hard Look Review After the Fact, 122 Harv. L. Rev. 1909, 1921 (2009) (contending that cost-benefit analysis shows that courts should apply a weakened version of the *Chenery* rule that is subject to harmless error analysis).

Kevin M. Stack, *The Constitutional Foundations of* Chenery, 116 Yale L. J. 952, 974 (2007) (finding constitutional roots for the *Chenery* contemporaneous rationale principle in the Nondelegation Doctrine).

Henry J. Friendly, Chenery *Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 Duke L. J. 199-200 (1969) (confessing, based on experience as federal judge, that application of *Chenery* may involve "more art than science").

the administrative law canon, *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759 (1969), provides an example. In it, he explained that "*Chenery* does not require that we convert judicial review of agency action into a ping-pong game" and remand in cases where the ultimate outcome is perfectly clear. This insistence on cutting to the chase certainly makes sense where a record is so one-sided as to compel a result as a matter of law as, in such cases, there is no agency decisional freedom upon which a court can infringe. Where, however, an agency has any discretion at all to take a different action on remand, it is difficult to square application of the harmless error doctrine with *Chenery*'s categorical language and reasoning. Be that as it may, courts will occasionally forgive agency errors of subsidiary fact or reasoning as harmless where the record, viewed as a whole, provides strong support for the agency's ultimate result. Review of immigration orders has provided an especially fertile ground for this practice.

The practice of remand without vacation might also be characterized as a gaping exception to *Chenery*'s contemporaneous rationale rule. After determining that a rule is arbitrary due to a failure of reasoned explanation, some courts, in particular the D.C. Circuit, will, under some circumstances, decline to vacate the rule but also remand to the agency to develop an adequate explanation. In effect, this practice allows a rule to stay in place while a post hoc rationale is developed for it—which is at least tricky to square with the contemporaneous rationale principle.

In sum, *Chenery*'s rule that "an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained" is a core command of modern administrative law. But, notwithstanding *Chenery*'s categorical language, courts find ways around it—with or without acknowledging that they are doing so. Reflecting this tension in the law, the great Judge Friendly commented fifty years ago that applying *Chenery* "to reverse and remand a decision that an administrative agency had power to make, and sufficient evidence to support, is … perhaps more art than science." Chenery *Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 Duke L. J. 199–200. (And this means that, at the next cocktail party you attend, when asked what you do, you may respond that you are an administrative law artist.)

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