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

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

ROBERTA S. KARMEL*

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

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I. INTRODUCTION

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

The purposes of these statutes can be gleaned from their preambles. The Securities Act is “[a]n Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof and for other purposes.” The Exchange Act is “[a]n Act to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.” Both statutes, but especially the Exchange Act, have been extensively amended in the eighty-five years since the SEC was created, adding to the agency’s mandate and responsibilities.\(^3\)

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

2. \textit{Id.} at 99. Because the controversies surrounding the creation of the SEC were not clearly resolved by Congress, legislators granted the SEC authority to issue its own rules. “Congress had broadly defined the Commission’s areas of expertise and invited it to forge its own mandate.” \textit{Id.}

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

President Franklin D. Roosevelt's message upon creating the SEC underlined the connection between the SEC’s mission and the capital markets:

The merchandise of securities is really traffic in the economic and social welfare of our people. Such traffic demands the utmost good faith and fair dealing on the part of those engaged in it. If the country is to flourish, capital must be invested in enterprise. But those who seek to draw upon other people's money must be wholly candid regarding the facts on which the investor's judgment is based. Yet, it was only in 1996 that Congress specifically required the SEC to consider, in addition to the protection of investors, the promotion of efficiency, competition and capital formation.

The inability of Congress to establish clear directives for the SEC to administer and efforts by Wall Street and other business interests to thwart securities regulation created a political climate favoring the SEC’s independence and respect for its expertise. For many years the courts deferred to the SEC in both its rulemaking and prosecutorial initiatives. Such deference was based on general public respect for the SEC’s staff and work and was assisted by the *Chevron* doctrine.

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8. Chevron v. Natural Resources Defense Council, 467 U.S. 837, 843-44 (1984) ("If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.").
Based on a Supreme Court case, this doctrine requires a two-step analysis. If a statute pursuant to which an agency rule has been passed is clear, the court can vacate a contrary agency rule. If the statute is ambiguous, then an agency may have discretion to implement the statute by rule. However, the agency’s action must not be arbitrary or unreasonable.\(^9\) Closely related to the *Chevron* doctrine is judicial deference to an agency’s interpretation of its own rules.\(^10\) These doctrinal constructs have bolstered the SEC’s independence.

A different tenet of statutory construction curtailing agency discretion is the “hard look” doctrine,\(^11\) based on the Administrative Procedure Act’s (“APA”) provision that a reviewing court can set aside agency action if the action was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”\(^12\) These conflicting doctrines allow a court reviewing agency action to utilize political preferences to uphold or strike down agency action, including rulemaking.

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

> In general, over many years, professional opinion has given the SEC excellent ratings on its performance. . .. Through many administrations Democratic and Republican, the SEC has on the whole maintained its technical competence, its energy, and its integrity. Its staff remains at a high level of ability, filled with enthusiasm and the moral certainty that it is performing an important public service.\(^13\)

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9. *Id.*


This complimentary language was then followed by a book highly critical of the SEC in its administration of its most important goal of corporate disclosure.

Skepticism about administrative agencies and regulatory reform took hold during the Carter Administration, which threatened to curtail the SEC’s independence by curtailing the SEC’s ability to represent itself in the courts.\textsuperscript{14} Although this initiative did not succeed, other ideas for supervising the SEC’s enforcement activities either by Congress or the Executive have been floated more recently.\textsuperscript{15}

Agency independence during the Reagan Administration was threatened by the Executive Branch through the imposition of cost benefit analyses for new rules and oversight by the Office of Information and Regulatory Affairs ("OIRA"). The efforts by OIRA to control agency regulation in this way continued through both Democratic and Republican administrations thereafter. Although the independent agencies like the SEC are not technically subject to OIRA cost benefit review, some administrations have “voluntarily” given OIRA review powers over proposed regulations. Further efforts to interfere with regulation have increased during the Trump Administration.

Although the OIRA regulatory review regime has not been applied to the SEC, in 1996 Congress amended various federal securities law statutes to require the Commission to consider “efficiency, competition and capital formation” when determining whether rules are in the public interest.\textsuperscript{16} This could be viewed as a type of regulatory impact analysis.\textsuperscript{17}

\begin{itemize}
\item[\textsuperscript{14}] See part III.A, infra.
\item[\textsuperscript{15}] See Section V, infra.
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Proponents of the unitary Executive attacked structures designed to protect independent decision making within the SEC, with mixed success.\textsuperscript{18} Appointment of Chairs and Commissioners with close ties to either the White House or other Executive branch agencies or key Congressional committees led to a new partisanship at the SEC and an erosion of both independence and expertise. Muscular trade associations not only lobbied against stringent new rules but went to court to attempt to vacate rules once they were adopted. Congress also became more energized in attempting to influence SEC regulation by passing statutes with extremely detailed mandates for rulemaking within specified time parameters.\textsuperscript{19}

Attacks on the administrative state, sometimes referred to derisively as the deep state, have increased during the Trump Administration. Yet, it is superficial to view the attacks on the administrative state as merely right-wing efforts to please business interests by derailing regulation. Many of the attacks on the administrative state are embedded in power struggles between the Executive, Judicial and Legislative branches of the government. Agencies like the SEC have become pawns in these power struggles and have survived them so far by conducting themselves with specialized expertise and dedication to the public interest. Nevertheless, the attacks are wounding, and lead to regulatory ossification rather than efficient and effective agency decision making.\textsuperscript{20}

These trends need to be understood in the context of a populism that (among other rallying cries) is pitting the poorly educated, the elderly, small businesses and others who find it difficult to cope with bureaucracy against intellectuals and experts who run the administrative state.


\textsuperscript{19} Sarbanes-Oxley, Dodd-Frank.

\textsuperscript{20} See analysis of Regulation Best Interest, Part II.E, \textit{infra}. 
Further, the populists are often aligned with some traditional business interests that blame regulation for their decline, or simply wish to be free of regulation in order to increase their profits. Ironically, it is those who fulminate against regulation that may need the administrative state the most. This irony can be seen regarding health care and environmental protection, and has a particular pattern in securities regulation.

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

This article will discuss several topics which are relevant to an understanding of attacks on the administrative state at the SEC. One of the most important is the imposition of a cost benefit analysis on SEC rulemaking, and instances where the D.C. Circuit court has vacated SEC rules either on the inadequacy of the cost benefit analysis or on the somewhat related ground that a new

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

rule was arbitrary or capricious. These matters will be discussed in Part II of the Article. Another type of attack is aimed at SEC independence, to be discussed in Part III. Finally, Part IV will discuss threats to the Chevron and related doctrines, or the deference by the federal courts to the SEC’s expertise. Part V will conclude with a plea for protecting the SEC against the destructive partisanship that is weakening the administrative state designed to protect the public against special interests.

II. COST BENEFIT RESTRICTIONS AND INTERPRETATIONS

A. CONFLICT BETWEEN DEFERENCE AND REGULATORY ANALYSIS

The deference that is supposed to be given to federal administrative agencies pursuant to the *Chevron* doctrine\(^\text{23}\) frequently has been ignored or given way to other administrative law doctrines utilized by courts when interpreting new rules by economic regulators. Some judges and legislators are skeptical of *Chevron* deference, as will be discussed in Part IV.

Instead of *Chevron* deference, however, the use of a cost-benefit analysis by the Circuit Court for the District of Columbia in passing on new rules by the SEC has in several cases led to vacating those rules as arbitrary and capricious under the APA\(^\text{24}\). Yet, the APA does not require the SEC to make a cost-benefit analysis that would satisfy the standards set by OIRA. When interpreting new SEC rules promulgated pursuant to Dodd-Frank\(^\text{25}\) or the Jumpstart Our Business

\(^{23}\) *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), gives a federal administrative agency deference in rulemaking entrusted to the agency by statute unless the agency’s determination is unreasonable, impermissible or arbitrary.

\(^{24}\) 5 U.S.C. §§ 551-559.

\(^{25}\) Dodd-Frank.
Startups Act (JOBS Act),\textsuperscript{26} the D.C. Circuit Court has not insisted on a cost-benefit analysis by the SEC but has recognized that a statutory mandate needs to be followed.

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

Cost-benefit analysis is an established means of assessing the merits of proposed rules and has become a feature of the regulatory landscape over the last few decades. Cost-benefit analysis is “the systematic identification of all of the costs and benefits associated with a forthcoming regulation, including nonquantitative and indirect costs and benefits, and how those costs and benefits are distributed across different groups in society.”\textsuperscript{27} The first mandatory review procedure for administrative agencies was established by Executive Order 121291 in 1981 by President Ronald Reagan, requiring new regulations be submitted to the OIRA for review.\textsuperscript{28} This centralized review process has persisted in subsequent administrations, establishing a long-standing mechanism of executive review of agency rulemaking to ensure that the proposed regulation strikes an acceptable balance between costs and benefits.\textsuperscript{29}

Independent regulatory agencies, like the SEC, are encouraged to conduct cost-benefit analysis in accordance with these policies, though are not required to under this regime.\textsuperscript{30} The

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\textsuperscript{27} MAEVE P. CAREY, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS REQUIREMENTS IN THE RULEMAKING PROCESS 1 (2014).


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requirement of cost-benefit analysis may also be statutorily mandated, and the Supreme Court has held that cost-benefit analysis may be relied upon by administrative agencies in promulgating standards and regulations even where their statutory authority is silent on the matter.\textsuperscript{31} Even among advocates of a strong regulatory state, cost-benefit analysis is not without its critics. The analysis necessarily relies on \textit{ex ante} assumptions made about unpredictable and non-quantitative effects, and in some cases, is an exercise in balancing the cost of regulation against public welfare or human life.\textsuperscript{32} The use of cost-benefit analysis in regulatory review at some level, however, is widely supported among scholars.\textsuperscript{33}

Cost-benefit analysis has been an idea applicable to agency rulemaking since the Reagan Administration and it has been embraced by both Democratic and Republican administrations. Nevertheless, conservatives and business groups have latched on to cost-benefit analysis to slow government regulation or prevent new regulations from coming into force. The use of cost-benefit analysis by the D.C. Circuit has therefore been criticized as either political decision making or otherwise inappropriate.

There is considerable debate about how and whether intangible benefits can be quantified in order to weigh such benefits against projected costs of new regulations.\textsuperscript{34} In the author’s opinion, to the extent the benefits of SEC regulations—investor protection, fair and orderly markets, and other intangible inputs that provide investors with confidence in the securities markets—cannot be

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\textsuperscript{32} See \textit{CAREY, supra note 27}, at 1.

\textsuperscript{33} Id.

\textsuperscript{34} See, \textit{e.g.}, LISA HEINZERLING & FRANK ACKERMAN, \textit{PRICING THE PRICELESS: COST-BENEFIT ANALYSIS OF ENVIRONMENTAL PROTECTION} (2002).
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measured in economic terms, weighing estimated regulatory costs against aspirational benefits is chimerical. New legislation may impose cost-benefit requirements on the SEC, and require the SEC to quantify benefits as well as costs, but it is unclear what effect such legislation would have since the SEC already goes through a fairly thorough cost-benefit exercise.35 Further, when a new statute mandates that the SEC pass a new rule, vacating that rule on the basis of a cost-benefit analysis is wrong, especially when the Congress has engaged in no such balancing exercise.

In four D.C. Circuit Court cases SEC rulemaking was upended for want of an adequate cost-benefit analysis and the SEC’s response to those cases was the creation of the Division of Risk, Strategy and Economic Analysis (“DERA”). In D.C. Circuit Court cases reviewing new rules under Dodd-Frank and the JOBS Act, the SEC’s cost-benefit analysis was either ignored or passed muster. One question raised in these cases is whether the SEC’s cost benefit analysis should be reviewed by the courts once it has been made. Another question is whether the courts are being driven by principles or politics.

B. HISTORY OF COST-BENEFIT ANALYSIS

According to Cass Sunstein, a cost-benefit analysis is an effort “(1) to quantify the anticipated consequences of regulatory action and (2) to monetize those consequences in terms of benefits and costs, subject to (3) a feasibility constraint . . . [because] some consequences may be hard or impossible to quantify or monetize.”36 The current formulation of this requirement, imposed on most federal administrative agencies by OIRA is not merely a procedural charge but

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a mandate that agencies show that the benefits of a new rule justify the costs and also that they have chosen the approach to maximize benefits.37

Professor Jeffrey Gordon has suggested that cost-benefit analysis originated in the torts system, where juries were allowed to determine the optimal level of consumer product safety, workplace health and safety or environmental amenities.38 According to John Coates, cost-benefit analysis in the federal system began in 1936 when Congress ordered agencies to weight the costs and benefits of flood control projects.39 In the 1970s, disillusionment with government regulation and the high cost to business of federal regulation in an inflationary economy, led to calls for regulatory reform, including better oversight of the administrative process.40 This regulatory reform movement followed a period of intense congressional activity creating new agencies with expansive regulatory reach, including the Environmental Protection Agency, the Consumer Product Safety Commission, the Occupational Health and Safety Administration and the Nuclear Regulatory Commission.41 Therefore, Presidents Nixon, Ford and Carter attempted to establish procedures for coordinating and overseeing agency rulemaking.42

40. Boutrous, supra note 28, at 247.
42. Boutrous, supra note 28, at 247.
Yet, it was President Reagan who introduced the first mandatory review process by OIRA. By executive order, all agencies were required to submit new regulations to OIRA for review under a cost-benefit analysis. OIRA was then to determine whether the regulations accomplished the Administration’s goals and agencies were prohibited from publishing regulations without OIRA’s approval. Every subsequent President, whether a Democrat or Republican, has continued such practice.

From the outset, OIRA’s cost-benefit review process has been controversial, and has had strong proponents and detractors. Advocates of cost-benefit analysis claim that it is an agency cost-control device, used by politically accountable officials to discipline agencies in their rulemaking initiatives. Also, it is supposed to increase transparency and enhance public engagement with the regulatory process. Many advocates of cost-benefit analysis embrace it as a deregulatory tool. Perhaps for this same reason, detractors argue that it is an effort to close down regulatory initiatives by business groups. Others have argued that federal judges should not be reviewing cost-benefit analysis by agencies because these are merely procedural obligations and should not be made substantive requirements. Commenters also argue that the essence of economic regulation makes cost-benefit requirements for economic regulators particularly problematic. Yet, some advocates

44. Id.
45. Coates, Cost Benefit, supra note 39, at 900 n. 42.
47. Gordon, supra note 38, at S353; Robert J. Jackson, Jr., Comment: Cost-Benefit Analysis and the Courts, 78 L. & CONTEMP. PROBS. 55 (2015) [hereinafter “Jackson, Comment”].
of cost-benefit analysis argue that it is more appropriate to economic regulation than to health and safety regulation.\textsuperscript{49}

Separation of powers issues also lead to controversy over cost-benefit analysis. OIRA’s role has been criticized as improper Executive Branch interference with agency rulemaking. For this reason, the SEC and other independent federal agencies have resisted compliance with the executive orders requiring that new regulations be reviewed by OIRA.\textsuperscript{50} When President Carter considered whether all agencies, including independent agencies should give advance notice of their agendas, offer an analysis of the impact on major regulatory proposals and conduct periodic reviews of existing regulations, \textsuperscript{51} there was strong pushback from Congress. Rep. Harley O. Staggers, D-W. Va., chairman of the Interstate and Foreign Commerce Committee, and John E. Moss, D-Calif., head of that panel’s Oversight and Investigations Committee, sent a five page letter of objections, warning that “before you decide finally whether to include independent regulatory agencies within the ambit of the executive order, you will consider the impact on its effectiveness that a possible executive-legislative confrontation may have.”\textsuperscript{52} Thirteen Senators, including the chairmen and ranking Republicans on the Governmental Affairs, Judiciary, Commerce and Banking, Housing and Urban Affairs Committee likewise fought to insulate the independent regulatory commissions from presidential domination. They said that “in their

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\item[50.] See Executive Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011) (stating that independent agencies should promote the goal of Executive Order 13,563).
\end{itemize}
unqualified view,” the proposed executive order “cannot lawfully be applied to the independent regulatory commissions without the express approval of Congress.”

No statute expressly requires the SEC to conduct a cost-benefit analysis, but in the 1970s the SEC began to do so voluntarily. In 1996, however, the Congress inserted into the National Securities Markets Improvement Act language that has been viewed by some as a cost-benefit analysis requirement, as follows:

Whenever . . . the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

In addition, Section 23(a)(2) of the Exchange Act requires the SEC to consider the impact that any rule promulgated under that act would have on competition and include in the rule’s statement of basis and purpose “the reasons for the Commission’s determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of the Act.”

Conservative members of Congress have drafted bills to impose a clearer and more stringent cost-benefit analysis requirement upon the SEC. This effort and similar efforts to involve the U.S. Government Accountability Office (GAO) in analyzing new regulations, would appear to be a push-back against regulation pursuant to Dodd-Frank. It is somewhat

53. Id.
54. Ahdieh, supra note 46, at 1999 and n.69.
55. See generally The National Securities Markets Improvement Act of 1996.
56. Id. at §106. This language is in the Securities Act of 1933, §2(b), the Securities Exchange Act of 1934, §3(f) and the Investment Company Act of 1940, § 2(c).
57. See generally Exchange Act.
disingenuous, since Scott Garrett, the former Chair of the House Committee on Banking, Housing and Urban Affairs, promoted an explicit cost-benefit analysis for SEC rulemaking, but also claimed that when the SEC implements the JOBS Act, a cost-benefit analysis is not required, since the JOBS Act is a deregulatory statute.60

On January 30, 2017, in the first weeks of his administration, President Trump signed Executive Order 13771, titled “Reducing Regulation and Controlling Regulatory Costs.” The order was most controversial for its requirement that for every new regulation, the relevant agency identify two regulations which could be repealed.61 This was part of a cost-cutting push, where a new rule’s costs to industry must be strictly balanced by removing the costs of other regulations.62 Critics describe this as a “dramatic departure” from the old approach of cost-benefit analysis, towards an approach that incentivizes regulations that burden industry as little as possible without any evaluation of the benefits provided,63 an approach sometimes referred as “cost-cost analysis.”64 Researchers also suggest that, along with de-emphasis of benefits, in requiring de novo review of the costs of old regulations, agencies seeking to deregulate are able to tweak the outcomes of a second round of cost-benefit analysis by relying on new assumptions and calculations, for example by adjusting their estimates for the “Value of a Statistical Life” to make certain rules appear to have fewer net benefits.65

63. Id.
New guidance from the Office of Management and Budget may also change how independent agencies like the SEC are answerable for their rulemaking. The memo focuses on the Congressional Review Act, which requires agencies to submit a complete copy of cost-benefit analysis to both houses of Congress for review prior to implementation of “major rules.” The new guidance formalizes the previously informal process by which OIRA determined which rules count as “major”: independent agencies must now submit advance notice of rules along with an analysis “sufficient to allow the OIRA to determine whether the rule is major.” Former OIRA director under President Obama, Cass Sunstein, suggested in an opinion on the new guidance that this could allow the OIRA to dispute an agency’s assessment of the costs of a proposed rule. The memo appears broad enough to encompass less formal guidance issued by the Commission, and some have raised the question about whether this might include no-action letters. It remains unclear what the total effect on the SEC will be as a result of this new guidance, with some analysis indicating that it could affect the agency’s analytical posture with respect to new rulemaking but


67. Id.


noting that it may not amount to a significant shift. A senior administration official anonymously characterized it as “business as usual” for the SEC.

Although agency utilization of cost-benefit methodologies can make regulation more efficient and more transparent, it can also lead to delays in rulemaking mandated by new legislation and the deadening of initiatives for new regulatory projects. Other statutes regulating the regulators can work a similar effect. These include the Paperwork Reduction Act of 1995, the Small Business Regulatory Enforcement Fairness Act of 1996, and the Final Regulatory Flexibility Act. Whether these laws make for better SEC rulemaking is a serious question. In my view they prolong the rulemaking process and create orders for final rules published in the federal register unnecessarily lengthy and prolix.

C. D.C. CIRCUIT COURT CASES VACATING SEC RULES

It is not only the Executive Branch that has been scrutinizing SEC rulemaking and favoring deregulation. In four very political cases, the D.C. Circuit Court vacated SEC rules on the basis of the agency’s failure to conduct an adequate cost-benefit analysis. These cases could have been


72. 44 U.S.C. § 3501 et seq.


74. 5 U.S.C. § 603.

75. For example, in the SEC’s promulgation of Regulation A-Plus, 57 pages in the Federal Register are devoted to the details of the rule, 21,807-64 and 24 pages are devoted to a cost benefit analysis and similar other analyses required by statute. Id. at 21,864-88.
decided on other grounds. Three cases involved line drawing between state and federal law in corporate governance matters, and the fourth case involved preemption of state insurance regulation. All of the cases are explainable on the ground that the court believed the SEC was intruding too far into dictating corporate board of director composition or other matters better left to state law.\textsuperscript{76} The plaintiffs in these cases were trade associations, and in the cases involving the regulation of mutual funds the plaintiff, which was the Chamber of Commerce, had rather tenuous standing. It is unclear exactly why the court used cost-benefit analysis to upend the regulations attacked by the plaintiffs. Perhaps the judges believed this was a less contentious ground than federalism, but the decisions have been criticized by some who think that courts should not be reviewing cost-benefit determinations by agencies.\textsuperscript{77}

In 1975, in a non-securities law case, the Supreme Court stated that “[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”\textsuperscript{78} Two years later, the Court decided \textit{Santa Fe Industries v. Green},\textsuperscript{79} involving a claim of breach of fiduciary duty by a board of directors in a short-form merger. The Court declined to apply Rule 10b-5 under the

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\item \textsuperscript{76} Jeffrey Gordon agrees with this analysis. Gordon, supra note 38, at S353-54.
\item \textsuperscript{77} See id. at S353 (“If applied through the machinery of the legal system--especially hard-look judicial review that invites de novo relitigation of empirically contestable conjectures--BCA is likely to stymie regulation aimed at the reduction of systemic risk in favor of privileging a status quo that we know is unstable.”); Coates, Cost-Benefit, supra note 39, at 909-26; Jackson, Comment, supra note 47 at 55 (“I argue only that, whatever position one takes about the appropriate role of CBA in financial regulation, all should agree that the courts should play virtually no role in conducting or reviewing that analysis.”) It has been argued that these decisions are the product of Republican judges appointed by Reagan, but I do not agree with this somewhat facile explanation. It is true that Republican SEC commissioners issued dissents in these cases, but the decisions involving investment company boards were from a Commission chaired by William Donaldson, a Republican.
\item \textsuperscript{78} Cort v. Ash, 422 U.S. 66, 84 (1975).
\item \textsuperscript{79} Santa Fe Industries v. Green, 430 U.S. 462 (1977).
\end{itemize}
Securities Exchange Act of 1934 (Exchange Act)\textsuperscript{80} to regulate internal corporate mismanagement, stating “[a]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.”\textsuperscript{81}

This principle that state law should govern corporate internal affairs laws in the absence of federal preemption was later applied by the Court in cases involving investment companies.\textsuperscript{82} In \textit{Chamber of Commerce of the United States of America v. Securities and Exchange Commission},\textsuperscript{83} the D.C. Circuit Court had an opportunity to apply this principle to SEC rulemaking involving investment company governance, but it instead vacated a regulation on the ground of an inadequate cost-benefit analysis. Functionally, the investment company is “a shell, a pool of assets consisting of securities, belonging to the shareholders of the fund.”\textsuperscript{84} However, investment companies in the United States are organized as corporations and have separate advisers and underwriters. The investment company does not have employees and its investments are managed by an affiliated organization. These relationships give rise to a variety of conflicts of interest which are regulated under the Investment Company Act of 1940 (Investment Company Act).\textsuperscript{85} Among other things, the Investment Company Act requires that forty per cent of the board of directors be “independent” or “disinterested.”\textsuperscript{86} Directors who are not independent encompass a long list of persons who have

\begin{footnotes}
\item[80.] 17 C.F.R. 240.10b-5.
\item[81.] 430 U.S. at 479.
\item[83.] 412 F.3d 133 (D.C. Cir. 2005).
\item[84.] Zell v. Intercapital Income Securities, Inc., 675 F.2d 1041, 1046 (9th Cir. 1982).
\item[85.] 15 U.S.C. §§ 80a et seq.
\item[86.] \textit{Id.} at § 80a-10(a).
\end{footnotes}
some business or professional relationship with the investment company or are affiliated with the
adviser, underwriter or broker for the investment company. 87

Congress’ purpose in structuring the Investment Company Act in this way was to assign
the disinterested directors the role of independent watchdogs to act as an independent check on the
management of the investment company. Yet, because an investment company is the creature of
its sponsor/adviser, there have been persistent questions as to whether independent directors can
provide effective oversight of the contractual relationship between the fund and the adviser. 88

Over the years, the SEC has conditioned a number of exemptions under the Investment
Company Act upon review and approval by independent investment company directors. Because
the Investment Company Act contains numerous sweeping prohibitions against transactions with
affiliated entities which are, in fact, commonplace, reliance on these exemptions is necessary to
permit investment companies to conduct ordinary business operations. 89

In 2001, at a time when there was debate over the corporate governance of public
companies because of a series of accounting scandals, the SEC determined to require the boards
of investment companies to have a majority of independent directors. At the time there was no
apparent crisis of confidence with respect to mutual fund governance, but the SEC was making a
general bid to regulate corporate governance and board composition, which resulted in the passage
of the Sarbanes-Oxley. 90 The SEC accomplished its goal of mandating that an investment company

87.  Id. at § 80a-2(a)(19).
88.  See SEC. & EXCH. COMM’N, DIV. OF INV. MANAGEMENT, PROTECTING INVESTORS: A HALF CENTURY OF
89.  For example, the exemptions permit funds to purchase securities in a primary offering where an affiliated
broker-dealer is a member of the underwriting syndicate, Rule 10f-3, 17 C.F.R. §270.10f-3, and permit the use of fund
assets to pay distribution expenses. Rule 12b-1, 17 C.F.R. § 270.12b-1.
See Roberta S. Karmel, Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes
Charge of Corporate Governance, 30 DEL. J. CORP. L. 70 (2005).
board be composed of a majority of independent directors by conditioning the operation of its exemptions under the Investment Company Act upon such a structure. Further, the SEC required the independent directors to select and nominate the board’s independent directors, and to hire counsel with no substantial ties to a fund’s manager. The SEC’s method for imposing its corporate governance ideas on mutual funds was not challenged by the fund industry, in part because many funds already had a majority of independent directors.

After this rule was passed, in early September 2003, the New York Attorney General began a widespread investigation into the mutual fund industry by bringing an action involving late trading, deceptive market timing and sales practices by mutual funds. The SEC was already working on mutual fund reform by the time the New York Attorney General brought these cases, but the actions of the Attorney General spurred the SEC to greater activism. During 2003, the SEC initiated sixteen rule making proceedings involving mutual funds. Further, since the mutual fund scandals broke, the SEC and state regulators took enforcement actions against nearly half of the largest mutual fund companies. In addition to permitting improper trading, these cases involved sales practice abuses and other matters. As the result of all of these problems, the SEC commenced


92. In my opinion, the SEC’s authority for changing the statutory standard of forty per cent independent directors to more than fifty per cent could have been questioned since the statute would appear to grant a mutual fund the right to have up to sixty per cent of its directors be non-independent.


further corporate governance and other reform of fund practices. Among other things, the SEC determined that any fund relying on any of its exemptions under the Investment Company Act must have a board comprised of at least 75 percent independent directors, and a chairman of the board who is an independent director. This rule was then attacked and vacated in part in *Chamber of Commerce v. SEC*.

The D.C. Circuit held that the SEC had authority to pass this rule and could leverage its exemptive authority under the Investment Company Act to regulate mutual fund corporate governance. The court’s decision was grounded on two rationales. First, the court held that the rule was related to a basic purpose of the act—the tempering of conflicts of interest inherent in the structure of investment companies. In this regard, the court distinguished between the SEC’s powers with regard to investment company corporate governance and its powers with regard to other public companies by invoking its prior decision in *Business Roundtable v. SEC*,\(^\text{96}\) and suggesting that the SEC would not have the power under the Exchange Act to generally mandate a separation of the CEO/Chairman positions. The court also interpreted the language of Section 10(a) of the Investment Company Act that a fund may have “no more than” 60 percent inside directors\(^\text{97}\) to be a minimum, not a maximum standard. The court further held that the SEC’s rule was not arbitrary, capricious, or an abuse of discretion, in violation of the APA because the SEC can undertake prophylactic responses to perceived risks of conflicts of interest in crafting exemptions.

Nevertheless, the court held that the SEC violated the APA by failing to consider the costs imposed on funds by the new rule separating the Chairman and CEO and suggested alternatives,

\(^\text{96}\) 905 F.2d 406, 415-416-17 (D.C. Cir. 1990).
\(^\text{97}\) 15 U.S.C. § 80a-10(a).
particularly a disclosure alternative. This holding essentially adopted the dissenting views of Commissioners Atkins and Glassman when the rule was adopted. On June 30, 2005, nine days after the Court of Appeals opinion was released, the SEC reaffirmed its promulgation of the rule, claiming that it had decided that the benefits of the rule outweighed its costs, and disclosure of investment company conflicts of interest were of limited utility. In fact, the primary justification for the affirmance of the rule appeared to be that Chairman Donaldson was resigning as Chairman of the SEC the next day. Two strong dissents were filed by Commissioners Glassman and Atkins.98

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

The D.C. Circuit held that although the SEC was not required to engage in additional fact gathering on remand, but that the agency’s extensive reliance upon extra-record materials in arriving at its cost estimates required further opportunity for comment. Since these materials were primary and not merely supplementary, the court held that the SEC violated the comment requirement of the APA. Since, however, vacating the rule which a majority of funds had complied with would be disruptive, the court decided to vacate the 75% independent director and

independent chair conditions of the rule, for 90 days for the SEC to address the costs issue. But after a new Chairman was appointed to head the SEC, the SEC did not go forward with this rulemaking or case. Nevertheless, most mutual funds voluntarily conformed their governance to the SEC’s regulation.100

A similar story can be told about a prior case in which the SEC vacated a new SEC rule, although not on the ground that the SEC failed to provide a cost-benefit analysis. SEC v. Business Roundtable101 is relevant to this Article because it is another case with perplexing logic which can be rationalized only if it is viewed as a rebuff to SEC regulation of internal corporate affairs. The SEC rule at issue in this case followed a controversial change by the New York Stock Exchange, Inc. (NYSE) to its one share/one vote listing requirement for public companies.102 After failing to persuade the NYSE and American Stock Exchange to come up with a uniform voting rights rule, the SEC adopted its own rule requiring all exchanges to bar the listing of a domestic corporation’s securities if that company acted separately to reduce the per share voting rights of existing stockholders.103 The Business Roundtable sued to invalidate this rule and succeeded in doing so. The D.C. Circuit Court held that although the SEC’s regulation was a “rule” under the Exchange Act, it was not “in furtherance of the purposes of the Exchange Act.”104 The court’s rationale was that there was no indication that Congress intended to permit such broad federal preemption over

100. 443 F. 3d 890, 908 (D.C. Cir. 2006).
102. For background on this change to stock exchange listing standards see Roberta S. Karmel, Qualitative Standards for “Qualified Securities”: SEC Regulation of Voting Rights, 36 CATH. UNIV. L. REV. 809 (1987).
104. 905 F.2d at 409-17.
corporate governance and shareholder rights. As a matter of statutory interpretation and logic this
decision makes little sense and has been much criticized,\textsuperscript{105} but as a matter of policy it is quite
consistent with Supreme Court and D.C. Circuit Court decisions striking down SEC rules
preempting state corporate governance regulation.\textsuperscript{106}

Another rebuff to the SEC based on an inadequate cost-benefit analysis was the decision
in \textit{American Equity Inv. Life Ins. Co. v. SEC},\textsuperscript{107} in which the D.C. Circuit Court vacated Rule 151A
under the Securities Act categorizing fixed income annuities as securities. Fixed income annuities
are hybrid financial products combining some of the benefits of fixed annuities with the added
earning potential of a security. Although annuities are exempt from the Securities Act, variable
annuities are not.\textsuperscript{108} In the mid-1980s, the SEC passed Rule 151 to provide an exemption from the
Securities Act for guaranteed investment contracts which were subject to state insurance regulation
where the insurer assumes the investment risk under the contract and the contract is not marketed
primarily as an investment.\textsuperscript{109}

In the mid-1990s insurance companies began marketing fixed income annuities, but the
SEC did not attempt to regulate them until 2007 when it passed Rule 151A. By this time, the total
amount of such assets totaled $123 billion. The decision vacating this rule is curious. First, the
court did an analysis under the \textit{Chevron} doctrine and found that the exemption for annuities was

\textsuperscript{105} See Coates, \textit{supra} note 48, at 913-21; see also James D. Cox, \textit{Iterative Regulation of Securities Markets

\textsuperscript{106} One difficulty in examining conflict between federal and state regulation of corporate internal affairs is
that the general state law default rule is private ordering, whereas the SEC operates by rules. Yet, the competition
between the SEC and Delaware for primacy in regulating corporate governance is real. See Jackson, Comment, \textit{supra}
note 47, at 58.

\textsuperscript{107} 613 F.3d 166 (2010).


\textsuperscript{109} 17 C.F.R. § 230.151(a).
ambiguous, but the SEC’s rule was reasonable. Then the court found the SEC contravened § 2(b) of the Securities Act because it failed to adequately consider the efficiency, competition, and capital formation effects of the Rule 151A, and therefore promulgation of Rule 151A was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law under the APA. Although the subject matter of this case involved an intersection between federal and state regulation of an insurance company product, the court did not examine whether state regulation of the product was adequate or comprehensive.

Another example of a case in which the D.C. Circuit struck down a rule of the SEC in the governance area is the SEC’s proxy access rule.110 Since it was more difficult for the court to claim that the SEC had no role in the corporate governance of public companies after SOX and since Congress gave the SEC authority to pass a proxy access rule in Dodd-Frank,111 the court had some difficulty in determining that the SEC rulemaking was beyond its authority. Therefore, it upended the proxy access rule on the basis of an inadequate cost-benefit analysis.

The regulation of proxy voting has resided at the intersection between federal and state law since the Exchange Act was passed in 1934. Although state law controls the holding of annual meetings to elect directors and the corporate governance aspects of proxy voting, federal securities laws control the solicitation of proxies. In 1977, shareholder activists began trying to persuade the SEC to revise rules to allow competing shareholder nominees to be included in opposition to the board of directors’ nominees. Following a 2003 SEC staff report,112 the SEC proposed a series of

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controversial rules to allow proxy access by institutional investors, but it was not until 2010 that Rule 14a-11 to this effect was finally adopted by the SEC.113

Corporate voting rights are generally fixed by a corporation’s charter, and the nature and extent of shareholder voting rights, as well as the mechanics of holding annual meetings to elect directors, are generally specified by state law. Yet, because shareholders in public companies are geographically dispersed, proxy voting is the dominant mode of shareholder decision-making, and the solicitation of proxies by public companies is regulated by the SEC. Section 14(a) of the Exchange Act114 makes it unlawful for any person to solicit any proxy, consent, or authorization with respect to any security registered under Section 12 of the Exchange Act115 in contravention of the SEC’s proxy rules.116

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

In 2003 and 2007, the SEC put out proposed proxy access rules,117 which never became final rules because of the intense opposition the proposals generated and the lack of consensus


116. 17 C.F.R. §§ 24014a-3-17.

with regard to the rules at the Commission level. Both proposals would have limited proxy access to shareholders who had held stock for a long period of time and who were large shareholders. In connection with these proposals, the SEC put out proposals to change the exclusion for shareholder proposals relating to elections.118

In the meantime, the SEC’s interpretation of its shareholder proposal rule was challenged in American Federation of State, County & Municipal Employees v. American International Group, Inc.119 The Second Circuit invalidated the SEC’s interpretation of Rule 14a-8(i)(8) and challenged the SEC to reinterpret the election exclusion or pass a new rule. In response, the SEC confirmed its position that shareholder proposals that could result in an election contest may be excluded under Rule 14a-8(i)(8), but sought comment as to whether the text of the rule should be changed.120 The SEC’s reaffirmation of its interpretation of Rule 14a-8(i)(8), and its 2007 proxy access rule proposal were both put out by a 3-2 vote, with Chairman Christopher Cox voting with the two Democratic commissioners on the proxy access rule proposal and with the two Republican commissioners with regard to the interpretative release on Rule 14a-8.

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

118. Shareholder Proposals, supra note 117, at 43,492.
119. 462 F.3d 21 (2d Cir. 2006).
120. Shareholder Proposals, supra note 117.
In holding that the SEC acted arbitrarily and capriciously for failing adequately to assess the economic effects of its proxy access rule, the D.C. Circuit Court in *Business Roundtable* determined that the SEC failed to appreciate the intensity with which issuers would oppose nominees pursuant to Rule 14a-11 and did not adequately assess the costs and frequency of election contests that would result. Very importantly, the court also asserted that the SEC acted arbitrarily and capriciously by failing to consider how union and state pension funds might utilize Rule 14a-11 to gain concessions unrelated to shareholder value. It is this finding that comes to grips with the political issue at the heart of the proxy access debates.

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

Since the petitioners who sued the SEC to abrogate Rule 14a-11 did not also attempt to strike down the SEC’s amendment to Rule 14a-8, the SEC determined that this amendment would become final. It therefore became possible for shareholders to make proposals to alter the procedures for electing directors and to request proxy access by-laws. Delaware eagerly jumped into this fault line between SEC and state regulation of proxy access and by court decision\(^\text{121}\) and

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121. CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008).
legislation\textsuperscript{122} proxy access became a matter of private ordering rather than a matter of SEC regulation.

In this case, inadequate cost-benefit analysis was a somewhat thin reed for the D.C. Circuit to rest its invalidation of the SEC proxy access rule since as the foregoing shows the SEC had been considering this regulation for many years and there was a voluminous comment record favoring the new rule. The decision was a political policy rejection of the SEC’s intrusion into corporate internal affairs. The court simply made use of an available administrative law tool—cost-benefit analysis—to justify its determination. Nevertheless, the foregoing decisions were a wake-up call to the SEC to revise and improve its methodology for cost-benefit analysis in rulemaking. The SEC also was further pressured to beef up its cost-benefit methodology by a report of the U.S. Government Accountability Office (GAO)\textsuperscript{123} and a report of the SEC Inspector General.\textsuperscript{124}

In September 2009, the SEC created the DERA to integrate financial economics and rigorous date analytics into the SEC’s core mission. In 2012, the Office of Risk, Strategy and Financial Innovation and the Office of the General Counsel of the SEC prepared a memorandum to all rule writing divisions and offices setting forth a methodology for cost-benefit analyses.\textsuperscript{125} This Guidance outlined the features of a cost-benefit analysis for rulemaking as follows: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of


\textsuperscript{123} GAO Report No. 12-151 (Nov. 2011).


\textsuperscript{125} Memorandum from the Division of Risk, Strategy, and Financial Innovation and the Office of General Counsel of the SEC to the Staff of the Rulewriting Divisions and Offices of the SEC (March 16, 2012), https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf [hereinafter Guidance].
alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.\textsuperscript{126}

The SEC’s methodology for creating a cost-benefit analysis differs from OIRA’s methodology and has been criticized on that ground.\textsuperscript{127} Other criticisms also have been levelled at the SEC’s methodology, but the D.C. Circuit seems to have been pacified. The SEC’s new effort for preparing a cost-benefit analysis in rulemaking became an issue in the many rules, some of them quite controversial, that the SEC was required to pass pursuant to Dodd-Frank and the JOBS Act, but ironically, the D.C. Circuit has not vacated any of the rules implementing these statutory provisions.

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

\begin{itemize}
  \item \textsuperscript{126} Id. at 4.
  \item \textsuperscript{127} Yoon-Ho-Alex Lee, \textit{The Efficiency Criterion for Securities Regulation: Investor Welfare or Total Surplus?}, 57 ARIZ. L. REV. 85 (2015).
\end{itemize}
Commerce led by Tom J. Donohue, and the Business Roundtable, have targeted SEC rulemaking.\footnote{They have been helped in their efforts by cases successfully prosecuted by Eugene Scalia, son of Antonin Scalia before a conservative D.C. court. See Patrick Caldwell, \textit{Did You Know That Antonin Scalia’s Son Is Sabotaging Wall Street Reform?} MOTHER JONES, July/Aug. 2014, http://www.motherjones.com/politics/2014/07/eugene-scalia-court-antonin-financial-reform.}

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

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

D. DODD-FRANK AND JOBS ACT RULEMAKING

Where new rulemaking is conducted pursuant to a regulatory mandate, the response of the courts to a cost benefit analysis challenge has been different than in the cases discussed above. Similarly, the courts have been unsympathetic to lack of a cost benefit analysis by the SEC when the Commission has engaged in deregulation.
Dodd-Frank is a formidable regulatory statute which required more than twenty federal agencies to promulgate 400 new rules.129 The SEC was given a particularly heavy workload—required to engage in 90 mandatory rulemaking proceedings and 20 studies.130 With regard to many of the particularly controversial rulemaking proceedings, the SEC had little discretion. This did not stop business groups from attempting to strike down new SEC rules on cost-benefit and other grounds. Where the SEC had so little maneuverability, the D.C. Circuit did not accept the cost-benefit challenges to the new rules, although it did strike down parts of the rules on other grounds.

Even before the SEC completed its assigned rulemaking tasks pursuant to Dodd-Frank, Congress passed the JOBS Act, a deregulatory statute. Deregulatory rulemaking is subject to the same administrative law requirements as new regulations,131 and in a case involving pre-emption of state blue sky law, two state blue sky commissioners sued the SEC to vacate a de-regulatory rule, on cost-benefit grounds, among others. The D.C. Circuit upheld the SEC’s rule.

Some of the rules Congress ordered the SEC to promulgate in Dodd-Frank did not even purport to be about investor protection. Section 1502 of Dodd-Franks mandated that the SEC require registered and reporting companies under the Exchange Act to disclose whether conflict minerals from the Democratic Republic of the Congo (DRC), or adjoining countries are necessary to the functionality or production of any of their manufactured products. The rationale for this rule was to achieve a humanitarian goal. War in the Congo had led to the deaths of millions of civilians from starvation and disease, and rape and other human rights violations were rampant. The war had been financed by groups profiting from the sale of conflict minerals, which included tantalum.

130. See Letter from Chair Elisse B. Walter, Chair SEC to A. Nicole Clowers, Director, Financial Markets and Community Investment, GAO, Jan. 9, 2013.
tin, gold, and tungsten. These minerals are found in most electronic products and other consumer goods.

The SEC carried out its conflict minerals mandate by adopting Rule 13p-1 and Form SD. If an issuer determines it is covered by the conflict minerals rule, it must conduct a reasonable country-of-origin inquiry to determine whether these minerals originated in the DRC. If so, the issuer must exercise reasonable due diligence on the source and chain of custody of its conflict minerals and certify a third-party audit of those products that have not been found to be DRC conflict free.

The estimated costs of these efforts were thought to be huge. In making a cost-benefit analysis of Rule 13p-1, the SEC essentially accepted estimates of the National Association of Manufacturers and a Tulane Law School study. A scathing critique of the SEC’s cost estimates argued that quantified cost-benefit analysis should never have been imposed on the SEC and should be eliminated. In any event, the D.C. Circuit upheld the SEC’s cost-benefit analysis, because the SEC “exhaustively analyzed the final rule’s costs,” and found that the rule would “impose competitive costs, but relatively minor or offsetting effects on efficiency and capital formation.” Further, the SEC argued that it lacked data that would have enabled it to quantify the benefits of the rule. The D.C. Circuit agreed, stating that “the rule’s benefits would occur half a world away in the midst of an opaque conflict about which little reliable information exists, and concern a subject about which the Commission has no particular expertise. Even if one could estimate how many lives are saved or rapes prevented as a direct result of the final rule, doing so


would be pointless because the costs of the rule—measured in dollars—would create an apples-to-bricks comparison.\textsuperscript{134}

This holding by the court could easily be applied to virtually all of the cases in which the D.C. Circuit has analyzed cost-benefit quantification by the SEC. With regard to the conflicts-mineral rule, the D.C. Circuit could not resist continuing to interfere with the SEC’s rulemaking, and despite upholding the Commission’s cost-benefit analysis, nevertheless decided to vacate a portion of the rule because it held that its “name and shame” feature violated the First Amendment.\textsuperscript{135}

The conflict minerals rule was generally controversial and unpopular. Attempts to repeal it have so far failed,\textsuperscript{136} but it is no longer being enforced.\textsuperscript{137} There is some irony to this non-enforcement as a deregulatory initiative since companies had learned to develop procedures for complying with the rule and due to pressure from activist investors have continued to follow it.\textsuperscript{138}

Another controversial Dodd-Frank rule that was challenged in the D.C. Circuit was the resource extraction rule, 13q-1, passed pursuant to section 1504 of Dodd-Frank.\textsuperscript{139} This provision also had little to do with investor protection, but was an attempt to empower citizens of resource-rich countries to hold their governments accountable. The provision mandated transparency by

\textsuperscript{134} Id.
\textsuperscript{135} Id. at 272-73.
\textsuperscript{139} 15 U.S.C. § 78m.
requiring issuers that extract oil, natural gas, or minerals to disclose payments made to the U.S. or foreign governments for the purpose of commercial development of these energy and other resources. The purpose of the provision was to fight corruption and authoritarianism.140

Business interests opposed the SEC’s rule in the D.C. Circuit, and the court held that the SEC had misinterpreted Exchange Act section 13(q) by requiring that the reports filed by companies subject to the rule be made public. Neither a cost-benefit analysis nor First Amendment analysis was therefore made. A U.S. district court in Massachusetts thereafter required the SEC to re-propose this rule, 141 and the SEC did so.142 The American Petroleum Institute again challenged this re-proposed rule.143

The foregoing cases were challenges from business groups. Lindeen v. SEC144 was a challenge by the blue sky commissioners of Massachusetts and Montana to a deregulatory rule, known as Regulation A-Plus, passed by the SEC pursuant to the JOBS Act. It is of interest not only because it was an attack from the left, rather than the right, to SEC rulemaking, but also because the D.C. Circuit rejected a challenge to the SEC’s rulemaking based on a cost-benefit analysis theory and instead applied the Chevron doctrine.

Under Section 3(b) of the Securities Act, the SEC has authority to exempt from the registration requirements offering of a small amount or a limited public offering.145 For many years,

144. 825 F.3d 646 (D.C. Cir. 2016).
this exemption was limited to $5 million or less, but the JOBS Act raised the amount of such an exempt offering to $50 million. The JOBS Act also directed the SEC to revamp Regulation A to make it more desirable. The SEC did so by expanding Regulation A into two tiers—Tier 1 for offerings up to $20 million and Tier 2 for offerings up to $50 million. Although the JOBS Act did not exempt offerings made under Section 3(b)(2) from state law securities regulation requirements, Congress allowed the SEC to do so. Section 18(b)(4) of the Securities Act, added by the National Securities Markets Improvement Act of 1996, had provided that Section 3(b)(2) securities were “covered securities” for purposes of section 18 if they were offered or sold on a national securities exchange, or “offered or sold to a qualified purchaser” as defined by the SEC. In crafting Regulation A-Plus, the SEC took advantage of this provision by defining a “qualified purchaser” as any person to whom securities are offered or sold in a Tier-2 Regulation A-Plus offering. The SEC justified this preemption of state blue sky law based on limitations on investment amounts by purchasers in such offering, the provision of audited financial statements and a requirement for annual reporting.

State blue sky commissioners sued the SEC arguing that a “qualified purchaser” needed to be a credentialed purchaser. The D.C. Circuit rejected this challenge by giving the SEC Chevron deference. One of the arguments by the state securities regulators was that the SEC’s rulemaking was arbitrary and capricious because its cost-benefit justification for Regulation A-Plus was too cryptic and did not adequately explain how Tier 2’s safeguards would mitigate the cost of preemption or provide evidence regarding preemption costs. The D.C. Circuit gave short shrift to

this argument by stating that the SEC was not required to “measure the immeasurable” or “conduct a rigorous, qualitative economic analysis unless the statute explicitly directs it to do so.”

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

E. THE BEST INTEREST RULE

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

The SEC’s best interest rule has a long and tortured history. The problems with the promulgation of the rule are embedded in differences between the regulation of brokers and the regulation of investment advisers. The relationship between brokers and their customers was

147. 825 F.3d at 658 (quoting Nat’l Ass’n of Mfrs. v. SEC, 748 F.3d 359, 369 (D.C. Cir. 2014)).
articulated by the SEC in the 1960’s as the “shingle theory.”\textsuperscript{148} This doctrine, developed by the SEC in administrative law cases, is that brokers impliedly represent that they will deal fairly with their customers and rests on an assumption that broker-dealers have fiduciary responsibilities to their clients. When a broker is acting as an agent such an assumption may rest on common law agency principles, but when a broker is acting as a principal or dealer, such an assumption may not be valid, at least under common law principles. Yet, broker-dealers commonly sell securities to both institutional and retail customers as principal, for example in initial public offerings or when securities are sold from a broker-dealer’s inventory. Further, securities firms often sell firm created or proprietary products to their customers.

Investment advisers, by contrast, have been held to owe fiduciary duties to their customers in an early Supreme Court case interpreting the Investment Advisers Act of 1940 (“Advisers Act”).\textsuperscript{149} An important difference between the regulation of broker-dealers and investment advisers is that broker-dealers are required by law to belong to a self-regulatory organization (currently FINRA)\textsuperscript{150} but advisers have never established such a self-regulatory organization. Further, there are many more investment advisers than broker-dealers.

Although there is some question as to whether the shingle theory can be enforced in a securities law case by a customer under the anti-fraud provisions,\textsuperscript{151} most cases by customers against broker-dealers are prosecuted in FINRA arbitrations.\textsuperscript{152} Instead of a general fiduciary duty

\begin{itemize}
\item[150.] 15 U.S.C.A. § 78o ("Registration and regulation of brokers and dealers").
\item[152.] See FINRA DISPUTE RESOLUTION TASK FORCE, FINAL REPORT AND RECOMMENDATION 1 (2015), available at https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf ("FINRA is, for all practical purposes, the sole arbitration forum in the United States for resolving disputes between broker-dealers, associated
\end{itemize}
regulation, FINRA has numerous specific rules enforcing obligations by brokers to their customers, very importantly including a suitability rule.\textsuperscript{153}

Many financial firms are dually registered as broker-dealers and investment advisers, but many are not. Further, customers may be only brokerage firm customers and not investment adviser customers, or they may be both. Historically, compensation by brokerage firm customers was fee based on transactions, whereas investment advisers charged fees based on assets under management. In 1995, a commission led by Daniel Tulley, chairman and CEO of Merrill Lynch, recommended that fee-based accounts at broker-dealers was a way to minimize conflicts of interest between brokers and retail customers.\textsuperscript{154} Conveniently, the change in compensation from brokerage commissions to fees on assets in an account coincided with ever decreasing brokerage commission charges after the unfixing of commissions in 1975.\textsuperscript{155}

The change in compensation for broker-dealers from transaction-based revenues to ongoing fees created a problem regarding the exemption from Adviser Act registration for broker-dealers. The Advisers Act excludes from the definition of “investment adviser” any broker or dealer that provides advisory services when such services are “solely incidental” to the conduct of the broker or dealer’s business and when such incidental advisory services are provided for no special compensation.\textsuperscript{156} In 1999 the SEC proposed a rule exempting fee-based brokerage accounts from the fiduciary requirements of the Advisers Act. The Financial Planning Association perceived

\textsuperscript{153} FINRA, Rule 2111 (2014) (“Suitability”).


\textsuperscript{156} Section 202(a)(11)(C) of the Investment Advisers Act of 1940, 15 USCA § 80b-2(11).
a threat to its fee-only investment advisers and sued the SEC and the D.C. Circuit vacated the SEC rule.\textsuperscript{157}

These developments occurred in the context of a significant change in retirement savings by individuals. Corporate defined benefit compensation plans were eliminated by many companies and for this reason and because of favorable tax treatment for individual retirement accounts, there was a shift by huge numbers of individuals to IRAs and other individually managed retirement accounts.\textsuperscript{158} The Obama Administration became concerned that retail investors were not being fully informed or fairly treated when making decisions about such accounts, particularly with regard to roll overs of corporate benefit pensions into IRAs. Therefore, the Treasury Department released a report outlining ways to increase fairness for investors that proposed that the SEC “establish a fiduciary duty for broker-dealers offering investment advice and harmonize the regulation of investment advisers and broker-dealers.”\textsuperscript{159}

In 2010 there were two important developments, setting up a conflict between the Department of Labor (“DOL”), an Executive branch agency and the SEC. In July 2010 Dodd-Frank was passed by the Congress and signed by President Obama.\textsuperscript{160} Dodd Frank gave the SEC the authority to harmonize the fiduciary standard for brokers, dealers and investment advisers who provide personalized investment advice to clients.\textsuperscript{161} Dodd-Frank also directed the SEC to conduct a study to evaluate “the effectiveness of existing legal or regulatory standards of care for brokers,

\begin{enumerate}
\item\textsuperscript{157} Fin. Planning Ass’n. v. SEC, 482 F.3d 481, 487-88 (D.C. Cir. 2007).
\item\textsuperscript{160} See Dodd-Frank.
\item\textsuperscript{161} Dodd-Frank § 913(g).
\end{enumerate}
dealers, investment advisers and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers . . .” 162

Not content with giving the SEC discretion to shape such a study, the statute enumerated fourteen specific considerations the Commission was required to consider in conducting the study.163

The SEC staff’s Study on Investment Advisers and Broker-Dealers was released on January 2011, over the dissenting votes of the two Republican SEC commissioners.164 In analyzing gaps, shortcoming and overlaps in regulation, the staff came up with a long list, including investor remedies for fraud.165 Also, the staff pointed out that broker-dealer regulation is essentially rule based by FINRA, whereas adviser regulation is essentially principles based on fiduciary duty. The Staff Study recommended that the SEC promulgate a harmonized uniform fiduciary standard for broker-dealers and investment advisers, but there was a serious lack of consensus at the Commission regarding such a recommendation and so no such rule proposal was issued until 2018.166

In the meantime, in September 2010, the DOL issued a rule proposal designed to limit conflicts of interest for financial advisers working with client retirement accounts.167 This rule would have applied not only to existing ERISA “fiduciaries” but to broker-dealers, investment advisers and insurance agents making recommendations to accounts regulated under ERISA and

162. § 913(b)(1).
163. § 913(c).
165. Id. at 104-05.
IRAs. This rule proposal was extremely controversial because of its broad reach and because it purported to create a private right of action for breaches of the rule. So in September 2011 DOL withdrew its conflicts of interest rule and predicted it would issue a re-proposal in 2012.

In 2013 the SEC released a request for comment on the costs and benefits of a uniform fiduciary duty rule and harmonization of adviser and broker regulations. This release resembled a July 2011 proposal of the Securities Industry and Financial Markets Association (SIFMA). Also in 2013 Thomas Perez was confirmed as Secretary of DOL and promised to listen to stakeholders before deciding on how to go forward with a fiduciary rule. In 2015, President Obama directed the DOL to re-propose its fiduciary rule and protect retirees from conflicted advice. The DOL did so in April 2015 proposing a rule that required fiduciary advice for all retirement accounts, including IRAs. The DOL held four days of hearings and received 3,000 comment letters, many of them negative. During the fall of 2015 the financial industry, Republican lawmakers and Republican SEC Commissioner Daniel Gallagher attacked the DOL rule and legislation was introduced to block the DOL rule, while Democratic Senator Elizabeth Warren and consumer groups supported the rule.

Some of the opposition to the DOL rule that came from the securities industry argued that the SEC, not the DOL, should be passing a fiduciary rule so that there would not be two sets of rules.

169. Id.
172. TOPOLESKI & SHORTER, supra note 167 at 8.
rules for brokerage accounts. The SEC did not, however, have the votes for such a rule. In 2015 SEC Chair Mary Jo White had announced her personal support for a fiduciary duty rule but cautioned that she did have sufficient Commission support for such a rule.

On April 6, 2016 DOL released the final version of its fiduciary rule. The Chamber of Commerce promptly filed a lawsuit to vacate the rule. Although the DOL’s rule was upheld in the district court, it was vacated in a split decision by the D.C. Court of Appeals. The grounds for the court’s opinion was that the rule went beyond the DOL’s statutory authority because it applied to IRA accounts and that it was arbitrary and capricious because it applied to certain insurance company products and not others.

On June 5, 2019 the SEC finally approved Rule BI, in a split vote, with the sole Democratic Commissioner, Robert Jackson, dissenting. Kara Stein, a former democratic commissioner had dissented from the proposed rule, which she dubbed “Regulation Status Quo.” The SEC’s Consumer Advocate also criticized the final rule and related SEC releases regarding the investment adviser exemption for broker-dealers. This long saga is an example of partisan squabbling set off by lobbying by industry and consumer groups and power struggles between the Executive and Congress over the role of the SEC vis-à-vis the DOL. The appropriate content of a fiduciary rule in order to protect the savings of retail investors was perhaps lost in the fog of partisan warfare. This kind of Washington Theater, in my opinion, does not result in good government, but rather regulatory ossification. The SEC’s adopting release is 771 pages of explanation and cost benefit analysis but does not materially change broker customer relationships. It does add extensive new

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176. Id. at 368-69.
disclosure and compliance obligations to brokers, continuing a rule-based regime rather than substituting a fiduciary standard. Regulation BI does outlaw some egregious conflict of interest sales practices including sales contests, sales quotas, bonuses and non-cash compensation based on the sales of specific securities or types of securities within a limited time frame.

The SEC’s releases on the fiduciary duty of advisers may be the most controversial part of the SEC’s best interest rule. The exemption from the Advisers Act for brokers is maintained. Critics of Regulation BI have complained that the SEC’s releases on the duty of advisers purports to weaken the fiduciary duty standard applicable to advisers.178

In general Regulation BI maintains the differences between the regulation of investment advisers and broker-dealers. The policy mantra throughout the SEC’s adopting release is that retail investors should have a choice of fees and products. Regulation BI establishes a standard of conduct for broker-dealers when making a recommendation of a securities transaction or investment strategy to a retail customer, no matter how wealthy the customer. To satisfy the best interest standard the broker-dealer must comply with four obligations: a disclosure obligation; a care obligation; a conflict of interest obligation; and a compliance obligation. According to the SEC’s adopting release, breach of Regulation BI will be judged by a negligence standard but there will be no private right of action created by the best interest rule. How this formulation will work out in FINRA arbitrations remains to be seen. The issue of whether a retail investor can sue for a breach of Regulation BI is one of the controversies dividing the Democrats and Republicans. The DOL fiduciary rule provided for such a claim.

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It is unlikely that Regulation BI will end the controversy over whether there should be a fiduciary duty obligation by brokers to their customers. Some state securities regulators do not believe the SEC best interest rule is sufficiently robust to protect investors. The Secretary of the Commonwealth of Massachusetts is planning to propose a fiduciary standard that would mandate brokers and investment advisers apply a fiduciary standard of care with regard to recommendations, advice and the selection of account types.179 New Jersey, Nevada and Maryland are also considering such a rule.180 The proposing release for Regulation BI references possible state regulations in conflict with the SEC’s best interest rule and takes no position on whether such state regulations would be preempted by the SEC’s regulation.181

On June 26, 2019 the House of Representatives passed an amendment to a financial services appropriations bill that would prevent the SEC from using funds to implement, administer, enforce or publicize the Standard of Conduct Interpretation and the Solely Incidental Interpretation.182 Since it is highly unlikely that there are sufficient votes in Congress to pass a substitute fiduciary duty or best interest rule, preventing the SEC from administering Regulation BI would just return matters to where they were in 2002. In the meantime, the securities industry was gearing up first, to implement DOL’s fiduciary rule and second, the SEC’s best interest rule. It would be surprising if no lawsuit is filed challenging the SEC’s best Interest rule. Such a suit


180. Id.

181. It is highly unlikely that an SEC rule can pre-empt state securities law regulations. See Roberta S. Karmel, Blue Sky Merit Regulation: Benefit to Investors or Burden on Commerce?” 53 Brooklyn L. Rev. 105 (1987).

182. H.R. 3351. What happened to this??? Query: Did the congress persons who voted on this bill actually read the SEC’s 773 page adopting release for Regulation BI between June 5 and June 26 or is this just another political ploy to discredit the SEC?
would have to come to grips with the SEC’s extensive economic and cost benefit analysis in the adopting release.

The cost benefit analysis in the adopting release for Regulation BI could be a ground for attacking the rule. Ten former Chief Economists of the SEC sent a comment letter to the Commission in response to the Regulation Best Interest proposal criticizing the SEC’s cost benefit analysis. According to the Statement by SEC Commissioner Robert Jackson opposing the final rule, the SEC offered no new data to support the rule and ignored important new evidence regarding the imposition of a fiduciary standard for broker-dealer recommendations.183

If there is an attack on Regulation Best Interest in the courts, should a court review the SEC’s cost benefit analysis? As previously stated, there is no statute requiring the SEC to engage in such an analysis. At best, a court could hold that the SEC’s rule is “arbitrary and capricious” under the APA for not harmonizing the fiduciary duties of broker-dealers and advisers. But Congress only gave the SEC such an option; it did not require the SEC to do so. If the SEC’s Regulation Best Interest is insufficiently protective of retail investors, it is the job of Congress to amend the laws to require that brokers have a fiduciary duty to their customers.

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

183. Jackson, Public Statement, supra note 22.
III. TARGETING INDEPENDENCE

A. INDEPENDENCE AND BI-PARTISANSHIP

Independence has always been a hallmark of the SEC’s structure and governance. As an independent agency, the SEC is supposed to be independent of the executive branch, but more importantly it should operate independently from the entities and industry it regulates. The purpose of its independence from the President is that regulated entities or persons under investigation can exert improper pressure on the SEC through the executive. An example of such corrupt interference with the SEC’s work was an effort by the Nixon White House to quash an SEC investigation of Robert Vesco, a notorious white-collar criminal. Sadly, this scandal led to the resignation and disbarment of an SEC Chairman.\(^\text{184}\)

The President can influence the SEC in a variety of ways from appointing Chairs and Commissioners who are sympathetic to the President’s political views to proposing cuts in the Commission’s budget, to exerting influence on positions taken by the SEC in Supreme Court cases.\(^\text{185}\) Yet, ideally, the Executive should not be interfering in SEC investigations or prosecutions and should allow the Commission to exercise its expertise in rulemaking.

The SEC’s Rules of Organization, Conduct and Ethics provide: The SEC is an independent Agency, and in performing their duties, members should exhibit a spirit of firm independence and reject any effort by representatives of the executive or legislative branches of the government to affect their independent determination of any matter being considered by the Commission. A member should not be swayed by partisan demands, public clamor or considerations of personal popularity or notoriety, so also he should be above fear of unjust criticism by anyone.\(^\text{186}\)


\(^{186}\) 17 C.F.R. § 200.58.
In recent years, the SEC’s independence has been undermined by partisan politics. By law, the SEC chair is appointed by the President, but no more than three out of five commissioners can be from the President’s party. Historically, SEC commissioners came from a wide variety of backgrounds and were respected for their expertise. Although they may have had differences of opinion on commission actions, these disagreements were not necessarily partisan. In recent years, however, appointments of Democratic and Republican commissioners have been paired and many commissioners have had a background as staffers in congressional committees with SEC oversight. Qualifications are based on ideological correctness and party loyalty rather than expertise. This has led to very contentious and partisan decision making, with many 3-2 decisions, or even worse, 2-1 votes on important issues. Dissents have been designed to encourage appeals to the D.C. Circuit court to overturn SEC rules. This partisanship has undermined the SEC’s mission and credibility and made it difficult for the SEC to complete rulemaking even when it is mandated by statute. Furthermore, these partisan squabbles have been fomented by both Republicans and Democrats.

Efforts to inflict Presidential control on SEC rulemaking through cost benefit analysis have been discussed above. A different kind of initiative was contemplated by the Carter Administration, which threatened SEC control of its own litigation. The securities laws provide authority for the SEC to bring injunctive actions in the district courts to prevent or curtail violations of the securities laws, but there is no express provision dealing with whether the SEC may represent itself or is required to be represented by the Department of Justice.\textsuperscript{187} Historically, the SEC has represented itself in the district and circuit courts, in cases where the SEC is the plaintiff,

\begin{footnote}
\textsuperscript{187} 15 U.S.C. 77t(a), 78u(e).
\end{footnote}
or where the SEC or an SEC commissioner or staffer is a defendant, and in amicus curie briefs. When a case is in the U.S. Supreme Court, the Solicitor General takes charge of the matter, but an SEC attorney usually writes the brief and argues the case. Not all agencies enjoy this independence. The SEC’s authority to conduct its own litigation has been upheld in many court decisions. It was also confirmed by Congress in hearings involving the Foreign Corrupt Practices Act legislation.

President Carter, in the name of greater governmental efficiency, proposed giving control of SEC litigation to the Department of Justice. This grab for power came to nothing as Congress was not inclined to divest the SEC of its power to litigate cases on its own. The rationale for the SEC’s control of litigation and its independence generally was articulated by the U.S. Supreme Court in 1947: When the SEC acts in area in which it brings to bear its “administrative expertise, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the . . . facts,” its judgment is one which it is “best equipped to make” and which is “entitled to the greatest amount of weight.”

More direct attacks on the SEC’s independence originate from cases invoking the Appointments Clause. These cases are based to some extent on the unitary executive theory. The theory of the unitary executive, simply stated, is the belief that the Constitution established an executive branch with complete control over all officials implementing the law. Under this

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188. Letter from Harvey L. Pitt, General Counsel, SEC, to Mr. F.T. Davis, Jr, Director, General Government Division, OMB, Dec. 6, 1977, at 2.

189. Id. at 2-7. It was also confirmed by Congress


theory, a president has "plenary power to control administration and execution of the laws," and restrictions on that power are anathema to the Constitution. Unitary executive theorists take their cues first from the Vesting Clause of Article II, which declares that "[t]he executive Power shall be vested in a President," and the Take Care Clause, which tasks the President with seeing that "the Laws be faithfully executed." Unitary executive theorists conceive of a hierarchical executive authority with the President sitting at its head.

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

One critic of the unitary executive theory has stated that it “is a theory no longer. . . . Each President exceeds his predecessor’s control of the Fourth Branch. ‘Presidential administration’ is

193. Lessig & Sunstein, supra note 192, at 7.
194. Art. II, S1, cl. 1.
195. Id. art. II, §3; Calabresi & Rhodes, supra note 192, at 1165-66.
196. Id. at 1165-66.
198. Id.
199. Lessig & Sunstein, supra note 192, at 9.
200. Id. at 8-9; Calabresi & Rhodes, supra note 192, at 1165-66; Prakash, supra note 197, at 701.
morphing into autocracy.” She blames this development on congressional and agency inertia, and the imposition of judicial rules on agency rulemaking.

B. ADMINISTRATIVE LAW JUDGES

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

The administrative proceeding as an in-house forum has been in existence since the SEC was created, but until very recently was used only for cases against registered entities in the securities business, and their associated persons, and accountants and lawyers. However, Dodd-Frank gave the SEC expanded authority to impose civil monetary penalties against persons associated with unregistered entities, for example, hedge fund employees or directors of public


202. Id. at 517.


corporations, so that such proceedings could be brought before a SEC ALJ.\footnote{205} It also gave the SEC the authority to impose bans on persons in the securities industry from associating across the entire industry.\footnote{206}

Proceedings before ALJs have been criticized on due process and other grounds. The Commission authorizes administrative proceedings and then judges them. While ALJs sometimes throw out cases prosecuted by the Division of Enforcement, and the Commission sometimes overrules initial decisions by ALJs, in most cases a respondent in an administrative proceeding has little chance of winning a dismissal of the charges. Because of the increased scope for administrative proceedings given to the SEC by Dodd-Frank, criticisms of ALJ cases mounted.

Several constitutional grounds were suggested as ways to attack the use of ALJs. The most viable was the Appointments Clause of Article II, Section 2, which provides that the President shall appoint all “Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law,” but that “Congress may by Law vest the Appointment of such inferior Officers, as they think proper in the . . .Heads of Departments.” Other attacks were based on deprivation of the right to a jury trial under the Seventh Amendment, violation of the Due Process Clause due to the combination of prosecutorial and judicial powers in the SEC, and non-delegation.\footnote{207}

In 2013, the SEC charged Raymond Lucia, who used his investment company to market a retirement strategy called "Buckets of Money" to prospective clients, with violating the Investment Advisers Act.\footnote{208} Lucia's case was heard before ALJ Cameron Elliot, who determined following a

\footnote{205}{Dodd Frank \textsection 929P.}
\footnote{206}{\textsection 925}
\footnote{207}{Platt, \textit{supra} note 204, at 14-22.}
\footnote{208}{SEC v. Lucia, 138 S.Ct. 2044, 2049 (2018).}
hearing that Lucia had committed the violations and imposed substantial civil penalties and a lifetime industry ban. Lucia appealed to the SEC, arguing that the entire proceeding against him was constitutionally invalid because Judge Elliot as an "Officer of the United States" had not been appointed through the permissible mechanisms. The Commission concluded that ALJs were "mere employees" not governed by the Appointments Clause (and thus could be selected by persons other than those enumerated in the Constitution. Lucia's argument was then rebuffed twice more: first by a three judge panel of the D.C. Circuit and then by an en banc rehearing (where the ten judge panel divided evenly). Asking for a resolution of the circuit split between D.C. and the 10th Circuit, Lucia made his way to the Supreme Court, where he finally found success.

While Lucia and other cases attacking ALJ proceedings were pending, the SEC took two steps to respond to the criticisms of the Commission’s use of administrative proceedings pursuant to its new Dodd-Frank authority. On May 8, 2015, the SEC Division of Enforcement published a statement explaining its approach to forum selection. These guidelines did not quiet criticisms of the SEC’s increased use of administrative proceedings since the Enforcement Division admitted

209. Id. at 2050.
210. Id.
211. Id.
212. 832 F.3d 277, 283-89 (2016).
214. Bandimere v. SEC, 844 F.3d 1168, 1179 (2016) (holding that the Commission's ALJs were "inferior officers" and thus "[holding] their office in conflict with the Appointments Clause").
that it is likely to go to an ALJ rather than a district court when a matter “is likely to raise unsettled and complex legal issues under the federal securities laws.”

In 2018, the Supreme Court held in *Lucia v. SEC* that the SEC's ALJs qualified as "Officers of the United States" under the Appointments Clause of the Constitution, Art. II, S 1, cl. 2, meaning that they could only be appointed by the mechanisms outlined in the Constitution. The Constitution limits the authority to appoint officers to the President, "courts of law," or "heads of departments." The Commission's ALJs were instead selected by staff.

Justice Kagan, writing for a seven person majority, concluded that the Commission's ALJs fall within the definition of "Officers of the United States" rather than "lesser functionaries." In determining this, Kagan relied on three previous Supreme Court rulings to form the framework of her analysis: *United States v. Germaine*; *Buckley v. Valeo*; and *Freytag v. Commissioner*. The Court in *Germaine* held that "civil surgeons" were merely employees, reasoning that to be an "Officer of the United States," one must hold a "continuing and permanent" position, rather than an "occasional and temporary" one. Nearly a century later, the Court in *Buckley* added another element to the test: a position is governed by the Appointments Clause where the employees "exercise significant authority pursuant to the laws of the United States."

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217. *Id.*
218. 138 S.Ct. at 2049.
219. Art. II, S 1, cl. 2.
220. 138 S.Ct. at 2049.
221. *Id.* at 2051 (citing *Buckley v. Valeo*, 424 U.S. 1, 126 n. 162 (1976)).
222. 99 U.S. 508 (1879).
225. 99 U.S. at 511-512.
In *Freytag*, where the Court had occasion to apply the requirements established in *Germaine* and *Buckley*, the Court held that the special trial judges of the United States Tax Court were officers because they: (1) held continuing office with ongoing and permanent duties specified in the tax code; and (2) had significant authority because they exercised "significant discretion" in presiding over adversarial hearings in which they "[took] testimony, conduct[ed] trials, rule[d] on the admissibility of evidence, and [had] the power to enforce compliance with discovery orders." Despite the fact that those Tax Court judges did not issue final decisions, as the government had argued, they were still officers.

Kagan concluded that "*Freytag* says everything necessary to decide this case." The SEC's ALJs clearly held continuing office established by law, a fact all conceded. Further, like the special trial judges in *Freytag*, the ALJs presided with authority and discretion over adversarial hearings, wielding "nearly all the tools of federal trial judges." The ALJs were arguably even more independent than their *Freytag* analogs, Kagan noted, because the Commission does not always review (though can) review their decisions. Therefore, "[i]f the Tax Court's [special trial judges] are officers . . . then the Commission's ALJs must be too." Lucia's hearing was therefore an "adjudication tainted with an appointments violation," the remedy for which was a new, constitutionally valid hearing before someone other than ALJ Elliott.

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227. 501 U.S. at 881.
228. *Id.* at 881-82.
229. *Id.* at 881.
231. *Id.*
232. *Id.*
233. *Id.* at 2053-54.
234. *Id.* at 2054.
235. *Id.* at 2055.
The politicization of ALJs accomplished by *Lucia* is unfortunate. If ALJs become political appointees they are likely to have less expertise and less independence than previously. Furthermore, *Lucia*, like some of the other cases discussed in this Article, demonstrated a total indifference to the substantive frauds committed by the defendant or the possible implications for the administration of the federal government’s many agencies with numerous ALJs. This is one of the many problems with the type of judicial review of cases coming from administrative agencies like the SEC. The Court is a generalist reviewer with no accountability or responsibility for the smooth functioning of the administrative state.

C. THE PCAOB

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

The SEC was frustrated for many years in its efforts to effectively regulate the accounting profession because accountants were powerful and well-organized and because the securities laws did not contain a strong framework for the regulation of auditing. The accounting profession was self-regulated rather than directly regulated by the SEC. Although the SEC disciplined accountants pursuant to Rule 2(e), after the fact of auditing failures, the Commission’s authority for
establishing auditing standards was weak. After the Enron and WorldCom scandals, and numerous accounting restatements, the Sarbanes-Oxley Act created the PCAOB to better regulate auditing. The PCAOB was intentionally set up as an independent body in order to be insulated from interference by the accounting profession for the objective of more closely monitoring the accounting firms which audit public companies under the federal securities laws.236 The Board was placed under the oversight authority of the SEC,237 and Commissioners could remove the Board members only for good cause with a formal Commission finding with “notice and opportunity for a hearing” which was subject to judicial review.238

Not surprisingly, this double independence structure was attacked as violating the President’s appointments power. In 2010, the Supreme Court held that the restraints placed on removal of board members on the PCAOB violated Constitutional separation of powers by failing to sufficiently place the Board under the President’s control.239 Chief Justice John Roberts found that the protections against removal afforded to Board members made the PCAOB unaccountable to executive authority and thus at odds with the Constitutional mandate that the President see that all laws are “faithfully executed.”240

The constitutional challenge to the Board was brought after it formally investigated the Nevada accounting firm Beckstead and Watts, LLP.241 Watts and the Free Enterprise Fund (a non-profit organization to which the firm belonged), sued the Board, asserting that the organization

237. 15 U.S.C § 7217(b)-(c).
238. § 7217(d)(3); 561 U.S. at 486.
239. Free Enter. Fund, 561 U.S. at 492.
240. Id. at 484; Art. II, §3.
241. 561 U.S. at 487.
was constitutionally invalid and should be enjoined from exercising its authority. The plaintiffs argued that: (1) the appointment of Board members was so far removed from Presidential control as to contravene separation of powers; and (2) that the appointment of Board members violated the Appointments Clause. The District Court granted summary judgment to the government. The D.C. Circuit affirmed this decision with a vigorous defense by now-Supreme Court Justice Brett Kavanaugh.

The Court first dealt with the threshold legal issue of jurisdiction. Sarbanes-Oxley provided for review of PCAOB rules or sanctions first by the SEC and then, under 15 U.S.C. § 78y in a court of appeals. The Supreme Court found that the District Court had accurately concluded that it had jurisdiction over the claims made by Watts and Free Enterprise, and that the § 78y review process was not the exclusive mechanism of review for Board actions.

The Court then turned to the pivotal issue: whether protections against at will removal of Board members contravened separation of powers. Executive authority extends to the “general administrative control of those executing the laws,” as confirmed in Myers v. United States, and that must include the “power of removing those for whom he cannot continue to be responsible.” A line of case law supports limitations on executive control over both the principal and inferior

242. Id.
243. Id. at 487-88.
244. Id. at 488. The United States had intervened to defend the constitutionality of Sarbanes-Oxley. Id.
246. 561 U.S. at 489-91.
247. Id. at 489.
248. Id. at 490-91.
249. Id. at 492-508.
250. 272 U.S. 52, 164, 117 (1926).
officers of agencies like the Federal Trade Commission, which the Court in *Humphrey’s Executor* distinguished as “quasi-legislative and quasi-judicial” and not “purely executive.” The permission also extends to inferior executive officers like independent counsels who report to the Attorney General.

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

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253. 561 U.S. at 495-98.

254. *Id.* at 495-96.

255. *Id.* at 496.

256. *Id.* (citing *Humphrey’s Executor*, 295 U.S. at 620).

257. *Id.*

258. *Id.* at 498.
Oxley, which remained in effect “with these tenure restrictions excised.”

259 Watts and Free Enterprise Fund’s remaining challenges to the Board under the Appointments Clause were rejected. 260

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

IV. THE END OF DEERENCE?

The holding of Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc. 261 is that when a statutory provision is ambiguous, if the interpretation of the statute by a federal agency is “based on a permissible construction of the statute,” 262 the agency’s interpretation is to be given “controlling weight.” 263 Although many scholars believe such review is consistent with whether a decision is arbitrary or capricious under the Administrative Procedure Act, 264 the deferential review required by Chevron generally is outcome determinative. 265 Chevron deference is based on the rationale that judges are not experts and the judiciary is non-political, so agencies should resolve the “competing interests which Congress itself either inadvertently did not resolve, or

259. Id. at 509.
260. Id. at 510-14.
262. Id. at 843.
263. Id. at 844.
265. Id. at n. 6.
intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.” 266

Since *Chevron* involved an executive branch agency and the language of the Court referred to the Chief Executive as the appropriate political branch to make policy choices, Randolph May has argued that *Chevron* deference should not be accorded to independent agencies since they are “less politically accountable than the executive branch with regard to their policy making decisions.”267 This argument is a non sequitur since federal judges are less politically accountable than executive branch or independent agencies. In addition, why should a generalist judge’s views trump the decision of an agency exercising expert judgement?

May also argues that independent agencies deserve less deference on a separation-of-powers principle.268 But this seems a variation on general skepticism of independent agencies because they are more closely tied to Congress than to the Executive.269 This alignment does not make them less accountable. It is basically a variation of the unitary executive theory discussed in Part III above.

Closely related to *Chevron* deference is *Auer*270 or *Seminole Rock*271 deference. These cases allow agencies to interpret their own regulations if the regulations are ambiguous. In *Kisor v. Willkie*272 the Supreme Court reaffirmed *Auer*, but Justice Gorsuch, in a long and contentious

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267. May, supra note 264, at 435.
268. *Id.*
concurring opinion argued that Auer should be reversed.\textsuperscript{273} He also suggested that the Court should review Chevron and overturn that case.\textsuperscript{274} Other justices have made similar arguments and encouraged cases that would undermine or reverse Chevron.\textsuperscript{275}

In Kisor v. Wilkie, the Supreme Court took up the question of whether case law establishing the doctrine of deferring to agencies’ reasonable interpretations of ambiguous regulations should remain good law.\textsuperscript{276} The Court, in an opinion by Justice Elena Kagan, ultimately affirmed the doctrine, called either the Auer or Seminole Rock doctrine, but established and elaborated on its limitations and applications.\textsuperscript{278} The Kisor opinion established that, for Auer deference to apply: (1) the regulation must remain genuinely ambiguous after a court has “exhaust[ed] all the ‘traditional tools’ of construction”;\textsuperscript{279} (2) the agency reading must be reasonable and within the bounds of permissible interpretation established by the court’s attempts to interpret the rule.\textsuperscript{280} Once proven to be a reasonable interpretation of a genuinely ambiguous rule, the interpretation must meet three more criteria for the presumption in its favor to hold. It must be (1) an authoritative rather than informal or unofficial interpretation on (2) a matter implicating the agency’s specific substantive expertise, and (3) be the result of a “fair and considered judgment.”\textsuperscript{281} Only then is Auer deference given.

\begin{itemize}
\item \textsuperscript{273} Id. at 2425-48.
\item \textsuperscript{274} Id. at 2446, n. 114.
\item \textsuperscript{275} But Justice Scalia supported Chevron deference at one time. See generally Antonin Scalia, Judicial Deferences to Administrative Interpretations of Federal Law, 1989 DUKE L. J. 511 (1989).
\item \textsuperscript{276} Kisor, 139 S.Ct. at 2408.
\item \textsuperscript{277} See Auer v. Robbins, 519 U.S. 452, 461-63 (1997)
\item \textsuperscript{278} See Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1945) (when the “meaning of the words used [in a regulation] is in doubt . . . . the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless plainly erroneous or inconsistent with the regulation”).
\item \textsuperscript{279} Kisor, 139 S.Ct. at 2415.
\item \textsuperscript{280} Id. at 2415-16.
\item \textsuperscript{281} Id. at 2416-18.
\end{itemize}
At issue in the underlying case was James Kisor’s application to the Department of Veterans Affairs ("VA") for disability benefits for post-traumatic stress disorder (PTSD). After his first application, in 1982, the VA denied him the benefits, finding he did not suffer the disorder. Decades later, in 2006, Kisor moved to reopen his claim and was granted them. However, the benefits only accrued from 2006 onward rather than his initial application date.\(^{282}\) The Board of Veterans’ Appeals affirmed this decision,\(^{283}\) as did the Court of Appeals for Veterans Claims.\(^{284}\) Under VA regulation, Kisor could not obtain retroactive benefits if there were no “relevant official service department records” which had not been considered in the initial denial.\(^{285}\) The records Kisor produced to satisfy this were deemed insufficient because they did not speak to whether he had PTSD and were thus not relevant.\(^{286}\) Kisor took the position that a service record only need to relate to the criteria for obtaining disability benefits in order to be relevant.\(^{287}\) The Federal Circuit upheld the determination as well, on the grounds that the Board’s interpretation was owed deference.\(^{288}\) Both parties’ interpretations of the regulatory language appeared reasonable and therefore Auer deference meant that the VA’s interpretation governed.\(^{289}\) This dispute landed before the Supreme Court as a question of whether or not to overturn the Auer doctrine protecting the VA’s interpretation of its own rule.

\(^{282}\) Id. at 2409.

\(^{283}\) Id.


\(^{285}\) See 38 CFR Section 3.156(c)(1) (2013).

\(^{286}\) Kisor v. Wilkie, 139 S.Ct. 2400, 2409 (2019).

\(^{287}\) Id.

\(^{288}\) Kisor v. Shulkin, 869 F.3d 1360, 1368 (Fed. Cir. 2017).

\(^{289}\) Id.
Under *Auer/Seminole Rock* deference, as a necessary part of the rulemaking authority delegated to them by Congress, agencies’ interpretations of their own ambiguous regulatory language are given primacy, where those interpretations are reasonable.290 In the *Seminole Rock* case in 1945, the Court upheld and enforced a regulatory interpretation of the Administrator of the Office of Price Administration, giving controlling weight to a position it found to be reasonable, as well as having been consistently held by the OPA.291 Decades later, in *Auer*, the Court cited *Seminole Rock* in granting deference to the Labor Department’s interpretation of the Fair Labor Standards Act because the interpretation at issue “was a creature of the [Labor Department’s] own regulations” and that the rule “comfortably bears the meaning [the Department] assigns.”292 The Court has presumed that such deference is part of Congressional intent in granting agencies the power to promulgate rules.293 The deference is also based on the rationale that the agencies who make the rules and work closely with the policy issues involved are in the best position to make determinations about such ambiguities.294 As Kagan described it, “the core theory of *Auer* deference is that sometimes the law runs out, and policy-laden choice is what is left over.”295 The Supreme Court reaffirmed this and concluded that *Auer* remained good law, but went further in specifying the constraints on its application.296

290. 139 S.Ct. at 2412-15.
294. *Id.* at 2413.
295. *Id.* at 2415.
296. *Id.* at 2408, 2415.
According to the Kisor ruling, Auer deference is applicable only where “a regulation is genuinely ambiguous.”297 Even then, Justice Kagan found, a reasonable agency interpretation of a genuinely ambiguous rule may not be accorded deference where there are countervailing reasons.298 Auer deference has no application where the rule is not genuinely ambiguous, meaning that it remains unclear even after the use of “all the ‘traditional tools’ of construction.”299 Auer deference also has no application where the agency interpretation does not “come within the zone of ambiguity” identified by the court through the implementation of its interpretive tools.300 Kagan also laid out three more requirements for the presumption that an agency’s reasonable interpretation of a genuinely ambiguous rule to hold. First, the interpretation must be official, rather than the position taken in some informal memorandum or policy speech by a mid-level employee.301 Second, it must implicate some substantive area of that agency’s expertise over which Congress could be presumed to have granted it authority.302 Finally, the interpretation must be a “fair and considered judgment,” and not be either a stance taken out of convenience or one that reverses course causing “unfair surprise.”303

In weighing Kisor’s argument that Auer and Seminole Rock, and the established doctrine described above, should be overturned, Justice Kagan turned to the principles of stare decisis. To overrule the doctrine required more than overturning just Auer, but “a ‘long line of precedents’—

297. Id. at 2415.
298. Id. at 2414.
300. Id. at 2415-16.
301. Id. at 2416-17.
302. Id. at 2417.
303. Id. at 2417-18.
each one reaffirming the rest and going back 75 years or more.” Further, upending the doctrine would introduce serious instability into the law. This doctrine, as described, survived Kisor’s attack on it. However, his specific case was remanded for determination consistent with the above-outlined limitations on Auer: specifically to require the Federal Circuit to exhaust all its interpretive tools in concluding the rule to be ambiguous and to find whether, if reasonable, this interpretation is of the category owed judicial deference.

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

V. CONCLUSION

304. Id. at 2422.
305. Id.
306. Id. at 2423-24.
Investor protection and capital formation are important components of financial regulation. If the SEC is undermined by power struggles between the Executive, Congress and the Judiciary, or partisan gridlock over regulation, the SEC will fail to achieve these important goals. Many on the right, led by President Trump, are openly trying to destroy the administrative state, but the left is not blameless. The Financial Choice Act,\textsuperscript{309} proposal by Representative Jeb Hensarling would subject not only SEC rulemaking but SEC enforcement to severe congressional review. The Enforcement Division would have to verify that its actions are within the SEC authority and consistent with the Administrative Procedure Act. The economic consequences of a civil penalty on an issuer would have to be considered. This idea of a cost-benefit analysis for enforcement cases strikes me as ludicrous. The recent move by Democrats to prevent the SEC from administering its Regulation Best Interest is a similar partisan interference with SEC’s regulation.

An even more trenchant example of partisan political pressure exerted on the SEC was conflicting Republican and Democratic reactions to the petition for rulemaking on public company disclosure of political contributions. After the Supreme Court decided \textit{Citizens United}\textsuperscript{310} the Committee on Disclosure of Political Spending, co-chaired by Professor Lucian Bebchuk of Harvard Law School and Robert J Jackson of Columbia Law School (subsequently an SEC commissioner), sent a petition to the SEC to start a rulemaking proceeding to require disclosure of corporate political contributions.\textsuperscript{311} This petition and its favorable response were prompted in part by a statement in \textit{Citizens United} by Justice Kennedy. He noted that “with the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the

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\textsuperscript{309} H.R. 5983, 114th Cong. 2d Sess. (Sept. 9, 2016).  \\
\end{flushright}
information needed to hold corporations and elected officials accountable for their positions and supporters.”  

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

In 2013 and 2014 there were bills introduced in Congress to compel the SEC to mandate political contributions disclosures and bills to prevent the SEC from mandating such disclosures. A provision written into the policy riders for the 2016 Omnibus Appropriations bill, passed on December 18, 2015, explicitly prohibited the SEC from using any funds to finalize political constitution disclosure rules during the fiscal year 2016. A group of Congressional leaders, led


313. See, e.g., rulemaking regarding conflict minerals, *supra* Part II.D.


Electronic copy available at: https://ssrn.com/abstract=3444565
by Sen. Charles Schumer, informed the SEC via an open letter that the language of the bill did not prohibit the Commission from preparing, researching, or investigating potential rules, and urged the SEC to remain committed to the issue.

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

The furor over the Bebchuk-Jackson political spending petition did not subside after these events. The nominations of two SEC commissioners to fill vacancies were held up in the Senate by Democrats because they did not testify during their confirmation hearings that they would push forward on a rulemaking advancing the petition. One of them, a Republican, Hester Pierce who once worked in the Senate, was re-nominated by President Trump. The other, a Democrat, Lisa Fairfax, was never confirmed. Even worse, Senator Elizabeth Warren suggested that Chair Mary Jo White be fired as SEC Chair by President Obama and demoted to a Commissioner because Chair White refused to engage in rulemaking to compel public companies to disclose their political contributions.318 Missing from this pique on the part of Senator Warren was the fact that the SEC was prohibited from doing so by legislation that Senator Warren voted for. Senator Warren also

criticized Chair White for embarking on a project to streamline SEC disclosure policy and improve public company reporting, a project prompted by mandates from Congress in the JOBS act and the FAST Act.

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

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

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

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

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

The concept of agency independence generally has meant freedom from control by the executive branch, based on delegation of congressional powers. Commissions like the SEC are often considered “arms” of Congress and, in any event, are accountable to Congress for their success or failure. Congress has many legitimate ways to influence the work of the SEC, the most important of which is fixing the Commission’s budget. Congressional oversight committees can also exert a strong influence on the work of the SEC. Yet, the courts have also recognized that


some degree of independence from Congress is also important in order to insulate these agencies from inappropriate pressures.\textsuperscript{325}

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

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

\textsuperscript{325} See D.C. Federation of Civic Associations v. Volpe, 459 F.2d 1231, 1246 (D.C. Fir. 1972); Pillsbury Co. v. Federal Trade Comm’n, 354 F.2d 952 (5th Cir. 1966).