

Rational Boundaries for SEC Cost-Benefit Analysis

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A series of D.C. Circuit cases invalidating SEC rules on economic analysis grounds has cast the agency's rulemaking authority in doubt. We analyze this case law, noting the incompatibility of strict cost-benefit analysis procedures designed for executive agencies with the structure and processes of multimember commissions like the SEC.

*The SEC has, until very recently, left courts and commenters free to develop an ad hoc, open-ended jurisprudence of economics in rulemaking that has effectively reversed the deference courts have traditionally shown to agency findings in their area of expertise—in this case, financial economics. *Business Roundtable v. SEC* shows how this jurisprudence has proven increasingly unworkable in practice; and yet, one current legislative proposal would codify and extend it further. We provide three solutions to this conundrum.*

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Introduction

A twenty-year line of appellate cases¹ culminating in the D.C. Circuit's devastating *Business Roundtable v. SEC* decision² has set a very high bar for economic analysis in rulemaking by financial regulators such as the Securities and Exchange Commission (SEC). Notwithstanding the Dodd-Frank Act's express affirmation of the agency's authority,³ the court struck down the SEC's long-pondered proxy access rule,⁴ and did so in a way that calls into question the practical ability of the SEC and other financial regulatory agencies with statutory economic analysis mandates to adopt future rules that will withstand challenge. Other financial regulators are alarmed,⁵ and with good reason, since their economic analyses of their own rules are generally less sophisticated than

1. *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC* (Chamber II), 443 F.3d 890 (D.C. Cir. 2006); *Chamber of Commerce v. SEC* (Chamber I), 412 F.3d 133 (D.C. Cir. 2005); *Timpinaro v. SEC*, 2 F.3d 453 (D.C. Cir. 1993).

2. *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

3. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 971, 124 Stat. 1376, 1915 (2010).

4. *Business Roundtable*, 647 F.3d at 1144.

5. See, e.g., OFFICE OF THE INSPECTOR GEN., U.S. COMMODITY FUTURES TRADING COMM'N, A REVIEW OF COST-BENEFIT ANALYSES PERFORMED BY THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH RULEMAKINGS UNDERTAKEN PURSUANT TO THE DODD-FRANK ACT (2011), available at http://www.cftc.gov/About/CFTCReports/oig_investigation_061311 (reviewing the cost-benefit analysis conducted by the CFTC in its Dodd-Frank rulemakings) [hereinafter CFTC OIG REPORT]; Arthur Fraas & Randall Lutter, *On the Economic Analysis of Regulations at Independent Regulatory Commissions*, 63 ADMIN. L. REV. (SPECIAL EDITION) 213 (2011) (reviewing the cost-benefit analysis conducted by independent regulatory commissions).

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the SEC's.⁶ Bills introduced in Congress promise to codify these cases and introduce additional anti-regulatory innovations,⁷ and to subject independent agency rules, including the SEC's, to review by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA).⁸ The SEC's incoming Chair led off her Senate confirmation hearing with a balanced view of this issue.⁹

We argue that the SEC should not retreat from economic analysis in rulemaking but should instead deploy its long-standing expertise in financial economics to improve both its rulemaking processes and the rules themselves. In so doing, it should insist on its right, derived from that expertise, to discern and define the boundary between economic analysis and policy choice, a distinction to which courts should defer.

The best vehicle for obtaining judicial blessing of the internal reforms it has already implemented may well be the proxy access rule itself. The SEC certainly has many other pressing priorities, but a re-proposal of an improved proxy access rule may be its best hope for the favorable opinion that this area of law sorely needs and which, we argue, the D.C. Circuit might be inclined to hand down.

Extending OIRA oversight to independent agencies like the SEC, by contrast, would erode the agencies' independence from the White House and invite more critical judicial review. OIRA oversight has a plausible rationale and bipartisan support but risks becoming a Trojan horse for more *Business Roundtable*-style anti-regulatory litigation. Once an agency's economic analysis has been second-guessed by OIRA, it should not be third-guessed by the courts. If Congress is to pass such a bill, it should take it as an opportunity to rebalance the relationship between the agencies and the courts and to remove existing statutory impediments to pre-decisional deliberations at the Commissioner level. Without these reforms, multi-member Commissions will be unable to lawfully carry on an intelligent conversation with the OIRA

6. For an assessment of economic analysis by financial regulators, see U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-151, DODD-FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION (2011), available at <http://www.gao.gov/assets/590/586210.pdf>.

7. See Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (2011).

8. Independent Agency Regulatory Analysis Act, S. 3468, 112th Cong. (2012).

9. See *Nominations Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 113th Cong. (2013) (statement of Mary Jo White, Nominee, Chair, U.S. Sec. & Exch. Comm'n), available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=619e5603-c2c8-4085-98c6-0014ce29bde7 ("With respect to rulemaking, rigorous economic analysis is important and should inform and guide the decisions that are made. Although challenging—particularly in the quantification of benefits—in my view, the SEC should seek to assess, from the outset, the economic impacts of its contemplated rulemaking. Such transparent and robust analysis, including consideration of the costs and benefits, will help ensure that effective and optimal solutions are achieved without unnecessary burdens or competitive harm. If confirmed, I would continue the efforts of the Commission to ensure that the SEC performs robust analysis in connection with its rules and in a manner that does not undermine the SEC's ability to carry out its mandate to protect investors and our capital markets.").

Administrator, leaving the OIRA process little more than a lightning rod for harsh judicial review.

In Part I, we review the background of the proxy access case, exploring possible reasons why the SEC volunteered decades ago for what in retrospect appears to have been a suicide mission: undertaking cost-benefit analysis (CBA) of its rules.¹⁰ We show that the trend in the case law toward an affirmative obligation to make economic determinations in the course of rulemaking antedates the statutes upon which more recent challenges have increasingly come to rely. Those statutes, adopted in the late 1990s, require the agency to consider, in addition to the protection of investors, the effects of its rules on efficiency, competition and capital formation (ECCF) when it adopts rules in the public interest. Rule challenges under the Administrative Procedure Act (APA) based on alleged defects in statutorily-required consideration of ECCF effects have been 100 percent successful to date;¹¹ none of the rules vacated and remanded for further analysis have ever been re-proposed.

The SEC's approach to economic analysis differs from that of agencies required to submit their CBA to OIRA. Without the benefits of a dialogue with OIRA's CBA experts, the SEC until recently left the job of defining the theory and boundaries of economic analysis under the ECCF statutes to courts and interested commenters. Abstaining from any construction of its own statute, the SEC left the D.C. Circuit free to develop an ad hoc, open-ended jurisprudence of economics in SEC rulemaking that has proven increasingly unworkable in practice.

We then turn in Part II to *Business Roundtable v. SEC*,¹² devoting substantial attention to the proposal/comment/adoption process: the first phase

10. For a discussion of cost-benefit analysis, see generally OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-4, at 2-3 (Sept. 17, 2003) [hereinafter OMB CIRCULAR NO. A-4], available at <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf>; MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006); STEPHEN G. BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 21 (1993); CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002); Michael Abramowicz, *Toward a Jurisprudence of Cost-Benefit Analysis*, 100 MICH. L. REV. 1708 (2002); E. Donald Elliott, *Only a Poor Workman Blames His Tools: On Uses and Abuses of Benefit-Cost Analysis in Regulatory Decision Making About the Environment*, 157 U. PA. L. REV. 178 (2009); John D. Graham, *Saving Lives Through Administrative Law and Economics*, 157 U. PA. L. REV. 395 (2009); Robert W. Hahn & Cass R. Sunstein, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis*, 150 U. PA. L. REV. 1489 (2002); Sally Katzen, *Cost-Benefit Analysis: Where Should We Go from Here?*, 33 FORDHAM URB. L.J. 1313, 1315-17 (2006); Timur Kuran & Cass R. Sunstein, *Availability Cascades and Risk Regulation*, 51 STAN. L. REV. 683 (1999); Thomas O. McGarity, *A Cost-Benefit State*, 50 ADMIN. L. REV. 7 (1998); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1 (1995); Eric A. Posner & Cass R. Sunstein, *Dollars and Death*, 72 U. CHI. L. REV. 537 (2005); Susan Rose-Ackerman, *Putting Cost-Benefit Analysis in its Place: Rethinking Regulatory Review*, 65 U. MIAMI L. REV. 335 (2011); and Cass R. Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651 (2001).

11. See cases cited *supra* note 1. The CFTC's recent district court victory in *Investment Co. Inst. v. CFTC*, CIV.A. 12-00612, 2012 WL 6185735 (D.D.C. Dec. 12, 2012), is on appeal and could break the regulators' losing streak. See *infra* Part V.

12. 647 F.3d 1144 (D.C. Cir. 2011). The *Business Roundtable* opinion has been widely criticized. James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C.*

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of the litigation. We examine the Court's harsh criticism of the SEC's treatment of the empirical economic analysis, in which it quietly substituted a heavy burden of proof for the deference normally afforded expert findings. We show, by reference to key economics papers in the record, that this particular criticism was unfounded. The Court also had additional, valid criticisms of both the rule and its adopting release, but we show that those can readily be corrected on remand.

We conclude Part II by observing that the best vehicle for re-establishing deference for expert agency determinations may well be a new version of the proxy access rule itself. A *Business Roundtable II* opinion would give the Court the opportunity both to commend the agency for learning the lessons it has been trying to teach and to dial back its apparent substitution of deference to expert agency judgments with a high burden of proof. A future opinion upholding a new proxy access rule would serve as a much-needed lodestar for doing economic analysis in a way that is both feasible and meaningful—not for the SEC alone, but for other financial regulators with similar requirements.

In Part III, we review reactions to *Business Roundtable*, beginning in Congress. Immediately after the decision, congressional Republicans called agency officials and outside experts in for testimony and initiated inspector general reviews of rulemaking in a dozen financial regulatory agencies. Soon thereafter, the agencies' critics introduced the Financial Regulatory Responsibility Act of 2011 (FRRA).¹³ The FRRA would stack the deck against all new financial regulations by passing them through a maze of exacting criteria, quantitative analysis, legislative approval, and litigation in which the

Circuit's Usurpation of SEC Rulemaking Authority, 90 TEX. L. REV. 1811, 1840 (2012); Jill E. Fisch, *The Long Road Back: Business Roundtable and the Future of SEC Rulemaking*, 36 SEATTLE U. L. REV. (forthcoming 2013), <http://ssrn.com/abstract=2164423>; Ian D. Ghrist, *How To Sufficiently Consider Efficiency, Competition, and Capital Formation in the Wake of Business Roundtable*, 14 TRANSACTIONS: TENN. J. BUS. L. (forthcoming 2013), <http://ssrn.com/abstract=2103416>; Grant M. Hayden & Matthew T. Bodie, *The Bizarre Law & Economics of Business Roundtable v. SEC*, 38 J. CORP. L. 1 (2012); Michael E. Murphy, *The SEC and the District of Columbia Circuit: The Emergency [sic] of a Distinct Standard of Judicial Review*, 7 VA. L. & BUS. REV. 125 (2012); Comment, *D.C. Circuit Finds SEC Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis*, 125 HARV. L. REV. 1088 (2012); Anthony W. Mongone, Note, *Business Roundtable: A New Level of Judicial Scrutiny and Its Implications in a Post-Dodd-Frank World*, 2012 COLUM. BUS. L. REV. 746 (2012); Stephanie Lyn Parker, Note, *The Folly of Rule 14a-11: Business Roundtable v. SEC and the Commission's Next Step*, 61 AM. U. L. REV. 715 (2012); J. Robert Brown, Jr., *Shareholder Access and Uneconomic Economic Analysis: Business Roundtable v. SEC*, DENV. U. L. REV. ONLINE (Sept. 30, 2011, 2:57 PM), <http://www.denverlawreview.org/online-articles/2011/9/30/shareholder-access-and-uneconomic-economic-analysis-business.html>; DENNIS KELLEHER, STEPHEN HALL & KATELYNN BRADLEY, BETTER MARKETS, INC., SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 59-68 (2012), <http://www.bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf> [hereinafter BETTER MARKETS]. The U.S. Chamber of Commerce sponsored a white paper in response. See PAUL ROSE & CHRISTOPHER WALKER, U.S. CHAMBER OF COMMERCE CENTER FOR CAPITAL MARKETS COMPETITIVENESS, THE IMPORTANCE OF COST-BENEFIT ANALYSIS IN FINANCIAL REGULATION (2013), available at <http://www.uschamber.com/sites/default/files/reports/CBA-Report-3.10.13.pdf> [hereinafter CHAMBER WHITE PAPER]. We contrast our policy prescriptions with those of other commentators in Part V, *infra*.

13. Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (2011).

agency would bear a “clear and convincing” burden of proof.¹⁴ We show that the FRRA, extreme as it may seem at first blush, is little more than a logical extension of the *Business Roundtable* case, the culmination of a trend empowering courts to strike down regulations almost at will.

Part IV discusses the SEC’s response to the *Business Roundtable* decision. We examine the agency’s attempt to square the difficult case law that led to the *Business Roundtable* decision with settled principles of administrative law, regulatory analysis, and microeconomic theory. We examine the longstanding role of financial economists at the SEC, a distinguished and growing cadre now housed in its three-year-old Division of Risk, Strategy, and Financial Innovation (RSFI). We assess the new guidance that RSFI and the SEC Office of General Counsel (OGC) recently posted for economic analysis (2012 Guidance), which consolidated procedural reforms set in motion long before the *Business Roundtable* decision.¹⁵ We conclude by noting that while the 2012 Guidance is a positive step, it should be refined and elaborated based on experience to draw rational boundaries around the “consideration” that the ECCF statutes require, and thereby make ECCF analysis both valuable and feasible. To enhance the degree of deference courts afford this line-drawing exercise, the Commission itself should adopt a future iteration of the 2012 Guidance as a policy statement. Such a statement should reflect the best practices that emerge from this effort, after notice and comment from the public would help courts reset the bar on judicial review of subsequent regulations to an attainable height. The SEC must set rational boundaries around the scope of its own economic analyses, boundaries within which data analysis and economic theory can inform, but not dictate, policy outcomes.¹⁶

Part V argues that multi-member commissions cannot be expected to act with the same degree of rationality and coherence as hierarchical bureaucracies. These quasi-legislative bodies engage in log-rolling to reach agreement that often does not map well onto cost-benefit analysis. This problem is exacerbated by the Sunshine Act, which prohibits agency leaders from engaging in private

14. See *infra* notes 169-178 and accompanying text.

15. U.S. SEC. & EXCH. COMM’N, CURRENT GUIDANCE ON ECONOMIC ANALYSIS IN SEC RULEMAKINGS (Mar. 16, 2012), http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_seculemaking.pdf [hereinafter 2012 Guidance].

16. Since *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), judicial deference to agency interpretation of ambiguous statutory provisions has been a central tenet of the administrative state. See, e.g., E. Donald Elliott, *Chevron Matters: How the Chevron Doctrine Redefined the Roles of Congress, Courts, and Agencies in Environmental Law*, 16 VILL. ENVTL. L.J. 1, 4 (2005); Cass R. Sunstein, *Beyond Marbury: The Executive’s Power To Say What the Law Is*, 115 YALE L.J. 2850, 2850 (2006) (“*Chevron* is not merely a counter-*Marbury* for the executive branch, but also the *Erie Railroad Co. v. Tompkins* of the last half-century.”); Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187, 190 (2006) [hereinafter Sunstein, *Chevron Step Zero*] (“*Chevron* might well be seen not only as a kind of counter-*Marbury*, but even more fundamentally as the administrative state’s very own *McCulloch v. Maryland*, permitting agencies to do as they wish so long as there is a reasonable connection between their choices and congressional instructions.”).

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deliberation.¹⁷ To illuminate this issue, we discuss a bill that would authorize the President to subject independent agencies, and their economic analysis of regulations, to OIRA review. Economic analysis should be a conversation, not a simple calculation or a confrontation. Conversations between the agency and OIRA could improve SEC rules, but only if Commissioners are legally permitted to have conversations among themselves before conversing with OIRA. Such a state of affairs would be far preferable to the SEC's failed twenty-year dialogue with the D.C. Circuit. We therefore recommend that any bill permitting OIRA review of independent agency economic analyses also preclude judicial review of such analyses.

I. Statutory, Administrative and Case Law Background

The SEC, like other independent agencies, has always been exempt from the cost-benefit analysis process mandated by Executive Order 12,866 and its predecessors.¹⁸ Agencies subject to EO 12,866 routinely quantify the costs and benefits of their proposed rules (often with the help of outside consultants) in analyses they submit to OIRA.¹⁹ While the OIRA process has not been without its critics, this dialogue affords the Executive Office of the President (and, in some high-profile instances, White House staff), other agencies, parties affected by the proposed regulations, and the public an important opportunity to influence agency regulations.²⁰ The cost-benefit analysis acknowledges and

17. Government in the Sunshine Act, Pub. L. 94-409, 90 Stat. 1231 (1976) (codified at 5 U.S.C. § 552b) [hereinafter Sunshine Act].

18. Exec. Order No. 12,866, 3 C.F.R. § 638 (1993) (exempting “independent regulatory agencies” as defined by the Paperwork Reduction Act, 44 U.S.C. §§ 3501-21 (2006), from the OIRA review process). A number of scholars and practitioners have advocated subjecting independent agencies to regulatory review. *See, e.g.*, Pildes & Sunstein, *supra* note 10. *See infra* Part III for a discussion of proposed legislation that would subject the independent agencies to additional procedural hurdles, including OIRA review.

19. 3 C.F.R. § 639 (1993) (“Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.”). For an overview of the effects of OIRA review on agency procedures, including their use of outside consultants, see Michael A. Livermore, *Cause or Cure? Cost-Benefit Analysis and Regulatory Gridlock*, 17 N.Y.U. ENVTL. L.J. 107 (2008) [hereinafter Livermore, *Cause or Cure?*]; and Michael A. Livermore, *Cost-Benefit Analysis and Agency Independence* (2012) (unpublished manuscript) (on file with authors). *See also* Paul R. Verkuil, *The Wait Is Over: Chevron as the Stealth Vermont Yankee II*, 75 GEO. WASH. L. REV. 921, 928 (2007) (“Agency officials, overwhelmed . . . are increasingly delegating . . . to private contractors and signing off on the results.”).

20. A substantial literature has analyzed the OIRA process. *See, e.g.*, Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260 (2006); James F. Blumstein, *Regulatory Review by the Executive Office of the President: An Overview and Policy Analysis of Current Issues*, 51 DUKE L.J. 851 (2001); Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 872 (2003); Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075 (1986); E. Donald Elliott, *TQM-ing OMB: Or Why Regulatory Review Under Executive Order 12,291 Works Poorly and What President Clinton Should Do About It*, 57 LAW & CONTEMP. PROBS. 167 (1994); Alan B. Morrison, *OMB Interference with Agency Rulemaking: The Wrong Way To Write a Regulation*, 99 HARV. L. REV. 1059 (1986).

seeks to quantify the trade-offs involved, and ideally rationally frames the policy debate, offering common ground as a starting point for both proponents and detractors of the rule to comment. For clarity, we will refer to these processes and procedures as “OIRA CBA.” OIRA CBA is, by its terms, exempt from judicial review²¹ and courts appear to have rarely looked to it when judging other aspects of a proposed rule.²² It is undisputed that the SEC is not required to perform OIRA CBA. But in the 1970s, it began to include cost-benefit sections in its releases anyway. That decision—eventually codified by Congress and ultimately aggressively enforced by the courts—laid the groundwork for *Business Roundtable*.

A. *Volunteering for a Suicide Mission?*

In the 1970s, shortly before EO 12,866’s key predecessor was promulgated,²³ the SEC voluntarily began to include in its proposing releases and adopting releases²⁴ a section entitled “Cost-Benefit Analysis.” We refer to this voluntary discussion of benefits and costs as “SEC CBA.” SEC CBA was never submitted to OIRA, although it was subject to public comment in the rulemaking process and, as we shall see, to judicial review. In 1996, the Congressional Review Act (CRA)²⁵ required submission of some of the information in the SEC CBA to the General Accounting Office (later named the Government Accountability Office) and then to Congress.²⁶

The SEC’s motivation for including SEC CBA in its releases back in the 1970s, when no statute or executive order required it, may have been a strategic

21. 3 C.F.R. § 649 (1993) (“This Executive order is intended only to improve the internal management of the Federal Government and does not create any right or benefit, substantive or procedural, enforceable at law or equity by a party against the United States, its agencies or instrumentalities, its officers or employees, or any other person.”). See *infra* Parts III & V for a discussion of proposed legislation that would effectively reverse this rule.

22. *But see* Hahn & Sunstein, *supra* note 10, at 1552 (suggesting that courts review OIRA CBA “to the extent those analyses are relevant to the legality of the agency’s conduct”). When Courts review compliance with statutes such as the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (2006), they incidentally review elements of OIRA CBA if the agency has cross-referenced them to fulfill those statutory requirements.

23. Exec. Order No. 12,291, 3 C.F.R. § 127 (1981) (providing a process for OIRA review of rules relatively similar to Executive Order 12,866, but subjecting most rules rather than only “significant” rules to review).

24. Documents that, if issued by other agencies, would typically be called “proposed rules” and “final rules,” respectively.

25. Congressional Review Act, 5 U.S.C. §§ 801-08 (2006).

26. *Id.* § 804. Agencies must also submit rules to OIRA for designation as either “major” or “minor” rules. This determination is much narrower than the Executive Order 12,866 review process. Though the CRA nominally allows Congress to overturn rules issued by independent agencies, Congress has never successfully used the CRA procedures to overturn a rule and appears to have generally ignored CRA submissions. See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO 06-601T, PERSPECTIVES ON 10 YEARS OF CONGRESSIONAL REVIEW ACT IMPLEMENTATION 1 (2006) (noting that from 1996 to 2006, members of Congress introduced only thirty-seven CRA disapproval resolutions, and only one was approved). To provide context, agencies issued approximately 40,000 rules during this period. See STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS 109 (2008).

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one with respect to the White House. In the early years of OIRA review, the White House and observers considered both the propriety and legality of including independent agencies within the scope of the executive order mandating such review.²⁷ President Reagan's Executive Order wound up exempting the independent agencies, but then-Vice President Bush followed up with a letter asking them to comply as though the Order applied to them.²⁸

It may have seemed prudent at the time for the SEC to begin including a (largely redundant) section entitled Cost-Benefit Analysis in releases; as long as SEC CBA was not subject to OIRA review and approval, it would have seemed that it could do little harm.²⁹ The optics of such a section may have been thought to appease the SEC's congressional overseers as well, which it seemed to do when those sections were not being read with a critical eye. Whatever the original rationale, once the practice had begun, those overseers naturally asked subsequent SEC Chairs whether they would continue SEC CBA. That question had only one right answer, however redundant SEC CBA may have been.

SEC CBA would ideally have been a means for the SEC staff to inform the Commissioners of the costs and the benefits of various policy options under consideration. However, SEC CBA generally only repeated policy arguments made elsewhere in the release, and supplied no additional information or analysis. SEC CBA did not quantify expected benefits, and its quantified costs were typically limited to a subset of the direct compliance burden, estimated for an entirely different purpose: a mandate under the Paperwork Reduction Act (PRA).³⁰

Of course, important trade-offs identified in SEC CBA should, and probably did, at times, influence the policy statements made in the preamble. Repeated admonitions to the SEC to involve staff economists earlier in the rulemaking process suggest, however, that the advice of those economists may often have been sought too late in the process to influence policy.³¹ Still, even

27. For a sense of this debate over time, see Hahn & Sunstein, *supra* note 10.

28. For this history, see BARRY D. FRIEDMAN, REGULATION IN THE REAGAN-BUSH ERA: THE ERUPTION OF PRESIDENTIAL INFLUENCE 78 (1995); Pildes & Sunstein, *supra* note 10, at 15 (stating that "not one" of the independent agencies that were asked voluntarily to comply "formally acknowledged their willingness to do so"); and Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 592-93 (1984).

29. See OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS 12 (2012), available at <http://www.sec-oig.gov/Reports/AuditsInspections/2012/499.pdf> [hereinafter KYLE REPORT] ("[A]lthough the SEC, an independent regulatory agency, is not expressly required to conduct cost-benefit analyses, SEC Chairmen have made a commitment to Congress that the Commission will conduct cost-benefit or economic analyses for its rulemakings.")

30. 44 U.S.C. §§ 3501-21 (2006) (requiring disclosure of the estimated time necessary to comply with information collection requests such as filling out forms; the burden-hours created by these forms were typically multiplied by wage data supplied by a securities industry trade association to calculate the PRA numbers, which were typically also referenced in SEC CBA).

31. See, e.g., OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, RULEMAKING PROCESS (2002), <http://www.sec-oig.gov/Reports/AuditsInspections/2002/347fin.htm>. For the most

if economic thinking and the work of the SEC's staff of professional economists did influence policy from time to time before judicial review began, SEC CBA contained scant evidence of it. As a result, SEC CBA for many years was treated as a procedural requirement, similar to the Regulatory Flexibility Act³² rather than a policy exercise.

In 1996, the National Securities Markets Improvement Act (NSMIA), part of Newt Gingrich's "Contract With America," amended the securities laws to require that the SEC consider the impact of its rules on "efficiency, competition and capital formation" (ECCF).³³ But after passage of NSMIA, the SEC added a new section to its releases, containing what we will refer to as "ECCF consideration." In many proposing releases, the entire ECCF consideration section was no more than an invitation to comment on the proposal's effects on efficiency, competition and capital formation, terms that to this day the Commission has never defined. SEC responses to these comments in the adopting releases were generally perfunctory.

B. Timpinaro: *Professional Traders*

SEC CBA began in the 1970s, but it was only in 1993 that the D.C. Circuit first reviewed it in a little-known case which presaged the jurisprudence that emerged from the ECCF statutes adopted later in the decade. *Timpinaro v. SEC*³⁴ involved NASDAQ's Short Order Execution System (SOES), which was "designed to provide the benefits of automatic execution to retail customer orders of limited size for securities quoted on the [NASDAQ] System."³⁵ At issue was a challenge brought by securities broker-dealers to a SEC rule prohibiting professional traders from making clever use of the SOES to earn riskless trading profits by exploiting a price disparity among different market

recent example at the time of this writing, see *id.* at vii ("SEC rulewriting divisions and RiskFin should consider ways for economists to provide additional input into cost-benefit analyses of SEC rulemakings to assist in including both quantitative and qualitative information to the extent possible.").

32. 5 U.S.C. §§ 601-12; see also Nat'l Tel. Co-op. Ass'n v. FCC, 563 F.3d 536, 540 (D.C. Cir. 2009) (noting that the Regulatory Flexibility Act is "purely procedural" and "imposes no substantive constraints on agency decisionmaking"). This section includes amendments made in the Small Business Regulatory Enforcement Fairness Act (SBREFA), Pub. L. No. 104-121, 110 Stat. 857 (1996), codified as amended at 5 U.S.C. § 601 *et seq.* According to a report of the CFTC's Inspector General, the corresponding sections of that agency's releases were colorfully referred to internally as the "caboose" of the release. CFTC OIG REPORT, *supra* note 5, at 16. That report, which inspired the flurry of Congressionally-instigated IG reports discussed *infra* note 162, views the term as indicative of the CFTC's dismissive attitude towards its own statutory economic analysis requirements.

33. 15 U.S.C. §§ 78c(f), 80a-2(c) (2006) (requiring that whenever "the Commission is engaged in rulemaking" it consider "whether the action will promote efficiency, competition, and capital formation").

34. 2 F.3d 453 (D.C. Cir. 1993). *Timpinaro* is not cited in the more recent cases discussed below, several of which were also written by Judge Ginsburg.

35. *Id.* at 455 (quoting Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Changes Related to the Small Order Execution System, 56 Fed. Reg. 52,092, 52,092 (Oct. 17, 1991)).

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makers in order to earn an arbitrage profit (the SEC termed this “picking off” the market makers).

In *Timpinaro*, Judge Douglas Ginsburg, himself a former OIRA Administrator and Assistant Attorney General for the Antitrust Division, began by commending the SEC for proceeding in its analysis from a “sound theory of market behavior.”³⁶ The “theory” in question was simply the SEC’s observation that in the absence of an SOES access rule protecting them from being “picked off” by professional traders, some market makers would cease making markets in certain stocks. The SEC presumed that this reduced competition among market makers would widen spreads and impair market liquidity.

The D.C. Circuit nonetheless remanded the rule, calling upon the SEC to produce evidence of the withdrawals from market making that its theory predicted, and to balance the value of avoiding wider spreads and reduced liquidity against the lost “benefit” of the professional traders’ activities, namely the improvements in efficiency in market pricing that would presumably result from market makers’ increased vigilance and more frequent updates of quotations, to mitigate the effectiveness of the professional traders’ tactics.³⁷

Citing a regression analysis by the National Association of Securities Dealers Department of Economic Research on the relationship between SOES activity and spreads as evidence of the apparent feasibility of the approach he required, Judge Ginsburg, noting that the SEC had not performed a regression analysis on its own, concluded that the SEC had not adequately substantiated its reasoning and remanded the rule for further analysis of its benefits and costs.³⁸ The SEC never promulgated a final version of the rule.

Timpinaro in retrospect appears as an unheeded wake-up call. Three years before Congress mandated consideration of ECCF factors, this case illustrates the tension between the protection of investors and the promotion of market pricing efficiency. SOES was designed to give small investors special access to the automatic execution, and the rules at issue were like the squirrel guard on a bird feeder, designed to prevent another species from appropriating the intended benefit. The reasoning in *Timpinaro* ignores this dynamic, making the rule stand or fall on the basis of an empirical, quantitative comparison of two countervailing effects that theory predicts would affect market pricing efficiency. Thus, a passing, unexceptional observation about the first- and second-order economic effects of the rule was elevated above the concerns for

36. *Id.* at 457.

37. *Id.* at 457-58.

38. *Id.* at 458 (“We cannot say whether such a study could or should have been conducted before the Professional Trader Rule was adopted, but the apparent feasibility of such a study reinforces our conviction that the SEC has not adequately substantiated its implicit claim that the effect of ‘professional SOES trading’ upon bid-ask spreads outweighs the beneficial effect of more timely pricing by market makers. We therefore remand this aspect of the case for the Commission to address the balance of benefits and costs associated with the Professional Trader Rule.”).

fairness to small investors and market makers that drove the rule in the first place. This aspect of the opinion anticipated not only the strong interpretations of the ECCF statutes that were soon to come,³⁹ but also the stringent terms of the FRRA, pending in Congress at the time of this writing.⁴⁰

C. *ECCF Statutes Enacted*

In the late 1990s, in the wake of Newt Gingrich's "Contract with America," Congress added the requirement to consider "efficiency, competition, and capital formation" to the Securities Act,⁴¹ the Exchange Act,⁴² the Investment Company Act,⁴³ and the Investment Advisors Act.⁴⁴ The ECCF amendments explicitly reiterated the Commission's primary mission, "the protection of investors," and applied the new criteria only where the Securities Laws already contemplated rulemaking "in the public interest."⁴⁵ What, exactly, did the ECCF require the agency to consider?

Congress did not define the terms "efficiency," "competition," or "capital formation."⁴⁶ "Efficiency" has a plain and ordinary meaning: doing more with less.⁴⁷ Efficiency is also a fundamental concept in economic theory, which posits that efficient markets produce a Pareto-optimal allocation of resources.⁴⁸ Pareto optimality under the Kaldor-Hicks criterion (also known as "weak Pareto efficiency") is the basis for most quantitative public policy analysis, including OIRA CBA.⁴⁹ Kaldor-Hicks assumes distributive effects are evened out somehow (or ignored) and focuses on net aggregate societal benefits instead.

However, all three ECCF factors are rightly viewed as aspects of efficiency. Economic efficiency (and inefficiency) are attributes of markets. Markets cannot be understood or assessed from an economic point of view without an understanding of the competitive forces at play, including barriers to new competition, making consideration of competition part and parcel of any

39. See *infra* Section I.C.

40. See *infra* Section III.B.

41. 15 U.S.C. § 77b(b) (2006).

42. *Id.* § 78c(f).

43. *Id.* § 80a-2(c).

44. *Id.* § 80b-2(c).

45. *Id.*

46. For a discussion of the legislative history of the ECCF amendments, see Cox & Baucom, *supra* note 12, at 1818-24.

47. See MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 397 (11th ed., 2003) (defining efficient as "productive of desired effects; esp.: productive without waste.").

48. See ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 350, 549 (1995).

49. See Richard A. Posner, *Cost-Benefit Analysis: Definition, Justification, and Comment on Conference Papers*, in COST-BENEFIT ANALYSIS: LEGAL, ECONOMIC, AND PHILOSOPHICAL PERSPECTIVES 317-18 (Matthew D. Adler & Eric A. Posner eds., 2001) (explaining that in a particular sense, "cost-benefit analysis" simply denotes the "Kaldor-Hicks . . . concept of efficiency."). For discussion of whether Kaldor-Hicks is an appropriate standard for agencies engaging in cost-benefit analysis, see DOUGLAS A. KYSAR, REGULATING FROM NOWHERE 103-04 (2010).

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discussion of the efficiency of markets. Under such a framework, capital formation becomes simply one aspect of allocative efficiency: not an estimate of a gross amount, but a measure of the extent to which the right amount of capital is being raised from the right investors and flowing to the right investments, at the right risk-adjusted returns.

Back in the 1990s, the SEC could perhaps have complied with the ECCF amendments by bringing SEC CBA more in line with OIRA CBA's focus on economic efficiency. Instead, SEC releases continued to include old-fashioned SEC CBA, and a new ECCF consideration section began to appear at the end of SEC releases, separated from SEC CBA by several other technical sections.⁵⁰ The ECCF consideration section rarely contained any new information; in fact, in many proposing releases it was no more than an invitation for public comment on "efficiency, competition and capital formation."⁵¹ These terms remained undefined. As a result, the corresponding section in the Adopting Release was nothing more than a response to commenters.⁵² Ironically, the SEC continued to devote greater effort and attention to the voluntary SEC CBA, while giving short shrift to the statutory ECCF consideration section, the section under which its economic analysis would ultimately be challenged. The SEC in effect handed over to the regulated entities (and other commenters) its prerogative to define the terms of its own statute, accepting whatever it was that the commenter *du jour* thought the terms meant. At the time, this may have seemed like the path of least resistance; the ensuing case law reveals where that path led.

D. Chamber I & Chamber II: *Mutual Fund Boards*

In 2004, the SEC, responding to concerns about conflicts of interest in the management of mutual funds, adopted a rule requiring that mutual fund boards be chaired by a director independent of the fund's investment advisor and that 75 percent of the board should be independent.⁵³ The U.S. Chamber of Commerce petitioned the D.C. Circuit to overturn the rule, primarily on statutory authority grounds, a claim Judge Ginsburg, writing once again for the

50. See, e.g., OTC Derivatives Dealers, 63 Fed. Reg. 59,362 (Nov. 3, 1998) (codified at 17 C.F.R. pts. 200, 240, 249).

51. See, e.g., Registration under the Securities Act of 1933 of Certain Investment Company Securities, 62 Fed. Reg. 47,934, 47,937 (Sept. 12, 1997) (codified at scattered parts of 17 C.F.R.) (merely noting at the end of the cost-benefit analysis that "[i]n addition, the amendments should have no adverse effects on efficiency, competition, or capital formation.").

52. This was in part because case law interpreting the APA's notice and comment requirements generally prohibits agencies from otherwise presenting new facts or arguments for the first time in the adopting release because they would otherwise be insulated from public comment. See, e.g., *Chamber II*, 443 F.3d at 900 ("[I]f the agency determines that additional fact gathering is necessary, then notice and comment are typically required.").

53. For an overview of the history and important insights, see Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STAN. J.L. BUS. & FIN. 1 (2006).

Court, rejected.⁵⁴ The Court likewise rejected most of the Chamber's ECCF contentions, noting "the extreme degree of deference" owed to an agency "when it is evaluating scientific data within its technical expertise."⁵⁵ Moreover, the Court found it proper for the Commission to reach conclusions based on its own and its staff's experience, rather than commissioning a study on the effect of an independent chairman on fund performance.⁵⁶ Backing off from his suggestion in *Timpinaro* that the SEC might be required to run its own empirical regression analyses to test the theoretical costs and benefits of a rule simply because it can,⁵⁷ Judge Ginsburg wrote that that the Court was "acutely aware that an agency need not—indeed cannot—base its every action upon empirical data; depending upon the nature of the problem, an agency may be 'entitled to conduct . . . a general analysis based on informed conjecture.'"⁵⁸

The rule fell nonetheless. The Court found that the SEC's failure to assess one relatively minor cost violated its obligation to consider ECCF factors, and the rule was therefore set aside under the APA.⁵⁹ Specifically, the release had acknowledged that an independent chairman might require more staff, but confessed that the SEC "had no reliable basis for estimating those costs,"⁶⁰ also noting that it had offered companies three different ways to satisfy the requirement. The agency therefore expressly declined to make cost estimates for the 75 percent independent director condition. In effect, the SEC had concluded that it was not worth the effort to calculate the costs of compliance because those costs would be so minor. The SEC's conclusion displeased the Court, which held: "[I]n [the] face of uncertainty, [an] agency must 'exercise its expertise to make tough choices about which of the competing estimates is most plausible, and to hazard a guess as to which is correct, even if . . . the estimate will be imprecise.'"⁶¹ *Chamber I* thus interpreted the ECCF consideration to require the agency to make quantitative determinations.⁶²

54. *Chamber I*, 412 F.3d at 136.

55. *Id.* at 143 (quoting *Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996)); see also Patricia M. Wald, *Judicial Review: Talking Points*, 48 ADMIN. L. REV. 350, 352 (1996) ("[Q]uestions have been raised about whether we in the courts are competent to review the minutiae of risk or cost-benefit analysis. For most of us, the answer is no.").

56. *Chamber I*, 412 F.3d at 142.

57. See *Timpinaro*, 2 F.3d at 457-58.

58. *Chamber I*, 412 F.3d at 142 (quoting *Melcher v. FCC*, 134 F.3d 1143, 1158 (D.C. Cir. 1998)). As we will see, this liberality was short lived. See *infra* notes 79-141 and accompanying text.

59. See 5 U.S.C. § 706 (2006) ("[T]he reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be—(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . .") (emphasis added). For an overview of the structure and history of the APA, see Edward Rubin, *It's Time To Make the Administrative Procedure Act Administrative*, 89 CORNELL L. REV. 95 (2003).

60. Investment Company Governance, 69 Fed. Reg. 46,378, 46,387 n.81 (Aug. 2, 2004) (codified at 17 C.F.R. pt. 270.)

61. *Chamber I*, 412 F.3d at 143 (quoting *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1221 (D.C. Cir. 2004)).

62. The remand was based on one additional ground: failure to consider an alternative approach to the problem (disclosure of whether or not the chairman is independent of the fund manager)

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The *Chamber I* court drew its key language from the *Public Citizen* case,⁶³ which involved a significantly stricter statutory requirement. The authorizing statute in that case directed the Federal Highway Administration to issue a notice of proposed rulemaking (NPRM) addressing the problem of truck driver fatigue. The NPRM was required by law to at least *consider* requiring truck drivers to install “automated and tamper-proof recording devices.”⁶⁴ The FHA declined to consider that requirement, citing the difficulty of assessment—a rationale the Court understandably rejected.⁶⁵ Holding otherwise would have made the Court complicit in nullification by the executive branch of a specific congressional directive.⁶⁶

But there is a world of difference between a statute instructing an agency to consider “efficiency” and a statute instructing an agency to consider a particular solution to a particular problem. When a statute instructs an agency to “consider” something as broad as “efficiency,” and the agency considers many aspects of efficiency and declines to address others, a reviewing court should hesitate to void the resulting rule. The extent to which the agency “considers” ECCF factors is a matter of judgment—one that can and should vary significantly depending upon the rule and its context. No matter how much analysis the SEC undertakes, a court can always point to an additional issue that should have been analyzed, or analyzed differently or more deeply.

Pressed for time because of the imminent departure of Chairman Donaldson and the fact that incoming Chairman Cox was likely to oppose the rule on policy grounds, the SEC developed the cost estimates required by *Chamber I* in a matter of days. The court again remanded the rule, this time on the ground that the new data used to estimate the costs had not been placed on the record for public comment.⁶⁷ In effect, the court ruled that the absence of notice and the opportunity to comment on the going rate for professional staff had prejudiced the Chamber.⁶⁸ The SEC lost *Chamber I* for failing to quantify, and lost *Chamber II* for not subjecting its quantitative data to the notice and comment process. Following *Chamber II*, the SEC dutifully opened a comment file, through which it received overwhelming confirmation that it had been

that had been endorsed by two dissenting Commissioners. *See id.* at 144 (“Finally, the Chamber argues the Commission gave ‘inadequate consideration’ to suggested alternatives to the independent chairman condition, citing as an example—the only significant one, it seems to us—the proposal, endorsed by the two dissenting Commissioners, that each fund be required prominently to disclose whether it has an inside or an independent chairman and thereby allow investors to make an informed choice.” (emphasis added)).

63. *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1209 (D.C. Cir. 2004).

64. *Id.* at 1221.

65. *Id.* at 1211.

66. For a description of strategic interaction between the branches, see William Eskridge, Jr. & John Ferejohn, *The Article I, Section 7 Game*, 80 GEO. L.J. 523 (1992).

67. *Chamber II*, 443 F.3d at 894.

68. *Id.* (“[T]he Commission failed to comply with section 553(c) of the APA, 5 U.S.C. § 553(c), by relying on materials not in the rulemaking record without affording an opportunity for public comment, to the prejudice of the Chamber.”).

right all along: the costs involved were slim to none.⁶⁹ Nonetheless, Chairman Cox and his colleagues did not re-propose the independent chairman rule and it has not been enacted as of this writing. Its moment had passed.

The remand notwithstanding, the *Chamber I* case evinced considerable deference to the SEC's expertise, offering considerable leeway for judgments, forecasts, "informed conjecture" and predictions based on the expert knowledge of the agency. This deference stands in stark contrast to the *Business Roundtable* case, which would later deride a Commission observation as "unutterably mindless."⁷⁰

Still, three aspects of *Chamber I* sowed seeds of future troubles. First, the court emphasized the alternative proposed by two dissenting Commissioners and the SEC CBA's failure to address this alternative.⁷¹ This discussion sent a message to future commissioners about the power of their statements at open meetings, particularly statements in dissent. This message was particularly important given the widely acknowledged increase in partisan polarization in Washington in recent years.⁷² The Exchange Act gives the President the power to fill a majority of seats on the Commission with members of his or her own party, but *Chamber I* (and, as we shall see, *Business Roundtable* as well) effectively gives an outvoted member the right to subject the rule to a more exacting standard of review. Statements by dissenting commissioners at the SEC open meeting approving the rule often trigger heightened judicial scrutiny of the rule provisions criticized in the dissenting statement. And these statements come too late in the adoption process to be addressed or rebutted by either the majority or the staff.

Second, *Chamber I* held that the SEC did not have the right to decide which costs were worth quantifying and which were not. Because it required the SEC, on the eve of the Chairman's departure, to hazard a guess about a matter the SEC deemed trivial and unlikely to affect the outcome, the rule died on remand, even though, as Murphy shows,⁷³ the re-opened comment file demonstrates that the SEC's conjecture that the direct costs of independent directors are trivial was confirmed. This outcome is a counterexample to observers who believe that policies based on sound empirics will survive

69. See Murphy, *supra* note 12, at 139-140.

70. *Business Roundtable*, 647 F.3d at 1156.

71. See *Chamber I*, 412 F.3d at 144 ("We conclude the Commission's failure to consider the disclosure alternative violated the APA. To be sure, the Commission is not required to consider [every alternative] Here, however, two dissenting Commissioners raised, as an alternative to prescription, reliance upon disclosure" (internal citations omitted) (emphasis added)).

72. For an overview of research on polarization of political elites, see Mark J. Hetherington, *Putting Polarization in Perspective*, 39 BRIT. J. POL. SCI. 413, 413 (2009) ("Scholarly research has demonstrated rather conclusively that American political elites have undergone a marked partisan polarization over the past thirty years.").

73. Murphy, *supra* note 12, at 139-40.

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agency regime change.⁷⁴ We assume no bad faith or blind partisanship, only that new management will naturally have priorities and agendas of its own, which will necessarily preoccupy them during their brief turn at the helm. As we elaborate in Parts III and IV, the SEC is in a far better position than the courts, based on its intimate knowledge of the financial markets and their problems—and of its own data resources and analytic capabilities—to identify the point of diminishing returns to further economic analysis, and to set rational boundaries around the exercise of that analysis. Without judicial deference to this key determination, any and all SEC regulations will face the threat of remand to consider just one additional factor.

Third, and perhaps most importantly, *Chamber I* subtly elevated the statutory mandate for the SEC to “consider” efficiency, competition and capital formation to and an independent obligation to *determine* (as best it can) the economic consequences of proposed rules.⁷⁵ The SEC could and should have interpreted the ECCF provisions as a purely procedural requirement, like the strictures of the Regulatory Flexibility Act.⁷⁶ Under this interpretation, the SEC would have satisfied its obligation merely by making a reasonable effort to address each of the required ECCF elements. As we discuss in greater detail below, such an SEC interpretation would be entitled to deference⁷⁷ but the SEC has never expressly interpreted the ECCF amendments.

Surprisingly, the specific “economic consequences” the Court required the SEC to chase down were not big-picture micro- or macroeconomic considerations, but minor particular costs.⁷⁸ The focus on minor cost estimates reinforced the SEC’s unfortunate, long-standing tendency to base the cost analysis in SEC CBA on hourly burden estimates provided for Paperwork Reduction Act purposes. Repetition of PRA estimates (multiplied by standard wage rates) adds no useful information to the release, and obscures what should be the real focus: the full range of social costs and benefits of a proposed action. Instead of building a top-down overview of the rule’s effects from an economic standpoint, delineating the anticipated first- and second-order effects of the proposed rule, SEC CBA often appears to be built from the bottom up,

74. See, e.g., Roberta Romano, *Regulating in the Dark*, in REGULATORY BREAKDOWN: THE CRISIS OF CONFIDENCE IN U.S. REGULATION 86 (Cary Coglianese ed., 2012).

75. *Chamber I*, 412 F.3d at 143.

76. For a more complete discussion, see Murphy, *supra* note 12, at 129-30.

77. For a description of different deference regimes, see Connor Raso & William N. Eskridge Jr., *Chevron as a Canon, Not a Precedent: An Empirical Study of What Motivates Justices in Agency Deference Cases*, 110 COLUM. L. REV. 1727 (2010). In recent years, a debate has emerged as to whether independent agencies should receive less deference because they are insulated from presidential control. See *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 547 (2009) (Breyer, J., dissenting) (arguing that an independent “agency’s comparative freedom from ballot-box control makes it all the more important that courts review its decisionmaking to assure compliance with applicable provisions of the law”); Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2376-77 (2001) (proposing to increase deference when the president has been more closely involved with the agency decision at issue and therefore “giving greater deference to executive than to independent agencies”).

78. *Chamber I*, 412 F.3d at 143.

based primarily on PRA costs and frequency estimates. Even in releases with good economics in them, like the Proxy Access Adopting Release, the inclusion of PRA numbers in the SEC CBA gave the rule's opponents an opening to emphasize the paperwork burden imposed by the rule and ignore the much larger ebenefits (and costs).

Under Chairman Cox, the SEC made no public statements about the *Chamber* cases. Nor did it publish any new rulemaking guidance or issue a formal interpretation of the ECCF consideration provision. Those cases may, however, explain the remarkable increase in length of the SEC CBA and ECCF consideration sections of SEC releases following these decisions. The economic analysis in SEC releases began to include more surveys of available empirical economic evidence, particularly in releases for controversial rules. In its propounding and evaluating of economic theories, and its reviews and evaluations of econometric literature, the SEC called on its staff economists in what was then called the Office of Economic Analysis to produce work that was substantially more sophisticated than the corresponding sections of releases from other financial regulatory agencies with similar statutory mandates.⁷⁹

E. American Equity: *Fixed Index Annuities*

In 2009, the SEC decided that fixed indexed annuities (FIAs) issued by state-regulated insurance companies should be regulated as securities if the component of the investment tied to stock market indices dominated the annuity component backed by the insurance company's balance sheet.⁸⁰ That determination would require sellers of such products to register as broker dealers. An insurance company engaged in the sale of FIAs, American Equity Investment Life Insurance Company, petitioned the D.C. Circuit to invalidate the rule, primarily on the ground that the SEC lacked authority to issue the rule. The Court accorded *Chevron* deference to the agency's interpretation of the statutory term "annuity" and so, as in *Chamber I*, the agency prevailed on the challenge to its statutory authority.⁸¹ But the ECCF challenge again prevailed. A make-weight argument that neither party appears to have taken seriously was now well on its way to becoming a very potent doctrine indeed.⁸²

79. For examples and a discussion of such efforts, see U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-151, DODD-FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION (2011), <http://www.gao.gov/assets/590/586210.pdf>.

80. Indexed Annuities and Certain Other Insurance Contracts, 74 Fed. Reg. 3138 (Jan. 16, 2009) (to be codified at 17 C.F.R. pts. 230, 240).

81. *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 173-74 (D.C. Cir. 2010).

82. A subsequent case, *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010), could easily be added to the list of ECCF cases. In that case, the Court invalidated the SEC's approval of fees charged by an exchange for data because the SEC had not presented evidence to support its view that similar data products from other exchanges were in fact substitute goods.

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Chief Judge Sentelle, writing for a D.C. Circuit panel that included Judge Ginsburg, remanded the indexed annuity rule, faulting the SEC’s competition analysis for failing to determine baseline levels of competition and efficiency under the preexisting state law regime—in other words, failing to find whether state law contained sufficient protections for investors to make informed decisions and sellers to make suitable recommendations.⁸³ In this, the court may have been alluding to, and pressing the SEC to adopt more generally, one of the fundamental requirements of OIRA CBA: specifying a baseline. Agencies conducting OIRA CBA then compare the current state of affairs absent the rule with the state of affairs anticipated following the adoption of the rule.⁸⁴

We agree that, even where quantification is not feasible, consideration of ECCF should begin with an assessment of whether the market is already competitive or concentrated, efficient or inefficient. The 2012 Guidelines, discussed below, adopt this general rule. Like other elements of economic analysis, however, this requirement can be extended to the point where the burden of execution is unreasonable and in some cases infeasible.⁸⁵ An antitrust analysis of competition and of the “baseline level of price transparency and information disclosure under state law”⁸⁶ in a single market is no small task, and a 50-state survey would impose correspondingly greater burdens. Similarly, the requirement to analyze whether sufficient protections existed in any of the states “to enable investors to make informed investment decisions and sellers to make suitable recommendations to investors”⁸⁷ taxed the agency’s resources, and contributed to its failure to respond quickly.

Before the SEC could promulgate a new rule containing the required analysis, Congress passed the Dodd-Frank Act, which stripped the SEC of authority to regulate FIAs, mooting the issue.⁸⁸ The D.C. Circuit Court never saw the extensive SEC staff work on the remand, which could have contributed to an incorrect but understandable assumption on Judge Ginsburg’s part that the

83. *American Equity*, 613 F.3d at 167-68.

84. OMB CIRCULAR NO. A-4, *supra* note 10, at 2-3.

85. For an extensive and thoughtful discussion of this problem in the environmental context, see Wendy Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1393-94 n.274 (2010) (“[V]irtually all of the information and analysis requirements are imposed on agencies without protecting them from candid disclosures or litigation-generating admissions against interest. These added analyses are often prepared near the end of the process, when the decision is close to final. As a result, the reports serve in practice only to increase the agency’s vulnerability to lawsuits and unwelcome political pressure if the agency slips and includes, in writing, some admissions against interest. Not surprisingly, agency general counsel and other high level officials appear to play a heavy hand in the drafting of the document, just as they do for proposed and final rules, and sometimes limit the analysis, potentially substantially.”).

86. *American Equity*, 613 F.3d at 178.

87. *Id.* at 179.

88. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989, 124 Stat. 1376, 1949-50 (2010) (to be codified at 15 U.S.C. § 77c)).

SEC simply was not listening—a misimpression which in turn could have influenced the tone of the *Business Roundtable* decision.

II. *Business Roundtable*: The Proxy Access Rule

A. *Proxy Access: A Policy Considered For 60 Years*

The question whether company proxy materials must include shareholder nominee proposals, and whether federal proxy rules that fail to do so frustrate stockholder rights under state law, has been debated since the establishment of federal regulation of the proxy process in 1934.⁸⁹ Regulations issued under the Exchange Act reserved the issuer's proxy materials for the solicitation of votes in favor of the slate of directors proposed by incumbent management, requiring challengers to provide proxy materials of their own.⁹⁰ No single ballot listed all candidates; instead, shareholders were urged in separate mailings to sign and return either one proxy card or the other.⁹¹ Modern electronic proxies work similarly.⁹²

Proxy access proposals proceed from a notion that proxy materials should be the shareholders' documents, and not the incumbent board's alone. Under this view, proxy statements should include, alongside the biographies of the incumbent board's nominees, biographies of certain shareholder nominees, with the nominees from both camps listed side by side on a single proxy card.⁹³

B. *The Comment Period*

The SEC CBA in the 2009 Proposing Release runs twenty-three pages. It reasons that incumbent directors faced with challengers with access to company proxy materials should be expected to work harder and improve company performance. In the SEC CBA, the SEC stated that it expected improved company performance once some directors were replaced and also anticipated improved performance even where incumbents were not challenged—much less replaced—reasoning again that the prospect of removal is likely to improve performance. The footnotes to this Section cited more than two dozen papers from leading journals, including the *American Economic Review*, the *Journal of*

89. For a history, see J. Robert Brown, Jr., *The SEC, Corporate Governance and Shareholder Access to the Board Room*, 2008 UTAH L. REV. 1339 (2008).

90. For a description of the proxy regime prior to the 2010 rule, see Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,670 (Sept. 16, 2010).

91. See Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1384 (2011).

92. See Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,670 (Sept. 16, 2010).

93. Kahan & Rock, *supra* note 91, at 1399.

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Finance, and the *Journal of Accounting Research*.⁹⁴ The cited studies showed that hybrid boards—that is, boards containing a minority of dissidents—were associated with improved shareholder value. The SEC cited other studies showing that even in companies where no dissidents were elected to the board, merely increasing the *prospect* of board accountability to shareholders creates shareholder value.⁹⁵

The SEC CBA explored the contrary view as well, citing comment letters to previous proxy access proposals (including comments of both the Business Roundtable and the Chamber), which argued that proxy access nominations would distract the board from more important responsibilities, induce them to take costly actions to mollify dissidents, and create polarization and disruption in boardroom dynamics that would impair, rather than enhance, board decision-

94. See 75 Fed. Reg. at 56,753-71 (citing LAWRENCE D. BROWN & MARCUS L. CAYLOR, *THE CORRELATION BETWEEN CORPORATE GOVERNANCE AND COMPANY PERFORMANCE* (2004); CHRIS CERNICH ET AL., *IRCC INST. FOR CORP. RESPONSIBILITY, EFFECTIVENESS OF HYBRID BOARDS* (2009), http://www.irccinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf; BETH YOUNG, *THE CORPORATE LIBRARY, THE LIMITS OF PRIVATE ORDERING: RESTRICTIONS ON SHAREHOLDERS' ABILITY TO INITIATE GOVERNANCE CHANGE AND DISTORTIONS OF THE SHAREHOLDER VOTING PROCESS* (2009), <http://www.sec.gov/comments/s7-10-09/s71009-568.pdf>; Ali C. Akyol et al., *Shareholders in the Boardroom: Wealth Effects of the SEC's Proposal to Facilitate Director Nominations*, 47 J. FIN. QUANT. ANALYSIS 1029 (2012); Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); Brad M. Barber, *Monitoring the Monitor: Evaluating CalPERS' Activism*, 16 J. INVESTING 66 (2007); Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005); Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010); Lucian A. Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2009); Marco Becht et al., *Corporate Governance and Control*, in 1A HANDBOOK OF THE ECONOMICS OF FINANCE 1 (George M. Constantinides et al. eds., 2003); Andrea Beltratti & René M. Stulz, *The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?*, 105 J. FIN. ECON. 1 (2012); Lisa Borstadt & Thomas Zwiirlein, *The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance*, 21 FIN. MGMT. 22 (1992); Bonnie G. Buchanan et al., *Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom*, 49 AM. BUS. L.J. 739 (2012); Brian R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500*, 65 BUS. LAW. 1 (2009); James F. Cotter et al., *Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?*, 43 J. FIN. ECON. 195 (1997); Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363 (2002); Olunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501 (2007); Jerry Goodstein et al., *The Effects of Board Size and Diversity on Strategic Change*, 15 STRATEGIC MGMT. J. 241 (1994); Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003); Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475 (2008); Re-Jin Guo et al., *Undoing the Powerful Anti-Takeover Force of Staggered Boards*, 14 J. CORP. FIN. 274 (2008); Benjamin E. Hermalin & Michael S. Weisbach, *Endogenously Chosen Board of Directors and Their Monitoring of the CEO*, 88 AM. ECON. REV. 96 (1998); David F. Larcker et al., *The Market Reaction to Corporate Governance Regulation*, 101 J. FIN. ECON. 431 (2011); Lynn A. Stout, *The Mythical Benefit of Shareholder Control*, 93 VA. L. REV. 789, 789 (2007); E. Norman Veasey & Christine T. DiGuglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761 (2008); Stephen M. Bainbridge, *A Comment on the SEC Shareholder Access Proposal* 17 (UCLA Sch. of Law Law & Econ. Research Paper No. 3-22, 2003), <http://ssrn.com/abstract=470121>; Milton Harris & Artur Raviv, *Control of Corporate Decisions: Shareholders vs. Management* (May 29, 2008) (unpublished manuscript), <http://ssrn.com/abstract=965559>.

95. Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,761 n.915.

making.⁹⁶ The SEC CBA also recognized the possibility that some investors might use the nomination process to extract private gain through board decisions at the expense of other shareholders, a reference the SEC would later argue was a tacit recognition of the potential, decried by the petitioners in the proxy access case, for blackmail by union pension plans.⁹⁷

Opposition from public companies and their Washington lobbies was wholly disproportionate to the modest cost savings the provisions would have provided to nominating shareholders.⁹⁸ The SEC may have put its finger on the true reason for issuer opposition when it noted that the benefit of including shareholders' nominees in the company's proxy materials might be "a significant improvement in [the nominating shareholder's] ability to have its nominees evaluated by shareholders in the same matter as they evaluate management's nominees."⁹⁹ The SEC, in other words, based its rule on the classic agency problem of ensuring management accountability to shareholders. The rule's opponents conflated the interests of the management they represented with those of most shareholders, viewing the rule as benefitting only shareholders who were public and union pension funds and activist investors, whose interests they claimed diverged systematically from those of other shareholders.

The Business Roundtable and the U.S. Chamber of Commerce mounted a highly professional joint attack on the proposed rule, retaining the same counsel that had won the *Chamber* and *American Equity* cases. Their opening salvo was a 114-page comment letter that reads like a brief, with a twenty-five page expert report from NERA Economic Consulting (the NERA Report) attached.¹⁰⁰ Like the petitions that began those earlier cases, the comment letter's leading legal contention, pressed for fifteen pages, was that the SEC lacked statutory authority to adopt a proxy access rule (an issue later mooted by the Dodd-Frank Act's express grant of such authority).¹⁰¹ The Business Roundtable's comment letter argued that, far from enhancing shareholder

96. *Id.* at 56,756-76.

97. *Id.* at 56,766.

98. *Id.* at 56,756 (noting that the \$18,000 savings involved in a hypothetical typical contest was not, in and of itself, "significant enough to drive the behavior of shareholders in large public companies").

99. *Id.* at 56,758. This non-quantitative, semiotic analysis of the effects of the rule was not challenged by the Business Roundtable or discussed in the *Business Roundtable* opinion.

100. Letter from Alexander M. Cutler, Chair, Corp. Leadership Initiative, Bus. Roundtable, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n 24-44 (Aug. 17, 2009), http://businessroundtable.org/uploads/hearings-letters/downloads/BRT_Comment_Letter_to_SEC_on_File_No_S7-10-09.pdf [hereinafter Business Roundtable Comment Letter]; see also ELAINE BUCKBERG & JONATHAN MACEY, NERA ECONOMIC CONSULTING, REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION, IN SUPPORT OF COMMENTS BY BUSINESS ROUNDTABLE (2009), http://www.nera.com/upload/Buckberg_Macey_Report_FINAL.pdf [hereinafter NERA REPORT].

101. Business Roundtable Comment Letter, *supra* note 100, at 24-44.

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value, proxy access would in fact reduce it.¹⁰² The Business Roundtable's NERA Report claimed that "companies with dissident board members substantially *underperform* compared to their peers," citing a study by David Ikenberry and Josef Lakonishok that we discuss in greater detail below.¹⁰³

In 2010, after receiving and reviewing the Business Roundtable's comment letter, along with approximately 600 others,¹⁰⁴ the SEC decided to raise the threshold for eligibility to use the streamlined access granted by the rule to shareholders or groups that had maintained three percent ownership for at least three years. This ownership requirement substantially reduced the number of entities that could rely on these proxy access rules.¹⁰⁵ To ensure that the public had notice of the material facts the SEC relied upon in this rule-making, several weeks before the rule was issued, the SEC publicly released the distribution statistics its staff economists had prepared, showing the number of companies and shareholder groups that would qualify for proxy access under different thresholds.¹⁰⁶

The Adopting Release reflected the expectation that the rule would act, both directly and indirectly, to increase shareholder value—both through the presence of newcomers on the board, and through the *in terrorem* effect of the prospect of challenger-proposed directors, or new members entering the club who had not been properly introduced through current members.¹⁰⁷ The agency recognized that important stakeholders, including two dissenting commissioners, disagreed with this prediction and it discussed these critiques at length.¹⁰⁸ The Adopting Release included a lengthy discussion of potential adverse effects on board performance,¹⁰⁹ and of the costs of incremental complexity in the proxy process. The cost discussion went on to recap the out-of-pocket costs involved, noting repeatedly that its numerical estimates,

102. *Id.* at 99-101.

103. NERA REPORT, *supra* note 100, at 9 (citing David Ikenberry & Josef Lakonishok, *Corporate Governance Through the Proxy Contest: Evidence and Implications*, 66 J. BUS. 405 (1993)) (emphasis added).

104. Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,669.

105. *Id.* at 56,774.

106. *Id.* at 56,669 ("The Commission re-opened the comment period as of December 18, 2009 for thirty days to provide interested persons the opportunity to comment on additional data and related analyses that were included in the public comment file at or following the close of the original comment period.")

107. *Id.* at 56,753-71.

108. *Id.* at 55,670; *see also* Kathleen L. Casey, Comm'r, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting to Adopt Amendments Regarding Facilitating Shareholder Director Nominations (Aug. 25, 2010), <http://www.sec.gov/news/speech/2010/spch082510klc.htm> ("The paradigm of a power struggle between directors and shareholders is one that activist, largely institutional, investors assiduously promote, and this rule illustrates a troubling trend in our recent and ongoing rulemaking in favor of empowering these shareholders through, among other things, increasingly federalized corporate governance requirements. Yet, these shareholders do not necessarily represent the interests of all shareholders, and the Commission betrays its mission when it treats these investors as a proxy for all shareholders.")

109. Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762; *id.* at 56,772-75.

including the frequency of election contests, had been made “for purposes of the PRA analysis” only.¹¹⁰

The SEC CBA in the Adopting Release also discussed the studies cited by the NERA Report and other relevant studies at some length, concluding that the evidence was mixed, and that some of the studies on both sides had methodological flaws.¹¹¹ The SEC relied on a study by J. Harold Mulherin and Annette Poulsen,¹¹² which noted that the Ikenberry performance data cited in the NERA Report were derived from a data set that had excluded all the firms that had been acquired or otherwise sold following the appearance of the dissident directors on the board, thus excluding from the sample the group of companies that accounted for most of the wealth gains from the proxy contests in question.¹¹³ The Adopting Release also noted that the Borstadt paper cited by the NERA Report had actually concluded that “dissident activity leads to gains for shareholders and is often followed by corporate reforms . . . such that the realized gains over the contest period appear to be permanent,” and that a survey article on corporate governance confirmed that this is the current academic consensus, stating that “[t]he latest evidence suggests that proxy fights provide a degree of managerial disciplining and enhance shareholder value.”¹¹⁴

The SEC adopted the proxy access rule on August 25, 2010 by a vote of three-to-two. Despite the express grant of statutory authority, one of the dissenting commissioners expressed her (prescient) belief at the Open Meeting “that the rule is so fundamentally and fatally flawed that it will have great difficulty surviving judicial scrutiny.”¹¹⁵

C. *The Challenge to the Rule*

The Business Roundtable quickly filed its challenge petition along with a motion for a stay.¹¹⁶ The Business Roundtable brief made its economic argument in four parts, arguing that the SEC: (a) erroneously attributed the rules’ costs to state law, (b) underestimated the frequency of election and failed to estimate their costs, (c) failed to address the impact of union and government

110. *Id.* at 56,764-71.

111. For a discussion of the studies, see *id.* at 56,755-76.

112. J. Harold Mulherin & Annette B. Poulsen, *Proxy Contests and Corporate Change: Implications for Shareholder Wealth*, 47 J. FIN. ECON. 279 (1998).

113. Ikenberry & Lakonishok, *supra* note 103, at 408 (“Companies not followed by Compustat were removed from the sample.”).

114. Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762 (citing Becht et al., *supra* note 94).

115. Casey, Statement at Open Meeting, *supra* note 108.

116. See Petition for Review, *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (No. 10-1305). On October 4, 2010, the SEC consented to stay the rule’s effective date pending the judgment of the Court. See Notice of Stay of Effective and Compliance Dates, 75 Fed. Reg. 64,641 (October 20, 2010).

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pension plans, and (d) erroneously assumed that in some cases companies would not actively oppose access candidates. The court ultimately devoted meaningful discussion to each of these economic arguments.

The Business Roundtable brief devoted little attention to empirical studies of the impact of proxy access on share price. In a footnote, the brief cited the NERA Report and one of the studies cited therein, noting that the SEC had “quibbled” with the methodology and conclusions of these studies and noting the SEC’s own caveats about one of the studies finding positive effects of boards composed of both incumbents and dissidents.¹¹⁷ The Business Roundtable brief did not otherwise mention the empirical studies, much less question the SEC’s treatment of those studies. It certainly did not argue that the studies constituted a ground for invalidating the rule.¹¹⁸

The SEC brief did not touch on the empirical studies either. Nonetheless, responding to the Business Roundtable’s argument that it was required to provide empirical support for its predictive judgments, the SEC argued:

Any assessment of the economic effects of Rule 14a-11, which creates for the first time a mechanism for shareholders to use company proxy materials to nominate director candidates, is necessarily predictive and hence uncertain. As this Court has explained, “predictive calculations are a murky science in the best of circumstances, and the [agency] naturally has no access to infallible data about [circumstances] that do not exist.” *Cablevision Sys. Corp.*, 597 F.3d at 1314. In such a case, an agency must “rel[y] on its own expertise to evaluate existing evidence” and make a judgment about how to proceed. *Rural Cellular Assoc. v. FCC*, 588 F.3d 1095 (D.C. Cir. 2009). In so doing, the Commission must only “acknowledge factual uncertainties and identify the considerations it found persuasive.”¹¹⁹

D. *The Opinion of the Court*

In July 2011, a unanimous panel of the D.C. Circuit handed down an opinion vacating the rule, finding the Commission to have acted arbitrarily and capriciously by failing “adequately to assess the economic consequences” of the rule.¹²⁰ Those economic consequences included costs and benefits, as well as the impact of shareholders with special interests. Under the cost-benefit rubric, the court disagreed with the Commission’s observation that some proxy access candidates might not be vigorously opposed, with its estimate of the frequency of election contests and, most importantly, with its assessment of empirical studies of the effect on stock prices of proxy contests and hybrid boards.¹²¹

117. Opening Brief of Petitioners at 32 n.4, *Business Roundtable*, 647 F.3d 1144 (No. 10-1305).

118. *Id.*

119. Initial Brief of Respondent at 36, *Business Roundtable*, 647 F.3d 1144 (No. 10-1305).

120. *Business Roundtable*, 647 F.3d at 1148.

121. Hybrid boards are incumbent-majority boards including some dissident members. The proxy access rule was at least arguably designed to create hybrid boards rather than induce a proxy contest for corporate control. The court offered why it found the hybrid board studies “unpersuasive.” *Id.*

1. Who Botched the Job?

As detailed above, the SEC thought it had won the skirmish over empirical data at the adopting release level when the petitioners effectively dropped that argument on appeal. It was neither briefed nor argued. Undeterred, Judge Ginsburg reached back into selected portions of the record to resurrect this issue as a centerpiece of the opinion.¹²² Neglecting the “extreme degree of deference” the court formerly admitted it owed to expert agency interpretations of scientific data,¹²³ the *Business Roundtable* opinion rejected the SEC’s assessment of the empirical evidence, holding: “In view of the admittedly (and at best) ‘mixed’ empirical evidence, we think the Commission has not sufficiently supported its conclusion that increasing the potential for election of directors nominated by shareholders will result in improved board performance and shareholder value.”¹²⁴

The opinion summarily¹²⁵ dismissed the SEC’s extensive review of the empirical evidence.¹²⁶ The court singled out “[o]ne commenter, for example, [who] submitted an empirical study showing that when dissident directors win board seats, those firms underperform peers by 19 to 40%.”¹²⁷ The opinion failed to inform readers of the opinion that the “commenter” in question was none other than petitioner Business Roundtable itself. The opinion also inaccurately referred to the NERA Report as an “empirical study” without noting that NERA was the Business Roundtable’s paid consultant.¹²⁸ The striking forty percent figure is from the Ikenberry/Lakonishok study, cited in the NERA Report.

The fact that the opinion mistook the NERA Report for an empirical study cited in that report matters. We note first that readers of the opinion are entitled to know whether a finding is made by experts the petitioner engaged or by authors of an independent study. This is especially true if the paid experts turn out to have used the data in the independent study to reach a conclusion very different from the conclusions the study’s own authors drew from their data.

This appears to have been the case here: in their paper, Ikenberry and Lakonishok state that they considered *and rejected* the explanation accorded

122. See J. Robert Brown Jr., *The SEC and the Non-Cost Benefit Analysis Analysis (Part 1)*, RACE TO THE BOTTOM (Apr. 23, 2012, 6:01 AM), <http://www.theracetothetobottom.org/home/the-sec-and-the-non-cost-benefit-analysis-analysis-part-1.html> (“[W]hatever one thinks of the DC Circuit’s opinion, . . . the decision does not really criticize the economic analysis used by the Commission. Instead, the court bought off on a mish mash of criticism of the staff’s approach, almost none of which would be corrected by a more rigorous cost benefit analysis.”).

123. *Chamber I*, 412 F.3d at 143.

124. *Business Roundtable*, 647 F.3d at 151.

125. See Hayden & Bodie, *supra* note 12, at 25 (“[T]he court’s own analysis of the empirical data is extremely cursory, particularly in contrast to that of the Commission.”).

126. See sources cited *supra* note 94.

127. *Business Roundtable*, 647 F.3d at 1151.

128. *Id.*

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their results by the NERA Report—the idea that proxy fights reduce shareholder value. The study’s authors found “this downward drift in returns for dissident victories . . . both unexpected and puzzling,” rejecting the “contention that proxy contests destroy value,” since that would “suggest[] that shareholders are not rational when they cast their proxies.”¹²⁹ The authors speculated that the result might be driven by either overly enthusiastic expectations of future corporate performance held by both dissident and passive shareholders or by the fact that companies that are successful takeover targets suffer particularly poor financial condition.¹³⁰

In sum, it appears that the petitioners’ experts came across an alarming figure in an academic study—a forty percent decline in shareholder value associated with dissent members on boards. They then interpreted this statistic as evidence of a causal relationship that the study’s own authors, in the conclusions section of the same paper, rejected as implausible. Undeterred, they and their clients conflated correlation and causation in a litigation point tantamount to a headline reading: “Proxy fights reduce shareholder value by forty percent!”¹³¹ The court accepted petitioners’ assertion uncritically, while accusing the SEC of paying inadequate attention to the empirical work before it, and of slipshod economic analysis in general.

As Hayden and Bowdie demonstrate, the court’s treatment of the rest of the economic evidence was no more rigorous or persuasive.¹³² The opinion simultaneously accuses the SEC of “discounting” contrary findings “completely,” and of “admit[ting]” that the evidence is “mixed.”¹³³ The court never explains why it found the SEC’s admittedly reasoned assessment of the empirical economic evidence wanting. It never explained why it found two cited studies “relatively unpersuasive,” beyond citing concerns the SEC itself candidly expressed about one of them.¹³⁴

Similarly, on the issue of the cost to oppose unqualified nominees, the court demanded that the SEC make its own estimate, once again importing the inapposite *Public Citizen* requirement to “make tough choices about which of the competing estimates is most plausible, [or] to hazard a guess as to which is correct.”¹³⁵ The approach the SEC actually took in the Adopting Release—

129. Ikenberry & Lakonishok, *supra* note 103, at 433.

130. *Id.* at 433-34.

131. Cf. ELAINE BUCKBERG & JONATHAN MACEY, NERA ECON. CONSULTING, REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION: IN SUPPORT OF COMMENTS BY BUSINESS ROUNDTABLE 9 (2009), available at www.nera.com/upload/Buckberg_Macey_Report_FINAL.pdf.

132. See Hayden & Bodie, *supra* note 12, at 25-27.

133. Referring, apparently to the studies cited in the NERA Report, the opinion claims that the SEC “completely discounted” them, “because of questions raised by subsequent studies, limitations acknowledged by the studies’ authors, or [its] own concerns about the studies’ methodology or scope.” *Business Roundtable*, 647 F.3d at 1151.

134. *Id.*

135. *Id.* at 1150.

discounting the cost claims of commenters by observing that some proxy access nominees would be deemed qualified and not actively opposed—was curtly dismissed as “mere speculation.”¹³⁶ Yet, such an assumption appears to be precisely the sort of “informed conjecture” the SEC was “entitled” to make under *Chamber I*.¹³⁷ It was also a correct conjecture, as any experienced M&A practitioner knows. Witness the recent advice of a notably vigorous defender of corporate boards under siege: alongside purely tactical and public relations maneuvers, Martin Lipton recommends that boards “[g]auge whether the best outcome is to *agree upon board representation* and/or strategic business change in order to avoid a proxy fight.”¹³⁸

The court appears to have applied a new burden of proof—the opposite of deference¹³⁹—to the SEC’s rule. The proxy access rule was vacated on “admittedly (and at best) ‘mixed’ empirical evidence,”¹⁴⁰ evidence that evidently failed to convince the court. If unclear, unconvincing evidence fails the test, perhaps the court meant to require that the SEC present “clear and convincing” evidence—a heavy and unprecedented burden of proof.¹⁴¹ Such a standard would turn the familiar hierarchy of judicial deference regimes on its head. The Court did not cite—much less reconcile or distinguish—the *Cablevision* and *Rural Cellular* decisions relied upon by the SEC for the proposition that agencies may rely on their expertise in evaluating contradictory and murky empirical evidence to make predictive judgments. As such, the decision represents a striking departure from the measured and balanced tone of *Chamber I*. Its strictures, if followed in future cases, would cast doubt upon the

136. *Id.*; see also Brown, *supra* note 12 (noting that the Court misinterpreted a comment letter from the American Bar Association to mean that the board’s fiduciary duty always required a scorched-earth, take-no-prisoners attitude towards shareholder nominees).

137. *Chamber I*, 412 F.3d at 142.

138. Martin Lipton, *Dealing with Activist Hedge Funds*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 9, 2012, 9:19 AM), <http://blogs.law.harvard.edu/corpgov/2012/08/09/dealing-with-activist-hedge-funds> (emphasis added). Lipton’s post also offers support for the SEC’s premise that a formerly complacent board may be expected to react to the mere threat of a disturbance to its comfortable incumbency by taking action to increase shareholder value, recommending that boards “[p]roactively address reasons for any shortfall versus peer company benchmarks; anticipate key questions and challenges from analysts and activists, and be prepared with answers” and “[r]eview . . . basic strategy and the portfolio of businesses in light of possible arguments for spinoffs, share buybacks, increased leverage, special dividends, sale of the company or other structural changes.” *Id.*

139. See Murphy, *supra* note 12, at 159; Raso & Eskridge, *supra* note 77, at 1737.

140. *Business Roundtable*, 647 F.3d at 1151.

141. BETTER MARKETS, *supra* note 12, at 53; Cox & Baucom, *supra* note 12, at 1813; and Murphy, *supra* note 12, at 163, all agree that an unprecedented and harsh new standard was applied. See also John Kemp, *The Trojan Horse of Cost Benefit Analysis*, REUTERS (Jan. 3, 2012), <http://blogs.reuters.com/great-debate/2012/01/03/the-trojan-horse-of-cost-benefit-analysis/> (“Whether quantitative cost benefit calculations are required by the law is unclear. The Administrative Procedure Act does not explicitly require them, but conservative jurists on the DC Circuit and lawyers like Scalia have stretched the requirements through case law, and may use the CFTC case to try to push them further. Ultimately, it will fall to the Supreme Court to decide how far Section 706 requires a quantified calculation before new rules are introduced.”).

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agencies' ability to enact rules that will withstand even flimsy challenges to their evaluations of economic evidence.

In corporate law, the business judgment rule gives boards the right to be wrong on occasion—a rule that allows business to be done in the real world. Absent an analogous deference regime in the context of agency rulemaking—which would give agencies the right to be imperfect without having their actions overturned in court—litigation will continue to chill financial regulation and reform.

2. Valid Criticisms

Some of the court's other criticisms, however, were valid and should be squarely addressed and corrected in any future proxy access proposing release. For example, the court pointed out that the release “discounted the costs of Rule 14a-11—but not the benefits—as a mere artifact of the state law right of shareholders to elect directors.”¹⁴² The release repeated its attribution of costs to state law ad nauseam, in a way that detracted from the persuasiveness of its presentation. And it is logically inconsistent to attribute the costs to state law while not crediting state law with the direct and indirect benefits predicted from the rule, particularly when the financial economics studies referenced elsewhere in the release could have been cited as measurements of net, rather than gross, benefits. While the SEC's release did quote and consider commenters' proxy fight cost estimates, its failure to make its own cost estimates is puzzling, and could be easily corrected in any future proxy access proposing release, given the accessibility of such data.

The release also fell short by not addressing forthrightly the Roundtable's contention that public and union pension plans might abuse the proxy access process.¹⁴³ The Adopting Release resorted to euphemism (“shareholders with narrow interests”¹⁴⁴), and alluded only briefly to the mitigating effects of fiduciary duties and its own requirements to disclose of conflicts of interest.¹⁴⁵ A new proposing release for a revamped proxy access rule should forthrightly address this issue, including an evaluation of the available evidence from the analogous activities of institutional investors advancing shareholder proposals. Commenters on the 2009 rule differed as to whether such proposals, when advanced by union or public pension plans, are typically advanced in good faith. In a new proposing release, the SEC should take the opportunity to state its views on this issue, for the public to support or dispute.

142. *Business Roundtable*, 647 F.3d at 1151. This seems to be the basis for the Court's more general and much quoted conclusion that “the Commission inconsistently and opportunistically framed the costs and benefits of the rule.” *Id.* at 1148.

143. *Id.* at 1151-52.

144. *Facilitating Shareholder Director Nominations*, 75 Fed. Reg. 56,668, 56,772 (Sept. 16, 2010).

145. *Id.*

A future Commission could also decide not to include mutual fund boards within the ambit of a new proxy access rule. Its stated reasons for including them in the 2009 rule were weak, and drew a disproportionate share of the court's scorn.¹⁴⁶ Mutual funds are unique in being both public issuers and major shareholders of public companies; wearing only their shareholder hats, mutual funds, through their interest groups, should be expected to favor, not oppose, proposals to enhance management accountability.

E. No Appeal

Despite the flaws in the D.C. Circuit opinion, the importance of proxy access, and the dangers to future rulemaking implicit in its precedential value, the SEC chose not to seek a re-hearing en banc in the proxy access case.¹⁴⁷ As a result, the decision stands. The SEC did not explain the reasons for its inaction. Perhaps the SEC was concerned with the difficulty of appealing an implicit standard of review, as opposed to an express departure from precedent.¹⁴⁸ Perhaps it shrank from the challenge of refuting each and every one of the court's criticisms—some of which, as noted above, were well-founded—in a single short petition. Perhaps it noted that the original panel included three active judges, meaning that, given the vacancies on the D.C. Circuit, the votes of five out of six of the remaining active judges would have been necessary to grant rehearing. Perhaps it feared an even harsher rebuke from Judge Ginsburg on a denial of rehearing.

A petition for certiorari might have seemed equally futile. Perhaps the Solicitor General signaled an unwillingness to proceed, for some of the reasons noted above. Moreover, as is often the case with administrative law issues, there was no conflict between circuits because all the relevant cases were heard in the D.C. Circuit.

But the SEC's decision left it—and other independent financial regulators—in a tough spot as far as future rulemaking is concerned. The majority of the Dodd-Frank rules, including most of the most important ones,

146. *Business Roundtable*, 647 F.3d at 1150-56.

147. Press Release, Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, Statement on Proxy Access Litigation (Sept. 6, 2011), <http://www.sec.gov/news/press/2011/2011-179.htm>.

148. Whatever we may think of what it did in practice, the *Business Roundtable* court announced it was following the "arbitrary and capricious" standard. See *Business Roundtable* 647 F.3d at 1148; see also *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983) ("The scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency We will uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned." (internal quotations omitted)); *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 413-14 (1971) ("In all cases, agency action must be set aside if the action was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law or if the action failed to meet statutory, procedural, or constitutional requirements." (internal quotations omitted)).

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remain unadopted, long after their statutory deadlines.¹⁴⁹ The GAO noted that some financial regulatory agencies attributed these delays to litigation risks.¹⁵⁰ Nor were those fears unfounded; as of this writing, a number of challenges to Dodd-Frank rules are pending in the D.C. Circuit.¹⁵¹ Opponents of regulation find in litigation of this kind a perfect weapon—one that kills regulations while leaving no fingerprints. It leaves them free to credibly claim that they do not oppose *good* regulations, only those in which regulators have acted before taking the time to understand fully the consequences of their actions.¹⁵²

F. Business Roundtable II?

The best way for the SEC to break this cycle of bad opinions is simple: it should reconsider, re-propose and re-adopt a new proxy access rule. Re-proposing the proxy access rule might seem like it should be agency's lowest priority right now, at a time when its rulemaking machinery is still clogged with Dodd-Frank and JOBS Act mandatory rules. But is it ever too early to address a root cause of massive backlog and delay?

Many of the factors weighing against seeking re-hearing en banc and petitioning for certiorari turn positive on this analysis. In place of having to defend mistakes in the 2010 adopting release, like the blaming of most costs on state law,¹⁵³ the agency will be free to step back and consider those costs forthrightly and consistently. Instead of being chained to dubious policy choices, like the inclusion of mutual fund boards, the Commission will be free to reconsider them. By cutting away the chaff, the agency can focus attention in the proceeding and the next appeal on what it got right the first time: the rule itself, and the empirical evidence in favor of its positive effects on stock prices.

The SEC's economic case will be bolstered by an important econometric study conducted in the wake of the litigation itself. Harvard economists used the litigation itself as an event study to assess the impact of the rule on stock

149. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 13-195, FINANCIAL REGULATORY REFORM: REGULATORS HAVE FACED CHALLENGES FINALIZING KEY REFORMS AND UNADDRESSED AREAS POSE POTENTIAL RISKS (2013), <http://www.gao.gov/assets/660/651401.pdf>.

150. *Id.* at 23.

151. *See, e.g.*, *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n*, No. 12-0612 (D.C. Cir. Dec. 27, 2012); *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, No. 12-5362 (D.C. Cir. Nov. 16, 2012); *Nat'l Ass'n of Mfrs. v. SEC*, No. 12-1422 (D.C. Cir. Oct. 19, 2012); *Am. Petroleum Inst. v. SEC*, No. 12-1398 (D.C. Cir. Oct. 10, 2012).

152. Leaders of other financial regulatory agencies have also noted publicly that CBA challenges have stretched scarce resources and threaten to delay rulemaking. *See, e.g.*, Silla Brush, *U.S. Regulators 'Paralyzed' by Cost-Benefit Suits, Chilton Says*, BLOOMBERG (Mar. 8, 2012, 6:00 AM), <http://www.bloomberg.com/news/2012-03-08/u-s-regulators-paralyzed-by-cost-benefit-suits-chilton-says.html> (noting a legal challenge to a CFTC rule and reporting Commissioner Bart Chilton's argument that Dodd-Frank opponents have used lawsuits challenging agency cost-benefit analysis to hinder the rulemaking process).

153. *See infra* note 142.

prices, finding statistically significant positive effects from the rule.¹⁵⁴ This real-time back testing was far more pertinent than any of the economic studies cited in the release and the rule challenge, which dealt only with analogous situations, and not with market reactions to the very rule in question. The researchers ranked public companies based on their “proxy accessibility”—that is, by the number of significant stockholders of three or more years standing—and examined stock price movements both on the day the SEC unanticipated announcements that it would suspend the rule in response to the Business Roundtable challenge and that it would not appeal. Looking at the differential stock price movements in more and less proxy accessible companies on those dates, the authors concluded that financial markets placed a positive value on proxy access.¹⁵⁵

On the other hand, a *Business Roundtable II* case would be heard by the same panel as before. Judge Ginsburg went out of his way, in a subsequent opinion in a wholly-unrelated EPA case, to aver in dictum that the “evidentiary problem in *Business Roundtable* was not limited to the agency’s insufficient treatment of any one study . . . it was the agency’s larger failure to deal with the weight of the evidence against it.”¹⁵⁶ This dictum, and more set out in the margin,¹⁵⁷ are a taste of what the SEC might have received had it sought rehearing *en banc* on its original proxy access release. This tone, however, should not deter the SEC from coming back into court with improvements.

154. Bo Becker et al., *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge*, 56 J. L. & ECON. (forthcoming 2013), <http://ssrn.com/abstract=1695666>. An *amicus* brief in the original *Business Roundtable* case cited this study to the court, but it was not mentioned in the opinion. For additional empirical support for the positive effects of shareholder activism, see Lucian Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. (forthcoming Oct. 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2248111.

155. Another study, which states that it “seeks to refute in part” the Harvard study, largely validates it instead. See Thomas Stratmann & J.W. Verret, *Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?*, 64 STAN. L. REV. 1431, 1434 n.15 (2012). Stratmann and Verret report negative stock-price effects, but their analysis is confined to the smallest of public companies—those with market capitalizations of less than \$75 million. Even this limited finding can be questioned, as it assumes without justification that the market reaction with respect to small public companies was confined to the small-issuer exemption and not to other provisions of the rule that may have been weaker (e.g., *less* encouraging of proxy access) than the market expected. In addition, the paper depends on the dubious assumption that a small-issuer exemption was so widely anticipated in the market that its absence from the final rule was unanticipated.

156. *Am. Petroleum Inst. v. EPA*, 684 F.3d 1342, 1351 (D.C. Cir. 2012).

157. *Id.* (“The API mistakenly places much weight upon our recent decision in *Business Roundtable v. SEC*. As the foregoing discussion makes clear, the EPA’s analysis of the proposed NAAQS was materially better than the analysis for which we faulted the SEC in that case. There the agency had ignored ‘numerous studies submitted by commenters that reached the opposite result’ and relied instead upon ‘two relatively unpersuasive studies.’ Putting aside the analytical incoherence of the SEC’s rationale, which would have been fatal by itself, the evidentiary problem in *Business Roundtable* was not limited to the agency’s insufficient treatment of any one study, though there was that; it was the agency’s larger failure to deal with the weight of the evidence against it. The EPA’s analysis at issue here was in no way comparable to the botched job on display in *Business Roundtable*.” (internal citations omitted)).

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In *American Petroleum*, the court applied the governing standards faithfully, holding that “[a]n agency’s action is arbitrary and capricious if it ‘entirely failed to consider an important aspect of the problem [or] offered an explanation for its decision that runs counter to the evidence before the agency.’”¹⁵⁸ Faced with a re-thought rule, and a scholarly release presenting a full and thoughtful assessment of the econometric evidence (instead of one in which a truncated discussion is relegated to footnotes), the Court might well be inclined not only to uphold the new rule, but to announce that the agency’s expertise in financial economics is entitled to judicial deference.

A future opinion upholding a new proxy access rule would yield positive effects far beyond those of the proxy access rule alone. Winning any case, but particularly this one, would signal to all financial regulators, regulated entities and issuers that the will of Congress cannot be lightly dismissed, and that the agency will persevere when its judgments are correct. In a jurisprudential landscape that today tells regulators how not to do it, such an opinion would serve as a lodestar for conducting economic analysis in a way that is both feasible and meaningful—not for the SEC alone, but for other financial regulators with similar requirements.

III. Congressional Responses to *Business Roundtable*

A. *Testimony and Inspector General Reports*

Like the *Chamber I* case before it, remanding the mutual fund governance rule,¹⁵⁹ the *Business Roundtable* decision moved the SEC’s critics in Congress to action.¹⁶⁰ SEC Chairman Mary Schapiro was immediately called to explain to the House Oversight Committee what she planned to do to correct the inadequacies in economic analysis noted in the opinion,¹⁶¹ and the minority members of the Senate Banking Committee requested that the inspectors general of the SEC and seven other federal financial regulators to conduct investigations and report back in a matter of weeks.¹⁶² The SEC’s inspector

158. *Id.* at 1350 (quoting *North Carolina v. EPA*, 531 F.3d 896, 906 (D.C. Cir. 2008)); *see* 5 U.S.C. § 706 (2006).

159. *See* Sherwin, *supra* note 53, at 27-29.

160. The case attracted attention on Capitol Hill. *See, e.g.*, CURTIS W. COPELAND, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 18 (2011), <http://www.fas.org/sgp/crs/misc/R41974.pdf>; CURTIS W. COPELAND, ADMIN. CONFERENCE OF THE U.S., REGULATORY ANALYSIS REQUIREMENTS 31 (2012), <http://www.acus.gov/wp-content/uploads/downloads/2012/06/Final-Recommendation-2012-1-Regulatory-Analysis.pdf>.

161. *See, e.g.*, Letter from Darrell E. Issa, Chairman, U.S. H. Comm. on Oversight & Gov’t Reform, to Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm’n (Apr. 29, 2011) (on file with authors).

162. *See* KYLE REPORT, *supra* note 29, at iii (“On May 4, 2011, the SEC Office of Inspector General (OIG) received a letter from several members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs requesting that the Inspector General review the economic analyses performed by the SEC in connection with six specific rulemaking initiatives undertaken pursuant to the Dodd-Frank Act.”).

general, citing the time needed to engage a qualified expert, elected to conduct a subsequent, more detailed investigation, and issued a second report several months later.¹⁶³

This second SEC IG Report, led by financial economist Pete Kyle (the Kyle Report), noted the internal staff efforts the SEC was already making, and its efforts to involve its economists more deeply in the rule writing process.¹⁶⁴ The Kyle Report also noted that the SEC had begun to develop a theoretical framework for economic analysis of rules, and was experimenting with combining the SEC CBA and ECCF consideration sections.¹⁶⁵ A key recommendation of the Kyle Report attempted to correct one unfortunate trend in the case law: the report advocated focusing on large-scale direct and indirect economic effects of rules, and placing less emphasis on relatively trivial PRA costs.¹⁶⁶

These pressures accelerated the trends already underway at the SEC¹⁶⁷ to give its economists, and economic analysis in general, a more prominent role in its rulemaking process.¹⁶⁸

B. *A Bill to Codify Business Roundtable*

Shortly after the inspector general reports, Senator Richard Shelby introduced the Financial Regulatory Responsibility Act of 2011 (FRRA),¹⁶⁹ a bill focused, like the *Business Roundtable* decision and its predecessors, on the importance of economic analysis of financial regulations.¹⁷⁰ We view the FRRA as no less than a codification of an expansive reading of the *Business Roundtable* decision.¹⁷¹ Unlike the ECCF amendments, the FRRA explicitly imposes a substantive requirement on agency rulemaking. It would restrict the rulemaking authority of the SEC and nine financial regulatory agencies to cases in which a cost-benefit analysis conducted under its standards has demonstrated

163. *See id.*

164. *Id.* at 15.

165. *Id.* at vi.

166. *Id.* at 12-15.

167. *Id.*

168. *See infra* Subsection II.B.2.

169. S. 1615, 112th Cong. (2011). The FRRA has been reintroduced as the Financial Responsibility Act of 2013, S.450, 113th Cong. (2013).

170. *See, e.g.,* Kemp, *supra* note 141, at 3 (noting that language in a *Wall Street Journal* editorial echoing language in the FRRA is “not really about cost benefit analysis at all in the narrow sense. The standard [it] seek[s] to enforce would be impossible to meet.”).

171. Critics of the SEC have also called upon Congress to codify the *Business Roundtable* decision. *See, e.g.,* *The SEC’s Aversion to Cost-Benefit Analysis: Hearing Before House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs*, 112th Cong. 40-53 (2012) (statement of Henry G. Manne, Dean Emeritus, George Mason University School of Law) [hereinafter Manne Testimony] (advocating that the ECCF “be strengthened and made escape-proof by confirming Congressional action”).

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that the *quantified* benefits of the regulation exceed its *quantified* costs.¹⁷² The FRRRA's rules for performing the analysis reflect an acute sensitivity to costs and a profound skepticism about benefits.¹⁷³

Under the FRRRA, rules that an agency wishes to adopt on the basis of benefits it cannot quantify would become mere recommendations to Congress, effective only if both houses adopt a Joint Resolution waiving the quantification requirements and directing the agency to publish the rule.¹⁷⁴ In this, the FRRRA resembles the REINS Act.¹⁷⁵ This exultation of the quantitative over the qualitative echoes *Timpinaro*, which focused on the SEC's failure to include a particular regression analysis at the expense of the broader discussion of costs and benefits.¹⁷⁶

The FRRRA takes a number of worthy, but patently unattainable, goals of CBA analysis and requires them by law as a predicate to regulation. Here are just a few of the twelve findings the FRRRA would require of agencies:

- A quantitative and qualitative assessment of all anticipated direct and indirect costs and benefits of the regulation (as compared to a benchmark that assumes the absence of regulation), including compliance costs, effects on economic activity, net job creation (excluding jobs related to ensuring compliance with the regulation), efficiency, competition, and capital formation; regulatory administrative costs and costs imposed by the regulation on State, local, or tribal governments or other regulatory authorities. . .
- Identification and assessment of all available alternatives to the regulation, including modification of an existing regulation or statute, together with an explanation of why the regulation meets the objectives of the regulation more effectively than alternatives. . .
- An assessment of how the burden imposed by the regulation will be distributed among market participants, including whether consumers, investors or small businesses will be disproportionately burdened. . .
- An assessment of the extent to which the regulation is inconsistent, incompatible, or duplicative with existing regulations of the agency or those of other domestic and international regulatory authorities with overlapping jurisdiction. . .
- An explanation of predicted changes in market structure and infrastructure and in behavior by market participants, including consumers and investors, assuming they will pursue their economic interests.¹⁷⁷

While this bill has little hope of advancing unless Senator Shelby becomes Senate Banking Committee Chairman once again,¹⁷⁸ the FRRRA deserves notice,

172. S. 1615 § 3(b)(4)(A) (“[A]n agency may not publish a notice of final rulemaking if the agency . . . determines that the quantified costs are greater than the quantified benefits.”).

173. See *id.* § 3(a)(6) (requiring agencies to provide an “identification and assessment of all available alternatives to the regulation” and “an explanation of why the regulation meets the objectives of the regulation more effectively than the alternatives”).

174. See *id.* § 3(b)(4)(C).

175. Regulations from the Executive in Need of Scrutiny (REINS) Act, H.R. 10, 112th Cong. (2011). Like the FRRRA, this bill would subject agency regulations to congressional approval.

176. See *Timpinaro v. SEC*, 2 F.3d 453 (D.C. Cir. 1993).

177. Financial Regulatory Responsibility Act of 2011, S. 1615 § 3(a), 112th Cong. (2011).

178. Senator Shelby pledged to the Chamber of Commerce that he would reintroduce his bill along with legislation to repeal portions of the Dodd-Frank Act. See Yin Wilczek, *Shelby Vows to*

if only because *Business Roundtable* has already moved the status quo reasonably close to the state of affairs it contemplated in several respects. Now that the statutory requirement to “consider” whether an action will promote efficiency has become, in effect, a requirement to “determine” those economic effects of the rule, those economic effects could be interpreted in future cases to include some or all of the FRRA’s elements. The case law already requires a thoughtful response to all major comments,¹⁷⁹ and under some cases rules with multiple rationales fail if the court disagrees with any one of them.¹⁸⁰ *Chamber I* mandated an analysis of alternative approaches, while *American Equity* called for an assessment of both the pre-existing regulatory regime and the baseline competitive structure.

The FRRA is part of a larger legislative effort. While the Act is specific to financial regulators, it shares the goals of other bills in Congress such as the Regulations from the Executive in Need of Scrutiny (REINS) Act,¹⁸¹ which would suspend the effectiveness of major agency rules pending approval by a joint resolution of Congress, and the Independent Agency Regulatory Analysis Act (IARAA),¹⁸² which would have authorized an Executive Order subjecting independent regulatory agencies’ cost-benefit analysis to OIRA.

Pursue ‘Real’ Reform If Republicans Regain Control of Senate, BANKING DAILY (BNA), July 26, 2012. He did so in early 2013. See Financial Responsibility Act of 2013, S. 450 (113th Cong.).

179. See, e.g., *Advocates for Highway & Auto Safety v. Fed. Highway Admin.*, 28 F.3d 1288, 1292 (D.C. Cir. 1994); *Indep. U.S. Tanker Owners Comm. v. Lewis*, 690 F.2d 908, 919 (D.C. Cir. 1982).

180. See *Nat’l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006) (“[W]here FERC has relied on multiple rationales (and has not done so in the alternative), and we conclude that at least one of the rationales is deficient, we will ordinarily vacate the order unless we are certain that FERC would have adopted it even absent the flawed rationale.”). *But see* *Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 353 (D.C. Cir. 1985) (“We obviously cannot affirm a decision based on three different and inconsistent answers to the same fundamental questions. In its brief, FERC elides this inconsistency by ignoring its second and third answers and urging only the first, which it says we accepted as sufficient in a closely analogous context in *Public Systems II*. This, we think, is post hoc rationalization—though by subtraction of old reasons rather than addition of new ones. Unless we can agree that FERC would necessarily have reached the same decision on the basis of the first reason (the multiple regulatory disparities rationale), we would in effect be affirming on a ground different from the one on which the agency based its decision, in contravention of the *Chenery* principle.”).

181. H.R. 10, 112th Cong. (2011). Like the FRRA, this bill would subject agency regulations to congressional approval.

182. S. 3468, 112th Cong. (2012). IARAA would codify, and therefore likely rigidify, many criteria in E.O. 12866 and Circular A-4. While section 4(a) of the bill would exempt compliance with the OIRA-agency dialog from judicial review, section 4(b) would deem “any determination, analysis, or explanation produced by the agency . . . pursuant to an Executive order issued under this Act . . . part of the whole record of agency action” in connection with judicial review, thus effectively reversing the exemption from judicial review central to traditional 12,866 Executive Orders. *Id.* at § 4(b). IARAA is thus an invitation to litigation by regulated entities, putting even more weapons at their disposal. A more balanced and effective approach would be to reverse the import of sections 4(b) and 4(c) of the Act, and combine the cost benefit analysis contemplated by the act with each independent agency’s existing economic requirements (ECCF, in the case of the SEC), and make the integrated analysis subject to the exclusive review of impartial OIRA, exempting it from judicial review.

IV. The SEC's Response: Better Economic Analysis

A. *The SEC's Economic Expertise*

Despite a history of prominent senior SEC staff economists dating back to 1935,¹⁸³ the SEC has not traditionally held itself out as an agency with particular expertise in economics—in contrast to other financial regulators like the Federal Reserve Board, which is led and staffed by economists. Nonetheless, the SEC's Division of Risk, Strategy, and Financial Innovation (RSFI) harbors a veritable faculty of financial economists, with twenty-three members of its well-published staff dedicated to rulemaking support, and many of them on leave from professorships at major universities.¹⁸⁴ The Division, therefore, is in a position to claim true expertise in the discipline. Commanding judicial deference begins with asserting expertise,¹⁸⁵ but the public faces of the lawyer-dominated SEC may have been reluctant to assume a public stance that would have strengthened the hand of another, more inward-looking professional group within the agency.

The SEC began implementing significant changes only in the wake of the *Business Roundtable* decision. The artificial separation of the SEC CBA and ECCF consideration sections was finally abandoned, beginning with the Municipal Advisors Registration release.¹⁸⁶ While this change may appear minor, it was later recognized and endorsed in the Kyle Report.¹⁸⁷ Releases under this new format contained a single “Economic Analysis” section, subsuming the old CBA and ECCF consideration sections. Those integrated sections began to track more closely the format of OIRA CBA: they began with

183. See U.S. SEC. & EXCH. COMM'N, TELEPHONE DIRECTORY, July 1, 1935, posted in the Virtual Museum and Archive of the History of Financial Regulation of the SEC Historical Society, http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1935_07_01_SEC_Telephone_Dir.pdf. For example, Technical Advisor Paul Gourrich was the author of *IS CAPITALISM ON TRIAL* (1931), *GOVERNMENT AND BUSINESS* (1938) and *DEMOCRACY AND DICTATORSHIP* (1939). Kemper Simpson, Economic Advisor and Director of the Office of Policy Research, authored *CAPITALIZATION OF GOODWILL* (1921), *INTRODUCTION TO WORLD ECONOMICS* (1934) and *BIG BUSINESS, EFFICIENCY AND FASCISM* (1941). The office or division in which the SEC's economists have worked has been known by many different names over the years, including the Office of Policy Research, the Economic Research Section, the Directorate of Economic and Policy Research, the Office of Economic Analysis and is currently known as the Division of Risk, Strategy, and Financial Innovation. The authors have compiled a list of previous names that are available at http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1935_0101_SECEconomistsT.pdf.

184. Like the economists at the Board of Governors of the Federal Reserve System, the SEC's economists are highly-credentialed and well-published. Compare <http://www.sec.gov/divisions/riskfin/economistbios.shtml>, with <http://www.federalreserve.gov/econresdata/theeconomists.htm>.

185. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 865 (1984) (noting that the “regulatory scheme is technical and complex” in deferring to the EPA).

186. Registration of Municipal Advisors, 76 Fed. Reg. 824, 872-78 (Jan. 6, 2011) (codified at 17 C.F.R. pts. 240, 249).

187. See KYLE REPORT, *supra* note 29, at 19; OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, REPORT OF REVIEW OF ECONOMIC ANALYSES CONDUCTED BY THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH DODD-FRANK ACT RULEMAKINGS (2011), http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf.

a statement of the problem being addressed, provided a baseline describing the existing situation, and assessed the costs and benefits of moving to the new regime the proposed rule would establish.

In 2012 testimony before a House subcommittee on the proxy access case, SEC Chairman Schapiro has indicated that this change has become the new norm. Schapiro promised a concerted effort to reform the SEC's rulemaking process and expand the agency's already strong team of financial economists—thus strengthening their role, and the role of economic analysis itself, in the rulemaking process. She even suggested that the Chief Economist will have formal sign-off, tantamount to a veto, on the economic analysis of rules. Such a procedural step can be expected to increase the power and prestige of economists within the SEC.¹⁸⁸

To live up to commitments made to Congress in the wake of *Business Roundtable*, and to implement the 2012 Guidance, the SEC is strengthening its economic staff as well. An additional sixteen Ph.D. economists are already to be joining the RSFI economists, with even greater additions requested for the future.¹⁸⁹

The impact of these changes is already being felt. Real economic analysis was decisive in garnering a unanimous Commission vote around the vexed question of defining swap intermediaries,¹⁹⁰ a key parameter of derivatives regulation commended to the Commission's discretion by the Dodd-Frank Act. An empirical analysis of market transactions revealed clear break points that Commissioners with differing predispositions could rally around. The staff's economic analysis prevented the deadlock or divided vote that would have

188. *Hearing Before the H. Subcomm. on TARP of the H. Comm. on Gov't and Oversight*, 112th Cong. 5, 5 (2012) (statement of Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n) ("The SEC has for years considered economic analysis to be a critical element of its rule writing process Our new guidance [on economic analysis] reflects many of the current best practices in economic analysis, which the agency will continue to refine in the future as necessary."). As the title of the hearing suggests, several other witnesses at the hearing strongly criticized the SEC's economic analysis efforts. *See, e.g., id.* at 40 (statement of Henry G. Manne, Dean Emeritus, George Mason University School of Law) ("[T]he SEC's problems with economics don't end with their failure to do the basic kind of analysis one would expect of an economic regulatory agency. They don't even do the kind of analysis that Congress has explicitly required them to do.").

189. Julie Goodman, *SEC RiskFin To Boost Staff, Economic Analysis*, INSTITUTIONAL INVESTOR'S COMPLIANCE REPORTER 1 (July 30, 2012) (reporting that RiskFin had 60 staffers when Division Director and Chief Economist Craig Lewis took office in May 2011, and that Lewis expected that number to increase to around 90 by the end of summer 2012).

190. *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 Fed. Reg. 30,595 (May 23, 2012) (to be codified at 17 C.F.R. pts. 1, 17); *see also* *Hearing Before the H. Subcomm. on Cap. Markets of the H. Comm. on Fin. Serv.* (Dec. 12, 2012) (testimony of Robert Cook, Director, SEC Div. of Trading and Markets), <http://www.sec.gov/news/testimony/2012/ts121212rc.htm>, ("As with other Commission rulemaking efforts, the Commission's Division of Risk, Strategy, and Financial Innovation ("RSFI") was extensively involved in the Commission's development of both of these rule sets. In particular, RSFI's analysis of single-name credit default swap data was especially informative in the development of the entity definition rules. This analysis provided critically important information regarding potential dealing activity in the credit default swap market, which helped the Commission shape the final rules and evaluate their potential economic consequences.") .

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resulted had some Commissioners reflexively advocated for “tougher” or “looser” regulation uninformed by data.

Another, even more important contribution of economic analysis to the policymaking process came recently in breaking the Commission’s well-publicized logjam over money market fund reform. Despite the Reserve Fund’s “breaking the buck,” and the unfortunate necessity of federal guaranties covering the rest of this \$3 trillion industry to prevent a catastrophic run on all the funds,¹⁹¹ SEC Chairman Schapiro had been unable to muster support for a flexible plan offering money market funds their choice of how to enhance their future stability.¹⁹² After a non-binding admonition from the Financial Stability Oversight Council, the RSFI analysis that was originally part of the failed 2012 draft proposing release was expanded and circulated as a stand-alone report,¹⁹³ after which Commissioner Aguilar announced his satisfaction and withdrew his opposition to the contemplated rule.¹⁹⁴

These are examples of how economic analysis should be used in rulemaking. They demonstrate that professional econometric work can both solve problems at the Commission level and promote the adoption of important rules. The amount of work these projects plainly entailed also shows that work of this kind is not to be assigned lightly, or used to pursue trivialities. The rational boundary of economic analysis includes the issues that the analysis can inform in a valuable and cost-effective manner, and excludes those that it cannot.

B. *The 2012 Guidance*

The SEC recognized that it had work to do to bring its economic analyses up to the standards applicable to executive agencies.¹⁹⁵ Those agencies are charged with “adopt[ing] a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs,”¹⁹⁶ “bas[ing] [] decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended

191. For an overview, see *Perspectives on Money Market Mutual Fund Reforms: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 112th Cong. (2012) (statement of Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n), <http://www.sec.gov/news/testimony/2012/ts062112mls.htm>.

192. See Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Statement on Money Market Fund Reform (Aug. 22, 2012), <http://www.sec.gov/news/press/2012/2012-166.htm>.

193. Memorandum from Div. of Risk, Strategy, and Fin. Innovation, U.S. Sec. & Exch. Comm’n, to Luis A. Aguilar, Troy A. Paredes, and Daniel M. Gallagher, Comm’rs, U.S. Sec. & Exch. Comm’n (Nov. 30, 2012), <http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf>.

194. See Luis A. Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, Statement on Money Market Funds as to Recent Developments (Dec. 5, 2012), <http://www.sec.gov/news/speech/2012/spch120512laa.htm>. At this writing, however, the rule has yet to be formally proposed.

195. See Exec. Order No. 12,866, 3 C.F.R. § 638 (1993).

196. *Id.* § 1(b)(6).

regulation,”¹⁹⁷ and “tailor[ing] its regulations to impose the least burden on society.”¹⁹⁸

Decades of agency experience and academic scholarship inform the CBA conducted by those agencies. The result is that these agencies have defined boundaries within which they can reasonably assess the costs and benefits of rules such as dam projects or workplace safety standards.¹⁹⁹ That body of work, however, does not map cleanly onto the financial regulatory landscape.²⁰⁰ Most financial regulators are exempt under Executive Order 12,866 and have not had the benefit of decades of experience with CBA.²⁰¹ They therefore need to begin this work afresh, informed by scholarship, to build the foundations of their own economic analysis requirements.

Thanks to internal staff efforts begun years earlier following the *Chamber* cases and revived and accelerated with the *American Equity* remand, the agency was not caught flat-footed by the need for well thought-out reform. The 2012 Guidance, discussed in more detail in Part IV, codifies the tentative steps taken in 2011, when the SEC began to replace the separate SEC CBA and ECCF sections with a single Economic Analysis section, intended to inform both the Commission and the public.²⁰² In contrast to its 1999 predecessor,²⁰³ which has remained confidential, the 2012 Guidance was made public in March of 2012 in response to congressional concerns.²⁰⁴ It acknowledges lessons learned from the case law and takes a respectful tone toward the cases while avoiding codification of their overbroad and unworkable dicta. In doing so, it both respects and subtly and implicitly responds to some of the ambiguities and misdirection in the case law, staking out sensible positions that, if followed in future releases, should be defensible in litigation.

The 2012 Guidance:

- Expressly equates the benefits of a rule with gains in economic efficiency (including enhanced competition, lower costs of capital, reduced transaction costs and elimination of market

197. *Id.* § 1(b)(7).

198. *Id.* § 1(b)(11).

199. See Livermore, *Cause or Cure?*, *supra* note 19, at 108-14 (describing the areas in which CBA is most commonly practiced).

200. See Katherine Schipper, *How Can We Measure the Costs and Benefits of Changes in Financial Reporting Standards?*, 40 ACCT. & BUS. RES. 309 (2010) (discussing challenges involved in adapting conventional, health, safety, and environmental CBA to the analysis of financial reporting standards).

201. Sherwin, *supra* note 53, at 4.

202. Registration of Municipal Advisers, 76 Fed. Reg. 824, 872-78 (Jan. 6, 2011) (to be codified at 17 C.F.R. pts. 240, 249).

203. See KYLE REPORT, *supra* note 29, at 6-14, 45 (discussing SEC’s rulemaking handbook, which “provides guidance applicable to SEC rulemaking and includes guidance specific to developing cost-benefit analyses”). The handbook was last updated in 1999 but has never been made public. *Id.* at 45.

204. 2012 Guidance, *supra* note 15, at 3.

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failures such as collective action problems), a move that squarely connects ECCF consideration requirements with OIRA CBA.²⁰⁵

- Notes the judge-made “obligation” for the agency to “determine as best it can the economic implications of the rule,”²⁰⁶ but correctly equates this with “broad economic issues” of efficiency and competition,²⁰⁷ and not with chasing down trivial costs. In doing so, it explains why certain facts cannot be ascertained, despite the risk of being ordered once again to “hazard a guess.”²⁰⁸
- Expressly connects the references in *American Equity* to the need to determine existing levels of competition, price transparency and information disclosure with the teaching of Circular A-4 that OIRA CBA begins with the determination of a baseline for comparison.²⁰⁹
- Calls upon SEC staff economists to seek out studies and empirical evidence that bear on predictive judgments, to work with rulewriters to include these studies in releases for comment, and to explain clearly why some studies and evidence are given more weight than others.²¹⁰
- Approaches the contradiction between the invitation in *Chamber I* to engage in “informed conjecture” and *Business Roundtable*’s subsequent rejection of “mere speculation” by mentioning neither.

In response to the Kyle Report and congressional inquiries, the SEC is improving the quality of its economic analysis through collaboration between policymakers and economists throughout the rulemaking process, recognizing that valid economic analysis cannot be “tacked on” as an afterthought. Real involvement of economists in the policymaking is real change in the culture of the agency.²¹¹

205. *Id.* at 10. As a leading textbook on cost-benefit analysis puts it: “One goal, efficiency, underlies CBA.” ANTHONY E. BOARDMAN ET AL., *COST-BENEFIT ANALYSIS: CONCEPTS AND PRACTICE* 43 (3d ed. 2006).

206. 2012 Guidance, *supra* note 15, at 10.

207. *Id.*

208. *Id.* at 13 n.34.

209. *Id.* at 7.

210. *Id.* at 13-14.

211. *See supra* Section IV.A regarding RSFI contributions to swap intermediary definitions and money market fund reform.

The SEC should ensure that such involvement pushes staff to more clearly define the market failure that each rule is intended to address and to define the markets affected by both the problem and the proposed solution. Such early planning will increase the connection between the substance of the rule and the economic analysis. Put differently, the economic analysis will be more compelling if it influences (rather than merely describes and rationalizes) the substance of the rule. Relatedly, staff economists should be given autonomy to construct the ECCF consideration as a dispassionate analysis of tradeoffs, not an exercise in advocacy. These are sound and constructive responses, and the contribution that economic data and economic analytic reasoning can make to rulemaking at the SEC and other financial regulators is potentially great.

C. *A Response to Critics of the 2012 Guidance*

The 2012 Guidance has met with criticism. Better Markets, Inc., a Washington-based pro-regulatory group,²¹² has called for its withdrawal, painting it as an unnecessary and illegitimate abdication of the SEC's rulemaking authority, especially with regard to rules required under Dodd-Frank.²¹³

Better Markets believes the ECCF statute should not be construed to require *any* form of cost-benefit analysis. Instead, the SEC should adopt “a more holistic approach to assessing the economic impact of its rules, one that does not view each rule in isolation, but considers the collective impact on the public and investors of all the reforms embodied in the Dodd-Frank Act.”²¹⁴ Under this approach, the costs of the Dodd-Frank rules as a whole would be evaluated against the “enormous” benefits “totaling trillions of dollars, measured not just in terms of the current crisis but also in light of a potentially worse financial disaster that may befall our country if reform is not fully implemented.”²¹⁵

This “holistic” approach would apparently excuse economic analysis from any obligation to explicate the means by which any Dodd-Frank rule in particular—Conflict Minerals, to take an example currently under court challenge²¹⁶—could itself mitigate any future financial crisis. Indeed, Better

212. According to its website, Better Markets is an organization that “promotes the public interest in financial reform in the domestic and global capital and commodity markets.” BETTER MARKETS: TRANSPARENCY, ACCOUNTABILITY, OVERSIGHT, <http://www.bettermarkets.com> (last visited Jan. 28, 2013).

213. BETTER MARKETS, *supra* note 12, at 59-67.

214. *Id.* at 67.

215. *Id.* at 76.

216. Dodd-Frank mandated that the SEC promulgate a rule requiring companies to publicly disclose their use of conflict minerals. See Press Release, Sec. & Exch. Comm'n, SEC Adopts Rule for Disclosing Use of Conflict Minerals (Aug. 22, 2012), <http://www.sec.gov/news/press/2012/2012-163.htm>; see also Opening Brief of Petitioners at 1, Nat'l Ass'n of Mfrs. v. SEC, No. 12-1422 (D.C. Cir. Jan. 16, 2013) (challenging the Conflict Minerals rule on the grounds that the SEC “did not determine

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Markets appears to deem the fact that Congress enacted the Dodd-Frank reforms to prevent future financial disasters as conclusive evidence that they will in fact do so, and that the benefits are therefore so “enormous” as to outweigh any costs. In this, Better Markets’ views may be usefully paired and contrasted with the views of Professor Henry Manne. Manne argues that regulation almost invariably does more harm than good and should be presumed to be counterproductive, but nonetheless praised the SEC’s guidance as a useful step forward.²¹⁷

Professor James Cox and Benjamin Baucom, in an article sharply critical of the *Business Roundtable* decision, correctly note that “[t]here is a decided tone in the D.C. Circuit decisions that the court believes it is they, and not the SEC, who are the econometricians.”²¹⁸ Admitting that “it is hard to know why that could be,” these authors nonetheless “counsel that the SEC in proposing its rules should do so as a lawyer, not as an econometrician or empiricist,” and views signs pointing toward the 2012 Guidance as continuing to “blindly walk[] into a trap it has set for itself,” where it will continue to be “hoisted by its own petard.”²¹⁹ We disagree, and maintain that if the SEC has an economics problem, it should look to its little-known band of financial economists for solutions.

We share other critics’ concerns about the *Business Roundtable* decision, and agree that “the SEC must fight to over-turn the approach to cost-benefit analysis set forth in *Business Roundtable*,”²²⁰ and recommend fighting it in a readopted proxy access rule. But the SEC simply cannot turn its back on decades of SEC Chairmen’s commitments²²¹ to Congress and decades of judicial precedent, some of which even predates the ECCF statutes.²²²

Moreover, there is a legitimate view that OIRA CBA may not be the best form for ECCF analysis at all, since many financial regulations—particularly the Dodd-Frank rules—confront situations of uncertainty rather than situations of risk. Hahn and Sunstein understand cost-benefit analysis to be

a quantitative and qualitative accounting of the effects of regulation, together with a duty to explain the grounds for action unless the benefits exceed the costs. On this view, the antonym

whether the rule will provide *any* benefits . . . , [and] the rule will impose staggering costs on American businesses”).

217. See Manne Testimony, *supra* note 171, at 41.

218. Cox & Baucom, *supra* note 12, at 1840.

219. *Id.*

220. BETTER MARKETS, *supra* note 12, at 58. One of us even argued last year that “in a perfect world, the SEC’s economic analysis of its rules, while valid and useful, should be exempt by law from judicial review, the way it is for executive agencies.” Bruce R. Kraus, *Challenge to SEC Rulemaking, PENSIONS & INVESTMENTS*, December 12, 2011, <http://www.pionline.com/article/20111212/PRINTSUB/312129993>.

221. See KYLE REPORT, *supra* note 29, at 6 (noting that “SEC Chairmen have made a commitment to Congress that the SEC will conduct cost-benefit or economic analyses in conjunction with its rulemaking activities”).

222. *Timpinaro v. SEC*, 2 F.3d 453 (D.C. Cir. 1993).

to regulation undertaken without anything like a clear sense of the likely consequences—or regulation that amounts to a stab in the dark.²²³

The authors immediately qualify this sweeping pronouncement in an equally sweeping footnote:

We are assuming throughout that regulators are acting in a situation of risk (where probabilities can be assigned to various outcomes) rather than uncertainty (where no such probabilities can be assigned). In a situation of uncertainty, when existing knowledge does not permit regulators to assign probabilities to outcomes, it is exceedingly hard to do cost-benefit analysis. In such circumstances, other decision rules may be useful, such as the maximin principle (choose the policy with the best worst-case outcome.)²²⁴

This qualification may be a mere footnote to much environmental, health and safety regulation—but it is an exception that swallows the rule, as far as many financial regulations are concerned.²²⁵ Certainly, rules under Dodd-Frank, which are largely designed to prevent or mitigate another once-in-a-lifetime financial crisis, fall under the category of uncertainty rather than risk. This distinction suggests why the FRRA's requirements for quantitative benefits analysis simply make no sense in the context of many financial regulations. Imposing a quantitative CBA requirement in situations for which the tool is ill-suited would simply disable regulators from acting in situations of uncertainty.

Nonetheless, the SEC has adopted a pragmatic view, recognizing that neither the courts nor its congressional overseers would tolerate its abandoning economic analysis entirely. Where it makes sense to do so, the agency has adopted a limited version of the holistic approach. While multiple regulations are required by statute, the SEC has tried to assess their economic impact as a group on the market as a whole, with consistent economic analyses across multiple related rules. It is also consonant with the 2012 Guidance to look to the mitigation of future crises of great magnitude as a justification for rules.

D. *Toward a Guidance 2.0*

The SEC is using the 2012 Guidance to integrate economic analysis into its rulemaking process. The current incarnation of the 2012 Guidance should be developed dynamically and improved continuously, based on the agency's experience. The more thorough and well-considered the guidance is, and the

223. Hahn & Sunstein, *supra* note 10, at 1499.

224. *Id.* at 1499 n.37.

225. Roberta Romano suggests that the SEC should respond to this uncertainty by placing an automatic sunset on rules adopted in response to a crisis. *See* Romano, *supra* note 74, at 100. We note that the SEC has complied fully with the Obama administration's executive order asking independent regulatory agencies to engage in retrospective review of rules. *See* Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011). The SEC issued a request for information on such retrospective review, *see* Retrospective Review of Existing Regulations, 76 Fed. Reg. 56,128 (Sept. 12, 2011), and it filed a plan with OIRA.

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more it allows the agency to tailor the economic analysis to the rule at hand, the more helpful it will be and the more deference it should command.

The 2012 Guidance was focused on how to write an economic analysis. Future work of SEC economists and policymaking lawyers should help the 2012 Guidance evolve still further into a meaningful, flexible, and feasible process for economic analysis of its rules—Guidance 2.0, if you will. Guidance 2.0 should formally recognize that the ECCF factors are, by the express words of the statute, merely factors that the agency should consider “in addition to” its primary mission, “the protection of investors” when considering, more broadly “the public interest.” The legislative history of the ECCF statute supports a continued emphasis on investor protection,²²⁶ in contrast to the FRRA, which is concerned primarily about the burdens on regulated entities that investor-protection measures generally entail.²²⁷

Guidance 2.0 should also establish and assert the agency’s expertise in financial economics. Moreover, a definitive agency construction of what it means to “consider” these factors should assert the right of the agency, as an expert in both financial markets and economics, to draw rational boundaries around the economic analysis suitable for each rule, informed by the realities of the data and analytic resources at its disposal, and the nature of the problem at hand. Neither the courts, nor Congress, nor the White House are likely to permit the SEC to wash its hands entirely of cost-benefit analysis. All should respect, however, a good-faith effort on the part of the agency to determine as best it can the economic effects of its rules.

The best path toward addressing these substantive questions may well be procedural. The Commission could establish a procedure for considering efficiency, competition and capital formation that begins at the term sheet stage of the rule, with a formal statement of how the ECCF requirement should be construed to be meaningful and feasible in context, and outlining what the consideration should entail. Such a statement would accompany the term sheet to the Chair’s office. Another formal step in the rulewriting process could entail the rulewriting team bringing the economic analysis contained in the release before senior officials, including the Chief Economist, for sign-off before the draft release is circulated to the commissioners. Awareness of these formal steps on the part of the rulewriting team would sensitize policymakers to the economics of the rule at all stages of the process. Both the proposing and adopting releases would include a record of these steps, and courts might come to view their job as ascertaining whether the agency’s procedures are reasonable, and whether the agency has followed them.

The Commission should resist the temptation to attempt to neuter the ECCF provisions entirely.²²⁸ The goal should be to create a rational, flexible

226. For an overview of the legislative history, see Cox & Baucom, *supra* note 12, at 1820.

227. Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (2011).

228. See BETTER MARKETS, *supra* note 12, at 59-68 (advocating neutering).

boundary around the economic analysis of each rule, within which the analysis is both feasible and meaningful. In doing so, the rule should assert that the SEC's expertise in financial markets, market participant behavior, and financial economics leave it, and not the courts, best situated to evaluate the competing claims and conflicting studies at issue.

The 2012 Guidance for the first time put forth an interpretation of the ECCF requirement as an economic one, one that deemed the statutory term "efficiency" to refer to the economic efficiency that underlies cost-benefit analysis. It also recognized that it is impossible to evaluate either competition or efficiency in any economically meaningful way without considering first what market or markets a particular rule affects.

"Competition" is well defined in antitrust law, and closely intertwined in economic theory with notions of efficiency. The SEC may in appropriate circumstances, evaluate the effect of its rules on competition the way the antitrust authorities review mergers, so that any market that would be sufficiently competitive after the rule's adoption to permit a merger under the DOJ or FTC antitrust guidelines would be sufficiently competitive to satisfy the SEC requirement. Such an analysis should be a sufficient answer to commenters who presuppose that any reduction in competition should be fatal, without regard to whether or not the market in question will remain competitive. Some commenters, notably the Business Roundtable and its consultants at NERA, seem to believe that the statutory term "competition" means the same thing as "U.S. competitiveness," a distinct and often conflicting goal, but one the Commission has never formally gainsaid.²²⁹

Finally, if "capital formation" is to be considered a statutory goal, it too requires definition. No one is in favor of capital formation by the promoters of Ponzi schemes. We believe capital formation is best viewed as a key aspect of allocative efficiency. The securities laws should provide informational and market structures that enable markets to allocate the right amount of capital to the right investment opportunities through appropriate prices and rates of return.

These issues are important, and Commissioners with strong opinions may find it difficult to reach agreement about them, especially since their debates will inevitably be informed not only by law and economics, but by understandable concerns about the potential for unintended consequences of these definitions to limit their own prerogatives and those of future Commissions. The added degree of judicial deference any future Guidance would be due if adopted by the full Commission may be relatively small.²³⁰

229. See NERA REPORT, *supra* note 100.

230. The ECCF statutes govern agency procedures, not the actions of regulated entities or other third parties, and no agency interpretation of them could apply to third parties any more than the statute itself does. If *Mead*'s limitation of Chevron deference to rules "carrying the force of law" is limited to rules that bind third parties, then no Commission construction of the ECCF statutes can be entitled to *Chevron* deference. See *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001) ("We hold

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Since Commission consensus will not be easily won, the SEC Chairman could choose not to seek it, increasing her flexibility. Our hope, nonetheless, is that Commissioners with different views will find common cause in adopting a construction of the ECCF statute as a policy statement²³¹ that preserves the SEC's capacity to adopt regulations in the public interest to protect investors, and empowers the Commission, rather than the courts, to consider economic factors in its rulemaking procedures. Whether adopted by the full commission or not, Guidance 2.0 should reserve to future rulemaking proceedings the agency's right to choose the right econometric tools for the job at hand.

E. Bounded Rationality and Rational Boundaries

Economic analysis will benefit the policymaking process only if the SEC can define and confine its scope within rational boundaries—boundaries within which it can be expected to produce useful insights for policymakers and earn the deference of reviewing courts. “It is evident that the rational thing to do is to be irrational, where deliberation and estimation cost more than they are worth.”²³² But how do we know when that is the case? Thought and deliberation ahead of regulatory (or any other) action are doubtless desirable, even though any such analysis will necessarily be incomplete.

Is it possible to know when time for deliberation is to give way to action? A second-order analysis about the value of the first may be in order, but the regression is infinite and there is no reason to expect the series to converge.²³³

that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that *Congress delegated authority to the agency generally to make rules carrying the force of law*, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.”) (emphasis added). Still, a well-considered Commission construction of the ECCF statutes should at least be entitled to a degree of judicial deference under *Skidmore v. Swift*, 323 U.S. 134, 140 (1944) (providing that deference to an agency interpretation or opinion is a function of the “thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.”).

231. Consistent with the discussion above, an interpretation issued as a policy statement would not hold the force of law. *See, e.g.*, *Consol. Edison Co. of N.Y. v. FERC*, 315 F.3d 316, 323 (D.C. Cir. 2003) (“‘Policy statements’ differ from substantive rules that carry the ‘force of law,’ because they lack ‘present binding effect’ on the agency.” (quoting *Interstate Natural Gas Ass’n v. FERC*, 285 F.3d 18, 59 (D.C. Cir. 2002))); *Troy Corp. v. Browner*, 120 F.3d 277, 287 (D.C. Cir. 1997); *Am. Bus. Ass’n v. United States*, 627 F.2d 525, 529 (D.C. Cir. 1980).

232. FRANK KNIGHT, *RISK, UNCERTAINTY AND PROFIT* 67 (1921) (quoted in John Conlisk, *Why Bounded Rationality?*, 34 J. ECON. LIT. 669, 686 (1996)). Conlisk discusses in detail the infinite regression problem that arises when economic analysis itself is costly. For an overview of bounded rationality, see DANIEL KAHNEMAN, *THINKING FAST AND SLOW* (2012); JAMES G. MARCH, *A PRIMER ON DECISION MAKING: HOW DECISIONS HAPPEN* (1994); Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); and Herbert Simon, *Bounded Rationality and Organizational Learning*, 2 ORG. SCI. 125 (1991).

233. *Id.* at 687. “If we can economize on economizing, we can economize on economizing on economizing, and so on.” *Id.*

At some point, “a decision must be taken on intuitive grounds.”²³⁴ The SEC itself, with its expert cadre of financial economists, is far more qualified than generalist courts to decide whether or not a particular line of analysis is worth pursuing. Respecting that judgment, if it is exercised reasonably (though informed by intuition), will more effectively employ scarce government analytical resources than will long, legislated checklists.²³⁵ The SEC is far more likely to win that respect if it improves the quality of its economic analysis.

“Long-term prophecies can be derived from scientific conditional predictions only if they apply to systems, which can be described as well-isolated, stationary, and recurrent. These systems are very rare in nature; and modern society is not one of them.”²³⁶ Economic analysis should therefore inform, but should not be expected or allowed to dictate, policy.

V. White House Review of Independent Agency Rules?

The debate about whether independent regulatory agencies should be made subject to OIRA began when OIRA was created and continues to this day.²³⁷ Generally unrecognized, however, is that whatever the merits of such review may be for executive agencies headed by one Presidential appointee, multi-member commissions as currently constituted cannot be expected to interact productively with OIRA. SEC staff charged with that interface would be able to speak at best for the Chairman’s office, and not for the Commission as a whole. This problem is exacerbated by Sunshine Act prohibitions on private pre-decisional deliberations between Commissioners as a group and staff. These structural and legal considerations make the degree of rationality we expect from hierarchical bureaucracies an unrealistic expectation where multi-member bi-partisan bodies are concerned.

A. *Rational Politics and Quasi-Legislative Bodies*

The Securities and Exchange Commission consists of five Commissioners, no more than three of whom may belong to the same political party. The SEC Chair is the CEO of the agency, and a Commissioner as well.²³⁸ The Chair’s direct reports include the Directors of each of the SEC divisions, which are, in turn, organized like typical federal bureaucracies, with one

234. LEIF JOHANSEN, 1 LECTURES ON MACROECONOMIC PLANNING: GENERAL ASPECTS 144 (1977).

235. Cf. Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (2011).

236. KARL R. POPPER, CONJECTURES AND REFUTATIONS: THE GROWTH OF SCIENTIFIC KNOWLEDGE 339 (1965).

237. For several early contributions to this debate, see *supra* note 20.

238. See Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE. L.J. 257, 265 n.36.

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important difference: proposing release or adopting releases can only be adopted by a majority vote at a public meeting of all Commissioners.²³⁹

The SEC Chair is powerful: the entire SEC staff reports to her. Still, the Chair cannot always count on the vote of the other two members of her party.²⁴⁰ This problem is exacerbated by the case law giving weight to dissenting opinions, as was the case in *Chamber I*.²⁴¹ A strong Chair can be effective in this environment nonetheless. Yet a compromise designed to win one vote is likely to cost another. Any Commissioner who is insufficiently appeased reserves the right to make a statement at the Open Meeting in which the rule is adopted, in a sentence or two—a statement that will weigh heavily against the rule’s validity if challenged in the Court of Appeals.

The notice-and-comment process for producing a rule takes many months of staff time, including drafting the rule and its release (including the economic analysis), reviewing and summarizing comments, and meeting with interested parties. But for the last thirty days before adoption, the rule belongs to the Commissioners. The staff during this period responds to questions and comments from individual commissioners, while the Chair’s office and senior staff try to build consensus around a particular version of the rule. In short, despite the Chair’s powerful leadership role, the Commission functions in crucial respects much like a mini-legislature, and its rules, while more focused and coherent than many bills that pass Congress, should nonetheless be understood as the product of logrolling compromises of the kind familiar to students of the legislative process.²⁴²

Rules adopted by multimember commissions are the result of a quasi-legislative process, unlike the processes of executive agencies. A bipartisan commission may only be able to act by allowing for the possibility of last-minute decisions, as logrolling compromises produce the final form of the rule on the eve of the Open Meeting.²⁴³ Where do such compromises leave the economic analysis section of the release, prepared before anyone could have known the final outcome? Those decisions, which economic analysis should inform but cannot determine, often resemble settlements reached on the

239. 5 U.S.C. § 552b (2006).

240. Witness SEC Chairman Schapiro’s inability to garner the three votes necessary to reform the capital structure and net asset value reporting rules for money market funds, which played a critical role in the financial crisis. See Nathaniel Popper, *Changes to Money Market Funds Stall*, N.Y. TIMES, Aug. 22, 2012, <http://www.nytimes.com/2012/08/23/business/sec-calls-off-vote-on-fund-regulation.html>.

241. *Chamber I*, 412 F.3d at 144.

242. A substantial theoretical literature and empirical literature have analyzed decision making in multimember bodies with different institutional characteristics; for an overview of some of the seminal works, see Edward L. Rubin, *Public Choice in Practice and Theory*, 81 CAL. L. REV. 1657 (1991).

243. For a discussion of an analogous problem with respect to rules developed by negotiated rulemaking, see Patricia M. Wald, *Negotiation of Environmental Disputes: A New Role for the Courts?*, 10 COLUM. J. ENVTL. L. 1, 22 (1985) (noting that negotiated rulemaking may produce a rule that is “pure political logrolling . . . rather than rational decisionmaking”).

courthouse steps more than they resemble a judge's reasoned decision after a trial on the merits.

While certainly subject to conflicting pressures from interest groups, Congress, and the White House, an executive agency headed by an individual can be expected to implement a more linear regulatory process. Executive agencies have a chain of command, perhaps ending at Secretary, Deputy, Assistant or Director levels, in which the buck stops somewhere within the Cabinet department or bureau in question. In an executive agency, policy options and decisions can flow down and up the chain in an orderly, logical manner, with big decisions made first, informed by cost-benefit analysis. OIRA CBA can form a constructive part of such a process.

B. *Making OIRA Review Work for Independent Agencies*

The Independent Agency Regulatory Analysis Act (IARAA), introduced during the last Congress, would have authorized the President to subject independent agencies, and their economic analysis of regulations, to OIRA review.²⁴⁴ The bill attracted bipartisan sponsorship and sparked significant debate.²⁴⁵ Opponents argued that the bill would interfere with agency independence and add further delays to a rulemaking process already stalled by excessive judicial review.²⁴⁶

Our observations about the structural incompatibility of OIRA review and independent agency structure have been cited in the debate against the bill.²⁴⁷ We stress here, in addition, that the judicial review provisions in IARAA invite devastating litigation in the Court of Appeals. Moreover, the SEC can argue with some justification that the 2012 Guidance and the enhanced role of its

244. Independent Agency Regulatory Analysis Act, S. 3468, 112th Congress (2012).

245. The bill received sufficient consideration that the heads of the SEC, CFTC, Federal Reserve Board, CFPB, NCUA, and FDIC coauthored a letter opposing the bill. *See* Letter from Ben S. Bernanke, Chairman, Bd. Of Governors, Fed. Reserve Sys., et al., to Sen. Joseph Lieberman, Chair, S. Comm. on Homeland Security and Governmental Affairs & Sen. Susan Collins, Ranking Member, S. Comm. on Homeland Security and Governmental Affairs (Oct. 26, 2012), <http://www.buckleysandler.com/uploads/104/doc/10-26-12%20Agency%20Letter%20to%20Lieberman%20re%20S%203468.pdf>.

246. *Id.* at 1 (arguing that the bill “would constitute a fundamental change in the role of independent regulatory agencies” and “would likely result in unnecessary and unwarranted litigation in connection with our rules”). For other critiques, *see, e.g.*, Mark Gongloff, *Senators Want To Give President Power To Stop Insufficiently Lenient Financial Regulations*, HUFFINGTON POST (Sept. 10, 2012, 2:30 PM), http://www.huffingtonpost.com/mark-gongloff/congress-financial-regulations_b_1871382.html (concluding that the bill “would create yet another helpful roadblock, another tactic to delay bank reforms for months while lawyers haggle”); Rena Steinzor, *The Independent Agency Regulatory Analysis Act, as Critiqued by Co-Sponsor Susan Collins and Me*, CPRBLOG (Aug. 1, 2012), <http://www.progressivereform.org/CPRBlog.cfm?idBlog=E42958C4-B61A-8FDA-62ACBF689F7D0313> (arguing that the bill “defeats the whole point of making the agencies independent at the outset”).

247. *Anti-Regulatory Bill Would Limit the SEC's Ability To Protect Investors*, CENTER FOR EFFECTIVE GOV'T (Nov. 6, 2012), <http://dev.ombwatch.org/anti-regulatory-bill-would-limit-SEC-ability-to-protect-investors%20> (discussing an early version of this article).

Rational Boundaries

Chief Economist in the rulemaking process have replicated at the staff level the kind of constructive, rational, economics-based dialogue that OIRA review is intended to foster.

We also recognize the value of economic analysis in rulemaking, and urge policy advocates and legislators to view IARAA not only as a threat to financial reform, but as an opportunity to fix the rulemaking process itself. Specifically, we recommend that any such bill include (i) an exemption from the Sunshine Act to facilitate pre-decisional deliberations at the Commissioner level and (ii) the recognition that the OIRA process will satisfy ECCF and similar requirements *per se*, creating a safe harbor from future litigation over the economic analysis of rules. While OIRA review would entail a loss of independence, independent agencies should be happy to discuss econometrics with OIRA if by doing so they preclude second-guessing by the D.C. Circuit. Given this situation, OIRA review—if coupled with the reforms we advocate—seems like a good trade for those in favor of effective, well-informed regulation.

1. Sunshine, Sunset

The Sunshine Act,²⁴⁸ like the Freedom of Information Act,²⁴⁹ is intended to foster openness and transparency in government.²⁵⁰ Congress required that important decisions be made openly, to give the public a full understanding of the Commission’s reasoning, and the compromises it made, a deeper understanding than one based only on minutes, background papers or formal statements.²⁵¹

Most of the work of the SEC’s rulewriting staff is exempt from FOIA under a broad exemption for pre-decisional deliberations.²⁵² The Sunshine Act lacks this particular exemption because, according to the legislative history, “[i]t is not sufficient for the purposes of open government to merely have the public witness agency votes. The meetings opened by Section 201(a) are not

248. 5 U.S.C. § 552b (2006).

249. *Id.* § 552.

250. See C. THOMAS DIENES ET AL., NEWSGATHERING AND THE LAW § 9.5(a) (2d ed. 1999).

251. See S. REP. NO. 94-354, at 5 (1975).

252. 5 U.S.C. § 552(b)(5) (2006); see also DIENES ET AL., *supra* note 250, § 10-2(c)(6). The exemption protects “inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than the agency in litigation with the agency.” 5 U.S.C. § 552(b)(5) (2006). The deliberative-process privilege (which some courts refer to as “executive privilege”) is frequently invoked under this exemption. We recommend adding this exemption to the Sunshine Act. The primary interest protected by the deliberative process privilege is the prevention of “injury to the quality of agency decisions.” NLRB v. Sears, Roebuck & Co., 421 U.S. 132, 151 (1975). Harms that the privilege is intended to avert include: (1) the loss of straightforward, candid discussions within an agency, which are crucial to the quality of agency decisions; (2) the deterioration of the integrity of agency decisions; and (3) public confusion as to an agency’s intentions, which would result from premature disclosure. DIENES ET AL., *supra* note 250, § 10-2(c)(6) (citing *Jordan v. Dep’t of Justice*, 591 F.2d 753, 772-74 (D.C. Cir. 1978)).

intended to be merely reruns staged for the public after the agency members have discussed the issue in private and predetermined their views. The whole decisionmaking process must be exposed to public scrutiny.”²⁵³

Public meetings of the Commission, streamed on the Web and often covered by the media, are set pieces, in which the Commissioners and staff read prepared remarks. Commissioners sometimes ask staff a question or two, but never question or address one another in public. They are, in a word, precisely what the Sunshine Act legislative history deemed insufficient. Yet they are certainly not reruns, either, because ever since the Sunshine Act, the important meetings the Act aimed to open to the public—the ones where the real discussions and negotiations are had—now no longer take place at all. Because three Commissioners are enough to pass a rule, and the Sunshine Act prohibits any kind of private policy discussion among more than two Commissioners, with or without the presence of rulewriting staff, the Sunshine Act has chilled Commissioner-level policy discussions entirely. It has left Commissioners to communicate as best they can through one-on-one meetings, seriatim written consents, commissioners’ counsel meetings and other awkward workarounds.

This unintended consequence has been widely decried,²⁵⁴ and undefended to our knowledge. Still, it is hard to persuade legislators to vote against “sunshine.” A new version of IARAA might offer a rare opportunity to fix a bad provision in a popular statute,²⁵⁵ by adding an exemption to permit pre-decisional deliberations. Economic analysis is a conversation, not a calculation or a confrontation. Conversations between the agency and OIRA could well improve SEC rules, but five Commissioners cannot be expected talk policy with the director of OIRA, when the Sunshine Act doesn’t even let them talk among themselves.

253. S. REP. NO. 94-354, at 18.

254. For a helpful overview, see Fisch, *supra* note 12, at 29-33. Criticism of the Sunshine Act by current and former SEC employees is particularly common. See, e.g., *Fixing The Watchdog: Legislative Proposals To Improve And Enhance The Securities And Exchange Commission: Hearing Before the H. Comm. on Fin. Serv.*, 112th Cong. 43 (statement of Stephen J. Crimmins, Former Deputy Chief Litig. Counsel, Enforcement Div., U.S. Sec. & Exch. Comm’n) (“In 20 years as Commission Secretary, I had the privilege of working for seven Chairmen, four acting Chairmen, and almost 20 Commissioners. Every one of them, at some point in time, expressed deep frustration with how the Sunshine Act was preventing them from really doing their job to the best of their ability.”).

255. While considering this issue, legislators might also consider loosening Paperwork Reduction Act restrictions on information-gathering to inform rulemaking. Even the resubmitted FRRR recognizes and attempts to address this problem. See Financial Regulatory Responsibility Act of 2013, S. 450 § 4, 113th Cong. (2013) (“For purposes of the Paperwork Reduction Act obtaining, causing to be obtained, or soliciting information for purposes of complying with [the regulatory analyses required by the bill] shall not be construed to be a collection of information” (internal citations omitted)).

2. Safe Harbor from Judicial Review

Litigation is a terrible way to do economic analysis. The twenty-year conversation between the D.C. Circuit and the SEC is evidence enough of that. Yet IARAA included provisions inviting litigation²⁵⁶ (in contrast to the CBA executive orders,²⁵⁷ which preclude it.) The IARAA's judicial review provisions appear to reflect an unpublished 1981 Justice Department opinion that found its way to the Hill,²⁵⁸ presumably leading the drafters to believe that the bill would preserve the status quo.²⁵⁹ But the law's review provisions would transform a theoretical possibility into an invitation to litigate every rule. In light of the current jurisprudence in the D.C. Circuit, any future bill should affirmatively protect the integrity of the OIRA review process by creating a true safe harbor from litigation over the economic analysis required.

Economic analysis requires sober agency considerations and assessments of costs and uncertainties. Private litigants must not be allowed to throw these findings back at the agency as “party admissions against interest,” undermining the validity of the very rules that the analysis informed. Agencies do not have “interests” the way private parties do. They are formulating policy—in which the only interest is the public interest, and the only goal is getting it right. Agencies are supposed to provide a candid assessment of available options to find the least bad one, and a hostile litigation environment is no place to do it.

The SEC realized in 2011 that a well-done cost-benefit analysis would more than satisfy its statutory ECCF requirements, and began performing both in a single section of its releases. The 2012 Guidance codified that change, and initiated a series of procedural changes improving its economic analysis of rules. Any future IARAA bill should acknowledge the same reality, and make it clear that the SEC shall be deemed to have “considered” efficiency,

256. S. 3468, 112th Cong. (2012). While section 4(a) of the bill would exempt compliance with the OIRA-agency dialogue from judicial review, section 4(b) would deem “any determination, analysis, or explanation produced by the agency . . . pursuant to an Executive Order issued under this Act . . . part of the whole record of agency action” in connection with judicial review, thus effectively reversing the exemption from judicial review central to OIRA-agency dialogue under E.O. 12,866. *Id.* § 4(b). IARAA is thus an invitation to litigation by regulated entities, putting even more weapons at their disposal. A more balanced and effective approach would be to reverse the import of sections 4(b) and 4(c) of the Act, and combine the cost-benefit analysis contemplated by the act with each independent agency's existing economic requirements (ECCF, in the case of the SEC), and make the integrated analysis subject to the exclusive review of impartial OIRA, exempting it from judicial review.

257. See sources cited *supra* note 21.

258. Memorandum from Larry L. Sims, Acting Ass't Att'y Gen., Office of Legal Counsel, to David Stockman, Dir., Office of Mgmt. & Budget, on Proposed Executive Order on Federal Regulation (Feb 22, 1981) (on file with authors).

259. See Letter from Jonathan H. Adler, Professor of Law, Case Western Reserve Univ. Sch. of Law, et al., to Sen. Joseph Lieberman, Chair, S. Comm. on Homeland Sec. and Gov't Affairs & Sen. Susan Collins, Ranking Member, S. Comm. on Homeland Sec. and Gov't Affairs (Jan. 2, 2013) (arguing that “S. 3468 would specifically bar the courts from reviewing whether OIRA and the rulemaking agency have complied with review procedures established by the President.”) (on file with authors).

competition and capital formation for Securities Act purposes if it substantially complies with OIRA requirements.

VI. Conclusion

The twenty-year conversation between the SEC and the court that we have described has been mostly about financial economics. While the SEC is the expert in the field, the conversation has been one-sided—and not just because the judges naturally have the last word.

The SEC, and not the court, is the expert in financial economics, but hasn't pressed its natural advantage in its long dialogue with the court. The SEC gave up on mutual fund boards, and lost another turn to speak when it lost authority over indexed annuities. In the following round, it could easily have refuted the court's demonstrably false charge that it had "botched" the proxy access-economics, but the rule's flaws made review by the full D.C. Circuit or Supreme Court understandably unappealing. Some at the lawyer-dominated SEC have been reluctant to admit that this story has been about economics at all. As a result, the Court's findings, rulings and misunderstandings still stand. The resulting pressures from Congress have led to the publication of the 2012 Guidance, and the agency's economics department has doubled in size.

Cost-benefit litigation has substantially slowed the pace of financial reform, and new cost-benefit legislation looms. We have offered the agency three strategies in response. First, the SEC should continue efforts to affirm its expertise in financial economics. The agency should welcome its reinforced corps of economists as real members of the rulewriting team, and insist on its right, derived from that expertise, to set the boundary between economic analysis and policy choice. Second, the SEC should re-propose a proxy access rule that has been improved through these new procedures in order to win favorable circuit court opinion on cost-benefit analysis. Third, if cost-benefit measures seem likely to pass Congress, the SEC should ensure that they are accompanied by reforms, including a safe-harbor from litigation, that will facilitate rather than impede the rulewriting process. These efforts should lead to economic analyses of future rules that are both meaningful and feasible, and help reclaim the judicial deference that the Commission's decisions are due.