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Consumer Finance Protection Bureau: Part 1

Teacher's Discussion Guide

This guide was prepared by Professor Howell Jackson and Kelley O'Mara, HLS JD '14 for the sole purpose of aiding classroom instructors in the use of "Consumer Finance Protection Bureau: Part 1." It provides analysis and questions that are intended to present alternative approaches to deepening students' comprehension of legal issues and energizing classroom discussion. HLS cases are developed solely as the basis for class discussion and participation. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective legal representation.

Exhibit 1: The *Proxy Access* Rule (75 Fed. Reg. 56668)

Statute	Dodd-Frank Act § 971(b):[1] "The Commission may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board of directors of the issuer, under such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors"
Rule	14a-11 would have required companies to include information about shareholder nominees for director in company proxy statements, and the names of the nominee or nominees as choices on company proxy cards, under specified conditions.
Conditions of Use	• "To use Rule 14a-11, a nominating shareholder or group will be required to satisfy an ownership threshold of at least 3% of the voting power of the company's securities entitled to be voted at the meeting. Shareholders will be able to aggregate their shares to meet the threshold." 75 Fed. Reg. at 56674. • "A nominating shareholder (or in the case of a group, each member of the group) will be required to have held the qualifying amount of securities continuously for at least three years as of the date the nominating shareholder or group submits notice of its intent to use Rule 14a-1." Id. at 56675. • "The nominating shareholder (or where there is a nominating shareholder group, any member of the nominating shareholder group) may not be holding the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11, and may not have a direct or indirect agreement with the company regarding the nomination of the nominee or nominees prior to filing the Schedule 14N." Id. • "The nominating shareholder or group must provide notice to the company of its intent to use Rule 14a-11 no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement and no later than 120 days prior to this date." Id. • "A company will not be required to include more than one shareholder nominee, or a number of nominees that represents up to 25% of the company's board of directors, whichever is greater."

[1] S. Rep. No. 176, S. REP. 111-176, 146-47 explains the rule. "It gives the SEC the authority to require issuers to allow shareholders to put Board nominees on the company proxy. It does not require the SEC to engage in rulemaking. The authority gives the SEC wide latitude in setting the terms of such proxy access. The Committee intentionally did not specify that shareholders must have held a certain number of shares or have held shares for a particular period of time to be eligible to use the proxy. If the SEC proposes rules, interested persons can offer their views on the appropriateness of proposed regulatory terms in the public comment process. The Committee feels that it is proper for shareholders, as the owners of the corporation, to have the right to nominate candidates for the Board using the issuer's proxy under limited circumstances."

	Id.
Limits	• "Rule 14a-11 will apply only when applicable state law or a company's governing documents do not prohibit shareholders from nominating a candidate for election as a director." Id. at 56674. • "The rule will apply to a foreign issuer that is otherwise subject to our proxy rules only when applicable foreign law does not prohibit shareholders from making such nominations." Id. • "The final rule will apply to companies that are subject to the Exchange Act proxy rules, including investment companies and controlled companies, but will not apply to "debt-only" companies." Id. • "The rule will apply to smaller reporting companies, but we have decided to delay the rule's application to these companies for three years." Id.

Exhibit 2: *Proxy Access* Rulemaking Costs and Benefits[2]

Benefits	Costs
Commission stated that the new rule would (1) Facilitate shareholders' ability to exercise their traditional state law rights to nominate and elect directors a. Traditional proxy contests are prohibitively expensive for shareholders wishing to exercise their rights (*minimally quantified*) b. Overcomes collective Action problem (2) Establish a minimum uniform procedure pursuant to which shareholders will be able to include their director nominees in a company's proxy materials and	Commission anticipated that the new rule may result in costs related to: (1) Potential adverse effects on company and board performance a. Election contests can be costly and time-consuming for board and management b. If boards become more responsive, may incur costs to enact policies that shareholders prefer c. May pressure boards to spend more time addressing shareholders, rather than focusing on strategy d. Companies may incur costs reconsidering or reconstituting

[2] With the exception of corporation administrative marginal cost increases and shareholder administrative cost savings, the rulemaking's discussion of costs and benefits was entirely qualitative

enhance shareholders' ability to propose alternative procedures that further shareholders' rights to nominate and elect directors a. Less costly than an opt-in approach and more realistic than an opt-out approach (3) Potentially improve overall board and company performance a. Facilitates the use of rights to overcome agency problems, which may increase efficiency and shareholder value b. May improve director responsiveness to shareholder concerns c. Director's may become more independent from management d. May improve quality of boards by increasing pool of potential directors (4) Result in more informed voting decisions in director elections due to improved disclosure of shareholder director nominations and enhanced communications between shareholders regarding director nominations. a. Disclosure requirements will provide voters with transparency needed to make an informed decision b. Allows shareholders to connect and coordinate without falling under the proxy solicitation rules c. Discontented shareholders will better be able to express their views through voting	nominations process e. May lead to unqualified individuals being elected f. May deter IPOs (2) Additional complexity in the proxy process a. Compliance costs may be significant, especially for companies with complex governance structures b. Legal advice required in facilitating contests (3) Preparing the required disclosures, printing and mailing, and costs of additional solicitations. a. Logistical and administrative costs (*minimally quantified*) b. Companies will have to investigate the candidates to vet the disclosures c. May increase shareholder proposals d. Boards may expend significant resources to defend against outsiders in elections

Exhibit 3: Reactions to the *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011)

- James D. Cox and Benjamin J.C. Baucom[3] believe that the opinion imposes a

[3] James D. Cox and 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, 1818-1819 (2012).

mandate to conduct quantitative CBA in rulemaking.

- Cox and Baucom argue that this standard is nearly impossible to satisfy.
    - "Because so much of what the SEC deals with is rulemaking that, on the one hand, produces benefits to investors, markets, market participants, and the economy as a whole that are speculative and non-quantifiable--and, on the other hand, entails costs that are easily quantifiable--it has invited a judicially contrived mandate for the SEC to rigorously set forth the case that the perceived benefits exceed the estimated costs. If that is what is required, then the D.C. Circuit has eviscerated the agency, at least in areas where challenges to its rules would be expected."[4]
    - "[N]ot all rules readily lend themselves to rigorous cost benefit analysis. Far better in most cases to make the analytical case that identifies the problem and carefully explain how the highly textured rule addresses the problems posed."[5]
- They assert that the standard imposed by the D.C. Circuit exceeds the requirements Congress intended to impose. "There can be little doubt that the D.C. Circuit has overstepped the permissible level of review intended for SEC rulemaking."[6]
    - The decision violates the Supreme Court's warning in Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978) that courts not impose an extra-statutory mandate. In that decision, the Supreme Court stated that "there are no circumstances which would ever justify a court in overturning an agency action because of a failure to employ procedures beyond those required by the statute."[7]
    - In American Textile Manufacturers Institute, Inc. v. Donovan, 452 U.S. 490 (1981), the Court observed that "Congress uses specific language when intending that an agency engage in cost-benefit analysis."[8]

- Harvard Law Review Note[9] asserts that the decision was erroneous and excessively political.
    - "The D.C. Circuit waded into a political fight under the guise of dispassionate scientific oversight to vacate a proxy access rule produced after years of open, contentious debate. While statutes require the SEC to consider the consequences of its regulations, courts should recognize the limitations of economics and of their own expertise by acknowledging

[4] *Id.* at 1834.
[5] *Id.* at 1841.
[6] *Id.* at 1833.
[7] Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 524 (1978). The Supreme Court stated that "there are no circumstances which would ever justify a court in overturning an agency action because of a failure to employ procedures beyond those required by the statute." Cox and Baucom supra note 2 at 1828-1829.
[8] American Textile Manufacturers Institute, Inc. v. Donovan, 452 U.S. 490 (1981).
[9] Administrative Law- Corporate Governance Regulation-D.C. Circuit Finds Sec Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis.-Business Roundtable v. Sec, 647 F.3d 1144 (D.C. Cir. 2011)., 125 Harv. L. Rev. 1088 (2012).

thorough, competent analyses. Perpetuating Business Roundtable's exacting review could impose a judicial blockade on complex financial rulemaking, which would impede regulators' ability to police the marketplace in accordance with congressional intent."[10]
    - "Economic models rely on politically controversial assumptions: the numbers may look concrete, but their origins often are not. Whether one believes that proxy access will improve corporate performance, for example, depends a great deal on one's political ideology. In Business Roundtable, the court took aim at just such political judgments despite the judiciary's institutional limitations."[11]
    - "[N]o analysis of a politically contentious issue could survive Business Roundtable's exacting arbitrary and capricious review. Over the years, the D.C. Circuit has earned a reputation for rigorous review of agency action, but its current approach sets the bar even higher. When costs and benefits are inestimable and projections differ, a panel could always vacate rulemaking, and would be particularly likely to do so when the agency's political assumptions affront the court's sensibilities."[12]
- J. Robert Brown, Jr. stresses that the "The D.C. Circuit imposed a 'nigh impossible' standard with respect to the applicable economic analysis." [13]
    - "The decision far exceeded the standards set out by Congress and the courts with respect to cost/benefit analysis."[14]
    - "The short term impact of the decision is to make more difficult the implementation of a shareholder access rule. The long term implications are more severe. The decision effectively discourages the SEC from using rulemaking as a means of establishing legal requirements and instead encourages the use of more informal and less uniform methods such as no-action letters and enforcement proceedings."[15]
- Anthony W. Mongone argues that the D.C. Circuit's standard, as articulated under Business Roundtable, is a drastic departure from what was intended by Congress[16]
    - "The court, however, strictly scrutinized the SEC's methodology and reached all of its drastic conclusions without engaging in a statutory interpretation analysis with respect to the actual level of agency 'consideration'--and thus the extent to which the court must scrutinize the SEC's analysis--demanded by the [the mandate]."[17]
    - "Had the court determined what the statute's enigmatic cost-benefit clause actually mandated, as required by longstanding Supreme Court

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[10] Id. at 1092
[11] *Id.* at 1093
[12] *Id.* at 1094
[13] J. Robert Brown, Jr., *Shareholder Access and Uneconomic Economic Analysis: Business Roundtable v. SEC*, DENVER UNIVERSITY LAW REVIEW ONLINE, VOL 88 (2011).
[14] *Id.*
[15] *Id.*
[16] Anthony W. Mongone, Business Roundtable: A New Level of Judicial Scrutiny and Its Implications in A Post-Dodd-Frank World, 2012 COLUM. BUS. L. REV. 746 (2012).
[17] *Id.* at 768.

precedent, it would have realized that entire portions of its opinion, namely its conclusions that the SEC failed to adequately consider the economic consequences of Rule 14a-11 on board performance and shareholder value, and of institutional investors using the rule to further individual interests, are themselves seriously erroneous. The regulatory climate at the time of the [the mandate]'s enactment, in fact, called for much more deference to agency rulemaking than the court afforded the SEC, as demonstrated by the legislative history of the APA."[18]

- "Both of the SEC's determinations regarding the economic consequences of Rule 14a-11 on board performance and shareholder value, and of institutional investors using the rule to further individual interests, would have surely been deemed 'reasonable' under Chevron and State Farm. Despite the existence of evidence supporting the contrary conclusion--that Rule 14a-11's costs outweigh its benefits in these areas--there is evidence supporting the SEC's conclusions. Thus, there is a 'rational connection between the facts found and choices made,' even if an alternative choice is more rational."[19]

Exhibit 4: *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005)

Independent Director Rule	• SEC had a longstanding rule that provided that mutual funds that satisfy certain conditions may be exempted from prohibitions on certain transactions (Rule 10f-3, 17 C.F.R. § 270.10f-3). • Since 2001, the exemptions had been conditioned on the condition that the fund had a *majority* of "independent directors" (directors who are not "interested persons" as defined in § 2(a)(19) of the ICA). • In 2004, the SEC promulgated the "independent director" rule to augment the condition. The new rule required that, in order to qualify for the exemptions, a fund must have a board of directors with (1) at least 75% independent directors and (2) an independent chairman.
Statutory Basis for Promulgating	• The Investment Company Act of 1940 §6(c) (15 U.S.C. § 80a–6(c)) • Confers upon the SEC "the broad authority to exempt transactions from rules promulgated under the ICA, subject only to the public interest and the purposes of the ICA." 412 F.3d at 138-39. • Chamber Court states that the ICA was passed in part because "Congress sought to control 'the potential for abuse inherent in the structure of [funds]' arising from the conflict of interests between advisers and shareholders." 412 F.3d at 136.
Purported	• SEC based promulgation in part on the observation that

[18] *Id.* at 768-69.
[19] Id. 788-89.

Benefits	“enforcement actions involving late trading, inappropriate market timing activities and misuse of nonpublic information about fund portfolios” revealed “a serious breakdown in management controls,” and signaled the need to “revisit the governance of funds.” 69 Fed.Reg. at 3472. • “Raising the percentage of independent directors from 50% to 75%, the Commission anticipated, would ‘strengthen the independent directors' control of the fund board and its agenda,’ 69 Fed. Reg. at 46,381, and ‘help ensure that independent directors carry out their fiduciary responsibilities,’ id. at 46,382.” 412 F.3d at 137. • “The Commission justified the independent chairman condition on the ground that ‘a fund board is in a better position to protect the interests of the fund, and to fulfill the board's obligations under the Act and the Exemptive Rules, when its chairman does not have the conflicts of interest inherent in the role of an executive of the fund adviser.’” 412 F.3d at 137.
Statutory Grounds for Overturning	• “The condemnation of the APA extends to any rule that is ‘arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.’ 5 U.S.C. § 706(2)(A). Although the ‘scope of review under the ‘arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency,’ we must nonetheless be sure the Commission has ‘examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made.’ *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). 412 F.3d at 140. • 15 U.S.C. § 80a–2(c): “Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is consistent with the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”
Court’s Holding	• “[T]he Commission violated its obligation under 15 U.S.C. § 80a–2(c), and therefore the APA, in failing adequately to consider the costs imposed upon funds by the two challenged conditions.” 412 F.3d at 144. • “[T]he Commission's failure to consider the disclosure alternative violated the APA.” 412 F.3d at 144. “In sum, the disclosure alternative was neither frivolous nor out of bounds and the Commission therefore had an obligation to consider it.” 412 F.3d at 145.
Court on Benefits	• “[T]he Commission reasonably concluded that raising the minimum percentage of independent directors from 50% to 75%

	would 'strengthen the hand of the independent directors when dealing with fund management, and may assure that independent directors maintain control of the board and its agenda.' 69 Fed.Reg. at 46,382." 412 F.3d at 141. • "[T]he Commission concluded that having an independent chairman would be beneficial because the chairman plays 'an important role in setting the agenda of the board[,] ... in providing a check on the adviser, in negotiating the best deal for shareholders when considering the advisory contract, and in providing leadership to the board that focuses on the longterm interests of investors.' 69 Fed.Reg. at 46,383. We have no basis upon which to second-guess that judgment." 412 F.3d at 141. • "[T]he Commission's effort to prevent future abuses of exemptive transactions was not arbitrary, capricious, or in any way an abuse of its discretion, in violation of the APA." 412 F.3d at 141. • "[T]he Commission, based upon 'its own and its staff's experience, the many comments received, and other evidence, in addition to the limited and conflicting empirical evidence,' concluded an independent chairman 'can provide benefits and serve other purposes apart from achieving high performance of the fund.' 69 Fed.Reg. at 46,383–46,384. The Commission's decision not to do an empirical study does not make that an unreasoned decision." 412 F.3d at 142.
Court on Costs	• "[A]lthough we recognize that an agency acting upon the basis of empirical data may more readily be able to show it has satisfied its obligations under the APA, see *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1124 (D.C.Cir.1984) (in informal rulemaking it is 'desirable' that agency 'independently amass [and] verify the accuracy of' data), we are acutely aware that an agency need not—indeed cannot—base its every action upon empirical data; depending upon the nature of the problem, an agency may be 'entitled to conduct ... a general analysis based on informed conjecture.' *Melcher v. FCC*, 134 F.3d 1143, 1158 (D.C.Cir.1998)." 412 F.3d at 142. • "With respect to the 75% independent director condition, the Commission, although describing three methods by which a fund might comply with the condition, claimed it was without a 'reliable basis for determining how funds would choose to satisfy the [condition] and therefore it [was] difficult to determine the costs associated with electing independent directors.' 69 Fed.Reg. at 46,387. That particular difficulty may mean the Commission can determine only the range within which a fund's cost of compliance will fall, depending upon how it responds to the condition but, as the Chamber contends, it does not excuse

	the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed." 412 F.3d at 143. • "Although the Commission may not have been able to estimate the aggregate cost to the mutual fund industry of additional staff because it did not know what percentage of funds with independent chairman would incur that cost, it readily could have estimated the cost to an individual fund, which estimate would be pertinent to its assessment of the effect the condition would have upon efficiency and competition, if not upon capital formation. And, as we have just seen, uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure." 412 F.3d at 144.
SEC's Actions in Response	• Less than two weeks later, the SEC re-released the final rule, unaltered and without invitation for further notice and comment. However, the rerelease included a much more extensive cost benefit analysis, including a quantitative analysis of the costs of the rule. • The D.C. Circuit vacated the new rule, though not because of the CBA. Rather, the court was disturbed by the fact that the Chamber and other interested parties were not given the opportunity to comment. • After reopening to comments, the rule is currently in effect 17 C.F.R. § 270.0-1(a)(7)(i), 17 C.F.R. § 270.0-1(a)(7)(iv)

