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Setting The Record Straight On Cost-Benefit Analysis And Financial Reform At The SEC

A Report From Better Markets, Inc.
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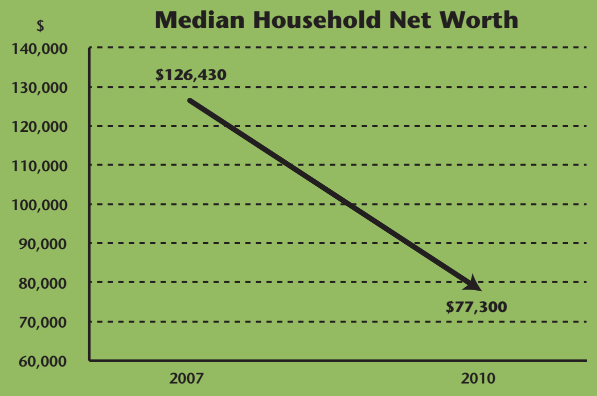

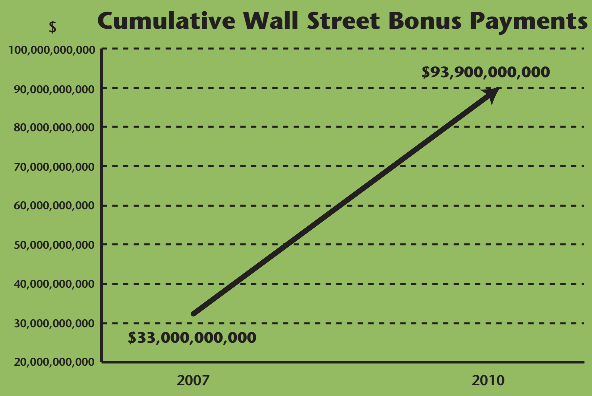


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KEY POINTS

THE CRISIS: The near collapse of the financial system in 2007-2009 and the ensuing economic crisis forced the United States government to spend, lend, guarantee, pledge, or otherwise use trillions of dollars to prevent a second Great Depression. The crisis—caused primarily by Wall Street's too-big-to-fail banks—continues to spread misery throughout the country, as 21 million Americans who want to work full-time cannot find employment, 46 million people have now fallen into poverty, median family net worth plummeted 38% from 2007 to 2010, and millions have lost their homes to foreclosure.

THE RESPONSE: Passed in 2010, the Dodd-Frank financial reform law completely overhauled our financial regulatory system to prevent a recurrence of this economic disaster. If implemented as intended, the law will establish greater transparency, accountability, and oversight throughout our financial markets. Most important, the law will re-regulate Wall Street and the giant banks so that they cannot again threaten our financial system, taxpayers, Treasury, or economy.

THE OPPOSITION: Wall Street and its allies have used their unlimited resources to wage a relentless fight against financial reform in the legislative, regulatory, judicial, and political arenas, but they have not yet been able to defeat it. Their latest strategy is to insist that each rule issued under the Dodd-Frank law must undergo a cost-benefit test that will be impossible to meet. This argument is being deployed in every possible forum to gut financial reform, and it lies at the core of recent lawsuits seeking to invalidate newly-adopted rules.

THE REALITY: The law does not require financial regulators such as the SEC to conduct cost-benefit analysis. The Legislative and Executive Branches weighed the costs and benefits, and they decided that protecting the American people required fundamental reforms, which will inevitably cost the financial industry billions of dollars. Congress and the President would never have adopted such significant protections only to enable the agencies to nullify their determination that the benefits of reform justify the costs. Every rule implementing financial reform must be considered in terms of the enormous collective benefit that all of the rules taken together will provide: Preventing more taxpayer bailouts, another financial crisis, and a second Great Depression.

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INTRODUCTION

This Report, "Setting the Record Straight on Cost-benefit Analysis and Financial Reform at the SEC," may sound esoteric and technical, but it is overwhelmingly important. It exposes Wall Street's latest, potentially lethal attack on financial reform, which seeks to impose a standard of cost-benefit analysis on financial regulators that is impossible to meet. This assault, in the guise of a "Trojan Horse,"[1] has already had significant success, dramatically slowing and weakening the implementation of financial reform. Unless it is effectively countered, it will put the country at grave risk of another financial crisis and more taxpayer bailouts.

Wall Street, the financial industry, and their allies deny or minimize their role in the financial collapse and the economic crisis, and they all obscure and conceal the depth and breadth of the suffering that they have caused throughout this country. They are also engaged in a misinformation campaign that has refocused the public debate away **from** the crisis and Wall Street's role in creating it **to** the new financial reform law and the rules being put in place to prevent another crisis. Indeed, Wall Street and its allies behave as though the law was passed for no reason at all and that they are being regulated and burdened for some mysterious, undeserved reason.

> ***Wall Street, the financial industry, and their allies are engaged in a misinformation campaign.***

In light of this, a critical step in setting the record straight is to review just how close the country came to a total collapse of the financial system and a second Great Depression, and just how severe and prolonged the crisis has been. In fact, the crisis did not end in the fall of 2008. The world was slipping into another depression in the first quarter of 2009, which compelled the U.S. government to announce on February 23, 2009—for the first time in the history of the country—that the full faith and credit of the United States would stand behind the

1 John Kemp, *The Trojan Horse of cost-benefit analysis,* Reuters, Jan. 3, 2012, http://blogs.reuters.com/great-debate/2012/01/03/the-trojan-horse-of-cost-benefit-analysis/.

entire banking and financial system. That was more than five months after Lehman Brothers declared bankruptcy.

This extraordinary measure was necessitated by Wall Street's unregulated and at times fraudulent trading and investing activities, which have caused and continue to cause enormous financial hardship and human suffering. The U.S. government has spent, lent, guaranteed, pledged, assumed, or otherwise used trillions of dollars to save Wall Street from itself and to prevent the crisis from becoming even worse. And, by virtually every measure—including widespread unemployment, decimated home values, evaporated wealth, and a sharp rise in poverty—our economy continues to reel from the crisis.

But, that has not stopped Wall Street from doing everything in its power to kill, gut, or weaken financial reform. The industry is, after all, in the business of maximizing their profits and they are not interested in protecting taxpayers or the Treasury. In fact, Wall Street banks benefit enormously from government subsidies and favorable treatment because they are too big to fail. That is what allows them to pocket the upside of their bets and stick the taxpayers with the bill when their bets go wrong. The heart of the crisis in 2007–2009 proves the point: While they may deny it, JPMorgan Chase, Goldman Sachs, Morgan Stanley, Merrill Lynch, Bank of America, AIG, Citigroup, and all of the other too big to fail financial institutions would have collapsed into bankruptcy but for the actions of the U.S. government and the taxpayer dollars used to bail them out and put them back on the road to profitability.

They claim that every rule and regulation passed to implement the Dodd-Frank Act must be subjected to exhaustive "cost-benefit analysis."

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[2] signed into law on July 21, 2010, was intended to fundamentally strengthen our regulatory system so that taxpayers would never again have to bail out Wall Street. However, having failed to prevent the passage of this comprehensive financial reform, the financial industry is redoubling its efforts to make sure the law is never implemented as intended. Their latest weapon to kill or weaken financial reform is to claim that every

2 Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

rule and regulation passed to implement the Dodd-Frank Act must be subjected to an exhaustive process they call "cost-benefit analysis."

"Cost-benefit analysis" is a seductively innocent sounding phrase. Indeed, it is an activity that on its face seems sensible and appealing. After all, assessing and weighing the costs and benefits of taking an action appears on the surface to be reasonable. However, in the context of regulation generally and financial regulation in particular, that thinking is simply wrong and it will likely kill financial reform, as Wall Street has intended all along. Moreover, the insistence on what can only be described as an extreme version of cost-benefit analysis has no legal basis. For example, Congress has never required the Securities and Exchange Commission ("SEC") to conduct cost-benefit analysis in its rulemakings, either in the securities laws as originally adopted or in the extensive amendments to those laws, including the Dodd-Frank Act.

The SEC must instead consider the rules under the Dodd-Frank Act as a collection of reforms designed to confer an enormous and overriding benefit.

Thus, setting the record straight on cost-benefit analysis means addressing a host of different claims and myths being advanced by opponents of financial reform. In the balance of this Introduction, we review the depth and gravity of the financial crisis and the urgency of reform. We also lay out some fundamental misconceptions about cost-benefit analysis. This sets the stage for a detailed legal discussion demonstrating that, far from conducting individualized, rule-by-rule cost-benefit analysis, the SEC must instead consider the rules under the Dodd-Frank Act as a collection of reforms designed to confer an enormous and overriding benefit: avoiding the massive costs of another financial collapse and economic crisis.

I. Financial reform was necessitated by the largest financial and economic collapse since the Stock Market Crash of 1929 and the Great Depression of the 1930s, and it was enacted to prevent a second Great Depression

As the aftershocks of the Lehman Brothers bankruptcy shook the world in September of 2008, the U.S. and global financial system seized up and nearly collapsed. Only massive, multi-trillion dollar interventions by the U.S. government and international institutions prevented that calamity in the fall of 2008 and the spring of 2009. Making matters worse, as the **financial system** was unraveling, the U.S. and global **economies** were also grinding to a halt. That too required multi-trillion dollar governmental actions to prevent a second Great Depression.

The wave of bailouts, buyouts, and other rescue efforts that were undertaken to support the nation's leading financial institutions revealed the depth of the unfolding crisis. In the days and weeks after the Lehman bankruptcy, the U.S. government nationalized Fannie Mae and Freddie Mac, and then effectively nationalized AIG and Citigroup through bailouts totaling hundreds of billions of dollars. To prevent their inevitable bankruptcies, investment banks Goldman Sachs and Morgan Stanley were allowed to quickly convert into bank holding companies, thereby receiving full access to the federal safety net. Bank of America acquired investment bank Merrill Lynch, and Wells Fargo acquired Wachovia (derailing Citigroup's attempt to buy Wachovia only days before). The nation's largest savings and loan association, Washington Mutual, failed, was seized by regulators, and was ultimately sold to JPMorgan Chase at a bargain basement price (similar to the bargain price JPMorgan paid for Bear Stearns in March 2008).

> ***The possibility of a second Great Depression was a very real prospect.***

Throughout this time, the U.S. government was creating innumerable rescue programs to prevent any financial institution or sector of the financial industry (including the $3.8 trillion money market fund industry) from collapsing. The much ballyhooed $700 billion TARP program was but one of the countless emergency measures adopted during this time.[3] Moreover, the U.S. government also assisted foreign banks and financial institutions throughout the world, not just those in the U.S.[4] The pace and scale

3 In what appears to be yet another attempt to minimize and understate the depth and cost of the crisis, some talk misleadingly as if TARP were the only government rescue program, and some even claim that TARP will make money. That is not accurate. TARP is currently projected to cost at least $60 billion. U.S. Dept. Of Treasury, TARP Monthly 105(A) Rep. – February 2012, 4 (Mar. 12, 2012). However, even if all TARP money were repaid in full, that hardly means it would have "made" money. The meritless claim made by people who know better is that if TARP (or any one of the other bailout programs) takes in one penny more than it lent out, then it made money. That is simply misleading. The only proper way to evaluate any of these programs is to determine the return that was or should have been received by the government **on a risk adjusted basis**. By that measure, **none** of the government bailouts "made" money. Rather, they have all cost taxpayers and the government hundreds of billions if not trillions of dollars—above and beyond all the other costs of the crisis.

4 For example, the Fed bailed out the foreign exchange markets with more than $2.9 trillion in October 2008 alone and with more than $5.4 trillion of foreign exchange swaps in the three months following the Lehman Brothers bankruptcy. *See* Better Markets' comment letters, *available at* http://bettermarkets.com/sites/default/files/TREAS-Comment%20Letter-%20ForEx%20Swaps-11%EF%80%A229%EF%80%A210.pdf; http://bettermarkets.com/sites/default/files/Treas-%20Comment%20Letter%20(followup)-%20Forex%20Swaps%202-25-11.pdf; and http://bettermarkets.com/sites/default/files/Treas-%20CL-%20meeting%20followup-%20FX%20exemption%203-23-11.pdf.

of deteriorating events was unprecedented, as the contagion from the liquidity and solvency crises spread rapidly to every corner of the financial system and the globe.[5]

But even those unprecedented actions, programs, and interventions—representing trillions of dollars—were not sufficient to stop the multiple crises from spiraling out of control, as almost every financial indicator continued to deteriorate and to do so at an accelerating pace into 2009. Indeed, as late as February 2009, more than five months after the Lehman bankruptcy, the financial systems and economies of the U.S. and the global community were still declining rapidly, with no bottom in sight. Policymakers were facing a very dark and dangerous abyss and the possibility of a second Great Depression was a very real and increasingly likely prospect.[6]

In response, the U.S. government took additional unprecedented actions. For example, on February 23, 2009, it announced that the full faith and credit of the United States would stand behind the financial system, which was thus effectively nationalized, as set forth in this dramatic policy statement:

> A strong, resilient financial system is necessary to facilitate a broad and sustainable economic recovery. The U.S. government stands firmly behind the banking system during this period of financial strain to ensure it will be able to perform its key function of providing credit to households and businesses. The government will ensure that banks have the capital and liquidity they need to provide the credit necessary to restore economic growth. Moreover, we reiterate our determination to preserve the viability of systemically important financial institutions so that they are able to meet their commitments.[7]

That historic step was followed by others, and trillions of additional government dollars were spent, lent, pledged, guaranteed, or otherwise used in an all-out effort to prevent a second Great Depression. We now know that those actions somehow worked, that the financial system did not entirely collapse, and that a second Great Depression was avoided. Having lost 54 percent of its value since its October 9, 2007

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5 Excellent comprehensive compendiums and timelines of these events have been created by researchers at the Federal Reserve Bank of New York and are available at: http://www.newyorkfed.org/research/global_economy/policyresponses.html.

6 *See, e.g., World Bank: Economy Worse Since Depression*, CNNMoney, Mar. 9, 2009,http://money.cnn.com/2009/03/09/news/international/global_economy_world_bank/ ("World Bank says global economy to shrink for the first time since World War II, dragged down by sharp decline in industry, trade"); *World Growth Grinds to Virtual Halt, IMF Urges Decisive Global Policy Response*, IMF Survey online, Jan. 28, 2009, *http://www.imf.org/external/pubs/ft/survey/so/2009/res012809a.htm* ("World growth is forecast to fall to its lowest level since World War II, with financial markets remaining under stress and the global economy taking a sharp turn for the worse, sending both global output and trade plummeting.").

7 Joint Statement by the Treasury, FDIC, OCC, OTS, and the Federal Reserve (Feb. 23, 2009) (full statement available at http://www.federalreserve.gov/newsevents/press/bcreg/20090223a.htm).

high, we also now know—with the benefit of hindsight—that the stock market hit its lowest point on March 9, 2009[8] and that the precipitous and uncontrolled decline of the financial markets and the economy stopped sometime in the March-April 2009 period.

The need to prevent such a calamity from ever happening again is overwhelmingly and indisputably clear.

However, and most important, even to this day no one knows exactly why or how complete disaster was averted. No one knows which policy, program, intervention, action, or expenditure—or what combination or order of those measures—arrested the downward spiral.

Nevertheless, the need to prevent such a calamity from ever happening again is overwhelmingly and indisputably clear: Not only did the financial collapse and economic crisis cost many trillions of dollars, it also caused vast, often unquantifiable, and still-ongoing human suffering, from skyrocketing unemployment, millions of home foreclosures, widespread poverty, and enormous wealth destruction, to foregone retirements, obliterated college funds, and, for many, the lost American Dream.[9] This proved yet again that, other than war, nothing devastates a country more than the economic ruin that follows a financial crisis such as the one that began in 2007.[10]

That is why the Executive and Legislative Branches worked together to enact comprehensive financial reform. The Dodd-Frank Act is intended to protect the American people, taxpayers, and the U.S. Treasury from ever again having to suffer through and pay for another financial collapse and economic crisis. Above all, it is intended to prevent a second Great Depression from afflicting the United States. That dire outcome was avoided, but just barely and through a measure of good luck. The American people may not be so fortunate next time and, most importantly, they should not have to depend on luck. They should have the benefit of laws, reforms, rules, and regulations

8 Jill Schlesinger, *A Year After Market Hit 12 Year Low*, CBSNews, Mar. 9, 2010, http://www.cbsnews.com/2100-500173_162-6281698.html; Alexandra Twin, *For Dow, another 12-year low*, CNNMoney, Mar. 9, 2009, http://money.cnn.com/2009/03/09/markets/markets_newyork/index.htm.

9 *See* Ari Shapiro, *American Dream Faces Harsh New Reality*, NPR, May 29, 2012, *available at* http://www.npr.org/2012/05/29/153513153/american-dream-faces-harsh-new-reality?sc=17&f=1001. The full extent of these devastating costs is detailed below and on the Better Markets website at www.bettermarkets.com. Better Markets will also be issuing a comprehensive report on the costs of the financial crisis.

10 *See, e.g.*, Fernando M. Martin, Fiscal Policy in the Great Recession and Lessons from the Past, Fed. Reserve Bank of St. Louis, Economic Synopses No. 1 (2012), *available at* http://research.stlouisfed.org/publications/es/12/ES_2012-01-06.pdf.

to protect them, and they should be able to count on their elected representatives and regulators to fulfill their duties and ensure that those safeguards are put in place.

That is what financial reform is all about, why it is so desperately needed, and why it must be implemented as comprehensively and quickly as possible.

II. Unable to defeat the passage of the Dodd-Frank Act, Wall Street is attempting to kill or weaken the implementation of financial reform through the application of cost-benefit analysis, a methodology that is incompatible with effective financial regulation

Cost-benefit analysis is a deeply flawed test for determining the validity of financial rules and regulations.

Having failed to prevent the passage of comprehensive financial reform in Congress, the financial industry—primarily the large Wall Street dealer banks—is now focused on killing or weakening financial reform by insisting that every rule implementing the Dodd-Frank Act must be subjected to exhaustive cost-benefit analysis. But cost-benefit analysis is a deeply flawed test for determining the validity of financial rules and regulations. Opponents of reform ignore these problems and simply invoke cost-benefit analysis as an obviously necessary and common sense approach to rulemaking. That thinking is wrong on many levels.

First, cost-benefit analysis generally assumes that all or most of the material costs **and** benefits of a regulation are quantifiable and comparable. In reality, **costs** are much easier to identify and calculate than **benefits**, which are often as much qualitative as quantitative. For example, if the SEC adopts a rule that prevents fraud and manipulation in the securities markets, how can the enormous benefit to investors and to society of an honest, un-manipulated market be calculated? Indeed, financial markets can serve their fundamental purpose as a capital-raising mechanism **only** if investors have confidence in those markets, believing them to be fair and free of fraud and manipulation (at least to some tolerable level). Given this dependence of our markets on investor attitudes, how can the benefit of that confidence and that willingness to participate be quantified? In sharp contrast, companies that must hire new staff and buy information technology to fulfill their compliance obligations know exactly how to quantify those costs. Thus, a cost-benefit analysis almost always favors industry and overweighs its costs. Conversely, no matter how much society, investors, and others benefit, those benefits are often amorphous and difficult to quantify.[11]

This problem is especially pronounced in connection with the rulemaking arising from the Dodd-Frank Act. Currently, the process is centered on each individual rule being proposed and then finalized by each agency. However, the Dodd-Frank Act was not passed by the Legislative and Executive Branches with this narrow focus in mind. The law was passed as a comprehensive and integrated whole designed and intended to prevent another financial collapse and economic crisis. In fact, it was passed to prevent a second Great Depression. Avoiding that calamity—if indeed it can be avoided in the future—will be the historic accomplishment of the Dodd-Frank Act, but how is that enormous benefit quantified? Such questions illustrate the fundamental flaw in applying cost-benefit analysis to the process of regulatory reform (and they also explain why the Legislative and Executive Branches decided not to impose such a condition on the implementation of financial reform).

Second, with regulation, even if the costs are higher than the benefits by some measure, a society often decides that the benefits in the long run still outweigh the costs. For example, if predatory and subprime lending had been stopped in the early 2000s (as a number of State Attorneys General tried to do before being thwarted by federal banking regulators[12]), many if not all of the ingredients of the crisis might not have materialized. How would that benefit be quantified? And, if the more than 3.6 million home foreclosures since 2008 could have been avoided, how would a regulation that provided such a benefit be measured? It would have to include not only the economic costs averted—including a massive decline in household wealth, losses sustained by lenders, hollowed-out communities, and others—but also the incalculable human suffering that could have been avoided as well.

This imbalance in cost-benefit analysis is starkly illustrated in the auto safety context. Ford's exploding gas tanks in Pintos may be the best example: Ford calculated that it would cost $137 million to correct a fatal design defect, but just $50 million to pay the claims of the estimated 180 people killed and 180 people injured from that

11 Financial regulation provides many examples of the distorted nature of cost-benefit analysis, and preventing market manipulation is only one of them. For example, the same point applies to measuring the benefit to society of bringing transparency and regulation to the shadow banking system, including in particular the $700 trillion derivatives market. The benefit of that transparency is enormous, but also impossible to quantify with any degree of accuracy. Pricing that benefit is even more challenging under the currently fragmented rulemaking process, where the impact of each rule is viewed in isolation rather than as part of a coherent collection of reforms. *See, e.g.,* Zoltan Pozsar et al., Shadow Banking, Fed. Reserve Bank of New York, Staff Report No. 458, (July 2010, revised Feb. 2012), *available at* http://www.newyorkfed.org/research/staff_reports/sr458.pdf.

12 Eliot Spitzer, *Predatory Lenders' Partner in Crime*, Washington Post, Feb. 14, 2008, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/02/13/AR2008021302783.html.

defect.[13] From one point of view, this cost-benefit analysis may make perfect economic sense: Spend $137 million to fix the exploding gas tanks, or save $87 million by just paying for the deaths and injuries. However, it also serves as a perfect illustration of the deficiencies of cost-benefit analysis from the perspective of society rather than an individual corporation or industry: It ignores unquantifiable human consequences as well as the moral component in regulatory decision-making.

Third, it is often assumed that the people advocating for cost-benefit analysis are doing so in good faith, with an open mind, and for the purpose of genuinely determining the most appropriate outcome, considering all relevant factors in context. That, however, is often not true, and it is decidedly not what is happening in the debate over financial reform. Almost all of the **proponents** for what they call "cost-benefit analysis" in financial regulation are **opponents** of financial reform. The two perspectives go hand-in-hand. For example, Senator Richard Shelby, who voted against the Dodd-Frank Act, has introduced a bill that would impose an extraordinarily burdensome standard of cost-benefit analysis on federal regulators.[14] In announcing the bill, Senator Shelby was clearly focused on a much larger target, as he proclaimed that "American job creators are under siege from the Dodd-Frank Act."[15] It is thus clear that cost-benefit analysis is the Trojan Horse in the battle over financial reform:

Almost all of the proponents for what they call "cost-benefit analysis" in financial regulation are opponents of financial reform.

> But the string of court challenges, and Shelby's bill, are not really about cost-benefit analysis at all in the narrow sense. The standard they seek to enforce would be impossible to meet. As Geithner observed, **the unstated aim is to beat back federal regulation**.[16]

Finally, too often cost-benefit analysis is portrayed as the only acceptable form of economic analysis applicable to rulemaking. That is simply not the case. Cost-benefit analysis is too often inflexible, incomplete, inappropriate, and difficult to apply. But, that does not mean that **no** economic analysis can or should be performed by regula-

13 *See* Douglas Birsch & John H. Fielder, The Ford Pinto Case: A Study in Applied Ethics, Business, and Technology 51-52 (State Univ. of N.Y. Press, 1994).

14 Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (introduced Sept. 22, 2011).

15 Press Release, *Shelby Introduces Financial Regulatory Responsibility* Act (Sept. 22, 2011), *available at* http://shelby.senate.gov/public/index.cfm/newsreleases?ID=df5330c4-80f7-479b-b6a3-c0b8e7d138be.

16 John Kemp, *The Trojan Horse of cost-benefit analysis*, Reuters, Jan. 3, 2012, http://blogs.reuters.com/great-debate/2012/01/03/the-trojan-horse-of-cost-benefit-analysis/.

tors. Indeed, as detailed below, Congress chooses from a full spectrum of economic analysis options, from none whatsoever on one end, to a highly detailed and prescriptive cost-benefit analysis on the other. The Legislative and Executive Branches, working together in enacting and implementing laws, prescribe the level of analysis that they believe is appropriate for particular regulations and in light of particular objectives. For financial regulation, they have determined that a minimal economic analysis should apply, which prioritizes the public interest, the protection of investors, and the integrity of our capital markets, rather than an exhaustive cost-benefit analysis, which would interfere with the achievement of those policy goals.

Cost-benefit analysis is not simply a neutral methodology that involves the mechanistic weighing of agreed upon cost and benefits.

Thus, cost-benefit analysis is not simply a neutral methodology that involves the mechanistic weighing of agreed upon costs and benefits. Instead, its use involves significant policy choices, implications, and outcomes. Indeed, although seemingly innocuous, cost-benefit analysis has become a battlefield, where the war over financial reform is now being waged. Following the "Executive Summary" below, the body of this Report analyzes that ongoing war, the SEC's very limited statutory duty to consider the economic impact of its rules, and the appropriate holistic analysis actually required by the law.

EXECUTIVE SUMMARY

Opponents of financial reform are undermining the implementation of the Dodd-Frank Act by claiming that financial regulators generally and the SEC in particular have an obligation to conduct a detailed and quantitative cost-benefit analysis for each and every one of the hundreds of rules they must promulgate. The intent of this strategy is two-fold: to slow the entire rulemaking process and to use the claim of industry costs to kill or weaken as many financial reform rules as possible.

However, the call for more detailed and quantitative cost-benefit analysis rests on a failure to recognize the vital importance of reform and on a series of misconceptions or baseless and biased claims that have gone un-scrutinized and unchallenged for too long. As clearly established by the statutory language, the legislative history, and the policy choices made by the Legislative and Executive Branches:

- The financial collapse and economic crisis were the result of nonexistent or inadequate regulation, and the goal of financial reform and the Dodd-Frank Act is to fill that void by re-regulating the financial industry. That re-regulation will inevitably impose or, more accurately, re-impose hundreds of billions of dollars in costs on the financial industry. Those costs arise from prohibiting activities that generate enormous revenues (such as proprietary trading, investing in hedge funds and private equity, and trading derivatives over-the-counter), and from imposing new requirements that entail initial and ongoing compliance costs. While there was no cost-benefit analysis conducted when the financial industry was deregulated, which culminated in December of 2000, the cost of the financial crisis that began in 2007 (a mere 7 years after the apogee of deregulation) is a very good proxy for the cost of deregulating the industry. However, society, not the financial industry, has had to bear almost all of those costs, which have exceeded trillions of dollars and which continue to mount. Financial reform is intended to shift the costs of preventing a future crisis from society back to the financial industry.

- The reason for re-imposing costs on industry goes beyond restoring basic economic fairness and forcing the industry to internalize the costs that it externalized to society. It is fundamentally necessary to prevent another financial and economic crisis like the one we have witnessed since 2007—or something much worse. In the last crisis, the United States avoided a second Great Depression by the closest of margins. There is no reason to think that the country will be fortunate enough to avoid such a calamity after the next financial crisis. In fact, there are reasons to believe that the next economic downturn following the next crisis would be even worse. Fiscal and monetary capacity is largely exhausted and several key policy tools used to stop the crises—such as the Federal Reserve Board's Section 13(3) authority[17]—have been eliminated or substantially curtailed.

- There is no basis for the industry's self-serving claim that regulation of the financial industry will impose unreasonable, much less crushing, burdens on Wall Street or that it will stifle overall economic growth. In fact, since the advent of financial market regulation in the early 1900s and even after the tremendous wave of regulation following the Crash of 1929, Wall Street and the financial industry have consistently complained about such burdens; but they have also consistently thrived, remaining one of the most profitable business sectors in our economy. Moreover, throughout this time, economic growth continued apace, a vibrant middle class emerged, and the country prospered. Therefore, if history is any guide, there is no reason to believe that the Dodd-Frank Act and the rules adopted to implement it will cripple the financial industry or stifle economic growth. Indeed, the facts show just the opposite.

- The law intentionally and by design does not require the SEC to conduct cost-benefit analysis. This choice by the Legislative and Executive Branches was deliberate because the imposition of stringent cost-benefit standards in financial regulation would inevitably lead to significant regulatory impediments, if not paralysis. Most important, this decision was made to ensure that the policy choices of Congress and the President are not jeopardized by the regulatory agencies charged with implementing those decisions.

- Far from a duty to apply an extensive cost-benefit analysis, the SEC and other financial regulators have a statutory obligation to consider the broad public interest and the underlying goal of the Dodd-Frank Act as they promulgate their rules. That goal was preventing another financial and economic crisis and the enormous financial losses and human suffering that it would inflict on the American people. The Legislative and Executive Branches witnessed the financial destruction caused by the crisis, implemented emergency measures to contain it, and then made the

17 Section 13(3) of the Federal Reserve Act, 12 U.S.C. § 343. For use of this authority during the last crisis, *see, e.g.,* Press Release of the Board of Governors of the Federal Reserve System (Sept. 16, 2008), *available at* http://www.federalreserve.gov/newsevents/press/other/20080916a.htm (announcing the first emergency action to bailout AIG). The Dodd-Frank Act substantially narrowed the scope of the emergency lending authority under Section 13(3). *See, e.g.*, Dodd-Frank Act, § 1101(a) (precluding access to credit under Section 13(3) by individual companies or any insolvent firm).

judgment that sweeping reforms were essential to prevent a recurrence. Two of the three branches of government adopted those reforms in the Dodd-Frank Act and then delegated the responsibility for implementing them to the financial regulators. Having done so, it is inconceivable that Congress and the President would expect each agency to second guess the determination that regulatory reform is imperative.

- It is equally inconceivable that the Legislative and Executive Branches would condition the implementation of those critical reforms on the outcome of a rule-by-rule cost-benefit analysis that prioritizes the cost of re-regulating industry over the benefits to the public interest. Indeed, there can be no doubt that the Legislative and Executive Branches intended the Dodd-Frank Act to serve as a comprehensive, integrated overhaul of our financial regulatory framework, and they further intended each rule to be considered as part of that whole.

It is inconceivable that the Legislative and Executive Branches would condition the implementation of critical reforms on the outcome of a rule-by-rule cost-benefit analysis.

- The recent decision of the D.C. Circuit in *Business Roundtable v. SEC* does not change this analysis, because the court improperly ignored the SEC's preeminent statutory duty to protect the public and investors first, and then, but only then, to "consider" the subordinate economic factors set forth in the law. The court's decision rests on two fundamental and recurrent errors, both contrary to longstanding precedent. First, the court was required to defer to the SEC's expertise and judgment, but it did not. Second, it was required to apply the limited economic analysis standard that the Legislative and Executive Branches established for the SEC, but it did not.[18] The decision is a classic example of a court legislating from the bench. Moreover, it violates the constitutional principle of separation of powers: Having undertaken extraordinary emergency actions to prevent the complete collapse of the U.S. and global financial systems, and to halt the economic crisis, all at a cost of trillions of dollars, the Legislative and Executive

18 *See, e.g.,* J. Robert Brown, Jr., *Cost Benefit Analysis and Business Roundtable*, *available at* http://ourfinancialsecurity.org/making-reform-a-reality/conferences/afr-conference-cost-benefit-analysis-and-financial-reform/ ("Lexis-Nexis search of the words 'arbitrary and capricious' in the D.C. Circuit alone yielded 2046 cases; 297 Supreme Court opinions used the phrase; Despite the depth of authority, the court in *Business Roundtable* cited only four cases. One was to a single U.S. Supreme Court case and cited for a very broad proposition. For the other three, the panel cited only to their own opinions.")

Branches joined together to pass comprehensive and integrated financial reform. The third branch of government, the judiciary, does not have the authority or power to second guess those policy judgments and decisions. Therefore, when properly challenged and properly considered, the *Business Roundtable* decision should not stand.

- Finally, as an independent regulatory agency, the SEC is subject to very limited Executive Branch influence, such as the nomination of its commissioners and its chairmen. In fact, the SEC and all of the independent regulatory agencies are expressly exempt from the provisions of executive orders and guidelines that require cost-benefit analysis. Equally important, each commissioner of each independent agency—regardless of party—owes a duty to that agency to maintain and protect its independence, which is vital to carrying out its regulatory mission. All commissioners are temporary stewards, responsible for safeguarding the agency's independence and leaving it as fully intact as it was the day they took office.

Detailing each of these points, the analysis in this Report focuses on the SEC's very limited statutory obligation to consider the economic impact of its rules and the attempt by opponents of regulatory reform to transform this duty into something far more onerous—in fact, impossible to meet. The core principles set forth here also apply to the other financial regulators, including the Commodity Futures Trading Commission.[19] These regulators must not be thwarted in their effort to implement the financial reform law through the application of cost-benefit standards that are not necessary, not workable, and above all, not required.

19 *See* Brief of Better Markets, Inc. as *Amicus Curiae* in Support of Defendant Commodity Futures Trading Commission, Inv. Co. Institute v. CFTC, No. 1:12-cv-00612 (BAH) (D.D.C. 2012) (filed June 29, 2012), *available at* http://bettermarkets.com/sites/default/files/ICI%20v.%20CFTC%20-%20Amicus%20Brief%20of%20Better%20Markets%20June%2025,%202012.pdf; *see also* Corrected Brief of Better Markets, Inc. as *Amicus Curiae* in Support of Defendant Commodity Futures Trading Commission, Int'l Swaps and Derivatives Ass'n v. CFTC, No. 11-cv-2146 (RLW) (D.D.C. 2011) (filed May 1, 2012), *available at* http://bettermarkets.com/sites/default/files/Corrected%20Brief%20of%20Better%20Markets%20as%20Amicus%20Curiae%20in%20Support%20of%20Defendant%20CFTC%20Apr.%2030,%202012.pdf.

DISCUSSION AND ANALYSIS

PART ONE: THE LAW DOES NOT REQUIRE THE SEC TO APPLY COST-BENEFIT ANALYSIS IN ITS RULEMAKINGS

I. Overview

The SEC was established in 1934 in the shadow of the Stock Market Crash of 1929 and in the midst of the Great Depression. It was created for the purpose of enforcing the securities laws as well as regulating the securities markets and the securities industry. Its mission is to enhance disclosure and transparency, prevent fraud and manipulation, and police and punish those who violate the law. Above all, the SEC is charged with protecting the public, investors, and the integrity of the markets.

To ensure that the SEC is able to fulfill its mission, Congress imposed **no** statutory obligation on the agency to conduct cost-benefit analysis when it promulgates rules. In fact, the Securities Laws[20] only require the SEC "to consider," after fulfilling its pre-eminent duty to protect investors and the public interest, whether rules will promote efficiency, competition, and capital formation. The plain language and the legislative history of the applicable statutory provisions show that the scope of this economic analysis is narrow and that the SEC has broad discretion when conducting it.

The SEC's limited economic analysis obligation contrasts sharply with statutory provisions governing other agencies.

Confirming this view, the SEC's limited economic analysis obligation contrasts sharply with statutory provisions governing other agencies in which Congress clearly intended that those agencies weigh costs and benefits in the rulemaking process. The Supreme Court has held that courts must respect these legislative choices, and must

20 In this Report, the "Securities Laws" refers to the four major federal securities statutes: the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Investment Company Act of 1940.

refrain from requiring an agency to conduct cost-benefit analysis unless the statutory language plainly requires it to do so. The Dodd-Frank Act is the most recent and compelling evidence that Congress has no intention of requiring the SEC to conduct cost-benefit analysis: It extensively amended the Securities Laws, but made no changes to the provision simply requiring the SEC to consider three factors in its rulemaking.

II. The SEC's preeminent duty when promulgating rules is to protect investors and the public interest

A. The SEC's priorities are defined by Congress's objectives

The SEC was established for the purpose of implementing the Securities Laws, and its primary duty is therefore to achieve the legislative objectives of those laws. As the Supreme Court has stated, "the rulemaking power granted to an administrative agency charged with the administration of a federal statute . . . . is the 'power to adopt regulations **to carry into effect the will of Congress as expressed by the statute.**'"[21]

Congress passed the Securities Laws first and foremost to protect investors and the public interest from fraud, abuse, and manipulation in the securities markets. Thus, the SEC's primary mission is to achieve these goals. These well-established principles of securities law provide an essential context for the debate over the role of economic analysis in SEC rulemakings.

B. Congress passed the Securities Laws to protect investors and the public interest

The best and most obvious evidence of Congress's objective is the vast collection of requirements and prohibitions actually adopted in the Securities Laws. They range from the registration regime for securities investments and market participants to the extensive disclosure requirements and broad antifraud provisions that prohibit deceit, manipulation, and other forms of abuse in securities transactions. The very nature of this regulatory framework—almost all of which imposes costs on industry—shows without question that Congress's primary intent was to protect investors and to promote fair and honest securities markets notwithstanding the costs on industry.

21 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976)(emphasis added).

The findings and the statements of purpose in the Securities Laws reflect these goals. For example, the opening provisions of the Securities Exchange Act of 1934 declare that

> transactions in securities . . . are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions . . .[22]

Another example is the Investment Company Act of 1940, which begins with a series of findings and a declaration of policy stating that "investment companies are affected with a national public interest;" that "the national public interest and the interest of investors are adversely affected" when investment companies are dominated by lack of disclosure, conflicts of interest, and irresponsible management; and that the policies and purposes of the law are "so far as is feasible, to eliminate those conditions."[23] As the agency responsible for administering this statute, the SEC's first duty is to promote and protect the interests that the law was enacted to serve.

The SEC's primary duty to protect investors and the public interest is also evident from the specific delegations of rulemaking authority found throughout the Securities Laws. Again and again, Congress defined the scope of the SEC's rulemaking authority in terms of the power to promulgate rules that the Commission deems "necessary or appropriate in the public interest and for the protection of investors."[24] Thus, the SEC's rulemaking authority is the means through which the SEC fulfills its congressionally established obligation to protect investors and the public interest.

Finally, a long line of Supreme Court decisions, relying extensively on legislative history, confirms that the Securities Laws are remedial statutes enacted to protect the public and investors by ensuring full and fair disclosure in the securities markets and preventing fraud and manipulation. For example, when the Court held that a presumption of reliance could apply in actions for fraud-on-the-market under the Securities Exchange Act of 1934, it was guided by the statute's fundamental purpose, described in these terms:

> The 1934 Act [which created the SEC] was designed to protect investors against manipulation of stock prices. Underlying the adoption of extensive disclosure requirements was a legislative philosophy: "There cannot

22 15 U.S.C. § 78b ("Necessity for Regulation"). They further state that the statutory purposes include maintaining "fair and honest markets," along with protecting the national banking system and interstate commerce. *Id.*

23 15 U.S.C. § 80a-1 ("Findings and Declaration of Policy").

24 *See, e.g.,* 15 U.S.C. § 77b(a)(10). All four of the principal Securities Laws include this public interest priority in provisions delegating rulemaking authority to the SEC.

be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy." This Court "repeatedly has described the fundamental purpose of the Act as implementing a philosophy of full disclosure."[25]

C. The SEC's duty to protect investors and the public interest has renewed importance in light of the 2008 financial crisis

The financial crisis of 2008 is a powerful reminder of the need to remain focused on the core purposes of securities regulation and the SEC's overriding duty to protect the public, investors, and the integrity of the markets. The Supreme Court's admonition about the importance of raising standards of conduct to the highest possible level following the Great Depression applies with equal force today:

If the public interest is subordinated to industry concerns over the costs of regulation, then the reforms embodied in the Dodd-Frank Act will have little chance of protecting our markets and our economy from the ravages of another financial crisis.

> "It requires but little appreciation… of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail" in every facet of the securities industry.[26]

If these goals are subordinated to industry concerns over the costs of regulation in the rulemaking process, then the reforms embodied in the Dodd-Frank Act will have little chance of protecting our markets and our economy from the ravages of another financial crisis. Thus, in promulgating rules under the Dodd-Frank Act, the SEC must be guided by the preeminent concerns of the public interest and the protection of investors, not the burdens of regulation on industry.

This, after all, is why the SEC was created, and its overriding mission has not changed.

25 *Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988) (quoted authorities omitted).

26 *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-87 (1963) (quoted authorities omitted).

III. The plain language of the Securities Laws shows that Congress did not require the SEC to conduct cost-benefit analysis in its rulemakings

A. The Securities Laws contain no cost-benefit language

The SEC's obligation to assess the economic impact of its rules is determined first and foremost by the actual statutory language that Congress passed and the President signed into law. The plain fact is that the Securities Laws do not include **any** language requiring the SEC to conduct cost-benefit analysis when it promulgates rules.

Instead, the Securities Laws impose—after the preeminent obligation to protect the public interest and investors—a narrowly framed obligation simply to "consider" three specific factors:

> Whenever . . . the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine **whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation**.[27]

The plain fact is that the Securities Laws do not include any language requiring the SEC to conduct cost-benefit analysis.

As explained more fully below, this statutory obligation is fundamentally different from the duty to conduct cost-benefit analysis. It does not require **any** assessment of costs and benefits whatsoever, let alone a quantification of costs and benefits, a comparison of the two, a finding that one outweighs the other, or any other specific methodology. Indeed, it does not even obligate the SEC to determine the "extent to which" a rule will promote the three factors—simply to consider whether a rule will do so.

In addition, nothing in these statutory provisions overrides the SEC's primary duty to put the interest of investors and the public ahead of all other considerations as it promulgates rules. In fact, the language quoted above expressly preserves that

27 15 U.S.C. § 77b(b) (amending the Securities Act of 1933); 15 U.S.C. § 78c(f) (amending the Securities Exchange Act of 1934); 15 U.S.C. § 80a-2(c) (amending the Investment Company Act of 1940); 15 U.S.C. § 80b-2(c) (amending the Investment Advisers Act of 1940) (emphasis added); *see also* 15 U.S.C. § 78w(a)(2) (requiring consideration of the impact of a rule on competition).

obligation. Furthermore, it contains none of the standard language that Congress typically uses and could easily have adopted had it wanted to reverse the SEC's priorities.

B. The wording that Congress adopted, on its face and as interpreted by the courts at the time of enactment, gives the SEC extremely broad discretion when considering the impact of its rules

Congress deliberately framed the SEC's duty in terms of an obligation simply to "consider" certain factors during the rulemaking process. The word "consider" is a general term that does not refer to any particular analytical process, and it certainly does not entail quantitative measurements or comparative weighing. Moreover, since 1950, well before Congress added these provisions to the Securities Laws in 1975, 1996, and 1999, the Supreme Court had already established the broad principle that when statutorily mandated considerations are not "mechanical or self-defining standards," they "in turn imply wide areas of judgment and therefore of discretion."[28] Under longstanding principles of statutory construction, the Legislative and Executive Branches are presumed to have known this when they chose the language for these statutory provisions subsequent to the Supreme Court rulings.

In *Secretary of Agriculture v. Central Roig Refining Co.*, the Court addressed the validity of marketing quotas established by the Secretary of Agriculture for imported sugar. The applicable statute required the Secretary to take three factors "into consideration." Even though the Secretary had given "no weight" to one of the factors, the Court had no difficulty upholding the quotas.[29] As the Court explained:

> By way of guiding the Secretary in formulating a fair distribution of individual allotments, **Congress directed him to exercise his discretion "by taking into consideration" three factors**: past marketings, ability to market, and processings to which proportionate shares pertained. Plainly these are not mechanical or self-defining standards. They in turn imply wide areas of judgment and therefore of discretion . . . Moreover, he is under a duty merely to take "into consideration" the particularized factors. The Secretary cannot be heedless of these factors in the sense, for instance, of refusing to hear relevant evidence bearing on them. But Congress did not think it was feasible to bind the Secretary as to the part his "consideration" of these three factors should play in his final judgment—what

28 *Sec'y of Agric. v. Cent. Roig Ref. Co.,* 338 U.S. 604, 611 (1950).

29 *Id.* at 610.

> weight each should be given, or whether in a particular situation all three factors must play a quantitative share in his computation.[30]

Also prior to the adoption of the 1996 and 1999 statutory provisions requiring the SEC to "consider" three factors when promulgating rules, the federal circuit courts, including the D.C. Circuit Court of Appeals, followed this deferential approach. Those courts specifically held that, when Congress requires an agency to "consider" a factor without indicating precisely how the agency must do so or how much weight the factor deserves, then the agency has broad discretion:

When Congress requires an agency to "consider" a factor without indicating precisely how the agency must do so or how much weight the factor deserves, then the agency has broad discretion.

> As long as the agency gives fair consideration to the relevant factors mandated by law, **the importance and weight to be ascribed to those factors is the type of judgment that courts are not in a position to make.**[31]

Thus, Congress chose wording that, on its face and as interpreted by the courts at the time, imposed a limited obligation on the SEC and, furthermore, left the agency with broad discretion in how to discharge that obligation. In short, there is no basis in the language of the Securities Laws for the proposition that the SEC must evaluate the costs and benefits of its rules, or that it must subordinate its mission of protecting investors and the public interest to any form of economic analysis.

30 *Id.* at 611-12.

31 *Florida Manufactured Hous. Ass'n v. Cisneros*, 53 F.3d 1565, 1577 (11th Cir. 1995) (emphasis added); *New York v. Reilly,* 969 F.2d 1147, 1150 (D.C. Cir. 1992) (same).

IV. The legislative history of the Securities Laws confirms that the SEC's economic impact test is narrow in scope and subordinate to investor protection and the public interest

A. The Securities Acts Amendments of 1975 were intended to prevent anticompetitive behavior that was harming investors, not minimize the costs of regulation to industry

The first appearance of a regulatory economic impact test applicable to the SEC was in the Securities Acts Amendments of 1975. Those amendments included the following provision, which required the SEC to "consider" the impact of its rules on competition:

> The Commission . . . , in making rules and regulations pursuant to any provisions of this title [15 U.S.C. §§ 78a et seq.], **shall consider among other matters** the impact any such rule or regulation would have on competition. The Commission . . . shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this title.[32]

Congress's focus on "competition" was unrelated to concerns—real or imagined—about regulatory burdens. The 1975 amendments were not written to curb "costly," "overzealous," or "burdensome" rulemaking, but to break down anticompetitive industry practices and Self-Regulatory Organization ("SRO") rules **that were harming investors**. The impetus for the statute was the brokerage crisis of 1968-1970, in which the archaic, paper-based system for trading and owning securities was overwhelmed by dramatic increases in the volume of trading.[33] In addition, the parochial mindset among broker-dealers and SROs had led to an anticompetitive market in which investors could not be assured of efficient and fair execution prices.

According to the Senate Report:

> Rather than responding to changing investor needs and striving for more efficient ways to perform their essential functions, the principal stock exchanges and the majority of established securities firms appear to have resisted industry modernization and to have been unable or unwilling to respond promptly and effectively to radically altered economic and technological conditions. As a result, **the securities industry** has caused

32 15 U.S.C. § 78w(a)(2).

33 H.R. Rep. No. 94-123, at 44 (1975).

misallocations of capital, widespread inefficiencies, and undesirable and potentially harmful fragmentation of trading markets.[34]

Obviously, the anticompetitive and undesirable conduct of the private sector was the focus of the Report and the basis for the law, not the rulemaking process of the SEC. Congress's fundamental goal in this statutory change was to serve the interests of investors and the public by eliminating "restrictive rules and practices which prohibit brokers from searching out the best price for their customer or which limit or impede market making activities."[35]

Congress was motivated not by a desire to spare industry any alleged "burdens" or "costs" of regulation, but by the opposite desire to control anti-competitive industry practices.

Although the amendments were specifically focused on abolishing non-competitive SRO rules and enforcement actions, in keeping with their more general objective of promoting and protecting competition, they also required the SEC to consider the anticompetitive effects of its own rules. However, even as to those provisions, the legislative history makes clear that Congress intended the standard to be flexible and the SEC's manner of implementation to be afforded deference:

> This explicit obligation to balance, against other regulatory criteria and considerations, the competitive implications of self-regulatory and Commission action should not be viewed as requiring the Commission to justify that such actions be the least anti-competitive manner of achieving a regulatory objective. Rather, the Commission's obligation is to weigh competitive impact in reaching regulatory conclusions. The manner in which it does so is to be subjected to judicial scrutiny upon review in the same fashion as are other Commission determinations, with no less deference to the Commission's expertise than is the case in other matters subject to its jurisdiction.[36]

Thus, in imposing this first economic analysis requirement, Congress was motivated not by a desire to spare industry any alleged "burdens" or "costs" of regulation, but by the opposite desire: to reign in the anticompetitive, predatory, and harmful

34 S. Rep. No. 94-75, at 1 (1975) (emphasis added).

35 H.R. Rep. No. 94-229, at 94 (1975) (Conf. Rep.).

36 S. Rep. No. 94-75, at 13 (1975).

practices of industry firms and SROs.[37] This was to be done in furtherance of the SEC's mission of protecting investors and the public interest. The conclusion is inescapable: The Securities Acts Amendments of 1975 provide no support for the notion that Congress intended the SEC to conduct cost-benefit analyses in its rulemakings.

B. The National Securities Markets Improvement Act of 1996 imposed a similarly limited duty to consider three factors

The second time Congress addressed the issue of economic considerations in the SEC's rulemaking was 21 years later, in the National Securities Markets Improvement Act of 1996 ("NSMIA"). NSMIA added the following clause to the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940:

> Whenever pursuant to this title the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate **in the public interest**, the Commission shall **also consider**, **in addition to the protection of investors**, whether the action will promote efficiency, competition, and capital formation.[38]

As with the 1975 Amendments, the limited scope of the provision is obvious on its face. It requires the SEC only to "consider" certain factors, and it expressly states that the evaluation must be made in the context of serving the public interest and protecting investors.

The underlying purpose of NSMIA was to eliminate the dual system of state and federal regulation over the securities industry. At the same time, however, Congress evinced no intention of displacing or subordinating the primary investor protection and public interest purposes of the Securities Laws. Indeed, it is clear that its intent was just the opposite:

> The development and growth of the nation's capital markets has prompted the Congress to examine the need for legislation modernizing and rationalizing our scheme of securities regulation to promote investment, decrease the cost of capital, and encourage competition. **The Managers have sought to achieve these goals while also advancing the historic com-**

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37 To a large extent, these were the same purposes underlying the Dodd-Frank Act: to reign in the anti-competitive, predatory, and harmful practices of the financial industry, as discussed in further detail below. This evidences the fact that in some very fundamental ways, little has changed over the decades and the need for the SEC to protect the public, investors, and the integrity of the markets remains as strong as it has ever been.

38 15 U.S.C. § 77b(b) (amending the Securities Act of 1933); 15 U.S.C. § 78c(f) (amending the Securities Exchange Act of 1934); and 15 U.S.C. § 80a-2(c) (amending the Investment Company Act of 1940) (emphasis added).

> **mitment of the securities laws to promoting the protection of investors**. In particular, the system of dual Federal and state securities regulation has resulted in a degree of duplicative and unnecessary regulation. Securities offerings and the brokers and dealers engaged in securities transactions are all currently subject to a dual system of regulation that, in many instances, is redundant, costly, and ineffective.
>
> . . . The Managers have sought to eliminate duplicative and unnecessary regulatory burdens **while preserving important investor protections** by reallocating responsibility over the regulation of the nation's securities markets in a more logical fashion between the Federal government and the states.[39]

Thus, in keeping with the overall purpose of NSMIA, Congress tasked the SEC with the obligation to "consider" the impact of its rules on efficiency, competition, and capital formation. But even as to that specific requirement, the legislative history makes clear that the required analysis is, as in the case of the 1975 Amendments, subordinate to investor protection and public interest goals. The House report states as much:

"For 62 years, the foremost mission of the Commission has been investor protection, and this section does not alter the Commission's mission."

> The new section [requiring consideration of the three factors] makes clear that matters relating to efficiency, competition, and capital formation are only part of the public interest determination, which also includes, among other things, consideration of the protection of investors. **For 62 years,**

39 H.R. Rep. No. 104-864, at 39-40 (1996) (Conf. Rep.).

the foremost mission of the Commission has been investor protection, and this section does not alter the Commission's mission.[40]

Additional legislative history relating to the 1996 amendments removes any question that Congress intended the SEC to exercise broad discretion in how it "considered" the impact of its rules. The 1996 Senate bill included a much more prescriptive clause that would have required the SEC's Chief Economist to prepare a report on each regulation proposed by the SEC, including

> (a) an analysis of the likely costs of the regulation on the U.S. economy, particularly the securities markets and the participants in those markets; and (b) the estimated impact of the rule on economic and market behavior, including any impact on market liquidity, the costs of investment, and the financial risks of investment.[41]

The report would have had to be provided to each SEC Commissioner and printed in the Federal Register before any regulation could become effective.[42]

This specific and burdensome requirement was rejected and only the more narrow provision became law. Thus, Congress considered and intentionally declined to establish a "mechanical or self-describing" process that the SEC would have to follow when assessing the economic impact of its rules, leaving the SEC to exercise its own judgment.

Congress rejected a far more specific and burdensome requirement and only the more narrow provision became law.

40 H.R. Rep. No. 104-622, at 39 (1996). The House report contains a statement suggesting that the Commission should include, when considering the three statutory factors, a "specific analysis" of costs and benefits associated with any rulemaking initiative. *Id.* However, this suggestion is not significant for several reasons. First, it conflicts with the statutory language, which is narrowly tailored and cannot reasonably be read to require an analysis of costs and benefits. Therefore, to interpret this lone portion of the legislative history as imposing a cost-benefit obligation, despite the actual statutory language, would certainly be, in the words of the Supreme Court, "hid[ing] elephants in mouse holes." *See* discussion *infra* Part One, Section V.A. Further, the statement in the report only suggests that an analysis of costs and benefits should be conducted where "practicable." *Id.* Finally, the statement has a flawed rationale. It indicates that an analysis of costs and benefits is "necessary" for purposes of Congress's review of rules under the Congressional Review Act ("CRA"). *Id.* But the CRA does not require agencies to conduct any cost-benefit analysis, and it does not expressly establish insufficient cost-benefit analysis as a basis for Congressional invalidation of a rule under the CRA. *See* 5 U.S.C. §§ 801-808. Instead, it only requires agencies to provide Congress with copies of such analyses "if any" i.e. to the extent they have conducted them. 5 U.S.C. § 801(a)(1)(B)(i). Therefore, the CRA cannot be cited as a justification for burdening the SEC with an obligation to conduct cost-benefit analysis.

41 S. Rep. No. 104-293, at 28-29 (1996) (Section 310).

42 *Id.* at 29.

C. The Gramm-Leach-Bliley Act of 1999 simply added the existing economic impact language to the Investment Advisers Act of 1940

The third and final time that Congress addressed the SEC's general obligation to consider the economic impact of its regulations was in the Gramm-Leach-Bliley Act of 1999 ("GLB"). GLB was passed in a deregulatory fervor aimed at dismantling the barriers that prevented consolidation among securities, banking, and insurance firms under the Glass-Steagall Act of 1933. However, as to SEC rulemaking, Congress simply passed a conforming amendment to the Investment Advisers Act ("IAA"), using precisely the same language that it had already inserted in the other three securities laws in 1996: It required the SEC, when promulgating rules under the IAA, simply to consider, in addition to the public interest, "whether the action would promote efficiency, competition, and capital formation."[43]

Thus, on the three occasions when Congress considered the subject during the nearly 25 year period from 1975 to 1999, it only imposed a narrowly formulated requirement that the SEC consider certain discrete effects of its rules. Furthermore, that obligation was always made subject to investor protection and the public interest, the preeminent goals underlying the federal Securities Laws.

43 15 U.S.C. § 80b-2(c) (amending the Investment Advisers Act of 1940). The Conference Report for GLB reveals that the Conferees were specifically concerned that the SEC might interfere with bank efforts to offer new hybrid products by insisting that the banks register as broker dealers. H.R. Rep. No. 106-434, at 164 (1999) (Conf. Rep.). GLB therefore required the SEC to conduct a rulemaking before attempting to regulate any such bank activity, and it even required the SEC to seek the concurrence of the Federal Reserve Board prior to any such rulemaking. *Id.* at 164, 165. To further allay concerns about possible SEC interference with banks, the report noted approvingly that the SEC was required to consider certain economic factors during any rulemaking process, including the effect on competition. *Id.* at 164-65. In an apparent effort to mollify the banks even more, the report chided the SEC for its past compliance with this requirement, and expressed its expectation that the SEC would "improve in this area." *Id.* at 165. Remarkably, however, notwithstanding this concern over potential regulatory overreaching by the SEC in the past, and notwithstanding this supposed disappointment over the SEC's allegedly lax approach to economic impact analysis in the rulemaking process, Congress made no alteration whatsoever to the SEC's obligation to protect the public interest, investors, and the integrity of the markets, and only then to consider the impact of its rules on efficiency, competition, and capital formation.

V. Congress's choice of language in the Securities Laws, and its repeated decision not to alter that language, reflects a determination that financial market regulation must not be conditioned on or subordinate to the results of cost-benefit analysis

A. When Congress wants an agency to conduct cost-benefit analysis, it makes its intentions clear, as demonstrated in many other federal laws

The absence of a cost-benefit requirement in the Securities Laws is not accidental: It reflects an underlying congressional determination that financial market regulation is an imperative that must not hinge on the outcome of a cost-benefit analysis applied to each implementing rule. Congress carefully chooses economic impact standards, and when it wants agencies to apply cost-benefit analysis, it makes its intention clear. The absence of any such requirement in the Securities Laws is therefore compelling evidence that cost-benefit analysis was never intended to apply and cannot be established by implication.

> ***The absence of a cost-benefit requirement in the Securities Laws reflects an underlying congressional determination that financial market regulation must not hinge on the outcome of a cost-benefit analysis applied to each implementing rule.***

Indeed, the Supreme Court has declared that an agency's duty to conduct cost-benefit analysis is not to be inferred lightly or without a clear indication from Congress.[44] That is because such an obligation can profoundly affect an agency's approach to regulation and can defeat congressional intent:

> Because benefits can be more accurately monetized in some industries than in others, Congress typically decides whether it is appropriate for an agency to use cost benefit analysis in crafting regulations. Indeed, this Court has recognized that "**[w]hen Congress has intended that an agency engage in cost benefit analysis, it has clearly indicated such intent on the face of the statute.**" American Textile Mfrs. Institute, Inc., v. Donovan, 452 U.S. 490, 510, 101 S. Ct. 2478, 69 L. Ed. 2d 185 (1981). Accordingly, we should not treat a provision's silence as an implicit source of cost benefit authority, particularly when such authority is elsewhere expressly granted and **it has the potential to fundamentally alter an**

44 *See Whitman v. American Trucking Ass'ns., Inc.*, 531 U.S. 457, 468 (2001); *American Textile Mfrs. Institute, Inc. v. Donovan*, 452 U.S. 490, 510 (1981).

agency's approach to regulation. Congress, we have noted, "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions--it does not, one might say, hide elephants in mouse-holes." *Whitman v. American Trucking Ass'ns., Inc.*, 531 U.S. 457, 468 121 S. Ct. 903, 149 L. Ed. 2d 1 (2001).[45]

Thus, when Congress intends cost-benefit analysis to apply to an agency's rulemaking process, it has not hesitated to make its intentions clear with an explicit mandate that refers to "costs" and "benefits" and that specifies the nature of the analysis the agency must conduct.[46]

When Congress intends cost-benefit analysis to apply to an agency's rulemaking, it makes its intentions clear with an explicit mandate.

For decades, Congress has imposed a range of different economic analysis obligations, as it deems necessary and appropriate, to achieve different congressional objectives. When Congress intends a formal cost-benefit analysis to apply, it makes that obligation explicit, often requiring a specific weighing or quantification of costs and benefits. When Congress wants to impose a limited and flexible obligation to consider certain cost and benefit consequences of its rules in light of important goals that serve the public interest, it makes that intention clear, without requiring that a comparative or quantitative cost-benefit analysis be performed.[47] And, when Congress does not intend either of those results, it imposes a rulemaking requirement that is entirely free from cost-benefit analysis, giving overriding importance to the particular statutory objectives at stake.

This latter type of economic impact obligation characterizes the SEC's duty under the Securities Laws and it stands in sharp contrast to the statutory provisions in which Congress explicitly mandates a balancing of costs and benefits or some form of quantification. For example, the Flood Control Act of 1936, one of the earliest examples of a statute requiring cost-benefit analysis, explicitly requires a balancing of enumerated

45 *Entergy Corp. v. Riverkeeper, Inc.,* 556 U.S. 208, 238-39 (2009) (emphasis added) (Stevens, J., dissenting). The majority in *Entergy* also recognized the continuing validity of the Court's analysis in *Whitman v. American Trucking Ass'ns., Inc.*, and *American Textile Mfrs. Institute, Inc. v. Donovan. Id.* at 222- 23.

46 *See American Textile Mfrs*, 452 U.S. 490, 510-512 (1981) (citing specific statutes which "demonstrate that Congress uses specific language when intending that an agency engage in cost-benefit analysis."); *Indus. Union Dep't, AFL-CIO v. API*, 448 U.S. 607, 710 n.27 (1980) (Marshall, J., joined by Brennan, White, and Blackmun, JJ., dissenting).

47 *See, e.g.,* 7 U.S.C. § 19(a) (Commodity Exchange Act).

benefits against enumerated costs.[48] Similarly, the Safe Drinking Water Amendments of 1996 impose a heavy duty on the Environmental Protection Agency to analyze specific factors, including the "[q]uantifiable and nonquantifiable health risk reduction benefits," the "[q]uantifiable and nonquantifiable costs," and "[t]he incremental costs and benefits associated with each alternative." [49]

Many federal statutes incorporate this same detailed and highly prescriptive language requiring agencies to conduct cost-benefit analysis. Other examples include the Clean Water Act of 1977,[50] the Energy Policy and Conservation Act of 1975,[51] the Clean Air Act Amendments of 1970,[52] the Outer Continental Shelf Lands Act Amendments of 1978,[53] and the Federal Water Pollution Control Act Amendments of 1972.[54]

On the other hand, as with the Securities Laws, Congress also deliberately imposes rulemaking requirements that are entirely free from cost-benefit analysis, given the paramount importance of the particular statutory objectives Congress seeks to achieve. For example, Section 109(b)(1) of the Clean Air Act, which requires the EPA to set air quality standards at a level to protect the public health, does not include any language requiring a cost-benefit analysis. Indeed, in *Whitman v. American Trucking Ass'ns*, the Supreme

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48 33 U.S.C. § 701a ("[The] Federal Government should improve or participate in the improvement of navigable waters . . . for flood-control purposes if the benefits to whomsoever they may accrue are in excess of the estimated costs, and if the lives and social security of people are otherwise adversely affected.").

49 42 U.S.C. § 300g-1(b)(3)(C).

50 33 U.S.C. § 1314(b)(4)(B) (1976 ed., Supp. III) ("Factors relating to the assessment of best conventional pollutant control technology . . . shall include consideration of the reasonableness of the relationship between the costs of attaining a reduction in effluents and the effluent reduction benefits derived, and the comparison of the cost and level of reduction of such pollutants from the discharge from publicly owned treatment works to the cost and level of reduction of such pollutants from a class or category of industrial sources. . . ."); *see also American Petroleum Inst. v. EPA,* 858 F.2d 261, 264 n.4, 265, & 265 n.5 (5th Cir. 1988) (contrasting the "strict cost/benefit correlation" for BCT levels in 33 U.S.C. § 1314(b)(4)(B) with the looser BAT levels in 33 U.S.C. § 1311(b)(2)(A) which do not require a "direct cost/benefit correlation," just that the limitation must only be "technologically and economically achievable").

51 42 U.S.C. § 6295(c), (d) (1976 ed., Supp. II) (Secretary "shall determine that the benefits of the [energy efficiency] standard exceed its burdens based, to the greatest extent practicable, on weighing" seven specified factors).

52 42 U.S.C. § 7545(c)(2)(B) (1976 ed., Supp. III) ("No fuel or fuel additive may be controlled or prohibited by the Administrator . . . except after consideration of available scientific and economic data, including a cost benefit analysis comparing emission control devices or systems which are or will be in general use . . . ").

53 43 U.S.C. § 1347(b) (1976 ed., Supp. III) (Offshore drilling operations must make "use of the best available and safest technologies which the Secretary determines to be economically feasible, wherever failure of equipment would have a significant effect on safety, health, or the environment, except where the Secretary determines that the incremental benefits are clearly insufficient to justify the incremental costs of utilizing such technologies.").

54 33 U.S.C. §§ 1312(b)(1)-(2) (Regulation shall not be effective if "there is no reasonable relationship between the economic and social costs and the benefits to be obtained."); 1314 (b)(1)(B) (duty to consider "the total cost of application of technology in relation to the effluent reduction benefits to be achieved from such application."); *see also EPA v. Nat'l Crushed Stone Ass'n*, 449 U.S. 64, 71 n.10 (1980) (describing § 1314(b)(1)(B) as a "'limited cost-benefit analysis' . . . intended to 'limit the application of technology only where the additional degree of effluent reduction is wholly out of proportion to the costs of achieving such marginal level of reduction. . . .'").

Court held that this section "unambiguously **bars** cost considerations" from the standard-setting process.[55] The Court noted that the statute was devoid of any language providing for such considerations, and it reasoned that Congress would certainly have mentioned them expressly if they were meant to be considered since cost concerns were "so full of potential for canceling the conclusions drawn from direct health effects."[56]

On the other hand, as in the Securities Laws, Congress also imposes rulemaking requirements that are entirely free from cost-benefit analysis.

Similarly, in *American Textile Manufacturers Institute, Inc. v. Donovan*, the Supreme Court held that a provision in the Occupational Safety and Health Act of 1970 requiring OSHA to set standards for occupational exposure to cotton dust could not have required cost-benefit analysis.[57] The statute mandated air quality standards that would, "to the extent feasible," assure that no employees would suffer material health impairments. In the Court's view this left no room for a cost-benefit analysis, as Congress had placed worker health above all other concerns:

> [Section] 6(b)(5) directs the Secretary to issue the standard that "most adequately assures . . . that no employee will suffer material impairment of health," limited only by the extent to which this is "capable of being done." In effect then . . . **Congress itself defined the basic relationship between costs and benefits**, by placing the "benefit" of worker health above all other considerations save those making attainment of this "benefit" unachievable. Any standard based on a balancing of costs and benefits by the Secretary that strikes a different balance than that struck by Congress would be inconsistent with the command set forth in § 6 (b)(5). Thus, cost-benefit analysis by OSHA is not required by the statute because feasibility analysis is.[58]

55 *See Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 471 (2001); *see also Cent. Ariz. Water Conservation Dist. v. EPA,* 990 F.2d 1531, 1542 n.10 (9th Cir. 1993) (finding that the EPA's Clean Air Act PSD program, 42 U.S.C. § 7491(g)(1), does not require a cost-benefit analysis).

56 531 U.S. at 469.

57 *American Textile Mfrs. v. Donovan*, 452 U.S. 490, 510-512 (1981).

58 *Id.* at 509.

In the Securities Laws as well, Congress made its own judgments about the costs and benefits of regulation. It determined that the benefits of protecting investors and the public interest outweighed the costs of regulation that were necessary to accomplish those preeminent goals. It therefore knowingly and intentionally chose not to require the SEC to conduct cost-benefit analysis, thus ensuring that the agency's rules would not "strike a different balance than that struck by Congress." Instead, Congress imposed a far more limited obligation simply to consider whether rules would promote three specific economic factors—efficiency, competition, and capital formation.

Indeed, before Congress considered and passed the amendments to the Securities Laws in 1975, 1996, and 1999, it had expressly included cost-benefit requirements in other statutes, but it declined to do so in the Securities Laws. This reflects Congress's long-standing and considered judgment that the benefits of protecting investors and preserving the integrity of our financial markets must not be subordinated to concerns about the costs of regulation.[59]

B. Congress has repeatedly refused to burden the SEC with a duty to conduct cost-benefit analysis, and the Dodd-Frank Act is the most compelling example of this resolve

Since Congress first imposed cost-benefit obligations on federal agencies in the 1936 Flood Control Act, it has amended the four major Securities Laws numerous times. Yet, each time Congress chose not to impose such an obligation on the SEC.

> ***The Dodd-Frank Act is the most recent and compelling evidence of Congress's continuing resolve not to inject cost-benefit analysis into the rulemaking process under the Securities Laws.***

The Dodd-Frank Act is the most recent and compelling evidence of Congress's continuing resolve **not** to add cost-benefit analysis into the rulemaking process under the Securities Laws. For example, Titles IV, VII, and IX of the Dodd-Frank

59 The bills proposed in Congress since the Dodd-Frank Act became law that seek to impose a duty to conduct cost-benefit analysis on the independent regulatory agencies further confirm this view. SEC Regulatory Accountability Act, S. 2373, 112th Cong. (introduced Apr. 26, 2012); Startup Act of 2011, S. 1965, 112th Cong. (introduced Dec. 8, 2011); Financial Regulatory Responsibility Act of 2011, S. 1615, 112th Cong. (introduced Sept. 22, 2011); SEC Regulatory Accountability Act, H.R. 2308, 112th Cong. (introduced June 23, 2011); A Bill to Improve Consideration by the Commodity Futures Trading Commission of the Costs and Benefits of its Regulations, H.R. 1840, 112th Cong. (introduced May 11, 2011). Courts have found such proposals relevant to finding that an agency's current statute does not already mandate a specific analysis of a rule's costs and benefits. *See, e.g.*, *American Textile Mfrs. Inst. v. Donovan*, 452 U.S. 490, 512 n.30 (1981) (citing a Senator's proposal that "directs the Secretary to recognize the cost-benefit ratio in promulgating a new standard and to publish information relative to the projected financial impact" as evidence that the current law did not require cost-benefit analysis).

Act extensively amended all four of the major Securities Laws, imposing a wide range of reforms intended to prevent another devastating financial crisis by reducing systemic risk, increasing transparency, and reigning in abusive conduct by market participants. The Act also required or authorized the SEC to promulgate nearly a hundred new implementing regulations.

Throughout this overhaul of the Securities Laws, however, Congress declined to expand in any way the general requirement that the SEC merely consider, as a secondary matter, whether its rules would promote efficiency, competition, and capital formation. In fact, the only appearance of cost and benefit considerations in the Dodd-Frank Act relating to securities regulation is limited to a small group of **studies** to be conducted by either the Comptroller General or the SEC itself.[60] Each of these studies is to be provided to Congress or one or more of its Committees, and they are clearly intended for the specific and limited purpose of supplying information to Congress that may warrant consideration in future legislation.

In fact, the only appearance of cost and benefit considerations in the Dodd-Frank Act relating to securities regulation is limited to a small group of studies.

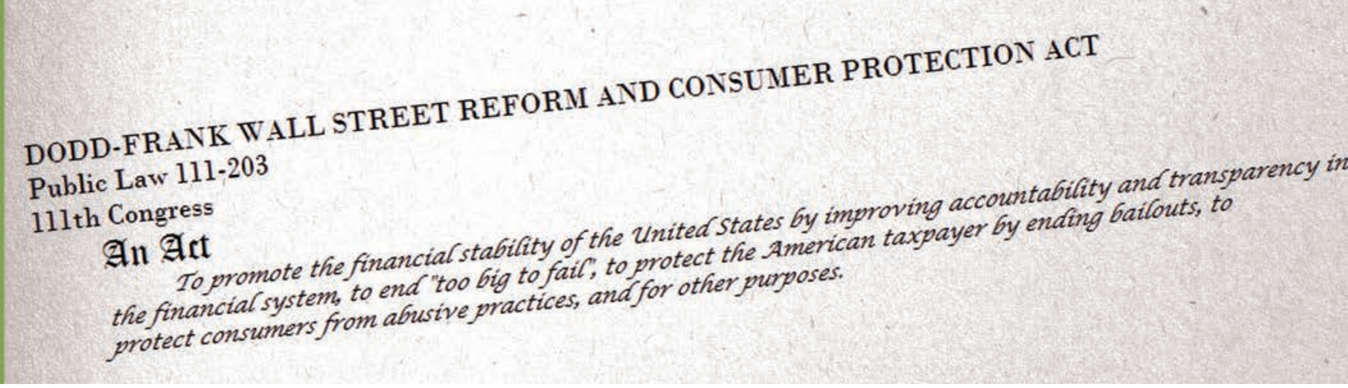
For example, Title IV of the Dodd-Frank Act requires the SEC to study the "feasibility, benefits, and costs" of requiring public reporting of short sale positions of publicly listed securities in real time.[61] That section of the law further requires the SEC to submit a report on the results of the study to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

60 *See* Dodd-Frank Act, §§ 412 (GAO to study "compliance costs associated with" custody rules); 913(c)(10) (SEC to study "potential benefits and harm to retail customers" that could result from eliminating the broker-dealer exclusion from the investment adviser definition and "the additional costs, if any, to the additional entities and individuals," among other considerations); 417 (SEC to study "the feasibility, benefits, and costs of requiring reporting publicly, in real time short sale positions"); 929Y (SEC to study "the economic costs and benefits of extending a private right of action for transnational securities fraud"); 976 (GAO to evaluate "the costs and benefits" of requiring additional disclosure by issuers of municipal bonds); 989(b) (GAO to study costs and benefits of the options for mitigating any systemic risk posed by proprietary trading); 989I (GAO to study certain "costs and benefits" associated with the exemption for small issuers under Section 404(b) of the Sarbanes-Oxley Act of 2002).

61 § 417(a)(2)(A).

However, neither this provision nor the other sections requiring the SEC to **study** costs and benefits express the intent or have the effect of requiring the SEC to conduct cost-benefit analysis before promulgating any new rules under the Dodd-Frank Act.[62] To the contrary, they confirm Congress's continuing resolve **not** to impose that burden on the SEC. Instead, Congress reserved to itself the responsibility for evaluating the costs and benefits of securities regulation, based upon information gathered by the SEC.

62 The Section 913 study has a connection to rulemaking insofar as the SEC must consider the "findings, conclusions, and recommendations" of the study, including various costs and benefits, if it chooses to issue a rule addressing the standards of care applicable to those who give investment advice about securities to retail customers. However, one component of the study relates to the "potential benefits and harm[s]" of amending the Investment Advisers Act, a step that only Congress could take. In addition, the obligation "to consider the findings, conclusions, and recommendations of the study" is unlike any requirement to conduct cost-benefit analysis, and as discussed in text above, it confers enormous discretion on the SEC.



PART TWO: THE APPLICATION OF COST-BENEFIT ANALYSIS TO FINANCIAL MARKET REGULATION IS WRONG ON POLICY AS WELL AS LEGAL GROUNDS BECAUSE IT WOULD THWART THE SEC'S ABILITY TO IMPLEMENT THE REFORMS IN THE DODD-FRANK ACT

I. Overview

The fundamental rationale for Congress's determination not to impose cost-benefit analysis on the SEC's rulemaking is clear: it would conflict with, and thereby frustrate, the SEC's ability to implement Congress's policy objectives. Applying comprehensive cost-benefit analysis to SEC rulemakings would cripple the SEC's ability to implement the regulatory protections that Congress required in the Securities Laws and more recently in the Dodd-Frank Act. Its application would also, in effect, subordinate the SEC's goals of protecting the public, investors, and the integrity of the markets to cost considerations of the industry that the SEC exists to regulate.

There is no better example of this threat than the ongoing effort to prevent or weaken the implementation of the Dodd-Frank Act. After two years of deliberation, the Legislative and Executive Branches adopted a broad array of reforms to prevent another financial crisis. They did so fully understanding that those reforms would not only impose significant costs on the financial industry, but would also eliminate some of Wall Street's very profitable but high-risk trading and business practices. Requiring cost-benefit analysis for each rule implementing the Dodd-Frank Act would second-guess and ultimately defeat this legislative and executive intent, including the judgment that the imposition of costs on the financial industry was necessary to obtain the enormous benefits of avoiding another crisis. And contrary to the claims of those who oppose regulatory reform, history shows that the imposition of

Requiring cost-benefit analysis for each rule implementing the Dodd-Frank Act would second-guess the judgment that the imposition of costs on the financial industry was necessary to obtain the enormous benefits of avoiding another crisis.

new regulatory costs and requirements will pose no threat to prosperity on Wall Street or to economic recovery from the financial crisis.

II. Congress recognized that cost-benefit analysis, by its nature, would actually interfere with investor protection and the public interest

The process of evaluating the costs and benefits of regulation is complex, speculative, and imprecise. The Office of Management and Budget, the steward of Executive Branch compliance with cost-benefit analysis under various executive orders,[63] acknowledges the inherent difficulty in quantifying regulatory costs and benefits:

> Many rules have benefits or costs that cannot be quantified or monetized in light of existing information . . . In fulfilling their statutory mandates, agencies must often act in the face of substantial uncertainty about the likely consequences. In some cases, quantification of various effects is highly speculative.[64]

Thus, under cost-benefit analysis, many advantages of regulation, no matter how important to society or to properly functioning markets, may be disregarded or simply

63 Executive orders can impose obligations on administrative agencies. However, contrary to the unsupported assertions of some, the SEC and the other independent regulatory agencies are expressly **excluded** from executive order provisions that require administrative agencies to conduct cost-benefit analysis. For example, Executive Order 12,866 establishing the modern era duty to conduct cost-benefit analysis, and providing for Office of Management and Budget ("OMB") review of agency rules, expressly excludes all agencies "considered to be independent regulatory agencies," such as the SEC (and the CFTC). Exec. Order No. 12,866, § 3(b), 58 Fed. Reg. 51,735 (Oct. 4, 1993). Executive Order 12,866 only requires the independent regulatory agencies to submit a regulatory agenda and a regulatory plan to OMB, not for the purpose of policing the substance of rules, but to provide for better coordination in the issuance of federal regulations. *Id.* § 4(b), (c). Consequently, OMB's guidance in Circular A-4 for conducting cost-benefit analysis does not apply to the SEC's rulemaking process. The two more recent executive orders issued by President Obama in 2011 did nothing to alter these limitations or to impose any obligation on independent regulatory agencies to conduct cost-benefit analysis. In fact, those orders scrupulously avoided doing so. Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011); Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011). Because these executive orders are sometimes cited for the proposition that even independent regulatory agencies must conduct cost-benefit analysis, a more detailed analysis of the role of the executive orders with respect to cost-benefit analysis is found in Appendix A. *See also* Letter from Better Markets to Jeffrey Zients, Acting Director of OMB (Feb. 29, 2012) (opposing a request that OMB evaluate the CFTC's compliance with cost-benefit standards), *available at* http://www.bettermarkets.com/sites/default/files/O'Malia%20CBA%20letter%20to%20OMB.pdf

64 Office of Mgmt & Budget, 2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandated on State, Local, and Tribal Entities, at 4 (2011).

not captured in the calculation.[65] Furthermore, the process is not only imprecise, it is also enormously time consuming, costly, and resource intensive.

> ***Technical and burdensome requirements relating to cost-benefit analysis "serve as a dilatory device, obstructing the agency from proceeding with its primary mission."***

Because of these unavoidable burdens and obstacles, the application of cost-benefit analysis can delay or prevent the achievement of the ultimate objectives underlying a statutory scheme, whether it be controlling environmental pollution or ridding the financial markets of systemic risk and abusive conduct.[66] In fact, critics of cost-benefit analysis have long warned that it has been used as a "device not for producing the right kind and amount of regulation, but for diminishing the role of regulation even when it was beneficial."[67] As observed by one court, the technical and burdensome requirements relating to cost-benefit analysis

> serve as a dilatory device, obstructing the agency from proceeding with its primary mission.[68]

For all of these reasons, whether an agency must conduct cost-benefit analysis, and at what level of detail, are policy decisions that must be left to Congress.

These burdens and obstacles apply with special force in the context of financial market regulation, where the costs and benefits are often contingent, unpredictable,

65 *See Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81, 91 (3d Cir. 1994) (recognizing that "much of a cost-benefit analysis requires predictions and speculation, in any context," and holding that the "absence of quantitative data [in the agency's cost-benefit analysis] is not fatal"); *American Fin. Services Ass'n. v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985) (finding that the agency's "predictions or conclusions" do not need to be "based on a rigorous, quantitative economic analysis").

66 Thomas J. Miles and Cass R. Sunstein, *The Real World of Arbitrariness Review,* 75 U. Chi. L. Rev. 761, 765 n.29 (2008) (citing Stephen Breyer, *Judicial Review of Questions of Law and Policy*, 38 Admin. L. Rev. 363, 391-93 (1986), for the proposition that "judicial requirements of an exhaustive investigation of alternatives may prevent agencies with scarce resources from making even minor changes," and Jerry L. Mashaw & David L. Harfst, The Struggle for Auto Safety at 149-51 (Harvard 1990), for the proposition that the "hard look" judicial review of cost-benefit analysis led the "National Highway Traffic Safety Administration to avoid rulemaking and focus on product recalls").

67 *See* Richard H. Pildes and Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. Chi. L. Rev. 1, 5 (1995).

68 *FMC Corp. v. Train,* 539 F.2d 973, 978-79 (4th Cir. 1976).

and exceedingly difficult to quantify.[69] The costs of compliance will often vary greatly depending on how a market participant chooses to adapt to a new regulation. For example, a financial institution may react to new rules by scaling back or shutting down one business line, while at the same time launching a new activity that results in even greater net profits.

> ***It is impossible to reliably quantify the precise monetary value of the losses that are never incurred by investors as a result of a new regulatory protection, or the cascading economic harms that are avoided when financial institutions are subjected to a stronger prudential standard and, as a direct result, do not collapse.***

Assessing the benefits of a financial regulation is even more difficult, since it typically involves speculative predictions about injuries to investors or other market participants that are avoided because of the rule. It is impossible to reliably quantify the precise monetary value of the losses that are **never incurred** by investors as a result of a new regulatory protection, or the cascading economic harms that **are avoided** when financial institutions are subjected to a stronger prudential standard and, as a direct result, do **not** collapse.[70] Equally important, cost-benefit analysis cannot possibly account for the non-monetary aspects of market upheaval and financial loss that regu-

69 One reason for the difficulty in quantifying costs and benefits stems from a lack of accessible data: it "doesn't (sic) exist or [it is] in the hands of market participants who don't want to share valuable intelligence." Josh Boak, Dodd-Frank foes beating path to courthouse door, Politico, Nov. 29, 2011, http://www.politico.com/news/stories/1111/69353.html. Moreover, industry proponents themselves struggle with the challenge of developing concrete measurements of costs and benefits, preferring instead simply to criticize the analyses performed by the agencies. *See* John Kemp, The Trojan Horse of cost-benefit analysis, Reuters, Jan. 3, 2012, http://blogs.reuters.com/great-debate/2012/01/03/the-trojan-horse-of-cost-benefit-analysis/ (noting that plaintiffs challenging the CFTC for failing to precisely estimate the benefits of the position limits rule, in *Int'l Swaps & Derivatives Ass'n. v. U.S. Commodity Futures Trading Comm'n*, Civil Action No. 11-cv-2146 (RLW) (Dec. 19, 2011), provided a study during the rule's comment period that "failed to measure its benefits, [and] dismiss[ed] them as 'very modest relative to the added costs of execution'"); *see also* Peter Eavis, Making a Theoretical Case About Volcker, DealBook N.Y. Times, Feb. 14, 2012, http://dealbook.nytimes.com/2012/02/14/making-a-theoretical-case-against-volcker/ (noting the lack of data provided by industry in its lengthy opposition to the Volcker rule, which prohibits proprietary trading).

70 The challenge of quantifying the benefits of a specific rule contrasts with quantifying the benefits of preventing a future crisis, as set forth *infra* at Part Five, Section IV, since the current crisis provides abundant data to serve as a benchmark or floor for estimating the costs that a future crisis would impose.

lation can prevent—the anguish and hardship resulting from poverty, homelessness, poor health, a lost college education, or a long-delayed retirement.

III. Cost-benefit analysis is especially inappropriate in rulemaking under the Dodd-Frank Act because Congress and the President have already made the judgment that the re-imposition of a significant regulatory burden on industry is a necessary consequence of meaningful financial reform

The application of cost-benefit analysis on a rule-by-rule basis is clearly inappropriate in the context of rulemaking under the Dodd-Frank Act. First, as discussed above, it would severely hamper, if not defeat, the ability of regulators to implement the crucial reforms in the Act, given the inherently burdensome, time consuming, and imprecise nature of the process. Second, the application of cost-benefit analysis ignores the determination already made by Congress and the President that the imposition (or, more accurately, the re-imposition) of significant regulatory burdens on industry is a necessary consequence of financial reform.

> ***Thus after seven decades of regulation, it took just seven years of de-regulation for the financial industry to engage in the high risk trading and reckless investments that nearly collapsed the financial system and almost ushered in a second Great Depression.***

Over a three-year period beginning in 2007 and culminating in the passage of the Dodd-Frank Act on July 21, 2010, Congress and the President witnessed the financial and economic destruction caused by the crisis, implemented emergency measures to contain it, and then made the judgment that comprehensive reforms were essential to protect investors, taxpayers, the Treasury, the financial system, and the economy from another financial crisis. The Legislative and Executive Branches determined that the industry would have to bear substantial regulatory burdens to achieve this overriding objective. Those burdens include initial and ongoing compliance costs as well as the elimination of extremely profitable lines of business. Congress and the President recognized these consequences but nevertheless imposed them to re-regulate the recently de-regulated financial industry, closing regulatory gaps and strengthening existing requirements for the benefit of investors, the public, and the entire economy.

The financial industry was very significantly regulated after the Stock Market Crash of 1929 and during the Great Depression. Those regulations protected the public, investors, taxpayers, the financial system, and the economy for seven decades.

It was no accident that they prevented a repeat of the Crash of 1929 and the Great Depression over that long span of time. However, those regulatory protections were removed, primarily during the 1990s, reaching a crescendo in 1999 with the passage of GLB and in 2000 with the passage of the Commodity Futures Modernization Act.

Thus after seven decades of regulation, it took just seven years of de-regulation for the financial industry to engage in the high risk trading and reckless investments that nearly collapsed the financial system and almost ushered in a second Great Depression. While the costs are still being counted and incurred, the U.S. government had to spend, lend, pledge, guarantee, insure, or otherwise use trillions of dollars to prevent the full collapse of the financial system and halt the economic crisis.

Preventing such a financial collapse and economic crisis from ever happening again, and avoiding the risk of a second Great Depression, were Congress's primary motivations in passing the Dodd-Frank Act. In many respects, the reforms in the Dodd-Frank Act re-regulate the financial industry as it had been regulated beginning in the 1930s. This re-imposition of regulation also means shifting the substantial costs of risky behavior and predatory practices from the public back onto the industry—or, as economists would say, forcing the industry to assume the costs of the externalities that they imposed on society when they were deregulated.

Title VII illustrates this legislative resolve. It establishes a broad range of regulatory requirements in the previously unregulated swaps market. For example, Title VII requires, among other things

- registration of market participants to ensure their fitness;
- recordkeeping and reporting to enable regulators to oversee market activities;
- exchange trading, central clearing, and public disclosure of transaction information to increase transparency and price competition;
- business conduct standards and prohibitions against conflicts of interest to prevent fraud, abuse, and unfair economic advantage;
- position limits, capital, collateral, and margin requirements to mitigate risk;

- chief compliance officers to foster compliance from within the industry and to complement regulatory oversight; and

- enforcement provisions to induce compliance with all of the requirements.[71]

There is no genuine dispute that these measures are necessary to bring integrity and stability to the derivatives markets. And it is equally clear that these reforms would be impossible to implement without imposing significant compliance costs on market participants, who will be required to pay filing fees, hire new staff, upgrade and maintain information technologies, and alter their business procedures. These reforms are also impossible without eliminating or scaling back profits derived from abusive or highly risky conduct.

Thus, the Dodd-Frank Act and the regulations promulgated thereunder must necessarily

- prohibit some activities, including fraudulent transactions and those based upon conflicts of interest;

- curtail other behaviors, including excessive speculation;

- force the reallocation of funds to other uses, such as capital and margin; and

- increase transparency and competition through pre- and post-trade reporting, thus reducing profit margins.

Further illustrating this approach, the Dodd-Frank Act imposes a broad set of regulatory reforms on bank holding companies and nonbank financial institutions, with the focus on systemically important institutions. They will pay necessary compliance costs from new requirements relating to registration, reporting, recordkeeping, public disclosures, risk committees, examinations, fees, and capital and leverage requirements,

71 *See* Standards applicable to dealers, major participants, trading facilities, and data warehouses in Dodd-Frank Act, §§ 712(d) (books and records); 724(c) (disclosures to counterparties in uncleared transactions); 726 (limits on control of designated clearing organizations, swap execution facilities, and designated contract markets by swap dealers and major swap participants); 731 (registration, recordkeeping, reporting, chief compliance officer, business conduct standards, capital and margin requirements for swap dealers and major swap participants, and authority of CFTC to limit their activities); 732 (conflicts of interest for futures commission merchants and introducing brokers); 737 (position limits); 763(d) (disclosures to counterparties in uncleared transactions); 763(h) (position limits); 764(a) (registration, recordkeeping, reporting, chief compliance officer, business conduct standards, capital and margin requirements for security-based swap dealers and major security based swap participants, and authority of SEC to limit their activities); 765 (limits on control of clearing agencies, security-based swap execution facilities, and exchanges by security-based swap dealers and major security based swap participants). *See also* §§ 723(a), 763(a), (d) (imposing mandatory clearing for all swaps or SBS required to be cleared, and imposing mandatory trading of swaps or SBS on exchanges, swap execution facilities, designated contract markets, or security-based swap execution facilities, for all transacting in swaps or SBS, except eligible contract participants, and for all swaps or SBS required to be cleared).

among other enhanced supervisory and prudential standards.[72] Key provisions of the statute will also eliminate some immensely profitable trading activities.[73] Most notable is the "Volcker Rule," which prohibits insured depository institutions, bank holding companies, and certain nonbank companies from almost all proprietary trading and all but de minimis investment in hedge funds.[74] These bans on highly profitable activities will effectively eliminate billions of dollars in annual revenue for the largest banks. For that reason, it was "furiously" opposed by lobbyists in Congress.[75] Yet Congress and the President insisted on its inclusion in the Dodd-Frank Act.

The Dodd-Frank Act imposes new requirements in many other sectors of the financial industry as well. Title IV establishes registration and reporting obligations for private fund advisers; Title IX enhances the regulation of securities firms, rating agencies, and securitizers; Title X creates an entirely new regulatory body for consumer financial products and services; and Title XIV extensively reforms mortgage lending and increases regulation of mortgage loan originators.

The reforms described above will impose significant, yet essential, regulatory burdens on the industry as a whole and on some individual firms. In fact, one 2010 analyst report[76] predicted industry costs of $3 billion to $5 billion in the following three years, with some companies spending $100 million to $200 million each and losing 20 to 30 percent of their profits.[77] Yet, in passing the Dodd-Frank Act, both Congress and

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72 §§ 112(d) (reporting by Bank Holding Companies & Nonbank Financial Institutions); 114 (registration of Covered Nonbank Companies); 116(a) (Bank Holding Companies with consolidated assets of $50 billion, or Covered Nonbank Companies to submit certified information reports); 161 (reporting by and government examinations of Covered Nonbank Companies); 165(b) (enhanced prudential standards for Covered Bank Holding Companies and Covered Nonbank Companies); 165(d) (reporting by Covered Bank Holding Companies and Covered Nonbank Companies); 165(f) (public disclosures by Covered Bank Holding Companies and Covered Nonbank Companies); 165(h) (risk committee requirements for Publicly Traded Covered Nonbank Companies and Publicly Traded Bank Holding Companies); 165(i) (stress tests to be performed on Bank Holding Companies with consolidated assets of $50 billion, or Covered Nonbank Companies); 210(o) (Orderly Liquidation Fund fees from Bank Holding Companies with consolidated assets of $50 billion, or Covered Nonbank Companies); 619 (Insured Depository Institutions, Bank Holding Companies, and Covered Nonbank Companies to keep records to comply with Volcker Rule).

73 *See, e.g.,* Provisions on capital requirements for Covered Nonbank Companies, §§ 165(b)-(c), 171; Covered Bank Holding Companies, § 165(b)-(c); Depository Institutions and Depository Institution Holding Companies, § 171; Bank Holding Companies, Savings and Loan Holding Companies, & Depository Institutions, § 616; Supervised Securities Holding Companies, § 618(d); and Covered Nonbank Companies engaging in activities covered by Volcker Rule, § 619.

74 § 619.

75 Remarks of Senator Dorgan, 156 Cong. Rec. S 116 (daily ed. Jan. 21, 2010) (noting the profits made by banks from proprietary trading, and determining that the Volcker Rule was necessary nonetheless to lessen the risk from "too big to fail" institutions).

76 Most cost estimates are focused exclusively on costs to the industry and are typically paid for or sponsored by the industry or its allies. Among many other deficiencies, these "reports" ignore the fact that numerous new lucrative business opportunities will inevitably arise as financial reform is implemented.

77 Accenture, *US Financial Regulatory Reform: Cost or Opportunity? Impact of The Dodd-Frank Wall Street Reform Act*, at 3 (2010).

the President decided that the enormous collective benefits of the law far exceeded the costs and lost profits that industry would have to absorb.[78]

Having made this judgment, it is inconceivable that Congress would

- expect each agency to second guess its legislative determination that regulation was imperative; and
- condition the implementation of those reforms on the outcome of a rule-by-rule cost-benefit analysis—a process that would allow costs to the very industry Congress intended to regulate to defeat or weaken implementation of the legislation.

Requiring the independent agencies to subject their congressionally mandated and authorized rulemaking to a cost-benefit analysis would defeat the very purpose of the law. In short, Congress simply would not pass a law only to empower the implementing agencies—or reviewing courts—to in effect repeal it.

> ***Congress never intended to subject regulatory reform to the burdensome, time-consuming, costly, imprecise, and obstructionist mechanism of cost-benefit analysis.***

This conclusion is inescapable, given the enormity of the financial crisis that Congress sought to address, the deliberative process that preceded enactment of the law, and the absence of statutory language requiring the SEC (or the other financial regulators) to apply cost-benefit analysis in its own implementation of the law. The Act is devoid of any provisions requiring regulators to conduct cost-benefit analysis as they promulgate their implementing regulations. Moreover, it contains very few provisions requiring even a consideration of costs and benefits in the rulemaking process.[79] This is compelling and conclusive evidence that Congress never intended to subject regulatory reform to the burdensome, time-consuming, costly, imprecise, and obstructionist mechanism of cost-benefit analysis.

This conclusion is further buttressed by the extensive participation of the Executive Branch in the legislative process that produced the most extensive regulation of the financial industry since the Great Depression. The President also witnessed the economic

78 *See BASF Wyandotte Corp. v. Costle,* 598 F.2d 637, 656 (1st Cir. 1979) ("Congress 'self-consciously made the legislative determination that the health and safety gains that achievement of the Act's aspirations would bring to future generations will in some cases outweigh the economic dislocation it causes to the present generation.'") (citing *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1037 (D.C. Cir. 1978)).

79 *Cf.* Dodd-Frank Act, §§ 1022(b)(2), 1041(c)(2) (requiring the Consumer Financial Protection Bureau to consider costs and benefits in connection with certain rulemakings).

destruction caused by the crisis, shared Congress's intent to fundamentally change the regulatory system to prevent a recurrence, and worked with Congress to develop legislative solutions.[80]

> ***It was also the judgment of both Congress and the President that the law would not allow Wall Street to avoid regulation by conditioning implementation of the Dodd-Frank Act on rule-by-rule cost-benefit analysis.***

It was the judgment of two branches of government, not Congress alone, that the financial industry would have to submit to massive reforms and bear substantial costs in the process. And it was also the judgment of both Congress and the President that the law should not and would not allow Wall Street to avoid regulation by conditioning implementation of the Dodd-Frank Act on rule-by-rule cost-benefit analysis.[81]

IV. History validates the judgment of Congress and the Executive Branch that strong regulation of the financial industry can be imposed without crippling Wall Street or stifling overall economic growth

Critics of regulatory reform argue that the costs Congress fully intended to impose under the Dodd-Frank Act are excessive and that they will cripple the financial industry and even stifle economic recovery from the financial crisis. However, using the past 100 years as a guide, there is no basis for the claim that regulatory reform, even on the scale required by the Dodd-Frank Act, will produce either of these consequences.

Since the emergence of financial market regulation, the financial services industry has argued that new regulatory requirements will have a devastating impact by imposing unbearable compliance costs. Yet Wall Street has always absorbed the cost of those new regulations and has consistently remained one of the most profitable sectors in our economy. For example, a century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary"

80 President Barack Obama, Office of the Press Secretary, The White House, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act (lamenting the costs of the financial crisis and stating that the Dodd-Frank Act will "empower consumers and investors, to bring the shadowy deals that caused this crisis into the light of day, and to put a stop to taxpayer bailouts once and for all").

81 The insistence on cost-benefit analysis is fundamentally irrational. Conditioning regulatory reform on the outcome of cost-benefit analysis is like preventing enforcement of the antitrust laws because of the economic costs and foregone profits that the monopoly company would have to bear. This thinking would in effect repeal the prohibition against monopolies whenever they are needed the most: when the abuses are rampant and highly profitable. The same is true here.

attack upon legitimate business that would cause nothing but harm.[82] However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely.[83]

Subsequently, when the federal securities laws were adopted, Wall Street staunchly opposed them, claiming that they would slow economic recovery by impeding the capital formation process and discouraging the issuance of new securities. In fact, in the years after the enactment of the federal securities laws, the nation's securities markets flourished and became what has often been described as the envy of the world. The same pattern has been repeated with each new effort to strengthen financial regulation, including deposit insurance, the Glass-Steagall Act, mutual fund reform, and the national market initiatives of the mid-1970s.[84]

When faced with new regulations, members of the regulated industry routinely argue that the costs and burdens are too heavy—but then they invariably adapt and thrive.

The lesson to be learned from this history is that when faced with new regulations, members of the regulated industry routinely argue that the costs and burdens are too heavy—but then they invariably adapt and thrive. Opponents of reform under

82 *See* Marcus Baram, *The Bankers Who Cried Wolf: Wall Street's History of Hyperbole About Regulation*, The Watchdog, Huffington Post, June 21, 2011, http://www.huffingtonpost.com/2011/06/21/wall-street-history-hyperbole-regulation_n_881775.html.

83 Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & Econ. 229, 249 (2003) ("In the 5 years following adoption of a merit review statute [the most stringent type of blue sky law statute], bank profits increased on average by nearly 5 percentage points . . .").

84 Marcus Baram, *supra* note 82; *see also* Nicholas Economides et al., *The Political Economy of Branching Restrictions and Deposit Insurance: A Model of Monopolistic Competition Among Small and Large Banks*, 39 J. L. & Econ. 667, 698 (1996) ("The American Bankers Association fights to the last ditch deposit guarantee provisions of Glass-Steagall Bill as unsound, unscientific, unjust and dangerous. Overwhelmingly, opinion of experienced bankers is emphatically opposed to deposit guarantee which compels strong and well-managed banks to pay losses of the weak . . .The guarantee of bank deposits has been tried in a number of states and resulted invariably in confusion and disaster . . . and would drive the stronger banks from the Federal Reserve System.") (quoting Francis H. Sisson, president of the American Bankers Association).

the Dodd-Frank Act are following this familiar pattern, and their attempts to minimize regulation by invoking the costs and burdens must be similarly discounted.[85]

Equally unfounded is the claim heard from opponents of regulatory reform that regulation is stifling overall economic growth and preventing a robust recovery from the financial crisis. This claim is unsupported by evidence or arguments, just repeated as a self-evident proposition. In fact, the slow pace of economic recovery is not attributable to regulation but instead to rampant unemployment and lack of consumer demand following the worst financial crisis since the Great Depression. We need more financial regulation, not less, to ensure that the economy recovers and that we never again experience such a profound and long lasting financial disaster.

"Economists who have studied the matter say that there is little evidence that regulations cause massive job loss in the economy, and that rolling them back would not lead to a boom in job creation."[86] In fact, the Bureau of Labor Statistics continuously surveys the private sector to understand the reasons for layoffs. Data for 2010 shows that only 0.2 percent of the people who lost their jobs in layoffs were let go because of government regulation.[87] By comparison, 30 percent were let go because of a drop in business demand.

Equally unfounded is the claim that regulation is stifling overall economic growth and preventing a robust recovery from the financial crisis.

In survey after survey, business owners consistently say that their reluctance to hire employees

85 Bradley Keoun & Jonathan D. Salant, Obama Plan Gets Wary Reception from Banks, Lawmakers (Update1), Bloomberg, June 18, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=ae85nCexFOv0 ("The brewing legislative battle recalls the industry's reluctance to accept reforms after the 1929 stock-market crash. I don't think anyone can buy the argument that by regulating too tightly, we'll choke off capitalism. . . That argument is as shallow now as it was then.") (citing Charles Geisst, Professor, Manhattan College); *see also* Fowler West, former CFTC Commissioner, Comment Letter No. 32607 to CFTC for Proposed Rule 76 FR 4752, Mar. 25, 2011, http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=32607&SearchText (urging CFTC to act despite industry objection and recalling that when the CFTC mandated traders on futures exchanges to time their trades to the nearest minute, rather than half hour, "the largest of the exchanges, as a part of its campaign to thwart our effort, created large buttons for their employees to wear that read: 'Endangered Species—Ask the CFTC.'"). Those seeking to block reform are not only exaggerating the impact of regulation, but also submitting incomplete, misleading, or inaccurate cost estimates. *See, e.g.*, John E. Parsons & Antonio S. Mello, Betting Against the Business, Nera Doubles Down, Mar. 19, 2012, http://bettingthebusiness.com/2012/03/19/nera-doubles-down/ (challenging industry estimates of the cost of margin requirements in derivatives transactions).

86 Jia Lynn Yang, *Does Government Regulation Really Kill Jobs? Economists Say Overall Effect is Minimal.*, Wash. Post, Nov. 13, 2011.

87 Bureau of Labor Statistics, U.S. Dep't of Labor, Rep. 1038, Extended Mass Layoffs in 2010, at Table 6 (Nov. 2011); *see also* Bureau of Labor Statistics, Economic News Release, Table 2. Reason for layoff: Extended mass layoff events, separations, and initial claimants for unemployment insurance, private nonfarm sector, selected quarters, 2010 and 2011 (Feb. 10, 2012), *available at* http://www.bls.gov/news.release/mslo.t02.htm.

> ***Regulation is clearly not interfering with corporate profits, cash reserves, or executive compensation.***

and expand production arises from uncertainty about consumer demand for products and services, not concern over regulation. One policy analyst recently canvassed numerous sources on the impact of financial regulation, ranging from the Bureau of Labor Statistics, the Wall Street Journal, the McClatchy Newspapers, and business trade data. [88] The surveys and data collected from these organizations debunk the myth that either existing regulation or uncertainty about future regulation over financial services is responsible for the current economic stagnation. For example, a Wall Street Journal survey of business economists found that "[t]he main reason U.S. companies are reluctant to step up hiring is scant demand, rather than uncertainty over government policies."[89]

Even as additional and essential regulations are being adopted, corporate America is actually faring well. Regulation is clearly not interfering with corporate profits, cash reserves, or executive compensation. Corporate profits are at record levels, representing over 10 percent of Gross Domestic Product ("GDP") after tax,[90] and executive compensation has nearly regained its pre-recession levels, with a reported remarkable 27 percent increase in median pay in 2010.[91] That level of compensation remained steady and even increased somewhat in 2011, with the top 100 CEOs receiving a total of $2.1 billion in compensation.[92]

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88 Bruce Bartlett, *Misrepresentations, Regulations, and Jobs*, Economix, NY Times, Oct. 4, 2011, http://economix.blogs.nytimes.com/2011/10/04/regulation-and-unemployment/.

89 *Id.*; *see also* Lawrence Mishel, *Regulatory Uncertainty Not To Blame for Our Jobs Problem,* The Econ. Pol'y Inst. Blog, Sept. 27, 2011, http://www.epi.org/blog/regulatory-uncertainty-jobs-problem/ (investment and hiring trends, along with survey data, show that slack demand is the key concern for small businesses); Patrick Jenkins, *Regulators Stand up for New Capital Rules,* Fin. Times, Oct. 10, 2011 (Financial Stability Board and Basel Committee on Banking Supervision conclude that increased bank capital requirements will only slow gross domestic product by .34 percent at its peak).

90 Data from the Department of Commerce indicates that average corporate profits after tax for 2011 were about $ 1.5 trillion, a record high. *See* Bureau of Econ. Analysis, Dep't of Commerce, Net Effects of the Tax Acts of 2002, 2003, 2008, 2009, and 2010 on Selected Measures of Corporate Profits (Mar. 29, 2012), *available at* http://www.bea.gov/national/; *see also* Fed. Reserve Bank of St. Louis, National Economic Trends, at 21 (Apr. 2012).

91 Matt Krantz & Barbara Hansen, *CEO Pays Soars While Workers' Pay Stalls,* U.S.A Today, Apr. 4, 2011, http://www.usatoday.com/money/companies/management/story/CEO-pay-2010/45634384/1; Henry Blodget, *CHARTS: Here's What The Wall Street Protesters Are So Angry About . . . ,* Bus. Insider, Oct. 11, 2011, http://www.businessinsider.com/what-wall-street-protesters-are-so-angry-about-2011-10?op=1.

92 Natasha Singer, *In Executive Pay, a Rich Game of Thrones*, N.Y. Times, Apr. 7, 2012.

The stagnant consumer demand holding back economic growth was a direct result of the financial crisis of 2008, and the financial crisis was a direct result of **too little** regulation. In the years leading up to the crisis, huge sectors of our financial markets (such as swaps) were completely unregulated, and other sectors (such as mortgage-backed securities) were poorly regulated.

The resulting costs of the crisis are enormous and lasting. As set forth below, they include unemployment totaling 12.5 million Americans, a massive drop in GDP, a huge decline in home values, and decimated retirement accounts. These costs, inflicted by Wall Street, are what brought our economy to a standstill, not excessive regulation.

PART THREE: *BUSINESS ROUNDTABLE* ILLUSTRATES THE FUNDAMENTAL FLAWS ARISING FROM THE APPLICATION OF COST-BENEFIT ANALYSIS: IT PLAINLY CONFLICTS WITH THE LAW AND IT NULLIFIES CONGRESS'S POLICY JUDGMENTS

I. Overview

Notwithstanding the SEC's narrow statutory duty under the Securities Laws to consider the impact of its rules, as set forth above, critics of financial reform have repeatedly insisted that the SEC (and other financial regulators) have a broad obligation to conduct extensive cost-benefit analysis. They have made this argument throughout the rulemaking process and they have begun to advance it in court as well. In fact, legal challenges to rules premised on an agency's alleged failure to conduct adequate cost-benefit analysis is a key weapon now being used to roll back, weaken, or slow implementation of the financial reforms Congress and the President enacted in the Dodd-Frank Act.

The most recent example of this is *Business Roundtable v. SEC* ("*Business Roundtable*"), decided in July 2011.[93] The court set aside the SEC's rule granting longstanding shareholders with a significant stake in a public company the right to include their board nominees in the company's proxy materials. The case illustrates the misapplication of both law and policy. Contrary to statutory language and legislative history, as discussed above, the court held that the SEC had failed adequately to consider the "economic effects" of its rule.[94] In addition, through the application of cost-benefit analysis—a standard never incorporated in the Securities Laws—the court

The case illustrates the misapplication of both law and policy.

93 647 F.3d 1144 (D.C. Cir. 2011).

94 *Id.* at 1148.

essentially repealed Congress's policy judgment in the Dodd-Frank Act that corporate governance should be enhanced for the benefit of investors through proxy access.

The decision has emboldened those who seek to invalidate the rules being promulgated under the Dodd-Frank Act. However, the court committed clear error in striking down the SEC's rule. The SEC had plainly met its statutory duty to consider whether the rule would promote efficiency, competition, and capital formation; to explain its approach; and to arrive at a rule reasonably calculated to achieve its objectives. Nevertheless, the court held the agency to a much more rigorous standard, one that was tantamount to a full-scale cost-benefit analysis for which there was no statutory basis.

In addition, rather than according the SEC the deference required under the Administrative Procedure Act ("APA") and long-standing Supreme Court precedent, the court repeatedly substituted its own judgment for that of the agency. The rule established in the case should be challenged, and any future court that correctly applies the law governing cost-benefit analysis and judicial review should establish a different standard against which to judge SEC rules.

II. The standard of judicial review under the Administrative Procedure Act and the Securities Laws is limited and deferential

Section 706(2)(A) of the APA establishes the standard of review that courts must apply when reviewing agency rules.[95] Specifically, it authorizes a reviewing court to "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary [and] capricious." However, the arbitrary and capricious standard is not a rigorous one, and as applied by the Supreme Court, it does **not** require logical or evidentiary perfection, only a basic rationality. A rule must not be set aside under this test unless the agency

> has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before

95 5 U.S.C. § 706(2)(A).

> the agency, or [the rule] is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.[96]

Moreover, the agency must simply "examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made." [97]

In addition to satisfying these basic requirements under the APA, every agency must also comply with any other specific requirements imposed by its "organic statute."[98] If Congress has required an agency to consider certain factors in its rulemaking, then it must do so, "as it is for Congress in the first instance to define the appropriate scope of an agency's mission."[99] Even this test, however, is a lenient one, and a court should not find a rule arbitrary and capricious unless the agency has "wholly failed" to comply with a specific statutory requirement, or if there is a "complete absence of any discussion of a statutorily mandated factor" in the agency's reasoning.[100] Under the Securities Laws, which constitute the SEC's "organic statutes," the SEC must, after taking into account the public interest and investor protection, simply "consider" whether its rule will promote efficiency, competition, and capital formation.[101]

In determining whether an agency has fulfilled the duties described above, courts have a very limited and deferential role. The Supreme Court in *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.* emphasized that

> 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.[102]

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96 *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) ("*State Farm*").

97 *Id.* (internal citations omitted).

98 *Pub. Citizen v. Fed. Motor Carrier Safety Admin.,* 374 F.3d 1209, 1216 (D.C. Cir. 2004).

99 *Id.*

100 *Id.*

101 *See* 15 U.S.C. § 77b(b) (amending the Securities Act of 1933); 15 U.S.C. § 78c(f) (amending the Securities Exchange Act of 1934); 15 U.S.C. § 80b-2(c) (amending the Investment Advisers Act of 1940); and 15 U.S.C. § 80a-2(c) (amending the Investment Company Act of 1940).

102 *State Farm*, 463 U.S. at 43.

The D.C. Circuit has elaborated on this view, holding that the

> 'arbitrary and capricious' standard of review is a highly deferential one, which presumes the agency's actions to be valid.[103]

That court further observed that this is

> especially true when the agency is called upon to weigh the costs and benefits of alternative policies, since such cost benefit analyses epitomize the types of decisions that are most appropriately entrusted to the expertise of an agency.[104]

The court concluded that the judiciary's role is simply

> to determine 'whether the decision was based on a consideration of the relevant factors and whether there has been a **clear error of judgment**.'[105]

> ***"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."***

Moreover, courts are to respect an agency's views where a statute mandates certain considerations without specifying how to analyze those considerations or the weight they deserve. In fact, as discussed above, the Supreme Court has recognized that when statutorily mandated considerations are not "mechanical or self-defining standards," they "imply wide areas of judgment and therefore of discretion."[106] As the Eleventh Circuit has stated, "[a]s long as the agency gives fair consideration to the relevant factors **mandated by**

103 *Envtl Def. Fund, Inc. v. Costle*, 657 F.2d 275, 283 (D.C. Cir. 1981); *see also American Fin. Services Ass'n v. FTC*, 767 F.2d 957, 985 (D.C. Cir. 1985).

104 *Ctr. for Auto Safety v. Peck,* 751 F.2d 1336, 1342 (D.C. Cir. 1985) (internal citations omitted).

105 *Id.* (citing *State Farm,* 463 U.S. at 43) (emphasis added).

106 *Sec'y of Agric. v. Cent. Roig Ref. Co.,* 338 U.S. 604, 611 (1950).

law, the importance and weight to be ascribed to those factors is the type of judgment that courts are not in a position to make."[107]

Thus, the standard of judicial review of rules under both the Securities Laws and the APA is highly deferential, especially where, as here, an agency is required simply to "consider" the impact of certain factors in the rulemaking process.

III. The court in *Business Roundtable* failed to adhere to these long-standing and critically important limitations on judicial review of agency rules

In *Business Roundtable*, the D.C. Circuit deviated from these well-established principles governing judicial review of rules under the APA. It also disregarded the specific and limited obligations of the SEC under the Securities Laws merely to "consider" whether its rules will promote efficiency, competition, and capital formation, after first ensuring that those rules adequately protect investors and the public interest.

The subject of the case was SEC Rule 14a-11, known as the proxy access rule. The rule was adopted to enhance board performance, and ultimately shareholder value, by facilitating shareholders' exercise of their traditional state law right to nominate and elect directors.[108] It would have required companies to include shareholder director nominees and related information in the board's proxy materials, rather than forcing shareholders to circulate separate proxy materials and to incur significantly greater expense.

The SEC also incorporated reasonable restrictions on this right of proxy access, to guard against potential abuses and the imposition of excessive burdens on companies. For example, only shareholders or groups of shareholders holding at least 3 percent of the company's voting shares for a period of at least three years were eligible to invoke the rule. In addition, the rule was subject to state laws prohibiting shareholders from

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107 *Florida Manufactured Hous. Ass'n v. Cisneros*, 53 F.3d 1565, 1577 (11th Cir. 1995) (emphasis added); *see also New York v. Reilly,* 969 F.2d 1147, 1150 (D.C. Cir. 1992). The D.C. Circuit's decision in *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F. 3d 1209 (D.C. Cir. 2004), does not change the rule established in these cases. In *Public Citizen,* the court expressed its view that the agency had a duty to "weigh" certain costs and benefits of its rule limiting truck driver shifts, even though the applicable statute simply required the agency to "consider" costs and benefits. However, the court's discussion of cost-benefit analysis was dicta in the purest sense. The court made very clear that its holding was based solely on the agency's "dispositive" failure "to consider a statutorily mandated factor—the impact of the rule on the health of drivers." *Id.* at 1216. Furthermore, the court read the cost-benefit obligation in tandem with a separate statutory provision, which required the agency not only to consider costs and benefits, but also to "deal[] with" a long list of specific issues relating to commercial motor vehicle safety. *Id.* at 1221. This was critical to the court's more prescriptive view, set forth in dicta, regarding the meaning of "consider."

108 *See* Adopting Release, 75 Fed. Reg. 56,668 (Sept. 16, 2010).

nominating board candidates, and it limited the number of shareholder nominees to 25 percent of all board seats.

Two fundamental errors pervade the court's decision. First, the court applied an economic impact test that has no statutory basis.

Two fundamental errors pervade the court's decision to invalidate the rule. First, the court applied an economic impact test that has no statutory basis.[109] The court repeatedly held that the SEC must determine all of the economic consequences of its rule, not just whether the rule would promote efficiency, competition, and capital formation.[110] The court deviated even further from the applicable standard by repeatedly faulting the SEC for failing to quantify and weigh the costs associated with the rule so that it could ascertain whether the rule would provide a "net benefit."[111] The court thus applied a traditional cost-benefit analysis, which the Securities Laws simply do not require.

Second, throughout its analysis of the rule, the court impermissibly substituted its judgment for that of the SEC. The court disagreed with and rejected the SEC's conclusions and predictions on a host of issues, including the likelihood that boards would oppose shareholder nominees and the weight that should be afforded to conflicting studies regarding the impact of the rule on company performance.[112] The court's back-and-forth debate with the SEC's contentions reveals the underlying flaw in the court's analysis: the SEC clearly had **considered** each of the points with which the court found fault. Furthermore, the SEC provided a rational explanation for the approach it took with respect to each issue. While the court may have disagreed in substance with the SEC's choices, it was not entitled to substitute its own judgment under the APA.

Second, the court impermissibly substituted its judgment for that of the SEC.

A full critique of the *Business Roundtable* case would be too lengthy to include here, but

109 *See* discussion *supra* at Part One.

110 *Business Roundtable*, 647 F.3d at 1148-49.

111 *See, e.g., id.* at 1153.

112 *See id.* at 1150-51.

such an analysis is set forth in Appendix B. A review of the court's treatment of just one issue illustrates the recurrent errors in the court's ruling.

The court ruled that the SEC had failed to assess the likelihood that boards would feel compelled to contest shareholder nominees and thereby incur costs.[113] However, the Securities Laws do not require this type of cost evaluation in the SEC's rulemaking process. In any case, even though not required to evaluate costs, the SEC actually **did** address the issue of possible board resistance to shareholder nominees and the burdens that might impose. The SEC rationally concluded that the need to oppose shareholder nominees would be minimized by two factors: the fiduciary duty of board members to act in the best interest of the company, and limits on the right of shareholders to invoke the rule based on the amount and duration of shares held.

It was neither necessary nor feasible for the SEC to predict the future impulses of corporate boards with any greater precision. The agency's "conjecture" on the subject (as the court characterized it) was at least as valid as the court's own speculations to the contrary, and there was no basis for the court to substitute its own judgment for that of the SEC.[114]

The court also ruled that the SEC failed "to estimate and quantify the costs it expected companies to incur" whenever they did decide to challenge a shareholder nominee.[115] But here too, the SEC was under no obligation to make those calculations. Thus, the court substituted its own judgment for that of the SEC and insisted on a quantitative cost-benefit analysis, all in direct conflict with the APA and the Securities Laws.

113 *Id.* at 1148-50.

114 The court substituted its judgment for that of the SEC many times in the decision, which was unjustified on several levels. First, the Supreme Court has prohibited that form of judicial "review," as it is judicial activism at its worst. *See State Farm*, 463 U.S. at 43. Second, on matters of pure speculation, the court obviously enjoyed no advantages over the SEC. Third, on issues requiring technical knowledge about proxy contests, corporate governance, and board performance, the court was decidedly ill-equipped to match the expertise and experience of the SEC and the professionals who work there. The case is a powerful illustration of the underlying rationale for the deferential approach to review of agency rules that courts are supposed to follow.

115 *Business Roundtable*, 647 F.3d at 1150.

IV. *Business Roundtable* illustrates the underlying rationale for Congress's decision not to require the SEC to conduct cost-benefit analysis

Business Roundtable illustrates the fundamental reason for Congress's deliberate decision not to require the SEC to conduct cost-benefit analysis in its rulemakings: Insisting on cost-benefit analysis not only imposes huge procedural burdens on agencies, it can also result in the de facto repeal of congressional policy determinations.

In the Dodd-Frank Act, Congress determined, with the concurrence of the President, that proxy access was an important enhancement in corporate governance at public companies. Accordingly, it authorized the SEC to establish that right for shareholders.[116] This grant of authority reflected Congress's judgment that enhanced shareholder participation in the board nomination process was a worthwhile goal and an important component of financial reform. After all, with respect to banks as well as all public companies, no one should be more concerned about the risk of corporate mismanagement, huge losses, and possible bankruptcy than shareholders, whose investments can be entirely extinguished.

> ***Insisting on cost-benefit analysis can also result in the de facto repeal of congressional policy determinations.***

The legislative history of the proxy access provision confirms the point. The Senate report explains that "[t]he Committee feels it is proper for shareholders, as the owners of the corporation, to have the right to nominate candidates for the Board."[117] The report also cites testimony from numerous witnesses with knowledge and expertise on the subject who supported the provision and explained its value. For example, the report quotes former SEC Chairman Richard Breeden, who offered this rationale for proxy access: "Overly entrenched boards have widely failed to protect shareholder interests for the simple reason that they sometimes think more about their own tenure than the interests of the people they are supposed to be protecting."[118] The report highlighted other testimony explaining that proxy access would "invigorat[e] board elections and mak[e] directors more responsive, thoughtful, and vigilant."[119]

The language of the statute and the legislative history also show that Congress was aware of—and made its own judgments about—the burdens that proxy access might

116 Dodd-Frank Act § 971.

117 S. Rep. No 111-176, at 146 (2010).

118 *Id.*

119 *Id.* at 147.

impose on issuers. First, in keeping with the primary objectives of the Securities Laws, Congress declared in the statute that the SEC should impose "such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors."[120] Then Congress specifically addressed the potential burdens that the rule could impose on companies by providing that the Commission could **exempt** an issuer or class of issuers from the proxy access rule, taking into account whether the requirement would "disproportionately burden **small** issuers."[121]

Congress specifically addressed the potential burdens by providing that the SEC could exempt an issuer or class of issuers from the proxy access rule.

The legislative history also reflects a sensitivity to the impact of the rule. The Senate Report notes that limits on the use of proxy access would be appropriate.[122] However, in keeping with Congress's high degree of deference to the Commission on such matters, the Senate Report further states that the grant of rulemaking authority "gives the SEC **wide latitude** in setting the terms of such proxy access."[123]

In short, Congress made its intentions clear: First, the SEC was to protect the interests of shareholders and investors, and second, it was to use its broad discretion to determine whether exemptions were warranted, principally for the purpose of protecting small issuers.

Thus, Congress

- held hearings and gathered its own evidence on the merits of proxy access;
- determined that it was a valuable right;
- understood that it would entail significant costs to issuers; and
- gave the SEC wide latitude to craft a rule using two parameters: first and foremost the interests of shareholders and investors, and second the impact on **small** issuers.

The D.C. Circuit's decision to subject the proxy access rule to far-reaching cost-benefit standards nullified all of these congressional judgments and essentially repealed

120 Dodd-Frank Act § 971(b).

121 Dodd-Frank Act § 971(c).

122 S. Rep. No 111-176, at 146 (2010).

123 *Id.* (emphasis added).

this provision of the Dodd-Frank Act. If allowed to stand, this approach to judicial review of SEC rules on cost-benefit grounds threatens the same harm over and over again.[124]

> ***The D.C. Circuit's decision to subject the proxy access rule to far-reaching cost-benefit standards nullified these congressional judgments.***

Accordingly, in any future cases, the SEC must fight to overturn the approach to cost-benefit analysis set forth in *Business Roundtable*. This will entail correcting the misunderstanding or claim that the SEC is required under the Securities Laws to shoulder the heavy burden of conducting cost-benefit analysis as it promulgates rules. In addition, it will require courts to consider every rule implementing the Dodd-Frank Act as part of a comprehensive set of reforms adopted by Congress for the central purpose of preventing another financial crisis and the enormous costs it would exact, as set forth in Part Five.

124 The D.C. Circuit's approach to review of SEC rules in *Business Roundtable* also ignores the Supreme Court's admonition in *Vermont Yankee Nuclear Power Corp. v. NRDC,* 435 U.S. 519, 543 (1978). In *Vermont Yankee,* the Supreme Court held that courts are not to impose procedural requirements on agency rulemaking beyond those set forth in the APA. *Id.* at 543. The Court explained that "if courts continually review agency proceedings to determine whether the agency employed procedures which were, in the court's opinion, perfectly tailored to reach what the court perceives to be the 'best' or 'correct' result, judicial review would be totally unpredictable." *Id.* at 546. Unfortunately, *Business Roundtable* validates the Supreme Court's concerns, albeit under a different legal theory. It signals a judicial proclivity to invalidate agency rules on the basis of "open-ended judicial interpretations of the requirement to engage in reasoned decision making." Richard J. Pierce, Jr., Administrative Law Treatise, Vol. I, at 662 (5th ed. 2010). Although the rationale for overturning agency rules has now shifted from the procedural grounds addressed in *Vermont Yankee* to the more substantive interference with agency decision making evident in *Business Roundtable,* the adverse impact on the implementation of Congressional policy is the same.

PART FOUR: THE SEC'S LATEST UNDERTAKING TO APPLY COST-BENEFIT ANALYSIS IS NOT REQUIRED UNDER THE LAW, WILL FURTHER UNDERMINE THE AGENCY'S ABILITY TO IMPLEMENT FINANCIAL REFORM, AND SHOULD BE ABANDONED IN FAVOR OF A HOLISTIC APPROACH TO ECONOMIC ANALYSIS

I. Overview

The SEC's Division of Risk, Strategy, and Financial Innovation, along with the Office of General Counsel, recently issued joint guidance on the economic analysis that all rule-writing teams within the agency will be expected to follow ("2012 Guidelines" or "Guidelines").[125] The 2012 Guidelines largely adopt the principles set forth in various executive orders and in OMB circular A-4 on the application of cost-benefit analysis, including the quantification of costs and benefits "to the extent possible."

> ***The 2012 Guidelines conflict with the SEC's governing statutes, with the legislative intent underlying those statutes, and with the ultimate policy objectives that Congress and the Executive Branch clearly sought to achieve in the Dodd-Frank Act.***

This development represents a very significant shift by the SEC, which could have profound implications for protecting the public, investors, and the securities markets. In one respect, the Guidelines are a well-intentioned response to criticisms from a few members of Congress (who largely oppose financial reform generally and the Dodd-Frank Act in particular), the SEC's prior Inspector General, and the D.C. Circuit's poorly reasoned decision in *Business Roundtable*. By making certain concessions to those few vocal critics, the agency may forestall the imposition of even more draconian cost-benefit standards. Indeed, some congressional proponents of cost-benefit

125 Memorandum from the Division of Risk, Strategy, and Financial Innovation and the Office of General Counsel, SEC, to Staff of the Rulewriting Divisions and Offices, SEC, *Current Guidance on Economic Analysis in SEC Rulemakings* (Mar. 16, 2012) ("2012 Guidelines").

analysis have introduced bills that would impose extraordinarily burdensome cost-benefit standards on the SEC and other regulators.[126]

However, the 2012 Guidelines conflict with the SEC's governing statutes, with the legislative intent underlying those statutes, and with the ultimate policy objectives that Congress and the Executive Branch clearly sought to achieve in the Dodd-Frank Act. Moreover, the net effect of the 2012 Guidelines will be to require a more rigid application of cost-benefit principles, thus adding to the agency's burdens, further slowing the implementation of the Dodd-Frank Act, and very likely weakening the rules that are ultimately adopted. Congress did not intend this result either when it adopted the original economic impact test for the SEC, or when it passed the major amendments to the Securities Laws in the Dodd-Frank Act.

Rather than changing policies in response to such external pressures, shouldering greater economic analysis burdens, and jeopardizing financial reform, the SEC must adhere to its statutory mandate requiring it to "consider" whether a rule will promote efficiency, competition, and capital formation. In addition, the SEC, in discharging its statutory obligations, should also consider the benefits of the entire collection of reforms under the Dodd-Frank Act, of which each rule is a part.

II. The 2012 Guidelines on cost-benefit analysis are the latest in a series of voluntary undertakings that exceed the actual legal requirements applicable to the SEC

For years, members of the senior staff at the SEC have indicated that the agency was committed to following some principles of cost-benefits analysis. For example, Arthur Levitt, a former SEC Chairman (and himself the product of a long career on Wall Street and now a senior advisor to Goldman Sachs) has reportedly said there was "an expectation that the SEC would perform cost-benefit analysis as part of the rulemaking process."[127] In addition, the SEC's Office of General Counsel developed internal guidelines reflecting principles of cost-benefit analysis, which were incorporated into a Compliance Handbook.[128]

Although these undertakings embraced some aspects of cost-benefit analysis, they also recognized certain limits, and they were careful to point out that neither the

126 *See* bills cited at note 59 *supra*.

127 *See* Office of the Inspector Gen., U.S. Sec. & Exch. Comm'n, Follow-up Review of Cost-Benefit Analysis in Selected SEC Dodd-Frank Act Rulemakings 6 (Jan. 27, 2012) (citing interview with members of SEC OGC on May 17, 2011) ("Follow-Up IG Report").

128 *Id.* at 6-9 (citing to the SEC Compliance Handbook).

Securities Laws nor any executive orders actually require the SEC to conduct cost-benefit analysis. For example, the SEC's website has for some time explained that "many of our existing practices are **consistent** with those described in the [executive order relating to cost-benefit analysis]," but it has also clearly stated that the agency is not subject to executive order provisions on cost-benefit analysis.[129]

Prior undertakings were also careful to recognize the impossibility of accurately capturing all or even the most important costs and benefits of a rule. The SEC's Compliance Handbook states that "[i]n many cases, it will not be possible to quantify the benefits of a rule."[130] In response to criticisms from the Inspector General ("IG") regarding the SEC's economic analysis of its rules, the Division heads have explained that "it can be quite difficult to estimate reliably the costs—and even more so, the benefits—of financial regulations," especially since "much of the data needed for detailed quantification of costs is possessed by private industry participants and can be difficult to obtain."[131]

Moreover, the SEC has in the past—appropriately and in accordance with its statute— actually disavowed some principles of cost-benefit analysis. For example, the Compliance Handbook, states that:

> There is no requirement that the SEC weigh the costs against the benefits, or conclude that the benefits outweigh the costs.[132]

In addition, the Office of General Counsel has adhered to the view that the non-discretionary component of rulemaking is not the appropriate subject of any type of cost-benefit assessment:

> The Commission engages in economic analyses to inform its exercise of discretion in crafting rulemaking . . . Where the Commission has no dis-

129 *Id.* at 6 (citing SEC, Improving Regulations: Reviewing Regulatory Requirements to Ensure They Continue to Promote Economic Growth, Innovation, Competitiveness & Job Creation, http://www.sec.gov/spotlight/regulatoryreviewcomments.shtml) (emphasis added).

130 Follow-Up IG Report, at 8.

131 Follow-Up IG Report, Appendix VI, at 3 & n.2 (Memorandum from Mark Cahn, General Counsel; Robert Cook, Director of Division of Trading and Markets; Meredith Cross, Director of Division of Corporate Finance; Craig Lewis, Director of Division of Risk, Strategy, and Financial Innovation; & Eileen Rominger, Director of Division of Investment Management, SEC, to H. David Kotz, Inspector General, *Management's Response to the Office of Inspector General's Draft Report, Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Rulemakings,* Report No. 499, dated January 13, 2012 (Jan. 25, 2012)).

132 Follow-Up IG Report, at 9.

cretion, the release should say so. Because the Commission is making no policy choices, there are no choices to analyze or explain.[133]

In its response to the IG report, the Division Directors also explained that:

> [W]here Congress has clearly expressed its will, we do not believe the Commission should undertake lightly an exercise that may be seen as second-guessing the wisdom of Congressional action.[134]

> ***The 2012 Guidelines have numerous legal, procedural, and substantive drawbacks.***

Even with these cautions and limitations, the SEC's earlier willingness to take costs and benefits "into account" created difficulties and fostered the expectation that the SEC could, would, and should conduct a full-scale cost-benefit analysis when promulgating rules. The new 2012 Guidelines represent a much stronger undertaking to apply principles of cost-benefit analysis, which will significantly increase the SEC's challenges in the rulemaking process. As explained below, they will not only impose more unnecessary burdens on the SEC, they will also solidify expectations regarding the SEC's duty and make it that much more difficult, if not impossible, for the agency to follow the legal standard of economic analysis that Congress actually intended.

III. The 2012 Guidelines are not required by statute, they are not justified or adequately explained, and they will impose new burdens that will undermine the SEC's ability to fulfill its mission

The 2012 Guidelines have numerous legal, procedural, and substantive drawbacks. As a threshold matter, they are not required under the law. The 2012 Guidelines acknowledge what the SEC has consistently recognized for years: No statute or executive order requires the SEC to conduct a formal cost-benefit analysis.[135] Yet, the 2012 Guidelines essentially ignore this basic proposition of law and embrace rulemaking

133 Follow-Up IG Report, at 10 & n.32 (citing Memorandum from David M. Becker, General Counsel, *Thoughts About Best Practices in Drafting Economic Analysis Sections of Releases for Dodd-Frank Related Rulemakings* (Privileged and Confidential) (Sept. 27, 2010)).

134 Follow-Up IG Report, Appendix VI, at 3.

135 2012 Guidelines, at 3-4.

obligations that are inconsistent with applicable statutory language and congressional intent.

They make no attempt to show how cost-benefit analysis could possibly enhance investor protection and the public interest, the SEC's core priorities.

Furthermore, the 2012 Guidelines offer very little justification for this departure from the legal standard. They simply assume that "a rule's potential benefits and costs should be considered in making a reasoned determination that adopting a rule is in the public interest."[136] The 2012 Guidelines also state that recent court decisions, reports from the GAO and the SEC's past Inspector General, and inquiries from certain members of Congress have "raised questions about and/or recommended" improvements to the Commission's economic analysis.[137]

However, these are not sufficient grounds for ignoring the language, legislative history, and critically important policy goals underlying the statutory provisions that Congress adopted to define the SEC's economic analysis obligation. Moreover, the 2012 Guidelines fail to address a host of important issues that weigh strongly **against** the adoption of cost-benefit standards:

- they make no attempt to show how cost-benefit analysis could possibly enhance investor protection and the public interest, the SEC's core priorities;
- they do not explain why the agency should second-guess Congress's consistent determination that the SEC should only be subject to a much more limited economic impact test;
- they include no discussion of the drain on scarce agency resources that cost-benefit analysis will entail;

136 *Id.* at 1.

137 *Id.*

- they fail to address the inevitable delays in the rulemaking process that will result; and
- they take no account of the weaker regulatory standards that will be an inevitable consequence of cost-benefit analysis.[138]

Indeed, the 2012 Guidelines do not explain or even mention the most fundamental problem: They will impair the SEC's ability to discharge its core mission of protecting investors and safeguarding the public interest. In short, the SEC has provided no substantive basis for elevating cost-benefit analysis and subordinating the protection of the public, investors, and the financial markets.

The 2012 Guidelines also raise significant procedural questions. They have not had the benefit of any sort of public comment or informed debate in which all sides of the issues have been thoroughly considered. At least those minimal procedures, which promote transparency and sound public policy, should be undertaken before the SEC implements such a significant change with profound implications.

Finally, the 2012 Guidelines will impose new and heavy burdens on the SEC, which in turn will have significant adverse consequences. For example, they require economists to be much more heavily involved in every rulemaking and at every stage of the process.[139] In addition to this staffing burden, the Guidelines require much more elaborate analytical procedures. Even where costs and benefits **cannot** be quantified, the Guidelines nevertheless still require

- partial quantification wherever possible;
- heavy reliance on approximations and assumptions;
- explanations as to why quantification is not possible;
- a discussion of uncertainties underlying the analysis; and
- an evaluation of the implications of those uncertainties.[140]

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138 While not a concern unique to the SEC, the 2012 Guidelines also fail to consider the unfortunate incentives they will create. The Guidelines dramatically change the SEC's rulemaking policy in a manner that is inconsistent with statutory provisions and congressional intent, based largely on the vocal criticisms of those who do not have the votes to change the law. Rather than appeasing those critics, the Guidelines will merely embolden that vocal minority and intensify their criticisms. Revealing their true intent, it is noteworthy that none of those in Congress who seek to impose full-scale cost-benefit analysis on the SEC have suggested increasing the SEC's budget so that it could fulfill such an obligation without major sacrifices in other program areas.

139 2012 Guidelines at 15.

140 *Id.* at 9-15.

> ***The application of the new 2012 Guidelines will have the perverse effect of making the SEC's rules more, not less, vulnerable to successful legal challenge.***

In an unexplained reversal of sound prior policy, the 2012 Guidelines also require staff to consider the economic effects of a rule even where Congress has **mandated** the rule and the impact is only attributable to a congressional determination and legislative action.[141] In addition, the Guidelines do not appear to recognize the critical point—expressly acknowledged in previous SEC guidance—that the SEC is not and should not be required to weigh the costs against the benefits or to conclude that the benefits outweigh the costs.

Application of the 2012 Guidelines promises to have a variety of negative consequences. The undertaking to apply exhaustive cost-benefit analysis will drain the agency's resources by necessitating the intensive involvement of many additional professional staff members, notably economists, at every stage of a rulemaking. It will certainly slow down the process of drafting and finalizing rules.

Perhaps most important, application of the 2012 Guidelines can be expected to result in the adoption of weaker standards in some cases, or none at all in others. When staff members struggle to quantify costs and benefits for meritorious rules, and find themselves unable to do so, they will likely dilute or withdraw those rules, fearing court challenges on cost-benefit grounds.

Ironically, the application of the new 2012 Guidelines will also have the perverse effect of making the SEC's rules more, not less, vulnerable to successful legal challenge. As the SEC attempts to satisfy an elaborate set of guidelines for cost-benefit analysis, it will create innumerable opportunities for challenge. Deprived of the broad discretion that Congress intended, and with the basic legal standard cast aside, all such cost-benefit analysis will be subject to de novo criticism, second-guessing, and review. Once untethered from the statutory standards under the Securities Laws and the APA, the SEC will be raising the bar on itself, needlessly increasing the risk that it will fall short in the eyes of a court.

American Equity Investment Life Ins. Co. v. SEC[142] illustrates the danger. In *American Equity*, the D.C. Circuit held that, although the SEC may not have been required to conduct an economic analysis for Rule 151A (subjecting fixed indexed annuities

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141 *Id.* at 8.

142 613 F. 3d 166, 177 (D.C. Cir. 2009).

to securities regulation), the SEC nevertheless undertook such an analysis during the rulemaking process, and the court decided that it would therefore hold the SEC to the standard it had set for itself.

Beyond the court room, the willingness of the SEC to incorporate principles of cost-benefit analysis in its rulemakings will only reinforce the misunderstanding that the SEC is and should be required to conduct a full blown cost-benefit analysis for each of its rules. This phenomenon was evident even before the 2012 Guidelines were adopted. The recent evaluation by the SEC's last Inspector General of the SEC's economic analysis in a number of Dodd-Frank Act rules illustrates the point.

In response to a May 4, 2011 request from Republican members of the Senate Banking Committee (who have—in substance—opposed financial reform and the Dodd-Frank Act),[143] the SEC's last IG reviewed the SEC's economic analysis in eleven rulemakings[144] under the Dodd-Frank Act. The two resulting reports confirm that the SEC is "not subject to an express statutory requirement to conduct cost-benefit analysis for its rulemakings."[145] They also confirm that the SEC is "not bound by" the executive orders and OMB guidelines governing cost-benefit analysis.[146]

To be faithful to the law, the 2012 Guidelines must be withdrawn.

Nevertheless, citing to the SEC's "voluntary undertaking," the IG focused almost exclusively on the SEC's compliance with the standards of cost-benefit analysis the agency imposed upon itself, and virtually ignored the actual statutory test applicable to SEC rulemakings. For example, the Follow-up IG Report faulted the SEC for failing adequately to quantify costs and benefits associated with its rules as called for by its undertakings.[147] In addition, applying the OMB's guidelines for cost-benefit

143 Letter from Richard C. Shelby, Michael Crapo, Bob Corker, Jim DeMint, David Vitter, Mike Johanns, Patrick J. Toomey, Mark Kirk, Jerry Moran, & Roger F. Wicker, Minority Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs, to Elizabeth A. Coleman, A. Roy Lavik, Eric M. Thorson, H. David Kotz, & Jon T. Rymer, Inspector Generals (May 4, 2011).

144 Of course, applying any cost-benefit analysis to just eleven rulemakings cherry-picked out of the entire Dodd-Frank Act reveals the tendentious and selective nature of the complaints the SEC has heard, which alone should discredit such complaints. *See* discussion *infra* at Part Five on the need for a holistic evaluation of the benefit of the rules implementing the Dodd-Frank Act.

145 Follow-Up IG Report, at v.; *see also* 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 (June 13, 2011) (emphasis added).

146 Follow-Up IG Report, at 5-6 (emphasis added).

147 *Id.* at vi.

analysis, the IG concluded that the SEC should evaluate costs and benefits even where it has no discretion because of a clear congressional mandate.[148]

Thus, the IG not only ignored the SEC's compliance with its actual statutory duty, it also concluded that that the SEC should essentially reevaluate congressional mandates by undertaking an independent cost-benefit analysis of those mandates. Nowhere in the reports did the IG evaluate the SEC's degree of compliance with its actual statutory duty to "consider" whether the rules would "promote efficiency, competition, and capital formation."[149]

The IG therefore reinforced—indeed, promoted—the misunderstanding, and the expectation, that the SEC is duty-bound to conduct cost-benefit analysis in its rulemakings, even though the law actually imposes a very different and much more flexible standard. The new 2012 Guidelines will solidify this baseless expectation and continue to move the SEC away from its true statutory duty and congressionally determined policy objectives.

IV. The SEC should abandon its approach of assuming a duty to conduct cost-benefit analysis where none exists, and at a minimum, it should consider the enormous benefits that the reforms in the Dodd-Frank Act collectively will provide

To be faithful to the law, the 2012 Guidelines must be withdrawn. To ensure that the SEC is able to implement the Dodd-Frank Act reforms effectively and efficiently, the agency must discontinue its willingness to perform exhaustive cost-benefit analysis.

After the SEC ensures that investors and the public interest are protected, it must focus its limited economic impact analyses on the statutorily mandated requirement: consideration of whether a rule will promote efficiency, competition, and capital formation. And, as it conducts this analysis, it should adopt a more holistic approach to assessing the economic impact of its rules, one that does not view each rule in isolation, but considers the collective impact on the public and investors of all of the reforms embodied in the Dodd-Frank Act—as explained in the following section.

148 *Id.* at 16-17.

149 The IG was also influenced by the bias reflected in the Congressional request. The May 4, 2011 letter asked the IG to go well beyond the applicable statutory requirements and assess the extent to which the SEC had actually conducted cost-benefit analysis. Follow-Up IG Report, at Appendix V.

PART FIVE: ANY RULE IMPLEMENTING THE DODD-FRANK ACT MUST BE EVALUATED IN LIGHT OF CONGRESS'S OVERRIDING GOAL, WHICH IS TO PREVENT ANOTHER FINANCIAL CRISIS

I. Overview

Every rule promulgated under the Dodd-Frank Act must be evaluated in terms of the overriding goal that Congress intended to achieve when it passed the comprehensive, interrelated law, and in terms of the enormous benefit that the rules collectively will provide to the public. That goal is to prevent another financial collapse and economic crisis, and that benefit is to avoid the economic costs, hardships, and human suffering that would inevitably accompany such disastrous events.

Congress declared that the wide-ranging regulatory reforms required or authorized under the Dodd-Frank Act were necessary to ensure that our financial system would remain stable and resilient and that failures and bailouts would be eliminated, reduced, or minimized. Requiring a narrow evaluation of the economic impact of each rule in isolation ignores the very purpose of the law and defeats rather than advances congressional intent.

Indeed, as set forth above, Congress intended to impose billions of dollars in compliance and other costs on the financial industry in the financial reform effort. This was not just to make reform possible, but also to more fairly allocate the risks and costs arising from Wall Street's reckless behavior. Congress deliberately made that decision and neither the agencies nor the courts have the authority to reverse it.

Congress intended to impose billions of dollars in compliance and other costs on the financial industry not just to make reform possible, but also to more fairly allocate the risks and costs arising from Wall Street's reckless behavior.

II. The Dodd-Frank Act was enacted first and foremost to prevent another financial collapse and economic crisis

The purpose of the Dodd-Frank Act is clear: "[t]o promote the financial stability of the United States" to prevent another financial collapse and economic crisis and avoid the massive costs they would impose on our society, our markets, and our economy as a whole.[150] The statute itself reflects this core purpose through its sheer breadth, depth, and detail. It addresses weaknesses and gaps in every major financial sector, including derivatives, banking, securities, commodities, and insurance. It includes provisions

- establishing an entirely new regulatory framework where none formerly existed in the swaps markets;
- fundamentally revising the tools necessary to monitor, limit, and remediate systemic risk in the banking sector; and
- expanding the existing regulatory structure in the securities and commodities markets.

Among its provisions are new standards relating to

- mandatory clearing and exchange trading of swaps;
- capital and margin requirements;
- business conduct standards;
- prohibitions on proprietary trading and investment in hedge funds by banks;
- position limits in the futures and swaps markets;
- resolution authority;
- credit rating agencies;
- private funds;
- consumer and investor protection; and
- corporate governance.

150 *See* Dodd-Frank Act, Preamble.

Congress's intent was unmistakable: Fundamentally change the entire regulatory structure so our financial markets can never again generate the levels of risk, recklessness, and abusive conduct that triggered the 2008 financial collapse and economic crisis.

The legislative history is replete with examples describing the Dodd-Frank Act in terms that clearly reflect this single overarching purpose. According to the Senate Report, for example:

> The primary purpose of [the Act] is to promote the financial stability of the United States. It seeks to achieve that goal through multiple measures designed to improve accountability, resiliency, and transparency in the financial system by: establishing an early warning system to detect and address emerging threats to financial stability and the economy, enhancing consumer and investor protections, strengthening the supervision of large complex financial organizations and providing a mechanism to liquidate such companies should they fail without any losses to the taxpayer, and regulating the massive over-the-counter derivatives market.[151]

Moreover, members of Congress consistently recognized both the enormous costs of the crisis and the need to prevent a recurrence as the driving force behind the Act—"to stop what happened from ever happening again."[152] For example, Senator Dodd, Chairman of the Senate Banking Committee, stated:

> The American public is sitting there in sort of stunned disbelief. Here we all acknowledge this huge problem that needs to be addressed for the 8.5 million people who have lost their job, the 7 million who have lost their homes, their retirement income. We know from all of the statistics what this financial crisis has caused.[153]

Similarly, Senator Dorgan expressed his concern for the taxpayers, estimating that it cost them "the Federal Reserve bailout commitment, $7.8 trillion; FDIC, $2 trillion; Treasury, $2.7 trillion; HUD, $300 billion—that is $12.8 trillion . . . lent, spent or committed on behalf of the American taxpayer to try to get out of this deep hole."[154] He also recognized that "15 or 16 million got out of bed [that] morning jobless, look-

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151 S. Rep. No. 111-176, at 2 (2010).

152 Senator Dorgan, 156 Cong. Rec. S 5931 (daily ed. July 15, 2010).

153 156 Cong. Rec. S 2688 (daily ed. Apr. 27, 2010).

154 156 Cong. Rec. S 2684 (daily ed. Apr. 27, 2010).

ing for work and can't find work,"[155] and that "[t]hey are the victims of this cesspool of greed we have watched for far too long."[156]

> ***Senator Levin declared the Dodd-Frank Act was necessary to "put an officer back on the beat on Wall Street so the jobs, homes, and futures of Americans are not again destroyed by excessive greed."***

Senator Carl Levin, Chairman of the Senate Permanent Subcommittee on Investigations, also commented that "for too long, too many firms on Wall Street have had free reign to profit at the expense of their own clients, to engage in the riskiest sorts of speculation, to prosper from their risky bets when they pan out, and to have the taxpayers cover the losses when they do not pan out."[157] The solution was the Dodd-Frank Act, which Senator Levin declared was necessary to

> put an officer back on the beat on Wall Street so the jobs, homes, and futures of Americans are not again destroyed by excessive greed.[158]

In fact, the Congressional Record is full of impassioned remarks from members of the House and Senate highlighting the terrible costs of the crisis, the need to alleviate the public's suffering, and the importance of reforms to prevent "future bailouts."[159]

When signing the Dodd-Frank Act on July 21, 2010, President Obama acknowledged that "the primary cause" of the severe recession "was a breakdown in our financial system."[160] The result was "the worst recession since the Great Depression," where "[e]ight million people lost their jobs;" "[t]ens of millions saw the value of their homes

155 *Id.*

156 156 Cong. Rec. S 5931 (daily ed. July 15, 2010).

157 156 Cong. Rec. S 5931 (daily ed. July 15, 2010).

158 *Id.*

159 *See, e.g.,* Remarks of Congressman Kingston, 156 Cong. Rec. H 626 (daily ed. Jan. 28 2009) (recounting the massive bailout costs and lamenting their contribution to the national debt); Remarks of Congressman Cummings, 156 Cong. Rec. H 15003 (daily ed. Dec. 16, 2009) (supporting assistance to the unemployed and the impoverished by observing that "[t]he COBRA, unemployment and food stamp extensions in this bill are crucial to help those who are in need or who have lost a job through no fault of their own. These small lifelines can be immense to those who are suffering. For some Americans who still face foreclosure, this funding can help keep them in their homes so that the loss of their job does not result in the further devastation of an entire family."); Remarks of Senator Bennet, 156 Cong. Rec. S 3512 (daily ed. May 11, 2010) ("At the heart of the Wall Street reform bill is an effort to prevent future bailouts.").

160 President Barak Obama, Office of the Press Secretary, The White House, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act.

and retirement savings plummet;" "[c]ountless businesses have been unable to get the loans they need and many have been forced to shut their doors;" "[a]nd although the economy is growing again, too many people are still feeling the pain of the downturn."

Accordingly, the President proclaimed that the Dodd-Frank Act would protect the public interest, and not private interests, so as

> to empower consumers and investors, to bring the shadowy deals that caused this crisis into the light of day, and to put a stop to taxpayer bail-outs once and for all.

III. Agencies as well as reviewing courts must consider the benefits of achieving this overriding objective as they consider the economic consequences of agency rules

Against this history and this obvious congressional resolve to prevent a future financial collapse and economic crisis, it is untenable to claim that the benefit of each implementing regulation must be viewed in isolation, divorced from the reality of the larger framework of which it is an integral part. The law is a comprehensive, integrated whole that is intended to provide layers of protection across the entire financial industry. As the SEC and the other financial regulators implement the Dodd-Frank Act through hundreds of rules, they must consider the larger goal of the statute and the collective benefit that their rules will provide in terms of preventing another crisis and the trillions of dollars in costs and the widespread human suffering that it would inflict.

> ***It is untenable to claim that the benefit of each implementing regulation must be viewed in isolation, divorced from the reality of the larger framework of which it is an integral part.***

This holistic view of the regulatory benefits arising from the Dodd-Frank Act is justified both legally and as a matter of policy. Legally, the federal Securities Laws require the SEC to consider the public interest and the protection of investors in its rulemaking process.[161] These are broad standards, and they not only permit, but affirmatively require the SEC to consider the large-scale benefits to the public of preventing another crisis.

The Dodd-Frank Act gives the SEC broad latitude to consider not only the impact of each rule on the three statutory factors, but also their much larger collective benefits.

This approach is also a matter of achieving Congress's policy objectives, and it is not a new concept in the law. In the environmental context, for example, courts have long been guided by Congress's overriding statutory objectives as they define the scope of an agency's duty to assess the economic impact of its rules. In *FMC Corp. v. Train*,[162] chemical manufacturers challenged water pollution standards set by the EPA, citing inadequate cost-benefit analysis. The statute simply required the agency to "consider" costs in establishing effluent standards, but industry representatives claimed that this provision required the agency to both quantify and compare costs and benefits.

The Fourth Circuit Court of Appeals rejected the industry's claim, holding that the agency had extremely broad discretion in assessing the costs of pollution abatement measures, given Congress's purpose in passing the Clean Water Act:

> The Act's overriding objective of eliminating by 1985 the discharge of pollution into the waters of our Nation indicates that Congress, in its legislative wisdom, has determined that the many intangible benefits of clean water justify vesting the Administrator with broad discretion, just short of arbitrary and capricious, in his consideration of the cost of pollution abatement.[163]

161 *See* discussion *supra* at Part One; *see also* 15 U.S.C. § 77b(b) ("Whenever pursuant to [the Securities Act of 1933] the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."); 15 U.S.C. § 78c(f); 15 U.S.C. § 80b-2(c); 15 U.S.C. § 80a-2(c).

162 539 F.2d 973 (4th Cir. 1976).

163 *Id. at* 978-79; *see also Florida Manufactured Hous. Ass'n v. Cisneros,* 53 F.3d 1565, 1578 (11th Cir. 1995) (recognizing HUD's broad discretion when considering factors, but also holding that the overarching statutory goal of reducing injuries, deaths, and property damage required HUD to consider the "general societal" benefits of avoiding wind damage to manufactured homes, not just the impact of construction standards on the price of each unit).

This approach applies with even greater force to the Dodd-Frank Act, an even more comprehensive and urgent set of reforms.[164] The Act's overriding objective of fortifying our regulatory system so that the financial markets never again precipitate a financial crisis gives the SEC broad latitude to consider not only the impact of each rule on the three statutory factors, but also their much larger collective benefits. Indeed, to fully serve the public interest and to implement the law as Congress intended, the SEC and other financial regulators must adopt this analysis.

The need to adopt a broad view of regulatory reform was recently espoused by Senator Tim Johnson, current Chairman of the Senate Banking Committee. On November 9, 2011, he wrote to the GAO and requested that they conduct a study of the aggregate costs of the financial crisis and the aggregate qualitative and quantitative benefits of the Dodd-Frank Act, "including those measures that will prevent future crises."[165] In the letter, Chairman Johnson emphasized two critical points. First, repealing or undermining Wall Street reform will "take us back to the same weak financial system that led to the worst economic crisis in generations and whose painful costs continue to devastate many Americans."[166] Second, as the implementation of the Dodd-Frank Act progresses, we must understand the aggregate costs of the crisis "to ensure Congress and the American people have a full economic perspective of regulations implementing" those reforms.[167]

In the same vein, Treasury Secretary Timothy Geithner recently asked: "Are the costs of reform too high? Certainly not relative to the costs of another financial crisis."[168] Secretary Geithner also criticized the effort to apply a narrow cost-benefit analysis to the Dodd-Frank rules, which are being challenged in court, as part of "a determined

164 *See* Ben S. Bernanke, Chairman, Board of Governors of the Fed. Reserve Sys., Speech at the 2012 Financial Markets Conference: Fostering Financial Stability (Apr. 9, 2012), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20120409a.htm ("The heavy human and economic costs of the crisis underscore the importance of taking all necessary steps to avoid a repeat of the events of the past few years.").

165 Letter from Tim Johnson, Senator, to Gene Dodaro, Comptroller General (Nov. 9, 2011), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Newsroom.PressReleases&ContentRecord_id=8a132c27-0eb1-c338-2d46-4626a5743305.

166 *Id.*

167 *Id.*

168 Tim Geithner, *Financial Crisis Amnesia*, Wall St. J., Mar. 1, 2012, http://online.wsj.com/article/SB10001424052970203986604577253272042239982.html.

> ***Even those who criticize regulatory reform have acknowledged the need to assess the impact of regulations on a collective basis.***

effort to slow and weaken reforms that are critical to our ability to protect Americans from another crisis."[169]

Even those who criticize and resist regulatory reform have acknowledged the need to assess the impact of regulations on a collective basis. For example, the Republican members of the Senate who wrote to the Inspector Generals of the financial regulators and requested a review of the economic analysis they perform obviously understood the importance of that broader approach, without fully articulating it.[170] In their letter, they requested an assessment of the extent to which each agency "is considering the **cumulative burden** of all Dodd-Frank rulemakings on market participants and the economy."[171]

Other critics of financial reform consistently insist that the "cumulative effect" of the Dodd-Frank Act and financial reform must be considered. For example, Jamie Dimon, the CEO of JPMorgan Chase & Co., the largest U.S. bank by assets, publicly confronted the Chairman of the Federal Reserve Board to raise this issue and to ask whether anyone has studied the cumulative effect of all of the Dodd-Frank Act reforms.[172]

However, any analysis of the "cumulative burden" of regulation, or the "cumulative effect" as Mr. Dimon puts it, obviously requires consideration of the **cumulative benefits** of regulation as well.

IV. The benefits of avoiding another financial crisis are enormous, totaling trillions of dollars, measured not just in terms of the current crisis but also in light of a potentially worse financial disaster that may befall our country if reform is not fully implemented

In the context of the Dodd-Frank Act, the value of a stronger and more comprehensive regulatory system is huge. It includes the benefits of sparing our economy and

169 Timothy Geithner, Treasury Secretary, Remarks, The Macroprudential Toolkit: Measurement and Analysis (Dec. 1, 2011), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1371.aspx.

170 Letter, *supra* note 143, at 3.

171 *Id.*

172 Annalyn Censky, *Jamie Dimon Gripes To Bernanke*, CNNMoney, June 7, 2011, http://money.cnn.com/2011/06/07/news/economy/jamie_dimon_bernanke_dodd_frank/index.htm.

our society the devastating consequences that another financial crisis would bring in the form of both monetary losses and human suffering.

A reasonable starting point for determining the cost of a future crisis is the cost of the current crisis that began in 2007, reached a crescendo in 2008, and continues to be felt to this day. Better Markets will be releasing a detailed report on those staggering costs, but here are some key measurements of the financial devastation the crisis has caused:

A reasonable starting point for determining the cost of a future crisis is the cost of the current crisis that began in 2007, reached a crescendo in 2008, and continues to be felt to this day.

- Gross domestic product ("GDP") has fallen dramatically and it is not expected to return to normal levels until at least 2018. At that time, the cumulative shortfall in GDP relative to potential GDP is expected to reach **$5.7 trillion**.[173]
- The unemployment rate skyrocketed to 10.1 percent in October of 2009, representing **15.4 million workers**, many of whom have become members of the permanently unemployed.[174]
- Government expenditures, including corporate bailouts, special lending facilities, unemployment benefits, and the economic stimulus package are well in excess of a trillion dollars. The value of the government's total commitment of support, provided through some 50 separate programs, is estimated at **$23.7 trillion**.[175]
- The national debt will increase by **$8 trillion** as of 2018 as a result of the crisis, due to the combined effects of government expenditures and reduced revenues.[176]
- The stock market fell by more than 50 percent in just 18 months, from October

173 Cong. Budget Office, The Budget and Economic Outlook: Fiscal Years 2012 to 2022 at 26 (Jan. 2012).

174 Mary Daly et al., A Rising Natural Rate of Unemployment: Transitory or Permanent?, Federal Reserve Bank of San Francisco, Working Paper 2011-05, at 2 (Sept. 2011); *see also* Bureau of Labor Statistics, U.S. Dept. of Labor, Spotlight on Statistics: The Recession of 2007-2009 (Feb. 12, 2012), *available at* http://www.bls.gov/spotlight/2012/recession/.

175 Office of the Special Inspector Gen. for the Troubled Asset Relief Program, Quarterly Rep. to Congress, 137 (July 21, 2009).

176 *See* Cong. Budget Office, The Budget and Economic Outlook (Jan. 2008); Cong. Budget Office, The Budget and Economic Outlook: An Update (Aug. 2009).

2007 until March of 2009, representing **$11 trillion** in evaporated wealth.[177]

- From 2007 to 2010, median family income fell 7.7 percent, from $49,600 to $45,800, and median family net worth fell 38.8 percent, **"erasing almost two decades of accumulated prosperity**."[178]

> ***From 2007 to 2010 median family income fell 7.7 percent, from $49,600 to $45,800, and median family net worth fell 38.8 percent, "erasing almost two decades of accumulated prosperity."***

- Home values have declined 33 percent since the crisis began, representing **$7 trillion** in lost value.[179]
- Over **11 million** homeowners own homes worth less than their mortgages, or about 22.8 percent of all residential properties with a mortgage.[180]
- A total of at least **3.6 million** homes—and by some accounts **5 million**—have been lost to foreclosure since the crisis began, with millions of additional foreclosures to come.[181]
- The number of families falling below the poverty line has climbed steadily since 2007, rising from 12.5 to 15.1 percent, representing over **46 million** individuals

177 Fed. Reserve Bank of St. Louis, FRED Economic Data, Dow Jones Industrial Average (DJIA) (2011), *available at* https://research.stlouisfed.org/; Peter A. McKay, *US Stocks Slip As Early Rally Evaporates; DJIA Down 7,* MarketWatch, Mar. 6 2009, http://www.marketwatch.com/story/us-stocks-slip-as-early-rally.

178 Board of Governors of the Fed. Reserve Sys., Fed. Reserve Bulletin Vol. 99 No. 2, Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances, at 1, 17 (June 2012), *available at* http://www.federalreserve.gov/econresdata/scf/scf_2010.htm; Binyamin Appelbaum, *Family Net Worth Drops to Level of Early '90s, Fed Says*, N.Y. Times, June 11, 2012 (emphasis added).

179 Board of Governors of the Fed. Reserve Sys., White Paper, The U.S. Housing Market: Current Conditions and Policy Considerations, at 3 (Jan. 4, 2012), *available at* http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf (citing Corelogic).

180 Corelogic, *Negative Equity Back to Q3 2009 Housing Market Trough* Level (Mar. 1, 2012); Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing*, at 11, 2011.

181 Corelogic, *CoreLogic Reports 66,000 Completed Foreclosures Nationally in April* (May 30, 2012); *Still Depressed, After All These Years*, N.Y. Times, June 23, 2012, at SR12..

deemed poor.[182] "The ranks of Americas's poor are on track to climb to levels unseen in nearly half a century."[183]

- The **human anguish** caused by the crisis has been enormous and incalculable, encompassing all of the psychological and physical health effects that come with unemployment, poverty, homelessness, delayed retirements, abandoned college educations, increased crime rates, and lost healthcare.[184]

- Maybe worst of all, the faith of the American people in **The American Dream**, where the U.S. is the land of opportunity, everyone gets a fair shot, and the next generation will have it better than the last, is dropping at an alarming rate, which is corrosive to the soul and spirit of our country.[185]

The Dodd-Frank Act reforms promise an enormous collective benefit—avoiding the costs of what would likely be a second Great Depression—but only if they are implemented on a collective basis.

It is impossible at this point to quantify all of the consequences of the still-unfolding financial crisis. Moreover, the actual costs of another crisis are almost certain to be far greater than what we have witnessed since 2007. This is attributable to the fact that our fiscal and monetary capacities to institute remedial measures and to absorb the costs of a future crisis have now become so depleted. With the annual budget deficit now exceeding 1.2 trillion dollars,[186] the Treasury will have far fewer fiscal tools at its disposal with which to manage another economic crisis. This vulnerability will persist for years to come, until something approximating a full recovery has been achieved.

From 2007 to 2010, the U.S. government responded to the financial and economic crisis by implementing trillions of dollars in emergency measures to prevent a

182 Carmen DeNavas-Walt et al., U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2010, at 14 (Sept. 2011), *available at* http://www.census.gov/prod/2011pubs/p60-239.pdf.

183 Hope Yen, *U.S. Poverty On Track To Rise To Highest Since 1960s*, Huffington Post, July 22, 2012, http://www.huffingtonpost.com/2012/07/22/us-poverty-level-1960s_n_1692744.html?view=print&comm_ref=false.

184 *See, e.g.* Daniel Sullivan & Till von Wachter, *Job Displacement and Mortality: An Analysis Using Administrative Data*, Quarterly J. of Econ., 1265 (Aug. 2009).

185 *See* Ari Shapiro, *American Dream Faces Harsh New Reality*, NPR, May 29, 2012, *available at* http://www.npr.org/2012/05/29/153513153/american-dream-faces-harsh-new-reality?sc=17&f=1001.

186 Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2012 to 2022, at Summary Table 1 (Jan. 2012).

precipitous slide into a second Great Depression.[187] To create a more lasting safeguard against another financial crisis, Congress adopted the comprehensive reforms in the Dodd-Frank Act. Those reforms promise an enormous **collective benefit**—avoiding the costs of what would likely be a second Great Depression—but only if they are implemented on a **collective basis**. Therefore, as regulators promulgate rules under the Dodd-Frank Act, and as courts review those rules, they must consider the entire set of reforms envisioned by Congress and the benefits that those reforms can provide as a single, coherent collection. If this approach fails, and if the cohesive framework envisioned in the Dodd-Frank Act is unraveled rule by rule on cost-benefit grounds, then the public, the markets, and the economy as a whole will once again be vulnerable to another financial downfall.

187 Some of those emergency measures were catalogued by the New York Fed. *See* Fed. Reserve Bank of New York, Financial Turmoil Timeline, June 2007-December 2012, *available at* http://newyorkfed.org/research/global_economy/Crisis_Timeline.pdf.

CONCLUSION

Our nation is still suffering from the worst financial disaster since the Great Depression. For the express purpose of preventing a recurrence of that crisis and the huge costs it would inevitably impose, Congress fundamentally reformed our system of financial regulation in the Dodd-Frank Act.

To ensure that the SEC and the other financial regulators are able to do their part in implementing those reforms, those agencies and any court reviewing their rules must reject attempts to sabotage the rulemaking process through the use of cost-benefit analysis. In reality, and contrary to the unfounded claims of those who oppose reform—

- **The Securities Laws do not require the SEC to conduct cost-benefit analysis when it promulgates rules.** On the contrary, Congress intentionally refrained from imposing that obligation, deciding instead that the SEC should continue to place investor protection and the public interest first among its priorities. With respect to economic impact, Congress determined that the SEC need only consider whether its rules will promote efficiency, competition, and capital formation. In the Dodd-Frank Act, Congress clearly confirmed this intent by making no changes to this limited duty.

- **Requiring the SEC to apply rigid cost-benefit analysis in its rulemaking process would create insurmountable obstacles to regulatory reform.** It is a time consuming, imprecise, and ultimately unreliable methodology in the realm of financial market regulation. Its application to implementation of the Dodd-Frank Act would be especially inappropriate, since Congress and the President have already determined that the industry must bear some significant new costs and forego some traditionally profitable activities to make our markets fundamentally more stable and fair. At the same time, the long history of financial regulation shows that the comprehensive reforms in the Dodd-Frank Act can be imposed without imperiling Wall Street or stifling economic growth.

- **The cornerstone of the attack on regulatory reform in the courts was wrongly decided.** In *Business Roundtable,* the D.C. Circuit panel ignored or misapplied virtually every principle or policy that bears upon the review of SEC rules: the very narrow statutory duty to consider economic impact in the rulemaking process; the legislative history and case law clearly supporting this reading of the law;

Supreme Court precedent holding that courts owe deference to agencies when reviewing their rules; and the policy judgments that Congress has already made regarding the need for regulation notwithstanding the costs that it imposes on industry. Accordingly, in any future rule challenge, the SEC must seek to overturn the approach to rule review adopted in *Business Roundtable*. In addition, the SEC should abandon its voluntary undertaking to apply cost-benefit analysis when it promulgates rules. That strategy is legally unjustifiable, and it will only further slow and weaken the process of financial reform.

- **Finally, the SEC, the other financial regulators, and any court reviewing their rules, must adopt a holistic approach when assessing the impact of the rules implementing regulatory reform.** They all must be guided by the central goal underlying the Dodd-Frank Act: to avoid the terrible costs of another financial collapse and economic crisis, which might well evolve into a second Great Depression. Every rule promulgated under that law can and should be evaluated in terms of the benefits, representing trillions of dollars, that the entire collection of reforms, acting together, will bring to our markets, our economy, and our society as a whole.

APPENDIX A

EXECUTIVE ORDERS DO NOT REQUIRE THE INDEPENDENT REGULATORY AGENCIES TO CONDUCT COST-BENEFIT ANALYSIS

Just as Congress has declined to impose the burdens of cost-benefit analysis on the SEC in the Securities Laws, the Executive Branch has similarly declined to do so in its executive orders. Although President Ronald Reagan and his successors in office issued a series of executive orders requiring the Executive Branch agencies to conduct cost-benefit analysis, those requirements do not apply to the independent regulatory agencies, including the SEC.

Independent regulatory agencies are fundamentally creatures of Congress rather than the Executive Branch, and since 1935, the Supreme Court has recognized that their independence must be assiduously protected from undue Presidential influence. "The authority of Congress, in creating quasi-legislative or quasi-judicial agencies, to require them to act in discharge of their duties independently of executive control cannot well be doubted."[1]

In recognition of this important policy, the independent regulatory agencies are expressly **excluded** from the executive order provisions that require agencies to conduct cost-benefit analysis in their rulemakings.[2] For example, President Clinton's 1993 Executive Order 12,866, establishing the modern era duty to conduct cost-benefit analysis and providing for OMB's review of agency rules, expressly excludes all agencies "considered

1 *Humphrey's Ex'r v. United States*, 295 U.S. 602, 629 (1935) (holding that the Chairman of the Federal Trade Commission could be removed by the President only for the specific causes enumerated in the Federal Trade Commission Act).

2 *See, e.g.,* Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993) (expressly excluding agencies "considered to be independent regulatory agencies"); *see also*, Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (Feb. 19, 1981); Exec. Order No. 12,498, 50 Fed. Reg. 1036 (Jan. 8, 1985); Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011).

to be independent regulatory agencies."[3] Similarly, OMB's guidance in Circular A-4 for conducting cost-benefit analysis does not apply to the SEC's rulemaking process.[4]

The two executive orders issued by President Obama in 2011 did nothing to alter these limitations or to impose any obligation on independent regulatory agencies to conduct cost-benefit analysis. In fact, those orders scrupulously avoided doing so. Executive Order 13,563 recapitulated the core principles in Executive Order 12,866, set forth some additional guidelines for the rulemaking process, and required agencies to develop a plan for retrospective rule review.[5] However, it is directed exclusively at the executive agencies and it expressly excludes the independent regulatory agencies from its scope.[6]

Executive Order 13,579 ("Order") addresses the independent agencies, but it does not obligate them to conduct cost-benefit analysis.[7] First, the Order does **not require** independent agencies to do anything. Unlike preceding orders directed to the executive agencies, and in recognition of the independence of independent agencies, it uses entirely advisory rather than mandatory language, consistently using "should" rather than "shall."

Second, the Order refrains from even requesting that the independent agencies conduct cost-benefit analysis in their rulemaking proceedings. Although it encourages the independent agencies to follow certain specified guidelines in prior executive orders, and to conduct retrospective rule review, it carefully excludes from that list any reference to the specific sections dealing with cost-benefit analysis.[8] Thus, in recognition and confirmation of their independence, the President did not attempt to impose cost-benefit analysis on independent regulatory agencies.

Finally, the Order makes perfectly clear that its intended purpose—to promote retrospective rule review—is as much to make regulation more effective as it is to make regulation less burdensome. For example, the Order asks all agencies, independent and

3 Exec. Order No. 12,866, § 3(b). Executive Order 12,866 only requires the independent regulatory agencies to submit a regulatory agenda and a regulatory plan to OMB, not for the purpose of policing the substance of rules, but to provide for better coordination in the issuance of federal regulations. *Id.* at § 4(b), (c).

4 Office of Mgmt & Budget, 2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities, at 4 (2011) ("OMB 2011 Report to Congress").

5 Exec. Order No. 13,563.

6 *Id.* § 7 (adopting the same meaning of "agency" as set forth in Executive Order 12,866, which excludes the independent agencies).

7 Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011).

8 Exec. Order No. 13,579, § 1(c) (encouraging independent agencies to comply with the requirements of Executive Order 13,563 relating to **public participation, integration and innovation, flexible approaches, and science,** but carefully avoiding imposition of cost-benefit analysis on the independent agencies).

non-independent alike, to identify rules that "may be **outmoded, ineffective, insufficient**, or excessively burdensome."[9] Elsewhere, the Order lists possible steps that agencies should take in accordance with their rule review, including steps "to **modify**, streamline, **expand**, or repeal" rules.[10] Thus, the Order asks each agency to focus on areas where rules must be strengthened, not only on areas where regulation should be scaled back or simplified.[11]

Removing any doubt, OMB itself plainly acknowledges that its purview does not extend to the independent regulatory agencies. In its most recent 2011 annual report to Congress on the overall benefits and costs of federal regulation, it clearly states that the regulations of the independent regulatory agencies "are not subject to OMB review under Executive Order 12,866."[12]

In short, there are no executive orders requiring independent regulatory agencies to conduct cost-benefit analysis as they promulgate rules. As discussed in the body of this Report, it is for Congress, rather than the Executive Branch, to determine the exact nature and scope of the economic analysis, if any, that independent agencies must conduct as they implement congressional policy.

9 *Id.* § 2(a) (emphasis added).

10 *Id.* (emphasis added).

11 President Obama issued another executive order on May 10, 2012, elaborating on the process of retrospective rule review and addressing issues such as public participation, setting priorities, and reporting to OIRA on progress. However, the order expressly exempts the independent regulatory agencies. *See* Exec. Order No. 13,610, § 5, 77 Fed. Reg. 28,469 (May 14, 2012).

12 OMB 2011 Report to Congress, at 4. Under The Regulatory Right to Know Act, OMB has a duty to provide Congress with an annual report totaling the costs and benefits of all federal rules. Pub. L. No. 106-554, § 1(a)(3), 114 Stat. 2763 (enacting § 624 of Title VI of H.R. 5658 (114 Stat. 2763A-161)), Dec. 21, 2000. But, OMB focuses on rulemakings issued by executive agencies and relies on GAO reports, issued under the Congressional Review Act, 5 U.S.C. § 801(a)(2)(A), for their brief descriptions of independent regulatory agency rules.

APPENDIX B

A COMPREHENSIVE ANALYSIS OF *BUSINESS ROUNDTABLE V. SEC*

Overview

In *Business Roundtable v. SEC*, a panel of the D.C. Circuit held that the SEC's proxy access rule was arbitrary and capricious because the agency failed to adequately assess the economic effects of the rule.[1] The court committed two fundamental errors that are reflected throughout the opinion. It held the SEC to an overly stringent cost-benefit analysis, while virtually ignoring the test that actually applies under the Securities Laws. It also departed from basic principles governing judicial review of rules under the Administrative Procedure Act ("APA"), by giving little if any deference to the SEC's rational resolution of competing considerations raised by the rule, and even substituting its own judgment for that of the SEC in many instances. The decision thus conflicts not only with the economic impact test Congress chose for SEC rules, but also with Supreme Court precedent requiring courts to show great deference to agencies when reviewing their rules under the APA.[2]

First, and most importantly, the court incorrectly held that the SEC was required to analyze the costs and benefits of its proxy access rule, faulting the agency for not quantifying certain costs and not determining whether the rule would provide a net

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1 647 F.3d 1144, 1148 (D.C. Cir. 2011).

2 In its analysis, the court relied heavily on two of its own precedents similarly faulting the SEC for the way it assessed the economic impact of its rules. *See Chamber of Commerce of the U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) ("*Chamber I*"); *American Equity Inv. Life Ins. Co. v. SEC*, 572 F.3d 923 (D.C. Cir. 2009). A detailed analysis of those cases is beyond the scope of this Report, but three important points deserve mention here. First, those two precedents largely share the same flaws exhibited in *Business Roundtable* and discussed above—a failure to adhere to the plain statutory language governing the SEC's obligation to consider the economic impact of its rules, and a failure to afford the SEC appropriate deference under APA jurisprudence. Second, to the extent judicial ideology affects the outcome in cases involving rule review, this series of adverse decisions from the D.C. Circuit against the SEC is not surprising, since the panels, although not identical, largely overlapped in each of the three cases. Finally, setting aside the merits of those two prior cases, the *Business Roundtable* decision unquestionably and on its face departed from controlling statutory language and Supreme Court precedent, as illustrated in the textual discussion above.

benefit. This, however, is not the SEC's duty.[3] **Its duty, as delineated by the Securities Laws, is first to protect investors and the public interest, and then simply to consider whether a rule will promote efficiency, competition, and capital formation**. The court failed to assess the SEC's compliance with this obligation, thus ignoring the most relevant portions of the SEC's rule release.[4] Far from a "**complete absence** of any discussion of a statutorily mandated factor,"[5] the SEC's adopting release shows that the agency considered the impact of the rule on all three statutorily mandated factors.[6]

Second, the court ignored the SEC's compliance with the more general mandate under the APA to consider all important aspects of a problem and to reach a rational and plausible result. With respect to the proxy access rule, it simply cannot be said that the SEC "**entirely failed** to consider an **important** aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or [the rule] is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[7] The SEC did in fact consider each and every issue raised by the court. For example, the court even acknowledged that the SEC did not, as the petitioners argued, entirely fail to consider the possibility that shareholders with special interests might abuse the rule.[8]

Also in derogation of standards of review under the APA, the court failed to apply the appropriate degree of deference[9] and inappropriately substituted its judgment for that of the agency.[10] This approach is reflected most notably in the court's discussion of the weight to be afforded to certain studies in the record.[11] The court's second-guessing of the agency's judgment is contrary to the relevant case law, as evidenced by its lack of citation to supporting authority.[12] This approach also undermines the quality of rulemaking, since judges, especially when reviewing agency analysis of costs

3 *See also Chamber I,* 412 F.3d at 143 (where the court similarly imposed an erroneous cost-benefit duty on the SEC).

4 *See* Adopting Release, 75 Fed. Reg. 56,668; 56,771-76.

5 *Pub. Citizen v. Fed. Motor Carrier Safety Admin.,* 374 F.3d 1209, 1216 (D.C. Cir. 2004) (emphasis added).

6 *See* Adopting Release, 75 Fed. Reg. at 56,771-76 (clearly addressing the rule's effect on efficiency, competition, and capital formation).

7 *Motor Vehicle Mftrs. Ass'n v. State Farm Mutual Auto. Ins. Co.,* 463 U.S. 29, 43 (1983) (emphasis added) ("*State Farm*").

8 *Business Roundtable,* 647 F.3d at 1152.

9 *See, e.g., Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996).

10 *State Farm*, 463 U.S. at 43.

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

12 *See also American Equity*, 572 F.3d 923 (D.C. Cir. 2009), in which the court also excessively scrutinizes the SEC's reasoning and second-guesses its determinations, while citing no authority for its conclusions.

and benefits, do not have the same knowledge, expertise, or independent access to information that agencies possess.[13]

At best, the approach to judicial review set forth in *Business Roundtable* will make the SEC's rulemaking process slower, more costly, and less effective. At worst, it will actually prevent the implementation of the vitally important reforms in the Dodd-Frank Act, thereby nullifying the policy decisions made by the Legislative and Executive Branches.

Here, we analyze the court's treatment of five issues, demonstrating the court's repeated departure from the applicable standards of judicial review.

Analysis

1. The costs of challenging shareholder nominees

First, the court criticized the SEC for minimizing issuer solicitation and campaign costs under the new rule. The agency found that those costs could be limited by: (a) the directors' fiduciary duties, which would compel them to not oppose a shareholder nominee, and (b) the threshold requirements for shareholders to use the rule. As to the first limitation, the court ruled that the SEC's "prediction" was "mere speculation," and it faulted the SEC for not presenting evidence that such director forbearance was actually seen in practice.[14] As to the second limitation, the court ruled that the criteria for invoking the proxy access rule did not address how much companies would spend in the event of a contested election. The court singled out the SEC's failure to "estimate and quantify the costs it expected companies to incur."[15] Overall, with respect to these two potential limitations, the court concluded:

> Because the agency failed to "make tough choices about which of the competing estimates is most plausible, [or] hazard a guess as to which is correct," we believe it neglected its statutory obligation to assess the economic consequences of its rule.[16]

In so finding, the court failed to apply the correct statutory standard governing the SEC's duty to consider the impact of its rules, and it failed to give the SEC the deference it was due under the case law. By insisting that the SEC must quantify and "assess the economic consequences of its rule," the court went well beyond the SEC's

13 Thomas J. Miles and Cass R. Sunstein, *The Real World of Arbitrariness Review,*75 U. Chi. L. Rev. 761,762 n.10 (2008) (citing Stephen Breyer, *Judicial Review of Questions of Law and Policy*, 38 Admin. L. Rev. 363, 388-90 (1986)).

14 *Business Roundtable*, 647 F.3d at 1150.

15 *Id.*

16 *Id.* (citing *Pub. Citizen*, 374 F.3d at 1221, and *Chamber I*, 412 F.3d at 143).

statutory mandate, which only requires consideration of efficiency, competition, and capital formation.

The court exclusively relied on *Public Citizen v. Fed. Motor Carrier Safety Admin.* and *Chamber I* to support its conclusion. However, the result in Chamber I was based on the result in *Public Citizen*, and the result in *Public Citizen* was distinguishable as dicta.[17] There the court faulted the agency for failing to estimate certain costs, but the discussion was irrelevant to the holding in the case. Moreover, the statutory provisions at issue in *Public Citizen* not only required the agency to "consider the costs and benefits," but also to "deal[] with" a long list of particularized factors relating to trucking safety. [18] This unjustifiable expansion of the SEC's duty, ultimately premised on a misreading of *Public Citizen*, is pervasive throughout the opinion in *Business Roundtable* and it undermines the holding of the court on each of the other issues discussed below.

Not only did the court err by ignoring the limited nature of the SEC's statutory duty to consider certain effects of its rules, it also misapplied legal precedent regarding cost-benefit analysis and judicial deference. Indeed, although the SEC was not required to evaluate the costs of the new rule, it actually did consider costs, and its approach should have satisfied the court even under its erroneous view of the applicable economic impact test. When there is a lack of factual certainty on the costs to issuers under the new rule, even agencies duty bound to conduct cost-benefit analysis are allowed to rely on "a general analysis based on informed conjecture."[19] Quantification of costs is not required.[20] The SEC complied with these standards. To approximate the expected costs of the new rule, it considered estimates submitted by commenters regarding the cost of proxy contests under then-current law.[21] Thus, the SEC actually met the unjustifiably high standard applied by the court, by considering and acknowledging the potential costs, based on its own expertise and the information submitted by the commenters.

The fact that the SEC also explained why costs may be limited does not mean that it failed "to assess the economic consequences of the rule." Rather, it shows that the SEC recognized these limits as factors that might affect the costs borne by issuers opposing shareholder nominees. The SEC recognized that directors might decide not

17 *See also* text and accompanying footnotes *supra* at Part Three, Section II.

18 *See Chamber I,* 412 F.3d 133, 143 (D.C. Cir. 2005). The statute at issue in *Pub. Citizen,* 49 U.S.C. § 31502(d), provided: "Before prescribing or revising any [HOS] requirement, [the FMCSA] shall consider the costs and benefits of the requirement." However, this section was read in tandem with the motor vehicle safety provisions in 49 U.S.C. § 31136.

19 *Melcher v. FCC,* 134 F.3d 1143, 1158 (D.C. Cir.1998).

20 *See American Fin. Services Ass'n v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985); *see also Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81, 91 (3d Cir. 1994); *FMC Corp. v. Train,* 539 F.2d 973, 978-979 (4th Cir. 1976).

21 75 Fed. Reg. at 65,770/1-2.

to oppose nominations in light of their fiduciary duties,[22] and also found that "under certain circumstances, company directors likely would oppose a particular shareholder director nominee."[23] This balanced qualitative consideration was sufficient to support the SEC's contention that directors **may** not contest a shareholder director nominee. There was no basis for requiring the SEC to further explain this possibility with reference to empirical data, as the court suggested.

Likewise, the possibility that the threshold limits might limit the number of nominees, and thus the number of proxy contests, was a legitimate expectation regarding the total costs to all issuers and it supported the SEC's decision to place limits on the rule's use.[24] Although the SEC did not (nor was it required to) quantify the cost savings of the rule's limitations, those limitations supported the inference that costs in the aggregate would be reduced. This qualitative assertion was sufficient as part of "a general analysis based on informed conjecture."[25]

2. The benefits of improved board performance and increased shareholder value

The court next faulted the SEC for concluding that the rule would improve board and company performance and increase shareholder value, finding that the SEC relied "exclusively and heavily" on two "**relatively unpersuasive** studies," while "completely discount[ing]" studies reaching the opposite result.[26] The court held that "[i]n view of the admittedly (and at best) 'mixed' empirical evidence," the SEC had "not sufficiently supported its conclusion."[27]

In coming to this conclusion, however, the court failed to abide by or even mention the relevant legal standard that applies when an agency is "evaluating scientific data within its technical expertise:" **courts owe agencies an "extreme degree of deference**."[28] Additionally, the "court is not to substitute its judgment for that of the

22 75 Fed. Reg. at 56,770/2 n.1007 (citing *Hall v. Trans-Lux Daylight Picture Screen Corp.*, 171 A. 226, 228 (Del. Ch. 1934)).

23 *Id.* at n.1007 (citing letters from the ABA and Business Roundtable).

24 *See, e.g.,* 75 Fed. Reg. 56,690/1-2 ("Based on our consideration of these competing interests, including balancing and facilitating shareholders' ability to participate more fully in the nomination and election process against the potential cost and disruption of the amendments, we have determined that requiring a significant ownership threshold is appropriate to use Rule 14a-11.").

25 *Melcher v. FCC,* 134 F.3d 1143, 1158 (D.C. Cir.1998).

26 *Business Roundtable,* 647 F.3d at 1151 (emphasis added).

27 *Id.*

28 *Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996) (emphasis added).

agency."[29] Under these principles, the SEC met its duty and the court erred in concluding otherwise.

The SEC found that what the court viewed as "unpersuasive" studies about hybrid boards were actually "a close, but not perfect, analog" to potential board performance under the new rules with shareholder nominated directors. These hybrid boards, which have a minority of dissident directors often as a result of proxy contests,[30] were well within the SEC's "technical expertise" as the regulator of proxy solicitations under Section 14(a) of the Securities Exchange Act of 1934.[31] Moreover, the SEC noted the limitations of the studies and bolstered its conclusions by referencing seven commenters,[32] one survey article,[33] and even one competing study, which acknowledged permanent gains in performance from dissident activity.[34]

Upon citing the relevant studies that contradicted its conclusion, the SEC elaborated in three lengthy footnotes why it "ha[d] reason to question some of their conclusions."[35] Rather than "completely discounting" these studies, the SEC addressed key discrepancies which affected their reliability, such as the statistical bias resulting from an improper sample selection.[36] In the words of a prior panel in the same circuit, "[a]lthough a more detailed discussion of the stud[ies] might have been useful, the Commission made clear enough the limitations of the stud[ies]."[37] Thus, according to precedent, the SEC's judgment about the studies was worthy of deference.

However, the court did not give the SEC the "extreme degree of deference"[38] it was owed. Rather, the court engaged in a de novo review, independently assessing the adequacy and validity of the data and asserting its own non-expert view on the subject matter. By doing so, the court supplanted the SEC's role in the rulemaking

29 *State Farm*, 463 U.S. at 43.

30 75 Fed. Reg. at 56,762/1.

31 15 U.S.C. § 78n.

32 75 Fed. Reg. at 56,762 n.923.

33 *Id.* at n.926.

34 *Id.* (citing Lisa Borstadt and Thomas Zwirlein, *The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance*, Fin. Mgm't (1992)).

35 75 Fed. Reg. at 56,762-3 at nn.926-928.

36 *See, e.g., id.*, at nn.926 & 928 (addressing the Inkenberry and Lakonishok study and the Cheffins study).

37 *Chamber I*, 412 F.3d 133, 143 (D.C. Cir. 2005) (citing *Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996)).

38 *Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996).

process and neutered the SEC's ability to resolve disputes over expert opinions through the application of its own knowledge and experience.

Additionally, the court's characterization of the SEC's analysis does not accurately reflect what the agency actually said in the adopting release. Specifically, the court's narrow reading disregards the multiple justifications provided by the agency.[39] The SEC's conclusion was not, as the court stated, that the rule "will" increase performance, but rather that there is a "potential" for improved performance.[40] In support of this conclusion, the SEC relied on "the totality of evidence and economic theory," finding that the rule might lead to increased responsiveness of boards to shareholder concerns, greater use of independent judgment on the part of shareholder nominated directors,[41] and a larger pool of qualified director candidates.[42] The studies on hybrid boards encompassed only part of the SEC's rationale. Yet, they were the focus of the court's holding on the matter.[43]

Furthermore, contrary to the court's assertion, that it "exclusively and heavily relied" on the two studies,[44] the SEC also referenced comment letters, a study published in a law journal, a survey article, and even an opposing study to support its view that the presence of minority dissident directors might improve board performance.[45]

Thus, as to the conflicting studies on board performance, the court again applied the wrong legal standard, misread and mischaracterized the rulemaking record, and ultimately substituted its own judgment for that of the SEC—the agency that has wrestled with the challenges of regulating corporate governance under the Securities Laws for decades. This aspect of the court's decision illustrates why courts are required to give deference to agencies like the SEC.

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39 The court applied a similarly narrow reading of the release with respect to investment companies, dismissing the SEC's determination that the rule's application to investment companies would yield benefits similar to that for operating companies. *See* 75 Fed. Reg. at 56,763/3. Additionally, the use of confidentiality agreements to limit costs on investment companies was, contrary to the court's implication, only one possible method acknowledged by the SEC to reduce costs. 75 Fed. Reg. at 56,767/2.

40 *See, e.g.*, 75 Fed. Reg. at 56,760/2; 56,763/2.

41 75 Fed. Reg. at 56761/1.

42 75 Fed. Reg. at 56, 764/1.

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

44 647 F.3d at 1151. The two studies the court refers to are: Chris Cernich *et al.*, IRRC Inst. for Corporate Responsibility, Effectiveness of Hybrid Boards (May 2009), *available at* www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoar ds.pdf; and J. Harold Mulherin & Annette B. Poulsen, *Proxy Contests & Corporate Change: Implications for Shareholder Wealth*, 47 J. Fin. Econ. 279 (1998).

45 *See supra*, notes 32-34.

APPENDIX B

3. The costs and benefits of the rule in relation to the state law right of shareholders to elect directors

Next, the court faulted the SEC for discounting the costs but not the benefits of the rule that were traceable to the already existing state law right of shareholders to elect directors. It held that this supposedly imbalanced reasoning was unacceptable since it failed to view costs "at the margin."[46] There are numerous flaws in the court's analysis of this issue.

First, as noted above, it constitutes a striking example of the court's erroneous tendency to equate the SEC's limited duty to consider certain factors with full-scale cost-benefit analysis. Nothing in the Securities Laws requires the SEC to evaluate the costs and benefits arising from its rules, much less to quantify those costs and benefits.

Second, the SEC actually did "discount" the benefits by recognizing that those benefits, including reduced cost to shareholders, would depend on the shareholder's use of the rule as an alternative to the traditional state law proxy contest.[47] Specifically, the SEC acknowledged that because of the rule's limitations, such as the requirement that the shareholder not hold the securities with the purpose of changing control, and shareholder preferences, the benefits might be limited to the extent that shareholders chose to exercise their traditional state law right to nominate and elect directors through a proxy contest.[48] Thus, the SEC appropriately discounted the benefits, as well as the costs, of the rule, in light of the existing state law regime for board nominations.

Third, contrary to the court's narrow reading, the SEC addressed the costs at the margin, albeit qualitatively rather than quantitatively. For example, the SEC addressed the possible costs to board performance and company performance resulting from a company's decision to respond to the rule by re-examining and adjusting their procedures.[49] Quantification was not required. Thus, given the SEC's expertise on the matter, and its rational explanation as to how it considered these elements, the court should have deferred to the agency's judgment on this point.

Finally, the court again disregarded the deferential standard and supplanted its own views about the costs of the rule for the SEC's very reasonable—although different—interpretation. A shareholder's right to nominate and elect directors is a right provided under state law. Thus, the cost resulting from a shareholder's exercise of this right is a baseline cost of being a company. Even the court acknowledged that the

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

47 75 Fed. Reg. at 56,756 n.867.

48 *Id.*

49 75 Fed. Reg. at 56,765/2.

state law right is a "necessary" cause of these costs.[50] By pointing out that the costs of invoking the new rule were ultimately costs derived from rights under state law, the SEC merely recognized that the rule changed the mechanism by which shareholders could utilize their rights, rather than granting shareholders fundamentally new rights. In short, the court erroneously found the SEC's reasoning to be "unacceptable" without any basis in the law or the record.[51]

4. The potential for abuse of the rule by shareholders with special interests

The court found that the SEC acted arbitrarily "[b]y ducking serious evaluation of the costs that could be imposed upon companies from use of the rule by shareholders representing special interests."[52] Recognizing that the SEC did not "entirely fail . . . to consider an important aspect of the problem,"[53] the court seemed to demand greater elaboration and quantification.

In fact, the SEC did consider shareholders' use of the rule to promote their own narrow interests and found that this scenario would be limited by the ownership and holding thresholds, which would demonstrate that the shareholder had a "significant, long-term commitment to the company," as well as the disclosure requirements, which would alert others to these special interests.[54] In support of the ownership threshold as a limit on pension funds' use and potential abuse of the rule, the SEC cited research that the ten largest public pension funds, together, would be unlikely to meet the threshold.[55] The SEC also recognized that the special interest issue would be limited by the provision requiring nominating shareholders to certify that they were not acting with "the purpose or effect of changing control."[56]

Thus, the SEC amply considered the issue and exceeded its duty by providing a qualitative analysis of the costs. The court should have accepted this analysis, and in failing to do so, it appears that the court was demanding quantification. Presumably, under the court's analysis, the SEC should have assumed that the rule would be misused,

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50 *Business Roundtable,* 647 F.3d at 1155.

51 The court applied a similar faulty analysis to the rule's effect on investment companies, ignoring the baseline costs of the state law right to nominate directors and the incremental considerations that the SEC did discuss. *See Business Roundtable,* 647 F.3d at 1155 (citing 75 Fed. Reg. 56,684/3); *cf* 75 Fed. Reg. 56,767/3.

52 *Business Roundtable,* 647 F.3d at 1152.

53 *Id.*

54 *Id.* (citing 75 Fed. Reg. 56,772/3 and 56,766/3).

55 75 FR 56,693/2 n.246 (citing Letter from Council of Institutional Investors (Jan. 14, 2010)).

56 75 FR 56,754/1-2.

and then quantified the frequency of this event and the costs associated with it. None of this analysis, however, is required under the applicable law.

5. Whether the impact of the rule on the total number of election contests would produce a net benefit

Finally, the court faulted the SEC for failing to address whether and to what extent the rule would replace traditional proxy contests.[57] According to the court, this data was necessary to establish "whether the rule will facilitate enough election contests to be of a **net benefit**."[58]

Here again, the court incorrectly required the SEC to conduct a cost-benefit analysis, and to prove that the rule was justifiable as offering more benefits than costs. The SEC is not required under the Securities Laws to find a "net benefit" to promulgate a rule. Rather, it only has to "consider" whether the rule will promote efficiency, capital formation, and competition.[59]

With respect to the merits of the issue, as the SEC noted, the rule was designed not to replace the traditional proxy contests, but rather to provide a different and less costly way for shareholders to nominate and elect directors.[60] The agency referenced data showing that one-third of the public issuers in a sample would have individual shareholders who would meet the ownership and holding requirements of the rule.[61] Whether these shareholders would use the rule depended on a variety of factors, such as whether a shareholder preferred "greater control over the mailing schedule and contents of their proxy materials."[62] In light of the factual uncertainty as to whether eligible shareholders would use the new rule over the traditional proxy contest, as well as legal precedent holding that the agency need not provide "complete factual support,"[63] the SEC adequately addressed the issue though a general qualitative analysis.

Additionally, whether or not the rule would have replaced traditional proxy contests did not determine whether the rule would have provided a "net benefit." The goal of the rule was not simply to "facilitate enough election contests." Rather, the rule offered a variety of other benefits, including responsiveness of boards to shareholder

57 *Business Roundtable,* 647 F.3d at 1153.

58 *Id.* (emphasis added).

59 The court also erroneously criticized the SEC for failing to determine whether the rule as applied to investment companies would result in a "net benefit." *Business Roundtable,* 647 F.3d at 1155.

60 *See* 75 Fed. Reg. at 56,755/2.

61 75 Fed. Reg. at 56,754/3.

62 75 Fed. Reg. at 56,756 n.867.

63 *FCC v. Nat'l Citizens Comm. for Broad.*, 436 U.S. 775, 813-14 (1978).

concerns since "incumbent directors [may be] more vulnerable to replacement by shareholder action."[64] Shareholders also could have benefited from being able to simply nominate directors under the new rule, and from the mere presence of the rule as an option to ensure management discipline.[65] In short, it was reasonable to expect that the rule would have deterred board complacency and encouraged accountability.[66] These were appropriate factors that the SEC considered in defense of the rule, and the court should have been more than satisfied with them under the limited standard of review.

Conclusion

In *Business Roundtable*, the D.C. Circuit court imposed a standard of economic analysis on the SEC that is far more onerous than what Congress intended in the Securities Laws. And the court ignored well-established precedent requiring courts to defer to reasonable agency judgments, not second-guess administrative decisions and ultimately those of Congress as well. Nevertheless, *Business Roundtable* is fueling the courtroom assault on regulatory reform, and it will continue to do so until its approach to economic analysis under the Securities Laws and its approach to judicial review under the APA are successfully challenged.

64 75 Fed. Reg. at 56,761/2.

65 *Id.*; *see also* 75 Fed. Reg. at 56,763.

66 75 Fed. Reg. at 56,761/1-2.

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