



Spring 3-1-1950

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Recommended Citation

Edgar A. Prichard, *The Ex Post Facto Aspect of Administrative Law*, 7 Wash. & Lee L. Rev. 19 (1950).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol7/iss1/3>

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THE EX POST FACTO ASPECT OF ADMINISTRATIVE LAW

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To our American brand of republican democracy the separation of the legislative from the judiciary is both basic and definitive. The Constitution vested in the Congress of the United States all of the legislative powers delegated by the people to the national government,¹ and in the Supreme Court and such other courts as Congress should thereafter establish the Constitution vested the judicial power of the United States.² The legislature cannot judge and the judges cannot legislate.

Judges can, however, make law, and they have been steadily making law since the first year of our nation,³ whether they have admitted it or not.⁴ The body of Federal court-made law (judicial precedent) now approaches a thousand volumes.⁵

Some of the jurists of the past who have recognized that courts do make law have criticized court-made law on the ground that it is retroactive in effect, or *ex post facto*.⁶ This *ex post facto* aspect of court-made law has been tolerated, however, apparently because it is a necessary concomitant of the separation of the legislative and the judiciary. If our judges, who cannot legislate, are to make law at all, it must have a retroactive effect upon the case at bar. Could they, having determined the case at bar under existing law, legislate a new rule of solely prospective application, the objection of retroactivity could be avoided. Such a plan would not work, of course, because of the separation of the judicial and legislative functions.

To these two classes of Federal law—Congress-made law and court-made law, Congress has in the present century added a third category—administrative law. This is a sort of law which does not fall readily into the Constitutional scheme of the separation of powers, for administrative law is made by agencies which are members of the execu-

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¹U. S. Const., Art. I.

²U. S. Const., Art. II.

³See Clark, *The Science of Law and Lawmaking* (1896) 11 et seq.

⁴See Cohen, *Law And the Social Order* (1933) 112; Frank, *Law and The Modern Mind* (1930) 32.

⁵U. S. Reports, Federal Reporter, Federal Cases and Federal Supplement.

⁶See Cohen, *Law and the Social Order* (1933) 117; Stone, *The Province and Foundation of Law* (1946) 168.

tive department, possess legislative powers and on occasion behave precisely like courts of law.⁷

Congress has long provided administrative agencies with rule-making power;⁸ that is, the power to formulate statements designed to implement, interpret or prescribe law or policy.⁹ Surely such a power is legislative in character and constitutes a re-delegation of the legislative power given exclusively to Congress by the Constitution. Congress has empowered many agencies to issue orders by a process known as adjudication¹⁰—to apply sanctions and to grant relief.¹¹ The handing down of orders, the imposition of sanctions and the granting of relief,¹² before the advent of administrative law, would surely have been considered exclusively in the judicial province.

As one might expect, the same objection leveled against court-made

⁷See Blachly and Oatman, *Administrative Legislation and Adjudication* (1934), *passim*.

⁸E.g., The Interstate Commerce Commission in 1920. 41 Stat. 498 (1920).

⁹The term "rule-making power" is used advisedly. The term is defined in the Administrative Procedure Act as the process of formulation, amendment or repeal of a rule. A rule is defined as "the whole or any part of any agency statement of general or particular applicability *and future effect* designed to implement, interpret, or prescribe law or policy or to describe the organization, procedure, or practice requirements of any agency" (italics added) 5 U. S. C. 1001 (c) (1940). The Administrative Procedure Act divides administrative action into only two categories: (1) rule-making (2) adjudication. It is interesting to note that this corresponds with Professor James Hart's division of the field in President's Committee on Administrative Management, Report With Special Studies 319 (1937), where he divided the field into: (1) the power to prescribe rules (2) to the power to determine conditions upon which contingent statutes will become operative. Blachly and Oatman worked out a much more involved system of classification. See *Sabotage of the Administrative Process*, Public Administration Review (1946).

¹⁰E.g., The Federal Trade Commission. See President's Committee on Administrative Management, Report with Special Studies (1937) 332.

¹¹"Adjudication" is defined by the Administrative Procedure Act as the agency process for the formulation of an order. An order is defined as "the whole or any part of the final disposition (whether affirmative, negative, injunctive or declaratory in form) of any agency in any matter other than rule-making" 5 U. S. C. 1001 (d) (1940).

¹²"Sanction" includes the whole or part of any agency (1) prohibition, requirement, limitation, or other condition affecting the freedom of any person; (2) withholding of relief; (3) imposition of any form of penalty or fine; (4) destruction, taking, seizure, or withholding of property; (5) assessment of damages, reimbursement, restitution, compensation, costs, charges, or fees; (6) requirement, revocation, or suspension of a license; or (7) taking of other compulsory or restrictive action. "Relief" includes the whole or part of any agency (1) grant of money, assistance, license, authority, exemption, exception, privilege, or remedy; (2) recognition of any claim, right, immunity, privilege, exemption, or exception; or (3) taking of any other action upon the application or petition of, and beneficial to, any person. 5 U. S. C. 1001 (1940).

law the objection that such law is retroactive or *ex post facto*¹³ in effect, has been made to administrative adjudications.¹⁴ As one of the agencies which has the power to make law by the application of sanctions and the granting of relief through the process of adjudication, the Securities and Exchange Commission has come in for its share of criticism.

The SEC also has the power to make law by the legislative process of rule-making.¹⁵ The existence of this legislative law-making power side by side, in the same agency, with judicial law-making power has posed a problem of propriety new to our jurisprudence:

Should the ex post facto aspect of judge-made law be tolerated when the law-making agency could avoid such retroactive effect by formulating under its legislative rule-making power a rule of only prospective application?

The problem was brought under judicial scrutiny recently by the two *Chenery Corporation* cases.¹⁶ The story goes back to November 8, 1937, when the Federal Water Service Corporation registered with the SEC as a public utility holding company. During the ensuing four years, while reorganization plans were in formulation pursuant to sections 7 and 11 (3) of the Public Utility Holding Company Act,¹⁷ certain members of Federal's management individually acquired roughly 10% of Federal's preferred stock in the over-the-counter market.¹⁸ Although the purchases were at considerably less than book value, and admittedly were designed to ensure control of the new company and to produce personal profits,¹⁹ nothing in the Holding Company Act²⁰ nor any SEC rule forbade such trading. However, the SEC, even though making no contention of bad faith or concealment, refused to approve any plan which allowed management to exchange shares so acquired

¹³The term "*ex post facto*" has been used throughout as synonymous with retroactive. This is the meaning used by Austin. See *Lectures on Jurisprudence* (Campbell ed. 1875) *passim*.

¹⁴See Pound, *Administrative Law* (1942) 97; Stone, *Law And Its Administration* (1915) 25 et seq.

¹⁵"The Commission shall have power to make, amend, rescind . . . rules, regulations and such orders as shall be necessary to carry out the policy of this chapter." 15 U. S. C. 79t (1940).

¹⁶*SEC v. Chenery Corp.*, 318 U. S. 80, 63 S. Ct. 454, 87 L. ed. 626 (1943); *SEC v. Chenery Corp.*, 332 U. S. 194, 67 S. Ct. 1575, 91 L. ed. 1995 (1947); Note (1949) 62 *Harv. L. Rev.* 478.

¹⁷15 U. S. C. 79g, 79k (e) (1940).

¹⁸16 officers and directors participated in the purchases. See *SEC v. Chenery Corp.*, 332 U. S. 194, 210, 67 S. Ct. 1575, 1760, 91 L. ed. 1995, 2006 (1947).

¹⁹See *SEC v. Chenery Corp.*, 318 U. S. 80, 85, 63 S. Ct. 454, 458, 87 L. ed. 626, 631 (1943).

²⁰15 U. S. C. 79a-79z-6 (1940).

ratably with other stockholders for new-company common stock.²¹ The reorganization plan finally passed by the SEC required officers to surrender the shares they had acquired pending reorganization for cost plus four per cent interest.²² The Chenery Corporation, a personal holding company controlled by Federal's president, petitioned the Court of Appeals of the District of Columbia, which set aside that part of the SEC's order denying management equal participation with other stockholders in the exchange of old-company preferred for new-company common.²³

Upon certiorari²⁴ the Supreme Court affirmed.²⁵ The Court found that the judicial precedents cited by the SEC did not sustain its conclusions,²⁶ and reiterated that a court cannot affirm the holding of an administrative agency which has reached a correct result by specious reasoning.²⁷ Mr. Justice Frankfurter then went on to state a principle that it is the province of administrative agencies to base their adjudications upon accumulated administrative experience rather than upon judicial precedent.²⁸ He added by implication that had the SEC promulgated a rule under its rule-making power, and had this been an application of such a rule, the Court would readily have upheld the SEC's judgment.²⁹ Mr. Justice Black disagreed all around. First, he found the cases cited by the SEC did support its position, and secondly, he saw no reason for reversing the SEC merely because it had thrown in a few cases to buttress its own administrative judgment.³⁰

²¹Federal Water Service Corp., 8 SEC 893 (1941).

²²Federal Water Service Corp., 10 SEC 200 (1941).

²³Chenery Corp v. SEC, 75 App. D. C. 374, 128 F. (2d) 303 (1942); Note (1942) 56 Harv. L. Rev. 126.

²⁴317 U. S. 609, 63 S. Ct. 52, 87 L. ed. 494 (1942).

²⁵SEC v. Chenery Corp., 318 U. S. 80, 63 S. Ct. 454, 87 L. ed. 626 (1943); Note (1943) 56 Harv. L. Rev. 1002.

²⁶Professor E. M. Dodd in Note (1943) 56 Harv. L. Rev. 1002, 1004 suggested that the Court here required a different standard of law-making than it would have required of a court. He pointed out that the cases cited by the SEC where lower Federal Courts denied compensation to participants in a corporate reorganization under Sec. 77B of the Bankruptcy Act of 1898 because they traded in corporate stock during reorganization, were very similar to the order of the SEC. Professor Dodd's contention may be borne out by the fact that the second time up the SEC's order was affirmed when it was based on administrative experience rather than judicial precedent.

²⁷SEC v. Chenery Corp., 318 U. S. 80, 94, 63 Sup. Ct. 454, 462, 87 L. ed. 626, 636 (1943); See U. S. v. Chicago, Milwaukee & St. Paul R. R., 294 U. S. 499, 511, 55 S. Ct. 462, 467, 79 L. ed. 1023, 1032 (1935).

²⁸SEC v. Chenery Corp., 318 U. S. 80, 93, 63 Sup. Ct. 454, 462, 87 L. ed. 626, 636 (1943).

²⁹318 U. S. 80, 92, 63 Sup. Ct. 458, 461, 87 L. ed. 626, 635 (1943).

³⁰318 U. S. 80, 95, 63 Sup. Ct. 458, 463, 87 L. ed. 626, 637 (1943).

Upon the remand, the SEC, relying this time upon its administrative experience rather than upon judicial precedent, reached the identical result.³¹ The Chenery Corporation again applied to the Court of Appeals for the District of Columbia, and again that court, in reliance upon the mandate of the Supreme Court, reversed the SEC.³²

The Supreme Court granted certiorari³³ a second time, and this time it reversed the Court of Appeals³⁴ and sustained the second adjudication of the SEC. Through Mr. Justice Murphy the Court said that the judgment of the SEC, supported by its cumulative administrative experience in the field of reorganization, was no abuse of discretion. The Court then went on to approve the action of the SEC in creating a new standard for governing future conduct by an *ad hoc* adjudication—approved the SEC's proceeding by order rather than by rule³⁵—regardless of the incidental retroactive or *ex post facto* effect upon the officers of Federal Water Service Corporation.³⁶

Practically all of the disagreement between the justices in the two Chenery Corporation cases has centered around the *ex post facto* aspect of the action of the SEC in proceeding by order rather than by rule. Had the SEC published a rule and applied it thereafter to this case, the rule would have been sustained in the first instance.³⁷ The SEC, however, felt that it lacked adequate experience with this problem to warrant crystalizing its present judgment into a hard-and-fast

³¹Federal Water Service Corp., Holding Company Act Release No. 5584. (Feb. 7, 1945).

³²Chenery Corp. v. SEC, 80 App. D. C. 365, 154 F. (2d) 6 (1946); Note (1947) 1 Rutgers L. Rev. 146.

³³328 U. S. 829, 66 S. Ct. 1025, 90 L. ed. 1606 (1946).

³⁴SEC v. Chenery Corp., 332 U. S. 194, 67 S. Ct. 1575, 91 L. ed. 1995 (1947).

³⁵332 U. S. 194, 203, 67 S. Ct. 1575, 1581, 91 L. ed. 1995, 2003 (1947).

³⁶The order certainly had an *ex post facto* effect upon the officers of Federal Water Service Corporation. Before the SEC's order, although it had frequently been stated that corporate officers are fiduciaries—e.g., Burnes Nat. Bank v. Mueller-Keller Candy Co., 86 F. (2d) 252, 254 (C. C. A. 8th, 1936); 3 Fletcher, Corporations 838 (1931)—no barrier had been erected against open and above-board dealings in corporate stock by officers with their corporation, *Chatz v. Midco Oil Corp.*, 152 F. (2d) 153 (C. C. A. 7th, 1945), cert. denied, 329 U. S. 717, 67 S. Ct. 49, 91 L. ed. 38 (1946); *Keely v. Black*, 91 N. J. Eq. 520, 111 Atl. 22 (1920), with the one exception contained in the Holding Company Act itself. 15 U. S. C. 799(b) (1940). Neither had there been any objection by the majority view to stock transactions between officers and stockholders, provided there was no showing of bad faith or misrepresentation. *Anderson v. Lloyd*, 64 Idaho 768, 139 P. (2d) 244 (1943). Even the stricter minority view went no further than to throw upon officers the further burden of proving good faith and full disclosure. *Nichol v. Sensenbrenner*, 220 Wis. 165, 263 N. W. 650 (1935). *A fortiori* over-the-counter trading has heretofore escaped censure. See *Goodwin v. Agassiz*, 283 Mass. 358, 362, 186 N. E. 659, 661 (1933).

³⁷See *SEC v. Chenery Corp.*, 318 U. S. 80, 92, 63 S. Ct. 458, 461, 87 L. ed. 626, 635 (1943).

rule,³⁸ and furthermore, since no rule existed when this case arose, even had such a rule been published it presumably would not have applied to this case.³⁹ Hence the SEC chose to use its power to make law by the process of adjudication. In other words, the SEC made a new law as a court would have made a new law.

The powers conferred by Congress upon the SEC were advisedly broad.⁴⁰ The Holding Company Act was designed to provide a broad framework which could be eked out by rules and varied by the SEC to meet new situations, hence obviating the ceaseless amendment required by earlier administrative acts.⁴¹ To implement this policy Congress provided the SEC with power to make rules of general application and to grant relief and to apply sanctions through adjudications.⁴²

When a Court makes a new law it is inevitably retroactive in effect.⁴³ When an administrative agency possessing rule-making power makes a new law it is not inevitably retroactive, for the administrative agency can use its legislative power to make a rule for future application, while adjudicating the case at bar under existing law.

Is the ex post facto aspect of a new administrative standard of conduct created by order a sufficient evil to *require* the administrative agency to use its rule-making power instead? The position of Justices Frankfurter and Jackson in the Chenery Corporation cases seems to be that it is.⁴⁴ This is not a recent conviction of Justice Frankfurter,⁴⁵ but it is interesting to note that Justice Jackson was once publicly associated with the other point of view.⁴⁶

Justice Jackson charged in the second Chenery case that the Court

³⁸SEC v. Chenery Corp., 332 U. S. 194, 202, 67 S. Ct. 1575, 1580, 91 L. ed. 1995, 2002 (1947).

³⁹Rules apply only prospectively. See note 9, supra.

⁴⁰See Cushman, *The Independent Regulatory Commissions* (1941) 336; Landis, *The Administrative Process* (1938) 66.

⁴¹See Landis, *The Administrative Process* (1938) 68.

⁴²15 U. S. C. 79t (1940).

⁴³See 1 Austin, *Jurisprudence* (Campbell ed. 1875) 487; Salmond, *Jurisprudence* (10th ed. 1947) 165.

⁴⁴This is substantially Professor Dodd's characterization of Frankfurter's opinion in the first Chenery case. See Note (1943) 56 Harv. L. Rev. 1002, 1005.

⁴⁵In *Colyer v. Skeffington*, 265 Fed. 17 (D. Mass. 1920) Mr. Felix Frankfurter filed a brief *amicus curiae*, contending that an administrative agency may not repeal an existing rule so as to affect the result in a particular case.

⁴⁶"It is recognized, however, that administrative agencies, like the courts, must often develop their jurisprudence in a piecemeal manner, through case-by-case consideration of particularized controversies." See Final Report of the Attorney General's Committee on Administrative Procedure (1941) 29, published over the signature of Attorney General Robert H. Jackson.

has changed its prevailing philosophy since the first *Chenery* case.⁴⁷ There seems a great deal of merit in Justice Jackson's argument. In the first *Chenery* case the Court said, through Justice Frankfurter, "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards."⁴⁸ In the Second *Chenery* case Justice Jackson argues, with Justice Frankfurter's concurrence, that this statement was a part of the holding of the first *Chenery* case,⁴⁹ and there is no doubt that it was so regarded by Justice Frankfurter when he wrote the opinion. The majority of the Court, however, speaking through Mr. Justice Murphy, said that the first *Chenery* case, "held no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency."⁵⁰ The truth of the matter is that, while all but one of the individual justices stuck by their guns, a change in Court personnel elevated the dissenters of the first *Chenery* case to the majority in the second *Chenery* case.⁵¹ The Court then simply followed the old ruse of narrowly construing a prior decision so as to avoid the necessity of overruling itself.

There are other reasons why the making of law during the decision of a particular case can be considered objectionable. Justice Jackson put his finger on one of them when he quoted Cardozo's statement, "Law as a guide to conduct is reduced to the level of mere futility if it is unknown and unknowable."⁵² Another objection is that a rule laid down during the decision of a particular case is seldom comprehensive, for it is apt to be too narrow or too broad because of the peculiarities of the

⁴⁷*SEC v. Chenery Corp.*, 332 U. S. 194, 210, 67 S. Ct. 1575, 1760, 91 L. ed. 1995, 2006 (1947).

⁴⁸*SEC v. Chenery Corp.*, 318 U. S. 80, 92, 63 S. Ct. 454, 461, 87 L. ed. 626, 635 (1943).

⁴⁹*SEC v. Chenery Corp.*, 332 U. S. 194, 212, 67 S. Ct. 1575, 1761, 91 L. ed. 1995, 2007 (1947).

⁵⁰332 U. S. 194, 200, 67 S. Ct. 1575, 1579, 91 L. ed. 1995, 2001 (1947).

⁵¹

<i>First Chenery Case</i>		<i>Second Chenery Case</i>	
MAJORITY	DISSENTERS	MAJORITY	DISSENTERS
Frankfurter	Black	Black	Frankfurter
Jackson	Murphy	Murphy	Jackson
Stone	Reed	Reed	
Roberts		Burton	
Rutledge		Rutledge	

⁵²*SEC v. Chenery Corp.*, 332 U. S. 194, 217, 67 S. Ct. 1575, 1763, 91 L. ed. 1995, 2010 (1947).

case at bar.⁵³ A fourth objection is that judge-made law is generally made and applied in haste, without opportunity for hearings, conference and study.⁵⁴

Of course, these objections applied to court-made law before administrative law was thought of. But Anglo-American jurists, while recognizing the validity of the objections, have still had relatively little criticism of court-made law. The critics have immediately realized that criticism of law-making by courts is criticism of the common-law system itself.⁵⁵

The common-law system, however, could probably have got along nicely without the addition of *ad hoc* adjudications by administrative agencies. When *ex post facto* effect could so easily have been avoided by using rule-making power, at the expense of only a little administrative convenience and of letting one act which the agency deemed reprehensible go unpunished, then it is difficult to see why the agency should not have been required to use its rule-making power. Allowing the SEC to proceed as it did in this case has given convenience the upper hand over traditional safeguards of personal rights. Opposition to *ex post facto* laws has been a part of the American tradition—the prohibition is written into the Constitution.⁵⁶ Even declaratory laws passed by the legislative process have been denied retroactive effect.⁵⁷

But the Supreme Court has opened the door, with only a hint that it may be partly closed in the future.⁵⁸ That which has been so long tolerated from judges will now be tolerated from administrative agencies. The bright spot in the picture is the remarkable restraint practiced by the administrative agencies since the *Chenery* ruling.⁵⁹ Perhaps the power will not be carried too far.

⁵³See Blachly & Oatman, *Administrative Legislation and Adjudication* (1934) 50.

⁵⁴See Austin, *Jurisprudence* (Campbell ed. 1875).

⁵⁵Austin, *Jurisprudence* (Campbell ed. 1875) 180; Stone, *Law And Its Administration* (1915) 45; Vinogradoff, *Common Sense In The Law* (1914) 207.

⁵⁶U. S. Const., Art. 1, § 9.

⁵⁷*Ogden v. Blackledge*, 2 Cranch 272 (U. S. 1804).

⁵⁸"Since the Commission, unlike a court, does have the ability to make law prospectively through the exercise of its rule-making powers, it has *less reason* to rely upon *ad hoc* adjudication to formulate new standards of conduct " [italics added] *SEC v. Chenery Corp.*, 332 U. S. 194, 202, 67 S. Ct. 1575, 1580, 91 L. ed. 1995, 2002 (1947).

⁵⁹In *Cities Service Co., SEC Holding Company Act* Release No. 7720 (October 1, 1947), and again in *American States Utilities Corp., SEC Holding Company Act* Release No. 7721 (October 3, 1947) the SEC passed up two opportunities for extending the rule formulated by order in *Federal Water Service, SEC Holding Company Act* Release No. 5584 (Feb. 7, 1945) and approved in the second *Chenery* case, *supra*. The SEC in the *Cities Service Co.* and *American States Utilities Corp.* cases

confined the Federal Water Service rule to the situation where there is: (1) a concerted purchase program by management; (2) a motive to acquire voting power; (3) a large scale of trading. Further, in Cities Service Co., the SEC included a promise to publish a rule of general application under its rule-making power as soon as possible. See SEC Holding Company Act Release No. 7720 (October 1, 1947) 16.