Rational Boundaries for SEC Cost-Benefit Analysis

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ABSTRACT

A series of D.C. Circuit cases invalidating SEC rules on economic analysis grounds has cast the agency's rulemaking authority in doubt. We trace the evolution of this case law, noting the incompatibility of strict cost-benefit analysis procedures designed for executive agencies with structure and processes of multimember commissions like the SEC. The SEC has, until very recently, abstained from defining its statutory requirements for economic analysis, and thereby left courts and commenters free to develop an ad hoc, open-ended jurisprudence of economics in SEC rulemaking that has proven increasingly unworkable in practice. Current legislative proposals would codify and extend the logic of this case law, and thereby make future financial regulations even less likely to survive judicial review—even regulations expressly mandated by Congress.

The SEC, faced with these substantial threats to its rulemaking authority should affirm its substantial and long-standing expertise in financial economics, and insist on the agency's right, derived from that expertise, to discern and define the boundary between economic analysis and policy choice. We view the SEC's staff's recent articulation of a theory of economic analysis as an important step in its response to these developments, and recommend continued refinement of its definition of its economic analysis mandates, and their relationship to the SEC's primary mission, the protection of investors. This effort 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, particularly if these staff efforts are adopted at the Commission level.

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INTRODUCTION

A ten-year line of appellate cases[3] culminating in the D.C. Circuit's devastating *Business Roundtable* decision[4] has set a very high bar for economic analysis in rulemaking by financial regulators such as the Securities and Exchange Commission (SEC or Commission). Notwithstanding the Dodd-Frank Act's express grant of statutory authority to issue it,[5] the court struck down the agency's long-pondered proxy access rule,[6] 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 timely challenge. Other financial regulators are alarmed,[7] and with good reason, since their economic analyses of their own rules is generally less sophisticated than the SEC's.[8] Bills pending in Congress promise to codify these cases and introduce additional antiregulatory innovations.[9]

Part I reviews the background of the proxy access case, exploring the reasons why the SEC may have 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 rulemaking antedates the statutes upon which challenges have increasingly come to rely. Those

[3] Am. Equity Inv. Life Ins. Co. v. SEC, 572 F.3d 923 (D.C. Cir. 2010); Chamber of Commerce v. SEC, 443 F.3d 890 (2006); Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005); Timpinaro v. SEC, 2 F.3d 453 (D.C. Cir. 1993).

[4] Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

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

[6] *Business Roundtable*, 647 F.3d at 1144.

[7] *See, e.g.*, COMMODITY FUTURES TRADING COMMISSION, GUIDANCE ON AND TEMPLATES FOR PRESENTING COST-BENEFIT ANALYSES FOR COMMISSION RULEMAKINGS (Sept. 29, 2010); COMMODITY FUTURES TRADING COMMISSION, STAFF GUIDANCE ON COST-BENEFIT CONSIDERATIONS FOR FINAL RULEMAKINGS ON THE DODD-FRANK ACT (May 13, 2011); Arthur Fraas & Randall Lutter, On the Economic Analysis of Regulations at Independent Regulatory Commissions (Apr. 2011), *available at* http://www.rff.org/RFF/Documents/Rff-DP-11-16_final.pdf.

[8] For an assessment of economic analysis by financial regulators, *see* GOVERNMENT ACCOUNTABILITY OFFICE, DODD FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION (2011).

[9] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. (2011).

[10] For a discussion of cost-benefit analysis, see generally OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR A-4 2-3 (Sept. 17, 2003); Susan Rose-Ackerman, *Putting Cost-Benefit Analysis in its Place: Rethinking Regulatory Review*, 65 U. MIAMI L. REV. 335, 356 (2011); John D. Graham, *Saving Lives Through Administrative Law and Economics*, 157 U. PA. L. REV. 395 (2009); 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); Sally Katzen, *Cost-Benefit Analysis: Where Should We Go from Here?*, 33 FORDHAM URB. L.J. 1313, 1315-17 (2006); MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006); Eric A. Posner & Cass R. Sunstein, *Dollars and Death,* 72 U. CHI. L. REV. 537 (2005); 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); Robert W. Hahn & Cass R. Sunstein, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651 (2001); 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); STEPHEN G. BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 21 (1993).

statues, adopted in the late 1990's, 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 efficiency, competition and capital formation (ECCF) have been 100% successful to date; none of the rules vacated and remanded for further analysis have ever been re-proposed.

These administrative, case law, and statutory forces produced an SEC approach to economic analysis that differs from that of agencies required to submit their CBA to the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA). Lacking a dialog with the CBA experts at OIRA, 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 agency construction of its own statute, the SEC left the court free to develop an *ad hoc*, open-ended jurisprudence of economics in SEC rulemaking that has proven increasingly unworkable in practice.

In Part II we review *Business Roundtable v. SEC*,[11] beginning with the long gestation of the rule proposed in 2007. We review the ensuing comment period—the first phase of the litigation—with a special focus on the economic analysis contained in the proposing proposed release, the economic arguments and criticisms submitted by commenters (especially the Business Roundtable itself) and dissenting SEC commissioners, and the SEC's response to these comments in its adopting release. In our analysis of the opinion, we devote particular attention to the Court's harsh criticism of the SEC's treatment of the empirical economic analysis, in which it substituted, *sub rosa*, a heavy burden of proof for the deference normally afforded expert findings. We also show, by reference to key economics papers in the record, that the Court's substantive criticism was unfounded under any procedural standard.

In Part III, we review the congressional reaction to *Business Roundtable*. The first stage included ranking minority members in the Senate and Committee Chairs in the House calling agency officials and outside experts in for testimony, and enthusiastically initiating inspector general reviews of cost-benefit analysis of rulemaking in a dozen financial regulatory agencies. Stage two included the introduction of a remarkable bill styled the Financial Regulatory Responsibility Act of 2011 (FRRA).[12] FRRA would stack the deck against all new financial regulations by passing then though a maze of exacting criteria, quantitative analysis, legislative approval, and litigation in which the agency would bear a "clear and convincing" burden of proof.[13] We show that FRRA, extreme as the bill may seem at first blush, is little more than a logical extension of *Business Roundtable* case, its precedents, and its likely progeny, the culmination of a trend empowering regulated entities to strike down regulations almost at will.

[11] 647 F.3d 1144 (D.C. Cir. 2011).
[12] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. (2011).
[13] *Infra* notes 143-157.

In Part IV, we review the SEC's response, beginning with an exploration of possible reasons why it chose not to apply for rehearing *en banc* or petition for *certiorari.*[14] We examine the longstanding role of financial economists at the SEC, a distinguished 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 defend the 2012 guidance against recent critiques, deeming it an earnest and valuable 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. Part IV also traces the SEC's dismal track record in the D.C. Circuit in part to structural and legal differences between the SEC and executive agencies. A multimember, bi-partisan commission, cannot be expected to perform with the same coherence as an agency headed by a single cabinet officer. Even if it were, the standards established by the court would be impossible in practical terms to satisfy. Part IV concludes by noting that while the 2012 staff Guidance is a positive step, it should be refined and elaborated based on experience to draw rational boundaries around the consideration the ECCF statutes require, and thereby make ECCF analysis both valuable and feasible. To enhance the degree of deference courts should afford this line-drawing exercise, the Commission itself should adopt a policy statement reflecting the best practices that emerge from this effort, after notice and comment from the public.[16] Commission action construing the SEC's statutory economic analysis requirements would reset the bar on judicial review of subsequent regulations to an attainable height.

In Part V, we further defend the agency's right to set rational boundaries around the scope of the economic analysis it performs. Drawing upon principles of cognitive psychology and behavioral economics, we show that, while cost-benefit analysis can be a useful corrective to human frailty, the proper scope of the analysis must derive from considerations outside the

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[14] James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811, 1840 (2012); BETTER MARKETS, INC. SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 59-68 (July 30, 2012), *available at* http://www.bettermarkets.com/sites/default/files/CBA%20Report.pdf ; 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); Grant M. Hayden & Matthew T. Bodie, *The Bizarre Law & Economics of* Business Roundtable v. SEC, 38 J. OF CORP. L. 1 (2012); J. Robert Brown, Jr., *Shareholder Access and Uneconomic Economic Analysis: Business Roundtable v. SEC*, Univ. of Denver Legal Studies Research Paper Series No. 11-14, 2011), 3-4 *available at* http://ssrn.com/abstract=1917451.

[15] SECURITIES AND EXCHANGE COMMISSION, CURRENT GUIDANCE ON ECONOMIC ANALYSIS IN SEC RULEMAKINGS, Mar. 16, 2012, *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.shtml.

[16] *United States v. Mead Corp.*, 533 U.S. 218 (2001); Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). Since *Chevron*, judicial deference to agency interpretation of ambiguous statutes provisions has been a central tenet of the administrative state. *See, e.g.*, Cass R. Sunstein, *Beyond Marbury: The Executive's Power to Say What the Law Is*, 115 YALE L.J. 2850, 2580 (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 U. CHI. L.R. 187, 190 (2006) ("*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."); E. Donald Elliott, Chevron *Matters*: *How the* Chevron *Doctrine Redefined the Roles of Congress, Courts, and Agencies in Environmental Law*, 16 VILL. J. ENVTL. L. 1, PIN (2005).

analysis itself. Part V concludes with a final word from Judge Ginsburg, who both distinguished and reaffirmed *Business Roundtable* in a recent, notable decision.

The SEC, faced with a substantial threat to its rulemaking authority should affirm its substantial and long-standing expertise in financial economics, and insist on the agency's right, derived from that expertise, to discern and define the boundary between economic analysis and policy choice. We commend its recent publication of internal guidance for economic analysis (the 2012 Guidance) as an important first step toward making economic analysis of future rules both meaningful and feasible. The SEC should continue to define what it means to "consider" efficiency, competition and capital formation, and to define how to construe these terms in particular rules, as well as their the relationship of these criteria to the SEC's primary mission, "the protection of investors." This effort, at both the staff and Commission levels, should help reclaim the judicial deference that the Commission's decisions are due.

PART I: STATUTORY, ADMINISTRATIVE AND CASE LAW BACKGROUND

The SEC, like other independent agencies, has always been exempt from the benefit-cost analysis process mandated by Executive Order 12,866 and its predecessors.[17] Executive agencies subject to EO 12,866 routinely quantify the costs and benefits of their rule proposals, often with the help of outside consultants, in analyses they submit to OIRA.[18] These analyses inform the agencies' dialog with OIRA about the policy choices at play in proposed rules. While the OIRA process has not been without its critics, this dialog affords the Executive Office of the President (on high profile rules, high-level White House staff may also become involved), other agencies, parties affected by the proposed regulations, and the public an important opportunity to influence agency regulations.[19] The benefit-cost analysis acknowledges and seeks to quantify the trade-offs involved, and ideally frames the policy debate in a rational way, offering common ground as a starting point for both proponents and detractors of the rule to comment. For clarity, we will refer

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[17] Exec Order No. 12,886, 3 C.F.R. 638 (1993) (exempting "independent regulatory agencies" as defined by the Paperwork Reduction Act, 44 U.S.C. §§ 3501–3521, from the OIRA review process). A number of scholars and practitioners have advocated subjecting independent agencies to regulatory review. *See, e.g.*, Richard H. Pildes & Cass Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV 1 (1995).

[18] *Id*. ("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. L.J. 107 (2008) and Michael A. Livermore, Cost-Benefit Analysis and Agency Independence, [unpublished paper, 2012].

[19] 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); Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 872 (2003); 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); E. Donald Elliott, *TQM-ing OMB: Or Why Regulatory Review Under 12,291 Works Poorly and What President Clinton Should Do About It*, 57 LAW & CONTEMP. PROBS. 167 (1994); Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075 (1986); Alan B. Morrison, *OMB Interference with Agency Rulemaking: The Wrong Way to Write a Regulation*, 99 HARV. L. REV. 1059 (1986).

to these processes and procedures as "OIRA CBA." OIRA CBA is, by its terms, exempt from judicial review[20] and courts appear to have rarely looked to the analysis when judging other aspects of the rule.[21]

A. Volunteering for a Suicide Mission?

In the 1970's, shortly before EO 12,866's key predecessor was promulgated,[22] the SEC voluntarily began to include in its "proposing releases" and "adopting releases" (also termed "proposed rules" and "final rules" respectively) 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)[23] 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.[24] Congress has never successfully invoked the CRA against the SEC or any other independent agency, and appears to have generally ignored those submissions.[25]

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).[26] The SEC had argued against enactment of this requirement, on grounds that it was duplicative of the SEC CBA.[27] But after passage of NSMIA, the SEC added a new, separate ECCF 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.

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[20] EXEC ORDER NO. 12,886, 3 C.F.R. 638 (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.").

[21] *But see* 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) (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. §§ 601-612 (Reg Flex), they incidentally review elements of OIRA CBA if agency has cross-referenced them to fulfill those statutory requirements.

[22] Exec. Order No. 12,291, 3 C.F.R. 127 (1981).

[23] Congressional Review Act, 5 U.S.C. §§ 801–808 (2012).

[24] *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.

[25] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, 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 205 (Princeton Univ. Press 2008).

[26] 15 U.S.C. §§ 78c(f) & 80a-2(c) (2012) ("Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

[27] SECURITIES AND EXCHANGE COMMISSION, Comments on H.R. 3005, at 4 (Oct. 7, 1996).

Why did the SEC start including SEC CBA in its releases back in the 1970s, when no statute or executive order required it? Why did it continue to do so after 1996, while relegating the new, statutorily mandated ECCF consideration to a largely duplicative section at the tail end of its releases? Possible answers to these questions may help provide clues as to how the line of cases leading up to *Business Roundtable* emerged, and may guide future agency and court responses, a topic we discuss in much greater depth in Part IV.

Was the purpose of SEC CBA was to inform the Commission of the costs and the benefits of various policy options under consideration? Perhaps. But SEC CBA consisted of a repetition of 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).[28]

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 the economists earlier in the rulemaking process suggest, however, that the advice of the economists may often have been sought too late in the process to influence policy.[29] Still, even 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. Perhaps partly due to a stylistic preference for including all policy arguments in the early sections of releases, SEC CBA appeared to merely rehash arguments already made, with a few PRA numbers was included. As a result, SEC CBA for many years was treated as a technical requirement, similar to PRA, Reg Flex[30] and SBREFA rather than a policy exercise.

Another possibility is that the inclusion of SEC CBA was a strategic maneuver with respect to the White House. In the early years of OIRA review, the White House and observers

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[28] 44 U.S.C. §§ 3501–3521 (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).

[29] *See, e.g.*, SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL, RULEMAKING PROCESS, (Jul. 12, 2002). *See also* Letter from Chairman Arthur Levitt Chairman, U.S. Sec. & Exch. Comm'n, to Senator Phil Gramm (April 22, 1997) (pledging that "The Commission as a whole shares your concern for meaningful economic analysis in its rulemakings, and it is our goal to make OEA a more integral part of the Commission's work" and promising "to ensure that the Commission's Office of Economic Analysis is consulted at an early stage of all regulatory initiatives."). For the most recent example at the time of this writing, *see* SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS vii (Jan. 27, 2012) ("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.").

[30] 5 U.S.C. §§ 601-612. This section includes amendments made in the Small Business Regulatory Enforcement Fairness Act (SBREFA), Pub. L. No. 104-121 (1996). According to a report of the CFTC's Inspector General, the corresponding sections of that agency's releases were colorfully referred internally to as the "caboose" of the release. [cite] That report, which inspired the flurry of Congressionally-instigated IG reports discussed *infra* note 139, view the term as indicative of the CFTC's viewing its own statutory economic analysis requirements as an afterthought, and not as part of the policy process.

considered both the propriety and legality of including independent agencies within the scope of Executive Order 12,911, the predecessor to EO 12,866.[31] Ultimately, the Executive Orders have exempted the independent agencies, but then-Vice President Bush followed up with a letter asking them to comply as though the Order applied to them.[32]

It may have seemed prudent at the time 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, what harm could it do?[33] The optics of such a section may have been thought to appease the SEC's congressional overseers as well. But once the practice was begun, those overseers asked subsequent SEC Chairmen whether they would continue SEC CBA, a question to which there was only one right answer, however redundant SEC CBA appeared to have been. Although the plea to Congress that "we do that already" failed in 1996 to deflect NSMIA's ECCF requirements,[34] separate SEC CBA and ECCF sections continued for about fifteen years thereafter.

B. *Timpinaro*: Professional Traders

Was SEC CBA included in releases because courts required it under the APA? Quite the opposite. 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 [35] that presaged elements of the jurisprudence that emerged from the ECCF statutes adopted later in the decade. *Timpinaro* 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."[36] At issue was SEC approval of NASD rules designed to prohibit professional traders from abusing SOES to make riskless trading profits at the expense of market makers.

In *Timpinaro*, Judge Ginsburg, himself a former OIRA Administrator and Assistant Attorney General for Antitrust, began by commending the SEC for proceeding in its analysis from a "sound theory of market behavior."[37] The SEC's "theory" was simply its observation that in the absence of a rule protecting them from being "picked off" through SOES by professional traders, some market makers would cease making markets. The SEC presumed that this reduced competition among market makers would widen spreads and impair market liquidity.

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[31] For a sense of this debate over time, see 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).

[32] For this history, see Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 592-93 (1984); Richard H. Pildes & Cass Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, at 15 (1995) (stating that "not one" of the independent agencies that were asked voluntarily to comply "formally acknowledged their willingness do to so."); BARRY D. FRIEDMAN, REGULATION IN THE REAGAN-BUSH ERA: THE ERUPTION OF PRESIDENTIAL INFLUENCE 78 (1995).

[33] *See supra* note 29 (noting that the "although 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.").

[34] *Supra* note 26.

[35] *Timpinaro*, 2 F.3d at 453. *Timpinaro* is not cited in the more recent cases discussed below, several of which were also written by Judge Ginsburg).

[36] *Id*. at 455 (quoting 56 Fed. Reg. 52,092 (Oct. 17, 1991)).

[37] *Id*. at 457.

The Court sided with petitioners in challenging the SEC to produce evidence of such withdrawals. More importantly, it required the SEC to balance the value of avoiding those costs against the lost "benefit" of the professional traders' activities, *viz*., 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.[38]

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 his approach, Judge Ginsburg concluded that the SEC had not adequately substantiated its reasoning and remanded the rule for further analysis of its benefits and costs.[39]

Timpinaro in retrospect appears as an unheeded wake-up call. Three years *before* Congress mandated consideration of efficiency, competition and capital formation, this case illustrates the tension between the protection of investors and the promotion of market pricing efficiency. SOES was designed 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 about the concerns for small investors and fairness to market makers that drove the rule in the first place. This aspect of the opinion was more anticipated not only the strong interpretations of the ECCF statutes that were soon to come, but also the stringent terms of FRRA, pending in Congress at the time of this writing, and discussed in Part III(B) below.

C. ECCF Statutes Enacted

The requirement to consider ECCF, in addition to investor protection, in rules adopted in the public interest entered the Securities Act, the Exchange Act and the Investment Company Act in 1996,[40] and the Investment Advisors Act in 1999.[41] What sort of consideration did ECCF

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[38] *Id*. at 457-58.

[39] *Id*. at 457-58 ("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.") (emphasis added).

[40] 15 U.S.C. § 77b(b) (Securities); 15 U.S.C.A. § 80a-2 (Investment Companies); 15 U.S.C.A. § 80b-2 (Independent Advisers Act) ("Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

[41] 15 U.S.C.A. § 80b-2 ("Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the

require? Congress did not define the terms "efficiency," "competition," and "capital formation." "Efficiency" has a plain and ordinary meaning: doing more with less.[42] Efficiency is also a fundamental concept in economic theory, which posits that efficient markets produce a Pareto-optimal allocation of resources.[43] Pareto efficiency under what is known as the Kaldor-Hicks criterion (which permits distributive effects to be ignored, and with a sole focus on societal net benefits overall) is the basis for most quantitative public policy analysis, including OIRA CBA.[44] Thus, consistent with its "we already do that" position, in 1996 the SEC could have complied with the new statute by bringing SEC CBA more in line with OIRA CBA's focus on economic efficiency, as it now is proposing to do under the 2012 Guidance.[45] Economic efficiency (and inefficiency) are attributes of markets, and a market is defined by its competitive structure, making consideration of competition part and parcel of any discussion of the efficiency of financial markets. Under such a framework, capital formation could be easily considered as well, where applicable.

Instead, SEC releases continued to include old-fashioned SEC CBA, and a new ECCF consideration section began to appear at the tail end of SEC releases, separated from SEC CBA by several other technical sections.[46] The ECCF consideration section rarely contained any new information; in fact, the ECCF consideration section in many proposing releases was no more than an invitation for public comment on "efficiency, competition and capital formation."[47] These terms remained undefined. As a result, the corresponding section in the adopting release was nothing more than a response to commenters, 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, insulated from public comment.[48] Ironically, the SEC continued to emphasize the voluntary SEC CBA section, while giving short shrift, and little thought, to the statutory ECCF consideration section under which its economic analysis would be challenged from that time forth. 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 the commenter du jour thought the terms meant. This may have seemed at the time to be the path of least resistance; a review of the ensuing case law reveals where that path led.

Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

[42] *See* MERRIAM-WEBSTER DICTIONARY (2012) (defining efficiency as "productive of desired effects; especially: productive without waste.").

[43] *See* ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 350, 549 (1995).

[44] *See* Richard A. Posner, *CBA: 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.").

[45] SECURITIES AND EXCHANGE COMMISSION, CURRENT GUIDANCE ON ECONOMIC ANALYSIS IN SEC RULEMAKINGS, Mar. 16, 2012, *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.shtml.

[46] *See, e.g.*, OTC Derivatives Dealers, 63 Fed. Reg. 59,362 (Nov. 3, 1998).

[47] *See, e.g.*, Registration under the Securities Act of 1933 of Certain Investment Company Securities, 62 Fed. Reg. 47,938, 47,948 (Sept. 10, 1997) (merely noting at the end of the cost-benefit analysis that "In addition, the amendments should have no adverse effects on efficiency, competition, or capital formation.").

[48] *See, e.g.*, *Chamber II*, 443 F.3d at 890.

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 include 75 percent independent members.[49] 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 Court, rejected.[50] The Court likewise rejected the Chamber's principal ECCF contentions, finding no cause to disturb the agency's judgment that one study submitted was unpersuasive, noting "the extreme degree of deference" owed to an agency "when it is evaluating scientific data within its technical expertise."[51] 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.[52] Backing off from his suggestion in *Timpinaro* that the SEC might be required to run its own regression analysis to support a rule simply because it can,[53] Judge Ginsburg wrote that he 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."[54]

The rule nonetheless fell. The Court found that the SEC's failure to assess a seemingly trivial cost violated its obligation to consider ECCF, and the rule was therefore set aside under the APA's judicial review provision.[55] Specifically, the release acknowledged that an independent chairman might require more staff, but confessed that the Commission "had no reliable basis for estimating those costs,"[56] and declined to address the costs of the 75 percent independent director condition, since it had offered companies three different ways to satisfy it. In effect, the SEC said, "we don't know how much, if anything, funds would spend on independent, vs. affiliated, directors and chairs, and it's obviously not worth the effort to find out." This was not enough for 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

[49] For an overview of the history and important insights, see Sherwin, *supra* note 167.
[50] *Chamber I*, 412 F.3d at 133.
[51] *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.").
[52] *Chamber I*, 412 F.3d at 142.
[53] *Supra* note 39.
[54] *Chamber I*, 412 F.3d at 142.
[55] 5 U.S.C. § 706 ("The 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 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).
[56] Investment Company Governance, Final Rule, 69 Fed. Reg. 46,378, 46,387 (Aug. 2, 2004).

will be imprecise.'"[57] *Chamber I* was the first case to interpret the ECCF consideration requirement as imposing an obligation to make quantitative determinations.[58]

The *Public Citizen* case, from which the above language is drawn, involved a different kind of statute, one directing the Federal Highway Administration to issue a notice of proposed rulemaking with several approaches to reduce the problem of truck driver fatigue, including the installation of "automated and tamper-proof recording devices."[59] The FHA declined to do so, citing the difficulty of assessment, a rationale the Court rejected.[60] But as Murphy has forcefully pointed out,[61] the issues involved in the two cases were different enough to make a dictum that sensible in one case unworkable in another. When Congress tells the agency to test automated, tamper-proof trip recorders in considering a particular rule, the court may legitimately hold that a rule that fails to test that kind of trip recorder is invalid. To do otherwise is legitimately viewed as a nullification by the Executive Branch of congressional prerogatives.[62] But when Congress tells the agency to "consider efficiency" when issuing rules, it is quite another thing for the court to void a rule in which the agency considered many aspects of efficiency on the ground that the agency did not determine how much mutual funds will spend to attract and retain independent, as opposed to affiliated directors. Unlike automated trip recorders, of which there were only one or two models on the market, "efficiency, competition, and capital formation," are broad, unbounded concepts, concepts that, in one or more of their many meanings, apply in many possible ways to all rulemakings. Proper "consideration" of ECCF 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 invalidated the rule, this time on the ground that the new data had not been placed on the record for public comment, *Chamber of Commerce v. SEC* (*Chamber II*).[63] In effect, the court ruled that the absence of notice and the opportunity to comment on the going rate for secretaries, chauffeurs,

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[57] *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).

[58] 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) that had been endorsed by two dissenting Commissioners. *See Chamber I* 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).

[59] Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1221 (D.C. Cir. 2004))

[60] *Id*. at 1211.

[61] Murphy, *supra* note 14, at 136-38.

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

[63] 443 F.3d at 894.

and professional staff had prejudiced the Chamber.[64] The court did not determine that the SEC had failed to consider important costs, instead focusing on the notice and comment issue. The SEC lost for failing to quantify, and then lost for quantifying with data not subjected to the notice and comment process. Following *Chamber II*, the SEC opened a comment file, through which it received overwhelming confirmation that it had been right all along: the costs involved were slim to none.[65] 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 derides a Commission observation as "unutterably mindless".[66]

Still, three aspects of *Chamber I* sowed seeds of future troubles. First, its emphasis on the alternative proposed by two Commissioners and the SEC CBA's failure to address it could not help but send a message to future Commissioners about the power of their statements at open meetings, particularly statements in dissent,[67] an important message, given the widely acknowledged increase in partisan polarization in Washington in recent years.[68] The Exchange Act gave 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) gave an outvoted member, if not a veto, the ability to subject the rule to a more exacting standard of review. The Open Meeting Statements that triggered the scrutiny in question come too late in the adoption process to be addressed or rebutted by either the majority or the staff. This significantly diminishes the power the Exchange Act vested in the three Commissioners who may be members of the President's party, or in any three Commissioners whose votes might carry a rule.

Second, it 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,[69] the re-opened comment file shows 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

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[64] *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.").
[65] *See* Murphy, *supra* note 14 at 139-140.
[66] *Business Roundtable*, 647 F.3d at 1156.
[67] In particular, 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,*") (citations omitted) (emphasis added).
[68] 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.").
[69] Murphy, *supra* note 14.

sound empirics will survive agency regime change.[70] We assume no bad faith or blind partisanship, only that new management will naturally have priorities and agendas of its own, that 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 court, based on it intimate knowledge of the financial markets and their problems and of its own data resources and analytic capabilities, to identify the point of diminished returns to further economic analysis, and to set rational boundaries around it. Without judicial deference to this key determination, any SEC regulation will be subject to remanded to consider "just this one more thing."

Third, and perhaps most importantly, *Chamber I* subtly elevated the mild statutory mandate for the SEC to "consider" efficiency, competition and capital formation into and an independent obligation to *determine* (as best it can) the economic consequences of proposed rules.[71] As Murphy has insightfully noted,[72] the ECCF provisions could have been interpreted as a purely procedural (rather than substantive) requirement like the Regulatory Flexibility Act, subject to a reasonableness standard. Under this interpretation, the SEC would have satisfied its obligation merely by making a reasonable effort to address each of the required ECCF elements. Instead, the Court construed the ECCF requirement as imposing a substantive requirement to make determinations of particular facts. What facts it is required to determine are revealed, under this system, only in the appellate court opinion.

Surprisingly, the specific "economic consequences" the Court required the SEC to chase down were not big-picture micro or macro-economic considerations, but relatively minor, particular costs.[73] The focus on minor direct 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 costs and benefits described. Instead of building a top-down overview of the rule's effects from an economic standpoint, delineating the anticipated first order and second order effects of proposed rule, SEC CBA often appeared to be built on from the bottom up, using 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 neglect the much larger benefits (and costs). Similarly, the FRRA requires multiple determinations of positive net impact on each of a variety of quantifiable factors (as opposed to mere consideration of the rules overall impact).

Under Chairman Cox, whatever the internal reaction to the *Chamber* cases may have been, the SEC made no public statements about the *Chamber* cases nor published any new rule writing guidance or formal interpretations of the ECCF consideration provision. The those cases may, however explain the remarkable increase in length of SEC CBA and ECCF consideration sections of SEC releases following these decisions. The economic analysis began to include

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[70] Romano, *infra* note 207.
[71] *Chamber I*, 412 F.3d at 143.
[72] Murphy, *supra* note 14, at 129-30.
[73] *Id*.

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.[74]

E. *American Equity*: Fixed Index Annuities

In 2009, the SEC decided that fixed indexed annuities (FIAs) with issued by state-regulated insurance companies should be deemed securities, if the component of the investment tied to stock market indexes dominated to annuity component backed by the insurance company's balance sheet.[75] That determination would require sellers of these products to be registered 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, mainly on statutory authority grounds. 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.[76] But once again, the ECCF consideration challenge 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.[77]

Chief Judge Sentelle, writing for a panel that included Judge Ginsburg, remanded the indexed annuity rule, finding the SEC's competition analysis wanting for lack of any finding as to baseline levels of competition and efficiency under the state law regime – in other words, failing to find whether the state law regime contained sufficient protections for investors to make informed decisions and sellers to make suitable recommendations.[78] 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, in which specifying a baseline is step one. OIRA CBA then compares the current state of affairs absent the rule with the state of affairs anticipated following the adoption of the rule.[79]

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. An antitrust analysis of competition and of the "baseline level of

[74] For examples and a discussion of such efforts, see GOVERNMENT ACCOUNTABILITY OFFICE, DODD FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION (2011).
[75] Indexed Annuities And Certain Other Insurance Contracts, 74 Fed. Reg. 3138 (Jan. 16, 2009).
[76] *Am. Equity*, 572 F.3d at 173-74.
[77] A subsequent case, NetCoalition v. SEC, 615 F.3d 525 (D.C. Cir. 2010), could easily be added to the list. 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.
[78] *Id*. at 167-68.
[79] OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR A-4 2-3 (Sept. 17, 2003).

price transparency and information disclosure under state law" in a single market is no small task, and a 50-state survey correspondingly greater. 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, taxed the agency's resources, and contributed to its failure to respond quickly. In any case, the emphasis on the interaction of the rule with the existing state law regime, and the mandate to determine a baseline competitive structure for the market appear to presage analogous provisions of FFRA, as we shall see.

Before the SEC could promulgate a rule containing the required analysis, Congress passed the Dodd-Frank Act, which stripped the SEC of authority to regulate FIAs, mooting the issue.[80] The 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 SEC simply wasn't listening to the Court, a misimpression which in turn could have influenced the tone of the *Business Roundtable* decision, discussed below.

PART 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.[81] In the meantime, regulations 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, relegating challengers to provide proxy materials of their own.[82] No single ballot listed all candidates; instead, shareholders were urged in separate mailings to sign and return either one proxy card or the other. Modern electronic proxies work similarly.[83]

Proxy access proceeds from a notion that annual meeting 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.

[80] 15 U.S.C. § 7262.
[81] 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), *available at* http://epubs.utah.edu/index.php/ulr/article/view/134/116
[82] 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).
[83] *Id*.

Public companies typically welcome proxy access proposals about as warmly as American patriots welcomed George III's proposals for quartering his Redcoats in their homes.[84] The vehemence of their opposition far exceeded the modest cost savings the provisions would have provided to nominating shareholders.[85] The SEC itself noted that the $18,000 savings involved in a hypothetically typical contest was not, in and of itself, "significant enough to drive the behavior of shareholders in large public companies," and attributed the increase in contests predicted by the Business Roundtable and others to a less readily quantifiable source.[86] The SEC may have put its finger on the dynamic underlying issuer opposition when it noted that having shareholder's "director nominees included in the company's proxy materials—as opposed to being included in its own proxy materials—pursuant to the new rules may be . . . a significant improvement in its ability to have its nominees evaluated by shareholders in the same matter as they evaluate management's nominees."[87]

As proposed in 2007,[88] proxy access entailed substantial limitations, which, although they failed to mollify the rule's opponents, sharply curtailed the rule's applicability. Few shareholders were empowered to submit nominees, and even then, not for the purpose of changing control of the company.

B. The Comment Period

The 2009 proxy access rule was more ambitious, necessitating significant staff work on the SEC CBA. The SEC CBA in the 2009 Proposing Release runs twenty-three pages, and reasons that incumbent directors, faced with proxy access, should be expected to work harder and improve company performance. The SEC CBA stated the Commission's expectation of improved company performance once some directors were replaced, and also anticipated improved performance even where incumbents were not challenged, much less replaced, to the extent that the prospect of removal (accountability) improves performance. The footnotes to this section cited more than two-dozen papers from leading journals, including the American Economic Review, Journal of Finance, and the Journal of Accounting Research.[89] The cited

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[84] *See* U.S. CONST. Amdt. 3.
[85] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,756.
[86] *Id*. at 56,756.
[87] *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.
[88] The current round of proxy access proposals actually began in 2003. *See* Security Holder Director Nominations, 68 Fed. Reg. 60,784 (October 14, 2003); Shareholder Proposals, 72 Fed. Reg. 43,466 (July 27, 2007); Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 43,488 (July 27, 2007); *Shareholder Proposals Relating to the Election of Directors,* 72 Fed. Reg. 70,450 (December 6, 2007).
[89] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,753-71 (*citing* Lisa Borstadt & Thomas Zwirlein, *The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance,* FIN. MGM'T (1992); Jerry Goodstein *et al., The Effects of Board Size and Diversity on Strategic Change,* 15 Strategic Mgmt. J. 241 (1994); James F. Cotter, Anil Shivdasani, & Marc Zenner, *Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?,* J. FIN. ECON. (February 1997); Benjamin E. Hermalin and Michael S. Weisbach, *Endogenously Chosen Board of Directors and Their Monitoring of the Board,* 88 AM. ECON. REV. 96 (1998); Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors,* 76 Tulane L. Rev. 1363 (2002)); Stephen M. Bainbridge, *A Comment on the SEC Shareholder Access Proposal* (Nov. 14, 2003) at 17, *available at http://ssrn.com/abstract=470121*; Marco Becht, Patrick Bolton

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.[90]

The SEC CBA explored the contrary view as well, citing comment letters from the 2003 and 2007 proposals (including comments of both the Business Roundtable and the Chamber), which pointed to the possibility of proxy access nominations distracting the board from more important responsibilities, taking costly actions to mollify dissidents that do not improve shareholder value, and the creating possibility of polarization and disruption in boardroom dynamics that impair, rather than enhance, board decision making.[91] 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.[92]

& Ailsa Roell, *Corporate Governance and Control,* Handbook of the Economics of Finance (2003); Paul Gompers, Joy Ishii, & Andrew Metrick, *Corporate Governance and Equity Prices,* 118 Q.J. ECON. 107 (2003); Nathan Cummings Foundation (noting the study by B. Lawrence Brown & Marcus Caylor, *The Correlation Between Corporate Governance and Company Performance,* Research Commissioned Institutional Shareholder Services (2004); Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards,* J. FIN. ECON. (Nov. 2005); 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'' (Nov. 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=890321*;* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise,* 93 *Va. L. Rev.* 675, 683 (2007); Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment,* J. FIN. ECON. (February 2007); Lynn A. Stout, *The Mythical Benefit of Shareholder Control,* 93 VA. L. REV. 789, 789 (2007); J.W. Verret, *Pandora's Ballot Box, Or a Proxy with Moxie? Majority Voting, Corporate Ballot Access, and the Legend of Martin Lipton Re-Examined,* 62 BUS. LAW. 1007, 1014 (2007); Re-Jin Guo, Timothy A. Kruse & Tom Nohel, *Undoing the Powerful Anti-Takeover Force of Staggered Boards,* J. Corp. Fin. (June 2008); Milton Harris and Artur Raviv, *Control of Corporate Decisions: Shareholders vs. Management* (May 29, 2008), *available at http://papers.ssrn.com/ sol3/papers.cfm?abstract_id=965559*; 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. 476, 488 (2008); 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); Ali C. Akyol, Wei Fen Lim and Patrick Verwijmeren, *Shareholders in the Boardroom: Wealth Effects of the SEC's Rule to Facilitate Director Nominations* (December 14, 2009); Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?,* 22 REV. FIN. STUDS. 783 (2009); Andrea Beltratti & Rene´ M. Stulz, *Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation* (July 2009); Bonnie Buchanan, Jeffry M. Netter, and Tina Yang, *Proxy Rules and Proxy Practice: An Empirical Study of US and UK Shareholder Proposals* (Sept. 2009); Chris Cernich, *et al., Effectiveness of Hybrid Boards*, IRRC INSTITUTE FOR CORPORATE RESPONSIBILITY (May 2009), *available at http://www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf*; Beth Young, *The Limits of Private Ordering: Restrictions on Shareholders' Ability to Initiate Governance Change and Distortions of the Shareholder Voting Process*, THE CORPORATE LIBRARY (Nov. 2009), *available at http://www.sec.gov/ comments/s7-10-09/s71009-568.pdf*; Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate,* 65 BUS. LAW. 329 (2010); Cheffins (2010), *Did Corporate Governance ''Fail'' During the 2008 Stock Market Meltdown? The Case of the S&P 500* ; David F. Larcker, Gaizka Ormazabal & Daniel J. Taylor, *The Regulation of Corporate Governance* (Jan. 16, 2010)).

[90] *Id*. at 56,761.

[91] *Id*. at 56,753-76.

[92] *Id*. at 56,766.

The Business Roundtable and the U.S. Chamber of Commerce mounted a highly professional joint attack on the proposal, retaining the same counsel who 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 attached (NERA Report).[93] 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.[94] The Business Roundtable's comment letter argued that, far from enhancing shareholder value, proxy access would in fact reduce it.[95] The Business Roundtable's NERA Report claimed that "Companies with dissident board members substantially *underperform* compared to their peers", citing a study by Ikenberry, which we discuss in greater detail below.[96]

In 2010, after receiving and reviewing the Business Roundtable's comment letter, along with approximately 600 others,[97] the SEC decided to further raise the thresholds to 3 percent ownership for at least three years. This substantially reduced the number of proxy-accessible companies.[98] To ensure that the public had notice of the material facts the SEC relied upon, several weeks before the rule was adopted, the SEC put on the public record 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.[99]

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 new members entering the club who had not been properly introduced through current members.[100] The agency recognized that important stakeholders, including two dissenting commissioners, disagreed with this prediction and discussed these critiques.[101] The Adopting Release included a lengthy discussion of the potential adverse effects on board performance,[102] and the costs related to additional complexity in the proxy process. The cost discussion went on to recap the out-of-pocket costs involved, noting

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[93] REPORT ON EFFECTS OF PROPOSED SEC RULE 14A–11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION, IN SUPPORT OF COMMENTS BY BUSINESS ROUNDTABLE, NERA ECONOMIC CONSULTING (2010).
[94] *Id*. at 24-44.
[95] *Id*. at 99-101
[96] David Ikenberry & Josef Lakonishok, *Corporate Governance through the Proxy Contest. Evidence and Implications*, 66 J. BUS. 420 (1993) (emphasis added);
[97] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,669.
[98] *Id*. at 56,774.
[99] *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.").
[100] *Id.* at 56,753-71.
[101] Statement of Commissioner Kathleen Casey, August 25, 2010 ("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.").
[102] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762; 56,772-75.

repeatedly that its numerical estimates, including the frequency of election contests, had been made "for purposes of the PRA analysis" only.[103]

The SEC CBA in the Adopting Release 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.[104] The SEC CBA noted, as pointed out by another study that NERA and the Court both cited and attempted to distinguish,[105] that the Ikenberry performance data cited in the NERA Report were necessarily 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.[106] 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."[107]

The SEC adopted the proxy access rule on August 25, 2010 by a vote of 3-2. Despite the express grant of statutory authority, one of the dissenting commissioners expressed her (prescient) belief at the Open Meeting that "that the rule is so fundamentally and fatally flawed that it will have great difficulty surviving judicial scrutiny."[108]

C. Briefing and Oral Argument

The Business Roundtable quickly filed its challenge petition along with a motion for a stay. On October 4, 2010, the SEC consented to the stay the rule's effective date pending the judgment of the Court.[109] The Business Roundtable brief opened its argument with the assertion that:

> "The Commission admitted that the Rules could have significant adverse consequences for American businesses, including 'management distraction and discord on the board' of directors . . . and less board time spend on 'long-term thinking and overseeing management, which, in turn, may negatively affect shareholder value.'"[110]

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[103] *Id*. at 56,764-71.
[104] For a discussion of the studies, see *id*. at 56,755-76.
[105] J. Harold Mulherin & Annette B. Poulsen, *Proxy Contests and Corporate Change: Implications for Shareholder Wealth*, 47 J. OF FIN. ECON. 279 (1998).
[106] Ikenberry & Lakonishok, *supra* note 96 at 408 ("Companies not followed by Compustat were removed from the sample.").
[107] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,762 (citing MARCO BECHT, PATRICK BOLTON & AILSA ROELL, CORPORATE GOVERNANCE AND CONTROL, HANDBOOK OF THE ECONOMICS OF FINANCE (2003)).
[108] Statement of Commissioner Kathleen Casey, August 25, 2010
[109] Notice of Stay of Effective and Compliance Dates, 75 Fed. Reg. 64,641 (October 20, 2010).
[110] Brief of the Business Roundtable and Chamber of Commerce at 32, *Business Roundtable*, 647 F.3d 1144 (No. 10-1305) (quoting Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,761). The SEC had

In a footnote, the Business Roundtable brief cited its 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.[111] The Business Roundtable did not otherwise mention the empirical studies. It did not question SEC's treatment of the studies anywhere in the brief. It did not argue that the studies constituted a ground for invalidating the rule.[112]

Following this backhanded compliment to the objectivity of the SEC CBA, the Business Roundtable brief made its economic argument in four parts, arguing that the SEC: (a) attributed the rules' costs to state law, (b) underestimated of the frequency of election and failed to estimate their costs, (c) failed to address union and government pension plans, and (d) assumed that in some cases companies would not actively oppose access candidates.

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."

D. The Opinion of the Court

In July, 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. Although the petitioners had effectively abandoned any argument about the empirical studies on appeal, Judge Ginsburg reached back (although, as we shall see, not very far) into portions of the record to resurrect this issue as a centerpiece of the opinion.[113] Neglecting the "extreme degree of deference" courts owe to expert

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acknowledged this possibility in the Proposing Release as well, viewing it as an important empirical question, with no clear answer from the empirical literature.

[111] The footnote allowed that the Adopting Release "quibbled" with the "methodology and conclusions of certain of these studies." *See id*. at 32 note 4.

[112] *Id*.

[113] *See also* J. Robert Brown Jr., *The SEC and Non-Cost Benefit Analysis*, The Race to the Bottom.org Blog Post, Apr. 23, 2012, *available at* http://www.theracetothebottom.org/home/the-sec-and-the-non-cost-benefit-analysis-

agency interpretations of scientific data,[114] the opinion rejected the SEC's assessment of the empirical evidence, holding that:

> In view of the admittedly (and at best) 'mixed' empirical evidence, [Fed. Reg.] at 56,761/1, 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.[115]

The opinion summarily[116] dismissed the SEC's extensive review of the empirical evidence.[117] 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%."[118] The opinion failed to inform readers of the opinion that the "commenter" in question was none other than petitioner Business Roundtable itself, inaccurately referring to the NERA Report as an "empirical study" without noting that NERA was the Business Roundtable's paid consultant.[119] The striking 40 percent figure is from the Ikenberry/Lakonishok study, which is cited in the NERA Report, but not directly by the opinion.

Does it matter that the opinion mistook the NERA Report for an empirical study it cited, or should our observation be dismissed as more quibbling? We note first that readers of the opinion are entitled 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 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."[120]

In sum, it appears that the petitioners' experts came across an alarming figure in an academic study—a 40% decline in shareholder value associated with dissent members on boards. They then interpreted this statistic as demonstrating a causation relationship that the study's own

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analysis-part-1.html ("whatever 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.") (internal citations omitted).

[114] *Chamber I*, 412 F.3d at 142.

[115] *Id*.

[116] *See* Hayden & Bodie, *supra* note 14 at 25 (the court's own analysis of the empirical data is extremely cursory, particularly in contrast to that of the Commission.").

[117] *Supra* note 99.

[118] *Business Roundtable*, 647 F.3d at 1151.

[119] *Id*.

[120] Ikenberry & Lakonishok, *supra* note 96.

authors, in the conclusions section of the same paper, rejected as implausible. Undeterred, they and their clients conflated correlation and causation into a headline point in their litigation (proxy fights reduce shareholder value by 40%!) The Court accepted petitioners' factoid uncritically, all the while accusing the SEC of paying inadequate attention to the empirical work before it, and of slipshod economic analysis in general.[121]

As Hayden and Bowdie demonstrate, the Court's treatment of the rest of the economic evidence no more rigorous or persuasive. The opinion accuses the SEC of simultaneously "discounting" contrary findings "completely" and of "admit[ting]" that the evidence is "'mixed.'"[122],"[123] without explaining why the SEC was wrong in doing to, or why it found two contrary studies "relatively unpersuasive," beyond citing concerns the SEC itself expressed about one of them.[124]

Similarly, on the issue of the cost to oppose unqualified nominees, the Court demanded that the SEC make its own estimate, repeating the *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.[125] The approach the SEC actually took in the Adopting Release—discounting the cost claims of commenters, observing that some proxy access nominees would be deemed qualified and not actively opposed—was curtly dismissed as "mere speculation."[126] Yet such an assumption appears to be precisely the sort of "informed conjecture" the SEC was "entitled" to make under *Chamber I*.[127] It was also correct, as every 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 board "[g]auge whether the best outcome is to *agree upon board representation* and/or strategic business change in order to avoid a proxy fight."[128] (emphasis supplied)

As between an agency that deals actively with every proxy fight there is, and a generalist court of appeals specialized in, if anything, administrative law, it should be unsurprising who held greater expertise. Although the Court also invalidated the rule on other grounds, it was

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[121] *See* Hayden & Bodie, *supra* note 14 at 25-27.
[122] *Id*.
[123] Referring, apparently to the studies cited in the NERA Report, the opinion accuses 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.
[124] *Id*.
[125] *Id.* at 1150.
[126] *See* Brown, *supra* note 14 (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).
[127] *Chamber I*, 412 F.3d at 142.
[128] Martin Lipton, *Dealing With Activist Hedge Funds*, The Harvard Law School Forum on Corporate Governance and Financial Regulation (Aug. 9, 2012), *available at* http://blogs.law.harvard.edu/corpgov/2012/08/09/dealing-with-activist-hedge-funds. Lipton's post also offer support for the SEC's premise that a formerly complacent board may be expected to react to a the mere threat of a disturbance to its comfortable incumbency but taking action to increase shareholder value, recommending that boards "Proactively address reasons for any shortfall versus peer company benchmarks; anticipate key questions and challenges from analysts and activists, and be prepared with answers" and "Review with the board 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".

prepared to do so solely for want of a citation to an obvious proposition squarely within the agency's areas of expertise.

We do not argue that the proxy access adopting release was a perfect work of art, or that all of the Court's other criticisms of it were wholly unfounded. For example, where 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"[129] it may have had a point. The release repeated its attribution of costs to state law *ad nauseum*, in a way that detracted from the persuasiveness of its presentation. While the SEC did quote and consider commenters' proxy fight cost estimates, its failure to make its own cost estimates is puzzling, given the accessibility of such data. Similarly, the release appeared tone-deaf to the differing situation of mutual fund cluster boards under the rules, a minor aspect of proxy access the opinion explored at great length.[130]

At the heart of its holdings concerning the SEC's economic analysis, the *Business Roundtable* Court did not expressly announce a new standard of review. The rule was vacated on "admittedly (at best) mixed empirical evidence,"[131] evidence that evidently failed to convince the Court. If unclear, unconvincing evidence fails the test, perhaps we may infer a standard requiring the SEC to present "clear and convincing" evidence, an unprecedented and heavy burden of proof. [132] This standard does not fit onto the familiar hierarchy of judicial deference regimes.[133] No precedent is cited for what level of support is required to support such a conclusion; the Court did not even cite—much less distinguish—the *Cablevision* and *Rural Cellular* decisions cited by the SEC for the proposition that agencies may rely on their expertise in evaluating contradictory and murky empirical evidence to make predictive judgments. The Court appears to have afforded the agency the opposite of deference, imposing instead an unspecified burden of proof. As such, the decision represents a striking departure from the measured and balanced tone of *Chamber I*, and, if taken at face value, its strictures cast doubt upon the SEC's ability to enact rules in the future that will withstand challenge based on economic analysis. In this, it prefigured legislation now pending in Congress,[134] as discussed below.

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[129] *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.
[130] *Business Roundtable*, 647 F.3d at 1154.
[131] *Business Roundtable*, 647 F.3d at 1151.
[132] Murphy, *supra* note 14; Cox & Baucom, *supra* note 14 and Better Markets, *supra* note 14 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 ("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.")
[133] Murphy, *supra* note 14; 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).
[134] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. § 8(e) (2011).

PART III: LEGISLATIVE RESPONSES[135]

A. Testimony and Inspector General Reports

Like the mutual fund governance rule before it,[136] the *Business Roundtable* decision provoked a prompt response from Congress.[137] SEC Chairman Mary Schapiro was immediately called to the Hill to explain to the House Oversight Committee what she planned to do to correct the inadequacies in economic analysis noted in the opinion,[138] and the minority members of the Senate Banking Committee requested the inspectors general of the SEC and seven other federal financial regulators to conduct investigations and report back in a matter of weeks.[139] The SEC's inspector general elected to conduct a subsequent, more detailed investigation, and issued a second, more in-depth report several months later.[140]

Thanks to internal staff efforts begun years earlier, following the *Chamber* cases, and revived and accelerated with the *American Equity* remand, the SEC was not caught flat-footed by these congressional demands. As noted in the in the reports of the SEC inspector general on SEC economic analysis of rulemaking, led by a leading academic financial economist, Pete Kyle (Kyle Report), the SEC was already making efforts to involve its economists more deeply in the rule writing process, had begun to develop a theoretical framework for economic analysis of rules, and was experimenting with combining the SEC CBA and ECCF consideration sections.[141] A key recommendation of the Kyle Report ran counter to a 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.[142]

B. A Bill to Codify *Business Roundtable*

Shortly after the inspector general reports, Senator Richard Shelby introduced FRRA,[143] an interesting bill focused, like the *Business Roundtable* decision and its predecessors, on the

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[135] *Id.*
[136] *See* Sherwin, *supra* note 167, at 27-29.
[137] The case attracted attention on Capitol Hill. *See, e.g.*, CONGRESSIONAL RESEARCH SERVICE, COST-BENEFIT ANALYSIS AND OTHER REQUIREMENTS IN THE RULEMAKING PROCESS 18 (2011); ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, REGULATORY ANALYSIS REQUIREMENTS 32 (2012).
[138] *See, e.g.*, Letter from Darrell E. Issa, Chairman, U.S. H.R. Comm. on Oversight & Gov't Reform, to Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n (Apr. 29, 2011).
[139] *See 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").
[140] *Id.*
[141] *Id*.
[142] *Id*. at 12-15.
[143] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. (2011).

importance of economic analysis of financial regulations.[144] FFRA is specific to financial-regulators, shares the goals of other bills in Congress such as the Regulations from the Executive in Need of Scrutiny (REINS) Act,[145] which would suspend the effectiveness of major agency rules pending approval by a joint resolution of Congress to the Independent Agency Regulatory Analysis Act (IARAA),[146] which would authorize an Executive Order subjecting independent regulatory agencies' cost-benefit analysis to OIRA. We view FRRA, in addition, as a codification of an expansive reading of the *Business Roundtable* decision and its precedents.[147]

FRRA 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 that the *quantified* benefits of the regulation exceed its *quantified* costs.[148] FRRA's rules for performing the analysis reflect an acute sensitivity to costs, and a profound skepticism about benefits.[149]

Other 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.[150] In this, FRRA resembles the REINS Act, introduced in the House, which would not permit any major rule having an economic impact of $100 million or more to come into effect

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[144] *See, e.g.*, John Kemp, *The Trojan Horse of Cost Benefit Analysis*, REUTERS, Jan 3, 2012 (noting that language in a WALL STREET JOURNAL editorial echoing language in the FFRA 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.").

[145] Regulations From the Executive in Need of Scrutiny Act, H.R. 10, 112th Cong. (2011). Like the FRRA, this bill would subject agency regulations to congressional approval.

[146] 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 record of agency action" in connection with judicial review, thus effectively reversing the exemption from judicial review central to traditional 12,866 Executive Orders. 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.

[147] 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. (2012) (statement of Henry G. Manne) (advocating that the ECCF "be strengthened and made escape-proof by confirming Congressional action."). [A] bill[s] introduced by Senator Shelby in previous sessions foreshadowed Business Roundtable as much as FFRA would codify it.

[148] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. § 3(b)(4)(A) (2011) ("an agency may not publish a notice of final rulemaking if the agency . . . determines that the quantified costs are greater than the quantified benefits").

[149] *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").

[150] *Id*. § 3(b)(4)(C).

absent a joint resolution of Congress. This exultation of the quantitative over the qualitative echoes *Timpinaro*.[151]

FRRA takes valid, but patently unattainable ideals of CBA analysis and requires them by law as a predicate to regulation. Here are just a few of the twelve required findings[152]:

- "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."

Implicit in these ideals is the notion that absent the omniscience required to attain them, society is better off unregulated.[153] The proponents of this legislation know full well that "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."[154] They are equally aware of the

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[151] *Timpinaro*, 2 F.3d at 453.
[152] For the full list, see S.1615 at § 3(a).
[153] This result would not necessarily dismay legal scholars who consider many regulations presumptively ill advised. *See, e.g.*, Manne*, supra* note 147, and Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC* at Sixty, 15 CARDOZO L. REV. 909 (1994);
[154] KARL POPPER, THE LOGIC OF SCIENTIFIC DISCOVERY (1934).

limitations of human cognition in general[155] and federal agency resources in particular, which they control tightly.

They know, therefore, that these requirements are impossible to satisfy completely. FRRA thus virtually guarantees the success of the litigation it contemplates, unless the judge is convinced of the rule's necessity by clear and convincing evidence, because the analysis it requires is unbounded. What human effort could ever describe "all" anticipated direct and indirect costs and benefits, much less "all available alternatives"? Moreover, FRRA gives these requirements sharp teeth: for one year after a rule becomes effective (either directly or after a congressional waiver) "a person that is adversely affected or aggrieved by the regulation is entitled to bring an action" in the D.C. Circuit.[156] If the court finds that these requirements have not been met, it is *required* to vacate the regulation under the standard implicit in *Business Roundtable*, "unless the agency shows by clear and convincing evidence that vacating the regulation would result in irreparable harm."[157]

Senator Shelby has made it clear that he will advance this bill if he becomes Senate Banking Committee Chairman once again.[158] Yet, as noted above, the *Business Roundtable* decision has already moved the status quo reasonably close to this state of affairs contemplated by FRRA in several respects. Now that the statutory requirement to "consider" whether an action will promote efficiency has become an extremely demanding analytic requirement under *Business Roundtable* to "determine" those economic effects of the rule, those economic effects may be interpreted in future cases to include all of FRRA's elements. The case law already requires a thoughtful response to all major comments,[159] and under some cases rules with multiple rationales fall if the court disagrees with any one of them.[160] *Chamber I* mandated an analysis of alternative approaches, while *American Equity* called for an assessment of both the

[155] For an overview of bounded rationality, see DANIEL KAHNEMAN, THINKING FAST AND SLOW (2012); Christine Jolls, Cass Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); JAMES G. MARCH, A PRIMER ON DECISION MAKING: HOW DECISIONS HAPPEN (1994); and Herbert Simon, *Bounded Rationality and Organizational Learning*, 2 ORG. SCI. 125 (1991).
[156] Financial Regulatory Responsibility Act of 2011, S.1615, 112th Cong. § 8(a) (2011).
[157] *Id*. § 8(c).
[158] Shelby proposed 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 Pursue 'Real' Reform If Republicans Regain Control of Senate*, BUREAU OF NATIONAL AFFAIRS, July 29, 2012.
[159] *See, e.g.*, Indep. U.S. Tanker Owners Comm. v. Lewis, 690 F.2d 908, 919 (D.C. Cir. 1982) (invalidating a rule for failing to respond adequately to comments); Advocates for Hwy. & Auto Safety v. Fed. Hwy. Admin., 28 F.3d 1288, 1292 (D.C. Cir. 1994).
[160] *See* National 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. Co-Op, 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.").

pre-existing regulatory regime and the baseline competitive structure. If assertions expressed by commenters about adverse indirect effects and alternatives and the other factors noted above are accorded the same benefit of the doubt as the Business Roundtable's comments recently were, judicial review post-*Business Roundtable* could come to resemble a challenge under FRRA.

PART IV: THE SEC RESPONSE

The SEC has work to do if its economic analyses are to become as meaningful as those of many of the executive agencies subject to Executive Order 12,866,[161] which charges executive agencies with "adopt[ing] a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs,"[162] "bas[ing] [] decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation,"[163] and "tailor[ing] its regulations to impose the least burden on society."[164]

Moreover, many 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.[165] That body of work, however, does not map cleanly onto the financial regulatory landscape,[166] a topic we discuss in greater detail below. Most financial regulators are exempt under Executive Order 12,866 and have not had the benefit of decades of experience with CBA.[167] They therefore need to begin this work afresh, likewise informed by scholarship, and perhaps by informal interactions with OMB's Office of Information and Regulatory Affairs (OIRA) itself, to build the foundations of their own economic analysis requirements. This section discusses how the SEC should go about this major task.

A. No Appeal

Despite the flaws in the D.C. Circuit opinion, the SEC chose not to seek a re-hearing *en banc* in the proxy access case.[168] The SEC did not explain its decision publicly. Perhaps the SEC was concerned with the difficulty of appealing an implicit standard of review, as opposed to an express departure from precedent. Moreover, given the large number of vacancies on the D.C.

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[161] EXEC ORDER NO. 12,886, 3 C.F.R. 638 (1993).
[162] *Id*. § 1(b)(6).
[163] *Id*. § 1(b)(7).
[164] *Id*. § 1(b)(11).
[165] *See* Michael A. Livermore, *Cause or Cure? Cost-benefit Analysis and Regulatory Gridlock*, 17 N.Y.U. L.J. 107 (2008) (describing the areas in which CBA is most commonly practiced).
[166] 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).
[167] 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, 4 (2006).
[168] Statement by SEC Chairman Mary Schapiro on Proxy Access Litigation, Sept. 6, 2011, *available at* http://www.sec.gov/news/press/2011/2011-179.htm.

Circuit at the time, the vote of five out of six of the then-active judges who were not themselves members of the *Business Roundtable* panel would have been necessary to grant the rehearing. Finally, as noted above, the opinion found a number of flaws in the complex release, each of which would have required a persuasive refutation in a single short petition, and not all of which were as simple to dispute as the opinion's mishandling of the empirical economics. A petition for *certiorari* might have seemed equally futile. Perhaps the Solicitor General signaled an unwillingness to proceed. As is sometimes the case with respect to administrative law issues, there was no conflict between circuits because all cases were heard in the D.C. Circuit. As noted above, the D.C. Circuit cases involved purported to be following the hallowed "arbitrary and capricious" standard,[169] depriving the SEC of a major doctrinal issue to attract the interest of the Supreme Court.

But this decision has left the SEC and other independent financial regulators in a tough spot, as far as future rulemaking is concerned, especially with dozens of rules mandated by Dodd-Frank in the works. The SEC therefore faces a significant analytic burden. This burden may not be theoretically possible to meet, even absent resource constraints.[170] The SEC and CFTC are required by law to regulate new markets, notably the notoriously opaque derivatives markets, where data are scare largely because there has been no regulation before. This burden is compounded by the fact that the agencies find themselves faced at the time of this writing with small budget increases from a Congress that would never have passed Dodd-Frank to begin with.[171]

B. The Economics Department of the SEC

Despite a history of prominent senior SEC staff economists dating back to 1935,[172] the Commission has never held itself out as having expertise in economics. Unlike generalist judges

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[169] 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. . . [w]e will uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned."); Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 414 (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.").
[170] 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 NEWS (Mar. 8, 2012) (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).
[171] *See, e.g.*, Sarah Lynch, *House GOP Seek to Slash CFTC Budget by $25 mln*, REUTERS NEWS (June 5, 2012).
[172] SECURITIES AND EXCHANGE COMMISSION, TELEPHONE DIRECTORY, July 1, 1935, posted in the Virtual Museum and Archive of the History of Financial Regulation of the SEC Historical Society (wws.sechistorical.org), *available at*
http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1935_07_01_SEC_Telephone_Dir.pdf. 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 a many different names over the years, including the Office of Policy Research, the

on the D.C. Circuit, the SEC's Division of Risk, Strategy, and Financial Innovation harbors a veritable faculty of financial economists, with twenty-three members of its well-published staff dedicated to rulemaking support—many of them on leave from professorships at major universities—is in a position to claim true expertise in the discipline. Commanding judicial deference begins with asserting expertise,[173] 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. In any event, after *Timpinaro*, the SEC did not begin to doubt its expertise in economics.

The SEC began implementing significant changes in the wake of the *Business Roundtable* decision. The artificial separation of SEC CBA and ECCF consideration was finally abandoned beginning with the Municipal Advisors Registration Release.[174] While this change may appear to be a minor detail, it was later recognized and endorsed in the Kyle Report.[175] Releases under this new format contained a single Economic Analysis section, subsuming the old CBA and ECCF consideration sections, and those integrated sections began to track more closely the format of OIRA CBA: they began with a statement of the problem being addressed, a baseline describing the existing situation, and an assessment of 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, promising a concerted effort to reform the SEC's rulemaking process, expand the agency's already strong team of financial economists, expanding their role, and the role of economic analysis itself, in the rulemaking process, even suggesting that the Chief Economist will have formal sign-off, tantamount to a veto, on the economic analysis of rules, a procedural step from which increased power and prestige within the agency can be expected to flow.[176]

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. SEC Historical Society, *available at*
http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1935_0101_SECEconomistsT.pdf.

[173] *See Chevron*, 467 U.S. at 865 (noting that the "regulatory scheme is technical and complex" in deferring to the EPA).

[174] Registration of Municipal Advisers, 76 Fed. Reg. 824, 872-78 (Jan. 6, 2011).

[175] SECURITIES AND EXCHANGE COMMISSION, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS, *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2012/499.pdf (Jan. 27, 2012); SECURITIES AND EXCHANGE COMMISSION, REPORT OF REVIEW OF ECONOMIC ANALYSES CONDUCTED BY THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH DODD-FRANK ACT RULEMAKINGS (June 13, 2011), *available at*
http://www.secoig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf.

[176] *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. (2012) (statement of Mary Schapiro) ("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.*, Manne*, supra* note 147 ("the 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.").

To live up to commitments made to Congress in the wake of *Business Roundtable*, and to implement the 2012 Guidance, described immediately below, the SEC is strengthening its economics staff as well. An additional sixteen Ph.D. economists are to be joining the RSFI economists in the near future, with even greater additions requested for the coming year.[177]

Cox and Baucom, in an article sharply critical of the *Business Roundtable* decision correctly note that "There 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."[178] 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."[179] We disagree, and maintain that if the SEC has an economics problem, it should look to its financial economists for solutions.

C. The 2012 Guidance

The SEC Staff's 2012 Guidance grew out of efforts begun in response to earlier cases, and responds as well to congressional concerns.[180] 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 future 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 failures such as collective action problems), a move that squarely connects ECCF consideration requirements with OIRA CBA.[181]

- notes the judge-made "obligation" for the agency to "determine as best it can the economic implications of the rule,"[182] but correctly equates this with "broad economic issues" of efficiency and competition,[183] and not with chasing down

[177] *SEC RiskFin To Boost Staff, Economic Analysis*, INSTITUTIONAL INVESTOR'S COMPLIANCE REPORTER 1 (July 30, 2012) (RiskFin had 60 staffers when Chief Economist Craig Lewis took over in May 2011, and Lewis expects that number to increase to around 90 by the end of the summer 2012).
[178] Cox & Baucom, *supra* note 14 at 1840.
[179] *Id*.
[180] SECURITIES AND EXCHANGE COMMISSION, CURRENT GUIDANCE ON ECONOMIC ANALYSIS IN SEC RULEMAKINGS, 3 Mar. 16, 2012, *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.shtml.
[181] *Id*. at 10. As a leading CBA textbook puts it, "[o}ne goal, efficiency, underlies CBA." ANTHONY E. BOARDMAN ET AL., COST-BENEFIT ANALYSIS: CONCEPTS AND PRACTICE 43 (3d ed. 2006)
[182] *Id.*
[183] *Id*.

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."[184]

- 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.[185]

- calls upon SEC staff economists to seek out studies and empirical evidence to bearing 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.[186]

- 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.

The 2012 Guidance 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, which, one hopes will better inform both the Commission and the public.[187]

The SEC's responses to the Kyle Report[188] and congressional inquiries indicate that it is improving 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.

Involving economists more completely in the policymaking process should not merely constitute a procedural change. 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.

Nonetheless, Better Markets, Inc., an organization that, according to its website, "promotes the public interest in financial reform in the domestic, and global capital and

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[184] *Id*. at 13.
[185] *Id*. at 7.
[186] *Id*. at 13-14.
[187] Registration of Municipal Advisers, 76 Fed. Reg. 824, 872-78 (January 6, 2011).
[188] *Supra* note 15.

commodity markets", argues that the SEC should withdraw the 2012 Guidance immediately.[189] Better Markets believes the ECCF statue should not be construed to require any form of cost-benefit analysis, but only "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."[190] 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."[191]

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 infamous example[192]—could conceivably mitigate any future financial crisis. Indeed, Better Markets appears to deem the fact that Congress enacted the Dodd-Frank reforms to prevent future, even more serious 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, who argues that regulation almost invariably do more harm than good and should be presumed to be counterproductive, but nonetheless praised the SEC's guidance as a useful step forward.[193]

The SEC has taken a middle view, considering the import and intent of its specifics before drafting the regulations required. Where it makes sense to do so, it has even adopted a limited version of the holistic approach, notably for the rules related to derivatives, where an integrated regulatory scheme covering a single set of significant markets is at issue. 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. But no legitimate approach to economic analysis can skip the key step of identifying the intended mode of action of the rule, and assessing its likely direct and indirect effects. To do so would be an evasion of the statutory obligation to consider efficiency.

We share Better Market's 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.*"[194] 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

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[189] BETTER MARKETS, INC. SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 59-68 (July 30, 2012), *available at* http://www.bettermarkets.com/sites/default/files/CBA%20Report.pdf.
[190] *Id*. at 67.
[191] *Id.* at 76.
[192] SEC Adopts Rule for Disclosing Use of Conflict Minerals, Aug. 22, 2012, *available at* http://www.sec.gov/news/press/2012/2012-163.htm.
[193] *See* Manne, *supra* note 147.
[194] BETTER MARKETS, INC. SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 58 (July 30, 2012), *available at* http://www.bettermarkets.com/sites/default/files/CBA%20Report.pdf

way it is for executive agencies."[195] But we recognize that after decades of judicial precedent, some of which even predates the ECCF statutes, decades of SEC Chairmen's commitments[196] to Congress, and what Professor Sunstein calls the complete, bi-partisan consensus surrounding cost-benefit analysis,[197] at least in the environmental, health and safety sphere, telling the court "we're not even going to try to do CBA or meaningful economic analysis any more" is not a viable option, from either a political or a jurisprudential point of view.

Where Better Markets would discard cost-benefit analysis, we would confine its scope within rational boundaries within which it can be expected to feasibly produce useful, non dispositive propositions for policy makers, earn (perhaps) some grudging respect of the reviewing courts for the agency's good faith efforts to improve the rules' efficiency. The net result would be to discourage the courts from moving the goal lines and the sidelines after the play is complete.

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. Once the agency is comfortable that it has developed such an approach, the best way to chart a new course for future rules through the rocky shoals of the Court of Appeals would be to qualify this interpretation of the ECCF statute for judicial deference, a subject we discuss further below.

D. Quasi-Legislative Bodies

There is a principled basis for holding rules adopted by multimember commissions like the SEC to a lower standard of rationality in economic analysis than that expected of executive agencies. On contentious rules, multimember, bi-partisan bodies inevitably must compromise to build a majority in support of a proposed rule, a subject we discuss below.[198] And compromise is further complicated by the Sunshine Act, which makes excessive collegiality among commissioners a crime: no more than two of them may meet outside of formally noticed public hearings, or formal closed sessions for enforcement matters.

The chairman has a powerful role; as CEO of the agency, its entire staff reports to her. Still, commissioners vote their own consciences, and the chairman cannot always count on the vote of the other two members of her party.[199] This problem is exacerbated by the case law

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[195] Bruce R. Kraus, Endangered Dodd-Frank Rules: Psychoanalyzing the SEC, at The Yale Law School Center for the Study of Corporate Law (October 6, 2011), *reprinted in* Bruce R. Kraus, *Challenge to SEC Rulemaking*, PENSIONS AND INVESTMENTS (December 12, 2011).
[196] *See supra* note 29.
[197] *Supra* note 10.
[198] 5 U.S.C. § 552(b). for most U.S. regulatory commissions (including the SEC)
[199] 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 Changes to Money Market Fund Stall*, NEW YORK TIMES (August 22, 2012), *available at* http://www.nytimes.com/2012/08/23/business/sec-calls-off-vote-on-fund-regulation.html.

giving weight to dissenting opinions, as was the case in *Chamber I*.[200] A strong chairman 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 has a strong chance of undoing thousands of hours of staff efforts, if the rule is challenged in the Court of Appeals.

The notice and comment process for producing a rule takes many months of staff time, 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 chairman's office and senior staff try to build consensus around a particular version of the rule. In short, despite the chairman'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.

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, informed by public comment and data at every turn. OIRA CBA can form a constructive part of such a process. 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. Those decisions can resemble settlements reached on the courthouse steps more than they resemble a judge's reasoned decision after a trial on the merits.

The detailed economic analysis that accompanied the thirty-day draft should certainly inform those final horse trades, but it will be an analysis of the full range of proposals theretofore under consideration, and not necessarily an in-depth look at the rule actually proposed. Moreover, even if time permitted such a review (which would risk having the accord among the majority of commissioners coming undone), the end result of the trades may be something that no single commissioner actually wanted, and no more coherent and rational, taken as a whole, than many statutes are. As long as Congress leaves securities regulation in the hands of a commission, its ECCF statute should not be construed to invalidate the predictable results of such a system. Otto von Bismarck is often alluded to at the SEC staff, "Those who love laws and sausages should not watch either one being made." SEC regulations are like sausages, too, and for the same reasons; economic analysis requires us to watch.

E. Toward an Agency Interpretation of the ECCF Statute

[200] *Chamber I*, 412 F.3d at 144.

Rather than discarding the 2012 Guidance, we recommend that the SEC elaborate, formalize, and build upon it. Once the SEC has turned the initial step represented by the 2012 Guidance into a meaningful, flexible and feasible process for economic analysis of its rules, qualifying that approach for enhanced judicial deference is the best way to chart a new course for future rules through the Court of Appeals. Rather than abandoning economics and economists in favor of law and lawyers, as Cox and Baucom[201] would do, we recommend embracing them as key participants in rulemaking. If the student has been receiving failing grades in economics, the only answer is to study harder, if the course is required for graduation.

While the 2012 Guidance was focused on how to write an economic analysis, the Commission's rule should also address the relationship under the ECCF statute between that analysis and the primary mission of the agency that statute recognizes, "the protection of investors." It should also establish and assert the agency's expertise in financial economics. Better Markets points out that the phrasing of the EFFC statute implies a primacy of investor protection over the economic factors, but a Commission finding to that effect should carry real weight with the reviewing court. 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, Congress or 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.

While this is not the place to elaborate a full set of recommendations for a meaningful yet feasible procedure for economic analysis of financial regulation, the Commission will have to reach agreement on a number of core issues to adopt the type of rule we envision. Any economically oriented interpretation of ECCF consideration requires a definition of the market or markets affected by the proposed rule and its leading alternatives. Efficiency and competition are attributes of markets, and have no rigorous meaning within the discipline of economics, not even a qualitative one, except in the context of a particular market. Market definition questions in antitrust law are notoriously thorny ones.

Should "efficiency" always be defined to mean economic efficiency? Is economic efficiency the same as Pareto efficiency, Pareto efficiency under the Kaldor-Hicks criterion,[202] or some broader measure of overall well being advanced by more philosophically minded scholars of cost-benefit analysis?[203] Or is it just the ordinary meaning of the term: doing more with less? Is the SEC and the public better off limiting its cost analysis to direct, quantifiable but possibly trivial costs, or should it attempt to address "big picture" costs and benefits, which are less certain but more important? How much effort should be devoted to ascertaining quantifiable

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[201] Cox & Baucom, *supra* note 14.
[202] *See* Posner, *supra* note 44 (explaining that in a particular sense, "cost-benefit analysis" simply denotes the "Kaldor-Hicks [] concept of efficiency.").
[203] *See* Adler and Posner, *supra* note 10.

costs and benefits, and how much weight should be given to them, as opposed to qualitative considerations?

"Competition" is well defined in antitrust law, and closely intertwined in economic theory with notions of efficiency. Should the SEC evaluate the effect of a proposed rule 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? Or is any reduction in competition to be considered a negative, even if the market will remain competitive? Some commenters, notably the Business Roundtable and its consultants at NERA seem to believe this means "U.S. competitiveness," a distinct and often conflicting goal.[204]

If "capital formation" is to be considered a good thing, it requires definition, too. No one is in favor of capital formation by the promoters of Ponzi schemes. 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.

To what extent is OIRA CBA an appropriate model of ECCF analysis? 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 to regulation undertaken without anything like a clear sense of the likely consequences—or regulation that amounts to a stab in the dark.[205]

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.)[206]

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

[204] *Supra* note 93.
[205] Hahn & Sunstein, *supra* note 31 at 1499.
[206] *Id*. at note 37.

concerned.[207] Certainly, rules under Dodd-Frank, designed to prevent or mitigate another once-in-a-lifetime financial crisis, like national defense policies, fall under the category of uncertainty, rather than risk. This important distinction suggests why FFRA'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.

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. As a result, the final rule may choose "all of the above" as the answer, reserving the right to choose the right tools for the jobs at hand in the future.

The key to the exercise will be to define what it means to "consider" these factors. Does consideration of efficiency imply the need for something like an OIRA CBA in all cases? In such cases, how should OIRA CBA be adapted to the circumstances of financial markets? The Commission will presumably wish to construe the statute (with the help of the legislative history)[208] to imply the primacy of investor protection. It will be free to announce an interpretation of economic analysis that positions it to inform, rather than replace, policy determinations. Under such a policy, there should be circumstances under which investor protection justifies a costly rule, one that decreases economic efficiency.

Should the quasi-legislative structure of the SEC be invoked to make it clear that the Commission has "considered" ECCF, even if the rule it adopts, resulting from logrolling, reflects an economic analysis of somewhat different alternatives? Will the traditionally lawyer-dominated SEC be able to bring itself to assert its own expertise in financial economics? Will courts respect that expertise, and permit the agency to set a reasonable scope for its consideration of ECCF, rule by rule, and have those boundaries respected by the courts?

The best path toward addressing these imponderable 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 the context, and outlining what the consideration should entail. Such a statement would accompany the term sheet to the chairman'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

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[207] Roberta Romano suggests that the SEC should respond to this uncertainty by placing an automatic sunset on such rules. 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. [cite] *See* Exec. Order No. 13,579, 76 F.R. 41587 (July 14, 2011). The SEC issued a request for information on such retrospective review. Retrospective Review of Existing Regulations, 76 F.R. 56,128 (Sept. 12, 2011) and filed a plan with OIRA.

[208] For an overview of the legislative history, see Cox & Baucom, *supra* note 14.

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.

In addressing these difficult questions, the Commission should construe the ECCF consideration requirement in accordance with the canon of statutory construction that calls for harmonization of different provisions of law, and giving them all effect.[209] It follows that the impossible, unbounded analysis required by FRRA should not be deemed a permissible construction of the ECCF consideration requirement, since such a construction would be tantamount to an abrogation of the agency's clear rulemaking authority.[210] Conversely, the Commission should resist the temptation to neuter the ECCF provisions entirely.[211] The goal should be to create a rational, flexible 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.

F: Judicial Deference to Agency Construction of the ECCF Statutes

Even the 2012 Guidance, a staff interpretation of the ECCF statutes contained, should be entitled to a degree judicial deference. Rumors of the death of *Skidmore* v. *Swift,*[212] appear for the present to be exaggerations,[213] it's continuing vitality confers a degree of deference upon agency policy statements and interpretations of inward-looking rules. Unlike *Chevron* deference, which either applies or does not, *Skidmore* yield a sliding scale of deference, which is a function of the attributes of the agency pronouncement at issue.[214] In a case involving an *amicus* brief and an interpretive bulletin of the Department of Labor, Justice Jackson set out *Skidmore* balance:

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[209] *See, e.g.*, Astoria Federal Savings & Loan Ass'n v. Solimino, 501 U.S. 104, 112 (1991); Sprietsma v. Mercury Marine, 537 U.S. 51, 63 (2003).

[210] *See* Branch v. Smith, 538 U.S. 254, 293 (2003) (noting that repeal by implication is disfavored).

[211] BETTER MARKETS, INC. SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 59-68 (July 30, 2012), *available at* http://www.bettermarkets.com/sites/default/files/CBA%20Report.pdf

[212] Skidmore v. Swift & Co., 323 U.S. 134 (1944). Doubts have arisen as to whether *Chevron* eliminated *Skidmore* deference and Justice Scalia has advocated this change in *Mead*, 533 U.S. at 250 (Scalia, J dissenting).

[213] Skidmore clearly survives, as the Court has continued to apply both *Skidmore* and *Chevron* in recent years. *See* Gonzales v. Oregon, 126 S. Ct. 904, 924–25 (2006) (applying Skidmore deference to an interpretive rule issued by the Department of Justice); *Mead,* 533 U.S. at 237 (stating *Skidmore* applies when "circumstances indicate no intent to delegate general authority to make rules with force of law . . ."); Thomas W. Merrill, *The Mead Doctrine: Rules and Standards, Meta-Rules and Meta Standards*, 54 ADMIN. L. REV. 807, 810 (2002) (noting that a multifactorial approach to deference "lives on under the mantle of *Skidmore*").

[214] One prominent commentator argues that while *Chevron* has the "power to control" a court, *Skidmore* has the "power to persuade." JEFFREY S. LUBBERS, A GUIDE TO FEDERAL AGENCY RULEMAKING 460 (2012). The Court itself used the phrase "power to persuade" in *Skidmore* and in more recent cases. *See, e.g.*, Christensen v. Harris County, 529 U.S. 576, 587 (2000).

> We consider that the rulings, interpretations, and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon 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.[215]

The 2012 Guidance was recently published, but, as the Kyle Report indicates, it is an outgrowth of an unpublished Compliance Manual dating back to the 1990's. Moreover, the SEC has substantial and burgeoning expertise in the discipline of financial economics.[216] If the recent plaudits from the SEC's Chairman in Congressional testimony this expertise continue there and in other venues and, more importantly, if they are reflected in the reality of day-to-day agency policies and procedures, courts should, *pro tanto*, afford deference to that manifest expertise. The current incarnation of the 2012 Guidance should not be enshrined as dogma, but rather its subject matter should be developed dynamically and improved continuously, based on experience. The more thorough and well-considered it is, and the more it allows agency to tailor the economic analysis to the rule at hand, the available data and the agency's capabilities,[217] the more deference it should command.

Once the agency is comfortable that its economic analysis procedures are feasible, meaningful and adaptable to the variety of rules that come before it, the Commission itself, and not just its staff, should consider putting them, or a subset of them on which the commissioners and staff agree, out for public comment, with a view to adoption by the Commission itself as a formal statement of policy. Commission action of this kind would substantially increase the judicial deference the policy would command.[218] Some might object that, in requesting

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[215] *Skidmore*, 323 U.S. at 140.
[216] Part IV(b), *supra*.
[217] *Supra* notes 180-197.
[218] Full Commission approval after notice and comment rulemaking is the degree of formality characterizing both the SEC's interpretive releases and its legislative rules and regulations. Still, it is doubtful, while still possible under a famously muddled case law, that a Commission interpretation of the ECCF statutes would qualify for *Chevron* deference. For one thing, it would likely to be deemed a mere policy statement, rather than a legislative rule carrying 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); *Mead,* 533 U.S. at 237. In *Skidmore*, the Court deferred to a Department of Labor amicus brief and interpretive bulletin. *Skidmore*, 323 U.S. at 137, 39-40. 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. United States v. Mead Corp., 533 U.S. 218 (2001) ("We hold 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). To hold the "force of law," the better view is that an interpretation must bind external parties. *See* Thomas W Merrill & Kristin E. Hickman, *Chevron's* Domain,

Commission action the agency would be tying its own hands or, once again, "walking into a trap." We submit, on the contrary, that if the policy balances manageable but worthwhile agency burdens with sensible limits on the depth and scope of the analysis ECCF requires, Commission action on this score will chart a path for the agency out of a trap it already finds itself in.

PART V: BOUNDED RATIONALITY AND RATIONAL BOUNDARIES

More than a decade ago, Professor Sunstein proclaimed a "general victory for the proponents of cost-benefit analysis" leaving the only topic for the "second generation debates" to be "about how (not whether) to engage in cost-benefit analysis." [219] He went on to call for the capitulation to this general victory of the remaining, isolated pockets of resistance—the independent agencies and for subjecting the CBA record to judicial review.[220] While we feel constrained to agree at this juncture that further resistance is futile, we maintain that by accepting the invitation to engage in those second generation debates, the SEC and its sister regulatory commissions have the opportunity to avoid "paralysis by analysis,"[221] and to negotiate favorable terms and conditions for their surrender. Indeed, the terms of that surrender may allow the SEC to use cost-benefit analysis as a useful nudge to writing rules with greater benefits and lower costs, not a counterproductive shove that dooms the rulemaking process altogether.[222] To that end, we now explore a fundamental paradox of cost-benefit theory to defend our view that the feasible and useful economic analysis requires boundaries that the analysis itself cannot set.

A. Administrators' Cognitive Biases

Professor Sunstein posits cost-benefit analysis as "a natural corrective" to the cognitive biases of "ordinary people," especially when interest groups "use these cognitive problems strategically."[223] If ordinary people are prone to misunderstanding, where will government find

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89 GEO. L.J. 833, 881 (2001). *But see* Cass R. Sunstein, *Chevron Step Zero*, 92 U. CHI. L.R. 187, 222-23 (2006) (noting that this question has not been definitively resolved).

Moreover, agencies cannot issue legislative rules unless Congress delegated the power to do so. *See* Am. Mining Cong. v. U.S. Dep't of Labor, 995 F.2d 1106, 1112 (D.C. Cir. 1993). The question of whether Congress delegated authority to the agency to act with the force of law is admittedly unclear. *See* Cass R. Sunstein, *Chevron Step Zero*, 92 U. CHI. L.R. 187, 190-91 (2006) (noting that the test as to whether Congress delegated to the agency the authority to act with the force of law has become "unruly"). *Mead,* 533 U.S. at 237 (stating *Skidmore* applies when "circumstances indicate no intent to delegate general authority to make rules with force of law . . ."). Indeed, in *Skidmore* the Court found that Congress did not delegate to the Department of Labor. *Skidmore*. 323 U.S. at 137, 39-40 (noting "Congress did not utilize the services of an administrative agency to find facts and to determine in the first instance whether particular cases fall within or without the Act. Instead, it put this responsibility on the courts.")

[219] *Id.* at 1655-56.

[220] *See, e.g.*, 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). To be fair, Hahn and Sunstein suggested subjecting agency CBA to judicial review only "to the extent those analyses are relevant to the legality of the agency's conduct." Given the ECCF statutes, and the Court's construction of them, this clause would not offer any relevant limitation on judicial review.

[221] *Id*. at 1663.

[222] Thanks due to William Eskridge for this observation.

[223] Cass R. Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651, 1661-62. (2001)

the extraordinary people needed to correct them?[224] The forefather of contemporary behavioral economics, Herbert Simon, might have been bemused by the thought that the administrative process could remedy human cognitive limitations. Simon is often "recognized as a hero and founding figure by all the competing clans and tribes in the study of decisionmaking"[225] by psychologists, economists and legal scholars. Many of these scholars sometimes appear to forget that his original work on bounded rationality stemmed from his observations at a summer job during college in 1935 at a government agency, the Parks and Recreation Commission of the City of Milwaukee.[226] It seems that the first place cognitive bias was observed in modern scholarship is, *prima facie*, the last place to expect to find its cure.

Recent treatments of the discovery that regulators are human, too,[227] attribute to them "action bias" (the felt need to "do something"), "motivated reasoning" (the tendency to rationalize preferred opinions, especially opinions that advance one's own interests) and the "illusion of explanatory depth" (systematic overestimation of our ability to understand complex phenomena).[228] These applications of cognitive psychology seem at first to be little more than new nomenclature for human nature, and imply a hopelessly infinite regress of imperfect corrections of imperfect judgments.[229] Yet there is no reason to expect congressional, judicial or academic critics of regulatory agency officials and staff to be any less subject to these biases than other mortals.[230]

Applied to oneself, these cognitive biases are essentially benign, part of what a person needs simply to get through the day, make a living, and maintain self-esteem. But when a powerful person projects the illusion of explanatory depth on a subordinate, the results sadden the soul, as where a parent punishes a disabled child for not being able to walk. Such is the case when the Court of Appeals requires the agency to explain all of the economic consequences of its actions, as though it could somehow do so.

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[224] Some observers have argued that an elite core of civil servants can overcome these biases. *See* Breyer, *supra* note 10. *See also* Cass Sunstein, *Cost-Benefit Default Principles*, 99 MICH. L. REV. 1651, 1708 (2001) ("Because the understanding of cost-benefit analysis is so much better developed within OMB than within courts and the legal culture, it is worth attending, with some care, to OMB's suggestions."). DeMuth & Ginsburg, *supra* note 19 at 1083-84, concede that agency personnel are more expert in their fields than OIRA personnel, but that OIRA staff are more expert in "the field of regulation itself."

[225] KAHNEMAN, THINKING, FAST AND SLOW 237 (2011).

[226] BRYAN D. JONES, BOUNDED RATIONALITY, 2 ANN. R. POL. SCI. 297 (1999) (citing HERBERT SIMON, THE POTLATCH BETWEEN POLITICAL SCIENCE AND ECONOMICS, IN COMPETITION AND COOPERATION: CONVERSATIONS WITH NOBELISTS ABOUT ECONOMICS AND POLITICAL SCIENCE, J. Alt, M. Levi, E. Ostrom eds. (Cambridge University Press 1999). Jones notes a tendency to think that Simon's work on organizations was an extension of his work on problem solving when, in fact "the intellectual path was the other way around." *Id*. at 300.

[227] Slavisa Tasic, *The Illusion of Regulatory Competence*, 21 CRITICAL REV. 423 (2009).

[228] *Id*. *See also* Leonid Rozenblit & Frank Keil, *The Misunderstood Limits of Folk Science: An Illusion of Explanatory Depth*, 26 COGNITIVE SCIENCE 521 (2002).

[229] *Supra* note 207 (suggesting one possible method to mitigate this problem).

[230] We feel constrained at this juncture to confess our own potential biases. Kraus was a lawyer in the SEC's RSFI division and could reasonably be suspected of motivated reasoning biased toward agency authority and toward an enhanced role for his former colleagues, the SEC's economists. On the other hand, readers should recall that heuristics and other cognitive biases arise and survive because they are usually sound and correct. *See* Jonathan Bendor, *Herbert A. Simon: Political Scientist*, 6 ANN. REV. POL. SCI. 433, 438-40 (2003). In other words, just because you're biased doesn't mean you're necessarily wrong.

Once capabilities for regulatory analysis far beyond those of mortals have been credibly attributed to the SEC's beleaguered staff, it is easy to deride the agency's actual actions as lazy or irrational, however good they may be. How difficult is it, really, to assess all the economic consequences of a given regulatory action? To get a sense of deliberation costs involved, consider the game of chess. Chess is played with thirty-two pieces on sixty-four squares, and yet, no one, computer or human, knows ALL the consequences of any particular move, with the exception of late endgame positions involving only a few pieces, for which complete tablebases have determined. One hundred years ago, in what is now recognized as the first formal theorem of game theory, Zermelo showed chess to be as fully soluble a game as tic-tac-toe.[231] But children figure out the solution to tic-tac-toe at an early age, while the full solution to checkers came only in 2007.[232] As a two-player game of perfect information, chess is, of course, radically simpler than the games financial regulators play with regulated entities, but even for chess, it has been estimated that even if the speed of computers continues to double every two years, that simple game will not be solved until the year 2250.[233]

"It is evident that the rational thing to do is to be irrational, where deliberation and estimation cost more than they are worth."[234] 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 stupendously incomplete. Is it possible to know when time for deliberation is to give way to action? Moreover, a second order analysis, about the value of the first may be in order, but Conlisk points out that the regress is infinite and that there is no reason to expect the series to converge.[235] As Johansen argued, "If we can economize on economizing, we can economize on economizing on economizing, and so on. At some point, a decision must be taken on intuitive grounds."[236]

Professor Sunstein in effect reaches the same conclusion about the role of intuition in deciding when enough analysis is enough. In his discussion of whether CBA survives CBA, he admits that "[t]he answer is that we cannot be sure."[237] He therefore is must ultimately ground his belief in the benefit of CBA on intuition: "But the current situation is not nearly as good as it could be, and if the analysis is done well, there is every reason to expect it will lead to improvements."[238] Countless examples of over-regulation and regulatory failures exposed by CBA certainly inform this intuition, but it remains intuition nonetheless. The case law analysis is

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[231] Ulrich Schwalbe & Paul Walker, *Zermolo and the Early History of Game Theory*, *available at* http://www.math.harvard.edu/~elkies/FS23j.03/zermelo.pdf.
[232] Jonathan Schaeffer et al., *Checker is Solved*, SCIENCE (2007), *available at* http://www.sciencemag.org/content/317/5844/1518.abstract
[233] S.S.J. Jaheruddin, *Chess Will Be Solved* (Jan. 4, 2011), *available at* http://home.telfort.nl/jaheruddin/f/Chess_will_be_solved.pdf.
[234] FRANK KNIGHT, RISK, UNCERTAINTY AND PROFIT 67 (1921) (*cited in* John Conlisk, *Why Bounded Rationality*, 34 J. ECON. LIT. 687 (1996)). Conlisk discusses in detail the infinite regress problem that arises when economic analysis itself is costly.
[235] Conlisk, *supra* note 234 at 897(*citing* LEIF JOHANSEN, LECTURES ON MACROECONOMIC PLANNING, PART 1, GENERAL ASPECTS (1977)).
[236] LEIF JOHANSEN, LECTURES ON MACROECONOMIC PLANNING, PART 1, GENERAL ASPECTS (1977).
[237] CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002).
[238] *Id*.

Parts II and III suggest that unbounded judicial review of the SEC's analysis has not led to improved rules, but has thwarted them.

B. Incentives and Biases of Policy Players

Opponents of regulation find in economic analysis a perfect weapon—one that kills regulations, while leaving no fingerprints. It leaves them free to credibly claim: "I'm not against *good* regulations, but how can we permit regulators to act before taking the time to understand fully the consequences of their actions?" The stakes are scaled by the multi-trillion dollar markets they affect.

Debating Pareto superior policies moves—those that make some better off, and no one worse of—is pointless, as Guido Calabresi famously pointed out,[239] since all those good things have happened already. But the Kaldor-Hicks criterion makes a crucial modification to Pareto, favoring policies would lead to a Pareto-superior result *assuming hypothetical transfers from winners to losers that do not in fact occur*.[240] This standard creates a regulatory game with a very big point indeed: the value of all those unmade transfer is a deadweight cost to those who would have received them, and they can be expected to fight hard against regulations that burden them, whether they are Kaldor-Hicks efficient or not, by all available means, including arguments challenging proponents to prove by clear and convincing evidence their proposal's economic efficiency. The incentives of regulated entities to oppose beneficial regulations are further enhances when other public-regarding policies, like the protection of investors, are taken into account. Given all this, no invocation of cognitive bias is needed to explain the intense opposition of petitioners with an interest in striking down economically efficient regulations that happen to burden them. It is entirely rational for them to fight the good rules with high-priced experts, lobbyists and lawyers, for whom motivated reasoning is their stock in trade.

Sunstein acknowledges that interest groups can be expected to "portray both costs and benefits in a self-serving manner."[241] With respect to SEC rules, this process has now moved to the next level, where those same canny interest groups appear to be on the brink of capturing the rules, processes, and procedures of economic analysis itself, through litigation and legislation both. Motivated reasoning theory offers the additional gloss that advocates of these positions and their legislative audience may well believe in good faith that their policy arguments are valid ones, despite being eerily coincident with their own economic interests.

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[239] Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211, 1216 (1991) ("if Pareto optimality means a place where no improvement can be made without ex ante creating the possibility that there will be some losers, then we are always there").

[240] *See* Posner, *supra* note 44; Boardman, *supra* note 181 at 88 ("a policy should be adopted if and only if those who will gain *could* fully compensate those who will lose and still be better off") (emphasis added); DeMuth & Ginsburg, *supra* note 19 at 884 ("Especially in environmental regulation, where regulated firms are paying (in the first instance) the costs of pure or nearly pure public goods, firms will characteristically favor the most lenient plausible standards while environmental groups will favor the most stringent plausible standards."). The Kaldor-Hicks criterion, and, by extension, the cost-benefit calculus from which it is derived have been criticized, *e.g.*, Uwe E. Reinhardt*, When Value Judgments Masquerade as Science*, N.Y. TIMES (Aug. 27 2010).

[241] Sunstein, *supra,* note 235.

The *Business Roundtable* decision stands as a counterexample to the poster children of CBA. The proxy access rule had been expressly and contemporaneously authorized by Congress,[242] and elicited positive stock market reaction in the brief period they were in force.[243] In *Chamber I* and *Chamber II*, the costs of mutual fund boards were found to be as indeed just as trivial as the SEC had intuited them to be, but only when the rule's moment had passed. Congress ousted the SEC's authority over insurance-based annuities before the SEC had time to present the Court with the 50-state baseline analysis it decided the rule required. We need a new vocabulary to begin to discuss these kinds of costs, the costs of CBA: "regulatory analysis failure" comes to mind. CBA does not contain a solution to the problem of where it should end within itself, as Conlisk demonstrates and Sunstein appears to agree. It can only come from informed intuition, which we believe the SEC, flawed and human though it may be, is in a better position to exercise than the Court of Appeals.

C. *Business Roundtable* Distinguished and Affirmed

In a subsequent opinion,[244] Judge Ginsburg reiterated and indeed strengthened his criticism of the SEC economic analysis of its proxy access rule.[245] In what the D.C. Circuit would rightly dismiss as a *post hoc* rationalization were an agency to attempt it before the court, Judge Ginsburg deemphasized his prior reliance on the Ikenberry study (or the NERA Report), averring 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."[246]

American Petroleum distinguished *Business Roundtable*, on which petitioner API relied heavily, upholding the EPS's nitrogen dioxide standards. API charged the EPA relying upon an

[242] 15 U.S.C. 78n(a).
[243] Bo Becker et. al, *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge* (Harv. Bus. School, Working Paper No. 11-052, 2012) (ranking public companies based on their "proxy accessibility," that is, by the number of significant stockholders of 3 or more years standing, and looking at stock price movements both on the day the SEC announced suspension of the rule in response to the BRT challenge, and on the day it announced it would not appeal the D.C. Circuit's ruling. Looking at the differential stock price movements in more vs. less proxy accessible companies on those dates, the authors conclude that financial markets placed a positive value on proxy access. An earlier version of this paper, based solely on the suspension of the rule, was brought to the attention of the Court of Appeals in an amicus brief, but was not acknowledged in the opinion.).
[244] American Petroleum Institute v. EPA, Slip. Op. No. 10-1079, D.C. Cir. July 17, 2012.
[245] *Id.* at 13-14 ("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, *see id.* at 1151; 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). If the SEC's rationale in not seeking rehearing *en banc* of the *Business Roundtable* decision was based in part upon a desire to deny Judge Ginsburg another platform from which to criticize the agency, this quotation suggests that the concern was well founded.
[246] *Id*.

unpublished, non-peer-reviewed meta-analysis and adopting its rule despite a lack of dose-response evidence, while ignoring a peer-reviewed study to the contrary. One cannot blame API's counsel for optimism in relying on *Business Roundtable* on facts like these.

As it did in *Business Roundtable*, the Court declared its review was proceeding under the arbitrary and capricious standard.[247] But in *American Petroleum*, it applied that standard faithfully,[248] rather than the implicit "clear and convincing standard," 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."[249]

It appears that the proxy access rule would have passed muster under this test, since, as the Court admits, the agency considered contrary evidence and offered explanations for not crediting it. The proxy access rule appears instead to have been judged under a far stricter standard, one under which the agency was required to "sufficiently" support its conclusion in view of "'mixed' empirical evidence" and "adequately . . . assess the economic effects of a new rule."[250] "Adequately" and "sufficiently" are subjective standards, measured only by the opinion of the judge—a sharp contract to the objective "entirely failed" and "explanation . . . counter to the evidence" standard set by the Supreme Court.

What accounts for the sharp difference between the two cases, which applied, *de facto,* different standards? Why did *American Petroleum* require the EPA only to acknowledge contrary studies and state reasons for disagreement, while *Business Roundtable* refused to accept the SEC's assessment of the evidence, second guessing the judgment of agency experts about which studies were reliable and which were not?

One possible unarticulated explanation is that the deference due to agencies' scientific expertise in fields like toxicology simply does not, in the opinion of the Court of Appeals, extend to expertise in financial economics. This can be viewed as a small aspect of a much larger debate about whether the social sciences as a group deserve to be called "sciences" at all. Economics, alone among the social sciences, awaits the news from Stockholm each fall, although critics are quick to point out the prize in economic sciences is not a real Nobel Prize at all, but merely an add-on financed by the Bank of Sweden.

Another strand of explanation resides in the ascendancy of law-and-economics in the legal academy, where law professors (most of them lawyers by training), several of whom have become respected jurists, have integrated economic reasoning into both legal scholarship and jurisprudence for decades. While this trend in a sense has elevated economics in the eyes of the bar, it may have also led to a view among some lawyers and judges that "anyone can do this," and that a lawyer's evaluation of empirical literature is as valid as the judgment of practicing

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[247] 5 U.S.C. § 706.
[248] North Carolina v. EPA, 531 F.3d 896, 906 (D.C. Cir. 2008) (quoting *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co*., 463 U.S. 29, 43 (1983).
[249] American Petroleum Institute v. EPA, Slip. Op. No. 10-1079, 11-12, D.C. Cir. (July 17, 2012).
[250] *Id*.

professional economists. The results in *Business Roundtable* suggest to the contrary that judicial deference to the SEC's expertise in financial economics is overdue.