

## OPINIONS

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# Setting a New Standard at the SEC

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**By Paul Schott Stevens**

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The controversial manner in which the Securities and Exchange Commission [readopted its mutual fund governance requirements](#) should not obscure the fact that the decision of the U.S. Court of Appeals for the District of Columbia Circuit has far-reaching significance for future SEC rulemaking.

Long after the finger pointing and heated exchanges subside, the court's ruling will be remembered for demanding a more stringent and thorough evaluation of the economic consequences of SEC regulation. And the markets and American investors will be the beneficiaries.

From the commission's perspective, the recent decision is significant for upholding the SEC's broad authority under the Investment Company Act, as well as the SEC's ability under the Administrative Procedure Act to condition the exemptions it grants in ways it believes necessary to prevent future abuses. The circuit court's decision in these respects is noteworthy but not particularly surprising.

More significant is the court's discussion of the commission's obligations to consider regulatory costs and alternatives. Under the Administrative Procedure Act, federal courts strike down rules that are "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law."

This standard of review, in application, has proved quite forgiving, and the courts traditionally show a high degree of deference to agency judgments.

Nonetheless, an administrative agency may be found to act arbitrarily and thus to violate the Administrative Procedure Act where it fails to consider factors Congress has mandated in other laws that are specific to the agency's activities.

### **'Statutory Obligation'**

The Investment Company Act identifies three such factors in the case of mutual fund rule making. Section 2(c) of that Act directs the SEC to consider the effect of its rules on "efficiency, competition and capital formation." Importantly, Congress has directed the SEC to consider these same three factors when developing rules for public companies and

securities markets, as well. It was the commission's failure to adequately consider these factors that impelled the court to remand the governance rules for further consideration by the agency.

As the circuit court observed, in light of these factors set forth in the Investment Company Act, the SEC has a "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."

This obligation extends to the anticipated compliance costs of its rules - a matter, in the court's view, that is "pertinent to the [SEC's] assessment of the effect [a rule] would have upon efficiency and competition, if not upon capital formation." It also extends to examination of all reasonable alternatives to a rule that may be suggested for its consideration.

## **Beneficial Effect**

Are the mutual fund governance rules exceptional? Has the SEC carefully attended to its statutory obligations in formulating other rules? Most fair observers would, I think, say it has not. Nor has a federal court of appeals had any occasion, prior to the Chamber of Commerce decision, to interpret the nature of the SEC's administrative obligations under the "efficiency, competition and capital formation" factors mandated in the major federal securities laws.

The ultimate impact of the chamber's lawsuit thus may prove to be much more important than the mutual fund governance rules, whatever their ultimate fate. Careful attention to "economic consequences," greater concern for identifying and quantifying compliance costs, openness to alternative approaches - all this would have a salient and highly beneficial effect on the way the SEC goes about its business. Future SEC chairmen would do well to pay heed to these larger implications of the court's decision.

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