THE COSTS OF MANDATORY COST–BENEFIT ANALYSIS IN SEC RULEMAKING

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ABSTRACT

Cost–benefit analysis can be a valuable tool when deployed at the Securities and Exchange Commission’s discretion to improve its rulemaking process and the overall quality of SEC rules. However, when a cost–benefit analysis obligation is imposed externally—whether from an explicit statutory command or from a de facto requirement enforced through judicial review—the costs of that mandatory cost–benefit analysis can be quite substantial. This Article identifies and explores the qualitative costs that have already been incurred, and are bound to continue, if the adequacy of the SEC’s cost–benefit analysis remains subject to extensive judicial scrutiny. These costs will only intensify if Congress amends the federal securities laws to add a host of new and onerous cost–benefit analysis requirements.

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INTRODUCTION

Although the Securities and Exchange Commission (“SEC”) has exercised its congressionally delegated rulemaking power on thousands of occasions since 1934, there have been relatively few litigation challenges seeking judicial review of SEC rules. Moreover, in those infrequent instances where litigants have challenged a rule’s validity, courts traditionally have accorded substantial deference both to the SEC’s process-based choices, as well as to the policy decisions reflected in the final rule. Over the last decade, however, the U.S. Court of Appeals for the D.C. Circuit has held that several challenged SEC rules were “arbitrary and capricious”—and therefore invalid—due to a perceived failure on the part of the SEC to conduct adequate cost–benefit analysis.1 As a result, the SEC no longer deploys rigorous cost–benefit analysis as a discretionary tool to improve the rulemaking process and the overall quality of the rules themselves. Instead, rigorous cost–benefit analysis has now become a de facto requirement for the SEC’s adoption of most new rules. In May 2013, the House of Representatives passed legislation by a vote of 235-161 that attempted to codify and considerably heighten this cost–benefit analysis obligation.2

Yet, there is no escaping the fact that an astonishingly small amount of analysis has actually been performed on the costs and benefits of such mandatory cost–benefit analysis. Professor John Coates explores this irony in a recent paper, which pointedly questions whether it is even possible for the SEC and other financial regulators to conduct meaningful cost–benefit analyses.3 His ultimate conclusion—that externally imposed cost–benefit analysis requirements “can be expected to do more to camouflage discretionary choices than to discipline agencies or promote democracy”—challenges both sides of the cost–benefit analysis debate to more carefully contemplate their positions.4 As Professor Coates recently tweeted, “Why

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4. Id. at 882.
impose new cost–benefit tests when cost–benefit analysis tests haven’t been shown to satisfy a cost–benefit test?5

I will leave it to others to wrangle over the benefits of cost–benefit analysis (whether discretionary or mandatory) in SEC rulemaking.6 Others are also in a better position to estimate the economic costs of performing and defending “adequate” cost–benefit analysis (leaving aside the question of what is adequate)—although here we can glean some insight from those costs associated with the proxy access rule that was invalidated in Business Roundtable v. SEC.7 The SEC has reported that “approximately 21,000 staff hours were spent on the proxy access rulemaking at an estimated labor cost of approximately $2.2 million spread over more than two years, [with] an additional 2,700 staff hours . . . on the ensuing litigation at an estimated labor cost of approximately $315,000”8—thus, the monetary cost of the cost–benefit analysis could be estimated from there.

My aim in this Article is to focus instead on some of the qualitative costs that have already been incurred, and are bound to continue, if the adequacy of the SEC’s cost–benefit analysis remains subject to extensive judicial scrutiny. These costs will only intensify if Congress amends the federal securities laws to require the SEC to comply with a host of new cost–benefit analysis requirements.

The Article proceeds in two parts. Part I first examines the most important statutory provisions, executive orders, and agency practices that relate to cost–benefit analysis in SEC rulemaking. It then discusses the judicial decisions that have left SEC officials convinced that many months, and oftentimes years, of quantitative cost–benefit analysis is a necessary precursor to the SEC’s adoption of any controversial new rule. Part I concludes with a discussion of the proposed SEC


6. Compare Coates, supra note 3, at 888 (arguing that the benefits of cost–benefit analysis “are likely to remain low” because of an inability “to precisely and reliability estimate the effects of financial regulation”), and Jeffrey N. Gordon, The Empty Call for Benefit-Cost Analysis in Financial Regulation, 43 J. LEGAL STUD. S351, S352 (2014) (contending that cost–benefit analysis “as applied to financial regulation is a serious category mistake”), with Eric A. Posner & E. Glen Weyl, Benefit-Cost Paradigms in Financial Regulation, 43 J. LEGAL STUD. S1 (2014) (contending that cost–benefit analysis is particularly apt for financial regulation and that financial regulators should be gathering even more data and performing even more rigorous analyses), and Eric A. Posner & E. Glen Weyl, Benefit-Cost Analysis for Financial Regulation, 103 AM. ECON. REV. PAPERS & PROCEEDINGS 393, 397 (2013) (proposing “principles for the quantitative evaluations of normative trade-offs in the regulation of financial markets”).

7. 647 F.3d at 1148.

Regulatory Accountability Act, which sets out a host of complex requirements that would make legally sufficient rulemaking exceedingly difficult. The proposed legislation imposes an uber cost–benefit analysis mandate that would require the SEC to explain why a new regulation meets its identified regulatory objectives “more effectively” than other available alternatives. Additionally, this cost–benefit analysis would obligate the SEC to “choose the approach that maximizes net benefits.” The proposed legislation would also require the SEC to explain the nature of the comments that it received in the course of its rulemaking process, the changes that it made in response to those comments, and “the reasons that the Commission did not incorporate those industry group concerns related to the potential costs or benefits in the final rule.” Conspicuously absent is any concomitant obligation on the part of the SEC to explain its reasons for failing to incorporate investor protection groups or other non-industry concerns regarding potential costs or benefits.

Part II then sets out to identify and explain the troubling consequences that flow from cost–benefit analysis rulemaking requirements that strip away the SEC’s discretion and, thus, its ability to function efficiently as an expert independent regulatory agency. It first discusses how the extensive scrutiny applied by the D.C. Circuit, in the words of one scholar, “shook the SEC’s confidence in its ability to adopt rules that would survive judicial scrutiny.” This scrutiny effectively forced the agency to expend substantial amounts of time and resources on cost–benefit analyses that often amount to no more than unreliable “guesstimations.” As a result, the SEC’s adoption of new rules—including a host of new regulations required by the Dodd–Frank Act of 2010 and the Jumpstart Our Business Startups (“JOBS”) Act of 2012—has been hampered substantially.

In addition to such “paralysis by analysis,” Part II posits four equally disconcerting costs of mandatory cost–benefit analysis requirements: (1) a future

10. Id. § (e)(2)(A).
11. Id. § (e)(3).
13. See Coates, supra note 3, at 887.
17. Thomas O. McGarity, A Cost-Benefit State, 50 ADMIN. L. REV. 7, 50 (1998) (observing that “[m]ost regulatory reformers prescribe an exceedingly ambitious cost-benefit analysis that would inevitably drain scarce agency analytical resources and slow down the rulemaking process” and suggesting that “paralysis may have been the ulterior goal of
that will almost certainly include rulemaking challenges initiated by investor protection groups seeking to invalidate deregulatory rules (based on claims that the SEC underestimated the investor protection benefits and overestimated the regulatory burdens on those subject to the status quo); (2) a greater predilection for “securities regulation by enforcement,” whereby the SEC entirely bypasses the rulemaking process on particularly contentious issues to “formulat[e] new regulatory policy through the prosecution of enforcement cases”; (3) heightened reliance on informal mechanisms, most notably no-action letters, which enable the SEC staff to graft new substantive requirements onto existing law under the guise of regulatory interpretations; and (4) fewer delegations of authority to the SEC and more “do-it-yourself” securities regulation by a Congress composed of non-expert decision-makers who can dispense with any type of cost–benefit analysis—quantitative or qualitative—whenever they deem it politically expedient to do so.

I. A BRIEF ANALYSIS OF THE CURRENT REGIME

A. Existing Statutory Provisions, Executive Orders, and SEC Practices Relating to Cost–Benefit Analysis

1. The Statutory Framework

The National Securities Markets Improvement Act of 1996 (“NSMIA”) is frequently cited as the statutory source of the SEC’s purported obligation to perform cost–benefit analysis in its rulemaking. The NSMIA added a new § 2(b) to the Securities Act of 1933, a new § 3(f) to the Securities Exchange Act of 1934, and a new § 3(c) to the Investment Company Act of 1940, all of which provide that whenever the SEC “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

some . . . who were not so concerned with achieving efficient regulation as with throwing sand into the regulatory gears”).


the action will promote efficiency, competition, and capital formation.”22 A few years later, in the Gramm–Leach Bliley Act of 1999, Congress imposed on the SEC that identical obligation in the Investment Advisers Act of 1940.23

These statutory provisions, however, fall far short of a congressional command to engage in any type of cost–benefit analysis, much less the quantitative cost–benefit analysis that has been effectively required for an SEC rule to survive judicial review. The aforementioned text merely obligates the SEC to “consider” factors relating to efficiency, competition, and capital formation in the course of agency rulemaking where it is also obliged to consider investor protection.24 Decades before the NSMIA, Congress imposed a similar “consider” command in § 23(a)(2) of the Exchange Act, which states that the SEC shall, “in making rules and regulations . . . [c]onsider among other matters the impact any such rule or regulation would have on competition.”25 The subsection further instructs that the SEC “shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act],” and requires a written statement of the “reasons” for the “determination that any [such] burden on competition . . . is necessary and appropriate in the furtherance of the purposes of [the Exchange Act].”26

When Congress wants to require an agency to perform cost–benefit analysis, it clearly knows how to impose that obligation. An often invoked example is the Commodities Futures Trading Commission (“CFTC”), which is required by the terms of the Commodity Exchange Act not only to “consider the costs and benefits” of its actions but also to “evaluate[]” those costs and benefits “in light of” five factors: “(A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations.”27 The proposed SEC Regulatory Accountability Act provides another obvious example.28

The fact that the SEC is presently obligated under the NSMIA to “consider . . . efficiency, competition, and capital formation” in rulemakings when it is also required to “consider . . . the public interest” clearly reflects a congressional determination that SEC rules must take into account an array of regulatory objectives beyond simply investor protection. But there is nothing in the text of those

22. 15 U.S.C. §§ 77b(b), 78c(f), 80a-2(c) (2012).
23. Id. § 80b-2(c) (requiring the SEC to consider whether its rulemaking will “promote efficiency, competition, and capital formation.”).
24. Coffee, supra note 16 (observing that “[o]n its face, this language is relatively soft, mandating that the Commission only consider these impacts, not that the SEC determine that the interests of investor protection outweigh those of efficiency, competition, and capital formation”).
26. Id.
28. See infra notes 146–53 and accompanying text.
provisions, nor in a careful analysis of the entire legislative record.\textsuperscript{29} to support the conclusion that “consider” means anything other than “to think about carefully” or “to take into account.”\textsuperscript{30} The term “consider” is used frequently throughout the federal securities laws—in more than 20 provisions in the Exchange Act alone. In some provisions, as it did in the NSMIA, Congress instructs that the SEC “shall consider” in the course of agency decision-making a specified factor or factors. In other provisions, Congress specifies that the SEC “may” take certain matters or factors into consideration. For example, Exchange Act § 21B authorizes the SEC to impose civil monetary penalties in agency cease-and-desist proceedings and subsection (c) enumerates six factors that the SEC “may” consider in making its determination as to “whether a penalty is in the public interest.”\textsuperscript{31} When the SEC adopts a final rule or issues a final order, it evidences its adherence to this “shall” obligation, or its exercise of its “may” discretion, by including in its release the factors it considered in the course of its decision-making.

Proponents of the view that the SEC is statutorily obligated to perform cost–benefit analysis on its rulemaking further look to the Administrative Procedure Act (“APA”).\textsuperscript{32} Section 706 of the APA authorizes federal courts to invalidate rules that are “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”\textsuperscript{33} As the Supreme Court first emphasized in Motor Vehicle Manufacturers Ass’n v. State Farm Mutual Automobile Insurance Co.,\textsuperscript{34} 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.”\textsuperscript{35} However, in performing this narrow review, courts are obliged to ensure that the agency has “examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made.”\textsuperscript{36} In turn, the judicial determination of whether an explanation is “satisfactory” requires a court to “consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.”\textsuperscript{37} Thus, an agency rule could be deemed “arbitrary and capricious” within the meaning of the APA “if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible

\begin{itemize}
  \item \textsuperscript{29} See James D. Cox & Benjamin J.C. Baucom, \textit{The Emperor Has No Clothes: Confronting the D.C. Circuit’s Usurpation of SEC Rulemaking Authority}, 90 Tex. L. Rev. 1811, 1818–24 (2012).
  \item \textsuperscript{30} \textit{Merriam Webster’s Collegiate Dictionary} 246 (10th ed. 1996).
  \item \textsuperscript{31} 15 U.S.C. § 78u-2(c) (2012).
  \item \textsuperscript{32} 5 U.S.C. §§ 501–706 (2012).
  \item \textsuperscript{33} \textit{Id.} § 706(2)(A).
  \item \textsuperscript{34} 463 U.S. 29 (1983).
  \item \textsuperscript{35} \textit{Id.} at 43.
  \item \textsuperscript{36} \textit{Id.} (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962)).
\end{itemize}
that it could not be ascribed to a difference in view or the product of agency expertise. 38

Notwithstanding the type of “hard look” judicial review of agency rulemaking it endorsed in State Farm, the Supreme Court has also emphasized the necessity of according substantial deference when an agency’s rulemaking interprets an ambiguous provision in a statute (Chevron deference), 39 or in the agency’s own rules and regulations (Seminole Rock deference). 40 Accordingly, both Chevron U.S.A., Inc. v Natural Resources Defense Council, Inc. and Bowles v Seminole Rock & Sand Co. impose on courts the obligation to accept all but unreasonable interpretations of ambiguous regulatory provisions—even in circumstances where, as a matter of first impression, a federal court would have construed the provision differently.

In addition to its obligation under the federal securities laws to consider specified factors, and its process-based obligations under the APA, SEC rulemaking is subject to regulatory analysis requirements set out in several other statutes. These statutes include: (1) the Regulatory Flexibility Act, which requires agencies to analyze all rules that have or will have a “significant economic impact on a substantial number of small entities”; 41 (2) the Congressional Review Act, which requires agencies to submit rules, together with any cost–benefit analysis performed, to Congress and the General Accountability Office (“GAO”), and delays the effectiveness of “major rules” (defined as rules having an expected impact of at least $100 million); 42 and (3) the Paperwork Reduction Act, which requires agencies to minimize the burdens of, and obtain Office of Management and Budget (“OMB”) approval for, “collections of information” from the public. 43

2. The Executive Branch

As an independent regulatory agency, the SEC is not formally subject to the cost–benefit analysis requirements in executive orders, which apply to rules adopted by executive department agencies. 44 Such requirements have been in place since the Nixon Administration, and have been both ratcheted up and down in the decades since. 45 Executive Order 12,291, issued in 1981 by President Reagan, prohibited executive agencies from undertaking any “regulatory action . . . unless the potential benefits to society for the regulation outweigh the potential costs” and required those agencies to choose the “alternative involving the least net cost to society” of all available alternatives. 46 But President Clinton tempered that mandate

45. See Guynn, supra note 21, at 647.
through a process outlined in Executive Order 12,866, which remains in place today.\textsuperscript{47} Among other changes, President Clinton’s Order instructed executive agencies to consider qualitative as well as quantitative measures of costs and benefits, and merely obligated such agencies to provide “a reasoned determination that the benefits of the intended regulation justify its costs.”\textsuperscript{48} Three years later, the OMB issued “best practices” for agencies bound by Executive Order 12,866,\textsuperscript{49} which were ultimately incorporated in OMB Circular A-4 during the George W. Bush Administration.\textsuperscript{50} President Obama’s Executive Order 13,563 builds on those mandates by instructing all executive agencies to use “the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.”\textsuperscript{51} Executive Order 13,579 encourages—but does not require— independent regulatory agencies to comply with the cost–benefit analysis obligations set forth in Executive Orders 12,866 and 13,563.\textsuperscript{52}

3. The SEC’s Policies and Practices

As an independent regulatory agency that has long regarded economic analysis as “an essential part” of its rulemaking,\textsuperscript{53} the SEC has frequently emphasized the value of quantifying the expected costs and benefits of proposed rules.\textsuperscript{54} In the 1970s, the SEC added the first professional economists to its staff,\textsuperscript{55} who were formally organized into an office headed by a chief economist.\textsuperscript{56} Soon thereafter, the SEC voluntarily began to include a “cost–benefit analysis” section in its rule proposals and adopting releases.\textsuperscript{57} Some have speculated that the SEC’s motivation may have been a strategic attempt to dissuade the Nixon Administration from attempting to extend the OMB’s review of executive agency rulemaking to the independent regulatory agencies.\textsuperscript{58} Throughout the 1980s, “the Chief Economist and

\textsuperscript{47} Exec. Order No. 12,866, 3 C.F.R. 638 (1993).
\textsuperscript{48} Id. §1(b)(6).
\textsuperscript{54} See id. (stating that “our staff’s guidance draws upon principles set forth in OMB Circular A-4 and Executive Orders 12866 and 13563”); Audit No. 347, Rulemaking Process, U.S. SECs. & EXCH’G COMM’N, (July 12, 2002), http://www.sec.gov/about/oig/audit/347fin.htm (stating that “the cost-benefit analysis section of a rule is becoming increasingly significant and [SEC officials] intend to more consistently follow the best practice principles in Executive Order 12866”).
\textsuperscript{57} Id. at 296.
\textsuperscript{58} Id. at 296–97.
his staff had increasing prominence."\(^{59}\) The Office of the Chief Economist later expanded into an Office of Economic Analysis.\(^{60}\) Then in 2009, the SEC created a new Division of Risk, Strategy, and Financial Innovation ("RSFI"), which combined three then-existing offices: the Office of Economic Analysis, Office of Risk Assessment, and Office of Interactive Data.\(^{61}\) A final change occurred in June 2013 when, "to better reflect its core responsibilities and focus," the SEC renamed the RSFI to the Division of Economic and Risk Analysis.\(^{62}\)

Over the last decade, the economists at the SEC have had their work subjected to intensive scrutiny from various directions. In May 2012, in response in large part to the "questions" raised in court decisions, GAO reports, and reports by the SEC's Office of Inspector General—as well as in congressional inquiries—the RSFI, along with the Office of General Counsel, issued and developed joint guidance that emphasizes the value of conducting rigorous economic analysis in SEC rulemaking.\(^{63}\) This relatively new guidance unambiguously endorses the principles set forth in Executive Orders 12866 and 13563, and in OMC Circular A-4. In so doing, it sets out several "substantive requirements for economic analysis in SEC rulemaking," which obligate rule-writing staff in all SEC divisions to: (1) "clearly identify the justification for the proposed rule";\(^{64}\) (2) "define the baseline" against which the economic effects of a rule will be measured;\(^{65}\) (3) identify and discuss "reasonable alternatives" to a proposed rule that might produce comparable results with fewer economic costs;\(^{66}\) and (4) analyze a proposed rule's economic consequences by "identify[ing] relevant benefits and costs" and "quantify[ing] expected benefits and costs to the extent feasible."\(^{67}\)

Although the SEC's issuance of this guidance has been criticized by some as a "significant shift... which could have profound implications for protecting the public, investors, and securities markets,"\(^{68}\) it is important to recognize that the guidance regards cost–benefit analysis as only one of the four enumerated requirements for economic analysis.

\(^{59}\) Thomas Lee Hazen, Roles and Functions of the Securities and Exchange Commission, SR043 ALI-ABA 31, 38 (2010).

\(^{60}\) See SEC, SEC Creates the Office of Economic Analysis, SEC NEWS DIGEST 88-19 (Feb. 1, 1988).


\(^{64}\) Id. at 5.

\(^{65}\) Id. at 6.

\(^{66}\) Id. at 8.

\(^{67}\) Id. at 9.

\(^{68}\) Dennis M. Kelleher et al., BETTER MARKETS, INC, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC 59 (2012).
“rather than as a stand-alone approach to evaluating the economic effects of a rule.”

**B. Cost–Benefit Analysis Requirements Imposed Through Judicial Interpretation**

Had SEC officials been left to their own devices, a rigorous cost–benefit analysis may well have become the routine precursor for any major new rule. But there is no escaping the fact that these officials now view themselves as practically bound by the D.C. Circuit’s “instruction that the [SEC] determine as best it can the economic implications of the rules it promulgates.” This instruction emanates most directly from the *Business Roundtable* decision, which was grounded in several prior precedents, including *American Equity Investment Life Insurance Co. v. SEC* and *Chamber of Commerce v. SEC*.

In *Business Roundtable*, notwithstanding the more than 21,000 hours of agency time expended in the development of Rule 14a-11’s limited provision of “proxy access” and a more than 73-page (or nearly 40,000-word) economic analysis of the rule upon its release, a unanimous D.C. Circuit panel vacated the rule because, in its view, the SEC had acted “arbitrarily and capriciously for having failed once again . . . adequately to assess the economic effects of a new rule.” In so doing, Circuit Judge Douglas Ginsburg, joined by Chief Judge David Sentelle and Circuit Judge Janice Rogers Brown, did not defer to the SEC’s assessment of the rule’s costs and benefits. Rather, the court found that:

[The SEC] inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.

The court further emphasized that the SEC had failed with respect to its “unique obligation” under § 3(f) of the Exchange Act to analyze rules for their

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70. *See* Brief of Respondent at 21, Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5 (D.C. July 2013) (No. 12-1668) (responding to petition for review of the SEC’s resource extraction rule that was issued pursuant to the mandate in Exchange Act § 13(q), enacted as part of the Dodd–Frank Act) (emphasis added).

71. *See* 647 F.3d 1144, 1148 (D.C. Cir. 2011).

72. 613 F.3d 166 (D.C. Cir. 2010).

73. 412 F.3d 133 (D.C. Cir. 2005).

74. *See* Schapiro Letter, supra note 8.


77. *Id.* at 1148–49.
impact upon “efficiency, competition, and capital formation,” and criticized the SEC for its unwillingness to “make tough choices about which of the competing estimates [it considered was] most plausible.” For these and other reasons, the court also found that the SEC’s decision to apply the proxy access rule to investment companies was “arbitrary.”

As we now know from the D.C. Circuit’s recent decision in American Petroleum Institute v. SEC, the petitioners in Business Roundtable lacked a statutory entitlement to have their case heard initially by the D.C. Circuit. Although the SEC advised the court that the petitioners’ statement of jurisdiction under § 25(b) of the Exchange Act was “not correct,” the agency expressly conceded that jurisdiction was proper under the Exchange Act, § 25(a). The Business Roundtable panel apparently adopted this view as well, but it made no specific finding on the issue of jurisdiction. That jurisdictional distinction, however, garnered attention in a subsequent rulemaking challenge to the SEC’s so-called “resource extraction rule,” which the SEC promulgated pursuant to a congressional command in the Dodd–Frank Act. To the great surprise of many, (most especially the SEC) the D.C. Circuit held, as a matter of first impression, that § 25(a)’s authorization of original appellate jurisdiction over “final orders entered by the Commission pursuant to [the Exchange Act]” does not encompass petitions by persons aggrieved by final Exchange Act “rules.” Instead, the jurisdictional provision for challenges to final rules promulgated under the Exchange Act is exclusively § 25(b), which extends appellate review only to persons “adversely affected by a rule promulgated pursuant to” Exchange Act, §§ 9(h)(2), 11, 11A, 15(c)(5) or (6), 15A, 17, 17A, or 19. Accordingly, because the SEC’s proxy access rule had been promulgated pursuant to its authority under § 14 of the Exchange Act, the Business Roundtable petitioners would today be required to initiate suit first in federal district court pursuant to 28 U.S.C. § 1331 and the APA.

The SEC’s defeat in Business Roundtable followed a series of similar setbacks brought about by the D.C. Circuit’s “super hard look review” of the SEC’s

78. Id.
79. Id. at 1150 (quoting Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1221 (D.C. Cir. 2004)).
80. Id. at 1156.
84. See infra notes 109, 111–13 and accompanying text.
85. See Am. Petroleum Inst., 714 F.3d at 1332 (observing that “the Commission agree[d] with petitioners that we have jurisdiction to hear this petition for review” and crediting intervenor Oxfam America for advancing the argument “that petitioners must first sue in the district court”).
86. Id. at 1333.
87. See id. (explaining that Exchange Act § 25(b) “not only expressly authorizes appellate review of agency rules, but it limits that review to rules issued pursuant to specific provisions of the Exchange Act, leaving all others to be challenged in the district court”).
cost–benefit analysis. In 2010, the court in American Equity struck down SEC Rule 151A, which interpreted the statutory term “annuity contract” to exclude fixed-index annuities, thereby subjecting such annuities to the registration provisions of the Securities Act. Original appellate jurisdiction would have been proper in that case because the rule had been promulgated pursuant to Securities Act § 19(a). Notably, however, § 19(a) does not require consideration of either the “public interest” or “the protection of investors,” and thus lacks the textual predicate that triggers the ostensible cost–benefit analysis command of Securities Act § 2(b). Chief Judge Sentelle, joined by Circuit Judges Ginsburg and Judith Rogers, nonetheless invalidated Rule 151A because “the SEC failed to properly consider the effect of the rule upon efficiency, competition, and capital formation.” In the court’s view, the SEC’s failure to consider these effects rendered the rule “arbitrary and capricious” under § 706 of the APA.

Chamber of Commerce, decided five years before American Equity, is widely regarded as the “turning point” from the SEC’s prior “blissful existence” in the D.C. Circuit. The case involved a mutual fund governance rule that exempted certain types of transactions by mutual funds from otherwise applicable prohibitions in the Investment Company Act (ICA) provided that at least 75% of the fund’s directors, as well as the fund’s chairperson, were independent from the investment adviser that managed the fund. The court’s decision to invalidate that rule centered on what the panel regarded as the SEC’s “statutory obligation to do what it can to apprise itself—and hence Congress and the public—of the economic consequences of a proposed regulation before it decides whether to adopt the measure.” And the “consideration” command in § 3(c) of the ICA was the purported source of this “statutory obligation.” Chief Judge Ginsburg, joined by Circuit Judges Rogers and David Tatel, held that the SEC “violated its obligation under [the ICA], and therefore the APA, in failing adequately to consider the costs imposed upon funds by the two challenged conditions.” The court further held that the SEC’s acknowledgement of its difficulties in estimating the costs of the funds compliance with those conditions “did not excuse the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed.”

88. Emily Hammond Meazell, Presidential Control, Expertise, and the Defe
90. Unlike the Exchange Act, which has separate appellate review provision for “final orders” and “final rules,” the Securities Act has a unary provision, which extends appellate review to “any person aggrieved by an order to the Commission.”
91. See supra note 22 and accompanying text.
92. Id. at 178.
93. Cox & Baucom, supra note 29, at 1814.
94. Chamber of Commerce v. SEC (Chamber I), 412 F.3d 133 (D.C. Cir. 2005).
95. Chamber I, 412 F. 3d at 136.
96. Id. at 144.
97. Id. at 136.
98. Id. at 144.
99. Id. at 144.
100. Id. at 143.
remanding this rule to the SEC “to address the deficiencies,” the principal precedent relied on by the court was *Public Citizen v. Federal Motor Carrier Safety Administration*, which involved a challenge to an agency rule that limited the maximum number of hours commercial motor vehicle operators were allowed to work. However, the *Public Citizen* court had invalidated that rule only after concluding that the agency did not even consider whether—let alone comply with—its statutory obligation to ensure that its rule would promote “driver health.”

In addition to the decisions in *Business Roundtable*, *American Equity*, and *Chamber of Commerce*, in the six-year period 2005–2011, the D.C. Circuit invalidated SEC rules on three other occasions and vacated one SEC order. One of those decisions struck down the mutual fund governance rule a second time, when the SEC reissued the rule after considering additional economic data. The same petitioners again sought judicial review, and the D.C. Circuit again found fault with the rulemaking process, this time because the SEC had “fail[ed] to comply with [§] 553(c) of the APA by relying on materials not in the rulemaking record without affording an opportunity for public comment, to the prejudice of the [petitioner].”

Litigation challenges involving the SEC’s rulemaking have continued unabated in the D.C. Circuit, which now hosts a full judicial bench with the additions of Judge Sri Srinivasan in May 2013, Judges Patricia Millett and Cornelia Pillar in December 2013, and Judge Robert Wilkins in 2014. Indeed, a host of congressional mandates in the Dodd–Frank Act have instructed the SEC to promulgate dozens of rules that effectuate Congress’s own policy judgments. Two of these rules were challenged by industry groups within days of their adoptions: a conflict minerals disclosure rule promulgated pursuant to Exchange Act § 13(p), and a resource extraction disclosure rule promulgated pursuant to Exchange Act § 13(q).

After an initial ruling by the U.S. Court of Appeals for the D.C. Circuit that it lacked subject matter jurisdiction to hear the challenge to the resource extraction disclosure rule in the first instance, the U.S. District Court for the District of

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101.  *Id.* at 145.
102.  374 F.3d 1209 (D.C. Cir. 2004).
103.  *Id.* at 1216 (holding that “‘the complete absen[c]e of any discussion’ of a statutorily mandated factor ‘leaves us with no alternative but to conclude that [the agency] failed to take account of this statutory limit on [its] authority,’ making the agency’s reasoning arbitrary and capricious”).
104.  See, e.g., *Fin. Planning Assoc. v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (invalidating rule that exempted broker-dealers from the Advisers Act notwithstanding their receipt of “special compensation” that was “incidental” to their brokerage services); *Chamber of Commerce v. SEC (Chamber II)*, 443 F.3d 890 (D.C. Cir. 2006); *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) (invalidating rule requiring the registration of hedge fund advisers under Advisers Act).
105.  See, e.g., *PAZ Secs., Inc v. SEC*, 566 F.3d 1172 (D.C. Cir. 2009) (vacating an SEC order that affirmed the NASD’s expulsion of a member firm).
106.  *See Chamber II*, 443 F.3d at 890.
107.  *Id.* at 894.
109.  *Id.* § 78m(q).
Columbia subsequently vacated SEC Rule 13q-1 on July 2, 2013 and remanded it to the SEC for further proceedings. Judge John Bates did not have to reach a number of arguments made by the petitioners (including that the SEC’s cost–benefit analysis was flawed) because the court concluded that the SEC had “misread [§ 13(q)] to mandate public disclosure of the reports, and its decision to deny any exemption was, given the limited explanation provided, arbitrary and capricious.” The SEC currently is working on a new proposal.

The SEC may also be required to redraft a portion of the conflict minerals disclosure rule for constitutional—rather than cost–benefit–analysis related—reasons. The rule at issue, which was promulgated pursuant to the congressional mandate in Exchange Act § 13(p), requires SEC reporting companies to submit a Form SD disclosing their use of gold, tantalum, tin, and tungsten from the Democratic Republic of Congo (“DRC”) and adjacent countries, if those minerals are “necessary” to one or more products made by the companies. The National Association of Manufacturers, the Chamber of Commerce, and the Business Roundtable initially filed a petition for review in the D.C. Circuit, and then subsequently moved for a transfer to district court based on the jurisdictional ruling in American Petroleum Institute. The plaintiffs then sought to convince the district court that the SEC failed to conduct an adequate cost–benefit analysis and misconstrued § 13(p) by failing to include a de minimis exemption. The plaintiffs further argued that the rule unconstitutionally compelled speech in violation of the First Amendment.

National Ass’n of Manufacturers v. SEC ultimately brought the SEC a long-awaited victory in a rulemaking challenge, first at the district court level, and less than a year later, at the D.C. Circuit. On July 23, 2013, on the parties’ cross-motions for summary judgment, then-District Judge—now D.C. Circuit Judge—Robert Wilkins found “no problems with the SEC’s rulemaking,” and disagreed that the conflict minerals disclosure scheme “transgresses the First Amendment.” Notably, in rejecting the plaintiffs’ contention that the SEC had contravened its statutory directives under the Exchange Act by failing to “analyze properly the costs and benefits of the Rule as a whole,” Judge Wilkins confronted that asserted premise head-on:

By their terms, [§§ 3(f) and 23(a)(2) of the Exchange Act] only obligate the SEC to “consider” the impact that a rule or regulation

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112. Id. at 11.
115. Am. Petroleum Inst. v. SEC, 714 F.3d 1329 (D.C. Cir. 2013); see supra notes 85–87 and accompanying text.
117. Id.
118. Id. at 82.
120. Nat’l Ass’n of Mfrs., 956 F. Supp. 2d at 45.
121. Id. at 55 (quoting Pls.’ Brief at 26–27).
may have on various economic-related factors—efficiency, competition, and capital formation. In doing so, the Commission may deem it appropriate (or even necessary) to weigh the costs and benefits of its proposed action as related to these enumerated factors, but to suggest that the Exchange Act mandates that the SEC conduct some sort of broader, wide-ranging benefit analysis simply reads too much into this statutory language.122

The court further found that there was simply “no statutory support for the Plaintiffs’ argument that the Commission was required to evaluate whether the Conflict Minerals Rule would actually achieve the social benefits Congress envisioned.”123 But, while the court clearly drew a distinction between the rule’s “humanitarian” implications and “the economic implications” at issue in Business Roundtable, Chamber of Commerce, and American Equity, it highlighted what it found to be a second important distinction: namely, that those cases all involved rules “that were proposed and adopted by the SEC of its own accord, with the Commission having independently perceived a problem within its purview and having exercised its own judgment to craft a rule or regulation aimed at that problem.”124 The conflict minerals rule, in contrast, was promulgated “pursuant to an express, statutory directive from Congress, which was driven by Congress’s determination that the due diligence and disclosure requirements it enacted would help to promote peace and security in the DRC.”125

In oral argument before D.C. Circuit Judges Sentelle, Srinivasan, and Raymond Randolph, the SEC once again defended against the petitioner’s claim that its cost–benefit analysis was flawed.126 But the First Amendment concern that the disclosure regime unconstitutionally compels private speech by forcing companies to “self-stigmatize” captured far more attention from the panel than any particular concern about the quality of the SEC’s cost–benefit analysis.127

The D.C. Circuit’s April 2014 decision constituted an overall win for the SEC, and an unequivocal one on the cost–benefit analysis challenge.128 Indeed, for the first time in nearly a decade, the court did not “see any problems with the Commission’s cost-side analysis.”129 It found that the SEC “exhaustively analyzed the final rule’s costs[,] . . . considered its own data as well and cost estimates submitted during the comment period[,] . . . and arrived at a large bottom line figure that the Association does not challenge.”130 The court also credited the SEC for

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122. Id. at 56.
123. Id.
124. Id. at 57–58.
125. Id. at 58. The court also questioned whether the “consider” command in Exchange Act § 3(f) was even applicable “to this rulemaking in the first place” since Congress did not use the triggering language when it required the SEC to issue a conflict minerals disclosure rule pursuant to § 13(p) of the Exchange Act. Id. at 58 n.15.
127. Id.
129. Id. at 369.
130. Id.
“specifically consider[ing] the issues listed [in Exchange Act § 3(f)],” and cited the SEC’s finding “that the rule would impose competitive costs, but have relatively minor or offsetting effects on efficiency and capital formation.” On the benefit side of the calculus, the court found it “difficult to see what the Commission could have done better,” noting that the agency determined that Congress sought “compelling social benefits” which the agency was “unable to readily quantify . . . because it lacked data about the rule’s effects.” The court further emphasized that an agency “need not conduct a ‘rigorous, quantitative economic analysis’ unless the statute explicitly requires it to do so.” Moreover, “[e]ven if one could estimate how many lives are saved or rapes prevented as a direct result of the final rule, doing so would be pointless because the costs of the rule—measured in dollars—would create an apples-to-bricks comparison.” Congress itself made the overall determination that the costs of conflict-minerals disclosures “were necessary and appropriate in furthering the goals of peace and security in the Congo,” and therefore, the court refused to fault the SEC for its unwillingness to “second-guess [ ] Congress.”

It remains to be seen whether National Ass’n of Manufacturers signals the D.C. Circuit’s full-throttle return to its traditional approach of substantial deference to an agency’s rulemaking. The decision could well be merely a limited respite aimed at agency rules that were promulgated pursuant to explicit congressional directives. Ultimately, however, even though the court did not “see any problems with” the SEC’s cost–benefit analysis, it sided with the plaintiffs (by a 2-1 vote) on the First Amendment challenge. The constitutionally infirm provisions required certain public companies to describe their products as not “‘DRC conflict free’” in the reports that they file with the SEC, and also required the companies to disclose this information on their websites. Judges Randolph and Sentelle viewed such mandatory disclosure as a type of compelled speech that could only be justified by a narrowly tailored regulation that directly and materially advances a substantial government interest.

In the wake of National Ass’n of Manufacturers, a sharply divided SEC voted to implement those portions of the conflict minerals disclosure rule that were not placed at issue in view of the court’s First Amendment ruling. The D.C.

133. Id. (quoting Inv. Co. Inst. v. Commodity Futures Trading Comm’n., 720 F.3d 370, 379 (D.C. Cir. 2013)).
134. Id. at 369, 370.
135. Id. (quoting 15 U.S.C. §§ 78m(p)(1A)(ii) & (E) (2012)).
136. Id. at 371–72.
137. Joint Statement on the Conflict Minerals Decision, SEC Commissioners Daniel M. Gallagher & Michael S. Piwowar,
Circuit subsequently granted the SEC a rehearing of the First Amendment analysis.\textsuperscript{142} The rehearing was prompted by the D.C. Circuit’s en banc decision in \textit{American Meat Institute v. U.S. Department of Agriculture}, which clarified that disclosure regulations may be directed at substantial governmental interests “beyond the interest in correcting misleading or confusing commercial speech.”\textsuperscript{143} But to prevail in the rehearing, the SEC will still have to defend Congress’s determination that conflict minerals disclosures directly advance “a substantial government interest.”\textsuperscript{144}

\textbf{C. Legislative Attempts to Heighten the SEC’s Existing Cost–Benefit Analysis Obligations}

The House of Representatives passed the proposed SEC Regulatory Accountability Act (“H.R. 1062”) on May 17, 2013 by a vote of 235-161.\textsuperscript{145} The bill would obligate the SEC to engage in mandatory cost–benefit analysis with respect to every proposed “regulation,” a term defined broadly to include “rules, orders of general applicability, interpretative releases, and other statements of general applicability that the agency intends to have the force and effect of law,” but that does not include internal SEC rules, regulations certified as “emergency action,” or regulations promulgated pursuant to an express statutory provision that explicitly “prohibits compliance with this provision.”\textsuperscript{146} It requires the SEC to utilize “the Chief Economist to assess the costs and benefits, both qualitative and quantitative, of the intended regulation and propose or adopt a regulation only on a reasoned determination that the benefits of the intended regulation justify the costs of the regulation.”\textsuperscript{147} It further requires the SEC to explain why the regulation meets its identified regulatory objectives “more effectively” than other available alternatives,\textsuperscript{148} and it obligates the SEC to “choose the approach that maximizes net benefits.”\textsuperscript{149} In so doing, the SEC is expected to “evaluate whether, constituent with the regulatory objectives the regulation is tailored to impose the least burden on society, including market participants, individuals, businesses of differing sizes, and other entities (including State and local governmental entities), taking into account, to the extent practicable, the cumulative costs of the regulations.”\textsuperscript{150} Additionally, the bill requires the SEC to explain the nature of the comments that it received in the course of its rulemaking process, the changes that it made in response to those

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  \item[143.] 760 F.3d 19, 23 (D.C. Cir. 2014).
  \item[144.] Id.
  \item[146.] H.R. 1062, 113th Cong. § 2(e)(6) (2013) (as passed by House, May 17, 2013).
  \item[147.] Id. § 2(e)(1)(B).
  \item[148.] Id. § 2(e)(1)(C).
  \item[149.] Id. § 2(e)(2)(A).
  \item[150.] Id. § 2(e)(2)(A)(ii).
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comments, and “the reasons that the Commission did not incorporate those industry
group concerns related to the potential costs or benefits in the final rule.”

The proposed legislation also imposes requirements that go far beyond
mandatory cost–benefit analysis obligations in connection with new SEC
regulations. For “major” regulations expected to have an economic impact greater
than $100 million annually, the SEC would be required to publish an assessment,
within two years, which must include consideration of “costs, benefits, and intended
and unintended consequences” using performance measures that were identified
when the rule was adopted. The SEC would also be required to review all
regulations every five years to determine whether any such regulations are
“outmoded, ineffective, insufficient, or excessively burdensome, and shall modify,
streamline, expand, or repeal them in ordinance with such review.” Such
obligatory second-looks, including the need to perform a second cost–benefit
analysis on major regulations adopted only two years before, provide industry
groups with the opportunity to refight their battles with the SEC and possibly in
court as well.

When asked about the bill in the course of her recent testimony before the
House Committee on Financial Services, SEC Chairperson Mary Jo White
emphasized that, while she is “a firm supporter of rigorous economic analysis,” she
nonetheless has substantial concerns about the bill, both in terms of the SEC’s
“ability to carry out our rulemaking function expeditiously and to provide market
participants with certainty.” Chairperson White predicted that if enacted, the bill
“would create a lot of litigation that . . . would undermine our ability to do our job”
because its additional requirement would put the agency’s rules “under constant
challenge.”

Former SEC Chairperson Arthur Levitt has also spoken out against the bill,
acknowledging the “superficial” appeal of a mandate that requires regulators to
analyze and weigh the burden of a new rule against the benefits. But, in Levitt’s
view, such analysis is “highly judgmental, and its outcome depends on the support
it has from Congress to get the data it needs.” Levitt concluded as follows:

I would much rather have Congress recognize that cost-benefit work
requires that the commission have significantly more power and
resources to gather and analyze data. What we need is not a
requirement to do more cost-benefit analysis, but better tools to do
the work well and with more precision. Otherwise, cost-benefit
analysis will become a permanent and immovable wall to future

151. Id. § 2(e)(3).
152. Id. § 2(e)(5).
153. Id. § 2(e)(4).
155. Id. at 12–13.
157. Id.
efforts to improve the stability, safety and transparency of financial markets.\textsuperscript{158}

President Obama’s strong opposition to H.R. 1062 echoed a similar theme.\textsuperscript{159} His statement of Administrative Policy emphasizes that the bill would: (1) “add onerous procedures that would threaten the implementation of key reforms related to financial stability and investor protection”; (2) instruct “the SEC to conduct time- and resource-intensive assessments after it adopts or amends major regulations before the impacts of the regulations may have occurred or be known”; and (3) “add analytical requirements that could result in unnecessary delays in the rulemaking process, thereby undermining the ability of the SEC to effectively execute its statutory mandates.”\textsuperscript{160}

Not to be thwarted by the President’s objections and the Senate’s clear unwillingness to act on the bill,\textsuperscript{161} the House ultimately seized on an alternative way to increase the amount of cost–benefit analysis in SEC rulemaking. The House–Senate 2014 budget agreement allocated $1.35 billion to the SEC—very close to the amount it received in 2013.\textsuperscript{162} But the SEC’s meager increase of $29 million was cannibalized by a rider directing the SEC to spend $44.5 million on activities within the SEC’s Division of Economic Analysis.\textsuperscript{163} The net result was a near-30% increase over the Division’s budget from 2013.\textsuperscript{164} Congress mentioned no other SEC division in the budget legislation, and it ignored the Obama Administration’s specific request for targeted funding for the Office of Compliance Inspections and

\textsuperscript{158} Id.


\textsuperscript{160} Id.

\textsuperscript{161} The Senate, however, had pending legislation of its own, including the Independent Agency Regulatory Analysis Act, S. 1173, 113th Cong. (2013), which was introduced by Senators Susan Collins (R-ME), Robert Portman (R-OH), and Mark Warner (D-VA). The bill would permit the President to order all independent regulatory agencies, including the SEC, to conduct a cost–benefit analysis of any new rule and to propose or adopt such rule “only upon a reasoned determination that the benefits of the rule justify its costs.” In addition, for any “economically significant rule,” independent agencies could be required to submit the rule for review by the Office of Information and Regulatory Affairs (“OIRA”), a unit of the OMB. The OIRA review would then become part of the published record for the rule. See Coates, supra note 3, at 924–26 (acknowledging the bill’s proviso that an agency’s “compliance” with its requirements is not subject to judicial review, but emphasizing “the fact that any public interagency process will create a larger record that will be used by litigators to attack particular agency judgments as arbitrary and capricious under the APA”).


\textsuperscript{164} Id.
Examinations, which would have enabled the Office to add 250 new investment adviser examiners to its existing staff of about 400.165

II. THE RAMIFICATIONS OF MANDATORY COST–BENEFIT ANALYSIS REQUIREMENTS

A. SEC Paralysis

As others have observed, the SEC’s inclination to insulate itself from litigation over the adequacy of its cost–benefit analysis has substantially slowed the pace of its rulemaking, and has prompted it to shelf many important regulatory initiatives.166 Additionally, extensive judicial scrutiny of the SEC’s cost–benefit assessments has decreased its willingness to revise and improve upon existing rules.167

Yet even before Business Roundtable and Chamber of Commerce, the SEC would sometimes view cost–benefit analysis as an insurmountable obstacle that impeded important regulatory change. Consider, for instance, Arthur Levitt’s account of the SEC’s skirmish with the accounting industry in the late 1990s over a rule that would have required greater auditor independence:

[When I moved to implement regulation prohibiting accounting firms from doing auditing and consulting work for the same companies, the Big Five firms threatened litigation, saying we had to do a cost-benefit analysis. Problem was, the big audit firms alone held the cost data. We asked them for those data, which they declined to provide.

Meanwhile, the benefits of the proposed rules were clear to me—they would have raised investor confidence in the quality of audits—but were difficult to quantify with precision. We were stuck, and the rule proposal died.

The fact that the S.E.C. was vindicated later, when these audit conflicts were identified as one of the accelerants of the dot-com bubble and our proposed independence rules were incorporated into the 2002 Sarbanes-Oxley securities law, is of little solace to me.168

The controversy surrounding the appropriate standard of conduct for the providers of investment advice to retail investors provides a more recent example of the SEC’s “paralysis by analysis.”169 Although the SEC was poised in early 2011 to propose a new rule that would have codified a recommendation to establish a uniform fiduciary standard for broker-dealers and investment advisers—a

165. Id.
166. See Hillary J. Allen, A New Philosophy For Financial Stability Regulation, 45 Loy. U. Chi. L.J. 173, 176 (2013) (observing that the delay in the implementation of key Dodd–Frank provisions can be attributed in part to “regulators girding for future administrative law challenges by engaging in painstaking consultation with the industry over the intricacies of their rulemaking”); Black, supra note 12, at 783.
167. See Allen, supra note 166, at 176; Black, supra note 12.
168. Levitt, supra note 156.
169. See McGarity, supra note 17.
recommendation embodied in a staff study that was mandated in the Dodd–Frank Act—the process was held in abeyance for more than two years. Then, in March 2013, the agency restarted its engine, but only with the quiet hum of an SEC Release “requesting data and other information, in particular quantitative data and economic analysis, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker–dealers and investment advisers.” And although the SEC has included fiduciary duty rulemaking in its long-term agenda for 2014, few expect the SEC to be “moving soon” and to be “looking to fight new fights this year.” One ironic twist involves a recent assertion by the Securities Industry and Financial Markets Association’s General Counsel that the Department of Labor should “stand down” and not issue an expected proposed rule regarding its definition of fiduciary standard of care until the SEC issues its own rules on the subject. But the SEC itself appears to be standing down, in all likelihood because it lacks the fortitude to wage a litigation battle with the broker–dealer industry over the adequacy of its cost–benefit analysis.

The SEC’s rulemaking obligation under the Dodd–Frank Act to require so-called CEO pay ratio disclosures further illustrates the current paralysis. Section 953(b) of the Act directed the SEC to require publicly traded companies to disclose the ratio of the median total annual income for all employees to the annual income of their chief executive officer in their annual reports. The SEC issued these proposed rules with an accompanying cost–benefit analysis in September 2013. The Chamber of Commerce’s Center for Capital Markets Competitiveness has claimed it would cost such companies more than $700 million a year to comply with the proposed pay ratio rules, compared to the $72.7 million estimated in the SEC release (an underestimate by more than 87%) and that the SEC likewise “underestimated compliance time by 560[hexagon].” But investor advocates have countered that “America’s corporations are not going to be spending 3.6 million hours to calculate ‘how much their typical workers take home,’” and that “the Chamber’s cost–benefit analysis was derived from a survey of about 3.1[percent] of the companies that would be covered by the SEC pay ratio rule, once adopted.”

170. See Black, supra note 12.
177. Id. (quoting Sam Pizzigati, an associate fellow at the Institute for Policy Studies).
Despite the mandate in the Dodd–Frank Act dating back more than four years, the SEC has yet to adopt final pay ratio rules.

B. Investor-Driven Rulemaking Challenges

As the litigation battles discussed in Part I of this Article reflect, thus far, challenges to the adequacy of the SEC’s cost–benefit analysis have been initiated and funded almost entirely by business trade groups such as the Business Roundtable and the Chamber of Commerce. These trade groups have been remarkably successful in convincing the D.C. Circuit to invalidate SEC rules that impose new and unwelcomed costs on the their members. But it is only a matter of time before investor- or consumer-protection groups begin to launch their own cost–benefit-analysis-based challenges. These challenges will almost certainly be mounted to thwart deregulatory rules, and will be bolstered by likely assertions that the SEC underestimated the investor or consumer benefits arising from existing regulatory protections, and overestimated the costs imposed by the status quo. “Rigorous” cost–benefit analysis, moreover, need not be confined to quantitatively estimating the monetary costs and benefits of a new SEC rule or the significant revision of a long-standing one. The analysis in cost–benefit analysis can also take into account the emotional costs and benefits of new policies and regulations.

Consider, for example, the SEC’s proposed “Regulation Crowdfunding,” which would allow issuers that are not SEC reporting companies to raise capital up to $1 million annually through the offer and sale of crowdfunded securities. Although it was the small business community that lobbied Congress for the JOBS Act provision that added this new transactional exemption to the Securities Act, the proposed regulation is drawing intense criticism from that very community and its supporters in Congress. Indeed, the SEC has been called upon “to ease the costs and burdens of the proposed requirements.” The small business community and other market participants can be expected to push hard for revisions during the regulation’s period of notice and comment because, once the SEC issues a final rule, a rulemaking challenge would be self-defeating. The Securities Act’s new

178. See Coates, supra note 3, at 916 (observing that cost–benefit analysis of financial regulation “can slow or stop deregulation as easily as it can slow or stop new regulation”). Investor- or consumer-driven litigation likewise can—and has—been initiated to challenge the SEC’s failure to enact rules that must be issued pursuant to congressional mandates. See Yin Wilczek, Relief Group Wants SEC to Issue Resource Payment Proposal by August, 47 SEC. REG. & L. REP. 211 (2015) (reporting on lawsuit filed by Oxfam, which alleges that the SEC’s “repeated failure to meet statutorily required deadlines [in connection with the resource extraction disclosure rule] presents a clear and indisputable instance of agency action ‘unlawfully withheld' under the Administrative Procedure Act”).

179. Huang, supra note 5.


182. Id.
crowdfunding exemption is not self-executing, and thus even a burdensome regulation would be preferable to no regulatory exemption at all.

Regulation Crowdfunding, however, could face a rulemaking challenge from a different direction entirely. An investor protection group could, perhaps, initiate a lawsuit alleging that the SEC had failed to adequately consider “the interests of investors” when it acceded to requests by market participants to remove some of the regulatory burdens on small businesses. Such a challenge could possibly zero in on the exemption’s effects on investors who are traditionally vulnerable to high-pressure sales tactics, such as senior citizens. Indeed, as SEC Commissioner Luis A. Aguilar emphasized in a recent speech, “[e]lder financial abuse is a problem growing exponentially, and the SEC must remain vigilant in detecting and prosecuting fraud targeted at the elderly.” Although Commissioner Aguilar voted in favor of the proposed Regulation Crowdfunding, he and Commissioner Kara Stein did so only after voicing their concerns about the “substantial risks” involved. Commissioner Aguilar was especially concerned about the potential for “affinity frauds,” and he welcomed comments from investor advocates as to whether “the proposed rules have enough safeguards built-in to protect investors from fraud and self-dealing and to provide them with confidence that they are being dealt with fairly and honestly.”

Commissioner Aguilar’s tepid support for the proposed Regulation Crowdfunding came on the heels of his outright dissent to the SEC rules (including new Reg D Rule 506(c)) that lifted the ban on general solicitation and advertising that previously applied to most private placements. His dissenting statement emphasized that he was “disappointed and saddened by the reckless adoption of these rules, which he regarded as “com[ing] at the expense of investors and plac[ing] investors at greater risk.”


Yet Commissioner Aguilar launched his starkest criticism at the SEC’s rulemaking process, going so far as to categorize it as “fatally flawed.” In his view, the “primary error” was traceable to the proposing release, which “excluded any substantive discussion of the various suggestions to mitigate risk from general solicitation that were raised by commenters prior to the issuance of the proposal.”

This exclusion prevented the SEC “from considering such suggestions at the adopting phase of the rulemaking.” His dissent went on to explain that:

> Numerous alternatives to the stripped-down version of the rule adopted here today are in the record, but—instead of considering them as part of the process of removing the ban on general solicitation, when it mattered most—the majority dismissed them out-of-hand, without data, without analysis, and without any substantive explanation.

Thus, he chastised his fellow Commissioners for ignoring the SEC staff’s guidance on economic analysis, which requires an “[i]dentification of alternative regulatory approaches, together with an evaluation of the benefits and costs, both quantitative and qualitative, of the main alternatives.” And seizing a page from the business trade groups’ playbook, he accused the SEC of abandoning its judicially recognized duty to enact rules “on the basis of empirical data and sound analysis,” and to ensure that such analysis “include[s] adequate consideration of reasonable alternatives.” He further faulted the SEC for failing “to adequately assess the economic effects of the new rule.” That economic analysis, in his view, included “numerous unsupported conclusions,” “unexplained contradictions,” and repeated acknowledgements that the SEC’s “data on the Rule 506 market is unreliable or incomplete.”

In addition to its newly adopted Reg. D Rule 506(c) and proposed rules for the crowdfunding exemption, the SEC’s rulemaking docket includes a number of other deregulatory initiatives mandated by the JOBS Act. These deregulatory initiatives include a so-called Reg. A+, which, as currently proposed, could also draw claims that it places investors at great risk. The proposing release contemplates an expansion of Reg. A that would allow nonreporting companies to conduct offerings of up to $50 million per year. And under the proposed rules, state securities regulators would be preempted from reviewing any so-called Tier 2

188. Id.
189. Id.
190. Id.
191. Id.
192. Id. (citing RDFI and General Counsel Guidance Memo).
193. Id. (quoting Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011)).
194. Id. (citing Chamber of Commerce v. SEC, 412 F.3d 133, 144–45 (D.C. Cir 2005)).
195. Id.
196. Id.
198. Id. at 3927.
offerings with dollar amounts $5–$50 million. Not surprisingly, state securities regulators have begun “lobbying efforts to try to persuade the SEC to change its mind on the preemption of blue sky laws for Tier 2 offerings.” Militating in favor of preemption is the frequently asserted claim that “more than half the cost” of a Reg. A offering is in dealing with the states. Militating against a preemption provision is the possibility of a streamlined state review process for Reg. A offerings, which is currently being developed by the North American Securities Administrators Association (“NASAA”). Although it is unlikely that NASAA would seek to invalidate any final regulation that is adopted by the SEC, NASAA has emphasized that there is “[u]ncertainty regarding the rule’s ability to withstand a legal challenge,” and that this uncertainty “may discourage companies . . . from utilizing the federal exemption.”

C. Regulation by Enforcement

Rulemaking, of course, is only one of the several vehicles used by the SEC to develop and apply its policy choices. The SEC can also effectively impose new regulatory requirements through the process of adjudicating administrative proceedings against alleged securities law violators or through the initiation of enforcement actions in federal district court. The Supreme Court expressly acknowledged in SEC v. Chenery Corporation 332 U.S. 194 (1947) that the announcement of a new regulatory interpretation in the course of a litigated proceeding will necessarily have a retroactive effect on the individual or entity subject to prosecution. But the Court nonetheless held that announcing new rules of law by means of adjudication was not an abuse of discretion per se. Indeed, the Court went so far as to emphasize that “the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency.” And citing Chenery, the D.C. Circuit has highlighted this discretion by observing that “it is the agency, not the court, which determines whether to proceed by rulemaking, by individual adjudication, or by a combination of the two.”

The SEC, however, need not apply rigorous cost–benefit analysis to its enforcement determinations. It may well choose to perform such analysis voluntarily in certain instances as an effective tool of policymaking. But it is by no means required to do so—and even the most ambitious legislative proposals for

199. Id. at 3930.
200. Wilczek, supra note 172.
203. Id.
204. 332 U.S. 194 (1947).
205. Id. at 203–04.
206. Id.
207. Id.
heightened cost–benefit analysis obligations stop sort of mandating such analyses for the SEC’s prosecutorial decisions and adjudications.

Increased regulation by enforcement is thus another likely consequence of the high level of judicial scrutiny applied to SEC rulemaking. We can also expect to see substantially more regulation by enforcement if the proposed SEC Regulatory Accountability Act becomes law.

Some scholars are already convinced that “the lengthy rule writing and rulemaking process” should be replaced on occasion with a regulation-by-enforcement approach that relies on courts and regulators to shape “the precise boundaries of what is prohibited and what is not.” Professor Frank Partnoy, for example, observes that “there are numerous new areas of financial market practice where this kind of approach might be preferable to establishing detailed rules in advance”—and, in particular, he emphasizes that such ex post assessments would avoid “detailed scrutiny” of an agency’s cost–benefit analysis. Professor Partnoy provides an illustration that centers on the proliferation of structured notes being sold to retail investors. He suggests that instead of considering “new rules designed to require disclosure and impose specific standards, such as suitability,” the SEC could simply initiate a series of enforcement actions against the sellers of structured notes. Then, “[t]hrough the adjudication of these cases, regulators—and judges—might establish new ex post standards to govern not only the conduct of the actors in those cases, but other future actors as well.” Other scholars, while not necessarily advocating for that approach, have nonetheless recognized that “when the SEC brings enforcement actions, it does not have to do cost–benefit analysis.”

Perhaps the SEC could even use regulation-by-enforcement to bring about proxy access, notwithstanding the rulemaking challenge and its ultimate loss in Business Roundtable, Section 14(a) of the Exchange Act and SEC Rule 14a-9 already extend broad antifraud authority to the SEC. Thus, the SEC could possibly use these provisions to effectively require publicly traded companies to disclose information about shareholder nominees in their proxy statements. As one scholar has argued, “[t]o the extent companies are seeking proxies for their candidates, shareholders likely have a need to know that in fact there are other candidates that may be nominated at the meeting.” With this regulation by

210. Id. (citing Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011)).
211. Id.
212. Id. at 118–19.
214. See supra notes 74–80 and accompanying text.
enforcement approach, he explains, “there is no need to conduct an economic analysis of any kind.”

The paradox here is that “for the most part, the regulated prefer that regulators utilize rulemaking over principles-based enforcement actions . . .” The reasons for this preference are many and have been explored in detail by others including, most famously by former SEC Commissioner, now Professor Roberta Karmel, and former SEC Chairperson Harvey Pitt. Professor Karmel was one of the first scholars to indict the SEC for “abus[ing] its prosecutorial independence by transforming its enforcement program into a policy-making, and, therefore, highly political tool.” She further argued that regulation by enforcement is antithetical to the values of governmental transparency and public participation, emphasizing that “[o]ther regulated persons who will become subject to [a] regulatory policy do not have the opportunity to object or to comment upon the new interpretation or rule, as they would have in a rulemaking proceeding.” Pitt and co-author Karen Shapiro echoed this critique and likewise argued “that notions of due process require ample, advance notification of precisely what types of conduct will be prohibited, before any person may be civilly or criminally prosecuted for a violation of those standards.”

D. Informal Guidance That Creates New and Practically Binding Law

The SEC hardly needs the extensive judicial scrutiny applied to its cost–benefit analysis to highlight the advantages of bypassing rulemaking altogether by announcing policy via informal mechanisms—for decades, it has routinely done so through no-action letters. And like the choice to announce regulatory interpretations through enforcement proceedings instead of rulemaking, courts are typically reluctant to interfere with this “policymaking form” choice.

As I have argued elsewhere, whether courts regard SEC no-actions letters as “law or lore,” those letters substantially affect the behavior of all market participants, rather than merely the particular no-action letter recipients. Indeed, by announcing regulatory interpretations through the vehicle of no-action letters, the SEC can both encourage favored conduct and discourage disfavored action and practices or, in some cases, eliminate them entirely.

But a host of problems can emerge when the SEC uses the no-action letter process as a policymaking tool. Such harms include: regulatory inefficiencies

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218. *Id.*
220. *KARMEL, supra* note 19, at 336.
221. *Id.* at 96.
225. See Nagy, *supra* note 20, at 923.
because the process is “time-consuming and cumbersome”; the absence of public participation that could provide the SEC with valuable insights and perspectives; and an increased likelihood of agency capture, due to the fact that the no-action process is essentially a private negotiation between the SEC and the requestor.

Equally troubling is the fact that, when a so-called regulatory interpretation announced in a no-action letter exceeds a reasonable and fair explanation of an existing statute or rule, the no-action letter process “contravenes the spirit, and arguably the letter of the APA’s notice and comment provisions.” My prior research reveals that, on a host of occasions, the SEC “has used the no-action letter process to graft new, substantive standards and obligations onto existing statutes or SEC rules” and “then applies these grafted norms in the course of its regulatory reviews, compliance examinations, and enforcement decisions as if they were regulatory requirements.” While judicial review of regulatory “interpretations” announced in no-action letters is theoretically possible, it is extraordinarily difficult to obtain, because despite their practical effect, courts typically do not view such letters as “final orders” of the SEC.

Like the SEC’s enforcement determinations, its no-action letter process clearly lacks a mandatory cost–benefit analysis component. Nor does a mandatory cost–benefit analysis obligation apply to regulatory interpretations announced in SEC releases, guidelines, or other types of agency or division-issued guidance. Congress requires the SEC to consider “efficiency, competition, and capital formation” in the course of its rulemaking, but even then, only in the course of agency rulemaking where it is also statutorily obliged to consider “investor protection.” And as we have seen, the D.C. Circuit’s view that the SEC is statutorily required “to determine as best it can the economic implications of the rule it has proposed” stems entirely from this “consideration” mandate as well.

Scholars have focused on this legal distinction between formats and, not surprisingly, have urged the SEC to eschew rulemaking by issuing guidance in certain particularly contentious policy areas. However, Congress—or at least a majority in the House—is arguably trying to stay one step ahead. The proposed SEC Regulatory Accountability Act imposes its uber cost–benefit analysis mandate on SEC “regulations,” a term that is broadly defined to include any “agency statement of general applicability and future effect that is designed to implement, interpret, or

228. Id. at 959.
229. Id. at 960.
230. Id. at 961.
231. See Board of Trade v. SEC, 883 F.2d 525, 530 (7th Cir. 1989).
232. See supra note 22 and accompanying text.
234. See, e.g., Galit A. Sarfaty, Human Right Meets Securities Regulation, 54 VA. J. INT’L L. 97, 123 (2013) (suggesting the issuance of interpretive guidance that “clarifies companies’ existing obligations to disclose human rights-related material risks” and emphasizing that such interpretative guidance would not require “a cost–benefit analysis that could be challenged in court”).
prescribe law or policy” and specifically includes “interpretive releases and other statements of general applicability that the agency intends to have the force and effect of law.”

This definition, however, would not extend to most no-action letters because they are typically issued by the SEC’s staff, and not the agency itself. Thus one likely consequence of the Act would be a strengthening of the SEC’s existing penchant for using no-action letters for policymaking. But the proposed definition of “regulation” would encompass a wide array of SEC releases and policy statements, and thus the Act’s requirements could apply to agency pronouncements that currently can be issued outside of the notice and comment requirements of the APA. In that event, the likely result would be a reduction in the number SEC releases and even more de facto regulation through the informal guidance contained in SEC no-action letters.

E. Fewer Congressional Delegations of Authority or Discretion to the SEC

Congress, of course, is not under any particular obligation to ensure that the securities legislation it passes satisfies rigorous cost–benefit analysis. Indeed, Congress can dispense entirely with economic analysis whenever it deems it politically expedient to do so. Congress, therefore, at least on occasion, may avoid delegations of authority to the SEC and may tackle the legislative crafting of detailed statutory provisions itself. Doing so enables Congress to sidestep the “paralysis by analysis” that inflicts the SEC while reducing the risk that an SEC rule will be struck down because of inadequate cost–benefit analysis.

Consider, for example, the crowdfunding exemption in the JOBS Act. While it is possible that an investor-protection group could challenge that regulation, it was Congress—not the SEC—that conducted the regulatory calculation and found that the benefits to small businesses outweighed the potential risks to investors. As others have recognized, Congress accorded the SEC remarkably little discretion over that exemption, notwithstanding Congress’s own lack of administrative expertise. As Judge Wilkins recently emphasized in National Ass’n of Manufacturers, a rule that is promulgated pursuant to an “express, statutory direction from Congress” commands greater deference than a rule that was “proposed and adopted by the SEC of its own accord, with the Commission having independently perceived a problem within its purview and having exercised its own

237. See Coffee, supra note 16, at 1067, 1080 (recognizing the possibility that “Congress could legislate its own standards without delegating the matter to administrative agencies,” but “stop[ing] short of recommending any across-the-board movement towards greater legislative specificity because it would entail undesirable rigidity”); see also Coates, supra note 3, at 917 (observing that rigorous judicial review of the adequacy of cost–benefit analysis in financial regulation has “given expert agencies an incentive to ask an inexpert Congress to tie their hands with inflexible statutory commands”).
238. See supra text accompanying notes 183–85.
239. See supra text accompanying notes 180–82.
judgment to craft a rule or regulation aimed at that problem.\textsuperscript{241} Regulation Crowdfunding falls clearly within the former category.

Congress may also be motivated to go even further than it did in the JOBS Act by enacting securities regulation that is self-executing, thereby eliminating any discretion on the part of the SEC. Congress followed this path, for example, when it passed the so-called Threat Reduction Act in August 2012.\textsuperscript{242} Section 219 of that Act added a new § 13(r) to the Exchange Act that directly obligates SEC reporting companies to include in their annual reports on Form 10-K and quarterly reports on Form 10-Q certain disclosures about their Iran-related dealings.\textsuperscript{243} Like the resource extraction reporting rule (now vacated), and the conflict minerals reporting rule (awaiting a decision on rehearing by the D.C. Circuit), business-trade groups have been very vocal about the costs associated with Iran-related reporting.\textsuperscript{244} But Congress’s Iran-related reporting requirement is impervious to a legal challenge—at least on cost–benefit analysis grounds—because the obligation stems directly from an express statutory provision rather than an SEC rule.\textsuperscript{245} It is therefore quite possible that we will be seeing other “direct” social and political reporting provisions in federal securities laws in the future.\textsuperscript{246}

\textbf{CONCLUSION}

Cost–benefit analysis can be a valuable tool when deployed voluntarily to improve the rulemaking process and the overall quality of SEC rules. But troubling consequences ensue when the SEC’s discretion is swept away and cost–benefit analysis requirements are effectively—or explicitly—mandated. As this Article has shown, the costs of such mandatory analysis in SEC rulemaking include: SEC paralysis, new investor-driven challenges to deregulatory initiatives, an increasing tendency for regulation by enforcement, a greater penchant for informal and

\footnotesize{\textsuperscript{241} See supra text accompanying note 124. Reinforcing Judge Wilkins’s ruling, the D.C. Circuit likewise observed that had the SEC “second-guessed” Congress’s conclusion “that a disclosure regime would help promote peace and stability in the Congo,” then “it would have been in an impossible position” because “promulgating some rule is exactly what Dodd–Frank required the Commission to do”). Nat’l Ass’n of Mfrs. v. SEC, 748 F.3d 359, 370 (D.C. Cir. 2014).


\textsuperscript{244} Yin Wilczek, Ex-SEC Official: Stay Tuned for Congress To Require More Social, Political Disclosures, 45 SEC. REG. & L. REP. 1638 (2013) (quoting statements that compliance with the Iran requirements has been “a ton of work” and “very, very expensive”).

\textsuperscript{245} The SEC staff has, however, issued interpretative guidance on the implementation of these new requirements. See Questions 147.01-147.07 in Compliance and Disclosure Interpretations: Exchange Act Sections, U.S. SEC. & EXCH. COMM’N, http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm (last visited Jan. 12, 2015).

\textsuperscript{246} See Wilczek, supra note 244 (referencing former SEC Corp. Fin. Director Meredith Cross’s observations about Congress’s “extremely strong” temptation “to require companies to provide disclosure about an activity as opposed to regulating the activity directly”).}
unofficial rulemaking by the SEC staff, and fewer congressional delegations of authority or discretion to the SEC. For anyone seeking to apply a cost–benefit test to the question of imposing new cost–benefit tests, an understanding of all these costs is essential.