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Defending the D.C. Circuit's Hard-Look Review

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DEFENDING THE D.C. CIRCUIT'S HARD-LOOK REVIEW

INTRODUCTION

Although corporate governance is predominately a state law issue, many corporations are subject to the jurisdiction of the Securities and Exchange Commission ("SEC") because they either are publicly traded, trade in securities, or do both. As a result, these companies are affected by corporate governance and other rules promulgated by the SEC. It should not be surprising then that organizations challenge these rules when they dislike the substance of the rules or how they were promulgated. For the past decade, some organizations have been successful in challenging SEC rules under the National Securities Markets Improvement Act[1] of 1996 ("NSMIA"). In one of the more recent cases, a group of organizations successfully challenged a rule promulgated by the SEC that would have given shareholders in every state access to the nomination process for directors in publicly held corporations.[2] However, these successes have attracted criticism from legal scholars who allege that the court deciding the cases, the United States Court of Appeals for the District of Columbia Circuit, has usurped the SEC's rulemaking authority.[3]

I. A HARD LOOK AT HARD-LOOK REVIEW

For nearly sixty-two years the SEC's rulemaking authority was constrained by just two requirements.[4] The SEC was required to promulgate rules that were "necessary or appropriate in the public interest" and, when it did so, it was required to consider whether the rule would promote the "protection of investors."[5] However, in 1996 Congress amended the securities laws that form the backbone of the SEC's authority[6] when it enacted the NSMIA.[7] The NSMIA added the requirement that "whenever . . . the [SEC] is engaged in

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[1] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 106(b), 110 Stat. 3416, 15 U.S.C. § 78a note.

[2] *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1146–47 (D.C. Cir. 2011).

[3] *See* James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811, 1818 (2012).

[4] *Id.*

[5] *Id.*

[6] *See* Securities Act of 1933 § 2(b), 15 U.S.C. § 77b(b) (2014); Securities Exchange Act of 1934 § 3(f), 15 U.S.C. § 78c(f) (2014); Investment Company Act of 1940 § 2(c), 15 U.S.C. § 80a-2(c) (2014).

[7] 110 Stat. 3416, 15 U.S.C. § 78a note.

rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[8] Congress left undefined "consider," "efficiency," "competition," and "capital formation."[9]

The actions of all federal agencies are subject to review under the Administrative Procedure Act ("APA")[10] and the respective agency's enabling statute. When the SEC promulgates a rule or issues a final order and that rule or order is challenged, it is often reviewed by the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit"). Since Congress enacted the NSMIA, the SEC has endured a string of successful challenges to its rules in the D.C. Circuit.[11] In each of these challenges, the D.C. Circuit held that the SEC had not properly considered the rule's economic effects.[12]

The SEC's series of defeats in the D.C. Circuit have not gone unnoticed by commentators, many among whom are judges, professors, and attorneys.[13] Instead of faulting the SEC's inability to articulate the reasoning behind its rules, some esteemed commentators have criticized the D.C. Circuit's "Hard-Look review" ("Hard-Look Review").[14] These commentators ("Critics") believe that the D.C. Circuit has usurped the SEC's rule making authority and, in so doing, has acted against the will of Congress and the Supreme Court of the United States.[15] Their criticism centers on the allegation that the D.C. Circuit goes beyond the review standard intended by Congress by requiring the SEC to conduct a cost-benefit-analysis ("CBA") whenever it considers the effects of a rule on the protection of investors, efficiency, competition, and capital formation ("Required Factors").[16] These Critics seem to believe that, even if the D.C. Circuit does not require the SEC to do a cost benefit analysis,

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[8] *Id.*

[9] Cox & Baucom, *supra* note 3, at 1818.

[10] *See generally* Administrative Procedure Act, 79 P.L. 404, 60 Stat. 237 (1946).

[11] *See* COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 18 (Wolters Kluwer ed., 7th ed. 2013); *see also* Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 178 (D.C. Cir. 2010); Chamber of Commerce of the United States v. SEC, 412 F.3d 133, 136 (D.C. Cir. 2005); Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

[12] *Id.* at 18.

[13] *See* Cox & Baucom, *supra* note 3, at 1833.

[14] *See generally id.* at 1830.

[15] *See id.* at 1813, 1828.

[16] *See id.* at 1813.

it is inappropriate to decide the validity of a rule based on the CBA the SEC conducted and put forth as justification for the rule.[17]

Does the D.C. Circuit usurp the SEC's rulemaking authority when it reviews the CBA the SEC conducts when considering the Required Factors? The short answer is "No." A thorough reading of the D.C. Circuit cases in question reveals that the D.C Circuit did not usurp the SEC's rulemaking power. This work will demonstrate that the D.C. Circuit applied well-settled precedent and applied the proper standard of review for agency action. To that end, this work will rely on the precedents that a rule promulgated by a federal agency stands or falls based on the justification the agency put forth at the time it adopted the rule[18] and that ambiguity in an enabling statute is an "express delegation" of power to an agency to interpret the ambiguity.[19] To establish a standard by which to judge the D.C. Circuit's analysis, Part II will explain the appropriate standard of review for agency action. Part III will discuss the statutes at issue. Part IV will then describe the D.C. Circuit decisions called into question and rebut the Critics' arguments.

II. *CHEVRON* ANALYSIS: THE PROPER STANDARD OF REVIEW

Agency action, and the subsequent review of agency action, is governed by the APA.[20] The proper standard of review for agency action under the APA ("Proper Standard of Review") is derived from Supreme Court precedent in *Chevron v. NRDC,*[21] *United States v. Mead Corp,*[22] *Vermont Yankee v. NRDC,*[23] *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co,*[24] and *National Cable & Telecommunications Ass'n v. Brand X Internet Services.*[25] Together, these five cases set out the Proper Standard of Review for agency action.

A court reviewing agency action applies a Chevron analysis ("Chevron Analysis").[26] The analysis counsels courts to first ask whether Congress has

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17 *See generally id.* at 1828–29.

18 *See* SEC v. Chenery Corp., 318 U.S. 80, 95 (1943).

19 *See* Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 843–44 (1984).

20 *See generally* 60 Stat. 237.

21 *See generally Chevron*, 467 U.S. 837.

22 *See generally* United States v. Mead Corp., 533 U.S. 218 (2001).

23 *See generally* Vt. Yankee Nuclear Power Corp. v. Nat. Res. Def. Council, Inc., 435 U.S. 519 (1978).

24 *See generally* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983).

25 *See generally* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967 (2005).

26 *See* United States v. Haggar Apparel Co., 526 U.S. 380, 392 (1999); *see also Chevron*, 467 U.S. at 843.

explicitly or implicitly delegated authority to the agency to make rules with the force of law ("Chevron Step Zero").[27] Because Congress delegates authority to agencies under the assumption that the agency has expertise in its given area, courts grant agencies varying levels of deference based on the specific action taken by the agency.[28] If the statute neither explicitly or implicitly delegates such authority to the agency then it may still enjoy some "respect,"[29] but it will not receive *Chevron*-level deference ("Chevron Deference").[30] Only if the statute grants the agency the authority to make rules with the force of law will the reviewing court accord the agency Chevron Deference.[31] If the statute does grant the agency such authority, the court's next step is to determine whether the language of the statute is ambiguous ("Chevron Step One").[32] At this stage, the court searches for the meaning Congress intended to give the language at issue and will analyze the text of the statute, consult dictionaries, and, depending on the judge, examine the legislative history of the statute.[33] If Congress's intent is made clear by this inquiry then that is the end of the matter; the court and the agency must give effect to the unambiguously expressed intent of Congress.[34] However, if the statute is silent or ambiguous with respect to the specific issue at hand, the court must determine whether the agency's interpretation was based on a permissible construction of the statue ("Chevron Step Two").[35] Simply put, the court looks to see if the agency's interpretation was reasonable in light of the statute. Courts also assess the agency's interpretation in light of previous court decisions regarding the statute at issue.[36]

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[27] *See Mead Corp.*, 533 U.S. at 226–27 (United States v. Mead Corp. is not particularly important to discussion that will follow because it only applies when Congress did not give an agency the authority to issue rules with the force of law. In every case cited by the Critics the SEC was given the authority to issue rules with the force of law).

[28] *See generally Chevron*, 467 U.S. at 844, 863, 865.

[29] *See* Skidmore et al. v. Swift & Co., 323 U.S. 134, 140 (1944) ("Skidmore Respect").

[30] *See Mead Corp.*, 533 U.S. at 226–27 (Even if an agency action does not receive *Chevron* deference it may still receive *Skidmore* Respect); *see also Chevron*, 467 U.S. at 843 (deferring to agency interpretation so long as it is reasonable in light of the statute at issue).

[31] *See Mead Corp.*, 533 U.S. at 226–27.

[32] *See Chevron*, 467 U.S. at 843.

[33] *See generally id.* (examining the plain meaning, meaning in context, and legislative history of the statute).

[34] *Id.* at 842–43.

[35] *See id. at* 843.

[36] *See* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. at 984 (In Brand X the Supreme Court complicated an agency's ability to interpret its enabling statute differently over time. Brand X requires a reviewing court to examine prior cases interpreting the statute at issue for a "clear" reading of the statute. If the reviewing court should find that a previous court established a "clear" reading of the statute, the reviewing court must give effect to that court's interpretation of the statute).

A reviewing court defers to the agency's interpretation unless it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[37] However, a reviewing court cannot set aside an agency rule that is "rational, based on consideration of the relevant factors, and within the scope of the authority delegated to agency by the statute."[38] Moreover, an agency is afforded a high level of deference when it interprets its enabling statute.[39] The reason for the high level of deference is found within *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 ("*Chevron*"). In *Chevron*, the Supreme Court held that ambiguity in a statute is an "express delegation" of power to an agency to define the ambiguity.[40] Although it might appear that once an agency has progressed to Chevron Step Two it enjoys smooth sailing to the finish line, the Supreme Court has made it clear that agencies are required to support their actions with logical reasoning.

In *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co* ("*State Farm*"), 463 U.S. 29 (1983), the Supreme Court offered four possible ways that an agency's justification for its actions would be unsatisfactory under the arbitrary and capricious standard.[41] Normally, "an agency rule would be arbitrary or capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view of the product of the agency expertise."[42] Reviewing courts cannot "make up for such deficiencies" because courts "may not supply a reasoned basis for the agency's action that the agency itself has not given."[43]

When a reviewing court thoroughly analyzes an agency's reasoning, it administers "Hard Look" Judicial Review ("Hard-Look Review").[44] Under Hard-Look Review, a court must "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."[45] To avoid having its action ruled arbitrary and capricious, an

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[37] 5 U.S.C. §706(2)(A).

[38] *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 42.

[39] *See generally Chevron*, 467 U.S. at 842–46.

[40] *Id.* at 843.

[41] *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

[42] *Id.*

[43] *Id.* (quoting SEC v. Chenery Corp., 332 U.S. 194, 196 (1943)).

[44] *See* Matthew C. Stephenson, *A Costly Signaling Theory of "Hard Look" Judicial Review*, 58 ADMIN. L. REV. 753, 757 (2014).

[45] *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

agency must "consider relevant factors," articulate a "rational connection between the facts found and the decision made," and offer a logical explanation for exercising its discretion.[46] When a court reviews an agency action, it is not to substitute its reasoning for that of the agency or provide reasoning for the agency that the agency has not advanced.[47] It is clear from the Supreme Court's decision in *State Farm*, 463 U.S. 29, that an agency's action must stand or fall based on the reasoning provided by the agency at the time the action was taken.[48] However, in a nod to agency expertise, courts will "uphold a decision of less than ideal clarity if the agency's path may be reasonably discerned."[49]

The danger of Hard-Look Review is that it may allow a reviewing court to substitute its reasoning for that of the agency. However, the potential for such a substitution was reduced by the Supreme Court's decision in *Vermont Yankee Nuclear Power Corp. v. Nat. Res. Def. Council, Inc*., 435 U.S. 519 (1978) ("*Vermont Yankee*"), wherein the Court held that reviewing courts are not to substitute their own notions of proper procedures for those of the agency they are reviewing.[50] The Court's decision in *Vermont Yankee* was based on the APA.[51] Section 553[52] of the APA generally establishes "the maximum procedural requirements which Congress was willing to have the courts impose upon agencies in conducting rulemaking procedures."[53] The formulation of procedures beyond statutory requirements is thus left to agency discretion.[54] Accordingly, "agencies are free to grant additional procedural rights in the exercise of their discretion."[55] On the other hand, the Supreme Court has not entirely precluded reviewing courts from imposing extra-statutory procedures on agencies. However, the Supreme Court has given no examples of what circumstances would "ever justify a court in overturning agency action because

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[46] *Id.* (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962)).

[47] *See id.*

[48] *See id.*

[49] *Id.* (quoting Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 286 (1974)).

[50] *See Vt. Yankee Nuclear Power Corp.*, 435 U.S. at 524.

[51] *Id.*

[52] 5 U.S.C. §553.

[53] *Vt. Yankee Nuclear Power Corp.*, 435 U.S. at 524.

[54] *See id.* at 525 (Extra-statutory procedures are left to agency discretion as a result of "the congressional determination that administrative agencies will be . . . in a better position than federal judges or Congress itself to design procedural rules adapted to the peculiarities of the industry and the tasks of the agency involved").

[55] *Id.*

of a failure to employ procedures beyond those required by statute."[56] Whatever those circumstances are, "if they exist," they are unknown.[57]

III. CONSIDER THE FACTORS

Although the primary purpose of the NSMIA was to further federalize the public offering of securities, the Act added economic factors for the SEC to consider when issuing rules.[58] With the NSMIA, Congress imposed upon the SEC the requirement that it "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation" ("Amended Standard").[59] In 1999 Congress passed the Gramm-Leach-Bliley Act that included an amendment to the Investment Advisers Act of 1940 ("IAA").[60] This amendment moved the IAA into the same review standard Congress had enacted in the NSMIA three years before.[61] Congress again left ambiguous "consider", "the protection of investors", "efficiency", "competition", and "capital formation."[62] Thus, Congress once more expressly delegated to the SEC the authority to reasonably interpret the terms.[63]

Because "consider" grammatically governs what level of analysis the SEC must give to each factor, the ultimate issue is determining what Congress meant when it used the verb. Webster's Dictionary defines "consider" as "to think about carefully," "to regard or treat in an attentive or kindly way," "to gaze steadily or reflectively," or "to come to judge or classify."[64] The common thread of the definitions is deep thought. In the context of the NSMIA, "consider" suggests that Congress intended the SEC to take into account the economic effects of a proposed rule before promulgating it.[65] The legislative histories of the NSMIA and the IAA establish only that Congress preferred an ambiguous standard to a precise one and that Congress intended to change at

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[56] *Id.*

[57] *Id.* (the Supreme Court has not elaborated as to what these circumstances may be).

[58] *See* 15 U.S.C. § 78a note (requiring the SEC to consider whether a proposed action will "promote efficiency, competition, and capital formation").

[59] 110 Stat. 3416, 15 U.S.C. § 78a note.

[60] *See* Investment Advisers Act of 1940 § 202(c), 15 U.S.C. § 80b-2(c) (1999); *see also* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 224, 113 Stat. 1338, 1402 (codified at 15 U.S.C. § 80b-2(c) (2014).

[61] 15 U.S.C. § 80b-2(c) (incorporating the Review Standard into § 202 of the Investment Advisers Act).

[62] *Compare* 110 Stat. 3416, *with* 15 U.S.C. § 80b-2(c).

[63] *See Chevron*, 467 U.S. at 843 (deferring to agency's interpretation of an ambiguous statute).

[64] *Consider*, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/consider (last visited Feb. 14, 2016).

[65] *See generally* 110 Stat. 3416, 15 U.S.C. § 78a note (passed in part to "provide more effective and less burdensome regulation").

least the level of discretion the SEC enjoyed in regards to rulemaking procedures.[66] However, "[t]he Constitution gives legal effect to the 'Laws' Congress enacts, Art. VI, cl. 2, not the objectives its Members aimed to achieve in voting for them."[67] Therefore, the only legislative history that matters is the text of the statutes. The D.C. Circuit's conduct, discussed *infra*, is strong evidence that it finds the Amended Standard to be ambiguous.[68] As a result, the SEC has the authority to offer a reasonable interpretation of the Amended Standard.[69] Consequently, the SEC's interpretation of the Amended Standard is the only one that truly matters.[70] Yet, the SEC has not explicitly interpreted the Amended Standard and has suffered multiple defeats as a result.[71]

IV. THE D.C. CIRCUIT'S HARD-LOOK REVIEW

The Critics' argument that the D.C. Circuit usurpation of the SEC's rulemaking power is built upon four D.C. Circuit cases, *Public Citizen v. Federal Motor Carrier Safety Administration* ("*Public Citizen*"),[72] *American Equity Investment Life Insurance Co. v. SEC* ("*American Equity*"),[73] *Chamber of Commerce of the United States v. SEC* ("*Chamber of Commerce*"),[74] and *Business Roundtable v. SEC* ("*Business Roundtable*").[75] Critics allege that the

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[66] *Compare* Securities Investment Promotion Act of 1996, S. 1815, 104th Cong. § 310 (1996) (Senate requiring reports by the SEC's Chief Economist), *with* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 106(b), 110 Stat. at 3424 (codified at 15 U.S.C. § 77b(b) (2014)) (rejecting the Senate's precise but overly cumbersome language but mandating that the SEC perform an economic analysis with knowledge that the SEC already performed such analyses on its own), *and* 15 U.S.C. § 80b-2(c) (Congress did not alter the language of the Amended Standard from the NSMIA).

[67] Graham Cty. Soil & Water Conservation Dist. v. United States ex rel. Wilson, 559 U.S. 280, 302 (2010) (Scalia, J., concurring).

[68] *See Bus. Roundtable*, 647 F.3d at 1148 (the Court broadly states that the SEC has an "obligation to consider the effect of a new rule 'upon efficiency, competition, and capital formation,'" which is almost the actual text of the Amended Standard. This suggests that the D.C. Circuit was giving the SEC the opportunity to interpret for itself what exactly its obligation entailed.).

[69] *See Chevron*, 467 U.S. at 843 (deferring to agency's interpretation of an ambiguous statute).

[70] *See generally id.*

[71] *See generally Chamber of Commerce of the United States*, 412 F.3d 133 (the SEC based its defense on the difficulty of determining costs rather than what it interpreted the Amended Standard to require); *Bus. Roundtable*, 647 F.3d 1144 (the SEC offered a cost-benefit analysis for support of its rule without stating that the Amended Standard required it to do so); *but see Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 172 (the SEC performed an economic analysis but argued that the Amended Standard did not require it to perform a thorough analysis).

[72] *See generally* Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209 (D.C. Cir. 2004).

[73] *See generally Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166.

[74] *See generally Chamber of Commerce of the United States*, 412 F.3d 133.

[75] *See generally Bus. Roundtable*, 647 F.3d 1144.

D.C. Circuit did not apply the Proper Standard of Review because it analyzed the CBAs the SEC submitted as justifications for the rules being challenged.[76] The argument stems from the Critics' belief that "consider" only requires the SEC to toss a factor back and forth without making a conclusion as to a rule's effect on that factor.[77] In contrast, the D.C. Circuit's opinions, discussed *infra*, suggest that the SEC must at least offer a guess as to a rule's effect before it can truly consider that effect. To demonstrate that the D.C. Circuit has done nothing more than perform a Chevron Analysis with Hard-Look Review, this section will describe the cases before rebutting the Critics' argument.

A. The Cases

In *Public Citizen*, 374 F.3d 1209, the D.C. Circuit reviewed a challenge to a rule issued by the Federal Motor Carrier Safety Administration ("FMCSA") revising limitations on the working hours of commercial motor vehicles operators.[78] FMCSA's enabling statutes required the agency to consider, among other things, "the impact of the rule on the health of drivers."[79] However, the FMCSA neglected to consider the impact its revision would have on the health of the drivers as required by statute.[80] As a result, the challengers argued that the rule was arbitrary and capricious.[81] The D.C. Circuit reviewed the challenge under the standard set by *State Farm*, 463 U.S. 29, which required the court to "ensure that the agency made a rational connection between the facts found and the choice made."[82] Citing *State Farm* for the principle that "an agency's rule is normally arbitrary and capricious if it entirely failed to consider and important aspect of the problem before it," the D.C. Circuit held that the revision was arbitrary and capricious.[83] The D.C. Circuit reasoned that "[a] statutorily mandated factor, by its definition, is an important aspect of any issue before an administrative agency, as it is for Congress in the first instance to define the appropriate scope of an agency's mission."[84] The court went on to note that the absence of any discussion of such an important factor leaves the court with "no alternative but to conclude

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76 *See generally* Cox & Baucom, *supra* note 3, at 1813.
77 *See generally id.* at 1821.
78 *Pub. Citizen*, 374 F.3d at 1211.
79 *Id.* at 1216.
80 *Id.*
81 *Id.*
82 *Id.*
83 *Id.*
84 *Id.*

that [the agency] failed to take into account . . . this statutory limit on its authority."[85]

In *Chamber of Commerce of the United States v. SEC*, 412 F.3d 133 (D.C. Cir. 2005), the D.C. Circuit reviewed a challenge to a SEC regulation promulgated under the Investment Company Act of 1940 ("ICA").[86] The regulation would have allowed an investment company to complete transactions normally prohibited by the ICA if the company had an independent chairman and at least 75% of its board was comprised of independent directors.[87] The challenger alleged, *inter alia*, that the SEC violated the APA by failing to properly consider the regulation's effect on competition, efficiency, and capital formation.[88] The D.C. Circuit held that the SEC had violated the APA because it did not consider an alternative to requiring an independent chairman and it failed to properly consider the regulation's effect on competition, efficiency, and capital formation.[89]

The SEC found abuses being perpetrated by mutual fund directors during transactions that involved conflicts of interest.[90] To reduce the chances for such abuse, the SEC amended the "Exemptive Rules" to produce more independent boards while facilitating beneficial transactions involving conflicts of interest.[91] The SEC reasoned that raising the required percentage of independent directors to 75% from 50% would "strengthen the independent directors" control of the fund board and its agenda"[92] as well as "help ensure independent directors carry out their fiduciary responsibilities."[93] The SEC justified requiring an independent chairman, stating: "[a] fund board is in a better position to protect the interests of the fund, and to fulfill the board's obligations . . . when its chairman does not have the conflicts of interest inherent in the role of an executive of the fund adviser."[94] Two of the five SEC Commissioners, concerned that the two conditions would impose "a substantial cost to fund shareholders" and under the belief that previously existing laws provided adequate opportunities for control by independent advisers, dissented

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85 *Id.*
86 15 U.S.C. § 80a-2(c).
87 *Chamber of Commerce of the United States*, 412 F.3d at 136.
88 *Id.*
89 *Id.* at 140.
90 *Id.* at 137.
91 *Id.*
92 *Id.*
93 *Id.*
94 *Id.*

from the rule's adoption.[95] The dissenting Commissioners faulted the SEC for failing to give "real considerations to the costs" of the 75% requirement, for inadequately justifying the independent chairman requirement, and for not giving due consideration to alternatives to the independent chairman.[96]

The D.C. Circuit found that it was required by *State Farm*, 463 U.S. 29 (1983), to determine whether the SEC "examined the relevant data and articulated a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[97] The court found that the SEC acted reasonably when it amended the Exemptive Rules as a preventative measure, but that the SEC had violated the APA because it did not properly consider the new rules' effect on competition, efficiency, and capital formation.[98]

The SEC claimed that it was difficult for it to establish the exact costs of the independent director requirement because it had no reliable way of determining how regulated funds would satisfy the condition.[99] The court held that such difficulty does not excuse the SEC from "its statutory obligation to determine as best it can the economic implications of the rule it has proposed."[100] The court reasoned that, even if the SEC could not establish the average cost of the conditions because it did not know how many funds would be effected by the conditions, it could have computed the cost to an individual fund which would have allowed it to estimate the effect the new Exemptive Rules would have on efficiency, competition, and capital formation.[101] The court recognized that uncertainty limited what the SEC could do but held that the uncertainty could not excuse the SEC from apprising "itself – and hence the public and the Congress – of the economic consequences of a proposed regulation before it decides whether to adopt the measure."[102] The court found that the SEC's failure to consider the costs imposed upon funds by the new Exemptive Rules was evidence that the SEC did not properly consider the

95 *Id.*
96 *Id.*
97 *Id.* at 140.
98 *Id.* at 136.
99 *Id.* at 143.
100 *Id.*
101 *Id.* at 143–44.
102 *Id.*

conditions' effect on competition, efficiency, and capital formation.[103] As a result, the court held that the SEC had violated the APA.[104]

Although a disclosure-based alternative to the independent chairman condition was endorsed by two dissenting Commissioners, the SEC did not consider the alternative when it adopted the new Exemptive Rules.[105] The proposal would have required funds to disclose whether it had an independent or inside chairman.[106] The SEC countered the challenge by asserting that Congress had rejected a "purely disclosure-based approach" under the ICA.[107] Nevertheless, the D.C. Circuit held that the SEC had violated the APA by not considering the alternative approach.[108] The court, reasoning that just because Congress required a means other than disclosure in some circumstances does not mean that Congress would not find disclosure an appropriate tool in others, rejected the SEC's ICA argument.[109] The court also found that the ICA, contrary to the SEC's position, required many disclosures.[110] Although it conceded that the SEC was not required to consider every conceivable alternative, the D.C. Circuit highlighted the facts that two SEC Commissioners had endorsed the disclosure proposal[111] and disclosure was "a familiar tool in the Commissioner's toolkit."[112] Therefore, the SEC could not claim that disclosure was either an unknown or uncommon alternative.[113] Because the SEC failed to give adequate consideration to a significant alternative and did not properly consider the economic effects of the new Exemptive Rules, the D.C. Circuit held that the amendments to the Exemptive Rules were arbitrary and capricious.[114]

In *American Equity Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), the D.C. Circuit reviewed a challenge to a SEC regulation that made fixed indexed annuities ("FIA") subject to federal securities laws.[115] The regulation, Rule

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103 *Id.*
104 *Id.* at 144.
105 *Id.* at 144.
106 *Id.* at 144–45.
107 *Id.* at 144–45.
108 *Id.* at 144.
109 *Id.*
110 *Id.*
111 *Id.*
112 *Id.*
113 *Id.*
114 *Id.*
115 *Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 167.

151A,[116] stated that FIAs were not annuity contracts and thus precluded FIAs from fitting an exception for annuity contracts within of the Securities Act of 1933 ("Securities Act").[117] The challengers contended that the regulation was arbitrary and capricious under the APA because the SEC had not properly considered the rule's effect on efficiency, competition, and capital formation.[118] The D.C. Circuit held that it was reasonable for the SEC to interpret "annuity contract" as to exclude FIAs because "annuity contract" was ambiguous within the Securities Act.[119] However, the court ultimately vacated Rule 151A after finding the SEC's consideration of the Required Factors arbitrary and capricious.[120]

The SEC contended that the challenge to its consideration of the Required Factors was a *non sequitur* because the Securities Act did not require it to undertake a thorough analysis of the rule's effect on the factors when it promulgated Rule 151A.[121] Although the D.C. Circuit seemed to agree that the SEC was not required to undertake such an analysis, it rejected the SEC's argument.[122] The "grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based."[123] Accordingly, Rule 151A was judged based on the analysis the SEC had conducted when it promulgated the rule.[124] In its analysis, the SEC concluded that that Rule 151A would promote competition by bringing about "clarity in what has been an uncertain area of law."[125] The court found this reasoning adequate because the SEC "cannot justify the adoption of a particular rule based solely on the assertion that the existence of a rule provides greater clarity to an area that remained unclear in the absence of any rule."[126] The court explained that "[w]hatever rule the SEC chose to adopt could equally be said to

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116 Rule 151A, 17 CFR § 230.151A.

117 15 U.S.C. § 77a.

118 *Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 172.

119 *Id.* at 174.

120 *Id.* at 179.

121 *Id.* at 177.

122 *Id.* ("We must reject the SEC's argument that no error occurred because the SEC was not required by the Securities Act to conduct a § 2(b) analysis"). If the D.C. Circuit believed § 2(b) required the SEC to perform a cost-benefit analysis it likely would have stated "We reject the SEC's argument because we find that the Securities Act does require it to conduct such an analysis." However, because the court did not, and did not decide the case in such a manner, it is likely that the D.C. Circuit agreed with, or at least found reasonable, the SEC's interpretation of §2 (b) of the Securities Act of 1933.

123 *Chenery Corp.*, 318 U.S. at 87.

124 *Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 177.

125 *Id.* at 177–78.

126 *Id.*

make the previously unregulated market clearer that it would be without that adoption."[127] The court conceded that resolving the legal status of FIAs might promote competition, but regarding whether Rule 151A placed FIAs either inside or outside of the exception within the Securities Act, the SEC would have clarified this uncertain area of law.[128] The D.C. Circuit held that the Securities Act "required more than this."[129] Section 2(b) of the Securities Act did not "ask for an analysis of whether *any* rule would have an effect on competition [. . .] [r]ather it asks for an analysis of whether the specific rule will promote [. . .] competition."[130] The D.C. Circuit found that the SEC's reasoning did not support the SEC's conclusion as to the specific effects Rule 151A would have on competition.[131]

The court also found that the SEC's analysis failed because the SEC made no findings as to the level of competition in the marketplace or the level of investor protection that existed under state law.[132] When the SEC considered Rule 151A's effect on investor protection, it concluded that the rule would promote investor protection by extending "the benefits of the disclosure and sales practice protections of the federal securities laws to FIAs".[133] By imposing disclosure requirements on FIAs, the SEC believed that Rule 151A would enable investors to "make more informed investment decisions about purchasing FIAs."[134] The SEC then concluded that Rule 151A would promote efficiency, competition, and capital formation based on its belief that Rule 151A would promote investor protection.[135] The SEC stated that Rule 151A would promote efficiency by allowing investors to make better decisions.[136] The SEC asserted that Rule 151A would promote competition because better informed investors making better decisions would promote competition among FIA issuers.[137] The SEC stated that Rule 151A would also promote competition because more broker-dealers would begin selling FIAs if their regulatory status was more definite.[138] Unfortunately for the SEC, it failed to

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127 *Id.* at 178.
128 *Id.*
129 *Id.*
130 *Id.*
131 *Id.*
132 *Id.*
133 *Id.* at 172.
134 *Id.*
135 *Id.*
136 *Id.*
137 *Id.*
138 *Id.*

assess the level of competition and investor protection afforded by state law regulations already in place.[139] Additionally, the SEC had not made any findings as to the level of competition in the marketplace that existed under state law regulations.[140] The court held that the SEC could not logically conclude that Rule 151A would enhance investor protection or allow investors to make better informed decisions because it did not know what protections and disclosure requirements were already in place at the time it promulgated Rule 151A.[141] The SEC's conclusions as to the economic effects of Rule 151A were therefore invalid because the SEC had stacked its conclusions as to those factors on the conclusion that Rule 151A would enhance investor protection.[142]As a result, the D.C. Circuit held that the SEC's consideration of Rule 151A's effect on competition, efficiency, and capital formation was arbitrary and capricious under § 706(2)(A) of the APA.[143]

In *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011), the D.C Circuit reviewed a challenge to SEC Rule 14a-11,[144] a regulation the SEC issued pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act[145] of 2010 ("Dodd-Frank Act"). The Dodd-Frank Act specifically authorized the SEC to promulgate rules that would grant shareholders access to the director nominating process of publicly held corporations.[146] Rule 14a-11 required companies subject to the SEC to include the names of board candidates nominated by the shareholders in proxy materials distributed during a director election.[147] The SEC conditioned shareholders' use of Rule 14a-11 on the requirements that the shareholder or group of shareholders must provide notice to the company of its intent to use Rule 14a-11 and have held a minimum of 3% of the company's securities entitled to vote for a minimum of three years prior to the date the shareholder or group submits notice of its intent to use Rule 14a-11.[148] The nominating shareholder or group must continue to own the voting shares though the date of

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139 *Id.* at 178.
140 *Id.*
141 *Id.*
142 *Id.* at 179.
143 *Id.* at 177.
144 Rule 14a-11, 17 C.F.R. § 240.14a-11 (2011).
145 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).
146 *See id.* § 971, 124 Stat. at 1915.
147 *Bus. Roundtable*, 647 F.3d at 1146.
148 *Id.* at 1147.

the election meeting.[149] As justification for Rule 14a-11, the SEC submitted its conclusion that the rule's potential costs would be justified by the "potential benefits of improved board and company performance and shareholder value."[150] The SEC rejected an alternative that would have let a company's board or shareholders choose whether to adopt Rule 14a-11 via corporate bylaws, stating that "exclusive reliance on private ordering under State law would not be as effective and efficient" at enabling shareholders to nominate and elect directors to the board.[151] The SEC also rejected a proposal to exclude investment companies from Rule 14a-11.[152] As in *Chamber of Commerce*, 412 F.3d 133, two Commissioners dissented and voted against the rule.[153] The dissenting Commissioners criticized the SEC for failing to act "on the basis of empirical data and sound analysis."[154]

The challengers argued that the SEC had violated the APA because the SEC did not adequately "consider the rule's effect upon efficiency, competition, and capital formation."[155] The D.C. Circuit explained that it must determine whether the SEC had "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choices made."[156] The court cited *Chamber of Commerce* for the proposition that the SEC has a "statutory obligation to determine as best it can the economic implications of the rule."[157] However, the D.C. Circuit's attempt to interpret of the statute's language is little more than a restatement of the statute. Less than a paragraph later, the court noted that the SEC "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation,'" an observation which merely rephrases the Amended Standard.[158] The court explained that the SEC would be acting arbitrarily and capriciously if it failed to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation."[159]

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149 *Id.*
150 *Id.* at 1148.
151 *Id.*
152 *Id.*
153 *Id.*
154 *Id.*
155 *Id.*
156 *Id.*
157 *Id.*
158 *Id.*
159 *Id.*

The SEC anticipated that Rule 14a-11 would reduce shareholder's costs in nominating directors because it would reduce printing, postage, and advertising costs compared to the costs incurred in a "'traditional' proxy contest."[160] The SEC also predicted that Rule 14a-11 would "mitigate collective action and free-rider concerns," which might "discourage a shareholder from exercising his right to nominate a director in a traditional proxy contest".[161] The SEC concluded that eliminating such concerns would have "the potential of creating the benefit of improved board performance and enhanced shareholder value."[162] The Adopting Release for Rule 14a-11 demonstrated that the SEC also predicted the rule would impose costs on companies and shareholders in the form of preparation costs for "disclosure, printing and mailing [. . .], and additional solicitations."[163] The SEC estimated that Rule 14a-11 might also have adverse effects on company performance such as "distracting management."[164] Ultimately, the SEC concluded that Rule 14a-11 would advance the "efficiency of the economy on the whole," and the rule's costs would be justified by its benefits.[165] The SEC reasoned that although boards might be motivated to "expend significant resources to challenge shareholder director nominees", directors may find that their fiduciary duties prevent them from "using corporate funds to resist [. . .] for no good-faith purpose".[166] The SEC believed that boards may therefore just include the shareholder-nominated board candidates in the proxy materials.[167] The SEC also stated that the ownership and holding period thresholds would "limit the number of shareholder director nominations."[168] Strangely, the SEC did not estimate the costs that companies opposing shareholder nominees would incur from solicitation and campaigning.[169]

The D.C. Circuit found the SEC's assertion that directors might not choose to oppose candidates nominated by shareholders "had no basis beyond mere speculation."[170] The court found that the SEC had presented no findings that

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160 *Id.* at 1149.
161 *Id.*
162 *Id.*
163 *Id.*
164 *Id.*
165 *Id.*
166 *Id.*
167 *Id.*
168 *Id.*
169 *See id.* at 1150.
170 *Id.*

"such a forbearance is ever seen in practice."[171] Moreover, the American Bar Association explained in a comment to the SEC that "the board will be compelled by its fiduciary duty to make an appropriate effort to oppose the nominee" if the board finds the shareholder nominee to be an inferior candidate.[172] The conditions for using Rule 14a-11 were only "reason[s] to expect election contests to be infrequent; it says nothing about the amount a company will spend [. . .] when there is a contested election."[173] Even though empirical evidence of the costs was "readily available" to the SEC, it failed to estimate the possible costs of the rule to companies.[174] The SEC did not claim estimating those costs was impossible, possibly because it had access to estimates that had purportedly already computed the costs.[175] The D.C. Circuit cited the SEC's failure to "make tough choices about which of the competing estimates is most plausible, [or] to hazard a guess as to which is correct," as support for holding that the SEC had "neglected its statutory obligation to assess the economic consequences of its rule."[176]

The record did not support the SEC's conclusion regarding Rule 14a-11 improving board performance and increasing shareholder value.[177] The SEC discounted studies submitted by commentators and relied exclusively on studies that were not highly relevant and which produced results even the SEC questioned.[178] The court found the empirical evidence in the record was "mixed" at best.[179] Accordingly, the court held that the SEC had not supported a logical connection between its findings and its conclusion that increasing the chance of electing shareholder nominees would enhance company performance and shareholder value.[180] Similarly, the court regarded the SEC's failure to give serious consideration to the possibility that costs "could be imposed [. . .] from use of the rule by shareholders representing special interests," as evidence that the SEC acted arbitrarily.[181] The court found the SEC also acted arbitrarily when it weighed the costs and benefits of Rule 14a-11 because it did

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171 *Id.*
172 *Id.*
173 *Id.*
174 *Id.*
175 *See id.*
176 *Id.*
177 *Id.* at 1151.
178 *Id.*
179 *Id.*
180 *Id.*
181 *Id.* at 1152.

not assess to what extent the rule would replace traditional proxy contests.[182] The SEC was therefore without a way to determine whether Rule 14a-11 would produce the net benefit that it claimed the rule would.[183]

The D.C Circuit found the SEC's framing of the costs and benefits to shareholders to be especially arbitrary because the SEC's reasoning was "internally inconsistent."[184] The SEC predicted that the savings shareholders would receive from a reduction in costs would "remove a disincentive for shareholders to submit their own director nominations" and therefore encourage election contests.[185] For support, the SEC cited comment letters stating that the frequency of election contests might be high.[186] However, when estimating the costs imposed by Rule 14a-11, the SEC concluded that the threshold requirements would limit use of the rule.[187] Because the SEC assumed a high frequency of use when it estimated the benefits of the rule but a low frequency of use when it estimated the costs of the rule, its reasoning was "internally inconsistent."[188]

Finally, because Rule 14a-11 was "arbitrary and capricious on its face," the court held that it was invalid as applied to investment companies.[189] The court found that investment companies are subject to different requirements that provide shareholder protections not applicable to publicly traded companies.[190] Although the SEC acknowledged the protections, it neither considered whether these protections reduced the benefit to be had from applying Rule 14a-11 to investment companies nor assessed the costs Rule 14a-11 would impose on investment companies by upsetting their unique governance structures.[191] The court characterized the SEC's justification for applying the rule to investment companies as "tantamount to saying the saving grace of the rule is that it will not entail costs if it's not used, or at least not used successfully to elect a director."[192]

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182 *Id.* at 1153.
183 *Id.*
184 *Id.*
185 *Id.*
186 *Id.* at 1154.
187 *Id.*
188 *Id.*
189 *Id.*
190 *Id.*
191 *Id.*
192 *Id.* at 1156.

B. The D.C. Circuit Applied the Proper Standard of Review

The critics' argument that the D.C. Circuit has usurped the SEC's rulemaking power is primarily based on the flawed assumption that the D.C. Circuit forced the SEC to perform a CBA.[193] Critics also argue that the D.C. Circuit applied an inappropriately thorough standard of review to the SEC's reasoning.[194] However, the D.C. Circuit did not require the SEC to perform a CBA and it applied the Proper Standard of Review.[195] If the SEC performs a CBA and submits it as justification for promulgating a rule, then the rule will have to stand or fall based on the CBA.[196]

Critics properly cite *Chamber of Commerce*, 412 F.3d 133, and *Business Roundtable*, 647 F.3d 1144, as cases where the SEC may have justified its rule with reasoning not required by Congress.[197] Critics are also correct to highlight the SEC's strange behavior in *Chamber of Commerce.* In Part VIII of the adoption release reviewed in *Chamber of Commerce,* the SEC thoroughly analyzed the effects the rule would have on the Required Factors.[198] In Part VI of the release, the SEC estimated the costs and benefits of the rule.[199] Remarkably, the SEC relied not on Part VIII, but on Part VI.[200] Although the court could have viewed the strange reliance to be evidence that the SEC had acted arbitrarily and capriciously, the standard imposed by the ambiguous statute was the SEC's to interpret.[201] Because the Amended Standard could reasonably be interpreted to require a cost-benefit analysis,[202] the court was likely apprehensive to find reliance on such an analysis to be arbitrary and capricious. On the other hand, the D.C. Circuit might have read the Amended Standard to require the SEC to submit a CBA. After all, the D.C. Circuit has consistently regarded the SEC's submission of a CBA as evidence that the

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193 *See generally* Cox & Baucom, *supra* note 3, at 1828 (arguing that "the D.C. Circuit's opinions repeatedly call for cost-benefit analysis").

194 *See generally id.* (arguing that the D.C. Circuit has developed a new, inappropriate, review standard).

195 *See generally Pub. Citizen*, 374 F.3d 1209 (the agency failed to properly consider a required factor); *Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166 (the court evaluated the SEC's conclusions that its rule would provide certain benefits); *Chamber of Commerce of the United States*, 412 F.3d 133 (the SEC offered a cost-benefit analysis and the court evaluated it); *Bus. Roundtable*, 647 F.3d 1144 (the SEC offered a cost-benefit analysis and the court evaluated it).

196 *See Chenery Corp.*, 318 U.S. at 87.

197 *Id.* at 1831.

198 *Id.* at 1831–32.

199 *Id.*

200 *Id.*

201 *See generally Chevron*, 467 U.S. at 842–45.

202 *See supra* Part III.

SEC considered the Required Factors.[203] It is also entirely possible that the court believed the SEC interpreted the Amended Standard to require a CBA and found that interpretation to be reasonable. On balance, it is unlikely that the D.C. Circuit interpreted the Amended Standard to require the SEC to perform a CBA because the court has accepted both CBAs and general economic conclusions as evidence that the SEC considered the Required Factors.[204]

Critics cite *American Textile Mfrs. Inst. v. Donovan* ("*Donovan*"), 452 U.S. 490 (1981), for the narrow presumption that "Congress uses specific language when intending that an agency engage in cost-benefit analysis."[205] They interpret *Donovan* to stand for the principle that, absent "clear verbiage" conveying Congress's intent, a reviewing court may not force an agency to engage in cost-benefit analysis.[206] Regardless of the fact that *Chevron*, 467 U.S. 837, and other post-*Donovan* precedent may have weakened such a conclusion, the Critics' argument is immaterial where the agency chooses on its own to conduct a CBA.[207] Furthermore, the Critics' argument does not account for when an agency reasonably, but possibly erroneously, interprets its enabling statute to require it to conduct a cost-benefit analysis and attempts to satisfy the self-imposed standard.[208]

In an attempt to weaken the precedential strength of *Chamber of Commerce*, 412 F.3d 133, Critics argue that the decision in *Chamber of Commerce* is not in line with *State Farm*, 463 U.S. 29.[209] They argue that in *State Farm* the Court simply held that "the agency failed to provide a reasoned basis through the use of cost-benefit analysis" whereas the D.C. Circuit in *Chamber of Commerce* "expressly held that the cost-benefit approach

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[203] *See generally Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166 (rather than holding that the SEC had failed entirely to meet the Amended Standard, the court evaluated the SEC's conclusions as to the economic effects of its proposed rule); *Chamber of Commerce of the United States*, 412 F.3d 133 (rather than holding that the SEC had failed entirely to meet the Amended Standard, the court evaluated the SEC's cost-benefit analysis); *Bus. Roundtable*, 647 F.3d 1144 (the court evaluated the SEC's cost-benefit analysis).

[204] *Compare Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166 (the court evaluated the SEC's conclusions that its rule would provide certain benefits), *with Chamber of Commerce of the United States*, 412 F.3d 133 (the SEC offered a cost-benefit analysis and the court evaluated it), *and Bus. Roundtable*, 647 F.3d 1144 (the SEC offered a cost-benefit analysis and the court evaluated it).

[205] Am. Textile Manufacturers Institute, Inc. v. Donovan, 452 U.S. 490, 510–11 (1981).

[206] *See* Cox & Baucom, *supra* note 3, at 1829.

[207] *See Chenery Corp.*, 318 U.S. at 87 (the "grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based").

[208] *See generally Chevron*, 467 U.S. 837 (an agency is afforded a high level of deference when it interprets its enabling statute).

[209] *See* Cox & Baucom, *supra* note 3, at 1832.

underlaid the Review Standard."[210] Had the D.C. Circuit done so in *Chamber of Commerce*, the Critics might be correct. However, in *Chamber of Commerce* the D.C. Circuit merely held that the cost-benefit analysis the SEC used to justify its rule was incomplete.[211] Consequently, *Chamber of Commerce* comports with *State Farm.* A court must resolve a challenge to agency action based on the reasoning the agency submitted at the time it performed the challenged action.[212] If a CBA formed even part of the SEC's justification for adopting a rule, *State Farm* requires the reviewing court to consider the CBA when judging the validity of the rule.[213] Not only did the SEC perform a CBA as part of adopting the rule at issue in *Chamber of Commerce*, but it also explicitly relied on the CBA in the adopting release.[214] The D.C. Circuit was therefore following *State Farm* when it analyzed the CBA submitted by the SEC.[215] Yet, as Critics are correct to point out, the SEC could have limited the scope of judicial review and stood on much better ground had it not relied on the CBA.[216] *Chamber of Commerce* is also similar to *State Farm* in that the SEC's failure to consider "a familiar tool in the Commission's tool kit" is similar to the NHTSA's failure to consider an airbag-only option.[217]

In another attempt to weaken the precedent relied on by the D.C. Circuit, Critics argue that *Public Citizen*, 374 F.3d 1209, was used inappropriately by the D.C. Circuit in the cases at issue.[218] *Public Citizen* forms the basis for *Chamber of Commerce*, 412 F.3d 133 (D.C. Cir. 2005), which in turn was heavily relied on in *Business Roundtable*, 647 F.3d 1144, 1153 (D.C. Cir. 2011), and *American Equity*, 613 F.3d 166 (D.C. Cir. 2010).[219] Critics

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210 *Id.*

211 *See Chamber of Commerce of the United States*, 412 F.3d at 143.

212 *See Chenery Corp.*, 318 U.S. at 95.

213 *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43 (holding that a reviewing court must determine whether the agency based its decision on a consideration the relevant factors and articulated a logical explanation for its decision).

214 *See* Investment Company Governance, Investment Company Act Release No. 26,520, 69 Fed. Reg. 46,378, 46,386–87, 46,388–89 (Aug. 2, 2004) (codified at 17 C.F.R. pt. 270) (using a cost-benefit analysis to justify the rule); *see also Chamber of Commerce of the United States*, 412 F.3d at 144.

215 *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43 (requiring a reviewing court to determine whether the agency articulated "rational connection between the facts found and the decision made").

216 *See* Cox & Baucom, *supra* note 3, at 1832.

217 *Compare Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 51("an alternative within the ambit of the existing standard"), *with Chamber of Commerce of the United States*, 412 F.3d at 144 ("a familiar tool in the Commission's toolkit").

218 *See* Cox & Baucom, *supra* note 3 at 1826–28.

219 *Compare Pub. Citizen*, 374 F.3d 1209 (finding that the agency acted arbitrarily and capriciously because it failed entirely to consider a required factor), *and Chamber of Commerce of the United States*, 412

endeavor to distinguish *Public Citizen* from *Chamber of Commerce* on the grounds that the review standards imposed by the statutes in the cases were different.[220] However, the APA is not statute-specific.[221] The differences between the statutes at issue in *Public Citizen* and *Chamber of Commerce* were irrelevant when the D.C. Circuit cited *Public Citizen* for the principle that a rule is arbitrary and capricious if the agency fails to consider the factors its organic statute requires it to consider.[222] Critics also argue that the D.C. Circuit inappropriately relied on *Public Citizen* because the agency in that case failed entirely to consider a required factor whereas in *Chamber of Commerce*, 412 F.3d 133, the SEC made an attempt to consider each factor.[223] This difference in effort is inconsequential. If anything, the effort differential only supports the obvious conclusion that it is easier for a court to hold that an agency action is arbitrary and capricious when an agency failed entirely to consider a factor than when it incompletely considers a factor. Indeed, where a court finds an attempt to consider every factor it must determine whether that attempt was adequate but where a court finds that an agency failed entirely to consider a factor it can end its inquiry there.

Although Critics cite the D.C. Circuit's use of the verb "determine" rather than "consider" in *Chamber of Commerce*, 412 F.3d 133, as evidence of the court going against Congress, the court's subsequent use of "determine" suggests the court was not imposing a higher standard upon the SEC than Congress required.[224] The D.C. Circuit explained in *Business Roundtable*, 647 F.3d 1144, that the SEC "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation.'"[225] The fear that the D.C. Circuit's use of "determine" established a higher standard of review than "consider" might require is undermined by the court's note in *Chamber of Commerce* stating that all it would require from the SEC is a guess

F.3d 133 (relying on *Pub. Citizen* to find that the SEC acted arbitrarily and capriciously because it failed to properly consider the Required Factors), *with Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166 (relying on *Chamber of Commerce* to find that the SEC acted arbitrarily and capriciously because it failed to properly consider the Required Factors), *and Bus. Roundtable*, 647 F.3d 1144 (relying on *Chamber of Commerce* to find that the SEC acted arbitrarily and capriciously because it failed to properly consider the Required Factors).

220 *See* Cox & Baucom, *supra* note 3, at 1826–28.

221 *See generally* Administrative Procedure Act, 79 P.L. 404, 60 Stat. 237 (1946) (applying to agencies unless Congress legislates otherwise).

222 *Compare Pub. Citizen*, 374 F.3d 1209 (the agency acted arbitrarily and capriciously because it failed to consider a required factor), *with Chamber of Commerce of the United States*, 412 F.3d 133 (the agency acted arbitrarily and capriciously because it failed to adequately consider required factors).

223 *See* Cox & Baucom, *supra* note 3, at 1826–28.

224 *Chamber of Commerce of the United States*, 412 F.3d at 143.

225 *Bus. Roundtable*, 647 F.3d at 115, 1148.

as to which is estimate is correct.[226] If using "determine" and "consider" interchangeably suggests anything other than that they are synonyms in common parlance, it is that the D.C. Circuit found the Amended Standard to be ambiguous. Although the D.C. Circuit could have been more careful with its choice in words, it did not attempt to interpret the ambiguity stemming from the verb "consider."[227] Regardless, the SEC precluded the court from reaching this issue in the cases because it submitted a CBA for each rule challenged.[228] The substance of the court's review suggests that the D.C. Circuit found the Amended Standard to be ambiguous on its face and thus deferred to the SEC's interpretation of what the Amended Standard required of it.[229] If the court deferred, and the court's actions are proof that it did, it likely took the SEC's repeated submissions of CBAs as an indication that the SEC interpreted the Amended Standard to require it to perform such analyses.[230]

The Critics favorably state that *American Equity*, 613 F.3d 166, may be the closest the D.C. Circuit has come to administering the Proper Standard of Review because in *American Equity* the court did not focus on "costs and benefits".[231] However, this is not evidence of a different review standard or the court restricting itself.[232] The reason the court did not analyze costs and benefits in deciding the case was because the SEC did not justify the rule at issue with a CBA.[233] Instead, the SEC came the closest here to using Chevron Deference by making legal conclusions about the rule's effects on the Required Factors.[234] Critics claim that *American Equity* is on better footing than the other D.C. Circuit cases because it "better adhered to the hard-look standards from State Farm and . . . the APA."[235] It is interesting then that Critics seek to undermine *American Equity.* Critics attempt to differentiate *American Equity* from *State Farm*, 463 U.S. 29, on the grounds that the statute in *State Farm*

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226 *See Chamber of Commerce of the United States*, 412 F.3d at 143.

227 *See id.* (the court restated the Amended Standard as it appeared in the NSMIA without attempting to interpret the language for itself).

228 *See Chenery Corp.*, 318 U.S. at 87 (the "grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based").

229 *See generally Chamber of Commerce of the United States*, 412 F.3d 133 (evaluating the justification the SEC provided without questioning if the Amended Standard required such an analysis).

230 *Id.*

231 Cox & Baucom, *supra* note 3, at 1829.

232 *See Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 177 (the SEC justified its ruling by simply concluding as to its effects on the factors without resorting a CBA).

233 *Id.*

234 *Id.*

235 Cox & Baucom, *supra* note 3, at 1829–30.

"specified the universe of data [the agency] must consider."[236] Critics again miss the mark. Both the statute at issue in *State Farm* and the statute at issue in *American Equity* required the respective agencies to consider relevant factors.[237] In both *American Equity* and in *State Farm*, the agencies lost by failing to adequately consider the relevant factors.[238] Just because the statute in *State Farm* specified the data that the agency must consider in addition to the factors does not differentiate that case from *American Equity.*

Contrary to the Critics' view, *Business Roundtable*, 647 F.3d 1144, did not require the SEC to perform a CBA or require the CBA to yield a net benefit.[239] The court examined the SEC's CBA because the agency relied on it to support its conclusion that Rule 14a-11 provided a net benefit.[240] If the SEC interprets the statute to require it to conduct a CBA and accordingly submits a CBA as part of its justification for promulgating a rule, *State Farm* commands the reviewing court to analyze the CBA.[241] Similarly, if the SEC does not interpret the statute to require it to perform a CBA but does one anyway, the reviewing court will analyze the CBA.[242] In *Business Roundtable* the court did not require the SEC to conclude that a rule would produce a net benefit.[243] Nevertheless, the SEC justified promulgating Rule 14a-11 by concluding that the rule produced a net benefit.[244] As a result, *State Farm* required the D.C. Circuit to ensure that the SEC articulated a logical connection between its findings and its conclusion that Rule 14a-11 produced a net benefit.[245] The SEC therefore suffered defeat not as a result of the D.C. Circuit usurping its rulemaking power, but because the SEC could not support its conclusions.

The Critics consider it "anomalous" that a large portion of the opinion in *Business Roundtable* involved the SEC's inability to justify shareholder access

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236 *Id.*

237 *Compare Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 172, *with Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 33.

238 *Compare Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 177–78 (holding only that "the SEC must defend its analysis before the court upon the basis it employed in adopting that analysis"), *with Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 46.

239 *See Bus. Roundtable*, 647 F.3d at 1148 (the SEC concluded that the benefits of the rule at issue could outweigh the costs of the rule).

240 *Id.*

241 *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43; *see also Chevron*, 467 U.S. at 843.

242 *Id.*

243 *See Bus. Roundtable*, 647 F.3d at 1148 (evaluating the SEC's cost-benefit analysis because the SEC justified promulgating the rule at issue with the CBA).

244 *See Bus. Roundtable*, 647 F.3d at 1153.

245 *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

to the nominating process because Congress "took the big policy issue, proxy access, off the table."[246] Here again, the Critics' narrow focus on the statutes at issue in the cases caused them to miss the Proper Standard of Review. The reason the court did not concentrate on the specific conditions was because the petitioner did not challenge the conditions.[247] The challenger established the scope of review when it contended that the decision to require shareholder access was arbitrary and capricious in light of the SEC's findings.[248] It is not the D.C. Circuit's responsibility to provide the challenger an argument different than the one advanced. The Dodd-Frank Act stated that the SEC "may include" a requirement in its rules that shareholders be given access to the nominating process.[249] The words "may include" suggest Congress recognized that shareholder access might not be appropriate in all circumstances. Congress left the decision to the SEC as to which circumstances, if any, necessitate shareholder access.[250] Consequently, *State Farm* required the SEC to establish a logical connection between its findings and its decision to exercise its discretion to require shareholder access.[251]

On the whole, the Critics' assertion that the D.C. Circuit's decisions have "invited a judicially contrived mandate for the SEC to rigorously set forth the case that the perceived benefits exceed the estimated costs"[252] entirely misses the court's reasoning in the above cases. The D.C. Circuit did not hold that the challenged rules were arbitrary and capricious because they failed to produce a net benefit.[253] The court held that the rules were arbitrary and capricious because the SEC failed to support its conclusions as to the rules' respective effects.[254] The court has only required that the SEC articulate a logical connection between its findings and its actions.[255]

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246 Cox & Baucom, *supra* note 3, at 1836.

247 *See Bus. Roundtable*, 647 F.3d at 1146 ("The petitioners argue the [SEC] promulgated the rule in violation of the [APA] because . . . the [SEC] failed adequately to consider the rule's effect upon efficiency, competition, and capital formation").

248 *See id.*

249 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, § 971, 124 Stat. at 1915.

250 *See generally id.*

251 *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

252 Cox & Baucom, *supra* note 3, at 1834.

253 *See generally Pub. Citizen*, 374 F.3d 1209; *Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166; *Chamber of Commerce of the United States*, 412 F.3d 133; *Bus. Roundtable*, 647 F.3d 1144.

254 *Id.*

255 *Id.*

CONCLUSION

With the Amended Standard, Congress created an ambiguous review standard open to interpretation by the SEC.[256] Under a Chevron Analysis the SEC has the authority to control the scope of judicial review by offering a reasonable interpretation of the ambiguous language.[257] Regardless of whether the statute specifically requires the SEC to perform a thorough cost-benefit analysis, and it most likely does not, the SEC continually submitted CBAs as justifications for its rules.[258] The Critics argue that the D.C. Circuit should "accord the regulatory agency deference on such indefinite, speculative, and arcane considerations, since judicial review of such a matter is beyond the court's core competency."[259] Judicial deference based on agency expertise is warranted when an agency applies its expertise to technical issues. However, an agency should not escape review where it fails to apply its expertise simply because it finds its task to be problematic. Furthermore, while reviewing technical aspects of agency actions may be beyond a court's core competency, determining whether an agency articulated a "rational connection between the facts found and the choice made" is not.[260]

As a final matter, the SEC's inability to use Chevron Deference to control the scope of judicial review counsels against granting it any special latitude.[261] If the SEC conducts a CBA and relies upon it for justification of an action, the court must analyze it.[262] The D.C. Circuit's opinions may encourage the SEC to assert its agency authority by retreating to legal conclusions which are at best no better than its inadequate empirical conclusions.[263] Yet, that result does

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256 *See supra* Part III.

257 *See supra* Part II.

258 *See generally Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166; *Chamber of Commerce of the United States*, 412 F.3d 133; *Bus. Roundtable*, 647 F.3d 1144.

259 *Id.*

260 *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

261 *See generally Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166; *Chamber of Commerce of the United States*, 412 F.3d 133; *Bus. Roundtable*, 647 F.3d 1144 (in each case, the SEC failed to structure its arguments to activate *Chevron* Deference).

262 *See Chenery Corp.*, 318 U.S. at 87 (the "grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based").

263 *See supra* Part IV.

not make the decisions any less correct. After all, the judiciary's role is "to say what the law is," not what it should be.[264]

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[264] *See* Marbury v. Madison, 5 U.S. 137 (1803) ("It is emphatically the province and duty of the judicial department to say what the law is").

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