ESSAY

COULD THE SEC SAVE BASIC THROUGH RULEMAKING?

ANEIL KOVALI

INTRODUCTION

Securities and Exchange Commission (SEC) Rule 10b-5 forbids material misstatements or omissions in connection with the purchase or sale of a security. The federal courts have held that this rule implies a cause of action that permits private plaintiffs to recover damages where they can show that a misrepresentation or omission caused them to suffer a loss because they traded in reliance on it.

In Basic Inc. v. Levinson, the Supreme Court held that under certain circumstances, investor-plaintiffs could satisfy the reliance requirement by invoking a rebuttable presumption. Under Basic’s fraud-on-the-market theory, anyone who purchases or sells a security traded on a market that efficiently incorporates information implicitly relies on the integrity of the security’s market price. Thus, if the market price of such a security is affected by a misrepresentation, persons transacting in the security are presumed to have relied on that misrepresentation. The Basic presumption facilitates class actions, since it replaces individualized inquiries into whether each plaintiff was aware of and relied upon a misrepresentation.

1 Associate, Wachtell, Lipton, Rosen & Katz. The views expressed in this Essay are my own, and do not necessarily represent the views of the firm or its clients. I thank Joseph Grundfest, Alexander Sarch, Bianca Nunes, and Jessica Rice for thoughtful comments and suggestions. Any remaining errors are mine.

4 Id. at 247.
with a common inquiry into the efficiency of the market and the nature of the misrepresentation. Because of the importance of class actions to the nation’s securities regime, Basic has become a foundational securities law doctrine.

But Basic has also faced substantial criticism. This criticism bubbled over in Amgen Inc. v. Connecticut Retirement Plans & Trust Funds, where four Justices signaled their willingness to reconsider Basic. Soon after, the Supreme Court granted certiorari in Halliburton Co. v. Erica P. John Fund, Inc., and is set to decide the continuing validity of Basic this Term. The existing regime for enforcement of the securities laws is thus under serious threat, and the question for the SEC is whether the agency can do anything about it.

The SEC has signed on to an amicus brief urging the Court to reaffirm Basic, but the agency’s Section 10(b) rulemaking authority suggests that it may have a more powerful tool at its disposal. In recent years, other agencies have reacted to judicial threats to their agenda through rulemaking. When the Supreme Court seemed poised to hold that disparate impact theories of relief were not available under the Fair Housing Act, the U.S. Department of Housing and Urban Development (HUD) reacted by proposing a rule that would resolve the statutory ambiguity in favor of the disparate impact theory. Because of the familiar administrative law

5 Amgen, 133 S. Ct. at 1193.
6 See id. at 1204 (Alito, J., concurring) (inviting a case in which the issue is properly presented); id. at 1204, 1206 (Scalia, J., dissenting) (describing Basic as an “arguably regrettable” “four-Justice opinion” whose rule is “found nowhere in the United States Code or in the common law of fraud or deception”); id. at 1208 n.4 (Thomas, J., dissenting) (stating, in a portion of the opinion joined by Justices Scalia and Kennedy, that “[t]he Basic decision itself is questionable”).
7 134 S. Ct. 616 (2013). In the interest of full disclosure, prior to my employment at Wachtell, Lipton, Rosen & Katz, attorneys at the firm submitted a brief on behalf of amici in Halliburton, urging that the Court reject the Basic presumption. See Brief for Former SEC Commissioners & Officials & Law Professors as Amici Curiae Supporting Petitioners, Halliburton, 134 S. Ct. 636 (No. 13-317), 2014 WL 69391.
9 See Brief for the United States as Amicus Curiae Supporting Respondent at 7-13, Halliburton, 134 S. Ct. 636 (No. 13-317), 2014 WL 466853.
10 See 42 U.S.C. § 3604 (2006) (making it unlawful “[t]o refuse to sell or rent after the making of a bona fide offer . . . or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin”). On November 7, 2011, the Court granted certiorari in Magnier v. Gallagher to address whether disparate impact claims were cognizable under the Act. 132 S. Ct. 548 (2011). It had recently concluded that a similarly worded provision in the Age Discrimination in Employment Act, 29 U.S.C. § 623(a) (2012), did not permit disparate impact theories of relief. See Gross v. FBL Fin. Servs., Inc., 129 S. Ct. 2343, 2350 (2009). I assisted counsel for the respondent in Magnier, as part of Harvard Law School’s Supreme Court Clinic.
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doctrine of *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 12 HUD’s rulemaking had the potential to reshape the outcome of the case. 13 Under *Chevron*, courts will defer to an agency’s reasonable resolution of a statutory ambiguity, provided that Congress empowered the agency to speak to the issue with the force of law. 14 If the Supreme Court had held that the Fair Housing Act was at least ambiguous as to the applicability of the disparate impact theory, it may well have found itself obligated to defer to the agency’s formally stated position on the question. Similarly, the SEC might attempt through rulemaking to fortify *Basic* before the Supreme Court decides *Halliburton*, or even to revive *Basic* after the decision if it suffers a defeat. 15

This Essay considers the SEC’s capacity to defend *Basic*. Although the question is close, there are substantial grounds for skepticism of the SEC’s power in this area. Absent a rulemaking, it seems unlikely that the SEC’s position will command material deference from the Supreme Court. Rulemaking may not change this outcome. Although several scholars have concluded that the SEC has rulemaking authority over the private right of action inferred from Rule 10b-5, the terms of Congress’s grant of rulemaking authority to the SEC suggest that it has not been delegated such authority. However, if the SEC can clear that hurdle, it may succeed in obtaining its favored result.

I. CURRENT FRAMEWORK

Section 10(b) of the Securities Exchange Act of 1934 provides that it is unlawful for any person “[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.” 16 Without additional action by the SEC, the statute would not

13 The Court never decided *Magnier* because the parties agreed to dismiss the case. See Magnier v. Gallagher, 132 S. Ct. 1306 (2012) (dismissing writ of certiorari); Lyle Denniston, *Fair Housing Case Dismissed*, SCOTUSBLOG (Feb. 10, 2012), http://www.scotusblog.com/2012/02/fair-housing-case-dismissed (noting that the position of petitioners—city officials in St. Paul, Minnesota—was weakened by HUD’s proposed rulemaking, which was designed to clearly establish disparate impact liability).
14 *Chevron*, 467 U.S. at 842-44.
15 See Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005) (“A court’s prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion.”).
forbid anything. It simply grants the SEC the authority to promulgate rules that prohibit manipulative or deceptive conduct.

The SEC exercised this authority by promulgating Rule 10b-5, which makes it unlawful to, in connection with the purchase or sale of a security, “make any untrue statement of a material fact,” or “engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.” Rule 10b-5 is the true acorn from which the judicial oak of the private right of action has grown. Without Rule 10b-5, Section 10(b) would not impose any duties, and thus there would be no duties for litigants to enforce through private lawsuits.

Because of this regulatory structure, the SEC has a plausible claim to deference as to the validity of Basic even without further rulemaking. Under Bowles v. Seminole Rock & Sand Co., courts will ordinarily defer to an agency’s interpretation of its own regulation unless that interpretation “is plainly erroneous or inconsistent with the regulation.” Unlike its more famous cousin, Chevron deference, Seminole Rock deference’s availability does not depend on whether the agency expressed its interpretation formally or informally: there would be little purpose to a doctrine calling for deference to an agency’s interpretation of its rules, but only if the agency expressed its interpretation through more rules. To the extent that the Basic doctrine can be framed as resolving an ambiguity in Rule 10b-5, Seminole Rock would suggest that courts should defer to the SEC’s position on its validity, even though that position was expressed only in an amicus brief.

However, the SEC has not had much luck invoking Seminole Rock. In a recent opinion, the Supreme Court observed that it had “previously expressed skepticism over the degree to which the SEC should receive deference regarding the [Rule 10b-5] private right of action.”

This skepticism is well grounded in more general administrative law doctrines. For example, an agency is not entitled to Seminole Rock deference where its regulation merely “parrot[s]” the text of the underlying statute.

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19 See Gonzales v. Oregon, 546 U.S. 243, 258 (2006) (noting that, as a prerequisite to Chevron deference, “the rule must be promulgated pursuant to authority Congress has delegated”).
20 Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2303 n.8 (2011) (citing Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 41 n.27 (1977)).
21 See Gonzales, 546 U.S. at 257 (declining to give Auer deference to the Attorney General’s interpretation of his own regulation).
Although the text of Rule 10b-5 does not copy the text of Section 10(b),\(^{22}\) the antiparroting principle is nonetheless implicated. The question before the Court is the validity of the Basic presumption, and no textual difference between Rule 10b-5 and Section 10(b) speaks to that question.\(^{23}\) In other words, to the extent that Section 10(b) is ambiguous as to the validity of Basic, Rule 10b-5 parrots that ambiguity.\(^{24}\) It would thus be difficult for the SEC to frame its position on Basic as an interpretation of Rule 10b-5 and claim the benefits of Seminole Rock deference. Instead, an informal statement on Basic’s validity would merely be an informal attempt to resolve an ambiguity in Section 10(b) and would attract little deference.\(^{25}\)

Seminole Rock has also seen its share of criticism. In Justice Antonin Scalia’s view, Seminole Rock disrespects the principle of separation of powers by allowing agencies to exercise both lawmaking and interpretive authority: an agency exercises lawmaking power by promulgating a rule, and Seminole Rock permits the agency to exercise interpretive power by supplying the controlling interpretation of that rule.\(^{26}\) In a separate concurrence, Chief Justice John Roberts acknowledged Justice Scalia’s argument and invited future litigants to bring the Supreme Court a case in which “the issue is properly raised and argued.”\(^{27}\) Chief Justice Roberts may be the swing vote in Halliburton,\(^{28}\) and his apparent sympathy for the separation-of-powers criticism of Seminole Rock may well lead him to conclude that deference is not warranted.

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\(^{22}\) If anything, the text of Rule 10b-5 parrots the text of section 17(a) of the Securities Act of 1933. See 15 U.S.C. § 77q(a) (2012); Joseph A. Grundfest, Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission’s Authority, 107 HARV. L. REV. 961, 980 n.71 (1994) (providing a blackline comparison between Rule 10b-5 and section 17(a)).

\(^{23}\) See Gonzales, 546 U.S. at 257 (declining to give Auer deference—i.e., Seminole Rock deference—in part because the government did “not suggest that its interpretation turned[ed] on any difference between the statutory and regulatory language”); see also Anell Kovvali, Seminole Rock and the Separation of Powers, 36 HARV. J.L. & PUB. POL’Y 849, 864 (2011).

\(^{24}\) Indeed, Rule 10b-5 arguably is more hostile to Basic than Section 10(b). Unlike Section 10(b), Rule 10b-5 refers to “deceit,” which is a traditional common law tort with the “core requirement of reliance.” John C.P. Goldberg & Benjamin C. Zipursky, The Fraud-on-the-Market Tort, 66 VAND. L. REV. 1755, 1757 (2013). By contrast, Section 10(b) speaks more generally of “manipulative or deceptive device[s].” 15 U.S.C. § 78j(b) (2012).

\(^{25}\) See, e.g., Gonzales, 546 U.S. at 258 (determining that the Attorney General’s informal interpretation was not entitled to deference under Chevron).


\(^{27}\) Id. at 1338-39 (Roberts, C.J., concurring). Chief Justice Roberts was joined by Justice Alito.

\(^{28}\) Chief Justice Roberts did not join any opinion criticizing Basic in the Amgen case, see Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013), but he is often aligned with the four Justices who did.
Indeed, an SEC interpretation of Rule 10b-5 would offer a particularly stark illustration of Justice Scalia’s views. Not all agency interpretations of agency rules amount to a combination of interpretive and lawmaking power. Often, an agency rule merely clarifies a duty imposed by the underlying statute, and is thus a product of interpretive power alone. An agency interpretation of such a rule does not present the dangers Justice Scalia identified. But, as noted above, Section 10(b), standing alone, imposes no duties. Rule 10b-5 is thus a product of lawmaking power in its purest sense, since it creates a duty where none existed before. It follows that SEC interpretations of Rule 10b-5 are at the core of the separation-of-powers critique of Seminole Rock. Cases based on Rule 10b-5 also have potential rhetorical value to those who believe that new restraints on agency power are necessary. It would be difficult to describe Rule 10b-5 as an attempt to clarify Section 10(b), since it offers little additional guidance. Instead, it represents an agency’s attempt to exercise the full extent of its delegated power.

Even if the Court denies the SEC Seminole Rock deference, the SEC’s position should attract deference under Skidmore v. Swift & Co. Under Skidmore, courts recognize that an agency’s position has the “power to persuade,” given the agency’s experience and expertise in administering a particular statutory regime. Yet there is little reason to believe that Skidmore will make the difference in the Court’s consideration of Basic. First, Skidmore is limited in its effect. The Supreme Court has recognized that even a law review article is “relevant to the extent it is persuasive”; extending the same courtesy to an agency’s position barely qualifies as deference. Given the passions surrounding Basic, it is unlikely that a Justice inclined to eliminate the presumption would be persuaded to rule otherwise because of Skidmore. Second, unlike Seminole Rock, the weight accorded an agency interpretation under Skidmore depends in part on the

29 See Kovvali, supra note 23, at 849-50 (arguing that the separation-of-powers criticism of Seminole Rock applies only to statutes that “allow an agency to unify the powers of lawmaking and law-exposition”).
30 See supra text accompanying notes 16-17.
31 323 U.S. 134 (1944).
32 Id. at 140.
34 See Peter L. Strauss, “Defersence” Is Too Confusing—Let’s Call Them “Chevron Space” and “Skidmore Weight,” 112 COLUM. L. REV. 1143, 1144-46 (2012) (suggesting that Skidmore is qualitatively different from deference doctrines like Chevron, since under Skidmore the agency’s position serves merely “as an element of independent judicial judgment”).
process that the agency used to announce its position. An agency’s amicus brief has only limited power to persuade, since it does not incorporate meaningful feedback from the public.

In sum, it is unlikely that the SEC would be able to alter the holding of Halliburton absent rulemaking.

II. RULEMAKING AND ITS CONSEQUENCES

The SEC could use its power under Section 10(b) to promulgate a notice-and-comment rule allowing private plaintiffs to invoke the Basic presumption. Such a rule would warrant a different analysis. As noted above, Chevron commands the courts to defer to certain agency interpretations of statutes. The Chevron analysis begins with a “Step Zero” inquiry, which asks whether Congress intended the agency’s ruling to have the “force of law.” If Step Zero is satisfied, courts proceed with the Chevron two-step, asking first whether the statute speaks clearly to the question at issue and second, if the statute does not provide a clear answer, whether the agency’s resolution of the statutory ambiguity is reasonable. Step Zero may be the tougher test for the SEC: the text of Section 10(b) provides reasons for skepticism as to the SEC’s authority to speak to the validity of the Basic doctrine with the force of law. Steps One and Two are less likely to present an obstacle for the SEC.

A. Chevron “Step Zero”

The Supreme Court has explained that Chevron deference is only appropriate where Congress has delegated to an agency the authority to speak to a question with the force of law. Although academic commentators have taken the position that the SEC has rulemaking authority over Basic, the language of Section 10(b) does not clearly support that position. This might lead a court to conclude that an SEC rule codifying Basic is unworthy of deference.

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35 See Skidmore, 323 U.S. at 140 (noting that the weight of an agency’s interpretation “will depend upon the thoroughness evident in its consideration, the validity of its reasoning, [and] its consistency with earlier and later pronouncements,” among other factors).


1. Adams Fruit Co. v. Barrett

In Adams Fruit Co. v. Barrett, the Supreme Court explained that an executive agency’s position was not entitled to Chevron deference because the agency lacked “administrative authority” over the statutory “enforcement provisions” at issue. Adams Fruit concerned the motor vehicle safety provisions of the Migrant and Seasonal Agricultural Worker Protection Act (AWPA), which mandated that the Secretary of Labor “promulgate standards” relating to the safety of vehicles used to transport migrant farmworkers. The AWPA also created a private right of action that “provided aggrieved farmworkers with direct recourse to federal court where their rights under the statute were violated.”

The Supreme Court refused to defer to the Department of Labor’s position that a state workers’ compensation law displaced the private right of action. The Court saw no statutory ambiguity for the agency to resolve. But the Court explained further that the agency had also failed to satisfy “[a] precondition to deference under Chevron,” namely, “a congressional delegation of administrative authority.” By expressly creating a private right of action, Congress “established an enforcement scheme independent of the Executive.” Congress had only given the Secretary of Labor the authority “to promulgate standards implementing AWPA’s motor vehicle provisions,” which did “not empower the Secretary to regulate the scope of the judicial power vested by the statute.” Since Congress had not delegated to the Secretary the authority to limit the scope of the private right of action, the Secretary’s views on the issue were not entitled to Chevron deference.

2. The Grant of Rulemaking Power in Section 10(b)

Given the precedent of Adams Fruit, the SEC’s ability to obtain deference in its defense of Basic depends on the scope of its rulemaking authority under Section 10(b). Commentators have urged that the SEC has sufficient

41 Id. at 650; see also 29 U.S.C. § 1841 (2012).
42 Adams Fruit, 494 U.S. at 650.
43 Id. at 649 (quoting the agency’s interpretation expressed in 29 C.F.R. § 500.122(b) (1989)).
44 Id.
45 Id.
46 Id. at 650.
47 Id.
48 Id.
rulemaking authority to overturn Basic,\textsuperscript{49} or even to “disimply” the entire private right of action under Section 10(b).\textsuperscript{50} While these commentators are hostile to Basic,\textsuperscript{51} their position suggests that the SEC indeed has the rulemaking authority to speak with the “force of law” to the question of Basic’s validity.

This position is based on the observation that Section 10(b) grants rulemaking authority to the SEC and that Basic is a judicially created doctrine used to implement the resulting Rule 10b-5. As Professor Grundfest has reasoned, the SEC’s greater power to eliminate Rule 10b-5 altogether through rulemaking suggests a lesser power to curtail the ability of private plaintiffs to enforce it through lawsuits.\textsuperscript{52}

However, there are at least two grounds for doubting the SEC’s power to promulgate a rule declaring that Basic is valid.\textsuperscript{53} Professor Grundfest’s argument is based on the SEC’s power to destroy, not to create. The SEC could eliminate Rule 10b-5, and thus eliminate all lawsuits based on Rule 10b-5 violations. The power to eliminate all liability under Rule 10b-5 suggests a power to more narrowly eliminate the fraud-on-the-market presumption in private lawsuits under the rule.\textsuperscript{54} While the power to


\textsuperscript{50} Grundfest, supra note 22, at 976-78.

\textsuperscript{51} Professors Bratton and Wachter argue that Basic’s fraud-on-the-market theory “should be abolished in cases where the issuer makes no trades.” Bratton & Wachter, supra note 49, at 75-76. Professor Grundfest has urged total abolition of the private cause of action, supra note 22, at 965-66, and has since made clear his view that Basic cannot be reconciled with the text of the securities laws. See Joseph A. Grundfest, Damages and Reliance Under Section 10(b) of the Exchange Act 40-43 (Rock Ctr. for Corporate Governance, Working Paper Series No. 150, 2013), available at http://ssrn.com/abstract=2377537.

\textsuperscript{52} See Grundfest, supra note 22, at 976-78.

\textsuperscript{53} A separate consideration might limit the SEC’s ability to stop the Supreme Court from tinkering at the margins of Basic. The Court might interpret Federal Rule of Civil Procedure 23 to require additional showings from plaintiffs at the class certification stage. The SEC would likely be unable to change the outcome of such a decision, since the Federal Rules of Civil Procedure are well outside its purview. At oral argument in Halliburton, Justice Kennedy, a confessed Basic skeptic, see supra note 6, expressed apparent enthusiasm for a doctrine that would require plaintiffs in 10b-5 actions to introduce at the class certification stage event studies showing that the misrepresentation distorted prices. See Transcript of Oral Argument at 18, 29, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 636 (2013) (No. 13-317), available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/13-317_7n5f.pdf. Justice Kagan and the government attorney representing the SEC’s position sought to shift the conversation from procedure back to substance, a domain where deference to the agency position would be more plausible. See Transcript of Oral Argument, supra, at 48-49.

\textsuperscript{54} See Bratton & Wachter, supra note 49, at 165 (suggesting that the power to foreclose all private lawsuits entails a corresponding power to foreclose some private lawsuits, that is, those that can succeed only because of the Basic presumption).
eliminate all private lawsuits does suggest a power to eliminate some lawsuits, it may not suggest a power to permit lawsuits that the courts would not otherwise allow.

The text of Section 10(b) offers another basis for skepticism of the SEC’s ability to promulgate a rule that saves Basic. Section 10(b) clearly authorizes the SEC to promulgate rules telling potential defendants what conduct is and is not unlawful, but the text is less clear about the SEC’s authority to determine which plaintiffs are empowered to seek damages for that unlawful conduct. To put the observation in H.L.A. Hart’s terms, Section 10(b) grants the SEC rulemaking authority over duty-defining “primary” doctrines, but is less clear as to the SEC’s rulemaking authority over the “secondary” doctrines that confer on particular plaintiffs the power to seek damages.

The distinction between primary and secondary doctrines is meaningful in the Rule 10b-5 context. For example, a person can violate the primary rules, and thus become criminally liable and civilly liable to the SEC, even if no actual transaction takes place. However, in order to satisfy the secondary rules and bring a successful action for damages, a private plaintiff must show that she actually bought or sold the affected security.

While the text of Section 10(b) clearly grants the SEC rulemaking authority over the content of primary doctrines, it is less clear about the SEC’s rulemaking authority over the content of secondary doctrines. Section 10(b) forbids the use of “any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe.” This language empowers the SEC to tell defendants whether certain conduct constitutes a violation. It does not explicitly empower the SEC to determine whether a private plaintiff’s lawsuit enforcing a primary doctrine can proceed. In the words of Adams Fruit, the text of the statute

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55 See supra text accompanying note 16.
57 See SEC v. Zandford, 535 U.S. 813, 899-20 (2002) (noting, with apparent approval, the SEC’s position that “a broker who accepts payment for securities that he never intends to deliver . . . violates § 10(b) and Rule 10b-5”).
58 See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731-32 (1975) (holding “that the plaintiff class for purposes of § 10(b) and Rule 10b-5 private damage actions is limited to purchasers and sellers of securities”).
only grants the SEC the power “to promulgate standards” of conduct for regulated entities.\textsuperscript{60}

Any limits on the SEC’s power over secondary doctrines would affect its capacity to save \textit{Basic}, since \textit{Basic} itself is a secondary doctrine. To prevail against a defendant in a civil suit or administrative action, the SEC does not need to show reliance.\textsuperscript{61} As a result, \textit{Basic} has nothing to do with the question of whether a defendant’s conduct contravenes Rule 10b-5. \textit{Basic} merely affects the success of a private plaintiff’s attempt to enforce Rule 10b-5. The content of \textit{Basic} also reveals that it is a secondary doctrine, since it speaks to the plaintiff’s conduct, not the defendant’s.\textsuperscript{62} Thus, it is far from

\textsuperscript{60} Adams Fruit Co., Inc. v. Barrett, 494 U.S. 658, 650 (1990). This limitation on the SEC’s rulemaking authority harmonizes it with the SEC’s enforcement authority. The SEC can proceed against defendants in court or through administrative enforcement actions. See Securities Exchange Act of 1934 § 21(d), 15 U.S.C. § 78u(d) (2012) (providing for civil actions); id. § 21B, 15 U.S.C. § 78u-2 (providing for administrative proceedings); id. § 21C, 15 U.S.C. § 78u-3 (providing for cease-and-desist proceedings). The adjudicative process allows the agency to announce a formal position on the legal questions in the case before the courts have the opportunity to weigh in. See id. § 25(a)(1), 15 U.S.C. § 78y(a)(1) (providing for judicial review of final orders by the SEC). For \textit{Chevron} purposes, a formal agency position announced through adjudication normally has the same claim to deference as a formal position announced through notice-and-comment rulemaking. See, e.g., Zandford, 535 U.S. at 819-20 (citing United States v. Mead Corp., 533 U.S. 218, 229-30 & 230 n.12 (2001)).

Though they are powerful tools in the SEC’s arsenal, adjudications only enable the SEC to take a formal position on primary doctrines. It is difficult to imagine a case in which a secondary doctrine—that is, a doctrine concerning the ability of a private plaintiff to bring a lawsuit—would come up in an administrative action pitting a defendant against the SEC. The regime created by Congress thus grants the SEC greater power over primary doctrines than over secondary doctrines. This represents a deliberate choice, since Congress could easily have created an alternative regime that granted the SEC more power to take binding positions on secondary doctrines. See Amanda M. Rose, Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5, 108 COLUM. L. REV. 1301, 1354-58 (2008) (suggesting that Congress grant the SEC the authority to decide whether a complainant can file a securities fraud action). Congress’s more restrictive approach suggests that the SEC’s positions on secondary doctrines are entitled to less deference, and prevents the SEC from commanding greater deference through an administrative adjudication.

\textsuperscript{61} Reliance is “an essential element” of private causes of action under § 10(b) because “proof of reliance ensures that there is a proper connection between a defendant’s misrepresentation and a plaintiff’s injury.” Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1192 (2013) (citation and internal quotation marks omitted). As a government agency charged with enforcing the securities laws, the SEC does not need to prove reliance in order to establish the right to pursue a defendant’s wrongdoing. Therefore, the SEC need not prove reliance to bring a successful civil action. See, e.g., SEC v. KPMG LLP, 412 F. Supp. 2d 349, 375 (S.D.N.Y. 2006) (citing SEC v. Credit Bancorp., Ltd., 195 F. Supp. 2d 475, 490-91 (S.D.N.Y. 2002)).

\textsuperscript{62} See supra notes 3-5 and accompanying text.
clear that Section 10(b) grants the SEC rulemaking authority over the *Basic* doctrine.\(^63\)

The SEC might respond by arguing that its clear rulemaking authority over primary doctrines gives it the power to shape the content of secondary doctrines like *Basic*. Neither Section 10(b) nor Rule 10b-5 explicitly provides for a private right of action. Instead, the courts inferred the private right of action from the wrongs defined by the statute and rule.\(^64\) The secondary doctrines that govern the private right of action are thus derived from the primary doctrines that define whether a defendant’s conduct is wrongful. As a result, secondary doctrines like *Basic* are not as isolated from the SEC’s power over primary doctrines as they might at first appear.

Applying this reasoning, it may be possible to frame the secondary doctrine of *Basic* as a derivation of an implicit primary doctrine. In other words, the plaintiff-facing doctrine of *Basic* might be seen as a reflection of the courts’ sense that certain defendants have committed a distinctive type of wrong. For example, in a recent article, Professors Goldberg and Zipursky argue that *Basic* is not merely an evidentiary presumption that allows plaintiffs to prove reliance in a distinctive way; rather, *Basic* expanded the substance of the private cause of action to reach a different type of wrong.\(^65\) Before *Basic*, the private cause of action allowed plaintiffs to recover for the substantive wrong of deceit—the wrong of making knowingly false assertions that sabotaged the plaintiffs’ decisions.\(^66\) After *Basic*, the private cause of action allows plaintiffs to recover for the wrong of distorting the market price of a security, thus causing economic loss to a plaintiff who traded in the justifiable belief that the price was not distorted.\(^67\)

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\(^63\) The SEC likely also lacks the ability to codify *Basic* via its general grant of rulemaking authority under section 23(a) of the Securities Exchange Act, see 15 U.S.C. § 78w(a)(1) (2012), since the SEC is neither charged with the “implement[ation]” of the secondary doctrines that define the private right of action nor “responsible” for their terms. Even if a rule codifying *Basic* would be within the rulemaking authority described in section 23, however, the language and structure of the statutory scheme may suggest that such a rule would not be entitled to the normal measure of *Chevron* deference. Congress’s grant of rulemaking authority in Section 10(b) is more specific than the general grant in section 23, and its seeming exclusion of secondary doctrines is a powerful indication that Congress did not intend that the courts defer to the SEC regarding the content of these doctrines. *Cf.* City of Arlington v. FCC, 133 S. Ct. 1863, 1875-77 (2013) (Breyer, J., concurring in part and concurring in the judgment) (examining numerous aspects of the statutory scheme before deferring to an agency position articulated in a rule promulgated pursuant to a general grant of rulemaking authority).

\(^64\) See Grundfest, *supra* note 22, at 964-65 & 964 n.3.

\(^65\) Goldberg & Zipursky, *supra* note 24, at 1791.

\(^66\) *Id.*

\(^67\) *Id.*
If *Basic* can be framed as implying a distinctive type of duty, it might come within the reach of the SEC’s authority. Even if this reasoning is insufficient to convince a court that the SEC can regulate *Basic* directly, the SEC might rework the primary doctrine and leave the rest of the work to the courts. Depending on the SEC’s ability to characterize the issue, the courts may well conclude that Congress granted the SEC the power to speak to *Basic*’s validity with the force of law.

B. *The Chevron Two-Step*

If a court concludes that an agency is authorized to speak with the force of law, it then proceeds with a two-step analysis. First, it applies the ordinary tools of statutory construction to determine “whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” But “if the statute is silent or ambiguous with respect to the specific issue,” the court must proceed to the second step and ask “whether the agency’s answer is based on a permissible construction of the statute.”

There are as many ways of understanding *Chevron* as there are administrative law professors. For present purposes, *Chevron* might be understood as an allocation of interpretative labor. When confronted with a statutory question, courts first employ “traditional tools,” such as textual analysis. Where those standard legal tools provide an answer, the courts declare that the statute is clear and end their inquiry. Where those tools do not provide an answer, the courts could take a second step, using tools more common to policymaking to decide the case. Indeed, courts will take this second step and use policymaking tools themselves if no deference-worthy agency position is available. But where such a position exists, *Chevron* presumes

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68 For example, the SEC might adopt a rule making it unlawful to cause an economic loss to a purchaser or seller of a security traded in an efficient market by distorting the market price of that security through a misstatement or omission of material fact. This is a primary doctrine—on its face it addresses only whether a defendant’s conduct is unlawful. But if a court derived secondary doctrines from this hypothetical rule, it likely would replicate *Basic*.


70 Id. (quoting Chevron, 467 U.S. at 843).

71 Scholars have even managed to disagree on the number of steps in the *Chevron* analysis. Compare Matthew C. Stephenson & Adrian Vermeule, *Chevron Has Only One Step*, 95 VA. L. REV. 597 (2009), with Kenneth A. Bamberger & Peter L. Strauss, *Chevron’s Two Steps*, 95 VA. L. REV. 611 (2009).

that Congress would rather have agency experts than generalist judges wield these policymaking tools.\footnote{For a broadly similar view of \textit{Chevron} and its foundations, see Cass R. Sunstein, \textit{Beyond Marbury: The Executive's Power to Say What the Law Is}, 115 \textit{Yale L.J.} 2580, 2591-95 (2006).}

As a result, if the Justices of the Supreme Court were to overturn \textit{Basic}, it would matter \textit{how} they did it. If they reached the result using the standard legal tools that characterize Step One, an SEC rule codifying \textit{Basic} would not survive judicial review. If, however, they used policy or empirical considerations more characteristic of Step Two, a well-reasoned SEC rule could save \textit{Basic}.

1. Step One

The above framing of the Step One inquiry might make the answer seem obvious. How could the Court conclude that the statutory text clearly establishes the invalidity of \textit{Basic}? On its face, Section 10(b) is completely silent on the issue, as it is on most issues concerning the private right of action. In addition, the Supreme Court itself found that \textit{Basic} represented the \textit{best} resolution of ambiguities in the Securities Exchange Act of 1934.\footnote{See \textit{Basic} Inc. v. Levinson, 485 U.S. 224, 243-47 (1988).} It would be awkward for the Court to hold that the doctrine it announced in \textit{Basic} involved such a misapplication of traditional legal tools.\footnote{\textit{Cf.} Noah Feldman, \textit{Supreme Court Isn't Impressed by Market Efficiency}, \textit{Bloomberg View} (Mar. 6, 2014), http://www.bloombergview.com/articles/2014-03-06/supreme-court-isn-t-impressed-by-market-efficiency (suggesting that at oral argument in \textit{Halliburton}, conservative Justices framed their attack on \textit{Basic} in economic terms to avoid awkwardness); \textit{cf. also infra} subsection II.B.2.}

But the simple awkwardness of declaring Supreme Court precedent unreasonable may not stay the hand of a Justice who believes that \textit{Basic} is clearly inconsistent with the statute. And there are serious textual arguments suggesting that the \textit{Basic} presumption is incompatible with Section 10(b). Analogizing to other statutory causes of action, Professor Grundfest has argued that the private right of action under Rule 10b-5 must include a robust reliance element.\footnote{See Grundfest, supra note 51, at 4-5 (arguing, based on an analogy to the express private right of action provided for in section 18(a) of the Securities Exchange Act, 15 U.S.C. \textsection{} 78r(a) (2012), for actual reliance as a precondition to recovery under Section 10(b)).}

If the Supreme Court rejects \textit{Basic} on these grounds, an SEC rule codifying it would fail at Step One of the \textit{Chevron} analysis.
2. Step Two

But there is good reason to believe that the Supreme Court would frame a decision rejecting or narrowing Basic in terms more characteristic of Chevron Step Two.

The Basic Court explained that its decision was based on a policy of encouraging investors to rely on the integrity of the financial markets, and on empirical studies regarding market efficiency.\(^77\) Even Basic’s critics seem to have embraced this framing of the issue. In Amgen, Justice Alito described Basic’s validity as a question of empirical fact rather than legal reasoning.\(^78\) Commentators have attempted to answer these empirical questions using statutory text,\(^79\) but even these textual arguments can only be evaluated with careful attention to subtle technical issues.\(^80\) The Court has seen little

\(^77\) *Basic*, 485 U.S. at 246-47.

\(^78\) See Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1204 (2013) (Alito, J., concurring) (noting that it may be appropriate to reconsider Basic given the existence of “more recent evidence suggesting that the presumption may rest on a faulty economic premise”). Similarly, at oral argument in *Halliburton*, Chief Justice Roberts insisted that the debate over Basic had been framed in empirical terms. See Transcript of Oral Argument, *supra* note 53, at 10-11. This framing of the issue is not mandatory. Basic could be understood not as an empirical statement about market efficiency, but as a normative statement that investors are entitled to rely on the integrity of market prices in certain circumstances. See Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 160.

\(^79\) In a package of securities litigation reforms, Congress adopted a ninety-day look-back provision limiting the damages awarded to a plaintiff to “the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the market price of that security during the 90-day period” following the revelation of the fraud. 15 U.S.C. § 78u-4(e)(1) (2012) (emphasis added). Commentators have inferred from this text that Congress believes that the market systematically overreacts to the revelation of fraud (thus creating opportunities for traders to make consistent above-average returns) and that the market takes ninety days to fully process the discovery of fraud; they have urged that such beliefs are inconsistent with the idea that a security’s price quickly and accurately incorporates all material public information. See, e.g., Grundfest, *supra* note 51, at 41-42.

\(^80\) First, the ninety-day look-back provision may only reflect a belief that a company’s stock price is volatile in the wake of revelations of fraud. Such volatility would not be inconsistent with market efficiency. In the wake of fraud, investors might rationally discount all the information they had received up to that point. As a result, new rumors would have an outsized effect on the total mix of information available, and thus would have an outsized effect on the security’s price. Second, even if the ninety-day look-back provision reflects Congress’s belief that the market systematically overreacts to fraud, thus making it possible for an ordinary investor to reap above-average profits by purchasing the stock of companies that have recently disclosed a fraud, this would not be inconsistent with market efficiency. Even in an efficient market, traders can reap outsized expected returns if they are prepared to take outsized risks. The market’s seeming overreaction may simply represent its effort to price in the riskiness of fraud-buffed stock. See Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* 19-20 (2000) (noting that efficient market hypothesis proponents have explained away seeming arbitrage opportunities by suggesting that the factors leading to above-average returns also create above-average risk).
reason to defer to the SEC where the questions presented could be resolved without reference to economics.\textsuperscript{81} The validity of Basic may well fall into a different category.

The nature of the issue itself also suggests that practical considerations rather than textual ones will drive the analysis. As noted above, the doctrines surrounding Section 10(b) and Rule 10b-5 can be divided into two categories: the primary doctrines that determine the lawfulness of a defendant’s conduct and the secondary doctrines that determine whether a plaintiff can bring a successful lawsuit. The courts employ different methodologies in elaborating on primary and secondary doctrines. Statutory text is at the center of cases addressing primary doctrines.\textsuperscript{82} By contrast, the courts emphasize “practical factors” in establishing secondary doctrines like Basic.\textsuperscript{83}

Part of this divergence is simple necessity. Section 10(b) and Rule 10b-5 explicitly address the primary doctrines defining what conduct is unlawful. But “[n]o language in either of those provisions speaks at all” to the secondary doctrines that govern “the contours of a private cause of action.”\textsuperscript{84}

The fairness concerns that motivate a strong emphasis on text in the primary context also have less force in the secondary context. It would be unfair to subject a person to criminal or civil liability for her conduct unless she had notice that her conduct was unlawful. As a result, it would be unfair to base the primary doctrines that determine the lawfulness of that conduct on considerations that are not evident from the face of the statute and rule. But a person who engages in unlawful conduct has no right to a precise estimate of her eventual civil liability.

Basic offers a particularly stark illustration of this point. Suppose that in a world without Basic, Doris publicly misstates a material fact with fraudulent intent. Having made the statement, Doris has no way of knowing whether she will be civilly liable to Peter, a stranger transacting in the affected security. Peter might rely on Doris’s misstatement, in which case Doris will be civilly liable to him. Doris has no control over or knowledge

\textsuperscript{81} See, e.g., Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2303 n.8 (2011) (citing Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 41 n.27 (1977)).

\textsuperscript{82} See, e.g., id. at 2302, 2305 (relying on a dictionary-based argument in holding that a defendant did not “make” a statement for purposes of Rule 10b-5).

\textsuperscript{83} See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975) (citing practical considerations in holding that plaintiffs cannot prevail in a Rule 10b-5 suit unless they have actually purchased or sold a security). The Supreme Court later held that its conclusion in Blue Chip Stamps was based on “policy considerations” which the Court viewed as appropriate in explicating a judicially crafted remedy,” not on an interpretation of the “words” of Section 10(b) or Rule 10b-5. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 80, 84 (2006) (citation omitted).

\textsuperscript{84} Blue Chip Stamps, 421 U.S. at 749.
of Peter’s investment process, yet it is “beyond peradventure” that she has adequate notice of the possibility that she will be held liable to him.\textsuperscript{85} Introducing Basic changes only the likelihood that Doris will be held liable to Peter, as Peter will have a claim even in the absence of actual reliance. Since Doris was already on notice of the possibility of being held liable to Peter, it is hard to see why fundamental fairness requires further notice. As a result, fairness does not demand the same emphasis on text in the secondary context as it does in the primary context.

Regardless of the reasons for the difference, the relative unimportance of the text means that courts lack an institutional advantage in evaluating secondary doctrines like Basic.\textsuperscript{86} In his dissent in Basic, Justice Byron White attacked the majority opinion by noting that the Court lacked “staff economists [and] experts.”\textsuperscript{87} For precisely that reason, the SEC’s position on the validity of Basic, if expressed in a well-reasoned rule, would be a strong candidate for deference under Chevron.\textsuperscript{88}

\textbf{CONCLUSION}

The SEC’s power to defend Basic is somewhat precarious. Unless it undertakes a rulemaking, its position is unlikely to command deference from the Supreme Court. Yet even an attempted rulemaking might be insufficient. Although some scholars have concluded that the SEC has rulemaking authority over Rule 10b-5 private actions, the terms of Congress’s grant of authority also support a narrower interpretation that would deny the SEC this power. However, if the SEC can clear the rulemaking authority hurdle, it may prevail in its defense of Basic.


\textsuperscript{85} See Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (declaring the existence of a private right of action under Rule 10b-5 to be “beyond peradventure”).

\textsuperscript{86} Cf. Matthew C. Stephenson, \textit{Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies}, 91 VA. L. REV. 93, 149-54 (2005) (arguing that, where a statute is ambiguous, courts should defer to the expertise of agencies to determine the existence of a private right of action).

\textsuperscript{87} Basic Inc. v. Levinson, 485 U.S. 224, 253 (1988) (White, J., concurring in part and dissenting in part).

\textsuperscript{88} A rule that is not supported by sufficient reasoning could be deemed invalid. See Bus. Roundtable v. SEC, 647 F.3d 1444, 1448-49 (D.C. Cir. 2011) (concluding that the SEC “acted arbitrarily and capriciously” in promulgating a proxy access rule because it failed to perform an adequate economic analysis of the new rule).