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Cutting in on the *Chevron* Two-Step

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Cutting in on the *Chevron* Two-Step

Erratum

Law; Administrative Law; Legislation; Courts; Supreme Court of the United States

CUTTING IN ON THE *CHEVRON* TWO-STEP

Catherine M. Sharkey*

Consider the following scenario: an ambiguous statutory provision could plausibly mean A or B—which could in fact be the opposite of A. A federal agency, drawing upon its scientific and/or experiential expertise, either has or could develop policy-based reasons backed by fact-intensive evidence to prefer one interpretation over the other. But instead of developing and setting forth its policy reasons and subjecting them to vetting in a notice-and-comment rulemaking, the agency instead justifies its interpretive choice in a rule, setting forth its legal analysis of statutory text, perhaps legislative history, and the purpose and structure of the statute as a whole. Subsequently, in a dispute over how the statutory provision should be interpreted, the agency claims that its interpretive view merits judicial deference. In statutory interpretation cases, courts typically invoke the Chevron Two-Step framework and, given that the agency has promulgated a rule, assuming the court agrees that the statutory provision is ambiguous at Step One, the agency is all but assured deference at Step Two.

What is wrong with this scenario? First, from a comparative institutionalist perspective, deference to agencies' statutory interpretations should be premised upon the agencies' policy-based expertise; thus, it should be withheld where agencies have not provided policy-based rationales for their interpretive choices. Second, the "reasoned decisionmaking" element of judicial review drops out of the picture altogether and thus judicial oversight of agencies is diminished. In other words, it should not be "per se" reasonable when an agency chooses—based on unarticulated and thus unvetted policy variables—between two permissible statutory interpretations.

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This Article proposes a doctrinal solution: the incorporation of State Farm hard look review into the Chevron Two-Step framework. The main goal is to extend the domain of State Farm “reasoned decisionmaking” review, widening the scope of agency rules subject to hard look review. By incorporating this hard look review within the Chevron framework, the model highlights the extent to which agency statutory interpretations are driven by underlying policy choices. And by collapsing the conceptual acoustic separation of Chevron and State Farm, the model makes it difficult for an agency to evade hard look review by convincing a court that it is a Chevron, not State Farm, case. Moreover, where the Chevron interpretive issue arises between private parties when the agency is not a party, and litigants accordingly cannot raise a direct State Farm challenge to the rulemaking, the model would open the door to an indirect State Farm challenge. This Article explores how this new doctrinal approach, one of hard look review of agency policy decisions at Chevron Step Two, will affect courts and agency decision-making.

Finally, the U.S. Supreme Court seems to have reached a critical juncture for Chevron. This particular form of Chevron retreat—widening the space for the application of State Farm—is fundamentally distinct from, and preferable to, setting Chevron aside. Whereas knocking down the Chevron pillar deals a blow to overexuberant regulators and promises to stem the tide of overregulation of the economy and health and safety, heightened judicial scrutiny of the Chevron-State Farm variety will force the agency’s hand in the context of deregulation as well.

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INTRODUCTION

*Chevron*¹ is under attack.² Justice Gorsuch, the U.S. Supreme Court’s newest member, has denounced *Chevron* as “a judge-made doctrine for the abdication of the judicial duty.”³ Chief among his complaints is that *Chevron* deference enables an agency to “reverse its current view 180 degrees anytime based merely on the shift of political winds and still prevail [in court].”⁴

1. *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

2. Today, there are calls to abandon *Chevron*, originating not only in academia but from the halls of Congress and chambers of judges as well. Recent U.S. Supreme Court opinions, eliding *Chevron* altogether or declining to defer for one reason or another, have led some scholars to proclaim the “terminal” state of the venerable doctrine of agency deference in statutory interpretation. *See, e.g.*, Michael Herz, *Chevron Is Dead; Long Live Chevron*, 115 COLUM. L. REV. 1867, 1868 (2015) (“[R]eports of *Chevron*’s death seemed to get significant confirmation at the end of the Supreme Court’s 2014–2015 Term, when the Court decided three important cases that suggested that *Chevron*’s condition was, if not terminal, at least serious.”); *see also* Philip Hamburger, *Chevron Bias*, 84 GEO. WASH. L. REV. 1187, 1190 (2016) (“[T]he Supreme Court has revealed some hesitation about *Chevron*.”); Jody Freeman, *The Chevron Sidestep: Professor Freeman on King v. Burwell*, ENVTL. L. PROGRAM, <http://environment.law.harvard.edu/2015/06/the-chevron-sidestep> [https://perma.cc/WZ95-HEXN] (last visited Mar. 15, 2018) (“[T]his may be annus horribilus for *Chevron*.”); Chris Walker, *The “Scant Sense” Exception to Chevron Deference in Mellouli v. Lynch*, YALE J. ON REG.: NOTICE & COMMENT (June 2, 2015), <http://www.yalejreg.com/blog/the-scant-sense-exception-to-chevron-deference-in-mellouli-v-lynch-by-chris-walker> [https://perma.cc/2DWP-A85B] (“[M]aybe, just maybe, [*Mellouli v. Lynch*] may . . . signal a further retreat from the once highly deferential approach under *Chevron* to judicial review of agency statutory interpretations.”). Cary Coglianese astutely captures that “[w]hat seems most clearly to have died . . . is any illusion of doctrinal simplicity that *Chevron*’s two basic steps might have promised.” Cary Coglianese, *Chevron’s Interstitial Steps*, 85 GEO. WASH. L. REV. 1339, 1343 (2017).

3. *Gutierrez-Brizuela v. Lynch*, 834 F.3d 1142, 1152 (10th Cir. 2016) (Gorsuch, J., concurring). This view is shared by some legal academics as well. *See, e.g.*, PHILIP HAMBURGER, IS ADMINISTRATIVE LAW UNLAWFUL? 12–13 (2014); Geoffrey Parsons Miller, Regulation: Political, Administrative, and Constitutional Accountability 2 (Nov. 29, 2016) (unpublished manuscript) (on file with the *Fordham Law Review*) (“[Judges] defer to agency interpretations of legal norms and examine agency determinations under a standard so deferential as to make judicial review, in many cases, little more than a chimera.”); *id.* (manuscript at 62) (“The administrative state—that modern Leviathan whose reach extends to every nook and cranny of modern life—has evolved to the point where it now operates virtually free of judicial oversight or supervision.”).

4. *Gutierrez-Brizuela*, 834 F.3d at 1152 (emphasis omitted).

Justice Gorsuch minces no words: “We managed to live with the administrative state before *Chevron*. We could do it again.”⁵

Can it be that *Chevron*’s durability is at risk?⁶ A seemingly banal case at the time it was decided, *Chevron* has become a pillar of the administrative state for what it has come to signify regarding the allocation of power and decision-making authority among Congress, federal agencies, and the courts.⁷ When agencies act with the force of law in interpreting statutory mandates, the *Chevron* “Two-Step” framework for judicial review asks first, whether Congress has answered the precise issue at hand (“Step One”), and second, only if not, directs courts, in the face of congressional silence or ambiguity, to defer to “permissible” or “reasonable” agency interpretations (“Step Two”).⁸

5. *Id.* at 1158.

6. Some have linked the Court’s pushback to wider hostility toward the ever-encroaching administrative state that allegedly threatens individual liberty and democratic governance. *See generally* Lisa Heinzerling, *The Power Canons*, 58 WM. & MARY L. REV. 1933 (2017); Catherine M. Sharkey, *The Administrative State and the Common Law: Regulatory Substitutes or Complements?*, 65 EMORY L.J. 1705, 1715 (2016) (“In a set of administrative law decisions over the past five years—primarily addressing the scope of deference that courts should give to federal agencies’ interpretations of congressional statutes (*Chevron* deference) and to agencies’ interpretations of their own regulations (*Auer* deference)—the conservative core Justices have outlined a wide-scale attack on the administrative state.”); Cass R. Sunstein & Adrian Vermeule, *The New Coke: On the Plural Aims of Administrative Law*, 2015 SUP. CT. REV. 41; *New Chevron Skeptics*, FEDERALIST SOC’Y (Jan. 15, 2016), <http://www.fed-soc.org/multimedia/detail/the-new-chevron-skeptics-event-audiovideo> [<https://perma.cc/25BF-PZRP>] (“When *Chevron* was first decided it was generally welcomed on the right side of the political spectrum But as the administrative state continues to grow, some now see *Chevron* as removing an important check on government power and an abdication of the judiciary’s authority to say what the law is.”). Whether the Court is chipping away at *Chevron* or signaling its longer-term demise is a question that has attracted much commentary, almost all of it plagued by a formidable baseline problem given the accumulated empirical evidence of the uneven and unpredictable manner in which agency deference doctrines have been applied over time by the Supreme Court (as well as the lower federal courts). *See, e.g.*, William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations from Chevron to Hamdan*, 96 GEO. L.J. 1083, 1120–23 (2008); Linda D. Jellum, *Chevron’s Demise: A Survey of Chevron from Infancy to Senescence*, 59 ADMIN. L. REV. 725, 772 (2007); Christopher J. Walker, *Chevron Inside the Regulatory State: An Empirical Assessment*, 83 FORDHAM L. REV. 703, 722–23 (2014).

7. *See* Thomas W. Merrill, *The Story of Chevron: The Making of an Accidental Landmark*, in ADMINISTRATIVE LAW STORIES 398, 399–428 (Peter Strauss ed., 2006).

8. *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 865–66 (1984); *id.* at 842–43 (“When a court reviews an agency’s construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.”); *see also id.* at 844 (“[A] court may not substitute its own construction of a statutory [provision] for a reasonable interpretation made by the administrator of an agency.”).

It is too soon to stop the *Chevron* dance. But it is high time for *State Farm*⁹ to cut in.¹⁰ *State Farm*'s absence from Justice Gorsuch's cynical view of courts' abdication to agencies' political whims is telling.

This Article urges the incorporation of *State Farm* into the *Chevron* framework. Put simply, *State Farm*'s demand for "reasoned decisionmaking"¹¹ from agencies puts the brakes on *Chevron* as a mandate for judicial acquiescence to agency statutory interpretations. The *Chevron-State Farm* conceptual framework acknowledges the inextricable link between questions of statutory interpretation (typically the domain of *Chevron*) and questions of agency discretionary policymaking authority (typically the domain of *State Farm*). Such a framework impacts a wide range of agency regulations, requiring agencies to provide factual support and reasoned explanation to support policy-based choices and determinations that undergird the agencies' statutory interpretations. It also has significance for questions pertaining to the role of cost-benefit analysis in agency regulation and many other fact-based interpretive questions as well, with courts applying arbitrary and capricious review to agencies' policy-based preferences for one statutory reading as opposed to another.

Deploying this framework, courts will defer only to reasoned agency interpretations, and agencies will thus be led to disclose their policy reasons and, ultimately, to make better regulatory decisions. The framework should induce agencies to articulate and defend the underlying *policy* reasons for their decisions (where relevant), rather than proffering legal briefs in support of their chosen statutory interpretation.

The stakes are larger than a doctrinal revision or twist would seem to portend. First, incorporating *State Farm* review into the *Chevron* framework highlights the agency expertise rationale for agency deference, particularly at Step Two.¹² The archetypal *Chevron* question is how best to construe ambiguous statutory terms in light of competing policy interests. The

9. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983).

10. Under *State Farm*, an agency rule is arbitrary or capricious if the agency (1) grounds its rule on factors that "Congress has not intended it to consider," (2) does not address "an important aspect of the problem," (3) explains its decision in such a way that "runs counter to the evidence before the agency," or (4) offers an explanation "so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Id.* at 43.

11. *Id.* at 52.

12. It is worth a reminder that "[t]here is no single widely accepted rationale for *Chevron*." Emily Hammond et al., *Judicial Review of Statutory Issues Under the Chevron Doctrine*, in *A GUIDE TO JUDICIAL AND POLITICAL REVIEW OF FEDERAL AGENCIES* 65, 69 (Michael E. Herz et al. eds., 2015). But it is fairly standard to recognize that "[i]n addition to characterizing statutory ambiguities as implicit delegations by Congress, the Court justified deference on two additional grounds: agency expertise and the superior democratic accountability of agencies as compared to courts." *Id.*

This Article pushes decidedly in the direction of expertise. To the extent that one advocated political accountability as the normative thrust of *Chevron*, then the fate of the *Chevron-State Farm* model would be less well assured. The incorporation of *State Farm* hard look review could be seen as infringing upon the agency's policy turf. Moreover, it might allow judges, under cover of hard look review, to mandate their preferred policy outcomes. In this way, hard look review might undermine the goal of uniformity, as judges with divergent ideological predilections might decide cases differently.

Chevron Court itself justified deference to agencies “whenever decision as to the meaning or reach of a statute has involved *reconciling conflicting policies*, and a full understanding of the force of the statutory policy in the given situation has depended upon *more than ordinary knowledge* respecting the matters subjected to agency regulations.”¹³ While elaborating on this judge-made doctrine, the Court has emphasized a comparative institutional rationale, namely that great deference is “justified because ‘[t]he responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones,’ and because of the agency’s greater familiarity with the ever-changing *facts and circumstances* surrounding the subjects regulated.”¹⁴ Agencies, in other words, have comparative policy expertise vis-à-vis courts; in the more recent words of the Court, “agencies are better equipped to make [these choices] than courts” and use their “expert policy judgment to resolve . . . difficult questions.”¹⁵

Second, the new framework reinvigorates the judicial role in ensuring that agencies have engaged in “reasoned decisionmaking.”¹⁶ The incorporation of *State Farm* into the *Chevron* framework recalibrates the balance and trade-offs between judicial oversight and an agency’s discretion and flexibility. Several scholars have persuasively rebutted the claim that *Chevron* deference is tantamount to judicial abdication of responsibility to “say what the law is” per *Marbury v. Madison*,¹⁷ or to “decide all relevant questions of law” and “interpret . . . statutory provisions” per Administrative Procedure Act (APA)

13. *Chevron*, 467 U.S. at 844 (emphases added) (quoting *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 699–700 (1984)).

14. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) (alteration in original) (emphasis added) (citation omitted) (quoting *Chevron*, 467 U.S. at 866).

15. *Nat’l Cable & Telecomm. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 980, 1003 (2005); see also William N. Eskridge Jr., *Expanding Chevron’s Domain: A Comparative Institutional Analysis of the Relative Competence of Courts and Agencies to Interpret Statutes*, 2013 WIS. L. REV. 411.

16. *Judulang v. Holder*, 565 U.S. 42, 53 (2011) (“[C]ourts retain a role, and an important one, in ensuring that agencies have engaged in reasoned decisionmaking.”).

17. 5 U.S. (1 Cranch) 137 (1803); *id.* at 177 (“It is emphatically the province and duty of the judicial department to say what the law is.”); see, e.g., Henry P. Monaghan, *The Dialogue at Sixty-Five* 35 (Oct. 23, 2017) (unpublished manuscript) (on file with the *Fordham Law Review*) (“[T]here has never been a pervasive notion that limited government mandated an all-encompassing judicial duty to supply all of the relevant meaning of statutes. Rather, the judicial duty is to ensure that the administrative agency stays within the zone of discretion committed to it by its organic act.” (quoting Henry P. Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1, 33 (1983))).

§ 706.¹⁸ At the same time, they insist that “judicial control of administrative action is a necessary condition for a legitimate constitutional order.”¹⁹

While fully consistent with these accounts, the *Chevron-State Farm* model is distinctly premised on the idea that effective judicial oversight—leading to effective agency regulation—is dependent upon forcing agencies to justify their policy-based choices (where relevant) when issuing rules that interpret statutes. This Article highlights the situation in which the agency’s permissible *legal* interpretation of a statute triggers deference that amounts to acquiescence to the agency’s unexamined *policy-based* choice between two or more potential readings of the statute without sufficient judicial oversight.

Part I describes how the traditional *Chevron* Two-Step framework can devolve into what Judge Patricia Wald termed “obsequious deference.”²⁰ A high-profile, decades-long legal challenge to the Environmental Protection Agency’s (EPA) promulgation of the Water Transfers Rule is a vivid illustration of the core problem—namely, an agency effectively uses *Chevron* Step One legal statutory interpretation arguments to justify what should be a policy-based interpretation at Step Two. This case is part of a wider trend of the weakening, if not effective nullification, of judicial oversight at *Chevron* Step Two. This application of *Chevron* Step Two is marred by courts’ tendency to “infer permissible means from permissible ends”²¹ instead of probing agencies’ implicit policy-based choices via *State Farm*-type review.

Part II evaluates the normative significance of the *Chevron-State Farm* conceptual framework at the dawn of what may be a new age for hard look

18. 5 U.S.C. § 706 (2012) (“To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action.”); *id.* § 706(2)(A) (providing that the reviewing court shall set aside an agency action, finding, or conclusion where it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law”); Coglianese, *supra* note 2, at 1347 (quoting 5 U.S.C. § 706); *see also* John F. Manning, *Chevron and the Reasonable Legislator*, 128 HARV. L. REV. 457, 459 (2014) (“[T]he reviewing court fulfills its duty to ‘interpret’ the statute by determining whether the agency has stayed within the bounds of its assigned discretion—that is, whether the agency has construed its organic act reasonably.”); Peter L. Strauss, “Deference” Is Too Confusing—Let’s Call Them “Chevron Space” and “Skidmore Weight,” 112 COLUM. L. REV. 1143, 1145 (2012).

19. Monaghan, *supra* note 17, at 35. As Monaghan elaborates, “The precise scope of judicial intervention is another matter. It may very well be that *ultra vires* review of administrative law making is all that is required in the (non-constitutional) law declaration context. The APA, however, seems to establish a more demanding scope for judicial intervention . . .” *Id.* at 36; *id.* at 37 (“[I]t is interesting that, as of this writing, no one seems to pay much attention to the actual language of § 706 of the Administrative Procedure Act.”); *see also* Hammond et al., *supra* note 12, at 69 (“[T]he *Chevron* Court defined the reviewing court’s role to be less extensive than not only the traditional one of saying what the law is, but also the role apparently envisioned in the APA . . .”).

20. Patricia M. Wald, *Judicial Review in Midpassage: The Uneasy Partnership Between Courts and Agencies Plays On*, 32 TULSA L.J. 221, 258 (1996) (“[After fifty years] we have yet to agree on how this review should operate in practice. We are still struggling with where to draw the line between obsequious deference and intrusive scrutiny.”).

21. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 559 (S.D.N.Y. 2014), *rev’d*, 846 F.3d 492 (2d Cir. 2017).

review at Step Two and explores how this new doctrinal approach will impact judicial review in the lower courts and its ultimate target: agency decision-making.

Any new conceptual framework in what Peter Strauss has aptly termed the “*Chevron* space”²² must confront formidable skepticism. First, scholars have spilled so much ink over competing interpretations of the *Chevron* framework—whether the canonical *Chevron* Two-Step analysis is really just one step, is preceded by a “Step Zero,” or has three or more steps, and on and on²³—that Jerry Mashaw once quipped that the Supreme Court should have issued an “environmental impact statement” when it issued its opinion.²⁴ Second, questions can be raised regarding what difference doctrinal language makes: does tinkering further with the *Chevron* framework simply transfer existing power and authority from one set of doctrinal boxes to another?²⁵ In what ways does it affect judicial outcomes?²⁶ In what ways do doctrinal changes affect agency administrators’ behavior?

Part II tackles these questions, albeit against the existing backdrop characterized by various approaches (and much confusion) with respect to

22. Strauss, *supra* note 18, at 1145.

23. E.g., Kenneth A. Bamberger & Peter L. Strauss, *Chevron’s Two Steps*, 95 VA. L. REV. 611, 624–25 (2009) (arguing that Step One addresses statutory permissibility whereas Step Two addresses reasonableness); Richard M. Re, *Should Chevron Have Two Steps?*, 89 IND. L.J. 605, 620 (2014) (“[T]he vision of *Chevron* propounded by Bamberger and Strauss might be relabeled ‘three-step *Chevron*.’”); Matthew C. Stephenson & Adrian Vermeule, *Chevron Has Only One Step*, 95 VA. L. REV. 597, 602 (2009) (“[I]nterpretation is an exercise in identifying the statute’s range of reasonable interpretations, a range that opens up a ‘policy space’ within which agencies may make reasoned choices”); *see also* Coglianesse, *supra* note 2, at 1345 (“[T]he prevailing legal justification for *Chevron* deference at Step 2 depends on courts ascending several additional steps after Step 1.”); Daniel J. Hemel & Aaron L. Nielson, *Chevron Step One-and-a-Half*, 84 U. CHI. L. REV. 757, 760 (2017) (“After deciding that the statute is ambiguous but before deciding whether the agency’s construction is permissible, these courts ask a separate question: whether the agency itself recognized that it was dealing with an ambiguous statute.”). *See generally* Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187 (2006).

24. JERRY MASHAW, *GREED, CHAOS, AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW* 222 n.19 (1997).

25. Cf. Jack M. Beermann, *End the Failed Chevron Experiment Now: How Chevron Has Failed and Why It Can and Should Be Overruled*, 42 CONN. L. REV. 779, 838–40 (2010) (noting that the Court generally splits along ideological lines regardless of deference doctrine deployed); Michael Herz, *Judicial Review of Statutory Issues Outside of Chevron*, in A GUIDE TO JUDICIAL AND POLITICAL REVIEW OF FEDERAL AGENCIES, *supra* note 12, at 129, 153 (“[I]t is not clear that we can or should take the doctrine at face value. Deference rules do not reliably constrain judges. Experience with *Chevron* has shown that judges have not simply folded their tents and ceded the field to agencies. One judge’s ambiguity is another’s clarity, one’s reasonableness another’s arbitrariness.”).

26. Richard Pierce, having reviewed empirical studies that examined the rate at which the Supreme Court and courts of appeals affirmed agency action under *State Farm* (64 percent), *Chevron* (60 to 81.3 percent), *Skidmore* (55.1 to 73.5 percent), *Auer* (90.9 percent), substantial evidence standard (64 to 71.2 percent), and *de novo* (66 percent), concludes that—apart from *Auer*—deference doctrines appear to have little influence on the rate of affirmance. *See* Richard J. Pierce, Jr., *What Do the Studies of Judicial Review of Agency Actions Mean?*, 63 ADMIN. L. REV. 77, 85 (2011).

the overlap and/or interplay between *Chevron* and *State Farm*,²⁷ the stringency of *State Farm* “hard look” review, and what suffices for “reasoned decisionmaking” by agencies. Returning to the core problem, if *Chevron* Step One is framed as whether the statute is ambiguous enough to support the agency’s interpretation, then the analysis effectively ends at Step One if the mere fact that the agency chose the interpretation is enough to trigger deference. But, even if Step Two is rendered meaningless, why should that matter so long as *State Farm* review comes in as, essentially, Step Three?

In other words, what is significant about the incorporation of *State Farm* into the *Chevron* framework? The incorporation model expands the domain of *State Farm* review, widening the berth of agency rules subject to hard look review. Several courts have taken the position that in statutory interpretation cases only a narrow subset of agency rules—either those with “procedural defects” or those where the agency has changed its prior position—are subject to an additional layer of independent *State Farm* review (either pre- or post-*Chevron* review). Indeed, some litigants do not even bring independent *State Farm* challenges in *Chevron* statutory interpretation cases. Perhaps most significantly, where the *Chevron* interpretive issue arises between private parties and thus the agency is not a party, litigants cannot raise a direct *State Farm* challenge to the rulemaking. The incorporation framework would allow an indirect challenge to the agency’s decision-making. In this way, the model increases the scope of pre-enforcement review in cases between private parties while increasing the specter of judicial review, in whose shadow the agency operates.

Part III frames the significance of the *Chevron-State Farm* conceptual framework for judicial review at a critical juncture for *Chevron*. This Article argues that this particular form of *Chevron* retreat—widening the space for the application of *State Farm*—is fundamentally distinct from setting *Chevron* aside. At a time of *Chevron* retreat, this approach seems preferable to jettisoning *Chevron* altogether or augmenting what has come to be known as *Chevron* Step Zero.²⁸

At present, there is a sharp debate (among scholars and increasingly the courts) on where the Supreme Court stands with respect to *Chevron* generally and, more particularly, the extent to which an agency must support its statutory interpretation with factual evidence or cost-benefit analyses for the interpretation to be considered reasonable. Prior Court cases seem to suggest that a full-fledged *State Farm* “hard look” standard may not apply to agency interpretations of particular statutory provisions.

27. See, e.g., Jack M. Beermann, *Chevron at the Roberts Court: Still Failing After All These Years*, 83 *FORDHAM L. REV.* 731, 745–46 (2014) (asserting that the Supreme Court’s “puzzling” reasoning in recent cases yields a framework that “fails to provide a satisfactory boundary between *Chevron* cases and arbitrary or capricious cases”).

28. See Thomas W. Merrill & Kristin E. Hickman, *Chevron’s Domain*, 89 *GEO. L.J.* 833, 836 (2001). See generally Sunstein, *supra* note 23.

But, a central premise of this Article is that *Michigan v. EPA*²⁹ and *Encino Motorcars, LLC v. Navarro*³⁰ signal a subtle yet momentous shift. While scholars have seized upon these cases to signal the demise or retreat of *Chevron*, they have missed a significant angle: the Court seems to have signaled its potential embrace of the proposed *Chevron-State Farm* framework. This present moment of *Chevron* retreat augurs well for the incorporation of meaningful arbitrary and capricious review at Step Two, which may now become a doctrinal reality (decades after some scholars first proposed certain versions of it).³¹

I. THE *CHEVRON* TWO-STEP AS JUDICIAL ACQUIESCENCE TO AGENCIES

A recent Second Circuit case, *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*,³² highlights the potential significance of the new *Chevron-State Farm* framework. The dispute concerns the interpretation of ambiguous statutory language by courts in the face of a choice of one permissible interpretation over another made by a regulatory agency. The *Catskill Mountains* litigation fits a wider body of cases deploying a perfunctory *Chevron* Step Two analysis;³³ these cases show the need to incorporate *State Farm* to resuscitate *Chevron*'s anemic Step Two.³⁴

29. 135 S. Ct. 2699 (2015).

30. 136 S. Ct. 2117 (2016).

31. While scholars advocated variants of hard look review at Step Two, *see infra* Part II.A.1, the approach basically fell on deaf judicial ears. Within the last few years—some two decades later—the Supreme Court has signaled this could now become doctrinal reality. *See infra* Part III.B.1.

32. 846 F.3d 492 (2d Cir. 2017), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018).

33. It is received wisdom that “it is rare for a court to set aside an agency interpretation in step two.” STEPHEN G. BREYER ET AL., *ADMINISTRATIVE LAW AND REGULATORY POLICY: PROBLEMS, TEXT, AND CASES* 319 (8th ed. 2017). The paucity of agency reversals at Step Two has also been demonstrated empirically. *See, e.g.*, Kent Barnett & Christopher J. Walker, *Chevron in the Circuit Courts*, 116 MICH. L. REV. 1, 34 (2017) (reporting a 6.2 percent reversal rate in circuit court decisions (from 2002 to 2013) that were resolved at Step Two); Orin S. Kerr, *Shedding Light on Chevron: An Empirical Study of the Chevron Doctrine in the U.S. Courts of Appeals*, 15 YALE J. ON REG. 1, 47 (1998) (reporting an 11 percent reversal rate at Step Two in a more limited study of circuit court decisions from 1995 through 1996).

34. To the contrary, Judge Harry Edwards and Linda Elliott argue:

It is not really surprising that most agency constructions of authorizing statutes survive review under *Chevron* Step Two. After all, in most such cases the agencies are acting pursuant to delegated authority, to achieve congressionally mandated policy objectives within their areas of expertise. The courts therefore properly defer to agency actions in such cases because deference is required under *Chevron*.

HARRY T. EDWARDS & LINDA A. ELLIOTT, *FEDERAL STANDARDS OF REVIEW: REVIEW OF DISTRICT COURT DECISIONS AND AGENCY ACTIONS* 177 (3d ed. forthcoming 2018). This line of argument, however, would hardly seem to justify a case like *Catskill IV*, in which the court accords mandatory *Chevron* deference to the EPA's legal interpretation, not its policy-based reasoning. Indeed, while it may follow that agencies' statutory interpretations should usually survive Step Two, this Article advocates that mandatory *Chevron* deference should be predicated upon agencies' policy-based reasoning, not their legal interpretations.

A. Catskill Mountains as a Vivid Illustration

Catskill Mountains, a decades-long environmental dispute regarding whether the EPA must issue water-pollution permits for systems that transport water from one waterbody to another, illustrates how the conventional *Chevron* Two-Step can devolve into automatic judicial acquiescence to agency statutory interpretations.

1. The EPA's Policymaking via Rulemaking

The complex water-pollution dispute at issue can be reduced to a simple analogy:

Two buckets sit side by side, one with four marbles in it and the other with none. [There is a rule prohibiting any addition of any marbles to buckets by any person.] A person comes along, picks up two marbles from the first bucket, and drops them into the second bucket. Has the marble-mover “add[ed] any marbles to the buckets”? On the one hand, [as the plaintiffs might argue,] there are now two marbles in a bucket where there were none before, so an addition of marbles has occurred. On the other hand, . . . [as the EPA would decide,] there were four marbles in buckets before, and there are still four marbles in buckets, so no addition of marbles has occurred.³⁵

When the interpretive question is confronted by a court, it is fair to say, as did the Eleventh Circuit, that “[w]hatever position we might take if we had to pick one side or the other we cannot say that either side is unreasonable.”³⁶

Since the passage in 1972 of the Clean Water Act (CWA), which prohibits “the discharge of any pollutant by any person,”³⁷ the EPA has taken the position that water transfers—which it defined in a regulation as activities that “convey[] or connect[] waters of the United States without subjecting the transferred water to intervening industrial, municipal, or commercial use”³⁸—were exempt from “National Pollutant Discharge Elimination System” (NPDES) requirements. The EPA, however, did not formalize its position until 2008, when it promulgated the Water Transfers Rule in

35. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 524 (S.D.N.Y. 2014) (quoting *Friends of Everglades v. S. Fla. Water Mgmt. Dist. (Friends I)*, 570 F.3d 1210, 1228 (11th Cir. 2009)), *rev'd*, 846 F.3d 492 (2d Cir. 2017). The analogy is helpful in terms of framing the conceptual issue. Nonetheless, it may be misguided to the extent that it suggests that the marbles (i.e., pollutants) and buckets (i.e., water bodies) do not have any complicated interactive properties, as is the case with pollutants that interact in complex ways depending on the nature of the specific properties of varying water bodies.

36. *Friends I*, 570 F.3d at 1228.

37. 33 U.S.C. § 1311(a) (2012). “[D]ischarge of a pollutant” is defined as “any addition of any pollutant to navigable waters from any point source.” *Id.* § 1362(12)(A). The statutory ambiguity is whether the phrase “any addition of any pollutant to” waters of the United States refers to an “addition” to a particular navigable water body, or instead (as the EPA has determined) an “addition” to the waters of the United States collectively.

38. 40 C.F.R. § 122.3(i) (2018).

response to numerous legal setbacks, namely, courts' refusal to defer to the agency's informal, albeit long-standing, position regarding water transfers.³⁹

Environmental conservation groups⁴⁰ and several states⁴¹ challenged the EPA's 2008 Water Transfers Rule as an impermissible exemption to the CWA's prohibition against the "discharge of any pollutant" without an NPDES permit.⁴² Several other states, municipalities, and agricultural groups intervened; they argued that requiring NPDES permits for water transfers essential for maintaining their water supplies would be disruptive and impose enormous costs.⁴³

2. The EPA's Legal Analysis in Lieu of Policy-Based Reasoning

The origins of the EPA 2008 Water Transfers Rule can be traced to the "Klee Memorandum," a 2005 legal memorandum issued by EPA General Counsel Ann Klee to all regional EPA administrators.⁴⁴ The Klee Memorandum analyzed the CWA's language, its legislative history, and

39. According to a brief by New York and other states, "EPA promulgated the Water Transfers Rule in the face of uniform federal circuit court precedent holding that the Clean Water Act requires a NPDES permit for the transfer of polluted water into a clean water body." Brief for the State of New York et al. at 14, *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492 (2d Cir. 2017) (No. 14-1823(L)); *see also id.* at 15 ("EPA adopted the Water Transfers Rule in 2008 in an attempt to overturn these decisions and similar court rulings."). Indeed, in the interim period, the EPA lost several challenges to its informal position on water transfers. *See, e.g.*, *Catskill Mountains Chapter of Trout Unlimited, Inc. v. City of New York (Catskill I)*, 273 F.3d 481, 490 (2d Cir. 2001) (holding that *Chevron* deference did not apply to the EPA's interpretation of the statute because it was "based on a series of informal policy statements made and consistent litigation positions taken by the EPA over the years" which "do not deserve broad [*Chevron*] deference"). Moreover, the Second Circuit rejected the EPA's views under lesser *Skidmore* "power to persuade" deference. *Id.* at 491. In August 2005, the EPA's Office of General Counsel issued a memorandum interpreting the statute to exclude water transfers from the NPDES program. After issuance of this interpretive memorandum, the Second Circuit declined to reconsider its holding in *Catskill I*. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. City of New York (Catskill II)*, 451 F.3d 77, 81, 83 n.5 (2d Cir. 2006) (noting that the informal memorandum before the court was not eligible for *Chevron* deference).

40. The environmental plaintiffs included Catskill Mountains Chapter of Trout Unlimited, Inc.; Theodore Gordon Flyfishers, Inc.; Catskill-Delaware Natural Water Alliance, Inc.; Federated Sportsmen's Clubs of Ulster County, Inc.; Riverkeeper, Inc.; and Waterkeeper Alliance, Inc. *Catskill III*, 8 F. Supp. 3d at 515 n.7.

41. The state plaintiffs included New York, Connecticut, Delaware, Illinois, Maine, Michigan, Minnesota, Missouri, Washington, and the government of the Province of Manitoba, Canada. *Id.* at 515 n.9.

42. *Id.* at 544. In their complaint, plaintiffs requested that the Water Transfers Rule be vacated as unlawful and arbitrary and capricious under APA § 706(2). Complaint for Declaratory Judgment and Injunctive Relief at 12, *Catskill III*, 8 F. Supp. 3d 500 (No. 08 Civ. 5606).

43. The intervenor-defendants included Alaska, Arizona, Colorado, Idaho, Nebraska, Nevada, New Mexico, North Dakota, Texas, Utah, and Wyoming; South Florida Water Management District; and multiple municipal water providers from western states. *Catskill III*, 8 F. Supp. 3d at 516.

44. *Id.* at 513 (describing the Memorandum from Ann R. Klee to EPA Regional Administrators on Agency Interpretation on Applicability of Section 402 of the Clean Water Act to Water Transfers (Aug. 5, 2005)).

relevant case law.⁴⁵ It concluded: “Congress intended to leave the oversight of water transfers to authorities other than the NPDES program.”⁴⁶

The EPA initiated notice-and-comment rulemaking on a proposed rule codifying the Klee Memorandum’s legal position that water transfers between navigable bodies of water do not require NPDES permits.⁴⁷ On June 13, 2008, the EPA issued its final rule—which it described as “nearly identical to the proposed rule”⁴⁸—adding as an “exclusion” to the NPDES program “[d]ischarges from a water transfer.”⁴⁹

To justify its rule, in its preamble and in response to comments, the EPA explicitly provided “legal” statutory interpretation reasoning: its analysis focused exclusively on inferring congressional intent from the language and structure of the statute.⁵⁰ The preamble states, “The Agency has concluded that, taken as a whole, the statutory language and structure of the Clean Water Act indicate that Congress generally did not intend to subject water transfers to the NPDES program.”⁵¹ The EPA’s interpretation of “addition”—namely that “water transfers . . . do not constitute an ‘addition’ to navigable waters to be regulated under the NPDES program”⁵²—followed inexorably from its conclusion regarding congressional intent. In the EPA’s own words, it

reasonably based the Water Transfers Rule on . . . Congress’s intent reflected in 33 U.S.C. § 1251(b) and (g) and § 1370 to avoid unduly

45. *Id.*

46. *Id.*

47. *Id.* at 514 (citing 71 Fed. Reg. 32,887 (June 7, 2006)). According to a comparative analysis conducted by the district court, “much, if not most, of the language in the preamble to the proposed rule is almost identical to language in the Klee Memorandum.” *Id.* at 540 (citations omitted).

48. National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. 33,697, 33,699 (June 13, 2008) (to be codified at 40 C.F.R. pt. 122). According to the district court,

this was also an understatement because, not only was the final rule nearly identical to the proposed rule, but much of the language in many sections of the final rule’s preamble was also nearly identical to various parts of the proposed rule’s preamble—which, again, was nearly identical in many respects to parts of the Klee Memorandum.

Catskill III, 8 F. Supp. 3d at 541. In the intervening two years, “EPA received over 18,000 comments on the rule, and it responded to the issues raised by these comments in a document filed as part of the Administrative Record.” *Id.* at 514.

49. *Catskill III*, 8 F. Supp. 3d at 514 (citing National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. at 33,708); *see also* Brief for the State of New York et al., *supra* note 39, at 16 (“To justify the Rule, EPA analyzed the ‘legal question’ of whether moving dirty water into clean water ‘constitutes an “addition”’ of pollutants under the Act. (This analysis derives from, and is essentially identical to, a legal memorandum issued in 2005 by EPA’s then-General Counsel Ann R. Klee (‘Klee Memorandum’), which [the Second Circuit] found unpersuasive in *Catskill II*.”).

50. In the preamble to the proposed rule, the EPA stated that the “proposed rule [was] based on the legal analysis contained in” the Klee Memorandum, which it referred to as an “interpretive memorandum.” *See* National Pollutant Discharge Elimination System (NPDES) Water Transfers Proposed Rule, 71 Fed. Reg. 32,887, 32,889 (June 7, 2006) (to be codified at 40 C.F.R. pt. 122); *see also* National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. at 33,697–708 (preamble); *id.* at 33,703 (response to comments).

51. National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. at 33,701.

52. *Id.* at 33,703.

burdening state authority over water allocations and water resources, including for critical drinking water, agriculture, and flood control needs; and EPA's conclusion that Congress would have considered pollution effects of water transfers to be treated through nonpoint source programs.⁵³

As the district court summarized, "EPA thus employed the same 'holistic analysis' it used in the Klee Memorandum and analyzed the same statutory provisions and excerpts of legislative history to support the same conclusion it adopted in the Klee Memorandum . . ." ⁵⁴

What is missing from the EPA's legal exegesis is any fact finding, critical analysis, or even explicit acknowledgement of the underlying policy considerations embedded in what is essentially an interpretive rule.⁵⁵ By relying solely on its view that it was *Congress's* intent to avoid unduly burdening the states,⁵⁶ the EPA did not independently evaluate any state-specific evidence of the impact of the proposed rule.

Moreover, having concluded that congressional intent tipped the balance in the direction of these state interests, the EPA did not engage in any kind of scientific analysis of water transfers in order to consider the competing policy considerations, namely the potential environmental, health, and economic harms caused by some interbasin transfers.⁵⁷ The EPA explicitly disclaimed reliance on any type of cost-benefit analysis or assessment of these competing policy considerations.⁵⁸ Indeed, the EPA was emphatic that its "Rule was not premised on assumptions about specific costs or benefits but on the conclusion that EPA's interpretation of the statute was more

53. Brief for Defendants-Appellants EPA and Gina McCarthy at 36, *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492 (2d Cir. 2017) (No. 14-1823(L)) (citing National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. at 33,698–99, 33,701–02).

54. *Catskill III*, 8 F. Supp. 3d at 541; *see also id.* at 543 ("In promulgating the Water Transfers Rule, . . . EPA relied entirely on a 'holistic approach' to statutory interpretation that it applied to answer the narrow question whether Congress intended to regulate water transfers under the NPDES program.")

55. *See* Brief for the State of New York et al., *supra* note 39, at 71 ("EPA explicitly stated that the Rule is based on EPA's legal interpretation rather than a scientific or factual analysis of the costs or benefits of NPDES permitting.")

56. As the district court stated, the EPA "focused almost exclusively on the statutory provisions supporting the CWA's states' rights goals." *Catskill III*, 8 F. Supp. 3d at 543.

57. As recounted by the district court:

[I]n the preamble's sole paragraph addressing concerns "that water transfers may have significant impacts on the environment, including (1) the introduction of invasive species, toxic blue-green algae, chemical pollutants, and excess nutrients; (2) increased turbidity; and (3) alteration of habitat . . .," EPA responded that the Water Transfers Rule "does not interfere with any of the states' rights or authorities to regulate the movement of waters within their borders," that "[s]tates currently have the ability to address potential instream and/or downstream effects of water transfers through their [Water Quality Standards (WQS)] and [Total Maximum Daily Load (TMDL)] programs," and that "[n]othing in [the rule] affects the ability for states to establish WQS appropriate to individual waterbodies or waterbody segments."

Id. at 542 (alterations in original).

58. Reply Brief for Defendants-Appellants EPA and Gina McCarthy at 26, *Catskill IV*, 846 F.3d 492 (No. 14-1823(L)) ("EPA did not suggest that it relied on a cost-benefit review of the type suggested by plaintiffs, and nothing requires EPA to have done so.")

conducive to Congress's goal of avoiding undue interference."⁵⁹ In the EPA's own words, it "simply drew a line that, in its judgment, honored the statutory purposes best."⁶⁰ The agency elaborated further: "EPA concluded that adopting the Water Transfers Rule drew the appropriate line to guard against undue interference. Nor did EPA need to explain further why it was not unduly burdensome on states to apply the NPDES program to water flows subject to intervening municipal or industrial use."⁶¹ As the government reiterated to the Supreme Court in its response to a petition for certiorari, "EPA did not purport to engage in a freestanding comparison of the costs and benefits of requiring NPDES permits for water transfers Instead, it simply attempted to ascertain the best reading of statutory provisions that Congress had enacted."⁶²

What is significant—and a point to which this Article returns—is that the EPA's "legal" interpretation of the Act depends upon factual assumptions that the EPA neither supported nor explained.⁶³ Moreover, the EPA acknowledged that it did not engage in any scientific or factual analysis of the effects of the Rule, which, it argued, was not necessary in light of its legal statutory interpretive analysis.

3. A Rare *Chevron* Step Two Loss Overturned on Appeal: *State Farm Drops Out*

In a rare *Chevron* Step Two loss for the EPA, the district court granted plaintiffs' motion for summary judgment.⁶⁴ At *Chevron* Step One, the court held the CWA to be ambiguous as to whether Congress intended the NPDES

59. *Id.* at 27.

60. *Id.* at 27 n.7; *see also* Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 50 ("[A]pplication of concepts like 'unnecessary' or 'undue' is necessarily a line-drawing exercise, and it is within EPA's discretion to draw that line.").

61. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 50.

62. Brief for the Federal Respondents in Opposition at 29, *New York v. EPA*, No. 17-418 (U.S. Jan. 19, 2018), 2018 WL 496967, at *29.

63. *See* Brief for the State of New York et al., *supra* note 39, at 74 ("Drawing a line that assumes certain facts while affirmatively refusing to consider any facts on either side of that line is the essence of arbitrary and capricious decision-making."); *see also* *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 560 (S.D.N.Y. 2014) ("[A]gencies deserve deference only for reasonably explained choices, and not for assumptions."), *rev'd*, 846 F.3d 492 (2d Cir. 2017).

64. *Catskill III*, 8 F. Supp. 3d at 567.

program to apply to water transfers.⁶⁵ At Step Two, the court held the Water Transfers Rule to be an unreasonable interpretation of the CWA.⁶⁶

In setting forth its interpretation of the CWA in its Water Transfers Rule, the EPA recognized that “the heart of this matter is the balance Congress created between federal and State oversight of activities affecting the nation’s waters” and recognized the underlying tension between the CWA’s dual purposes “to protect water quality” and to “recognize[] the delicate relationship between the CWA and State and local programs.”⁶⁷ The district court likewise recognized that the EPA was “‘called upon to balance two legislative policies in tension’—which is ‘precisely the paradigm situation *Chevron* addressed.’”⁶⁸ More specifically, in this case, the district court emphasized how the agency’s exercise of its delegated authority to interpret ambiguous statutory language “involve[d] difficult policy choices.”⁶⁹

As part of its Step Two analysis, the district court chose an unconventional path and applied the *State Farm* standard.⁷⁰ The court explained that “[b]ecause *State Farm* identifies certain factors relevant to whether an agency’s action is ‘arbitrary and capricious’ under the APA, those same factors are relevant to whether EPA’s action is ‘arbitrary and capricious’ under *Chevron* step two.”⁷¹ The court emphasized that the “EPA’s obligation to provide a reasoned explanation for its decision requires it to undertake *some* kind of analysis—scientific, technical, or otherwise—and it is the Court’s job, at step two, to determine whether that analysis was sufficient.”⁷²

65. *Id.* at 524 (“Ultimately, the Court agrees with EPA that the statutory text alone is ambiguous and is arguably susceptible of either interpretation.”). The district court elaborated: Here, the Court has already found that the statutory text, by itself, does not resolve the issue. Now, it further finds that a holistic analysis of the statute does not help clarify the statutory text. It therefore agrees with EPA that “the overall statutory context and legislative history do not resolve, but rather reinforce, the[] textual ambiguities,” and thus it also agrees with EPA and the Eleventh Circuit that “the ‘broader context of the statute as a whole’ [leaves] ambiguous whether the NPDES program was intended to apply to water transfers.”

Id. at 532 (alterations in original) (citations omitted).

66. *Id.* at 543 (“For multiple reasons, the Court finds EPA’s analysis to be arbitrary and capricious.”).

67. National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. 33,697, 33,701 (June 13, 2008) (to be codified at 40 C.F.R. pt. 122).

68. *Catskill III*, 8 F. Supp. 3d at 532 (quoting *Mich. Citizens for an Indep. Press v. Thornburgh*, 868 F.2d 1285, 1283 (D.C. Cir. 1989)).

69. *Id.* at 533.

70. *Id.* (“[T]o help courts ensure that an interpretation is permissible, an agency must provide a reasoned explanation for its action.” (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983))); *see also id.* (noting that “it is the agency’s responsibility, not [a court’s], to explain its decision” and rejecting an agency interpretation where “the agency ha[d] failed to supply the requisite ‘reasoned analysis’”); *id.* (“Furthermore, ‘an agency’s action must be upheld, if at all, on the basis articulated by the agency itself,’ and a court ‘may not supply a reasoned basis for the agency’s action that the agency itself has not given.’” (quoting *State Farm*, 463 U.S. at 43, 50)).

71. *Id.* at 533–34 n.19.

72. *Id.* at 534 n.19. At this point in its analysis, however, the court seems to contemplate that a purely “legal” statutory analysis might suffice. *See id.* (“Here, EPA chose to undertake a statutory—or, in its words, ‘legal’—analysis. Assuming that this choice was appropriate, EPA still had to apply the analysis in a reasonable fashion.”). As this Article explains in Part

According to the court, “[t]he agency . . . also has a duty to consider alternative policies and explain why it chose one option over others.”⁷³ Moreover, “it has ‘a duty’ to ‘examine’ and to ‘justify’ the ‘key assumptions’ underlying its interpretation.”⁷⁴

The district court rejected the Water Transfers Rule as an unreasonable and arbitrary construction for several reasons.⁷⁵ Significant for purposes of this Article, the court criticized the EPA for refusing to consider reasonable policy alternatives⁷⁶ and for “fail[ing] to provide a reasoned explanation to support a number of critical choices and determinations EPA made, either implicitly or explicitly, when it adopted the Water Transfers Rule.”⁷⁷

One significant unaddressed fact-dependent issue bearing upon the agency’s statutory interpretation was its failure to articulate why water-transfer regulation is an “unnecessary interference” with state-level actions. Throughout the preamble, the EPA highlighted Congress’s intent that the federal government not “unnecessarily” or “unduly” burden or interfere with states’ water-management activities.⁷⁸ But, as the district court noted, in stating that requiring NPDES permits for water transfers would unnecessarily or unduly interfere with state authority, “its failure to articulate why water-transfer regulation is an ‘unnecessary’ interference ‘[did] not so much answer the question as ask it.’”⁷⁹ Although “[p]erhaps EPA *could have* explained

II.B.1, a purely legal statutory analysis should not suffice where such an analysis inevitably hinges on policy choices dependent upon facts that the agency should have to justify. Alternatively, an agency’s legal interpretations should be subject to *Skidmore* deference (at *Chevron* Step One), not mandatory deference at Step Two.

73. *Id.* at 534 (citing *State Farm*, 463 U.S. at 48).

74. *Id.* at 535 (quoting *Appalachian Power Co. v. EPA*, 135 F.3d 791, 818 (D.C. Cir. 1998)).

75. *Id.* at 546 (“EPA’s interpretation was not supported by a reasoned explanation because it chose a flawed methodology from the start. To resolve the ambiguity. . . , it asked questions that were too narrow and thus could not logically support EPA’s conclusion.”); *id.* at 548 (“The Court finds EPA’s decision to rely exclusively on one statutory goal while largely ignoring the other to be arbitrary and capricious for a number of reasons.”); *id.* at 550 (“EPA applied its chosen methodology in a way that was internally inconsistent and was not sufficiently explained in light of EPA’s self-imposed and statutory duty to consider multiple and competing statutory goals.”); *id.* at 557 (“[I]n addition to finding that EPA did not provide a reasoned explanation for its decision in the context of its duty to balance the statute’s competing goals, the Court also finds that EPA failed to explain how its action was consistent with and why it does not frustrate the one goal it did consider.” (citing *State Farm*, 463 U.S. at 43)).

76. *Id.* at 553 (“EPA’s failure to consider reasonable alternative policy choices that would have been consistent—indeed, possibly more consistent—with its interpretation of the statute renders its ultimate policy choice arbitrary and capricious.” (citing *State Farm*, 463 U.S. at 51)); *id.* at 551 (“In addition to failing to explain why it chose not to regulate water transfers under NPDES, EPA also failed to provide a reasoned explanation for its decision to reject the designation-authority option. . . . [T]his proposal would have allowed EPA, on a case-by-case basis, to designate certain water transfers as requiring an NPDES permit. In this way, the designation-authority option was somewhat of a compromise between the ‘total regulation’ approach EPA rejected and the ‘minimal regulation’ approach it ultimately chose.”).

77. *Id.* at 558.

78. National Pollutant Discharge Elimination System (NPDES) Water Transfers Rule, 73 Fed. Reg. 33,697, 33,700–02 (June 13, 2008) (to be codified at 40 C.F.R. pt. 122).

79. *Catskill III*, 8 F. Supp. 3d at 554 (alteration in original) (quoting *Shays v. FEC*, 414 F.3d 76, 101 (D.C. Cir. 2005)).

why,” the district court found that “the administrative record ‘[was] insufficient to permit [the] [C]ourt to discern [EPA’s] reasoning or to conclude that [EPA] has considered all relevant factors’ related to this issue, and the Court ‘may not itself supply a reasoned basis for [EPA’s] action that the agency itself has not given.’”⁸⁰

On appeal, the Second Circuit reversed, holding that it was error for the district court to have incorporated the stricter *State Farm* standard into its *Chevron* Step Two analysis.⁸¹ The court concluded: “While we have great respect for the district court’s careful and searching analysis of the EPA’s rationale for the Water Transfers Rule, we conclude that it erred by incorporating the *State Farm* standard into its *Chevron* Step Two analysis and thereby applying too strict a standard of review.”⁸² The appellate court agreed with the district court’s view that the EPA’s statutory interpretation implicated policy choices: “[I]n light of the potentially serious and disruptive practical consequences of requiring NPDES permits for water transfers, the EPA’s interpretation here involves the kind of ‘difficult policy choices that agencies are better equipped to make than courts.’”⁸³

Nevertheless, it did not hesitate to accord *Chevron* deference to what was essentially an interpretive rule (that nonetheless was subjected to notice-and-comment rulemaking).⁸⁴ And, in doing so, it articulated a role of minimal judicial oversight: “We view the EPA’s promulgation of the Water Transfers Rule here as precisely the sort of policymaking decision that the Supreme Court designed the *Chevron* framework to insulate from judicial second- (or third-) guessing.”⁸⁵ More specifically, the appellate court made clear that it viewed *State Farm*’s scope as rather limited; it was relegated to “non-interpretive rule[s]” or “rule[s] setting forth a changed interpretation of a statute.”⁸⁶ The court set forth a dichotomy, whereby “*State Farm* is used to evaluate whether a rule is procedurally defective as a result of flaws in the

80. *Id.* at 556 (third, fourth, fifth, sixth, and seventh alterations in original). Here, the district court makes an implicit connection to the *Chenery* doctrine, to which this Article returns. See *infra* Part II.B.2.

81. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 520 (2d Cir. 2017) (“At last, we reach the application of the second step of *Chevron* analysis, upon which our decision to reverse the district court’s judgment turns.”), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018); *id.* at 523–24 (“[T]he plaintiffs’ challenge to the Water Transfers Rule is properly analyzed under the *Chevron* framework, which does not incorporate the *State Farm* standard.”).

82. *Id.* at 521 (“An agency’s initial interpretation of a statutory provision should be evaluated only under the *Chevron* framework, which does not incorporate the *State Farm* standard.”).

83. *Id.* at 533 (quoting *Nat’l Cable & Telecomm. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005)).

84. *Id.* at 506.

85. *Id.* at 500–01. The court emphasized that, when the judicial branch intervenes in administrative law disputes that involve all three branches of government, “we are not only last, we are least.” *Id.* at 507. Moreover, the court continued, “For us to decide for ourselves what in fact is the preferable route for addressing the substantive problem at hand would be directly contrary to this constitutional scheme.” *Id.*

86. *Id.* at 521; see also *id.* at 523 (“[I]f all interpretive rules were reviewable under APA § 706(2)(A) and the *State Farm* standard, [the Court’s] pronouncements in *Brand X* and *Fox Television Stations* would have been unnecessary.”).

agency's decisionmaking process,"⁸⁷ while "*Chevron* . . . is generally used to evaluate whether the conclusion reached as a result of that process—an agency's interpretation of a statutory provision it administers—is reasonable."⁸⁸

Having decided that *State Farm* should fall out of the equation in the case of the EPA's rule, the court readily found that the EPA's rationale for its interpretation "was sufficiently reasoned to clear *Chevron*'s rather minimal requirement that the agency give a reasoned explanation for its interpretation."⁸⁹

B. A More Widespread Problem, in Theory and in Practice

What is most troubling about *Catskill Mountains* is that the "reasoned decisionmaking" element of judicial review drops out altogether. The court implies that *Chevron* Step Two reduces to intuitive "reasonableness" of result and that deference can be accorded to what is essentially an interpretive rule. Moreover, *State Farm* reasonableness review is foreclosed.

The notion of *Chevron* Step Two as judicial acquiescence to agency statutory interpretation relies to some extent on a background principle of acoustic separation of *Chevron* and *State Farm* review.⁹⁰ Thus, the EPA persuaded the Second Circuit in *Catskill Mountains* that "the requirement of a 'reasoned explanation' is 'quite a different enterprise' in a statutory-interpretation matter than in a standard arbitrary-and-capricious case."⁹¹ This distinct perspective enabled the EPA to rely implicitly on unsupported factual conclusions (that would not be reviewed under *State Farm*) while claiming to rely on a purely legal analysis (that warranted *Chevron* deference).

Echoing this view, a panel from the D.C. Circuit has voiced the opinion that "[t]he *Chevron* step two question . . . is not whether [a] proposed alternative is an acceptable policy option but whether the [agency's] rule

87. *Id.* at 521 (citing *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016)); *id.* at 522 ("If the rule is not defective under *State Farm* . . . that conclusion does not avoid the need for a *Chevron* analysis, which does not incorporate the *State Farm* standard of review."). This Article disagrees with the Second Circuit's interpretation of *Encino Motorcars*, discussed *infra* Part III.B.1.b. In *Encino Motorcars*, the Supreme Court did rely on the procedural nature of the agency's error. *Encino Motorcars*, 136 S. Ct. at 2125. In that case, the "procedural" error consisted of writing a conclusory opinion devoid of any reasoning whatsoever and failing to take into account any of the rulemaking comments. *Id.* at 1227. Thus, while the Court termed this "procedural," it was akin to hard look review under APA § 706(2)(A).

88. *Catskill IV*, 846 F.3d at 521.

89. *Id.* at 524 ("[W]e can see from the EPA's rationale how and why it arrived at the interpretation of the Clean Water Act set forth in the Water Transfers Rule.").

90. There is a rife debate surrounding whether *State Farm* review is akin to "hard look" review or rather a minimum rationality review. But certainly if it is the former, more searching inquiry—and, as this Article argues, even if a more lax approach is adopted—the persistence of *Chevron* Step Two as agency acquiescence rests, in large part, on its distinctness from *State Farm*.

91. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 39 (quoting *Cont'l Air Lines, Inc. v. Dep't of Transp.*, 843 F.2d 1444, 1452 (D.C. Cir. 1988)).

reflects a reasonable interpretation of [the statute].”⁹² When courts toe this line, Step Two review seems fated to be perfunctory.

1. Acoustic Separation of *Chevron* and *State Farm*

Chevron and *State Farm* are sometimes presented as two pillars of administrative law in significant tension with one another—with *Chevron* ushering in an era of deferential judicial review of agency legal interpretation and *State Farm* one of robust judicial review of agency policymaking.

One way scholars and courts have resolved the alleged tension is to insist upon an acoustic separation, with *Chevron* deference applying to the “legal” domain of statutory interpretation and *State Farm* hard look review governing the “policy” sphere of discretionary agency adjudication and rulemaking.⁹³ As Ron Levin aptly put it, “The habit of thinking about *Chevron* and arbitrariness review in separate conceptual boxes is deeply entrenched.”⁹⁴ Several conventional administrative law textbooks (perhaps for sound pedagogical organizational reasons) reinforce this view of *Chevron* as the relevant judicial review standard for issues of statutory construction, as distinct from *State Farm* review, which applies to the realm of agency rulemaking.⁹⁵ Following this expository view, at *Chevron* Step Two, courts accord no deference to an agency’s unreasonable statutory interpretation—

92. *Coal. for Common Sense in Gov’t Procurement v. United States*, 707 F.3d 311, 317 (D.C. Cir. 2013).

93. *See, e.g.*, Wald, *supra* note 20, at 244 (“Arbitrary and capricious review focuses on an agency’s decisionmaking processes and explanations. *Chevron*, on the other hand, focuses on statutory language, structure and purpose.”).

94. Ronald M. Levin, *The Anatomy of Chevron: Step Two Reconsidered*, 72 CHI.-KENT L. REV. 1253, 1296 (1997). As Levin elaborated:

Chevron proclaims itself to be a case about “construction of a statutory provision.” That phrase, to many minds, connotes a set of distinctively “legal” issues, involving (for example) statutory language, legislative history, structure and purposes, and canons of construction, as distinguished from the kind of inquiry a court makes when it is overseeing an exercise of administrative discretion.

Id. at 1266–67 (citation omitted) (quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 866 (1984)).

95. *Accord, e.g.*, RONALD A. CASS ET AL., ADMINISTRATIVE LAW: CASES AND MATERIALS 130–37, 161–67 (6th ed. 2011) (including *Chevron* within “Judicial Review of Questions of Law” and *State Farm* within “Arbitrary and Capricious Review of Questions of Fact or Policy”). Compare JOHN F. MANNING & MATTHEW C. STEPHENSON, LEGISLATION AND REGULATION 737–854 (2d ed. 2013) (discussing *Chevron* throughout a chapter entitled “Statutory Interpretation in the Administrative State”), with *id.* at 668–735 (discussing *State Farm* in a subsection entitled “Modern ‘Hard Look’ Review and *State Farm*” within “Judicial Review of Agency Rules” in a chapter entitled “The Regulatory Process”). There are notable exceptions. PETER L. STRAUSS ET AL., GELLHORN AND BYSE’S ADMINISTRATIVE LAW: CASES AND COMMENTS 1029 (11th ed. 2011) (recognizing the interaction between *Chevron* and *State Farm* and including a section entitled “Notes on the Relationship Between *Chevron* and *State Farm*”); see also RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 7.4, at 604 (5th ed. 2010) (“[T]he question whether an agency engaged in reasoned decision-making within the meaning of *State Farm* often is identical to the question a court must answer under step two of the test announced in *Chevron* . . . —is an agency’s construction of an ambiguous provision in an agency-administered statute reasonable?”); *id.* § 3.6, at 219 (“It seems apparent that step two of *Chevron* is *State Farm*.”). For further discussion, see *infra* Part II.A.1.

that is, “arbitrary, capricious, or manifestly contrary to the statute.”⁹⁶ Although both cases employ the “arbitrary or capricious” formulation, *State Farm*’s arbitrary and capricious review under the APA probes an agency’s technical and factual findings that underpin policy decisions and rulemakings.⁹⁷ A court deems an agency rulemaking (or adjudication) arbitrary or capricious if the agency failed to consider “an important aspect of the problem,” to “examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made,” or to consider “alternative way[s] of achieving” the statute’s objective.⁹⁸

For some scholars and courts, there is a distinct dividing line between agency interpretation and policymaking. At a descriptive level, Jack Beermann explains that “[t]he analysis under *Chevron* Step Two is completely different from the usual analysis under the arbitrary or capricious standard.”⁹⁹ In a similar vein, Cary Coglianese suggests that “[t]he key lesson is that [*Chevron*] Step [Two]’s reasonableness criterion calls for an inquiry into interpretive reasonableness, which is different than policy reasonableness or reasoned decisionmaking under the APA’s arbitrary and capricious standard.”¹⁰⁰

At a normative level, Matthew Stephenson and Adrian Vermeule advocate keeping the interpretive question and “reasoned decisionmaking” question analytically distinct.¹⁰¹ Likewise, Kenneth Bamberger and Peter Strauss believe that oversight of agency interpretation should involve different factors from oversight of agency policymaking.¹⁰² Similarly, a panel of the D.C. Circuit reasoned that although *Chevron* Step Two “sounds closely akin to plain vanilla arbitrary-and-capricious style review,” it should be clear that “interpreting a statute is quite a different enterprise than policymaking.”¹⁰³

This separation of *Chevron* and *State Farm* is too rigid as a conceptual matter: there are myriad instances in which an agency’s interpretive view is dependent upon its resolution of policy choices. Moreover, in practice, it has led some courts down the primrose path to a largely perfunctory Step Two.

96. *Chevron*, 467 U.S. at 844.

97. See, e.g., Cass R. Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177, 181 (“[T]he courts have used this language [from APA § 706] to force agencies to take, and later to initiate on their own, a ‘hard look’ at the factual and policy issues involved in regulation.”); see also *id.* at 183 (“The procedural and substantive elements of the hard-look doctrine are a controversial gloss on judicial review for arbitrariness, which is authorized by the APA.”).

98. *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 48 (1983).

99. Beermann, *supra* note 27, at 745.

100. Coglianese, *supra* note 2, at 1386.

101. Stephenson & Vermeule, *supra* note 23, at 604 (“Our proposed revision would clarify the doctrine while keeping the interpretive question and the ‘reasoned decisionmaking’ question analytically separate.”).

102. Bamberger & Strauss, *supra* note 23, at 622 (“Indeed, there is good reason to conclude that oversight of agency interpretation should appropriately incorporate factors distinct from those developed in the review of an agency’s exercise of policymaking expertise in light of a technical or scientific record . . .”).

103. *Cont’l Air Lines, Inc. v. Dep’t of Transp.*, 843 F.2d 1444, 1452 (D.C. Cir. 1988).

2. Perfunctory *Chevron* Step Two (and Missing *State Farm*)

In *Catskill IV*, the EPA's view of *Chevron* review as categorically distinct from, and more deferential than, *State Farm* review ultimately prevailed. Namely, according to the EPA, courts should accord great deference to agencies at Step Two, recognizing that "the 'reasoned explanation' requirement sets a low threshold" in light of "the great deference Congress has granted implementing agencies."¹⁰⁴ More specifically, the agency need not explain nor justify its policy-relevant choice among competing viable statutory interpretations: "*Chevron* does not require the agency to convince the courts that its chosen interpretation is the best; instead, the agency's interpretation must simply be among the permissible alternatives."¹⁰⁵ But, as the district court had deftly noted, "if the fact that [the EPA] chose" among plausible interpretations was "enough to trigger deference," then *Chevron* Step Two is effectively a nullity.¹⁰⁶

When *State Farm* review drops out of the equation (as it did at the Second Circuit), *Chevron* deference is tantamount to judicial acquiescence to the agency's interpretation. The Second Circuit is perhaps uniquely forthright about its track record: "[I]n many recent cases, we have applied *Chevron* Step Two without applying *State Farm* or conducting an exacting review of the agency's decisionmaking and rationale."¹⁰⁷

*Ciba-Geigy Corp. v. Sidamon-Eristoff*¹⁰⁸ is another case in point. Reaching *Chevron* Step Two in a challenge to the EPA's interpretation of the Resource Conservation and Recovery Act (RCRA),¹⁰⁹ the Second Circuit declared that the challenger (an operator of a hazardous waste site in New

104. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 39.

105. *Id.* at 48.

106. See *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 559 (S.D.N.Y. 2014) ("[T]he Eleventh Circuit's step-two approach renders step two almost entirely unnecessary, because if the question at step one is framed as whether the statute is ambiguous enough to support the agency's interpretation, then the analysis effectively ends at step one if the fact that the agency chose the interpretation is enough to trigger deference."), *rev'd*, 846 F.3d 492 (2d Cir. 2017). Matthew Stephenson and Adrian Vermeule make this point and explain a host of problems this creates. See Stephenson & Vermeule, *supra* note 23, at 603–08. They do not consider, however, the extent to which the redundant Step Two might be displacing independent *State Farm* review.

107. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 522–23 (2d Cir. 2017) (citing *Stryker v. SEC*, 780 F.3d 163, 167 (2d Cir. 2015), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018); *Florez v. Holder*, 779 F.3d 207, 211–12 (2d Cir. 2015); *Lee v. Holder*, 701 F.3d 931, 937 (2d Cir. 2012); *Adams v. Holder*, 692 F.3d 91, 95 (2d Cir. 2012); *WPIX, Inc. v. ivi, Inc.*, 691 F.3d 275 (2d Cir. 2012)), *petition for cert. filed*, No. 17-446 (U.S. Sept. 14, 2017). *WPIX* stands apart from these other lax Step Two cases. There, the court applied heightened judicial scrutiny by applying *Skidmore* at *Chevron* Step Two. *WPIX*, 691 F.3d at 283.

108. 3 F.3d 40 (2d Cir. 1993).

109. Section 6926(g)(2) of the RCRA provides, "The Administrator shall, if the evidence submitted shows the State requirement to be substantially equivalent to the [federal requirement], grant an interim authorization to the State to carry out such requirement *in lieu of direct administration in the State by the Administrator of such requirement.*" *Id.* at 48–49 (alteration in original) (quoting 42 U.S.C. § 6926(g)(2) (2012)). *Ciba* argued that after state authorization, the federal program was entirely displaced. The court readily found that the italicized language was ambiguous and proceeded to Step Two. *Id.* at 49.

York) “must show that EPA’s interpretation fails a *highly deferential reasonableness test*, applied with due regard to the statutory purpose.”¹¹⁰ The court’s Step Two analysis consisted of an invocation of the statutory purposes (“protection of the environment and public health”), followed by a cursory statement that the administration of federal permits will avoid potential gaps in regulation if left to the states alone.¹¹¹ There is nary a reference to any such policy reasoning by the agency in the administrative record. The court therefore seems in essence to be giving *Chevron* deference to the agency’s legal interpretation of the statute.

The Second Circuit is hardly the only court to deploy an anemic Step Two. Indeed, it largely followed the Eleventh Circuit’s approach to an earlier challenge to the EPA’s Water Transfers Rule. At Step One, the court concluded that Congress had not answered the precise question at issue given that there were two reasonable ways to read the statute.¹¹² Then, at Step Two, the court deferred to the agency’s interpretation, explaining that “[b]ecause the EPA’s construction is one of the two readings we have found is reasonable, we cannot say that it is ‘arbitrary, capricious, or manifestly contrary to the statute.’”¹¹³ According to the court, “[a]ll that matters is whether the regulation is a reasonable construction of an ambiguous statute. In other words, there must be two or more reasonable ways to interpret the statute, and the regulation must adopt one of those ways.”¹¹⁴ But this effectively renders Step Two a nullity—all of the work is done at Step One; having determined that there is ambiguity such that two or more interpretations are within the zone of reasonableness, there is nothing further that the agency must explain or justify with respect to its choice among these interpretations.¹¹⁵

The D.C. Circuit certainly has issued its fair share of lax Step Two decisions as well. In *Continental Air Lines, Inc. v. Department of Transportation*,¹¹⁶ the court held that “[r]easonableness’ in this context means . . . the compatibility of the agency’s interpretation with the policy goals . . . or objectives of Congress.” According to the court, under this “less exacting standard,” even a “not particularly compelling” interpretation should be upheld if it is “not patently inconsistent with the statutory

110. *Id.* (emphasis added).

111. *Id.* (“Continued administration of federal permits past the immediate moment of state authorization avoids the gap in regulation that might occur if the state failed to immediately issue a new permit containing all applicable requirements, and allows the state and federal regulators the opportunity to coordinate in an effective manner a gradual transfer of jurisdiction.”).

112. See *Friends of Everglades v. S. Fla. Water Mgmt. Dist. (Friends I)*, 570 F.3d 1210, 1227 (11th Cir. 2009).

113. *Id.* at 1228 (quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984)).

114. *Id.* at 1219.

115. *Id.* at 1221 (noting that “deciding how best to construe statutory language is not the same thing as deciding whether a particular construction is within the ballpark of reasonableness” required under *Chevron*).

116. 843 F.2d 1444 (D.C. Cir. 1988).

scheme.”¹¹⁷ Indeed, only an agency interpretation that “actually frustrated the policies that Congress was seeking to effectuate” should be overturned.¹¹⁸

*Adirondack Medical Center v. Sebelius*¹¹⁹ provides another stark illustration of how an agency’s policy analysis that underlies its statutory analysis evades judicial scrutiny. Following a change to the formula used to calculate reimbursements to hospitals under Medicare, some hospitals received overpayments.¹²⁰ Congress enacted a limited legislative solution, and the Secretary of Health and Human Services, acting on a broad grant of authority, decided to spread the fiscal pain of the fix more broadly than Congress’s targeted solution would allow.¹²¹ By statute, the Secretary was authorized to provide for adjustments to payment amounts “as the Secretary deems *appropriate*.”¹²² At *Chevron* Step One, the court held that the statute was ambiguous given that there were “two plausible readings of the statute.”¹²³ Having so determined at Step One, there was little further scrutiny at Step Two into the “reasonableness of the Secretary’s interpretation.”¹²⁴ What is entirely missing is anything from the administrative record regarding the Secretary’s weighing of the pros and cons between what are conceded equally plausible readings. Indeed, in response to the Hospital’s challenge of the Secretary’s action on policy grounds, the court emphatically demurred: “Such policy arguments are more properly addressed to legislators or administrators, not to judges.”¹²⁵

Even in some situations where the D.C. Circuit has remanded cases back to the agency, it has not demanded policy reasons to support the agency’s statutory interpretation. In *Prime Time International Co. v. USDA*,¹²⁶ the D.C. Circuit maintained that, “[o]n remand, USDA did exactly what we asked of it” where the agency revised its previous view that its interpretation was “mandated by the plain text” of the statute to its being “the optimal reading” of the statute.¹²⁷ The case involved a challenge to the USDA’s “Per Stick Rule,” whereby it calculated each cigar manufacturer’s statutorily mandated “pro rata” assessment based on the number of cigars (i.e., “sticks”) that the manufacturer put into commerce.¹²⁸ On remand, the USDA solicited public comments on whether it should revisit its Per Stick Rule.¹²⁹ But when it issued its determination declining to revisit the Rule, it simply set forth its

117. *Id.* at 1452.

118. *Id.* at 1453.

119. 740 F.3d 692 (D.C. Cir. 2014).

120. *Id.* at 695.

121. *Id.* at 695–96.

122. *Id.* (emphasis added) (quoting 42 U.S.C. § 1395ww(d)(5)(I)(i) (2012)).

123. *Id.* at 698.

124. *Id.* at 700.

125. *Id.* (quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 864 (1984)).

126. 753 F.3d 1339 (D.C. Cir. 2014).

127. *Id.* at 1340–41.

128. *Prime Time*, a manufacturer of small cigars, argued that the Rule’s equal treatment of small and large cigars violated the statutory “pro rata basis” requirement. *Id.*

129. *Id.* at 1340.

prior legal interpretation as the “optimal” one.¹³⁰ On appeal, the D.C. Circuit—guided by two lines of established case law affording *Chevron* deference to “agency actions that resolve ‘interstitial . . . legal question[s]’ related to an agency’s expertise”¹³¹ and “reasoned agency decisions made in response to remands”¹³²—readily found the agency’s interpretation of ambiguous language “reasonable.”¹³³ What is entirely missing is any discussion of the actual reasons why USDA classified cigars on a per-stick basis.¹³⁴ If the USDA is entitled to *Chevron* deference based on its expertise, presumably it should be required to set forth its policy-relevant reasons based on its experience and judgment.

The Supreme Court has a similar track record of laxity at Step Two and of specifically conferring deference on the basis of an agency’s purely legal interpretive view. In *Mayo Foundation for Medical Education and Research v. United States*¹³⁵—where the Court upheld the Treasury Department’s interpretation of whether medical residents were “students” within the meaning of a tax statute—the Court decided that the “ultimate question” was whether Congress “would have intended and expected” the agency to fill the statutory gap.¹³⁶ The Court stated upfront that “[r]egulation, like legislation, often requires drawing lines.”¹³⁷ And its Step Two review was an extremely light touch; it was enough that the agency’s statutory interpretation was “perfectly sensible,” it “would further the purpose” of the statute, and that the agency “did not act irrationally.”¹³⁸ The Court did not require any fact finding or empirical basis to support the agency’s policy-relevant choice; so long as it had not drawn an irrational line—or one at odds with congressional purpose—its choice was acceptable.

More than a decade earlier, in *Pension Benefit Guarantee Corp. v. LTV Corp.*,¹³⁹ the Court likewise exercised a light touch by deferring to an agency’s interpretation based upon its “judgments about the way the real world works” without requiring any empirical basis or vetting of such “judgments” in the administrative record.¹⁴⁰ The Court ultimately upheld the agency’s interpretation¹⁴¹ based on the agency’s conclusion that certain pension plans would “frustrate one of the objectives” of the statute because it would reduce “employee resistance” to plan termination.¹⁴² The Court was satisfied that the agency’s “judgments about the way the real world works”

130. *Id.*

131. *Id.* at 1341 (alteration in original) (quoting *Mylan Labs., Inc. v. Thompson*, 389 F.3d 1272, 1279–80 (D.C. Cir. 2004)).

132. *Id.* (quoting *PDK Labs. Inc. v. DEA*, 438 F.3d 1184, 1189 (D.C. Cir. 2006)).

133. *Id.* at 1341–43.

134. Nor does the agency’s brief mention any relevant policy considerations. See Final Brief for the Appellees, *Prime Time*, 753 F.3d 1339 (No. 13-5204).

135. 562 U.S. 44 (2011).

136. *Id.* at 58, 60.

137. *Id.* at 59.

138. *Id.* at 59–60.

139. 496 U.S. 633 (1990).

140. *Id.* at 651–52.

141. *Id.* at 656.

142. *Id.* at 651.

provided adequate justification and did not require anything further to demonstrate reasoned decision-making.¹⁴³

In sum, this relatively lax Step Two analysis, highly deferential to agency legal interpretations—with *State Farm* entirely missing—proceeds as follows: so long as the agency, acting pursuant to Congress’s delegated authority (express or implied), sets forth a “permissible” interpretation based entirely on traditional tools of statutory interpretation, then courts (having already determined delegated authority and ambiguity at Step One) should defer thereto, absent any evidence of policy-based reasoning. Such judicial acquiescence sets the stage for the introduction of a competing model featuring more searching judicial scrutiny—namely, the incorporation of *State Farm* into *Chevron* Step Two—to which we now turn.

II. A NEW *CHEVRON-STATE FARM* FRAMEWORK

The new *Chevron-State Farm* framework proposed here charts a different path. First, it acknowledges that the realms of agency statutory interpretation and discretionary agency action like rulemaking can be inextricably linked. The idea of injecting *State Farm* review into the *Chevron* Two-Step is to direct courts to look to the administrative record—the preamble justifying the agency’s interpretation and, specifically, the factual support and policy justifications for the agency’s choices. Under this framework, courts at Step Two should demand the relevant agencies’ *policy*-relevant analyses and not instead be lulled into accepting agencies’ *legal* interpretations on the basis of statutory text, legislative history, and canons of statutory interpretation (which might guide courts at Step One).¹⁴⁴

The agency, operating under the shadow of such heightened judicial review, should focus on the empirical consequences of making various policy choices that inform its legal interpretation of the statute. This apparatus will apply to a host of statutory interpretation contexts; namely, wherever the agency’s policy choices, backed by empirical factual support, guide its interpretation of ambiguous statutory provisions.¹⁴⁵

143. *Id.*

144. As Hammond et al. explain:

Courts have long considered agency interpretations of statutory language to be persuasive evidence of statutory meaning for various institutional reasons. Agency staff often play a major role in drafting legislation; agencies are responsible for the initial application of the statute; and agencies’ day-to-day interactions with particular statutes make it likely that they will have a relatively sophisticated view of how a statute fits into a coherent regulatory scheme.

Hammond et al., *supra* note 12, at 87. *But see* Herz, *supra* note 25, at 129, 151 (“To my knowledge, no court has expressly stated that *Skidmore* applies within step one; some courts have expressly rejected any sort of deference within step one. Nonetheless, the *Skidmore* factors ‘seem to keep popping up as considerations that courts recite while applying *Chevron* step one,’ suggesting that something along these lines may be happening.” (quoting Ronald M. Levin, *Mead and the Prospective Exercise of Discretion*, 54 ADMIN. L. REV. 771, 782 & n.50 (2002))).

145. Consider, in this vein, how Don Elliott argued that “*Chevron* moved the debate from a sterile, backward-looking conversation about Congress’ nebulous and fictive intent to a forward-looking, instrumental dialogue about what future effects the proposed policy is likely

The *Chevron-State Farm* model would expand the reach of *State Farm* review, widening the berth of agency rules subject to hard look review. Several courts have taken the position in statutory interpretation cases that only a narrow subset of agency rules—either those with “procedural defects” or those where the agency has changed its prior position—are subject to an additional layer of independent *State Farm* review (either before or after *Chevron* review). Exacerbating this trend, some litigants do not bring independent *State Farm* challenges in *Chevron* statutory interpretation cases.

Perhaps most significantly, where the *Chevron* interpretive issue arises between *private* parties—that is, when the agency is not a party and thus litigants cannot raise a direct *State Farm* challenge to the rulemaking—this Article’s framework would allow for an indirect *State Farm* challenge to the agency’s decision-making. The model thus increases the scope of pre-enforcement review in cases between private parties, all the while extending the specter of judicial review, in whose shadow the agency operates.

Moreover, the specter of judicial review impacts agencies’ internal structures and regulatory choices. If, “[a]t the margins, agency decisions after *Chevron* reflect more weight on policy choices and less on legalistic interpretations,”¹⁴⁶ that effect would be augmented with the infusion of *State Farm*-type review. Moreover, if *Chevron* already has helped to “reduce[] the relative power of lawyers within agencies and [has] strengthened the voices of officials in other disciplines,”¹⁴⁷ the infusion of *State Farm* review should hasten this trend as well.

A. *The Interplay of Chevron and State Farm*

This Part considers the evolution of academic proposals and judicial efforts to incorporate heightened judicial scrutiny into the *Chevron* framework. For decades, several scholars have advocated and, more recently, some judges have started to deploy, a more muscular *Chevron* Step Two. There nonetheless remains much confusion in the courts about the doctrinal relationship between *Chevron* Step Two and *State Farm* arbitrary and capricious review.¹⁴⁸

1. Growing Academic Consensus

This Article stands on the shoulders of giants in administrative law who have previously advocated, in various forms, for the incorporation of some variant of *State Farm* hard look review into *Chevron* Step Two.

In the 1990s, Mark Seidenfeld advocated a “revamping of the *Chevron* doctrine as one means of ensuring that agencies act deliberately yet remain

to have.” E. Donald Elliott, *Chevron Matters: How the Chevron Doctrine Redefined the Roles of Congress, Courts and Agencies in Environmental Law*, 16 VILL. ENVTL. L.J. 1, 13 (2005).

146. Elliott, *supra* note 145, at 13.

147. *Id.* at 2.

148. See, e.g., Hammond et al., *supra* note 12, at 70 (“Just as there is no general consensus as to *Chevron*’s proper justification, so there is no general consensus as to how *Chevron* should operate.”).

politically accountable.”¹⁴⁹ Seidenfeld’s “syncopated” *Chevron* would “downplay[] the first beat of the *Chevron* two-step and emphasize[] the second beat by requiring reviewing courts to scrutinize more carefully the reasonableness of agencies’ statutory interpretation.”¹⁵⁰ With respect to *Chevron* Step One, “deliberative democracy counsels placing primary responsibility for statutory interpretation in the administrative agency.”¹⁵¹ But, at the same time, at Step Two, in order “to ensure deliberative decisionmaking, as well as to avoid excessive special interest influence and agency capture, courts must retain the authority to review agency interpretations in a meaningful manner.”¹⁵²

Most relevant here, Seidenfeld specifically advocated “[t]aking a hard look under *Chevron*’s step two.”¹⁵³ Seidenfeld’s chief concern was that agencies would make political choices “to appease political pressure from an interest group.”¹⁵⁴ For this reason, his two-step model is designed to reveal whether the action “constitutes a direct benefit accorded to a particular interest group, [in which case] the agency must explain why that benefit is good public policy in light of the statutory objectives.”¹⁵⁵ He elaborated:

[I]n reviewing an agency’s interpretation, courts should require the agency to identify the concerns that the statute addresses and explain how the agency’s interpretation took those concerns into account. In addition, the agency should explain why it emphasized certain interests instead of others. . . . The agency should also respond to any likely contentions that its interpretation will have deleterious implications.¹⁵⁶

Tackling the issue from the standpoint of doctrinal clarity, Ron Levin proposed a “simple solution” to the quandary faced by the D.C. Circuit regarding the respective domains of *Chevron* Step Two and arbitrary and capricious review under APA § 706(2)(A): “these two steps in the review process should be deemed not just overlapping, but identical.”¹⁵⁷ Levin reasoned that, “If the courts would define the scope of the *Chevron* step one inquiry and of arbitrariness review as broadly as they should, there would be

149. Mark Seidenfeld, *A Syncopated Chevron: Emphasizing Reasoned Decisionmaking in Reviewing Agency Interpretations of Statutes*, 73 TEX. L. REV. 83, 127 (1994).

150. *Id.* at 87.

151. *Id.* at 127. Seidenfeld’s approach “frowns upon courts using traditional tools of statutory construction to remove questions of law from agency discretion.” *Id.* at 133.

152. *Id.* at 127.

153. *Id.* at 128; *see id.* at 129 (“Substituting something akin to hard look review for the deferential reasonableness standard that courts have used in *Chevron*’s step two would go far toward implementing the deliberative model.”); *see also* Eskridge, *supra* note 15, at 454 (“*Chevron* Step Two needs to have some teeth, if for no other reason than to keep agencies aware that their work is being monitored and, sometimes, to require further deliberation from the agency.”).

154. Seidenfeld, *supra* note 149, at 131.

155. *Id.*

156. *Id.* at 129.

157. Levin, *supra* note 94, at 1254. Levin acknowledges Seidenfeld’s prior work: “Although Professor Seidenfeld believes that under current law step two is so deferential as to be almost inconsequential, he thinks it *should* be invigorated through an infusion of ‘hard look’ methodology.” *Id.* at 1266 n.59 (citation omitted).

no need for a separate and distinct *Chevron* step two, and that test could simply be absorbed into arbitrariness review.”¹⁵⁸

Peter Strauss and Ken Bamberger joined an emerging academic consensus on this point. In their account, Step One is an “interpretive” question to be resolved by independent judicial judgment.¹⁵⁹ Conceptually, Step One is the process of defining the area in which the agency can operate; this “zone of indeterminacy”¹⁶⁰ that constitutes an agency’s “*Chevron* space” “must be judicially determined.”¹⁶¹ In other words, it is “a statement of what the law is.”¹⁶² Agency input is welcome at this step, but it is accorded “*Skidmore* weight” commensurate with its power to persuade.¹⁶³ In sum, at Step One, courts define the statutory boundaries in which the agency can act.¹⁶⁴

If Step One defines boundaries for the realm of “reasonable” agency interpretations, then Step Two probes the “reasoned decisionmaking” of the agencies.¹⁶⁵ On this view, Step Two is a decision-making question where the court plays an oversight function. Strauss has conceived of this “*Chevron* space” as one where an agency can make a “policy judgment permitted by the statutory language” that “could be revisited as changing circumstances might suggest.”¹⁶⁶

While this Article leans heavily on each of these prior accounts, each of these variants of hard look review at Step Two differs in subtle ways from this Article’s approach. Bamberger and Strauss agree that Step Two is properly viewed as arbitrary and capricious review but, in their view, the particular context presented in cases applying *Chevron* means that this review is *not* akin to *State Farm* hard look review.¹⁶⁷ This is because the focus at

158. *Id.* at 1254–55; see also Gary S. Lawson, *Reconceptualizing Chevron and Discretion: A Comment on Levin and Rubin*, 72 CHI.-KENT L. REV. 1377, 1378–79 (1997) (“Professor Levin would convert step one into an all-things-considered assessment of the substantive reasonableness of the agency’s interpretation and make step two a straightforward application of arbitrary or capricious review. There would then be no separate application of § 706(2)(A) to agency legal conclusions. Sign me up.”).

159. Bamberger & Strauss, *supra* note 23, at 611 (distinguishing “questions of statutory implementation assigned to independent judicial judgment (Step One) from questions regarding which the courts’ role is limited to oversight of agency decisionmaking (Step Two)”).

160. Strauss, *supra* note 18, at 1165 n.101 (quoting Michael Herz, *Deference Running Riot: Separating Interpretation and Lawmaking Under Chevron*, 6 ADMIN. L.J. AM. U. 187, 199 (1992)).

161. *Id.* at 1165.

162. *Id.*

163. Other scholars agree with this conception of Step One. See, e.g., Herz, *supra* note 2, at 1880–81 (describing courts’ role at Step One as doing “what Congress wants” and giving “the statute the best possible reading, not . . . adopt[ing] the best possible policy”).

164. Accord Eskridge, *supra* note 15, at 451 (“The judiciary’s main comparative advantage is its ability to enforce the rule of law and jurisdictional limits upon agencies that stray from legal constraints, which justifies the Supreme Court’s focus on Step One.”).

165. Accord Herz, *supra* note 2, at 1885 (arguing that courts’ Step Two review should be focused on “determining whether the agency, free of statutory constraint, engaged in reasoned decisionmaking”).

166. Strauss, *supra* note 18, at 1163; see also Herz, *supra* note 2, at 1883 (describing how courts, at Step Two, are not looking at an agency “interpretation” of the statute but instead at “a policy judgment” to be reviewed “pursuant to the arbitrary-and-capricious test”).

167. Bamberger & Strauss, *supra* note 23, at 625.

Step Two may be on interpretive methods as opposed to the soundness of fact-based judgments.¹⁶⁸ Specifically, they argue that at Step Two courts determine “whether agencies have permissibly exercised the interpretive authority delegated to them by reasonably employing appropriate methods for elaborating statutory meaning” such as legislative history and normative canons of construction.¹⁶⁹

Similarly, in Seidenfeld’s model, “to satisfy the second step of the syncopated *Chevron*, the agency should explain why its interpretation is good policy in light of the purposes and concerns underlying the statutory scheme.”¹⁷⁰ Moreover, with this endeavor in mind, at Step Two, “the courts should employ traditional tools of construction.”¹⁷¹

Levin’s vision of hard look review at Step Two comes the closest to this Article’s. Levin examined a line of D.C. Circuit cases that he endorsed: “The hard look case law basically requires an agency to generate a ‘reasoned analysis’ supporting its exercises of discretion, ‘examin[ing] the relevant data and articulat[ing] a satisfactory explanation for its action.’”¹⁷² As Levin succinctly explained, “the court has transformed the *Chevron* step two question of whether the agency action was ‘reasonable’ into a question of whether it was ‘reasoned.’”¹⁷³ Levin, nevertheless, remained agnostic with respect to the stringency of judicial review.¹⁷⁴

This Article builds on this descriptive account and seeks to provide normative justification beyond doctrinal clarity. Significantly, the agency does not deserve *Chevron* deference for its resolution of ambiguities unless

168. More specifically, Bamberger and Strauss claim that *State Farm* review does not play “much of a role in review of lower-stakes NLRB ‘unfair labor practice’ determinations or SSA benefit determinations,” and as such, they doubt that “the *State Farm* factors always identify the totality of factors involved in a reasonable process of statutory construction.” *Id.* at 622.

169. *Id.* at 623–24.

170. Seidenfeld, *supra* note 149, at 129.

171. *Id.* at 130.

172. Levin, *supra* note 94, at 1263 (alterations in original) (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 57 (1983)).

173. *Id.*

174. *Id.* at 1255 (“[D]espite the prominence of the arbitrariness test in my analysis, I also will not explore whether that test is being applied too intrusively or too deferentially.”); *see also id.* at 1296 (“The skeptical reader may have doubts about the social utility of my analysis—a pure exercise in attempted clarification, with no aspiration to promote either more deferential or more intrusive judicial review.”). David Zaring extended Levin’s analysis to argue that the two tests are one and the same. *See* David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 162 (2010) (“The idea is that a court must first decide whether the agency is interpreting its legal authority reasonably, and then secondly, that it should decide whether the action is, in a more general sense, arbitrary or capricious. But we do not need two tests for these sorts of cases. If *Chevron* review does in fact turn on reasonableness, the possibility that an agency interpretation of law might be presumed to be reasonable despite failing the arbitrary and capricious test is awfully unlikely. Indeed, to my knowledge, no court has concluded that reasonable legal interpretations are nonetheless components of arbitrary agency action.”). But Zaring claimed that this test is “something without much substantive bite at all” and should be seen as “chiefly imposing procedural obligations on agencies, so that courts can act in the few cases where they feel comfortable concluding that an agency action is completely beyond the pale, which they can only do if they have an adequate explanation of what, exactly, the agency was doing.” *Id.* at 164–65.

it can articulate a *policy* basis for that resolution that can meet the standards of *State Farm*.

2. A Mixed Picture in the Courts

My fairly exhaustive review of D.C. Circuit jurisprudence on *Chevron* and *State Farm* revealed no consistent approach to the *Chevron-State Farm* interplay or the level of scrutiny deployed under either judicial review standard.¹⁷⁵ Looking at a larger set of *Chevron* cases in all of the circuit courts from 2003 to 2013, Kent Barnett and Christopher Walker have likewise found inconsistent approaches to *Chevron* Step Two (albeit without probing the significance of the interplay with *State Farm*).¹⁷⁶

Several D.C. Circuit cases have defined “arbitrary and capricious” or “unreasonable” at *Chevron* Step Two with a nod to *State Farm*.¹⁷⁷ Other cases are more equivocal but likewise seem to suggest something more than a lax Step Two standard tantamount to judicial acquiescence.¹⁷⁸ In other cases, *State Farm* operates in tandem with *Chevron* analysis—typically as Step Three (but in some cases preceding the *Chevron* analysis). But, even where the D.C. Circuit has recognized the *Chevron-State Farm* overlap, the court’s overall emphasis seems more skewed toward scrutiny of the agency’s legal analysis.¹⁷⁹

175. In order to get a sense of the interplay between *Chevron* and *State Farm*, I reviewed all D.C. Circuit cases (a total of thirty-five) that cite both *Chevron* and *State Farm* over a ten-year period (from January 1, 2006, to June 30, 2016). In order to get a sense of the extent to which *State Farm* was “missing” in statutory interpretation questions, I also reviewed all D.C. Circuit cases that cite *Chevron* over a shorter two-year period (from January 1, 2014, until June 30, 2016). There were forty-nine *Chevron* cases, which, because some cases include multiple separate interpretations, constitute a total of fifty-six decisions. Of those, twelve cite *State Farm*. Thus, *State Farm* was invoked in roughly one-fourth of the *Chevron* cases.

176. See generally Kent Barnett & Christopher J. Walker, *Chevron Step Two’s Domain*, 93 NOTRE DAME L. REV. (forthcoming 2018).

177. See, e.g., *North Carolina v. EPA*, 531 F.3d 896, 906 (D.C. Cir. 2008) (defining “arbitrary and capricious” at *Chevron* Step Two with the incorporation of *State Farm*); *Nat. Res. Def. Council, Inc. v. Daley*, 209 F.3d 747, 755–56 (D.C. Cir. 2000).

178. See, e.g., *Village of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 660 (D.C. Cir. 2011) (“At *Chevron* step two we defer to the agency’s permissible interpretation, but only if the agency has offered a reasoned explanation for why it chose that interpretation.”).

179. Barnett and Walker take up the Herculean task of attempting to code and then classify circuit courts’ approaches to *Chevron* Step Two into three broad categories (leaving aside “other” (28 percent of cases)): “hyper-textualism” (12 percent of cases); “hyper-purposivism” (28 percent of cases); and “arbitrary-and-capricious review” (33 percent of cases). Barnett & Walker, *supra* note 176 (manuscript at 5). Certainly textualist and purposivist reasoning constitute components of the agency’s “legal” analysis. And Barnett and Walker agree that “it is difficult to see how a similar or more expansive textual or structural inquiry at step two adds much to the inquiry.” *Id.* (manuscript at 12). It is less clear the extent to which courts engaged in a *State Farm*-like hard look review of discretionary policy choices in the category of “arbitrary-and-capricious review.” As Barnett and Walker explain:

When courts apply the arbitrary-and-capricious approach at *Chevron* step two, they usually focus on the quality of (or lack thereof) the agency’s reasoning, with heightened scrutiny when an agency has changed its interpretation or advanced conflicting interpretations. . . . Sometimes, however, the courts take a hard look at the agency’s reasoning and fault the agency for failing to take into account certain

Nonetheless, to the extent that there is a groundswell of enthusiasm among individual judges, if not the majority of panel decisions in the D.C. Circuit, for a more muscular Step Two or incorporation of *State Farm* into the *Chevron* analysis, this trend may take root now that the Supreme Court seems to have signaled approval of that approach.¹⁸⁰

a. *Chevron-State Farm Overlap*

The Supreme Court's decision in *Judulang v. Holder*¹⁸¹ intimates that *Chevron* Step Two and arbitrary and capricious review under the APA are substantially similar in context, but the case nonetheless raises questions regarding the interplay between questions of statutory interpretation and policymaking. Justice Kagan, writing for a unanimous Court, struck down the Board of Immigration Appeals's (BIA) use of a "comparable-grounds approach" to determine the availability of deportation relief on the ground that the BIA's decision to adopt this method was arbitrary and capricious in contravention of the APA.¹⁸² The lack of correlation between the BIA's method and the legitimate issue of an individual's fitness to remain in the United States illustrated that the agency's decision had represented "a clear error of judgment" or had not been "based on a consideration of the relevant factors," thus leading the Court to conclude that the BIA "ha[d] failed to exercise its discretion in a reasoned manner."¹⁸³

Tellingly, the government had urged the Court to apply *Chevron* Step Two rather than *State Farm* arbitrary and capricious review.¹⁸⁴ The Court rejected the government's invitation but nonetheless suggested that the doctrinal choice was irrelevant to the outcome of the case.¹⁸⁵ The Court opined that *Chevron* Step Two and arbitrary and capricious review are often "the same, because under *Chevron* step two, [the court asks] whether an agency interpretation is 'arbitrary or capricious in substance.'"¹⁸⁶ When an agency action does not involve the interpretation of any statutory language, "the

factors. Sometimes, moreover, the courts fault the agency for failing to provide a reasoned decision at all.

Id. (manuscript at 26–27) (footnotes omitted).

180. See *infra* Part III.B.2 (discussing a few post-*Michigan* D.C. Circuit decisions); cf. Barnett & Walker, *supra* note 176 (manuscript at 30) ("[T]he relatively strong showing of the arbitrary-and-capricious review standard (which had a better showing than other analytical methods) suggests that circuit courts have better internalized the Supreme Court's repeated references to that method than other methods.").

181. 565 U.S. 42 (2011).

182. *Id.* at 53–55. Under the comparable-grounds method, the availability of deportation relief to an illegal immigrant who resided in the United States and had one or more prior criminal convictions was to be determined based on "whether the ground for deportation charged in a case has a close analogue in [section 212(c) of the Immigration and Nationality Act's] list of exclusion grounds." *Id.* at 49.

183. *Id.* at 53.

184. *Id.* at 52 n.7.

185. *Id.*

186. *Id.* at 52 n.7 (citing *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53 (2011)).

more apt analytic framework . . . is standard ‘arbitrary [or] capricious’ review under the APA.”¹⁸⁷

Several earlier D.C. Circuit cases similarly pointed out the overlap or redundancy between *Chevron* Step Two and *State Farm*. Thus, in *Pharmaceutical Research & Manufacturers of America v. FTC*,¹⁸⁸ the court remarked, “As is often the case, our review here of the FTC’s interpretation of its authority under *Chevron* Step Two overlaps with our arbitrary and capricious review under 5 U.S.C. § 706(2)(A).”¹⁸⁹

Indeed, Judge Harry Edwards has suggested that “[t]he occasional analytical overlap between *Chevron* Step Two and arbitrary and capricious review can sometimes make it difficult to determine under which standard a case should be decided.”¹⁹⁰ Judge Patricia Wald has explained that “[b]ecause both standards require the reviewing court to ask whether the agency has considered all of the factors made relevant by the statute, this court has often found the *State Farm* line of cases relevant to a *Chevron* step two analysis.”¹⁹¹

b. A More Muscular Step Two

Here, this Article considers courts’ embrace of a more muscular Step Two, albeit a heightened judicial scrutiny focused on the agency’s *legal*

187. *Id.*

188. 790 F.3d 198 (D.C. Cir. 2015).

189. *Id.* at 204 (“Therefore, the analysis [above] rejecting PhRMA’s *Chevron* Step Two arguments applies here as well in our rejection of PhRMA’s claims resting on Section 706(2)(A).”); *Agape Church, Inc. v. FCC*, 738 F.3d 397, 410 (D.C. Cir. 2013) (“The same points that address Petitioners’ *Chevron* Step Two claim also make it clear that their arbitrary and capricious claim fails. The analysis of disputed agency action under *Chevron* Step Two and arbitrary and capricious review is often ‘the same, because under *Chevron* step two, [the court asks] whether an agency interpretation is arbitrary or capricious in substance.” (alteration in original) (citing *Judulang*, 565 U.S. at 52 n.7)); *Gen. Am. Transp. Corp. v. Interstate Commerce Comm’n*, 872 F.2d 1048, 1053 (D.C. Cir. 1989) (“[T]he questions posed—has the Commission adopted an impermissible construction of the Act and is its . . . policy arbitrary and capricious—are quite similar. Both questions require us to determine whether the Commission, in effecting a reconciliation of competing statutory aims, has rationally considered the factors deemed relevant by the Act.”).

190. HARRY T. EDWARDS ET AL., *FEDERAL STANDARDS OF REVIEW OF DISTRICT COURT DECISIONS AND AGENCY ACTIONS* 218 (2d ed. 2013).

191. *Arent v. Shalala*, 70 F.3d 610, 620 (D.C. Cir. 1995) (Wald, J., concurring). According to Judge Wald, *Chevron* focuses on the substantive reasonableness of a particular agency action whereas *State Farm* focuses on the process by which that action was undertaken. *Id.* at 619.

justifications.¹⁹² *AT&T Corp. v. Iowa Utilities Board*¹⁹³ marked the first time that the Supreme Court rejected an agency's interpretation at Step Two.¹⁹⁴ The case involved FCC regulations that required Local Exchange Carriers to provide market entrants with a panoply of services to ensure these entrants could compete quickly without duplicating technologies that the market incumbents already held.¹⁹⁵ The FCC interpreted the statutory terms "necessary" and "impair," which were critical for the FCC's policy of requiring incumbents to provide access to a suite of network services to new entrants.¹⁹⁶ Notwithstanding the ambiguity of the word "necessary" and the concomitant interpretive discretion implied by the statute's structure, Justice Antonin Scalia for the majority held that the agency's interpretation was unreasonable.¹⁹⁷

A few years earlier, Judge Laurence Silberman penned the majority decision in *National Ass'n of Regulatory Utility Commissioners v. Interstate Commerce Commission*,¹⁹⁸ a paradigmatic example of a more muscular approach to *Chevron* Step Two. In that case, the plaintiffs raised an APA challenge to regulations that altered the interstate motor carrier registration system, which had been promulgated by the Interstate Commerce Commission (ICC) under the Intermodal Surface Transportation Efficiency Act.¹⁹⁹ Under the Act, Congress delegated to the ICC "the task of balancing conflicting policy objectives."²⁰⁰

At *Chevron* Step Two, the court examined the ICC's decision-making process and found it wanting, commenting that it "strikes us as not so much a balance of conflicting policy goals as the acceptance of one without any real consideration of the other."²⁰¹ The court further specified what it expected to find in the regulatory record: "At minimum, the Commission must explain how such an alternative could possibly substitute, under any

192. See Hammond et al., *supra* note 12, at 96 ("[T]he scope of what courts will consider under this more rigorous approach varies. For example, courts that do not consider the broader tools of statutory construction at step one, such as canons of construction and legislative history, may apply these tools instead at step two. But opinions that have already considered such materials at step one can appear awkward when they also look to these materials at step two because the analyses appear duplicative. Such materials may include all the conventional statutory sources: the terms or sections of the text of the statute, the overall structure of the statute, the legislative history, and the court's understanding of the purpose of the statute. The range of statutory materials thus varies, and the comprehensiveness of the examination varies as well." (footnote omitted)).

193. 525 U.S. 366 (1999).

194. Hammond et al., *supra* note 12, at 99 ("Courts are also mindful of agency interpretations that appear to ignore or misunderstand important statutory provisions. In the first case in which an agency lost at step two before the Supreme Court, *AT&T Corp. v. Iowa Utilities Board*, this was one of the agency's failings.").

195. *AT&T Corp.*, 525 U.S. at 389.

196. *Id.* at 390–92.

197. *Id.* at 392 ("Because the Commission has not interpreted the terms of the statute in a reasonable fashion, we must vacate."); see also *id.* at 397–401 (Souter, J., dissenting) (characterizing the majority's decision as a Step Two decision).

198. 41 F.3d 721 (D.C. Cir. 1994).

199. *Id.* at 723–24.

200. *Id.* at 728.

201. *Id.*

plausible cost/benefit analysis, for the traditional—and congressionally approved—method of roadside enforcement.”²⁰² The court accordingly held that the ICC had acted “unreasonably.”²⁰³

What is more, the court elaborated that its conclusion held “whether one considers the case as one involving a question of *Chevron* Step II statutory interpretation or a garden variety arbitrary and capricious review or, as we do, a case that overlaps both administrative law concepts.”²⁰⁴ Judge Silberman had previously explained the difference in terms of the scope of the specific congressional delegation implicated²⁰⁵:

When Congress’ instructions are conveyed at a high level of generality, an agency is not likely to consider its action as an “interpretation” of the authorizing statute, nor is that action likely to be challenged as a “misinterpretation.” . . . When, on the other hand, the statute is quite specific, agency action normally is evaluated in terms of how faithfully it follows the more detailed direction; in such cases the question is more obviously whether the agency permissibly interpreted the statute.²⁰⁶

But the type of scrutiny called for by Judge Silberman—consistent with a line of D.C. Circuit cases—is focused on *legal* reasoning.²⁰⁷ Judge Silberman, concurring in *Global Tel*Link v. FCC*,²⁰⁸ similarly there endorsed a level of review that would more closely scrutinize the reasoning provided by the agency before providing *Chevron* deference. Recognizing that there are ambiguities in statutes, which may be exploited to achieve policy goals, he endorsed a heightened standard of review at *Chevron* Step Two. Citing *Michigan v. EPA*, Judge Silberman called for “muscular use of [*Chevron* Step Two] analysis” and argued that this is a necessary check on “inappropriate administrative adventure.”²⁰⁹ Judge Silberman’s concern was as follows:

Chevron itself involved a phrase “stationary source” that was not at all defined and clearly could equally refer to (a) a factory complex, or (b) a specific emitter of pollution. But it would have been unreasonable to refer

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.* at 727 (“Whether an agency action is to be judged as reasonable, in accordance with the APA’s general arbitrary and capricious standard, or whether it is to be examined as a permissible interpretation of a statute *vel non* depends, at least theoretically, on the scope of the specific congressional delegation implicated.”).

206. *Id.* (“[T]he more an agency purports to rely on Congress’ policy choice—as set forth in specific legislation—than on the agency’s generally conferred discretion, the more the question before the court is logically treated as an issue of statutory interpretation, to be judged by *Chevron* standards.”).

207. *See, e.g., Council for Urological Interests v. Burwell*, 790 F.3d 212, 233 (D.C. Cir. 2015) (“In making [a Step Two] assessment, we look to what the agency said at the time of the rulemaking—not to its lawyers’ post-hoc rationalizations.”); *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 798 (D.C. Cir. 2004) (“[D]eference to an agency’s interpretation of a statute is not appropriate when the agency wrongly ‘believes that interpretation is compelled by Congress.’” (quoting *Arizona v. Thompson*, 281 F.3d 248, 254 (D.C. Cir. 2002))).

208. 859 F.3d 39 (D.C. Cir. 2017). For discussion of this case, see *infra* text accompanying notes 422–27.

209. *Id.* at 60 (Silberman, J., concurring).

to (c) a whole city. Yet too many times agencies have taken advantage of an ambiguity to pursue a (c), (d), or (f) interpretation that accorded with policy objectives.²¹⁰

In other words, ambiguity alone should not permit courts to abdicate their responsibility to ensure that an agency's interpretation of a statute is not patently unreasonable.

Likewise, in *National Mining Ass'n v. Kempthorne*,²¹¹ the court recognized the overlap between *Chevron* Step Two and arbitrary and capricious review.²¹² But the court evaluated the agency's rule solely through tools of statutory construction to ensure that the agency provided an interpretation that is "arguably consistent with the underlying statutory scheme in a substantive sense."²¹³ The court did not scrutinize the agency's underlying policy justifications; nor was any *State Farm* challenge discussed in the opinion. Instead, the court conducted a fairly searching review of the legal basis for the agency's action before deciding in its favor.²¹⁴

By contrast, this Article proposes not more stringent scrutiny of legal reasoning (which should take place at Step One) but rather *State Farm* hard look scrutiny of policy reasoning at Step Two.

B. Agency Policy-Based Reasoned Decision-Making

Here, this Article comes to the heart of the *Chevron-State Farm* framework—the normative goal of mandating “reasoned decisionmaking” by agencies acting under a wide variety of congressional authorizing statutes. The model is premised on the principle that courts, via judicial review, “retain a role, and an important one, in ensuring that agencies have engaged in reasoned decisionmaking.”²¹⁵ Its normative scope rests on the notion that “the resolution of ambiguity in a statutory text is often more a question of policy than of law.”²¹⁶ In other words, with respect to ambiguous statutory language, agencies must often choose between viable (or permissible) interpretations on the basis of policy-inflected choices. And, with *State Farm*

210. *Id.*

211. 512 F.3d 702 (D.C. Cir. 2008).

212. *Id.* at 710 n.4 (“Given the overlap between step-two *Chevron* review and the arbitrary-and-capricious review called for by § 1276(a)(1) and the APA, the contention that the 1999 Rule violates § 1276(a)(1) fails for similar reasons.” (citation omitted)). This case concerned the Secretary of the Interior’s interpretation of the term “valid existing rights” to prevent surface mining in sensitive areas. *Id.* at 705. The National Mining Association asserted that the Department of the Interior was depriving it of due process and effecting a taking of its property in violation of the Fifth Amendment. *Id.* at 711.

213. *Id.* at 709–10 (quoting *Kennecott Utah Copper Corp. v. U.S. Dep’t of the Interior*, 88 F.3d 1191, 1206 (D.C. Cir. 1996)). The court sought to ensure that the construction of the statute offered by the Department of the Interior was consistent with substantive canons of construction.

214. *Id.* at 712 (“The district court properly accorded *Chevron* deference to the Secretary’s interpretive rule.”).

215. *Judulang v. Holder*, 565 U.S. 42, 53 (2011).

216. *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 696 (1991).

incorporated into *Chevron* Step Two, the agency is forced to give reasons for choosing between these options.²¹⁷

More specifically, no longer will conclusory explanations or legal analysis suffice to justify policy choices.²¹⁸ Agencies cannot cloak their policy choices in legal statutory interpretation garb. Whereas, operating under the specter of lax Step Two review agencies may have been incentivized to rely on purely “legal” analysis to effectively insulate such positions from judicial review, this strategy will, under my model, no longer work.

Nor is it enough that an agency has promulgated an interpretive rule through notice-and-comment rulemaking if it has failed to vet its policy choice by relying solely (or primarily) on legal statutory interpretation arguments. Contrary to the winning argument of the EPA on appeal in *Catskill Mountains*, the mere “exercise [of] its *Chevron*-triggering power to make rules through notice and comment”²¹⁹ should not suffice for reasonableness. In other words, it should not be per se reasonable when an agency chooses—based on unarticulated and thus unvetted policy variables—between two permissible statutory interpretations.

Instead, the courts must assume an independent role to analyze the *means* by which agencies choose statutory interpretations. In other words, “[A]t step two, courts cannot infer permissible means from permissible ends—it is instead their duty independently to analyze the means.”²²⁰

1. Elevating Policy over Law (or Why Courts Defer to Agencies)

The implications of adopting the *Chevron-State Farm* model go beyond the outcomes of particular disputes. The model insists on adherence to the normative justification for *Chevron* deference at Step Two, namely that the agency has made a *policy* choice to which the courts should defer. It highlights a functional comparative expertise rationale for agency deference. It has always been the case that among “[t]he principles underlying” *Chevron* deference is the need for an agency to apply “more than ordinary knowledge”—that is, “agency expertise”—when “fill[ing] . . . gap[s] left, implicitly or explicitly, by Congress.”²²¹

The incorporation model tips the balance further to make clear that “we defer to an agency’s statutory interpretations not only because Congress has delegated lawmaking authority to the agency, but also because that agency

217. *Cf. Sw. Power Pool, Inc. v. Fed. Energy Regulatory Comm’n*, 736 F.3d 994, 995 (D.C. Cir. 2013) (“[W]e find that the Commission failed to provide a reasoned explanation for its decision. It leapt to an interpretation of one item of evidence without explaining its implicit rejection of alternative interpretations, and, equally without explanation (or at least adequate explanation), it disregarded evidence that the applicable law required it to consider.”).

218. *Cf. AT&T Wireless Servs. v. FCC*, 270 F.3d 959, 968 (D.C. Cir. 2001) (“Conclusory explanations for matters involving a central factual dispute where there is considerable evidence in conflict do not suffice to meet the deferential standards of our review.”).

219. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 32.

220. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 559 (S.D.N.Y. 2014), *rev’d*, 846 F.3d 492 (2d Cir. 2017).

221. *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 55–56 (2011) (quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984)).

has the expertise to produce a reasoned decision.”²²² This expertise, more specifically, is policy expertise grounded in “the agency’s greater familiarity with the ever-changing facts and circumstances surrounding the subjects regulated.”²²³

Here, too, the EPA’s argument in *Catskill Mountains* against the incorporation of *State Farm* puts the point into sharp relief: “It is . . . implied delegation of authority, rather than a record of the application of special expertise in a particular case, that gives rise to *Chevron* deference.”²²⁴ By contrast, pursuant to the incorporation model, courts should defer to an agency’s statutory interpretation only when the agency has demonstrably applied expertise and rational thought to resolve a policy problem.

It is worth considering how the incorporation model would shape agency behavior when promulgating rules. It should induce more policy vetting as part of the administrative record to support agencies’ policy-based reasons.²²⁵ Agencies operating in anticipation of *State Farm* review of the underlying factual premises, which support the agency’s policy choice that drives its interpretive rule, will vet the empirical evidence during the notice-and-comment period and ultimately make better regulatory decisions.

As a vivid counterexample, consider the EPA’s premise, adopted by the Second Circuit in *Catskill Mountains*, that the Water Transfers Rule “lay well within the agency’s discretion, and accordingly must be upheld under the

222. *Village of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 660 (D.C. Cir. 2011). On the “expertise-forcing” role of judicial review of agencies, see Jody Freeman & Adrian Vermeule, *Massachusetts v. EPA: From Politics to Expertise*, 2007 SUP. CT. REV. 51, 52, and David J. Barron, *From Takeover to Merger: Reforming Administrative Law in an Age of Agency Politicization*, 76 GEO. WASH. L. REV. 1095, 1148 (2008). Cf. Ronald J. Krotoszynski, Jr., *Why Deference?: Implied Delegations, Agency Expertise, and the Misplaced Legacy of Skidmore*, 54 ADMIN. L. REV. 735, 756 (2002) (suggesting that a reviewing court should accord deference to “the extent that the agency can demonstrate that the action at issue reflects and incorporates the benefit of agency expertise,” but when such a demonstration cannot be made, “deference is not justified in light of the APA’s [arbitrary and capricious] mandate”).

223. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000).

224. Reply Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 58, at 23. A strong case can be made that the Supreme Court has signaled a shift of late toward this agency-expertise rationale. In earlier cases, such as *Mayo*, the Court paid no particular heed to the Treasury’s “expertise” in physicians’ employment or training in deferring to its interpretation. *Accord id.* (“[I]n affirming the agency’s exercise of [its] discretion, the Court [in *Mayo*] simply noted that the agency’s statutory interpretation was ‘perfectly sensible,’ that it had determined it ‘would further the purpose’ of the statute, and it ‘did not act irrationally’—with no mention of any Treasury ‘expertise’ in physicians’ employment or training.”). But contrast this with the Court’s recent *King v. Burwell* decision, in which it denied *Chevron* deference to the IRS, in part due to the agency’s lack of expertise. For further discussion, see *infra* Part III.A.

225. As will be discussed further, the Court’s decision in *Michigan v. EPA* provides another striking example. See *infra* Part III.B.1.a. In that case, the EPA provided a “Legal Memorandum” accompanying its proposed supplemental finding. See Supplemental Finding That It Is Appropriate and Necessary to Regulate Hazardous Air Pollutants from Coal- and Oil-Fired Electric Utility Steam Generating Units, 81 Fed. Reg. 24,420, 24,421 n.3 (Apr. 25, 2016) (to be codified at 40 C.F.R. pt. 63). The incorporation model, in sharp contrast, would require the agency to consider empirically based costs and benefits in making its threshold decision whether to regulate.

deferential *Chevron* standard.”²²⁶ To address the “reasonableness” requirement of *Chevron* Step Two, the EPA stated that it “reasonably explained why, in light of the various indications of congressional intent, it adopted what the district court acknowledged to be a permissible interpretation.”²²⁷

Significant for the purposes of this Article, the EPA was quite explicit that it believed it had authority to choose any possible “legal” interpretation of the Act without engaging in fact finding of any sort.²²⁸ As the district court noted (and the EPA did not dispute), the EPA “based its interpretation on an analysis of many of the same provisions the Court analyzed at step one”—the “parts of the statute and its legislative history that the Court discussed in its step-one analysis.”²²⁹ Thus, the court continued, “the primary flaw underlying EPA’s entire analysis is that EPA effectively attempted to use *Chevron*-step-one arguments to justify its interpretation at step two.”²³⁰ As the district court recognized, this problem effectively renders *Chevron* Step Two defunct: “[I]n the context of what EPA acknowledges are two permissible interpretations, it cannot explain its choice of one of those interpretations by arguing only that the interpretation was permissible, because permissibility alone is not a sufficient reasoned explanation.”²³¹

How might this have looked under the *Chevron-State Farm* incorporation model? The EPA would have been required to justify its choice between two permissible legal interpretations by pointing to facts developed in the administrative record. The record in that case reflected that the EPA, in its response to public comments, asserted various, apparently unsubstantiated, “beliefs” regarding the potential harms from interbasin transfers and the potential burdens upon the states from requiring permits.²³² Specifically, the EPA asserted that exempting interbasin transfers from permitting requirements would avoid “unnecessarily” or “unduly” burdening states’ water allocations.²³³

226. Reply Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 58, at 2; *see also* Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 21 (“The Water Transfers Rule is a reasonable interpretation of an ambiguous statute, and should be upheld under the deferential framework of *Chevron*.”).

227. Reply Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 58, at 22.

228. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 37 (“Although EPA chose one of the interpretations of the statute recognized as permissible by the district court, that court improperly required EPA to explain its choice in far more detail than the law requires.”); *id.* at 48 (arguing that “the agency’s interpretation must simply be among the permissible alternatives” and distinguishing *State Farm* as a “case involv[ing] an agency’s detailed technical and factual findings, not a statutory construction”).

229. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 539–40 (S.D.N.Y. 2014), *rev’d*, 846 F.3d 492 (2d Cir. 2017).

230. *Id.* at 558. As the court elaborated, “Indeed, EPA employed the exact same ‘holistic approach’ to statutory interpretation in both the Water Transfers Rule and in the step-one analysis in this case.” *Id.*

231. *Id.*; *see also* *Friends of Everglades v. S. Fla. Water Mgmt. Dist. (Friends I)*, 570 F.3d 1210, 1228 (11th Cir. 2009) (reasoning that because the statute permitted the interpretation, the EPA’s choice was *per se* reasonable).

232. Brief for the State of New York et al., *supra* note 39, at 72 n.13.

233. *Catskill III*, 8 F. Supp. 3d at 544.

But determining whether the burdens of permitting justify the costs requires factual findings that the EPA never made.²³⁴ Indeed,

EPA has conceded that the Rule is not based on any “scientific analysis of” inter-basin transfers or any study of the effects of such unregulated transfers “on the costs of drinking water treatment, recreation, or commercial fishing.” Nor did EPA ever evaluate or find any facts regarding the burdens of compliance with NPDES permitting.²³⁵

Moreover,

the principal reason that NPDES permitting would be costly is if water transfers are highly polluted—the precise situation when compliance costs might be justified by the benefits of cleaner water. But EPA has no way of knowing how to weigh these competing interests because it failed to consider any of the “relevant factors.”²³⁶

As the states’ brief highlights, “[a]rtificial transfers of contaminated water from one water body to another harm water quality, degrade the environment, endanger public health, and cause billions of dollars in economic damage.”²³⁷

The EPA decided not to consider these environmental, health, and economic effects notwithstanding myriad public comments raising the issue and factual evidence supporting various concerns.²³⁸

The issue goes beyond a simple disagreement regarding the quantum of factual or empirical evidence in the administrative record necessary to support the EPA’s policy-based conclusion. The EPA took the position that it need not put forth *any* such policy-based evidence; instead, it took cover behind its legal analysis, relying wholly on the very same materials (statutory text, purposes, and legislative history) that led the court to conclude that there was ambiguity at *Chevron Step One*.²³⁹ Again, the EPA was quite upfront about this and complained that the district court “erroneously undertook a searching and skeptical examination of EPA’s reasoning” and “improperly required EPA to explain its choice in far more detail than the law requires.”²⁴⁰

234. See Brief for the State of New York et al., *supra* note 39, at 71.

235. *Id.* at 71 (citations omitted).

236. *Id.* at 73.

237. *Id.* at 4; see also *id.* at 5 (“Inter-basin transfers containing pollutants such as industrial waste, toxic blue-green algae, or fecal coliform can contaminate waters used for drinking or recreation, creating the risk of illness and even death. And conveying pollutants from one water body to another often wreaks havoc on surrounding property values and businesses that rely on a clean water supply, including fishing and tourism. Conveying polluted water into clean water bodies can destroy aquatic ecosystems by introducing invasive species and disease into new water bodies.” (citations omitted)).

238. *Id.* at 17 (“EPA thus never considered the severe environmental, health, and economic harms caused by some inter-basin transfers that move polluted water into cleaner waterways, despite receiving thousands of public comments warning of such dangers.”).

239. As the district court concluded, “It thus appears that EPA relied on the presumed validity of its interpretation to justify its decision not to address an issue, consideration of which was necessary to establish the validity of its interpretation. In other words, it put the motor before the boat.” *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500, 557 (S.D.N.Y. 2014), *rev’d*, 846 F.3d 492 (2d Cir. 2017).

240. Brief for Defendants-Appellants EPA and Gina McCarthy, *supra* note 53, at 35, 37.

2. *Chenery* and Review of Administrative Records

The *Chenery* doctrine²⁴¹—that, in reviewing agency decisions, courts should consider only those rationales the agencies offered in their decisions—reinforces the normative ideal of the *Chevron-State Farm* model.²⁴² As the Supreme Court held in *SEC v. Chenery Corp. (Chenery I)*²⁴³, when Congress has delegated “a determination of policy or judgment . . . [to] the agency alone . . . , a judicial judgment cannot be made to do service for an administrative judgment.”²⁴⁴ The Second Circuit added:

Were courts obliged to create and assess ex-post justifications for inadequately reasoned agency decisions, courts would, in effect, be conscripted into making policy. Such an activity is, for myriad and obvious reasons, more properly the province of other bodies, particularly where . . . the other body is an agency that can bring to bear particular subject matter expertise.²⁴⁵

Expounding on this rationale, Kevin Stack has argued that “Congress delegates in part so that agencies will exercise their expertise and flexibility in view of changing conditions, . . . [and] *Chenery* provides a way to ensure that the agencies will do so.”²⁴⁶ More specifically, “the deference the Court applies at Step Two is implicitly conditioned on the agency’s having worked through the problem, with reason-giving as the overt expression of its exercise of discretion and expertise.”²⁴⁷ In this way, “compliance with the *Chenery* principle operates as a condition for the agency to receive deference in *Chevron* Step Two.”²⁴⁸

It is thus striking in the *Catskill Mountains* decision—especially in light of the EPA’s reliance solely on legal analysis—that the Second Circuit reasoned, “Another factor favoring the reasonableness of the Water Transfers Rule’s interpretation of the Clean Water Act is that compliance with an NPDES permitting scheme for water transfers is likely to be burdensome and costly for permittees, and may disrupt existing water transfer systems.”²⁴⁹ Here, the court looked not to the EPA’s administrative rulemaking record for

241. See *SEC v. Chenery Corp. (Chenery II)*, 332 U.S. 194, 196 (1947); *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80, 95 (1943).

242. Others—most notably Kevin Stack—have noted “the extent to which the *Chenery* and *Chevron* doctrines are conceptually intertwined, with each having implications for the other.” Kevin M. Stack, *The Constitutional Foundations of Chenery*, 116 *YALE L.J.* 952, 1004 (2007). Stack has argued forcefully that “compliance with *Chenery* is a necessary condition for *Chevron* deference.” *Id.*

243. 318 U.S. 80 (1943).

244. *Id.* at 88.

245. *Lin v. U.S. Dep’t of Justice*, 416 F.3d 184, 192 (2d Cir. 2005).

246. Stack, *supra* note 242, at 981; see also *id.* at 1007 (“[T]he core demand for reason-giving and justification provides a check that the agency has exercised its expertise.”).

247. *Id.* at 1005.

248. *Id.*

249. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 529 (2d Cir. 2017), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018).

relevant evidence but instead to factual information put forth in *briefs* filed by the intervenor-defendants in the case.²⁵⁰

Oddly, the Second Circuit acknowledged that “[t]he district court made no findings of fact in the course of answering the purely legal question before it” and, for that reason, it “express[ed] no view as to the likelihood that requiring NPDES permits for water transfers would lead to the results identified above.”²⁵¹ Instead, the court noted that “concerns that such results might arise are plausible and could support the EPA’s interpretation of the Clean Water Act in the Water Transfers Rule.”²⁵² Had the court incorporated *State Farm* into its *Chevron* review scheme, this post hoc rationalization of the agency’s policy decision—not grounded in an evidentiary record—would have been barred by *Chenery*. Not only does *Chenery* cohere with the incorporation model in terms of directing the agency to develop fact-based justifications in the administrative record but failure to embrace the incorporation model threatens to weaken, if not erode, *Chenery*.²⁵³

250. The court’s description from the parties’ briefs is rather lengthy:

[S]everal intervenor-defendant water districts assert that it could cost an estimated \$4.2 billion to treat just the most significant water transfers in the Western United States, and that obtaining an NPDES permit and complying with its conditions could cost a single water provider hundreds of millions of dollars. Similarly, intervenor-defendant New York City submits that if it is not granted the permanent variances it has requested in its most recent permit application, it will be forced to construct an expensive water-treatment plant, and *amicus curiae* the State of California argues that requiring NPDES permits would put a significant financial and logistical strain on the California State Water Project. Further, *amici curiae* the American Farm Bureau Federation and Florida Farm Bureau Federation argue that the invalidation of the Water Transfers Rule would (i) throw the status of agricultural water-flow plans into doubt, and (ii) require state water agencies to increase revenues to pay for permits for levies and dams, which they would likely accomplish by raising agricultural and property taxes, and which in turn would raise farmers’ costs and hurt their international economic competitiveness.

Id. (citations omitted). The States, though not invoking *Chenery*, nonetheless brought this issue to the Second Circuit’s attention. See Brief for the State of New York et al., *supra* note 39, at 71–72 (“Although defendants now speculate that permitting will be so cost-prohibitive as to interfere with States’ water allocations, EPA made no such finding—instead, it stressed that the Rule was based on a legal analysis ‘rather than an assessment of [the] costs or administrative burdens’ of permitting.”); *id.* at 72 n.14 (“Appellate counsels’ post-hoc claims about permits’ theoretical burdens cannot save the Rule when EPA never assessed the real-world costs in jumping to its unsupported conclusions.” (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 49–50 (1983))).

251. *Catskill IV*, 846 F.3d at 529 n.34.

252. *Id.*; see also *id.* at 529 (“The potential for such disruptive results, if accurate, would provide further support for the EPA’s decision to interpret the statutory ambiguity at issue so as not to require NPDES permits for water transfers.”).

253. In *Catskill IV*, the Second Circuit, by failing to invoke *Chenery*, appears to have joined the ranks of courts that have held that *Chenery* does not apply in cases of purely legal reasoning. See *Ark. AFL-CIO v. FCC*, 11 F.3d 1430, 1440 (8th Cir. 1993) (“[T]he Supreme Court clearly limited *Chenery* to situations in which the agency failed to make a necessary determination of fact or of policy.”); *Bldg. & Constr. Trades Dep’t v. U.S. Dep’t of Labor Wage Appeals Bd.*, 829 F.2d 1186, 1189 (D.C. Cir. 1987) (“The *Chenery* rule . . . does not apply when the question presented is one of statutory construction.”); *N.C. Comm’n of Indian Affairs v. U.S. Dep’t of Labor*, 725 F.2d 238, 240 (4th Cir. 1984) (finding no *Chenery* issue because “interpretation of a federal statute is not ‘a determination or judgment which an

C. Resuscitating State Farm

A formidable challenge to the incorporation model is the suggestion that, even if *Chevron* Step Two is lax or defunct, it does not matter so long as, thereafter, courts apply *State Farm* arbitrary and capricious review as a kind of Step Three in the overall analysis.²⁵⁴

This Part begins with an analysis of the *State Farm* review as “Step Three,” a model generally associated with the D.C. Circuit. This Article then suggests two realms in which the incorporation model might make a difference in practice. First, the model would potentially expand the reach of *State Farm* review.²⁵⁵ Second, if more speculatively, it could augment (at least in the short term) the stringency of judicial scrutiny overall.²⁵⁶

1. *State Farm* Review as “Step Three”

The D.C. Circuit seems fairly adept at applying *State Farm* as Step Three.²⁵⁷ Judge Edwards, in particular, has been an avid purveyor of this approach. In *United States Postal Service v. Postal Regulatory*

administrative agency alone is authorized to make” (quoting *SEC v. Chenery Corp. (Chenery II)*, 332 U.S. 194, 196 (1947))).

254. In a similar vein, Stephenson and Vermeule argue that “[t]rying to save *Chevron*’s two steps by reading one of them as equivalent to arbitrary and capricious review serves no useful purpose and creates additional problems.” Stephenson & Vermeule, *supra* note 23, at 604. In a sense, what follows is an attempt to respond to their forceful critique.

255. As should be clear, this Article’s main concern is with scenarios in which the “reasoned decisionmaking” element of judicial review drops out altogether. While I argue that the incorporation of *State Farm* into the *Chevron* framework will expand *State Farm*’s domain, I do not mean to suggest that stand-alone *State Farm* challenges could not be raised and addressed by courts. *Cf. id.* at 606 (“Courts may mistakenly conclude that they must always resolve the question of interpretive plausibility before addressing the issue of reasoned decisionmaking, because the former is part of Step One and the latter is part of Step Two.”).

256. This Article concedes that the predicted effect (both direction and magnitude) is ultimately an empirical question (and highly speculative). My intuition is that, at least in the short run, the incorporation of *State Farm* into the *Chevron* framework would heighten overall scrutiny by drawing courts’ attention to the need for an additional element of review against the backdrop of the status quo of relatively lax Step Two analysis.

257. For example, in *Van Hollen v. FEC*, 811 F.3d 486 (D.C. Cir. 2016), having decided that the agency “easily clear[ed] the *Chevron* Step Two hurdle,” the D.C. Circuit panel methodically proceeded to the arbitrary and capricious inquiry, *id.* at 495; *see also* Nat. Res. Def. Council v. U.S. Nuclear Regulatory Comm’n, No. 14-1225, 2016 WL 1639661, at *12 (D.C. Cir. Apr. 26, 2016) (“Having concluded the Commission’s interpretation of Rule (L) is reasonable . . . we now consider whether NRDC’s petition for waiver was properly denied. The Commission’s determination is entitled to deference as long as it was not arbitrary and capricious.”). Likewise, in *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010), the D.C. Circuit panel first concluded that the SEC had acted within the bounds of its statutory authority when it adopted a particular approach to assessing certain New York Stock Exchange fees under the Exchange Act, and thus rejected petitioners’ *Chevron* argument, *id.* at 533–34. The court then took up petitioner’s *State Farm* challenge that the agency had insufficiently justified some of the conclusions that it purportedly relied upon when making the decision to adopt this approach and allowed it to proceed. *Id.* at 537–44; *see also* Sw. Power Pool, Inc. v. Fed. Energy Regulatory Comm’n, 736 F.3d 994, 995 (D.C. Cir. 2013) (holding FERC’s plausible interpretation and resolution of a contract provision to be arbitrary and capricious under “both the Administrative Procedure Act and [a] ‘*Chevron*-like analysis,’” given FERC’s failure to consider record evidence and alternative methods of contractual construction).

Commission,²⁵⁸ the agency survived *Chevron*, but not *State Farm*, review.²⁵⁹ The Postal Regulatory Commission claimed authority to regulate activities that have “rate effects” rather than outright rate changes and rejected proposals from the Postal Service concerning price adjustments to certain “market-dominant” products.²⁶⁰ After deciding that the Commission’s action survived *Chevron* review, the court proceeded to apply arbitrary and capricious review.²⁶¹ The court held that, although the Commission had the requisite authority to “assess mail preparation requirements that have rate effects,” the Commission nonetheless “fail[ed] to reasonably explain its decision” in light of its “differential treatment of seemingly like cases.”²⁶² The court remanded the order to the Commission “to enunciate an intelligible standard and then reconsider its decision in light of that standard.”²⁶³

In *American Petroleum Institute v. EPA*,²⁶⁴ the EPA claimed to be balancing competing policies to encourage recycling against the potential dangers of creating a loophole for noncompliance.²⁶⁵ The court concluded that the legal basis for the EPA’s decision on an interpretive question survived *Chevron* Step Two,²⁶⁶ but the agency’s stated policy justifications were inadequate to survive *State Farm* arbitrary and capricious review.²⁶⁷ Specifically, the court (per Judge David Sentelle) held that “[i]t may be permissible for EPA to determine that the predominant purpose of primary treatment is discard,” but the “EPA has not set forth why it has concluded that the compliance motivation predominates over the reclamation motivation.”²⁶⁸ In particular, “[l]egal abandonment of property is premised on determining the intent to abandon, which requires an inquiry into facts and circumstances.”²⁶⁹ Recognizing that “the second step of *Chevron* analysis and *State Farm* arbitrary and capricious review overlap, but are not

258. 785 F.3d 740 (D.C. Cir. 2015).

259. *Id.* at 744.

260. *Id.* at 743.

261. *Id.* at 750–56.

262. *Id.* at 753.

263. *Id.* at 756.

264. 216 F.3d 50 (D.C. Cir. 2000).

265. *Id.* at 57. At issue was a series of orders regulating oil-bearing wastewaters produced in the process of petroleum refining as solid waste and hazardous waste for the purposes of regulation under the Resource Conservation and Recovery Act (RCRA). *Id.* at 54. EPA sought to regulate the oil-bearing wastewaters, which they argued were discarded for the purposes of RCRA. *Id.* at 54–55.

266. *Id.* at 57 (“Where an industrial byproduct may be characterized as discarded or ‘in process’ material, EPA’s choice of characterization is entitled to deference.”).

267. *Id.* at 58 (“In short, EPA has not set forth why it has concluded that the compliance motivation predominates over the reclamation motivation. Perhaps equally importantly it has not explained why that conclusion, even if validly reached, compels the further conclusion that the wastewater has been discarded. Therefore, because the agency has failed to provide a rational explanation for its decision, we hold the decision to be arbitrary and capricious.”).

268. *Id.* at 57–58.

269. *Id.* at 57.

identical,”²⁷⁰ the court struck down the EPA’s regulation of oil-bearing wastewaters under arbitrary and capricious review.²⁷¹

A decade earlier, *American Mining Congress v. EPA*²⁷² presented a similar statutory interpretation issue involving the same ambiguous statute as applied to a different waste material.²⁷³ As in *American Petroleum Institute*, the agency survived the *Chevron* challenge to the legal permissibility of its interpretation but failed its duty, under *State Farm*, to articulate a sufficiently rational connection between the information on the record and its ultimate rule.²⁷⁴ Writing the majority opinion, Judge Edwards insisted that “[d]eference to the agency does not . . . require us to abdicate the judicial duty carefully to ‘review the record to ascertain that the agency has made a reasoned decision.’”²⁷⁵

Judge Edwards, while conceding that “*Chevron* review and arbitrary and capricious review overlap at the margins,”²⁷⁶ has consistently held the view that *Chevron* and *State Farm* review are analytically distinct. *Chevron* is “principally concerned with whether an agency has authority to act under a statute.”²⁷⁷ And agencies are accorded great deference, particularly at Step Two:

a reviewing court’s inquiry under *Chevron* is rooted in statutory analysis and is focused on discerning the boundaries of Congress’ delegation of authority to the agency; and as long as the agency stays within that delegation, it is free to make policy choices in interpreting the statute, and such interpretations are entitled to deference.²⁷⁸

270. *Id.*

271. *Id.* at 58. By comparison, in *Solvay USA Inc. v. EPA*, 608 F. App’x 10 (D.C. Cir. 2015), the court recognized “‘that EPA engaged in reasoned decisionmaking to decide which characterization is appropriate’ for different types of non-hazardous materials.” *Id.* at 12 (quoting *Am. Petroleum Inst. v. EPA*, 216 F.3d 50, 57 (D.C. Cir. 2000)). The court held that “[b]ecause EPA ‘has considered the relevant factors and articulated a rational connection between the facts found and the choice made,’ we uphold the rule.” *Id.* at 13 (quoting *Nat’l Ass’n of Clean Air Agencies v. EPA*, 489 F.3d 1221, 1228 (D.C. Cir. 2007)).

272. 907 F.2d 1179 (D.C. Cir. 1990).

273. *Id.* at 1186 (“This court has recently had occasion to consider the meaning of the term ‘discarded’ in RCRA under the first step of *Chevron* analysis. In [an earlier *American Petroleum Institute* decision in the D.C. Circuit], we concluded that the term ‘discarded’ was marked by the kind of ambiguity demanding resolution by the agency’s delegated lawmaking powers.” (citing *Am. Petroleum Inst. v. EPA*, 906 F.2d 729 (D.C. Cir. 1990))).

274. *Id.* at 1192 (“The agency did not exceed its statutory authority in treating the six wastes as ‘discarded,’ and thus subject to RCRA Subtitle C regulation. Nor did it run afoul of the APA notice-and-comment requirement. However, EPA failed in the 1988 Rule to articulate a rational connection between the data on which it purportedly relied and its decision to reject the petitioners’ admittedly significant challenges.”).

275. *Id.* at 1187 (quoting *Nat’l Res. Def. Council v. EPA*, 902 F.2d 962, 968 (D.C. Cir. 1990)).

276. *Arent v. Shalala*, 70 F.3d 610, 615 (D.C. Cir. 1995).

277. *Id.*

278. *Id.*; see also *id.* (“The paradigmatic *Chevron* case concerns ‘[t]he power of an administrative agency to administer a congressionally created . . . program.’ In such a case, the question for the reviewing court is whether the agency’s construction of the statute is faithful to its plain meaning, or, if the statute has no plain meaning, whether the agency’s interpretation ‘is based on a permissible construction of the statute.’” (alterations in original))

Judge Edwards characterized the distinction as between what is “permissible” under *Chevron* versus what is “reasonable” under *State Farm*.²⁷⁹

In some cases, then, much hinges on the courts’ characterization of the case as a “*Chevron*” or “*State Farm*” case. In an oft-cited case, *Arent v. Shalala*,²⁸⁰ the parties raised *Chevron* and *State Farm* challenges to the FDA’s food labeling regulation defining “substantial compliance” under the Nutrition Labeling and Education Act of 1990.²⁸¹ Judge Edwards, for the majority, distinguished *Chevron* and *State Farm* and found only the latter to be applicable.²⁸² Thus, because “there [was] no question that the FDA had authority to define the circumstances constituting food retailers’ substantial compliance with the NLEA’s voluntary labeling guidelines,” according to Judge Edwards, “[t]he only issue . . . [was] whether the FDA’s discharge of that authority was reasonable.”²⁸³

2. Expanding *State Farm*’s Domain

If jurisdictions were to follow the D.C. Circuit’s approach of using *State Farm* as Step Three, that would be a step in the right direction. The incorporation of *State Farm* into the *Chevron* Two-Step framework would nonetheless be preferable as it would likely expand the domain of agency rules subject to *State Farm* review.

a. Beyond Changes in Agency Position and Procedural Defects

Employing an acoustic separation approach to *State Farm* and *Chevron* review, some courts, in statutory interpretation cases, unduly limit the domain of *State Farm* to agency rules that suffer from procedural defects, or scenarios where the agency has changed its interpretive position.²⁸⁴ Lower courts, moreover, have looked to prior U.S. Supreme Court decisions to support their position. Chief among these prior precedents is *National Cable & Telecommunication Ass’n v. Brand X Internet Services*,²⁸⁵ where the Court

(citations omitted) (quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 843 (1984)).

279. *Id.* at 616 n.6 (“In such situations, what is ‘permissible’ under *Chevron* is also reasonable under *State Farm*.” (emphasis added)).

280. 70 F.3d 610 (D.C. Cir. 1995).

281. More specifically, the FDA labeling requirements for raw fish and produce were to remain voluntary unless the FDA determined that there was not “substantial compliance” with the voluntary guidelines. *Id.* at 612–13. The FDA interpreted “substantial compliance” to be met if sixty percent of stores evaluated were in compliance. *Id.* at 612.

282. *Id.* at 614–15 (“Although the parties argue this case in terms of both *Chevron* analysis and arbitrary and capricious review, they interpret the case as one involving review of any agency’s construction of a statute and look primarily to *Chevron* for the appropriate analytical framework. We, however, do not find *Chevron* controlling.”).

283. *Id.* at 616.

284. See, e.g., *Mizrahi v. Gonzales*, 492 F.3d 156, 173 n.21 (2d Cir. 2007) (concluding, after conducting the *Chevron* Two-Step, that “*State Farm* is not applicable because the BIA decision in *Mizrahi*’s case does not represent a change in agency course”).

285. 545 U.S. 967 (2005).

upheld *Chevron* deference to an agency's change in interpretation and suggested, in dicta, that:

Unexplained inconsistency is, at most, a reason for holding an interpretation to be an arbitrary and capricious change from agency practice under the Administrative Procedure Act. For if the agency adequately explains the reasons for a reversal of policy, 'change is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency.' 'An initial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis' . . . or a change in administrations. That is no doubt why in *Chevron* itself, [the] Court deferred to an agency interpretation that was a recent reversal of agency policy.²⁸⁶

In an earlier case, *Rust v. Sullivan*,²⁸⁷ the Court likewise held that regulations were entitled to *Chevron* deference notwithstanding their "sharp break from the Secretary's prior construction of the statute."²⁸⁸ The case involved the Court's review of regulations promulgated by the Department of Health and Human Services, which had revised its position on the interpretation of Title X governing funds earmarked for family planning services. In that context, the Court, citing *State Farm*, held that "the Secretary amply justified his change of interpretation with a 'reasoned analysis.'"²⁸⁹

In the face of these decisions, several lower courts have conceded that *State Farm* review may be incorporated as part of *Chevron* Step Two, but only in the limited circumstance where the agency has changed its interpretive position.²⁹⁰

Other courts limit the incorporation of *State Farm* into the *Chevron* analysis to rules with "procedural defects."²⁹¹ Recall that the Second Circuit

286. *Id.* at 981–82 (first alteration in original) (first quoting *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 742 (1996); then quoting *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 863–64 (1984)).

287. 500 U.S. 174 (1991).

288. *Id.* at 186.

289. *Id.* at 187 (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983)). The Court elaborated:

The Secretary explained that the regulations are a result of his determination, in the wake of the critical reports of the General Accounting Office (GAO) and the Office of the Inspector General (OIG), that prior policy failed to implement properly the statute and that it was necessary to provide "clear and operational guidance" to grantees about how to preserve the distinction between Title X programs and abortion as a method of family planning." He also determined that the new regulations are more in keeping with the original intent of the statute, are justified by client experience under the prior policy, and are supported by a shift in attitude against the "elimination of unborn children by abortion."

Id. (quoting 53 Fed. Reg. 2923–24 (Feb. 2, 1988) (codified at 42 C.F.R. pt. 59)).

290. *See, e.g., Ala. Educ. Ass'n v. Chao*, 455 F.3d 386, 397 (D.C. Cir. 2006) (reversing an agency statutory interpretation under *Chevron* Step Two because the agency "failed to supply a reasoned analysis supporting its change of position"); *AFL-CIO v. Brock*, 835 F.2d 912, 917 (D.C. Cir. 1987).

291. In prior work, I have argued that procedural irregularities in agency rulemaking might defeat *Chevron* deference and warrant, at most, *Skidmore* deference. *See* Catherine M.

in *Catskill Mountains* embraced such a limited view of *State Farm*'s applicability.²⁹² This view of *State Farm* arbitrary and capricious review in the statutory interpretation context as relegated exclusively to the "procedural" realm, unconcerned with substantive aspects of the agency decision, is erroneous. It gives short shrift to the part of the *State Farm* test that looks to whether "the agency has relied on factors which Congress has not intended it to consider."²⁹³

Moreover, even after putting forward this narrow "procedural defect" domain for *State Farm* review, the Second Circuit acknowledged that one of the plaintiffs had indeed argued that the EPA's rule was procedurally defective but "only in the context of a *Chevron* Step Two argument."²⁹⁴ The court thus concluded that "the interpretive Rule here is properly reviewed only under the *Chevron* standard, which does not incorporate the *State Farm* standard."²⁹⁵ It is not clear why the court did not feel compelled nonetheless to consider this a stand-alone *State Farm* challenge, which the court could decide before or after the *Chevron* Two-Step.²⁹⁶

Sharkey, *Federalism Accountability: "Agency-Forcing" Measures*, 58 DUKE L.J. 2125, 2180 (2009) [hereinafter Sharkey, *Federalism Accountability*] ("My own view has been that the agency's views should be accorded *Skidmore* 'power to persuade' (not *Chevron* mandatory) deference—a position apparently endorsed by the Court in *Wyeth*."); see also Catherine M. Sharkey, *Preemption by Preamble: Federal Agencies and the Federalization of Tort Law*, 56 DEPAUL L. REV. 227, 256–57 (2007) (advocating that courts condition any deference to an agency's preemption position on that agency's compliance with the strictures of the Federalism executive order). I have also noted previously the link between *Skidmore* deference and the importation of "hard look" review. See Catherine M. Sharkey, *Products Liability Preemption: An Institutional Approach*, 76 GEO. WASH. L. REV. 449, 498 (2008) (urging *Skidmore* "power to persuade" deference as a means to "encourag[e] agencies to engage in formal notice-and-comment rulemaking processes that, arguably, vet the agency decisionmaking process and make the agency respond to substantive concerns raised by all affected parties"); see also Sharkey, *Federalism Accountability*, *supra*, at 2191 ("Skidmore deference provides courts with an appropriate tool to scrutinize the 'reasoned explanations' provided by agencies."). *Wyeth v. Levine*, 555 U.S. 555 (2009), featured prominently in this account because the Court highlighted that the FDA's failure to "offer[] States or other interested parties notice or opportunity for comment" rendered its views on state law "inherently suspect," *id.* at 577.

292. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 521 (2d Cir. 2017) ("State Farm is used to evaluate whether a rule is procedurally defective as a result of flaws in the agency's decisionmaking process."), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018).

293. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

294. *Catskill IV*, 846 F.3d at 524 n.31.

295. *Id.*

296. In this case, moreover, plaintiffs clearly raised *State Farm* challenges in their complaint. See Complaint, *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill III)*, 8 F. Supp. 3d 500 (S.D.N.Y. 2014) (No. 08 Civ. 8430). This leads to the next reason the incorporation model will widen the domain for *State Farm* review—namely, some litigants who raise claims of error in statutory interpretation (clearly subject to the *Chevron* framework) do not raise independent *State Farm* challenges. And several courts—the D.C. Circuit among them—are sticklers for considering only the precise claims raised by the litigants. Of course, one could readily object to the need for doctrinal changes on account of litigant error (or misjudgment), whether based on lack of sophistication or neglect. But this does not consider the much less appreciated category of private litigants who stand to lose, which is addressed next in Part II.C.2.b.

b. Indirect Agency Challenges in Private Party Disputes

When statutory interpretation challenges arise between private parties where the agency is not a party, a direct *State Farm* challenge is not an option.²⁹⁷ The incorporation framework thus enables a form of indirect challenge to agency decision-making in this context.²⁹⁸

In prior work, I pioneered this concept in the context of federal preemption decisions—where a preemption defense was raised by a defendant manufacturer against state products liability claims—which I argued could provide “an apt avenue for a new form of indirect challenge to agency rulemaking and regulatory actions with wider applicability.”²⁹⁹ As I explained: “What I have in mind is an extension of [the *State Farm*] framework of hard look review in the context of court preemption decisions. Courts are well poised to police agencies’ flouting of their responsibilities in the domains of regulatory review and interpretation.”³⁰⁰ In the preemption context, the indirect challenge would work as follows:

[C]ourts should import a “*State Farm* with teeth” standard from APA rulemaking challenges . . . [C]ourts should insist on substantial evidence in the rulemaking record to support an agency’s conclusion that state law conflicts with, or frustrates the purposes of, a federal regulatory scheme. And courts should accord *Skidmore* “power to persuade” deference (rather than mandatory *Chevron* deference) to an agency’s interpretive views on preemption based upon the consistency, care, formality, and relative expertise of the agency.³⁰¹

297. For representative cases between private parties in which an agency regulation is at issue, see generally *Glob. Crossing Telecomms., Inc. v. Metrophones Telecomms., Inc.*, 550 U.S. 45, 58 (2007); *Bible v. United Student Aid Funds, Inc.*, 799 F.3d 633, 650–51 (7th Cir. 2015); *Leyse v. Clear Channel Broad., Inc.*, 697 F.3d 360, 372 (6th Cir. 2012); *Schafer v. Astrue*, 641 F.3d 49, 61 (4th Cir. 2011); *Cordiano v. Metacon Gun Club, Inc.*, 575 F.3d 199, 221 (2d Cir. 2009); *Satterfield v. Simon & Schuster, Inc.*, 569 F.3d 946, 949 (9th Cir. 2009); *Core Commc’ns, Inc. v. Verizon Pa., Inc.*, 493 F.3d 333, 335 (3d Cir. 2007); *Cohen v. JP Morgan Chase & Co.*, 498 F.3d 111, 124–25 (2d Cir. 2007); *Pension Benefit Guar. Corp. v. Asahi Tec Corp.*, 979 F. Supp. 2d 46, 70–72 (D.D.C. 2013); *Newsome v. Young Supply Co.*, 835 F. Supp. 2d 406, 415 (E.D. Mich. 2011).

298. This second rationale for the expansion of the domain of *State Farm* gains even more significance in light of the Supreme Court’s *Encino Motorcars* decision, *see infra* Part III.B.1.b, which is a statutory interpretation case between two private parties wherein the Court nonetheless incorporated *State Farm* into its *Chevron* analysis (or so I argue).

299. Sharkey, *Federalism Accountability*, *supra* note 291, at 2185; *id.* at 2184 (“It remains to be seen the extent to which courts will reinvigorate and expand ‘hard look’ review of agency action. *Wyeth v. Levine* could expand the domain of direct challenges to preemption provisions in notice-and-comment rulemakings should agencies be spurred in that direction. It also stands as a progenitor of a new form of indirect challenge, arising when the preemption defense is raised against state tort causes of action.”); *see also* Catherine M. Sharkey, *State Farm “With Teeth”: Heightened Judicial Review in the Absence of Executive Oversight*, 89 N.Y.U. L. REV. 1589, 1639–40 (2014) (“The agency reference theory of preemption thus harnesses the federal administrative process—including *State Farm*’s hard-look review of an agency’s factual determinations and *Skidmore*’s ‘power to persuade’ deference—for purposes of judicial resolution of preemption challenges in civil litigation (where the agency is not a party).” (footnote omitted)).

300. Sharkey, *Federalism Accountability*, *supra* note 291, at 2185–86.

301. Sharkey, *supra* note 299, at 1640.

The Eleventh Circuit's analysis in *Friends of the Everglades v. South Florida Water Management District*³⁰² is one example in which the court applied *Chevron* deference to the EPA's rule in the context of a statutory interpretation argument. Significantly, the court did not consider whether the EPA provided a reasoned explanation for its interpretation—nor, in that case, could the private parties to the litigation have raised an independent *State Farm* challenge.

Contrast this with the Sixth Circuit's approach in *Leyse v. Clear Channel Broadcasting, Inc.*³⁰³ A consumer brought an action against a radio station operator and alleged that the consumer received automated telephone calls from the operator in violation of the Telephone Consumer Protection Act.³⁰⁴ An FCC rule exempted specific prerecorded telephone calls from the ambit of the Act.³⁰⁵ Faced with interpreting an ambiguous provision of the Act, the court reached Step Two of the *Chevron* inquiry. At that juncture, the court specifically invoked the *State Farm* factors.³⁰⁶ Before according *Chevron* deference to the FCC at Step Two, the court, invoking the *State Farm* factors, probed the agency's policy reasoning—specifically the rule's effect on privacy.³⁰⁷

One objection to this form of indirect agency challenge is that it could upend private parties' settled expectations or reliance on prior (unchallenged) agency decisions. But recall that the agency was not a party in the seminal *Skidmore* case either.³⁰⁸ Michael Herz aptly noted that *Skidmore* was private litigation, and, as such, “[t]his setting requires independent judicial judgment in a way that direct review of the agency's exercise of delegated authority might not.”³⁰⁹ But, whereas the origins of *Skidmore* deference may be linked to the private party setting, following *Mead*, “the federal courts have invoked *Skidmore* and stated that agency interpretations to which *Chevron* does not

302. 570 F.3d 1210 (11th Cir. 2009).

303. 697 F.3d 360 (6th Cir. 2012), *amended and superseded on jurisdictional grounds*, 545 F. App'x 444 (6th Cir. 2013). It is perhaps significant that the private parties themselves embraced the *Chevron-State Farm* model. Compare Brief for Appellant at 40–41, *Leyse*, 697 F.3d 360 (No. 10-3739) (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)), with Brief for Appellee at 35, *Leyse*, 697 F.3d 360 (No. 10-3739) (citing *State Farm*, 463 U.S. at 43).

304. *Leyse*, 697 F.3d at 362–63 (citing 28 U.S.C. § 2342(1) (2012)).

305. *Id.* at 366 (citing Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, 70 Fed. Reg. 19,330–31, 19,335 (Apr. 13, 2005)).

306. *Id.* at 372.

307. *Id.* at 365 (citing *In re Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991*, 18 FCC Rcd. 14014, ¶ 136 (July 3, 2003); *Notice of Proposed Rulemaking*, 17 FCC Rcd. 17459, ¶ 30 (Sept. 18, 2002)). In its rulemaking, the FCC noted that very few individuals indicated that they had been affected by prerecorded messages akin to those at issue and, accordingly, found that they did not fall within the statutory term at issue. *In re Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991*, 18 FCC Rcd. 14014, ¶ 145, (July 3, 2003).

308. See Herz, *supra* note 25, at 129, 131 (noting that *Skidmore*'s approach to judicial review “seemed . . . linked to the nature of the lawsuit—in particular, to the fact that the agency was not a party”).

309. *Id.* (citing Ronald M. Levin, *Identifying Questions of Law in Administrative Law*, 74 GEO. L.J. 1, 56–58 (1985)).

apply still merit respect under *Skidmore*.³¹⁰ And, as Herz pointed out, “[i]n doing so, they have made no distinction whatever between private litigation and suits to which the agency is a party.”³¹¹

A second objection in the collateral-challenge context is the absence of a government lawyer to explain the policy bases for the agency’s action. Of course, at least one of the private party’s lawyers would have an incentive to take on that role. Moreover, a court could and should invite the agency to file an amicus brief in which it defends and explains its rule.³¹²

Third, the remedy in this type of “indirect” challenge is incomplete. Given that the agency is not a party to the lawsuit, the court cannot remand back to the agency for further elaboration. In this way, it resembles how preemption challenges serve as an indirect challenge to FDA regulations. Moreover, just as with the FDA in that example, an agency will be on notice that courts will not defer to its regulation in litigation, which may induce a behavioral response on the part of the agency. Specifically, the agency will be induced to demonstrate its expertise by providing policy-based justifications based upon facts and evidence vetted during the notice-and-comment rulemaking process.

Courts might also consider wielding the doctrine of primary jurisdiction to withhold adjudication until the agency acts and could enter an injunction in the interim.³¹³ The doctrine of primary jurisdiction “permits a court itself to ‘refer’ a question to the Secretary. . . . A court may then stay its proceedings—for a limited time, if appropriate—to allow a party to initiate agency review. Lower courts have sometimes accompanied a stay with an injunction designed to preserve the status quo.”³¹⁴ Whereas typically primary jurisdiction is invoked in situations where the agency has not yet engaged in rulemaking, in this context, courts might invoke primary jurisdiction in order to send the issue back to the agency so that it can develop fact-based policy evidence. In other words, primary jurisdiction could

310. *Id.* at 133.

311. *Id.*

312. See *Bible v. United Students Aid Funds, Inc.*, 799 F.3d 633, 639 (7th Cir. 2015) (discussing how the Secretary of Education was invited by the court to file an amicus brief explaining the agency’s position). I have investigated this issue in the realm of FDA prescription drug preemption cases, where I found that

not only are federal courts more likely to defer to federal agencies, but—equally important in terms of explaining the decision-making process of courts—federal courts are more likely than state courts to solicit the views of the FDA and the FDA is more apt to intervene on its own in federal court cases.

Catherine M. Sharkey, *Federalism in Action: FDA Regulatory Preemption in Pharmaceutical Cases in State Versus Federal Courts*, 15 J.L. & POL’Y 1013, 1020 (2007).

313. For a discussion of primary jurisdiction in the area of tort preemption, see Catherine M. Sharkey, *Tort-Agency Partnerships in an Age of Preemption*, 15 THEORETICAL INQUIRIES L. 359, 383–85 (2014); see also *id.* at 385 (“Direct input from federal agencies and primary jurisdiction . . . offer two alternative avenues for pursuing new forms of tort-agency partnerships in the health and safety realm.”).

314. *Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644, 673–74 (2003) (Breyer, J., concurring) (citations omitted); see also *Cox v. Gruma Corp.*, No. CV 12-6502-YGR, 2013 WL 3828800, at *1 (N.D. Cal. July 11, 2013).

function as a means in essence to remand the rulemaking back to the agency in situations where the agency is not a party.

As a final note, private litigation may turn out to be the elusive context in which the deference standard really matters. Thus, Michael Herz reported (based on a study conducted by Bill Funk) that the court's choice of *Chevron* or *Skidmore* deference made a difference in only a single case of the first twenty-five cases decided after *Mead*.³¹⁵ Moreover (as noted in a footnote), that one case was a private lawsuit.³¹⁶

3. Against Minimum Rationality

A more subtle effect than expanding the domain of *State Farm* review is the extent to which the incorporation model would heighten the stringency of judicial review. This view is underpinned by my intuition that the “redundancy” or overlap conception of *Chevron* Step Two and *State Farm* has had the unfortunate consequence of allowing the “reasoned decisionmaking” element to drop out of the equation.

The *Chevron-State Farm* conceptual framework provides an opportunity to revisit the normative debate surrounding hard look review. There is an ongoing debate whether *State Farm* review is akin to “hard look” review or “minimum rationality” review.³¹⁷ A long-standing argument in favor of hard look review is its salient effect on the quality of enacted regulations.³¹⁸ The

315. See Herz, *supra* note 25, at 153 n.99.

316. *Id.* (citing *Matz v. Household Int'l Tax Reduction Inv. Plan*, 265 F.3d 572 (7th Cir. 2001) (en banc)). In *Matz*, the court initially accorded *Chevron* deference to the IRS's interpretation (articulated in an amicus brief) of “partial termination.” *Matz v. Household Int'l Tax Reduction Inv. Plan*, 227 F.3d 976 (7th Cir. 2000). On remand, after the Court decided *Mead*, the court revoked its prior *Chevron* deference given the informality of the IRS amicus brief. *Matz*, 265 F.3d at 574. Any private party distinction calls out for further empirical testing. My nonsystematic review of private party cases yielded agency positions upheld and overturned under *Skidmore*, with no discernible pattern. Compare *Freeman v. Quicken Loans, Inc.*, 626 F.3d 799, 805 (5th Cir. 2010) (rejecting HUD's policy statement under *Skidmore* deference), with *Lozano v. Twentieth Century Fox Film Corp.*, 702 F. Supp. 2d 999, 1004 (N.D. Ill. 2010) (applying *Skidmore* deference to uphold the FCC's interpretation).

317. Compare Sharkey, *supra* note 299, with Jacob Gersen & Adrian Vermeule, *Thin Rationality Review*, 114 MICH. L. REV. 1355, 1356 (2016), and Scott A. Keller, *Depoliticizing Judicial Review of Agency Rulemaking*, 84 WASH. L. REV. 419, 456 (2009) (“APA arbitrary and capricious review after *Fox Television* simply asks whether the agency's reasons were ‘rational’—it does not require courts to take a hard look at agency action or go through the *State Farm* dicta criteria for invalidating agency action.”).

318. I have argued previously that *State Farm* is information-forcing; its advance into the *Chevron* Two-Step will enhance this effect. *Michigan v. EPA* continues the path of heightened judicial review of agency rulemaking and, in particular, agency consideration of costs and benefits that was first forged by *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). If *Business Roundtable* was a wake-up call to the SEC and other financial service regulators, then *Michigan v. EPA*, notwithstanding the environmental context in which it was decided, sounded a second alarm. Internal changes that have been wrought within the EPA and SEC provide vivid illustrations of this quality-forcing change on regulations that are promulgated in the shadow of this heightened form of judicial scrutiny. See Sharkey, *supra* note 299, at 1632–34. Nonetheless, there is a paucity of empirical evidence (qualitative or quantitative) of agencies' behavioral response in the shadow of more aggressive judicial review. This is a call for an empirical turn in future scholarship with a focus on ways the doctrine shapes agencies' behavior.

core of the argument is that agencies are incentivized to collect and analyze sufficient data, which the court can consult when reviewing the agency's actions.³¹⁹ Agencies are thereby forced to engage in more reasoned decision-making so that they are equipped to show courts that they considered all relevant policy variables rather than simply setting forth conclusory statements of their legal authority to act.

But, as this Article argues, if the starting point for courts is that *Chevron* Step Two is a “highly deferential” standard, then any redundancy or overlap view puts downward pressure on the *State Farm* level of stringency. Thus, in *Village of Barrington v. Surface Transportation Board*,³²⁰ the D.C. Circuit characterized its *Chevron* Step Two review as “highly deferential.”³²¹ The court seemed primed, after this, to engage in highly deferential arbitrary and capricious *State Farm* review—especially given the way it melded the two analyses.

The incorporation model, by contrast, draws attention to the need to buttress the overall level of judicial scrutiny above and beyond the “anemic” *Chevron* Step Two. This is consistent, for example, with Judge Wald's position in *Arent*, where she argued that *State Farm* adds stringency above and beyond *Chevron* Step Two.³²²

Once again, the Second Circuit's *Catskill Mountains* decision illustrates how the incorporation model would augment the level of overall judicial scrutiny of agency statutory interpretation. Recall that the court characterized *State Farm* as “a much stricter and more exacting review of the agency's rationale and decisionmaking process than the *Chevron* Step Two standard.”³²³ And indeed, its rejection of an approach akin to the incorporation model was outcome determinative.

III. TWO FORMS OF *CHEVRON* RETREAT

We stand at an important *Chevron* crossroads.³²⁴ Scholars and courts embrace sharply conflicting views of the Supreme Court's stance on *Chevron* generally and, more particularly, the extent to which an agency must support its statutory interpretation with factual materials or cost-benefit analyses to be considered reasonable.

319. Matthew C. Stephenson, *A Costly Signaling Theory of “Hard Look” Judicial Review*, 58 ADMIN. L. REV. 753, 777 (2006) (providing a sophisticated theoretical account whereby more stringent judicial review leads to better regulatory records, less action by agencies overall, and increased average expected value associated with those actions that agencies do undertake). For further discussion, see generally James R. Rogers & Georg Vanberg, *Resurrecting Lochner: A Defense of Unprincipled Judicial Activism*, 23 J.L. ECON. & ORG. 442 (2007); Mark Seidenfeld, *Hard Look Review in a World of Techno-Bureaucratic Decisionmaking: A Reply to Professor McGarity*, 75 TEX. L. REV. 559 (1997).

320. 636 F.3d 650 (D.C. Cir. 2011).

321. *Id.* at 667.

322. *Arent v. Shalala*, 70 F.3d 610, 620 (D.C. Cir. 1995).

323. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 521 (2d Cir. 2017), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018).

324. *See, e.g.*, Coglianese, *supra* note 2, at 1340 (“Having inspired a vast number of judicial opinions and scholarly writings, today the decision finds itself at the center of an intensive debate over its legitimacy and even its continued existence.”).

At this critical juncture, when some academics and courts are signaling a retreat from *Chevron*, it is important to disaggregate and sharply distinguish two very different approaches. Scholars have typically grouped together the Court's separate lines of *Chevron* retreat. For example, Lisa Heinzerling has put forth a provocative thesis—that the Court's decisions (notably including *King v. Burwell*³²⁵ and *Michigan v. EPA*) constitute the emergence of new “power canons” of statutory interpretation whereby “the Court took interpretive power from an administrative agency, power that would normally have been the agency's due under the *Chevron* framework, and kept it for itself.”³²⁶

The more radical retreat—illustrated aptly by the Court's decision in *King*—entails setting the *Chevron* framework aside, in that case under the so-called “major questions” exception. This augments the authority of the court to decide whether regulation comports with congressional statutes, thus bypassing any need to engage with input from the underlying regulator. *Chevron*'s death by a thousand cuts³²⁷—placing more questions outside of *Chevron*'s domain at what has been termed the “*Chevron* Step Zero” inquiry—is consistent with one view that links the Court's hostility toward the administrative state to a longer-term deregulatory project. *Chevron* Step Zero is thus the battleground for making distinctions between issues of “law” reserved to courts and issues of “policy” delegated to agencies.

But there is a second form of retreat that, this Article contends, as a conceptual matter, is fundamentally distinct. This seeming rollback of *Chevron* deference makes room for judicial scrutiny of agency policymaking discretion under *State Farm* “hard look” review. Such a *Chevron* retreat thus entails not judicial usurpation of the agency's role in statutory interpretation but instead judicial oversight of the reasoned decision-making of the underlying regulator.

Against this backdrop, *Michigan* and *Encino Motorcars* signal a shift in the direction of the new *Chevron-State Farm* conceptual framework, which directs courts to scrutinize the factual premises and underlying policy reasons supporting an agency's interpretive position. The present moment of *Chevron* retreat may thus be ushering in meaningful arbitrary and capricious review at Step Two.

325. 135 S. Ct. 2480 (2015).

326. Heinzerling, *supra* note 6, at 1933; *see also* Seth P. Waxman, *The State of Chevron: 15 Years After Mead*, 68 ADMIN. L. REV. ACCORD 1, 3 (2016) (“[W]hat is new [in decisions, including *King v. Burwell* and *Michigan v. EPA*] is that the Justices are more willing to be explicit in their skepticism [of *Chevron*].”). *But see* Ronald A. Cass, *Is Chevron's Game Worth the Candle?—Burning Interpretation at Both Ends*, in LIBERTY'S NEMESIS: THE UNCHECKED EXPANSION OF THE STATE 57, 57–69 (Dean Reuter & John Yoo eds., 2016) (depicting the fragmentation of *Chevron* into different tests for different judges and positing that parts of the *Chevron* formula are in the process of being weakened, amended, or abandoned).

327. *See* Asher Steinberg, *Another Addition to the Chevron Anticanon: Judge Kavanaugh on the “Major Rules” Doctrine*, NARROWEST GROUNDS (May 7, 2017), <http://narrowestgrounds.blogspot.com/2017/05/another-addition-to-chevron-anticanon.html> [https://perma.cc/ZSS6-7U8H].

A. *Setting Chevron Aside*

King fits the paradigm of a *Chevron* Step Zero determination that, given the enormous political and economic significance of the issue at stake, the court should resist implied delegation to the agency. Moreover, *King* expands this Step Zero “major questions” inquiry by suggesting that the agency before the court is not the right agency and thus the court should proceed on its own to interpret the statute.³²⁸ It thus represents a distinct form of a retreat from *Chevron*, one that could readily be deployed in service of a broader project to tighten the bounds on the ever-inflating administrative state. By aggressively applying *Chevron* Step Zero and setting *Chevron* aside in areas wherein regulatory agencies operate, the court removes those agencies from the realm of statutory interpretation, even where those questions are highly policy dependent. The court thereby substitutes its interpretation for the agency’s and, by default, becomes the relevant policymaker. Seen in this light, *Chevron* Step Zero totally undermines the allocation of issues of “law” to courts and issues of “policy” to agencies. And, at a broader level, the *Chevron* Step Zero debate implicates the legitimacy and appropriate scale of the administrative state.

King is the Court’s latest “*Chevron* Step Zero” decision involving the so-called “major questions” exception to *Chevron* deference. In these “major questions” cases, the Court has set aside the *Chevron* framework on the ground that the statutory interpretation issue was an “extraordinary” question that carried too much economic and political significance for an agency to decide.³²⁹

King implicated an enormously high-stakes question of statutory interpretation involving several key provisions of the Patient Protection and Affordable Care Act. Section 1311 of the Act authorized all states to create health insurance exchanges, which are government-run entities that facilitate the buying and selling of health insurance.³³⁰ Section 1321 of the Act authorized the Secretary of the U.S. Department of Health and Human Services (HHS) to establish exchanges in states that declined to create an exchange.³³¹ Section 1401 of the Act added § 36B to the Internal Revenue

328. *King*, 135 S. Ct. at 2488–89; see also Christine Kexel Chabot, *Selling Chevron*, 67 ADMIN. L. REV. 481, 497–506 (2015) (discussing *King* and its implications for *Chevron* Step Zero); Adam J. White, *Defining Deference Down*, YALE J. ON REG.: NOTICE & COMMENT (June 26, 2015), <http://www.yalejreg.com/blog/defining-deference-down-by-adam-j-white> [<https://perma.cc/8LKN-N8M8>] (observing that “[a]fter *King v. Burwell*, the ‘major questions’ doctrine is emphatically a *Chevron* Step Zero question”).

329. See Abigail R. Moncrieff, *Reincarnating the “Major Questions” Exception to Chevron Deference as a Doctrine of Noninterference (Or Why Massachusetts v. EPA Got It Wrong)*, 60 ADMIN. L. REV. 593, 603 (2008). Cass Sunstein has argued that *King* “entrenched” the exception to *Chevron* for questions with great “economic and political significance.” Cass R. Sunstein, *The Catch in the Obamacare Opinion*, BLOOMBERG (June 25, 2015, 2:22 PM), <http://www.bloombergtv.com/articles/2015-06-25/the-catch-in-the-obamacare-opinion> [<https://perma.cc/TS5S-S6HV>]. According to Sunstein, *King* represents an assertion of judicial power that could significantly impact the Court’s future application of *Chevron* and “establishes a principle that’s likely to haunt future presidents.” *Id.*

330. 42 U.S.C. § 18031 (2012).

331. *Id.* § 18041.

Code, which authorized health insurance subsidies—in the form of new refundable tax credits—for individuals enrolled in coverage through “an Exchange established by the State under Section 1311.”³³² The interpretive question was whether such tax credits were thereby limited to state exchanges created under section 1311 or should also be made available to individuals covered by the federal exchanges established under section 1321.³³³ The Internal Revenue Service (IRS), within the Department of Treasury, said the latter.

More specifically, the IRS and Treasury Department issued a rule, following the notice-and-comment process, that authorized premium subsidies in both the state exchanges established in sixteen states and the District of Columbia (established pursuant to section 1311), and in the federal exchanges created by HHS in the states that did not create their own exchanges (pursuant to section 1321).³³⁴ Plaintiffs challenged the IRS-Treasury interpretation on the ground that it exceeded the agency’s authority and was contrary to the plain text of the Act and, thus, that it failed at *Chevron* Step One.³³⁵

The Fourth Circuit applied the conventional *Chevron* Two-Step framework to this statutory interpretation issue. At Step One, the court held that the statutory language was ambiguous.³³⁶ At Step Two, the court deferred to the IRS’s interpretation, taking into account the agency’s reliance on the policy objectives behind the law and the role of tax credits in effectuating those goals.³³⁷

The Supreme Court affirmed the Fourth Circuit but on an alternative ground. In a six-to-three decision, the majority, per Chief Justice Roberts, set aside the *Chevron* framework in light of the “deep ‘economic and political significance’” of the interpretive question at hand.³³⁸ According to Chief

332. I.R.C. § 36B(b)(2)(A) (2012).

333. *King*, 135 S. Ct. at 2488.

334. Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,377, 30,377 (May 23, 2012) (to be codified at 26 C.F.R. pts. 1, 602).

335. See Brief for Appellants at 48, *King v. Burwell*, 759 F.3d 358 (4th Cir. 2014) (No. 14-1158).

336. *King*, 759 F.3d at 367–72. In reaching its conclusion that the definition of “established by the State” was ambiguous, the court looked to other aspects of the statute taken as a whole—including the facts that the Act allowed, but apparently did not require, that states create their own exchanges, and that federal and state insurance exchanges are subject to the same disclosure requirements. See *id.* In rather sharp contrast, in *Halbig v. Burwell*, 758 F.3d 390 (D.C. Cir. 2014), the D.C. Circuit panel majority held that the statutory language was clear (in the opposite direction, namely limiting tax subsidies to state-created exchanges), and thus resolved the case at *Chevron* Step One, *id.* at 412. Judge Edwards, in dissent, found the language ambiguous. *Id.* at 414–15 (Edwards, J., dissenting). The D.C. Circuit granted a petition for rehearing en banc and vacated the panel’s decision. *Halbig v. Burwell*, No. 14-5018, 2014 WL 4627181, at *1 (D.C. Cir. Sept. 4, 2014) (per curiam). The proceedings were stayed, however, pending the Supreme Court’s decision in *King*. *Halbig v. Burwell*, No. 14-5018, 2014 U.S. App. LEXIS 23434, at *11 (D.C. Cir. Nov. 12, 2014) (per curiam).

337. *King*, 759 F.3d at 373 (“In answering this question in the affirmative we are primarily persuaded by the IRS Rule’s advancement of the broad policy goals of the Act.”).

338. *King*, 135 S. Ct. at 2489 (“Whether those credits are available on Federal Exchanges is thus a question of deep ‘economic and political significance’ that is central to this statutory

Justice Roberts, the case was one of the “extraordinary case[s]” in which there is reason to doubt that statutory ambiguity represented an implicit delegation of interpretive authority to the agency.³³⁹ Moreover, the *Chevron* framework was especially inappropriate here, Chief Justice Roberts remarked, given that it would have empowered an agency—the IRS—that had “no expertise in crafting health insurance policy” to decide questions that would have enormous policy implications.³⁴⁰ While the Court ultimately concluded that the IRS’s reading underlying the regulation was the correct interpretation of the statute, the majority was emphatic: “This is not a case for the IRS.”³⁴¹

Reading the Supreme Court decision in *King*, one is left with the impression that the only relevant agency is the IRS. But, as Judge Edwards recognized in his dissent in *Halbig v. Burwell*³⁴²—the D.C. Circuit opinion addressing the same issues as *King*—HHS and its actions are relevant here, too.³⁴³ In *Halbig*, the panel majority held that the statutory language was clear and thus resolved the case at *Chevron* Step One.³⁴⁴ Judge Edwards, in dissent, however, found the language ambiguous and proceeded to *Chevron* Step Two.³⁴⁵ At that juncture, he would have given deference to the IRS for its determination, in coordination with HHS, to provide tax premium subsidies for those enrolled in state or federal exchanges.³⁴⁶ According to Judge Edwards, the Act delegated authority to HHS and IRS, which acted jointly in administering certain tax provisions of the Act.³⁴⁷

There are thus *two* relevant agencies to consider and two respective rulemaking records to probe at Step Two. The IRS apparently recognized that HHS had relevant agency expertise on the matter. During the course of its rulemaking, the IRS reached out to HHS so that HHS, in its exchange regulation, could clarify the statutory ambiguity by “deeming HHS

scheme; had Congress wished to assign that question to an agency, it surely would have done so expressly.” (quoting *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2444 (2014))).

339. *Id.* at 2488–89 (“In extraordinary cases, . . . there may be reason to hesitate before concluding that Congress has intended . . . an implicit delegation [to the agency].” This is one of those cases.” (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159 (2000))). According to the Chief Justice, this case fit the “extraordinary case” paradigm given the high political and economic stakes. *Id.* at 2489 (“The tax credits are among the Act’s key reforms, involving billions of dollars in spending each year and affecting the price of health insurance for millions of people.”).

340. *Id.* at 2489.

341. *Id.*

342. 758 F.3d 390 (D.C. Cir. 2014).

343. *Id.* at 415–17 (Edwards, J., dissenting).

344. *Id.* at 412 (majority opinion).

345. *Id.* at 414–15 (Edwards, J., dissenting).

346. *See id.* at 425.

347. *Id.* at 413 (“Because IRS and HHS have been delegated authority to jointly administer the ACA, this case is governed by the familiar framework of [*Chevron*].”); *id.* at 415 (“*Chevron* applies because IRS and HHS are tasked with administering the provisions of the ACA in coordination. . . . The IRS’s rule defines ‘Exchange’ by reference to the HHS’s definition, which provides that subsidies are available to low-income taxpayers purchasing insurance on an Exchange ‘regardless of whether the Exchange is established and operated by a State . . . or by HHS.’”).

exchanges to be exchanges established by States.”³⁴⁸ HHS issued a notice of proposed rulemaking to include in the definition of “Exchange,” “an Exchange established or operated by the Federal government if a State does not establish an Exchange.”³⁴⁹ IRS and Treasury then incorporated the HHS definition of exchange into their proposed and final premium tax credit rules.³⁵⁰

In inquiring whether it had the correct agency before it, the Court should have considered the relevance of HHS (and its rulemaking record) in addition to the IRS.³⁵¹ Chief Justice Roberts might still have been able to set aside *Chevron* for such an “extraordinary” case, but he certainly could not have

348. JOINT STAFF OF THE H. COMM. ON OVERSIGHT & GOV'T REFORM, H. COMM. ON WAYS & MEANS, 113TH CONG., ADMINISTRATION CONDUCTED INADEQUATE REVIEW OF KEY ISSUES PRIOR TO EXPANDING HEALTH LAW'S TAXES AND SUBSIDIES 18 (2014). The House Committees, in an in camera review of deliberative materials relevant to the IRS rule, uncovered evidence of IRS officials reaching out to HHS officials on this issue. *Id.* at 17–18. As the report details:

IRS employees . . . sent an email to several HHS officials [including the Deputy Administrator at the Centers for Medicare and Medicaid Services, Deputy Director of the Center for Medicaid and CHIP Services, and Deputy Director for Policy and Regulations at the Center for Consumer Information & Insurance Oversight] asking that HHS remedy the problem by deeming HHS exchanges to be exchanges established by states in HHS's exchange regulation.

Id. at 18.

349. Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans, 76 Fed. Reg. 41,866, 41,868 (July 15, 2011) (to be codified at 45 C.F.R. pts. 155–56); *see also* Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans; Exchange Standards for Employees, 77 Fed. Reg. 18,310, 18,310 (Mar. 27, 2012) (to be codified at 45 C.F.R. pts. 155–57). HHS offered its view as a regulatory interpretation of section 1321 of the Act, which gave HHS authority to set up exchanges in states that did not create an exchange. 42 U.S.C. § 18041 (2012).

350. Health Insurance Premium Tax Credit, 76 Fed. Reg. 50,931, 50,940 (Aug. 17, 2011) (to be codified at 26 C.F.R. pt. 1) (“Exchange has the same meaning as in 45 CFR 155.20.”); *see also* Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,377, 30,378 (May 23, 2012) (to be codified at 26 C.F.R. pts. 1, 206) (“[T]he term Exchange has the same meaning as in 45 CFR 155.20, which provides that the term Exchange refers to a State Exchange, regional Exchange, subsidiary Exchange, and Federally-facilitated Exchange.”).

351. Lisa Heinzerling makes a related point:

Consider the Court's insistence in *King* that Congress choose the right agency for the interpretive job. Although the Court does not acknowledge it, in fact, the Court needed to do important interpretive work even in deciding that the IRS was not the right agency for this job. In choosing to focus on agency expertise, the Court needed to choose a substantive frame for the Affordable Care Act: was it a health-care statute, ill-suited to the IRS's skill set, or was it a tax revenue statute, well within the IRS's wheelhouse? The best answer was probably that it was both—an exceedingly complex regulatory regime that contained many different elements, calling on a variety of forms of agency expertise. But the Court's search for *the* correct interpretive agent pressed it to identify just one characterization of the Affordable Care Act. This was not a neutral—or even sensible—antecedent interpretive decision.

Heinzerling, *supra* note 6, at 1989. The question whether the Act in fact delegated joint authority to HHS and IRS is a difficult one; for my purposes, it matters less what the correct answer to this question is as opposed to when and how it is best to structure the inquiry. The core point is that the question of implied delegation—especially when more than one agency is involved—is one that might be better made in connection with the court's scrutiny of the agency's administrative record.

bolstered this determination on the ground that the agency before it, in the case of HHS, “has no expertise in crafting health insurance policy of this sort.”³⁵² And the administrative record suggests joint policymaking determinations on the part of the IRS and HHS.³⁵³

It is not too surprising that Chief Justice Roberts would seize the opportunity in *King* to advance a broader agenda of resisting the administrative state by cutting back on *Chevron*. As conservative newspaper columnist George Will noted:

[T]he court denied the power of the IRS—and, inferentially, the power of the executive branch—to be the final word on statutory interpretation.

....

Roberts’ ruling advanced a crucial conservative objective, that of clawing back power from the executive branch and independent agencies that increasingly operate essentially free from congressional control and generally obedient to presidents.³⁵⁴

But what is somewhat mystifying is that the rest of the majority—including Justices Kennedy, Ginsburg, Breyer, Sotomayor, and Kagan (the latter four of whom are rarely aligned with their more conservative brethren in bemoaning regulatory expansion and the encroachment of the administrative state)—signed on to this proposition.³⁵⁵

The case that puts *King* in sharpest relief—and produces the strongest suggestion that Chief Justice Roberts may have a broader project in mind—

352. *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015).

353. See Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans, 76 Fed. Reg. at 41,866 (“The Departments of Health and Human Services, Labor, and the Treasury (the Departments) are working in close coordination to release guidance related to Exchanges in several phases.”); Health Insurance Premium Tax Credit, 76 Fed. Reg. at 50,932 (“The Departments of Health and Human Services and Treasury are working in close coordination to release guidance related to Exchanges, in several phases.”).

354. George F. Will, *The Wrinkle in Roberts’s Decision*, WASH. POST, July 5, 2015, at A17.

355. Two immediate possible rejoinders come to mind. First, *King*—conceived of as a straightforward application of the “major questions” exception to *Chevron*—applied here with particular force, given the truly high stakes of the decision, namely with the fate of the Act hanging in the balance. See Richard Lempert, *In King v. Burwell, An Easy Answer to the ACA’s Definition of “Exchange,”* BROOKINGS INSTITUTION (Mar. 3, 2015), <http://www.brookings.edu/blogs/fixgov/posts/2015/03/04-king-burwell-aca-exchange-supreme-court-lempert> [<https://perma.cc/7UBK-W3F6>] (observing that the case “could torpedo the Affordable Care Act”). Moreover, given the truly “extraordinary” nature of the case, the more *Chevron*-friendly Justices could rest assured that *King* would be easily distinguishable down the road. A second response hinges on the particular political stakes—namely that upholding the Act on *Chevron* grounds, giving deference to the IRS’s interpretation of ambiguous statutory language, would mean that the Act would be susceptible to political unraveling down the road, should the IRS change its interpretation in a new administration. Indeed, Chief Justice Roberts raised this concern at oral argument. See Transcript of Oral Argument at 76, *King*, 135 S. Ct. 2480 (No. 14-114) (expressing concern about the possibility that subsequent administrations might be able to change the operative definition of “Exchange” if the Court were to uphold the IRS’s interpretation on the ground of *Chevron* deference). On this view, the Justices’ signing on to this proposition involved an explicit political calculus rather than an expression of any skepticism regarding the broader administrative state.

is another case implicating the scope of *Chevron* deference, *City of Arlington v. FCC*.³⁵⁶ In that case, the majority refused to deploy *Chevron* Step Zero as a means to grant the Court sole authority to determine questions of agency jurisdiction.³⁵⁷ Chief Justice Roberts (joined by Justices Kennedy and Alito) disagreed and vociferously argued that it was entirely proper to reserve such “legal” determinations for the Court to consider the question independently: “[B]efore a court may grant such deference, it must *on its own* decide whether Congress—the branch vested with lawmaking authority under the Constitution—has in fact delegated to the agency lawmaking power over the ambiguity at issue.”³⁵⁸

At one level, *Chevron* Step Zero is thus the battleground for making distinctions between issues of “law” reserved to courts and issues of “policy” delegated to agencies. But, at a broader level, the *Chevron* Step Zero debate implicates the legitimacy and appropriate scale of the administrative state. Chief Justice Roberts’ dissent in *City of Arlington* warned that “the danger posed by the growing power of the administrative state cannot be dismissed.”³⁵⁹ The Chief Justice’s majority decision in *King*—setting *Chevron* aside on the basis that the agency before it is not relevant—enlarges *Chevron*’s Step Zero and thereby signals a potential avenue for challenging agency action.³⁶⁰

356. 133 S. Ct. 1863 (2013); *see also* Heinzerling, *supra* note 6, at 1958 (“It is not hard to see how the Court’s roundabout route in *King* satisfies some of the [Chief’s] larger goals as stated in his dissent in *City of Arlington*.”); Kristin E. Hickman, *The (Perhaps) Unintended Consequences of King v. Burwell*, 43 PEPP. L. REV. 56, 58 (2015) (arguing that *King* represents the Court’s cutting back on *Chevron* deference, particularly when viewed in light of the similarities between Chief Justice Roberts’s majority opinion in *King* and dissent in *City of Arlington*); Leandra Lederman & Joseph C. Dugan, *King v. Burwell: What Does It Portend for Chevron’s Domain?*, 43 PEPP. L. REV. 72, 79 (2015) (suggesting that *King* might constitute a step in Chief Justice Roberts’s “massive revision” to *Chevron*, and thereby follow on the heels of *City of Arlington*); Freeman, *supra* note 2 (“[E]nter the Chief Justice [in *King*]. His artful and bold move today breathes new life into *Brown & Williamson* . . . and rectifies his defeat in *Arlington*. That is a lot to accomplish in two paragraphs.”); Chris Walker, *What King v. Burwell Means for Administrative Law*, YALE J. ON REG.: NOTICE & COMMENT (June 25, 2015), <http://www.yalejreg.com/blog/what-king-v-burwell-means-for-administrative-law-by-chris-walker> [<https://perma.cc/2468-2TCF>] (characterizing the Court’s assertion of authority in *King* as “a judicial power grab over the Executive in the modern administrative state,” which could have significant implications for future challenges to administrative agency actions).

357. *City of Arlington*, 133 S. Ct. at 1874–75. Justice Scalia, writing for the majority, reasoned that it would be unworkable to distinguish between jurisdictional questions (i.e., does the agency have authority to act in this manner?) and nonjurisdictional questions (i.e., those secondary questions that arise when it is clear that the agency has authority to act in this manner). *Id.* at 1869–70. In sum, “[t]he reality, laid bare, is that there is *no difference*, insofar as the validity of agency action is concerned, between an agency’s exceeding the scope of its authority (its ‘jurisdiction’) and its exceeding authorized application of authority that it unquestionably has.” *Id.* at 1870.

358. *Id.* at 1880 (Roberts, C.J., dissenting) (emphasis added). According to the dissent, the lower court should not have accorded *Chevron* deference to the FCC’s interpretation unless and until it had independently decided that Congress had delegated the authority to interpret the specific regulatory provision at issue. *Id.* at 1879–80.

359. *Id.* at 1879; *see also id.* (characterizing federal agencies’ “poking into every nook and cranny of daily life”).

360. *See* Jonathan H. Adler & Michael F. Cannon, *King v. Burwell and the Triumph of Selective Contextualism*, 2014 CATO SUP. CT. REV. 35, 71 (noting how the Court, by setting

B. State Farm Cutting In

In the last several years, in a progression of cases, the Supreme Court has addressed whether agencies are obligated to conduct cost-benefit analysis or some form of detailed fact finding when interpreting a statute. Embedded in this issue is the related yet, to date, largely ignored issue of the interplay between the respective conceptions of “reasonableness” under *Chevron* and *State Farm*.

While scholars have seized upon *Michigan* and *Encino Motorcars* to signal the demise or retreat of *Chevron*, they have missed a significant angle—namely, that the Supreme Court seems to have signaled its embrace of a new *Chevron-State Farm* framework.

1. In the U.S. Supreme Court

Michigan embraces the interplay between *Chevron* and *State Farm* in the statutory interpretation realm. The majority rejected an EPA regulation at *Chevron* Step Two—finding the agency’s interpretation of “appropriate and necessary” statutory language unreasonable—while simultaneously relying on *State Farm* to bolster its determination that the EPA’s failure to consider costs as part of its threshold decision to regulate was unreasonable. Here, this Article makes the case that, in considering the extent to which an agency must support its statutory interpretations with factual materials or cost-benefit analysis in order to be deemed “reasonable,” the Court has forged the way for the new *Chevron-State Farm* conceptual framework.

a. Michigan v. EPA

In *Michigan v. EPA*, the Court invalidated (and remanded to the EPA) an EPA rule limiting power-plant emissions of certain hazardous pollutants.³⁶¹ In making a threshold determination to regulate, the EPA determined that it was “appropriate and necessary” to regulate under the Clean Air Act without considering costs.³⁶² Industry groups and twenty-one states challenged the emissions standards, arguing that the EPA’s interpretation of the Clean Air Act was unreasonable and that the agency’s ultimate decision that it was

Chevron aside, “g[ave] opponents of agency action a new arrow for their legal quivers”); Heinzerling, *supra* note 6, at 1984 (“[T]hreatening to throw out the *Chevron* framework altogether when Congress is perceived to have chosen the wrong agency for the job may be highly disturbing to a wide variety of regulatory regimes.”); *id.* at 1991 (“The interpretive principle embraced in *King* did not, as it happens, upend the legislative work product at issue in that case, but it did plant a land mine for future cases.”); *cf.* Freeman, *supra* note 2 (“At a minimum, this will add an extra step and an extra hurdle to the government’s defense of every regulation with an arguably significant impact on the economy. And at worst, it will mean that more policy decisions fall outside the *Chevron* framework, and that agency regulations that might once have received deference will be struck down more of the time.”).

361. *Michigan v. EPA*, 135 S. Ct. 2699, 2712 (2015).

362. Section 112(n) of the Clean Air Act directed the EPA to regulate, as “appropriate and necessary,” hazardous air pollutants emitted by electricity-generating facilities. 42 U.S.C. § 7412 (2012). The EPA was to conduct a study on the remaining health hazards posed by these emissions after the implementation of other Clean Air Act provisions and to consider the results of this study in deciding whether to regulate. *See id.* § 7412 (n)(1)(A).

“appropriate and necessary” to regulate the emissions was arbitrary and capricious.³⁶³ By applying *Chevron*, the D.C. Circuit rebuffed the challenges, upheld the regulations, and ruled that the EPA’s interpretation was “clearly permissible.”³⁶⁴

In a narrow five-to-four decision, the Supreme Court reversed. Justice Scalia, writing for the majority, reasoned that while “*Chevron* directs courts to accept an agency’s reasonable resolution of an ambiguity in a statute that the agency administers,” the EPA had “strayed far beyond th[e] bounds [of reasonable interpretation]” in concluding that it could ignore costs when making threshold determinations as to whether regulation would be appropriate.³⁶⁵

Michigan v. EPA stands for many things to different commentators. What is at first remarkable about it is the extent to which there is broad agreement that (in the words of Justice Kagan in dissent) “sensible regulation requires careful scrutiny of the burdens that potential rules impose.”³⁶⁶ And the majority proclaimed (with no need for any citation whatsoever): “Agencies have long treated cost as a *centrally relevant factor* when deciding whether to regulate.”³⁶⁷ The majority elaborated: “Against the backdrop of this established administrative practice, it is unreasonable to read an instruction to an administrative agency to determine whether ‘regulation is appropriate and necessary’ as an invitation to ignore cost.”³⁶⁸ Cass Sunstein heralded the case as a “ringing endorsement of cost-benefit analysis by government agencies.”³⁶⁹

Jacob Gerson and Adrian Vermeule, however, resisted this characterization. They insisted on a narrower read of the decision as “principally an interpretive holding, about the meaning of the phrase

363. See Joint Brief of State, Industry, and Labor Petitioners, *White Stallion Energy Ctr., LLC v. EPA*, 748 F.3d 1222 (D.C. Cir. 2014) (No. 12-1100). The plaintiffs challenged various aspects of the EPA’s action as arbitrary and capricious, and they suggested (though they did not explicitly argue) that the agency was not entitled to *Chevron* deference. See *id.* at 2–3, 33–34; see also Joint Reply Brief of State, Industry, and Labor Petitioners at 24–28, *White Stallion*, 748 F.3d 1222 (No. 12-1100) (countering the EPA’s argument that its action was entitled to deference under *Chevron*).

364. *White Stallion*, 748 F.3d at 1238. The majority concluded that the word “appropriate” was ambiguous in isolation and that the EPA’s reasonable interpretation of this ambiguous statutory term was permissible. *Id.* at 1238–41.

365. *Michigan*, 135 S. Ct. at 2707 (citing *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2442 (2014)). Justice Scalia likewise wrote the majority opinion in *Utility Air*, holding that the EPA’s interpretation of the triggering event for the Clean Air Act’s permitting requirement was “unreasonable because it would bring about an enormous and transformative expansion in EPA’s regulatory authority without clear congressional authorization.” *Util. Air*, 134 S. Ct. at 2444. *Michigan*, following on the heels of *Utility Air*, likewise denied the EPA deference at *Chevron* Step Two.

366. *Michigan*, 135 S. Ct. at 2722 (Kagan, J., dissenting).

367. *Id.* at 2707 (majority opinion) (emphasis added).

368. *Id.* at 2708.

369. Cass R. Sunstein, *Thanks, Justice Scalia, for the Cost-Benefit State*, BLOOMBERG (July 7, 2015, 9:00 AM), <https://www.bloomberg.com/view/articles/2015-07-07/thanks-justice-scalia-for-the-cost-benefit-state> [https://perma.cc/BFN2-GJHX] (observing that all nine Justices adhere to a presumption that cost is relevant to regulatory decision-making absent clear evidence of congressional intent to the contrary).

‘appropriate and necessary’ in a particular section of the Clean Air Act.”³⁷⁰ In their article “Thin Rationality Review,” they argued that *Michigan* “stands only for the unobjectionable proposition that rationality requires consideration of both the ‘advantages *and* the disadvantages of agency decisions.”³⁷¹ According to Gerson and Vermeule, “[t]he days of systematically aggressive hard look review, as in the D.C. Circuit’s decisions from the 1970s and early 1980s, are mostly behind us.”³⁷² Today, they claimed, “[i]n the run of cases, arbitrary and capricious review entails a predictably and sensibly deferential review of agency policy judgments.”³⁷³

Even if their claim (which I have challenged on descriptive and on normative grounds)³⁷⁴ is correct, the question remains: what about the Court’s citation of *State Farm* in *Michigan*? Conspicuously absent from Gerson and Vermeule’s account³⁷⁵ is any acknowledgment of the Court’s citations of *State Farm* within its *Chevron* analysis. Could such citations in fact signal a new conceptual approach by the Supreme Court?

At the outset, the *Michigan* majority framed its analysis as follows:

Federal administrative agencies are required to engage in “reasoned decisionmaking.” “Not only must an agency’s decreed result be within the scope of its lawful authority, but *the process by which it reaches that result must be logical and rational.*” It follows that agency action is lawful only if it rests “on a consideration of the relevant factors.”³⁷⁶

After previewing its conclusion that the EPA’s interpretation fails under *Chevron*, the majority cited *State Farm* once again in the course of its statutory interpretation analysis, reasoning that “[a]lthough th[e] [statutory] term [‘appropriate’] leaves agencies with flexibility, an agency may not ‘entirely fai[l] to consider an important aspect of the problem’ when deciding whether regulation is appropriate.”³⁷⁷

370. Gerson & Vermeule, *supra* note 317, at 1383.

371. *Id.*

372. *Id.* at 1367.

373. *Id.* at 1362.

374. See Sharkey, *supra* note 299.

375. Indeed, this feature was likewise overlooked by the Second Circuit in *Catskill IV*. The parties briefed and argued the case before the Court decided *Michigan v. EPA*. However, the case is cited in the Second Circuit’s decision: “Even under this deferential [*Chevron*] standard, . . . agencies must operate within the bounds of reasonable interpretation.” *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 520 (2d Cir. 2017) (quoting *Michigan*, 135 S. Ct. at 2707), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018). But, in the very next paragraph, the court faulted the district court for incorporating *State Farm* into the *Chevron* analysis. *Id.* at 521. This is precisely what the Court did in *Michigan v. EPA*. Nor did the dissent in *Catskill IV* recognize this feature of the *Chevron-State Farm* interplay. The dissent invoked *Michigan v. EPA* in support of its argument that “the Water Transfers Rule is not entitled to deference because it will lead to absurd results.” *Id.* at 546 (Chin, J., dissenting) (citing *Michigan*, 135 S. Ct. at 2707) (“No regulation is ‘appropriate’ if it does ‘significantly more harm than good.’”). The thrust of Judge Chin’s argument was that “[d]eference has its limits; I would not defer to an agency interpretation that threatens to undermine that entire system.” *Id.* at 547.

376. *Michigan*, 135 S. Ct. at 2706 (emphasis added) (first quoting *Allentown Mack Sales & Servs., Inc. v. NLRB*, 522 U.S. 359, 374 (1998); then quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

377. *Id.* at 2707 (fifth alteration in original) (quoting *State Farm*, 463 U.S. at 43).

The Court's purpose in citing *State Farm* is concededly cryptic. During oral argument, Justice Scalia offered a potentially far-reaching view: unless the statute prohibits considerations of cost, *State Farm* arbitrary and capricious review under the APA requires it.³⁷⁸ This goes farther than I would.³⁷⁹ However, where agencies do perform cost-benefit analysis—as they are often obliged to do pursuant to executive order—it is fair game for judicial review.³⁸⁰

Michigan demonstrates that the Court might in fact have adopted something akin to the *Chevron-State Farm* conceptual framework in the context of evaluating the EPA's choice to disregard costs in deciding whether it was "appropriate" to regulate. But the decision, in order to be faithful to this framework, should have acknowledged, at *Chevron* Step Two and pursuant to *State Farm*, that the Office of Information and Regulatory Affairs (OIRA) had already scrutinized and approved the cost-benefit analysis underlying the EPA's rule.³⁸¹ As I have argued, this would have appropriately led to more deferential judicial review at this stage.³⁸²

378. Transcript of Oral Argument at 14, *Michigan*, 135 S. Ct. 2699 (Nos. 14-46, 14-47, 14-49) ("I'm not even sure I agree with the premise that . . . when Congress says nothing about cost, the agency is entitled to disregard cost. I would think it's classic arbitrary and capricious agency action for an agency to command something that is outrageously expensive and . . . in which the expense vastly exceeds whatever public benefit can be . . . achieved. I would think that's . . . a violation of the Administrative Procedure Act.")

379. Sharkey, *supra* note 299, at 1617 ("An agency's failure to conduct a regulatory impact analysis pursuant to the executive order is not judicially reviewable. Nor are agencies expressly required to conduct cost-benefit analysis by the plain text of the arbitrary and capricious standard of section 706 of the APA.")

380. *Id.* at 1618–19 ("[I]f agencies (be they executive or independent) do undertake a cost-benefit analysis, courts will review it. [Thus] regulatory impact analyses should—and as a practical matter do—play a role in substantive judicial review of the underlying regulation under *State Farm* arbitrary and capricious review."); see also Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. ON REG. 545, 594 (2017) ("[A]ny fact on which the agency relied in making its decision is subject to review under the 'arbitrary and capricious' standard of the [APA]."). *State Farm*, moreover, is itself a prime example, whereby the court reviewed NHTSA's cost-benefit analysis in connection with its decision to revoke a previous passive-restraint requirement. See Sharkey, *supra* note 299, at 1609–11.

381. See National Emission Standards for Hazardous Air Pollutants from Coal- and Oil-Fired Electric Utility Steam Generating Units and Standards of Performance for Fossil-Fuel-Fired Electric Utility, Industrial-Commercial-Institutional, and Small Industrial-Commercial-Institutional Steam Generating Units, 77 Fed. Reg. 9304, 9441 (Feb. 16, 2012) (to be codified at 40 C.F.R. pts. 60, 63) (explaining that the Rule was subject to OIRA review).

382. See Revesz, *supra* note 380, at 599 ("[I]f more stringent review is appropriate for agencies that do not undergo Executive Branch review, it reasonably follows that those that are subject to such vetting deserve more deferential review. Sharkey embraces this view and advocates 'that a court *should* take into account whether OIRA has given its imprimatur to the agency's cost-benefit analysis when calibrating the level of scrutiny it directs to the task at hand.');" see also Brief of the Institute for Policy Integrity at New York University School of Law as Amicus Curiae in Support of Respondents at 23–24, *Michigan*, 135 S. Ct. 2699 (Nos. 14-46, 14-47, 14-49) (arguing that agencies and OIRA are well equipped to conduct cost-benefit analysis of regulations and that, "when courts can refer to such analysis and executive branch review, there is less need to second-guess the agency's analytical process" (citing Sharkey, *supra* note 299, at 1592)). For a provocative counterargument, see generally Lisa Heinzerling, *Inside EPA: A Former Insider's Reflections on the Relationship Between the Obama EPA and the Obama White House*, 31 PACE ENVTL. L. REV. 325 (2014). Heinzerling

The EPA conducted a Regulatory Impact Analysis (RIA) of the regulation—as was required under the Executive Order—which was subject to OIRA review. This is amply supported in the regulatory record that the Supreme Court reviewed. Indeed, it is referenced in the majority decision.³⁸³ Justice Kagan made the most explicit argument in dissent: “EPA knew that, absent unusual circumstances, the rule would need to pass . . . cost-benefit review in order to issue.”³⁸⁴ Indeed, based on the agency’s cost-benefit analysis (which had received OIRA’s imprimatur), Justice Kagan stated that the outcome here would be “a rule whose benefits exceed its costs by three to nine times.”³⁸⁵ Justice Kagan thus framed the central question as “whether EPA can reasonably find it ‘appropriate’ to trigger the regulatory process based on harms (and technological feasibility) alone, given that costs will come into play, in multiple ways and at multiple stages, before any emission limit goes into effect.”³⁸⁶

But—as Justice Scalia responded, making an explicit link to the *Chenery* doctrine—the EPA did not make these potentially powerful arguments put forth by Justice Kagan.³⁸⁷ Indeed, before the Court, “EPA concede[d] that

served as Senior Climate Policy Counsel to the EPA Administrator and Associate Administrator of the Office of Policy at the EPA. *Id.* at 325 n.**. According to Heinzerling, OIRA “actively pressed EPA to interpret its governing statutes to allow cost-benefit analysis, even where EPA had a long history of interpreting them not to allow it.” *Id.* at 350. Heinzerling argues that agencies’ statutory interpretations should not be subject to *Chevron* deference “when an interpretation is foist upon [the relevant agency] by OIRA.” *Id.*

383. *Michigan*, 135 S. Ct. at 2705–06 (“In accordance with Executive Order, the Agency issued a ‘Regulatory Impact Analysis’ alongside its regulation. This analysis estimated that the regulation would force power plants to bear costs of \$9.6 billion per year. . . . [T]he regulatory impact analysis took [ancillary benefits] into account, increasing the Agency’s estimate of the quantifiable benefits of its regulation to \$37 to \$90 billion per year.”).

384. *Id.* at 2721 (Kagan, J., dissenting) (citing Exec. Order No. 12,866, 3 C.F.R. § 638 (1993)). Justice Ginsburg also highlighted this fact at oral argument:

[C]an you clarify for me why this [fact that the rule imposes high costs] is . . . at this stage something that we should be concerned about because there is this regulatory impact assessment and that . . . has said that the benefits vastly exceed the costs, and that’s . . . an impact analysis and has gone through the [OIRA] process and [OIRA] concluded that EPA appropriately calculated the costs.

Transcript of Oral Argument, *supra* note 378, at 39–40. And the issue surfaced in an interchange between Justice Scalia and Solicitor General Donald Verrilli, as well:

JUSTICE SCALIA: General Verrilli, let me . . . ask a question about costs. There . . . are economic costs. There are other costs. Is it . . . the Agency’s position that no cost can be taken into account? . . .

GENERAL VERRILLI: . . . I think that cost would be taken into account in the OIRA regulatory impact analysis.

JUSTICE SCALIA: But not for the listing.

GENERAL VERRILLI: But . . . not for the listing.

JUSTICE SCALIA: Not for the listing. That’s right.

Id. at 70.

385. *Michigan*, 135 S. Ct. at 2722 (Kagan, J., dissenting).

386. *Id.* at 2717.

387. *Id.* at 2710 (majority opinion) (“This line of reasoning contradicts the foundational principle of administrative law that a court may uphold agency action only on the grounds that the agency invoked when it took the action. When it deemed regulation of power plants appropriate, EPA said that cost was *irrelevant* to that determination—not that cost-benefit

the regulatory impact analysis ‘played no role’ in its appropriate-and-necessary finding.”³⁸⁸ It is important, then, to keep in mind that the majority did not determine that the EPA’s action was indefensible.³⁸⁹

Indeed, on remand, the EPA justified the regulation by conducting cost analyses.³⁹⁰ Seen in this light, the EPA chose a risky litigation strategy at the outset (a strategy unlikely to be employed again)—namely, one that repeatedly disclaimed any reliance whatsoever on costs at the threshold stage.³⁹¹ *Michigan* thus stands far removed from the classic situation whereby an agency’s action would not withstand *State Farm* review at *Chevron* Step Two. Disagreement with its ultimate holding—failing to uphold the emissions regulation at issue—should by no means foreclose an embrace of the *Chevron-State Farm* framework or cloud sober evaluation of it.

analysis would be deferred until later. . . . What it said is that cost is irrelevant to the decision to regulate.” (citing *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80, 87 (1943)).

388. *Id.* at 2706 (citation omitted); see also *id.* at 2711 (“The Government concedes . . . that ‘EPA did not rely on the [regulatory impact analysis] when deciding to regulate power plants,’ and that ‘[e]ven if EPA had considered costs, it would not necessarily have adopted . . . the approach set forth in [that analysis].’” (citation omitted)).

389. *Id.* at 2711 (“It will be up to the Agency to decide (as always, within the limits of reasonable interpretation) how to account for cost.”).

390. On December 1, 2015, the EPA published a notice of a proposed rule. See Supplemental Finding That It Is Appropriate and Necessary to Regulate Hazardous Air Pollutants from Coal-and Oil-Fired Electric Utility Steam Generating Units, 80 Fed. Reg. 75,025 (Dec. 1, 2015) (to be codified at 40 C.F.R. pt. 63). The proposal was open for comments until January 15, 2016, and received approximately forty comments. *Supplemental Finding That It Is Appropriate and Necessary to Regulate Hazardous Air Pollutants from Coal- and Oil-Fired Electric Utility Steam Generating Units*, REGULATIONS.GOV (Jan. 15, 2016, 11:59 PM), <https://www.regulations.gov/document?D=EPA-HQ-OAR-2009-0234-20497> [<https://perma.cc/4X8N-AC6A>]. The proposal stated that taking cost into consideration did not alter the EPA’s original conclusion that it is appropriate and necessary to regulate hazardous air-pollutant emissions from electric utility steam-generating units (EGUs). Supplemental Finding That It Is Appropriate and Necessary to Regulate Hazardous Air Pollutants from Coal-and Oil-Fired Electric Utility Steam Generating Units, 80 Fed. Reg. at 75,025. The EPA specifically noted that a cost-benefit analysis was performed in accordance with Executive Orders 12,866 and 13,563 as part of the MATS Rule regulatory impact analysis. *Id.* at 75,039. The EPA estimated that even an underestimation of the annual benefits, at \$37 to \$90 billion, would outweigh the estimated annual costs of \$9 billion by a 3-to-1 or 9-to-1 ratio. *Id.* at 75,040. In sum, the EPA stated that these cost analyses, conducted in direct response to the Court in *Michigan v. EPA*, had no effect on its conclusion that regulation of EGUs was appropriate; in fact, cost analysis independently supported that conclusion. *Id.* at 75,041. On April 25, 2016, the EPA published its final finding: it is both appropriate and necessary to regulate hazardous air pollutant emissions from EGUs. Supplemental Finding That It Is Appropriate and Necessary to Regulate Hazardous Air Pollutants from Coal- and Oil-Fired Electric Utility Steam Generating Units, 81 Fed. Reg. 24,420 (Apr. 25, 2016) (to be codified at 40 C.F.R. pt. 63). After receiving public comments, the EPA concluded that “a consideration of cost does not cause [the EPA] to change [its] determination that regulation . . . is appropriate and necessary and the EGUs are, therefore, properly included on the CAA section 112(c) list of sources that must be regulated under CAA section 112(d).” *Id.*

391. See also *White Stallion Energy Ctr., LLC v. EPA*, 748 F.3d 1222, 1263 (D.C. Cir. 2014) (Kavanaugh, J., concurring in part and dissenting in part) (“EPA’s official position in this Court is that the costs identified in the Regulatory Impact Analysis should have ‘no bearing on’ the determination of whether regulation is appropriate.” (emphasis added)).

b. Encino Motorcars, LLC v. Navarro

Encino Motorcars likewise supports my reading of *Michigan* as signaling the arrival of a new *Chevron-State Farm* conceptual framework. Moreover, it highlights the significance of the framework as a means to expand the scope of indirect *State Farm* challenges to agency rules in private party litigation.

The key statutory interpretation issue before the Court in *Encino Motorcars* arose out of an overtime-pay dispute between private parties. Several “auto service advisors” alleged violations of overtime pay under the Fair Labor Standards Act (FLSA)³⁹² against their employer car dealership.³⁹³ The defendant car dealership argued that service advisors were exempt from the overtime requirements under the FLSA, which includes a statutory exemption for “any salesman, partsman, or mechanic primarily engaged in selling or servicing automobiles.”³⁹⁴ According to the defendant, a service advisor is a “salesman” who “service[s] automobiles” and thus fits within the plain language of the exemption.³⁹⁵ The Department of Labor (DOL), however, had promulgated a 2011 rule (via notice-and-comment rulemaking) that defined the statutory terms more narrowly and also specifically excluded service advisors from the statutory exemption.³⁹⁶

The Ninth Circuit framed its analysis as follows: “We conduct the familiar two-step [*Chevron*] inquiry to determine whether to defer to the agency’s interpretation.”³⁹⁷ The court held that Step One was readily satisfied: “It is not clear from the text of the statute whether Congress intended broadly to exempt any salesman who is involved in the servicing of cars or, more narrowly, only those salesmen who are selling the cars themselves.”³⁹⁸

Next, at Step Two, the court acceded to the plaintiffs’ demand that the court defer to the agency’s interpretation.³⁹⁹ Specifically, the court noted that

392. 29 U.S.C. §§ 201–219 (2012).

393. *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2121 (2016).

394. 29 U.S.C. § 213(b)(10)(A).

395. *Navarro v. Encino Motorcars, LLC*, 780 F.3d 1267, 1269–70 (9th Cir. 2015), *vacated*, 136 S. Ct. 2117.

396. As the agency explained in 2011, the regulatory definitions “limit[] the exemption to salesmen who sell vehicles and partsmen and mechanics who service vehicles.” Updating Regulations Issued Under the Fair Labor Standards Act, 76 Fed. Reg. 18,832, 18,838 (Apr. 5, 2011) (to be codified in scattered parts of 29 C.F.R.).

397. *Encino Motorcars*, 780 F.3d at 1271. The Ninth Circuit reversed the district court, which held that the agency’s action was not a legislative rule but a mere interpretation not worthy of *Chevron* deference. *Navarro v. Mercedes Benz of Encino*, No. CV 12-08051-RGK, 2013 WL 518577, at *3 (C.D. Cal. Jan. 25, 2013), *rev’d in part sub nom.* *Navarro v. Encino Motorcars, LLC*, 780 F.3d 1267 (9th Cir. 2015), *vacated*, 136 S. Ct. 2117. Moreover, the district court declined to accord even a lesser form of deference on the ground that the agency’s interpretation was an unreasonable construction of the statute. *Id.*

398. *Encino Motorcars*, 780 F.3d at 1272.

399. Appellants’ Opening Brief at 17, *Encino Motorcars*, 780 F.3d 1267 (No. 13-55323) (citing *United States v. Mead Corp.*, 533 U.S. 218, 228 (2001)) (arguing that the DOL should be accorded deference “proportional to its power to persuade”). Plaintiff-appellants invoked *Skidmore*, as opposed to *Chevron*, deference. *Id.* at 20–21. Appellees countered that *Chevron* deference was not appropriate given that the regulation conflicts with the plain wording of the statute. Brief for Appellee at 8, *Encino Motorcars*, 780 F.3d 1267 (No. 13-55323). Moreover, as far as *Skidmore* deference was concerned, appellees argued that given “the shifting positions

“[b]ecause we consider here a regulation duly promulgated after a notice-and-comment period, *Chevron*’s ‘reasonableness’ standard applies.”⁴⁰⁰ And—consistent with many other courts’ lax Step Two review—the court found that “where there are two reasonable ways to read the statutory text, and the agency has chosen one interpretation, we must defer to that choice.”⁴⁰¹

The Supreme Court, however, subjected the agency’s policy-inflected statutory interpretation choice to closer inquiry. The Court probed the regulatory record and found the agency’s reasoning wanting:

[T]he Department said almost nothing. It stated only that it would not treat service advisors as exempt because “the statute does not include such positions and the Department recognizes that there are circumstances under which the requirements for the exemption would not be met.” It continued that it “believes that this interpretation is reasonable” and “sets forth the appropriate approach.”⁴⁰²

This cursory, wholly legalistic justification did not pass muster with the Court.

The Court, moreover, repeatedly invoked *State Farm*. It recited the familiar dictate for agency rulemaking; namely that “[t]he agency ‘must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.’”⁴⁰³ The Court then linked this “procedural requirement[.]” of “giv[ing] adequate reasons for its decisions”⁴⁰⁴ to *Chevron* deference. It stated that “*Chevron* deference is not warranted where the regulation is ‘procedurally defective’—that is, where the agency errs by failing to follow the correct procedures in issuing the regulation.”⁴⁰⁵ Citing both *Chevron* and *State Farm*, the Court opined that “[a]gencies are free to change their existing policies as long as they provide a reasoned explanation for the change.”⁴⁰⁶

of the DOL, the clear Legislative action contrary to the DOL’s position, and the lack of fair warning to potentially affected groups,” the DOL should be given no deference. *Id.* at 15.

400. *Encino Motorcars*, 780 F.3d at 1272.

401. *Id.* at 1277.

402. *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2127 (2016) (quoting Updating Regulations Issued Under the Fair Labor Standards Act, 76 Fed. Reg. 18,832, 18,838 (Apr. 5, 2011)); *see also id.* (“Whatever potential reasons the Department might have given, the agency in fact gave *almost no reasons at all.*” (emphasis added)).

403. *Id.* at 2125 (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

404. *Id.*

405. *Id.* (quoting *United States v. Mead Corp.*, 533 U.S. 218, 227 (2001)); *id.* (“[W]here the agency has failed to provide even that minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law.” (citing *State Farm*, 463 U.S. at 42–43)); *id.* at 2126 (“An arbitrary and capricious regulation of this sort is itself unlawful and receives no *Chevron* deference.” (citing *Mead*, 533 U.S. at 227)); *id.* at 2127 (“This lack of reasoned explanation for a regulation that is inconsistent with the Department’s longstanding earlier position results in a rule that cannot carry the force of law. It follows that this regulation does not receive *Chevron* deference in the interpretation of the relevant statute.” (citing *State Farm*, 463 U.S. at 42–43)).

406. *Id.* at 2125.

Encino Motorcars is consistent with a new *Chevron-State Farm* conceptual framework. This consistency becomes apparent when the case is read against the background of the Ninth Circuit decision that it reversed (a ringing endorsement of a permissive Step Two approach to deferring to the regulatory agency) and considering how the Court repeatedly invokes *State Farm* (hitherto absent from the lower courts' *Chevron* analyses).⁴⁰⁷

But this Article fully recognizes that *Encino Motorcars* is susceptible to different interpretations.⁴⁰⁸ To begin, in concluding that “the 2011 regulation was issued without the reasoned explanation that was required in light of the Department’s change in position and the significant reliance interests involved,” the Court highlighted the relevance of two somewhat related variables, namely, the change in agency position and industry reliance.⁴⁰⁹ According to the Court, the 2011 rule represented an abrupt volte-face by the DOL from its “decades-old practice of treating service advisors as exempt.”⁴¹⁰ And “[i]n light of this background [of reliance on the part of the

407. See *Navarro v. Encino Motorcars, LLC*, 780 F.3d 1267, 1272–77 (9th Cir. 2015), *vacated*, 136 S. Ct. 2117 (2016); *Navarro v. Mercedes Benz of Encino*, No. CV 12-08051-RGK, 2013 WL 518577, at *3 (C.D. Cal. Jan. 25, 2013), *rev'd in part sub nom. Navarro v. Encino Motorcars, LLC*, 780 F.3d 1267 (9th Cir. 2015), *vacated*, 136 S. Ct. 2117. The Court vacated and remanded the case back to the Ninth Circuit to interpret the statute without according *Chevron* deference to the DOL’s interpretation. On remand, the Ninth Circuit came to the same conclusion—this time as a matter of de novo statutory interpretation. *Navarro v. Encino Motorcars, LLC*, 845 F.3d 925, 939–40 (9th Cir. 2017), *cert. granted*, 138 S. Ct. 54 (2017) (No. 16-1362). The court noted that it was not clear whether it was to apply *Skidmore* deference to the agency’s position—but, to cover all bases, ruled that even if it did not, it would reach the same conclusion. *Id.* at 929 n.3 (noting that, “[a]lthough the agency held a contrary position in intervening years,” the agency’s reasoning is “persuasive and thorough”).

408. There is no consensus regarding where *Encino Motorcars* fits within the *Chevron* framework; but most seem to agree that the case is *not* an example of heightened scrutiny at Step Two. Dan Hemel and Michael Pollack characterize *Encino Motorcars* as *Chevron* Step 0.5 (not Step Two)—where courts ask whether the agency has followed the proper procedures to fill the gaps Congress intended. Michael Pollack & Daniel Hemel, *Chevron Step 0.5*, YALE J. ON REG.: NOTICE & COMMENT (June 24, 2016), <http://yalejreg.com/nc/chevron-step-0-5-by-michael-pollack-and-daniel-hemel/> [<https://perma.cc/PN3W-QYK4>]. Moreover, they insist that it is not a *State Farm* case because *State Farm* has nothing to do with agency statutory interpretation. *Id.*

409. *Encino Motorcars*, 136 S. Ct. at 2126.

410. *Id.* at 2123. In fact, as demonstrated by the regulatory history, spanning more than four decades, the agency reversed course on two separate occasions. In 1970, in an interpretive regulation (not subject to notice and comment), the DOL set forth regulatory definitions of the statutory terms. Significantly, DOL limited the term “salesman” to those who sell vehicles and also specifically excluded service advisors (who sell repair and maintenance services but not vehicles) from the exemption. But, in 1978, DOL changed its position and issued an opinion letter that defined “salesman” to include service advisors. See Dep’t of Labor, Wage & Hour Div., Opinion Letter No. WH-467 (July 28, 1978), 1978 WL 51403. And in 1987, the agency amended its Field Operations Handbook consistent with its opinion letter. See DEP’T OF LABOR, WAGE & HOUR DIV., FIELD OPERATIONS HANDBOOK § 24L04-4, Insert No. 1757 (1987). Twenty-one years later, DOL issued a notice of proposed rulemaking to amend its 1970 regulation to adopt the broader definitions (ensconced in the 1978 opinion letter and 1987 handbook revisions). See Updating Regulations Issued Under the Fair Labor Standards Act, 73 Fed. Reg. 43,654, 43,658–59, 43,671 (July 28, 2008) (to be codified in scattered parts of 29 C.F.R.). But, four years later (and with a change in presidential administration), in 2011, DOL changed course again and issued a final rule that did an about-face from the proposed rule and reverted back to the agency’s 1970 position.

retail automobile and truck dealership industry], the Department needed a more reasoned explanation for its decision to depart from its existing enforcement policy.”⁴¹¹ Read in this light, DOL was denied deference not because it failed to provide sufficient policy-based justifications for its interpretation but because it failed to justify its interpretation against decades of contradictory practice. Thus, while *Encino Motorcars* holds that agency reason giving of some kind is required at *Chevron* Step Two—absent an abrupt about-face and concomitant thwarted reliance interests—the requirement may be minimal (i.e., more than “almost nothing”).⁴¹²

Next, focusing on the Court’s multiple invocations of *State Farm* has led some to conclude that *Encino Motorcars* is really a *State Farm*, not *Chevron*, case. Thus, Adrian Vermeule characterized the case as banal, standing simply for the proposition that “[a]rbitrary regulations are directly invalid; and although that does also entail they should receive no deference, one hardly needs to say so, and there is no need at all to comment on it.”⁴¹³ In a similar vein, the Second Circuit in *Catskill Mountains* read the case “to stand for the proposition that where a litigant brings both a *State Farm* challenge and a *Chevron* challenge to a rule, and the *State Farm* challenge is successful, there is no need for the reviewing court to engage in *Chevron* analysis.”⁴¹⁴

But this overlooks a significant feature of the *Encino Motorcars* litigation—namely, that it was between private parties, neither of which invoked *State Farm* as a direct challenge to the agency’s 2011 rulemaking. Instead, by importing *State Farm* into the *Chevron* framework *sua sponte*, the Supreme Court in effect sanctioned an indirect challenge to the agency’s

411. *Encino Motorcars*, 136 S. Ct. at 2126.

412. *See id.* at 2127 (“In light of the serious reliance interests at stake, the Department’s conclusory statements do not suffice to explain its decision.”); *see also* Asher Steinberg, *Encino Motorcars, Cuozzo, and the Impossible Dream of Step Two Arbitrary and Capricious Review*, NARROWEST GROUNDS (June 29, 2016), <http://narrowestgrounds.blogspot.com/2016/06/encino-motorcars-cuozzo-and-impossible.html> [<https://perma.cc/DMB6-EYHV>]. In a separate concurrence, Justice Ginsburg made the point that “the extent to which the Department is obliged to address reliance will be affected by the thoroughness of public comments it receives on the issue.” *Encino Motorcars*, 136 S. Ct. at 2128 n.2 (Ginsburg, J., concurring). The majority, too, noted the link between the notice-and-comment record and the sufficiency of the agency’s reasons: “[T]hough several public comments supported the Department’s reading of the statute, the Department did not explain what (if anything) it found persuasive in those comments . . .” *Id.* at 2127 (majority opinion).

413. Adrian Vermeule, *Encino Is Banal*, YALE J. ON REG.: NOTICE & COMMENT (June 23, 2016), <http://yalejreg.com/nc/encino-is-banal-by-adrian-vermeule/> [<https://perma.cc/7ZHM-NSKF>]. Vermeule argues that when an agency action is procedurally defective, it is not valid and invalid actions cannot receive deference. Vermeule does not think that there is any element of reasonableness that came into play; the DOL simply did not follow procedure. *Id.*

414. *Catskill Mountains Chapter of Trout Unlimited, Inc. v. EPA (Catskill IV)*, 846 F.3d 492, 522 (2d Cir. 2017), *cert. denied* No. 17-446, 2018 WL 1037580 (U.S. Feb. 26, 2018). The government echoed this view in its brief in opposition to a petition for certiorari. Brief for the Federal Respondents in Opposition, *supra* note 62, at 27 (“[W]hen a court concludes that agency action is invalid under *State Farm*, it need not engage in a *Chevron* analysis.”); *see also id.* at 28 (“The Court [in *Encino Motorcars*] thus treated the agency’s failure to offer a reasoned explanation as a ground for declining to engage in *Chevron* analysis, not as a circumstance to be considered at *Chevron*’s second step.”).

rulemaking in a private lawsuit where the agency was only an amicus (and, moreover, not until the case reached the Supreme Court).⁴¹⁵

Far too little attention has been paid to the implications of such indirect challenges, both in terms of the proper role of the agency as well as the proper remedy when remand to the agency is not an option.⁴¹⁶ At oral argument in *Encino Motorcars*, Justice Breyer remarked, “I was sort of surprised that nobody in the Ninth Circuit referred to a doctrine that nobody refers to anymore. It’s called primary jurisdiction. And it can be used to ask the relevant department to file a brief, and nobody did that.”⁴¹⁷

This particular feature—namely the potential for increasing the scope of pre-enforcement review of agency rules in cases between private parties—may be the most novel component of the new *Chevron-State Farm* conceptual framework.

2. In the D.C. Circuit

It is telling to return to the D.C. Circuit jurisprudence to see whether, in fact, the trend towards heightened judicial scrutiny—by way of *State Farm* as Step Three or incorporation of *State Farm* into *Chevron* review—has advanced in the wake of the Supreme Court’s decisions in *Michigan* and *Encino Motorcars*.⁴¹⁸

a. *State Farm as Step Three*

The D.C. Circuit has developed a line of jurisprudence in which a relatively lax Step Two, focused on the legal interpretive question, is followed by a more robust application of *State Farm* arbitrary and capricious review scrutinizing the agency’s administrative record to find support for its interpretive stance. Moreover, a few post-*Michigan* cases seem to point in the direction of such enhanced judicial scrutiny by emphasizing that an agency, even as it sails through the *Chevron* Two-Step, may fail *State Farm* arbitrary and capricious review by failing to consider an important aspect of the issue before it or by disregarding policy alternatives without adequate explanation.

415. The Secretary of Labor participated as an amicus (for the first time in the case) at the Supreme Court level, and then supplied a brief in support of the plaintiffs-appellants at the Ninth Circuit on remand. See Brief for the Secretary of Labor as *Amicus Curiae* in Support of Plaintiffs-Appellants, *Navarro v. Encino Motorcars, LLC*, 845 F.3d 925 (9th Cir. 2016) (No. 13-55323).

416. See *supra* Part II.C.2.b.

417. Transcript of Oral Argument at 36–37, *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117 (2016) (No. 16-1362). Justice Breyer advocated this approach in a concurring opinion in *Pharmaceutical Research & Manufacturers of America v. Walsh*, 538 U.S. 644, 673 (2003) (Breyer, J., concurring), a Medicaid preemption case.

418. There is likewise some evidence this shift is catching on outside of the D.C. Circuit as well. For example, in *Consumer Financial Protection Bureau v. Mortgage Law Group, LLP*, 157 F. Supp. 3d 813 (W.D. Wis. 2016), the federal district court relied on *Michigan v. EPA* and invalidated a portion of a regulation as arbitrary and capricious under *Chevron* Step Two.

Judge Edwards has steadfastly maintained that an “[a]gency action may be consistent with the agency’s authorizing statute and yet arbitrary and capricious under the APA”—in other words, it can readily pass *Chevron* but fail *State Farm*.⁴¹⁹ On this view,

a court may conclude that an agency action is based on a permissible interpretation of its enabling statute, yet, nevertheless find the action an invalid exercise of decisionmaking authority under 5 U.S.C. § 706(2)(A), because the agency ‘entirely failed to consider an important aspect of the problem’ or otherwise failed to engage in reasoned decisionmaking.⁴²⁰

Judge Edwards has written the majority opinion in two noteworthy post-*Michigan* cases. In *Global Tel*Link v. FCC*, the D.C. Circuit refused to defer to the agency’s interpretation of the statute, evincing great concern for the process and reasoning behind the agency’s policy.⁴²¹ The case concerned an FCC order to regulate intrastate rates for inmate payphone providers in response to market failure.⁴²² Judge Edwards wrote the majority opinion holding that there was no longer a *Chevron* deference issue in the case because the agency abandoned its argument for deference to a prior interpretation.⁴²³ Judge Edwards then proceeded to review the factual basis for the FCC’s order under *State Farm* asking whether the agency exercised “reasoned decisionmaking” in arriving at its conclusion.⁴²⁴ Judge Edwards subsequently clarified that there was no justification on the record or support by way of reasoned decision-making.⁴²⁵ Moreover, addressing the interplay of *State Farm* and *Chevron*, Judge Edwards concluded—with a clear nod, albeit without citation, to *Encino Motorcars*—“[i]t is clear that no *Chevron* deference is due to agency decisions that are unsupported by reasoned decisionmaking.”⁴²⁶

In *Animal Legal Defense Fund v. Perdue*,⁴²⁷ the appellants argued that the USDA renewed zoo operators’ licenses in violation of the Animal Welfare Act, which states that “no license shall be issued until the dealer or exhibitor shall have demonstrated that his facilities comply with the standards promulgated by the Secretary.”⁴²⁸ The court (per Judge Edwards) applied

419. *Animal Legal Def. Fund, Inc. v. Perdue*, 872 F.3d 602, 619 (D.C. Cir. 2017).

420. EDWARDS ET AL., *supra* note 190, at 218 (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)); *see also* *EchoStar Satellite L.L.C. v. FCC*, 704 F.3d 992, 1001–02 (D.C. Cir. 2013) (“[T]he agency’s decision fails for want of reasoned decisionmaking, not for lack of authority.”).

421. *See generally* *Global Tel*Link v. FCC*, 859 F.3d 39 (D.C. Cir. 2017), *amended by* 866 F.3d 397 (D.C. Cir. 2017).

422. *Id.* at 43–44.

423. *Id.* at 50.

424. *Id.* at 51.

425. *Global Tel*Link v. FCC*, 866 F.3d 397, 417 (D.C. Cir. 2017).

426. *Id.*

427. 872 F.3d 602 (D.C. Cir. 2017).

428. *Id.* at 606 (quoting 7 U.S.C. § 2133 (2012)). Appellants alleged that the USDA was aware of multiple violations of the AWA by the zoo operators. *Id.* Moreover, they “asserted that the agency’s reliance on the Sellners’ self-certification of compliance as part of its renewal determination, despite having knowledge that the certification was false, was arbitrary and capricious” in violation of the APA. *Id.*

the *Chevron* Two-Step. At Step Two (after finding the statutory provision ambiguous at Step One), the court was quite deferential to the agency's legal interpretation. The USDA "assert[ed] that its renewal scheme balances the AWA's 'dual, but sometimes competing, goals of protecting both the animals and the businesses that exhibit them.'"⁴²⁹ Moreover, the agency claimed that "it would be too burdensome to require more from applicants in the context of license renewals than the regulations currently demand."⁴³⁰ At that point, the USDA's legal reasoning resembles the EPA's in *Catskill Mountains*—putting forth its view based upon the purposes of the statute and its conclusory assertion that it has struck the right balance.

But, unlike the EPA in *Catskill Mountains*, the USDA was not home free once it cleared the *Chevron* Two-Step. Nor did reasoned decision-making fall out of the equation altogether. Instead, *State Farm* reared its head. Indeed, the court highlighted that arbitrary and capricious review does not depend "on the agency's legal authority, but instead on the agency's ability to demonstrate that it engaged in reasoned decisionmaking."⁴³¹ And the court, finding that "the agency's explanation for its decision runs counter to the evidence allegedly before it,"⁴³² remanded the case back to the agency for additional investigation or explanation.⁴³³

*Humane Society of the United States v. Zinke*⁴³⁴ is another notable foil to *Catskill Mountains*. The Humane Society sued the Department of the Interior, alleging that one of its rules violated both the Endangered Species Act and the APA.⁴³⁵ At issue were two distinct statutory interpretation questions implicated by a controversy over delisting a subsegment of the grey wolves' population so as to remove it from the auspices of the Act.

The D.C. Circuit applied "the familiar two-step *Chevron* framework."⁴³⁶ At *Chevron* Step One, the court readily found ambiguity in two statutory phrases—"distinct population segment" and "range"—neither of which is defined by the Act or relevant regulations.⁴³⁷

429. *Id.* at 617.

430. *Id.*

431. *Id.* at 619 (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983)).

432. *Id.*

433. *Id.* at 620 ("We hold that, on this record, the District Court erred in granting the Government's motion to dismiss Appellants' arbitrary and capricious claim. We therefore vacate that judgment and remand the case to the District Court with instructions to remand the record to the agency. 'Where we "cannot evaluate the challenged agency action on the basis of the record before [us], the proper course . . . is to remand to the agency for additional investigation or explanation.'" (alteration in original) (quoting *CSI Aviation Servs., Inc. v. U.S. Dep't of Transp.*, 637 F.3d 408, 416 (D.C. Cir. 2011))).

434. 865 F.3d 585 (D.C. Cir. 2017).

435. *Id.* at 594.

436. *Id.* at 595.

437. The first interpretation question was whether the Act permits the Service to carve out of an already listed species a "distinct population segment" for the purpose of delisting that segment and withdrawing it from the Act's purview. *Id.* at 590 (quoting 16 U.S.C. § 1532(16) (2012)). The statute listed five factors and suggested that agency actions must be based on the best available scientific and commercial data. *Id.* (citing 16 U.S.C. § 1533(b)(1)(A)). The second interpretive question was whether, under the Act, a determination of endangered or

At Step Two, the court concluded that the Fish and Wildlife Service's interpretations, respectively, were a "reasonable reading of statutory text"⁴³⁸ and "based on a permissible construction of the statute."⁴³⁹ The court's Step Two analysis examined the statutory text and purposes. Throughout its analysis, the court relied heavily on the Service's 2011 Rule⁴⁴⁰—with some striking parallels to the EPA's Rule in *Catskill Mountains*. Similar to the "Klee Memorandum" issued by the EPA General Counsel, the Solicitor of the Department of the Interior issued a memorandum analyzing the statutory authority for designating distinct population segments for the specific purpose of delisting them.⁴⁴¹ After a false start of sorts (a rule published without notice and comment that was vacated due to this procedural infirmity), the Service issued a subsequent rule that likewise relied upon the Solicitor's earlier memorandum.⁴⁴² Specifically, "the Service again expressly adopted the *legal analysis* in the Solicitor's Opinion regarding its authority to delist a segment."⁴⁴³ The Rule also included the Service's interpretation of "range" to refer to a species's current range at the time its status is evaluated for listing.⁴⁴⁴

Summing up its *Chevron* inquiry, the court—like the Second Circuit in *Catskill Mountains*—signaled a highly deferential approach at Step Two. First, highlighting that Congress delegated "broad administrative and interpretive power to the [Service]," the court emphasized that the task of defining and listing endangered species "requires an expertise and attention to detail" that favors deferring to agency so long as its interpretation is "reasonable."⁴⁴⁵ Finally, citing *Encino Motorcars*, the court noted parenthetically that "[a]gencies are free to change their existing policies so long as they provide a reasoned explanation for the change."⁴⁴⁶

But, unlike in *Catskill Mountains*, the court's analysis did not end there. The court, invoking *State Farm*, rebuked the agency for failing to consider

threatened status turns on threats the species faces "throughout all or a significant portion of its range." *Id.* at 603 (quoting 16 U.S.C. § 1532(6), (20)); *see also id.* at 604 ("[T]raditional rules of statutory construction do not answer the question of whether 'range' means current or historical range.").

438. *Id.* at 597.

439. *Id.* at 605; *see also id.* at 603 ("Because the Service's interpretation of 'range' as focusing on 'current range' is reasonable, we uphold it.").

440. *See id.* at 597–98, 605.

441. *Id.* at 592.

442. *Id.* at 592–93; *see also id.* at 590 ("The Secretary of the Interior has delegated the authority to determine whether a species is 'endangered' or 'threatened' to the Fish and Wildlife Service.").

443. *Id.* at 594; *see also id.* at 599 ("The Solicitor's Opinion, formally adopted by the Service, has now explicitly interpreted the Act to allow the segment tool for delisting."). The Service also analyzed the five statutory endangerment factors and concluded that the Western Great Lakes segment was neither endangered nor threatened throughout a significant portion of its range. *Id.* at 594.

444. *Id.* at 603.

445. *Id.* at 600 (alteration in original) (quoting *Babbitt v. Sweet Home Chapter of Cmty. for a Great Or.*, 515 U.S. 687, 708 (1995)).

446. *Id.* at 599 (quoting *Encino Motorcars, L.L.C. v. Navarro*, 136 S. Ct. 2117, 2125 (2016)).

“an important aspect of the problem” it faced.⁴⁴⁷ Moreover, it signaled the relevance of agency findings and record evidence to the pertinent statutory interpretation questions.⁴⁴⁸ “Such a failure to address ‘an important aspect of the problem’ that is factually substantiated in the record is unreasoned, arbitrary, and capricious decisionmaking.”⁴⁴⁹

The court’s *State Farm* inquiry followed its resolution of the *Chevron* Two-Step, and it specifically addressed the *Chevron-State Farm* interplay. “While analysis of the reasonableness of agency action ‘under *Chevron* Step Two and arbitrary and capricious review is often the same, the Venn diagram of the two inquiries is not a circle.”⁴⁵⁰ The question thus remained whether the agency “arbitrarily and capriciously” failed to consider an important aspect of the problem it faced.⁴⁵¹ The court ensured that the reasoned decision-making element did not fall out as a consequence of an overly deferential *Chevron* Step Two. Moreover, the court was prepared to thwart an agency that had attempted to insulate itself from such heightened judicial inquiry.⁴⁵²

b. *State Farm Cuts In*

In *MetLife, Inc. v. Financial Stability Oversight Council*,⁴⁵³ the federal district court rescinded the Financial Stability Oversight Council’s (FSOC) final determination, which designated MetLife as a nonbank financial company subject to enhanced supervision—what has come to be known as a “SIFI” or “systemically important financial institution.”⁴⁵⁴ The FSOC voted nine to one to designate MetLife pursuant to its finding that MetLife’s “material financial distress . . . could pose a threat to the financial stability of

447. *Id.* at 605. With respect to the first interpretive question, the “fundamental error” was that “the Service failed to address the impact that extraction of the segment would have on the legal status of the remaining wolves in the already-listed species.” *Id.* at 600. And, with respect to the second, “because the Service categorically excluded the effects of loss of historical range from its analysis,” the court determined that the Service’s conclusion was “insufficiently reasoned, and therefore arbitrary and capricious.” *Id.* at 603.

448. *Id.* at 595 (concluding that the Act permits the designation “but only when the Service first makes the proper findings”); *see also id.* at 605 (“As with the Service’s designation of distinct population segments, the rub in this case is not with the Service’s interpretation of the statute, but with its application of the statute to the *record at hand*.” (emphasis added)).

449. *Id.* at 606 (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)); *see also id.* (“An important factor—the possible enduring consequences of significant loss of historical range—was left out of the analysis all together.”).

450. *Id.* at 605 (citation omitted) (quoting *Pharm. Research & Mfrs. of Am. v. FTC*, 790 F.3d 198, 209 (D.C. Cir. 2015)).

451. *Id.*

452. *Id.* at 606 (“[I]n undertaking that omitted analysis on remand, the Service will have to grapple with predicate questions that the Service has evaded thus far.”).

453. 177 F. Supp. 3d 219 (D.D.C. 2016).

454. *Id.* at 230. Section 113 of the Dodd-Frank Act authorizes the FSOC to designate certain nonbank financial companies for supervision by the Board of Governors of the Federal Reserve System under enhanced prudential standards. 12 U.S.C. § 5323(a)(1) (2012); *see also* DAVID SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* 6, 79–80 (2011).

the United States.”⁴⁵⁵ The FSOC promulgated its designation rule—sometimes referred to as “Guidance”⁴⁵⁶—by notice and comment.⁴⁵⁷ In its rule, the FSOC interpreted the quoted statutory language from the Dodd-Frank Act as follows: “The Council will consider a ‘threat to the financial stability of the United States’ to exist if there would be an *impairment* of financial intermediation or of financial market functioning that would be sufficiently severe to inflict *significant damage* on the broader economy.”⁴⁵⁸

MetLife challenged the FSOC’s final determination on the basis that its designation was arbitrary and capricious.⁴⁵⁹ The district court, relying heavily on *Michigan*’s “reasoned decisionmaking” mandate,⁴⁶⁰ rescinded the

455. 12 U.S.C. § 5323(a)(1). Congress provided two determination standards in the statute: (1) when “material financial distress” at a company “could pose a threat to the financial stability of the United States” or (2) when the very “nature, scope, size, scale, concentration, interconnectedness, or mix of the [company]’s activities” could pose the same threat. *Id.* In its final determination, the FSOC relied on the first determination standard. *MetLife*, 177 F. Supp. 3d at 238 (“The First Determination Standard requires a causal connection between the company’s material financial distress and the resultant ‘impairment of financial intermediation or of financial market functioning.’” (quoting 12 C.F.R. § 1310 Appendix A.II.a)). With respect to this standard, Congress listed eleven nonexhaustive statutory factors for FSOC to consider. 12 U.S.C. § 5323(a)(2) (identifying factors such as “extent of the leverage of the company,” “extent and nature of the off-balance-sheet exposures of the company,” “the amount and nature of the financial assets of the company,” as well as “any other risk-related factors that [FSOC] deems appropriate”). Once so designated, a company is subject to “[e]nhanced supervision” and “prudential standards” to be set by the Federal Reserve. *See id.* § 5365.

456. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,637 (Apr. 11, 2012) (to be codified at 12 C.F.R. pt. 1310) (providing “Proposed Guidance” referred to as “interpretive guidance” by the FSOC).

457. The FSOC promulgated a Final Rule and an Appendix to the Rule entitled “[FSOC] Guidance for Nonbank Financial Company Determinations.” *Id.* at 21,656; *see also* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,264, 64,264 (Oct. 18, 2011) (to be codified at 12 C.F.R. pt. 1310) (second notice of proposed rulemaking); Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4555, 4555 (Jan. 26, 2011) (to be codified at 12 C.F.R. pt. 1310) (first notice of proposed rulemaking); Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 75 Fed. Reg. 61,653 (Oct. 6, 2010) (to be codified at 12 C.F.R. ch. XIII). Public comments were received on the Guidance. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. at 21,640–47. The federal district court treated the FSOC’s designation as a legislative rule but suggested that its analysis would not be affected even if it were instead considered an interpretive rule. *MetLife*, 177 F. Supp. 3d at 227 n.6 (“[E]ven if the Guidance were an ‘interpretive rule’ . . . the agency would still be required—to avoid acting arbitrarily and capriciously—to explain any changes.” (citing *Perez v. Mortg. Bankers Ass’n*, 135 S. Ct. 1199, 1209 (2015))).

458. Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. at 21,657 (emphases added). The FSOC further identified three “transmission channels” through which “significant damage on the broader economy” might be inflicted: (1) exposure, (2) asset liquidation, or (3) critical function or service. *Id.* The Council also laid out a three-stage designation process. *Id.* at 21,660–62. In its final determination, the FSOC analyzed whether material financial distress could spread through the exposure and asset-liquidation channels. *See MetLife*, 177 F. Supp. 3d at 229.

459. *MetLife*, 177 F. Supp. 3d at 238. Congress provided that judicial review is “limited to whether the final determination made . . . was arbitrary and capricious.” 12 U.S.C. § 5323(h).

460. *MetLife*, 177 F. Supp. 3d at 230 (quoting *Michigan v. EPA*, 135 S. Ct. 2699, 2706 (2015)).

final determination on two grounds: FSOC's "unacknowledged departure from its guidance" and its "express refusal to consider cost."⁴⁶¹

The district court highlighted two components of *State Farm's* "reasoned decisionmaking" mandate relevant to its analysis. First, *State Farm* "ordinarily demands that an agency acknowledge and explain the reasons for a changed interpretation."⁴⁶² The court held that "FSOC made critical departures from two of the standards it adopted in its Guidance, never explaining such departures or even recognizing them as such."⁴⁶³ More specifically, the court concluded that "FSOC reversed itself on whether MetLife's vulnerability to financial distress would be considered and on what it means to threaten the financial stability of the United States."⁴⁶⁴ The court reasoned that "[a]lthough an agency can change its statutory interpretation when it explains why, FSOC insists that it changed nothing."⁴⁶⁵ Moreover, the court insisted that the FSOC would have had to demonstrate "good reasons" for its change of policy.⁴⁶⁶

Second, and separate and apart from the agency change-of-position scenario, reasoned decision-making requires "consideration of [all of] the relevant factors,"⁴⁶⁷ including (at least when relevant) cost. The court chastised the FSOC for "assum[ing] the upside benefits of designation . . . but not the downside costs of its decision."⁴⁶⁸ By "focus[ing] exclusively on the presumed benefits of its designation and ignor[ing] the attendant costs," the court held that the FSOC's action was "unreasonable under the teachings of *Michigan v. Environmental Protection Agency*."⁴⁶⁹

461. *Id.* at 223.

462. *Id.* at 233; *see also id.* ("An initial agency interpretation is not instantly carved in stone." (quoting *Verizon v. FCC*, 740 F.3d 623, 636 (D.C. Cir. 2014))).

463. *Id.* at 230.

464. *Id.* at 223; *id.* at 230 ("That alone renders FSOC's determination process fatally flawed.").

465. *Id.* at 223; *see also id.* at 233 ("Although it denies having changed course, FSOC invokes *Fox Television* for the proposition that any change was explained and, therefore, permissible. FSOC is incorrect on both points."); *id.* at 235 ("FSOC has steadfastly refused (and still refuses) to acknowledge that it changed positions on whether Dodd-Frank requires FSOC to assess vulnerability to financial distress.").

466. *Id.* at 235 (citing *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009)); *id.* at 236 ("Having changed policies from the Guidance to its Final Determination, FSOC was required to state 'good reasons' for doing so." (quoting *Fox Television*, 556 U.S. at 515)); *see also id.* at 235 n.14 ("In short, 'a reasoned explanation is needed for disregarding facts and circumstances that underlay or were engendered by the prior policy.'" (quoting *Fox Television*, 556 U.S. at 516)).

467. *Id.* at 240 (quoting *Michigan v. EPA*, 135 S. Ct. 2699, 2706 (2015)).

468. *Id.* at 230. The court, moreover, stated that "FSOC *purposefully* omitted any consideration of the cost of designation to MetLife." *Id.* (emphasis added); *see also id.* at 239 ("There is no doubt that FSOC refused to consider the costs of its Final Determination to MetLife, and purposefully so.").

469. *Id.* at 223; *see also id.* at 230 ("That is arbitrary and capricious under the latest Supreme Court precedent." (citing *Michigan*, 135 S. Ct. at 2699)); *id.* at 241 ("Because FSOC refused to consider cost as part of its calculus, it is impossible to know whether its designation 'does significantly more harm than good.' That renders the Final Determination arbitrary and capricious." (quoting *Michigan*, 135 S. Ct. at 2707)).

The court read *Michigan* as a directive to regulatory agencies (and to courts reviewing agency action) to consider cost as a significant aspect of the decision to regulate.⁴⁷⁰ The court, moreover, highlighted the *Michigan* Court's recognition of the centrality of cost-benefit analysis to the administrative state.⁴⁷¹ Turning to the particular statutory language at issue, the court drew a parallel between the *Michigan* Court's interpretation of "appropriate" in the Clean Air Act and "[a]ppropriate" [as] the touchstone of the catch-all factor in Dodd-Frank Section 113.⁴⁷² Thus, the court concluded that, "[i]n light of *Michigan* and of Dodd-Frank's command to consider all 'appropriate' risk-related factors, FSOC's position [was] at odds with the law and its designation of MetLife must be rescinded."⁴⁷³

There has been a great deal of academic commentary on *MetLife*, but scant attention has been given to its significant implications for heightened judicial scrutiny.⁴⁷⁴ Indeed, *MetLife* is an exemplar of the *Chevron-State Farm* incorporation model. The FSOC argued that "[a]t a minimum, the Council's interpretation of the statute is a permissible one that merits *Chevron*

470. *Id.* at 240 ("One would not say that it is even rational, never mind 'appropriate,' to impose billions of dollars in economic costs in return for a few dollars in health or environmental benefits." (quoting *Michigan*, 135 S. Ct. at 2707)).

471. *Id.* ("Agencies have long treated cost as a centrally relevant factor when deciding whether to regulate. Consideration of cost reflects the understanding that reasonable regulation ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions." (quoting *Michigan*, 135 S. Ct. at 2707–08)).

472. *Id.* The court nonetheless appreciated an important distinction—namely, "Notwithstanding this facial similarity between Dodd-Frank and the Clean Air Act, . . . Dodd-Frank only requires FSOC to consider appropriate 'risk-related' factors." *Id.*; *see also id.* at 241 ("The same textual hook in 12 U.S.C. § 5323(a)(2)(K) ('appropriate') would thus require FSOC to consider the cost of designating a company for enhanced supervision, provided that cost is a 'risk-related' factor.").

473. *Id.* at 242 (quoting 12 U.S.C. § 5323(a)(2)(K)).

474. Two recent notable exceptions are Geoffrey Miller and Adam White. Geoffrey Miller characterizes the *MetLife* decision as "an example of appropriately deferential, but nevertheless meaningful review." Miller, *supra* note 3 (manuscript at 57). As Miller recounts, "Judge Collyer rejected [FSOC's] designation in a devastating opinion pointing to the FSOC's failure to follow discernible standards, failure to undertake reasoned analysis, failure to engage with bona fide arguments put forward by the company, pervasive use of unsupported assumptions, and unexplained changes of position." *Id.* (manuscript at 58). According to Miller, "This sorry bill of particulars would probably not have sufficed to overcome *Chevron* deference in its maximal form, but it was more than enough for Judge Collyer." *Id.* Adam White makes the case that "Dodd-Frank requires the FSOC to provide substantial evidence for its nonbank SIFI determinations" "through its express incorporation of the 'arbitrary and capricious' standard of review." Adam J. White, Too Big for Administrative Law?: FSOC Designations and the Fog of "Systemic Risk" 39 (Dec. 9, 2016) (unpublished manuscript) (on file with the *Fordham Law Review*). Moreover, White concludes that the FSOC's approach "seems to exceed the minimal limits on agency discretion imposed by the D.C. Circuit." *Id.* (manuscript at 42). But instead of looking to heightened judicial scrutiny, White instead turns his attention to Congress. *See id.* ("[I]f the FSOC's nonbank SIFI designation framework falls short of the requirements of administrative law—then fault does not lie primarily with the FSOC. Rather, it reflects Congress's failure to make the substantive policy decision itself."); *see also id.* (manuscript at 13) ("[Congress] gave the FSOC effectively open-ended statutory discretion to define the systemic-risk inquiry on a case-by-case basis.").

deference.”⁴⁷⁵ The district court did not dispute the relevance of *Chevron*;⁴⁷⁶ indeed, at the outset of its analysis, the court made clear that “[u]nder the *Chevron* framework, an agency merits deference to a reasonable interpretation of an ambiguous statute.”⁴⁷⁷ But then—relying heavily upon *Michigan*—the court likewise imposed *State Farm* scrutiny at the second step.⁴⁷⁸ Moreover, while the court characterized the *State Farm* standard as “[h]ighly deferential,”⁴⁷⁹ at the same time it insisted that “[t]he standard is not toothless.”⁴⁸⁰

In deciding to designate MetLife, the FSOC interpreted the statutory provisions of Dodd-Frank by promulgating a rule that set forth the standards that governed the agency’s determination. Specifically, the FSOC interpreted a “‘threat to the financial stability of the United States’ to exist if there would be an *impairment* of financial intermediation or of financial market functioning that would be sufficiently severe to inflict *significant damage* on the broader economy.”⁴⁸¹ These standards are fact-based policy considerations and thus appropriately subject to *State Farm* review. The district court was thus on solid ground in concluding that “[t]his Court cannot affirm a finding that MetLife’s distress would cause severe impairment of financial intermediation or of financial market functioning—even on arbitrary-and-capricious review—when FSOC refused to undertake that analysis itself.”⁴⁸²

To be sure, the fact that the underlying fact finding necessitates predictive judgments may appropriately temper the nature of the court’s review.⁴⁸³ But it should not serve to insulate the agency from judicial scrutiny.

CONCLUSION

The present moment of *Chevron* retreat may usher in meaningful judicial scrutiny at Step Two by incorporating *State Farm* arbitrary and capricious review. Agencies and courts have danced the *Chevron* Two-Step in a manner

475. *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219, 236 n.18 (D.D.C. 2016).

476. Specifically, the court did not dispute the FSOC’s invocation of *Chevron* deference. *See id.* at 236 n.18 (“The Court does not deny that FSOC has the authority to interpret the statute. However, having formally interpreted congressional intent to require a vulnerability analysis . . . , FSOC was not free to abandon that approach without explanation.”).

477. *Id.* at 233 n.12.

478. *Id.* at 230.

479. *Id.* at 229 (quoting *AT&T Corp. v. FCC*, 220 F.3d 607, 616 (D.C. Cir. 2000)).

480. *Id.* at 230.

481. Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,657 (Apr. 11, 2012) (to be codified at 12 C.F.R. pt. 1310 Appendix A.II.a) (emphases added).

482. *MetLife*, 177 F. Supp. 3d at 237; *see also id.* (agreeing with MetLife’s allegation that “[b]ecause it never projected any estimated losses, FSOC never established a basis for a finding that MetLife’s material financial distress would ‘materially impair’ MetLife counterparties within the meaning of the Council’s Interpretive Guidance”).

483. *See id.* (“Predictive judgment must be based on reasoned predictions; a summary of exposures and assets is not a prediction.”); *see also White, supra* note 474 (manuscript at 40) (“Even if courts owe substantial deference to an agency’s predictive expertise, such deference does not overcome these basic factual requirements.”).

that has devolved into judicial acquiescence to agencies' legal statutory interpretations, thus evading judicial scrutiny of their policy-based choices. By requiring that the "reasoned decisionmaking" by agencies includes fact finding or cost-benefit analysis of underlying policy choices vetted in the administrative record, the *Chevron-State Farm* model will ensure that agency expertise is at the center of the discussion and will produce more effective regulatory decisions. Moreover, the model expands the realm of indirect *State Farm* challenges to agency rules in private party litigation implicating *Chevron* statutory interpretation issues.

While the heightened judicial scrutiny of the *Chevron-State Farm* model is most closely associated with imposing fact-finding and cost-benefit analysis requirements upon agencies,⁴⁸⁴ suggesting a conservative valence, it can just as readily be put to use by courts in terms of scrutinizing deregulatory actions by agencies⁴⁸⁵ when not backed by sufficient policy reasons evaluated against the background of the existing administrative records.⁴⁸⁶

Given the era of hyperpartisan political polarity in which we live, this should be a significant selling point. At the agency level, this polarity translates into scores of dramatic flip-flops in agency positions when a President of one party replaces a President of the other party. The *Chevron-State Farm* model would enable courts to temper the effects of this tendency by forcing agencies to give robust policy-based reasons for their changes in policy-inflected statutory interpretation. In other words, it would put the brakes on what Justice Gorsuch decried as agency actions driven solely by a "shift of political winds"⁴⁸⁷—without sacrificing *Chevron*.

The incorporation model is nonpartisan in nature; it is aimed at good governance. Its time has come.

484. The *MetLife* decision discussed above provides a particularly vivid illustration. FSOC made a decision to regulate by designating MetLife; this regulatory decision was then overturned by the court. *See supra* Part III.B.2.b.

485. The *Catskill Mountains* case would fit here because the courts were called upon to review the EPA's decision not to impose permitting requirements. *See supra* Part I.A.

486. In a recent blog posting, Jack Beermann makes a related point (which leads me to believe that he would endorse the *Chevron-State Farm* model). *See* Jack Beermann, *The Deregulatory Moment and the Clean Power Plan Repeal*, HARV. L. REV. BLOG (Nov. 30, 2017), <https://blog.harvardlawreview.org/the-deregulatory-moment-and-the-clean-power-plan-repeal> [<https://perma.cc/47W6-R39Q>] ("And when an agency decides to change course, whether to increase or decrease the level of regulation, it should be based upon a thorough and reasoned re-evaluation of the policies embodied in the relevant statutory scheme, not a legalistic reinterpretation of the underlying statute. Deregulation should be evaluated on its policy merits, not on the legalistic musings of agency and Justice Department lawyers.").

487. *Gutierrez-Brizuela v. Lynch*, 834 F.3d 1142, 1152 (10th Cir. 2016) (Gorsuch, J., concurring).