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# Resiliency, Adaptation, and the Upsides of Ex Post Lawmaking

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# RESILIENCY, ADAPTATION, AND THE UPSIDES OF EX POST LAWMAKING\*

DONALD T. HORNSTEIN\*\*

*Although the U.S. Constitution and the constitutions of many states and foreign countries properly prohibit ex post facto lawmaking in the criminal context, the practice takes place quite regularly in other settings. This Essay argues that there are numerous reasons for this phenomenon, including the need for a resilient legal system to be able to respond to those who game the law through practices known as “regulatory arbitrage.”*

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## INTRODUCTION

At first blush, it is hard to imagine having anything nice to say about legal institutions making law retroactively. It was to prohibit after-the-fact criminalization that the Framers drafted the two ex post facto clauses of the U.S. Constitution, in Sections 9 and 10 of Article I, one of the nation’s first restrictions on both federal and state levels of government.<sup>1</sup> The constitutions of many states contain similar

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1. See U.S. CONST. art. I, § 9, cl. 3 (“No Bill of Attainder or ex post facto Law shall be passed.”) (prohibition on the federal government); U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts . . .”) (prohibition on state governments). See generally Burgess v. Salmon, 97 U.S. 381, 384 (1878) (“An *ex post facto* law is one which imposes a punishment for an act which was not punishable at the time it was committed, or a punishment in addition to that then prescribed.”).

provisions,<sup>2</sup> and the sentiment is consistently, if not perfectly, echoed across the constitutions of countries as diverse as Brazil, Indonesia, and Norway.<sup>3</sup> Even as to civil law, Thomas Jefferson once opined about government acting “against natural right” when it declares the law after the fact: “[T]he omission of a caution which would have been right, does not justify the doing what is wrong.”<sup>4</sup>

It may be surprising, therefore, to learn that retroactive lawmaking is, in fact, neither uncommon nor undefended. Speaking of the Supreme Court’s tradition of applying new interpretations of the Constitution to decide cases already before it, Harvard law professor Steven Smith recounts Justice Souter’s observation that retroactive applications are “overwhelmingly the norm,”<sup>5</sup> as well as Justice Scalia’s argument that retroactive applications are constitutionally *required* because the Court can only decide what the law “*is*.”<sup>6</sup> Less metaphysically,<sup>7</sup> it is a regular practice in virtually all common law courts to apply “retroactively” newly announced legal

2. *See, e.g.*, COLO. CONST. art. II, § 11 (“No ex post facto law . . . shall be passed by the general assembly.”); N.C. CONST. art. I, § 16 (“Retrospective laws, punishing acts committed before the existence of such laws and by them only declared criminal, are oppressive, unjust, and incompatible with liberty, and therefore no ex post facto law shall be enacted.”). *See generally* Neil Colman McCabe & Cynthia Ann Bell, *Ex Post Facto Provisions of State Constitutions*, 4 EMERGING ISSUES ST. CONST. L. 133 (1991) (including a survey of ex post facto provisions in state constitutions).

3. CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 5, XL (Braz.), *translated in* 3 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 5 (Gisbert H. Flanz ed., Supp. 2011) (“[T]he penal law shall not be retroactive, except to the benefit of the defendant.”); CONSTITUTION OF REPUBLIC OF INDONESIA, Chapter XA, art. 28I(1), *translated in* 9 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 15–16 (Gisbert H. Flanz ed., Supp. 2011) (“[T]he right not to be tried under a law with retrospective effect . . . cannot be limited under any circumstances.”); CONSTITUTION OF NORWAY, art. 97, *translated in* 14 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 19 (Gisbert H. Flanz ed., Supp. 2011) (“No law must be given retroactive effect.”); *see also* Universal Declaration of Human Rights, G.A. Res. 217 (III) A, U.N. Doc. A/RES/217(III), art. 11 (Dec. 10, 1948), *available at* <http://www.un.org/en/documents/udhr/index> (“No one shall be held guilty of any penal offence on account of any act or omission which did not constitute a penal offense, under national or international law, at the time when it was committed.”).

4. Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1813), *in* 13 THE WRITINGS OF THOMAS JEFFERSON: DEFINITIVE EDITION 326, 327 (Albert Ellery Bergh ed., 1907).

5. STEVEN SMITH, *LAW’S QUANDARY* 62 (2004).

6. *Id.*

7. The reference to the metaphysics of retroactivity is intended as a paean to a recent book that is both important and charming, *Law’s Quandary*, by Harvard law professor Steven Smith. The “quandary” is the tension between, on the one hand, the near-metaphysical presumption behind retroactivity that the law is “there” to be discovered and declared and, on the other hand, the modern notion of law as a purely positivist enterprise launched by Justice Oliver Wendell Holmes’s famous lecture on *The Path of the Law*. SMITH, *supra* note 5, at 44–51.

principles to the disputes at bar in myriad tort, property, or contract cases.<sup>8</sup> For over half a century in federal administrative law, since the Supreme Court's 1947 opinion in *SEC v. Chenery Corp.*,<sup>9</sup> it cannot even be contested that federal agencies may announce new principles of law retroactively in adjudications rather than prospectively in rulemakings.<sup>10</sup> And, in the legal academy, there exists an especially robust literature on legal transitions and the question of retroactive applications of new law that inheres in them.<sup>11</sup>

The surprising persistence of retroactivity is, however, only the starting point for this Essay. The larger inquiry tests the link between retroactivity and the twin properties of resiliency and adaptation in legal systems, the subject matter of this symposium. My central theme is that it is precisely this link that often explains retroactivity's persistence. After laying out in Part I some general observations about resiliency and adaptation in legal systems, I explore in Part II those places in the law where retroactivity is not only tolerated but sometimes celebrated. In Part III, I make the descriptive claim that retroactivity is often accepted precisely when the law is faced with questions of resiliency and adaptive capacity. And I sketch—and endorse<sup>12</sup>—the normative case for retroactivity when such questions

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8. See Timothy A. Baughman, *Justice Moody's Lament Unanswered: Michigan's Unprincipled Retroactivity Jurisprudence*, 79 MICH. B. J. 664, 665 (2000) (“[A]n overruling that is wholly prospective, applying not even in the case before the Court, is at least arguably beyond the authority of the Court, as it does not resolve any ‘case.’ ”); Bradley Scott Shannon, *The Retroactive and Prospective Application of Judicial Decisions*, 26 HARV. J.L. & PUB. POL'Y 811, 839 (2003) (“It is an unavoidable implication of the adjudicative function that the cases considered by courts almost invariably involve conduct or events that occurred in the past. This means that the resolution of the legal issues virtually always involves the ‘retroactive’ application of some controlling rule of law, at least in the sense that the determination of which law to apply to past conduct or past events is ordinarily post hoc.”). Indeed, even in some criminal cases, most notably those involving sex offenders, retroactivity has occasionally been allowed. See Wayne A. Logan, *The Ex Post Facto Clause and the Jurisprudence of Punishment*, 35 AM. CRIM. L. REV. 1261, 1269–75 (1998) (addressing the Supreme Court's upholding of Kansas's Sexually Violent Predator Act in *Kansas v. Hendricks*, 521 U.S. 346 (1997), which imposed an indefinite period of involuntary civil confinement upon a convicted sex offender less than one month before he was due to be released from prison).

9. 332 U.S. 194 (1947).

10. See, e.g., David L. Shapiro, *The Choice of Rulemaking or Adjudication in Administrative Policy*, 78 HARV. L. REV. 921, 921–26 (1965).

11. See, e.g., DANIEL SHAVIRO, WHEN RULES CHANGE: AN ECONOMIC ANALYSIS OF TRANSITION RELIEF AND RETROACTIVITY 25–27 (2000); Michael Graetz, *Retroactivity Revisited*, 98 HARV. L. REV. 1820, 1821–26 (1985); Kenneth Kress, *Legal Reasoning and Coherence Theories: Dworkin's Rights Thesis, Retroactivity, and the Linear Order of Decisions*, 72 CALIF. L. REV. 369, 377–402 (1984); Saul Levmore, *Changes, Anticipations, and Reparations*, 99 COLUM. L. REV. 1657, 1657–62 (1999).

12. With some qualifications, see *infra* Part III.

are on the line. In particular, I argue that *ex post* lawmaking is valuable in two types of situations: when governments are faced with unforeseen events, and especially when governments are faced with “dynamic noncompliance,” situations when previously announced rules spawn strategic behavior that seeks to game the law through novel mechanisms that would otherwise straddle the law’s letter while unquestionably violating its purpose.

### I. RESILIENCY AND ADAPTATION AS SYSTEMS PROPERTIES

I begin by noting that neither resiliency nor adaptation is an unalloyed good. One can imagine a resilient legal system that returns to roots that are merely path dependent to begin with<sup>13</sup> or, worse, a resilient system based on suspect or even despised intellectual foundations. The resiliency of the slave property system in the antebellum South comes to mind.<sup>14</sup> Similarly, there is such a thing as too much adaptivity. Economist Kenneth Arrow’s impossibility theorem<sup>15</sup> is a case in point, explaining situations in which a majority-based political system can devolve into periods of endless cycling of unstable, temporary majorities—threatening any associated system of majority-based laws with bleak prospects for consistency over time or anything resembling a stable rule of law. Along the same lines, the value of adaptation presupposes a reference point, “adaptive to what?” Thus, a legal system so adaptive that it allows legal “rights” to be regularly subordinated to the wishes of the powerful might so often undermine the system’s normative precommitments to justice and individual rights that the system’s adaptivity becomes one of its greatest weaknesses.

These caveats noted, I take the central problem of this symposium to be the responsiveness of legal systems to various types

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13. See, e.g., Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 643–63 (1996) (explaining path dependence of comparative corporate and bankruptcy laws in the United States and Japan).

14. See, e.g., ROBERT WILLIAM FOGEL, *WITHOUT CONSENT OR CONTRACT: THE RISE AND FALL OF AMERICAN SLAVERY* 238–81 (1989) (describing the persistence of southern slavery despite almost 100 years of various forms of antislavery campaigns).

15. Arrow’s theorem posits situations in which disaffected voters who lose a plurality vote on an issue can soon thereafter reframe issues into winning pluralities, only thereafter to themselves become subject to similarly formed new winning combinations, and so on, through endless periods of legislative “cycling.” See DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* 38–39 (1991) (introducing Arrow’s theorem and noting that a summary of Arrow’s work is found in DENNIS C. MUELLER, *PUBLIC CHOICE II* 384–99 (1989)); *id.* at 39 (“Arrow’s Theorem presents a conceptual barrier to combining individual preferences into some overall measure of social welfare.”).

of unwanted surprises—especially including such exogenous shocks to the body politic as financial crises or environmental disasters, the subjects of many of the symposium’s fine papers—in which the properties of resilience and adaptation are intuitively good things. From this starting point, it is no surprise that symposium participants borrow working definitions of resilience and adaptation from the natural and social sciences where these properties are viewed as valuable, even central, system qualities.<sup>16</sup> Thus, from this literature, Professor J.B. Ruhl provides us with an excellent, working definition of resilience: “‘the capacity of a system to experience shocks while retaining essentially the same function, structure, feedbacks, and therefore identity.’”<sup>17</sup> And building on this definition, Professor Ruhl suggests a similar working definition of adaptation from the concept of “adaptive capacity”<sup>18</sup> in the natural and social sciences, to mean “[t]he idea that a system might sense threats to system equilibrium and respond by changing resilience strategies without changing fundamental attributes . . . .”<sup>19</sup> These definitions established, Professor Ruhl, as is customary with his fine body of work on systems theory<sup>20</sup> and the law,<sup>21</sup> then fleshes out the complex interplay between

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16. See, e.g., Carl Folke, *Resilience: The Emergence of a Perspective for Social-Ecological Systems Analyses*, 16 GLOBAL ENVTL. CHANGE 253, 254 (2006) (“[R]esilience determines the persistence of relationships within a system and is a measure of the ability of these systems to absorb changes of state variables, driving variables, and parameters, and still persist.” (quoting C.S. Holling, *Resilience and Stability of Ecological Systems*, 4 ANN. REV. ECOLOGY & SYSTEMATICS 1, 17 (1973))).

17. J.B. Ruhl, *General Design Principles for Resilience and Adaptive Capacity in Legal Systems — with Applications to Climate Change Adaptation*, 89 N.C. L. REV. 1373, 1375–76 (2011) (quoting Brian Walker et al., *A Handful of Heuristics and Some Propositions for Understanding Resilience in Social-Ecological Systems*, ECOLOGY & SOC’Y (June 2006), <http://www.ecologyandsociety.org/vol11/iss1/art13>).

18. Adaptive capacity has been defined as “an ability to become adapted (i.e., to be able to live and to reproduce) to a certain range of environmental contingencies.” Gilberto C. Gallopin, *Linkages Between Vulnerability, Resilience, and Adaptive Capacity*, 16 GLOBAL ENVTL. CHANGE 293, 300 (2006).

19. Ruhl, *supra* note 17, at 1388.

20. Systems theory is “the transdisciplinary study of the abstract organization of phenomena, independent of their substance, type, or spatial or temporal scale of existence. It investigates both the principles common to all complex entities, and the (usually mathematical) models which can be used to describe them.” Francis Heylighen & Cliff Joslyn, *What is Systems Theory?*, PRINCIPIA CYBERNETICA WEB (Nov. 1, 1992), <http://pespmc1.vub.ac.be/systheor.html>.

21. See generally J.B. Ruhl, *Complexity Theory as a Paradigm for the Dynamical Law-and-Society System: A Wake-Up Call for Legal Reductionism and the Modern Administrative State*, 45 DUKE L.J. 849 (1996) (utilizing the scientific method to explain the complex interactions between law and society); J.B. Ruhl & James Salzman, *Mozart and the Red Queen: The Problem of Regulatory Accretion in the Administrative State*, 91

resilience and adaptation, including situations where the two concepts can operate in tandem to preserve a system's identity in the face of outside shocks, as well as situations where the two concepts can war against each other.<sup>22</sup> He does so by introducing such other features of systems thinking as reliability, scalability, modularity, and evolvability.<sup>23</sup>

In my Essay, I am grateful for Professor Ruhl's core definitions of resiliency and adaptation and am happy to use them as jumping off points. In Parts II and III, I explore how these notions in fact shed light on the law's surprisingly robust tolerance of ex post lawmaking. But, that said, I otherwise do not attempt to fit my conclusions within Professor Ruhl's broader systems perspective. This is because there is still a great deal of difficulty (at least for me) in mapping systems theories, premised on their own internally coherent nomenclature and properties, onto legal systems, which are typically judged by distinct sets of economic and social criteria.<sup>24</sup>

Thus, for example, under Professor Ruhl's conceptual lexicon, a systems approach might describe an "unmistakable flip" from one "equilibrium state to another" when the environmental law system changed in the 1970s from one based on common law doctrines such as nuisance law to one based on more proactive and comprehensive

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GEO. L.J. 757 (2003) (exploring the problem of "regulatory accretion" in the administrative state).

22. *E.g.*, Ruhl, *supra* note 17, at 1389 ("Indeed, an overly strong design focus on adaptability can undermine resilience. Optimizing the system to adapt to a particular set of disturbances could potentially decrease resilience to unknown disturbances.").

23. *Id.* at 1385 (quoting David L. Alderson & John C. Doyle, *Contrasting Views of Complexity and Their Implications for Network-Centric Infrastructures*, 40 IEEE TRANSACTIONS ON SYSTEMS MAN & CYBERNETICS 839, 840 (2010)). "Scalability" can mean how well a system is able to adapt to increased demands, or how well a solution to a problem can work when the size of the problem increases. *Scalability Definition*, DICTIONARY.COM, <http://dictionary.reference.com/browse/scalability> (last visited Apr. 29, 2011). "[M]odularity . . . is widely seen as one of the central principles of evolvability. The idea is that modular organization favors evolvability by allowing one module to change without interfering with the rest of the organism." Thomas F. Hansen, *Is Modularity Necessary for Evolvability? Remarks on the Relationship Between Pleiotropy and Evolvability*, 69 BIOSYSTEMS 83, 84 (2003). "Evolvability" is defined as "the ability of random variations to sometimes produce improvement." Gunter P. Wagner & Lee Altenberg, *Perspectives: Complex Adaptations and the Evolution of Evolvability*, 50 EVOLUTION 967, 967 (1996).

24. And I say this as someone who, like Professor Ruhl, has attempted to do exactly that. See Donald T. Hornstein, *Complexity Theory, Adaptation, and Administrative Law*, 54 DUKE L.J. 913, 916 (2005) ("Part I of this Article considers whether theories of adaptation, especially those found in the complexity theory literature, might add value descriptively to legal doctrines, institutions, and analytic tools.").

statutory/administrative structures.<sup>25</sup> As a matter of historical understanding, I find this observation both accurate and very useful. But at the level of regulatory design, which I believe is the context in which we are exploring resiliency and adaptation, I have a harder time making the observation tractable. For example, are we to conclude that the modern regulatory system of, say, protecting endangered species, has actually worked, and, if so, how are we to reconcile this new system with the species-extinction crisis that has accelerated in the forty years since the “flip” (by which I mean, despite the flip)?<sup>26</sup> Which parts of the new system have worked, and which have not? I simply have a hard time connecting the various attributes of scalability, modularity, evolvability, and the like, into a prescriptive framework in which I have more confidence than the traditional touchstones of conventional legal analysis, such as collective-action problems, conflicting social norms, lack of incentives, and special-interest rent-seeking.

For the same reasons, I am politely declining Professor Ruhl’s invitation to situate my thoughts about resilience and adaptation strongly within the borders of “new governance” theory, which he describes as fashioning “new model[s] of collaborative, multi-party, multi-level, adaptive, problem-solving” governance.<sup>27</sup> In doing so, I emphasize that I am hostile neither to the sentiment behind such institutional experimentation, nor to the periodic proposals for new solutions that are made under the new governance banner.<sup>28</sup> I am simply confessing that I am not yet a true believer.

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25. Ruhl, *supra* note 17, at 1384.

26. See, e.g., Craig Hilton-Taylor et al., *State of the World’s Species*, in *WILDLIFE IN A CHANGING WORLD: AN ANALYSIS OF THE 2008 IUCN RED LIST OF THREATENED SPECIES* 15, 15 (Jean-Christophe Vié et al. eds., 2009), available at <http://data.iucn.org/dbtw-wpd/edocs/RL-2009-001.pdf> (“[T]he Living Planet Index which monitors population trends in 1,686 animal species shows an overall decline of 30% for the period 1970 to 2005 and the increasing rates of extinction of both described and undescribed species [are] a direct and indirect result of human activities.”) (citation omitted); Letter from Julia Marton-Lefèvre, Dir. Gen., Int’l Union for Conservation of Nature, to Ministers of the Environment 1 (Oct. 12, 2010), available at [http://cmsdata.iucn.org/downloads/letter\\_to\\_ministers\\_cbd\\_cop10\\_final.pdf](http://cmsdata.iucn.org/downloads/letter_to_ministers_cbd_cop10_final.pdf) (“Biodiversity loss is continuing at unprecedented rates and urgent action is needed to ensure the resilience of people and nature, and to avoid catastrophic tipping points.”).

27. Ruhl, *supra* note 17, at 1397 (quoting Bradley C. Karkkainen, “New Governance” in *Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping*, 89 MINN. L. REV. 471, 473 (2004)).

28. See Hornstein, *supra* note 24, at 948 (“At least as framed by their original developers, these projects genuinely seek to improve the quality of regulatory decisionmaking.”).



Five years ago, I participated in a symposium at Duke Law School, on “Incrementalism and the Administrative State,” that shared some intellectual overlap with this symposium on resiliency and adaptation. There, two giants in environmental law sometimes associated with the new governance school, Jody Freeman and Dan Farber, used an example of a new breed of “modular” environmental regulation, an experimental entity known as “CalFed.”<sup>29</sup> This example of new governance was presented as a “model of creative pragmatism” matched in scope with the broad dimensionality of natural resource management in the San Francisco Bay Delta region, thereby bringing the regulatory advantages of both “modularity” and “scalability” to the problem.<sup>30</sup> Although Freeman and Farber were careful to note problems in CalFed’s design,<sup>31</sup> there was an unmistakable air of hope in their treatment of its prospects.<sup>32</sup> Yet, CalFed has since been regarded as a failure.<sup>33</sup> Indeed, Professor Ruhl, himself, recently added to the postmortems: “[T]he CalFed approach is too dependent on faith that ‘regulatory brilliance’ will emerge from the strongly coordinated collective entity.”<sup>34</sup> Thus, although I have nothing but admiration for the intellectual pioneers who are attempting to theorize new governance, I am not yet confident that we have a tractable systems theory with which to propose entirely new breeds of legal institutions more resilient and adaptive than our current ones.

However, using Professor Ruhl’s core definitions of resiliency and adaptation, which focus on the ability of legal systems to respond to “shocks,” I am willing to suggest at least a weaker connection between ex post lawmaking and the broader new governance project. To the extent new governance depends on institutions that proceed incrementally, evolving (and changing) legal rules based on trial and error, then these institutions will face many of the same conceptual

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29. Jody Freeman & Daniel A. Farber, *Modular Environmental Regulation*, 54 DUKE L.J. 795, 837–76 (2005) (case study of CalFed).

30. *Id.* On the failure of CalFed despite its promise as an example of creative pragmatism, see Dave Owen, *Law, Environmental Dynamism, Reliability: The Rise and Fall of CALFED*, 37 ENVTL. L. 1145, 1195–1208 (2007).

31. Freeman & Farber, *supra* note 29, at 866–76.

32. *Id.* at 866 (“For all of these reasons, CalFed deserves a significant amount of credit.”); *id.* at 876 (“Yet despite its imperfections, and regardless of its future, CalFed has already provided a powerful illustration of what we think of as modular environmental regulation.”).

33. See Owen, *supra* note 30, at 1195–1208.

34. J.B. Ruhl & James Salzman, *Climate Change, Dead Zones, and Massive Problems in the Administrative State: A Guide for Whittling Away*, 98 CALIF. L. REV. 59, 115 (2010) (citing Owen, *supra* note 30, at 1215).

challenges of (un)predictability and unsettling of expectations that underlie objections to retroactivity generally. Thus, to the extent retroactivity can be defended from such critiques because of the resilience and adaptiveness it offers, the defense may add support to the types of regulatory designs often propounded by new governance scholars.

## II. RESILIENCY, LEGAL TRANSITIONS, AND *CHENERY II*

If, as proposed above, retroactive lawmaking makes the law more resilient and adaptive to previously unforeseen “shocks,” then theories of resiliency can shed light on the law’s surprisingly robust tolerance of ex post facto lawmaking. As a starting point, despite the firm prohibition in the Constitution’s ex post facto clauses against retroactivity in the criminal law, the Supreme Court has *not* extended those protections to governmental actions outside of the criminal law. In one of its earliest decisions, the 1798 opinion in *Calder v. Bull*,<sup>35</sup> the Court held that the clauses were not “inserted to secure the citizen in his private rights, of either property, or contracts . . . [but rather] to secure the person of the subject [only] from injury, or punishment, in consequence of such law.”<sup>36</sup> Thirty years later, the Court reiterated its *Calder* holding, rejecting a retroactivity challenge to a state property measure,<sup>37</sup> despite a dissenting opinion explicitly challenging the historical conclusions reached by the *Calder* Court.<sup>38</sup> The *Calder* holding has been “rigorously followed” since its inception.<sup>39</sup>

This hardly means, however, that broader problems with retroactivity have not been raised in areas outside of the criminal law. Although common law courts routinely apply newly announced principles of tort, contract, and property law to the disputes before them (a type of retroactivity),<sup>40</sup> they sometimes choose not to upset

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35. 3 U.S. (3 Dall.) 386 (1798).

36. *Id.* at 390 (opinion of Chase, J.).

37. *See Satterlee v. Matthewson*, 27 U.S. (2 Pet.) 380, 413–14 (1829) (rejecting challenge to a law changing relationship of owner and tenant of real property); Harold J. Krent, *The Puzzling Boundary Between Criminal and Civil Retroactive Lawmaking*, 84 GEO. L.J. 2143, 2153–54 (1996) (discussing the Court’s “restrictive reading of the Ex Post Facto Clause” and subsequent adherence to that standard).

38. *Satterlee*, 27 U.S. (2 Pet.) at 681–87 (Johnson, J., dissenting) (challenging the historical foundations of the Court’s holding in *Calder*); *see also* Krent, *supra* note 37, at 2154 (citing Justice Johnson’s claim that the “far sounder view was that the clause applied to civil as well as criminal matters”).

39. Krent, *supra* note 37, at 2154.

40. *See, e.g.*, Richard H. Fallon, Jr. & Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 HARV. L. REV. 1731, 1734–35 (1991) (“In its 1982 decision in *Harlow v. Fitzgerald*, the Supreme Court held that officials sued in

existing expectations absent action from legislatures.<sup>41</sup> Although federal courts reviewing economic legislation under the Due Process Clause require merely that Congress meet minimum standards of rationality,<sup>42</sup> the somewhat more searching inquiries under the Takings Clause can be understood as addressing the associated retroactivity problems that same legislation may cause when it unduly upsets reasonable investment-backed expectations.<sup>43</sup> Professor Frederick Schauer notes that the ubiquity of questions attending the fairness of legal transitions have so split into two literatures and subliteratures—“one dealing with taxation, tort liability, and occasionally the takings of property; the other dealing with rules,

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constitutional tort actions generally are immune from damages liability unless their conduct violated ‘clearly established’ law. The *Harlow* Court hardly invented qualified immunity, but it did reshape the doctrine so that, for the first time, officials are shielded from damages liability whenever the plaintiff relies on ‘new’ law.”); Christopher Serkin, *Existing Uses and the Limits of Land Use Regulations*, 84 N.Y.U. L. REV. 1222, 1222 (2009) (“Various land use doctrines—from zoning to the vested rights doctrine to amortization rules for prior nonconforming uses—assume that the government cannot eliminate existing uses without paying compensation.”); Richard E. Speidel, *Contract Excuse Doctrine and Retrospective Legislation: The Winstar Case*, 2001 WIS. L. REV. 795, 795 (“Law, whether by legislation, regulation, or judicial decision, changes over time. Sometimes the change is totally prospective and has no effect on contracts entered before the legislation’s effective date. In other cases, the change has some retrospective effect, ranging from ex post invalidation from the date of the contract, to impairment of future performance under an existing contract. In these latter cases, the new law, even if prospective in application, may have explicit or implicit retrospective effect in that future contract performance is made illegal, prevented, hindered, or made more expensive by the subsequent government act.”).

41. See, e.g., *Santa Fe Indus. v. Green*, 430 U.S. 462, 479 (1977) (“Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.”).

42. See, e.g., *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729 (1984) (“Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches . . . .”); *Usery v. Turney Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976) (“[L]egislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and . . . the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way.”).

43. See *Kaiser Aetna v. United States*, 444 U.S. 164, 179 (1979) (holding that a landowner’s investment in dredging a pond to make it navigable was an interest “sufficiently important [that] the Government must condemn and pay for before it takes over the management of the landowner’s property”); *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978) (finding “the extent to which the regulation has interfered with distinct investment-backed expectations . . . [to be a] relevant consideration[]”).

precedents, reasons, and the other devices of legal stability”—that they rarely engage with each other.<sup>44</sup>

Yet in this Essay I seek specifically to address the role in regulatory design that retroactive policymaking might contribute to the law’s resilience and adaptiveness. And there are two areas of regulatory design where questions of retroactivity most often arise. The first is captured by what is known as the “standards versus rules” debate, the second in what is known in administrative law as the *Chenery II* doctrine. After briefly describing the first, most of my argumentation is located in the *Chenery II* doctrine of policymaking ex post by administrative agencies in adjudications.

The literature on rules and standards is enormous, and longstanding. In one of the classics in the field, *Form and Substance in Private Law Adjudication*,<sup>45</sup> Professor Duncan Kennedy referenced a thick “jurisprudence of rules” that analyzes two fundamentally different types of legal solutions to societal problems: “One formal mode favors the use of clearly defined, highly administrable, general rules; the other supports the use of equitable standards producing *ad hoc* decisions with relatively little precedential value.”<sup>46</sup> The difference between rules and standards has been illustrated with simple examples, such as a speed limit of “65 miles-per-hour” being a “rule” as opposed to the more general admonition, “drive carefully,” being a “standard.”<sup>47</sup> It has also been captured by metaphors, such as the difference between “crystal and mud.”<sup>48</sup> But these descriptions belie the rich literature that captures debates over the range of criteria by which rules versus standards can be judged<sup>49</sup> as well as the

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44. Frederick Schauer, *Legal Development and the Problem of Systemic Transition*, 13 J. CONTEMP. LEGAL ISSUES 261, 265 (2003). Schauer attempts to explain this split by conjecturing that “jurisprudential transition literature, which considers the desirability of change to be its major focus, and the taxation/torts/takings transition literature, which takes the change as a given . . . have focused on different stages of the larger transition process, or on different actors in that process.” *Id.* at 266.

45. Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1685 (1976).

46. *Id.*

47. Hans-Bernd Schafer, *Rules Versus Standards in Rich and Poor Countries: Precise Legal Norms as Substitutes for Human Capital in Low-Income Countries*, 14 S. CT. ECON. REV. 113, 116 (2006).

48. *See id.* (citing Carole M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 577–604 (1988)).

49. Compare Kennedy, *supra* note 45, at 1685–86 (suggesting the normative difference between rules and standards reduces to fundamental philosophical disagreements between the relative values of “individualism” and “altruism,” refracted through “a hundred and fifty years of moral, economic, and political dispute”), with Louis Kaplow, *Rules Versus*

range of arguments about the relative desirability of rules versus standards in particular situations.<sup>50</sup> For our purposes, though, one of the most salient differences between the two is that rules are typically viewed as specifying how law applies ahead of time (*ex ante*), whereas standards explain how law applies to particular behavior only after the conduct has occurred (*ex post*).<sup>51</sup> The use of standards, therefore, raises retroactivity issues.<sup>52</sup>

The rules versus standards debate spills over into a debate over competing procedural approaches to generating law, a debate captured in a parallel (and equally longstanding) literature on the relative virtues of “rulemaking” and “adjudication.”<sup>53</sup> Generally speaking, this literature does not so much chronicle a “debate” as it records a well-recognized shift away from adjudication and toward rulemaking as the preferred process by which to create law.<sup>54</sup> At an instrumental level, this shift can be seen in the increasing importance to countless fields of law of statutes and statutory/regulatory regimes in lieu of the older case-by-case adjudicatory approach of common law courts—the sort of “flips” Professor Ruhl describes in this symposium as that which occurred in the 1970s in federal environmental law.<sup>55</sup> At a jurisprudential level, the shift to

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*Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559 (1992) (applying standard economic criterion of efficiency to determine the relative merits of rules versus standards).

50. Kaplow, *supra* note 49, at 568–85.

51. *Id.* at 559–60. The rules versus standards debate is, among other things, about the difference between “*ex ante* versus *ex post* creation of the law.” *Id.* at 562.

52. To be clear, the use of standards does not raise a retroactivity “problem.” The literature on rules versus standards includes arguments that it is precisely this element of nonclarity *ex ante* that give standards one of their more defensible normative virtues. See, e.g., Seana Valentine Shiffrin, *Essay: Inducing Moral Deliberation: On the Occasional Virtues of Fog*, 123 HARV. L. REV. 1214, 1216–17 (2010) (explaining that standards, because they are “fuzzy,” are more likely to encourage moral deliberation among those within the penumbra of the standard than are clear rules that already demarcate areas of good and bad behavior).

53. See, e.g., M. Elizabeth Magill, *Agency Choice of Policymaking Form*, 71 U. CHI. L. REV. 1383, 1383–86 (2004); Glen O. Robinson, *The Making of Administrative Policy: Another Look at Rulemaking and Adjudication and Administrative Procedure Reform*, 118 U. PA. L. REV. 485, 508–36 (1970); Shapiro, *supra* note 10, at 921–26; Peter L. Strauss, *Rules, Adjudication, and Other Sources of Law in an Executive Department: Reflections on the Interior Department’s Administration of the Mining Law*, 74 COLUM. L. REV. 1231, 1244–64 (1974).

54. E.g., Magill, *supra* note 53, at 1403–04 n.69 (“To say that there was a debate, however, implies more diversity of opinion than can be found in that literature. . . . [T]he drift of these articles [in administrative law scholarship] was fairly uniform: agencies should use rulemaking more often than they did.”).

55. GUIDO CALABRESI, *A COMMON LAW FOR THE AGE OF STATUTES* 1–3 (1982); Henry H. Drummonds, *The Dance of Statutes and the Common Law: Employment, Alcohol, and Other Torts*, 36 WILLAMETTE L. REV. 939, 994–95 (2000) (“Common law

rulemaking may also have reflected the triumph of legal positivism as an explanation of the legal enterprise, replacing the idea that courts apply “the law,” ethereal truths discoverable by judges, with the idea that the law was entirely a product of human invention and thus every bit within the analytical province of legislators, regulators, and experts of various kinds.<sup>56</sup> At an epistemological level, the triumph of rulemaking also reflected the growing conviction that the world was better understood and policy better made through the analytical approach of “comprehensive rationality,” by which goals and means would be fully specified, compared, and chosen synoptically via techniques such as formal decision theory or cost-benefit analysis, as opposed to a world view shaped “incrementally” through a pattern of case-by-case experimentation and adjustment.<sup>57</sup> Rulemaking was associated with comprehensive rationality, adjudication with incrementalism.<sup>58</sup> And, because rulemaking would produce rules ex ante, it added important procedural advantages over adjudication, such as greater opportunities for democratic participation in the formulation of the law, more transparency, and greater clarity ahead of time about what sort of behavior was acceptable.<sup>59</sup> Adjudication, because it occurred after the fact and in a setting where only the conduct of particular individuals or organizations was at stake, had none of these advantages.<sup>60</sup> Moreover, because policy announced in adjudication occurred ex post, it provided little guidance ahead of

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courts create new torts, as well as apply and modify existing torts, in the exercise of their common law powers. It has always been so. . . . In the Age of Statutes, it is not surprising that courts now create new torts out of statutory duties. *Nearing v. Weaver* recognized a new tort where police agencies failed to perform a statutory duty to enforce domestic relations restraining orders. *Chartrand v. Coos Bay Tavern* recognized a new tort for serving tavern customers who were ‘visibly intoxicated,’ in violation of a statute. *Scovill v. Astoria* recognized a tort for violation of a statute requiring that intoxicated persons who present dangers to themselves or others be kept in protective custody. Courts just as properly, and for varying reasons, often refuse to create new torts for violations of statutory duties in other contexts.”)

56. See SMITH, *supra* note 5, at 41–65 (discussing the concept of “the law” and what it means).

57. See Colin S. Diver, *Policymaking Paradigms in Administrative Law*, 95 HARV. L. REV. 393, 399–400 (1981).

58. See *id.*

59. See *id.* at 410–11, 424.

60. See *id.* at 403–04.

time as to what the law required.<sup>61</sup> Adjudication, therefore, had a retroactivity problem.<sup>62</sup>

Enter the *Chenery* litigation<sup>63</sup> and a moment in administrative law when the issues of rules versus standards, rulemaking versus adjudication, and the problem of retroactivity all coalesced. The *Chenery* cases arose in the mid-twentieth century, in the aftermath of the Great Depression, and in the early days of President Franklin Roosevelt's "New Deal" legislative agenda. At issue was the Public Utility Holding Company Act of 1935<sup>64</sup> ("PUHCA") which, despite its oblique title, was perhaps the most controversial of the securities laws passed by the New Deal Congress.<sup>65</sup> Although the PUHCA touched on only one segment of the economy (the provision of utilities such as water and electricity) and addressed itself only to one aspect of this segment (the emergence of financially complicated "holding" companies that owned controlling stock in public utilities), the PUHCA was the New Deal securities law most often challenged in court, at the center of the majority of all securities-law actions reaching the Supreme Court between 1935 and 1955.<sup>66</sup>

The PUHCA was controversial because of its substantive financial policy and because of the pervasiveness, under the statute, of government's role in matters of private ordering. As a matter of financial policy, the PUHCA required the significant restructuring of all public utility holding companies, forcing them to shed "non-integral" holdings (those unrelated to their core public utility businesses), thereby limiting their operations "to a single integrated public utility system."<sup>67</sup> In comparison to earlier provisions of the

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61. *See id.* at 420–21.

62. *See* SEC v. *Chenery Corp.* (*Chenery II*), 332 U.S. 194, 203 (1947) ("Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency.").

63. *See generally id.* (sustaining an adjudicative order issued by the SEC and challenged by *Chenery Corporation*); SEC v. *Chenery Corp.* (*Chenery I*), 318 U.S. 80 (1943) (setting aside an adjudicative order issued by the SEC and challenged by *Chenery Corporation*).

64. Public Utility Holding Company Act of 1935, Pub. L. No. 74-333, 49 Stat. 803 (repealed 2005).

65. *See* Morris L. Forer, *A Postscript to the Administration of the Public Utility Holding Company Act: The Hydro-Electric System Case*, 45 VA. L. REV. 1007, 1007–08 (1959).

66. *See* A.C. Pritchard & Robert B. Thompson, *Securities Law and the New Deal Justices*, 95 VA. L. REV. 841, 865 (2009).

67. § 11(b)(1), 49 Stat. at 820 (repealed 2005); *see also* *Chenery II*, 332 U.S. at 204–05 (discussing operation of PUHCA section 11(e)). The purpose of this requirement was to reduce the amount of overleveraging in which public utility holding companies had been engaged. *See generally* Forer, *supra* note 65 (discussing the purpose and effects of the

legislation that were struck during its congressional passage, in particular a provision that would have eliminated these kinds of holding companies altogether,<sup>68</sup> the integrated-holdings requirement might have been viewed as relatively modest. At its core, it sought to reduce opportunities for overleveraging and speculation that had notoriously characterized the industry.<sup>69</sup> But, in comparison to the mechanisms of other New Deal securities laws, such as the disclosure provisions in the Securities Acts of 1933 and 1934,<sup>70</sup> the PUHCA was attacked as an unprecedented intrusion of government power into the market.<sup>71</sup> Section 11 of the PUHCA authorized the Securities and Exchange Commission (“SEC”) to approve any “voluntary” reorganization plans submitted by holding companies or, if none were forthcoming, to hold adjudicatory hearings after which the SEC itself could order particular reorganization measures.<sup>72</sup> The PUHCA also delegated rulemaking powers to the SEC, giving the agency power to adopt rules to help with implementation of the statute.<sup>73</sup> In light of the substantial powers given the agency by the PUHCA, there were frequent claims from the utility industry that the statute’s “socialis[t]” backers wanted to “‘nationalize’ ” the industry.<sup>74</sup>

At issue in the *Chenery* cases was an SEC adjudicative order issued under section 11(e) disapproving parts of a reorganization plan submitted by Christopher Chenery and other officers and directors of a public utility holding company.<sup>75</sup> Under this plan, *preferred* shares in the “old” holding company, including preferred shares recently

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PUHCA). In keeping with the spirit of speculation that led to the 1929 stock market crash, these kinds of holding companies had frequently pledged as collateral their ownership interests in public utilities (regulated businesses with guaranteed but unspectacular profit margins) for loans that could in turn be invested in more flamboyant ventures possessing greater potential for outsized, speculative gains. When the stock market crash took down the speculative ventures, the holding companies defaulted on these loans and the lenders foreclosed on the underlying collateral, the nation’s supposedly “boring” public utility companies themselves. Thus, an unexpected artifact of the stock market crash was the indirect financial chaos it spawned even in safe sectors of the economy, including industries providing such bedrock services as fresh water and electric power.

68. See Pritchard & Thompson, *supra* note 66, at 865–66.

69. See *supra* note 67.

70. See Pritchard & Thompson, *supra* note 66, at 865–67.

71. See *id.* at 866–67.

72. §§ 11(b), (e), 49 Stat. at 820–23 (repealed 2005).

73. See *Chenery I*, 318 U.S. 80, 92 (1943) (“Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different.”).

74. See Pritchard & Thompson, *supra* note 66, at 866–67 (quoting ARTHUR M. SCHLESINGER, *The Politics of Upheaval, in THE AGE OF ROOSEVELT* 305, 306 (1957)).

75. *Chenery II*, 332 U.S. 194, 196 (1947); *Chenery I*, 318 U.S. at 81.



purchased by Chenery and the other officers and directors, would be redeemable for common (voting) shares in the “new,” reorganized company.<sup>76</sup> It was acknowledged that management, in purchasing preferred shares in the old company, had not been involved with any kind of insider trading and had not otherwise violated any existing securities law or regulation.<sup>77</sup> It was also clear, however, that the new emphasis on preferred shares was something of a switch. In earlier proposals for reorganization, the Chenery group had proposed exchanging *common* shares in the old company for common shares in the new one.<sup>78</sup> The reason for the change was wholly tactical: an outside bidder for control of the reorganized company had emerged and had been buying up common shares in the old company in an effort to outmaneuver the Chenery group for post-reorganization ownership.<sup>79</sup> Although the SEC allowed the company to reorganize, it forced the Chenery group to turn in its preferred shares almost for cost (more or less getting back the price it paid for the preferred shares), in contrast to the far greater profit the Chenery group would have realized had it been able to redeem the preferred shares for common shares in the new, reorganized company, and then sell those common shares on the open market.<sup>80</sup> To justify this result, the SEC in its section 11 order announced a principle under the PUHCA: management of a public utility holding company cannot trade in the company’s securities during reorganization.<sup>81</sup>

At first, any kind of retroactivity problem with the SEC’s rationale was not immediately apparent. In explaining its order, the SEC stated that the agency was merely following what it believed to be a well-known common law fiduciary principle, that management can never trade in its own company’s securities during any kind of reorganization.<sup>82</sup> The problem with this explanation, however, is that

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76. *See Chenery I*, 318 U.S. at 81, 84–85.

77. *See Chenery II*, 332 U.S. at 197 (“It was also plain that there was no fraud or lack of disclosure in making these purchases.”).

78. *See generally* Roy A. Schotland, *A Sporting Proposition—SEC v. Chenery*, in *ADMINISTRATIVE LAW STORIES* 169, 176–78 (Peter L. Strauss ed., 2006) (discussing the PUHCA and the dealings of the Chenery group, which gave rise to two Supreme Court cases challenging the constitutionality of the SEC’s order regarding the buying and selling of public utility holding company securities by management at those companies during a section 11 reorganization).

79. *See id.*

80. *See id.*

81. *See id.*

82. *See Chenery II*, 332 U.S. at 197–98 (“[The SEC] felt that officers and directors of a holding company in the process of reorganization under the [PUHCA] were fiduciaries

it was flatly incorrect. In the first of two actions by the Chenery group against the SEC's action, the Supreme Court held (in an opinion known as *Chenery I*) that there simply was not a general, common law prohibition against management buying and selling such securities, provided that full disclosure was made.<sup>83</sup> Having corrected the agency's misunderstanding of the common law, the Court remanded the Chenery group's proposal back to the agency for reconsideration,<sup>84</sup> as it was the agency to which Congress had delegated the task of supervising these kinds of reorganizations.

On remand, the SEC again disapproved the Chenery group's proposed reorganization and again stated its belief that management should not trade in securities of their own companies during a section 11 reorganization.<sup>85</sup> This time, however, the agency located its no-trading policy in the PUHCA itself.<sup>86</sup> The agency explained that, as the purpose of the PUHCA was to insulate consumers' public utility service from turmoil created by financial manipulation within public utility holding companies, it would effectuate the *statute's* goals to prohibit just this sort of management trading during reorganization.<sup>87</sup> After all, the SEC explained, the Chenery group's sudden decision to elevate the value of preferred shares in the old company not only lowered the relative value of (old) common shares held by the outside bidders competing with the Chenery group for control of the reorganized company, it also lowered the value of common shares that might have been purchased and held by pension funds, widows, and orphans who had sought to invest in (what they thought to be) the relatively safe public utility sector.<sup>88</sup> The PUHCA was enacted because holding-company financiers had disastrously turned the

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and were under a duty not to trade in the securities of that company during the reorganization period."); Schotland, *supra* note 78, at 176–78.

83. See *Chenery I*, 318 U.S. 80, 88, 90, 93–94 (1943); Schotland, *supra* note 78, at 178–82.

84. See *Chenery I*, 318 U.S. at 95. In doing so, the *Chenery I* Court established one of the core principles of modern administrative law: “that the courts could not uphold an agency order on grounds other than those invoked by the agency.” Kevin M. Stack, *The Constitutional Foundations of Chenery*, 116 YALE L.J. 952, 961 (2007); accord *Chenery I*, 318 U.S. at 95 (holding 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”).

85. See Stack, *supra* note 84, at 961.

86. See *id.*

87. See *Chenery II*, 332 U.S. at 199–200.

88. *Id.* at 205 (“[T]he Commission felt that a management program of stock purchases would give rise to the temptation and the opportunity to shape the reorganization proceeding so as to encourage public selling on the market at low prices.”).

provision of basic public utilities into their own financial playground (not unlike what would happen over half a century later in the Enron scandal).<sup>89</sup> Therefore, from the SEC's point of view, it was important that the Chenery group not be permitted to continue what the agency saw as a "business-as-usual" approach of stock purchases during reorganization that were designed to buttress management's strategic positions at the expense of financial stability in the public utility sector.<sup>90</sup>

According to the Chenery group, however, this presented a retroactivity problem. In a second Supreme Court challenge, the Chenery group argued that even if the agency were correct about management's actions being inconsistent with the PUHCA's statutory purpose, the agency could not suddenly announce this new policy after-the-fact and retroactively apply it to conduct that, when undertaken, had not violated anything the agency had announced.<sup>91</sup> Congress, after all, had delegated the SEC both adjudicatory power under section 11 and the power to adopt broad implementing rules.<sup>92</sup> It would be an abuse of discretion, the Chenery group argued, for the agency to forego rulemaking as the vehicle for its new policy.<sup>93</sup> Not unlike arguments frequently made in the rules versus standards debate, the Chenery group argued that law should be contained in precise rules that put players on notice as to what was, or was not, allowed.<sup>94</sup>

In *Chenery II*, the Supreme Court rejected the Chenery group's argument, upheld the SEC, and announced as a principle of administrative law that agencies are free to choose whether policymaking under a statutory delegation is best made prospectively through the agency's rulemaking powers or incrementally and retroactively through the agency's adjudicatory authority.<sup>95</sup> And, although there has been interstitial movement in the courts of appeals finding particular settings where the agency's choice might be constrained,<sup>96</sup> the Supreme Court has since reiterated that *Chenery II* remains good law.<sup>97</sup>

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89. See *infra* notes 137–44 and accompanying text (discussing comparisons to Enron).

90. See *Chenery II*, 332 U.S. at 205.

91. See *id.* at 199–200.

92. *Id.* at 201.

93. *Id.* at 199–200.

94. See *id.*

95. See Magill, *supra* note 53, at 1406.

96. See, e.g., William D. Araiza, *Agency Adjudication, the Importance of Facts, and the Limitations of Labels*, 57 WASH. & LEE L. REV. 351, 365–76 (2000) (discussing several

III. *CHENERY II* AND A DEFENSE OF EX POST LAWMAKING

Assailing the retroactivity elements of the Court's decision, *Chenery II* is sometimes pinpointed as a critical threat to the rule of law and an open invitation to rank lawlessness.<sup>98</sup> Thus, an article in the "First Principles" series published by the Heritage Foundation<sup>99</sup> states that "[t]he case also serves as a good illustration of the kind of injustice the American Founders sought to avoid by instituting a Constitution structured around the separation of powers and grounded in the rule of law."<sup>100</sup> This critique continues, "[I]n the *Chenery* case, the company had no way of knowing what to do or not to do in order to maintain its ownership and was forced to rely on whatever *ad hoc* decision the administrators in the SEC felt like making."<sup>101</sup> The article concludes, "Against such a scenario, the advantages of the Founders' rule-of-law system are evident."<sup>102</sup>

There are two obvious problems with such a sweeping critique of *Chenery II*. First, and most obviously, the critique paints with such a broad brush that it redacts the words of the actual Constitution and instead inserts words and concepts that, apparently, the critique wishes *would* have been used instead. Thus, it is worth recalling that the Founders inserted into the actual Constitution an *ex post facto* clause aimed only at the post-hoc imposition of *criminal* penalties, an interpretation of the Constitution adopted by the *Calder v. Bull*<sup>103</sup>

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circuit court decisions finding policymaking via agency adjudication to be improper when the same agency had itself previously chosen rulemaking as the procedural mechanism).

97. In *NLRB v. Bell Aerospace Co.*, 416 U.S. 267 (1974), the Court reinforced the vitality of *Chenery II*, holding that retroactivity concerns do not constrain an agency's ability to make policy via adjudication even when doing so has the effect of reversing previously announced policies. *Id.* at 295.

98. In his dissent to *Chenery II*, Justice Jackson called the case "the first instance in which the administrative process is sustained by reliance on that disregard of law which enemies of the process have always alleged to be its principal evil. It is the first encouragement this Court has given to conscious lawlessness as a permissible rule of administrative action." 332 U.S. at 217 (Jackson, J., dissenting).

99. RONALD J. PESTRITTO, THE HERITAGE FOUND., THE BIRTH OF THE ADMINISTRATIVE STATE: WHERE IT CAME FROM AND WHAT IT MEANS FOR LIMITED GOVERNMENT 1 (Nov. 20, 2007), available at <http://www.heritage.org/Research/Reports/2007/11/The-Birth-of-the-Administrative-State-Where-It-Came-From-and-What-It-Means-for-Limited-Government> (noting that "[n]othing written here is to be construed as necessarily reflecting the views of the Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress"). This article was published by the Heritage Foundation in its "First Principles Series," which is described as "explor[ing] the fundamental ideas of conservatism and the American political tradition." *See id.*

100. PESTRITTO, *supra* note 99, at 2.

101. *Id.* at 3.

102. *Id.*

103. 3 U.S. (3 Dall.) 386 (1798).

Court in 1798 and followed ever since.<sup>104</sup> That the Constitution would not straightjacket the *non*-criminal-law policy choices of a new democratic majority is hardly surprising given that it was written by revolutionaries who had fought and died precisely with such a new systemic transition in mind.<sup>105</sup> Second, the critique similarly misreads the country's history in the sixty years since *Chenery II* was decided. The critique reads *Chenery II* as launching the country into an era of retroactive policymaking via adjudication, an era of "ad hoc" administrators operating outside the rule of law. In fact, the past fifty years are routinely regarded as those where (ex ante) rulemaking has "[t]riumph[ed]"<sup>106</sup> over (ex post) adjudication.<sup>107</sup>

In fact, both at its inception and since, *Chenery II* reflects an important but much more occasional feature of our legal system: an ability to ensure fidelity to legitimately (but newly adopted) statutory regimes when they are challenged by conduct that could not have been anticipated. In short, an element of retroactivity is necessary to ensure the resilience of legal systems by allowing implementing agencies to adapt (ex post) to unforeseen challenges. Indeed, the *Chenery II* Court, in a frequently cited passage, emphasized exactly that:

In other words, problems may arise in a case which the administrative agency could not reasonably foresee, problems which must be solved despite the absence of a relevant general rule. . . . In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective.<sup>108</sup>

Moreover, this understanding of *Chenery II* explains even those few instances in the courts of appeals (primarily a handful of cases in the Ninth Circuit) where courts have since forced agencies to proceed

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104. See *supra* notes 35–39 and accompanying text.

105. See Schauer, *supra* note 44, at 269 (noting that "the United States at the founding . . . was engaged in a dramatic replacement of the English approach to political institutions," even if in other ways for practical reasons they might choose to "continue[] the substance, the procedure, and the institutions of the English common law").

106. Diver, *supra* note 57, at 409 (referring to the "[t]riumph of [c]omprehensive [r]ationality"). "Beginning in the mid-1960's and accelerating rapidly during the early years of the 1970's, a new consensus about policymaking began to emerge. The key doctrinal shift was the enhanced emphasis on rulemaking as a method of formulating policy." *Id.*

107. See, e.g., Magill, *supra* note 53, at 1403 n.69 (noting a consensus that rulemaking was the preferred policymaking vehicle).

108. *Chenery II*, 332 U.S. 194, 202–03 (1947).

only by rulemaking.<sup>109</sup> There, courts have emphasized that, when an agency had itself previously known enough about a problem to undertake rulemaking, it could not simply switch gears and instead use after-the-fact adjudication.<sup>110</sup> Instead, it is when agencies face an uncertain implementation landscape, one that necessarily puts agencies in a “learning curve” posture,<sup>111</sup> that agencies are on their strongest ground in proceeding incrementally, and ex post, through adjudicatory policymaking.

And there are other reasons for considering *Chenery II* to be less the threat to rule-of-law values than is claimed by its attackers. There is, for example, the fact that the *Chenery II* Court itself inserted a type of escape valve: retroactive application of a policy would not be allowed when its benefits were outweighed by unfairness to the adjudicatee. As the Court stated,

But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law.<sup>112</sup>

Ignoring this feature of the opinion, attacks on *Chenery II* sometimes suggest that the SEC actively misled the *Chenery* group. Thus, one such critique states:

When it became clear that the SEC would allow preferred stockholders to convert their shares of the old company into

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109. See, e.g., Araiza, *supra* note 96, at 367–72 (discussing cases where appellate courts have held that an agency could not proceed by adjudication but rather must proceed by rulemaking).

110. See *id.*

111. See *id.* at 394–95 (using the “learning curve” metaphor).

112. *Chenery II*, 332 U.S. at 203. In *Retail, Wholesale & Department Store Union v. NLRB*, 466 F.2d 380 (D.C. Cir. 1972), for example, the D.C. Circuit Court of Appeals applied this *Chenery* standard to a case involving a decision of the National Labor Relations Board to require a company retroactively to reinstate and give back-pay to a group of strikers after a Supreme Court decision that required such remedies. *Id.* at 393. This case established a five-part test for determining whether an agency decision could have retroactive effect:

(1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

*Id.* at 390.

shares of the newly reorganized company, the Chenery Corporation went out and bought itself a large block of preferred stock on the open market . . . but the SEC explicitly excluded Chenery from making such a conversion, thus depriving Chenery of its ownership.<sup>113</sup>

In fact, neither the Chenery group nor any holding company management group had ever sought, or received, advance approval from the SEC to purchase shares of any kind during reorganization. As the *Chenery II* Court stated, “Hence, we refuse to say that the Commission, which had not previously been confronted with the problem of management trading during reorganization, was forbidden from utilizing this particular proceeding for announcing and applying a new standard of conduct.”<sup>114</sup> Approximately thirty years later, in *NLRB v. Bell Aerospace Co.*,<sup>115</sup> the Court reiterated the validity of *Chenery II* while also noting that it did not, nor was it intended to, countenance any kind of active bad faith by government administrators.<sup>116</sup> Indeed, the Court emphasized just such an outer limit to retroactive policymaking: “This is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good faith reliance on Board pronouncements . . . [n]or are fines or damages involved here.”<sup>117</sup> Both *Chenery II* and *Bell Aerospace* clearly distinguish between what we might call “mere” retroactivity, and the caricature of bad faith, bait-and-switch governmental conduct that critics of *Chenery II* sometimes falsely allege.

There remains, then, what might be the core claim of the *Chenery II* critics, that “mere” retroactivity is always unjust and inconsistent with the rule of law. This claim has normative, empirical, and, in the specific case of the Chenery group, historical flaws. Normatively, there is the problem of the arbitrary baseline. If reliance

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113. PESTRITTO, *supra* note 99, at 2.

114. *Chenery II*, 332 U.S. at 203 (emphasis added).

115. 416 U.S. 267 (1974). In *Bell Aerospace*, the Supreme Court upheld the National Labor Relations Board’s decision to change its definition of “employees” to include “buyers” in an adjudication, but not to punish the company retroactively for having refused to negotiate with a union of buyers before the rule was changed. *Id.* at 294–95.

116. *Id.* at 294. The *Bell Aerospace* Court even extended *Chenery II* to allow agencies to change policies when new facts require it, so long as it was not unjust to do so. *Id.* (“The possible reliance of industry on the Board’s past decisions with respect to buyers does not require a different result. It has not been shown that the adverse consequences ensuing from such reliance are so substantial that the Board should be precluded from reconsidering the issue in an adjudicative proceeding.”).

117. *Id.*

based on past law is always to be protected, what of the Constitution itself and the ensuing laws passed by the newly formed federal and state governments, could they not be legitimately enforced when they upset prior “Tory” expectations legitimately formed during the then-legal colonial regime? Or, fast-forwarding through the country’s history, is the rule of law so demanding that, when the Thirteenth Amendment was ratified in 1865 prohibiting slavery, all existing master-slave relationships had to be “grandfathered in,” lest we upset reliance interests formed under the antebellum slave laws? As Professor Harold Krent notes, “[r]etroactive lawmaking can comport with democratic ideals by allowing a current majority to be free from the controlling grasp of majorities past.”<sup>118</sup> Thus, under the Due Process Clause, the Court has always required mere “rationality” when economic legislation adjusts “the burdens and benefits of economic life” even when the legislation “upsets otherwise settled expectations . . . [or] impose[s] a new duty or liability based on past acts.”<sup>119</sup> Similarly, under the Takings Clause the Court has never required compensation for all so-called “regulatory takings,” but only as a general matter for those that go “too far.”<sup>120</sup> As Justice Holmes famously stated in *Pennsylvania Coal v. Mahon*,<sup>121</sup> the case widely credited with creating the idea of “regulatory takings” in the first place, “Government hardly could go on if, to some extent, values incident to property could not be diminished without paying for every such change in the general law.”<sup>122</sup> Given this normative justification, it is little surprise that, as an empirical matter, the Court has consistently upheld retroactive legislation against claims by those it affects that it violates the rule of law.<sup>123</sup>

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118. Krent, *supra* note 37, at 2146. Indeed, even if one takes the less rosy public-choice view of legislation—that some laws reflect not the public interest but the influence of special interests—then the possibility that such laws can be undone by subsequent “public-spirited” legislation raises the cost (and thereby dilutes the effectiveness) of rent-seeking and political capture. *Id.* at 2145.

119. *Usery v. Turner Elhorn Mining Co.*, 428 U.S. 1, 15, 16 (1976).

120. *See Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 105 (1978).

121. 260 U.S. 393 (1922).

122. *Id.* at 413.

123. *See, e.g., United States v. Carlton*, 512 U.S. 26, 34 (1994) (limiting availability of deduction for proceeds of sales of stock to employee stock ownership plans); *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992) (upholding retroactive enactments designed to improve Michigan’s compensation benefits law); *United States v. Sperry Corp.*, 493 U.S. 52, 64–65 (1989) (reallocating litigation costs); *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 734 (1984) (imposing sanctions on employers who withdrew from pension plans); *Usery*, 428 U.S. at 6 (imposing liability on mine employers for employee disabilities due to black lung disease); *United States v. Monsanto Co.*, 858



Indeed, the historical setting of *Chenery II* illustrates precisely why the SEC's actions as to the Chenery group's preferred-shares gambit during reorganization was both understandable and defensible, and not the result of bureaucratic whim. The *Chenery* case arose under a statute, the PUHCA, that focused specifically on one type of corporate form, the public utility holding company, that had played an outsized role in the country's economic history.<sup>124</sup> In the early years of the twentieth century, as it became clear that centralized power plants possessed economy-of-scale advantages over more localized and distributed generation strategies, public utility holding companies emerged as a type of centralized financing mechanism with advantageous access to capital needed for the breathtaking pace of the country's electrification.<sup>125</sup> Although "[e]ngineers and technically trained managers dominated the early history of the major holding companies,"<sup>126</sup> "during the stock-market boom of the 1920's the utility holding company became an instrument of high finance that . . . [at the time had] no parallel in the entire history of American business—not even in the earlier history of the railroads."<sup>127</sup> In particular, utility holding companies came to be known for pyramid structures in which "preferred" shares were used to concentrate favorable ownership and dividend treatment to the relatively few owners of arcane, specially created holding companies over the vast majority of "common" stock holders in the underlying public utilities (the bottom of the pyramid), who had been led to believe in the safety of their investment in "electricity."<sup>128</sup> It was after the stock market crash of 1929 and the ensuing economic depression exposed the weakness of the highly leveraged scheme that public utility holding companies had become, that the PUHCA was passed,<sup>129</sup> to break up the "reckless promoters" of "the power

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F.2d 160, 174 (4th Cir. 1988) (imposing retroactive liability on handlers and transporters of hazardous substances).

124. This narrative is taken largely from an excellent historical summary: Richard D. Cudahy & William D. Henderson, *From Insull to Enron: Corporate (Re)Regulation After the Rise and Fall of Two Energy Icons*, 26 ENERGY L.J. 35, 53–57 (2005).

125. *Id.* at 57.

126. *Id.* at 54 (citing THOMAS P. HUGHES, NETWORKS OF POWER: ELECTRIFICATION IN WESTERN SOCIETY, 1880–1930, at 393 (1983)).

127. JAMES C. BONBRIGHT, PUBLIC UTILITIES AND THE NATIONAL POWER POLICIES 24 (1972).

128. See Cudahy & Henderson, *supra* note 124, at 53 (noting especially that utility and early holding company investors had been told, "if the light shines, you know your money is safe") (citation omitted).

129. *Id.* at 73–78.

trust.”<sup>130</sup> Thus, when the Chenery group, during the mandatory PUHCA reorganization, traded in its own securities (and through the mechanism of “preferred” shares no less) in a way that benefited itself as management but at the risk of lowering the value of the old common stock held by “regular” investors, the SEC found that the practice violated the broader purposes of the statute, a legal conclusion the *Chenery II* Court had no trouble upholding.<sup>131</sup> Given the legal appropriateness of the agency’s action, (not a matter simply of bureaucratic whim), it’s hard to see how the Chenery group was treated unfairly by the Commission’s relatively solomonic order: the reorganization was approved and the Chenery group was forced to redeem its preferred shares for cost, getting back all of the money it had paid for its preferred shares<sup>132</sup> (and even awarded “cost plus dividends” for the time value since purchase).<sup>133</sup>

It is not difficult to generalize on the wisdom of *Chenery II* and the value of the law preserving for itself the ability, *ex post*, to respond to unforeseen circumstances. Consider simply the country’s subsequent history with energy markets. Near the end of the twentieth century, a growing faith in market competition began to replace the suspicion of market manipulation that had underlain the PUHCA.<sup>134</sup> By the 1990s, under new statutes such as the Public Utility Regulatory Policy Act of 1978<sup>135</sup> and the Energy Policy Act of 1992,<sup>136</sup> new energy regulators had undone “much of the work accomplished by the SEC in breaking up the holding companies . . . [and n]ew utility conglomerates emerged, such as Enron.”<sup>137</sup> In 1997, Jeffrey Skilling, Enron’s president and chief operating officer, testified before Congress: “I am absolutely certain, Mr. Chairman,

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130. *Id.* at 68 (quoting President Franklin Roosevelt).

131. *See Chenery II*, 332 U.S. 194, 207 (1947) (“[T]he Commission’s action is based upon substantial evidence and is consistent with the authority granted it by Congress.”).

132. *Id.*

133. *Id.* at 198.

134. *See, e.g.*, Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 38 (2005) (“[T]he norms governing transactions prior to the Enron and WorldCom scandals included . . . a dominance of market economism and shareholder wealth maximization.”).

135. Public Utility Regulatory Policy Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified as amended in scattered sections of 15, 16, 30, 42, and 43 U.S.C.).

136. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified in scattered sections of 15, 16, 38, and 42 U.S.C.).

137. Pritchard & Thompson, *supra* note 66, at 913–14; *see also* Cudahy & Henderson, *supra* note 124, at 85 (stating that the Energy Policy Act of 1992 “created a new category of power plants . . . that were exempt from the PUHCA’s corporate ownership and geographic provisions”).

that if you reconvene this panel ten years from now, all of us will wonder aloud why we ever let the monopoly persist for so long.”<sup>138</sup> On August 14, 2001, Skilling resigned from Enron, just months before Enron itself filed for bankruptcy, one of the largest bankruptcies in U.S. history.<sup>139</sup> In the various postmortems, a consensus emerged that, among other things, Skilling and Enron had deliberately camouflaged Enron’s lack of profitability through an arcane and complicated web of special-interest companies that kept Enron’s actual debts off of its balance sheet.<sup>140</sup> Skilling claimed that, in creating these special entities, he had technically followed all applicable accounting rules.<sup>141</sup> But, like the SEC using the tool of ex post adjudicatory policymaking to respond to a new situation in *Chenery II*, federal prosecutors successfully used the default admonition against “fraud” in the federal securities laws, which itself has elements of an “ex post” standard (in the “standards versus rules” sense), to successfully prosecute Skilling and his fellow Enron conspirators.<sup>142</sup> Although Skilling recently succeeded in the Supreme Court in having some of these criminal counts reversed because they were based on an impermissibly vague (and novel) interpretation of the federal “honest services” statute,<sup>143</sup> the Court left untouched the ability of the legal system to use the “standards-based” fraud statutes to respond ex post to the violation of society’s norms against unfair dealing, despite the use of novel financial mechanisms.<sup>144</sup>

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138. Cudahy & Henderson, *supra* note 124, at 88 (quoting *Competitive Change in the Electric Power Industry: What Are the Issues Involved in Competition? Hearing Before the S. Comm. on Energy and Natural Res.*, 105th Cong. 11 (1997) (testimony of Jeffrey Skilling, President and Chief Operating Officer, Enron Corporation)).

139. See *Skilling v. United States*, 130 S. Ct. 2896 (2010).

140. See Cudahy & Henderson, *supra* note 124, at 95 (“Prior to its collapse, the worst thing that analysts had to say about Enron was that they could not understand the company’s business model. As early as 1996, some analysts acknowledged that Enron’s trading transactions were so complex that they represent a black box, making it difficult to calculate the company’s future profitability.”) (footnotes omitted) (internal quotation marks omitted); Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structure*, 70 U. CIN. L. REV. 1309, 1315–17 (2002) (noting that even sophisticated investors could not understand Enron’s use of SPEs).

141. *Skilling*, 130 S. Ct. at 2934.

142. *Id.* at 2911 (noting that the jury convicted Skilling of nineteen counts of fraud).

143. *Id.* at 2933.

144. Citing to the Brief for the United States, the Court said:

If Congress were to take up the enterprise of criminalizing “undisclosed self-dealing by a public official or private employee,” it would have to employ standards of sufficient definiteness and specificity to overcome due process concerns. The Government proposes a standard that prohibits the “taking of official action by the employee that furthers his own undisclosed financial interests

Moving beyond the energy markets at issue in both *Chenery II* and Enron, it is possible to reconceptualize the “rules versus standards” and “rulemaking versus adjudication” debates, and make an especially strong case for retroactivity when the law faces the problem of dynamic noncompliance, also sometimes known as “regulatory arbitrage” or “regulatory gaming.”<sup>145</sup> The problem is simple to understand. If the “rule of law” requires that the only valid legal system is one comprising a myriad of detailed and fully specified rules, subrules, exceptions, and caveats, it would paradoxically guarantee its own failure. The problem is especially well recognized in the tax literature, for the U.S. tax code is (notoriously) known to resemble just such a highly specified system.<sup>146</sup> Yet it is precisely because the system is so highly specified that it has spawned a virtual industry of aggressive “tax planning” designed “to manipulate the rules endlessly to produce results clearly not intended by the drafters.”<sup>147</sup> For generations of tax lawyers, the motto for this sort of regulatory gaming is taken from the language Judge Learned Hand used in *Helvering v. Gregory*<sup>148</sup>: “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose

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while purporting to act in the interests of those to whom he owes a fiduciary duty,” so long as the employee acts with a specific intent to deceive and the undisclosed conduct could influence the victim to change its behavior. That formulation, however, leaves many questions unanswered. How direct or significant does the conflicting financial interest have to be? To what extent does the official action have to further that interest in order to amount to fraud? To whom should the disclosure be made and what information should it convey? These questions and others call for particular care in attempting to formulate an adequate criminal prohibition in this context.

*Id.* at 2933 n.44 (internal citations omitted).

For an interesting account that, in fact, the Enron case is not a good example of “standards” coming to the rescue of a “rule-based” accounting system, see generally William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023 (2003).

145. See generally Stacey L. Dogan & Mark A. Lemley, *Antitrust Law and Regulatory Gaming*, 87 TEX. L. REV. 685 (2009) (exploring the dynamics and effects of regulatory gaming); Frank Partnoy, *Financial Derivatives and the Costs of Regulatory Arbitrage*, 22 J. CORP. L. 211 (1997) (explaining regulatory arbitrage and relating it to derivatives regulation).

146. See Rachele Y. Holmes, *Deconstructing the Rules of Corporate Tax*, 25 AKRON TAX J. 1, 10 (2010) (“With over 1,000 forms and nearly 100,000 pages of Code and Treasury regulations, the U.S. tax system can be fairly categorized as a thicket of complicated rules [and] the current U.S. tax system is a cumbersome creation of stupefying complexity.”) (citation omitted).

147. David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860 (1999).

148. 69 F.2d 809 (2d Cir. 1934), *aff’d*, 293 U.S. 465 (1935).

that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."<sup>149</sup> From this starting point, there has since spawned an enormous literature on tax evasion, tax avoidance, and tax shelters, a welter of "[m]anipulation . . . [that is] inefficient, loses revenue, and demoralizes others."<sup>150</sup> Yet regulatory gaming is hardly limited to tax law. Antitrust law has grappled with attempts by pharmaceutical companies to engage in "product hopping," whereby "branded companies" (those still enjoying patent protection before generic substitutes are allowed) make "repeated changes in a drug's formulation to prevent generic substitution rather than to improve the efficacy of the drug product."<sup>151</sup> The criminal law had to respond to attempts by the manufacturers of designer drugs to stay one molecule ahead of laws specifying which particular drugs were classified as "controlled substances."<sup>152</sup> Securities law has to contend with the unintended side effect of regulations imposing costs on nonderivatives transactions, which "create an incentive for parties to structure economically equivalent derivatives transactions that avoid the reach of the regulation."<sup>153</sup>

My point is both normative and descriptive. Normatively, the problem of regulatory gaming *requires* some ability of the law to adapt by acting retroactively, ironically to preserve the resiliency of legal systems in the face of rational but potentially debilitating regulatory gaming. Professor Partnoy reaches this conclusion in the case of complex financial derivative transactions, stating that "[d]erivatives participants exposed to common law liability—especially for fraud—may not be able to avoid such ex post regulation through regulatory arbitrage."<sup>154</sup> Similarly, in tax law, the academic

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149. *Id.* at 810.

150. Weisbach, *supra* note 147, at 860. *See generally* Assaf Likhovski, *The Duke and the Lady: Helvering v. Gregory and the History of Tax Avoidance*, 25 CARDOZO L. REV. 953, 954 n.1 (2004) (citing literature and contrasting the view that "tax evasion" is a crime whereas "tax avoidance" is "behavior by the taxpayer that is aimed at reducing tax liability but that does not constitute a criminal offense," with the observation of President Franklin Roosevelt that "tax avoidance means that you hire a \$250,000-fee lawyer, and he changes the word 'evasion' into the word 'avoidance.'" (citations omitted).

151. Dogan & Lemley, *supra* note 145, at 687.

152. *See* Dan M. Kahan, *Ignorance of the Law Is an Excuse—But Only for the Virtuous*, 96 MICH. L. REV. 127, 138 (1997) (suggesting that criminal law listing prohibited substances by chemical composition led drug sellers to alter the composition "ever so slightly" so that the drug produces the same effect on the users but is not on the prohibited substance list).

153. Partnoy, *supra* note 145, at 227–28 (discussing "regulatory arbitrage" in securities law).

154. *Id.* at 253–54.

literature regularly concludes that regulatory gaming can only be solved by augmenting tax rules with “a principles-based” regime,<sup>155</sup> “anti-abuse” metarules,<sup>156</sup> or deliberately “fuzzy” rules.<sup>157</sup> And antitrust scholars report that antitrust law, especially when used by the government as opposed to private litigants, should “[move] away from rules (ex ante, limited factor liability determinants) and toward standards (ex post, multi-factor liability determinants)” to avoid problems of regulatory avoidance and arbitrage.<sup>158</sup> Not surprisingly, the same literature posits the descriptive claim as well, that in all of these fields, the law has increasingly and deliberately found it necessary in fact to preserve options for ex post lawmaking to guard against regulatory gaming.<sup>159</sup> At a broad level, regulatory gaming is just one example of the type of unexpected activity, which the law must often confront, that the *Chenery* Court acknowledged in providing regulators with flexibility in their responses.

#### CONCLUSION

Properly understood, *Chenery II* is neither revolutionary nor unique. Rather, it reflects a consistent strand in our jurisprudence that weaves throughout administrative law, the common law, constitutional jurisprudence under the Takings and Due Process Clauses, and specific trends in regulatory design in fields as diverse as environmental law, securities law, tax law, and antitrust. Professor Maria Savasta-Kennedy opened this symposium on resilience and adaptation by noting how buildings in California have design features that let them absorb seismic shocks, both large and small.<sup>160</sup> *Chenery II* and the other examples of ex post lawmaking buttressing our jurisprudence are each as sensible, useful, and justified. And there is an understanding throughout American law that these features are useful precisely because of the resilience and adaptiveness they offer.

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155. See Holmes, *supra* note 146, at 2.

156. Weisbach, *supra* note 147, at 860–62.

157. Saul Levmore, *Double Blind Lawmaking and Other Comments on Formalism in the Tax Law*, 66 U. CHI. L. REV. 915, 915 (1999).

158. See Daniel A. Crane, *Rules Versus Standards in Antitrust Adjudication*, 64 WASH. & LEE L. REV. 49, 49 (2007).

159. See *supra* notes 144–53.

160. See Maria Savasta-Kennedy, *Introduction to the North Carolina Law Review Symposium, Adaptation and Resiliency in Legal Systems*, 89 N.C L. REV. 1365, 1365 (2011).

