

# RECENT DEVELOPMENTS

## LITTLE POWER STRUGGLES EVERYWHERE: ATTACKS ON THE ADMINISTRATIVE STATE AT THE SECURITIES AND EXCHANGE COMMISSION

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*This Article describes the power struggles among the three branches of the federal government and Democrats and Republicans to control rulemaking and other activities at the Securities and Exchange Commission (SEC). Although the SEC was designed to be an independent and nonpartisan agency where Commissioners and staff exercised independent judgment and expertise to protect the investing public from Wall Street depredations, partisan struggles have undermined the agency's work. Instead of protecting the SEC from these ideological power plays, the courts have also upended SEC rules in decisions that appear to be more political than respectful of governmental efficiency and integrity and have resulted in regulatory ossification. Developments that have impacted the SEC's effectiveness are the imposition of cost-benefit regulations, skepticism about deference, and the erosion of independence.*

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## INTRODUCTION

The Securities and Exchange Commission (SEC or Commission) was created as an independent federal administrative agency, designed to bolster capitalism by exerting its specialized expertise to increase investor confidence.<sup>1</sup> The agency was established in 1934, during the depths of the Great Depression following the collapse of the stock market and the banking system. Although the Federal Trade Commission (FTC) initially implemented the Securities Act of 1933 (Securities Act), the SEC was established in 1934 pursuant to the Securities Exchange Act of 1934 (Exchange Act).<sup>2</sup>

The purposes of these statutes can be gleaned from their preambles. The Securities Act is an act “[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof and for other purposes.”<sup>3</sup> The Exchange Act is an act “[t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.”<sup>4</sup> Both statutes, but especially the Exchange Act, have been extensively amended in the more than eighty-five years since the SEC’s creation, adding to the agency’s mandate and responsibilities.<sup>5</sup> In 1996, Congress specifically required the SEC

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1. Felix Frankfurter, who is generally credited with drafting the Securities Act, was skeptical that Congress could legislate to effectively administer the structure or behavior of the modern economy. He also wondered whether a democratically elected President would appoint talented regulators. He therefore believed in the creation of a class of expert administrators. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 59–60 (1982).

2. *Id.* at 99. Because Congress did not resolve the controversies surrounding the creation of the SEC, legislators granted the SEC authority to issue its own rules. “Congress had broadly defined the Commission’s areas of expertise and invited it to forge its own mandate.” *Id.*

3. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74, 74.

4. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881, 881.

5. *See generally* Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb (1940)

to consider, in addition to the protection of investors, the promotion of efficiency, competition, and capital formation.<sup>6</sup>

Two significant statutes which gave the SEC detailed instructions for extensive rulemaking were the Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley)<sup>7</sup> and the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank).<sup>8</sup> Both of these statutes were passed as a result of serious financial failures in the capital markets by a Congress suspicious of the securities industry and opponents of regulation.

Congress’s inability to establish clear directives for the SEC to administer, as well as efforts by Wall Street and other business interests to thwart securities regulations, created a political climate favoring the SEC’s independence and respect for its expertise. For years, courts deferred to the SEC in its rulemaking and prosecutorial initiatives. Such deference was based on general public respect for the work of the SEC’s staff and was assisted by the *Chevron* doctrine.<sup>9</sup> If a statute pursuant to which an agency rule has been passed is clear, the court can vacate a contrary agency rule. If the statute is ambiguous, then an agency may have discretion to implement the statute by rule. However, the agency’s action must not be arbitrary or unreasonable.<sup>10</sup> Closely related to the *Chevron* doctrine is judicial deference to an agency’s

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(supplementing the Securities Act of 1933 and amended by Pub. L. No. 86-760, 74 Stat. 902 (1960)); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-52 (1940); Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21 (1940); National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3426, 3437 (amending the Investment Company Act of 1940 and the Investment Advisers Act of 1940); Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97, 97, 163 (amending the Securities Act of 1933 and Securities Exchange Act of 1934); Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (amending §§ 12, 13, 14, and 16 of the Securities Act of 1934); Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79–79z-6 (1935) (repealed by the Energy Policy Act of 2005, 42 U.S.C. § 15801, and replaced by 42 U.S.C. § 16451 (2006)).

6. See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3424 (expanding the SEC’s mandate to include the promotion of efficiencies, competition, and capital formation).

7. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered §§ 11, 15, 18, 28 and 29 U.S.C.).

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

9. *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984) (“If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.”).

10. *Id.* at 844.

interpretation of its own rules.<sup>11</sup> These doctrinal constructs have bolstered the SEC's independence.

A different tenet of statutory construction curtailing agency discretion is the “hard look” doctrine,<sup>12</sup> based on the Administrative Procedure Act's (APA's) provision that a reviewing court can set aside agency action if the action was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”<sup>13</sup> The “hard look,” juxtaposed to *Chevron*, allows reviewing courts to utilize political preference to uphold or strike down agency action.

Pushback against the administrative state generally, including the SEC, began in the 1980s and continued through Democratic and Republican administrations. In 1979, Professor Homer Kripke wrote:

In general, over many years, professional opinion has given the SEC excellent ratings on its performance . . . . Through many administrations, Democratic and Republican, the SEC has on the whole maintained its technical competence, its energy, and its integrity. Its staff remains at a high level of ability, filled with enthusiasm and with the moral certainty that it is performing an important public service.<sup>14</sup>

The compliment was overshadowed as the book rebuked the SEC's administration of its most important goal—corporate disclosure.<sup>15</sup>

Skepticism about administrative agencies and regulatory reform took hold during the Carter Administration, which threatened to undermine the SEC's independence by curtailing the SEC's ability to represent itself in court.<sup>16</sup> Although this initiative did not succeed, other ideas for supervising the SEC's enforcement activities have been floated more recently.<sup>17</sup>

Agency independence was threatened during the Reagan Administration with the imposition of cost–benefit analyses for new rules and oversight by

11. *Auer v. Robbins*, 519 U.S. 452, 461–63 (1997); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945) (When the “meaning of the words used [in a regulation] is in doubt . . . the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.”).

12. *See Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 415–16 (1971).

13. Administrative Procedure Act (APA), 5 U.S.C. §§ 551–559, 561–570a, 701–706, 706(2)(A) (2012).

14. HOMER KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* 8 (1979).

15. *See generally* KRIPKE, *supra* note 14 (outlining the problematic issues with the current disclosure system).

16. *See infra* Part II.A.

17. *See infra* Conclusion (noting Congressional and Executive supervisory proposals).

the Office of Information and Regulatory Affairs (OIRA).<sup>18</sup> The efforts by OIRA to control agency regulation in this way continued through Democratic and Republican administrations thereafter. Although independent agencies like the SEC are not technically subject to cost–benefit review, some administrations have “voluntarily” given OIRA review powers over proposed regulations. Further efforts to interfere with regulation have increased during the Trump Administration.

Although the OIRA regulatory review regime has not been applied to the SEC, Congress amended various federal securities law statutes in 1996 to require the Commission to consider “efficiency, competition, and capital formation” when determining whether rules are in the public interest.<sup>19</sup> This could be viewed as a type of regulatory impact analysis.<sup>20</sup>

Proponents of the unitary executive theory attacked structures designed to protect independent decisionmaking within the SEC with mixed success.<sup>21</sup> The appointment of chairs and commissioners with close ties to either the White House, other Executive branch agencies, or key congressional committees led to new partisanship at the SEC and an erosion of both independence and expertise.<sup>22</sup>

Attacks on the administrative state, referred to derisively as the deep state, have increased during the Trump Administration. Yet, it is superficial to view these attacks as merely right-wing efforts to please business interests by derailing regulation. Many of the attacks are embedded in power struggles between the Executive, Judicial, and Legislative Branches of the government. Agencies like the SEC have become pawns in these power struggles and have survived them thus far by conducting themselves with specialized expertise and

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18. See Exec. Order No. 12,291, 46 Fed. Reg. 13,193, 13,193–94 (Feb. 19, 1981) (creating cost–benefit analysis requirements).

19. 15 U.S.C. §§ 77b, 78c(f), 80a-2(c), 80b-2(c) (2012).

20. See Reeve T. Bull & Jerry Ellig, *Statutory Rulemaking Considerations and Judicial Review of Regulatory Impact Analysis*, 70 ADMIN. L. REV. 873, 881 (2018) (discussing congressional action around regulatory economic analysis).

21. See *Lucia v. SEC*, 138 S. Ct. 2044, 2054–55 (2018) (curtailing the independence of administrative law judges). Efforts to derail the Public Company Accounting Oversight Board (PCAOB) were unsuccessful. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 484 (2010) (evidencing an unsuccessful effort to derail the PCAOB).

22. Muscular trade associations amplified efforts to prevent the rulemaking and vacate existing rules. See, e.g., Part II.C (discussing attacks on the PCAOB). Furthermore, Congress attempted to expand its influence with the passage of extremely detailed rulemaking mandates. See generally Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (outlining each step of the entire rulemaking mandate in great detail); Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 771–75 (illustrating the extremely detailed rulemaking mandates).

dedication to the public interest. Nevertheless, the attacks are wounding, and lead to regulatory ossification rather than efficient and effective agency decisionmaking.<sup>23</sup>

These trends need to be understood in the context of a populism that, among other rallying cries, is pitting the poorly educated, the elderly, small businesses, and others—those who find it difficult to cope with bureaucracy—against intellectuals and experts who run the administrative state. Further, the populists are often aligned with some traditional business interests that blame regulation for their decline, or simply wish to be free of regulation to increase their profits. Ironically, it is those who fulminate against regulation that may need the administrative state the most. This irony can be seen regarding health care and environmental protection<sup>24</sup> and has a particular pattern in securities regulation.

Most retail investors today have their savings in mutual funds or pension funds. Although these institutional investors are regulated, their business interests are not necessarily aligned with their investors. Sophisticated investors may have significant investments in hedge funds and private equity funds. These private funds were only brought within the ambit of SEC registration by Dodd–Frank and they are very lightly regulated. Current SEC Chairman Jay Clayton has voiced concerns about the retail investor, but important rulemaking initiatives in recent years have acceded to the concerns of institutional investors and financial firms.<sup>25</sup> In part, this is because the public interest rarely walks in the door of a rulemaking proceeding and is difficult to quantify in a cost–benefit analysis.

This Article will discuss several topics which are relevant to an understanding of attacks on the administrative state at the SEC. Part I discusses one of the most important attacks: the imposition of a cost–benefit analysis on SEC rulemaking and instances where the D.C. Circuit has vacated SEC rules, either on the inadequacy of the cost–benefit analysis or on the somewhat related ground that a new rule was arbitrary or capricious. Part II examines the

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23. See *infra* Part I.E (analyzing the Regulation Best Interest Rule).

24. See generally Jacob Bor et al., *Population Health in an Era of Rising Income Inequality: USA, 1980–2015*, 389 LANCET 1475, 1475 (2017) (warning of the “health-poverty trap” and noting that “[g]rowing survival gaps across income percentiles since 2001 reflect falling real incomes among poor Americans as well as an increasingly strong association between low income and poor health”); James K. Boyce, *Inequality and Environmental Protection*, in INEQUALITY, COOPERATION, AND ENVIRONMENTAL SUSTAINABILITY 314 (Jean-Marie Baland et al. eds., 2007) (reviewing the literature connecting income inequality to environmental injustice and exposure to environmental harm).

25. See Robert J. Jackson, Jr., *Statement on Final Rules Governing Investment Advice*, SEC (June 5, 2019), <https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd> [hereinafter Jackson, *Final Rules Governing Investment Advice*].

attacks orchestrated at the behest of the Executive Branch and intended to undermine SEC independence. Finally, Part III will consider threats to *Chevron* and related doctrines and the deference by the federal courts to the SEC's expertise. This Article concludes with a plea for protecting the SEC against the destructive partisanship that is weakening the administrative state, which is designed to protect the public against special interests.

## I. COST-BENEFIT RESTRICTIONS AND INTERPRETATIONS

### A. *Conflict Between Deference and Regulatory Analysis*

The deference that federal administrative agencies should be given pursuant to *Chevron*<sup>26</sup> has been frequently ignored, or given way to other administrative law doctrines utilized by courts when interpreting new rules by economic regulators.<sup>27</sup> Some judges and legislators are skeptical of *Chevron* deference.

Instead of *Chevron* deference, the use of a cost-benefit analysis by the D.C. Circuit in reviewing new rules passed by the SEC has in several cases led to vacating those rules as arbitrary and capricious.<sup>28</sup> Yet, the APA does not require the SEC to make a cost-benefit analysis that would satisfy the standards set by OIRA. When interpreting new SEC rules promulgated pursuant to Dodd-Frank or the Jumpstart Our Business Startups Act (JOBS Act),<sup>29</sup> the D.C. Circuit has not insisted on a cost-benefit analysis by the SEC but has recognized that a statutory mandate needs to be followed.

Although the SEC is not required by any statute or executive order to include a cost-benefit analysis in its rulemaking, in response to the D.C. Circuit's decisions, the agency has put in place a rigorous cost-benefit analysis procedure. Whether this new mode of rulemaking has made the D.C. Circuit more favorably inclined to uphold SEC rulemaking is difficult to discern.

The first mandatory review procedure for administrative agencies was established by Executive Order 12,291 in 1981 by President Ronald Reagan, requiring new regulations be submitted to OIRA for review.<sup>30</sup> This

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26. *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984) (giving a federal administrative agency deference in rulemaking entrusted to the agency by statute unless the agency's determination is unreasonable, impermissible, or arbitrary).

27. Skepticism of *Chevron* deference within the judiciary is discussed *infra* Part III.

28. APA, 5 U.S.C. §§ 551-559, 561-570a, 701-706, 551-59 (2012).

29. Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

30. Exec. Order No. 12,291, 46 Fed. Reg. 13,193, 13,193-94 (Feb. 19, 1981); Helen G. Boutros, *Regulatory Review in the Obama Administration: Cost-Benefit Analysis for Everyone*, 62 ADMIN. L. REV. 243, 247 (2010).

centralized review process has persisted in subsequent administrations, establishing a long-standing mechanism for executive review of agency rulemaking to ensure that the proposed regulation strikes an acceptable balance between costs and benefits.<sup>31</sup> Cost–benefit analysis is an established means of assessing the merits of proposed rules and has become a feature of the regulatory landscape over the last few decades. The analysis is “the systematic identification of all of the costs and benefits associated with a forthcoming regulation, including nonquantitative and indirect costs and benefits, and how those costs and benefits are distributed across different groups in society.”<sup>32</sup>

Independent regulatory agencies, like the SEC, are encouraged to conduct cost–benefit analyses in accordance with these policies, but they are not required to do so under this regime.<sup>33</sup> The requirement of cost–benefit analysis may also be statutorily mandated, and the Supreme Court has held that cost–benefit analysis may be relied upon by administrative agencies in promulgating standards and regulations even where their statutory authority is silent on the matter.<sup>34</sup> Cost–benefit analysis is not without its critics. The analysis necessarily relies on *ex ante* assumptions made about unpredictable and non-quantitative effects and, in some cases, is an exercise in balancing the cost of regulation against public welfare.<sup>35</sup> The use of cost–benefit analysis in regulatory review at some level, however, is widely supported among scholars.<sup>36</sup>

Democratic and Republican administrations have embraced the application of cost–benefit analysis to agency rulemaking. Nevertheless, conservatives and business groups have latched on to cost–benefit analysis to slow government regulation or prevent new regulations from coming into force. Therefore, the D.C. Circuit’s use of the analysis has been criticized as either political decisionmaking or otherwise inappropriate.

The debate over how, and whether, intangible benefits can be quantified and subsequently weighed against the projected costs of new regulations is considerable.<sup>37</sup> In the author’s opinion, to the extent the benefits of SEC

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31. Boutros, *supra* note 30, at 248; Benjamin Minhao Chen, *What’s in a Number: Arguing About Cost–Benefit Analysis in Administrative Law*, 22 LEWIS & CLARK L. REV. 923, 924 (2018).

32. MAEVE P. CAREY, CONG. RESEARCH SERV., R41974, COST–BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 1 (2014), <https://crsreports.congress.gov/product/pdf/R/R41974>.

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

34. Chen, *supra* note 31, at 925; *Entergy Corp. v. Riverkeeper, Inc.*, 556 U.S. 208, 223 (2009) (citing *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984)).

35. See CAREY, *supra* note 32, at 1 (explaining rationalization between “benefits not traded in the market (e.g., health or lives)”).

36. *Id.*

37. See, e.g., Frank Ackerman & Lisa Heinzerling, *Pricing the Priceless: Cost–Benefit Analysis of Environmental Protection*, 150 U. PENN. L. REV. 1553, 1572 (2002).

regulations—investor protection, fair and orderly markets, and other intangible inputs that provide investors with confidence—cannot be measured in economic terms by weighing estimated regulatory costs against aspirational benefits is chimerical. New legislation may impose cost–benefit requirements on the SEC; however, it is unclear what effect such legislation would have since the SEC already goes through a fairly thorough cost–benefit exercise.<sup>38</sup> Further, when a new statute mandates that the SEC pass a new rule, vacating that rule on the basis of a cost–benefit analysis is wrong, especially when Congress has engaged in no such balancing exercise.

In four D.C. Circuit cases, SEC rulemaking was upended for want of an adequate cost–benefit analysis. In response, the SEC created the Division of Economic and Risk Analysis (DERA). Subsequently, in D.C. Circuit cases reviewing new rules under Dodd–Frank and the JOBS Act, the SEC’s cost–benefit analysis was either ignored or passed muster. One question raised in these cases is whether the courts should review the SEC’s cost–benefit analysis once it has been made. Another question is whether politics or principles are driving the courts.

### B. History of Cost–Benefit Analysis

According to Cass Sunstein, a cost–benefit analysis is an effort “(1) to quantify the anticipated consequences of regulatory action and (2) to monetize those consequences in terms of benefits and costs, subject to (3) a feasibility constraint . . . [because] some consequences may be hard or impossible to quantify or monetize.”<sup>39</sup> The current formulation of this requirement, imposed on most federal administrative agencies by OIRA, is not merely a procedural charge but a mandate that agencies show that the benefits of a new rule justify the costs and also that they have chosen the approach to maximize benefits.<sup>40</sup>

Professor Jeffrey Gordon has suggested that cost–benefit analysis originated in the torts system, where juries were allowed to determine the optimal level of consumer product safety, workplace health and safety, or environmental amenities.<sup>41</sup> According to John Coates, cost–benefit analysis in the federal system began in 1936 when Congress ordered agencies to weigh the

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38. See Independent Agency Regulatory Analysis Act of 2017, S. 1448, 115th Cong. § 3(a)(6) (2017); Regulatory Accountability Act of 2017, S. 951, 115th Cong. § 3(b)(5) (as reported by S. Comm. on Homeland Sec. & Governmental Affairs, Feb. 14, 2018).

39. Cass R. Sunstein, *Financial Regulation and Cost–Benefit Analysis*, 124 YALE L.J. F. 263, 264 (2015).

40. *Id.*; see Exec. Order No. 13,563, 76 Fed. Reg. 3821, 3821 (Jan. 21, 2011).

41. Jeffrey N. Gordon, *The Empty Call for Benefit–Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S355–56 (2014).

costs and benefits of flood control projects.<sup>42</sup> In the 1970s, disillusionment with government regulation and the high cost of federal regulation to business in an inflationary economy led to calls for regulatory reform.<sup>43</sup> This regulatory reform movement followed a period of intense congressional activity that created new agencies with expansive regulatory reach, including the Environmental Protection Agency, the Consumer Product Safety Commission, the Occupational Safety and Health Administration, and the Nuclear Regulatory Commission.<sup>44</sup> Therefore, Presidents Nixon, Ford, and Carter attempted to establish procedures for coordinating and overseeing agency rulemaking.<sup>45</sup>

Yet, President Reagan's 1981 Executive Order<sup>46</sup>—requiring agencies to submit new regulations for review—required OIRA to determine whether the regulation accomplished the Administration's goals. Every subsequent President, Democrat and Republican alike, has continued the practice.<sup>47</sup>

From the outset, OIRA's cost-benefit review process has been controversial, and has had strong proponents and detractors. Advocates claim that it is an agency cost-control device, used by politically accountable officials to discipline agencies in their rulemaking initiatives.<sup>48</sup> It is supposed to increase transparency and enhance public engagement with the regulatory process. Moreover, cost-benefit analysis has been embraced as a deregulatory tool. Perhaps for this same reason, detractors argue that it is an effort to close down

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42. John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 900 (2015) [hereinafter Coates, *Cost-Benefit*].

43. Boutros, *supra* note 30, at 247 n.24 (requesting better oversight of administrative processes).

44. See generally ENV'T PROT. AGENCY, ORDER 1110.2, INITIAL ORGANIZATION OF THE ENVIRONMENTAL PROTECTION AGENCY (1970), <https://archive.epa.gov/epa/aboutepa/epa-order-11102-initial-organization-epa.html> (organizing Environmental Protection Agency (EPA) and establishing administrative roles within the agency); Consumer Product Safety Act, Pub. L. No. 92-573, 86 Stat. 1207 (1972) (codified as amended at 15 U.S.C. §§ 2051–89) (elaborating on the purpose and organizational structure of the Consumer Product Safety Commission); Occupational Safety and Health Act of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (codified as amended at 29 U.S.C. §§ 651–78) (outlining Congress's intent to authorize the Secretary of Labor to set occupational standards through what is now known today as the Occupational Safety and Health Administration); Energy Reorganization Act, Pub. L. No. 93-438, tit. 2, 88 Stat. 1233 (1974) (codified as amended at 42 U.S.C. § 5841) (abolishing the Atomic Energy Commission and establishing the Nuclear Regulatory Commission).

45. Boutros, *supra* note 30, at 247.

46. Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (Feb. 19, 1981).

47. Boutros, *supra* note 30, at 247–48.

48. Coates, *Cost-Benefit*, *supra* note 42, at 900.

regulatory initiatives by business groups.<sup>49</sup> Others have argued that federal judges should not be reviewing agencies' cost-benefit analyses because these analyses are merely procedural obligations and should not be made substantive requirements.<sup>50</sup> Detractors also argue that the essence of economic regulation makes cost-benefit requirements particularly problematic.<sup>51</sup>

Separation of powers issues also lead to controversy over cost-benefit analysis. OIRA's role has been criticized as improper Executive Branch interference with agency rulemaking. For this reason, the SEC and other independent federal agencies have resisted compliance with the executive orders requiring that OIRA review new regulations.<sup>52</sup> When President Carter considered whether all agencies—independent agencies included—should give advanced notice of their agendas, offer an analysis of the impact on major regulatory proposals, and conduct periodic reviews of existing regulations,<sup>53</sup> there was strong pushback from Congress. Members of the Interstate and Foreign Commerce Committee sent a five page letter of objections, warning that “before you decide finally whether to include independent regulatory agencies within the ambit of the executive order, you will consider the impact on its effectiveness that a possible executive-legislative confrontation may have.”<sup>54</sup> Thirteen Senators, likewise fought to insulate the independent regulatory commissions from presidential domination. They said that “[i]n their ‘unqualified view,’” the proposed executive order “‘cannot lawfully be applied to the independent regulatory commissions’ without the express approval of Congress.”<sup>55</sup>

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49. Robert B. Ahdieh, *Reanalyzing Cost-Benefit Analysis: Toward A Framework of Function(s) and Form(s)*, 88 N.Y.U. L. REV. 1983, 1994–95 (2013); Dennis M. Kelleher et al., *The Dodd-Frank Act is Working and Will Protect the American People If It Is Not Killed Before Fully Implemented*, 20 N.C. BANKING INST. 127, 136 (2016).

50. Gordon, *supra* note 41, at S353; Robert J. Jackson, Jr., *Comment: Cost-Benefit Analysis and the Courts*, 78 L. & CONTEMP. PROBS., no. 3, 2015, at 55, 56 [hereinafter Jackson, *Comment*].

51. See John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: A Reply*, 124 YALE L.J. F. 305, 308–09 (2015) [hereinafter Coates, *Reply*] (noting challenges financial regulators face when little of the benefits can be known). *Contra* Paul Rose & Christopher J. Walker, *Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture*, 66 STAN. L. REV. ONLINE 9, 12–13 (2013) (arguing that cost-benefit analysis is more appropriate to economic regulation than health and safety regulation).

52. See Exec. Order No. 13,579, 76 Fed. Reg. 41,587, 41,587 (July 14, 2011) (stating that independent agencies should promote the goal of Executive Order 13,563).

53. Improving Government Regulations, Proposed Executive Order, 42 Fed. Reg. 59,740, 59,744–45 (Nov. 18, 1977).

54. Richard E. Cohen, *A Fight Over Independence*, NAT'L J., Dec. 31, 1977, at 2016, 2016 (quoting a letter from Reps. Harley O. Staggers, D-W. Va., and John E. Moss, D-Cal.).

55. *Id.* (including the chairmen and ranking Republicans on the Governmental Affairs, Judiciary, Commerce and Banking, Housing and Urban Affairs Committee as signatories).

No statute expressly requires the SEC to conduct a cost–benefit analysis, but in the 1970s the SEC began to do so voluntarily.<sup>56</sup> In 1996, however, the Congress inserted into the National Securities Markets Improvement Act<sup>57</sup> language which some viewed as a cost–benefit analysis requirement, as follows:

Whenever . . . 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.<sup>58</sup>

In addition, the Exchange Act requires the SEC to consider the impact that any rule promulgated under that act would have on competition.<sup>59</sup> Further, it requires the rule’s statement of basis and purpose include “the reasons for the Commission’s or the Secretary’s determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Act].”<sup>60</sup>

Conservative members of Congress have drafted bills to impose a clearer and more stringent cost–benefit analysis requirement upon the SEC.<sup>61</sup> This effort and similar efforts to involve the U.S. Government Accountability Office (GAO) in analyzing new regulations would appear to be a push-back against regulation pursuant to Dodd–Frank.<sup>62</sup> It is somewhat disingenuous, since Scott Garrett—the former Chairman of the House Financial Services Committee’s Capital Markets Subcommittee—promoted an explicit cost–benefit analysis for SEC rulemaking, but also claimed that when the SEC implemented the JOBS Act, a cost–benefit analysis is not required since the JOBS Act is a deregulatory statute.<sup>63</sup>

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56. Ahdieh, *supra* note 49, at 1999, 1999 n.69.

57. *See generally* National Securities Markets Improvement Act of 1996, H.R. 3005, 104th Cong. (enacted) (amending securities laws and providing what some interpret as a cost–benefit analysis mandate).

58. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424. This language is in the Securities Act of 1933, 15 U.S.C. § 77b(2)(b) (2018); the Securities Exchange Act of 1934, 15 U.S.C. § 78c(f) (2018); and the Investment Company Act of 1940, 15 U.S.C. § 80-2(c) (2018).

59. 15 U.S.C. § 78w(a)(2).

60. *See* 15 U.S.C. § 78w(a)(2).

61. *See, e.g.*, SEC Regulatory Accountability Act, H.R. 1062, 113th Cong. (2013) (introduced by former Representative Scott Garrett (R–N.J.) to establish explicit cost–benefit analysis requirements for the SEC).

62. *See* Coates, *Cost–Benefit*, *supra* note 42, at 921–25.

63. Maria Lokshin, *Garrett Says Advancing SEC Cost–Benefit Bill A Priority, but “Timing” May Doom Prospects*, BLOOMBERG L. (June 11, 2012), <https://news.bloomberglaw.com/securities-law/garrett-says-advancing-sec-cost-benefit-bill-a-priority-but-timing-may-doom-prospects?context=search&index=0>.

On January 30, 2017, in the first weeks of his Administration, President Trump signed Executive Order 13,771, titled “Reducing Regulation and Controlling Regulatory Costs.”<sup>64</sup> This was primarily a cost-cutting push and a dramatic departure from the old approach of cost–benefit analysis toward an approach that incentivizes regulations that burden industry as little as possible without any evaluation of the benefits provided.<sup>65</sup>

New guidance from the Office of Management and Budget (OMB) may change how independent agencies like the SEC are answerable for their rule-making. OMB’s memo focuses on the Congressional Review Act, which requires agencies to submit a complete copy of cost–benefit analysis to both houses of Congress for review prior to implementation of “major rules.”<sup>66</sup> The new guidance formalizes the previously informal process by which OIRA determined which rules count as “major:” independent agencies must now submit an advanced notice of rules along with an analysis “sufficient to allow OIRA to determine whether the rule is major.”<sup>67</sup> Cass Sunstein, OIRA Administrator under President Obama, suggested in an opinion that the new guidance could allow OIRA to dispute an agency’s assessment of the costs of a proposed rule.<sup>68</sup> The memo appears broad enough to encompass less formal guidance issued by the SEC, and some have raised the question about whether this might include no-action letters.<sup>69</sup> It remains unclear what the total effect of this new guidance on the SEC will be. Some analyses indicate that it could affect the agency’s analytical posture with respect to new rulemaking, while noting that it may not amount to a significant shift.<sup>70</sup> A

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64. Exec. Order No. 13,771, 82 Fed. Reg. 9339, 9339 (Feb. 3, 2017) (requiring agencies identify two existing regulations to repeal for each new regulation).

65. *Id.*

66. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, GUIDANCE ON COMPLIANCE WITH THE CONGRESSIONAL REVIEW ACT 1, 2–4 (2019), <https://www.whitehouse.gov/wp-content/uploads/2019/04/M-19-14.pdf>.

67. *Id.* at 3, 5.

68. Cass R. Sunstein, Opinion, *Trump White House Seeks New Power Over Agencies*, BLOOMBERG (Apr. 23, 2019, 11:25 A.M.), <https://www.bloomberg.com/opinion/articles/2019-04-23/trump-seeks-more-control-of-fed-sec-and-other-agencies>. Pro-industry voices, in contrast, welcomed the new guidance as a “real step toward curtailing the abuses of the administrative state.” *OMB Guidance on Major Rules & Regulatory Dark Matter is a Real Step Toward Stopping Regulatory Abuses*, COMPETITIVE ENTER. INST. (Apr. 12, 2019), <https://cei.org/content/omb-guidance-major-rules-regulatory-dark-matter-real-step-toward-stopping-regulatory-abuses>.

69. *Guidance, Supervisory Expectations, and the Rule of Law: How do the Banking Agencies Regulate and Supervise Institutions?: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 116th Cong. 10 (2019), <https://www.banking.senate.gov/imo/media/doc/McCoy%20Testimony%204-30-19.pdf> (statement of Patricia A. McCoy, Professor of Law, Boston College Law School).

70. *Congressional Review Act: OMB Memo Would Make SEC, CFTC and Other Independent Agency’s*

senior administration official anonymously characterized it as “business as usual” for the SEC.<sup>71</sup>

Although agency utilization of cost–benefit methodologies can make regulation more efficient and more transparent, it can also lead to delays in rule-making mandated by new legislation and the deadening of initiatives for new regulatory projects. Other statutes regulating the regulators can work a similar effect.<sup>72</sup> Whether these laws make for better SEC rulemaking is a serious question. In my view, they prolong the rulemaking process and create orders for final rules published in the Federal Register unnecessarily lengthy and prolix.<sup>73</sup>

### C. D.C. Circuit Court Cases Vacating SEC Rules

It is not only the Executive Branch that has been scrutinizing SEC rule-making and favoring deregulation. In four very political cases, the D.C. Circuit vacated SEC rules on the basis of the agency’s failure to conduct an adequate cost–benefit analysis.<sup>74</sup> These cases could have been decided on other grounds. Three cases involved line drawing between state and federal law in

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“Major Rule” Analyses Subject to Executive Branch Review, ROPES & GRAY (Apr. 29, 2019), <https://www.ropesgray.com/en/newsroom/alerts/2019/04/Congressional-Review-Act-OMB-Memo-Would-Make-SEC-CFTC-and-Other-Independent-Agency-Major-Rule>.

71. Mark Schoeff Jr., *Trump Administration Puts Potential New Hurdle in Path of Regulation Best Interest*, INVESTMENTNEWS (Apr. 15, 2019), <https://www.investmentnews.com/article/20190415/FREE/190419959/trump-administration-puts-potential-new-hurdle-in-path-of-regulation>.

72. See generally Regulatory Flexibility Act, 5 U.S.C. § 603 (2018) (requiring federal agencies analyze the impact of regulations upon smaller entities); Paperwork Reduction Act, 44 U.S.C. § 3501 (2012) (requiring agencies to reduce the paperwork burden of the federal government); Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (codified in scattered sections of 5 U.S.C.) (regulating the regulator by more closely considering small business interests).

73. For example, in the SEC’s promulgation of Regulation A-Plus (referred to as Regulation A+), fifty-seven pages in the Federal Register are devoted to the details of the rule and twenty-four pages are devoted to a cost–benefit analysis and similar other analyses required by statute. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,807–88 (Apr. 20, 2015) (codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, 260).

74. See generally *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (holding the SEC Proxy Access Rule was arbitrary and capricious); *Chamber of Commerce of the U.S. v. SEC*, 443 F.3d 890 (D.C. Cir. 2006) (vacating portions of the SEC’s Exemptive Rules under the Investment Company Act of 1940); *Chamber of Commerce of the U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (remanding because of issues with the 75% independent condition and independent chairman condition); *Bus. Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (holding the SEC exceeded its authority when it issued a rule on voting power).

corporate governance matters, and the fourth case involved preemption of state insurance regulation. All these cases can be explained on the ground that the court believed the SEC was intruding too far into dictating the composition of corporate boards of directors or other matters better left to state law.<sup>75</sup> The plaintiffs in these cases were trade associations,<sup>76</sup> and in the cases involving the regulation of mutual funds the plaintiff—the Chamber of Commerce—had rather tenuous standing.<sup>77</sup> It is unclear exactly why the court used cost-benefit analysis to upend the regulations attacked by the plaintiffs. Perhaps the judges believed this was a less contentious ground than federalism, but the decisions have been criticized by some who think that courts should not be reviewing cost-benefit determinations by agencies.<sup>78</sup>

In 1975, in a non-securities law case, the Supreme Court stated that “[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”<sup>79</sup> Two years later, the Court decided *Santa Fe Industries v. Green*,<sup>80</sup> involving a claim of breach of fiduciary duty by a board of directors in a short-form merger.<sup>81</sup> The Court declined to apply Rule 10b-5<sup>82</sup> to regulate internal corporate mismanagement, stating “[a]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.”<sup>83</sup>

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75. Jeffrey Gordon agrees with this analysis. Gordon, *supra* note 41, at S353–54.

76. *See supra* note 74 and accompanying text.

77. *See id.*

78. *See* Gordon, *supra* note 41, at S353 (“If applied through the machinery of the legal system—especially hard-look judicial review that invites de novo relitigation of empirically contestable conjectures—BCA is likely to stymie regulation aimed at the reduction of systemic risk in favor of privileging a status quo that we know is unstable.”); Coates, *Cost–Benefit*, *supra* note 42, at 909; Jackson, *Comment*, *supra* note 50, at 55 (“I argue only that, whatever position one takes about the appropriate role of CBA in financial regulation, all should agree that the courts should play virtually no role in conducting or reviewing that analysis.”). It has been argued that these decisions are the product of Republican judges appointed by Reagan, but I do not agree with this somewhat facile explanation. It is true that Republican SEC commissioners issued dissents in these cases, but the decisions involving investment company boards were from a Commission chaired by William Donaldson, a Republican.

79. *Cort v. Ash*, 422 U.S. 66, 84 (1975).

80. 430 U.S. 462 (1977).

81. *Id.* at 464–65, 468.

82. 17 C.F.R. § 240.10b-5 (2019).

83. *Santa Fe Indus.*, 430 U.S. at 479.

This principle that state law should govern corporate internal affairs laws in the absence of federal preemption was later applied by the Court in cases involving investment companies.<sup>84</sup> In *Chamber of Commerce of the United States v. SEC*,<sup>85</sup> the D.C. Circuit had an opportunity to apply this principle to SEC rulemaking involving investment company governance.<sup>86</sup> Instead, it vacated a regulation on the ground of an inadequate cost-benefit analysis.<sup>87</sup> Functionally, the investment company is “a shell, a pool of assets consisting of securities, belonging to the shareholders of the fund.”<sup>88</sup> However, investment companies in the United States are organized as corporations and have separate advisors and underwriters. The investment company does not have employees and its investments are managed by an affiliated organization. These relationships give rise to a variety of conflicts of interest which are regulated under the Investment Company Act of 1940 (Investment Company Act).<sup>89</sup> Among other things, the Investment Company Act requires that at least 40% of the board of directors be independent or disinterested.<sup>90</sup> Directors who are not independent encompass a long list of persons who have some business or professional relationship with the investment company.<sup>91</sup>

Congress’s purpose in structuring the Investment Company Act in this way was to assign the disinterested directors the role of independent watchdogs to act as an independent check on the management of the investment company. Yet, because an investment company is the creature of its sponsor or advisor, questions persist as to whether independent directors can provide effective oversight of the contractual relationship between the fund and the advisor.<sup>92</sup>

Over the years, the SEC has conditioned a number of exemptions under the Investment Company Act upon review and approval by independent investment company directors. Because the Investment Company Act contains numerous sweeping prohibitions against transactions with affiliated entities which are, in fact, commonplace, reliance on these exemptions is necessary to permit investment companies to conduct ordinary business operations.<sup>93</sup>

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84. See *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 108 (1991); *Burks v. Lasker*, 441 U.S. 471, 477–80 (1979).

85. 412 F.3d 133 (D.C. Cir. 2005).

86. *Id.* at 133.

87. *Id.* at 144.

88. *Zell v. Intercapital Income Sec., Inc.*, 675 F.2d 1041, 1046 (9th Cir. 1982).

89. 15 U.S.C. §§ 80a (2012).

90. § 80a-10(a).

91. § 80a-2(a)(19) (including those affiliated with an advisor, underwriter, or broker).

92. See DIV. OF INV. MGMT., SEC, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 264–66 (1992), <https://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf>.

93. For example, the exemptions permit funds to purchase securities in a primary offering

In 2001—a time of debate over the corporate governance of public companies due to a series of accounting scandals—the SEC decided to require the boards of investment companies to have a majority of independent directors. While no apparent crisis of confidence with respect to mutual fund governance existed, the SEC made a general bid to regulate corporate governance and board composition, which resulted in the passage of Sarbanes–Oxley.<sup>94</sup> The SEC accomplished its goal to mandate that an investment company board be composed of a majority of independent directors by conditioning the operation of its exemptions under the Investment Company Act upon such a structure. Further, the SEC required the independent directors to select and nominate the new independent directors and to hire counsel with no substantial ties to a fund’s manager.<sup>95</sup> The SEC’s method for imposing its corporate governance ideas on mutual funds was not challenged by the fund industry, in part because many funds’ boards already had a majority of independent directors.<sup>96</sup>

After this rule was passed, the New York Attorney General began a widespread investigation in early September 2003 into the mutual fund industry by bringing an action involving late trading, deceptive market timing, and sales practices by mutual funds.<sup>97</sup> The SEC was already working on mutual fund reform when New York’s Attorney General brought these cases, but the actions of the Attorney General spurred the SEC to greater activism. During 2003, the SEC initiated sixteen rulemaking proceedings involving mutual

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where an affiliated broker-dealer is a member of the underwriting syndicate, Rule 10f-3, 17 C.F.R. § 270.10f-3 (2019), and permit the use of fund assets to pay distribution expenses. Rule 12b-1, 17 C.F.R. § 270.12b-1 (2019).

94. See generally Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C.) (Sarbanes–Oxley). See Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 79 (2005).

95. See generally Role of Independent Directors of Investment Companies, 66 Fed. Reg. 3734 (Jan. 16, 2001) (to be codified at 17 C.F.R. pts. 239, 240, 270, 274) (announcing final rules regarding the role of independent directors in investment companies that rely on certain exemptive rules of the Investment Company Act).

96. In my opinion, the SEC’s authority for changing the statutory standard of 40% independent directors to more than 50% could have been questioned since the statute would appear to grant a mutual fund the right to have up to 60% of its directors be nonindependent.

97. See Complaint at 2–4, *State v. Canary Capital Partners*, No. 2003-402830, 2003 WL 25691660 (N.Y. Sup. Ct. Sept. 3, 2003), [https://ag.ny.gov/sites/default/files/press-releases/archived/canary\\_complaint.pdf](https://ag.ny.gov/sites/default/files/press-releases/archived/canary_complaint.pdf); see also Ann Davis et al., *Fund Probe Turns to Wall Street; Most Major Securities Firms Face SEC Demands for Data; Agency Queries Eighty Mutual Funds*, WALL ST. J. (Sept. 10, 2003), <https://www.wsj.com/articles/SB106314336070206800>.

funds.<sup>98</sup> After the scandals broke, the SEC and state regulators brought enforcement actions against nearly half of the largest mutual fund companies.<sup>99</sup> These cases involved improper trading, abusive sales practices, and other matters. Because of these problems, the SEC commenced further corporate governance and other reforms of fund practices. The SEC determined, among other things, that any fund relying on exemptions under the Investment Company Act must have a board comprised of at least 75% independent directors and a chairman of the board who is an independent director.<sup>100</sup> This rule was then attacked and vacated in part in *Chamber of Commerce of the United States v. SEC*.<sup>101</sup>

The D.C. Circuit held that the SEC had authority to pass this rule and could leverage its exemptive authority under the Investment Company Act to regulate mutual fund corporate governance.<sup>102</sup> The court's decision was grounded on two rationales. First, the court held that the rule was related to a basic purpose of the Act—the tempering of conflicts of interest inherent in the structure of investment companies.<sup>103</sup> In this regard, the court distinguished between the SEC's powers with respect to investment company corporate governance and its powers related to other public companies by invoking its prior decision in *Business Roundtable v. SEC*;<sup>104</sup> moreover, the court suggested the SEC lacked the power under the Exchange Act to generally mandate a separation of the CEO or Chairman positions.<sup>105</sup> The court also interpreted the language of § 10(a) of the Investment Company Act that a fund may have no more than 60% independent directors<sup>106</sup> to be a minimum, not a maximum, standard. The court further held that the SEC's rule “was not arbitrary, capricious, or in any way an abuse of its discretion, in

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98. See *Mutual Funds: Trading Practices and Abuses that Harm Investors: Hearing Before the Subcomm. on Fed. Fin. Mgmt. of the S. Comm. on Homeland Sec. & Governmental Affairs*, 108th Cong. 1–2 (2003) (statement of Paul F. Roye, Director, Division of Investment Management, SEC), <https://www.hsgac.senate.gov/imo/media/doc/110303roye.pdf>.

99. See Paul F. Roye, Dir., Div. of Inv. Mgmt., SEC, Speech by SEC Staff: Remarks Before the ICI General Membership Meeting (May 20, 2004), <http://www.sec.gov/news/speech/spch052004pfr.htm>.

100. Investment Company Governance, 69 Fed. Reg. 46,378, 46,382 (Aug. 2, 2004) (to be codified at 17 C.F.R. pt. 270).

101. 412 F.3d 133, 145 (D.C. Cir. 2005).

102. *Id.* at 136.

103. *Id.* at 138–39.

104. 905 F.2d 406 (D.C. Cir. 1990).

105. *Id.* at 416–71.

106. 15 U.S.C. § 80a-10(a) (2012).

violation of the APA” because the SEC can undertake prophylactic responses to perceived risks of conflicts of interest in crafting exemptions.<sup>107</sup>

Nevertheless, the court held that the SEC violated the APA by failing to consider the costs imposed on funds by the new rule separating the Chairman and CEO and suggested alternatives, particularly a disclosure alternative.<sup>108</sup> This holding essentially endorsed the dissenting views of Commissioners Atkins and Glassman when the rule was adopted.<sup>109</sup> On June 30, 2005, nine days after the Court of Appeals opinion was released, the SEC reaffirmed its promulgation of the rule, claiming that it had decided that the benefits of the rule outweighed its costs and disclosure of investment company conflicts of interest were of limited utility. In fact, the primary justification for the affirmation appeared to be that Chairman Donaldson was resigning the next day. Commissioners Glassman and Atkins filed two strong dissents.<sup>110</sup>

The SEC did not reopen its rulemaking for further comment on the ground that it had previously called for comment on the costs of complying with the new rule. However, based on materials not in the rulemaking record, including a widely used industry survey, the SEC determined a range of costs for the options a fund might use to meet the 75% independent director condition. With regard to the new requirement for an independent chair, the SEC assumed costs would derive principally from increased compensation and additional staff. The SEC then concluded that the costs would be extremely small relative to fund assets for which boards are responsible and relative to the expected benefits. The SEC also asserted that nearly 60% of all funds then met the 75% independent director requirement.

The D.C. Circuit held that, although the SEC was not required to engage in additional fact gathering on remand, the agency’s extensive reliance upon extra-record materials in arriving at its cost estimates required further opportunity for comment.<sup>111</sup> Since these materials were primary and not merely supplementary, the court held that the SEC violated the comment requirement of the APA.<sup>112</sup> However, vacating the rule which a majority of funds had already complied with would be disruptive, so the court decided to vacate

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107. *Chamber of Commerce of the U.S.*, 412 F.3d at 141.

108. *Id.* at 136.

109. Investment Company Governance, 69 Fed. Reg. 46,378, 46,390–93 (Aug. 2, 2004) (to be codified at 17 C.F.R. pt. 270) (comments of dissenting Commissioners faulting the promulgation of the rule for failure to properly consider costs of implementation as well as less costly alternatives).

110. Investment Company Governance, 70 Fed. Reg. 39,390, 39,403, 39,405–06 (July 7, 2005) (to be codified at 17 C.F.R. pt. 270) (comments of dissenting Commissioners lambasting the Commission’s rushed response in light of the circumstances).

111. *Chamber of Commerce of the U.S.*, 412 F.3d at 142–44.

112. *Id.*

for ninety days the 75% independent director and independent chair conditions.<sup>113</sup> After a new Chairman was appointed, the SEC did not go forward with this rulemaking or case.<sup>114</sup> Nevertheless, most mutual funds voluntarily conformed their governance to the SEC's regulation.<sup>115</sup>

Another rebuff to the SEC based on an inadequate cost-benefit analysis was the decision in *American Equity Investment Life Insurance v. SEC*,<sup>116</sup> in which the D.C. Circuit Court vacated Rule 151A—categorizing fixed index annuities as securities—under the Securities Act.<sup>117</sup> Although annuities are exempt from the Securities Act, variable annuities are not.<sup>118</sup> In the mid-1980s, the SEC passed Rule 151 to provide an exemption from the Securities Act for guaranteed investment contracts which were subject to state insurance regulation where the insurer assumes the investment risk under the contract and the contract is not marketed primarily as an investment.<sup>119</sup>

In the mid-1990s, insurance companies began marketing fixed index annuities, but the SEC did not attempt to regulate them until 2007 when it passed Rule 151A. By this time, the amount of such assets totaled \$123 billion.<sup>120</sup> The decision vacating this rule is curious. First, the court did an analysis under the *Chevron* doctrine and found that the exemption for annuities was ambiguous, but the SEC's rule was reasonable.<sup>121</sup> Then the court found the SEC contravened § 2(b) of the Securities Act because it failed to adequately consider the efficiency, competition, and capital formation effects of the Rule 151A; therefore, promulgation of Rule 151A was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law under the APA.<sup>122</sup> Although the subject matter of this case involved an intersection between federal and state regulation of an insurance company product, the court did not examine whether state regulation of the product was adequate or comprehensive.

113. *Chamber of Commerce of the U.S. v. SEC*, 443 F.3d 890, 909 (D.C. Cir. 2006) (remanding to the SEC to address cost issues).

114. THOMAS P. LEMKE, ET AL., 1 REGULATION OF INVESTMENT COMPANIES § 6.03[1] (2019).

115. *See Chamber of Commerce of the U.S.*, 443 F.3d at 908 (noting that nearly 60% of mutual funds had already complied).

116. 613 F.3d 166 (2010).

117. *Id.* at 167–68, 179 (defining fixed index annuities as “hybrid financial product[s] that combine[] some of the benefits of fixed annuities with the added earning potential of a security”).

118. *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211–12 (1967) (citing *SEC v. Variable Annuity Life Ins. Co. of Am. (VALIC)*, 359 U.S. 65 (1959)).

119. 17 C.F.R. § 230.151(a) (2019).

120. *American Equity Inv. Life Ins.*, 613 F.3d at 170.

121. *Id.* at 173–74.

122. *Id.* at 177–79.

Another example of a case in which the D.C. Circuit struck down an SEC rule in the governance area is the SEC's proxy access rule in *Business Roundtable v. SEC*.<sup>123</sup> Since it was more difficult for the court to claim that the SEC had no role in the corporate governance of public companies after Sarbanes–Oxley and since Congress gave the SEC authority to pass a proxy access rule in Dodd–Frank,<sup>124</sup> the court had some difficulty in determining that the SEC rulemaking was beyond its authority. Therefore, it upheld the proxy access rule on the basis of an inadequate cost–benefit analysis.<sup>125</sup>

The regulation of proxy voting has resided at the intersection between federal and state law since the Exchange Act was passed in 1934. Although state law controls the holding of annual meetings to elect directors and the corporate governance aspects of proxy voting, federal securities laws control the solicitation of proxies. In 1977, shareholder activists began trying to persuade the SEC to revise rules to allow competing shareholder nominees to be included in opposition to the board of directors' nominees. Following a 2003 SEC staff report,<sup>126</sup> the SEC proposed a series of controversial rules to allow proxy access by institutional investors, but it was not until 2010 that Rule 14a-11 to this effect was finally adopted.<sup>127</sup>

Corporate voting rights are generally fixed by a corporation's charter. The nature and extent of shareholder voting rights, as well as the mechanics of holding annual meetings to elect directors, are generally specified by state law. Yet, because shareholders in public companies are geographically dispersed, proxy voting is the dominant mode of shareholder decisionmaking, and the SEC regulates solicitation of proxies by public companies. Section 14(a) of the Exchange Act<sup>128</sup> makes it unlawful for any person to solicit any proxy, consent, or authorization with respect to any security registered

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123. 647 F.3d 1144 (D.C. Cir. 2011).

124. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 971, 124 Stat. 1376, 1915 (2010) (codified as amended at 15 U.S.C. § 78n(a) (2012)).

125. *Bus. Roundtable*, 647 F.3d at 1156 (lambasting the SEC's renationalization of cost as “unutterably mindless”).

126. *See generally* DIV. OF CORP. FIN., SEC, STAFF REPORT: REVIEW OF THE PROXY PROCESS REGARDING THE NOMINATION AND ELECTION OF DIRECTORS (2003), <https://www.sec.gov/news/studies/proxyreport.pdf> (recommending rules to allow shareholders to place their director nominees on the corporation's proxy materials after SEC Staff of the Division of Corporate Finance completed a review of SEC rules and regulations regarding director nominations and elections).

127. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,668, 56,782 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

128. 15 U.S.C. § 78n(a) (2012).

under § 12 of the Exchange Act<sup>129</sup> in contravention of the SEC's proxy rules.<sup>130</sup>

In addition to prescribing the materials that must be sent to stockholders with a proxy solicitation, the proxy rules provide the right to make shareholder proposals, which the company is required to include in its proxy solicitation as long as the proponent meets all of the requirements of Rule 14a-8. Until Rule 14a-8 was amended, simultaneously with the SEC's adoption of proxy access in Rule 14a-11, Rule 14a-8(i)(8) permitted corporations to omit any shareholder proposal that related to an election to office.<sup>131</sup>

In 2003 and 2007, the SEC proposed proxy access rules, which were never finalized because of intense opposition and the lack of consensus at the Commission level.<sup>132</sup> Both proposals would have limited proxy access to large shareholders who had held stock for a long period of time. In connection with these proposed rules, the SEC put out suggestions to change the exclusion for shareholder proposals relating to elections.<sup>133</sup>

In the meantime, the SEC's interpretation of its shareholder proposal rule was challenged in *American Federation of State, County & Municipal Employees v. American International Group, Inc.*<sup>134</sup> The Second Circuit invalidated the SEC's interpretation of Rule 14a-8(i)(8) and challenged the SEC to reinterpret the election exclusion or pass a new rule.<sup>135</sup> In response, the SEC confirmed its position that shareholder proposals that could result in an election contest may be excluded under Rule 14a-8(i)(8), but sought comment as to whether the text of the rule should be changed.<sup>136</sup> The SEC's reaffirmation of its interpretation of Rule 14a-8(i)(8), and its 2007 proxy access rule proposal were both put out by a 3–2 vote, with Chairman Christopher Cox voting with the two Democratic commissioners on the proxy access rule proposal and with the two Republican commissioners with regard to the interpretative release on Rule 14a-8.

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129. § 78l.

130. 17 C.F.R. §§ 24014a-3–17 (2019).

131. § 14a-8(i)(8).

132. *See* Security Holder Director Nominations, 68 Fed. Reg. 60,784, 60,784–85 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274) (proposing rules requiring companies to give shareholders access to corporate proxy materials in certain circumstances for inclusion of director nominees); Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 43,488, 43,492 (proposed Aug. 3, 2007) (to be codified at 17 C.F.R. pt. 240) (proposing a rule that would regulate shareholder director nominations that are not control-related).

133. Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. at 43,492–93.

134. 462 F.3d 121, 125 (2d Cir. 2006).

135. *Id.* at 129–31.

136. Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. at 43,492.

This political impasse at the Commission level shifted with the election of President Obama and Mary Schapiro's accession to SEC Chairman. In 2010, the SEC adopted Rule 14a-11, which provided that shareholders or a group of shareholders who have held 3% of a company's voting securities for at least three years prior to the date of a director nomination could nominate up to 25% of the directors of a board. This rule was applicable to both public companies and investment companies. The two Republican commissioners dissented from the promulgation of the rule.

In holding that the SEC acted arbitrarily and capriciously for failing adequately to assess the economic effects of its proxy access rule, the D.C. Circuit in *Business Roundtable* determined that the SEC failed to appreciate the intensity with which issuers would oppose nominees pursuant to Rule 14a-11 and did not adequately assess the costs and frequency of potential election contests.<sup>137</sup> Very importantly, the court also asserted that the SEC acted arbitrarily and capriciously by failing to consider how union and state pension funds might utilize Rule 14a-11 to gain concessions unrelated to shareholder value.<sup>138</sup> It is this finding that comes to grips with the political issue at the heart of the proxy access debates.

Not all shareholders believe that proxy access would be desirable or that a greater number of proxy contests would increase shareholder values. The advocates for proxy access have primarily been union and government pension funds. Mutual funds have opposed proxy access both as applied to their own organizations and as investors in other companies. Retail investors do not seem to have been considered in the SEC's deliberations since few of them would own a sufficient number of shares to take advantage of proxy access. The D.C. Circuit Court chastised the SEC for its inadequate cost-benefit analysis and for passing a rule for the benefit of only certain investors.<sup>139</sup>

Since the petitioners who sued the SEC to abrogate Rule 14a-11 did not also attempt to strike down the SEC's amendment to Rule 14a-8, the SEC determined that this amendment would become final. It therefore became possible for shareholders to make proposals to alter the procedures for electing directors and to request proxy access by-laws. Delaware eagerly jumped into this fault line between SEC and state regulation of proxy access; through court decision<sup>140</sup> and legislation,<sup>141</sup> proxy access became a matter of private ordering rather than SEC regulation.

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137. *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1153 (D.C. Cir. 2011).

138. *See id.* (noting comments that anticipated investors pursuing self-interested objectives rather than those of unions and state and local governments).

139. *Id.* at 1152.

140. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 240 (Del. 2008).

141. H.B. 19, 145th Gen. Assem. (Del. 2009) (enacted and added to § 112 to Del. Code, tit. 8).

In this case, inadequate cost–benefit analysis was a somewhat thin reed for the D.C. Circuit to rest its invalidation of the SEC proxy access rule since, as the foregoing shows, the SEC had been considering this regulation for many years and there was a voluminous comment record favoring the new rule. The decision was a political policy rejection of the SEC’s intrusion into corporate internal affairs. The court simply made use of an available administrative law tool—cost–benefit analysis—to justify its determination. Nevertheless, the foregoing decisions were a wake-up call to the SEC to revise and improve its methodology for cost–benefit analysis in rulemaking. The SEC also was further pressured to beef up its cost–benefit methodology by a report of the GAO<sup>142</sup> and a report of the SEC Inspector General.<sup>143</sup>

In September 2009, the SEC created the DERA to integrate financial economics and rigorous data analytics into the SEC’s core mission. In 2012, the Office of Risk, Strategy and Financial Innovation and the Office of the General Counsel of the SEC prepared a memorandum to all rule writing divisions and offices setting forth a methodology for cost–benefit analyses.<sup>144</sup> This Guidance outlined the features of a cost–benefit analysis for rulemaking as follows:

- (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.<sup>145</sup>

The SEC’s methodology for creating a cost–benefit analysis differs from OIRA’s methodology and has been criticized on that ground.<sup>146</sup> Other criticisms also have been leveled at the SEC’s methodology, but the D.C. Circuit seems pacified. The SEC’s new effort for preparing a cost–benefit analysis in rulemaking became an issue in the many rules—some quite controversial—that the SEC was required to pass pursuant to Dodd–Frank and the JOBS Act. Ironically, the D.C. Circuit has not vacated any of the rules implementing these statutory provisions.

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142. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-12-151, DODD–FRANK ACT REGULATIONS: IMPLEMENTATION COULD BENEFIT FROM ADDITIONAL ANALYSES AND COORDINATION 9–12, 37–39 (2011).

143. OFFICE OF INSPECTOR GEN., SEC, FOLLOW-UP REVIEW OF COST-BENEFIT ANALYSES IN SELECTED SEC DODD–FRANK ACT RULEMAKINGS, REPORT NO. 499 12–14 (2012).

144. Memorandum from SEC, Div. of Risk, Strategy & Fin., and SEC, Office of the Gen. Counsel, to Staff of the Rulewriting Divs. & Offices regarding Current Guidance on Economic Analysis in SEC Rulemakings, 1 (Mar. 16, 2012), [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_secrulemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf).

145. *Id.* at 4.

146. Yoon-Ho Alex Lee, *The Efficiency Criterion for Securities Regulation: Investor Welfare or Total Surplus?*, 57 ARIZ. L. REV. 85, 89–90 (2015).

For many years, the SEC was afforded deference by the courts to its rulemaking. In recent years, however, the D.C. Circuit has given the SEC little deference. What happened? I believe two developments account for this change. First, Washington has become extremely political and dysfunctional, and judges—along with the public—no longer respect expertise. Second, as long as the SEC was limited to the regulation of the securities industry, and the securities industry generally went along with SEC regulation, there were few challenges to SEC rulemaking. When the SEC's remit spread to general corporations, however, beginning with Sarbanes–Oxley in 2002 and then further expanded by Dodd–Frank, business interests began to aggressively push back against SEC rulemaking. Certain well-funded trade associations, especially the U.S. Chamber of Commerce led by Tom J. Donohue, and the Business Roundtable, have targeted SEC rulemaking.<sup>147</sup>

Cost–benefit analysis has been thrust upon the SEC and it has endeavored to comply with this assignment, but by and large neither the costs nor the benefits of new rules are reasonably ascertainable. When the D.C. Circuit disagrees with a policy encapsulated into an SEC rule, defects with the SEC's cost–benefit analysis is an easy basis for vacating the rule. Of course, one could argue that *Chevron* deference is similarly an easy way for a court to uphold a new SEC rule.<sup>148</sup>

The APA requires all proposed rules to be published in the Federal Register. Most SEC rule proposals are detailed and lengthy. Affected business interests and the public then have time to comment on the rules, and these comments are painstakingly reviewed by the SEC's staff. After this long and transparent process, good government would not seem to require that business interests get another bite at the apple by taking the SEC to court and attacking new rules on grounds that do not really go to the merits of the rule or obvious procedural defects in the rulemaking process. This is a game of raw politics that is a disservice to the SEC, the public, and even regulated business interests.

#### D. *Dodd–Frank and JOBS Act Rulemaking*

Where new rulemaking is conducted pursuant to a regulatory mandate, the response of the courts to a cost–benefit analysis challenge has been different than in the cases discussed above. Similarly, the courts have been

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147. They have been helped in their efforts by cases successfully prosecuted by Eugene Scalia, son of Antonin Scalia, before a conservative D.C. court. See Patrick Caldwell, *Did You Know That Antonin Scalia's Son Is Sabotaging Wall Street Reform?*, MOTHER JONES (July–Aug. 2014), <http://www.motherjones.com/politics/2014/07/eugene-scalia-court-antonin-financial-reform>.

148. *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984) (stating that “[i]f Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation”).

unsympathetic to a lack of a cost–benefit analysis by the SEC when the Commission has engaged in deregulation.

Dodd–Frank is a formidable regulatory statute which required more than twenty federal agencies to promulgate 400 new rules.<sup>149</sup> The SEC was given a particularly heavy workload—required to engage in ninety mandatory rule-making proceedings and twenty studies.<sup>150</sup> The SEC had little discretion with regard to many of the particularly controversial rulemaking proceedings. This did not stop business groups from attempting to strike down new SEC rules on cost–benefit and other grounds. Where the SEC had so little maneuverability, the D.C. Circuit did not accept the cost–benefit challenges to the new rules, although it did strike down parts of the rules on other grounds.<sup>151</sup>

Even before the SEC completed its assigned rulemaking tasks pursuant to Dodd–Frank, Congress passed the JOBS Act, a deregulatory statute. Deregulatory rulemaking is subject to the same administrative law requirements as new regulations,<sup>152</sup> and in a case involving preemption of state blue-sky law, two state blue-sky commissioners sued the SEC to vacate a deregulatory rule, on cost–benefit grounds.<sup>153</sup> The D.C. Circuit upheld the SEC’s rule.

Some of the rules Congress ordered the SEC to promulgate in Dodd–Frank did not even purport to be about investor protection. Section 1502 of Dodd–Frank mandated that the SEC require registered and reporting companies under the Exchange Act to disclose whether “conflict minerals” from the Democratic Republic of the Congo (DRC) or adjoining countries are necessary for the functionality or production of any of their manufactured products. The rationale for this rule was to achieve a humanitarian goal.<sup>154</sup>

The SEC carried out its conflict minerals mandate by adopting Rule 13p-1 and Form SD. If an issuer determines it is covered by the conflict minerals rule, it must conduct a reasonable country-of-origin inquiry to determine

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149. Paul Rose & Christopher J. Walker, *Dodd–Frank Regulators, Cost–Benefit Analysis, and Agency Capture*, 66 STAN. L. REV. ONLINE 9, 9 (2013).

150. See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-13-195, FINANCIAL REGULATORY REFORM: REGULATORS HAVE FACED CHALLENGES FINALIZING KEY REFORMS AND UNADDRESSED AREAS POSE POTENTIAL RISKS 44 (2013), <https://www.gao.gov/assets/660/651401.pdf> (acknowledging the GAO’s recommendations around rulemaking).

151. See *infra* notes 156–158 and accompanying text.

152. *FCC v. Fox Television Servs., Inc.*, 129 S. Ct. 1800, 1811 (2009).

153. See *infra* notes 168–171 and accompanying text.

154. 15 U.S.C. § 78m(p) (2012). War in the Democratic Republic of the Congo (DRC) had led to the deaths of millions of civilians and it had been financed by groups profiting from the sale of conflict minerals, which are found in most electronic products and other consumer goods. The rule was intended to limit the purchases of the conflict materials by making consumers more informed on the products they were purchasing and to make companies aware of the conflicts the products were involved with funding.

whether these minerals originated in the DRC. If so, the issuer must exercise reasonable due diligence on the source and chain of custody of its conflict minerals and certify a third-party audit of those products that have not been found to be DRC conflict free.

The estimated costs of these efforts were thought to be huge. In making a cost–benefit analysis of Rule 13p-1, the SEC essentially accepted estimates of the National Association of Manufacturers and a Tulane Law School study. A scathing critique of the SEC’s cost estimates argued that quantified cost–benefit analysis should never have been imposed on the SEC and should be eliminated.<sup>155</sup> Regardless, the D.C. Circuit upheld the SEC’s cost–benefit analysis because the SEC “exhaustively analyzed the final rule’s costs,” and found that the rule would “impose competitive costs, but have relatively minor or offsetting effects on efficiency and capital formation.”<sup>156</sup> Further, the SEC argued that it lacked the data to quantify the benefits of the rule. The D.C. Circuit agreed, stating that “the rule’s benefits would occur half-a-world away in the midst of an opaque conflict about which little reliable information exists, and concern a subject about which the Commission has no particular expertise.”<sup>157</sup>

This holding could easily be applied to virtually all cases where the D.C. Circuit has analyzed SEC’s cost–benefit quantification. As to the conflicts-mineral rule, the court could not resist continuing to interfere with the SEC’s rulemaking. Despite upholding the Commission’s cost–benefit analysis, the court nevertheless decided to vacate a portion of the rule, holding that its “name-and-shame” feature violated the First Amendment.<sup>158</sup>

The conflict-minerals rule was generally controversial and unpopular. Attempts to repeal the rule have so far failed,<sup>159</sup> but the rule is no longer enforced.<sup>160</sup> There is some irony to this nonenforcement as a deregulatory initiative since companies had learned to develop procedures for complying

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155. Jeff Schwartz & Alexandra Nelson, *Cost–Benefit Analysis and the Conflict Minerals Rule*, 68 ADMIN. L. REV. 287, 290–94 (2016); see also Joshua T. White, *Quantified Cost–Benefit Analysis at the SEC*, 2 ADMIN. L. REV. ACCORD 53, 54–55 (2016).

156. Nat’l Ass’n of Mfrs. v. SEC, 748 F.3d 359, 369 (D.C. Cir. 2014).

157. *Id.* (further articulating the impracticability of quantifying the final rule’s benefits as it “would create an apples-to-bricks comparison”).

158. *Id.* at 372–73.

159. See *Conflict Minerals Face Uncertain Future*, NAT’L L. REV. (Oct. 6, 2017), <https://www.natlawreview.com/article/conflict-minerals-rule-faces-uncertain-future>.

160. See Michael S. Piwowar, Public Statement, *Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule*, SEC (Apr. 7, 2017), <https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule>.

with the rule and—due to pressure from activist investors—have continued to follow it.<sup>161</sup>

The foregoing cases were challenges from business groups. *Lindeen v. SEC*<sup>162</sup> was a challenge by the blue-sky commissioners of Massachusetts and Montana to a deregulatory rule, known as “Regulation A-Plus,” passed by the SEC pursuant to the JOBS Act. The challenge is of interest because it was an attack from the left—rather than the right—to SEC rulemaking, and also because the D.C. Circuit rejected a cost–benefit analysis challenge to the SEC’s rulemaking and instead applied the *Chevron* doctrine.<sup>163</sup>

Under § 3(b) of the Securities Act, the SEC has authority to exempt from the registration requirements an offering of a small amount or a limited public offering.<sup>164</sup> For many years, this exemption was limited to five million dollars or less, but the JOBS Act raised the amount to \$50 million. The JOBS Act also directed the SEC to revamp Regulation A to make it more desirable. The SEC complied by expanding Regulation A into two tiers—Tier 1 for offerings up to \$20 million and Tier 2 for offerings up to \$50 million.<sup>165</sup> Although the JOBS Act did not exempt offerings made under § 3(b)(2) from state law securities regulation requirements, Congress allowed the SEC to do so. Section 18(b)(4) of the Securities Act provides that § 3(b)(2) securities are “covered securities” for purposes of § 18 if they are offered or sold on a national securities exchange, or “offered or sold to a qualified purchaser.”<sup>166</sup> In crafting Regulation A-Plus, the SEC took advantage of this provision by defining a “qualified purchaser” as any person to whom securities are offered or sold in a Tier-2 Regulation A-Plus offering.<sup>167</sup> The SEC justified this preemption of state blue-sky laws based on limitations on investment amounts by purchasers in such offerings, the provision of audited financial statements, and a requirement for annual reporting.

State blue-sky commissioners sued the SEC, arguing that a “qualified purchaser” needed to be a credentialed purchaser. The D.C. Circuit rejected

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161. Marc Butler, *Why the Conflict Minerals Rule Refuses to Die*, INTELLIGIZE (June 21, 2018), <https://www.intelligize.com/why-the-conflict-minerals-rule-refuses-to-die/>.

162. 825 F.3d 646 (D.C. Cir. 2016).

163. *Id.* at 162–63, 165–66.

164. 15 U.S.C. § 77r (2012).

165. Amendments for Small and Additional Issues Exemption Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,903 (Apr. 20, 2015) (codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, 260).

166. 15 U.S.C. § 77r.

167. Amendments for Small and Additional Issues Exemption Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,899.

this challenge by giving the SEC *Chevron* deference.<sup>168</sup> One argument by the state securities regulators was that the SEC's rulemaking was arbitrary and capricious because its cost-benefit justification for Regulation A-Plus was too cryptic and did not adequately explain how Tier 2's safeguards would mitigate the cost of preemption or provide evidence regarding preemption costs. The D.C. Circuit gave short shrift to this argument by stating that the SEC was not required to "measure the immeasurable" or "conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so."<sup>169</sup>

The cases discussed in this Part are difficult to reconcile except on political grounds. Unfortunately, the partisanship in Congress has infected the SEC. Many commissioners are now chosen in pairs and both the Democratic and Republican commissioners frequently come from congressional staffs. They have continued congressional quarrels concerning financial regulation by issuing vigorous dissents from SEC rulemakings that have laid the ground for D.C. Circuit opinions, some of which also divide by party as the majority opinion adopts cost-benefit analysis, *Chevron* deference, or another form of statutory construction to justify striking down or upholding a new SEC rule.

#### E. *The Best Interest Rule*

The political struggles between the Executive, Legislative, and Judicial Branches, as well as the partisan struggles between Democrats and Republicans and between business and consumer advocates, can be seen impacting the regulatory responsibilities of the SEC in the battles leading up to the 2019 promulgation of a best interest rule for financial firms. The SEC's Regulation Best Interest (best interest rule or Regulation BI) occurred after a nine-year struggle to formulate a rule based on a simple and basic concept—brokers should put the interests of their customers ahead of their own interests when making a recommendation for the purchase or sale of a security.

The SEC's best interest rule has a long and tortured history. The problems with the promulgation of the rule are embedded in differences between the regulation of brokers and the regulation of investment advisers. The SEC articulated the relationship between brokers and their customers in the 1960's as the "shingle theory."<sup>170</sup> This doctrine—developed by the SEC in administrative law cases—is that brokers impliedly represent that they will

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168. *Lindeen*, 825 F.3d at 656–57 (holding that the SEC's definition of a qualified purchaser satisfied *Chevron* step two).

169. *Id.* at 658 (quoting Nat'l Ass'n of Mfrs. v. SEC, 748 F.3d 359, 369 (D.C. Cir. 2014)).

170. See *Hughes v. SEC*, 174 F.2d 969, 974–76 (D.C. Cir. 1949) (discussing the expected conduct of business for brokers and dealers in securities); see also Roberta S. Karmel, *Is the Shingle Theory Dead?*, 52 WASH. & LEE L. REV. 1271, 1273–80 (1995) (describing the shingle theory).

deal fairly with their customers and rests on an assumption that broker-dealers have fiduciary responsibilities to their clients. When a broker is acting as an agent such an assumption may rest on common law agency principles, but when a broker is acting as a principal or dealer, such an assumption may not be valid—at least under common law principles. Yet, broker-dealers commonly sell securities to both institutional and retail customers as principal, for example in initial public offerings or when securities are sold from a broker-dealer’s inventory. Further, securities firms often sell firm-created or proprietary products to their customers.

Investment advisers, by contrast, have been held to owe fiduciary duties to their customers by an early Supreme Court case interpreting the Investment Advisers Act of 1940 (Advisers Act).<sup>171</sup> An important difference between the regulation of broker-dealers and investment advisers is that broker-dealers are required by law to belong to a self-regulatory organization (currently the Financial Industry Regulatory Authority (FINRA))<sup>172</sup> but advisers have never established such a self-regulatory organization. Further, there are many more investment advisers than broker-dealers.

Although there is some question as to whether a customer can enforce the shingle theory in a securities case under the anti-fraud provisions,<sup>173</sup> most cases by customers against broker-dealers are prosecuted in FINRA arbitrations.<sup>174</sup> Instead of a general fiduciary duty regulation, FINRA has numerous specific rules enforcing obligations by brokers to their customers, including a very important suitability rule.<sup>175</sup>

While many financial firms are dually registered as broker-dealers and investment advisers, many are not. Customers may be only brokerage firm customers and not investment adviser customers, or they may be both. Historically, compensation by brokerage firm customers was transaction fee-based, whereas investment advisers charged fees based on assets under management. In 1995, a commission led by Daniel Tully, Chairman and CEO of Merrill Lynch, recommended that fee-based accounts at broker-dealers was a way to minimize conflicts of interest between brokers and retail

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171. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 191–92 (1963) (interpreting § 206 of the Investment Advisers Act).

172. 15 U.S.C. § 78o (2012) (outlining “registration and regulation of brokers and dealers”).

173. See Karmel, *Is the Shingle Theory Dead?*, *supra* note 170, at 1273–80.

174. See FINRA DISPUTE RESOLUTION TASK FORCE, FINAL REPORT AND RECOMMENDATIONS 1 (2015), <https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf> (“FINRA is, for all practical purposes, the sole arbitration forum in the United States for resolving disputes between broker-dealers, associated persons, and customers.”).

175. FINRA, RULE 2111: SUITABILITY (2014), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111#the-rule>.

customers.<sup>176</sup> The change in compensation from brokerage commissions to fees on assets in an account conveniently coincided with ever decreasing brokerage commission charges after the unfixing of commissions in 1975.<sup>177</sup>

The change in compensation for broker-dealers from transaction-based revenues to ongoing fees created a problem regarding the exemption from Advisers Act registration for broker-dealers. The Advisers Act excludes from the definition of “investment adviser” any broker or dealer that provides advisory services when such services are “solely incidental” to the conduct of the broker or dealer’s business and when such incidental advisory services are provided for no special compensation.<sup>178</sup> In 1999, the SEC proposed a rule exempting fee-based brokerage accounts from the fiduciary requirements of the Advisers Act. The Financial Planning Association perceived a threat to its fee-only investment advisers and sued the SEC; the D.C. Circuit vacated the SEC rule.<sup>179</sup>

These developments occurred in the context of a significant change in retirement savings by individuals. Many companies eliminated corporate-defined benefit compensation plans. For this reason and because of favorable tax treatment for individual retirement accounts (IRAs), there was a huge shift of individuals to IRAs and other individually managed retirement accounts.<sup>180</sup> The Obama Administration became concerned that retail investors were not being fully informed or fairly treated when making decisions about such accounts, particularly about roll overs of corporate benefit pensions into IRAs. Therefore, the Treasury Department released a report outlining ways to increase fairness for investors that proposed the SEC “[e]stablish a fiduciary duty for broker-dealers offering investment advice and harmonize the regulation of investment advisers and broker-dealers.”<sup>181</sup>

In 2010, there were two important developments that set up a conflict between the Department of Labor (DOL), an Executive branch agency, and the SEC. Dodd–Frank gave the SEC the authority to harmonize the fiduciary standard for brokers, dealers, and investment advisers who provide per-

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176. SEC, REPORT OF THE COMMITTEE ON COMPENSATION PRACTICES (1995), <https://www.sec.gov/news/studies/bkrcomp.txt>.

177. See Leslie Wayne, *Is Wall Street Ready for Mayday 2?*, N.Y. TIMES (Apr. 28, 1985), <https://www.nytimes.com/1985/04/28/business/is-wall-street-ready-for-mayday-2.html>.

178. 15 U.S.C. § 80b-2(a)(11) (2012).

179. *Fin. Planning Ass’n. v. SEC*, 482 F.3d 481, 493 (D.C. Cir. 2007).

180. James McWhinney, *The Demise of the Defined-Benefit Plan*, INVESTOPEDIA, <https://www.investopedia.com/articles/retirement/06/demiseofdbplan.asp> (last updated Feb. 18, 2020).

181. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATIONS 71 (2009), [https://www.treasury.gov/initiatives/Documents/FinalReport\\_web.pdf](https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf).

sonalized investment advice to clients.<sup>182</sup> Dodd–Frank also directed the SEC to conduct a study to evaluate “the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, . . . and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers . . . .”<sup>183</sup> Not content with giving the SEC discretion to shape such a study, the statute enumerated fourteen specific items for consideration.<sup>184</sup>

The SEC staff’s Study on Investment Advisers and Broker-Dealers was released in January 2011, over the dissenting votes of the two Republican SEC commissioners.<sup>185</sup> The study recommended that the SEC promulgate a harmonized uniform fiduciary standard for broker-dealers and investment advisers. However, there was a serious lack of consensus at the Commission regarding such a recommendation and so no such rule proposal was issued until 2018.<sup>186</sup>

In the meantime, in September 2010, the DOL issued a proposed rule designed to limit conflicts of interest for financial advisers working with client retirement accounts.<sup>187</sup> This rule would have applied not only to existing Employee Retirement Income Security Act (ERISA) “fiduciaries” but to broker-dealers, investment advisers, and insurance agents making recommendations to accounts regulated under ERISA and IRAs.<sup>188</sup> This rule proposal was extremely controversial because of its broad reach and because it purported to create a private right of action for breaches of the rule.<sup>189</sup> DOL withdrew its conflicts of interest rule in September 2011 and predicted it would issue a re-proposal in 2012.

In 2013, the SEC released a request for comment on the costs and benefits of a uniform fiduciary duty rule and harmonization of adviser and broker

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182. 15 U.S.C. § 78o note (2012) (Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers).

183. *Id.*

184. *Id.*

185. SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS (2011), <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

186. *See generally* Regulation Best Interest, 83 Fed. Reg. 21,574 (May 9, 2018) (to be codified at 17 C.F.R. pt. 240) (soliciting comments on the proposed rule establishing a code of conduct for those associated with a broker-dealer).

187. *See* JOHN J. TOPOLESKI & GARY SHORTER, CONG. RESEARCH SERV., R44884, DEPARTMENT OF LABOR’S 2016 FIDUCIARY RULE: BACKGROUND AND ISSUES 7–8 (2017), <https://crsreports.congress.gov/product/pdf/R/R44884>.

188. *See* Stephen Miller, *DOL’s Proposed Definition of “Fiduciary” Draws Fire, Support*, SHRM (Feb. 16, 2011), <https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/fiduciarydebate.aspx>.

189. *Id.*

regulations.<sup>190</sup> This release resembled a July 2011 proposal of the Securities Industry and Financial Markets Association (SIFMA). Also in 2013, Thomas Perez was confirmed as Secretary of DOL and promised to listen to stakeholders before deciding how to proceed with a fiduciary rule.<sup>191</sup> Then, in 2015, President Obama directed the DOL to re-propose its fiduciary rule and protect retirees from conflicted advice.<sup>192</sup> The DOL did so in April 2015 by proposing a rule that required fiduciary advice for all retirement accounts, including IRAs. The DOL held four days of hearings and received 3,000 comment letters—many of them negative. During the fall of 2015, the financial industry, Republican lawmakers, and Republican SEC Commissioner Daniel Gallagher attacked the DOL rule. Legislation was introduced to block the rule, which Democratic Senator Elizabeth Warren and supportive consumer groups opposed.<sup>193</sup>

Some of the opposition to the DOL rule that came from the securities industry argued that the SEC, not the DOL, should be passing a fiduciary rule to avoid having two sets of rules for brokerage accounts. The SEC did not, however, have the votes for such a rule. In 2015, SEC Chairman Mary Jo White announced her personal support for a fiduciary duty rule but cautioned that she did not have sufficient Commission support.

On April 6, 2016, DOL released the final version of its fiduciary rule.<sup>194</sup> The Chamber of Commerce promptly filed a lawsuit to vacate the rule. Although the DOL's rule was upheld in the district court, it was vacated in a split decision by the Fifth Circuit.<sup>195</sup> The grounds for the court's opinion were that the rule exceeded the DOL's statutory authority because it applied to IRA accounts and that it was arbitrary and capricious because it only applied to certain insurance company products.<sup>196</sup>

On June 5, 2019, the SEC finally approved Regulation BI, in a split vote. The sole Democratic Commissioner, Robert Jackson, dissented. Kara Stein, a former Democratic Commissioner, had dissented from the proposed rule,

190. Duties of Brokers, Dealers, and Investment Advisors, 78 Fed. Reg. 14,848, 14,848 (Mar. 7, 2013).

191. Melanie Waddell, *DOL Chief Perez Prepared to Explain Final Fiduciary Rule*, THINKADVISOR (Mar. 28, 2016), <https://www.thinkadvisor.com/2016/03/28/dol-chief-perez-prepared-to-explain-final-fiduciary-rule/>.

192. TOPOLESKI & SHORTER, *supra* note 187, at 8.

193. Mark Schoeff Jr., *As DOL Fiduciary Rule Heats Up, Both Sides Dig In*, INVESTMENTNEWS (Oct. 27, 2015), <https://www.investmentnews.com/article/20151004/FREE/310049995/as-dol-fiduciary-heats-up-both-sides-dig-in>.

194. Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,946 (Apr. 8, 2016).

195. Chamber of Commerce of the U.S. v. Dep't of Labor, 885 F.3d 360, 388 (5th Cir. 2018).

196. *Id.* at 387–88.

which she dubbed “regulation status quo.”<sup>197</sup> The SEC’s Consumer Advocate also criticized the final rule and related interpretative releases regarding the investment adviser exemption for broker-dealers. This long saga is an example of partisan squabbling—set off by lobbying from industry and consumer groups—and power struggles between the Executive and Congress over the role of the SEC vis-à-vis the DOL.

The appropriate content of a fiduciary rule necessary to protect the savings of retail investors was perhaps lost in the fog of partisan warfare. This kind of Washington Theater, in my opinion, does not result in good government, but rather regulatory ossification.<sup>198</sup> Regulation BI’s adopting release is 771 pages of explanation and cost-benefit analysis but it does not materially change broker customer relationships.<sup>199</sup> It does add extensive new disclosure and compliance obligations to brokers, continuing a rule-based regime rather than substituting a fiduciary standard. Regulation BI does outlaw some egregious conflict of interest sales practices including sales contests, sales quotas, bonuses, and noncash compensation based on the sales of specific securities or types of securities within a limited timeframe.

The SEC’s releases on the fiduciary duty of advisers may be the most controversial part of the SEC’s best interest rule. The exemption from the Advisers Act for brokers is maintained. Critics of Regulation BI have complained that the SEC’s releases on the duty of advisers purports to weaken the fiduciary duty standard applicable to advisers.<sup>200</sup>

In general, Regulation BI maintains the differences between the regulation of investment advisers and broker-dealers. The policy mantra throughout the SEC’s adopting release is that retail investors should have a choice of fees and products. Regulation BI establishes a standard of conduct for broker-dealers when making a recommendation of a securities transaction or investment strategy to a retail customer, irrespective of wealth. To satisfy the best interest standard the broker-dealer must comply with four obligations: a disclosure obligation, a care obligation, a conflict of interest obligation, and a compliance obligation. According to the SEC’s adopting release, breach of Regulation BI will be judged by a negligence standard but there will be no

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197. See Tara Siegel Bernard, *S.E.C. Seeks to Require Brokers to Put Their Clients First*, N.Y. TIMES (Apr. 18, 2018), <https://www.nytimes.com/2018/04/18/business/sec-brokers-rules.html> (“Perhaps it would be more appropriate to call it regulation status quo.”).

198. Kathryn E. Kovacs, *Rules About Rulemaking and the Rise of the Unitary Executive*, 70 ADMIN. L. REV. 515, 547–48 (2018).

199. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,318 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240).

200. Jackson, *Final Rules Governing Investment Advice*, *supra* note 25; see SEC v. Capital Gains Research Bureau, 375 U.S. 180, 203–07 (1963) (Harlan, J., dissenting).

private right of action created. How this formulation will work out in FINRA arbitrations remains to be seen. The issue of whether a retail investor can sue for a breach of Regulation BI is one of the controversies dividing the Democrats and Republicans. The DOL fiduciary rule provided for such a claim.<sup>201</sup>

It is unlikely that Regulation BI will end the controversy over whether there should be a fiduciary duty obligation by brokers to their customers. Some state securities regulators do not believe the SEC's best interest rule is sufficiently robust to protect investors, and may pass regulations subjecting brokers to a fiduciary standard with regard to recommendations, advice, and the selection of account types.<sup>202</sup> The proposing release for Regulation BI references possible state regulations in conflict with the SEC's best interest rule and takes no position on whether such state regulations would be preempted by the SEC's regulation.<sup>203</sup>

If there is an attack on Regulation BI in the courts, should a court review the SEC's cost-benefit analysis? The cost-benefit analysis in the adopting release for Regulation BI could be a ground for attacking the rule. Ten former Chief Economists of the SEC sent a comment letter to the Commission in response to the Regulation BI proposal criticizing the SEC's cost-benefit analysis. According to the statement by SEC Commissioner Robert Jackson opposing the final rule, the SEC offered no new data to support the rule and ignored important new evidence regarding the imposition of a fiduciary standard for broker-dealer recommendations.<sup>204</sup>

The destructive power struggle between Democrats and Republicans and between the Obama White House, the Congress, and the SEC were certainly not in the interest of retail investors who must fend for themselves when switching from defined benefit plans to contribution plans like IRAs. It also seems contrary to the interests of businesses that keep attacking these rules but must plan to comply. This power struggle is also not in the public interest since a public that lacks sophistication about investments is unlikely to save wisely for retirement. Yet, it would not be appropriate for the courts to clean up this mess.

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201. See Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,020–21, 21,033 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2550).

202. Greg Iacurci, *Galvin to Propose Fiduciary Rule for Massachusetts Brokers*, INVESTMENTNEWS (June 14, 2019), <https://www.investmentnews.com/galvin-to-propose-fiduciary-rule-for-massachusetts-brokers-79969>.

203. It is highly unlikely that an SEC rule can preempt state securities law regulations. See generally Roberta S. Karmel, *Blue Sky Merit Regulation: Benefit to Investors or Burden on Commerce?*, 53 BROOK. L. REV. 105 (1987) (examining state merit regulation).

204. Jackson, *Final Rules Governing Investment Advice*, *supra* note 25.

## II. TARGETING INDEPENDENCE

### A. *Independence and Bi-Partisanship*

Independence has always been a hallmark of the SEC's structure and governance. As an independent agency, the SEC is supposed to be independent of the Executive Branch, but more importantly it should operate independently from the entities and industry it regulates. The purpose of its independence from the President is that regulated entities or persons under investigation can exert improper pressure on the SEC through the Executive.<sup>205</sup>

The President can influence the SEC in a variety of ways from appointing Chairs and Commissioners sympathetic to the President's political views, to proposing cuts in the Commission's budget, or by exerting influence on positions taken by the SEC in Supreme Court cases.<sup>206</sup> Yet, ideally, the Executive should not be interfering in SEC investigations or prosecutions and should allow the Commission to exercise its expertise in rulemaking.

The SEC's Rules of Organization, Conduct and Ethics provide:

[The SEC] is an independent Agency, and in performing their duties, members should exhibit a spirit of firm independence and reject any effort by representatives of the executive or legislative branches of the government to affect their independent determination of any matter being considered by the Commission. A member should not be swayed by partisan demands, public clamor or considerations of personal popularity or notoriety, so also he should be above fear of unjust criticism by anyone.<sup>207</sup>

In recent years, the SEC's independence has been undermined by partisan politics. By law, the SEC Chairman is appointed by the President, but no more than three out of five commissioners can be from the President's party. Historically, SEC commissioners came from a wide variety of backgrounds and were respected for their expertise. Although they may have had differences of opinion on Commission actions, these disagreements were not necessarily partisan. In recent years, however, appointments of Democratic and Republican commissioners have been paired and many commissioners have had a background as staffers in congressional committees with SEC oversight. Qualifications are based on ideological correctness and party loyalty rather than expertise. This has led to very contentious and partisan

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205. An example of such corrupt interference with the SEC's work was an effort by the Nixon White House to quash an SEC investigation of Robert Vesco, a notorious white-collar criminal. Sadly, this scandal led to the resignation and disbarment of an SEC Chairman. See ROBERTA S. KARMEL, *REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VERSUS CORPORATE AMERICA* 66–67 (1982).

206. Steven J. Cleveland, *Resurrecting Court Deference to the Securities and Exchange Commission: Definition of "Security"*, 62 CATH. U. L. REV. 273, 285–92 (2013).

207. 17 C.F.R. § 200.58 (2019).

decision making, with many 3–2 decisions, or even worse, 2–1 votes on important issues. Dissents have been designed to encourage appeals to the D.C. Circuit to overturn SEC rules. This partisanship has undermined the SEC's mission and credibility. It has made it difficult for the SEC to complete rule-making, even when it is mandated by statute. Furthermore, both Republicans and Democrats have fomented these partisan squabbles.

Efforts to inflict Presidential control on SEC rulemaking through cost–benefit analysis have been discussed above. The Carter Administration contemplated a different kind of initiative which threatened SEC control of its own litigation.<sup>208</sup> The securities laws provide authority for the SEC to bring injunctive actions in the district courts to prevent or curtail violations of those laws, but there is no express provision dealing with whether the SEC may represent itself or if it is required to be represented by the Department of Justice.<sup>209</sup> Historically, the SEC has represented itself in the district and circuit courts, in cases where the SEC is the plaintiff, or where the SEC or an SEC commissioner or staffer is a defendant, and in amicus curie briefs. When a case is in the U.S. Supreme Court, the Solicitor General takes charge of the matter, but an SEC attorney usually writes the brief and argues the case.<sup>210</sup> Not all agencies enjoy this independence. The SEC's authority to conduct its own litigation has been upheld in many court decisions.<sup>211</sup> It was also confirmed by Congress in hearings involving the Foreign Corrupt Practices Act legislation.<sup>212</sup>

President Carter, in the name of greater governmental efficiency, proposed giving control of SEC litigation to the Department of Justice. This grab for power came to nothing as Congress was disinclined to divest the SEC of its ability to independently litigate. The rationale for the SEC's control of litigation and its independence generally was articulated by the U.S. Supreme Court in 1947: When the SEC acts in an area in which it brings to bear its “administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the . . . facts,” its judgment is one which it is “best equipped to make” and which is “entitled to the greatest amount of weight.”<sup>213</sup>

More direct attacks on the SEC's independence originate from cases invoking the Appointments Clause. These cases are based to some extent on the unitary executive theory. The theory of the unitary executive, simply

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208. See *supra* text accompanying note 14.

209. 15 U.S.C. §§ 77t(a), 78u(e) (2012).

210. Letter from Harvey L. Pitt, Gen. Counsel, SEC, to Mr. F.T. Davis, Jr., Dir., Gen. Gov't Div., Off. of Mgmt. & Budget 2 (Dec. 6, 1977) (on file with author).

211. *Id.* at 2–7 (on file with author). It was also confirmed by Congress.

212. Unlawful Corporate Payments Act of 1977, H.R. REP. NO. 95–640, at 9–10 (1977).

213. SEC v. Chenery Corp., 332 U.S. 194, 209 (1947) (Jackson, J., dissenting).

stated, is the belief that the Constitution established an executive branch with complete control over all officials implementing the law.<sup>214</sup> Under this theory, a president has “plenary power to control administration and execution of the laws,” and restrictions on that power are anathema to the Constitution.<sup>215</sup> Unitary executive theorists take their cues first from the Vesting Clause of Article II, which declares that “[t]he executive Power shall be vested in a President,”<sup>216</sup> and the Take Care Clause, which tasks the President with seeing that “the Laws be faithfully executed.”<sup>217</sup> Unitary executive theorists conceive of a hierarchical executive authority with the President sitting at its head.<sup>218</sup>

There are gradations of the unitary executive ideology, the strongest of which grants a President full and absolute power to execute the laws, directly control the execution of those laws through his subordinates, and remove them at will.<sup>219</sup> Lesser forms of the unitary executive would grant the President veto authority over discretionary use of executive power by lesser officials, or to remove, at will, principal officers with whom he or she disagrees.<sup>220</sup> A still weaker form of the theory grants Congress “a wide degree of authority to structure government as it sees fit,”<sup>221</sup> while stronger forms increasingly require direct Presidential administrative control and bar congressional interference with Presidential authority over executive officers.<sup>222</sup>

One critic of the unitary executive theory has stated that it “is a theory no longer . . . . Each President exceeds his predecessor’s control of the Fourth Branch. ‘Presidential administration’ is morphing into autocracy.”<sup>223</sup> She blames this development on congressional and agency inertia, and the imposition of judicial rules on agency rulemaking.<sup>224</sup>

214. See, e.g., Steven G. Calabresi & Kevin H. Rhodes, *The Structural Constitution: Unitary Executive, Plural Judiciary*, 105 HARV. L. REV. 1153, 1158 (1992) (discussing Congress’s powers around executive officers); Lawrence Lessig & Cass R. Sunstein, *The President and the Administration*, 94 COLUM. L. REV. 1, 2 (1994) (exploring the concept of a unitary executive).

215. Lessig & Sunstein, *supra* note 214, at 7.

216. U.S. CONST. art. II, § 1, cl. 1.

217. U.S. CONST. art. II, § 3; Calabresi & Rhodes, *supra* note 214, at 1165–66.

218. Calabresi & Rhodes, *supra* note 214, at 1165–66.

219. Saikrishna B. Prakash, *Fragmented Features of the Constitution’s Unitary Executive*, 45 WILLAMETTE L. REV. 701, 701 (2009).

220. *Id.*

221. Lessig & Sunstein, *supra* note 214, at 9.

222. *Id.* at 8–9; Calabresi & Rhodes, *supra* note 214, at 1165–66; Prakash, *supra* note 219, at 701.

223. Kathryn E. Kovacs, *Rules About Rulemaking and the Rise of the Unitary Executive*, 70 ADMIN. L. REV. 515, 516 (2018).

224. *Id.* at 516–17.

### B. Administrative Law Judges

After the SEC determines that an enforcement investigation has uncovered evidence of a violation of the securities laws, the agency can institute an action for an injunction in a federal district court, refer the matter for criminal prosecution to the Department of Justice, or institute an administrative proceeding before an Administrative Law Judge (ALJ). Until 2018, ALJs were hired by the Commission's Office of Human Resources with input from the chief ALJ and the U.S. Office of Personnel Management. They were thus subject to competitive selection and were nonpolitical.<sup>225</sup> The Commission then had no direct role in hiring the ALJs.<sup>226</sup> Even though ALJs were SEC employees, their hiring process and other procedures were an effort to maintain their independence.

The administrative proceeding as an in-house forum has been in existence since the SEC was created, but until very recently was used only for cases against registered entities in the securities business, their associated persons, and accountants and lawyers. However, Dodd-Frank gave the SEC expanded authority to impose civil monetary penalties against persons associated with unregistered entities, for example, hedge fund employees or directors of public corporations, so that such proceedings could be brought before an SEC ALJ.<sup>227</sup> It also gave the SEC the authority to impose bans on persons in the securities industry from associating across the entire industry.<sup>228</sup> This increased scope for administrative proceedings given to the SEC by Dodd-Frank, led to increased criticisms of ALJ cases.

Several constitutional grounds were suggested as ways to attack the use of ALJs. The most viable was the Appointments Clause of Article II, Section 2, which provides that the President shall appoint all "Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law," but that "Congress may by Law vest the Appointment of such inferior Officers, as they think proper in the . . . Heads of Departments."<sup>229</sup> Other attacks were based on deprivation of the right to a jury trial under the Seventh Amendment, violation of the Due Process Clause due to the combination of prosecutorial and judicial powers in the SEC, and nondelegation.<sup>230</sup>

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225. 5 U.S.C. § 3105 (2012). See Kent Barnett, *Against Administrative Judges*, 49 U.C. DAVIS L. REV. 1643, 1654 (2016) (describing the process by which administrative law judges (ALJs) are appointed).

226. Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1, 4 (2015-16).

227. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1862-65 (2010).

228. § 925, 124 Stat. at 1850-51.

229. Platt, *supra* note 226, at 14.

230. *Id.* at 17-22.

In 2013, the SEC charged Raymond Lucia, who used his investment company to market a retirement strategy called “Buckets of Money” to prospective clients, with violating the Investment Advisers Act.<sup>231</sup> Lucia’s case was heard before ALJ Cameron Elliot, who determined following a hearing that Lucia had committed the violations and imposed substantial civil penalties and a lifetime industry ban.<sup>232</sup> Lucia appealed to the SEC, arguing that the entire proceeding against him was constitutionally invalid because Judge Elliot as an “Officer of the United States” had not been appointed through the permissible mechanisms.<sup>233</sup> The Commission concluded that ALJs were “mere employees” not governed by the Appointments Clause—and thus could be selected by persons other than those enumerated in the Constitution.<sup>234</sup> Lucia’s argument was then rebuffed twice more: first by a three judge panel of the D.C. Circuit<sup>235</sup> and then by an en banc rehearing where the ten judge panel divided evenly.<sup>236</sup> Asking for a resolution of the circuit split between D.C. and the Tenth Circuit,<sup>237</sup> Lucia made his way to the Supreme Court, where he finally found success.<sup>238</sup>

In 2018, the Supreme Court held in *Lucia v. SEC*<sup>239</sup> that the SEC’s ALJs qualified as “Officers of the United States” under the Appointments Clause of the Constitution, Article II, Section 2, Clause 2, meaning that they could only be appointed by the mechanisms outlined in the Constitution.<sup>240</sup> The Constitution limits the authority to appoint officers to “Courts of Law,” or “Heads of Departments” to the President.<sup>241</sup> The Commission’s ALJs were instead selected by staff.<sup>242</sup>

Justice Kagan, writing for a seven person majority, concluded that the Commission’s ALJs fall within the definition of “Officers of the United

231. *Lucia v. SEC*, 138 S. Ct. 2044, 2049 (2018).

232. *Id.* at 2049–50.

233. *Id.* at 2050.

234. *Id.*

235. *Lucia v. SEC*, 832 F.3d 277, 283–89 (D.C. Cir. 2016) (finding that the president does not need to appoint the SEC’s ALJs because their decisions are not final).

236. *Lucia v. SEC*, 868 F.3d 1021, 1021 (D.C. Cir. 2017) (declining to review the case in a per curiam opinion).

237. *Bandimere v. SEC*, 844 F.3d 1168, 1179 (10th Cir. 2016) (holding that the Commission’s ALJs were “inferior officers” and thus they “held [their] office[s] in conflict with the Appointments Clause . . .”).

238. *SEC v. Lucia*, 138 S. Ct. 2044, 2056 (2018) (reversing the judgment of the Court of Appeals and remanding the case for further proceedings consistent with this opinion).

239. 138 S. Ct. 2044 (2018).

240. *Id.* at 2049.

241. U.S. CONST. art. II, § 2, cl. 2.

242. 138 S. Ct. at 2049.

States” rather than “lesser functionaries.”<sup>243</sup> In determining this, Justice Kagan relied on three previous Supreme Court rulings to form the framework of her analysis: *United States v. Germaine*;<sup>244</sup> *Buckley v. Valeo*;<sup>245</sup> and *Freytag v. Commissioner*.<sup>246</sup> The Court in *Germaine* held that “civil surgeons” were merely employees, reasoning that to be an “Officer of the United States,” one must hold a “continuing and permanent” position, rather than an “occasional and intermittent” one.<sup>247</sup> Nearly a century later, the Court in *Buckley* added another element to the test: A position is governed by the Appointments Clause where the employees “exercise[d] significant authority pursuant to the laws of the United States.”<sup>248</sup>

*Freytag* held that the Tax Court’s special trial judges were officers because they: (1) held continuing office with ongoing and permanent duties, and (2) had significant authority because they presided over adversarial hearings.<sup>249</sup> Despite the fact that those Tax Court judges did not issue final decisions, they were still officers. Applying this to *Lucia*, the SEC’s ALJs clearly held continuing office established by law, a fact all conceded.<sup>250</sup> Further, like the special trial judges in *Freytag*, the ALJs presided with authority and discretion over adversarial hearings, wielding “nearly all the tools of federal trial judges.”<sup>251</sup> The ALJs were arguably even more independent than their *Freytag* analogs, Kagan noted, because the Commission does not always, though it can, review their decisions.<sup>252</sup> Therefore, “[i]f the Tax Court’s [special trial judges] are officers . . . then the Commission’s ALJs must be too.”<sup>253</sup> *Lucia*’s hearing was therefore an “adjudication tainted with an appointments violation,” the remedy for which was a new, constitutionally valid hearing before someone other than ALJ Elliott.<sup>254</sup>

The politicization of ALJs accomplished by *Lucia* is unfortunate. If ALJs become political appointees they are likely to have less expertise and less independence than previously. Furthermore, *Lucia*, like some of the other cases discussed in this Article, demonstrated a total indifference to the substantive

243. *Id.* at 2051 (citing *Buckley v. Valeo*, 424 U.S. 1, 126 n.162 (1976)).

244. 99 U.S. 508 (1879).

245. 424 U.S. 1 (1976).

246. 501 U.S. 868 (1991).

247. 99 U.S. at 511–12.

248. 424 U.S. at 126.

249. 501 U.S. at 891–92 (discussing the judicial functions of the Tax Court’s special trial judges).

250. *Lucia v. SEC*, 138 S. Ct. 2044, 2053 (2018).

251. *Id.*

252. *Id.* at 2053–54.

253. *Id.* at 2054.

254. *Id.* at 2055.

frauds committed by the defendant or the possible implications for the administration of the federal government's many agencies with numerous ALJs. This is one of the many problems with the type of judicial review of cases coming from administrative agencies like the SEC. The Court is a generalist reviewer with no accountability or responsibility for the smooth functioning of the administrative state.

*C. The Public Company Accounting Oversight Board*

The constitutionality of the Public Company Accounting Oversight Board (PCAOB) fared better than the SEC's ALJs, although the PCAOB was also subject to a serious attack pursuant to the Appointments Clause. The PCAOB is a nonprofit corporation composed of five members, appointed by the SEC after consultation with the Board of Governors of the Federal Reserve System and the Secretary of the Treasury. The PCAOB's mission is to "oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports."<sup>255</sup> The PCAOB also oversees audits of broker-dealers. The SEC approves the Board's rules, standards, and budgets.

The SEC was frustrated for many years in its efforts to effectively regulate the accounting profession because accountants were powerful and well-organized and because the securities laws did not contain a strong framework for the regulation of auditing. The accounting profession was self-regulated rather than directly regulated by the SEC. Although the SEC disciplined accountants pursuant to Rule 2(e), after the fact of auditing failures, the Commission's authority for establishing auditing standards was weak. After the Enron and WorldCom scandals, and numerous accounting restatements, Sarbanes-Oxley created the PCAOB to better regulate auditing.<sup>256</sup> The PCAOB was intentionally set up as an independent body to be insulated from interference by the accounting profession for the objective of more closely monitoring the accounting firms which audit public companies under the federal securities laws.<sup>257</sup> The Board was placed under the oversight authority of the SEC,<sup>258</sup> and Commissioners could remove the Board members only for good cause

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255. *About the PCAOB*, Pub. Co. Accounting Oversight Bd., <https://pcaobus.org/About/Pages/default.aspx> (last visited May 14, 2020).

256. 15 U.S.C. §§ 7213–15 (2012); *see* Steven B. Harris, Bd. Member of the PCAOB, Remarks to Kennesaw State Graduate Student Meeting (May 16, 2013), [https://pcaobus.org/News/Speech/Pages/05162013\\_Kennesaw.aspx](https://pcaobus.org/News/Speech/Pages/05162013_Kennesaw.aspx).

257. 15 U.S.C. § 7211; *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 484–85 (2010).

258. 15 U.S.C. § 7217(b)–(c).

with a formal Commission finding with “notice and opportunity for a hearing” which was subject to judicial review.<sup>259</sup>

Not surprisingly, this double independence structure was attacked as violating the President’s appointments power. In 2010, the Supreme Court held that the restraints placed on removal of Board members of the PCAOB violated Constitutional separation of powers by failing to sufficiently place the Board under the President’s control.<sup>260</sup> Chief Justice John Roberts found that the protections against removal afforded to Board members made the PCAOB unaccountable to executive authority, and thus, at odds with the Constitutional mandate that the President see that all laws are “faithfully executed.”<sup>261</sup>

The constitutional challenge to the Board was brought after it formally investigated the Nevada accounting firm Beckstead and Watts, LLP.<sup>262</sup> Watts and the Free Enterprise Fund (a nonprofit organization to which the firm belonged), sued the Board, asserting that the organization was constitutionally invalid and should be enjoined from exercising its authority.<sup>263</sup> The plaintiffs argued that: (1) the appointment of Board members was so far removed from Presidential control as to contravene separation of powers; and (2) that the appointment of Board members violated the Appointments Clause.<sup>264</sup> The District Court granted summary judgment to the government.<sup>265</sup> The D.C. Circuit affirmed this decision with a vigorous dissent by now-Supreme Court Justice Brett Kavanaugh.<sup>266</sup>

The pivotal issue was whether protections against at-will removal of Board members contravened separation of powers.<sup>267</sup> Executive authority extends to the “general administrative control of those executing the laws,” as confirmed in *Myers v. United States*,<sup>268</sup> and that must include the “power of removing those for whom he cannot continue to be responsible.”<sup>269</sup> A line of case law supports limitations on executive control over both the principal and inferior officers of agencies like the FTC, which the Court in *Humphrey’s Executor*

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259. § 7217(d)(3); *Free Enter. Fund*, 561 U.S. at 486.

260. *Free Enter. Fund*, 561 U.S. at 492, 495–98.

261. *Id.* at 484.

262. *Id.* at 487.

263. *Id.*

264. *Id.* at 487–88.

265. *Id.* at 488. The United States had intervened to defend the constitutionality of Sarbanes–Oxley. *Id.*

266. *Id.*; *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 537 F.3d 667, 685–715 (D.C. Cir. 2008) (Kavanaugh, J., dissenting).

267. *Free Enter. Fund*, 561 U.S. at 492, 502–08.

268. 272 U.S. 52 (1926).

269. *Id.* at 117, 164.

*v. United States*<sup>270</sup> distinguished as “quasi-legislative and quasi-judicial” and not “purely executive.”<sup>271</sup> The permission also extends to inferior executive officers like independent counsels who report to the Attorney General.<sup>272</sup>

The Court in *Free Enterprise Fund*, however, drew the line at restraining the president’s removal powers over inferior officers any further.<sup>273</sup> If, the Court reasoned, the Commission could remove a Board member at will and the President could then “hold the Commission to account for its supervision of the Board,” that would not unduly limit the President’s removal power and responsibility for executing the laws.<sup>274</sup> Sarbanes–Oxley, however, prevented at-will removal, leaving the President unable to hold the Commission accountable for the actions of the PCAOB.<sup>275</sup> The Commissioners could be accountable only for their determination of good cause or lack thereof, a determination the President could only upend if it “constitute[d] ‘inefficiency, neglect of duty, or malfeasance in office.’”<sup>276</sup> The Court described that structure as “not merely add[ing] to the Board’s independence, but transform[ing] it.”<sup>277</sup> The diminution of executive power was, in the Court’s view, untenable and “incompatible with the Constitution’s separation of powers.”<sup>278</sup> The Court did, however, find that the tenure provisions were severable from the rest of Sarbanes–Oxley, which remained in effect “with these tenure restrictions excised.”<sup>279</sup> Watts and Free Enterprise Fund’s remaining challenges to the Board under the Appointments Clause were rejected.<sup>280</sup>

Although the PCAOB survived its destruction, it was a very close call. Congressional efforts to insulate this new regulator from improper influence by the accounting profession created a complex agency within an agency. Whether this structure will prevent future accounting failures like Enron and WorldCom remains to be seen.

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270. 295 U.S. 602 (1935).

271. *Id.* at 628–29; *see also* *United States v. Perkins*, 116 U.S. 483, 485 (1886) (upholding limitations on the removal of inferior officers); *Free Enter. Fund*, 561 U.S. at 492–93 (summarizing precedent).

272. *Morrison v. Olson*, 487 U.S. 654, 663 (1988).

273. *Free Enter. Fund*, 561 U.S. at 495–98.

274. *Id.* at 495–96.

275. *Id.* at 496.

276. *Id.* (citing *Humphrey’s Executor v. United States*, 295 U.S. 602, 620 (1935)).

277. *Id.*

278. *Id.* at 498.

279. *Id.* at 509.

280. *Id.* at 510–14.

### III. THE END OF DEFERENCE?

The holding of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*<sup>281</sup> is that when a statutory provision is ambiguous, if the interpretation of the statute by a federal agency is “based on a permissible construction of the statute,”<sup>282</sup> the agency’s interpretation is to be given “controlling weight.”<sup>283</sup> Although many scholars believe such review is consistent with whether a decision is arbitrary or capricious under the APA,<sup>284</sup> the deferential review required by *Chevron* generally is outcome determinative.<sup>285</sup> *Chevron* deference is based on the rationale that judges are not experts and the judiciary is non-political. Therefore, agencies should resolve the “competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.”<sup>286</sup>

Since *Chevron* involved an executive branch agency and the language of the Court referred to the Chief Executive as the appropriate political branch to make policy choices, Randolph May has argued that *Chevron* deference should not be accorded to independent agencies since they are “less politically accountable than the executive branch with respect to their policymaking actions[.]”<sup>287</sup> This argument is a non sequitur since federal judges are less politically accountable than the Executive Branch or independent agencies. In addition, why should a generalist judge’s views trump the decision of an agency exercising expert judgment?

May also argues that independent agencies deserve less deference on a separation-of-powers principle.<sup>288</sup> But this seems a variation on general skepticism of independent agencies because they are more closely tied to Congress than to the Executive.<sup>289</sup> This alignment does not make them less accountable. It is basically a variation of the unitary executive theory discussed in Part II above.

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281. 467 U.S. 837 (1984).

282. *Id.* at 843.

283. *Id.* at 844.

284. APA, 5 U.S.C. §§ 551–559, 561–570a, 701–706, 706(2)(A) (2012); see Randolph J. May, *Defining Deference Down, Again: Independent Agencies, Chevron Deference and Fox*, 62 ADMIN. L. REV. 433, 434 n.5 (2010).

285. *Id.* at 434 n.6.

286. *Chevron*, 467 U.S. at 865–66.

287. May, *supra* note 284, at 435.

288. *Id.*

289. See Geoffrey P. Miller, *Independent Agencies*, 1986 SUP. CT. REV. 41, 63–64 (1986) (explaining and dismissing the “arm of Congress” theory of independent agencies).

Closely related to *Chevron* deference is *Auer*<sup>290</sup> or *Seminole Rock*<sup>291</sup> deference. These cases allow agencies to interpret their own regulations if the regulations are ambiguous. In *Kisor v. Wilkie*<sup>292</sup> the Supreme Court reaffirmed *Auer*, but Justice Gorsuch, in a long and contentious concurring opinion argued that *Auer* should be reversed.<sup>293</sup> He also suggested that the Court should review *Chevron* and overturn that case.<sup>294</sup> Other justices have made similar arguments and encouraged cases that would undermine or reverse *Chevron*.<sup>295</sup>

In *Kisor v. Wilkie*,<sup>296</sup> the Supreme Court took up the question of whether case law establishing the doctrine of deferring to agencies' reasonable interpretations of ambiguous regulations should remain good law.<sup>297</sup> The Court, in an opinion by Justice Elena Kagan, ultimately affirmed the doctrine, called either the *Auer*<sup>298</sup> or *Seminole Rock* doctrine,<sup>299</sup> but established and elaborated on its limitations and applications.<sup>300</sup> The *Kisor* opinion established that, for *Auer* deference to apply: (1) the regulation must remain genuinely ambiguous after a court has "exhaust[ed] all the 'traditional tools' of construction,"<sup>301</sup> and (2) the agency reading must be reasonable and within the bounds of permissible interpretation established by the court's attempts to interpret the rule.<sup>302</sup> Once proven to be a reasonable interpretation of a genuinely ambiguous rule, the interpretation must meet three more criteria for the

290. *Auer v. Robbins*, 519 U.S. 452 (1997).

291. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945).

292. 139 S. Ct. 2400 (2019).

293. *Id.* at 2425–48 (Gorsuch, J., concurring).

294. *Id.* at 2446 n.114.

295. But Justice Scalia supported *Chevron* deference at one time. *See generally* Antonin Scalia, *Judicial Deference to Administrative Interpretation of Law*, 1989 DUKE L.J. 511 (1989) (arguing *Chevron* deference was not a new concept when the court issued its opinion in 1984).

296. The underlying case concerned James Kisor's application to the Department of Veterans Affairs (VA) for disability benefits for post-traumatic stress disorder (PTSD)—initially denied in 1982. In 2006, his claim was granted but the benefits were not retroactive. Although both parties' interpretations of the pertinent regulatory language appeared reasonable, under *Auer* deference the VA's interpretation governed.

297. *Kisor*, 139 S. Ct. at 2408.

298. *See Auer v. Robbins*, 519 U.S. 452, 461–63 (1997).

299. The doctrine provides as a necessary part of rulemaking that agencies' interpretations of their own ambiguous regulatory language are given primacy, where those interpretations are reasonable.

300. *See Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945) (when the "meaning of the words used [in a regulation] is in doubt . . . the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation").

301. 139 S. Ct. at 2415.

302. *Id.* at 2415–16.

presumption in its favor to hold. It must be (1) an authoritative rather than informal or unofficial interpretation on (2) a matter implicating the agency's specific substantive expertise, and (3) be the result of a "fair and considered judgment."<sup>303</sup> Only then is *Auer* deference given.

In weighing *Kisor's* argument that *Auer* and *Seminole Rock*, and the established doctrine described above should be overturned, Justice Kagan turned to the principles of stare decisis. To overrule the doctrine required more than overturning just *Auer*, but "a 'long line of precedents'—each one reaffirming the rest and going back 75 years or more."<sup>304</sup> Further, upending the doctrine would introduce serious instability into the law.<sup>305</sup> This doctrine, as described, survived *Kisor's* attack on it. However, his specific case was remanded for determination consistent with the above-outlined limitations on *Auer*: specifically to require the Federal Circuit to exhaust all its interpretive tools in concluding the rule to be ambiguous and to find whether, if reasonable, this interpretation is of the category owed judicial deference.<sup>306</sup>

In his concurring opinion in *Kisor*, Justice Gorsuch takes a pot shot at the administrative state<sup>307</sup> and eliminating *Chevron* and *Auer* deference seems to be part of a conservative agenda. A bill to amend § 706 of the APA, called the Separation of Powers Restoration Act of 2016, would have demolished *Chevron* by requiring a de novo standard of review for "all relevant questions of law, including the interpretation of constitutional and statutory provisions[] and rules."<sup>308</sup> It would also have overturned *Auer* by disallowing agencies to interpret their own regulations. If passed, such a bill probably would have pernicious effects on SEC rulemaking and give business interests even more leverage than they have now when challenging SEC rules.

## CONCLUSION

Investor protection and capital formation are important components of financial regulation. If the SEC is undermined by power struggles between the Executive, Congress, and the Judiciary, or partisan gridlock over regulation, the SEC will fail to achieve these important goals. Many on the right, led by President Trump, are openly trying to destroy the administrative state, but

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303. *Id.* at 2416–18.

304. *Id.* at 2422.

305. *Id.*

306. *Id.* at 2423–24.

307. *Id.* at 2446–47 (Gorsuch, J., concurring) ("[I]n the 21st century, '[t]he administrative state wields vast power and touches almost every aspect of daily life.' Among other things, it produces 'reams of regulations'—so many that they dwarf the statutes enacted by Congress.>").

308. Separation of Powers Restoration Act of 2016, S. 2724, 114th Cong. § 2(2) (2016).

the left is not blameless. The Financial Choice Act of 2016,<sup>309</sup> proposed by Representative Jeb Hensarling, would subject not only SEC rulemaking but SEC enforcement to severe congressional review. The Enforcement Division would have to verify that its actions are within the SEC authority and consistent with the APA. The economic consequences of a civil penalty on an issuer would have to be considered. This idea of a cost–benefit analysis for enforcement cases strikes me as ludicrous. The recent move by Democrats to prevent the SEC from administering its Regulation BI is a similar partisan interference with the SEC’s regulation.

An even more trenchant example of partisan political pressure exerted on the SEC was conflicting Republican and Democratic reactions to the petition for rulemaking on public company disclosure of political contributions. After the Supreme Court decided *Citizens United*,<sup>310</sup> the Committee on Disclosure of Political Spending, co-chaired by Professor Lucian Bebchuk of Harvard Law School and Robert J. Jackson of Columbia Law School—subsequently an SEC commissioner—sent a petition to the SEC to start a rulemaking proceeding to require disclosure of corporate political contributions.<sup>311</sup> This petition and its favorable response were prompted in part by a statement in *Citizens United* by Justice Kennedy. He noted that “[w]ith the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.”<sup>312</sup>

Although repeal of *Citizens United* has become a political rallying cry for many Democrats, the issue of improper political influence coming from campaign contributions and lobbying activities is not that simple. A lot of “dirty money” comes from individual donations. A lot of corporate contributions come from political actions committees (PACs) where employees decide where money should be spent. Extensive lobbying is done by trade associations. The SEC received millions of comments supporting the Bebchuk–Jackson petition from a wide array of the public—public interest groups, federal law makers, trade unions, and major investment firms. The SEC also received many adverse comments. Also, political contribution disclosures are already required to be made to the Federal Election Commission. This issue was essentially political; it compelled the SEC to enforce all worthwhile (or not so worthwhile)

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309. H.R. 5983, 114th Cong. §§ 323, 415, 631 (2016).

310. *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 319 (2010).

311. Letter from the Comm. on Disclosure of Corp. Political Spending to Elizabeth M. Murphy, Sec’y, SEC 1–2 (Aug. 3, 2011), <http://www.sec.gov/rules/petitions/2011/petn4-637.pdf> (Petition for Rulemaking); see also Lucian A. Bebchuk & Robert J. Jackson, *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923, 967 (2013).

312. *Citizens United*, 558 U.S. at 370.

federal regulations, or corporate activities by way of its disclosure rules can become a quagmire.<sup>313</sup>

In 2013 and 2014, there were bills introduced in Congress to compel the SEC to mandate political contributions disclosures and bills to prevent the SEC from mandating such disclosures.<sup>314</sup> A provision written into the policy riders for the 2016 Omnibus Appropriations bill, passed on December 18, 2015, explicitly prohibited the SEC from using any funds to finalize political constitution disclosure rules during the fiscal year 2016.<sup>315</sup> A group of congressional leaders, led by Sen. Charles Schumer, informed the SEC via an open letter that the language of the bill did not prohibit the Commission from preparing, researching, or investigating potential rules, and urged the SEC to remain committed to the issue.

At least one nonprofit organization sought to force the SEC to enact a political contribution disclosure rule, when the SEC failed to act. On January 4, 2016, Judge Rosemary Collyer dismissed the suit, writing that “[s]ince the SEC has not denied the petition and . . . [the nonprofit organization] has not asserted that the SEC ‘failed to act in response to a clear legal duty,’ it follows that he failed to state a valid APA claim upon which relief can be granted.”<sup>316</sup> The decision essentially holds that the SEC is not obligated to respond to petitions by nonprofit organizations and private citizens seeking to set the SEC’s rulemaking agenda.<sup>317</sup>

The furor over the Bebchuk–Jackson political spending petition did not subside after these events. The nominations of two SEC commissioners to fill vacancies were held up in the Senate by Democrats because they did not testify during their confirmation hearings that they would push forward on a rulemaking advancing the petition. One of them, Republican Hester Pierce who once worked in the Senate, was re-nominated by President Trump. The

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313. See, e.g., Rulemaking Regarding Conflict Minerals, *supra* Part I.D.

314. Rob Tricchinelli, *House Committee Approves \$1.4B for SEC, Teeing Up Conflict with Senate on Funding*, BLOOMBERG L. (June 30, 2014), [https://www.bloomberglaw.com/product/blaw/document/X80JAEUS000000?criteria\\_id=dd6074b88c840b76a5491db14b680726&searchGuid=4cbba21f-923d-4f51-b966-732c8b4e3e30](https://www.bloomberglaw.com/product/blaw/document/X80JAEUS000000?criteria_id=dd6074b88c840b76a5491db14b680726&searchGuid=4cbba21f-923d-4f51-b966-732c8b4e3e30); *Democrats Unveil Legislation to Require Shareholder Say on Political Spending*, BLOOMBERG L. (Apr. 29, 2013), <https://news.bloomberglaw.com/securities-law/democrats-unveil-legislation-to-require-shareholder-say-on-political-spending?context=search&index=0>.

315. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 div. O § 707, 129 Stat. 2242, 3029–30 (2015).

316. Silberstein v. SEC, 153 F. Supp. 3d 233, 239 (D.D.C. 2016).

317. Former SEC Chairman Arthur Levitt—a Democrat—in a Wall Street Journal op-ed asserted that the SEC’s agenda should not be decided by rulemaking petitions. Arthur Levitt, Jr., *Let the SEC Set Its Own Agenda*, WALL ST. J. (Oct. 23, 2016), <https://www.wsj.com/articles/let-the-sec-set-its-own-agenda-1477261742>.

other, a Democrat, Lisa Fairfax, was never confirmed. Even worse, Senator Elizabeth Warren suggested that Chair Mary Jo White be fired as SEC Chairman by President Obama and demoted to a Commissioner because Chair White refused to engage in rulemaking to compel public companies to disclose their political contributions.<sup>318</sup> Missing from this pique on the part of Senator Warren was the fact that the SEC was prohibited from doing so by legislation that Senator Warren voted for. Senator Warren also criticized Chair White for embarking on a project to streamline SEC disclosure policy and improve public company reporting,<sup>319</sup> a project prompted by mandates from Congress in the JOBS Act and the Fixing America's Surface Transportation (FAST) Act.<sup>320</sup>

The suggestion that the Chair of the SEC be fired seems to be an election year gambit. When he was running for President, Senator John McCain asserted that if he were President, he would fire the then Chair of the SEC for failing to prevent the 2008 financial crisis. The SEC is supposed to be a collegial agency of nonpartisan experts. Instead, it has become an agency riven by partisanship due to politicians trying to score points and gain publicity, and judges who are more attentive to business than governmental interests.

Four former Chairs of the Federal Reserve Board recently expressed their convictions that “the Fed and its chair must be permitted to act independently and in the best interests of the economy, free of short-term political pressures and, in particular, without the threat of removal or demotion of Fed leaders for political reasons.”<sup>321</sup> Their reasons were that “an economy is strongest and functions best when the central bank acts independently of short-term political pressures and relies solely on sound economic principles and data.”<sup>322</sup> It could similarly be argued that the capital markets are strongest and function best when the SEC is able to act independently and relies on sound legal and policy principles and data.

In her last public address before resigning as SEC Chairman, Mary Jo White pleaded for the SEC's independence as vital to serving a leadership role in the broader financial regulatory regime. She stated:

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318. Letter from Sen. Elizabeth Warren to President Barack Obama (Oct. 14, 2016), [https://www.warren.senate.gov/files/documents/2016-10-14\\_SEC\\_Letter\\_to%20POTUS\\_OCR.pdf](https://www.warren.senate.gov/files/documents/2016-10-14_SEC_Letter_to%20POTUS_OCR.pdf).

319. *Id.* at 6; *see* Concept Release, Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,916 (Apr. 22, 2016) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249).

320. Pub. L. No. 114-94, § 72002, 129 Stat. 1312, 1790 (2015).

321. Paul Volcker et al., *America Needs an Independent Fed*, WALL ST. J. (Aug. 5, 2019, 6:48 PM), <https://www.wsj.com/articles/america-needs-an-independent-fed-11565045308>.

322. *Id.*

I strongly believe that the agency's independence has been critical in allowing it to use its expert judgment to do what is best for investors and the markets—a task that could otherwise be rendered impossible by the whims of political pressure or the public mood. The Commission, in fact, was created as an independent expert agency in 1934 precisely because Congress identified a need for that strength in overseeing the American capital markets.<sup>323</sup>

The President's power to remove agency members from office only for "cause" has long been considered a key feature of agency independence by academics. I believe that two other earmarks of independence—agency control of its own litigation and independent funding—are more important as a practical matter. Although the SEC takes more money into the U.S. Treasury than its budget, from registration fees and fines, the SEC budget is subject to annual appropriations by Congress. Serious efforts to insulate the SEC from partisan and Wall Street interference by giving the agency independent funding authority floundered in 1977 due to congressional opposition and once again in Dodd–Frank due to Democratic opposition.

The concept of agency independence generally has meant freedom from control by the Executive Branch, based on delegation of congressional powers. Commissions like the SEC are often considered "arms" of Congress and, in any event, are accountable to Congress for their success or failure. Congress has many legitimate ways to influence the work of the SEC, the most important of which is fixing the Commission's budget. Congressional oversight committees can also exert a strong influence on the work of the SEC.<sup>324</sup> Yet, the courts have also recognized that some degree of independence from Congress is also important to insulate these agencies from inappropriate pressures.<sup>325</sup>

The Trump White House and some conservative judges would like to destroy the administrative state. Members of Congress—both Republicans and Democrats—are threatening the SEC's independence. Agencies are often criticized for having been captured by the industries they regulate, but agency capture occurs by way of congressional pressure and legislative mischief making. Also, at fault are judicial decisions second guessing the SEC's expertise and ultimately adding to the agency's ossification and prolix rulemaking releases.

I do not believe the SEC is perfect, but it could do a better job as a regulator if it were allowed to operate as a nonpartisan, independent expert collegial body.

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323. Mary Jo White, Chair, SEC, Speech at the Economic Club of New York: The SEC after the Financial Crisis: Protecting Investors Preserving Markets (Jan. 17, 2017), <https://www.sec.gov/news/speech/the-sec-after-the-financial-crisis.html>.

324. Cleveland, *supra* note 206, at 293–97.

325. See *D.C. Fed'n of Civic Ass'ns v. Volpe*, 459 F.2d 1231, 1246 (D.C. Cir. 1971); see also *Pillsbury Co. v. FTC*, 354 F.2d 952, 954, 963–64 (5th Cir. 1966).

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