Strategic Instruments: Legal Structure and Political Games in Administrative Law

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This article presents models of strategic behavior by agencies and courts where the ability to manipulate the instruments of decision making, rather than merely selecting policy choices, allows actors to insulate their policy choices from higher level review. The theory is based on the notion that decision instruments (for example, rulemaking and adjudication for agencies, statutory interpretation and reasoning process review for courts) pose differential costs and payoffs for both the initiating and reviewing actors, each of whom have resource constraints. Because the initiating actor has the choice among instruments to make a decision (and to which a higher level reviewing actor is tied), the initiating actor can manipulate decision costs in a strategic fashion (choosing high-cost instruments to discourage higher level review, in particular). This article adds new insight into how judges and agencies engage in strategic decision making.

1. Introduction

The use of particular administrative instruments by regulators to advance policy goals has fluctuated greatly over the last three decades. The 1970s, for example, were known as the "era of rulemaking" as regulators enjoyed the minimal procedural requirements of informal rulemaking to advance their policy aims (Scalia, 1981). By the mid-1980s, however, rulemaking had "ossified" as courts heaped on additional process requirements for agency rulemaking (McGarity, 1992). Regulators increasingly abandoned rulemaking and instead choose other instruments, such as adjudication, policy manuals, guidelines, policy statements, and the like, to implement new regulatory policy (Anthony, 1992). Similarly, the use of particular judicial instruments by judges to review and reverse regu-

latory decisions (e.g., statutory interpretation and process review) shifted over time. Process-based remands (and reversals) of agency decisions, for example, rose precipitously during the late 1970s and throughout the 1980s while the use of statutory interpretation to discipline regulators began to fall off by the mid-1980s (Wald, 1988; Cohen and Spitzer, 1994). In this article we present a theory of strategic behavior to understand the choice of administrative and judicial instruments by agencies and courts, and to suggest some reasons for the shifts in instrument use over time.

Our theory expands and complements recent developments in the theory of legislative design of agency decision making (e.g., McCubbins, Noll, and Weingast, 1987, 1989; Epstein and O'Halloran, 1994; Lupia and McCubbins, 1994; Bawn, 1995; Spiller and Tiller, 1997). In the agency design framework, administrative instruments are seen as structures and processes put upon the agency ex ante by a coalition of enacting politicians to ensure that agencies promote the enacting politicians' policies in future decisions. The range of instruments and processes available to the enacting coalition is quite large and allows politicians to tailor their control to their governance needs.[1] Consequently, agency preferences are endogenous in that they are induced by the administrative procedures set by the enacting coalition. Strategic choices by agencies about the instruments they use are not explored. In contrast, our model assumes that regulators exercise considerable discretion in the choice of regulatory instruments.[2] Instrument choice is strategic as it impacts on the decision costs and payoffs of both the initiating and the reviewing entities. Since agencies and courts operate in an environment of scarce resources, decision costs and payoffs have implications for the probability of review of a particular decision by higher level actors, as well as for the direct welfare of the initiating entity.[3] Our model gives the judiciary a prominent role both with respect to agency strategy and with respect to the competitive games among courts within the judicial hierarchy. We consider, for example, why an agency might choose one instrument (say, adjudication) over another (say, rulemaking) as a way to avoid reversal by an appellate court, or why an appellate court wishing

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1. See, however, Moe (1989) for a discussion of the limits of agency control by legislators. Moe notes that agency experts have a conflict of interest with legislators (and benefit from asymmetric information) which results in imperfect control by legislators. For a more general overview of positive political theory approaches as they apply to administrative law, see Rodriguez (1994) and Spence (1997).

2. For instance, we may refer to the choice between policy-making instruments, such as the regulator's choice between rulemaking and adjudication, while the work of McCubbins, Noll, and Weingast relates more specifically to the choice the enacting coalition might make regarding the processes of a particular instrument, such as whether rulemakings or adjudications must include a certain class of persons for participation. We believe an understanding of how agencies and courts use the various instruments available to them is necessary to understand the parameters of administrative and judicial discretion and how the game, between regulators and courts, actually gets played.

3. Our approach is more in line with the work of Hamilton and Schroeder (1994), who similarly view the agency's choice of instruments as a strategic decision. They focus mainly on agency strategies to avoid congressional discipline.

to discourage Supreme Court review might reverse an agency through process objections rather than statutory interpretation. The insight is that players can strategically manipulate instruments in order to impact the decision costs and payoffs of their competitors.

Two variants of the basic model are developed here. The first describes a bilateral game between a regulatory agency and a court from which optimal strategies for an agency are determined. In that model we characterize the instruments in a generic fashion as "high-cost" and "low-cost" instruments (with "cost" relating not only to the agency's decision-making processes, but also to the appellate court's costs and payoffs in reviewing and reversing the agency decision). We then develop a bilateral game between a lower court (federal district court or appellate court panel, for example) and a higher court (full circuit en banc or Supreme Court, again as an example) and consider the resulting optimal strategies for the lower court.

2. Instruments and Decision Costs

Our theory of strategic instrument choice is built upon two basic tenets. First, administrative and judicial decision making is costly and is undertaken in an environment with limited resources. Consequently, an actor's decision cost in making policy is a key component of the strategic calculus. By "decision cost" we mean (1) the amount of organizational resources required to calculate the likely policy consequences of one's own actions and (2) the resources required to perform the processes and procedures required to issue a decision, or group of decisions if such is needed, to control the policy of another actor (for example, the costs to a court of conducting single versus multiple reviews of agency actions in order to stop an agency policy). Decision costs can be considered large or small depending on the relative value they bring—that is, the amount of policy payoff a decision gives for an actor per unit of time and effort put forth.

Second, actors make choices not only about policy outcomes, but also the means (instruments) to achieve those policy outcomes. For agencies, the choice of decision instruments often comes down to a choice among rulemaking, adjudication, or more casual instruments such as policy statements and manuals. For courts, standing, reviewability, statutory interpretation, and process review are the more common instruments upon which a court bases its decisions when reviewing administrative agency action. The use of these various instruments results in differential decision costs to the initiating actor (agencies and lower courts) as well as imposes differential costs on any reviewing entity (various levels of the courts). To avoid reversal, actors may trade off their own institutional efficiency, which could be achieved best through one particular instrument (agency rulemaking, for example), for a more burdensome instrument choice (multiple agency adjudications, for example), if such choice imposes even greater relative decision costs on competing actors (such as a reviewing court). In short, as the political goals of the initiating institution come in conflict with those of a reviewing institution, imposing decision costs on the reviewing institution may be a successful strategy to discourage strict monitoring and reversal.

In our framework, the goal of each individual actor is to achieve a policy outcome as close to its policy preferences at the lowest cost; in other words, each actor wishes to maximize its net utility. We define the net utility as the utility an actor receives from the final policy outcome less that actor's decision cost in reaching that policy outcome. That is, we assume the net utility of an actor is separable in policy and decision costs.

The relevant policy outcome for an actor is the one that takes place after all actors (agencies and courts) have made their moves in the game. The desire to affect the final policy outcome is what triggers strategic behavior. If players were concerned merely with their own decision outcomes, they would generally choose a low-cost decision instrument as that would be the most efficient way to reach the desired policy in a resource-constrained environment. The presence of competing players, however, means that those policy choices are vulnerable to reversal. Policy maximizing actors then, so as to get the most out of their effort, must take into consideration the actions of others and the value of high-cost decision instruments.

3. Agency Strategy Under Political Competition

3.1 Basic Framework

We now present the more salient aspects of our framework through a series of figures. Formal models are set out in the appendixes. Figures 1–3 illustrate how an agency can manipulate the decision costs and payoffs of a court by selecting among various administrative policy instruments which the court must review if such court wishes to reverse the agency policy. As there are considerable variations in the decision costs associated with reviewing the various instruments, the agency can protect certain policy outcomes from the court by choosing an appropriate instrument. In choosing that instrument the agency balances the differential decision costs and payoffs both for itself and for the reviewing court.

Consider Figure 1. This figure represents agency decision making in the absence of judicial review.[4] That is, assume, for the moment, that the agency's choice is the final policy outcome, whether such choice implements a new policy or retains the status quo. Ignoring the courts allows us to consider the constraining effect of the agency's own resource limitation before introducing the added constraints of judicial review. Let A, in the figure, represent the ideal policy point of the agency, x_0 the status quo, and x any new policy the agency selects other than the status quo. We present three possible locations for the status quo (x_0^1, x_0^2, x_0^3) to illustrate the different situations the agency might face. Assume that the agency's utility declines monotonically (and linearly) the farther policy is from its ideal point A. The agency's utility is represented by $U_A(X)$, where X may take the values x or x_0. In the figure, $U_A(x_0^1) > U_A(x_0^2) > U_A(x_0^3)$.

Ideally the agency would like to implement A (the agency's ideal policy point); to do so, however, requires the expenditure of time and effort (decision

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4. We do not model here the interaction of these actors with the legislature and the president. As will become clear, though, Congress can impact policy outcomes by changing the decision and reviewing the costs of agencies and courts. We discuss these issues later.
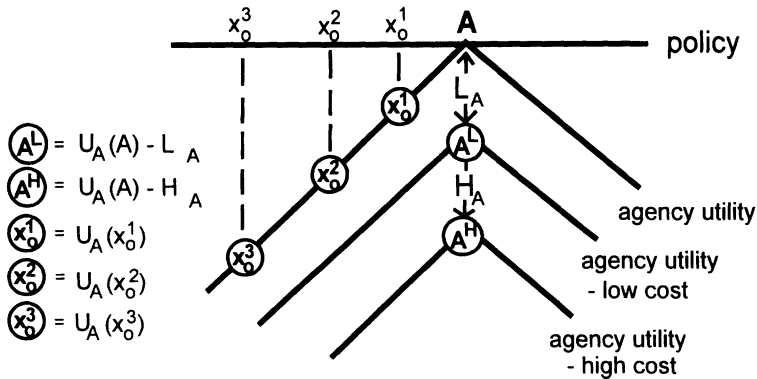
Figure 1. Net utility for agency absent judicial review.

costs). We let L_A and H_A represent those decision costs required of the agency when making a policy decision through a high-cost instrument (H) and a low-cost instrument (L), respectively. Note that these costs relate solely to the agency's own resources. We also assume that doing nothing—that is, accepting the status quo—involves the least expenditure of decision cost for the agency and we standardize that cost to zero; accordingly, $H_A > L_A > 0$. The agency's net utility from making a new policy A is given by $U_A(A) - L_A$ if achieved through instrument L and $U_A(A) - H_A$ if done through instrument H. These are identified in Figure 1 by circles A^L and A^H, respectively. Clearly, moving policy to A through a low-cost instrument would always provide the agency with higher net utility than moving policy to A through a high-cost instrument—that is, $U_A(A) - L_A > U_A(A) - H_A$.

While an agency would generally like to implement A as the new policy, the decision costs may make the relative gain in policy not worth the effort. In Figure 1 the agency's net utility of accepting x_0^1 (if x_0^1 were the status quo) is greater than the net utility the agency would have in bringing the policy to A through L—that is, $U_A(x_0^1) > U_A(A) - L_A$. This is reflected in the figure as circle A^L being higher than circle x_0^1. In this case the agency acquiesces to the status quo, even though the agency prefers policy A. In comparison, the agency's net utility at x_0^2 or x_0^3 (if either of those were the actual status quo) is less than the agency's net utility of A achieved through the use of L—that is, $U_A(A) - L_A > U_A(x_0^2) > U_A(x_0^3)$. This is reflected in the figure as circle A^L being higher than circles x_0^2 and x_0^3. In such cases the agency would choose to act by setting a new policy A through instrument L.[5] Lemma 1 in Appendix B summarizes the equilibrium outcomes for agency behavior when judicial review is not available.

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5. If the agency was limited to using H as its decision instrument, then only x_0^3 would be worth changing (clear circle A^H above clear circle x_0^3, but below clear circles x_0^2 and x_0^1).

By definition, a low-cost instrument is more efficient for the agency than a high-cost instrument for changing policy. Consequently, in the absence of judicial review, a policy-maximizing agency would rarely, on its own, choose a high-cost instrument to change policy. This is not to say that we would never see the use of a high-cost instrument. It may be that the agency is required by statute to engage in policy making through the high-cost instrument.[6] Moreover, we may see the use of high-cost instruments for other reasons. Adjudication, for example, may be a high-cost endeavor for a certain agency wishing to change policy. Perhaps it would require multiple adjudications (given their fact-specific nature) to create a desired policy and thus might not be feasible in comparison to the use of rulemaking. This, however, does not mean that the agency would not use individual adjudications for purposes other than creating a policy, such as enforcing an established policy against a violator.

Consider, now, the threat of judicial review. Legal challenges to the actions of federal regulatory agencies are taken to the federal courts. By statutory design, some appeals go directly to a federal appellate court while others work their way through the lower district courts before coming to the appellate court. When a case comes to the appellate court, a three-member panel is selected to hear the case. These panels are generally required to make decisions on all cases appealed to them from both regulatory agencies and district courts.

We assume that agency inaction, that is, a decision by the agency to retain the status quo, will not invoke judicial review.[7] This, however, does not mean that the court was necessarily an irrelevant actor in the calculations of the agency. Indeed, the reason for the inaction may well have been the threat of judicial review and reversal. Whether the agency refused to act due to its own resource constraints or because of the threat of certain reversal by the court, the empirical observation is the same—no new agency policy. The distinction, nonetheless, remains analytically important for understanding the strategic behavior that may have taken place. In our model the court only comes into strategic consideration for the agency if, considering its own decision costs, the agency would like to change policy from the status quo. In Figure 1, those circumstances existed when the status quo was located at x_0^2 and x_0^3. If x_0^1 were the status quo, the presence of a court would not be a strategic consideration for the agency because achieving a policy change would not be worth the agency's own decision cost in the first instance.

As with agencies, we assume that the time and energy resources of courts are constrained. Furthermore, we assume that courts must expend resources to review and reverse new agency policies and the resources required vary with

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6. See Spiller and Tiller (1997) for a model of congressional control over agencies through the structuring of decision costs.

7. This, of course, is not always the case. An interested party may challenge agency inaction based on the agency's nonresponsiveness to a congressional directive to change policy. Or, circumstances (technological or otherwise) may have changed to make the status quo no longer in compliance with the statutory directive. We do not investigate these possibilities in this model as we believe judicial review of agency action, rather than inaction, to be the main case. For a discussion of the limited occasions for judicial review of agency inaction, see Sunstein (1986).
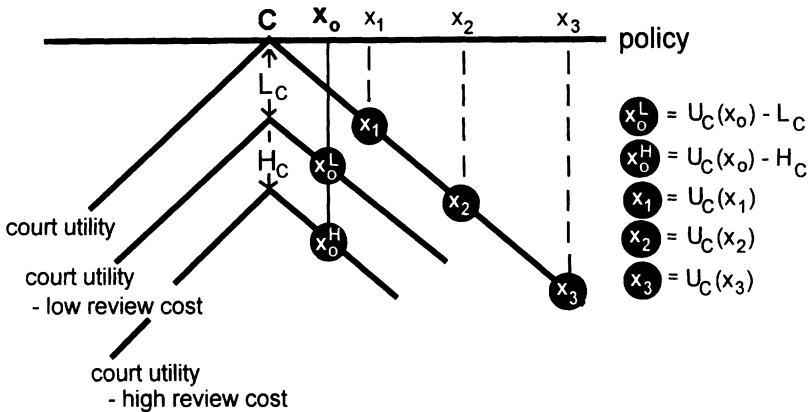
Figure 2. Net utility for court of appeals reviewing agency action.

(1) whether the court upholds or reverses (or remands) the agency and (2) if reversing, the agency instrument reviewed by the court. While our model allows the agency to decide policy on a continuum of choices, we restrict the court's choice to two options: affirm the new policy x or reverse the agency and reinstate the status quo x_0. We assume that affirming the agency choice is the least costly option for the court and we standardize that amount to zero. Reversing the agency would require more court resources to undermine agency rationales and interpretations. Furthermore, because deference to agency decision making by courts is the presumed norm, there would be less need to expend resources explaining the court's ruling in an affirmance than in a reversal [*Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984)]. That is, there would be less need for the court to spend resources protecting its decisions from further scrutiny from higher courts, a risk we discuss in Section 4.

Refer now to Figure 2. We let C represent the ideal policy point of the court in charge of reviewing agency policy. As with the agency we assume that the court's utility declines monotonically the farther policy is from the court's ideal point C. This utility is represented by $U_C(X)$. As noted above, we assume that the decision costs for reversals are not uniform, but rather are determined in part by the type of agency instrument the court is called upon to review. For simplicity, we will assume that if the agency used a high-cost instrument to make a policy, a court wishing to reverse that policy would need to expend higher resources than if it were reversing an agency decision made with a low-cost instrument. In other words, an agency's use of a high-cost instrument (H) translates into high-cost review for the court, while an agency's use of a low-cost instrument (L) translates into low-cost review for the court.[8] Let H_C and L_C

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8. It is certainly possible that what is low-cost decision making for the agency could result in high-cost review for the appellate court (or vice versa). The model could be expanded to include these possibilities without losing its basic insights about agency strategy. For ease of exposition, these complexities are not addressed here.

represent high-cost and low-cost judicial review, respectively. Furthermore, let $H_C > L_C > 0$ with 0 being the standardized cost for a court affirmance of the agency policy choice (essentially we are assuming that reversal is more costly than affirmance). Thus the court's net utility from reversing an agency policy that was made through instrument L is given by $U_C(x_0) - L_C$; if reversing an agency policy accomplished through H, the court's net utility is given by $U_C(x_0) - H_C$. Should the court affirm the agency policy, its net utility is given by $U_C(x)$.

In Figure 2 we have three possible agency policies (x_1, x_2, and x_3) for the court's consideration. Note that if the agency sets x_1 as the policy choice, regardless of whether the agency did so through L or H, the court would affirm the agency outcome. The court's net utility in affirming the agency is greater than its net utility through reversing agency policy x. That is, $U_C(x_1) > U_C(x_0) - L_C > U_C(x_0) - H_C$. In the figure, darkened circle x_1 represents the court's utility in accepting the new agency policy, while darkened circles x_0^L and x_0^H represent the court's utility in reversing the agency through low-cost and high-cost review (thereby returning policy to the status quo). Because darkened circle x_1 is located higher than darkened circles x_0^L and x_0^H, the court would affirm the agency policy.

Agency policy x_2 is a different case. If the agency policy were accomplished through a low-cost instrument, then the court could use low-cost judicial review to reinstate the status quo and receive higher utility than accepting x_2. That is, $U_C(x_0) - L_C > U_C(x_2)$. This is reflected in Figure 2 as darkened circle x_0^L being higher than darkened circle x_2. If, however, the agency had accomplished x_2 through a high-cost instrument (H), then the court would not overturn the agency decision since the court's net utility would be higher with an affirmance. That is, $U_C(x_2) > U_C(x_0) - H_C$. In Figure 2, this is reflected as darkened circle x_2 being higher than darkened circle x_0^H.

Finally, should the agency chose x_3 as its policy choice, whether through L or H, the court would be certain to reverse as its net utility in reversing the agency and reestablishing the status quo would be greater than acquiescing to the agency policy. That is, $U_C(x_0) - L_C > U_C(x_0) - H_C > U_C(x_3)$. In Figure 2, this is reflected by the darkened circles x_0^L and x_0^H being located higher than the darkened circle x_3.

We now can consider the full game between agency and court. Refer to Figure 3 which includes both an agency and a court with their respective utility functions. The agency can be seen as having three potential policy choices that maximize its net utility: (1) accept the status quo, (2) choose the policy nearest its ideal point that, using a low-cost instrument, will not be reversed by the court; and (3) choose the policy nearest its ideal point that, using a high-cost instrument, will not be reversed by the court. The optimal choice for the agency is the one of these three policy and instrument combinations that brings it the highest net utility. We can see the game at work in Figure 3.

The viable policy choices can be determined by calculating the trade-off for the court in terms of policy and decision costs. Assume the agency is contemplating a change in policy through a low-cost instrument L. We know that the
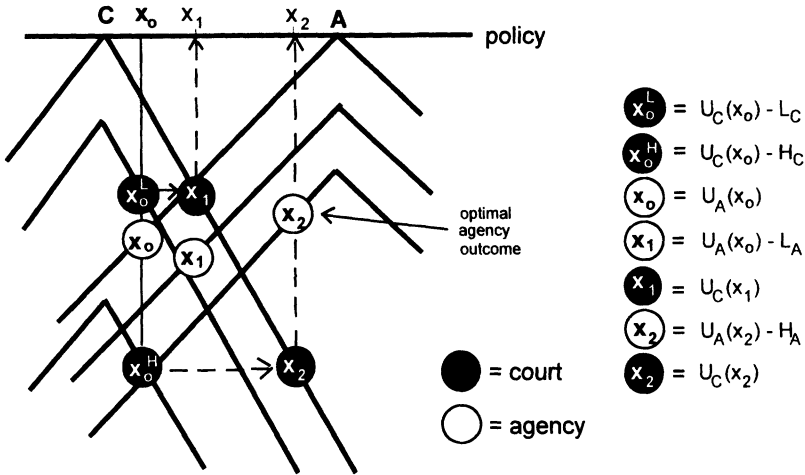
Figure 3. Agency strategies in the presence of judicial review.

net utility that the court receives in reversing the agency is $U_C(x_0) - L_C$ when the agency has chosen to change policy through a low-cost instrument. In Figure 3, that utility is identified as darkened circle x_0^L. Through inspection of the figure we can find an agency policy where the court would get as much net utility in accepting such policy as it would in reversing it through low-cost review and reestablishing the status quo. In the configuration of Figure 3, that policy is identified as x_1. Note that darkened circle x_1 (the court's net utility at x_1) is at the same level as darkened circle x_0^L (the court's net utility in reestablishing x_0). That is, the court should be indifferent between accepting policy x_1 or reversing to the status quo. Assume that the court does not reverse when it is indifferent. While this agency outcome is stable in terms of judicial review, it is not very appealing to the agency. The agency's net utility at x_1, if accomplished through L, is given by $U_A(x_1) - L_A$. The clear circle x_1 identifies the agency's net utility at this policy point. While this is the best that it can do through a low-cost instrument, the agency would nevertheless be better off accepting the status quo since the agency's net utility in accepting the status quo is higher than its net utility in changing policy to x_1 through instrument L. That is, $U_A(x_0) > U_A(x_1) - L_A$. This is revealed in the figure as the clear circle x_0 (the agency's net utility in just accepting the status quo) being higher than the clear circle x_1 (the agency's net utility in choosing policy x_1 through a low-cost instrument).

There is, of course, one other possibility; the agency could, using a high-cost instrument H, choose the policy nearest its ideal point that would not be reversed by the court. When the agency has chosen to change policy through a high-cost instrument, the court receives a utility of $U_C(x_0) - H_C$ in reversing the agency. In Figure 3, that utility is identified as that associated with the darkened circle x_0^H. Through inspection we can find the agency policy point where the court would get as much net utility in accepting such policy as it

would in reversing it through high-cost review. In Figure 3 we identify that point as x_2. Note that, by construction, the height of the darkened circle x_2 (the court's net utility at x_2) is the same as that associated with darkened circle x_0^H (the court's net utility in reestablishing x_0). The agency's net utility at x_2 is given by $U_A(x_2) - H_A$. The clear circle x_2 identifies the agency's net utility at this policy point. Note that this policy would give the agency higher net utility than either accepting the status quo or selecting x_1 through a low-cost instrument. That is, $U_A(x_2) - H_A > U_A(x_0) > U_A(x_1) - L_A$. This is revealed in the figure as the clear circle x_2 being higher than either clear circle x_1 or clear circle x_0. In short, the optimal policy choice for the agency in the configuration of Figure 3 is x_2 achieved through a high-cost instrument.[9] The more general solution to the agency/court game is presented in Proposition 1 of Appendix B.

3.2 Broader Implications

Several implications regarding the behavior of regulatory agencies can be derived from this analysis. We consider two here: agency inaction and the agency's selection of adjudication over rulemaking as a way to change regulatory policy.

Agency Inaction. Agency inaction may be the result of three possible conditions (see Proposition 1 in Appendix B, items A, B.2.i, and B.3.ii). First, the status quo may be presently located at the agency's ideal point ($x_0 = A$), leaving no reason for the agency to engage in policy change. Second, the decision cost the agency must incur to change a policy not at its ideal point ($x_0 \neq A$) may not be worth the gain in utility (L_A and $H_A > U_A(x) - U_A(x_0)$ for $x_0 \neq A$). In other words, the agency would like a new policy, but agency costs in initiating the change are not worth the minor policy improvement. Third, the court may be a credible threat to reverse the agency if the agency changes policy. A policy change would be reversed and the agency would have accomplished nothing but lost resources.

The implications of these conditions are that the likelihood of agency inaction increases as (1) the distance between the agency's ideal point and the status quo decreases (A nears x_0); (2) the distance between the agency's ideal point A and the court's ideal point C increases; (3) the agency's decision costs increase; and (4) the court's decision costs decrease. The first two of these can be the result of electoral turnover, with agency and court personnel being installed with newly elected administrations. The latter two can be the result of several factors, including legislative control efforts. Congress can, for example, pass legislation requiring more cumbersome agency decision-making

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9. Note that the game we present here involves only one agency and one court. More typically, a court reviews multiple agencies. This means that the equilibrium choice of one agency can be affected by the choices of other agencies who are similarly making instrument choices that affect the resources required of the court to review and reverse. We do not solve that more complicated game here, but we believe this framework can be extended to encompass such complexities. We leave that for future work.

processes, thereby increasing agency decision costs (consequently, making the status quo more attractive to agencies). A similar effect can be achieved by reducing the agency's budget (Spiller and Tiller, 1997). Congress can also change the resources and decision costs of the courts either by changing the rules of judicial review or by altering the size of the federal judiciary (McCubbins, Noll, and Weingast, 1995; de Figueiredo and Tiller, 1996; Spiller and Tiller, 1997).

Rulemaking versus Adjudication. The two agency instruments most discussed in the legal literature have been rulemaking and adjudication.[10] It is well established that under the Administrative Procedures Act (APA) agencies may not only engage in both forms of decision making, but may use either as a policy vehicle.[11] Rulemaking, by its very design, is considered to be an efficient policy-making mechanism. A single rulemaking, for example, may result in a generic rule with sweeping changes for the way a whole class of entities is regulated. The benefit to the regulator would be that a great amount of policy discretion is funneled into a format that has a wide impact, while economizing on agency time and resources (just one agency proceeding) (Pierce, 1988). In this sense, rulemaking can be thought of as a low-cost decision instrument for agencies.

While adjudication is ordinarily perceived to be case specific, applying to only one or a few persons or regulated entities,[12] it can nonetheless be an effective, if somewhat more costly, policy-making mechanism. A series of adjudications can make it quite clear to interested groups that the agency has embarked on a new policy objective, even though the new policy was never formally stated in a rule. Consider, for example, the National Labor Relations Board (NLRB) and its policy regarding withdrawal of union recognition by employers. Like most other federal agencies, the NLRB has both rulemaking and adjudicative powers. But it has shunned rulemaking as a policy instrument in determining whether employers can withdraw union recognition. Instead, the NLRB has established a "neutral" adjudicative standard through a series of cases that, in fact, has produced a policy that employer withdrawals of recognition

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10. Unless indicated otherwise, the term "rulemaking" refers to informal rulemaking. Other instruments may be available as well. Agency policy statements, guidance documents, and policy manuals, for example, may announce agency policy, subjecting regulated parties to regulatory requirements without the normal procedural protections for interested parties inherent in rulemaking and adjudication.

11. In 1935, the Supreme Court established the fundamental authority of agencies to exercise both judicial and legislative powers—that is, deciding individual cases (adjudication) or making rules (rulemaking) [*Humphrey's Executor v. United States*, 295 U.S. 602 (1935)]. The Supreme Court expanded this right in 1947 by allowing agencies to use either instrument in announcing new policy [*SEC v. Chenery Corporation*, 332 U.S. 194 (1947)]. The authority of an agency to promulgate substantive policy by rules, even when an agency's enabling act did not specifically authorize rulemaking authority, has also been supported by the courts [*National Petroleum Refiners v. Federal Trade Commission*, 482 F.2d 672 (D.C. Cir. 1973)].

12. Given that the definition of an adjudicative order is quite broad, the term "adjudication" necessarily captures many (informal) agency processes even though they may lack the (formal) trial-type characteristics associated with judicial proceedings [5 U.S.C. 554–558].

will be generally unlawful. In particular, the NLRB supposedly considers the "totality of the circumstances" in determining whether the employer has acted in good faith in withdrawing recognition. However, the NLRB's good faith standard, "although ostensibly a highly fact-dependent totality-of-the-circumstances test, approaches a per se rule in application: Withdrawals of recognition will nearly always be found unlawful" (Flynn, 1995:395).[13]

Another example is the Federal Energy Regulatory Commission (FERC) and its attempt to deregulate oil pipeline rate regulation. FERC initially attempted to deregulate all pipelines through a single rate determination case involving one oil pipeline [21 FERC 61,260 (1982) (*Opinion No. 154*)]. When that action was struck down by the D.C. Circuit, FERC responded by deregulating individual pipelines through case-by-case adjudications, a method that successfully dodged judicial reversal [44 FERC 61,066 (1988) (*Buckeye I*); order on reh'g, 45 FERC 61,046 (1988) (*Buckeye II*); *Opinion and Order on Initial Decision*, 53 FERC 61,473 (1990) (*Opinion No. 360*); order on reh'g, 55 FERC 61,084 (1991) (*Opinion No. 360-A*)].[14] There are other cases of agencies switching from rulemakings to adjudications for policy making.[15]

That adjudication can be a successful policy-making tool does not necessarily mean it would be as cost efficient for the agency as rulemaking (given the "single proceeding" and generic appeal of rulemaking). In this sense we can consider adjudication a high-cost instrument for the agency.[16] But compared with rulemaking, adjudication has other benefits. First, because of their wide policy impact, rulemakings are likely to be heavily scrutinized by courts, especially those courts with competing policy preferences. In contrast, a series of adjudications (with each adjudication holding perhaps only a piece of the

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13. "The Board has long held that after the expiration of the one-year certification period, an employer may withdraw recognition of the union and refuse to bargain if it can show either that the union has in fact lost majority status, or that the company has a good-faith doubt, based on objective factors, as to the union's majority status. The Board maintains that the existence of a good-faith doubt, the defense that is invariably relied upon, is judged by the totality of the circumstances, and may be established through an accumulation of circumstantial evidence. A thorough review of the withdrawal-of-recognition case law, however, reveals that circumstantial evidence, no matter how abundant, is rarely, if ever, enough to satisfy the good-faith doubt test. In practice, the Board deems the test satisfied only if the employer has proven that a majority of the bargaining unit has expressly repudiated the union. Such direct evidence, however, is nearly impossible to gather lawfully" (Flynn, 1995).

14. See Tiller (1998) for a discussion of oil pipeline deregulation and the interaction between the FERC and the D.C. Circuit.

15. For another example, consider Mashaw and Harfst (1990) which describes how strict judicial oversight caused the National Highway Traffic Safety Administration to turn from rulemaking to recalls (adjudications). See also Mashaw (1994).

16. This is not to say that we should always consider rulemaking the low-cost instrument and adjudication the high-cost instrument. For some agencies, rulemaking offers less efficiency due to the numerous procedural requirements Congress has imposed upon that agency's specific rulemaking process. Furthermore, where there are only a few firms in the regulated industry, one adjudication by itself may govern much of the industry, thereby making it as cost effective as a rulemaking might be. In short, broad generalizations about the decision costs of rulemaking and adjudication for an agency should be taken with some caution.

larger policy) is more difficult for a court to review collectively as each case may make its way before a different panel or different court altogether. Second, it is relatively easier for a court to discern a new policy when it comes in the form of a rule, while an adjudication can disguise a new policy in the facts of the specific case, truly not revealing itself until several cases play out in other courts (with the instant case long decided and beyond the reach of the particular court involved). Third, if a reviewing court reverses or remands an agency rule, the policy may be ordered dead or effectively becomes so due to the administrative delay resulting from the process of remedying the flaws. Thus the agency loses the benefits of its time and resource investment in promulgating the rule in the first place.[17] By comparison, the prospect of a reversal of an adjudication has a much smaller deterrent effect on the regulator, as the lost administrative cost of a judicially remanded order is generally much less than that of a remanded rule. Moreover, the reversal of an adjudication does not necessarily defeat the particular policy objective sought by the regulator, as reversal of an adjudication can be treated by the regulator as specific to the facts of the case and not deter-minative of a larger policy objective which can be attained through subsequent adjudications.

With the above assertions in mind, if we treat rulemaking as the low-cost instrument and adjudication as the high-cost instrument, our framework suggests that the likelihood that an agency will choose adjudication over rulemaking to change policy increases as (1) the decision-making resources of the agency increase (agency's decision costs decrease); (2) the decision-making resources of the courts increase (court's decision costs decrease); and (3) the distance between the agency's ideal point and the court's ideal point increases (see Proposition 1, Appendix B).

If our assessment about the relative cost and policy impacts of rulemaking and adjudication are accurate, then our theory helps to explain the shift away from rulemaking in the 1980s and the move to other instruments for agency policy. More specifically, the last two conditions noted above were most probably met in the late 1970s and early 1980s. First, the decision-making resources of the federal appellate courts increased. In 1978 Congress made one of the largest expansions of the federal appellate judiciary by increasing the number of judgeships on those courts by more than one-third (35 new judgeships added to an existing 97).[18] These judgeships were filled by a Democratic president (Carter) and confirmed by a Democratic Senate. More judgeships meant more decision resources for these courts. Second, the gap between the ideological preferences of the judiciary and the agencies increased in the early 1980s. By the time of Carter's departure the federal appellate judiciary (the D.C. Circuit in particular) was full of Democrats, many of whom were staunchly liberal. In contrast, the ideal points of agencies were quickly to become more conservative as Reagan loyalist took control. Consequently, by the early 1980s an ideological

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17. See Breyer (1986) for a discussion of this matter.

18. See de Figueiredo and Tiller (1996) for an analysis of the political determinants of expansion of the federal judiciary.

chasm between agencies and the courts (especially the Democrat-laden D.C. Circuit) had occurred. In other words, the distance between the ideal points of agencies and courts increased. That scholars began to notice the "ossification" of rulemaking and the increased use of adjudication (and other nonrulemaking instruments) to change policy is consistent with the implications of our model. More specifically, regulators during this period, knowing that the courts were a hurdle for policy change, increasingly abandoned rulemaking and instead turned to administrative instruments that would be more difficult and costly for the appellate courts to monitor and reverse.

4. Appellate Court Strategy

In the previous section we examined agency strategy. We now model the strategies of courts in charge of reviewing agency policies. These courts are generally either federal district courts or panels of the federal courts of appeal, the latter being the main case. We call these courts the "lower courts" in our framework below. The lower court strategies we refer to here are aimed not at the agencies, but at the "higher courts" (the full circuit en banc and the Supreme Court).[19] These higher courts have the right to review lower court determinations if challenged by the litigants. While such review is not mandatory, lower courts nonetheless pay heed to the possibility of review and make their decisions accordingly. Just as agencies try to protect their policy outcomes from the lower courts through the strategic selection of administrative instruments, lower court judges are likewise given toward protecting their decisions from higher court review through the strategic selection of judicial instruments (i.e., the legal grounds upon which they make their decisions).[20]

4.1 Judicial Instruments

The most common legal challenges to an agency decision generally fall into two categories: statutory interpretation and reasoning process. The federal courts may discipline an agency on either of these grounds (or "judicial instruments" as we call them). The statutory challenges generally relate to the agency's interpretation of a statute under which it has been directed to make policy. Statutes, however, are not always clear about Congress' policy intentions, how the policies should be implemented, or what standards should be used in determining

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19. See Tiller (1998) for appellate court strategy aimed at agencies.

20. While the model considers situations where the lower court will affirm as well as reverse the agency, we concentrate the strategic aspects of the model on the latter—judicial reversal of agency decision making. We choose this scenario because the former action—judicial affirmance of agency decisions —is the presumed legal norm and does not invite the level of strategic consideration for the lower court as would reversing an agency decision. Moreover, because the instruments used for reversal are more limited and easily identified, we are more willing to make assertions about their decision cost characteristics. Recall that in the agency strategy model above, we were hesitant to incorporate specifically named instruments into the model because the decision costs of the instruments could vary greatly from agency to agency. We believe there is more consistency in the relative decision costs of the judicial instruments commonly used to reverse agencies. Accordingly, we can integrate the named instruments directly into the model. We turn now to those instruments.

how to apply them. In the absence of higher court review, reversing an agency decision based on statutory interpretation can be an efficient instrument for a lower court wishing to thwart an agency policy that the court dislikes. It is efficient as a reversal instrument because (1) if the court so chooses, it requires little more than looking at the statutory language itself and determining that it meant something other than what the agency determined that it meant, and (2) unlike other judicial instruments, an agency policy reversed on statutory interpretation is generally not remediable by the agency without further legislative action. In short, a statutory interpretation reversal effectively stops the regulator in its tracks. The relative gain in policy control for the court, given the relatively modest decision cost to achieve it, makes this instrument a low-cost decision instrument for the lower court.

When the prospect of higher court review enters the calculus, however, statutory interpretation may appear less attractive for the lower court. For several reasons, selecting it may subject the lower court to a substantially greater level of scrutiny by the higher courts than had it chosen other available instruments. First, because the lower court decision does not rely on the characterization of the adjudicative facts (which can be detailed and complex) but rather on the words or legislative history of the statute, there is low information distortion for the higher court. This makes it easier for the higher court to monitor the lower court's behavior, thus reducing the higher court's decision costs. Second, a decision based on statutory interpretation allows the higher courts to similarly use the readily available interpretive approaches or canons of statutory construction in reversing the lower court without exerting much effort to undo the reasoning of the lower court—again, a low-cost decision for the higher court. Finally, the dominant doctrine governing statutory interpretation, as announced by the Supreme Court, is deferential to agency decisions [*Chevron, U.S.A., Inc. v. Natural Resources Defense Counsel*, 467 U.S. 837 (1984)]. Thus a lower court decision reversing an agency based on statutory interpretation may be more likely to signal itself as a vulnerable decision.[21] In short, compared to other instruments, statutory interpretation leads to low-cost review for the higher courts and, consequently, greater reversal risk for the lower court.

The process instrument represents the other side of the coin. Process challenges, as we define them here, relate to the regulator's failure to exercise reasoned decision-making processes in determining the policy (such as the regulator's failure to consider particular evidence,[22] failure to address particular

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21. See, however, Shapiro and Levy (1995) who argue that the *Chevron* doctrine is relatively "indeterminate"—that is, easily manipulated by judges so as to appear to be followed regardless of the policy outcome. Cross and Tiller (1998, 1999) identify conditions under which *Chevron* does seem to have a constraining effect—that is, when the lower court is divided and the minority member has *Chevron* deference on her side. For a more general study of the effects of the *Chevron* decision on lower courts, consider Schuck and Elliot (1990) and Cohen and Spitzer (1994).

22. For adjudications (and some types of rulemakings), the APA requires that the decision of the administrator must be supported by "substantial evidence." The substantial evidence test, then, gives the court discretion to discipline an agency whose decision conflicts with the court's preferred policy preferences.

alternatives suggested by affected parties,[23] or perhaps the failure to fully explain why the regulator changed the policy at all).[24] While it may be easy for a lower court to think up "appropriate" processes that should have been carried out by the agency, or evidence that should have been considered by the agency, the court is nonetheless required to get more familiar with the factual minutia of the case. The court must often weigh through mounds of data and studies to substantiate a process flaw, something that often takes judges away from their expertise. Furthermore, the defeat of an agency policy is not always as certain through a process reversal as it would be through statutory interpretation, as the agency, in time, may find itself with the resources to remedy the earlier process flaws. This stands in contrast to statutory interpretation where the court may limit its inquiry to the words of the statute and quash the agency's policy objective once and for all. In short, as compared to statutory interpretation, we believe the process instrument to be a more costly exercise, in terms of time and resources, for the lower court to carry out.[25]

Irrespective of its own cost, there are some benefits for the lower court in using the process instrument. First, manipulation of the process instrument by the lower court makes the case less transparent to higher courts. In order to determine whether the court has disguised its own policy agenda in a process decision, the higher court would have to reexamine the facts of the adjudication or rulemaking in detail and reexamine the logic of both the regulator and lower court in arriving at their outcomes. Because all agency processes are full of analytic indeterminables, a lower court wanting to find one will be able to do so, and it can be a considerable exercise for the higher court to explain away the "discovery." Moreover, the governing doctrine for judicial review of agency reasoning process (the "hard look" review) is less deferential to agency decision making, which means that lower court judges should presumptively have wide latitude in examining the reasonableness of agency decision-making processes. It would therefore take substantially more effort from the higher court to undo a lower court's process-based decision than a statute-based decision.[26]

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23. APA section 553 requires that an agency issue a "concise general statement of basis and purpose" with final rules. APA section 706(2)(A) requires that agency rules not be "arbitrary and capricious." These requirements taken together have created the basis for review by judges of the analytical reasoning of the regulator whereby the court analyzes the "concise statement" to see if the regulator performed all the analytic requirements so as not to be "arbitrary and capricious." See *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971), and *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 103 S.Ct. 2856 (1983).

24. We do not include strict procedural challenges here. Those generally relate to the agency's lack of, or defect in, formal procedures required by the APA or the organic statute (such as the rights of interested parties to be notified or to be given an opportunity to be heard). Since the Supreme Court greatly restricted use of this instrument in 1978, we do not incorporate it here. See *Vermont Yankee Nuclear Corp. v. NRDC*, 435 U.S. 519 (1978).

25. It is, however, possible to build situations when the opposite is true—that is, statutory interpretation involves a much more detailed analysis by the court as to the meaning of the statute (thereby making it a costly exercise in terms of judicial time and resources). Nonetheless, we are concerned here with what we believe to be the main case.

26. See Strauss (1987) for a discussion of the limited resources of the Supreme Court and its implications for review of agency decision making.

To summarize, the judicial reversal instruments we have identified here have distinctive features that affect policy impact and decision costs. For the lower court, statutory interpretation is an efficient low-cost instrument for reversing agency outcomes. What makes it less desirable is that statutory interpretation invites low-cost review from the higher courts as well. Process is a more costly instrument for the lower court to use; however, it imposes greater costs on the higher reviewing courts, encouraging them to defer to the lower court more often. A strategic-minded lower court will balance these trade-offs and choose the instrument giving it the highest net utility. We now examine the structure of interaction in a model and consider the optimal strategies for the lower court.

4.2 The Framework

As in the previous section, we present here an informal discussion of the framework, leaving the formal derivation for the appendixes. Figures 4 and 5 illustrate the basic features of our model. The figures illustrate how, given the decision costs associated with the various judicial instruments (statutory interpretation and reasoned decision making, in particular), the lower court can protect certain policy outcomes from the higher courts by the strategic choice of an instrument.

Consider Figure 4. This figure represents the lower court's decision making in the absence of higher court review. In other words, assume that the lower court's choice is the final outcome. Ignoring the higher courts for the moment allows us to consider the constraining effects of the lower court's own resource limitations. We again let C represent the ideal policy point of the lower court in charge of reviewing an agency policy decision. In this model we take the agency's policy choice x as exogenous.[27] We show three possible locations for the new agency policy (x_1, x_2, and x_3) to illustrate the different situations the lower court might face. Note that in this configuration $U_C(x_1) > U_C(x_2) > U_C(x_3)$.

Ideally the lower court would like to have policy at point C, but we assume that its options are discrete—that is, the lower court must choose between the new agency policy x or the status quo x_0.[28] Moreover, to reverse the agency and return policy to x_0 will result in decision costs for the court. We let si_C and p_C represent those decision costs required of the lower court to reverse the agency and return the policy to the status quo through statutory interpretation and process, respectively. Following the discussion above, we assume that statutory interpretation is less costly than process for the court if it wishes to reverse the agency. We also assume that acquiescing to the new agency policy involves the least cost for the lower court and we standardize that amount to be zero; accordingly, $p_C > si_C > 0$. The lower court's net utility from reversing the agency and returning policy to the status quo is given by $U_C(x_0) - si_C$ if done through statutory interpretation and $U_C(x_0) - p_C$ if done through the

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27. A more general treatment should deal with the implications of endogenous decision costs over the three-level hierarchy of review, which includes the agency and the higher courts. We leave that for future work and concentrate here on the bifurcated games.

28. The framework could also be adjusted to accommodate the assumption that the appellate panel had nondiscrete choices upon review.
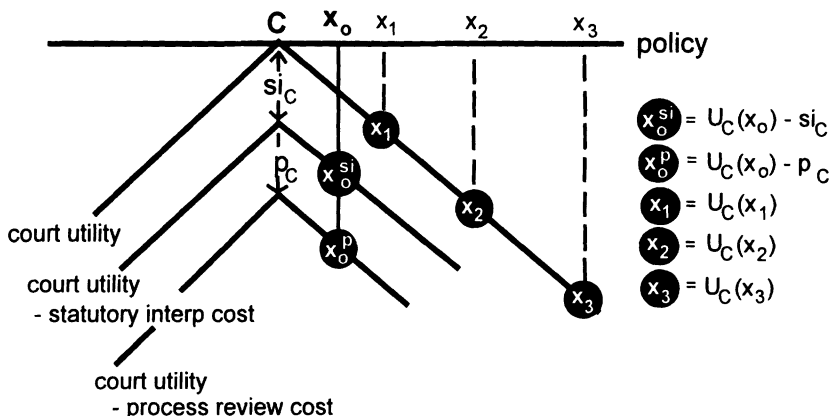
Figure 4. Net utility for lower court absent higher court review.

process instrument. These utility levels are identified with points in Figure 4 by the shaded dots x_0^{si} and x_0^p, respectively. The court's net utility in accepting the agency's new policy is $U_C(x)$ (represented by darkened circles x_1, x_2, and x_3).

Clearly, reversing agency policy through statutory interpretation should generally provide the lower court with higher net utility than reversing the agency through the process instrument—that is, $U_C(x_0) - si_C > U_C(x_0) - p_C$.[29] It may be, however, that the lower court prefers to accept the new agency policy, either because it outright prefers the new policy to the status quo or because the decision costs of reviewing and writing a reversal eliminate the relative gain in policy from reinstating the status quo. In Figure 4, the lower court's utility of accepting x_1 (if x_1 is the new agency policy) is greater than reversing to the status quo through either judicial instrument—that is, $U_C(x_1) > U_C(x_0) - si_C > U_C(x_0) - p_C$. In this case, the court accepts the new agency policy. If x_2 were the agency policy, the lower court would gain in utility by reversing the agency through statutory interpretation, but not through process. That is, $U_C(x_0) - si_C > U_C(x_2) > U_C(x_0) - p_C$. Finally, if x_3 were the policy selected by the agency, the court would gain by reversing the agency through either statutory interpretation or process, although more through statutory interpretation. That is, $U_C(x_0) - si_C > U_C(x_0) - p_C > U_C(x_3)$. Lemma 3 in Appendix C summarizes the equilibrium outcomes.

Now consider the presence of a higher court (full circuit en banc or the Supreme Court). These higher courts must expend resources if they wish to review and reverse a lower court. Moreover, the resources required of the higher court vary with the judicial instrument chosen by the lower court when

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29. There may, of course, be cases where the court is constrained in its choice of instruments by the facts of the particular case or the arguments put forth by the litigant. We abstract from these circumstances.
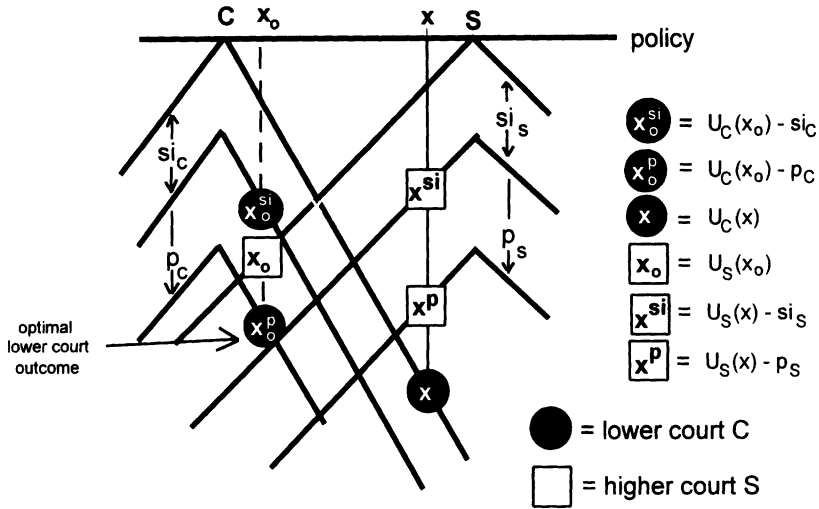
Figure 5. Lower court strategies in the presence of higher court review.

it reversed the agency. The imperative for the lower court is to maximize its net utility in the face of review by the higher court taking both its own and the higher court's decision costs into account.

Refer to Figure 5. We let S represent the ideal policy point of the higher court. As with the lower court, we assume that the higher court's utility declines monotonically the further policy is from its ideal point S. This utility is represented by $U_S(X)$. We let si_S and p_S represent those decision costs required of the higher court to review and reverse a lower court's decision that was based on statutory interpretation and process, respectively. As mentioned above, reviewing and reversing a statutory interpretation decision is relatively cheaper for the higher court than reviewing and reversing an appellate panel's decision based on process. We also assume that not reversing the lower court is the least cost alternative for the higher court; accordingly, $p_S > si_S > 0$. If the higher court reverses the lower court, the policy reverts to the agency's policy choice x. Thus the utility of the higher court is given by $U_S(x) - si_S$ if reversing a statutory interpretation decision of the lower court; by $U_S(x) - p_S$ if reversing a process-based decision of the lower court; and by $U_S(x_0)$ if the higher court affirms. These utility levels are positioned in Figure 5 as clear squares x^{si}, x^p, and x_0. We can now see the game at work in Figure 5.

Observe the possible choice set for the lower court in the configuration of preferences and decision costs set out in Figure 5. Recall that the agency policy x is an exogenous shock in our game between the lower and higher court. On the one hand, the lower court could choose to accept the agency policy, thereby leaving it with a utility given by $U_C(x)$. We identify this as darkened circle x in Figure 5. Clearly this does not provide the lower court with much utility. On the other hand, the lower court could choose to reverse the agency and bring

policy back to the status quo. The lower court has two options in this respect. First, it could choose to reverse the agency through statutory interpretation, thereby leaving the lower court with a net utility given by $U_C(x_0) - si_C$. We let darkened circled x_0^{si} represent this utility point. This outcome, however, is not stable. The higher court would get greater utility out of reversing this lower court decision (thereby returning policy to x) than accepting the lower court's decision (and thus leaving policy at the status quo), that is, $U_S(x) - si_S > U_S(x_0)$. This is reflected in Figure 5 as the clear square x^{si} being located higher than the clear square x_0. Such a result would be disastrous for the lower court as it would have essentially wasted decision-making resources $(-si_C)$ on reversing an agency policy that it would later be forced to accept (due to the higher court reversal). The lower court has a preferable second option; it could choose to reverse the agency through a process instrument, as this will give it a higher net utility than accepting the agency policy (darkened circle x_0^p higher than darkened circle x) and will be sustained by the higher court (clear square x_0 higher than clear square x^p). In short, Figure 5 shows a configuration under which the lower court has an incentive to manipulate the judicial instruments by utilizing a particularly expensive one. In this particular case, the motivation is simply to insulate policy from higher court review. This is but one scenario and there are several others.[30] The strategic choices for the lower court and the response of the higher court in all possible configurations are summarized as Proposition 2 in Appendix C.

4.3 Broader Implications

In this model the frequency of any particular decision strategy for the lower court depends, in part, on the policy alignments among the relevant actors (lower courts, higher courts, and the agencies) and the resources available for making decisions. Consider various alignment possibilities. First, if the agency, lower court and higher court are all politically aligned (implying that both the lower court and higher court prefer the agency's policy preferences over the previous status quo) there should be few agency reversals by the courts. Moreover, when reversals do occur, there should be no strategic benefits to the lower court of choosing process over statutory interpretation as the grounds for reversal.

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30. Note that our model does not consider the possibility of interaction between asymmetric information (lower court "hiding" its policy choice through process) and the fact that a higher court reviews multiple lower courts. This could certainly affect the equilibrium. For example, assume that three circuit courts hear appeals from a particular agency in the same year. The first two courts affirm and the third reverses on process grounds. The agency appeals the case it lost. The Supreme Court could plausibly believe that the process reversal was policy based (since the first two affirmances did not find such process problems). When the Supreme Court is uninformed about the location of an agency decision in the policy space, the Court may draw inferences about that location from differences among the circuits. This means that the third lower court to review may forgo a process reversal because of the signal sent by the prior lower court decisions. Were the third lower court now to use a process reversal, the suspicions of the Supreme Court may be raised.

Second, if the lower court and higher court are aligned against the agency, the lower court will reverse the agency more often; but again, there should be no strategic preference for process reversals over statutory interpretation reversals as the higher court would let any such decisions stand. In fact, the use of statutory reversals should go up, as this is generally more efficient for the lower courts. This could be the condition of the late 1980s and early 1990s as the federal appellate courts and the Supreme Court were full of Republican appointees while agencies turned over to less conservative Bush appointees in 1988 and then to Democrats in 1992. Cohen and Spitzer (1994) found, for example, that after several years of deference to agency interpretations of statutory language, there was a significant increase in the use of statutory interpretation by appellate courts to reverse agency decisions by the late 1980s.

Finally, our model suggests that if agencies and higher courts are aligned against the lower courts, the lower courts will increase their strategic use of process to reverse the agencies. In so doing, the higher court's costs of review are increased, thus decreasing the probability of higher court reversal. One could view the early to mid-1980s as representative of such conditions. The Supreme Court was notably conservative, as were the new agencies coming under Reagan's control. The appellate courts, however, were still heavily staffed with Democratic appointees from the Carter years. Using the process instrument to reverse agencies, the federal appellate courts prevented many regulators from upsetting the more liberal status quo policies of the past, while avoiding the scrutiny of the Supreme Court. There is evidence of an increased use in process instruments during this time (Wald, 1988) and evidence that during the broader period of the 1980s this type of alignment in individual cases (agency policy outcomes and appellate court preferences misaligned) produced systematic preferences for the use of the process instrument for reversal by appellate courts (Smith and Tiller, 1998).[31]

In addition to political alignments, changing resource conditions among the actors can affect the likelihood of review and reversal. For example, the expansion of the federal appellate courts in the late 1970s essentially increased their resources in comparison to the Supreme Court, which did not expand. By the early 1980s this translated into the ability of liberal appellate courts to engage in more process analysis at the expense of the conservative Supreme Court which would find it too costly to closely scrutinize all these decisions.

5. Conclusions

Our framework suggests new implications for the study of strategies undertaken by agencies and courts to accomplish their own policy goals. At the heart of our framework is the notion that actors can impose costs on other players through the instruments chosen to make and review policy. Our model suggests that the agency will often choose one instrument over the others, taking into account

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31. Revesz (1997) also found that the D.C. Circuit judges tended to use process to reverse EPA decisions that went against the judges presumed policy preferences.

(1) its cost in selecting a policy through a particular instrument and (2) the costs to the court of reviewing policy made with the various instruments. The more likely it is that a court will reverse an agency policy, the more likely that an agency will attempt to impose higher decision costs on the court (through the selection of an instrument with high review costs), with the expectation that a strict review will not take place.

With respect to the lower courts in charge of reviewing agency policies, they must also make choices about what grounds, or judicial instruments (statutory interpretation and process being the ones discussed herein), they will use to frame their decisions reversing agency policy. If they expect a higher court to have a different policy preference, the lower court will attempt to discourage higher court reversal by imposing greater decision costs on the higher courts through the selection of an appropriate instrument. At some point the reviewing costs are too great for the higher court and it opts to defer to the lower court with minimal scrutiny. In our model, we assumed that a process-based reversal performed this role for the lower court.

Our framework is a simplification of a very complex game among agencies and courts. As such, it must be considered only a first approximation. Nonetheless, the insights about decision instruments and their effects on policy control deserve more attention than the current literature presents. To that end, our theory of the strategic use of instruments lays the basic groundwork for further analysis. Extensions to the theory should include the role of other actors (OMB, Congress, and litigating parties perhaps), other instruments, and other decision cost considerations. Finally, although we do not present here empirical support for our framework, the results of this article are consistent with the conventional wisdom about the evolution of the administrative and judicial instruments during the last decade. We leave all those extensions for future work.

Appendix A: General Assumptions

A.1 Preferences

There are three players: an agency, a court of appeals, and the Supreme Court, each with an ideal policy position Z ($Z = A, C, S$) within the policy space $\mathfrak{R}$. Let x_0 represent the status quo policy. We assume that neither the court of appeals nor the Supreme Court implement "new" policies. For simplicity we assume that all players have linear Euclidean utility functions, given by $U_Z(X_Z)$.

Definition 1. $U_Z(X_Z) = -\alpha_Z|X - Z|$, where $\alpha_Z \geq 0$ represents the intensity of actor Z's preferences.

A.2 Sequence of Decision Making

The sequential structure of the game is as follows:

(1) The agency selects a policy $X_A = \{x, x_0\}$;
(2) The court of appeals reviews any agency decision x which changes policy from the status quo, $X_C = \{x, x_0\}$.

(3) The Supreme Court considers the court of appeals' decision and either upholds or reverses the court of appeals.[32] $X_S = \{x, x_0\}$.

A.3 Decision Costs and Decision Making

Making a policy decision X_Z, whether by the Supreme Court, court of appeals, or the agency, requires an expenditure of resources T_Z, called here *decision costs*. Let $T_Z = \{t_Z, 0\}$, $Z = A, C, S$, where $t_Z > 0$. t_Z is assumed to be invariant to the choice of x. Let $T_Z = 0$ when an actor does not change policy from that established in the previous stage.

Appendix B: Agency/Court of Appeals Interaction: Administrative Instruments

Let $X_A = \{x^i, x_0\}$ be the agency's policy choices where $i = \{L, H\}$ (L being a low-cost instrument, e.g., rulemaking, and H a high-cost instrument, e.g., adjudication) indicates the regulatory instrument used to achieve a new policy x. Let the agency's net utility for a given policy choice be given by $U_A(X_A) - t_A$, where $t_A = \{L_A, H_A, 0\}$, with $H_A > L_A > 0$ represents those decision costs required of the agency when making a policy decision through a low-cost instrument, a high-cost instrument, or when leaving the status quo.

Call $A(i)$, where i reflects the instrument used for implementing its ideal point, $i = L, H$, the set of status quo policy points that the agency would accept rather than incurring decision costs to achieve a policy at its ideal point.

Definition 2. $A(i) = \{x_0 \mid U_A(x_0) \geq U_A(A) - i_A\}$ for $i = L, H$.

Lemma 1. Given that $H_A > L_A > 0$, then we obtain that
A) In the absence of judicial review, an agency will never choose a high-cost instrument to change policy.
B) If $x_0 \in A(L)$, then x_0 becomes the agency's policy choice.
C) If $x_0 \notin A(L)$, then $(x^L = A)$ becomes the agency's choice.

Proof. Our assumptions about decision costs imply that in changing the policy from the status quo to the agency's preferred policy point, a low-cost instrument is more efficient for the agency than adjudication if judicial review is not going to take place. Points (B) and (C) are straightforward and follow the definitions of $A(L)$.

Consider the review by the court of appeals of an agency decision. Let $X_C = \{x_0^i, x\}$, $i = \{L, H\}$, where L or H refer to the instrument chosen by the agency in moving away from the status quo, represent the court of appeals' policy choice after an agency has made a policy decision made through a low-cost instrument or high-cost instrument. Let $t_C = (L_C, H_C)$, $H_C > L_C > 0$, where L and H represent the instrument chosen by the agency, represent the court of appeals' decision costs of reversing an agency decision. Call $C(i)$ the

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32. We treat the decision not to grant certiorari the same as a decision by the Supreme Court, if certiorari were granted, to uphold the lower court decision.

set of agency policies that when made through a particular instrument will not be reversed by the court of appeals.

Definition 3. Let $C(i) = \{x^i \mid U_C(x_0) - i_C \leq U_C(x)\}$ for $i = L, H$.

Lemma 2. Let $C^i_{x_0}$ be the solution to $U_C(x) = U_C(x_o) - i_C$ that is closest to the agency's ideal point A, then
  A) If $x^i \in C(i)$, $I = L, H$, then x^i is the choice for the court of appeals;
  B) If $x^i \notin C(i)$, then x_0 is the choice for the court of appeals.

Proof. It is straightforward recognizing that policies made through low-cost instruments (x^L) which fall within $C(L)$ and policies made through high-cost instruments (x^H) which fall within $C(H)$ will not be reversed by the court of appeals.[33]

Proposition 1 now summarizes the discussion on equilibrium instruments and policy outcomes.

Proposition 1. Equilibrium instruments and policy outcomes in the Agency/Court of Appeals Game. The optimal agency choice is a pair (x^*, i^*) where x^* represents the optimal policy choice and i^* represents the optimal instrument choice. $x^* = \{x_0, A^i, C^i_{x_0}\}$ and $i^* = \{L, H\}$. The choice of (x^*, i^*) is given by

  A) If $x_0 \in A(L)$ then $x^* = x_0$.
  B) If $x_0 \notin A(L)$, and

    B.1) $A \in C(L)$, then $x^* = A$, $i^* = L$;
    B.2) $A \notin C(L)$ but $A \in C(H)$, then $x^* = \{x_0, A^i, C^i_{x_0}\}$, where

      B.2.i) $x^* = x_0$, if $x_0 \in A(H)$ and $U_A(x_0) > U_A(C^L_{x_0}) - L_A$;
      B.2.ii) $x^* = C^L_{x_0}$ and $i^* = L$, if $x_0 \notin A(H)$ and $U_A(C^L_{x_0}) - L_A > U_A(x_0)$;
      B.2.iii) $x^* = A$ and $i^* = H$, if $x_0 \notin A(H)$ and $U_A(A) - H_A > U_A(C^L_{x_0}) - L_A$;

    B.3) $A \notin C(H)$, then $x^* = \{x_0, C^i_{x_0}\}$, where

      B.3.i) $x^* = C^i_{x_0}$ and $i^* = L, H$ if $U_A(C^i_{x_0}) - i_A > U_A(C^k_{x_0}) - k_A$, $k \neq i$, and $U_A(C^i_{x_0}) - i_A > U_A(x_0)$;
      B.3.ii) $x^* = x_0$ if $U_A(x_0) > U_A(C^k_{x_0}) - k_A$, $k = L, H$.

Proof. The agency problem can be fully characterized through four scenarios.
  Scenario 1: $x_0 \in A(L)$. If the utility the agency would get from the status quo is greater than the net utility the agency would receive from changing the status quo to the agency's ideal position through a low-cost instrument, then the agency leaves x_0 intact.

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33. Note that $C(L)$ is a subset of $C(H)$.

Scenario 2: $x_0 \notin A(L)$ *and* $A \in C(L)$. In this case the agency will move policy to A through the low-cost instrument, and the court of appeals will acquiesce.

Scenario 3: $x_0 \notin A(L)$, $A \notin C(L)$ *but* $A \in C(H)$. In this case the agency must make a choice among three alternatives. It can choose to maintain the status quo (x_0); it can choose to move policy to its ideal position through a high-cost instrument; or, it can choose the best policy possible through the low-cost instrument such that it will not be reversed—that is, $C^L_{x_0}$. It will choose the one among these which gives it the highest net utility.

Scenario 4: $x_0 \notin A(L)$ *and* $A \notin C(L)$ *and* $A \notin C(H)$. In this scenario the agency has three viable choices. First, it can choose the best policy possible through a low-cost instrument which will not be overturned by the court, $C^L_{x_0}$. Second, it could choose the best policy possible through a high-cost instrument which will not be overturned by the court, $C^H_{x_0}$. Finally, it could choose to leave the status quo (x_0) intact. It will choose the option among these which gives it the highest net utility. ∎

Appendix C: Court of Appeals/Supreme Court Interaction: Judicial Instruments

Assume that the Supreme Court's decision costs are affected by the review instruments chosen by the court of appeals in reversing an agency decision. We assume that there are only two instruments available to the courts: a low-cost instrument, statutory interpretation (si), and a high-cost instrument, reasoning process (p). Let $X_C = \{x_0^g, x\}$, $g = si, p$, represent the court of appeals' decision to either reverse an agency (x_0^g) through instrument g or to sustain the agency action (x). $X_C = x$ represents the appellate court not reversing the agency at all.

Let $t_C = \{si_C, p_C, 0\}$, $p_C > si_C > 0$, represent the costs to the court of appeals to review an agency decision using either the statutory interpretation (si) or the process (p) instrument. Let $C(g)$ represent the set of agency decisions which the appellate court is willing to accept rather than incurring the costs of reversing and reinstating the status quo x_0 through instrument g.

Definition 4. Let $C(g) = \{x \mid U_C(x) > U_{CA}(x_0) - g_C\}$ for $g = si, p$.[34]

Lemma 3 provides the Court of Appeals' optimal strategies in the absence of review by the Supreme Court that case.

Lemma 3. In the absence of Supreme Court review, the equilibrium outcomes for the court of appeals is as follows:
A) If $X_A = x_0$, then x_0 remains the policy outcome.
B) If $x \in C(si)$, then x is the policy outcome.
C) If $x \notin C(si)$, then x_0^{si} is the policy outcome.

Proof. There are four scenarios.

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34. It is clear that $C(si)$ is a subset of $C(p)$.

Scenario 1: $X_A = x_0$. In this case the policy outcome remains x_0. The remaining three scenarios occur when the agency has made a new policy choice.

Scenario 2: $x \in C(si)$. In this case $U_C(x_0) - si_C < U_C(x)$.[35] Thus $X_C = X_A = x$.

Scenario 3: $x \notin C(si)$ and $x \in C(p)$. In this case $U_C(x_0) - si_C > U_C(x)$, but $U_C(x_0) - p_C < U_C(x)$. Hence $X_C = x_0^{si}$.

Scenario 4: $x \notin C(si)$ and $x \notin C(p)$. In this scenario $U_C(x_0) - si_C > U_C(x)$ and $U_C(x_0) - p_C > U_C(x)$. The court of appeals, however, would always reverse the policy through statutory interpretation ($X_C = x_0^{si}$) as it is the court's least-cost alternative. Note that since the outcomes of scenario 3 and 4 are the same, the key issue then becomes whether or not x belongs to $C(si)$. ∎

We can then derive the following corollary:

Corollary. In the absence of Supreme Court review, there is no need for the court of appeals to use the process instrument to defeat an undesirable agency policy. Thus if an agency decision is worth reversing, then the court of appeals will do it through statutory interpretation.

To analyze the optimal strategies for the court of appeals given the existence of a Supreme Court, and the optimal Supreme Court response, we need some more definitions. Let $X_S = \{x^g, x_0\}$ when $X_C = x_0^g$ and $X_S = \{x_0^g, x\}$ when $X_C = x$, where $g = si, p$. Let $T_S = \{si_S, p_S\}$, $p_S > si_S > 0$, represent the decision cost of the Supreme Court in reviewing Court of Appeals or agency decisions.

Call $SC_x(g)$ the set of Court of Appeals decisions reversing agency policy ($X_C = x_0^g$) such that the utility for the Supreme Court of accepting such decision ($U_S(x_0)$) is greater than or equal to the net utility it would receive should it reverse the Court of Appeals and reinstate the agency policy ($U_S(x) - g_S$).

Definition 5. $S_x(g) = \{x_0 \mid U_S(x_0) \geq U_S(x) - g_S\}$.

Consider now the set of Court of Appeals' decisions upholding agency policy such that the utility for the Supreme Court in sustaining such decision is greater than or equal to its net utility were it to reverse the Court of Appeals, and thus the agency, through a particular policy instrument ($U_S(x_0) - g_S$). Call this set $S_{x_0}(g)$.

Definition 6. $S_{x_0}(g) = \{x \mid U_S(x) \geq U_S(x_0) - g_S\}$.

Being that the Supreme Court is at the top of the review hierarchy, and thus will not have to strategize against further review, from the Corollary we know that it has little incentive to reverse an agency policy through any means other than statutory interpretation as such method is the least cost alternative for the Court. Consequently, the set $S_{x_0}(p)$ becomes irrelevant.

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35. Note that, in the absence of Supreme Court review, any agency policy which the Court of Appeal would not reverse through statutory interpretation, would likewise not be reversed by the Court of Appeal through analytic process. $U_C(x_0) - p_C < U_C(x)$ when $U_C(x_0) - si_C < U_C(x)$.

The equilibrium instruments and policy outcomes are given in Proposition 2 below.

Proposition 2. Equilibrium instruments and policy outcomes in the Appeals Court/Supreme Court Game. In a bilateral game between the Court of Appeals and the Supreme Court the equilibrium policies are given as follows:

A) If $X_A = x_0$, then x_0 remains the policy outcome.
B) For cases where $X_A = x$ and $x \in C(si)$:

   i) If $x \in S_{x_0}(si)$, then $X_C = x$ and $X_S = x$;
   ii) If $x \notin S_{x_0}(si)$, then $X_C = x$ and $X_S = x_0^{si}$.

C) For cases where $X_A = x$ and $x \notin C(si)$ and $x \in C(p)$:

   i) If $x_0^{si} \in S_x(si)$ and,

      a) if $x \in S_{x_0}(si)$, then $X_C = x_0^{si}$ and $X_S = x_0$;
      b) if $x \notin S_{x_0}(si)$, then $X_C = x$ and $X_S = x_0^{s}$;

   ii) If $x_0^{si} \notin S_x(si)$, then $X_C = x$ and $X_S = x$.

D) For cases where $X_A = x$ and $x \notin C(si)$ and $x \notin C(p)$:

   i) If $x_0^{si} \in S_x(si)$ and,

      a) if $x \in S_{x_0}(si)$ then, $X_C = x_0^{s}$ and $X_S = x_0$;
      b) if $x \notin S_{x_0}(si)$ then, $X_C = x$ and $X_S = x_0^{si}$;

   ii) if $x_0^{si} \notin S_x(si)$ and,

      a) if $x_0^{p} \in S_x(p)$, then $X_C = x_0^{p}$ and $X_S = x_0$;
      b) if $x_0^{p} \notin S_x(p)$, then $X_C = x$ and $X_S = x$.

Proof. Consider the following four scenarios:

Scenario 1: $X_A = x_0$. In this scenario x_0 is the final policy outcome. In the remaining scenarios, the Supreme Court has the opportunity to review as the agency has made a new policy x.

Scenario 2: $x \in C(si)$. In this case, agency reversals, if at all, will be done by the Supreme Court, and such reversals will be made through statutory interpretation. If agency policy x survives the review of the court of appeals, it will not stand if $U_S(x_0) - si_S > U_S(x)$. If, on the other hand, $U_S(x) \geq U_S(x_0) - si_S$, then the agency policy will stand ($X_S = x$).

Scenario 3: $x \notin C(si)$ *and* $x \in C(p)$. In this scenario the Court of Appeals choice is to either reverse through statutory interpretation ($X_C = x_0^{si}$) or to let the agency policy stand ($X_C = x$). Its choice depends on what the Supreme Court can be expected to do.

Consider first the situations where $x_0^{si} \in S_x(si)$. In such a case $X_C = x_0^{si}$ and $X_S = x_0$. If $x \notin S_{x_0}(si)$, then the court of appeals has an incentive to let the policy pass through to the Supreme Court and let such Court reinstate the status quo. The court of appeals gets what it wants without having to spend its own resources to get it. Accordingly, $X_C = x$; $X_S = x_0^{si}$. If, however, $x_0^{si} \in S_x(si)$ and $x \in S_{x_0}(si)$, then the court of appeals will be sure to reverse the agency itself and it would do so without fear of Supreme Court reprisal.

Finally, consider the situation where $x_0^{si} \notin S_x(si)$. Here the court of appeals will accept x, which the Supreme Court will sustain as the final outcome ($X_C = x$; $X_S = x$).

Scenario 4: $x \notin C(si)$ and $x \notin C(p)$. Now consider the case where agency policy is outside the court of appeals' nonreversal sets for both statutory interpretation and process. The choices for the court of appeals, then, are to 1) reverse the agency policy through statutory interpretation (x_0^{si}), 2) reverse the agency through process (x_0^p), or 3) to leave the agency policy intact (x). The court of appeals' choice will depend on what it expects the Supreme Court to do.

If $x_0^{si} \in S_x(si)$ and $x \in S_{x_0}(si)$. then $X_C = x_0^{si}$ and $X_S = x_0$. If, however, $x_0^{si} \in S_x(si)$ and $x \notin S_{x_0}(si)$, then the court of appeals will let the Supreme Court do the work of reinstating the status quo. In other words, the court of appeals gets what it wants without having to spend its own resources to get it. Accordingly, $X_C = x$ and $X_{SC} = x_0^{si}$.

If $x_0^{si} \notin S_x(si)$, but a reversal through the appellate court's second-best alternative—process—would survive ($x_0^p \in S_x(p)$), then the court of appeals will reverse the agency policy through the process instrument (x_0^p).[36] The Supreme Court will accept this choice and the status quo will once again be the final policy outcome ($X_C = x_0^p$; $X_S = x_0$). If, however, $x_0^p \notin S_x(p)$, then the court of appeals reluctantly accepts the agency policy x and the Supreme Court lets the decision stand ($X_C = x$; $X_S = x$).

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36. Recall that $x \notin C(p)$.

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