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Note

Judicial Review of SEC Rules: Managing the Costs of Cost-Benefit Analysis

Rachel A. Benedict∗

On July 22, 2011, the staff at the Securities and Exchange Commission (SEC) heard the discouraging news that approximately 21,000 hours of its work over the past two years[1] were lost when a federal circuit court overturned the new proxy access rule.[2] The SEC reviewed and incorporated 600 public comments in constructing the rule, with an estimated cost of $2.2 million to the agency.[3] The time and money spent over the last two years were not the SEC's only investment in this rule—the SEC had evaluated similar regulations on multiple occasions dating back to 1942.[4] The time seemed ripe for enacting the new rule in light of recent corporate scandals and the Dodd-Frank financial reform legislation explicitly authorizing the SEC to promulgate a proxy access rule.[5] Yet the D.C. Circuit effectively sent the SEC back to the drawing board when it found that the rule was "arbitrary and capricious" despite the SEC's seventy-three pages of cost-benefit analysis.[6]

∗ J.D. Candidate 2013, University of Minnesota Law School. I would like to thank the editors and staff of the *Minnesota Law Review* for their helpful advice and edits, and my husband, David, for his continuous support throughout my legal education. Copyright © 2012 by Rachel A. Benedict.

1. *See* Letter from Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, to Scott Garrett, Representative, U.S. House of Representatives 2 (Aug. 5, 2011), *available at* http://www.law.du.edu/documents/corporate-governance/sec-and-governance/SEC-letter%208-5-11.pdf.

2. Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

3. Letter from Mary L. Schapiro to Scott Garrett, *supra* note 1, at 2.

4. *See* Exchange Act Release No. 34-3347, 7 Fed. Reg. 10,653 (Dec. 18, 1942); Exchange Act Release No. 13,901, 12 SEC Docket 1630 (Aug. 29, 1977); Exchange Act Release No. 34-31,326, 52 SEC Docket 2028 (Oct. 16, 1992); Exchange Act Release No. 34-47,778, 80 SEC Docket 248 (May 1, 2003).

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

6. *Bus. Roundtable*, 647 F.3d at 1148; J. Robert Brown, Jr., *Shareholder Access and Uneconomic Analysis:* Business Roundtable v. SEC 2 (Univ. of

Courts have long been held to a deferential standard in setting aside arbitrary and capricious agency actions.[7] However, judicial application of this standard to the SEC's cost-benefit analyses has become increasingly stringent, with the D.C. Circuit alone vacating three SEC rules in the past seven years for failure to adequately consider the costs of the rule.[8] This pattern only aggravates the SEC's struggle to stretch its limited resources across a rapidly growing workload.[9] The strain on SEC resources is especially problematic since the Dodd-Frank legislation tasked the SEC with promulgating more than ninety mandatory rules.[10] More stringent judicial scrutiny of SEC cost-benefit analyses delays enactment of rules,[11] and the recent string of D.C. Circuit decisions invalidating SEC rules could jeopardize dozens of other SEC rules mandated under the Dodd-Frank legislation.[12] Additionally, the cost of conducting a comprehensive cost-benefit analysis may outweigh the corresponding efficiency gains for some rules, since a single cost-benefit analysis can cost as much as six million dollars.[13]

This Note argues that the scope of judicial review of SEC cost-benefit analysis must be clearly defined in order to prevent rendering cost-benefit analysis itself an inefficient and overly burdensome exercise. Part I discusses the traditional standard of agency review, the role of cost-benefit analysis in SEC rule-

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Denver Strum Coll. of Law, Working Paper No. 11-14, 2011), *available at* http://ssrn.com/abstract=1917451.

7. Administrative Procedure Act, 5 U.S.C. § 706 (2006).

8. *See Bus. Roundtable*, 647 F.3d at 1148; Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 177–79 (D.C. Cir. 2010); Chamber of Commerce v. SEC, 412 F.3d 133, 143–44 (D.C. Cir. 2005).

9. U.S. GEN. ACCOUNTING OFFICE, GAO-02-302, SEC OPERATIONS: INCREASED WORKLOAD CREATES CHALLENGES 13 (2002) (highlighting the disproportionately small increase in the number of SEC staff compared with the growth of its workload over the last decade).

10. *See Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/spotlight/dodd-frank.shtml (last modified Sept. 7, 2012).

11. *See* Ira Teinowitz, *Investor Council Urges SEC to Keep Fighting on Proxy Access*, THE DEAL PIPELINE (Aug. 24, 2011, 6:04 AM), http://www.thedeal.com/content/regulatory/investor-council-urges-sec-to-keep-fighting-on-proxy-access.php.

12. *See id.*

13. *See* CONG. BUDGET OFFICE, REGULATORY IMPACT ANALYSIS: COSTS AT SELECTED AGENCIES AND IMPLICATIONS FOR THE LEGISLATIVE PROCESS viii (1997), *available at* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/40xx/doc4015/1997doc04-entire.pdf.

making, and the increasingly strict standard imposed on SEC rules. Part II examines the problems with subjecting SEC cost-benefit analysis to an unduly strict standard of judicial review. Part III introduces several alternative solutions to the current standard of review that would reduce the administrative burden of comprehensive economic analysis while preserving the overall benefits of a thoughtful cost-benefit analysis. This Note concludes that the most effective solution is for Congress to make a clear statement limiting the required scope of the SEC's cost-benefit analysis. Such a statement is necessary to ensure that the efficiency gains from cost-benefit analysis outweigh the expense of conducting the analysis in the first place.

I. JUDICIAL REVIEW OF SEC RULES

Congress has increasingly delegated its rulemaking authority to administrative agencies, tasking them with the responsibility of establishing regulations that implement the broad directives it has issued.[14] Political pressures often hamper Congress's ability to act efficiently and can prevent reasoned debate.[15] Agencies are well-equipped to assume this rulemaking role because their independence insulates them from the volatility of the political climate.[16] At the same time, the United States' democratic system and constitutional separation of powers require agencies to be accountable to each of the branches of government, thus tempering agency independence.[17] This Part discusses the extent of judicial constraints on SEC rulemaking in three sections. First, it examines the standard of judicial review provided in the Administrative Procedure Act (APA), the SEC's enabling statutes, and case law. Next, it addresses the role of cost-benefit analysis in agency rulemaking. Finally, this Part describes recent appellate court decisions invalidating SEC rules for failure to conduct adequate cost-benefit analyses.

14. *See* 1 CHARLES H. KOCH, JR., ADMINISTRATIVE LAW AND PRACTICE § 4:10 (3d ed. 2010).

15. Renee M. Jones, *Legitimacy and Corporate Law: The Case for Regulatory Redundancy*, 86 WASH. U. L. REV. 1273, 1306–08 (2009).

16. *Id.* at 1310.

17. *Id.* at 1319; *see also* FCC v. Fox Television Stations, Inc., 556 U.S. 502, 536 (2009) (Kennedy, J., concurring) ("If agencies were permitted unbridled discretion, their actions might violate important constitutional principles of separation of powers and checks and balances.").

A. STANDARD OF REVIEW UNDER THE ADMINISTRATIVE PROCEDURE ACT

The APA was enacted in 1946 in response to New Deal legislation.[18] It establishes federal agency rulemaking procedures and grants federal courts the power to set aside agency rules that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[19] Agency rules are typically evaluated under the arbitrariness standard of review,[20] though courts have offered different formulations of the standard over time.[21] In *National Ass'n of Home Builders v. Defenders of Wildlife*, a 2007 decision, the Supreme Court articulated a narrow scope of review for arbitrariness:

> [W]e will not vacate an agency's decision unless it "has relied on factors which Congress had not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[22]

The circuit courts have followed this formulation of the arbitrariness standard, finding it satisfied when there is a "rational connection between the facts found and the choice made."[23] A reviewing court is not permitted to substitute its own policy judgment for that of the agency when it applies the arbitrariness test.[24] In sum, an agency rule will fail under the deferential arbitrariness standard only if it is entirely without a rational basis.[25]

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18. George B. Shepherd, *Fierce Compromise: The Administrative Procedure Act Emerges from New Deal Politics*, 90 NW. U. L. REV. 1557, 1558–59 (1996) ("The APA expressed the nation's decision to permit extensive government, but to avoid dictatorship and central planning.").

19. Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2006).

20. *See* 3 KOCH, *supra* note 14, § 9:25[4](a).

21. *See id.* § 9:25[1] (noting that "there is no clear meaning for arbitrariness review").

22. 551 U.S. 644, 658 (2007) (quoting Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983)).

23. Greenbaum v. EPA, 370 F.3d 527, 542 (6th Cir. 2004) (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962)); *see also* Bluewater Network v. EPA, 370 F.3d 1, 11 (D.C. Cir. 2004); Anderson v. U.S. Dep't of Transp., 213 F.3d 422, 423 (8th Cir. 2000).

24. FCC v. Fox Television Stations, Inc., 556 U.S. 502, 513–14 (2009) ("We have made clear, however, that 'a court is not to substitute its judgment for that of the agency,' and should 'uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.'" (quoting *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43; Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc., 419 U.S. 281, 286 (1974))).

25. *See* 3 KOCH, *supra* note 14, § 9:25[2] (recognizing that the arbitrari-

B. THE ROLE OF COST-BENEFIT ANALYSIS IN AGENCY RULEMAKING

The APA's general standard for federal agencies is accompanied by the requirements set forth in the SEC's enabling statutes.[26] The Securities Exchange Act requires the SEC to take into consideration a rule's impact on efficiency, competition, capital formation, and protection of investors.[27] Courts have interpreted this statutory mandate to require the SEC to conduct an economic analysis for proposed rules.[28]

Cost-benefit analysis has played an increasingly significant role in rulemaking decisions since the 1970s.[29] Cost-benefit analysis seeks to objectively quantify the projected consequences, both monetary and intangible, of a proposed rule in order to determine whether it will result in a net gain to the public.[30] Though the overall value of cost-benefit analysis was hotly contested for years, a general consensus in favor of conducting some level of economic analysis appears to have emerged.[31] Now, the debate surrounding cost-benefit analysis centers on the proper extent of such analysis and the judiciary's role in evaluating its adequacy.[32]

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ness test "rejects only those decisions which are outside any conceivable rational alternative").

26. Jones, *supra* note 15, at 1313.

27. Securities Exchange Act of 1934, 15 U.S.C. § 78c(f) (2006) ("Whenever . . . the Commission is engaged in rulemaking . . . the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."). The Investment Company Act of 1940 sets forth the same requirement. *See* 15 U.S.C. § 80a-2(c) (2006). While the efficiency, competition, and capital formation considerations collectively compose the requirement to conduct an economic analysis, the protection of investors was the SEC's founding mission. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml (last modified Oct. 12, 2012).

28. *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011) ("The Commission . . . has a 'statutory obligation to determine as best it can the economic implications of the rule.'" (quoting Chamber of Commerce v. SEC, 412 F.3d 133, 143 (D.C. Cir. 2005))); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 177–79 (D.C. Cir. 2010) (finding that the SEC failed to consider the rule's effects on efficiency, competition, and capital formation when it did not engage in a well-reasoned economic analysis).

29. 1 KOCH, *supra* note 14, § 4:51.

30. *Id.* §§ 4:51, 4:52[1].

31. CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION xi (2002).

32. *Id.*; *see also* Susan Rose-Ackerman, *Putting Cost-Benefit Analysis in Its Place: Rethinking Regulatory Review*, 65 U. MIAMI L. REV. 335, 335 (2011)

The Supreme Court has not provided much guidance in defining when and to what extent cost-benefit analysis must be used in agency decision making.[33] The only direction that can be inferred from Supreme Court decisions is that cost-benefit analysis is required when the statutory language or legislative history reflects Congress's intent that the agency engage in economic analysis.[34] Though the Supreme Court has implicitly recognized the utility of cost-benefit analysis, it will not judicially require an agency to undertake an economic analysis in rulemaking unless the statute can be interpreted to incorporate such a requirement.[35]

C. RECENT APPELLATE REVIEW OF SEC COST-BENEFIT ANALYSIS

As a result of the Supreme Court's silence on the proper bounds of judicial review of agency cost-benefit analysis, lower courts have been given a substantial degree of freedom.[36] In a series of recent opinions, the D.C. Circuit has used this freedom to invalidate SEC rules for failure to adequately consider their economic consequences.[37] The three subsections below discuss the findings and rationales of those opinions.

1. *Chamber of Commerce v. SEC*

In 2005, the D.C. Circuit handed down the first of its three recent decisions criticizing the SEC's cost-benefit analysis of a

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(recognizing the value of cost-benefit analysis but arguing that its use should be limited to regulatory areas that comport well with its underlying assumptions).

33. 1 KOCH, *supra* note 14, § 4:51[3].

34. *See* Indus. Union Dep't, AFL-CIO v. Am. Petrol. Inst., 448 U.S. 607, 644–46 (1980) (finding that the statute and its legislative history contemplated that the agency undertake some measure of a cost-benefit analysis before promulgating a new regulatory standard); 1 KOCH, *supra* note 14, § 4:51[3] ("[The Supreme Court's] current position might be summarized as requiring that any cost/benefit analysis must be under expressed direction of Congress or of executive leadership.").

35. *See* 1 KOCH, *supra* note 14, § 4:51[3].

36. *See* Brett Friedman et al., *Recent Decisions of the United States Court of Appeals for the District of Columbia Circuit: Administrative Law*, 74 GEO. WASH. L. REV. 619, 656–57 (2006) (noting that the lack of a clear standard for reviewing SEC economic analyses "puts a large amount of power in the hands of future courts").

37. *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 177–79 (D.C. Cir. 2010); Chamber of Commerce v. SEC, 412 F.3d 133, 143–44 (D.C. Cir. 2005).

new rule.[38] The court found that the SEC violated the APA when it passed a rule amendment increasing board independence requirements for mutual funds without fully considering its costs.[39]

The SEC passed this amendment in response to recent abuses in the mutual fund industry, believing that the amendment's strengthened board independence requirements would address the root problem behind these abuses—the failure of investment company boards to prevent their advisers' conflicts of interest.[40] The SEC based the rule on its experience, comment letters, and other evidence, but it did not conduct an extensive empirical study because the available data was conflicting and unpersuasive.[41] The court found that the SEC's failure to base the rule amendment on an empirical study did not constitute arbitrary action under the APA.[42]

However, the SEC had difficulty providing an aggregate cost prediction for the rule because of the many ways a fund could satisfy its conditions.[43] The court determined that the SEC's failure to estimate costs to the best of its ability violated its obligation under the Investment Company Act and the APA.[44] The uncertainty involved in the cost calculation did "not excuse the Commission from its statutory obligation to do what it can to apprise itself—and hence the public and the Con-

38. *Chamber of Commerce*, 412 F.3d at 136.

39. *Id.* The amendment conditioned certain exemptions on the mutual fund having a board with at least seventy-five percent independent directors and an independent chairman. *Id.* at 137. Previously, only fifty percent of a fund's directors were required to be independent. *Id.* at 141.

40. *Id.* at 140–41; *see also* Jones, *supra* note 15, at 1327 ("The mutual fund scandals . . . were serious enough to command regulators' attention, yet they lacked the political salience necessary to spur Congress to action. This regulatory space . . . represents a middle ground in which the SEC's role as first responder is critical.").

41. Investment Company Governance, 69 Fed. Reg. 46,378, 46,383–84 (Aug. 2, 2004).

42. *Chamber of Commerce*, 412 F.3d at 142 ("[W]e are acutely aware that an agency need not—indeed cannot—base its every action upon empirical data; depending upon the nature of the problem, an agency may be 'entitled to conduct . . . a general analysis based on informed conjecture.'" (quoting Melcher v. FCC, 134 F.3d 1143, 1158 (D.C. Cir. 1998))).

43. Investment Company Governance, 69 Fed. Reg. at 46,387.

44. *Chamber of Commerce*, 412 F.3d at 144 (holding that the SEC violated its duty to consider whether the rule would promote efficiency, competition, and capital formation under the Investment Company Act, rendering the rule arbitrary under the APA); *see* Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2006); Investment Company Act of 1940, 15 U.S.C. § 80a-2(c) (2006).

gress—of the economic consequences of a proposed regulation."[45]

The *Chamber of Commerce* decision failed to clearly state judicial expectations for a proper agency cost-benefit analysis. Though the court did not require the SEC to conduct an empirical analysis based on data it considered unpersuasive, the SEC was required to estimate costs, even when it believed there was no reliable basis for such a calculation.[46] This resulted in significant uncertainty as to when courts will require empirical data to support proposed rules.[47]

2. *American Equity Investment Life Insurance Co. v. SEC*

The second decision in the D.C. Circuit's trilogy of opinions vacating SEC rules based on faulty cost-benefit analysis was handed down in 2010.[48] The rule at issue in this case rendered fixed index annuities (FIAs) subject to disclosure requirements and other protections.[49] The SEC proposed this rule because FIAs involve significant investment risk based on the underlying securities market but lack the protections associated with securities instruments.[50]

The court held that the rule was arbitrary and capricious under the APA because the SEC's analysis of its effects on efficiency, capital formation, and competition under the Exchange Act was flawed.[51] The SEC found that the rule's benefits (creating regulatory certainty, assisting investors in making informed decisions through enhanced disclosure, and increasing investor confidence) outweighed the associated costs (registration and disclosure costs and loss of revenue to insurance companies that stop issuing FIAs).[52] Though the SEC conducted a cost-benefit analysis, the court determined that its fatal defect

45. *Chamber of Commerce*, 412 F.3d at 144.

46. *See* Friedman et al., *supra* note 36, at 647.

47. *Id.* at 656–57 (arguing that the court's vague holding "puts a large amount of power in the hands of future courts" and will likely cause agencies to conduct an empirical analysis for all rules in order to protect themselves from the uncertainty associated with judicial review).

48. Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 179 (D.C. Cir. 2010).

49. *Id.* at 171.

50. *Id.*

51. *Id.* at 177.

52. Indexed Annuities and Certain Other Insurance Contracts, 74 Fed. Reg. 3138, 3161–72 (Jan. 16, 2009).

was a failure to determine the existing level of efficiency, competition, and capital formation under the current legal regime.[53]

3. *Business Roundtable v. SEC*

In 2011, the D.C. Circuit struck down the SEC's new proxy access rule in its most recent decision regarding cost-benefit analysis.[54] The rule at issue required companies to include shareholder nominees for director elections in their proxy materials in order to mitigate the prohibitive expense to shareholders of distributing the proxy materials on behalf of shareholder-nominated candidates.[55] The SEC had proposed a similar proxy access rule on many occasions dating back to the 1940s[56] out of concern that shareholders exercising their legal right to submit director nominations were unlikely to be successful under the current system.[57] The SEC finally adopted the rule in 2010, pursuant to Congress's specific grant of authority in the Dodd-Frank legislation.[58]

Though the SEC dedicated more than 21,000 staff hours to the rule[59] and produced a substantial body of economic analysis,[60] the court found that it failed to adequately consider the rule's effect on efficiency, competition, and capital formation, and therefore acted arbitrarily.[61] The court sharply criticized the SEC for making speculative predictions, relying on two empirical studies that the court found unpersuasive, and failing to address the possibility that special interest shareholders will submit nominees in order to gain leverage.[62] This decision has

53. *Am. Equity*, 613 F.3d at 177–79.

54. Bus. Roundtable v. SEC, 647 F.3d 1144, 1156 (D.C. Cir. 2011).

55. Brown, *supra* note 6, at 1. The proxy access rule only permitted shareholders owning three percent or more of the company's stock for at least three years to include a limited number of nominees (not to exceed twenty-five percent of the board) in the company's proxy materials. *Id.*

56. *See* Exchange Act Release No. 34-3347, 7 Fed. Reg. 10,653 (Dec. 18, 1942); Exchange Act Release No. 34-13,901, 12 SEC Docket 1656 (Aug. 29, 1977); Exchange Act Release No. 34-31,326, 52 SEC Docket 2028 (Oct. 16, 1992); Exchange Act Release No. 34-47,778, 80 SEC Docket 248 (May 1, 2003); Exchange Act Release No. 34-56,160, 91 SEC Docket 544 (July 27, 2007).

57. *Bus. Roundtable*, 647 F.3d at 1147.

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

59. *See* Letter from Mary L. Schapiro to Scott Garrett, *supra* note 1, at 2.

60. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668, 56,753–76 (Sept. 16, 2010) (producing twenty-three pages of cost-benefit analysis for the proxy access rule).

61. *Bus. Roundtable*, 647 F.3d at 1148–49.

62. *Id.* at 1150–52.

garnered significant criticism from commentators who are concerned about the long-term consequences of imposing a "nigh impossible" standard for cost-benefit analyses in SEC rulemaking.[63]

In sum, the D.C. Circuit's recent trilogy of decisions illustrates a trend toward heightened judicial scrutiny of SEC cost-benefit analyses. However, the court's reasoning in these three cases is inconsistent and fails to clearly establish judicial expectations for cost-benefit analyses. The lack of statutory basis for this level of judicial scrutiny and its potential to interfere with other important rulemaking objectives is problematic. Given the preceding discussion, Part II analyzes the issues associated with strict judicial review of SEC cost-benefit analysis and evaluates the alternative solutions.

II. MANAGING COST-BENEFIT ANALYSIS IN A COST-EFFECTIVE MANNER

Increasingly stringent judicial review of SEC cost-benefit analysis has a direct and substantial impact on the agency's ability to carry out its responsibilities and its statutory mandate.[64] The first section of this Part will examine the problems that result from stringent judicial treatment of the SEC's cost-benefit analyses—delays in enacting important rules, magnified costs of rulemaking, reluctance to update previously enacted rules, and deviation from the SEC's statutory obligations. The second section will discuss possible alternatives to address these problems and critique them based on the statutory and precedential context for judicial review of cost-benefit analysis as discussed in Part I.

63. *See, e.g.*, Brown, *supra* note 6, at 4–5 (arguing that the court's decision "imposed an extraordinarily difficult burden on the Commission" that "make[s] rulemaking more difficult and encourage[s] legal challenges"); Stanley Keller, *What Now for Proxy Access?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 18, 2011, 9:29 AM), http://blogs.law.harvard.edu/corpgov/2011/08/18/what-now-for-proxy-access/ (stating his concern about the "high, nigh impossible, bar the Court set that could put in jeopardy most SEC rulemaking of any complexity or controversy").

64. *See* Frank B. Cross, *Pragmatic Pathologies of Judicial Review of Administrative Rulemaking*, 78 N.C. L. REV. 1013, 1019 (2000) ("The shadow of judicial review has a pervasive effect on agency decisionmaking, and the commands of preceding cases can have an enormous unforeseen effect on policymaking, even in areas that are not related directly to the policies previously litigated.").

A. PROBLEMS WITH STRICT JUDICIAL REVIEW OF SEC COST-BENEFIT ANALYSIS

The D.C. Circuit's recent trilogy of opinions invalidating SEC rules for failure to conduct an adequate cost-benefit analysis all reached the same outcome, but they did not enunciate a consistent standard for the holdings.[65] As a result, the SEC is left with significant uncertainty as to the extent of cost-benefit analysis required for a rule to survive judicial challenge in the future.[66] Consequently, new SEC rules are delayed and the costs associated with rulemaking continue to grow. Furthermore, the SEC is hesitant to alter existing rules because such modification is subject to the same judicial scrutiny as a new rule. The judiciary's increasingly stringent review of cost-benefit analysis also distracts the SEC from its fundamental mission of investor protection and undermines its independence.

1. Rulemaking Delays

Strict judicial review of cost-benefit analysis renders the SEC rulemaking process unnecessarily time-consuming, thereby slowing the enactment of valuable legislation.[67] Such delays occur for several reasons. First, uncertainty as to the level of judicial scrutiny encourages the SEC to engage in defensive rulemaking by conducting a comprehensive cost-benefit analysis for every rule it promulgates.[68] In order to protect rules from judicial invalidation, cost-benefit analysis becomes a "prophylactic measure" that is exercised regardless of the value that it adds to a particular rule.[69] Attempting to anticipate every pos-

65. *See supra* Part I.C.

66. *See* JERRY L. MASHAW, GREED, CHAOS, AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW 165 (1997) (noting that most commentators agree judicial review of agency rules causes uncertainty because of the courts' lack of sophistication in agency matters).

67. *See* Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 DUKE L.J. 1385, 1412 (1992). "Important rulemaking initiatives grind along at such a deliberate pace that they are often consigned to regulatory purgatory, never to be resurrected again." *Id.* at 1388.

68. *See* Friedman et al., *supra* note 36, at 657–58 ("The threat of judicial review and the uncertainty over what a reviewing court will find to be 'arbitrary and capricious' are two of the principal reasons that administrative rulemaking has become ossified, creating significant delays for agencies seeking to develop regulations.").

69. *See id.* at 657 (arguing that the SEC will engage in cost-benefit analysis for every rule as a result of the vague standard set forth in *Chamber of Commerce v. SEC*); *see also* MASHAW, *supra* note 66, at 165 ("[T]he real imped-

sible challenge to a proposed rule and developing economic data in response involves a substantial, and potentially endless, exertion of time and resources.[70]

Second, stringent judicial review of cost-benefit analysis causes rulemaking delay by decreasing the quantity of rules that the SEC is able to promulgate.[71] Conducting an intensive cost-benefit analysis for each rule not only lengthens the timeline for an individual rule but also necessarily detracts from the SEC's ability to promulgate other, equally urgent rules in a timely manner.[72] As a result, the SEC's ability to enact a comprehensive regulatory agenda is severely constrained—the invalidation of a single rule can create a ripple effect that upsets a vast number of interrelated rules.[73] For example, the D.C. Circuit's review of the proxy access rule in *Business Roundtable* also required the SEC to place a stay on an amendment to a related rule, because the amendment "was designed to complement [the proxy access rule] and is intertwined."[74] The court's invalidation of the proxy access rule may have changed the regulatory situation so much that the SEC must conduct a new-cost benefit analysis and open a new comment period to validly

iment created by judicial review is uncertainty. Because the courts are relatively uninformed about what is important among the many issues thrown up by parties seeking review of a rule, and because they are technically and scientifically unsophisticated in analyzing the issues that they perceive to be critical to a rule's 'reasonableness,' the perception in the agencies is that anything can happen. This produces defensive rulemaking, if not abandonment of the rulemaking process.").

70. *See* Cross, *supra* note 64, at 1023 (noting that the time an agency spends "playing defense" takes away from its ability to take affirmative regulatory action); McGarity, *supra* note 67, at 1412 ("Because they can never know what issues dissatisfied litigants will raise on appeal, they must attempt to prepare responses to all contentions that may prove credible to an appellate court, no matter how ridiculous they may appear to agency staff."); David S. Hilzenrath, *Appeals Decision Is a Victory for Opponents of SEC's New Wall Street Regulations*, WASH. POST (Aug. 11, 2011), http://www.washingtonpost.com/business/economy/appeals-decision-is-a-victory-for-opponents-of-secs-new-wall-street-regulations/2011/08/05/gIQAGSAg8I_story.html (quoting former SEC commissioner Harvey J. Goldschmid's comment that "[i]f the court's unrealistic requirements were applied across the board, the regulatory process would grind to a halt").

71. Cross, *supra* note 64, at 1021.

72. *See id.*

73. *See id.* at 1027–36 (arguing that ad hoc judicial invalidation of rules creates "agenda disruption" and fails to recognize the broad interrelatedness of agency rules).

74. Order Granting Stay, Securities Act Release No. 9149, Exchange Act Release No. 63,031, Investment Company Act Release No. 29,456, File No. S7-10-09 (Oct. 4, 2010).

lift the stay on the amendment.[75] This type of constraint is especially problematic in light of the SEC's substantial rulemaking responsibilities under the Dodd-Frank legislation.[76] While Congress continuously increases the SEC's workload, the courts decrease the SEC's ability to perform these duties in a timely manner.[77] Rulemaking delay undermines one of the primary benefits of delegating rulemaking authority to agencies: their ability to act quickly and decisively in response to changing circumstances.[78]

Third, judicial scrutiny of cost-benefit analysis causes enormous rulemaking delay with respect to the particular rule that a court remands or invalidates.[79] Justice Stephen Breyer recognized that "[a] remand of an important agency rule (several years in the making) for more thorough consideration may well mean several years of additional proceedings, with mounting costs, and the threat of further judicial review leading to abandonment or modification of the initial project irrespective of the merits."[80] After losing all the time and resources associated with an invalidated or remanded rule, the SEC is reluctant to risk the loss of more time and resources, essentially gambling with taxpayer money, by trying again.[81] As a result, judicial invalidation or remand of a rule is likely to kill it altogether, as SEC resources are already dedicated to other pro-

75. *See* Keller, *supra* note 63. However, failure to lift the stay would create significant confusion for companies and shareholders. *See* Yin Wilczek, *Corporate Governance: Court Vacates SEC's Proxy Access Rule, Cites Failure to Assess Economic Impact*, BANKING DAILY, July 25, 2011, *available at* 2011 WL 2938907.

76. *Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, *supra* note 10 (stating that the Dodd-Frank Act contains more than ninety provisions that mandate SEC rulemaking and dozens more conferring discretionary rulemaking authority).

77. R. Shep Melnick, *Administrative Law and Bureaucratic Reality*, 44 ADMIN. L. REV. 245, 246 (1992) ("Judicial review has subjected agencies to debilitating delay and uncertainty. Courts have heaped new tasks on agencies while decreasing their ability to perform any of them.").

78. Gray v. Powell, 314 U.S. 402, 412 (1941) ("It is not the province of a court to absorb the administrative functions to such an extent that the executive or legislative agencies become mere fact-finding bodies deprived of the advantages of prompt and definite action.").

79. *See* Stephen Breyer, *Judicial Review of Questions of Law and Policy*, 38 ADMIN. L. REV. 363, 383 (1986).

80. *Id.*

81. Cross, *supra* note 64, at 1024 ("[I]n addition to slowing the process of rulemaking, judicial review can have the effect of discouraging rulemaking altogether.").

jects that rank higher on the list of priorities than the failed rule.[82]

2. Heightened Costs of Rulemaking

In addition to rulemaking delays, strict judicial review of cost-benefit analysis causes the SEC to conduct expensive economic analyses that may not result in rules with corresponding cost savings or efficiency gains.[83] Though a thorough cost-benefit analysis may be worthwhile for some rules, requiring such an analysis for every rule the SEC promulgates inevitably results in some unnecessary agency expenditures.[84] When the purpose of a cost-benefit analysis is to ensure that the cost of a particular regulation is justified, it is absurd for an agency to expend more of its scarce resources conducting an analysis than could be gained back in efficiency benefits.[85] In many cases, the additional cost-benefit analysis conducted to protect a particular rule from invalidation does not improve the substance of the rule—it only bolsters the SEC's defense of its position.[86]

82. *See* McGarity, *supra* note 67, at 1401 ("[A] trip back to the drawing board can send the project spinning off in odd directions or, worse, can consign it to oblivion as the agency's limited staff resources are committed to other projects, institutional memory fades, and more immediate priorities press old rulemaking initiatives to the bottom of the agenda."). *But see* H.R. REP. NO. 104-622, at 24 (1996) ("The bill also would require the SEC to consider the burden of regulations or rules on capital formation, efficiency, and competition. Because the SEC currently conducts cost-benefit analysis in conjunction with its rulemakings, [we] would not expect this provision to result in any additional costs to the federal government."). Congress failed to consider the impact of stringent judicial review of SEC cost-benefit analysis on rulemaking costs and clearly did not intend such analysis to be the resource-draining procedure that it is today. *See id.*

83. *See* Cross, *supra* note 64, at 1022 (commenting that excessive judicial scrutiny causes "certain rules—that otherwise could be justified in themselves—[to] become cost ineffective in light of the additional procedural demands").

84. Comprehensive cost-benefit analysis for minor rules will generally be an inefficient use of agency resources, since a single cost-benefit analysis can cost more than six million dollars. *See* CONG. BUDGET OFFICE, REGULATORY IMPACT ANALYSIS: COSTS AT SELECTED AGENCIES AND IMPLICATIONS FOR THE LEGISLATIVE PROCESS viii (1997), *available at* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/40xx/doc4015/1997doc04-entire.pdf.

85. *See* McGarity, *supra* note 67, at 1391 ("When agencies expend twice as many resources to achieve the same results, the taxpayer is the ultimate loser.").

86. *See* Cross, *supra* note 64, at 1046 ("Judicial review does not improve the substance of regulations, just their explanation to an uninformed judicial audience. Resources devoted to such procedures and explanations (and re-

Furthermore, the costs associated with defending a particular rule that comes under judicial challenge are significant.[87] The resources that the SEC dedicates to respond to judicial proceedings are allocated away from other important rulemaking and enforcement initiatives.[88] The costs related to defending a challenged rule are so large that special interest groups can use the threat of a judicial proceeding to pressure the SEC to compromise on the proposed regulation, or prevent the issuance of the rule altogether.[89] Judicial review of SEC rules essentially creates another chance for parties who unsuccessfully opposed a regulation at the legislative level to prevent its implementation by challenging the rule through judicial channels, at great expense to the agency and ultimately to taxpayers.[90] Judicially attacking a rule based on its cost-benefit analysis is a particularly potent approach for activists because it allows a sympathetic court to remand or invalidate the rule without appearing to substitute its judgment for that of the agency.[91] For example, some scholars argue that the Chamber of Commerce initiated the *Chamber of Commerce v. SEC* litigation despite its weak connection to the mutual fund industry in order to spur judicial activism with regard to SEC rulemaking.[92] Strict judicial re-

sources devoted to discovering what procedures and explanations will be required) must be taken from other concerns, such as assessing a rule's merits or conducting additional rulemaking proceedings.").

87. *See* WILLIAM F. WEST, ADMINISTRATIVE RULEMAKING: POLITICS AND PROCESSES 188 (1985).

88. *See* Cross, *supra* note 64, at 1046.

89. *See* WEST, *supra* note 87, at 188 ("[A]gency resource costs associated with judicialized procedures were so great that they often served as a disincentive to issue rules or as a lever which industry used to secure concessions on proposed regulations.").

90. *See* Cross, *supra* note 64, at 1064 (characterizing judicial review of agency rules as "a legislative bone thrown to the unsuccessful opponents of regulatory legislation" (quoting MASHAW, *supra* note 66, at 185)); *see also* Brett McDonnell, *Dynamic Statutory Interpretations and Sluggish Social Movements*, 85 CALIF. L. REV. 919, 920–21 (1997) (suggesting that political activists often choose to achieve short-run gains through judicial action rather than long-run gains through directly appealing to Congress because court action does not require mobilizing as many supporters).

91. *See* Jones, *supra* note 15, at 1325 (recognizing that successful industry group challenges to SEC rules in court "embolden regulated entities and the courts to meddle unnecessarily in otherwise sound rulemaking procedures"); McGarity, *supra* note 67, at 1401 (arguing that there is a significant danger of "judicial overreaching" when a court reviews a rule for the adequacy of its analysis because the line between procedural review and substantive review becomes blurred).

92. *See, e.g.*, Donald C. Langevoort, *The SEC as a Lawmaker: Choices About Investor Protection in the Face of Uncertainty*, 84 WASH. U. L. REV.

view of the SEC's cost-benefit analysis is especially troubling because it can create an avenue for interested parties to challenge SEC rules that are contrary to their political preferences, thus undermining one of the SEC's primary institutional advantages—political independence.[93]

The excessive costs that strict judicial review imposes on the SEC are particularly burdensome given the SEC's severe budget constraints. SEC Chairwoman Mary Schapiro stated that the SEC's current budget "is a strain that is already having an impact on our core mission—separate and apart from the new responsibilities that Congress gave us."[94] Furthermore, she estimates that the SEC needs to hire more than 800 new employees in order to implement the Dodd-Frank legislation but will be unable to do so without additional funding.[95] The litigation and procedural costs associated with stringent judicial review in combination with the SEC's inadequate budget ultimately ensure that the SEC will not be able to carry out its responsibilities, including the promulgation of rules that Congress has deemed essential to market recovery.[96] Furthermore, strict judicial review of cost-benefit analysis may have the perverse effect of forcing the SEC to devote more of its scarce resources to secure lawyers who can anticipate challenges and defend the rules, leaving fewer resources to address the substance of the rule.[97] Courts do not take into account the constraints on

1591, 1594 (2006) (suggesting that interest groups have broad policy objectives beyond an opposition to the particular rule when they bring legal challenges).

93. *See* Jones, *supra* note 15, at 1310, 1332 (noting that the SEC's insulation from political pressures enables it to fulfill its rulemaking role and that "[t]he ultimate effect of intrusive judicial review is to deprive the SEC of its ability to nimbly address new problems and challenges that arise in the financial markets").

94. Jim Puzzanghera, *SEC Chairwoman Warns of Budget Constraints as Republicans Look to Cut More*, L.A. TIMES (Feb. 4, 2011, 1:08 PM), http://latimesblogs.latimes.com/money_co/2011/02/sec-budget-schapiro-republicans-financial-reform-wall-street.html.

95. *Id.*

96. *See* James B. Stewart, *As a Watchdog Starves, Wall Street Is Tossed a Bone*, N.Y. TIMES (July 15, 2011), http://www.nytimes.com/2011/07/16/business/budget-cuts-to-sec-reduce-its-effectiveness.html?_r=1 (noting that the SEC's 2011 budget was frozen despite the vast expansion of its duties under the Dodd-Frank legislation and arguing that the House Appropriations Committee is "starving the agency responsible for bringing financial wrongdoers to justice").

97. *See* Cross, *supra* note 64, at 1039 (arguing that judicial challenges to agency rules have "spurred agencies to devote exorbitant levels of resources to lawyering," forcing agencies to focus more on the process than the substance of the regulation (citing Loren A. Smith, *Judicialization: The Twilight of Admin-*

SEC resources when evaluating a rule, demanding optimal cost-benefit analysis for the individual rule before it without considering the consequences on other important rulemaking initiatives.[98]

3. Reluctance to Modify Previously Promulgated Rules

Stringent judicial review of cost-benefit analysis makes the SEC unwilling to modify or repeal enacted rules.[99] Since the standard of judicial review is the same for repealing or amending old rules as enacting new rules, the SEC is as cautious about committing substantial resources to update previously enacted rules as it is to promulgate new rules.[100] Justice Breyer recognized that "[t]he stricter the review and the more clearly and convincingly the agency must explain the need for change, the more reluctant the agency will be to change the status quo."[101] Though agencies were designed to respond with agility to changing circumstances, the heavy burden of cost-benefit analysis imposed by stringent judicial review creates a disincentive for the SEC to reopen old rules or simplify their requirements.[102] Even if experience has proven that a rule amendment or repeal would be clearly beneficial and desirable, the SEC is likely to stick to its previous (and perhaps no longer tenable) position rather than exposing itself to substantial risk by "reopen[ing] a Pandora's box."[103] The continuation of previ-

istrative Law, 1985 DUKE L.J. 427, 429)); *see, e.g.*, J.W. Verret, *The Curious Case of the Proxy Access Rule*, TRUTH ON THE MARKET (July 22, 2011, 1:26 PM), http://truthonthemarket.com/2011/07/22/the-curious-case-of-the-proxy-access-rule/ (suggesting that the SEC's fundamental problem is that "it is an agency with too many lawyers and not enough economists").

98. *See* Cross, *supra* note 64, at 1042–43 (arguing that "judicial tunnel vision" causes courts to demand "unreasonably high standards for individual regulations" at a severe cost to the agency's other responsibilities).

99. *See* McGarity, *supra* note 67, at 1390.

100. *See id.* at 1419–20; *see also* Jerry L. Mashaw & David L. Harfst, *Regulation and Legal Culture: The Case of Motor Vehicle Safety*, 4 YALE J. ON REG. 257, 294 (1987) (arguing that judicial review of the decision process "gives enormous leverage to the status quo, whether the status quo is no rule . . . or the continuance of a rule").

101. Breyer, *supra* note 79, at 391; *see id.* at 391–93 (arguing that strict judicial review of agency rules creates a disincentive for agencies to update or even make minor improvements to previously promulgated rules).

102. *See* McGarity, *supra* note 67, at 1412 ("Having gone to the considerable effort of a successful rulemaking, the agencies are understandably reluctant to change their rules to adapt to experience with the rules or changed circumstances.").

103. Jones, *supra* note 15, at 1324 (arguing that the SEC's reluctance to amend rules reduces regulatory flexibility).

ously enacted rules is the likely result, even if they no longer comport with experience or are ineffective in light of modern financial markets.[104]

4. Disruption of the SEC's Mission and Statutory Foundation

Strict judicial review of cost-benefit analysis focuses too heavily on the SEC's obligation to consider efficiency, competition, and capital formation, while undercutting the SEC's primary founding mission to protect investors.[105] The growing importance of cost-benefit analysis distracts the courts from the SEC's primary goal of protecting investors because such analysis tends to focus on quantifiable economic results rather than intangible regulatory benefits.[106] Furthermore, strict judicial review of cost-benefit analyses has the general effect of reducing the quantity of rules the SEC is able or willing to promulgate, thereby undercutting Congress's protective goals.[107]

The recent D.C. Circuit opinions invalidating SEC rules for inadequate cost-benefit analyses demand much more extensive

104. *See* McGarity, *supra* note 67, at 1390 ("Once an agency has endured the considerable expense and turmoil of writing a rule, it has every incentive to leave well enough alone. Once the legal and political dust has settled, an agency is inclined to let sleeping dogs lie. Even when forced by statute to revisit existing rules, an agency is very reluctant to change them.").

105. *See The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 27. The requirement that the SEC consider a rule's effect on capital formation, efficiency, and competition was not added until 1996. *See* H.R. REP. NO. 104-622, at 24 (1996).

106. Rose-Ackerman, *supra* note 32, at 347 ("Many regulations are meant to take account of values over and above economic efficiency. . . . A pure cost-benefit test, with its omission of distributive, fairness, and procedural concerns, would not encompass the purposes of these statutory mandates."). For example, the EPA was reluctant to impose any regulations on hazardous air pollutants because it feared strict judicial review would invalidate the rule and, consequently, failed to protect the public from health risks imposed by such pollutants. *See* Cross, *supra* note 64, at 1050 ("If courts insist that 'regulation, once undertaken, must be draconian, the government avoids regulating many substances at all.'" (quoting CASS R. SUNSTEIN, AFTER THE RIGHTS REVOLUTION 92 (1990))).

107. *See* Cross, *supra* note 64, at 1050 ("[J]udicial review perversely undermines the protective goals of statutes by deterring regulation."); *see also* Letter from Jeff Mahoney, Gen. Counsel, Council of Institutional Investors, to Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n 2 (Aug. 19, 2011), *available at* http://www.cii.org/UserFiles/file/resource%20center/correspondence/2011/08-1911%20Letter%20to%20SEC%20on%20Proxy%20Access%20%28Final%29.pdf (arguing that the court's decision in *Business Roundtable v. SEC* prevented the SEC from implementing "a critically important rule designed to benefit long-term investors and the markets").

procedural requirements of the SEC than the statutes provide.[108] The SEC is statutorily mandated to consider the effects of its rules on competition, efficiency, and capital formation[109] and the judiciary has the authority to invalidate such rules only if the rules are arbitrary and capricious.[110] Yet the court has implied procedural requirements to the SEC's rulemaking process that are not expressed in the guiding statutes,[111] demanding much more extensive cost-benefit analysis than the statutes envisioned.[112] Such judicial activism interferes with congressional intent, creates uncertainty in the rulemaking process, and makes the SEC more vulnerable to the policy preferences of courts and interest groups.[113]

B. Alternative Approaches for Making Cost-Benefit Analysis a More Useful Rulemaking Tool

The inconsistent but increasingly stringent judicial review of SEC cost-benefit analyses has resulted in substantial problems and uncertainty that must be addressed for the SEC to effectively achieve its congressionally delegated responsibili-

108. *See, e.g.*, Brown, *supra* note 6, at 1 ("The [*Business Roundtable v. SEC*] decision far exceeded the standards set out by Congress and the courts with respect to cost/benefit analysis.").

109. Securities Exchange Act of 1934, 15 U.S.C. § 78c(f) (2006); Investment Company Act of 1940, 15 U.S.C. § 80a-2(c) (2006).

110. Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2011).

111. Antonin Scalia, *Back to Basics: Making Law Without Making Rules*, REGULATION, July/Aug. 1981, at 25, 26 ("The courts have attached many procedural requirements not explicit in the APA. Th[i]s include[s] the requirement[] . . . that the agency justify the rule in detail and respond to all substantial objections raised by the public comments. The 'arbitrary and capricious' standard for judicial review has evolved from a lick-and-a-promise to a 'hard look' by appellate courts.").

112. *See* Letter from Jeff Mahoney to Mary L. Schapiro, *supra* note 107, at 1 ("The [*Business Roundtable v. SEC*] decision reflects a failure to abide by the standards applicable to judicial review of agency determinations and, in particular, agency cost-benefit analysis."); *see also* Richard J. Pierce, Jr., *Two Problems in Administrative Law: Political Polarity on the District of Columbia Circuit and Judicial Deterrence of Agency Rulemaking*, 1988 DUKE L.J. 300, 310 ("In order to survive judicial review, an agency's 'concise general' statement of basis and purpose must deal comprehensively and in detail with each issue raised in comments, no matter how trivial that issue appears to the agency.").

113. *See* Pierce, *supra* note 112, at 301 (noting that the D.C. Circuit substitutes its judgment for that of the agency and "imposes rigorous requirements that agencies support each element of a policy decision with detailed discussion of factual predicates and comprehensive reasoning from factual premises to policy conclusions").

ties.[114] Despite the problems that cost-benefit analysis creates when reviewed under an improperly strict standard, it can be a valuable tool in the rulemaking process that helps to identify the relative advantages of various regulatory options.[115] This section discusses three possible approaches to mitigate the problems caused by strict judicial review of SEC cost-benefit analysis, thereby allowing cost-benefit analysis to become an instrument that benefits rulemaking, rather than impeding it. This section concludes that none of the three approaches discussed provide a realistic solution. The optimal solution is discussed in Part III.

1. Third Party Review of SEC Rules Prior to Enactment

One approach to minimizing the likelihood of judicial invalidation of SEC rules, and the destabilizing effects associated, is to require the SEC to submit all rules that it intends to implement to a third party that will review and approve the cost-benefit analysis supporting each rule.[116] The best way to implement this approach is to give the Office of Management and Budget (OMB) oversight responsibility. The OMB is a cabinet-level executive office that assists the President in supervising administrative agencies.[117] The OMB may be particularly well-suited for this role because it is already responsible for reviewing executive agencies' proposed regulations that are economically significant to ensure that the agency has evaluated alternatives and assessed the costs and benefits.[118] In its 2011

114. *See supra* Part II.A (discussing the problems associated with stringent judicial review of SEC cost-benefit analysis).

115. *See* 1 KOCH, *supra* note 14, § 4:51 (recognizing that cost-benefit analysis assists in rulemaking but cannot replace the rulemaking decision).

116. *See* McGarity, *supra* note 67, at 1448–50 (discussing executive review of agency rulemaking).

117. *The Mission and Structure of the Office of Management and Budget*, OFF. OF MGMT. & BUDGET, http://www.whitehouse.gov/omb/organization_mission/ (last visited Oct. 17, 2012).

118. *See id. See generally* Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993) (directing the OMB to review economically significant rules—i.e., expected annual economic effect of $100 million or greater—proposed by executive agencies to ensure that the cost-benefit analysis is adequate and that the regulations are consistent with the President's priorities and with the regulations promulgated by other agencies). As an independent agency, the SEC is not included in the executive order giving the OMB regulatory review authority over proposed rules. *See* CURTIS W. COPELAND, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 17 (2011), *available at* http://www.fas.org/sgp/crs/misc/R41974.pdf.

Report to Congress, the OMB stated that it would be "desirable to obtain better information on the benefits and costs of the rules issued by independent regulatory agencies" as well.[119] Making the OMB responsible for reviewing SEC rules has several advantages. First, it should improve the likelihood that SEC rules will be upheld in court by putting the cost-benefit analysis through an additional level of review before the rule is promulgated.[120] Second, the President could implement this approach by amending the executive order requiring OMB review of other agencies' rulemaking to include the SEC, which would be much easier to accomplish than a solution that requires congressional action.[121] Third, the executive order's limited application to economically significant rules should allow the SEC to retain some flexibility and discretion over the analyses it conducts for minor rules.[122] Finally, the OMB can create consistency and avoid redundancy across agency regulations, ensuring a more coherent national policy.[123]

There are serious concerns with conferring regulatory review power over SEC rules to the OMB. Such supervisory power gives the President a substantial amount of control, which may undermine the SEC's independence.[124] One of the OMB's regulatory review objectives is to ensure "adherence to . . . the

119. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, 2011 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 31 (2011).

120. *See* Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 830 (2003) (arguing that OMB review of agency rules provides a "quality check on pending rules"); *see also* Elaine Buckberg et al., *Will Court Short-Circuit Dodd-Frank?*, POLITICO (Aug. 15, 2011), http://www.politico.com/news/stories/0811/61363.html#ixzzlV6GiBAVP ("Better regulation, able to survive review by the D.C. Circuit Court, will likely require incorporating substantive and independent economic analysis into the development of every rule as standard operating procedure.").

121. *See* COPELAND, *supra* note 118, at 36 n.115 (noting that the decision not to include independent agencies in OMB review in the past was politically, not legally, motivated).

122. *See* Exec. Order No. 12,866, 58 Fed. Reg. at 51,737 (excluding all independent regulatory agencies from the scope of the executive order).

123. *See* Croley, *supra* note 120, at 830–31; McGarity, *supra* note 67, at 1430 ("Substantive presidential review can help ensure consistency in policy implementation across the executive branch and thereby help prevent agencies from acting at cross-purposes with one another.").

124. *See* McGarity, *supra* note 67, at 1429 ("[T]he OMB review process became the primary vehicle for presidential micro-management of the rulemaking process.").

President's priorities and commitments."[125] This objective, along with the OMB's position as a cabinet-level executive office, creates a clear danger that OMB review conclusions will be influenced by how well the proposed regulation comports to presidential policy preferences.[126] Though the SEC falls within the executive branch as an independent agency, review of SEC rules implementing congressional directives by an executive office implicates separation of powers concerns because it gives the President authority over rulemaking as well as enforcement.[127] In exchange for the political insulation necessary for the SEC to effectively promulgate rules, as an independent agency it is subordinated to all three branches of government—Congress delegates its rulemaking authority, the President enforces its rules, and the judiciary reviews its rules to ensure that they comply with the statutory authorization.[128] Additionally, OMB review can significantly aggravate rulemaking delays and costs.[129] A close review of the cost-benefit analyses behind rules proposed by many agencies necessarily postpones the enactment of desired regulations.[130] Furthermore, even rules that are critically important to the agency may be low in the OMB's priorities, resulting in further delay.[131] Worse yet, the OMB's political influences could cause it to threaten delay in order to extort the agency into conceding to substantive changes to the rule.[132] In sum, OMB review of SEC cost-benefit

125. *The Mission and Structure of the Office of Management and Budget*, *supra* note 117.

126. *See* McGarity, *supra* note 67, at 1432–33 (noting that "OMB staffers are not reluctant to supplant congressional policy judgments with their own policy preferences," which can significantly alter the substance of the rule).

127. *See* Croley, *supra* note 120, at 832 ("[A]ctivist presidential oversight is meddlesome, for Congress delegates regulatory power to agencies, not to the president, and while the president is charged with executing the law, that constitutional charge does not justify presidential reshaping of agencies' regulatory initiatives.").

128. Certain aspects of executive enforcement are particularly controversial. *See id.* at 833 (arguing that congressionally granted agency discretion should not be supplanted by presidential preferences); Peter L. Strauss, *Presidential Rulemaking*, 72 CHI.-KENT L. REV. 965, 983–84 (1997) (arguing that the President should not act "as if rulemakings were *his* rulemakings").

129. *See supra* Part II.A.1 (rulemaking delay).

130. *See* McGarity, *supra* note 67, at 1432 (noting that OMB review of large regulatory projects can take years).

131. *See id.* at 1431.

132. *See id.* at 1433 (noting that agencies may "covertly allow their decisions to be guided by considerations that Congress has precluded or to reflect extrastatutory policies" in order to salvage some remnant of the rule from OMB review).

analysis is not a viable solution because it magnifies problems of rulemaking delays and costs and involves significant separation of powers and independence risks, which outweigh any consistency benefits or negligible improvement in cost-benefit analysis quality.

2. Increase the SEC's Budget to Support Comprehensive Cost-Benefit Analysis

Another possible approach to alleviating the negative effects of aggressive judicial review of cost-benefit analysis is to boost the SEC's budget to accommodate the increased burden imposed by conducting a comprehensive cost-benefit analysis for each rule. An important reason behind the SEC's failure to effectively fulfill its responsibilities is its severe budget constraints.[133] Congress cannot realistically expect the SEC to be successful when it delegates massive rulemaking tasks but fails to provide enough resources to complete them.[134] Though increased budget appropriations would go a long way in aiding the overworked SEC staff, it is highly unlikely in a time of debt crisis and opposition to tax increases that the SEC's tight budget will change anytime soon.[135] The SEC's 2011 budget was frozen despite a significant increase in its responsibilities.[136] Not only is the SEC unlikely to see an increase in its budget large enough to address the problems of rulemaking delay and cost, but budgetary relief alone would not be enough to address the disruption of the SEC's mission that undue emphasis on cost-benefit analysis creates.

3. Enact Legislation Heightening the SEC's Cost-Benefit Analysis Obligations

Another approach to managing the problems associated with aggressive judicial review of SEC cost-benefit analysis is to statutorily require the SEC to conduct a comprehensive cost-benefit analysis for each rule, essentially codifying the most stringent judicial opinions. A bill introduced in June 2011 proposes to take this approach by amending the Securities Exchange Act of 1934 to require the SEC to conduct a cost-benefit analysis according to a list of enumerated considerations before

133. *See supra* Part II.A.2 (rulemaking costs).
134. *See* McGarity, *supra* note 67, at 1437.
135. *See id.*
136. *See* Stewart, *supra* note 96.

promulgating any rule.[137] The bill also requires the SEC to periodically review previously enacted rules to determine whether they are "outmoded, ineffective, insufficient, or excessively burdensome,"[138] which helps to ensure the continued efficacy of existing rules. The greatest benefit of this approach is its potential to alleviate uncertainty, which underlies many of the problems discussed in Part II.A.[139] Furthermore, a clear definition of cost-benefit analysis requirements may help to curtail the practice of judicially challenging a rule to accomplish the policy objectives of interest groups, which in turn would decrease litigation costs.[140]

Though this approach appears beneficial on its face, multiple complicating factors undercut its viability. The most fatal defect is that it is impossible for the SEC to comply with these heightened statutory requirements without a substantial budgetary increase, which is highly unlikely to occur.[141] This approach is extremely expensive to implement and likely will not produce a significant improvement in the quality of relatively minor rules.[142] Additionally, requiring such a high level of cost-benefit analysis for every rule inevitably amplifies problems of rulemaking delay.[143] Finally, it is questionable whether codifying specific requirements can adequately address the ever-changing application of cost-benefit analysis to a broad range of rules. Statutorily mandating heightened cost-benefit analysis obligations for the SEC is not a workable option because it amplifies the problems of rulemaking delay and cost and attempts

137. *See* SEC Regulatory Accountability Act, H.R. 2308, 112th Cong. § 2 (2011).

138. *Id.* § 2(e)(4).

139. *See supra* Part II.A; *see also* Friedman et al., *supra* note 36, at 657–58 (arguing that uncertainty leads to an ossification of the rulemaking process).

140. *See supra* Part II.A.2 (discussing interest groups' use of judicial review to advance policy preferences); *see also* Langevoort, *supra* note 92, at 1594.

141. *See supra* Part II.B.2 (discussing the SEC's budget constraints); *see also* Arthur Levitt, Jr., *Don't Gut the SEC*, N.Y. TIMES (Aug. 7, 2011), http://www.nytimes.com/2011/08/08/opinion/dont-gut-the-sec.html ("What we need is not a requirement to do more cost-benefit analysis, but better tools to do the work well and with more precision. Otherwise, cost-benefit analysis will become a permanent and immovable wall to future efforts to improve the stability, safety and transparency of financial markets.").

142. *See* COPELAND, *supra* note 118, at 35.

143. *See supra* Part II.A.1 (rulemaking delay); *see also* COPELAND, *supra* note 118, at 35 (arguing that requiring a cost-benefit analysis for all rules without respect to their size or importance would "delay hundreds of non-significant, administrative rules that industry and the public would often like to see in place (e.g., traffic separation schedules and temporary safety zones)").

to expressly define a process that essentially boils down to case-by-case judicial discretion.

In light of the significant problems threatening the SEC's long-term effectiveness and the failures of various approaches to solve them, Part III endorses a final approach that provides the optimal balance of agency discretion tempered by appropriate checks on the arbitrary exercise of its discretion.

III. CONGRESS SHOULD LIMIT THE SCOPE OF THE SEC'S REQUIRED COST-BENEFIT ANALYSIS

The current state of judicial review of SEC cost-benefit analysis is one of debilitating uncertainty that subjects SEC rulemaking to an impossibly high standard.[144] A viable solution to this situation must promote greater consistency and predictability in judicial review of SEC cost-benefit analysis, enabling the SEC to efficiently fulfill its primary mission of protecting investors.[145] Accordingly, this Note argues that the best solution is a clear statement by Congress expressly limiting the required scope of SEC cost-benefit analysis.[146] A similar statement by the Supreme Court would be the next best solution. Such action is necessary to ensure that cost-benefit analysis of SEC rules is a worthwhile and productive exercise.

A difficulty inherent to this approach is appropriately defining the limitation on cost-benefit analysis requirements. One method is to mandate cost-benefit analysis only for "economically significant" rules[147] while giving the SEC discretion to conduct such an analysis for other rules. Judicial review of cost-benefit analysis that the SEC conducts could be expressly lim-

144. *See* Keller, *supra* note 63 (discussing the *Business Roundtable v. SEC* decision and commenting that "[t]here are many (and I am one) who, although believing the SEC acted unwisely in adopting proxy access, at least in the form of [the proxy access rule], are concerned about the high, nigh impossible, bar the Court set that could put in jeopardy most SEC rulemaking of any complexity or controversy").

145. *See The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 27.

146. *See generally* McGarity, *supra* note 67, at 1462 ("Although informal rulemaking should never be entirely free of constraints imposed by the President, Congress, and the courts, a successful future for this decisionmaking device requires that all three branches 'back off' and let it function with greater freedom and flexibility.").

147. The executive order requiring OMB review of executive agency rules similarly limits OMB review to rules that are economically significant (i.e., rules with an annual economic effect greater than $100 million). *See* Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993).

ited to enforcing clear congressional directives and courts could be required to defer to the SEC's interpretation of ambiguous statutory terms and to its conclusions when empirical findings are unavailable or uncertain.[148] Though there is significant precedential support for these limitations on judicial review,[149] the failure of the Supreme Court to expressly define judicial review of agency cost-benefit analysis,[150] along with the significant degree of inconsistency within the D.C. Circuit alone,[151] clearly demonstrates the need for authoritative guidance in this area.

One avenue to implement this solution is for the Supreme Court to reemphasize the principle of judicial deference specifically in the context of cost-benefit analysis.[152] Supreme Court action has the potential advantage of being relatively swift, provided that the Court grants certiorari to a case raising this issue. However, it may not be effective in ensuring consistency among the lower courts, especially given the fact that appellate courts have a history of expanding the role of judicial review in agency rulemaking despite Supreme Court efforts to restrict it.[153] As a result, Supreme Court action may not be a complete

148. *See* MASHAW, *supra* note 66, at 166 ("Legal review by the courts should assure that authority exercised is authority legitimately conferred, that it is neither misused nor neglected, and that the basic norms of participatory fairness and substantive nonarbitrariness are respected."); Pierce, *supra* note 112, at 322, 327 (arguing that courts should give agencies a high degree of deference when reviewing their findings of fact "in conditions of uncertainty" and should "confine their role to enforcing those policy decisions Congress actually has made").

149. *See, e.g.*, Greenbaum v. EPA, 370 F.3d 527, 542 (6th Cir. 2004) (finding the APA's arbitrariness standard satisfied when there is a "rational connection between the facts found and the choice made" (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962))); Bluewater Network v. EPA, 370 F.3d 1, 11 (D.C. Cir. 2004) (same); Anderson v. U.S. Dep't of Transp., 213 F.3d 422, 423 (8th Cir. 2000) (same); Office of Commc'n of United Church of Christ v. FCC, 707 F.2d 1413, 1440 (D.C. Cir. 1983) ("[C]ost-benefit analyses epitomize the types of decisions that are most appropriately entrusted to the expertise of an agency; certainly appellate briefs and arguments would ill-equip a court that would seek to balance for itself the myriad considerations involved in any complex administrative policy decision."). A court is not permitted to substitute its own policy judgment for that of the agency. FCC v. Fox Television Stations, Inc., 556 U.S. 502, 513–14 (2009).

150. *See* 1 KOCH, *supra* note 14, § 4:51(3) ("The Supreme Court has engaged in a rather ambiguous treatment of cost/benefit analysis.").

151. *See supra* Part I.C.

152. *See* Pierce, *supra* note 112, at 327–28 (arguing that "the Supreme Court must play a significant role" in solving the problems caused by courts "imposing unrealistic requirements on agencies").

153. *See id.* at 304 ("[T]he D.C. Circuit consistently expanded the role of

solution, though it would certainly provide a much-needed start.

A second way to implement this solution is for Congress to codify the suggested limitations on judicial review of SEC cost-benefit analysis.[154] The most significant drawback of this approach is that it requires the political momentum necessary to pass federal legislation. However, Congress's desire for the SEC to enact the Dodd-Frank legislation in a timely and cost-effective manner may make this legislation more appealing to lawmakers.[155] Furthermore, congressional action is clearly authoritative and is more likely to change the way courts review the cost-benefit analyses supporting SEC rules.

Either congressional or Supreme Court implementation of this solution would promote significant improvements to the SEC's current rulemaking process by reducing rulemaking delays and costs associated with the uncertainty surrounding judicial review, thus giving the SEC more flexibility in revisiting old rules and carrying out its founding mission without undue fears of aggressive judicial review. Though congressional action is the preferable alternative given its binding impact, Supreme Court action is also a desirable approach, especially if it is more likely to occur.

CONCLUSION

The inconsistent and increasingly stringent standards of judicial review imposed on SEC cost-benefit analyses have created significant uncertainty in the rulemaking process. This uncertainty over judicial requirements of cost-benefit analysis causes the SEC to conduct extensive cost-benefit analyses for all of its rules in order to protect them from risk of invalidation. The result is substantial and debilitating delays in rule promulgation, rapidly rising costs, a reluctance to update existing rules, and distraction away from the SEC's primary mission—protecting investors. The SEC's massive rulemaking responsibility under the Dodd-Frank legislation only aggravates these

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the judiciary in policymaking, while the Supreme Court attempted to force the D.C. Circuit to assume a less expansive role in government policymaking. The Supreme Court's efforts to date have not been successful.").

154. *See* McGarity, *supra* note 67, at 1443 (noting that Congress could amend the APA to limit the extent of cost-benefit analysis required of agencies).

155. *See Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, *supra* note 10 (noting the multitude of Dodd-Frank provisions that require expedient SEC rulemaking).

problems, which collectively endanger the continuing efficacy of the SEC.

Judicial review of SEC cost-benefit analysis must be clearly constrained in a way that requires courts to defer to the SEC's empirical findings. Congressional enactment of a statement limiting the reach of judicial review over agency cost-benefit analysis is likely to be the effective avenue for implementing the desired change. However, Supreme Court action applying such a limitation would also go a long way toward tempering the appellate courts' imposition of excessive demands on SEC cost-benefit analysis. Either alternative would substantially increase predictability and consistency in the rulemaking process, establish more realistic expectations for SEC rules, and help ensure that SEC use of cost-benefit analysis for a given rule itself passes a cost-benefit test.