Comments

BUSINESS ROUNDTABLE V. SEC: RISING JUDICIAL MISTRUST AND THE ONSET OF A NEW ERA IN JUDICIAL REVIEW OF SECURITIES REGULATION

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INTRODUCTION

The U.S. Securities and Exchange Commission (SEC) was born out of the Securities and Exchange Act of 1934[1] (1934 Act) in the aftermath of the Great Depression as a means for regulating the stock market, enhancing transparency and corporate information-sharing and, ultimately, protecting investors. Armed with Congress' grant of rulemaking and enforcement authority, the SEC, since its inception, has promulgated rules aimed at realizing the SEC's mandate. But securities regulation by the SEC did not come about unopposed. Indeed, since as early as 1936, interest parties have challenged a number of the SEC's promulgated rules.[2] This Comment will explore the recent history of judicial challenge to SEC rulemaking, specifically in the area of securities regulation. Through an examination of the eight cases since 1990, where the D.C. Circuit invalidated an SEC-promulgated rule in the area of securities regulation, this Comment argues that the D.C. Circuit's most recent ruling in *Business Roundtable v. SEC*[3] (*Business Roundtable II*) represents a turning point indicative of an unprecedented level of heightened judicial scrutiny of securities regulation. Such heightened scrutiny, epitomized by *Business Roundtable II*'s elevated demands—and, in effect, substantive review—of the SEC's cost-benefit analysis, poses a real threat to future attempts at securities regulation, as well as SEC rulemaking abilities more generally.[4]

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1. Securities Exchange Act of 1934 § 4, 15 U.S.C. § 78d (2006).

2. *See* Jones v. SEC, 298 U.S. 1 (1936) (challenging the SEC's ability to prevent a party's withdrawal of a registration statement in the face of an SEC proceeding challenging the truth and sufficiency of that statement); *see also* E. Thomas Sullivan & Robert B. Thompson, *The Supreme Court and Private Law: The Vanishing Importance of Securities and Antitrust*, 53 EMORY L.J. 1571 (2004) (examining every U.S. Supreme Court decision on a securities issue between 1933 and 2004).

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

4. During the final editorial work on this Comment, the Columbia Business Law Review published Anthony W. Mongone, Note, *Business Roundtable: A New Level of Judicial Scrutiny and Its Implications in a Post-Dodd-Frank World*, 2012 COLUM. BUS. L. REV. 746 (2012). While there is some overlap, Mr. Mongone's Note and this Comment are different because they each examine *Business Roundtable II* through a different lens. Most notably, Mr. Mongone analyzes the court's holding by looking at the legislative history of the National Securities Markets Improvement Act of 1996 and the standard of judicial review contemplated by the Act. This Comment, conversely, approaches *Business Roundtable II* through an examination of the D.C. Circuit's analysis in prior cases concerning SEC rules and regulations. Separately, James D. Cox and Benjamin J.C. Baucom argue in *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811, 1813 (2012) (also published during the final editorial work on this Comment), that "the level of review invoked by the D.C. Circuit in *Business Roundtable* and its earlier decisions is dramatically inconsistent with the standard enacted by Congress." Though similar, my Comment and the Cox and Baucom

I. BACKGROUND

A. Setting the Stage: From New York to Washington, D.C.

In July of 2011, only eleven days before the D.C. Circuit issued its opinion in *Business Roundtable II*, Judge Rakoff of the Southern District of New York held that Rajat Gupta, a corporate executive tied to the insider-trading scheme the SEC was investigating at Raj Rajaratnam's Galleon Group, may bring a lawsuit against the SEC alleging that the SEC, in its investigation, had violated Gupta's rights under the Equal Protection Clause.[5] In so deciding, Judge Rakoff served the SEC a number of strong blows, from questioning the SEC's motives when it filed an administrative proceeding against Gupta,[6] to all but accusing the SEC of arbitrarily discriminating against identical defendants.[7]

Just a few months after that opinion, Judge Rakoff struck once again in *SEC v. Citigroup Global Markets Inc.*, where he departed, though not unprecedentedly,[8] from the trend of courts accepting settlements that the SEC reaches with other parties.[9] The SEC and Citigroup had reached the

articles are different, because the latter compares the D.C. Circuit's standard of review in *Business Roundtable II* and its predecessors with that prescribed by Congress. This Comment, however, compares the court's approach in *Business Roundtable II* with the approach in that case's predecessors. The Journal of Corporation Law also published Grant M. Hayden & Matthew T. Bodie, *The Bizarre Law and Economics of* Business Roundtable v. SEC, 38 J. CORP. L. 101 (2012). In that piece, the authors focus on the issue of shareholder voting rights and discuss how *Business Roundtable II* is part of a "growing preference amongst some law and economics commentators for a Potemkin-Village version of shareholder democracy . . . ." *Id.* at 102. By contrast, this Comment examines the D.C. Circuit's approach to all SEC rulemaking, not just rules related to proxy access. Finally, in Rachel A. Benedict, Note, *Judicial Review of SEC Rules: Managing the Costs of Cost-Benefit Analysis*, 97 MINN. L. REV. 278 (2012), the author reviews a trilogy of cases that includes *Business Roundtable II*, *id.* at 284, and advocates the need for a more clearly defined scope of SEC cost-benefit analysis. *Id.* at 279. This Comment takes a different approach in that it provides a comprehensive historical case law analysis of judicial review of SEC rulemaking since the first *Business Roundtable* case in 1990. This Comment is also different in that it sees *Business Roundtable II* as a turning point in judicial review of SEC rulemaking, and thus discusses this latest case's significance and consequences for federal securities law generally.

5. Gupta v. SEC, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011).

6. *See id.* at 506 (describing the SEC's move as a "seeming exercise in forum-shopping").

7. *See id.* at 514 ("[W]e have the unusual case where there is already a well-developed public record of Gupta being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why this should be so.").

8. *See, e.g.*, SEC v. Bank of Am. Corp., 653 F. Supp. 2d 507 (S.D.N.Y. 2009).

9. 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

settlement at issue in the form of a consent judgment.[10] In this case, as had been practiced by the SEC and regulated parties before, the consent judgment required Citigroup to pay a penalty, but allowed it to refrain from making any admissions as to the charges.[11] When first faced with the SEC-Citigroup consent judgment, Judge Rakoff put some questions to the parties, asking, as the basis of his questions, how the settlement would provide any substantive relief to harmed parties.[12] Ultimately, the court refused to approve the proposed settlement, because, Judge Rakoff wrote, it "has not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment."[13] In refusing to rubberstamp the consent judgment, Judge Rakoff further wrote that "[a]n application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous"[14] and concluded that a consent judgment such as the one presented "serves no lawful or moral purpose and is simply an engine of oppression."[15]

A number of commentators have viewed such opinions from the Southern District of New York as a sign of rising hostility towards the SEC. For example, Michael McConnell, a former judge on the U.S. Court of Appeals for the Tenth Circuit, called the *Citigroup* opinion "startling to say the least."[16] He continued: "Judge Rakoff has effectively taken on the role of a prosecutor, second-guessing the SEC's law enforcement decisions" and ultimately, he projected, leading to impossibly costly litigation that would prevent the SEC from pursuing many enforcement actions.[17] On the other hand, some see the circuit court's opinions as less of a criticism of the SEC and more an expression of concern with holding Wall Street and financial institutions accountable.[18] This view prompts the

10. *Id.* at 330.
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.* at 335.
15. *Id.*
16. Joe Palazzolo, *Law Blog Expert Panel: Ex-Judges on Rakoff's Citi Ruling*, LAW BLOG (Dec. 19, 2011, 10:21 AM), http://blogs.wsj.com/law/2011/12/19/law-blog-expert-panel-ex-judges-on-rakoffs-citi-ruling/.
17. *Id.*
18. *See e.g.*, Reynolds Holding, *Courts More Willing to Second-Guess Wall Street*, BREAKINGVIEWS (Dec. 05, 2011), http://blogs.reuters.com/breakingviews/2011/12/05/courts-more-willing-to-second-guess-wall-street/ ("[Judge Rakoff's] opinion showed little fear of creating market uncertainty, arguing that the public interest is better served by holding companies' feet to the fire than by quietly settling disputes without any admission of wrongdoing."); Daniel Kaufmann & Veronika Penciakova, *Judge Rakoff Challenge to the S.E.C.: Can Regulatory Capture be Reversed?*, BROOKINGS INST. (Dec. 02, 2011), http://www.brookings.edu/opinions/2011/1202_rakoff_challenge_kaufmann.aspx ("The judge's

question: Is it within the courts' purview to seek accountability from private institutions?

The Second Circuit has since granted a stay to Judge Rakoff's ruling in *Citigroup*.[19] In its decision, the Second Circuit criticized Judge Rakoff's view that the SEC-Citigroup settlement was not in the public interest. "It is not . . . the proper function of federal courts to dictate policy to executive administrative agencies," read the opinion.[20] "[F]ederal judges—who have no constituency—have a duty to respect legitimate policy choices made by those who do. The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones . . . . "[21]

Irrespective of the Second Circuit's stay in *Citigroup*, the New York court's opinions give pause for thought as to whether we are at a new junction in the relationship between the SEC and the judiciary. To explore the existence and extent of such a phenomenon, this Comment will look to the very center of judicial review of the SEC—the D.C. Circuit and its line of opinions on SEC securities regulation

B. Judicial Review of Agency Rules

Over the years, and as the SEC, along with other agencies, was challenged in the courts, a number of administrative law doctrines were developed to demarcate the limits of judicial review of agency rules and orders. Most relevantly, agency action became entitled to greater judicial deference after *Chevron, U.S.A., Inc. v. Natural Resource Defense Council, Inc.*[22] Under what became known as "*Chevron* deference," a court reviews an agency's construction of a statute with a two-step test.[23] First, the court asks "whether Congress has directly spoken to the precise question at issue."[24] If Congressional intent is clear, the court's inquiry ends. If, however, the court finds the intent of Congress ambiguous, or if the statute is silent with respect to the issue, "the question for the court is whether the agency's answer is based on a permissible construction of the statute."[25]

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ruling brings to light, once more, the extent to which the regulatory agency may have been subject to capture and undue influence by financial institutions, while also potentially challenging the status quo.").

19. U.S. SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 169 (2d Cir. 2012).
20. *Id.* at 163.
21. *Id.* (*citing* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 866 (1984)) (internal quotation marks omitted).
22. 467 U.S. 837 (1984).
23. *Id.* at 842-43.
24. *Id.* at 842.
25. *Id.* at 843.

A second enhancement to judicial review of agency decisions and rules was the enactment of the Administrative Procedure Act (APA), which requires, among other things, that a court set aside agency actions it finds "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[26] In determining whether an agency action is arbitrary or capricious, a court must ensure that the agency in question has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[27] Unlike *Chevron*, the APA and the Supreme Court's interpretation of it in *State Farm*, demonstrate heightened judicial scrutiny for agency actions. Indeed, the APA's instruction became known as the "hard look doctrine," because it requires courts to more closely examine information the agency provides in its reasoning.[28] Enacted in 1966, the "arbitrary and capricious" standard was viewed as a response to the "pervasive distrust of administrative agencies and the growth of public interest regulation."[29] By virtue of the nature of lawsuits brought to them, the judges of the D.C. Circuit played a key role in the development of "arbitrary and capricious" review of agency decisions, unanimously agreeing that the court should not "continue the deference that characterized judicial review of administrative agency action during the 1940s and 1950s."[30] The standard of review has been wielded by the D.C. Circuit to invalidate countless agency actions over the decades, including the SEC's Rule 14a-11 in *Business Roundtable II*. Indeed, "courts continue to develop administrative common law doctrines and to employ those already in their doctrinal arsenal . . . with regularity and vigor."[31]

Congress has also enacted the National Securities Market Improvement Act of 1996 to amend the Investment Company Act of 1940 (ICA) to require the SEC in its rulemaking to consider: (1) "whether an action is necessary or appropriate in the public interest," (2) "the protection of investors," and, (3) "whether the action will promote efficiency, competition, and capital formation."[32] The Act thus in a way complements "arbitrary and capricious" review by specifying what the SEC in particular

26. Administrative Procedure Act § 10(e)(1), 5 U.S.C. § 706(2)(A) (2006).

27. Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (citing Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962)).

28. *See* Matthew Warren, Note, *Active Judging: Judicial Philosophy and the Development of the Hard Look Doctrine in the D.C. Circuit*, 90 GEO. L.J. 2599 (2002).

29. *Id.* at 2599.

30. *Id.* at 2600.

31. Gillian E. Metzger, *Embracing Administrative Common Law*, 80 GEO. WASH. L. REV. 1293, 1320 (2012).

32. National Securities Markets Improvement Act of 1996 § 106(a), 15 U.S.C. § 77b(b) (2000).

must consider so that its actions are not found to have violated the APA's hard look doctrine.

Most recently, President Barack Obama issued Executive Order 13563,[33] "Improving Regulation and Regulatory Review," requiring administrative agencies to: (1) run a cost-benefit analysis of its proposed rules, (2) tailor its regulations such that society is least burdened, (3) select approaches that maximize net benefits, (4) specify performance objectives, and (5) consider alternatives to direct regulations.[34] The order further requires all agencies to use the "best available techniques to quantify anticipated present and future benefits and costs as accurately as possible."[35] Because the SEC is an independent regulatory commission and not an executive agency, Executive Order 13563 technically does not apply to the SEC's rulemaking.[36] The order was thus extended to explicitly apply to independent regulatory agencies through Executive Order 13,579,[37] "Regulation and Independent Regulatory Agencies." The latter order underscores that "[i]ndependent regulatory agencies, no less than executive agencies, should promote that goal [outlined in Executive Order 13,563]."[38]

C. *Judicial Review of SEC Actions*

It is against this administrative law backdrop and the still-evolving balance between agency rulemaking authority and judicial review that the securities regulations of the SEC have been challenged in courts. Over more than two decades, since 1990, the SEC has had to (unsuccessfully) defend eight securities-related regulations in the D.C. Circuit.[39] This Comment will

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33. Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 18, 2011).

34. *Id.*

35. *Id.*

36. *See Assessing Agency Cost-Benefit Analysis for Dodd-Frank Rules*, SECURITIES LAW DAILY, Apr. 30, 2012, *available at* 2012 WL 1452277 (explaining that although Executive Orders like this one technically do not apply to the SEC because it is an independent regulatory commission and not an executive branch agency, agencies have traditionally followed the spirit of executive orders).

37. Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 11, 2011).

38. *Id.*

39. The eight cases are: Bus. Roundtable v. U.S. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (challenging SEC rule on proxy access and shareholder-nominated candidates); Am. Equity Life Ins. Co. v. U.S. SEC, 613 F.3d 166 (D.C. Cir. 2009) (challenging SEC regulation of fixed income annuities); Fin. Planning Ass'n v. U.S. SEC, 482 F.3d 481 (D.C. Cir. 2007) (challenging exemption of broker-dealers from the Investment Advisers Act); Goldstein v. U.S. SEC, 451 F.3d 873 (D.C. Cir. 2006) (challenging SEC rule on hedge fund exemptions); Chamber of Commerce of U.S. v. U.S. SEC, 443 F.3d 890 (D.C. Cir. 2006) (challenging same upon remand); Chamber of Commerce of U.S. v. U.S. SEC, 412 F.3d 133 (D.C. Cir. 2005) (challenging SEC regulation of mutual funds); Teicher v. U.S. SEC, 177 F.3d 1016 (D.C. Cir. 1999) (challenging SEC limitations on persons who commit certain offenses

examine each of these cases and argue that, while the D.C. Circuit vacated the rule at issue in each instance, the most recent of the cases, *Business Roundtable II*, represents a turning point in judicial review of the SEC's actions. Unlike in preceding cases, the D.C. Circuit in *Business Roundtable II* conducted an unusually aggressive examination of the factual record the SEC presented in support of its rule.[40] Indeed, especially viewed in tandem with recent court actions in New York, *Business Roundtable II* amounts to the D.C. Circuit's "strongest admonition of the SEC to date"[41] and may hint at general rising distrust, or even hostility, by the federal courts towards the SEC. The court's analysis in *Business Roundtable II* also raises serious questions about the SEC's rulemaking power in the area of securities regulation, as it sets an unprecedentedly high bar for the SEC to meet before it promulgates a new rule.

This Comment will explore the recent history of the adjudication of securities regulation, bookended by the two *Business Roundtable* cases, and the possible implications of the D.C. Circuit's ruling in the 2011 case. Part II of this Comment looks at *Business Roundtable II*, its precedents, and how the two differ. In Part III, I examine the significance of the phenomenon of heightened judicial scrutiny of SEC actions and its potential repercussions. Finally, Part IV briefly addresses any alternatives that exist to the looming status quo.

What we see today could signal the onset of a new era in the relationship between federal courts and the SEC. It is important to be aware of these undercurrents of change, signaling rising distrust of SEC rulemaking. It is equally important to consider what the consequences of such a change, if realized, would be, so that the strides made in securities regulation since the 1934 Act are not undermined.

II. *BUSINESS ROUNDTABLE II* AND ITS SEVEN SISTERS

A. The Road to Business Roundtable II

The SEC has no doubt had a tumultuous relationship with the D.C. Circuit and the Supreme Court. While judicial analyses of SEC action have ranged between "expansive" and "restrictive,"[42] in the few years before

related to investment advising); Bus. Roundtable v. U.S. SEC, 905 F.2d 406 (D.C. Cir. 1990) (challenging rule regarding corporate listings on national security exchanges).

40. *Business Roundtable II*, 647 F.3d 1144 (D.C. Cir. 2011).

41. Thomas Stratmann & J.W. Verret, *Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?*, 64 STAN. L. REV. 1431, 1445 (2012).

42. *See* Sullivan & Thompson, *supra* note 2 (examining every U.S. Supreme Court decision on a securities issue between 1933 and 2004 and categorizing each as exhibiting

1990, the SEC was experiencing a period of relatively low judicial resistance—the SEC "often prevailed in the lower courts and saw the Supreme Court deny numerous petitions for certiorari."[43] These few years of deference to the SEC came to an abrupt end with the D.C. Circuit's 1990 ruling in *Business Roundtable v. SEC* (*Business Roundtable I*),[44] striking an SEC rule pertaining to self-regulatory organizations ("SROs"), thus marking "increasing hostility towards SEC regulations not specifically grounded in statutory text"[45] and "presag[ing] the current attitude towards SEC rulemaking."[46]

In the twenty-one years bookended by the D.C. Circuit's decisions in *Business Roundtable I* and *Business Roundtable II*, the SEC defended securities-related rules against challenges seven times in the same court. It lost every time.

1. *Business Roundtable I*

In *Business Roundtable I*, analyzing the issue under *Chevron* deference, the D.C. Circuit found "in excess of the Commission's authority"[47] its Rule 19c-4, which barred SROs from listing the stock of "a corporation that takes any corporate action with the effect of nullifying, restricting or disparately reducing the per share voting rights of [existing common stockholders]."[48] Declaring that Rule 19c-4 "directly interferes with the substance of what the shareholders may enact,"[49] the court reasoned that it was impermissible for the SEC to promulgate a rule that "directly controls the substantive allocation of powers among classes of shareholders,"[50] which is normally in the purview of state corporate law.[51] The court examined the SEC's claim that it could promulgate such a rule

either an "expansive" or "restrictive" reading of the statutes granting the SEC rulemaking authority).

43. *Chasing the Devil Around the Stump: Securities Regulation, the SEC and the Courts*, SEC. & EXCH. COMM'N HISTORICAL SOCIETY (Feb. 23, 2012), http://www.sechistorical.org/museum/galleries/ctd/ctd_05a_era_caution_adjusts.php (citing Sullivan & Thompson, *supra* note 2).

44. 905 F.2d 406 (D.C. Cir. 1990).

45. Jodie A. Kirshner, *What Rough Beast . . . Slouches Towards Bethlehem:* Business Roundtable v. SEC *and the SEC's Delegated Rulemaking Authority*, 25 ANN. REV. BANKING & FIN. L. 497, 513 (2006).

46. *Id.*

47. 905 F.2d at 407. "SEC" and the "Commission" are used interchangeably.

48. *Id.* (internal quotations marks omitted).

49. *Id.* at 411.

50. *Id.* at 407.

51. *Id.* at 412.

because it falls under its mandate of protecting public interest.[52] To this, the court plainly said, "'public interest' is never an unbounded term."[53] Finally, the court held that it was not the intent of Congress for the SEC to regulate corporate governance.[54]

In sum, the court looked at the SEC's interpretation of congressional intent through the lens of *Chevron*, deemed that Rule 19c-4 regulated substance whereas Congress had only meant for the SEC to regulate procedure, and held the rule invalid. For nine years thereafter, *Business Roundtable I* was the D.C. Circuit's final and clearest word on what the SEC can and cannot regulate, marking a clear departure from how the SEC had fared in lower courts in previous years.[55]

2. *Teicher v. SEC*[56]

The *Teicher* rule challenge originally stemmed from the SEC's action against two individuals who had been criminally convicted for participation in an insider-trading scheme.[57] Upon being barred from participating from various branches of the securities industry, the two challenged the SEC's interpretation of section 15(b)(6) of the 1934 Act, which allowed the SEC to "place limitations on the activities or functions of [such convicted persons] . . . ."[58] Applying *Chevron*, the court held that the SEC's interpretation that the section allows it to bar convicted persons' participation in *any* securities industry it controls was unreasonable and contrary to the intent of Congress.[59] Once again, the opinion looked solely at the SEC interpretation of a statute and compared it with context and congressional intent.

52. *Id.* at 413.
53. *Id.* at 413.
54. *Id.* at 417.
55. *Chasing the Devil Around the Stump: Securities Regulation, the SEC and the Courts*, VIRTUAL MUSEUM AND ARCHIVE OF THE HISTORY OF SECURITIES REGULATION (Feb. 23, 2012), http://www.sechistorical.org/museum/galleries/ctd/; *see also* Kirshner, *supra* note 45, at 513 (contending that "the *Business Roundtable [I]* holding appears more likely today than it did fourteen years ago when the case was decided").
56. 177 F.3d 1016 (D.C. Cir. 1999).
57. *Id.* at 1017.
58. Securities Exchange Act of 1934 § 15(b)(6), 104 Stat. 931, 952-53 (1990) (current version at 15 U.S.C. § 78o(b)(6)(A) (2006)).
59. *Teicher*, 177 F.3d at 1021.

3. *Chamber of Commerce I*[60]

In *Chamber of Commerce of the United States v. SEC* ("*Chamber of Commerce I*"), the D.C. Circuit invalidated an SEC rule that required mutual funds to have no less than seventy-five percent independent directors and an independent chairman.[61] While the court found that the SEC had authority to promulgate the rule under the ICA and that the rule was not arbitrary or capricious under the APA, it faulted the SEC for its failure under the ICA to consider the impact of the rule on efficiency, competition, and capital formation.[62] Recognizing the difficulty of running reliable empirical studies, the D.C. Circuit wrote that "uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation . . . ."[63] In addition, the SEC, in explaining why it had adopted the rule, did not address an alternative to the rule put forward during the notice and comment period and raised by two dissenting Commissioners.[64] The court found that this was equally fatal to the rule's promulgation, because while the "Commission is not required to consider 'every alternative . . . conceivable by the mind of man . . .[,]'"[65] that particular alternative was "neither frivolous nor out of bounds and the SEC therefore had an obligation to consider it."[66] While the court did not require that the SEC always conduct an empirical study (the "decision not to do an empirical study does not make that an unreasoned decision"[67]), the case provided guidance on the *process* of SEC rulemaking by suggesting that the SEC "would be well served to [conduct empirical studies] when facts are available"[68] and to "set out a vague standard for when agency decisions must be based on empirical data and provide[] open-ended guidelines for future determinations regarding when it is appropriate for agencies to engage in rulemaking without considering empirical studies."[69]

60. Chamber of Commerce of U.S. v. SEC, 412 F.3d 133 (D.C. Cir. 2005).
61. *Id.*
62. *Id.* at 144.
63. *Id.* at 144.
64. *Id.*
65. *Id.* (citing *Motor Vehicle Mfrs Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 51 (1983).
66. *Id.* at 145.
67. *Id.* at 142.
68. David S. Ruder, *Balancing Investor Protection with Capital Formation Needs After the SEC Chamber of Commerce Case*, 26 PACE L. REV. 39, 51 (2005).
69. 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

4. *Chamber of Commerce II*[70]

In *Chamber of Commerce I*, the D.C. Circuit remanded the rule to the SEC "to address the deficiencies."[71] On remand, the SEC re-adopted the same conditions invalidated in *Chamber of Commerce I*, adding some empirical data to bolster its decision. The Chamber of Commerce once again challenged the rule, and the D.C. Circuit once again held that the SEC's *process* was flawed because the SEC "failed to comply with section 553(c) of the APA, 5 U.S.C § 553(c), by relying on materials not in the rulemaking record without affording an opportunity for public comment, to the prejudice of the Chamber."[72] Here, the court held, "[t]he Commission's extensive reliance upon extra-record materials in arriving at its cost estimates, and thus in determining not to modify the two conditions [at issue in *Chamber of Commerce I*], however, required further opportunity for comment . . . "[73]—a procedural step that the SEC was deemed to have failed to follow. In other words, the rule once again failed on a relatively trivial *process* ground.

5. *Goldstein v. SEC*[74]

At issue here was the SEC's rule requiring that hedge fund investors be counted as fund clients for purposes of an exemption that excused investment advisers with fewer than fifteen clients from registering under the Investment Advisers Act (IAA).[75] The SEC once again failed to defend the rule, as the D.C. Circuit invalidated it for conflicting with statutory purpose.[76] Analyzing the case through *Chevron*, the court wrote that although no official definition existed for "client," "[t]he lack of a statutory definition of a word does not necessarily render the meaning of a word ambiguous."[77] The court also highlighted that the definition the Commission now sought to apply inexplicably diverged from the SEC's own prior definition, rendering it "completely arbitrary."[78] And finally, because the new rule/definition "create[d] a situation in which funds with one hundred or fewer investors are exempt from the more demanding

(2006).

70. Chamber of Commerce of U.S. v. SEC, 443 F.3d 890 (D.C. Cir. 2006).
71. 412 F.3d at 145.
72. 443 F.3d at 894.
73. *Id.* at 901.
74. Goldstein v. SEC, 451 F.3d 873, 884 (D.C. Cir. 2006).
75. *Id.* at 874.
76. *Id.* at 884.
77. *Id.* at 878.
78. *Id.* at 883.

Investment Company Act, but those with fifteen or more investors trigger registration under the Advisers Act," the court held that the rule was arbitrary.[79] Here again, the court found that the SEC statutory interpretation was impermissible through "narrow"[80] reasoning pertaining to interpretation and process.

6. *Financial Planning Ass'n v. SEC*[81]

In this case, the SEC had attempted to exempt broker-dealers from the requirements of the IAA when they receive special compensation for their services.[82] The court found that the first step of *Chevron* had been satisfied such that the IAA was not ambiguous as to the definition of "investment adviser."[83] Consequently, the SEC's rule exceeded its authority and the SEC was held to lack the power to craft new exemptions under the Act.[84]

7. *American Equity Investment Life Insurance Co. v. SEC*[85]

The final precedent to *Business Roundtable II* provides some foreshadowing for what the court would eventually do in *Business Roundtable II*. The SEC rule at issue here classified fixed indexed annuities (FIAs) offered by insurance companies as non-annuity contracts, thus requiring that they be subject to regulation under the Securities Act of 1933.[86] While the D.C. Circuit held that the SEC's classification of FIAs was not unreasonable under *Chevron*,[87] it still found that the SEC had "failed to consider the efficiency, competition, and capital formation effects of the new [r]ule" and invalidated the rule under the APA.[88] In its analysis, the court criticized the SEC's claim that the rule would enhance competition because of the ambiguity that the absence of a rule on the

79. *Id.* at 884.

80. Dustin G. Hall, *The Elephant in the Room: Dangers of Hedge Funds in Our Financial Markets*, 60 FLA. L. REV. 183, 187 (2008).

81. 482 F.3d 481 (D.C. Cir. 2007).

82. *Id.* at 483.

83. The IAA carved out six exemptions from its broad definition in § 202(a)(11), including "(C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." 15 U.S.C. § 80b-2(a)(11) (2006). The text of the act also read that "(H) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order." 15 U.S.C. § 80b-2(a)(11).

84. *Fin. Planning Ass'n*, 482 F.3d at 492.

85. Am. Equity Inv. Life Ins. Co. v. U.S. SEC, 613 F.3d 166 (D.C. Cir. 2009).

86. *Id.* at 167.

87. *Id.* at 174.

88. *Id.* at 176.

matter had created. "The SEC cannot justify the adoption of a particular rule based solely on the assertion that the existence of a rule provides greater clarity to an area that remained unclear in the absence of any rule."[89] Rather, the court said, the APA requires "an analysis of whether the *specific rule* will promote efficiency, competition and capital formation."[90] From there, the court held insufficient the SEC's entire cost-benefit analysis, as it was largely based on the weak foundation of the "rule clarity" rationale, and the SEC had failed to provide empirical data to support its presumptions.[91]

In the nineteen years between 1990 and 2009, the D.C. Circuit invalidated all seven SEC securities regulations challenged in the court.[92] The grounds for invalidation varied between faulty statutory interpretation or lack of authority under *Chevron* and failure to meet the demands of the ICA and the APA.[93] With this line of holdings, and especially the court's reasoning in *Chamber of Commerce I* and *American Equity Life Insurance*, the SEC had been warned that empirical studies will often be required of it, and that such studies will have to be rule-specific. In no case, however, did the court engage in aggressive substantive review of the SEC's empirical rationale behind its rulemaking.

B. The SEC's Latest and Biggest Defeat in the D.C. Circuit

In *Business Roundtable II*, the D.C. Circuit overturned a proxy access rule promulgated by the SEC, Rule 14a-11, aimed at allowing shareholders to more easily and cheaply nominate non-incumbent candidates for corporate boards. Had it been upheld, Rule 14a-11 would have "require[d] a company subject to the [1934] Act proxy rules . . . to include in its proxy materials 'the name of a person or persons nominated by a [qualifying] shareholder or group of shareholders for election to the board of directors.'"[94] In invalidating the rule, the court held that the SEC had "acted arbitrarily and capriciously for having failed . . . adequately to assess the economic effects of a new rule."[95] Stating the rationale plainly, Judge Ginsburg, writing for the court, wrote that the SEC "inconsistently and opportunistically framed the costs and benefits of the rule; failed

89. *Id.* at 177-78.
90. *Id.*
91. *Id.* at 179.
92. *See* cases cited *supra* note 39.
93. *Id.*
94. *Bus. Roundtable v. U.S. SEC,* 647 F.3d at 1147 (quoting 75 Fed. Reg. 56,668, 56,682-83, 56,782-83).
95. *Id.* at 1148.

adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to the substantial problems raised by commenters."[96]

The court's approach in *Business Roundtable II* departs from that in the case's precedents in a number of ways. First, in terms of standard of review, whereas the SEC had been entitled to *Chevron* deference in some of the prior cases, *Chevron* had no place in *Business Roundtable II*, because there was no issue of statutory interpretation or ambiguity. At its outset, therefore, the court's reasoning rested solely on the strict requirements of the ICA and the APA, without the SEC being owed any deference in its rulemaking.

Second, the court here showed no recognition for the difficulties an agency might face in developing its cost-benefit analysis and predicting future trends. In *Chamber of Commerce I*, for example, the court exhibited acute awareness "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.'"[97] In *Business Roundtable II* on the other hand, without considering whether this instance would be one where an agency could base its decision on "informed conjecture," the court found that "the Commission's prediction directors might choose not to oppose shareholder nominees had no basis beyond mere speculation."[98]

Third, unlike in prior cases, the D.C. Circuit here conducted a substantive assessment of the numbers and data the SEC relied on or forewent relying on. For example, assessing the SEC's argument that Rule 14a-11 would improve board performance and increase shareholder value, the court strongly criticized the SEC for "rel[ying] exclusively and heavily upon two *relatively unpersuasive* studies, one concerning the effect of 'hybrid boards' (which include some dissident directors) and the other concerning the effect of proxy contests in general, upon shareholder value."[99] The court found it insufficient that the SEC had discounted those studies "because of questions raised by subsequent studies, limitations acknowledged by the studies' authors, or [the Commission's] own concerns about the studies' methodology or scope."[100] It is unclear why the court found the studies the SEC did rely on "relatively unpersuasive," or why the

96. *Id.* at 1148-49.
97. *Chamber of Commerce I*, 412 F.3d at 142 (quoting Melcher v. FCC, 134 F.3d 1143, 1158 (D.C. Cir. 1998)).
98. *Business Roundtable II*, 647 F.3d at 1150.
99. *Id.* at 1151 (emphasis added).
100. *Id.*

court found itself, in contrast to other securities-related cases, in a position to assess the soundness of methodology and empirical data regarding a promulgated SEC rule.[101] Rather, the court "simply chose the opposite side of a politically charged debate."[102] The court's intervention here thus differs widely from its approach in the two other cases where the SEC's cost-benefit analysis was found insufficient. In finding that the SEC had failed to meet its statutory obligation to assess the economic consequences of a proposed regulation in *Chamber of Commerce I*, the court did not go so far as to evaluate the substance of the different studies the SEC had considered. Rather, acknowledging that the SEC would be "excused for failing to consider [an] alternative if it were, for whatever reason, unworthy of consideration,"[103] the court merely found that the alternative not assessed by the SEC was neither frivolous nor out of bounds and thus required inclusion in the SEC's weighting.[104] In *American Equity*, where the court held arbitrary and capricious the SEC's consideration of efficiency, competition, and capital-formation implications, the court here, too, did not assess the soundness of empirical data.[105] Rather, it faulted the SEC for having based its entire reasoning on the shaky assumption that the existence of a rule—any rule—would have positive repercussions in the three areas requiring analysis under the APA.[106] In contrast, the SEC submitted to the D.C. Circuit a brief of over sixty pages and thorough explanations for its promulgation of Rule 14a-11 in preparation for litigation in *Business Roundtable II*.[107] Furthermore, the court in *Business Roundtable II* wrote that the agency "failed to make tough choices about which of the competing estimates is most plausible, [or] to *hazard a guess as to which is correct*."[108] Query whether the D.C. Circuit, under the bar it had just set for the SEC, would have found acceptable or adequate reasoning based on a hazarded guess.

Finally and relatedly, whereas the court's objections to SEC action in many of *Business Roundtable II*'s precedents can be attributed to the SEC's failure to follow required procedure, it is arguably impossible to do the same in the 2011 decision. In *Business Roundtable I*, the court applied *Chevron* to reject the SEC's statutory interpretation that it may take action

101. *Id.*
102. *D.C. Circuit Finds SEC Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis*, 125 HARV. L. REV. 1088, 1094 (2012).
103. 412 F.3d at 144.
104. *Id.* at 145.
105. 613 F.3d at 179.
106. *Id.* at 177-79.
107. Brief for Respondent, Bus. Roundtable v. U.S. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (No. 10-1305), 2011 WL 2014799.
108. 647 F.3d at 1150 (emphasis added) (internal quotation marks omitted).

on issues of substantive corporate governance; action in the area of substantive corporate governance is reserved for the states, the court reasoned.[109] In *Teicher*, *Goldstein*, and *Financial Planning Association*, the issue was a matter of statutory interpretation and the court never in these decisions invalidated the SEC rule based on the SEC's cost-benefit analysis.[110] In *Chamber of Commerce I*, as discussed above, the rule at issue was remanded to the SEC because the SEC failed to utilize any empirical studies per the demands of the ICA and had failed *entirely* to consider alternatives, not because the court deemed those alternatives more persuasive than the empirical evidence presented by the SEC.[111] In *Chamber of Commerce II*, the basis of the court's ruling was purely procedural, given the SEC's failure to subject new evidence to notice and comment.[112] Finally, in *American Equity Life Insurance*, the court rejected the SEC rule because the SEC provided a weak rationale as to how its new rule improves efficiency, competition and capital formation ("any rule is better than no rule."). The SEC's reasoning was nowhere as thorough as it was in its adoption of Rule 14a-11.

Lastly, it is also important to note the context of *Business Roundtable II*. The SEC promulgated Rule 14a-11 after the enactment of the Dodd-Frank Consumer Protection Act and its express grant of authority to the SEC to adopt proxy access rules.[113] This context further highlights the D.C. Circuit's aggressive approach to reviewing the SEC's rulemaking.

III. THE IMPLICATIONS OF HEIGHTENED JUDICIAL SCRUTINY

The new attitudes exhibited by the D.C. Circuit, for the time being, and especially if the attitudes self-realize into a long-term trend, will not be without repercussions for the general field of corporate governance. *Business Roundtable II* leaves open the question of just how much empirical evidence the D.C. Circuit would require to accept SEC action on corporate governance as adequately reasoned. In the area of shareholder voting alone, opinions abound as to whether increasing proxy access is

109. *Business Roundtable I*, 905 F.2d 406, 408-09 (D.C. Cir. 1990).

110. *Fin. Planning Ass'n*, 482 F.3d at 483; *Goldstein*, 451 F.3d at 874; *Teicher*, 177 F.3d at 1017.

111. *Chamber of Commerce I*, 412 F.3d at 145.

112. *Chamber of Commerce II*, 443 F.3d at 909.

113. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 103 Stat. 440 (codified as amended in scattered sections of 2, 5, 7, 11, 12, 15, 16, 18, 19, 20, 22, 25, 26, 28, 29, 30, 31, 41, 42, 44, 49, and 112 U.S.C.). The Act was effective in July 2010. Rule 14a-11 was to be effective in November 2010. Shareholder Nominations, 75 Fed. Reg. 56,782 (to be codified at 17 C.F.R. §240.14a-11), *invalidated by* Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

desirable for the market and, by extension, increases shareholder value. For example, in an extensive event analysis, Ali C. Akyol concluded that proxy access diminishes shareholder value.[114] In contrast, Bo Becker, also employing event analysis, concluded that "financial markets placed a positive value on shareholders access" and, by extension, proxy access maximizes shareholder value.[115] Had the SEC presented one of these studies over the other, would the court have accepted that? It is indeed questionable whether it is for the courts, based on the judiciary's generally limited expertise in such specialized areas, to assess the substance of these studies and approve just one as a satisfactory basis for regulatory action.

It is true that some judges are particularly learned and experienced in securities regulation, with a sophisticated understanding of the field. However, given the doctrine of stare decisis, as well as the judicial tradition of courts and judges borrowing from each other across circuit lines, one judge's successful heightened scrutiny in a single instance or action is only in a limited way, if at all, generally acceptable for all judges and courts.[116]

Even if one deems judges sufficiently well-prepared to so incisively scrutinize the substance of empirical evidence selected by the SEC as a check on SEC balance and impartiality, it is difficult to argue that judges themselves are any more immune to political and other external influences in their decision-making. For example, Delaware judges take into consideration the state's supremacy in charter competition and in setting national corporate law standards, actively attempt to balance their opinions with the interests of the state.[117]

Furthermore, while courts are generally deferential to agencies' statutory interpretations and other rulemaking under *Chevron*, the recent decisions related to statutory interpretation in the D.C. Circuit seem to dilute that deference—by setting ever-higher bars for meeting the requirements of the ICA and the standards of arbitrary and capricious review under the APA, the D.C. Circuit weakens the policy reasons

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114. Ali C. Akyol et al., *Shareholders in the Boardroom: Wealth Effects of the SEC's Rule to Facilitate Director Nominations*, (Dept. of Fin., Univ. of Melbourne, Working Paper, June 7, 2010), *available at* http://ssrn.com/abstract=1526081.

115. Bo Becker et al., *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge* 4 (Harvard Bus. Sch., Working Paper No. 11-052, 2010), *available at* http://hbswk.hbs.edu/item/6581.html.

116. *See D.C. Circuit Finds SEC Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis*, *supra* note 102, at 1092 ("Courts hardly outperform the SEC at evaluating the imperfect science of economics. Judges can struggle with expert testimony in their own decisions, and traditional training leaves most jurists ill-prepared to engage with sophisticated econometrics.").

117. Renee M. Jones, *Legitimacy and Corporate Law: The Case for Regulatory Redundancy*, 86 WASH. U. L. REV. 1273, 1292 (2009).

underlying *Chevron*.

Business Roundtable II, in particular, extends the boundaries of arbitrary and capricious review—an implication that must not go unchecked. The holding raises serious questions about how the SEC or any other agency can succeed at a cost-benefit showing. While cost-benefit analysis should ideally provide an objective, impartial basis for decision-making, "[it] has become a powerful weapon in the hands of vocal opponents of regulation."[118] In their book on the use of cost-benefit analysis in health and environmental regulation, Frank Ackerman and Lisa Heinzerling discuss how cost and benefit calculations may be skewed.[119] For example, "there is a tendency to overestimate the cost of regulations in advance of their implementation."[120] In other words, while ideally objective, cost-benefit analysis is a highly manipulable tool—governments and businesses alike may influence its outcome based on the desired result. On the agency side, "officials are not pure technocrats, but political beings who routinely make decisions based not on their scientific merit, but as a result of 'congressional pressure, interest group lobbying, bureaucratic (but non-expertise-based) policy views, or bureaucratic protection of turf or other self-interest.'"[121] Pressures from other (non-scientific) sources and self-interest similarly lead businesses to take their own positions.

The court in *Business Roundtable II* also seems to underestimate the difficulty of accurately predicting the impact of rules to make a truly falsifiable empirical cost-benefit case. Especially in the field of financial and securities regulation, "key variables may be difficult to quantify"[122] and too many externalities are possible. In addition, no guidelines exist for what the D.C. Circuit will consider sound cost-benefit analysis. If cost-benefit analysis is to become a permanent and aggressively reviewed fixture in SEC rulemaking, the agency must be able to turn to a series of guidelines or standards such that its analysis is sound without being overly cumbersome. The SEC would also have to add to its staff industry and economics experts for the sole reason of keeping up with the standards set

118. FRANK ACKERMAN & LISA HEINZERLING, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING 35 (2004). The authors criticize the use of cost-benefit analysis in health and environmental regulation, but many of the points they make are relevant to financial regulation as well.

119. *Id.* at 36.

120. *Id.* at 37 (citing ROBERT CAMERON MITCHELL & RICHARD T. CARSON, USING SURVEYS TO VALUE PUBLIC GOODS: THE CONTINGENT VALUATION METHOD 34 (1989)).

121. Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STAN. J.L. BUS. & FIN. 1, 54 (2006) (quoting Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2278-90 (2001)).

122. *Id.* at 59.

in *Business Roundtable II*.[123]

The D.C. Circuit has yet to hear another SEC case since *Business Roundtable II*, so it is unclear whether the court will attempt to limit the applicability of its holding. Nonetheless, the courts have cited *Business Roundtable II* in a number of opinions examining rules and regulations by other agencies and departments. On the one hand, there are signs that the D.C. Circuit may attempt to cabin the holding of *Business Roundtable II* to its facts—or perhaps just to the SEC. For example, in *American Petroleum Institute v. EPA*, the D.C. Circuit attributed the outcome of *Business Roundtable II* to "the [SEC's] larger failure to deal with the weight of the evidence against it."[124] Accordingly, the court stated that the American Petroleum Institute had "mistakenly place[d] much weight" on *Business Roundtable II*, because the EPA's analysis related to a rule on a national ambient air quality standard for nitrogen dioxide "[is] materially better than the analysis" for which the SEC was faulted.[125] In another opinion, the court distinguished *Business Roundtable II* from *Ass'n of Private Sector Colleges & Universities v. Duncan*, where the Association sued the Department and Secretary of Education under the APA for regulations promulgated under the Higher Education Act.[126] The court highlighted that the Department of Education does not share the "unique [statutory] obligation" that the SEC has to consider the effect of a rule on efficiency, competition, and capital formation.[127] The court set clear lines for itself when it put the onus on the regulation challenger to point to data or a study that an agency ignored. The Association having failed to do so, the court wrote, renders "*Business Roundtable* . . . of no help to its argument."[128] Most recently, in *Investment Co. Institute v. U.S. Commodity Futures Trading Commission*, the D.C. Circuit upheld against challenge amendments that the Commodity Futures Trading Commission (CFTC) made to regulations regarding commodity pool operators.[129] Distinguishing the CFTC's decision-making process from that of the SEC in *Business Roundtable II*, the court wrote that:

> the CFTC not only considered what regulations were already in

123. *See* Henry T.C. Hu, *Too Complex to Depict? Innovation, "Pure Information," and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601, 1686 (2012) (stating that a practical consequence of *Business Roundtable II* is "the need both for additional SEC staff with the requisite specialized expertise and a process of rulemaking that is more demonstrably interdisciplinary . . . .").

124. 684 F.3d 1342, 1351 (D.C. Cir. 2012).

125. *Id.*

126. 681 F.3d 427 (D.C. Cir. 2012).

127. *Id.* at 448 (quoting *Business Roundtable II*, 647 F.3d at 1148).

128. *Id.*

129. No. 12-00612 (BAH), 2012 WL 6185735 (D.D.C. Dec. 12, 2012).

> place but committed to streamlining the agency's compliance requirements. This shows that, unlike the SEC in *Business Roundtable [II]*, the CFTC considered and evaluated whether other regulatory requirements "reduce the need for, and hence the benefit to be had from" registration and reporting requirements with the CFTC.[130]

The court concluded: "these cases are distinguishable."[131]

On the other hand, in at least one instance, *Business Roundtable II* proved helpful to a district court in overturning an agency rule for failure to present a "satisfactory explanation for [the agency's] action including a rational connection between the facts and the choice[s] made."[132] Further, the distinctly heightened level of judicial scrutiny in *Business Roundtable II* may have practical implications. On the one hand, it may increase litigation as organizations like the Business Roundtable and the Chamber of Commerce are emboldened to challenge SEC regulations. At the same time, however, the case exhibited such a high level of scrutiny that it may, at least temporarily, paralyze the SEC's ability to promulgate new rules.[133] In essence, not only could litigation become unpredictable in the aftermath of *Business Roundtable II*, but the case is also "sufficiently threatening that an overworked and underfunded SEC may feel intimidated and compromise its rules, watering them down, to avoid the risk of another humiliating decision . . . ."[134]

How the D.C. Circuit and other courts will interpret *Business Roundtable II* in future cases is thus unclear. When it comes to SEC rules, however, the D.C. Circuit's emphasis on cost-benefit analysis prompts the question: How can the court decide which empirical case is more convincing without giving deference to one party over another, engaging in aggressive substantive review or, worse, simply exercising a substantive veto over regulations it does not like?[135]

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130. *Id.* at *50.

131. *Id.*

132. *See, e.g.*, Berge v. United States, No. 10-0373, 2012 WL 3039736, at *34 (D.D.C. Jul. 26, 2012) (citing *Business Roundtable II*) (holding that the applied behavioral analysis aspect of the Department of Defense health system for the Armed Services was arbitrary and capricious).

133. *See* John C. Coffee, Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1066 (2012) (arguing that *Business Roundtable II* "cast[s] a substantial cloud over the SEC's continuing ability to adopt other rules implementing the Dodd-Frank Act, even those not related to corporate governance").

134. *Id.* at 1067.

135. *See also* J. Scott Colesanti, *Laws, Sausages, and Bailouts: Testing the Populist View of the Causes of the Economic Crisis*, 4 BROOK. J. CORP. FIN. & COM. L. 175, 194 (2010) ("As 2010 unfolds, courts occasionally remind observers that the judiciary shall play

IV. TO MAINTAIN THE STATUS QUO OR SEEK ALTERNATIVES?

Business Roundtable II raises new challenges for the SEC in the area of securities regulation, and the agency will have to adapt to the heightened standards set forth in the D.C. Circuit decisions. Short of the D.C. Circuit retracing a few of its own steps in *Business Roundtable II*, I see four possible alternatives that, separately or jointly, can help avoid paralysis in securities regulation and corporate governance more generally.

First, there is the possibility of private ordering in corporate governance and particularly on the issue of proxy access and the balance of power between shareholders and managers. In an article commenting on proxy access and the fate in the D.C. Circuit of Rule 14a-11, Professor Jill Fisch argues that "federal regulation is poorly suited for regulating corporate governance," whereas "[p]rivate ordering offers a more flexible mechanism" for doing so.[136] Fisch outlines the many deficiencies in the SEC's basis for Rule 14a-11 while criticizing the court's oversight of these problems in favor of taking "the unprecedented approach of second-guessing the conclusions of the SEC's economic analysis."[137] Private ordering could help prevent such judicial moves while alleviating the "destructive ambiguity" of proxy access.[138]

Conversely, and as a second alternative, Congress could enact legislation that explicitly states what the SEC will have to promulgate as a final rule on contentious governance and securities issues, such as proxy access. Of course, this alternative is far from ideal because it undermines the SEC's rulemaking authority and, more importantly, puts corporate governance in the hands of non-expert actors (members of Congress) who often yield to political pressures.

Third, a sort of "rapprochement" between the D.C. Circuit and the SEC could be brokered if the former begins to recognize, and the latter begins to admit, the role of politics in rulemaking.[139] This would entail the agency acknowledging instances where politics superseded empirical reasoning and courts viewing certain political influences as appropriate and legitimate.[140] The benefits of such a relationship include de-politicizing science, softening the "ossification" charge increasingly directed at

a role in the resolution of the economic crisis.").

136. Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 435 (2012).

137. *Id.* at 439.

138. *Id.*

139. Kathryn A. Watts, *Proposing a Place for Politics in Arbitrary and Capricious Review*, 119 YALE L.J. 2 (2009).

140. *Id.*

arbitrary and capricious review, and enabling greater political accountability by forcing disclosure of agencies' political influences.[141] Under this scenario, the SEC may still have to analyze costs and benefits, but legitimate political influences in its decision-making would not prove automatically fatal to a rule.

Fourth, the change could come from *within* the SEC, whereby the SEC would "reorient the reasoning supporting the proposed regulatory initiative"[142] and would do so "as a lawyer, not as an econometrician or empiricist."[143] In other words, that the D.C. Circuit has struck each one of the challenged SEC rules since *Business Roundtable I* could be more about the approach and methodology of the SEC team defending the rule. The SEC must recognize the key role that "[s]ophisticated number crunching" has come to play in the development of contemporary corporate law,[144] and must strengthen its abilities accordingly. It could also draw some lessons from the way other agencies go about conducting cost-benefit analyses to overcome judicial challenges to their rules and regulations.[145]

Finally, if cost-benefit analysis is to be accepted as an essential tool in securities regulations and other SEC rulemaking, reform measures can be undertaken to prevent two evils: that judges and courts substitute the SEC's judgment for their own as a sort of substantive veto, and that the Commission "draft lengthy statements of basis and purpose filled with lengthy explanations and data that courts ultimately may, or may not, consider" adequate.[146] Such reforms could include promulgating formal cost-benefit analysis guidelines for the SEC to follow in its rulemaking, creating a cost-sharing structure between the SEC, other financial regulators, and industry actors so that running the analysis would not become too costly for the SEC (a stick for the industry), and requiring ex post analyses of promulgated regulation in an effort to inform future empirical studies (a stick for the SEC).[147] In addition, the SEC could be allowed to subject the cost-benefit analysis tool to a cost-benefit analysis to ascertain whether the tool is worthwhile in specific instances of rulemaking, thus "limit[ing] the use of [cost-benefit analysis] to those cases where the efficiency gains resulting from such analysis are likely to exceed

141. *Id.* at 40-45.

142. Cox & Baucom, *supra* note 4, at 1839.

143. Cox & Baucom, *supra* note 4, at 1840.

144. Matthew T. Bodie, *The Post-Revolutionary Period in Corporate Law: Returning to the Theory of the Firm*, 35 SEATTLE U. L. REV. 1033, 1037 (2012).

145. *See generally* Cox & Baucom, *supra* note 4, at 1840–43 (examining "recent signs" that cost-benefit analysis and economists more generally would be given a greater role in the Commission's rulemaking processes).

146. Watts, *supra* note 139, at 41 (internal quotation marks omitted).

147. Sherwin, *supra* note 121, at 53–58.

its costs."[148]

CONCLUSION

This Comment has explored the D.C. Circuit's holdings in cases challenging the SEC's rulemaking in the area of securities regulations since 1990. While the D.C. Circuit invalidated the SEC rule in question in each of the eight challenges before it, the most recent decision, *Business Roundtable II*, constitutes a turning point in judicial review of SEC action. By undertaking aggressive substantive review of the SEC's economic analysis and empirical reasoning, the D.C. Circuit engaged in unprecedented heightened judicial scrutiny towards the SEC and set forth new (if vague) demands for extensive empirical basis and cost-benefit analysis in SEC rulemaking. The case thus raises questions about the SEC's future rulemaking ability and whether it will be able to make falsifiable empirically-based cases for its rules that the court could deem adequate.

With the relationship between the judiciary and the SEC at a clear crossroads and a phenomenon of judicial aggression identified, it is now important to think about the road ahead and the measures necessary to serve the public interest such that years of advances in corporate governance and regulation are not so easily—or inadvertently—eviscerated.

148. Sherwin, *supra* note 121, at 59.