Iterative Regulation of Securities Markets after Business Roundtable:

A Principles-Based Approach

James D. Cox
Duke University

It is hard to believe there is an SEC regulation that has had greater impact than the anti-fraud provision, Rule 10b-5. The provision broadly proscribes any material misrepresentation or omission in connection with the purchase or sale of a security by any means or instrumentality of interstate commerce.\(^1\) Due to its breadth, its impact is ubiquitous, stretching to include garden variety misrepresentations,\(^2\) broker misappropriation of customer funds,\(^3\) pump-and-dump schemes,\(^4\) failures to update public announcements,\(^5\) misstatements in proxy statements,\(^6\) and, of course, inside trading.\(^7\) Ambiguity regarding the rule’s key components, such as what is a misrepresentation,\(^8\) what is material,\(^9\) and what facts establish the requisite scienter,\(^10\) are generally fact-specific so that the rule’s scope is inherently ambiguous with the effect that fear of a potential violation elicits a good deal of precautionary behavior, especially for the more risk averse. Those who engage in securities-related transactions have genuine cause to fear that a disclosure gaff in connection with a business transaction could visit uncertainty, delay and liability. Caution is further underscored by the reality that, not only are violations of Rule 10b-5 subject to enforcement efforts by the world’s best funded securities regulator, but more significantly private enforcement actions also exist.

Students of the history of Rule 10b-5 are well aware of the casualness by which the antifraud provision came into existence:


\(^2\) See e.g., Dupuy v. Dupuy, 511 F.2d 641 (5th Cir. 1975)(misrepresentation committed in face-to-face dealings between family members of non-public company).

\(^3\) See e.g., SEC v. Zandford, 535 U.S. 813 (2002)(client was “duped into believing” his funds were being invested conservatively when in fact the broker was engaged in a systematic embezzling funds generated by sales).


\(^5\) See e.g., Weiner v. Quaker Oats Co., 129 F.3d 310 (3d Cir. 1997)(pending acquisition necessitated duty to update regarding earlier stated policy regarding debt-equity ratios the company sought to maintain).

\(^6\) See e.g., Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir. 1967).

\(^7\) See text and authorities at notes to , infra.

\(^8\) See e.g., The Wharf (Holdings) Limited v. United Int’l Holdings, Inc., 532 U.S. 588 (2001)(rejecting argument that omission not a misrepresentation within scope of act because it did not involve the value of an underlying security).

\(^9\) See e.g., Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011)(drug’s possible danger to its users can be material despite the absence of statistically significant study indicating harm).

\(^{10}\)
I went to work one day in May, 1942, and I did my normal job as an Assistant Solicitor of the SEC. Somebody called me and said there is something wrong going on in Boston (a company president was buying in shares from his own shareholders without telling them of much improved earnings). He asked what we could do about it. I wasted no time; I got some people in, we drafted a rule, we presented it to the Commission, and, without any hesitation, the Commission tossed the paper on the table saying they were in favor of it. One Commission member said, "Well, we're against fraud, aren't we?" So, before the sun was down, we had the rule that is now Rule 10b-5.\textsuperscript{11}

The casualness with which Rule 10b-5 was adopted reflects the very different regulatory era that existed in 1942; there was no Administrative Procedure Act. In contrast, presently agency rulemaking is conditioned not only on providing notice and opportunity for affected parties to comment, but that rulemaking must not on review be arbitrary or capricious.\textsuperscript{12} Certainly the former was lacking for Rule 10b-5 and we can only surmise, but with good cause for such surmise, the outcome with respect to the latter. If concern for the APA were not sufficient, then today’s 900 pound Gorilla in the rulemaking room is Business Roundtable.\textsuperscript{13} In a decision that likely ranks as the most significant decision in the history of the SEC, the DC Circuit struck down the SEC’s adoption of a Rule 14a-11 that provided very limited rights of shareholders of reporting companies to nominate directors.\textsuperscript{14} In adopting the rule, the SEC was acting pursuant to the then recently enacted Dodd-Frank granting it express power to adopt a rule providing shareholders authority to nominate directors,\textsuperscript{15} the benefits of providing such access to shareholders had been a topic the SEC had studied for several years.\textsuperscript{16}

Thus, looking back on the rainy afternoon, during far simpler times, when Rule 10b-5 was adopted, we might well conclude that Rule 10b-5 could never be adopted within the contemporary legal landscape. But, is this necessarily so? This article closely examines the limits of Business Roundtable and more specifically sets forth one strategy that can be pursued in the present regulatory climate in which cost-benefit analysis, although controversial, if not problematic, cannot presently be ignored.


\textsuperscript{12} Administrative Procedure Act, 5 U.S.C. § 706(2)(A)(setting forth a general review standard of “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law”).

\textsuperscript{13} Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

\textsuperscript{14} The basic requirement was that nominations were limited to those (individually or collectively) that had held 3 percent of the voting shares for 3 years; such a holder(s) could nominate no more than one-fourth of the board seats and the provision could not be used by a holder seeking to change control or to gain a number of board positions in excess of the maximum permitted by the rule. 17 C.F.R. § 240.14a-11(b)(1)(2010)


\textsuperscript{16} See e.g., Staff of the U.S. Securities and Exchange Commission Report, Review of the Proxy Process Regarding the Nomination and Election of Directors (July 15, 2003). Points that were not acknowledge and therefore not considered in Business Roundtable was the weight, if any, to be given to the fact the SEC had for several years studied the question of shareholder access and, more fundamentally, that after such SEC consideration the Congress amended the Securities Exchange Act to confer on the SEC authority for rules providing such access.
I. The Read of the Cost-Benefit Green for SEC Rulemaking

*Business Roundtable* dramatically changed the regulatory gauntlet for the SEC. The historical irony is that this occurred over a matter that would have trivial effect on business\(^\text{17}\) so that the ultimate irony is that a case that chastised the SEC for failing to consider cost-benefit on close analysis in reality had little of each.

For several years, under pressure from the institutional investor community, the SEC had considered the desirability of amending the proxy rules to provide limited access to the nominating process for directors of reporting companies. The SEC did not act, however, largely because any rule would confront an earlier D.C. Circuit opinion, also brought by the Business Roundtable, holding that Exchange Act Section 14 did not authorize the SEC to impose a one-share one-vote requirement.\(^\text{18}\) Among the provisions included in the historic Dodd-Frank Act was the authority for the SEC to prescribe the procedure and conditions for such access. With lightening-like speed, the SEC adopted Rule 14a-11 that included a set of conditions\(^\text{19}\) that must be met for shareholder access. The conditions were such that the final rule was believed so narrow that not more than a handful of public companies in any year would be subject to shareholders invoking it.\(^\text{20}\) It was over this mouse that the lion-like *Business Roundtable* opinion roared, and with such ferocity, that the resulting holding impacts and retards, and in some instances likely paralyzes, SEC regulatory activity. Thus, the visible kill of the predatory business interests was small indeed, but it set the table for those interests to later enjoy multiple future feasts.

The *Business Roundtable* decision is a model of injudicious decisionmaking.\(^\text{21}\) First, at no point in his decision did Judge Ginsburg acknowledge that Dodd-Frank expressly authorized the SEC to provide rules for shareholder access to the proxy nominating process. The opinion frames the issue before the court on the propriety of an SEC rule providing shareholder access to the nominating process; *Business Roundtable* did not focus on the specific conditions set forth in Rule 14a-11 that must be satisfied in order for a shareholder to invoke the benefits of the rule. Because Congress clearly empowered the SEC to exercise its administrative expertise to develop

---

\(^{17}\) The sources of the rule’s weaknesses were conditioning its application on the proponent or proponents being holders of 3 percent of the outstanding voting shares and then limiting nominations to no more than one-fourth of the total board seats. For a close analysis of the inconsequential effects of the ill-fated Rule 14a-11, see Marcel Kahan & Edward Rock, The Insignificance of Proxy Access, 97 Va. L. Rev. 1347 (2011).


\(^{19}\) Former Rule 14a-11, adopted SEC, Facilitating Shareholder Director Nominations, Securities Act Rel. No. 9136 (Aug. 25, 2010)(among other limitations, conditioned the rule on the proponent holding 3% or more of a reporting company’s voting stock for at least 3 years to nominate only a small number of directors).

\(^{20}\) See Marcel Kahan & Edward Rock, The Insignificance of Proxy Access, 97 Va. L. Rev. 1347, 1420-1426 (2011)(close analysis of available data to conclude that the rule would have led to few actual nominations and those so nominated would likely be defeated).

\(^{21}\) It is not the purpose of this article to set forth the multiple failings of *Business Roundtable*. A close examination of Judge Ginsburg errors appears in 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 (2012). The focus here is to develop one approach, among many, that can be pursued not only to address *Business Roundtable* but to meet the ever-widening crowd of academics, policymakers, and practitioners who call regulatory initiatives have more empirical support of expected costs and related benefits believed to flow from the rule being proposed.
the process, it was unnecessary and inappropriate for the court to reconsider that policy issue.\textsuperscript{22} Congress, by expressly providing the SEC with authority to craft a rule providing access, took the general question off the table. That is, the DC Circuit had no greater authority to question this issue than it would have had if a challenge were made regarding whether the bidder in a tender offer must disclose certain information prior to making its bid for shares.\textsuperscript{23}

By not addressing the fact that Congress expressly empowered the SEC to issue rules providing shareholder access to the nomination process Business Roundtable overlooks a critical distinction between the 2011 Business Roundtable decision and the 1990 Business Roundtable decision where the D.C. Circuit struck down the SEC’s effort to mandated a one-share, one-vote for many public companies. The earlier Business Roundtable decision was an instance that would have expanded the SEC’s jurisdiction regarding the organic voting power of publicly traded shares; heretofore, this was a matter solely of state concern so that this became one of the grounds for declaring the SEC’s regulation of super-voting shares an invalid exercise of power under Section 14 of the Exchange Act. As pointed out by a fellow contributor to this symposium, a hard look is much more justified in instances in which the effect of a rule is expanding an agency’s turf.\textsuperscript{24} In contrast, the proxy access rule was preceded by an extension of the SEC’s authority by Congress; it was not the SEC engaging alone to push regulation into a heretofore state-dominated area.

Thus, the court’s focus should have been on the SEC’s exercise of its regulatory power in establishing the conditions for such access. Indeed, the court studiously avoided even quoting the rule, let alone considering the benefits or burdens of each condition or the conditions collectively. Because the grant of authority to the SEC is clear and unequivocal,\textsuperscript{25} the focus of

\textsuperscript{22} Cf. Nat’l Assoc. of Mfgs. V. SEC, 748 F.3d 359, \textsuperscript{23} See Exchange Act Section 14(d)(1), 15 U.S.C. § 78n(d)(1) (parallel to Section 14(a), making it unlawful for commencement of certain tender offers without first filing information SEC had authority to require in connection with the conduct of such tender offer).

\textsuperscript{24} Professor John Coates in this symposium persuasively makes the case that “hard look” review is especially justified as a means to address agency “empire-building” which occurs when agency’s launch into heretofore unregulated areas, such as proxy access. See John C. Coates IV, Towards Better Cost-Benefit Analysis: An Essay On Regulatory Management, ___ Law and Contemp. Prob. ___ (2015). Professor Coates, while appearing to place proxy access into the “jurisdiction-expansion” realm for which heightened scrutiny is justified does not consider in his analysis that Congress had empowered the SEC to enter this new area. Indeed, proxy access after Dodd-Frank appears consistent with Professor Coates’ analysis of the SEC’s actions regarding auditor assessment of management’s internal control certifications post the enactment of Sarbanes-Oxley Act Section 404 mandating such assessments. Id. at ___.

\textsuperscript{25} There may have been some room for Judge Douglas Ginsburg’s approach had Congress broadly empowered the SEC with authority “necessary and appropriate to enhance the role of shareholders in the election of directors.” In that case, the broader inquiry into whether, among other alternatives (e.g., instead of the state statutory norm that director election occur by receipt of a plurality vote that directors not be elected unless they receive a majority of the votes cast), a rule providing shareholders the means to nominate directors could be open for discussion along the line taken in Business Roundtable. Such consideration would be necessary to evaluate the choice, among many it could have taken, the SEC took to act within the Congressional authority “to enhance the role of shareholders in the election of directors.” In contrast, Congress in Dodd-Frank narrowed the focus to
review should have been on the Commission’s exercise of that authority in terms of the procedure, conditions, and resulting rights flowing from the rule. Because Business Roundtable did not focus its review on how the SEC implemented the authority granted it by Dodd-Frank, the opinion is little less than a harangue on agency excess.

The most troubling feature of Business Roundtable is it ignores the clear meaning of the congressionally established review standards for SEC rulemaking and clear import of the legislative intent behind the review standards. The applicable review standard for SEC rules provides that when “engaged in rulemaking” the SEC “is required to consider or determine whether an action is necessary or appropriate in the public interest” and “also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”26 Business Roundtable’s held the SEC acted arbitrarily by failing to weigh costs and benefits in connection with the “efficiency, competition and capital formation.”27 Judge Douglas Ginsburg would have benefited had he considered the source, and ultimately the meaning, of the quoted review standard. This portion of the review standard was added in 1996 laws by the National Securities Markets Improvement Act (NSMIA) to three of the four securities.28 The decision’s error, however, is that the review standard does not require with respect to any of these criterion that the SEC determine or find that the adopted rule would “promote efficiency, competition, and capital formation;” instead, the review standard required only that the SEC consider the rule’s effect in each of these areas. The SEC did so consider, in fact, as discussed earlier, the SEC had been considering for years the benefits of providing shareholder access to the nominating process for directors. Nonetheless, the D.C. Circuit did not believe those efforts were not with the acuity and precision the court believed necessary. At several locations the opinion references assessments of costs and benefits.29 Various committee reports leading to Congress’ enacted of the “promote efficiency, competition and capital formation” criteria, while referencing the desirability of cost-benefit analysis in SEC rulemaking, nevertheless clearly rejected cost-benefit analysis as a formal standard. For example, cost-benefit analysis was included in the Senate’s version of the legislation; the Senate’s version, however, was not carried forward into NSMIA.30 Moreover, in 1999, when Congress ultimately extended the “promote efficiency, competition, and capital formation” to the Investment Advisers Act, in the same legislation it amended the Commodity Futures Trading Act with very different

---


28 For a close analysis of how the legislative history and more particularly the language employed by Congress in introducing in 1996 the expanded review criteria do not support Judge Ginsburg’s reasoning, 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 (2012).

29 See e.g., 647 F.3d at 1150 (faulting SEC as it failed “to estimate and quantify the costs it expected companies to incur”) Id. at 1153 (rebuking the SEC for failing “in weighing the costs and benefits” to consider the extent the new rule would “take the place of traditional proxy contests”).

30 See Cox & Baucom, note _ supra at 1819-1820 (recounting how in the legislative efforts leading to the 1996 broadening of the SEC’s review standards the Senate’s effort was initially embodied in Senate Bill 1815 that clearly demanded cost-benefit analysis; but this requirement vanished after the competing House and Senate bills were reconciled in conference).
language that unquestionably called for cost-benefit analysis to support regulatory actions by the Commodity Futures Trading Commission. As important as these considerations are they were considered not part of the Judge Ginsburg’s reasoning in Business Roundtable.

We therefore should conclude that Business Roundtable rests on very problematic grounds. Nonetheless, that decision and other precedents that lurk within the SEC rulemaking jurisprudence, and more generally throughout contemporaneous regulatory setting, have the following operative impact: “hard look” review compels agencies such as the SEC to undertake efforts at precision and acuity that are indistinguishable from rigorous cost-benefit. Business Roundtable gives testament that this is a high standard, fraught with the potential for second guessing by judiciary, and more so by a panel hostile to the broad objectives Congress sought to advance by empower the agency to act.

II. Correlation vs Causation

Despite the multiple grounds for believing Business Roundtable was wrongly decided and that cost-benefit analysis is not required for SEC rulemaking, regulators should nonetheless appreciate that formulation of sound policy requires a process that at least mimics that of cost-benefit analysis. Among the objectives of this message is that the agency should seek when proposing a rule to include among its inputs systematic and transparent efforts to minimize its burdens and maximizing its benefits. Moreover, the contemporary political climate clearly anticipates that regulators will reduce regulatory burdens relative to the benefits sought. Thus, the scorching rhetoric of Business Roundtable houses a truism that a close assessment of the costs and benefits matter a good deal in the sound formulation of policy.

The challenge for the SEC in meeting this expectation is perhaps greater than that faced by sister agencies where benefits are not only somewhat easier to measure and value but also the costs and benefits are easier to associate with the regulatory change. To illustrate, consider the complaint that the Sarbanes-Oxley Act of 2002 reduced IPOs, drove foreign issuers away from U.S. capital markets, and caused domestic companies to go private or dark (and thereby avoid increased regulation that SOX imposed on reporting companies). Each of these correlates to some degree with the enactment of SOX. But if this were the test, then as was stated years ago in connection with an observation that older men were frequent patrons of burlesque shows, burlesque causes baldness.

To be sure, there was indeed a spike up in going private and dark in the years surrounding SOX’s enactment. But it was also a time when interest rates began to decline so that

---

32 See John C. Coates, IV, Cost-Benefit Analysis of Financial Regulation, _ Yale L. J._ (forthcoming 2015)(arguing that financial regulation poses unique degrees of complexity due to their constructed and integrated nature that renders cost-benefit analysis problematic); Jeffrey N. Gordon, The Empty Call for Cost-Benefit Analysis in Financial Regulation, working paper, (Dec. 24, 2013)(describing finance as a constructed system due to its existence being the product of financial regulation so that necessarily changes in the regulatory quilt produces a very different system that are harder to foresee than in more scientifically bound systems from which cost-benefit analysis has sprung, albeit with questionable predictive results).
restructuring and particularly private equity was not just profitable but thrived. To isolate causality between SOX and the reduction in the number of reporting companies necessarily requires simultaneously isolating the effects of lower interest rates on the behavior of investment bankers seeking high returns through financial engineering. For example, the causal connection to SOX is greatly reduced by evidence that during this same period buyouts were occurring at about same pace in the U.K.-beyond the reach of SOX. In addition to falling interest rates, a further conflicting variable is the exuberance of the earlier .Com market. The hot IPO market of the late 1990s is now understood to have prompted many companies to go public only to retreat when markets and their share prices collapsed in 2002, raising the question whether continued public status was worth the commensurate burdens.

Recently, Professors John Coates and Suraj Srinivasan provide an insightful assessment of the extensive empirical research on SOX’s impact. The studies they review, while measuring the consequences of congressional initiatives that regulators reflected in their own regulations, nonetheless reflect the above concern: direct costs associated with a regulatory initiative are much easier to identify and measure than it is to identify and measure an initiative’s benefits or indirect costs. To illustrate this point, consider the most controversial provision of SOX, the infamous Section 404(b) which calls for auditors to attest to management’s certification with respect to whether material deficiencies exist in the firm’s internal controls.

Section 404(b) quickly became the lightning rod for business outcry against SOX. Whereas the SEC estimated average compliance cost per issuer of $91,000, experience gathered from a sample of Fortune 1000 companies reported average costs to comply with the internal control requirement was $5.9 million. The Section 404(b) compliance costs were significantly greater in the initial years than in later years reflecting a combination of deferred maintenance on reporting systems, a costly learning curve by both auditors and their clients, and open-ending directive issued by the Public Company Accounting Standards Board that had been established by SOX to establish auditing standards and procedures for public companies. Particularly disquieting was that available data reflected that compliance with Section 404(b) disproportionately burdened smaller issuers; issuers with a market capitalization less than $75


34 John C. Coates & Suraj Srinivasan, SOX after Ten Years: A Multidisciplinary Review


36 Charles River Assoc., Sarbanes-Oxley Section 404 Costs and Remediation of Deficiencies: Estimates From a Sample of Fortune 1000 Companies (Apr. 2005).

37 GAO, Sarbanes-Oxley Act, Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies, 16 Fig. 1 & Tbl. 4 (GAO-06-361 (Apr. 2006); Financial Executives International Annual Survey and The 404 Cost Study (Sept. 2009)(companies with revenues exceeding $5 billion spent 0.06% oe their revenues on SOX compliance whereas companies with less than $100 million in revenue spent2.55 % (In 2004 these costs represented about 40% of total audit fees, but declined to 32.5 % in 2007).

million reported costs to implement the internal controls requirement represented 1.14 percent of annual revenues in 2003 and 2004, whereas firms with a market capitalization above $1 billion incurred compliance cost that represented 0.13 percent of revenues.\textsuperscript{39} Thus, the costs of implementing the new reporting requirement were substantial and not well estimated by the adopting agency.\textsuperscript{40}

The calculus on Section 404(b)’s benefits is more positive; but after all, this characteristic is the nature of benefits. However ex ante as well as ex post the benefits were neither easily estimated or easily measureable. For example, financial restatements that were rising in the years immediately preceding SOX accelerated in the post-SOX years, peaking in 2006 and declining thereafter. The decline was as steep as the disturbing rise in restatements.\textsuperscript{41} Restatements document the error of earlier reports so that their presence can reflect weaknesses in earlier reporting systems so that a reduced number of restatements can be thought to be the result of improved reporting. Even if this thesis is accepted, so that the frequency of restatements is reflection of improvement in financial reporting, the case for the benefits of Section 404(b) remains problematic. Because restatements were on the rise prior to SOX’s enactment, it could be argued that implementation of Section 404(b) was without causal affect. To be sure, restatements accelerated after Section 404(b) went into effect, but we might believe that the forces that stimulated discovery of restatements prior to the implementation of Section 404(b) gathered strength over time. Moreover, there were other provisions in SOX itself that could have contributed to the detection of pre-SOX reporting errors that were corrected in SOX’s wake. After SOX, accountants became more independent as three of the Big 4 auditing firms divested their consulting business\textsuperscript{42} and SOX broadly prohibited auditors from providing a range of business services to audit clients.\textsuperscript{43} Furthermore, SOX and listing requirements changed not just the composition of the audit committee, making it not only more independent of management, but also caused audit committees to be made up of individuals better attuned to discharge the role of the audit committee.\textsuperscript{44} Mandated audit partner rotations,\textsuperscript{45} whistleblower hotlines,\textsuperscript{46} and

\textsuperscript{39} Not to be missed is the selection bias with respect to reported costs of smaller issuers. Because of the firestorm that greeted Section 404(b) and the likely impact compliance with the provision would have on smaller issuers, the SEC granted a series of delays to its implementation for non-accelerated filers (i.e., reporting companies with a market capitalization less than $75 million). Thus, those who did comply were likely companies who believed their reporting system did not contain material internal control weaknesses. Thus, their compliance costs could be expected to be lower than the average for their smaller issuer cohort.

\textsuperscript{40} It should be understood that Congress mandated attestation of internal controls, leaving it to the SEC and newly created PCAOB to implement the mandate. This factor unlikely explains the unforeseen costs of the mandate.


\textsuperscript{42} See Exchange Act to add Section 10A(g), 15 U.S.C. § 78j-1(g).

\textsuperscript{43} See James D. Cox, Robert W. Hillman & Donald C. Langevoort, Securities Regulations: Cases and Materials 600-604 (7th Ed. 2013).


subjecting audit firms to periodic inspections by PCAOB\(^{47}\) in combination forced greater independence on the part of the auditor and, thus, could have had their own effect on unearthing and reporting restatements. Thus, just which of these initiatives including Section 404(b), or what combination of them, produced the reduction in restatements? Further confounding the causal calculation is that after 2007, the earlier internal control procedures for implementing Section 404(b) that were embodied in PCAOB AS No. 2 were replaced by AS NO. 5; the former was much more inclusive whereas AS No. 5 is principles-based so that auditors enjoy greater discretion to the auditor in attesting to management’s assessment of internal controls.\(^{48}\) Most importantly, the new standard allowed much more judgment to be exercised in carrying out the evaluation allowed the auditor to scale its review. The new auditing standard complicates the causality of Section 404(b). Without the new auditing standard, the question was complicated enough in isolating the decline in restatements (the surrogate for assessing overall quality of financial reporting) from declines caused but other developments that can be seen as also strengthening financial reporting. With a new auditing standard believed to weaken implementation of Section 404(b), the question is whether the decline in restatements is the product of any of the SOX provisions or simply the new variable, ASR No. 5. That is, against these variables we can consider that there are two possible but conflicting interpretations of the post-SOX experiences centered on restatements. One view is that the more relaxed, less formal, auditing standard, nonetheless fulfills the goals of Section 404(b) so that financial reporting is more trustworthy because of the auditor attestation. Alternatively, the new auditing standard weakened Section 404(b)’s impact and in turn weakens the quality of financial reporting; but indirectly makes the case that Section 404(b) if wisely implemented improved financial reporting.

The implication of the above is, as concluded by Professors Coates and Srinivasan, direct costs of a regulation can be determined, at least ex post; however, isolating and measuring benefits are much more problematic in part because of the difficulty of establishing causality. That difficulty is heightened in the instance of financial regulation because of the interconnectedness of financial regulation. The markets are what we made them to be through regulations that are interdependent; that is, markets reflect a web of regulation so that when a new regulation is written and its likely impact is to be assessed it must occur with a conscious regard for the web into which the new regulatory initiative will be inserted. Ex ante, the problems of assessing costs and benefits must be understood to be not just greater but fraught with judgments, assumptions and estimates that challenge the efficacy of the process. In a sense, this problem is similar to a core complaint leveled against financial reporting itself: the bedrock of financial reporting are the metrics of generally accepted accounting principles the application of each to a firm rests on scores of estimates, assumptions and judgments so that financial reports of firms that are intrinsically mirror images of one another can vary widely depending on the particular constellation of judgments, assumptions and estimates that are made. In that sphere, the financial reports are not deemed misleading or even incorrect if the process that expressly includes within it discretion is adhered to by the preparers of the reports. As reasoned above, the

\(^{47}\) See Sarbanes-Oxley Act Section 104. At least equally important, Section 101 established an independent body to both promulgate and enforce standard operating procedures auditors must follow in the conduct of their attestation with respect to reporting companies.

\(^{48}\) See generally Rob’t R. Moeller, Sarbanes-Oxley Internal Controls: Effective Auditing with AS 5, Cobit and ITIL Ch. 3 (2008).
APA’s arbitrary and capricious standard, and more particularly the operative verb, “consider,” in the SEC’s review standard rightly direct attention not on finite evidence supporting a finding that measureable benefits exceed measureable costs. Rather, what is required of the SEC is a thoughtful and deliberate process whereby it considered means to maximize expected benefits while minimizing expected costs.

III. Regulation by Enforcement

While it is correct to say that Business Roundtable imposes a significant restraint on SEC rulemaking, it is not correct to conclude that the decision has the same degree of restraint on the SEC as a regulator. This is because much of the regulation of the SEC has occurred not through rulemaking but its robust enforcement efforts for which the earlier-discussed review standards do not apply. The review standard, in response to testimony given by then SEC Chairman Arthur Levitt, rephrased the House bill’s language to make clear that the review standard applied only to “rulemaking.”

The most dramatic illustration of how regulation of capital markets occurs through enforcement is the fulsome body of law on inside trading. Cady, Roberts & Co., an SEC enforcement proceeding against a broker-dealer, was quickly followed by the landmark SEC v. Texas Gulf Sulphur Co., and now a trilogy of Supreme Court establish the regulatory web for inside trading. Their highly nuanced body of directives addresses a range of issues to defining wrongful trading, tipping and misappropriation. Despite continuing debate on the social welfare of inside trading, the prohibitions for inside trading are no less effective because they were developed through litigation rather than rulemaking.

More generally, even though the SEC has resorted to Exchange Act Section 10(b) for authority detailed rules regulating a variety of market conduct, the most significant impacts of the antifraud provision are a consequence of the principles established through public and private suits founded on the principles embodied in Rule 10b-5 itself. Similarly, litigation has greatly

\[\text{\textsuperscript{50}} \text{In the Matter of Cady, Roberts & Co., 40 S.E.C. 907 (1961).} \]
\[\text{\textsuperscript{51}} \text{401 F.2d 833 (1969)(en banc).} \]
\[\text{\textsuperscript{52}} \text{Chiarella v. U.S., 445 U.S. 222 (1980)(the sine qua non for any violation is a fiduciary duty with respect to use of the information); Dirks v. Securities and Exchange Commission, 463 U.S. 646 (1983)(tippers and their tippees violate when aware that tip was in breach of an underlying fiduciary duty); and U.S. v. O’Hagan, 521 U.S. 642 (1997)(misappropriation of information can be the basis of a violation).} \]
\[\text{\textsuperscript{53}} \text{See e.g., Rule 10b-10, 17 C.F.R. § 240.10b-10 (regulating the content of trade confirmations; Rule 10b-17, 17 C.F.R. § 240.10b-17 (timely notice of record dates related to certain corporate actions, such as dividend declarations), and Regulation M, 17 C.F.R. § 242.100 et. seq. (the so-called distribution rules regulating such conduct as purchases during a distribution as well as certain short selling).} \]
\[\text{\textsuperscript{54}} \text{For example, an overarching concern for all companies, public and private, is whether there is a duty to disclose information known to be material. Case law that has accreted overtime around Rule 10b-5 establishes the boundaries of such a disclosure duty. See e.g., Gulati, Bauman and Langevoort \frac{3}{4} truth. More generally, most of the jurisprudence defining materiality, a threshold consideration not only with the obligation to disclose under the antifraud provision as well as many directives for filings with the SEC, has been created by litigation under the} \]
informed the boundaries of the private offering exemption, discussed below. A current illustration of the use of enforcement to develop standards of conduct is the stepped-up enforcement actions by the SEC defining the boundaries of the duty of broker-dealers to supervise subordinates.

It is therefore possible through enforcement of existing general proscriptions of fraud, such as Rule 10b-5, to regulate conduct and for the SEC to do this without encountering the burdens of the review standards. Nonetheless, the enforcement actions must be true to the principles underlying Rule 10b-5 and courts can be expected, as they have in the past, to be sensitive to the expected burdens flowing from expansion of the antifraud provision.\(^{55}\) A benefit of this approach is it promotes reactions through changed business practices whose consequential costs can be analyzed in future rulemaking.

IV. Regulating by Principles and Safe Harbors

There are three pillars that enable the SEC’s to fulfill the goals of the federal securities laws: specific congressional directives, the broad rulemaking authority the SEC has to carry out the directives’ objectives, and the authority of the SEC to enforce the statutes and rules committed to its stewardship. For example, we find the Securities Act prohibits the offer or sale of a security unless a registration statement has been filed with the SEC; the act further provides, however, numerous exemptions to this prohibition, the most famous being an offer or sale of a security “by an issuer not involving any public offering.” And, the SEC enjoys a broad grant of authority to fulfill the prohibitions and define their exemptions.

Consider the operation of the private offering exemption provided by Section 4(a)(2) of the Act: “transactions by an issuer not involving any public offering.”\(^{56}\) The generality with which this exemption is expressed permits it to be understood as “principles based” as distinct from finite and technical conditions to meet the exemption which would be considered, at least in this essay, as “rules based.” Ambiguity with reference to a provision’s scope is an inherent feature of a principles based exemption and in the case of the private offering exemption the meaning was developed through SEC enforcement actions as well as administrative guidance provided through SEC announcements. Ultimately, in 1982, the SEC, building on five decades of experience in both the courts and the administrative practice, greatly facilitated the aggregation of capital by resort to the private offering exemption by adopting Rule 506, a safe-harbor for private offerings.\(^{57}\) Rule 506 embodies the codification of understandings and practices that had crept into the private offering lore over the years made the exemptions more certain through a high-degree of specificity. The significance of Rule 506 begins by recognizing that more capital was raised in recent years through various exemptions from registration that are provided by the antifraud rule. Cox Sec Reg chap. 12. And causality, a feature in all private litigation, is shaped almost entirely by case precedents. Exception would be the PSLRA bounce back rule.

55 The classic illustration of this concern is Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), conditioning private actions on the plaintiff being a purchaser or sell for fear that otherwise cases would be difficult to dispose of before trial and that a loose standing provision would lead to vexatious litigation.


57 17 C.F.R. § 230.506.
Securities Act than was raised by all registered public debt and equity offerings; the importance of Rule 506 in this tabulation is that it is the gateway for most exempt offerings. 58

Another illustration of the tandem operation of a broadly based prohibition and a complementary safe harbor is the securities laws prohibition against manipulation of securities prices. In the 1950s, the SEC adopted a set of so-called distribution rules designed to proscribe purchases believed to be manipulative in connection with a distribution and to authorize stabilization of securities prices in connection with a distribution. 59 The former broadly prohibited issuers and their representatives from purchasing the issuer’s shares during a distribution, unless the purchases conformed to the tightly drafted requirements to be deemed stabilizing in connection with public offering carried out by underwriters. The authority for the rules was broadly founded on the enabling language of Sections 9 and 10(b) of the Exchange Act.

The distribution rules were not only broadly written but were broadly interpreted by the SEC. For example, an issuer with outstanding securities convertible into, or warrants exercisable for, its common stock, was viewed to be engaged in an on-going distribution of the common stock. 60 The SEC’s regulatory position was underscored when it initiated an enforcement action against Georgia-Pacific Corporation arguing that its purchases of its own shares in connection with acquisition of other companies not only violated the distribution rule but the antifraud provision, Rule 10b-5. 61 At the heart of the SEC’s case was that Georgia-Pacific had agreed to acquire several businesses, paying for each with shares of its own stock. The exact number of shares to be issued in each acquisition was to be determined by the NYSE share price at certain points in time. The SEC argued that Georgia-Pacific’s market purchases were undertaken to drive up the price of its shares so that fewer shares would have to be issued to affect each of the purchases. 62 The case was ultimately settled with Georgia-Pacific consenting to an injunction barring it from carrying out purchases for the purpose of creating actual or apparent active trading in its shares. 63 The victory against Georgia-Pacific wetted the SEC’s appetite for expanding the prohibition to like cases. Over the next decade, the SEC proposed and re-proposed Rule 13e-2 that broadly proscribed open market purchases that at least covered the practice prosecuted in Georgia-Pacific. 64 Of interest in this article is the Commission’s proposed proscription occurred after it sought, and obtained, in the 1968 Williams Act amendments specific authority in Exchange Act Section 13(e), authority to adopt rules with respect to

58 See Vladimir Ivanov & Scott Bauges, Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D exemption, 2009-2012, Tbl. 2 and Fig. 4 (July 2013).
62 Id. at 95,488.
reporting company purchases of their outstanding equity securities.\textsuperscript{65} Comments on the proposed rules were favorable; however, the reason the proposal enjoyed support was that despite the proposed rule’s breadth and new burdens, its overarching benefit was that the proposed rule was believed to reduce uncertainty with respect to issuer share repurchases.\textsuperscript{66}

The 1980 national election changed the regulatory climate; this political shift was reflected with the demise of earlier proposed Rule 13e-2 and the adoption of Rule 10b-18. Unlike the former route of broadly proscribing issuer repurchases, the newly adopted Rule 10b-18 was in effect a safe harbor that set forth clearly articulated conditions that, if met, rendered issuer repurchases immune from being deemed manipulative. Similar to the experience with the Rule 506 safe harbor described above, the Rule 10b-18 safe harbor became the beacon by which issuers today engage in open market purchases.

From the preceding account we can see that a principle can come through either a rule or an enforcement order. The norm developed through either medium produces observable effects that can inform later rulemaking. Where the statute clearly announces a principle and renders its violation enforceable, the SEC has a base upon which it can regulate not just through enforcement of the provision but also in a prudential way. A similar result can be achieved through a successful enforcement action. The very robust no-action letter regime, and the less formal conversations with SEC staff, are each reflective of a good deal of prudential regulation in vast sectors of the federal securities laws. It is in these areas that customs have developed and those customs frequently give rise to safe harbors. And, the safe harbors but more than that; they become the manner for conducting business.

Thus, we should consider the two-step approach to regulation illustrated by the SEC’s regulation of private offerings and issuer repurchases whereby the first step is a broad principles-based prohibition and the second step is development of a safe-harbor from the principle with such development being based on refinements developed through litigation.\textsuperscript{67} To be sure, this is

\textsuperscript{65} 15 U.S.C. § 78m(e).
\textsuperscript{66} Feller & Chamberlin, note _, supra at 4.
\textsuperscript{67} Many provisions of the securities laws are not proscriptive, but enabling. But this is not a limitation on the iterative approach developed here. For example, the SEC’s ability to act by enforcement and protective safe harbors is not possible because absent a rule identifying conduct as unlawful there is no enforceable principle. The illustration of this is Section 14(a)(2) authorizing the SEC to adopt rules regarding proxy access for the nomination of directors. There the SEC’s foray into providing a very limited route for shareholder access to nominating directors was foiled by Business Roundtable. Because the provision is only enabling there clearly is no enforceable principle absent a rule announcing the principle. At the same time, is it beyond question that it could be a material omission in failing to disclose in the company’s proxy statement that a holder of 15 percent of a reporting company’s shares was rebuffed in suggesting a nominee to the board? Whether or not a court might be persuaded under the right set of facts that enough facts were alleged to survive a motion to dismiss, there likely would be enough uncertainty among issuers to see the benefit of a safe harbor in the face of repeated efforts by activist shareholders to obtain board seats. The SEC could consider circling back to Section 14(a)(2) to clear the air a bit by adopting a safe harbor to potential Rule 14a-9 concerns that would provide protection to firms whose bylaws provided a means for activist access to the
a long-term strategy and one not well suited to address market developments that occur rapidly and need to be quickly addressed. Nonetheless, there are ample areas where market events permit regulation to evolve so as to benefit from the experiences of incremental steps forward. Rules 506 and 10b-18 stand witness to positive experiences provided by a lengthy gestation period.

*Business Roundtable* concerns do not disappear by taking an approach that links principles-based proscription with safe harbor rules. There is some appeal to the argument that since safe harbors are optional, and provide a dispensation from a hard principle, that a lighter review might be in order for the adoption of a safe harbor. This may well be the case, but safe harbors are nonetheless subject to the review standard. In *Chamber of Commerce v. SEC*, Judge Ginsburg, perhaps as a warm up for his later opinion in *Business Roundtable*, struck down an SEC proposed safe harbor for investment advisors wishing to engage in a range of transactions that otherwise the Investment Company Act bars advisors from engaging. Absent the safe harbor, the pathway for advisors wishing to engage in many common related party transactions was to obtain approval of the SEC. *Chamber of Commerce* arose from the SEC amending its existing safe harbor permitting certain transactions by an advisor, but conditioned the dispensation on the mutual fund having a board whose members were at least seventy-five percent independent of the fund’s advisor and that the board’s chair was also independent. The newly adopted safe harbor replaced one that only required that fifty percent of the directors be independent and made no provision for the board’s chair to be independent. In the release adopting the safe harbor, the SEC stated that because it did not have a reliable basis to know what procedures funds would pursue to recruit and maintain additional independent directors so as raise the percentage from fifty to seventy-five percent it was difficult for the SEC to determine the costs associated with the proposal. This difficulty was rejected; the court concluded that such difficulty “does not excuse the Commission from its statutory obligation to determine, as best it can, the economic implications of the rule it has proposed.” The Commission was similarly faulted for not attempting to estimate what, if any, costs might from the board chair being independent were such a chairman then to introduce new staffing needs. Adding further weight to the nominating process. This reaches a result distinguishable from *Business Roundtable* since proxy access is not being imposed but is an optional prophylaxis to possible alleged omissions in the proxy statement. Indeed, it was on just such reasoning that the SEC justified the shareholder proposal provision now embodied in Rule 14a-8 that allows stockholders meeting certain requirements to have their a proposal they intend to introduce at an upcoming stockholder meeting included on management’s solicitation materials. The SEC justified the rule on the grounds it would be a material misrepresentation for management, as management customarily does with its own solicitations, a proxy to vote on any matter that may be introduced at the upcoming annual meeting if management then not in connection with such request identify a proposal that it was aware would be introduced at the meeting that management opposed.

412 F.3d 133 (D.C. Cir. 2005).

412 F.3d at 143.

“Although the Commission may not have been able to estimate the aggregate costs of the mutual fund industry of additional staff because it did not know what percentage of funds with independent chairman would incur that costs, it readily could have estimated the costs of an individual fund, which estimate would be pertinent to its assessment of the effect the condition would have on efficiency and competition, if not upon capital formation. . . . [U]ncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself— and
to its rejection, the Commission was faulted in adopting the safe harbor from considering disclosure, the more familiar mechanism for securities regulation.\(^71\)

Chamber of Commerce, however, casts only a minor cloud over the two-step process advanced here. For years, because the fund industry had enjoyed a safe harbor for otherwise prohibited activities that was conditioned on a fund’s board meeting a fifty percent independence requirement, the adoption of the safe harbor can easily be seen as action that is introducing more stringent regulation than before rather than providing both certainty and dispensation as was the case with Rules 506 and 10b-18 discussed earlier. Thus, in Chamber of Commerce, the safe harbor was being narrowed with the effect that commercial flexibility was being constrained not liberated from an over-arching prohibition. To be sure, regulated parties can still challenge a newly minted safe harbor, no doubt seeking greater liberality, but they do so with a healthy respect that the SEC is not required to act. This political calculus no doubt explains the mild support that proposed Rule 13e-2 received: it is not the best rule for the regulated but it is better than the likely alternatives.

V. Mean Reverting Jurisprudence?

In recent years, the SEC has certainly incurred reversals before the D.C. Circuit. But it is the stridency and sweeping mandate of Business Roundtable that most becalms the SEC’s regulatory trajectory. Elsewhere the author has made the case that not only was Judge Ginsburg’s reasoning inconsistent with the language and history of the SEC’s review standard, it is dramatically inconsistent with the Supreme Court precedent, most of which was not referenced at all in Business Roundtable. Indeed, the major body of precedent Ginsburg invoked was his earlier decision in Chamber of Commerce v. SEC,\(^72\) discussed above. In turn, Chamber of Commerce relied on the D.C. Circuit’s earlier decision, Public Citizen v. Federal Motor Carrier Safety Administration,\(^73\) which struck down an agency rule limiting the number of hours commercial drivers could work, reasoning that the agency failed to give any attention, as required by its enabling act, that a rule “ensure that . . . the operation of commercial motor vehicles does not have a deleterious effect on the physical condition of the operators.”\(^74\) The review standard guiding Public Citizen clearly mandated cost-benefit analysis, and the opinion did observe that there were possible infirmities with such analysis in connection with the rule; however, this was dicta since the analysis clearly found that the agency “wholly failed to comply with this [i.e., the “ensure”] specific statutory requirement.”\(^75\) Thus, what Ginsburg committed was seriously misreading Public Citizen when deciding Chamber of Commerce and then magnifying that mistake in Business Roundtable.

\(^{71}\) 412 F.3d at 144 (“the disclosure alternative was neither frivolous nor out of bounds and the Commission therefore had an obligation to consider it”).

\(^{72}\) 412 F.3d 133 (D.C. Cir. 2005).

\(^{73}\) 374 F.3d 1209 (D.C. Cir. 2004).

\(^{74}\) Id at 1216 (citing 49 U.S.C. § 31136 (a)(4)(2006)).

\(^{75}\) 374 F.3d a7 1216.
Public Citizen, while referencing that the agency’s adoption of a rule might well have been faulted for failing to address the statute’s express requirement that rules be supported by cost-benefit analysis, did not do so. Of note is that author of Public Citizen was Judge Sentelle, who also authored American Equity Investment Life Insurance Co. v. SEC, which vacated a rule that had the effect of requiring indexed annuity options to be registered with the SEC. The SEC had initiated the regulatory change because it believed that definitively characterizing indexed annuity options as securities would “bring about clarity in what [had] been an uncertain area of the law.” Writing for the panel, Judge Sentelle focused on the incompleteness of the SEC’s analysis and not on the presence or absence of cost-benefit analysis; the court looked at the SEC’s findings that the rule change would favorably impact “efficiency,” “competition,” and “capital formation.” The court concluded that the SEC “did not disclose a reasoned basis for its conclusions that Rule 151A would increase competition” and that the “SEC’s failure to analyze the efficiency of the existing state law regime renders arbitrary and capricious the SEC’s judgment that applying securities law would increase efficiency.” Thus, Judge Sentelle applied bedrock administrative law embodied in Motor Vehicle Manufacturers Ass’n v. State Farm Mutual Automobile Co., holding that when an agency finds its rule is supported by cost-benefit analysis that is not supported by a reasoned analysis that the rule will be vacated as being arbitrarily and capriciously adopted, even though the enabling legislation does not mandate cost-benefit analysis. Hence, in American Equity, the agency’s action was vulnerable because it was not able to support its conclusions that providing clarity by rendering indexed annuity options a security would enhance efficiency, competition and capital formation any more than a rule that clarified that this product was not a security.

Judge Sentelle most recently entered the regulatory review scene in Investment Company Institute v. CFTC. The regulatory quilt for swap transactions changed dramatically following the Financial Crisis of 2008 and the ensuing passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Dodd-Frank authorized the SEC and CFTC to regulate most swaps, thereby reversing the deregulatory steps of the Commodity Futures Modernization Act of 2000. Thus, the CFTC earlier in reliance on the 2000 legislation had removed regulated investment companies from being deemed commodity pool operators; the rule challenged in Investment Company Institute returned matters pretty much where they were before 2000. As a consequence, regulated investment companies that carried on activities that rendered them commodity pool operators would, in addition to certain investor fraud protections, be required to register with the CFTC and periodically to provide it with certified reports bearing on their transactions in swaps. Judge Sentelle stated “[a]s a reviewing court, “our role is to determine whether the [agency] decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.” Importantly, this standard was stated in the context of the court’s review of the CFTC’s requirement to “consider the costs and benefits” of a rule being adopted. The court emphasized that the CFTC closely considered whether information that it

---

613 F.3d 166 (D.C. Cir. 2010).
76
613 F.3d 166 (D.C. Cir. 2010).
77 Id. at 177 (quoting Indexed Annuities and Certain Other Insurance Contracts, Securities Act Rel. No. 8996, 74 Fed. Reg. 3138, 3171 (Jan. 16, 2009)).
79 720 F.3d 370 (D.C. Cir. 2013).
80 Id. at377 (internal quotations are from Motor Vehicle Mfgs. Ass’n v. State Farm Mut. Auto Ins. Co., 436 U.S. 29, 43 (1983)).
sought regarding the fund’s operations of commodity pools was otherwise available and concluded it was not. The CFTC’s close consideration of these concerns allowed Judge Sentelle to distinguish the present regulatory effort from earlier efforts by the SEC which was broadly dismissive that alternative regulatory efforts already addressed the goal sought by the SEC. For example, Judge Sentelle observed that, in *American Equity*, the SEC made no effort in considering whether state regulation of indexed annuities provided the clarity and protection the SEC believed would flow from its new Rule 151A. \(^{81}\) Despite operating under a review standard that calls for consideration of costs and benefits, and a standard that also lists multiple factors to be so considered, the court held that the CFTC was not required to calculate the costs incident future regulations that are yet unknown. \(^{82}\) Thus, if the current action is the first of likely several future iterative regulatory steps, the calculus that is required is that incident the initial, not a later ultimate, step. Indeed, *Investment Company Institute* is welcoming to iterative regulation; it openly approved of the need for the CFTC to compel registration and regular reporting as a necessary step toward formulation of regulatory steps to implement the congressional mandate. \(^{83}\) Later, the court showed additional sympathy for the regulatory agency by holding that agencies are not required to measure the immeasurable. \(^{84}\) This was in response to the appellants’ complaint that the agency failed under the review standard because it had not placed a “precise number” on the benefits that data collection would have in preventing future financial crises; instead, the CFTC met the standard by discussing the unquantifiable benefits. \(^{85}\) Indeed, Judge Sentelle concludes that the CFTC is not subject, as some agencies are, to producing rigorous quantitative analysis in support of its regulations. \(^{86}\)

**VI. Conclusion**

Financial market regulation is a complex undertaking and unintended consequences lurk behind ever well-meaning regulatory effort. The CFTC’s steps toward bringing regulated investment companies that are commodity pool operators were no doubt taken with trepidation flowing not only from a host of unknowns but also the reality that sweeping regulatory directives other than information gathering would be difficult to achieve. Thus, the understanding and nurturing hand the DC Circuit most recently extended in *Investment Company Institute* is likely more reflective of understanding the challenge faced by the regulator than it is of blowing a new pro-regulatory wind across America. The sensitivity that *Investment Company Institute* reflects minimally stands in stark contrast to the quixotic harangue of *Business Roundtable*. Surely we find better moorings with the former than the latter. Thus, iterative regulation in which

\(^{81}\) *Id* at 378 (the “CFTC did consider whether RICs were otherwise regulated, and concluded that CFTC regulation was necessary despite the existing SEC regime” quoting the district court, Investment Company Institute v. CFTC, 891 F. Supp.2d at 217 (D.C. )


\(^{83}\) *Id*. at 380. The CFTC also argued that no commenters on its proposed rule provided data that could be considered a substitute for what was sought by the rule’s the register and report requirement.

\(^{84}\) *Id*. at 379 (agencies are not required to adduce empirical data that cannot be obtained, quoting FCC v. Fox Television Stations, Inc., 556 U.S. 502, 519 (2009).

\(^{85}\) *Id*.

\(^{86}\) *Id* (citing American Financial Services Ass’n v. FTC, 767 F.2d 957, 986 (D.C. Cir. 1985) where the court’s review of the enabling statute led to it holding that not only required the agency to produce quantitative and qualitative assessments of the rules costs and benefits but also estimates of the rule on the nation’s economy).
regulatory goals are achieved in stages has much to commend itself and Investment Company Institute provides support for this strategy.

By far the approach most within reach and worthy of consideration is that whenever regulation is considered it is advisable to do so incrementally with the level being dictated by the breadth and complexity of the area to be regulated. Thoughtful regulation requires a good deal of insight into the likely consequences of the regulations. While Investment Company Institute provides encouraging support that the first step of an iterative approach, the regulator nonetheless lacks Casandra-like vision of the future so that it can undertake reliable analysis of the burdens and benefits of a particular regulatory initiative. It is here that staged regulation, continuing the incremental approach, can build a compelling case to support the rule by demonstrating how evidence gathered at each stage informs the agency how to next proceed, including tweaking of its past initiatives. It would also be useful throughout the process to demonstrate how experience gained has enabled the agency, consistent with its presumed expertise, to adapt its rules so as to reduce their burdens on the regulated while increasing their expected benefits. Another key feature will be sensitivity that compliance costs have a disproportionate effect on smaller companies. Thus, through scaling regulation the SEC can underscore its commitment to meeting the review standard that calls on it to consider investor protection against efficiency, competition and capital formation. To be sure, as discussed earlier, with financial regulation it will be difficult, if not impossible to disentangle a particular initiative from other forces. On this concern, decisions such as Investment Company Institute embody a reassuring perspective, as the emphasis is on the process not the precision by which the analysis is undertaken. With iterative regulation will find less speculation surrounding the inputs into that process than if regulation occurred in a non-iterative fashion.