# The Sixth Commissioner

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# THE SIXTH COMMISSIONER

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## I. INTRODUCTION

Once described as the "the crown jewel of the financial regulatory infrastructure,"[1] the Securities and Exchange Commission's (SEC) domain has been invaded by the D.C. Circuit Court of Appeals. In two decisions—*Chamber of Commerce v. SEC*[2] and *Business Roundtable v. SEC*[3]—the D.C. Circuit has drastically reduced the SEC's rulemaking authority through a restrictive interpretation of a key provision of the federal securities laws.[4] That provision instructs the SEC, as part of rulemaking, to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[5]

The SEC has never issued an explicit interpretation of this statutory language, referred to as the "ECCF mandate." However, since 1996, when the ECCF mandate was added to the federal securities laws through § 106 of the National Securities Market

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[1] *Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 110th Cong. 7 (2008) (testimony of Arthur Levitt, Jr., Senior Advisor, The Carlyle Group), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=7480cab6-cfb7-473a-a741-457ac59e3747.

[2] 412 F.3d 133 (D.C. Cir. 2005).

[3] 647 F.3d 1144 (D.C. Cir. 2011).

[4] *See* discussion *infra* Part II (discussing the D.C. Circuit's interpretation of the ECCF mandate).

[5] National Securities Markets Improvement Act (NSMIA) of 1996, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424–25 (adding to the Securities Act of 1933, 15 U.S.C. § 77b(b) (2012), to the Securities Exchange Act of 1934 (2012), 15 U.S.C. § 78c(f) (2012), and to the Investment Company Act of 1940, 15 U.S.C. § 80a-2(c) (2012)). Subsequently, this amendment was added to the Investment Advisers Act of 1940. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 224, 113 Stat. 1338, 1402 (1999) (codified at 15 U.S.C. § 80b-2(c) (2012)) (incorporating this language into § 202 of the Investment Advisers Act of 1940). In addition, under § 23(a)(2) of the Securities Exchange Act of 1934 (Exchange Act), the SEC must, when adopting rules under that act, consider the impact that any such rule will have on competition. *See* 15 U.S.C. § 78w(a)(2) (2012) (codifying § 23(a)(2) of the Exchange Act). The Exchange Act also prohibits the SEC from adopting any rule that would impose a burden on competition not "necessary or appropriate in furtherance of the purposes" of that act. *Id.* While this Article focuses on the language added to the Securities Act of 1933 (Securities Act) and the Exchange Act pursuant to § 106 of the NSMIA, it would also apply, by extension, to the other mandates under the Securities Act and Exchange Act requiring the SEC to make findings about the effects of its rules on competition.

Improvement Act (NSMIA), the SEC has consistently conducted qualitative analyses to fulfill its requirements.[6]

The D.C. Circuit in *Chamber of Commerce* and *Business Roundtable* rejected the SEC's interpretive approach, instead declaring that the ECCF mandate requires the SEC to perform what essentially amounts to a quantitative cost-benefit analysis.[7] Because the SEC failed to adequately quantify the costs and benefits of its rules in those cases, the court found the SEC's rulemaking to be arbitrary and capricious, in violation of § 706 of the Administrative Procedures Act (APA).[8]

*Chamber of Commerce* and *Business Roundtable* have been widely criticized on the basis that the D.C. Circuit applied an inappropriately high standard of review to SEC rulemaking.[9] This Article identifies a more fundamental problem with the D.C. Circuit's decisions: by supplanting the SEC's interpretation of the ECCF mandate with its own, the D.C. Circuit has upset the division of power that lies at the heart of our system of government. It is this division of power that undergirds the administrative law principle that courts give deference to administrative agencies' interpretations of statutes that they administer.[10] By declaring an interpretation that is inconsistent with SEC practice, the D.C. Circuit has trumped the interpretive practices of the SEC—the regulator charged with administering the federal securities laws—by effectively taking on the role of a new, sixth SEC commissioner.

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[6] *See infra* notes 201–09 and accompanying text (discussing the SEC's cost-benefit analyses).

[7] *See* discussion *infra* Part II (discussing the holding and reasoning of these two decisions).

[8] *See infra* notes 40–43, 53–57 and accompanying text.

[9] *See, e.g.*, 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, 1828 (2012) ("Through its single-minded focus on cost-benefit analysis, the ultimate effect of the *Chamber of Commerce* and *Business Roundtable* decisions appears to be nothing less than establishing a new review standard."); Michael E. Murphy, *The SEC and the District of Columbia Circuit: The Emergency of a Distinct Standard of Judicial Review*, 7 VA. L. & BUS. REV. 125, 139, 148, 163–64 (2012) (noting that based on a review of *Business Roundtable, American Equity* and *Chamber of Commerce*, the D.C. Circuit is withholding deference from SEC rulemaking).

[10] *See, e.g.*, Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843–44 (1984) (noting that the Court has "long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer").

Ironically, the D.C. Circuit's interpretative approach could drive the SEC to ignore many significant effects of its own rules. This is because it is difficult to estimate the costs and benefits of complying with disclosure rules.[11] Because the SEC regulates primarily through disclosure,[12] this limitation is especially applicable to its rulemaking efforts. Additionally, as I argue in this Article, many of the costs and benefits of SEC rules cannot be quantified.[13] Critically, it is impossible to quantify the effects of SEC rules on firm strategic and risk management processes. Strategic management refers to the process a firm employs to generate gains and thereby remain competitive.[14] While implementing a strategic management process helps motivate employees, creates better employee attachment to the selected strategy, and builds firm commitment, scholars of strategic management widely recognize that these benefits are unquantifiable.[15] Many of the benefits of risk management, too, are intangible.[16] As such, any consideration of purely quantitative effects of SEC rules will either ignore or not adequately capture the effects of its rules on firm processes designed to ensure firms' competitive survival.

Moreover, with so many potential pitfalls in SEC cost-benefit analyses, it will become substantially easier for parties to challenge SEC rulemaking.[17] In fact, the SEC is increasingly facing challenges to its rules on the basis that it failed to adequately assess the economic effects of its rules.[18] Ultimately,

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[11] *See infra* notes 312–13 and accompanying text (highlighting the difficulties in quantifying the effects of disclosure rules).

[12] JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 39–40 (3d ed. 2003).

[13] *See* discussion *infra* Part V.B (discussing the SEC's challenges in implementing a cost-benefit analysis).

[14] *See* Nadelle Grossman, *The Duty to Think Strategically*, 73 LA. L. REV. 449, 456 n.25, 457 (2013) (describing the process and goals involved in managing a firm's strategy).

[15] *See infra* note 334 and accompanying text (quoting two commentators who underscore the difficulty in quantifying strategic management).

[16] *See infra* note 334 and accompanying text.

[17] A person has standing to challenge a rule under the APA where that person is aggrieved by agency action and has an interest that falls within the class of interests sought to be protected. Administrative Procedures Act, 5 U.S.C. § 702 (2012).

[18] *See, e.g.*, Nat'l Ass'n of Mfrs. v. SEC, 956 F. Supp. 2d 43, 55–56 (D.C.C. 2013), *overruled by* Am. Meat Inst. v. U.S. Dep't of Agric., 760 F.3d 18 (D.C. Cir. 2014) (describing plaintiffs' first challenge to the SEC's conflict minerals rule, which asserted that the SEC failed to

this could lead to increased uncertainty about the future of SEC rules and, in turn, a decline in rulemaking efforts.

The problems exposed by this Article are not merely academic. The SEC must pass numerous rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[19] as well as the Jumpstart Our Business Startups Act (JOBS Act),[20] and it cannot afford to have more of its rules avoided to satisfy a judicially-contrived ECCF mandate.

To address these concerns, in this Article I argue that the SEC must exert its regulatory authority and clearly prescribe what the ECCF mandate means. In doing that, the SEC must clearly preserve its right to engage in a qualitative analysis where the context so requires. Moreover, setting out a clear model for how the SEC satisfies the ECCF mandate will give parties affected by SEC rules, as well as courts, a standard by which to determine whether or not the SEC has satisfied its statutory mandate. Issuing such an interpretation would then relegate the D.C. Circuit and other courts to their usual role of assessing whether or not the SEC, in rulemaking, acted arbitrarily or capriciously under § 706 of the APA in performing the analysis the SEC has dictated is required.

Part II of this Article reviews the *Chamber of Commerce* and *Business Roundtable* decisions. In particular, it explains how the D.C. Circuit in those decisions interprets the ECCF mandate as requiring the SEC to engage in a quantitative cost-benefit analysis in its rulemaking. As the discussion points out, the D.C. Circuit failed to even question the ambiguous nature of the ECCF mandate, concluding that it clearly requires a quantitative cost-benefit analysis.

Yet as Part III explains, the ECCF mandate is ambiguous. For example, it is not clear how the ECCF mandate relates to the long-standing constraints on the SEC to act in the public interest and

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properly analyze the costs and benefits of the rule in contravention of its statutory directive to do so under the Exchange Act). While the Court of Appeals ultimately ruled in favor of the SEC on this challenge, this case exemplifies the trend of challenges to SEC rulemaking due to alleged deficiencies in the SEC's cost-benefit analysis under the ECCF mandate.

[19] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S.C.).

[20] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

for the protection of investors. It is also not clear what the SEC must consider to satisfy the ECCF mandate's provisions. The ambiguous nature of the ECCF mandate triggers application of principles of administrative law that reconcile agency power to interpret an ambiguous statute that it administers with the power of judicial review.

Part IV reviews those principles of administrative law. In particular, it reviews the *Chevron* and *Skidmore* standards that courts apply in reviewing agency action that interprets ambiguous statutes. That discussion explains why the absence of explicit SEC guidance on the meaning of the ECCF mandate created an opportunity for the D.C. Circuit to draw its own conclusion about the meaning of that statutory provision. On the other hand, that discussion questions the court's failure to give any deference to the SEC's interpretation, which can be culled from decades of analysis under the ECCF mandate. Ultimately, Part IV reasons that the SEC can still exert its authority and issue its own interpretation of the ECCF mandate. It also argues that if such an interpretation were issued through notice-and-comment rulemaking, that interpretation would trump the D.C. Circuit's interpretation.

While Part IV thus shows that the SEC *can* still realize the full scope of its authority by interpreting the ECCF mandate notwithstanding the *Chamber of Commerce* and *Business Roundtable* decision, Part V argues that the SEC *should* do so. It argues that the SEC should do so by explicitly setting out its interpretation in a substantive rule, adopted through notice-and-comment rulemaking, to trigger the deferential *Chevron* review standard. Issuing such an interpretation would allow the SEC to create an analytical framework for the ECCF mandate that takes into account the broad, intangible effects of its rules, including the impact of its rules on firm strategic and risk management processes.

## II. *CHAMBER OF COMMERCE* AND *BUSINESS ROUNDTABLE*

The D.C. Circuit has become a significant player in the regulation of securities.[21] In particular, through two cases, the

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[21] *See, e.g.*, Paul Rose & Christopher J. Walker, *Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture*, 66 STAN. L. REV. ONLINE 9, 9–10 n.3 (2013), http://www.stan

D.C. Circuit has exerted an authority clearly granted to the SEC; that is, the authority to interpret an ambiguous provision of securities law—the ECCF mandate.[22] Yet the court has done this without much fanfare. It is not that commentators have not raised flags about the significance of these decisions or their impact on SEC rulemaking—in fact, commentators quite frequently comment on and criticize these decisions.[23] But these decisions are typically criticized on the basis that the court applied an unduly high standard of review to SEC rulemaking.[24] I argue that one of the real problems exposed by these cases is the D.C. Circuit's disregard for the SEC's authority to interpret rules under the securities laws.[25] By placing itself in the role as interpreter of a key provision of the securities laws, the D.C. Circuit has disregarded principles of administrative law that undergird the balance of power among the three branches of government.[26]

To begin this discussion, Parts II.A and II.B, respectively, review the two decisions of the D.C. Circuit—*Chamber of Commerce*[27] and *Business Roundtable*[28]—in which that court overturned SEC rulemaking due to a defective quantitative analysis under the ECCF mandate. Then, Part II.C summarizes existing critiques of these cases. It also exposes the problem that this Article addresses—that the D.C. Circuit has encroached on the SEC's domain in interpreting the securities laws.

### A. *CHAMBER OF COMMERCE*

The first decision overturning SEC rulemaking on the basis of a defective ECCF mandate analysis came after the SEC passed a rule that imposed conditions on mutual funds, in addition to those

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fordlawreview.org/online/dodd-frank—regulators-cost-Benefit-analaysis-and-agency-capturre (noting that Circuit's prominent role in assessing challenges to financial regulations).

[22] *See* discussion *infra* Part IV.A–B (surveying the *Chevron* and *Skidmore* standards of review and analyzing the application of those standards to the SEC).

[23] *See* discussion *infra* Part II.C (highlighting criticisms of the *Chamber of Commerce* and *Business Roundtable* decisions).

[24] *See infra* notes 62–63 and accompanying text.

[25] *See* discussion *infra* Part IV (suggesting that courts should apply *Chevron* to SEC rulemaking).

[26] *See infra* notes 172–78 and accompanying text (explaining the separation of powers rationale for deferring to an agency's statutorily-delegated gap-filling action).

[27] Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005).

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

already imposed, before allowing them to engage in otherwise prohibited transactions under the Investment Company Act.[29] Specifically, under that rule, a mutual fund had to have a board with at least 75% independent directors and an independent chairman before being able to engage in any of the otherwise prohibited transactions.[30] The SEC's stated goals behind imposing these additional conditions were to prevent "late trading, inappropriate market timing activities, and [the] misuse of nonpublic information about fund portfolios."[31] According to the SEC, the new rules "provide for greater fund board independence and are designed to enhance the ability of fund boards to perform their important responsibilities under each of the rules."[32]

Plaintiff, the Chamber of Commerce, petitioned the D.C. Circuit for review of this rule.[33] In the opinion, then-Chief Judge Douglas H. Ginsburg, writing for a three-judge panel, held that the SEC had the authority to add conditions to the exemptive transactions for mutual fund boards as it had done under the rule.[34] The SEC had this authority, the court held, because the Investment Company Act "confers upon the Commission broad authority to exempt transactions" under the statute.[35] The court also did not find that the SEC's decision to add conditions for engaging in exemptive transactions, or its justifications for this rule, was arbitrary, capricious, or an abuse of discretion in violation of the APA.[36]

However, the court held that the SEC has a "statutory obligation to determine as best it can the economic implications of

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[29] *See Chamber of Commerce*, 412 F.3d at 137 (explaining the operation of the SEC rule); Investment Company Governance, 69 Fed. Reg. 46,378 (Aug. 2, 2004) (proposed to be codified in scattered sections of 17 C.F.R. pt. 270) (identifying the conditions in the final rule). The rules and statute generally prohibit a fund from engaging in certain transactions by which the adviser might gain at the expense of the shareholders. *See* Investment Company Act, 15 U.S.C. § 80a-12(a)–(g) (2012) (prohibiting certain action by investment companies and delegating responsibility to the SEC to define some of those companies' obligations).

[30] Investment Company Governance, 69 Fed. Reg. at 46,381.

[31] *Chamber of Commerce*, 412 F.3d at 137 (quoting Investment Company Governance, 69 Fed. Reg. 3472, 3472 (proposed Jan. 23, 2004)).

[32] *Id.* (quoting Investment Company Governance, 69 Fed. Reg. at 46,379).

[33] *Id.* at 136.

[34] *Id.* at 138–39.

[35] *Id.* at 139.

[36] *Id.* at 140–41.

the rule it has proposed."[37] The court cited to *Public Citizen v. Federal Motor Carrier Safety Administration* for this proposition.[38] According to Judge Ginsburg, this duty exists by virtue of the ECCF mandate.[39] By failing to estimate in numeric terms the costs of its rule, either on an aggregate basis or to a particular fund, the court found that the SEC failed to adequately assess the effects the new conditions would have upon efficiency, competition, and capital formation.[40] In addition, the court found that the SEC had failed in its obligation to consider the alternative of requiring disclosure rather than substantive regulation.[41] According to the court, the disclosure alternative, which was favored by the two dissenting Commissioners, was neither an "uncommon" nor an "unknown" alternative.[42] As such, the SEC's rule violated the APA.[43]

### B. *BUSINESS ROUNDTABLE*

In 2011, the D.C. Circuit, in another three-judge panel opinion authored by Judge Ginsburg, again struck down an SEC rule because the SEC failed to conduct a adequate cost-benefit analysis under the ECCF mandate.[44] That case, the oft-discussed (and criticized) *Business Roundtable v. SEC*, involved the Business Roundtable and Chamber of Commerce's challenges to Rule 14a-11 issued by the SEC under the Securities Exchange Act of 1934 (the Exchange Act).[45] Rule 14a-11 required public companies to include

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[37] *Id.* at 143 (citing to Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1221 (D.C. Cir. 2004)).

[38] *See id.*

[39] *Id.* at 144. While the ECCF mandate in the case existed under the Investment Company Act, the mandate is identical to the one added to the Securities Act and the Exchange Act by § 106 of the NSMIA. *Compare* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 224, 113 Stat. 1338, 1402 (1999) (codified at 15 U.S.C. § 80b-2(c) (2012)) (amending the Investment Advisers Act by adding a subsection on "Consideration of Promotion of Efficiency, Competition, and Capital Formation"), *with* NSMIA, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424–25 (1996) (adding the same to the Securities Act and Exchange Act).

[40] *Chamber of Commerce*, 412 F.3d at 144. Contrary to the plaintiff's request, the court did not find that the SEC violated the ECCF mandate by failing to either develop new or consider existing empirical data comparing the performance of funds led by inside and independent chairmen. *Id.* at 142.

[41] *Id.* at 144–45.

[42] *Id.* at 144.

[43] *Id.*

[44] Bus. Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011).

[45] *Id.* at 1146.

information about certain shareholders' director nominees in the companies' proxy statements.[46] It also required those companies to give their shareholders an opportunity to vote on those shareholder-nominated directors.[47]

The SEC passed Rule 14a-11 in 2010,[48] spending nearly two years and over $2.2 million in the effort.[49] Its basis for the rule was to eliminate the federal securities laws' impediments to shareholders' exercise of their state corporate law right to nominate and elect directors.[50] It thus sought to have the proxy process be as effective as an in-person meeting of shareholders.[51]

The D.C. Circuit once again stated that the SEC has a "statutory obligation to determine as best it can the economic implications of the rule."[52] Additionally, the court again held that the SEC failed to assess the economic effects of its rule.[53] According to the court, 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; [and] neglected to support its predictive judgments," among other problems.[54] For example, the court found that the SEC "relied upon insufficient empirical data when it concluded that Rule 14a-11 will improve board performance and increase shareholder value,"[55] where the SEC had relied on two studies the court found "relatively unpersuasive."[56] Because the SEC failed to effectively consider the effects of its rule upon efficiency, competition, and capital formation under the ECCF mandate, the court found that the

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[46] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,677 (Sept. 16, 2010) (proposed to be codified at 17 C.F.R. § 240.14a-11).

[47] *Id.*

[48] *Id.* at 56,668.

[49] Letter from Mary L. Schapiro, SEC Chairman, to Rep. Scott Garrett (Aug. 5, 2011), *available at* http://www.law.du.edu/documents/corporate-governance/sec-and-governance/SEC-letter%208-5-11.pdf.

[50] Facilitating Shareholder Director Nominations, 75 Fed. Reg. at 56,669.

[51] *See id.* at 56,668, 56,670.

[52] Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C. Cir. 2005)).

[53] *Id.*

[54] *Id.* at 1148–49.

[55] *Id.* at 1150.

[56] *Id.* at 1151.

SEC's promulgation of the proxy access rule was arbitrary and capricious under the APA.[57]

### C. CONCERNS RAISED BY *CHAMBER OF COMMERCE* AND *BUSINESS ROUNDTABLE*

Numerous commentators have criticized the *Chamber of Commerce* and *Business Roundtable* decisions. One basis for criticism is that the D.C. Circuit relied on *Public Citizen v. Federal Motor Carrier Safety Administration*[58] for the proposition that the SEC must assess the economic effects of its rules.[59] As commentators note, *Public Citizen* involved a statutory regime explicitly requiring the Federal Motor Carrier Safety Administration to engage in a cost-benefit analysis.[60] The ECCF mandate, in contrast, does not contain a similarly explicit cost-benefit analysis requirement.[61]

Another frequently-expressed criticism is that the court failed to defer to the SEC's analysis under the ECCF mandate.[62] In fact, the court has been decried for having inappropriately applied a heightened review standard.[63]

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[57] *Id.* at 1156.

[58] 374 F.3d 1209 (D.C. Cir. 2004).

[59] *See* Chamber of Commerce of Commerce v. SEC, 412 F.3d 133, 142 (D.C. Cir. 2005) (discerning "the Commission's . . . statutory obligation to determine as best it can the economic implications of the rule it has proposed" and citing *Public Citizen*); *Business Roundtable*, 647 F.3d at 1148 (same); *see also* Murphy, *supra* note 9, at 137 (recognizing *Chamber of Commerce*'s reliance on *Public Citizen* for the former's conclusion that " 'economic consequences' should be carefully assessed").

[60] *See, e.g.*, Cox & Baucom, *supra* note 9, at 1828 ("*Chamber of Commerce* rested its analysis and conclusions on the dicta arising from a case where the regulatory agency was operating under a markedly different review standard."); Murphy, *supra* note 9, at 137 (noting that by relying on *Public Citizen*, "the *Chamber of Commerce* decision reached beyond the arbitrary and capricious jurisprudence to find support for a higher standard of judicial review in a specific statutory requirement, albeit one with an entirely dissimilar purpose and scope").

[61] *See* discussion *infra* Part III.B (analyzing the ambiguity of the ECCF mandate).

[62] *See, e.g.*, Cox & Baucom, *supra* note 9, at 1828 ("Through its single-minded focus on cost-benefit analysis, the ultimate effect of the *Chamber of Commerce* and *Business Roundtable* decisions appears to be nothing less than establishing a new review standard."). Similarly, Professors Grant Hayden and Matthew Bodie criticize the court in *Business Roundtable* for failing to both "analyze the relevant research" and "understand the limits of applying that research to the question at hand." Grant M. Hayden & Matthew T. Bodie, *The Bizarre Law and Economics of* Business Roundtable v. SEC, 38 J. CORP. L. 101, 125 (2012).

[63] *See* Cox & Baucom, *supra* note 9, at 1828 ("[T]he ultimate effect of the . . . decisions appears to be nothing less than establishing a new review standard."). These two decisions

Specifically, the D.C. Circuit never even entertained that there might be an alternative analytical approach to the ECCF mandate apart from a quantitative cost-benefit analysis.[64] The court also found that the SEC had insufficient support for its conclusions about the effects of its rules where those conclusions were based on nonquantitative analyses[65] or, in some cases, inadequately persuasive quantitative analyses.[66] In this way, the court seemingly decided that a quantitative analysis is required under the ECCF mandate, though without justifying the rationale for this interpretive approach.

By applying this interpretation to the ECCF mandate, the D.C. Circuit violates one of the basic tenets of administrative law: that it is up to the agency that administers a federal statute, not the courts, to interpret an ambiguous provision of that statute.[67] By immersing itself in the administration of securities laws without giving any deference to the SEC's selected analytical approach to the ECCF mandate, the D.C. Circuit wrested this role from the

may also be challenged on the grounds that they merely reflect the views of the three-judge panels that decided them and not the views of the D.C. Circuit. In fact, it is no surprise that the author of these opinions, Judge Ginsburg, applied a heightened standard of review to the SEC's rulemaking, for he has previously questioned the policy of deferring to agencies under *Chevron*. *See* Douglas H. Ginsburg & Steven Menashi, *Nondelegation and the Unitary Executive*, 12 U. PA. J. CONST. L. 251, 271 (2010) (noting that *Chevron* transfers policymaking power to agencies and asserting "that democracy is weakened when the locus of policymaking shifts from the Congress to an agency"). For support, Judge Ginsburg cited the political scientist Theodore Lowi, who "has argued [that] the delegation of policy problems to administrative agencies fosters 'the atrophy of institutions of popular control' because agency heads exercise their discretion in accordance with relationships between agencies and interest groups rather than a full view of national priorities." *Id.* at 271–72 (quoting THEODORE J. LOWI, THE END OF LIBERALISM: IDEOLOGY, POLICY, AND THE CRISIS OF PUBLIC AUTHORITY 86–90 (1969)). For a discussion of why decisions as to the meaning of an ambiguous statute decided by a panel rather than the full court should not preclude subsequent agency action to interpret that same ambiguous statute, see discussion *infra* Part IV.D.

[64] *See supra* notes 52–53 and accompanying text.

[65] *See supra* note 54 and accompanying text.

[66] *See supra* notes 55–56 and accompanying text.

[67] *See, e.g.*, Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (holding that where such a statute is ambiguous, "a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency").

SEC, creating a power imbalance between a congressionally-created agency and the courts.[68]

Still, the SEC is in part to blame for this power imbalance. In particular, the SEC has been utterly passive in specifying what is affirmatively required by the ECCF mandate. For one, as discussed in Part IV, the SEC has failed to explicitly interpret the ECCF mandate.[69] Instead, the SEC's interpretation must be garnered from a review of how it conducts its analysis under the ECCF mandate in its substantive rules. Additionally, the SEC has allowed itself to be unwittingly led down the path of quantitative analysis by groups challenging its rules. In fact, in its briefs in both *Chamber of Commerce* and *Business Roundtable*, the SEC tried to convince the court that it had performed adequate cost-benefit analyses.[70] It did not, however, assert that it did not interpret the ECCF mandate as requiring such a quantitative analysis, even though historically the SEC has not performed such quantitative analyses.[71] In sum, by failing to exert its authority to explicitly interpret an ambiguous provision of the federal securities laws, the SEC opened the door to the D.C. Circuit's imposition of what appears to be a cost-benefit analysis requirement on the SEC—an interpretive approach to the ECCF mandate that, as I argue in Part V, fails to allow the SEC to consider the intangible effects of its rules.[72]

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[68] *See, e.g.*, Richard J. Pierce, Jr., *Democratizing the Administrative State*, 48 WM. & MARY L. REV. 559, 568 (2006) (stating the "constitutional principle" that "politically unaccountable judges cannot overrule policy decisions made by politically accountable agencies").

[69] *See infra* notes 198–201 and accompanying text (noting the lack of explicit guidance but discerning the SEC's interpretation of the ECCF mandate by analyzing other proposed and final rules).

[70] *See* Brief of the Securities and Exchange Commission, Respondent at 43, Chamber of Commerce v. SEC, 412 F.3d 133 (2005) (No. 05-1240), 2005 WL 3067063 (maintaining that none "of the Commission's cost estimates is inaccurate so as to render the estimate of any cost component unreasonable"); Initial Brief of the Securities and Exchange Commission, Respondent at 11, Bus. Roundtable v. SEC, 647 F.3d 1144 (2011) (No. 10-1305), 2011 WL 496545 (arguing that the SEC engaged in a cost-benefit analysis in considering Rule 14a-11 and that it proposed several changes to minimize costs).

[71] *See infra* notes 201–03 and accompanying text.

[72] *See* discussion *infra* Part V (noting the defects of this cost-benefit analysis, including the difficulty in quantifying the effects of disclosure rules and the increased length of the rulemaking process).

## III. SECURITIES LAW REVIEW STANDARDS

From their inception, the Securities Act of 1933 (the Securities Act)[73] and the Exchange Act of 1934[74] (together with the Securities Act, the Acts), jointly comprising the core federal securities statutes, have granted the SEC broad authority to regulate securities and securities markets.[75] The rationale behind granting the SEC such broad authority was to give the SEC flexibility to regulate in light of ever-evolving securities practices.[76]

However, that authority is limited in important ways. In particular, as originally passed, unless the SEC is discharging an express obligation under one of the Acts, the Acts require the SEC to act in the public's interest and for the protection of investors.[77] These standards are discussed in Part III.A below.

Additionally, whenever the SEC is engaged in rulemaking, the Acts require that it consider, in addition to the protection of investors, whether the rule promotes efficiency, competition, and capital formation.[78] This standard—referred to as the ECCF mandate—is discussed in Part III.B below.

### A. THE "PUBLIC INTEREST" AND THE "PROTECTION OF INVESTORS"

The stock market crash of 1929 marked the start of a grim period in the U.S. economy. In fact, from the crash in 1929 to 1932, stock prices fell by 80%.[79] As Representative Charles Anderson Wolverton remarked to Congress in 1934, the years succeeding the 1929 stock market crash were marked by

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[73] 15 U.S.C. §§ 77a–77aa (2012).

[74] *Id.* §§ 78a–78pp.

[75] *See infra* notes 89–99 and accompanying text (surveying specific and general grants of rulemaking authority by those Acts).

[76] *See infra* notes 90–91 and accompanying text (discussing Representative Samuel Rayburn's comments on the purpose of the Securities Exchange Act).

[77] *See, e.g.*, 15 U.S.C. § 77d-1 (2012) (allowing the SEC to issue rules regarding intermediaries "for the protection of investors and in the public interest"); § 77h-1 (similar delegation regarding the issues of temporary orders); § 77j(a)(4) (similar delegation regarding information required on registration statements); § 772-3 (similar delegation concerning the SEC's exemption of "any person, security, or translation").

[78] *See, e.g.*, 15 U.S.C. §§ 77b(b) (Securities Act), 78c(f) (Exchange Act).

[79] Stock Market Crash, PBS, http://www.pbs.org/fmc/timeline/estockmktcrash.htm (last visited Feb. 16, 2014).

> grief and suffering that overwhelmed and carried away not merely the gains of speculative debauch, not merely the savings of those who had invested in securities, but eventually the savings of the frugal and thrifty who had deposited their funds in banking institutions, and finally destroyed the operating profits of every business in the country.[80]

Congress reacted swiftly to the rampant fraud and speculation that were seen as having thrown the U.S. equity securities market into turmoil. Specifically, it enacted the Securities Act in 1933[81] and the Exchange Act in 1934.[82]

By and large, the animating goals behind these two Acts were preventing fraud and unfair practices in the securities market.[83] The Securities Act largely tackled fraud by requiring disclosure from public firms in their offering and sale of securities.[84]

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[80] 78 CONG. REC. 6793, 7864 (1934) (statement of Rep. Charles Anderson Wolverton); *see also* Letter from President Franklin D. Roosevelt to Rep. Sam Rayburn (Mar. 26, 1934) ("The people of this country are, in overwhelming majority, fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929."), *reprinted in* H.R. REP. NO. 1383, at 2 (1934).

[81] Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2012)).

[82] Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)).

[83] *See* 78 CONG. REC. 7689–7717 (1934) (recording the House debates on the Exchange Act, with one Representative remarking that the bill "protects investors, controls market manipulations that are destructive to values, and tends to curb destructive speculation") (statement of Rep. Ford); 7861–69 (similar debate regarding the bill); 7920–62 (same); 8007–21 (same); 8023–40 (same); 8086–8117 (recording additional debate on the bill and the votes of the Representatives); *see also* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 408 (1990) ("Conventional wisdom holds that the Exchange Act was passed in response to the 1929 crash. This view is correct at least in the sense that stock exchange legislation was inevitable once the public blamed the stock market crash for the Depression."); John H. Walsh, *Can Regulation Protect "Suckers" and "Fools" from Themselves? Reflections on the Rhetoric of Investors and Investor Protection Under the Federal Securities Laws*, 8 J. BUS. & SEC. L. 188, 193 (2008) (discussing how the Acts' purposes included preventing securities fraud and general thievery, dishonesty, and cheating).

[84] *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (noting that "[a] fundamental purpose, common to [the Acts is] to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*," with respect to the issuance of securities); Milton H. Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340, 1340–41 (1966) (noting the emphasis in the Acts on "full and fair disclosure"); H.R. REP. NO. 85, at 2 (1933) ("There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and

According to the Securities Act's preamble, the Securities Act is "[a]n Act to provide full and fair disclosure of the character of securities sold . . . and to prevent frauds in the sale thereof."[85] The latter—the preventing of unfair practices in the securities markets—was largely addressed through the Exchange Act's grant to the SEC of oversight power over trading activity in the securities markets.[86] As § 2 of the Exchange Act states:

> For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective . . . and to insure the maintenance of fair and honest markets in such transactions.[87]

However, the Acts do not set out detailed prohibitions on actors in the securities markets to achieve these purposes. Rather, the Acts largely lay out a framework by which they are to be administered.[88] They then grant the chief administrator—the SEC—the authority to implement the Acts.[89]

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that no essentially important element attending the issue shall be concealed from the buying public.") (statement of President Franklin D. Roosevelt). Of course, regulating disclosure indirectly regulates conduct, as firms tend to change their conduct to provide what is viewed as favorable disclosure. In any event, there are some instances where the SEC has regulated conduct, often by requiring the stock exchanges to adopt rules of conduct. One example is where the SEC has directed stock exchanges to prohibit the listing of the securities of any company that does not have an independent audit committee. *See* 17 C.F.R. § 240.10A-3 (2008).

[85] Securities Act, 48 Stat. at 74.

[86] 15 U.S.C. § 78b (2012); *see also* A.A. SOMMER, JR., SECURITIES PRIMARY LAW SOURCEBOOK, Vol. C., at I-5 (1999) (discussing the SEC's oversight power); Letter from President Franklin D. Roosevelt to Rep. Sam Rayburn (Mar. 26, 1934), *reprinted in* H.R. REP. NO. 1383, at 2 (1934) (listing the two main goals as curtailing speculation and giving the government the supervisory ability to correct future abuses).

[87] Exchange Act, 15 U.S.C. § 78b.

[88] *See infra* notes 89–99 and accompanying text (explaining this framework, which grants broad discretion to the SEC).

[89] *See infra* notes 89–99 and accompanying text (explaining the Security Act's administration). Numerous jurists and commentators have questioned the authority of Congress to delegate lawmaking power to executive agencies. *See, e.g.*, Ginsburg &

The intent to give the SEC broad authority under the Acts was captured in statements made by Representative Samuel Rayburn, one of the most influential members of Congress at the time, during the legislative debates surrounding the Acts. Namely, according to Representative Rayburn,

> all through the hearings the representatives of the exchanges and the so-called 'representatives of business' in this country pounded into the committee the unwisdom of particularizing in the legislation, or going further than simply fixing the outstanding standards for the administrative body to go by. We went through the bill, and everywhere that we could find a place to give authority to the [Federal Trade Commission] to make rules and regulations to govern these matters we gave it to them . . . .[90]

The federal securities laws were structured as framework legislation, granting the SEC broad authority to implement the laws, for numerous reasons. For one, this allows the regulator with the most knowledge about and expertise over the securities market—the SEC—to create appropriate regulation.[91] Moreover, this structure gives the SEC "necessary latitude to expand or contract disclosure rules in light of changes in the relevant context in which securities issuers conduct their businesses."[92] In other words, this structure of regulation provides for much-needed flexibility in a constantly changing environment. If Congress did not provide for this kind of flexibility in regulation, the regulation

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Menashi, *supra* note 63, at 254–56 (discussing the "necessary corollary of the theory of the unitary executive," which is "the idea that the Congress cannot delegate its lawmaking powers to the executive or the judiciary"). The nondelegation doctrine is beyond the scope of this Article.

[90] 78 CONG. REC. 7696 (1934) (statement of Rep. Rayburn). This refers to the FTC because at the time the Acts were debated in Congress, the House version contemplated that the FTC would be the chief administrator. Thel, *supra* note 83, at 457 (noting that the House's version of the Exchange Act would have had the FTC administer "everything except margin levels").

[91] *See generally* Notice of Commission Conclusions and Rulemaking Proposals, Securities Act Release No. 5627, 1975 WL 160503, at *6 (Oct. 14, 1975) [hereinafter Release No. 5627] (noting that Congress expected the SEC "to develop an expertise" necessary for it "to discharge its responsibilities under the Securities Act and the Securities Exchange Act").

[92] *Id.*

of securities would only address past problems and not current or future ones. Thus, by designing the federal securities laws as a broad framework, Congress essentially left to the SEC the task of determining how best to protect investors.[93] It is likely for these reasons that the Acts are filled with numerous grants of authority to the SEC, both general and specific.

In terms of general grants, both Acts authorize the SEC to pass rules in furtherance of their purposes. Specifically, § 19(a) of the Securities Act authorizes the SEC to "make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions" of the Securities Act.[94] Section 23(a) of the Exchange Act contains an equivalent, broad grant of authority to the SEC to make rules.[95]

Moreover, both Acts contain numerous specific grants of authority to the SEC. For example, § 3(b)(1) of the Securities Act gives the SEC the authority to issue rules exempting a class of securities from that Act.[96] This grant of exemptive authority is significant because it gives the SEC power to determine that a particular security does not fall under the scope of the Securities Act's registration regime. Thus, through rulemaking, the SEC can dictate to which securities the Securities Act applies.

Similarly, pursuant to § 12(h) of the Exchange Act, the SEC may exempt an issuer or class of issuers from the reporting requirements under § 12.[97] One of the primary protections afforded by the Exchange Act is the public dissemination by public companies of their current, material information.[98] By giving the

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[93] In addition to granting the SEC the permission to administer the Acts, in numerous provisions, the Acts also direct the SEC to act. *See, e.g.*, Exchange Act, § 10C, 48 Stat. 881 (codified at 15 U.S.C. § 78j-3(a)(1) (2012)) (obligating the SEC to direct the national securities exchanges and associations "to prohibit the listing of any equity security of an issuer . . . that does not comply with" stated independence requirements for its compensation committee).

[94] Securities Act, § 19(a), 48 Stat. 74 (codified at 15 U.S.C. § 77s (2012)).

[95] *See* Exchange Act, § 23(a), 48 Stat. 881 (codified at 15 U.S.C. § 78w(a)(1) (2012)) (granting the SEC the authority "to make such rules and regulations as may be necessary or appropriate").

[96] Securities Act, § 3(b)(1), 48 Stat. 74 (codified at 15 U.S.C. § 77c(b)(1) (2012)).

[97] Exchange Act, § 12(h), 48 Stat. 881 (codified at 15 U.S.C. § 78l(b) (2012)).

[98] *See* David S. Ruder et al., *The Securities and Exchange Commission's Pre- and Post-Enron Responses to Corporate Financial Fraud: An Analysis and Evaluation*, 80 NOTRE DAME L. REV. 1103, 1112–13 (2005) (explaining disclosure requirements, including the relevant forms, for publicly held companies under the Exchange Act).

SEC the power to issue rules exempting issuers from this reporting requirement, the SEC can essentially dictate the scope of a key Exchange Act protection.

Yet these are only two examples of the specific grants of rulemaking authority to the SEC in the Acts. The Acts together contain hundreds of other specific grants of authority to the SEC. In fact, a search of the Securities Act revealed twenty-four statutory provisions that expressly grant rulemaking authority to the SEC. A similar search of the Exchange Act revealed sixty-two statutory provisions with such grants.[99]

However, the specific authority granted to the SEC in the Acts is not unlimited. Specifically, in each instance where the Acts grant the SEC authority to act, including to create rules, the SEC must determine[100] that its actions are "in the public interest" and "for the protection of the investors."[101]

Thus, for example, while § 3(b)(1) of the Securities Act, discussed above, gives the SEC the power to issue rules exempting a class of securities from that Act, under that provision, the SEC may only issue such rules "if it finds that the enforcement of this [Act] with respect to such securities is not necessary in the public interest and for the protection of investors."[102] Similarly, pursuant to § 12(h) of the Exchange Act, also discussed above, the SEC may only exempt an issuer or class of issuers from the reporting requirements under § 12 "if the Commission finds . . . that such

[99] The search of both Acts was conducted in Westlaw using the search inquiry "Commission /s may or shall /s rule!" To the extent a statutory provision not only granted the SEC rulemaking authority but also then described the prior grant of authority, this would over-count such grants. On the other hand, the search results were tallied by separate section of the Acts; thus, to the extent specific sections of the Acts contain multiple grants of rulemaking authority to the SEC, this would under-count such grants. Moreover, it would under-count grants that did not use either the discretionary term "may" or the mandatory term "shall" in creating rulemaking authority.

[100] Sometimes the Acts require the SEC to "find" instead of "determine" that its actions further these interests. *See, e.g.*, 15 U.S.C. § 78q-1(b)(1) (2012). However, these two terms appear to be used interchangeably. Thus, the analysis in this Article of the term "determine" would also apply where the word "find" is used in the Acts.

[101] To support this conclusion, a research assistant recorded each use of the terms "protection of investors" and "the public interest" within the Acts and noted whether or not these terms limited SEC authority. The research assistant found that these terms were used throughout the Acts to limit SEC authority, including specific grants of rulemaking authority.

[102] Securities Act, § 3(b)(1), 48 Stat. 74 (codified at 15 U.S.C. § 77c(b)(1) (2012)).

action is not inconsistent with the public interest or the protection of investors."[103]

In contrast, the SEC's general authority is not qualified by the need to protect investors or to further the public interest.[104] This raises the question whether SEC rulemaking is in fact constrained by these standards. That is because the SEC could always argue that in passing a rule, it is doing so pursuant to its general authority rather than specific authority. On the other hand, if the SEC were passing a rule that directly fits within a specific grant of authority under either Act, most likely the public interest and protection of investors limits would apply to that action.[105] In any event, the SEC views itself as limited by those principles in all of its rulemaking efforts.[106]

It is not entirely clear how the SEC's actions are limited where it must act to protect investors and promote the public interest. As to the latter, courts in other contexts have generally interpreted language about an agency needing to act in the public interest "as granting only the incidental powers needed for accomplishment of stated statutory purposes."[107] In other words, this language takes its meaning from the substantive provisions of the relevant act, and requires the agency to act only in furtherance of the purposes of that act.

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[103] Exchange Act, § 12(h), 48 Stat. 881 (codified at 15 U.S.C. § 78l(h) (2012)).

[104] *See, e.g.*, Exchange Act, § 23(a)(1), 48 Stat. 881 (codified at 15.U.S.C. § 78w(a)(1) (2012)) (outlining the general grant of authority to the SEC in the Exchange Act). The general authority in the Exchange Act is qualified by the need for the SEC to consider the impact of its actions on competition. *Id.* § 23(a)(2). This limit, also comprising part of the ECCF mandate, is discussed below. *See* discussion *infra* Part III.B.

[105] This would follow from the rule of interpretation that the specific provision would supplant the general one. Radzanower v. Touche Ross & Co., 426 U.S. 148, 153 (1976); *see also* John F. Manning, *Separation of Powers as Ordinary Interpretation*, 127 HARV. L. REV. 1939, 2012–13 (2011) (asserting that "[i]f two enacted laws arguably cover the same subject, the one more specifically addressing the shared topic governs").

[106] *See* Release No. 5627, *supra* note 91, at *1 ("The Commission has broad discretion with regard to the promulgation of disclosure requirements under the federal securities laws, limited only by the requirement that it determine that such disclosures are necessary to discharge its statutory responsibilities or are necessary or appropriate in the public interest or for the protection of investors.").

[107] Note, *Disclosure of Payments to Foreign Government Officials Under the Securities Acts*, 89 HARV. L. REV. 1848, 1867 (1976); *see also* Gage v. U.S. Atomic Energy Comm'n, 479 F.2d 1214, 1220 n.19 (D.C. Cir. 1973) (reasoning that a federal statute, the National Environmental Policy Act, "does not mandate action which goes beyond the agency's organic jurisdiction").

Adopting this definition of public interest, in a release issued in 1975, the SEC declined to require disclosure of information that furthered the policies of environmental protection under the National Environmental Protection Act of 1969 (NEPA).[108] According to the SEC, the Acts give the SEC authority to require disclosure (among other things), and it was Congress's expectation that the SEC would use this disclosure authority "to require the dissemination of information which is or may be economically significant."[109] Thus, in the SEC's view, requiring "disclosure which is necessary or appropriate 'in the public interest' does not generally permit the [SEC] to require disclosure for the sole purpose of promoting social goals unrelated to [the economic purposes behind] the[ ] Acts."[110]

As to the protection of investors constraint, in the same 1975 release discussed above, the SEC noted that the Acts purposefully did not define what investor interests were protected, giving the SEC discretion to determine those ever-evolving interests.[111] Thus, the SEC can take account of investors' changing priorities and evolving economic conditions through its disclosure rules.[112] It can also take account of the fact that investors' interests diverge.[113] Thus, despite the fact that the SEC has repeatedly identified the need to protect investors' interests in receiving full disclosure of information deemed necessary for informed

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[108] Release No. 5627, *supra* note 91, at *7. The SEC issued the release following an order by the District Court for the District of Columbia. That order concluded that the SEC failed to comply with the APA in its informal rulemaking process by failing to describe in its rule what it viewed as its obligations under NEPA, as well as what alternatives it considered and why it rejected those alternatives. *Id.* at *2–3. The court thus "ordered the Commission to undertake 'rulemaking action to bring the Commission's corporate disclosure regulations into full compliance with the letter and spirit of NEPA.'" *Id.* at *3 (quoting Natural Res. Def. Council v. SEC, 389 F. Supp. 689, 693 (1974)). The release contains the SEC's conclusions and proposal for future rulemaking following the investigation it undertook under the court's order. *Id.* at *2.

[109] *Id.* at *5.

[110] *Id.* at *7.

[111] *Id.* at *6 ("The Commission's broad discretion to require disclosure provides necessary latitude to expand or contract disclosure rules in light of changes in the relevant context in which securities issuers conduct their businesses.").

[112] *See id.* (referring to economic factors which could not have been foreseen in 1933 and 1934).

[113] *See id.* at *7 (noting that "it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions").

investment decisions,[114] the SEC has preserved the right to not require disclosure desired by a limited segment of the investing public where the costs to issuers would likely outweigh the benefits to most investors.[115] And for this purpose, the SEC has not indicated that these costs and benefits are to be quantified.

B. THE (AMBIGUOUS) ECCF MANDATE

Congress passed the NSMIA in 1996.[116] The primary purpose of that statute was to preempt state securities laws.[117] However, the NSMIA also provided, in § 106, that whenever the SEC is engaged in rulemaking and is required to consider or determine what is "necessary or appropriate in the public interest," the SEC must "also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[118]

As was previously discussed in Part II, the D.C. Circuit in *Chamber of Commerce* and *Business Roundtable* views the ECCF mandate as imposing a quantitative cost-benefit analysis requirement on the SEC.[119] However, as this discussion explains, the meaning of the ECCF mandate is not clear. In other words, the ECCF mandate does not clearly impose on the SEC a quantitative cost-benefit analysis.

To begin, § 106 of the NSMIA, setting out the ECCF mandate, presents two interpretive problems. First, it is not clear what the relationship is, if any, between the ECCF mandate and the duty on the SEC to act in the public interest and for the protection of

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[114] *See, e.g.*, Press Release, U.S. Sec. and Exch. Comm'n, SEC Charges New York-Based Firm and Owner in Penny Stock Scheme (Aug. 22, 2012) ("By violating the registration provisions of the securities laws and dumping billions of unregistered shares into the over-the-counter market, Bronson deprived investors of important information . . . ."), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171484054#.UwkLjOPZ_pE.

[115] Release No. 5627, *supra* note 91, at *7.

[116] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996).

[117] *See* Cox & Baucom, *supra* note 9, at 1819 ("Most of the focus of the legislative history was directed to the central substantive changes NSMIA introduced—namely, preempting much of the states' role in the registration of public offerings of securities.").

[118] NSMIA, § 106, 110 Stat. 3416, 3424 (codified as amended in scattered sections of 15 U.S.C.).

[119] *See supra* notes 37–43, 53–57 and accompanying text (summarizing the holdings and reasoning of those opinions).

investors. Section 106 might, for example, expand on what is traditionally thought of as comprising the public interest. On the other hand, § 106 arguably only clarifies what amounts to the public interest, for it does not state that the SEC must *only* consider efficiency, competition, and capital formation when determining what is in the public interest. Alternatively, § 106 might elicit SEC consideration of new factors—ones not captured by the public interest.[120] Second, it is not clear what each of the components of the ECCF mandate—that is, the terms *consider*, *efficiency*, *competition*, and *capital formation*—means, nor how the SEC satisfies this mandate.

Courts "employ[ ] traditional tools of statutory construction" to determine whether Congress's intent behind statutory language is clear.[121] One tool courts commonly employ to determine whether a statute is unclear is to look at the plain or natural meaning of the language.[122] Plain meaning can be obtained by looking at a dictionary or using common sense.[123] Moreover, statutory language is given meaning "in light of the statutory purpose."[124] If either of these tools indicates the meaning of statutory language, then that language controls, and there is no need for an agency to interpret the language.[125]

Here, looking for a plain meaning does not resolve either interpretive problem identified above. First, the language does not

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[120] *See* NSMIA, Pub. L. No. 104-290, § 106(b), 110 Stat. 3416, 3424 (codified as amended in scattered sections of 15 U.S.C.) (directing the SEC to "*also* consider" the listed factors (emphasis added)).

[121] Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 n.9 (1984).

[122] *See, e.g.*, Smith v. United States, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, [courts] normally construe it in accord with its ordinary or natural meaning."); Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 645–46 (1990) (emphasizing that the plain language of a statute limited the agency's discretion to matters arising under that specific statute).

[123] United States v. Granderson, 511 U.S. 39, 71 (1994) (Rehnquist, C.J., dissenting) (encouraging the parties to "consult[ ] a dictionary [and] common sense").

[124] SEC v. Ralston Purina Co., 346 U.S. 119, 124–25 (1953); *see also* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 431–32 (1984) (making this same point in the context of terms of the Copyright Act tendered ambiguous by technological change); United States v. Bacto-Unidisk, 394 U.S. 784, 799 (1969) ("[W]here the statute's language seemed insufficiently precise, the 'natural way' to draw the line 'is in light of the statutory purpose.' " (quoting *Ralston Purina*, 346 U.S. at 124–25)).

[125] *Chevron*, 467 U.S. at 843 n.9 ("If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question of issue, that intention is the law and must be given effect.").

state how it relates, if at all, to the public interest review standard. For example, does § 106 expand on, exclusively define, or clarify what it means for the SEC to act in the public interest? On the one hand, the language arguably adds a new, or expands the existing, review standard applicable to SEC rulemaking because the word *also* in § 106 of the NSMIA suggests that the language is imposing an additional standard on the SEC—one that did not exist before.[126] Moreover, nowhere does § 106 mention that considerations of efficiency, competition, and capital formation comprise all of what the SEC must consider when considering the public interest, thus arguably expanding on what is thought to be in the public interest.

On the other hand, the plain meaning of the language arguably only clarifies what the public interest is—that is, the interest in promoting efficiency, competition, and capital formation. This interpretation is supported by the Congressional Budget Office's conclusion that § 106 of the NSMIA was cost-neutral, as it did not impose any new obligations on the SEC.[127] Clearly, if this statutory provision expanded the nature of the constraint on the SEC, thus requiring it to engage in additional analysis as to efficiency, competition, and capital formation in passing rules, that action would have added some cost to SEC rulemaking. But if the purpose of § 106 was simply to codify what the SEC already considered under the dictate to act in furtherance of the public interest, then one may question why Congress included § 106 in the NSMIA at all, for it would not have been necessary to pass an already implemented analysis.[128] Thus, the language was likely intended to require some additional or different analysis from the SEC.

Even if we can reconcile how the ECCF mandate fits with the existing limits on SEC action, another interpretive challenge

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[126] *See* NSMIA, Pub. L. No. 104-290, § 106(b), 110 Stat. 3416, 3424 (codified as amended in scattered sections of 15 U.S.C.) (requiring the SEC to "*also* consider" "efficiency competition, and capital formation" (emphasis added)); Cox & Baucom, *supra* note 9, at 1820 (noting that the ECCF mandate "language suggests [that] more, indeed much more, would be required of the SEC in rulemaking than was the prior practice").

[127] *See* H.R. REP. NO. 104-622, at 24 (1996) (concluding that it "would not expect this provision to result in any additional costs to the federal government").

[128] *See* Fund for Animals, Inc. v. Kempthorne, 472 F.3d 872, 877 (D.C. Cir. 2006) ("[C]ourts presume that Congress has used its scarce legislative time to enact statutes that have some legal consequence.").

arises: the meaning of the ECCF mandate and how the SEC fulfills this mandate.

Beginning with the specific words within the mandate: while other statutes use the term *consider*,[129] how the relevant agency fulfills that mandate varies depending on the context and overall regulatory landscape for that agency.[130] Yet what is clear is that the term *consider* at least excludes the need for the SEC to *determine* conclusively the effect of its rules on efficiency, competition, and capital formation.[131] But short of that, it is not clear what the SEC must do to fulfill this consideration requirement.

Moreover, the meaning of the terms efficiency, competition, and capital formation depend on their context. For instance, the term efficiency could refer to either the efficiency of the capital markets or the efficiency of the rulemaking process.[132] With respect to capital markets, there are at least two kinds of efficiency: either fundamental value efficiency or informational efficiency.[133] If the term efficiency as used in the ECCF mandate refers to the former, then the SEC would consider whether its rules prevent the stock market from accurately reflecting firms' fundamental values.[134] If the term refers to the latter, then the SEC would consider whether its rules prevent the stock market from reflecting all available information, regardless of whether it reflected firms' fundamental

[129] *See, e.g.*, National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. § 4332 (2012) (requiring all agencies of the federal government to develop methods to ensure that "consideration" is given to the environmental impact of decisionmaking).

[130] *See* Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 350–51 (1989) (describing that under the National Environmental Policy Act, an agency must only *consider* adverse environmental effects, and may still decide that other values outweigh these effects); *see also* Cox & Baucom, *supra* note 9, at 1818–19 ("Congress . . . did not explain what level of consideration the SEC was required to give these items when engaged in rulemaking.").

[131] *See also* Cox & Baucom, *supra* note 9, at 1821 (arguing that "consider" does not require the SEC to "determine," and noting that Congress initially had included the word "determination" in an early draft of the bill).

[132] *See id.* (questioning whether "efficiency" means "efficiency of the capital markets").

[133] *See* Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 639–40 (2003) (defining and providing examples of informational and fundamental value efficiency).

[134] *See id.* at 640 (describing markets as "efficient in the fundamental value sense if stock prices respond to available information not only quickly but *accurately*, so that market prices mirror the best possible estimates, in light of all available information, of the actual economic values of securities in terms of their expected risks and returns").

values.[135] If the term efficiency refers instead to SEC rulemaking, then the term likely refers to the achievement of the desired outcome of the rule through minimum effort and expense.[136] Because the term efficiency could have any of these meanings, by definition it is ambiguous.[137]

Similarly, it is not clear whether the term competition refers to the U.S. capital markets as a whole, or to the competitiveness of individual firms.[138] And, it is not clear how the SEC satisfies the ECCF mandate if an action would further one of the factors—such as efficiency—but impair another one, such as competition.[139]

Another tool of construction dictates that parties look at legislative history to shed light on Congress's intent.[140] Here, there is some support in the legislative history demonstrating that the ECCF mandate was intended to impose a cost-benefit analysis requirement on the SEC. For example, according to the House Report accompanying its version of the NSMIA, "[i]n considering efficiency, competition, and capital formation, the Commission shall analyze the potential costs and benefits of any rule-making initiative, including, whenever practicable, specific analysis of such costs and benefits."[141] Yet, even if this were the case, it is still not clear if this refers to a quantitative cost-benefit analysis, nor if such a quantitative analysis fulfills the SEC's obligation to protect the public interest. That is because, as discussed above, it

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[135] *Id.* at 639–40 ("[T]he market is efficient with respect to a piece of information if a trader who becomes aware of the information cannot make money by trading on it.").

[136] *See* Paul Rose & Christopher J. Walker, *The Importance of Cost-Benefit Analysis in Financial Regulation*, CENTER FOR CAPITAL MARKETS 26 (Mar. 2013), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf (proposing that the term might refer to a measurement of "the net benefits that society gets from its scarce resources").

[137] *See* Carrieri v. Jobs.com Inc., 393 F.3d 508, 519 (5th Cir. 2004) (holding that language will be considered ambiguous if it is " 'susceptible to more than one reasonable interpretation or more than one accepted meaning' " (quoting United States v. Kay, 359 F.3d 738, 743 (5th Cir. 2004))).

[138] *See* NSMIA, Pub. L. No. 104-290, § 106(b), 110 Stat. 3416, 3424 (offering no guidance beyond the single word, efficiency).

[139] *See id.*; Cox & Baucom, *supra* note 9, at 1821.

[140] *See, e.g.*, Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 649 (1990) (consulting legislative history to determine Congress's intent); Lindahl v. Office of Pers. Mgmt., 470 U.S. 768, 810 (1985) (explaining that legislative history "will always be a necessary tool of statutory construction" and suggesting that is weight "cannot be prescribed by inflexible canons of construction").

[141] H.R. REP. NO. 104-622, at 39 (1996).

is not clear whether § 106 of the NSMIA added an entirely new standard, expanded what it means for the SEC to act in the public interest, or merely clarified what amounts to the public interest.[142]

In contrast, the Senate Report accompanying its version of the NSMIA did not specifically refer to a cost-benefit analysis.[143] Moreover, had Congress intended to impose a quantitative cost-benefit analysis requirement on the SEC, the NSMIA would certainly have explicitly done so, much as Congress has done in other statutes. For example, in 2000, Congress amended the Commodity Exchange Act to require the Commodity Futures Trading Commission (CFTC) to "consider the costs and benefits of [the promulgation of regulations]."[144] In fact, the statute specified that the CFTC was to consider those costs and benefits in light of objectives similar to those under the federal securities laws—that is, "efficiency, competitiveness, and financial integrity of futures markets."[145] Thus, the absence of language specifying that the SEC must engage in a cost-benefit analysis under the NSMIA lends further support to the conclusion that such an analysis was not intended by Congress.

In sum, while legislative history sheds some light on the meaning of § 106 of the NSMIA, it does not clearly evidence Congress's intent behind the provision, either as to the relationship between the ECCF mandate and the existing review standards applicable to the SEC, or on how the SEC satisfies the ECCF mandate. Thus, we must look to other statutory construction tools to see if Congress's intent can be identified.

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[142] *See supra* notes 125–27 and accompanying text.

[143] While the Senate's version of the NSMIA included language suggesting a possible cost-benefit analysis, see generally Securities Investment Promotion Act of 1996, S. 1815, 104th Cong. (1996), the Senate's language was rejected in the conference convened to reconcile the House and Senate bills. *Compare* H.R. REP. NO. 104-864, at 27 (1996) (Conf. Rep.) (containing the language of § 106 as enacted into law), *with* S. REP. NO. 104-293, at 16 (1996) (proposing that "the SEC . . . provide to the public an assessment of the economic impact of its regulations and actions"); *see also* Cox & Baucom, *supra* note 9, at 1820 (suggesting that "[t]he conferees apparently preferred the House's loosely worded, indefinite language to the more precise, quantitatively driven approach approved by the Senate").

[144] *See* Commodity Futures Modernization Act (CFMA) of 2000, Pub. L. No. 106-554, § 15(a)(1), 114 Stat. 2763, 2763A-403 (2000).

[145] 7 U.S.C. § 19(a)(2)(B) (2012).

Courts often use maxims of construction to give statutes meaning.[146] According to one such maxim, "Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language."[147] This maxim is relevant here, for in the Senate's initial version of the NSMIA, it explicitly included a cost-benefit analysis.[148] However, in enacting the NSMIA, Congress rejected this language in favor of the more open-ended ECCM mandate.[149] This rejection demonstrates Congress's intent to not force a cost-benefit analysis requirement on the SEC through the ECCF mandate.

Several conclusions can be drawn from the above discussion. One is that the ECCF does not, by its language, call for a quantitative cost-benefit analysis. Second, Congress's intent behind the language is not clear. Consequently, the language of the ECCF mandate can be characterized as ambiguous.[150] This conclusion necessitates analysis under applicable law to determine how ambiguous statutory language is given meaning. This, in turn, will help determine whether the D.C. Circuit acted properly in *Business Roundtable* and *Chamber of Commerce.* It will also help identify the way forward for the SEC in conducting analyses under the ECCF mandate.

## IV. CLARIFICATION OF AMBIGUOUS STATUTES—*CHEVRON* AND *SKIDMORE* STANDARDS OF REVIEW

Where a statute that an agency administers is left ambiguous by Congress, the first question is whether Congress has delegated to the agency interpretational authority.[151] This is often referred to as a *Chevron* "step zero" question.[152]

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[146] *See* First Nat'l Bank of Chi. v. Standard Bank & Trust, 172 F.3d 472, 476 (7th Cir. 1999) (noting that "[a]dministrative rules are subject to same well-known maxims of construction as legislative statutes" and determining the plain meaning of the statute and regulation at issue).

[147] Nachman Corp. v. Pension Benefit Guar. Corp., 446 U.S. 359, 393 (1980).

[148] *See* S. REP. NO. 104-293, at 16 (1996).

[149] *See* NSMIA, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424.

[150] *See* Carrieri v. Jobs.com Inc., 393 F.3d 508, 519 (5th Cir. 2004) (defining ambiguity as " 'susceptible to more than one reasonable interpretation' " (quoting United States v. Kay, 359 F.3d 738, 743 (5th Cir. 2004))).

[151] *See* Thomas W. Merrill & Kristin E. Hickman, Chevron*'s Domain*, 89 GEO. L.J. 833, 873–74 (2001) ("[A] decision by Congress to give an agency authority to promulgate

In the case of the SEC, it has clearly been granted the authority to interpret the ECCF mandate. Specifically, as discussed in Part III, the SEC has been granted broad authority to regulate securities and the securities markets, including to issue binding rules with respect to these matters.[153] As such, there is no question but that Congress has delegated interpretational authority to the SEC.

Where an agency interprets an ambiguous statute, a court may review that interpretive action for reasonableness under the *Chevron* review standard.[154] In contrast, where an agency does not have the authority to interpret an ambiguous statute, a court with jurisdiction may do so.[155] However, even in that context, the court will afford an agency interpretation some deference under the *Skidmore* review standard.[156]

Part IV.A below discusses both of these review standards, as well as when they apply. It argues that given the broad, enabling nature of the securities laws, if the SEC were to interpret the ECCF mandate as part of a rule promulgated under notice-and-comment rulemaking, such interpretation would be entitled to deference under *Chevron*.

Part IV.B then considers the impact on the review standard analysis where the agency, like the SEC, is an independent agency. As that discussion shows, courts apply the same standards of review to agency actions regardless of whether the agency is an independent agency. In fact, there is some argument that the creation of an agency as an independent agency calls for the presumptive application of the deferential *Chevron* review standard.

Next, Part IV.C discusses whether courts apply a different standard of review where an agency is interpreting a statute that defines the scope of its own authority. This discussion is included

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legislative rules implementing a statute is enough to charge the agency with administration of the statute.").

[152] *See id.* at 873 (proposing this term to describe the first step in the analysis).

[153] *See supra* notes 89–90 and accompanying text (discerning this intent and discussing a statement made during a congressional debate).

[154] *See infra* notes 161–65 and accompanying text (explaining the *Chevron* doctrine).

[155] See *infra* note 195 and accompanying text (explaining the deference due under the *Skidmore* and *Mead* doctrines).

[156] *See infra* note 196 and accompanying text (examining the level of deference that courts accord agency decisions under *Skidmore*).

because the ECCF mandate arguably defines the scope of the SEC's authority—that is, it limits the SEC's authority to promulgate rules. As that discussion explains, despite some argument to the contrary, courts do not apply a heightened standard merely because an agency promulgates a rule that interprets a statutory provision defining the scope of its authority.

### A. *CHEVRON* AND *SKIDMORE* DEFERENCE

*Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[157] is the leading case assessing the validity of an agency's interpretation of a statute that it administers through informal notice-and-comment rulemaking.[158] In that case, the Environmental Protection Agency (EPA) issued a regulation under the nonattainment provisions of the Clean Air Act allowing states to adopt a plant-wide definition of "stationary source."[159] Petitioners filed for review of the regulation, and the case made its way to the Supreme Court.[160]

In its holding, the Court set forth a two-part test to determine whether an agency's interpretation of an ambiguous statute, when subject to a challenge, is valid.[161] Under the first step of the test, the court determines whether the statutory language is clear and unambiguous.[162] If the language is clear and unambiguous, the agency does not have discretion to interpret the statute contrary to its clear and unambiguous meaning.[163] If, however, the statutory language is silent or ambiguous, then under step two, the court assesses whether the agency's interpretation of the statute is

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[157] 467 U.S. 837 (1984).

[158] *See generally id.* at 843–45 (setting out the applicable legal standards); *see also* Kristin E. Hickman & Matthew D. Krueger, *In Search of the Modern* Skidmore *Standard*, 107 COLUM. L. REV. 1235, 1242 (2007) (noting that *Chevron*'s two-part test was a useful "tool for organizing judicial analysis" but did not present new doctrine).

[159] *Chevron*, 467 U.S. at 839–40.

[160] *Id.* at 837.

[161] *Id.* at 842–43.

[162] *Id.*

[163] *Id.*

permissible.[164] Under this second step, a court is to defer to any reasonable agency interpretation.[165]

Applying these principles, the Court in *Chevron* found first that Congress did not have a specific intent behind the *stationary source* concept, giving the EPA the discretion to make a reasonable policy choice as to this term.[166] It also held that the EPA's definition of the term *source* was a permissible construction of the statute.[167]

According to the Court, the basis for deference to an agency is Congress's explicit or implicit delegation of authority to the agency.[168] In terms of implicit authority, an agency is impliedly granted authority to interpret the terms of a statute, thereby filling gaps left in the statute by Congress.[169] Moreover, the Court also stated that a basis for such deference is the agency's specialized knowledge regarding the matters falling within its regulation.[170] Thus, a court may not substitute its judgment for the agency's judgment.[171]

The design of our democratic system of government thus undergirds judicial deference to agency statutory interpretations. Under that system, politically accountable agencies (rather than politically unaccountable judges) are viewed as extensions of the Executive Branch, authorized to act in an essentially legislative manner to fill the gaps Congress leaves in statutes.[172]

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[164] *Id.* at 843.

[165] *Id.* at 844; *see also id.* at 843 n.11 ("The court need not conclude that the agency construction was . . . the reading the court would have reached if the question initially had arisen in a judicial proceeding.").

[166] *Id.* at 845.

[167] *Id.* at 866.

[168] *Id.* at 843–44.

[169] *Id.* at 844.

[170] *See id.* (noting that interpreting statutes that agencies administer often requires "more than ordinary knowledge respecting the matters subjected to agency regulations" (quoting United States v. Shimer, 367 U.S. 374, 382 (1961))).

[171] *Id.*; *see also* Motor Vehicle 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."). *See generally* R. George Wright, *Arbitrariness: Why the Most Important Idea in Administrative Law Can't Be Defined, and What this Means for the Law in General*, 44 U. RICH. L. REV. 839 (2010) (arguing that the arbitrary and capricious standard is context-driven).

[172] *See Chevron*, 467 U.S. at 843 (instructing that a "court does not simply impose its own constriction on the statute"); *see also* Pierce, *supra* note 68, at 562 ("*Chevron* deference is based on constitutional principles that are central to our democratic system of government—politically accountable agencies, rather than politically unaccountable judges,

Consistent with this separation of powers, where a court finds that a statute is ambiguous and that the agency charged with administering that statute has not interpreted the ambiguous provision, the court may interpret that provision.[173] However, according to the Supreme Court in *National Cable & Telecommunications Ass'n v. Brand X Internet Services*,[174] the agency may later interpret the ambiguous provision, and the agency's interpretation controls.[175] That is because "*Chevron* established a 'presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.' "[176] Such deference ensures that "agencies, not courts . . . fill statutory gaps."[177] Thus, where a court interprets an ambiguous statutory provision and the agency subsequently interprets that provision, even in a way different from the court, that later agency interpretation is entitled to *Chevron* deference.[178]

While the challenged action in *Chevron* was an agency interpretive regulation,[179] the Court did not limit its holding to only such agency action.[180] This caused some commentators to

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should make the policy decisions that are inherent in the process of giving meaning to ambiguous texts that Congress has assigned agencies to implement.").

[173] *See Chevron*, 467 U.S. at 843 (acknowledging that a judicial construction "would be necessary in the absence of an administrative interpretation").

[174] 545 U.S. 967 (2005).

[175] *See id.* at 982 (explaining that a judicial construction trumps an agency construction only if the statute is unambiguous "and thus leaves no room for agency discretion").

[176] *Id.* (quoting Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735, 740–41 (1996)); *see also* Kenneth A. Bamberger & Peter L. Strauss, Chevron*'s Two Steps*, 95 VA. L. REV. 611, 616–17 (2009) ("If the holding entails a judicial determination that the statute cannot bear the meaning the agency has given it, such a determination limits the interpretation on which any future agency action can be based. But it does not constrain the agency's action within any statutory discretion the court acknowledges the agency has.").

[177] *Nat'l Cable*, 545 U.S. at 982.

[178] *See id.* at 983 (affirming that "whether Congress has delegated to an agency the authority to interpret a statute does not depend on the order in which the judicial and administrative constructions occur"); *see also* Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 969, 989 (1992) (proposing that "the logic of *Chevron*" indicates that courts should follow later agency interpretations in cases involving ambiguous statutes).

[179] Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 840–41 (1984).

[180] *See id.* at 844 (requiring only "a reasonable interpretation made by the administrator of an agency").

view *Chevron* as applying to "any authoritative administrative interpretation of a statute" that the agency was charged with administering.[181] However, more recent Supreme Court jurisprudence suggests that *Chevron* deference only applies to agency rulemaking actions that have the "force of law."[182] Specifically, according to the Supreme Court in *United States v. Mead Corp.*, "*Chevron* [is not] applicable where statutory circumstances indicate no intent to delegate general authority to make rules with force of law, or where such authority was not invoked."[183] Instead, interpretive rules that lack the force of law are only entitled to respect under *Skidmore v. Swift & Co.*[184]

*Mead* also stands for the proposition that a court is more inclined to give an agency deference where its authorizing statute expressly grants to the agency the authority to engage in rulemaking.[185] Thus, the Court in *Mead* reasoned that "a very good indicator of delegation meriting *Chevron* treatment [is] express congressional authorization[ ] to engage in the process of rulemaking."[186]

Still, it remains unclear when an agency is entitled to *Chevron* deference because it is acting with the force of law—in other words, with implied congressional authority.[187] While *Mead* clearly indicates that an agency acts with the force of law where it acts through notice-and-comment rulemaking or adjudication, the

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[181] *See* Hickman & Krueger, *supra* note 158, at 1242–43 (explaining that this is Justice Antonin Scalia's view on the matter).

[182] United States v. Mead Corp., 533 U.S. 218, 221 (2001).

[183] *Id.* at 237; *see also* Christensen v. Harris Cnty., 529 U.S. 576, 587 (2000) ("Interpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant *Chevron*-style deference."); Hickman & Krueger, *supra* note 158, at 1245 (describing *Christensen* as holding that "*Chevron* is appropriate for those agency interpretations 'arrived at after, for example, a formal adjudication or notice-and-comment rulemaking' " (quoting *Christensen*, 529 U.S. at 587)).

[184] *See Mead*, 533 U.S. at 221 (citing Skidmore v. Swift & Co., 323 U.S. 134 (1944)). For a discussion of the difficulty in determining whether or not an agency interpretation has the force of law and thus entitled to *Chevron* deference, see Merrill & Hickman, *supra* note 151, at 845–48.

[185] *Mead*, 533 U.S. at 229.

[186] *Id.*

[187] *See* Hickman & Krueger, *supra* note 158, at 1246 (encouraging reviewing courts to "consider all circumstances surrounding the statutory scheme and agency action" to determine whether Congress intended the agency's interpretations to carry the force of law).

Court expressly rejected those as the sole contexts in which an agency acts with the force of law.[188]

Where the *Chevron* review standard does not apply, the alternative review standard originating from *Skidmore v. Swift & Co.* does.[189] That case involved an interpretive bulletin issued by the Administrator of the Department of Labor's Wage and Hours Division applying the Fair Labor Standards Act (FLSA) to various scenarios.[190] The purpose of that bulletin was to give guidance about whether the Administrator viewed certain uses of time as "working time" for which employees were owed overtime pay under the FLSA.[191] While the bulletin did not specifically contemplate whether the time firefighters spent on call amounted to working time, the Administrator applied it that way.[192]

In its review of the Administrator's decision following a challenge by petitioners, the U.S. Supreme Court noted that the Administrator's rulings, interpretations, and opinions were not controlling upon the Court.[193] Nevertheless, "by reason of their authority, [they] do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance."[194] In other words, while *Skidmore* authorizes a court to interpret a statute, an agency's interpretation is due some deference because of its expertise and experience.[195] However, the amount of weight a court gives to an agency's interpretation depends on "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."[196]

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[188] *See Mead*, 533 U.S. at 231 ("[W]e have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded.").

[189] 323 U.S. 134 (1944).

[190] *Id.* at 136–39.

[191] *Id.* at 138.

[192] *Id.* at 139.

[193] *Id.* at 139–40.

[194] *Id.* at 140.

[195] *See* Hickman & Krueger, *supra* note 158, at 1305 ("Under both *Skidmore* and *Mead*, however, where Congress has not vested the agency with primary interpretive authority, expertise and other factors may call for judicial deference, but the courts rather than the agencies hold ultimate interpretive authority." (citing United States v. Mead, 533 U.S. 218, 226–27 (2001); *Skidmore*, 323 U.S. at 137)).

[196] *Skidmore*, 323 U.S. at 140.

Thus, when interpreting a statute, courts give some deference to agencies due to agencies' expertise and informed and reasoned decisionmaking. That is true despite the absence of an implied delegation of congressional authority. However, because of the absence of such implied authority, the level of deference varies based on the factors identified in *Skidmore*.[197]

B. APPLYING *CHEVRON* AND *SKIDMORE* TO THE SEC

The SEC has not issued any explicit statements specifying the meaning of the ECCF mandate. Namely, it has not issued any rules or other interpretive guidance specifying either what the mandate means or how the SEC complies with it.

On the other hand, one can glean how the SEC interprets the ECCF mandate by looking at how the SEC discusses the ECCF factors in the "back half" of its proposed and final rules—that is, the place where it discusses its analysis under the ECCF mandate,[198] the Paperwork Reduction Act,[199] and the Regulatory Flexibility Act.[200] A review of the back-half of its rules shows that the SEC his historically interpreted the ECCF mandate as allowing a qualitative discussion about the effects of SEC rules on efficiency, competition, and capital formation.[201] For example, in the back-half of proxy access Rule 14a-11, which was at issue in *Business Roundtable*,[202] the SEC's discussion of the effects of the rule on efficiency, competition, and capital formation is almost entirely qualitative.[203] If we view these manifestations as

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[197] *See id.* (listing thoroughness of consideration, validity of reasoning, and consistency as appropriate guideposts).

[198] *See* Exchange Act, 15 U.S.C. § 78c(f) (2012).

[199] *See* Paperwork Reduction Act of 1980, 44 U.S.C. §§ 3501–3521 (2012).

[200] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601–612 (2012).

[201] *See* Arthur Fraas & Randall Lutter, *On the Economic Analysis of Regulations at Independent Regulatory Commissions*, 63 ADMIN. L. REV. 213, 232 (2011) (finding, in a survey of regulatory impact analysis performed by all independent regulatory commissions, that the "SEC has provided largely qualitative discussions on the [Regulatory Flexibility Act] and [ECCF]").

[202] *See* discussion *supra* Part II.B (examining the reasoning and holding of that decision).

[203] *See* Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,756 56,771–76 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249) [hereinafter Proxy Access Rule]. While the SEC's ECCF mandate analysis does refer to the quantified costs and cost-savings associated with its rule, the rule contains very limited discussion of the quantitative costs and benefits of the rule. *See id.* at 56,756 (providing a limited discussion of "direct cost savings").

interpretive actions, then the SEC has indeed interpreted the ECCF mandate to permit a qualitative discussion.

Since the 1970s and until recently, also in the back-half of its rules, the SEC has engaged in a separate cost-benefit analysis in its rulemaking.[204] However, even there, the SEC has largely engaged in a qualitative analysis, setting out much the same discussion as the discussion under the ECCF mandate.[205] For example, in the proxy access rule mentioned above, the SEC separately discussed the costs and benefits of Rule 14a-11.[206] While the SEC did quantify some of the direct cost savings expected from the rule[207] as well as some of the costs of compliance,[208] its discussion was otherwise largely qualitative.[209]

In the wake of the *Business Roundtable* decision, the SEC started folding together its discussion of its ECCF mandate analysis and its cost-benefit analysis under the heading "Economic Analysis."[210] While the SEC seems to increasingly favor a

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[204] Bruce Kraus & Connor Raso, *Rational Boundaries for SEC Cost-Benefit Analysis*, 30 YALE J. ON REG. 289, 296 (2013) (noting that this was a "voluntary discussion of benefits and costs"); *see also* Proxy Access Rule, 75 Fed. Reg. at 56,756 (discussing generally the benefits of the proxy access rule).

[205] Kraus & Raso, *supra* note 204, at 297 ("SEC [cost–benefit analysis] generally only repeated policy arguments made elsewhere in the release . . . . SEC [cost-benefit analysis] 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)."); *see also* OFFICE OF INSPECTOR GEN. OF THE SEC, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSIS IN SELECTED SEC DODD-FRANK ACT RULEMAKINGS, REP. NO. 499, at 1–2 (2012) [hereinafter Kyle Report II], *available at* http://www.sec-org.gov/Reports/AuditsInspections/2012/499.pdf (finding, in a review of six major SEC rules, "that the SEC had conducted a systematic cost-benefit analysis" of each rule, but also asserting that there was a "lack of macro-level analysis and a lack of quantitative analysis on the impact of the rules"); Fraas & Lutter, *supra* note 201, at 232–33 (finding, in a survey of regulatory impact analyses performed by all independent regulatory commissions, that the SEC "provide[s] quantitative estimates of direct costs" but not other costs "such as increased transaction costs or a reduction in market efficiency . . . that might arise with these rules").

[206] *See* Proxy Access Rule, *supra* note 203, at 56,755–71.

[207] *See, e.g., id.* at 56,756 (suggesting that the rule will save shareholders "at least $18,000 on average in printing and postage costs").

[208] *See, e.g., id.* at 56,769 (estimating printing and mailing costs of including a shareholder proposal in the company proxy statement, using its analysis conducted for purposes of the Paperwork Reduction Act).

[209] *See generally id.* at 56,755–71.

[210] *See* Kraus & Raso, *supra* note 204, at 325–26 (discussing the SEC's abandonment of the "artificial separation" between the cost-benefit analysis and ECCF sections); *see also* Conflict Minerals, 77 Fed. Reg. 56,274, 56,333–34 (Sept. 12, 2012) [hereinafter Conflict Minerals Rule] (codified at 17 C.F.R. pts. 240 & 249b) (discussing, under the heading

quantitative approach to this analysis,[211] much of its analysis remains qualitative. For example, in its recently adopted conflict minerals rule, the SEC noted that it was "unable to readily quantify with any precision" the social benefits of its rule, which was required by Dodd-Frank.[212]

If we view the SEC's analysis at the back-half of its rules as interpretive actions, then courts, in reviewing SEC rulemaking, should give such interpretive actions deference under *Chevron*.[213] That is because Congress clearly intended to give the SEC broad discretion to implement the securities laws. Such discretion is apparent from the broad grants of rulemaking authority as well as numerous specific grants of rulemaking authority within the Acts.[214] Under *Mead*, such numerous, explicit grants demonstrate Congress's intent to confer broad rulemaking authority on the SEC.[215] Moreover, these interpretations emerge from rules that were the subject of notice-and-comment rulemaking, justifying *Chevron* deference.

Yet, it is not clear whether an agency interpretation that can only be deciphered by analyzing the agency's practices merit *Chevron* deference. As is discussed above, *Mead* instructs that the *Chevron* standard does not apply to an agency action that does not have the force of law.[216] Here, it is arguable whether the SEC's interpretive choice, visible only upon a review of SEC analyses subsumed within substantive rules and not as a result of an explicit statement about the meaning of the ECCF mandate, has the force of law.

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"Economic Analysis," the costs and benefits of the rule as well as its effects on efficiency, competition, and capital formation).

[211] *See, e.g.*, Conflict Minerals Rule, 77 Fed. Reg. at 56,334 (stating that the SEC was "relying particularly on those comment letters that provided quantification and were transparent about their methodologies").

[212] *Id.* at 56,335; *see also* 15 U.S.C. § 78m(p)(1)(A) (2012) (establishing reporting requirements for manufacturers who may be sourcing "conflict minerals").

[213] Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984).

[214] *See, e.g.*, Securities Act, 15 U.S.C. § 77c(b)(l) (2012) (granting the SEC authority to exempt certain classes of Securities from the Act); Exchange Act, 15 U.S.C. § 78l(h) (2012) (granting the SEC authority to exempt certain issues from the Act's reporting requirements).

[215] *See* United States v. Mead Corp., 533 U.S. 218, 219 (2001) (recognizing that "generally conferred authority and other statutory circumstances" may indicate a congressional intent that agency interpretations should have the force of law).

[216] *See id.* at 219; *see also supra* notes 183–84 and accompanying text.

However, even under *Skidmore*, a court should, at a minimum, give some deference to the SEC's manifested interpretation.[217] That is because the SEC has specialized expertise over a highly technical area of the law—securities and securities markets. This expertise is necessary to understand and evaluate the effects of rules in these areas. Moreover, the SEC has a long history of regulating securities and securities markets.[218] In contrast, courts, which consider disputes in myriad areas, do not have such experience or expertise.[219] Thus, there is an argument that the SEC should receive a healthy amount of deference under *Skidmore*.

Still, as *Skidmore* instructs, if the extent of deference given to the SEC varies with "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,"[220] a court might not give a high level of deference to the SEC's interpretation. That is because by virtue of culling an interpretation of the ECCF mandate from the SEC's analysis under that mandate, the SEC does not seem to have given much consideration to, or justified (at least publicly) its reasoning for, its interpretation. Moreover, with the SEC increasingly conducting a quantitative analysis under the ECCF mandate, the SEC has taken an inconsistent analytical approach to the ECCF mandate over time, even if not through formal "pronouncements."[221]

Even if, under *Skidmore*, the SEC was not entitled to much deference, the D.C. Circuit's decisions in *Chamber of Commerce* and *Business Roundtable* reveal an utter lack of deference to the SEC. In fact, in holding that the ECCF mandate requires the SEC to consider the economic effects of its rules through some level of

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217 *See* Skidmore v. Swift & Co., 323 U.S. 134, 139–40 (1995) (citing factors useful in determining the weight given to certain agency determinations).

218 Zachary J. Gubler, *Public Choice Theory and the Private Securities Market*, 91 N.C. L. REV. 745, 755–59 (2013) (describing the creation of the SEC by the Securities Acts and the basic regulation of the securities market).

219 Joan MacLeod Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for the Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 302 (2005) ("[J]udicial deference to federal agency interpretations stems in part from . . . lack of expertise vis-à-vis the federal agencies.").

220 *Skidmore*, 323 U.S. at 140.

221 *See supra* notes 207–08 and accompanying text (discussing the SEC's quantification of costs and benefits in a recent rule).

quantitative analysis, the D.C. Circuit never even stated that it was considering the SEC's analytical approach to the ECCF mandate.[222]

Admittedly, the argument that the D.C. Circuit afforded some deference to the SEC's interpretation without expressly doing so is not baseless.[223] In fact, the SEC itself has historically included a discussion in its rules of the rules' costs and benefits.[224] Moreover, the SEC does attempt to quantify some of the effects of its rules.[225] However, because the SEC's cost-benefit analyses have historically been qualitative and not quantitative,[226] the court was likely not basing its interpretation on that practice. SEC practice, therefore, did not seem to inform the D.C. Circuit's interpretive choice.

Notwithstanding the D.C. Circuit's decisions, there may still be room for the SEC to act and issue an explicit interpretation of the ECCF mandate. If the SEC was to interpret the ECCF mandate in

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[222] *See generally* Chamber of Commerce v. SEC, 412 F.3d 133, 143–44 (D.C. Cir. 2005) (reasoning toward its conclusion concerning the mandate); Bus. Roundtable v. SEC, 647 F.3d 1144, 1151 (2011) (same).

[223] *See Chamber of Commerce*, 412 F.3d at 143 (concurring with an SEC determination regarding the persuasiveness of an empirical study).

[224] *See supra* note 204 and accompanying text (noting an SEC practice of using cost-benefit analyses during rulemaking).

[225] *See supra* notes 207–08 and accompanying text (highlighting the cost savings discussion in a proxy access rule).

[226] *See supra* note 209 and accompanying text (recognizing the largely qualitative nature of a recent rule). To the extent the SEC has quantified the effects of its rules, it has been to estimate the burden of compliance under the Paperwork Reduction Act. *See supra* notes 207–08 and accompanying text. It is also important to note that the court in *Chamber of Commerce* and *Business Roundtable* did not require the SEC to engage in a quantitative cost-benefit analysis under Executive Orders 12,866 and 13,563. *See Chamber of Commerce*, 412 F.3d at 143 (describing the basis for its holding, which consisted in part of the *Public Citizen* decision); *Bus. Roundtable*, 647 F.3d at 1148–51 (same); *see also* Exec. Order No. 12,866, 3 C.F.R. 638 (1994), *reprinted as amended in* 5 U.S.C. § 601 (2012) (excluding from the Order those agencies "considered to be independent regulatory agencies"); Exec. Order No. 13,563, 76 Fed. Reg. 3821, 3822 (Jan. 21, 2011) (defining agency for purposes of the Order's applicability according to Exec. Order 12,866, which excludes independent agencies). Under these Executive Orders, along with a related circular issued by the Office of Management and Budget—Circular A-4—agencies are required to quantify and express in monetary units the costs and benefits of their proposed rules to the extent possible. *See* Executive Order 12,866, 3 C.F.R. 638, § 6(a)(C); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-4, at 27 (2003), *available at* http://www.whitehouse.gov/omb/circulars_a004_a-4/ [hereinafter CIRCULAR A-4] ("You should monetize quantitative estimates whenever possible."). However, those Executive Orders and circular only apply to executive agencies, not independent agencies. *See* Executive Order 12,866, 3 C.F.R. 638, § 3(b) (excluding independent federal agencies, like the SEC). Thus, the SEC is not bound by them.

a way that has the force of law, such an interpretation would be subject to review under the *Chevron* standard. That is because the primary basis for deference under *Chevron* is the implied delegation of authority to an agency.[227] In the SEC's case, the securities laws were designed to give the SEC broad authority to implement the laws.[228] This is apparent from the broad grants of authority within the Acts and the hundreds of specific grants of authority to the SEC under the Acts, as well as the securities laws' design as a framework legislation to enable the SEC to regulate in a changing policy environment.[229] It would also make sense to defer to the SEC using the other rationale for *Chevron* deference; that is, the SEC's specialized knowledge of, and experience regulating, securities and securities markets.[230] Under this reasoning, the SEC might not be stuck with the D.C. Circuit's interpretive choice if it thought such choice was unwise.[231]

### C. REVIEW STANDARD APPLICABLE TO INDEPENDENT AGENCIES

One may properly question whether courts apply a different standard of review to agency action where the agency is independent—i.e., an agency in which the head or heads may only be removed by the President "for cause."[232] As Justice Elena

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227 Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984).

228 *See supra* notes 88–97 and accompanying text (noting that the broad framework provides significant discretion to the SEC).

229 *See supra* note 93 and accompanying text.

230 *See Chevron*, 467 U.S. at 865 (reasoning that Congress might prefer that agencies "charged with responsibility for administering" a statute interpret that statute, given their "great expertise").

231 See *supra* Part V.B for a discussion of why the SEC should not interpret the ECCF mandate as requiring a quantitative cost-benefit analysis.

232 *See* Morrison v. Olson, 487 U.S. 654, 687–93 (1988) (upholding a for a cause limitation on the President's removal of officers of independent agencies). Congress often creates independent agencies to allow a body of experts to gain experience through their length of service and to operate independent of the President. *See* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2327 (2001) (arguing that in delegating power to an independent agency rather than an Executive Branch official, "Congress must be thought to intend the exercise of that power to be independent"). Thus, they can exercise their judgment free from interference by any governmental officials or departments. As a result, they are insulated from politics and are primarily guided by their expertise. It is for this reason that most, if not all, of the financial regulators—including the SEC—are independent agencies. *See* Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE L.J. 257, 262–63 (stating that when Congress chooses particular sectors of the economy for agency regulation, it expects the regulators to gain expertise). Still, those agencies are held accountable through other governmental channels. *See id.* at

Kagan has artfully argued while a professor at Harvard Law School, the source of judicial deference to agency interpretations of statutes is presidential involvement in administrative decisions.[233] Justice Kagan argues that because of the lack of presidential control over independent commissioners, courts should give their interpretive decisions less deference.[234]

Under Justice Kagan's view, any SEC interpretation of the ECCF mandate would not be entitled to *Chevron* deference because the SEC is an independent agency. That might mean that the SEC's interpretations would fall on the lower end of the *Skidmore* deference spectrum, or even that the SEC's interpretations merit no deference under *Skidmore*.

Other commentators, however, have argued that the independent nature of the SEC justifies applying a *more deferential* standard of review to its rulemaking. For example, Bruce Kraus and Connor Raso argue that the SEC's multimember, bipartisan, independent nature justifies granting greater deference to SEC rulemaking than to executive agencies.[235] That is because any rule that is approved by this kind of commission is necessarily the result of compromise, with last-minute horse-trades to get the rule passed.[236] As such, courts should leave the rules that pass through such a process undisturbed.[237]

Despite the arguments for applying either a higher or lower standard of review to independent agencies, existing Supreme Court jurisprudence does not apply a different standard of review to independent agencies.[238] According to the Supreme Court in *FCC v.*

260–63 (recognizing the collegial decisionmaking of these bodies and the limited nature of their jurisdiction).

[233] Kagan, *supra* note 232, at 2372–73.

[234] *Id.* at 2376–77; *see also* Randolph J. May, *Defining Deference Down: Independent Agencies and* Chevron *Deference*, 58 ADMIN. L. REV. 429, 453 (2006) (arguing for "a reading of *Chevron* that accords less deference to independent agencies' decisions than to those of executive branch agencies").

[235] *See* Kraus & Raso, *supra* note 204, at 336–38.

[236] *See id.* at 337 (characterizing the SEC as a kind of "mini-legislature").

[237] *See id.* at 342 (encouraging the SEC to "press[ ] its natural advantage in its long dialogue with the court"); *see also* Steven J. Cleveland, *Resurrecting Court Deference to the Securities and Exchange Commission: Definition of "Security,"* 62 CATH. U. L. REV. 273, 285–97 (2013) (arguing that the SEC is politically accountable to Congress and the President, which justifies applying a *Chevron* level of deference to SEC action that clarifies an ambiguous statute).

[238] *See* FCC v. Fox Television Stations, Inc., 556 U.S. 502, 525 (2009) (plurality opinion) (noting that the APA "makes no distinction [in this regard] between independent and other

*Fox Television Stations, Inc.*, "it is assuredly not 'applicable law' that rulemaking by independent regulatory agencies is subject to heightened scrutiny."[239] As such, SEC action is subject to *Chevron* deference to the same extent as executive agency action.

D. SAME STANDARD APPLIES TO AGENCY'S INTERPRETATION OF ITS OWN STATUTORY AUTHORITY

Some commentators have also argued that courts should apply a heightened standard of review to an agency's interpretation of a statutory provision that speaks to the scope of that agency's authority. For example, well-known administrative law scholars Thomas Merrill and Kristin Hickman have argued that agencies should not be entitled to *Chevron* deference where they are interpreting the scope of their own power.[240] That is because *Chevron* deference flows from Congress's delegation to agencies of legislative power.[241] This delegation carries with it an implication that the agency has discretion to exercise that power.[242] However, Congress generally does not intend to grant an agency discretion to interpret the scope of its own authority, for that would undermine courts' ability to "polic[e] the boundaries of agency power."[243]

Merrill and Hickman would largely divert from the *Chevron* framework agency interpretations of the scope of their own authority at *Chevron* step zero.[244] *Chevron* step zero precedes a *Chevron* analysis, and occurs as a court determines whether *Chevron* even applies.[245] At this stage, under Merrill and Hickman's proposal, courts would inquire into Congress's intent in determining the level of deference to accord an agency's decision.[246] If a court concluded that Congress did not intend to defer to an

agencies"); *see also* May, *supra* note 234, at 442 ("[T]he Supreme Court has previously applied the *Chevron* doctrine to independent agencies without any suggestion that they are due any less deference than executive agencies.").

239 *Fox Television Stations*, 556 U.S. at 525.

240 Merrill & Hickman, *supra* note 151, at 909–10.

241 *Id.* at 910–11.

242 *Id.*

243 *Id.* at 909–11.

244 *Id.* at 912–13.

245 Cass Sunstein first described *Chevron* step zero in an article aptly named after this analytical step. Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187, 191 (2006).

246 Merrill & Hickman, *supra* note 151, at 912.

agency's statutory interpretation, that agency would not receive *Chevron* deference for that interpretation.[247] Instead, the agency interpretation would be reviewed under the less deferential *Skidmore* standard.[248]

If courts did not defer to agency statutory interpretations that speak to the scope of their authority, it is questionable whether the SEC would receive *Chevron* deference for its interpretation of the ECCF mandate. That is because the ECCF mandate arguably limits the scope of the SEC's authority. Namely, the ECCF mandate limits the SEC in rulemaking by requiring the SEC to consider certain factors as part of its analysis of the public interest.[249] As such, Congress might not have authorized the SEC to determine the meaning of this limit, which impacts whether or not it has authority to promulgate rules. If there were such a scope-of-jurisdiction exception to *Chevron* deference, though, under Merrill and Hickman's proposed framework, any such SEC interpretation would at least be entitled to some deference under *Skidmore*.[250]

Despite the rationale for applying a heightened standard of review to agency rulemaking that speaks to the scope of the agency's authority, the Supreme Court recently clearly disavowed such a heightened review standard. Specifically, in *City of Arlington v. FCC*,[251] the Supreme Court was called on to review whether the Federal Communications Commission (FCC) acted properly when it issued a declaratory ruling interpreting a provision of the Communications Act of 1934 that specified when local governments had to act on siting applications for wireless facilities.[252] The cities of Arlington and San Antonio, Texas, challenged the FCC's interpretive action. The FCC lacked the authority to interpret this provision, according to the plaintiffs, as the Communications Act generally reserved to the states (rather than the FCC) authority to implement the statutory scheme.[253]

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[247] *Id.*

[248] *Id.*

[249] *See* discussion *supra* Part III.B (analyzing the public interest, protection of investors, efficiency, competition, and capital formation limitations on the SEC's rulemaking).

[250] Skidmore v. Swift & Co., 323 U.S. 134 (1944).

[251] 133 S. Ct. 1863 (2013).

[252] *Id.* at 1866–67.

[253] *Id.* at 1867.

In its opinion, the Supreme Court held that there is no distinction between an agency's "jurisdictional" and "nonjurisdictional" interpretations.[254] Rather, the question is always whether the agency exceeded the powers given to it by Congress.[255] As such, according to the Court, it "ha[s] consistently held 'that *Chevron* applies to cases in which an agency adopts a construction of a jurisdictional provision of a statute it administers.' "[256] The Court thus affirmed the Fifth Circuit's application of the *Chevron* standard to the FCC's interpretive action.[257]

An SEC interpretation of the ECCF mandate would not, as a result, be subjected to heightened review simply because that provision arguably speaks to the scope of the SEC's authority. Rather, under *City of Arlington*, such an interpretive action by the SEC would be entitled to *Chevron* deference if that interpretive action had the force of law.

## V. THE NEED FOR SEC ACTION: INTERPRET THE ECCF MANDATE

As I discuss above, the SEC has exposed itself to challenges to its rules and is allowing the D.C. Circuit to dictate how the SEC engages in securities regulation. This is apparent not only from the SEC's failure in litigation to challenge the need for it to engage in a quantitative cost-benefit analysis (QCBA),[258] but also from subsequent agency internal reviews and guidance. In particular, in 2011 and 2012, the SEC's Office of Inspector General conducted

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[254] *Id.* at 1868. Professor Cleveland has also identified the difficulty of distinguishing jurisdictional versus nonjurisdictional interpretations in the context of securities legislation. *See* Cleveland, *supra* note 237, at 281 (noting that "[e]very interpretation of a statute necessarily concerns that statute's reach," and therefore involves a jurisdictional question). For example, he questions whether an SEC interpretation of the word "security" is jurisdictional given that the gateway issue to regulation by the SEC is whether an instrument is a security under the Acts. *Id.* Cleveland also argues that politically accountable agencies are better suited to making policy-type decisions as to matters falling within their statutory sphere than are politically insulated courts. *Id.* at 283. In addition, he argues that judicial deference to the SEC might be necessary to achieve a uniform federal regulatory regime, thus avoiding inconsistent judicial opinions. *Id.* at 282.

[255] *City of Arlington*, 133 S. Ct. at 1869.

[256] *Id.* at 1871 (quoting 1 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 3.5 (5th ed. 2010)).

[257] *Id.* at 1867, 1875.

[258] *See supra* note 71 and accompanying text (explaining the SEC's position in its *Chamber of Commerce* and *Business Roundtable* briefs).

an internal study and issued a report highlighting deficiencies in SEC economic analyses in rulemaking.[259] One conclusion from those reports is that the SEC needs to more consistently involve economists throughout all stages of rulemaking to be able to better quantify the effects of its rules.[260] Moreover, following those reports, the SEC issued an internal memo emphasizing the essential role "[h]igh-quality economic analysis" plays in SEC rulemaking.[261]

Additionally, several legislators have recently introduced bills that would require the SEC to engage in a QCBA in rulemaking. For example, in 2013, Senator Rob Portman proposed a bill—the Independent Agency Regulatory Analysis Act of 2013—that would extend QCBA guidance applicable to non-independent executive agencies to independent agencies such as the SEC.[262]

It is problematic for the SEC to engage in a QCBA in rulemaking for many reasons. Those reasons include the inability to adequately quantify the costs of complying with disclosure rules, the inability to quantify the benefits of SEC rules, and the inability to capture the intangible effects of SEC rules on strategic management processes.

Ultimately, the SEC must exert its authority and interpret the ECCF mandate in a way that reflects the often intangible effects of its rules. The SEC simply cannot continue to implement the D.C. Circuit's interpretation, which ignores the realities of the SEC's regulatory regime, nor can it accept untenable legislative solutions.

Part V.A below reviews what is entailed in a QCBA. I focus on the QCBA guidance applicable to non-independent agencies because that is the kind of analysis legislators have been urging

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[259] OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, REPORT OF REVIEW OF ECONOMIC ANALYSES PERFORMED BY THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH DODD-FRANK ACT RULEMAKINGS (2011), *available at* http://www.sec.gov/about/offices/oig/reports/audits/2011/report_6_13_11.pdf [hereinafter Kyle Report I]; Kyle Report II, *supra* note 205.

[260] Kyle Report I, *supra* note 259, at 42–43.

[261] SEC Memorandum from Risk, Strategy & Financial Innovation (RSFI) and the Office of the General Counsel (OCG), to Staff of the Rulewriting Divisions and Offices 1 (March 16, 2012) [hereinafter SEC Memo], *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[262] *See* Independent Agency Regulatory Analysis Act of 2013, S. 1173, 113th Cong. § 3(a) (2013) (affirming the President's authority to "require independent regulatory agencies to comply . . . with regulatory analysis requirements applicable to other agencies").

the SEC to adopt and that the SEC has indicated it will increasingly undertake.[263] That Part also describes the pressure mounting on the SEC to adhere to that QCBA guidance in rulemaking. Part V.B then explains why it is problematic for the SEC to engage in a QCBA. Finally, Part V.C lays out the way forward for the SEC. In particular, I suggest that the SEC should exert its authority and issue a rule setting out its analytical approach to the ECCF mandate. That approach must not require the SEC to engage in a QCBA where such a methodological approach fails to effectively capture the effect of SEC rules on efficiency, competition, and capital formation.

### A. AN SEC COST-BENEFIT ANALYSIS: PRESSURE MOUNTS

The SEC has never interpreted the ECCF mandate as requiring it to engage in a cost-benefit analysis.[264] Yet, at least since the 1970s, the SEC has included in its rules a discussion of the costs and benefits of its rules.[265] The inclusion of this analysis reflects the SEC's longstanding view that considerations of costs and benefits in rulemaking is "good regulatory practice."[266] Nonetheless, that discussion has primarily analyzed the qualitative effects of its rules.[267]

Yet, as is apparent from the D.C. Circuit's decisions in *Chamber of Commerce* and *Business Roundtable*, the D.C. Circuit views the SEC as having a legal duty to quantitatively assess the economic effects of its rules.[268] In its decisions, the court appears to hold the SEC to standards for rulemaking applicable only to non-independent agencies.[269] Those standards derive from presidential Executive Orders 12,866 (EO 12,866)[270] and 13,563[271] as well as

[263] *See supra* notes 288–300 and accompanying text (noting prodding in this direction by Congress and the SEC's Office of the Inspector General).

[264] SEC Memo, *supra* note 261, at 3 ("No statute expressly requires the Commission to conduct a formal cost-benefit analysis as part of its rulemaking activities.").

[265] *See supra* note 204 and accompanying text (discussing the SEC's use of cost-benefit analysis in rules, including in a 2010 proxy access rule).

[266] SEC Memo, *supra* note 261, at 3.

[267] *See supra* notes 203–07 and accompanying text.

[268] *See* discussion *supra* Part II.A–B (discussing the reasoning of those two decisions).

[269] *See* Executive Order 12,866, 3 C.F.R. 638, § 3 (1994), *reprinted as amended in* 5 U.S.C. § 601 app. at 803 (2012) (defining the agencies that are subject to the Order as those that are not "independent regulatory agencies").

[270] *See id.*

Office of Management and Budget (OMB) Circular A-4,[272] which sets out the OMB's guidance in implementing EO 12,866.[273] A cost-benefit analysis under those two Executive Orders and Circular A-4 (together, the QCBA Guidance) involves the following stages of analysis:

First, under the QCBA Guidance, an agency

> should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by *compelling public need*, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people.[274]

Thus, before regulating, an agency subject to the QCBA Guidance must make a case that there is a significant market failure or other compelling public need.

Next, an agency must examine alternative approaches.[275] That is, an agency must determine that federal regulation is the best solution to fill that need before regulating.[276] Here, again, the QCBA Guidance reinforces the presumption against regulation.[277]

The QCBA Guidance recommends two complementary methods to analyze the likely outcomes of the various regulatory alternatives—a cost-effectiveness analysis and a cost-benefit analysis.[278] Under a cost-effectiveness analysis, an agency seeks to identify the alternative that achieves the most effective use of

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[271] *See* Executive Order 13,563, 76 Fed. Reg. 3821, 3821 (Jan. 21, 2011) (requiring agencies subject to Executive Order 12,866 to engage in cost-benefit analysis and emphasizing quantitative considerations).

[272] *See* CIRCULAR NO. A-4, *supra* note 226.

[273] *Id.* at 1; *see also* SEC Memo, *supra* note 261, at 4 (affirming the principles from Circular A-4 and EO 12,866).

[274] Executive Order 12,866, 3 C.F.R. 638, § 1(a) (emphasis added); *see also* CIRCULAR A-4, *supra* note 226, at 2 (explaining that "[b]efore recommending Federal regulatory action, an agency must demonstrate that the proposed action is necessary").

[275] CIRCULAR A-4, *supra* note 226, at 2.

[276] *See id.* at 3–4 ("Even where a market failure clearly exists, you should consider other means of dealing with the failure before turning to federal regulation.").

[277] *Id.* at 4.

[278] *Id.* at 5.

resources.[279] The QCBA Guidance states that the cost-effectiveness analysis should be prepared "for all major rulemakings for which the primary benefits are improved public health and safety."[280] Under a cost-benefit analysis, an agency identifies the alternative that "maximizes" net benefits.[281] The QCBA Guidance shows a strong preference for performing this analysis using monetary units or, where monetary units are not available, other quantitative terms.[282] Only where it is not feasible to quantify costs and benefits does the QCBA Guidance contemplate a qualitative discussion of those costs and benefits.[283]

While the D.C. Circuit in *Chamber of Commerce* and *Business Roundtable* did not expressly state that the SEC was bound by the QCBA Guidance, it appeared to be applying standards borrowed from those guidelines in its analysis of the ECCF mandate. For example, in *Chamber of Commerce*, the court found that the SEC had violated its obligation under the APA because it had failed to consider the disclosure alternative to its regulation.[284] This duty to consider alternatives derives from the QCBA Guidance, or at least the philosophy behind those guidelines, that an agency must not only try to seek non-federal rulemaking solutions, but also pursue the alternative that is most cost-effective and provides the highest net benefits.[285]

Moreover, in both *Chamber of Commerce* and *Business Roundtable*, the court criticized the SEC for deficiencies in its consideration of the costs and benefits of regulation.[286] In particular, it challenged SEC conclusions about the costs and benefits of its rules in the absence of what the court viewed as

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[279] *Id.* at 6.

[280] *Id.* at 5.

[281] *Id.* at 6.

[282] *Id.*

[283] *Id.* at 14.

[284] Chamber of Commerce v. SEC, 412 F.3d 133, 144–45 (D.C. Cir. 2005).

[285] *See* Executive Order 13,563, 76 Fed. Reg. 3821, 3821 (Jan. 21, 2011) (affirming that the regulatory system must employ the "least burdensome tools for achieving regulatory ends" and "must take into account benefits and costs"); CIRCULAR A-4, *supra* note 226, at 3–7 (urging agencies to exercise caution in determining whether and what federal regulatory action is appropriate).

[286] *See supra* notes 40, 54–56 and accompanying text (describing the D.C. Circuit's reasoning in finding the SEC analysis defective in both cases).

adequate quantitative information.[287] Again, the need to engage in a QCBA derives at least in principle from the QCBA Guidance.[288] As such, the court appeared to be holding the SEC to standards similar to those set out in the QCBA Guidance.

The D.C. Circuit decisions have also accompanied a broader push by some members of Congress to require the SEC to perform a more rigorous QCBA. First, in 2011, the Senate Banking Committee requested the SEC Office of Inspector General (SEC OIG) to assess the SEC's economic analysis performed in connection with rulemaking under Dodd-Frank.[289] In two reports prepared in response to that request, the SEC OIG identified ways in which the SEC has fallen short in its economic analysis.[290] For example, according to the first report, published in 2011, the SEC OIG found that the SEC failed to consistently involve economists throughout the rulemaking effort.[291] That, in turn, disabled the SEC from effectively quantifying the costs and benefits of several of the studied rules.[292] Moreover, in the second report, the SEC OIG recommended that the SEC "rulewriting divisions and the Division of Risk, Strategy, and Financial Innovation (RiskFin) . . . 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."[293] Once again, these reports and recommendations demonstrate the perception that SEC rulemaking is inadequate without a QCBA.

In 2011, shortly after the SEC OIG issued its first report, Senator Richard Shelby introduced the Financial Regulatory Responsibility Act of 2011 (FRRA).[294] This bill, reintroduced in 2013,[295] would essentially require the SEC to engage in the analysis currently required of executive agencies under the QCBA

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[287] *See supra* notes 55–56 and accompanying text (noting the court's rejection of two studies that were "relatively unpersuasive"); *see also* Bus. Roundtable v. SEC, 647 F.3d 1144, 1151 (D.C. Cir. 2011).

[288] *See generally* Executive Order 13,563, 76 Fed. Reg. at 3821 (establishing the principles underlying the QCBA Guidance); CIRCULAR A-4, *supra* note 226, at 6 (same).

[289] Kyle Report I, *supra* note 259, at 2; Kyle Report II, *supra* note 205, at i.

[290] *See* Kyle Report I, *supra* note 259, at 42–43; Kyle Report II, *supra* note 205, at iv–viii.

[291] Kyle Report I, *supra* note 259, at 42.

[292] *See id.* at 42–43 (finding that the economists' varying level of communication with different initiatives contributed to deficiencies in the cost-benefit analyses).

[293] Kyle Report II, *supra* note 205, at 15.

[294] S. 1615, 112th Cong. (2011).

[295] S. 450, 113th Cong. (2013).

Guidance.[296] Senator Rob Portman has also proposed a bill—the Independent Agency Regulatory Analysis Act of 2013 (IARAA)—that would extend the QCBA Guidance to independent agencies such as the SEC.[297]

Members of Congress have also pointed out the risk of the SEC not engaging in a QCBA. Namely, in 2012, the Committee on Capital Markets Regulation sent a letter to the leaders of the Senate Banking Committee and the House Financial Services Committee identifying inadequacies with SEC and other financial agency cost-benefit analyses in rulemaking under Dodd-Frank.[298] According to the Committee, particularly in light of the D.C. Circuit's decision in *Business Roundtable* and a then-pending challenge to a rule of the Commodity Futures Trading Commission passed under Dodd-Frank, "many of the rules under Dodd-Frank could be subject to successful challenge in the courts due to inadequate cost-benefit analysis."[299]

In response to this pressure from legislators and the courts, the SEC indicated that it will adhere to the QCBA Guidance. In particular, a 2012 memo from the SEC's Office of General Counsel and its Office of Risk, Finance, and Strategy, instructed SEC rulewriting divisions and offices to perform a QCBA similar to that

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[296] *See id.* § 3(a) (requiring the SEC and other independent agencies to, among other things, (1) identify the need for regulation, (2) explain why non-federal regulatory solutions are not adequate to address that need, (3) analyze the adverse impact of the regulation on market participants and economic activity or agency effectiveness, (4) quantitatively and qualitatively assess the costs and benefits of the regulations, (5) justify the regulation if quantitative benefits do not exceed quantitative costs, and (6) identify and assess all available alternatives).

[297] *See* S. 1173, 113th Cong. § 3(a) (2013) (affirming the President's authority to require independent regulatory agencies "to comply . . . with regulatory analysis requirements applicable to other agencies").

[298] Letter from the Comm. on Capital Mkts. Regulation to Chairman Tim Johnson, Ranking Member Richard Shelby, Chairman Spencer Bacchus & Ranking Member Barney Frank (Mar. 7, 2012) [hereinafter CCMR Letter], *available at* http://capmktsreg.org/2012/03/lack-of-cost-benefit-analysis-in-dodd-frank-rulemaking.

[299] *Id.* The Committee on Capital Markets Regulation based this conclusion in part on a study it had conducted of independent financial agency rulemaking. *See generally* Rose & Walker, *supra* note 136 (studying the three D.C. Circuit decisions affecting an assessment of cost-benefit analysis in financial regulation). In that study, the Committee found that 57 rules contain no cost-benefit analysis; 85 rules contain cost-benefit analysis that is entirely non-quantitative; and only 50 rules contain quantitative cost-benefit analysis. CCMR Letter, *supra* note 298. Moreover, "[o]f these Rules, the vast majority limit their cost-benefit analysis to a review of the costs of paperwork, legal and compliance review, technology enhancements, and the like and do not contain any analysis of the expected broader economic impact of the Rule." *Id.*

required under the QCBA Guidance.[300] SEC rulewriting divisions and offices were thus instructed to, among other things,

> (1) identify and describe the most likely economic benefits and costs of the proposed rule and alternatives; (2) quantify those expected benefits and costs to the extent possible; (3) for those elements of benefits and costs that are quantified, identify the source or method of quantification and discuss any uncertainties underlying the estimates; and (4) for those elements that are not quantified, explain why they cannot be quantified.[301]

### B. PROBLEMATIC NATURE OF COST-BENEFIT ANALYSIS FOR THE SEC

Supporters of a QCBA give numerous reasons for this analytical approach in connection with rulemaking. First, they argue that QCBA ensures that rules that are adopted are efficient.[302] By calculating the costs and benefits of rules, an agency can thus ensure that the benefits of the regulation justify the costs.[303] If they do not, an agency must explain why the rule is nonetheless justified.[304] QCBA also limits the impact of interest groups.[305] It does that by increasing accountability and transparency.[306] By requiring a QCBA, an interest group cannot simply push through a regulation that it desires.[307]

According to Cass Sunstein, another reason to support QCBA is that it corrects for cognitive defects that can lead to poor judgments.[308] For example, Sunstein contends, "[t]o the extent

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[300] SEC Memo, *supra* note 261, at 9–10.

[301] *Id.*

[302] *See* CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION 21 (2002) (discussing how, in addition to imposing a procedural requirement, a cost-benefit analysis imposes a substantive requirement that the benefits justify the costs).

[303] *See id.* Sunstein concedes that in some cases quantification of costs and benefits is not possible. *Id.* Here, Sunstein supports being as precise as possible to achieve the goal in "the most reasonable manner." *Id.*

[304] *Id.*

[305] *See id.* at 27 (arguing that such an analysis "reduc[es] interest-group control and promot[es] public attention to what is really at stake").

[306] *Id.*

[307] *Id.*

[308] *See* Cass R. Sunstein, *Cognition and Cost-Benefit Analysis*, 29 J. LEGAL STUD. 1059, 1059 (2000).

that people lack information, or base their judgments on mental shortcuts that produce errors, a highly responsive government is likely to blunder."[309] This problem is compounded by processes such as the "social cascade[ ]," where many people come to a certain belief because of what they think other people believe.[310] According to Sunstein, "[c]ost-benefit analysis is a natural corrective, above all because it focuses attention on the actual effects of regulation."[311]

On the other hand, there are numerous concerns with a QCBA, many of which are salient in SEC regulation. For one, it is difficult to quantify the effects of disclosure rules.[312] That is because it is difficult to predict with any certainty how conduct will change as a result of disclosure.[313] This is especially pertinent in the case of securities regulation—primarily disclosure-based regulation[314]—where different investors react differently to disclosure.[315] What one investor might find material might be irrelevant to another investor.[316] In addition, many investors do not have the resources or expertise needed to understand complex

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[309] *Id.* at 1065 (footnote omitted).

[310] *Id.* at 1066–67.

[311] *Id.* at 1065.

[312] Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 HARV. L. REV. 1838, 1866 (2013).

[313] *See* Conference Report, Curtis W. Copeland, Economic Analysis and Independent Regulatory Agencies 97–98 (Apr. 30, 2013), http://www.acus.gov/sites/default/files/documents/Copeland%20Final%20BCA%20Report%204-30-13.pdf (noting, in a report prepared for the Administrative Conference of the United States, that "[w]hen rules involve information disclosure . . . it is difficult to know with any degree of certainty how behaviors will actually change, particularly in reaction to a single rule").

[314] SELIGMAN, *supra* note 12.

[315] *See* Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 BUS. LAW. 317, 323 (2007) (stating that investors may react in a variety of reasonable ways to particular information). Moreover, as Omri Ben-Shahar and Carl Schneider have argued, even if people received, understood, and remembered information necessary to their decisions, people err in how they process information "because they distort, filter, and misinterpret information." OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 107 (2014).

[316] Sauer, *supra* note 315, at 355 ("[M]ateriality, as we have seen, lies much in the eye of the beholder."). The concept of "materiality" is also not determined using a quantitative model; rather, courts look to what would be relevant to a reasonable investor. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."); *see also* Sauer, *supra* note 315, at 321 (noting that under *TSC Industries'* standard, "[j]udges and juries find no alternative but to imagine themselves as investors in the security at issue"). Thus, this is a contextual inquiry. *Id.*

disclosure.[317] There may also be a saturation point of disclosure for some investors, where those investors no longer respond to additional disclosure.[318] Moreover, rules spelling out an over-abundance of disclosure might drive market participants to other markets.[319] As Omri Ben-Shahar and Carl Schneider have argued, all of these investor-specific effects of disclosure demonstrate not only that the benefits of disclosure are small, but that "mandated disclosure has unappreciated costs that are hard to measure and substantial enough to undermine the enterprise."[320]

Other commentators attack a QCBA requirement on the basis that it unduly slows down regulation. As Professor Thomas McGarity has argued, "[a]nalytical requirements can contribute to the 'ossification' of the rulemaking process."[321] An ossification, or hardening, of the rulemaking process at the SEC could leave investors and the public unprotected in an environment where securities markets and market players are constantly inventing new financial instruments. In fact, many commentators believe that the SEC contributed to the latest economic crisis by not acting

[317] *See* BEN-SHAHAR & SCHNEIDER, *supra* note 315, at 7 ("[B]ecause the choices for which [disclosure] seeks to prepare disclosees are unfamiliar, complex, and ordinarily managed by specialists, novices cannot master them with the disclosures that lawmakers usually mandate."); Steven L. Schwarcz, *Disclosure's Failure in the Subprime Mortgage Crisis*, 2008 UTAH L. REV. 1109, 1114 (arguing that while institutional investors may hire experts where their benefits exceed their costs, "the benefit gained from fully understanding complex transactions is intangible and harder to quantify").

[318] *See* BEN-SHAHAR & SCHNEIDER, *supra* note 315, at 8, 94–106 (discussing the disclosure "overload" and "accumulation" problems); Sauer, *supra* note 315, at 355 ("[T]oo much [information], particularly of a trivial or speculative nature, can muddle and diffuse disclosure and thereby lessen its usefulness.").

[319] *See* BEN-SHAHAR & SCHNEIDER, *supra* note 315, at 11, 171–82 (arguing that the aggregate cost of thousands of disclosure mandates is not modest, and includes costs such as the cost of precluding better regulation and undermining existing regulation, and the cost of exacerbating inequality by failing to help the poor and ill-educated); Steven L. Schwarcz, *Temporal Perspectives: Resolving the Conflict Between Current and Future Investors*, 89 MINN. L. REV. 1044, 1080–81 (2005) ("[I]n a world of evolving international capital markets, erring on the side of disclosure [in the case of ambiguity] may impose competitive costs on the markets themselves, driving some future investors to invest in other, perhaps foreign, reputable markets with lower perceived risks.").

[320] Omri Ben-Shahar & Carl E. Schneider, *The Futility of Cost Benefit Analysis in Financial Disclosure Regulation* 15 (Coase-Sandor Inst. for Law and Econ., Working Paper No. 680, 2014), http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article-2346&context=Law_and_economics.

[321] Thomas O. McGarity, *A Cost-Benefit State*, 50 ADMIN. L. REV. 7, 26 (1998).

quickly enough to regulate asset-backed securities.[322] Requiring the SEC to engage in a QCBA would surely only delay the rulemaking process more and, in turn, impair the SEC's ability to respond to securities market developments. This is especially concerning in the current environment where, under Dodd-Frank and the JOBS Act, the SEC is tasked with promulgating numerous rules.[323] Needless to say, if the SEC had to justify each of its rules under a QCBA and faced legal challenges similar to those in *Business Roundtable* for any shortcomings in that analysis, the SEC's effort to implement Congress's intent behind those acts would be stymied.[324]

Critics of QCBA also point out that a QCBA requires a quantification of risk—that is, a quantification of the probability and magnitude of future events.[325] Performing this analysis requires a great deal of information—information that is often not available.[326] Because "the line must be drawn somewhere," information about underlying risk "is never complete."[327] As such,

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322 *See, e.g.*, Henry T.C. Hu, *Too Complex to Depict? Innovation, "Pure Information," and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601 (2012) (asserting that the SEC disclosure paradigm's failure in the face of "complex realities" continues to contribute to the financial crisis).

323 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, § 913(l), 15 U.S.C. § 80b-11(h)(2) (2012) ("The Commission shall . . . examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices . . . ."); Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306, 326 (2012) (codified in scattered sections of 15 U.S.C.) (authorizing promulgation of SEC rules); *see also Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, SECURITIES & EXCHANGE COMMISSION, Feb. 12, 2015, http://www.sec.gov/spotlight/dodd-frank.shtml ("Th[e] [Dodd-Frank Act] contains more than 90 provisions that require SEC rulemaking, and dozens of other provisions that give the SEC discretionary rulemaking authority."); Jumpstart Our Business Startups (JOBS) Act, SECURITIES & EXCHANGE COMMISSION, Dec. 22, 2014, http://www.sec.gov/spotlight/jobs-act.shtml ("The [JOBS] Act requires the SEC to write rules and issue studies on capital formation, disclosure and registration requirements.").

324 *See* Letter from Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve System et al., to Joseph Lieberman, Chairman, Comm. on Homeland Sec. and Gov't Affairs (Oct. 26, 2012), http://dev.ombwatch.org/files/regs/financial_regulators_ltr_lieberman_collins_s3468.pdf ("[T]he [IARAA] also would interfere with our ability to promulgate rules critical to our missions in a timely manner and would likely result in unnecessary and unwarranted litigation in connection with our rules.").

325 *See* McGarity, *supra* note 321, at 12–13 ("Risk assessment begins with the rudimentary principle that risk is a function of probability and consequences.").

326 *See id.* at 13 (noting that "both safety and health risk assessments require a great deal of information and much of this information is difficult to obtain").

327 *Id.*

even with extensive resourced devoted to it, risk assessments are not accurate.[328]

Relatedly, a QCBA would not capture the intangible effects of SEC rules on firm strategic and risk management processes. A firm's strategic management process is its process for generating future gains.[329] As part of that process, a firm's top officers along with other relevant stakeholders formulate a plan for that firm to remain competitive; the firm's employees throughout the enterprise then implement that plan through their various decisions and tasks.[330] Moreover, as the future comes to pass and new risks and opportunities are identified, a firm's strategic management plan cycles that information back to the relevant planners to ensure the plan evolves as necessary for competitive success.[331] Risk management describes a firm's process for identifying, assessing, and taking appropriate action to control down-side risk.[332] It works hand-in-hand with the strategic management process, feeding information about potential risks and their impact into the strategic planning process.[333]

Strategic management commentators commonly describe unquantifiable, intangible benefits of implementing a strategic management process.[334] That is because you cannot place a number on benefits such as having a clear direction for the firm, motivating employees, and providing consistency in the decisionmaking process.[335] Similarly, risk management experts

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[328] *Id.*

[329] *See* Grossman, *supra* note 14, at 456 & n.25.

[330] *See id.* at 457–70 (outlining the strategic processes involved in strategic management).

[331] *Id.* at 471.

[332] *See* ROBERT R. MOELLER, COSO ENTERPRISE RISK MANAGEMENT 22–23 (2007) (distaining risk management to "a four-step process: (1) risk identification, (2) quantitative or qualitative assessment of the documented risks, (3) risk prioritization and response planning, and (4) risk monitoring").

[333] Grossman, *supra* note 14, at 462–63.

[334] *See, e.g.*, FRED R. DAVID, STRATEGIC MANAGEMENT: CONCEPTS AND CASES 18 (2003) ("[Strategic planning] does not provide a ready-to-use prescription for success."); PETER FITZROY & JAMES M. HULBERT, STRATEGIC MANAGEMENT: CREATING VALUE IN A TURBULENT WORLD 352 (2005) ("[A]ny attempt to fully explain corporate performance would require a complete audit of the strategic management process . . . . [I]t is naïve and deceptive to treat a living organism merely as a set of numbers.").

[335] *See* DAVID, *supra* note 334, at 18 (listing "[f]ailing to create a collaborative climate," "[f]ailing to communicate the plan to employees," and "[v]iewing planning to be unnecessary" as strategic planning pitfalls); FITZROY & HULBERT, *supra* note 334, at 352

declare that it is impossible to fully quantify the benefits of risk management.[336] The inability to quantify all of the benefits of having strategic and risk management processes means that changes in those processes stemming from new or changed SEC rules are also not quantifiable. Yet such an impact could be quite significant, going to the heart of a firm's systems to remain competitive.

The challenge of subjecting the SEC to QCBA is apparent by looking at SEC rulemaking. Consider, for example, the SEC's analysis of the economic effects of its proxy enhancement disclosure rules. Those rules require public firms to disclose compensation policies and practices that are reasonably likely to have a material adverse effect on the company.[337] In its rule release, the SEC observed that

> [c]ompanies may also face costs related to the disclosure of the company's compensation policies to the extent that it provides management with incentives to adopt risk-averse strategies that result in the abandonment of risky projects whose returns otherwise would compensate for the amount of additional risk. This could discourage beneficial risk-taking behavior.[338]

However, the SEC could not quantify the potential costs from these rules in encouraging an inefficient amount of risk-taking.[339]

Similarly, the SEC observed that its new requirements on disclosure of the board's role in risk oversight could lead to costs "if a company re-evaluates its leadership structure or the board's role

("[M]anagement must also ensure that appropriate structures, systems, and processes are in place to facilitate implementation . . . .").

336 *See* FITZ & HULBERT, *supra* note 334, at 15 (discussing the general benefits of strategic management).

337 *See* Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,345, 68,358 (Dec. 23, 2009) (codified at 17 C.F.R. pts. 229, 239, 240, 249, 274) (noting the SEC's purpose in passing the proxy enhancement rules of increasing the transparency of risk so that "[i]nvestors can allocate capital across companies, [and] toward companies where the risk incentives are more aligned with an investor's risk preference").

338 *Id.* at 68,356–57.

339 *See id.* at 68,356 (recognizing that there will be "costs associated with the new disclosure" requirements, but failing to specify a certain amount).

in risk oversight and decides to make changes as a result."[340] Yet again, the SEC could not attach a number to this cost.[341]

Both of these instances exemplify the inability of a QCBA to capture significant effects of SEC rules on key risk management processes. While supporters of an SEC QCBA would not place too much stock in the SEC's own characterization of its inability to quantify these effects, their inability to do so is consistent with the literature on risk and strategic management.

The above indicates the impossibility of quantifying the intangible effects of SEC rulemaking on firm risk and strategic management processes. Any measure to require or even encourage the SEC to engage in a QCBA under the ECCF mandate must accordingly be viewed with caution, since people often become overly confident in numbers.[342] Here, even if the SEC were to estimate in monetary terms the costs of a proposed rule and describe qualitatively the unquantifiable effects, such as those on firm strategies and risk-taking, there is a risk that constituents will focus solely on the numeric estimates rather than the accompanying qualitative discussion. As such, the quantitative information could still dominate the inquiry as to whether the rule generates net benefits.

That is not to say that the SEC should never attempt to quantify the effects of its rules. As supporters of a QCBA point out, on some level, quantifying costs and benefits can lead to more efficient rulemaking and thus more rational decisionmaking by ensuring that agencies pursue rules that create "net positive effect[s] on society."[343] Supporters also argue that a QCBA forces agencies to consider a broad range of effects of their rules as

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[340] *Id.* at 68,357.

[341] *See id.*

[342] *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, 1499–1500 (2002) (noting that it is possible that a quantitative cost-benefit analysis will drown out "soft variables"); McGarity, *supra* note 321, at 24 (noting that attaching numbers to risk assessments portrays confidence but risks misleading the public). *But see* Hahn & Sunstein, *supra*, at 1500 (noting that the record does not support the concern that a cost-benefit analysis might drown out soft variables, and citing as an example EPA limits on arsenic in drinking water).

[343] *See, e.g.*, Rose & Walker, *supra* note 21, at 11.

compared to alternatives.[344] In that process, it can force agencies to overcome their cognitive biases that might otherwise drive an agency to overestimate a particular outcome.[345] In fact, the SEC has demonstrated that it can quantify the administrative burden of complying with its rules, and that quantification does not appear to be undermining the SEC's consideration of other qualitative effects of its rules.[346] But the SEC should neither be required nor presumed to have to quantify the effects of its rules. This holds true especially where such a quantification would fail to capture important effects of its rules, be too speculative to be helpful, cause interested parties to ignore non-quantifiable effects, or undermine the SEC Commissioners' ability to reach compromise on a topic of regulation required by Congress.[347]

### C. SEC: PROMULGATE A RULE DEFINING THE ECCF MANDATE

To avoid these problems, I propose that the SEC exert its authority and interpret what the ECCF mandate means and how the SEC fulfills that mandate. In particular, it should do so within one of its substantive rules, in the portion of the rule in which the SEC discusses the effects of its rules on efficiency, competition, and capital formation under the ECCF mandate as well as the costs and benefits of its rules. The rule should lay out a methodological framework for the SEC to follow in considering the effects of its rules on efficiency, competition, and capital formation. That framework should anticipate and welcome qualitative discussion given that some of the most significant effects of SEC rules are intangible and cannot be quantified. Though the framework would therefore focus on qualitative aspects of the SEC's analysis, it might still invite certain quantitative analysis

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344 *See id.* ("Cost-benefit analysis requires an agency to consider the various economic effects of a particular regulation as opposed to possible alternatives, including the alternative of no regulation at all.").

345 *See id.* (arguing that quantifying risks "reduces the likelihood that cognitive biases negatively affect regulatory efforts").

346 *See supra* notes 207–08, 211 and accompanying text (discussing a quantitative analysis that was embedded in a larger quantitative analysis of a recent proxy access rule).

347 *See* Sidney A. Shapiro & Christopher H. Schroeder, *Beyond Cost-Benefit Analysis: A Pragmatic Reorientation*, 32 HARV. ENVTL. L. REV. 433, 450 (2008) ("[Cost benefit analysis] has not displaced the operation of politics in regulatory review, its methodology lacks accuracy, and it is subject to being manipulated according to an analyst's policy preferences.").

where the SEC determines that such analysis will allow the SEC to most effectively consider the effects of its rules. The rest of this discussion explains the elements of this proposal.

First, I propose that the SEC specify the meaning of the ECCF mandate and what methodological framework the SEC uses to satisfy that mandate in a substantive rule adopted through notice-and-comment rulemaking.[348] I propose this approach because by including the interpretation in a rule passed through notice-and-comment rulemaking, the public will be given a voice in the rulemaking process.[349] Thus, interested constituents such as the Business Roundtable and Chamber of Commerce could have input into the SEC's approach. That voice would better enable the SEC to identify the interests it serves under the securities laws and ensure that it is in fact protecting those interests.[350] It would also help the SEC identify any weaknesses in its proposal and identify alternative ways to address those weaknesses.[351]

If the SEC interpreted the ECCF mandate within a substantive rule adopted through notice-and-comment rulemaking, under *Chevron*, courts would defer to the SEC, for it would be acting with the force of law.[352] That is true even though the rule might be inconsistent with the D.C. Circuit's decisions in *Business Roundtable* and *Chamber of Commerce*. After all, the SEC, not the

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[348] The SEC has numerous rules forthcoming under the Dodd-Frank Act in which it could incorporate this interpretation. *See Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act: Pending Action*, SECURITIES & EXCHANGE COMMISSION (Feb. 12, 2015), http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml.

[349] *See* Administrative Procedures Act, 5 U.S.C. § 553(b) (2012) (setting out the notice requirements for informal rulemaking).

[350] *See* Dismas Charities, Inc. v. U.S. Dep't of Justice, 401 F.3d 666, 678 (6th Cir. 2005) (explaining that "the purpose of the requirement of notice and comment is to give those with interests affected by rules the chance to participate in the promulgation of the rules," to "ensure fair treatment for persons to be affected by regulations," and " 'to ensure that affected parties have an opportunity to participate in and influence agency decision making at an early stage' " (quoting U.S. Steel Corp. v. EPA, 595 F.2d 207, 214 (5th Cir. 1979))); *see also* N.J. Dep't of Envtl. Prot. v. EPA, 626 F.2d 1038, 1049–50 (D.C. Cir. 1980) (noting that "the agency is more likely to give real consideration to alternative ideas" during the early stages of rulemaking, when "affected parties have an opportunity to participate" (quoting *U.S. Steel Corp.*, 595 F.2d at 214)).

[351] *See Dismas*, 401 F.3d at 678 (recognizing the role of notice-and-comment in influencing agency decisionmaking and proposing consideration of alternative ideas); *N.J. Dep't of Envtl. Prot.*, 626 F.2d at 1049–50 (same).

[352] *See* discussion *supra* Part IV.A–B (sketching the outlines of *Chevron* and *Skidmore* deference).

courts, has been given the primary authority to interpret ambiguous securities laws.[353]

The SEC would greatly benefit from this deference. The proposed rule would preclude courts from scrutinizing the SEC's methodology for fulfilling the ECCF mandate under either *Skidmore* or some other less deferential standard. That, in turn, should prevent a court from scrutinizing the SEC's analysis under the ECCF mandate in rulemaking, as the D.C. Circuit did in *Chamber of Commerce* and *Business Roundtable*. Avoiding such scrutiny would allow the SEC to craft rules without judicial second-guessing of its analysis or conclusions, so long as the agency complies with the framework that it established in its rule. Ultimately, the process of rulemaking would become more efficient, allowing the SEC to fulfill its twin objectives of protecting investors and the public interest through rulemaking.

In their article, Bruce Kraus and Connor Raso also contemplate additional SEC guidance on how the SEC will fulfill the ECCF mandate.[354] Yet they suggest that such guidance take the form of guidance similar to the SEC's 2012 memo.[355] I believe my approach—having the SEC include its interpretation in a substantive rule promulgated through notice-and-comment rulemaking—would be preferable because of the participatory component to that process. Such an approach would also allow the SEC to receive *Chevron* deference for its interpretation of the ECCF mandate, reducing the likelihood that courts will closely review the SEC's ECCF analysis in future rulemaking.

With respect to the methodological framework, for the reasons I specified in Part V.B, I would counsel the SEC to not adopt a QCBA framework. This is because such a framework would fail to capture the impact of SEC disclosure rules, including their impact on important strategic and risk management processes. It would also delay SEC rulemaking by opening the SEC up to challenges like those in *Chamber of Commerce* and *Business Roundtable*,

[353] *See supra* note 153 and accompanying text.

[354] *See* Kraus & Raso, *supra* note 204, at 332 (suggesting that "the 2012 Guidance should be developed dynamically and improved continuously, based on the agency's experience").

[355] *See id.* at 333 ("Future work of SEC [policymakers] should help the 2012 Guidance evolve still further into . . . Guidance 2.0, if you will.").

where the court either disagreed with the SEC's selected estimate or identified costs that the SEC failed to quantify.

Even promulgating a framework that calls for consideration of non-quantifiable effects where quantification is *not possible*, similar to the standard set out in the QCBA Guidance, presumes that the numerical estimates are superior to qualitative disclosure. But there are many costs and benefits to qualitative disclosure where quantification is neither possible nor desirable.[356]

For one, a thorough, meaningful discussion of the effects of SEC rules on efficiency, competition, and capital formation would allow the SEC Commissioners to have a more complete sense for the effects of SEC rules, especially where the effects cannot be accurately captured quantitatively. Such discussions should, in turn, lead to better rulemaking and better rules. Similar concerns underlie Professor James Cox and Benjamin Baucom's suggestion that the SEC address analytically—not econometrically—a rule's probable impact on efficiency, competition, and capital formation.[357] For them, a thoroughly reasoned analysis of these effects is better than attempting to justify a rule through economic efficiency.[358]

Another benefit to a meaningful qualitative approach is that it would allow the SEC to present in its rules the nature of the dialogue among the SEC commissioners on the advantages and disadvantages of the rule. As lawyers, the Commissioners would surely be better able to present their views in a qualitative, discursive style.[359] This approach would therefore make their approval process more transparent.

Additionally, meaningfully analyzing the qualitative effects of rules, and disclosing such analysis in the rule, would make the rulemaking process more transparent to laypersons. By including too much econometric analysis in its rules, the SEC may be undermining the ability of the public to participate in rulemaking,

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[356] *See* discussion *supra* Part V.B (discussing the problems that a quantitative cost-benefit-analysis might generate).

[357] Cox & Baucom, *supra* note 9, at 1841.

[358] *Id.*

[359] In 2013, President Barack Obama appointed Michael S. Piwowar, the only current non-lawyer, to the Commission. *See* SEC Biography: Commissioner Michael S. Piwower, U.S. SEC. & EXCH. COMM'N (Nov. 4, 2014), http://www.sec.gov/about/commissioner/piwowar.htm#.VQWN-mN_mM8.

hurting the very people it is designed to protect. While some groups have the capacity to understand sophisticated econometric modeling, the rules might not protect the less sophisticated groups who most need protecting.

Still, it is possible that the SEC's selected methodological framework will call for *some* QCBA analysis. That is especially true for those costs that can be accurately quantified. But the SEC's adopted framework must describe how the quantifiable and intangible factors will be considered together to ensure the SEC and the public do not ignore or undervalue the intangible effects of SEC rules on efficiency, competition, and capital formation.

## VI. CONCLUSION

*Chamber of Commerce* and *Business Roundtable* raise concerns not only about the proper level of judicial review of agency action, but more broadly about the separation of power between courts and agencies. As this Article argues, it is the nature of Congress's broad grant of authority to the SEC that necessitates definite SEC action to exert its authority and interpret the ECCF mandate. Courts, in turn, would need to give that interpretation deference under *Chevron*. Such deference is essential to our system of government, for it assures that courts do not undermine Congress's will, expressed through legislative grants of authority. That the SEC should employ a qualitative model in conducting analysis under the ECCF mandate is merely a suggestion to avoid the pitfalls associated with over-reliance on quantitative data. Only the SEC can and should determine the most appropriate methodology to most effectively enable it to analyze the effects of its rules on efficiency, competition, and capital formation, as it seeks to advance the public interest and protect investors.