CONSIDERING THE COST: APPLYING *MICHIGAN V. EPA* TO FINANCIAL REGULATIONS

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INTRODUCTION

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank"),[1] the largest overhaul of American financial regulation since the Roosevelt administration.[2] Dodd–Frank implemented few of its changes directly; rather, its 2,300 pages granted authority to ten financial regulatory agencies to create hundreds of rules that together would touch almost every aspect of American finance.[3] So began a gargantuan conflict among financial regulators, consumer advocates, and banking interests to control the shape of finance's regulatory landscape.[4]

Banks and other large financial companies soon recognized that they could contest the scope of the Dodd-Frank regulations more effectively through the courts than through lobbying regulators.[5] The D.C. Circuit has struck down multiple Securities and Exchange Commission ("SEC") regulations in recent cases based on deficiencies in the agency's cost–benefit analysis of those regulations.[6] In particular, *Business Roundtable v. SEC*,[7] decided a little over a year after Congress passed Dodd–Frank, suggested that the D.C. Circuit would apply almost unlimited judicial review to the SEC's cost–benefit calculations.[8] Hoping to take advantage of this opportunity, a

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1 Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 7, 12, 15, 18, 22, 31, and 42 U.S.C.).

2 *See* Damian Paletta & Aaron Lucchetti, *Law Remakes U.S. Financial Landscape*, WALL STREET J. (July 16, 2010), http://www.wsj.com/articles/SB10001424052748704682604575369030061839958.

3 *See id.*

4 *See id.*

5 *See* Ben Protess, *Court Ruling Offers Path to Challenge Dodd-Frank*, N.Y. TIMES (Aug. 17, 2011, 8:41 PM), https://dealbook.nytimes.com/2011/08/17/court-ruling-offers-path-to-challenge-dodd-frank.

6 *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 177 (D.C. Cir. 2010); Chamber of Commerce of U.S. v. SEC, 412 F.3d 133, 144 (D.C. Cir. 2005).

7 647 F.3d 1144 (D.C. Cir. 2011).

8 *See Bus. Roundtable*, 647 F.3d at 1151–53; John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 918–19 (2015).

number of business associations filed lawsuits in the D.C. Circuit seeking to vacate rules promulgated under Dodd–Frank by the SEC and the Commodity Futures Trading Commission ("CFTC") on the grounds that their cost–benefit analyses were insufficient.[9] While these initial challenges had mixed success,[10] Obama Administration officials expressed concern that the mere threat of legal challenge could force financial regulators to slow the pace at which they issued new rules.[11] They also provided the blueprint for further challenges to Dodd–Frank rules as the rulemaking process dragged on.[12]

The *Business Roundtable* rule also caught the attention of legal scholars, who devoted numerous articles to discussing the wisdom of its rule and the specific methods agencies could use to comply with it.[13] But while they discussed the issues presented by the D.C. Circuit's precedents, the Supreme Court weighed in for the first time on the subject of cost–benefit analyses with its decision in *Michigan v. EPA*.[14] Justice Scalia's opinion in that case, although concerned on its face with cost–benefit analysis in an environmental regulation, was based on a textual argument broad enough to affect regulations in a wide range of areas.[15] Despite this breadth, very little has been written on the effect that *Michigan* might have on the challenges to Dodd–Frank rules in the D.C. Circuit.[16] But that effect is far-reaching; *Michigan* not only identifies a new statutory mandate for considering the costs of regulations but also offers guidance for settling an uncertain and hotly contested area of the law.[17] The best way to harmonize *Michigan* with the D.C. Circuit's cost–benefit analysis precedents is through a rule that requires agencies to

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9 *See* Nat'l Ass'n of Mfrs. v. SEC, 956 F. Supp. 2d 43, 46 (D.D.C. 2013); Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 8 (D.D.C. 2013); Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n, 891 F. Supp. 2d 162, 166 (D.D.C. 2012); Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n, 887 F. Supp. 2d 259, 260–61 (D.D.C. 2012).

10 *Compare* Inv. Co. Inst. v. Commodity Futures Trading Comm'n, 720 F.3d 370, 372 (D.C. Cir. 2013) (affirming the district court's judgment upholding the CFTC regulation), *and Inv. Co. Inst.*, 891 F. Supp. 2d at 221 (upholding the CFTC regulation), *with Int'l Swaps & Derivatives Ass'n*, 887 F. Supp. 2d at 284 (vacating the CFTC regulation).

11 *See* Nick Paraskeva, *Cost-Benefit Lawsuits Snarl Dodd-Frank Implementation*, REUTERS (Dec. 9, 2011), http://blogs.reuters.com/financial-regulatory-forum/2011/12/09/cost-benefit-lawsuits-snarl-dodd-frank-implementation.

12 *See, e.g.*, Metlife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 223 (D.D.C. 2016); Secs. Indus. & Fin. Markets Ass'n v. U.S. Commodity Futures Trading Comm'n, 67 F. Supp. 3d 373, 384 (D.D.C. 2014).

13 *See, e.g.*, Donna M. Nagy, *The Costs of Mandatory Cost-Benefit Analysis in SEC Rulemaking*, 57 ARIZ. L. REV. 129, 155 (2015); Richard L. Revesz, *Quantifying Regulatory Benefits*, 102 CAL. L. REV. 1423, 1430 (2014).

14 135 S. Ct. 2699 (2015).

15 *See* Andrew M. Grossman, Michigan v. EPA*: A Mandate for Agencies to Consider Costs*, 2014–2015 CATO SUP. CT. REV. 281, 293–94.

16 *Cf. id.* (interpreting *Michigan v. EPA*, 135 S. Ct. 2699 (2015), to apply the D.C. Circuit's cost–benefit rules to areas outside finance without discussing the impact it might have on financial regulation itself, in one of the few articles to consider the issue directly).

17 *Michigan*, 135 S. Ct. at 2711.

choose a method of accounting for costs and benefits that allows them to systematically determine whether costs significantly exceed benefits.

This Comment examines the effect of the Supreme Court's holding in *Michigan v. EPA* on the D.C. Circuit's precedents concerning the sufficiency of cost–benefit analyses in financial regulations. Part I describes the legal background of cost–benefit analyses of financial regulations pre-*Michigan*, including the statutory provisions mandating cost–benefit analyses, the development of D.C. precedent in this area, and the state of those precedents at the time the Supreme Court decided *Michigan*. Part II discusses the opinion in *Michigan* and the language in Dodd–Frank that makes its holding applicable to financial regulations. Finally, Part III analyzes a number of possible paths to harmonizing *Michigan* with the D.C. Circuit's precedents on cost–benefit analyses. The analysis draws from scholarship in the area and from established principles of statutory interpretation to find an application of *Michigan* to this area of law. This application gives effect to every word of the relevant statutes and avoids the pitfalls that scholars have identified in the pre-*Michigan* state of affairs.

I. BACKGROUND—THE REQUIREMENT THAT AGENCIES COMPARE COSTS AND BENEFITS

Cost–benefit analysis requirements for financial regulations do not spring from any single source. Their statutory origins lie in provisions of the organic statutes for the SEC and the CFTC.[18] While the language of these provisions is not identical, the D.C. Circuit has read the provisions together as a unified doctrine through the common machinery of the Administrative Procedure Act ("APA").[19] Before any attempt can be made at harmonizing this doctrine with the decision in *Michigan*, it is necessary to understand both the statutes that underpin the requirement that financial regulators consider costs and benefits and the evolution of the D.C. Circuit's precedent in this area.

A. *Statutory Background*

The basic foundation of the D.C. Circuit's cost–benefit analysis doctrine is the APA, which governs nearly all judicial review of federal regulations.[20]

18 *See* 7 U.S.C. § 19(a)(1) (2012); 15 U.S.C. § 78c(f) (2012).

19 *See, e.g.*, Inv. Co. Inst. v. Commodity Futures Trading Comm'n, 720 F.3d 370, 378 (D.C. Cir. 2013) (reviewing a CFTC regulation under the APA standard of review, and discussing cases involving SEC regulations as an integral part of its analysis).

20 *See* JAMES T. O'REILLY, ADMINISTRATIVE RULEMAKING §16:1, Westlaw (database updated Apr. 2018).

The APA limits courts' ability to review agency decisions, empowering them to overturn an agency's actions, including promulgated regulations, only if the court makes one of six specific findings regarding the agency action.[21] The most important of these is the finding that the agency's action is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[22] This "arbitrary and capricious" standard "is a narrow one. The court is not empowered to substitute its judgment for that of the agency."[23] The D.C. Circuit has relied on the arbitrary and capricious standard in reviewing every case involving a financial agency's cost–benefit analysis.[24]

The SEC and the CFTC are required by their organic statutes to consider costs and benefits when promulgating regulations.[25] The Securities Exchange Act of 1934 requires the SEC to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[26] The D.C. Circuit has held since 2005 that this provision requires the SEC to consider the costs and benefits of its proposed regulations.[27] The Commodity Exchange Act is even clearer in its requirement: the CFTC is explicitly required by statute to consider the costs and benefits of its actions in light of five factors.[28] However, despite the explicit statutory language, one court has characterized the CFTC's cost–benefit requirement as "not particularly demanding" because it does not require costs and benefits to be calculated in any rigorous way, nor does it require that the CFTC abandon a proposed action if it finds that costs exceed benefits.[29]

Other financial regulators, including the Federal Reserve, Federal Deposit Insurance Corporation, and Financial Stability Oversight Council, are not subject to a general statutory mandate to consider the costs and benefits of their actions.[30] However, they are subject to the Paperwork Reduction Act, the Regulatory Flexibility Act, and the Congressional Review Act, which apply to all agencies and which require consideration of costs within narrowly

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21 *See* 5 U.S.C. § 706(2).

22 § 706(2)(A).

23 Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc., 419 U.S. 281, 285 (1974) (quoting Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971)).

24 *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

25 *See* 7 U.S.C. § 19(a)(1); 15 U.S.C. § 78c(f).

26 15 U.S.C. § 78c(f).

27 *See* Chamber of Commerce of U.S. v. SEC, 412 F.3d 133, 144 (D.C. Cir. 2005).

28 *See* 7 U.S.C. § 19(a)(2) ("The costs and benefits of the proposed Commission action shall be evaluated in light of-- (A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations.").

29 Secs. Indus. & Fin. Mkts. Ass'n v. Commodity Futures Trading Comm'n, 67 F. Supp. 3d 373, 430–31 (D.D.C. 2014).

30 *See* Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S368–69 (2014).

specified domains.[31] The Office of the Comptroller of the Currency had previously been subject to a cost–benefit requirement while it was part of the Treasury Department, but the Office was converted into an independent agency under Dodd-Frank and is thus no longer subject to those requirements.[32]

B. *D.C. Circuit Precedent on Cost–Benefit Analyses*

D.C. Circuit precedent on cost–benefit analyses begins with a case that does not involve financial regulation at all, but rather automotive regulation. In *Public Citizen v. Federal Motor Carrier Safety Administration*,[33] the court struck down a revision of a regulation that limited the hours that long-haul truckers could work in a given period.[34] The court based its holding on its determination that the agency had completely neglected to consider a statutorily mandated factor in crafting its regulation, rather than on deficiencies in its cost–benefit analysis.[35] However, the court also included extensive dicta in which it noted that the statute required the agency to create a cost–benefit analysis, an analysis the court found insufficient under the statute.[36]

The critiques in *Public Citizen* were soon applied to financial regulations in *Chamber of Commerce v. SEC*,[37] a case concerning a rule requiring a certain proportion of independent directors on investment company boards of directors.[38] The court vacated the regulation because the SEC had treated uncertainty about certain costs as a reason to avoid considering those costs to the extent that it could not estimate them.[39] The D.C. Circuit again struck down an SEC regulation for an insufficient cost–benefit analysis in *American Equity Investment Life Insurance Co. v. SEC*.[40] In this case, the court vacated the SEC's rule because the agency had not considered whether existing state regulations were sufficient to produce the benefits sought by federal regulation.[41] Importantly, both *Chamber of Commerce* and *American Equity Investment Co.* were decided based on whether the SEC had included all the required factors in its analysis, whether that meant accounting for every category of cost or ensuring that those costs were compared against the

31 *See id.* at S368.
32 *See id.* at S369.
33 374 F.3d 1209 (D.C. Cir. 2004).
34 *See* Pub. Citizen v. Fed. Motor Carrier Safety Admin., 374 F.3d 1209, 1214–17 (D.C. Cir. 2004).
35 *See id.* at 1216.
36 *See id.* at 1218–19, 1221–22.
37 412 F.3d 133 (D.C. Cir. 2005).
38 *See id.* at 136.
39 *See id.* at 143–44.
40 613 F.3d 166 (D.C. Cir. 2010).
41 Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 178–79 (D.C. Cir. 2010).

appropriate baseline. In neither case did the court question the SEC's factual determinations in the categories they did consider.

The boundary preventing the court from reviewing the substance of agency cost–benefit analyses evaporated just one year later in *Business Roundtable*. *Business Roundtable*, the most controversial case in this line of precedent, concerned a regulation requiring companies to grant shareholder proxy access—i.e., to notify shareholders of certain opposition candidates during corporate board elections.[42] The court held that the cost–benefit analysis accompanying the regulation was insufficient on a number of grounds, all rooted in the specific content of the agency's analysis, rather than the relatively broad strokes referenced in the cases preceding it.[43] Specifically, the court faulted the SEC for underestimating the costs corporations would incur by contesting board elections.[44] The SEC relied (in the court's view) on "relatively unpersuasive studies" in determining that proxy access would improve shareholder value and failed to consider that investors such as labor unions and public pension funds might abuse proxy access for their own gain.[45] The wisdom of the proxy access rule has been questioned by a number of scholars, which lends support to the court's decision as a policy matter.[46] However, the court's apparent willingness to "substitute its judgment for that of the agency"[47] led to widespread condemnation in academia, even from scholars who have otherwise been vocally supportive of stronger cost–benefit analysis requirements.[48]

The most important development in this area after *Business Roundtable* is the decision in *Investment Co. Institute v. Commodity Futures Trading Commission*,[49] which upheld a CFTC regulation that increased oversight over derivatives traders.[50] The court distinguished *Business Roundtable* by describing its rule as being essentially the same as the rule in *American Equity Investment Co.*, where the court struck down a regulation because the agency failed to consider benefits from an appropriate regulatory baseline.[51] This

42 *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1147 (D.C. Cir. 2011).

43 *See id.* at 1148–54; Coates, *supra* note 8, at 917–19.

44 *See Bus. Roundtable*, 647 F.3d at 1149–52.

45 *Id.*

46 *See, e.g.*, Thomas Stratmann & J.W. Verret, *Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?*, 64 STAN. L. REV. 1431, 1465 (2012).

47 Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc., 419 U.S. 281, 285 (1974) (quoting Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971)).

48 *See, e.g.*, Cass R. Sunstein & Adrian Vermeule, *Libertarian Administrative Law*, 82 U. CHI. L. REV. 393, 441 (2015) (describing the *Business Roundtable* decision as "an excessively aggressive exercise of the power of judicial review, with undue second-guessing of the complex administrative record"); Nagy, *supra* note 13, at 157.

49 720 F.3d 370 (D.C. Cir. 2013).

50 *See* Inv. Co. Inst. v. Commodity Futures Trading Comm'n, 720 F.3d 370, 372, 374 (D.C. Cir. 2013).

51 *See id.* at 378.

description of *Business Roundtable*, at odds with the scholarly community's interpretation of that case, created confusion about how deeply the D.C. Circuit intended to analyze agency cost–benefit analyses.[52]

II. *MICHIGAN V. EPA*

Not long after the D.C. Circuit's flurry of decisions concerning cost–benefit analysis, the Supreme Court, for the first time, issued its own opinion on the subject, though in a very different context. *Michigan v. EPA* concerned a regulation limiting the emissions of air pollutants from power plants.[53] Justice Scalia, writing for a 5–4 majority, found the Environmental Protection Agency's ("EPA") regulation to be arbitrary and capricious under the APA because the agency had improperly failed to consider the costs of its regulation at a statutorily specified point in the regulatory process.[54] Justice Kagan, writing for the four dissenting Justices, took issue with the majority's characterization of the agency's decision-making process, arguing that the agency had adequately considered costs throughout the regulatory process and, therefore, had not violated the statute.[55] Justice Thomas wrote a concurring opinion arguing that the behavior of the EPA in this case should prompt the Court to reconsider its deference to agency interpretations of the statutes they execute under the *Chevron* doctrine and its progeny.[56]

A. *Factual Background*

In *Michigan*, the EPA promulgated a regulation under a statute that required it to conduct a study of air pollutants and regulate power plant emissions if, after the study, the agency found it was "appropriate and necessary" to do so.[57] The EPA did find as much, based on its determination that the air pollutants it studied were hazardous to human health.[58] The EPA then wrote and promulgated its regulation, along with a regulatory impact analysis required by executive order.[59] The regulatory impact analysis calculated the costs of the regulation at over $9 billion per year, while calculable benefits rested between $4 and $6 million per year.[60] It also calculated that the regulation would have second-order or ancillary benefits, from reducing

52 *See* Sunstein & Vermeule, *supra* note 48, at 450–51.
53 *See* Michigan v. EPA, 135 S. Ct. 2699, 2704 (2015).
54 *See id.* at 2707–08.
55 *See id.* at 2714–15 (Kagan, J., dissenting).
56 *See id.* at 2712 (Thomas, J., concurring).
57 *See id.* at 2705 (majority opinion).
58 *See id.*
59 *See Michigan*, 135 S. Ct. at 2705–06.
60 *See id.* (noting that the agency could not fully calculate the direct benefits of the regulation).

emissions of pollutants that were not classified under the statute, between $37 and $90 billion per year.[61] The EPA did not make these calculations until after it decided to regulate power plants, and it did not consider the costs of regulating before it made the initial decision to regulate power plant emissions.[62]

B. *The Majority Decision in* Michigan

The Court held that the failure to consider costs at the opening stages of regulation meant the EPA had shirked the statutory requirement that it find regulation to be "appropriate and necessary" before it acted.[63] Justice Scalia, writing for the majority, observed that "[o]ne would not say that it is even rational, never mind 'appropriate,' to impose billions of dollars in economic costs in return for a few dollars in health or environmental benefits," and therefore the APA "requires at least some attention to cost" during the regulatory process.[64]

There are a number of moving parts in the decision. Strictly speaking, the holding is based on the time at which the agency considers costs: the Court held that it was insufficient for the cost considerations to come after the agency decided to regulate when the statute required it to first determine whether regulation was "appropriate and necessary."[65] But the reason *why* it is inappropriate to ignore costs is that, without prior cost consideration, the agency may decide to create regulations whose costs are wildly out of scale with their benefits.[66] So, while the narrowest reading of the opinion might suggest that an agency may be able to meet its statutory burden by considering costs without any relation to benefits,[67] an interpretation that is more faithful to the logic of the opinion would demand some comparison of costs to benefits, and a finding that the costs do not significantly outweigh the benefits.

There is also a question of whether the agency is allowed to consider only benefits directly related to the goals envisioned under its operating statute. The Court distinguished between direct benefits, which were very low compared to costs in this case, and "ancillary effects," whose benefits dramatically outweighed costs in the same regulation.[68] The distinction in the

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61 *See id.* at 2706.

62 *See id.*

63 *See id.* at 2707.

64 *Id.*

65 *See Michigan*, 135 S. Ct. at 2707.

66 *See id.*

67 Such an interpretation might rely heavily on the statement in the opinion that "[w]e need not and do not hold that the law unambiguously required the Agency . . . to conduct a formal cost-benefit analysis . . . . It will be up to the Agency to decide . . . how to account for cost." *Id.* at 2711.

68 *See id.* at 2706.

opinion, along with some of its language in which the Court characterizes benefits as being very small compared to costs, may indicate that only direct benefits can be considered.[69] But in another part of the opinion, the Court stated that the word "cost" can indicate any "disadvantage" as a result of the regulation, rather than just the cost of compliance.[70] This may indicate, in a symmetrical fashion, that indirect or ancillary benefits are as worthy of consideration as the direct benefits envisioned by statute.

C. *The Dissenting Opinion*

Justice Kagan, joined by Justices Ginsburg, Breyer, and Sotomayor, dissented from the majority's holding that the EPA's decision making was arbitrary and capricious under the APA.[71] Her dissent is based on two premises: that it was within the EPA's authority to delay its cost–benefit considerations until later stages of the regulatory process, and that the EPA did eventually find that the benefits of its power plant emissions regulation did exceed its costs.[72]

Immediately, it is notable how narrow Justice Kagan's dissent is. Justice Kagan agrees explicitly at the outset that the EPA's regulation could be struck down as arbitrary and capricious if the agency had failed to consider costs at some stage of the regulatory process, due to the presence of the "appropriate and necessary" language.[73] This agreement indicates that the majority's holding—that "appropriate and necessary" language includes a cost–benefit requirement—enjoys substantially more support among the Justices than *Michigan*'s 5–4 split might otherwise suggest.[74]

Justice Kagan's contention that the EPA did find that benefits exceeded costs in this case is more problematic. This can be the case only if the benefits calculation includes what the majority referred to as "ancillary benefits," and indeed the numbers cited in the dissent are consistent with the ancillary benefits described in the majority opinion.[75] This portion of the dissent highlights a potential inconsistency in the majority's holding: the majority does not explicitly reject the consideration of ancillary benefits, but unless it does so, it is forced to admit that the regulation it struck down actually has dramatically higher benefits than costs.

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69 *See id.* ("The costs to power plants were thus between 1,600 and 2,400 times as great as the quantifiable benefits from reduced emissions of hazardous air pollutants.").

70 *Id.* at 2707.

71 *See Michigan*, 135 S. Ct. at 2714–15 (Kagan, J., dissenting).

72 *See id.* at 2714–15, 2721 (Kagan, J., dissenting).

73 *See id.* at 2714 (Kagan, J., dissenting).

74 *See id.* (Kagan, J., dissenting) ("I agree with the majority . . . that EPA's power plant regulation would be unreasonable if '[t]he Agency gave cost no thought *at all*.'").

75 *Compare id.* at 2706 (majority opinion) *with id.* at 2721 (Kagan, J., dissenting).

The dissent also highlights how differently the case may have been decided if the statutory language had not been particular about the timing of the EPA's regulatory decisions. Justice Kagan describes at great length the intricate cost considerations the EPA performed before issuing its final rule and insists that the results of this extensive analysis should control even in the face of statutory language requiring an initial determination of "appropriateness and necessity."[76] This extensive cost consideration, undertaken over a decade, is considerably more detailed than some of the analyses that accompany the multitude of regulations promulgated in the immediate wake of Dodd–Frank.[77] Even under the majority's rule, a case in which the statute required the final rule to be promulgated only as appropriate and necessary may thus have turned on the quality of the agency's analysis, rather than its timing. This might have changed the outcome for the EPA in *Michigan* and might bode worse for agencies whose cost–benefit analyses are less diligent and that would prefer to read the *Michigan* rule more narrowly.

D. *"Appropriate and Necessary" Language in Dodd–Frank*

Dodd–Frank contains many instances of the language, in a number of variations, at issue in *Michigan*.[78] This includes the section on regulating position limits,[79] which was at issue in one of the first lawsuits against a Dodd–Frank regulation.[80] This language qualifies the authority granted by Dodd–Frank to every financial regulator in some fashion, including the SEC and CFTC, as well as the agencies that are not subject to statutorily mandated cost–benefit analysis. Additionally, the provision of the Securities Exchange Act the D.C. Circuit has interpreted as a cost–benefit mandate specifically applies to rulemaking whenever the SEC "is required to consider or

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76 *See id.* at 2718–22.

77 *See generally* COMMODITY FUTURES TRADING COMM'N OFFICE OF THE INSPECTOR GEN., A REVIEW OF COST-BENEFIT ANALYSES PERFORMED BY THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH RULEMAKINGS UNDERTAKEN PURSUANT TO THE DODD-FRANK ACT ii (2011), https://www.cftc.gov/sites/default/files/idc/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf (suggesting that early Dodd–Frank cost–benefit analyses could have benefitted from "a more robust process" that was "clearly permitted" by guidance documents).

78 *Compare Michigan*, 135 S. Ct. at 2704 ("appropriate and necessary"), *with* 7 U.S.C. § 6a(a)(4) (2012) ("as appropriate), 12 U.S.C. § 16 (2012) ("necessary or appropriate"), 12 U.S.C. § 371c(f)(4) ("necessary or appropriate"), 12 U.S.C. § 5389 ("necessary or appropriate"), 12 U.S.C. § 5390(a)(7)(D) ("deems appropriate"), *and* 12 USC § 5390(c)(8)(H)(i) ("necessary or appropriate").

79 A position limit is a regulation on the maximum amount a single investor can invest in a single asset or derivative based on that asset. *See Definition of Position Limit*, FIN. TIMES, http://markets.ft.com/research/Lexicon/Term?term=position-limit (last visited Oct. 20, 2018).

80 *See* Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n, 887 F. Supp. 2d 259, 261 (D.D.C. 2012); 7 U.S.C. § 6a(a)(4) (including "as appropriate" language in CFTC's authority under Dodd–Frank to regulate position limits).

determine whether an action is necessary or appropriate in the public interest."[81] This language may mean that the *Michigan* rule applies to proposed SEC rules even apart from their authority under Dodd–Frank. Because the D.C. Circuit precedents on cost–benefit analyses rely on a statutory mandate to consider costs and benefits, the remainder of this Comment applies primarily to the SEC and CFTC.

One immediate issue in applying *Michigan* to the Dodd–Frank regulations is that Dodd–Frank does not use the precise phrase "appropriate and necessary" in every instance where the word "appropriate" is used to qualify the scope of an agency's regulatory power.[82] The Court makes clear, however, that "appropriate" and "necessary" have distinct meanings and that it is the word "appropriate" which encompasses cost considerations.[83] The Court considered an argument by the EPA that "appropriate and necessary" means only that the agency found that existing regulations would not completely cure the problem of harmful air pollution.[84] The Court rejected that argument, observing that if this was all that was meant by the statute, then it would read only "necessary," rather than "appropriate and necessary."[85] This indicates that the Court understood the word "necessary" to mean the regulation is expected to achieve real benefits and not be mooted by existing regulations or other circumstances. The word "appropriate," by contrast, means those benefits are worth pursuing by regulation, which includes considering their cost.[86]

III. INTERPRETING COST–BENEFIT REQUIREMENTS IN LIGHT OF *MICHIGAN V. EPA*

There are a number of possible ways to harmonize *Michigan* with existing precedent on cost–benefit analyses for financial regulations. Little scholarly attention has been paid to this subject, so most of the alternatives analyzed in this section are drawn from the D.C. Circuit's pre-*Michigan* decisions. These alternatives range from a narrow interpretation that confines

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81 15 U.S.C. § 78c(f); *see also* Chamber of Commerce of U.S. v. SEC, 412 F.3d 133, 144 (D.C. Cir. 2005), *vacated in part*, 443 F.3d 890 (D.C. Cir. 2006).

82 *See, e.g.*, 7 U.S.C. § 6a(a)(2)(A) ("[T]he [CFTC] shall by rule, regulation, or order establish limits on the amount of positions, *as appropriate*, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market." (emphasis added)).

83 *See Michigan*, 135 S. Ct. at 2705, 2707, 2710.

84 *See id.* at 2710.

85 *See id.*

86 *See id.* at 2707 ("In particular, 'appropriate' is 'the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors.' . . . One would not say that it is even rational, never mind 'appropriate,' to impose billions of dollars in economic costs in return for a few dollars in health or environmental benefits." (quoting White Stallion Energy Ctr., LLC v. EPA, 748 F.3d 1222, 1266 (D.C. Cir. 2014))).

Michigan to the issue of when cost considerations should take place in rule-making to a full-throated endorsement of *Business Roundtable*–style judicial review. Ultimately, *Michigan* is best understood by an interpretation that threads the needle between *Business Roundtable*'s heavy-handed review and the relatively permissive review used in cases such as *Investment Co. Institute*.

A. *The Narrow Rule*

The most straightforward way to apply *Michigan v. EPA* to the D.C. Circuit's precedents is to apply it as little as possible. The *Michigan* holding is most directly related to the stage of the regulatory process at which the EPA began to consider costs and benefits; the agency waited until after it had decided to regulate power plants before exploring how much it would cost power plants to be regulated, in contravention of the statute.[87] It is tempting, then, to apply this holding naïvely and argue that all *Michigan* stands for is that where "appropriate and necessary" language is used in a statute, agencies promulgating regulations under that statute must give some consideration to cost before deciding whether to regulate.

This interpretation misunderstands the thrust of the Court's opinion and is especially misleading in areas such as financial regulation where statutory requirements to consider cost already exist. The Court held that cost considerations needed to be made before the decision to regulate because the statute required the agency to consider whether it was "appropriate and necessary" to regulate *at all*, rather than just determining the "appropriate and necessary" content of regulation.[88] That is not the case in many sections of Dodd–Frank, which ask the agency to consider the appropriate content of its regulations and not just whether it is "appropriate and necessary" to regulate as a threshold consideration.[89] If "appropriate and necessary" determines only the regulatory stage at which costs are to be considered, then that language in Dodd–Frank is superfluous insofar as it applies to the SEC or CFTC. Both agencies

87 *See id.* at 2705–07.

88 *See id.* at 2711–12; 42 U.S.C. § 7412(n)(1)(A) (2012) ("The Administrator shall regulate [power plants] under this section, if the Administrator finds such regulation is appropriate and necessary after considering the results of the study required by this subparagraph.").

89 *See, e.g.*, 7 U.S.C. § 6a(a)(2)(A) (2012) ("[T]he [CFTC] shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market."); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413(b)(1)(B), 124 Stat. 1376, 1578 (2010) ("Upon completion of a review under subparagraph (A), the [SEC] may, by notice and comment rulemaking, make such adjustments to the definition of the term 'accredited investor' . . . as the Commission may deem appropriate for the protection of investors, in the public interest, and in light of the economy.").

are already required by another statutory provision to consider costs and benefits in determining the content of their regulations.[90] This narrow reading of *Michigan* therefore results in surplus, meaningless statutory language, which under accepted canons of statutory construction should be avoided whenever possible.[91]

Even if it were fair to understand *Michigan* as requiring the SEC and CFTC, under Dodd–Frank, to simply move their cost considerations to the beginning of the regulatory process, a broader interpretation would still be necessary to give force to the holding of the opinion. The *Michigan* opinion rests on the idea that it is not appropriate to promulgate a regulation whose costs dramatically exceed its benefits.[92] Neither the CFTC nor the SEC were explicitly required under pre-*Michigan* law to reject regulations where expected costs exceeded expected benefits, so long as they had considered all the requisite elements of those costs and benefits.[93] So *Michigan* must require some substantive change to the way the SEC and CFTC perform cost–benefit analyses, because they must now not only consider costs and benefits but compare them to one another and determine that costs do not significantly outweigh benefits.

B. *The* Business Roundtable *Rule*

Michigan might also be read as a vindication of the *Business Roundtable* rule, which required utmost precision in comparing benefits and costs, backed by the promise of almost unlimited judicial review. This is also inconsistent with the Court's opinion in *Michigan*. The *Michigan* Court explicitly states that its rule does not require a formal cost–benefit analysis and that agencies retain discretion to decide how to account for costs and benefits, subject only to "the limits of reasonable interpretation."[94] If *Business Roundtable* stands for anything outside the rule in *Investment Co. Institute* (discussed in Section III.C), it stands for the requirement that agencies produce quantified evidence sufficient to convince the reviewing court that its accounting of costs and benefits is correct. That rule cannot be read into an opinion which says explicitly that full quantification of costs and benefits is not required and that agencies may account for costs and benefits to their own satisfaction.

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90 *See* 7 U.S.C. § 19(a)(1) (CFTC); 15 U.S.C. § 78c(f) (2012) (SEC).

91 *See* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 174 (2012).

92 *See Michigan*, 135 S. Ct. at 2707.

93 *See* 7 U.S.C. § 19(a)(1) (CFTC); 15 U.S.C. § 78c(f) (SEC); Secs. Indus. & Fin. Mkts. Ass'n v. U.S. Commodity Futures Trading Comm'n, 67 F. Supp. 3d 373, 430–31 (D.D.C. 2014) (describing CFTC's cost–benefit requirement as "not particularly demanding" in part because the CFTC could still choose to promulgate a regulation whose costs exceeded its benefits).

94 *Michigan*, 135 S. Ct. at 2711.

Additionally, and more to the point, *Business Roundtable*'s holding is a disfavored anomaly. Legal scholars have openly disputed whether it is even possible as a practical matter to follow its holding in normal regulatory situations.[95] Its holding was drastically tapered in a case heard just two years after *Business Roundtable* was decided, in an opinion written by a judge who was on the *Business Roundtable* panel.[96] Even if *Michigan* could fairly be read to incorporate the *Business Roundtable* holding, policy considerations alone would forbid it so long as a viable alternative exists.

C. *The* Investment Co. Institute *Rule*

Having dispensed with the extreme positions, the next to consider is the rule from *Investment Co. Institute*. The court in that case incorporated the rule from *American Equity Life Insurance Co.* that agencies must measure costs and benefits from a baseline that includes all existing regulations, but it went on to specifically vindicate the CFTC's decision not to quantify certain expected benefits of its regulation.[97] Reasonable as its holding sounds, *Investment Co. Institute* cannot provide a complete answer to the issue of how to harmonize *Michigan* with existing precedent. As an initial matter, if *Business Roundtable* is as disfavored as some scholars suspect, then *Investment Co. Institute* to a large extent *is* the D.C. Circuit's pre-*Michigan* precedent, since it purports to incorporate *Chamber of Commerce* and *American Equity Life Insurance Co*.[98] If *Investment Co. Institute* is the extant rule in the D.C. Circuit, *Michigan* cannot be read to require an identical rule without creating surplus statutory language because its rule operates through a different part of the statute.

Even assuming that surplusage is not an issue, the court's willingness in *Investment Co. Institute* to allow the CFTC to leave the principal benefits of its regulation wholly unquantified conflicts with the holding in *Michigan*. While *Michigan* does not require full quantification of costs and benefits, it does require that costs not significantly outweigh benefits.[99] The *Michigan* Court's willingness to characterize the EPA regulation's costs as being thousands of times greater than its benefits, despite the agency's statement that it

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95 *See* Coates, *supra* note 8, at 997–99 (arguing that attempts at fully quantifying costs and benefits in financial regulation amount to little more than "number-laden guesswork"); Gordon, *supra* note 30, at S373–74 (arguing that problems of circularity make the costs and benefits of financial regulations impossible to measure in advance).

96 *See* Gordon, *supra* note 30, at S373 (noting that Judge David Sentelle, who wrote the opinion in *Investment Co. Institute v. CFTC*, was on the *Business Roundtable* panel and also wrote the opinion in *American Equity Investment Life Insurance Co. v. SEC*).

97 *See* Inv. Co. Inst. v. Commodity Futures Trading Comm'n, 720 F.3d 370, 378–79 (D.C. Cir. 2013).

98 *See id.* at 376, 378.

99 *See Michigan*, 135 S. Ct. at 2707, 2711.

could not fully quantify the regulation's benefits, highlights the inherent difficulty in comparing a quantified cost to an intangible benefit.[100] Further, *Michigan* requires that agency consideration of costs and benefits be "reasonable,"[101] and justifications of agency regulations that rely on unquantified benefits make it impossible for outside observers to know whether it is reasonable to believe that the regulation's benefits outweigh its costs.[102]

D. *Threading the Needle*

The discussion in the previous section highlighted the need for an interpretation that threads the needle between avoiding an interpretation of *Michigan* that requires full quantification and one that allows agencies to avoid quantifying large portions of their cost–benefit analysis. *Michigan* explicitly disqualified any interpretation that mandated a single, standard method of cost consideration.[103] But it also explicitly disqualified any method that would validate a regulation which "does significantly more harm than good."[104] The D.C. Circuit precedent elucidated in *Investment Co. Institute* and *American Equity Investment Co.* also highlights the long-established principle of administrative law that a court should not delve so deeply into the agency's decision making that it displaces the agency's expert judgment with its own opinion.[105] Rather, the court should analyze the sufficiency of the agency's decision-making process instead of the specific fruits of that process. Taken together, the best way to harmonize *Michigan* with D.C. Circuit precedent on financial regulators' cost–benefit analyses is with a rule that requires agencies to choose a method of accounting for costs and benefits that allows it to determine, in a systematic way, whether costs significantly exceed benefits.

At first glance, this formulation may seem utterly banal. Financial regulators, unlike environmental regulators who must balance pecuniary costs with environmental costs and public health costs, can express essentially all their regulatory costs and benefits in a single unit of account: the U.S. dollar. One might assume from this fact that essentially any cost–benefit analysis

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100 *See id.* at 2706; Nick Hodges, *Solving the Zero Problem: Marginal Analysis as a Second Best Alternative to Cost-Benefit Analysis*, 27 STAN. L. & POL'Y REV. 159, 175 (2016) (observing that critics of the regulation at issue in *Michigan* assumed that unquantified benefits were "miniscule" compared to the quantified costs).

101 *Michigan*, 135 S. Ct. at 2711.

102 *See* Hodges, *supra* note 100, at 174.

103 *See Michigan*, 135 S. Ct. at 2711 ("We . . . do not hold that the law unambiguously required the Agency . . . to conduct a formal cost-benefit analysis in which each advantage and disadvantage is assigned a monetary value.").

104 *Id.* at 2707.

105 Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n, 720 F.3d 370, 376 (D.C. Cir. 2013); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 173–74 (D.C. Cir. 2010).

that a financial regulator might perform would be able to decide at the bottom line whether costs exceed benefits. But while costs and benefits might all be expressed in the same units, predicting the effects of a financial regulation can be extraordinarily difficult. Finance is a deeply interconnected artificial system in which even small changes can have unexpected consequences in far-flung corners of the market.[106] This is particularly true with respect to systemic risk, the danger that Dodd–Frank is primarily intended to address.[107] Systemic risk is the chance that a failure in one part of the market spreads to the rest of the market.[108] This risk is unexpected by its nature, with its causes and method of propagation usually understood only after the fact, once the relevant information comes to light.[109] Because both the odds of a systemic risk event and the damage potential of that risk are very difficult to know in advance, regulatory agencies have often insisted that the benefit of a regulation intended to curb systemic risk is unquantifiable.[110] But if the agency claims only unquantifiable benefits for its regulations, it is difficult to see how it can claim that those benefits nonetheless outweigh the regulation's costs. Agencies and courts alike tend to interpret unquantified benefits as being equivalent to *zero* benefits, in which case such regulations would always be invalid under the *Michigan* rule.[111] But Dodd–Frank is explicitly designed to produce these regulations, so without a method for comparing unquantified benefits with quantified costs, the *Michigan* rule might annul Congress's intent to ameliorate systemic risk in the American financial sector.

Thankfully, scholars have identified a number of "second-best" methods agencies can use to indirectly compare unquantified benefits to quantified costs.[112] The Office of Management and Budget, which regulates the cost–benefit analyses that executive agencies perform under an executive order, accepts several such methods when full quantification proves difficult or impossible.[113] The most promising of these for financial regulation may be break-even analysis, which is used to determine the lowest level of benefits that would exceed a regulation's costs.[114] Another possible technique is marginal analysis, which seeks to compare related regulations when costs and benefits can be quantified but are not expressed in the same units.[115] In a

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106 *See* Gordon, *supra* note 30, at S374.

107 *See* Paletta & Lucchetti, *supra* note 2.

108 *See* George G. Kaufman, *Banking and Currency Crises and Systemic Risk: Lessons from Recent Events*, ECON. PERSPECTIVES, Aug. 2000, at 9, 14.

109 *See id.* at 15.

110 *See* COMMODITY FUTURES TRADING COMM'N OFFICE OF THE INSPECTOR GEN., *supra* note 77, Ex. 2, at 41.

111 *See* Hodges, *supra* note 100, at 175.

112 Revesz, *supra* note 13, at 1427 (explaining that these techniques are "second-best" because it would be preferable to have a specific quantity where possible).

113 *See* Hodges, *supra* note 100, at 177–80.

114 *See* Revesz, *supra* note 13, at 1426–27.

115 *See* Hodges, *supra* note 100, at 182–83.

marginal analysis, the costs and benefits of each level of regulation are estimated and compared to find a point at which incurring additional regulatory costs brings diminishing returns.[116]

Under the *Michigan* rule, courts should leave it to the agency to decide which of these methods to use in its cost–benefit analysis or even to decide on another similar method of its own devising. But courts should insist that the agency actually choose a method of this variety, so that the court is confident that the agency's method of considering costs and benefits is one that can reliably answer whether a regulation's costs exceed its benefits. Anything less and the agency has run afoul of the *Michigan* rule and its own organic statute.

1. Break-Even Analysis

Break-even analysis is an especially celebrated second-best method, largely thanks to the advocacy of Professor Cass Sunstein.[117] It is useful when, as is frequently the case, an agency can precisely quantify the costs of its regulations but has only limited information about its potential benefits.[118] In these cases, the regulation's cost serves as a reference point to determine the minimum benefit level necessary to justify passing the regulation.

In the case of regulations designed to reduce the risk of future financial crises, the main issue of uncertainty is the effect of a regulation on the chances that another financial crisis will occur. The magnitude of a crisis can be estimated after the fact and used to frame the expected cost of a future crisis,[119] but the odds that another crisis will occur, let alone the amount by which a particular regulation changes those odds, has been described by the D.C. Circuit as "immeasurable."[120] Using the known quantities (the regulation's costs and the expected cost of a future financial crisis), an agency can employ break-even analysis to estimate the minimum change in the risk of a future financial crisis that would justify the regulation, and from there decide whether the regulation is reasonably capable of effecting a change of that size.

Suppose, for example, that a proposed financial regulation will cost $5 billion per year in compliance costs and reduced revenues. The Federal

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116 *See id.* at 183 (explaining that if there are no diminishing returns, or if returns increase with greater regulation, this analysis would suggest that the highest level of regulation is appropriate).

117 *See, e.g.*, Cass R. Sunstein, *Financial Regulation and Cost-Benefit Analysis*, 124 YALE L.J.F. 263, 270–75 (2015); Cass R. Sunstein, *The Limits of Quantification*, 102 CAL. L. REV. 1369, 1385–89 (2014).

118 *See Financial Regulation and Cost-Benefit Analysis, supra* note 117, at 272.

119 *See* David Luttrell et al., *Assessing the Costs and Consequences of the 2007–09 Financial Crisis and Its Aftermath*, ECON. LETTER, Sept. 2013, at 1, 4 (estimating the cost of the 2007–09 financial crisis as between $6 and $14 trillion).

120 Inv. Co. Inst. v. Commodity Futures Trading Comm'n, 720 F.3d 370, 379 (D.C. Cir. 2013).

Reserve Bank of Dallas has estimated that the cost of the 2007–09 financial crisis was between $6 and $14 trillion.[121] Even at the most conservative end of that range, to justify the regulation's costs, it would need to reduce the annual risk of a financial crisis by 0.08%. As a back-of-the-envelope calculation, assuming that the 2007–09 crisis is a similar event to the 1929 crisis that precipitated the Great Depression, then the average annual risk of a crisis is one in seventy-eight, or about 1.28%. So for the regulation to be worth its cost, it would need to reduce the total annual risk of a financial crisis to 1.20%, or about one in eighty-three. With this information, the agency is in a much better position to decide whether the regulation's scope is large enough to justify believing that it would have such an effect, and therefore whether its costs significantly exceed its benefits.

2. Marginal Analysis

Whereas break-even analysis is useful to fill in missing quantitative information in a cost–benefit analysis, marginal analysis is useful when attempting to analyze the relationship between costs and benefits that cannot be directly compared. The most obvious application is in environmental regulation, where costs are generally expressed in dollars while benefits are expressed in damage to human health and to the environment.[122] But there are also applications in financial regulation—for example, when dealing with issues of general corporate practice that cannot easily be converted into dollar amounts.[123] One such area of financial regulation is the very issue at stake in *Business Roundtable*: shareholder access to a company's proxy materials.[124] The costs of the proxy access rule are mostly a function of the number of proxy contests engendered as a result of the rule.[125] The benefits of proxy access lie largely in the potential for improved corporate governance by installing directors whose interests are better aligned with the interests of

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121 *See* Luttrell et al., *supra* note 119, at 1.

122 *See* Michigan v. EPA, 135 S. Ct. 2699, 2705 (2015) (noting that the EPA justified promulgating an air pollution regulation by reference to the damage such pollution does to human health and the environment); Hodges, *supra* note 100, at 183–84 (providing an example of marginal analysis that compares compliance costs to the harmful effect of a toxin on human health) .

123 *See Financial Regulation and Cost-Benefit Analysis, supra* note 117, at 271 (observing that "[t]he universe of financial regulations is very large" and defies simple categorization).

124 *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1146–47 (D.C. Cir. 2011); Hodges, *supra* note 100, at 198 (identifying the *Business Roundtable* issue as an area where marginal analysis may be useful). Note that the application of marginal analysis to the issue in this Comment differs from the one Mr. Hodges applied.

125 *See Bus. Roundtable*, 647 F.3d at 1149–50 (noting that corporations incur millions of dollars during each proxy contest and that there is good reason to believe that practically every shareholder nomination in which the board preferred its own candidate would result in a proxy contest).

shareholders.[126] These benefits do not scale directly with the number of proxy contests; shareholder nominees do not always win in proxy contests, and the SEC has recognized that even when those nominees do win, they sometimes clash destructively with the rest of the board, degrading corporate governance rather than improving it.[127] In such cases, the proxy contest is doubly costly: the corporation incurs costs from the proxy contest itself and incurs costs again when the new director turns out to be of lower quality than his predecessor. There is also the potential for certain "special interest" shareholders, such as labor unions and state pension funds, to abuse proxy access rules as a means of pressuring the board to enact an agenda favorable to them at the expense of the corporation or other shareholders.[128]

While the benefits of high-quality corporate governance (and the costs of low-quality corporate governance) can theoretically be monetized by reference to a company's share price, as with benefits to human health, this may obscure rather than illuminate the actual effects of the regulation. The exchange rate between corporate governance and share price is not easy to estimate ex ante and may depend on individual circumstances.[129] In addition, an analysis that used dollars on both sides of the ledger would not be able to distinguish between a reduction in cost due to a lower expected number of proxy contests (by restricting proxy access, against the goals of the rule[130]) and a reduction due to higher-quality corporate governance on average (furthering the goals of the rule).[131] Because the costs and benefits of the regulation are difficult to adequately express in the same units, traditional cost–benefit analysis may not be useful in this case. Marginal analysis, on the other hand, can be used to compare the costs and benefits of the regulation.

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126 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,073–74 (June 18, 2009) (codified at 17 C.F.R. § 240.14a-8). Note that another significant portion of the benefits of this proposed rule consisted of reducing the costs of nominating directors to the shareholder-nominators. This benefit is fully quantifiable and not large enough to justify the costs of the regulation on its own. *See Bus. Roundtable*, 647 F.3d at 1150 (finding the lowest estimate of a proxy contest to be $800,000); Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,073 (finding the average total cost to shareholders for soliciting a proxy contest to be $368,000, which the regulation would directly reduce by only $18,000 per contest).

127 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,075.

128 *Bus. Roundtable*, 647 F.3d at 1151–52; *see also* Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,075 ("[T]he proposals could introduce a cost to shareholders to the extent that the nomination procedure is used by shareholders to promote an agenda that conflicts with other shareholders' interests.").

129 *See Bus. Roundtable*, 647 F.3d at 1151 (finding that the empirical evidence on this subject was mixed at best); Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,073–75 (listing changes in corporate governance as both a potential benefit and a potential cost, depending on the individual interests of incoming directors).

130 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,026 (expressing the SEC's intent to remove impediments to shareholders nominating and electing directors).

131 *See id.* (explaining one rationale of the rule as enhancing the accountability of directors to shareholders, with improved corporate governance as a result).

In crafting its proposed regulation, the SEC considered a number of alternative rules.[132] These alternatives included allowing shareholder access only after certain triggering events occurred (such as an expression of widespread shareholder displeasure with a particular director, or a successful shareholder vote to add proxy access to the corporation's bylaws) and changing the ownership threshold necessary to gain proxy access.[133] It rejected the triggering events approach because it felt the need to remove as many impediments to shareholder proxy access as practicable.[134] The ownership threshold requirements were arbitrary by design, and the SEC expressed uncertainty about whether the thresholds chosen were proper.[135]

There is thus a continuum of possible regulations according to the ownership thresholds required for proxy access and the presence (and content) of triggering events necessary for proxy access. Higher ownership thresholds restrict proxy access to larger investors, which would likely reduce the number of proxy contests. But it may not reduce governance-improving and governance-degrading contests equally; shareholders with large stakes in a single company may be disproportionately likely to be specially interested shareholders if those interests are particularly tied to the fate of the company or if the prospect of control over the board through proxy access is especially important to them. If that is the case, and if specially interested shareholders are more likely to nominate governance-degrading directors, the reduced costs of fewer proxy contests may be offset by significantly higher costs after the proxy contests are over.

In a similar fashion, triggering event requirements also reduce the total number of proxy contests by reducing the circumstances in which shareholders receive proxy access. These events may also screen for governance-degrading directors if designed to do so. The primary triggering event the SEC considered, in which proxy access can be achieved only if 35% or more of shareholders vote to withhold a particular director, does this by ensuring that proxy access is possible only if a large number of shareholders believe that a particular director is incompetent or otherwise unfit for office.[136] However, this trigger requires the coordination of a large portion of a company's shareholders, and an attempt to coordinate this group may prove to be nearly as expensive as a proxy contest on its own. If that is the case, then the benefits of the proxy access rule—subsidizing proxy contests so that governance-improving contests become more likely—will go largely unrealized, as the cost to receive the so-called subsidy would nearly match the cost of mounting an unsubsidized proxy contest.

With this range of possible regulations to choose from, the agency can estimate both the number of proxy contests and the expected ratio of

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132 *See id.* at 29,079.

133 *See id.*

134 *See id.* at 29,079, 29,026.

135 *See id.* at 29,079–80.

136 *See* Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,032.

governance-enhancing to governance-degrading contests for each option. From these estimates, the agency conducts marginal analysis by choosing the regulation that maximizes the number of governance-enhancing contests up to the point where governance-degrading contests become numerous enough to offset the benefits of additional successful contests. From there, the agency can determine whether there is an expected net improvement in corporate governance and whether that increase is large enough to justify the cost of implementing the regulation.

As demonstrated by the preceding examples, not every second-best method of performing cost–benefit analysis is applicable to every situation. The agency's economists and other experts will need to determine which method is most appropriate for each regulation they consider. But *Michigan* requires that for each regulation, some method is chosen and employed which can determine that the regulation's benefits exceed its costs.

CONCLUSION

Cost–benefit analyses are likely to remain a hotly contested issue in the D.C. Circuit at least as long as financial regulators continue to issue rules pursuant to Dodd–Frank authority. The D.C. Circuit's precedents on the issue have been in flux as the court has grappled with the deluge of lawsuits over regulators' Dodd–Frank authority. The court will soon need to decide how to shape its chaotic precedents into a rule that conforms with the Supreme Court's ruling in *Michigan v. EPA*. When it does, it should harmonize *Michigan* with its precedents in a way that gives full effect both to existing statutory requirements to consider costs and to the Supreme Court's construction of "appropriate and necessary" statutory language. It should also avoid the temptation to read *Michigan* as authorizing unlimited judicial review of agency regulations, and instead find a middle ground that demands that agencies analyze their regulations in a systematic way without opening the door for judicial second-guessing.