IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, Petitioner, v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Respondent.	**ON PETITION FOR REVIEW** No. 05-1240

EMERGENCY MOTION

MOTION FOR STAY, OR, ALTERNATIVELY, FOR EXPEDITED BRIEFING BY PETITIONER CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

Dated: July 26, 2005

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Pursuant to Rule 18 of the Federal Rules of Appellate Procedure and the Rules of this Court, petitioner Chamber of Commerce of the United States of America moves this Court for a stay of the "independent chair" and "75 percent independence" requirements for mutual funds that were re-adopted by the Securities and Exchange Commission just one week after being remanded by this Court. Investment Company Governance; Final Rule; 70 Fed. Reg. 39,390 (July 7, 2005); Exh. A. Alternatively, the Chamber requests expedited review. **Movant requests a ruling prior to August 16, 2005.**[1]

The final statement of reasons justifying the Commission's action here was characterized by the current Acting Chairman of the Commission as "an assembly of false statements, unsupported assumptions, flawed analysis, and misinterpretations." 70 Fed. Reg. at 39,404. Indeed, the rulemaking was conducted as a mad dash to a predetermined outcome, with public comment omitted and two of the five Commissioners denied meaningful participation in the Commission's decision. In the absence of a stay, meaningful review by this Court will have been precluded also, because the rule's January 2006 compliance date already is forcing mutual funds to irreversibly incur many of the costs this Court ordered the Commission to consider and that this litigation is intended to review. A stay therefore is necessary for this Court to review the Commission's compliance with the remand Order and to prevent the now-former majority of the Commission from entrenching the disputed provisions as a *fait accompli* in which the intended roles of the public, fellow Commissioners, and the Court have all been foiled.

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[1] On July 13, 2005, petitioner filed a motion for stay with the Commission. Exh. B. The Commissioners deadlocked on the stay request by a vote of 2-2, and accordingly on July 15 the Commission issued an order stating, "The Commissioners being evenly divided, the Motion has not been granted." Exh. C. At approximately 1:45 p.m. on July 26, 2005, undersigned counsel gave notice of this motion to John Avery of the Commission's Office of General Counsel. Service was made by hand simultaneously with the filing in this Court.

FACTUAL AND PROCEDURAL BACKGROUND

This case involves the Commission's re-adoption of two legal requirements that had been invalidated by this Court just one week before. The requirements were amendments to pre-existing "exemptive" rules of the Commission, which permit mutual funds to engage in certain activities provided that certain conditions are satisfied. In a 2004 rulemaking, the Commission adopted several new conditions, two of which were challenged by the Chamber of Commerce in this Court. The first condition provides that the chair of the board of mutual funds must be independent of the "adviser" that establishes and manages the fund. The second requires that 75 percent of the board members as a whole also be independent of the adviser.

In a unanimous decision on June 21, the Court ruled that the two provisions had been adopted in violation of the Administrative Procedure Act and the Investment Company Act of 1940 ("ICA"), 15 U.S.C. §§ 80a *et seq.* *Chamber of Commerce of the United States v. Securities Exch. Comm'n*, No. 04-1300 (D.C. Cir. June 21, 2005) ("Slip Op.") (mandate not yet issued), at 19, Exh. D. Specifically, the Court ruled, the Commission had given inadequate consideration to the costs of the independent chair and 75 percent independence provisions, and to the effects of those costs on efficiency, competition, and capital formation, as required by Section 2(c) of the ICA, 15 U.S.C. § 80a-2(c). Slip Op. at 15-17. The Court also ruled that the Commission had given inadequate consideration to at least one significant alternative to the independent chair requirement: the alternative would have required funds to prominently disclose whether they have a management or independent chair. *Id.* at 17-19.

In the rulemaking and litigation, the Commission had insisted that determining the provisions' costs and effects on efficiency, competition, and capital formation was "difficult" and there was no "reliable basis" to do so. *Id.* at 15 (citing 69 Fed. Reg. 46,378, 46,387 (Aug. 2, 2004)). The Commission made similar representations in a congressionally-mandated report:

"[T]he additional costs, if any, [of the independent chair requirement] are speculative at this point, and the Commission has no reliable basis for estimating those costs," it stated. Securities and Exchange Commission, Exemptive Rule Amendments of 2004, at 60 (April 2004).

The Court rejected this argument in its June 21 remand decision, ordering that the Commission was to "determine as best it can the economic implications of the rule" and to "do what it can to apprise itself—and hence the public and Congress—of the economic consequences" of the provisions. The Commission was to exercise its "best judgment" on the disclosure alternative to the independent chair requirement also. Slip Op. at 15, 17-19.

Although its position before the Court had been that it currently had "no reliable basis" to make the projections demanded by the Court, on remand the Commission performed an extraordinary about-face in which it "reconsidered" and resolved the issues with unprecedented speed and without the benefit of public comment. The very day the Court issued its decision, the chief of staff to the Chairman of the Commission emailed the other Commissioners that "the staff had reviewed the Court's opinion and 'concluded that the Court's concerns can be addressed on the basis of the record already before the Commission.'" 70 Fed. Reg. at 39,403, 39,406. The two Commissioners who had dissented from the earlier rulemaking were not consulted on this decision to forego notice and comment. Indeed, the decision was made while three of the five Commissioners were traveling abroad.

The next morning, June 22, the Commission posted a notice that it would consider the Court's remand decision at an Open Meeting just one week later, on June 29. *Id.* at 39,406. This was the last day a notice could be posted for a meeting on the 29th, since at least one week's notice for Commission meetings is required by law. 5 U.S.C. § 552b(e)(1). The 29th, in turn was viewed by the Commission majority as the last day it could "reconsider" the two invalidated

provisions, since the following day was the Chairman's last with the Commission—with the Chairman gone, the rule's proponents would not be assured of the votes needed to re-adopt the provisions. Accordingly, speed was paramount. Just as the other Commissioners were not consulted in the decision to proceed on the basis of the existing rulemaking record, so they were excluded from the decision to discharge the Commission's responsibilities under the remand Order in just a week's time: The day the notice for the June 29 Open Meeting was posted, one of two of the dissenters from the earlier adoption of the rule was the designated "duty officer," with responsibility for scheduling and similar administrative matters. The outgoing Commission Chairman—who was out of the country at the time—peremptorily displaced her as duty officer in order to schedule the hastily-called June 29 meeting. 70 Fed. Reg. at 39,403.

What ensued was—in the words of one dissenting Commissioner—"The SEC's Race To Beat the Clock." *Id.* at 39,410. Just three days after the Court's decision, the staff gave the Commissioners a 27-page draft final "adopting release" "that purported to analyze the issues remanded by the Court." *Id.* at 39,406. The draft release that was to be voted on at the June 29 meeting was not available to Commissioners until the evening before. *Id.* at 39,404, 39,406. Any dissents from the decision were due by mid-day on the 28th, just one week after the Court's decision and before circulation of the release to be voted on the next day.

In its June 21 decision, the Court had made clear that the Commission majority needed to consider the views of dissenting Commissioners who opposed adoption of a rule. Slip Op. at 17-19. Yet, on remand, the views of the two dissenting Commissioners were never solicited. In the

words of Commissioner Atkins, "Not a single member of the SEC staff contacted me or my staff to solicit my view or any input as to how the SEC should respond to the Court's decision."[2]

Public comment was also barred. In light of the Commission's earlier protestations that it had "no reliable basis" to make the "difficult" assessments demanded by the Court, the leading industry association of mutual funds submitted a letter to the Commission offering to gather pertinent data by surveying its members. 70 Fed. Reg. at 39,407. Some funds had begun complying with the new requirements and could provide valuable, current information—not just estimates. *Id.* (citing Letter from Elizabeth R. Krentzman, Investment Company Institute, to Commission (June 27, 2005), Exh. B(1)). The Commission rebuffed this offer (for public comment, a minimum of 30 days must be allowed), and sought to exclude from the public record evidence that the offer even had been made. 70 Fed. Reg. at 39,405. Other requests for a period of public comment also were rejected.

The Commission's race to re-adopt the independent chair and 75 percent independence provisions provoked widespread opposition. *See, e.g.*, Deborah Solomon, *Donaldson's Finale Draws Uproar: Departing SEC Head Sets Vote for Mutual-Fund Rule On the Day Before His Exit*, WALL ST. J., June 28, 2005; Riva D. Atlas, *Ex-Officials Urge S.E.C. To Postpone A Vote*, N.Y. TIMES, June 25, 2005. Former Commissioners, including at least one who had publicly supported the provisions, warned that re-adopting them so quickly and without public comment gave the appearance of attempting to entrench a predetermined outcome without due respect for the Court's remand Order and the requirements of law. *See* Letter from former Chairman Harvey L. Pitt to Commission (June 23, 2005); Letter from former Commissioner Bevis

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[2] This statement is taken from an unofficial transcript that was prepared of the June 29 Open Meeting. The official transcript is not yet available.

Longstreth to Commission (June 24, 2005); Letter from former Commission staffer Walter B. Stahr to Commission (June 24, 2005). The Commission's actions "threaten . . . its long-term credibility with the public, with Congress, and with the courts," one former Commissioner warned. Letter from former Commissioner Joseph A. Grundfest to Commission (June 23, 2005).[3]

At the June 29 Open Meeting, the Commission proceeded, as expected, to re-adopt the challenged provisions by a 3-2 vote. Although the Commission had barred public comment and had scheduled the June 29 meeting on the premise that the rule could be re-adopted "on the basis of the record already before the Commission," 70 Fed. Reg. at 39,404, 39,406, in the adopting release approved on the 29th it repeatedly reached beyond the existing record to justify the rule. The Commission knew, for example, that among the key determinants in the costs of the challenged provisions were the number of independent directors that would be necessary; the salary they would be paid; and the frequency with which they would be replaced and recruiting costs accordingly would be incurred. To estimate these and other costs, the Commission relied substantially on assertions in industry newsletters that were not part of the prior rulemaking record. *See id.* at 39,392 nn.24, 28; 39,393 nn.33; 39,394 n.48; 39,395 n.73. The newsletters were prepared by Meyrick C. Payne of Management Practice Inc. ("MPI"), whose income depends in part on seminars he conducts on compliance with the challenged provisions. *See* Exh. B(4). During the week the Commission was scurrying to justify re-adoption of the provisions, Payne circulated an email urging others to voice their support for the independent

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[3] All letters known to the Chamber that were submitted to the Commission to express concern about the challenged provisions' hasty re-adoption were attached to the Motion for Stay filed with the Commission. Exh. B(1).

chair provision and suggesting appropriate media contacts. 70 Fed. Reg. at 39,407 n.28. The Commission justified its reliance on the Payne newsletters on the ground that they were "publicly available" although, as one dissenting Commissioner noted, the Commission did not seek to obtain the data underlying the newsletters' assertions because "doing so would contradict the majority's intention to rely only on the purportedly adequate public record." *Id.* at 39,407.

The Commission also recognized that the costs of its new requirements would include increased reliance on legal counsel by independent chairmen and the other independent directors. To estimate these costs, the Commission relied only on the "experience" of unidentified Commissioners or staff. "Based upon our experience," the Commission said, "we estimate that, on average, the new independent directors will use an additional 30 hours annually of independent legal counsel services." *Id.* at 39,393. Similarly, "[b]ased upon our experience, we estimate that, on average, the independent chairman will use independent legal counsel a total of 50 hours a year more under the amendments." *Id.* at 39,397. The Commission did not identify what this "experience" was, nor how it resembled—and differed—from the new legal regime the Commission was creating. The Commission also did not explain why it was preferable to make this unidentified "experience" the basis for its estimates rather than soliciting comment from funds that already have independent chairs and 75 percent independent directors.

Two Commissioners dissented from the Commission's action. The now-Acting Chairman of the Commission condemned the Commission's final statement of reasons as "flawed," "false," and "unsupported." *Id.* at 39,404. She apologized "to the Court, for the agency's failure to respond appropriately to the court's directive to undertake a meaningful review, . . . to those staff members who were uncomfortable having to participate in this exercise, [a]nd . . . to the public . . . ." *Id.* at 39,405. The other dissenting Commissioner said,

"[T]he majority's Remand Release only perpetuates the cavalier attitude with which we have approached our obligations in this rulemaking." Although "the Court gave the Commission a chance to redeem itself," he said, "the majority has squandered this opportunity." *Id.* at 39,409.[4]

Mutual funds must comply with the re-adopted provisions by January 16, 2006. 69 Fed. Reg. at 46,378. The Chamber of Commerce filed a petition for review challenging the Commission's re-adoption of the provisions on July 7, the same day the Commission's action was published in the Federal Register (70 Fed. Reg. 39,390).

SUMMARY OF ARGUMENT

Issuance of a stay depends on four factors: (i) the prospect of irreparable injury if relief is withheld; (ii) the likelihood that petitioner will prevail on the merits or, at minimum, that a "serious legal question" is presented; (iii) the possibility of harm to others if relief is granted; and (iv) the public interest. Cir. Rule 18(a)(1); *Washington Metro. Area Transit Comm'n v. Holiday Tours, Inc.*, 559 F.2d 841, 844 (D.C. Cir. 1977) ("An order maintaining the status quo is appropriate where a serious legal question is presented . . . whether or not movant has shown a mathematical probability of success."). These factors are considered in conjunction, so that a particularly strong showing as to one will counterbalance a less compelling showing on others. *Virginia Petroleum Jobbers Ass'n v. Federal Power Comm'n*, 259 F.2d 921, 925 (D.C. Cir. 1958).

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[4] The Adopting Release also included an extraordinary clause "instructing" the Commission's Office of General Counsel "to take such action as it considers appropriate to respond to any [additional legal] proceedings relating to this rulemaking." 70 Fed. Reg. at 39,391 n.14. At the June 29 meeting, the General Counsel refused to answer a Commissioner's question about the meaning and purpose of this clause, which appears intended to keep the current Commission from directing the General Counsel to cease defending this obviously flawed rule.

Mutual funds must be in compliance with the Commission's new requirements in scarcely more than 5 months from now. 69 Fed. Reg. at 46,378. If a stay is not granted, the costs the Court previously ordered the Commission to examine will to a large extent already have been irrevocably incurred before the Court has an opportunity to ensure that the Commission complied with its Order. Similarly, without a stay these costs and other potentially irrevocable changes will be imposed on mutual funds and investors before the Court can ensure that the Commission did not—as it did once before—give short-shrift to important rulemaking considerations and legal requirements in this hasty, one-week "reconsideration."

ARGUMENT

I. A STAY IS NECESSARY TO PREVENT IRREPARABLE HARM AND TO ENABLE THIS COURT TO PROVIDE MEANINGFUL RELIEF

In the absence of a stay, mutual funds and their investors will incur significant costs that are the subject of this litigation and the Court's earlier remand Order, before the Court has an opportunity to determine whether those costs were legitimately imposed. Second, in the absence of a stay, the two challenged provisions will oust the leadership of thousands of mutual funds in a manner that may be irreversible even if the Chamber ultimately succeeds in the litigation.

1. A principal objective of the Court's remand was to ensure that the Commission adequately assessed and considered the costs of the challenged provisions. Yet it is some of those very costs the Court wanted more closely reviewed—and avoided if appropriate—that would irretrievably be incurred if a stay is not granted. Even according to the Commission's own (flawed) "analyses," recruitment costs alone could cost a fund more than $110,000 per independent director. 70 Fed. Reg. at 39,392-39,393. Some funds would need to recruit as many as three new independent directors, the Commission has stated, putting initial compliance costs for those funds at more than $330,000. These will be sunk costs for funds that cannot be

recouped in the event the Chamber prevails in this litigation. Similarly, the Commission conceded that independent directors will command larger salaries than management directors—by the Commission's (conservative) estimate, a board overseeing a single fund could incur as much as $100,800 a year in additional costs by seating three independent directors in place of management directors. *Id.* at 39,393. The increased role of independent directors and chairs will also increase staff costs, which the Commission now estimates at nearly $315,000 per fund board a year. *Id.* at 39,394. All of these are sunk costs that will reduce investor returns and cannot be recouped if the Court invalidates the Commission's rushed "reconsideration" on remand.

The compliance date of the rule is January 16, 2006, little more than 5 months from now, much shorter than the average time to decision in this Court. Even with expedited review, the Court's decision in the earlier litigation over these provisions took 8 months. Accordingly, if a stay is not granted, the January 2006 compliance date will have passed and funds and their investors will have incurred the irretrievable costs discussed above before a decision is reached. When the Commission first issued this rule, it allowed funds 18 months to come into compliance, in recognition that identifying, recruiting, and retaining directors takes time—as does the proxy solicitations that will be necessary in some instances to install new directors. 69 Fed. Reg. at 46,378. With little more than 5 months before the rule's compliance date, it is plain that only a stay can assure a fair and orderly process in which the costs of the challenged provisions—and the likely permanent changes they would effect on all funds relying on one of the ten exemptive rules being amended—are not imposed before the Court's review is completed. *See* CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2948.1 (2d ed. 1995) (a stay is appropriate when failure to grant it would impair the court's ability to grant an effective remedy).

2. A second and independent reason for a stay is that once funds come into compliance with the challenged provisions, the very identity of their leadership will be altered in a manner that is unlikely to be reversed in the event of a favorable decision for the Chamber. This is not the ordinary rulemaking challenge in which regulated entities can revert to their earlier practice in the event the litigation succeeds. Rather, this rule changes the very identity of the decisionmakers in a manner that in many instances will prove irreversible. The Chamber's ultimate success in this lawsuit would neither remove the chairs and directors appointed as a consequence of the Commission's new rule, nor restore those whom the rule ousted. Rather, absent a stay, the new chairs and directors would remain and would have significant responsibility for determining whether they continued on the board and who succeeded them. *See* 15 U.S.C. § 80a-16. They often would perpetuate their board service for a variety of reasons, including but not limited to a concern not to further disrupt company operations or impair board morale. *See* Decl. of Jonathan R. Macey ¶¶ 11, 23, 25-26, Exh. B(2).[5]

In short, this important sector of the economy should not be forced to incur irreversible costs and management changes without prior judicial review of agency action that this Court has already once found invalid. A stay is appropriate.

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[5] The Chamber provided declarations from Jonathan R. Macey and Geoffrey H. Bobroff as exhibits to its Emergency Motion for Stay before the Court in No. 04-1300. The harms that those declarations indicated would result in the absence of a stay are now only more imminent, given the limited time remaining before the compliance date. The Macey and Bobroff Declarations were attached to the Motion for Stay filed with the Commission. Exhs. B(2)-(3).

II. THE CHAMBER'S PETITION IS SUBSTANTIALLY LIKELY TO SUCCEED ON THE MERITS OR, AT A MINIMUM, RAISES SERIOUS LEGAL QUESTIONS

The Chamber is substantially likely to succeed on the merits of this second challenge to the Commission's action. At minimum, the Chamber's petition raises serious legal issues that warrant a stay pending this Court's review. *See Washington Metro. Area Transit Comm'n*, 559 F.2d at 844. Indeed, at the time of this filing fully half the current Commission—including its Acting Chairman—have publicly stated that the Commission's re-adoption of the two challenged provisions grossly abused basic elements of administrative process.

The Commission's re-adoption of the independent chair and 75 percent independence provisions was deeply flawed in at least six separate respects:

First, the Commission's race to conduct the June 29 public meeting before the Chairman departed reflected an impermissible resolve to re-adopt the provisions unchanged, rather than to soberly and objectively conduct the analyses ordered by the Court and to follow them wherever they might lead, as required by the APA.

It is elementary that when a rule is remanded by a court, the agency has no less a duty to comply with its rulemaking obligations than it had during the initial rulemaking. *See Checkosky v. SEC*, 139 F.3d 221, 225-26 (D.C. Cir. 1998) (holding that the Commission violated the APA on remand). "[T]he Commission [must] . . . face squarely and forthrightly the legal and practical consequences of its decision," *Checkosky v. SEC*, 23 F.3d 452, 465-66 (D.C. Cir. 1994), and may not "prematurely and arbitrarily rubber stamp[ ] the previously approved" provisions of a rule. *CPC Int'l, Inc. v. Train*, 540 F.2d 1329, 1332 (8th Cir. 1976) (emphasis added).

But it was precisely such a "premature rubber stamping" that the Commission engaged in here. In its initial rulemaking, its report to Congress, and its briefs before this Court, the Commission repeatedly insisted that it had "no reliable basis" in the existing rulemaking record

to make the "difficult" cost assessments sought by the Chamber. 70 Fed. Reg. at 39,404, 39,406; 69 Fed. Reg. at 46,387, 46,389; Securities and Exchange Commission, Exemptive Rule Amendments of 2004, at 60. The Court rejected the Commission's protestations, ordering it to "determine as best it can the economic implications of the rule" and to "do what it can to apprise itself . . . of the economic consequences" of the provisions. Slip. Op. at 15, 17, 19 (emphases added). Then, in an extraordinary reversal, the Commission determined on the very day the decision issued that what it previously claimed was impossible "'can be addressed on the basis of the record already before the Commission.'" 70 Fed. Reg. at 39,403 (emphasis added). In fact, the only reason this could be done was because, to the provisions' proponents, it had to be done to secure the Chairman's vote before he departed the Commission. *Id.* at 39,391.

In a telling statement on the day of the Court's decision, one Commissioner told a reporter that the "'[t]he procedural deficiencies cited [in the Court's decision] should be easy to remedy. This is better than a total defeat for the Chamber of Commerce,'" he continued, "'but they should not be feeling good.'" Robert Schmidt, *SEC Must Reconsider Fund Governance Rule, Court Says*, BLOOMBERG NEWS, June 21, 2005. The Commissioner's meaning was clear: Even before reviewing the assessment being prepared at breakneck pace by the staff, the bare Commission majority planned to re-adopt the provisions. "Procedures" would be changed, but without the openness to a different substantive result that is the sole purpose of a remand.

Second, in its "race to beat the clock" (70 Fed. Reg. at 39,410), the Commission precluded any semblance of the deliberative and consultative process required of agencies constituted as a commission. The Commission majority and staff never solicited or considered the views of the two dissenting Commissioners (*id.* at 39,404, 39,407-39,408), even though, just a week before, this Court had stressed the necessity of considering dissenters' views. Slip Op. at

17-19. Instead, the Commission deployed an unprecedented series of procedures to ram through a pre-ordained, ill-considered conclusion before one of the three votes needed to rubber stamp that decision was lost. On the very day of this Court's decision, without prior consultation or time to review the rulemaking record, the Chairman had his chief of staff inform fellow Commissioners that the Court's decision "'can be addressed on the basis of the record already before the Commission.'" 70 Fed. Reg. at 39,403. The Chairman then ousted his fellow Commissioner as duty officer in order to hastily schedule a re-vote the day before his departure, and set in motion procedures that gave the Commissioners just hours to consider a draft release. Ordinarily, the Commission's normal procedures allow at least two weeks, and often thirty days, for review. *Id.* at 39,404, 39,406. Small wonder one of the dissenting Commissioners explicitly stated that she did not "have . . . an opportunity to review the release as adopted." *Id.* at 39,404.

In short, the Commission's conduct in this rulemaking is irreconcilable with the rule's own characterization of proper deliberative processes. A chairman, the Commission said in adopting the original rule, must "encourage open dialogue and healthy skepticism." "[H]ealthy . . . governance," the Commission wrote, requires the right "tone," culture," and "meaningful dialogue." 69 Fed. Reg. at 46,383. Congress did not establish a five-member Commission so that three of them could jam into place preordained decisions without meaningfully consulting their colleagues. But that is how the now-former majority proceeded here.

Third, the Commission improperly failed to permit public comment while simultaneously relying on inadequate extra-record "evidence."

Public comment is essential to an agency properly educating itself about prospective regulatory action. Comment "allow[s] the agency to benefit from the expertise and input of [] parties," *National Tour Brokers Ass'n v. United States*, 591 F.2d 896, 902 (D.C. Cir. 1978), and

"educates the agency, thereby helping to ensure informed agency decisionmaking." *Chocolate Mfrs. Ass'n of United States v. Block*, 755 F.2d 1098, 1103 (4th Cir. 1985). Notably, notice and comment also helps ensure "that the agency maintains a flexible and open-minded attitude towards its own rules." *National Tour Brokers Ass'n*, 591 F.2d at 902 (emphasis added). Accordingly, on remand it is ordinary for an agency to receive additional public comment. Significantly, that was the procedure followed by the agencies in the two decisions cited by the Court in remanding the challenged provisions here. *See* Slip Op. at 19 (citing *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027 (D.C. Cir. 2002), and *Allied-Signal, Inc. v. NRC*, 988 F.2d 146 (D.C. Cir. 1993)); *and see* 67 Fed. Reg. 65,751 (Oct. 28, 2002), and 58 Fed. Reg. 50,859 (Sept. 29, 1993) (further public comment on both rules).

Additional public comment was plainly necessary here, since the Commission repeatedly had protested that it lacked the evidence needed for the "difficult" cost estimates required by the Court. Slip Op. at 15 (citing 69 Fed. Reg. at 46,387). The Commission's sudden claim that it did have sufficient evidence, 70 Fed. Reg. at 39,403 (email from Chairman's chief of staff), was necessary to preclude further public comment, which would have taken more than the week that remained before the Chairman's departure. But the claim was false: the Commission did need data beyond the record, and therefore resorted repeatedly to newsletters by Meyrick Payne to generate estimates that it considered supportive of the rulemaking. *See id.* at 39,392 nn.24, 28; 39,393 nn.33; 39,394 n.48; 39,395 n.73. As noted, Payne has been a partisan in this rulemaking and his income depends in part on boards having to satisfy the two challenged provisions. *See id.* at 39,407 n.28; Exh. B(4). The Commission has suggested that its reliance on Payne's newsletters was appropriate because Payne's reports are "publicly available." But "public availability" is not a barometer of reliability (the *National Enquirer* is publicly available), nor is

the availability of some "evidence" grounds to bar consideration of public comments and other evidence that may be publicly available.

The Commission's repeated reliance on the unidentified "experience" of unidentified Commissioners or staff to estimate the rule's costs was also clear error. *Supra* at 7; 70 Fed. Reg. at 39,393, 39,395. This resort to select individuals' personal experience under some other legal regime further confirms that the Commission determined that it did need more evidence than the rulemaking record contained, but it circumvented notice and comment because the procedures it followed were determined by the Chairman's resolve to entrench the challenged provisions before his departure, rather than by consideration of the best means to satisfy the Court's remand Order and the demands of the APA and ICA. The Commission's reliance on selective extra-record material was particularly inappropriate in circumstances where mutual funds that had actual cost data stood willing and able to gather and provide it through regular notice and comment procedures. *See* 70 Fed. Reg. at 39,407 (Investment Company Institute's offer to survey its members). In short, the Commission neither "examine[d] the relevant data," nor did "the best it can" to satisfy the Court's Order. Slip Op. at 9 (internal citations omitted). *See also Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C. Cir. 1977); *Connecticut Light & Power Co. v. NRC*, 673 F.2d 525, 531 (D.C. Cir. 1982) (noting agencies' obligation to make publicly available the data underlying their rulemaking decisions).

Fourth, the extra-record material the Commission used to manufacture its cost assessments is dubious on its face, and certainly should not be accepted without the independent check that is supplied by notice and comment. For instance:

a) The Commission stated that in preparing its estimates it "rel[ied] where appropriate on data that can be obtained or confirmed through publicly available filings under the Federal

securities laws." 70 Fed. Reg. at 39,393. Yet the Commission nowhere identified the funds whose filings purportedly formed the bases for its estimates.

b) The Payne newsletters on which the Commission relied provide no description of the methodology underlying their reports, nor any data that can be subjected to independent testing. For example, the Commission relied on a two-page summary of a 2003-04 survey of mutual fund directors' compensation, but, as a dissenting Commissioners noted, "the Commission staff did not obtain a copy of the underlying nonpublic survey, apparently because doing so would contradict the majority's intention to rely only on the purportedly adequate public record." *Id.* at 39,407. By relying on these newsletters to the exclusion of other public comment without examining the underlying data and methodology, the Commission abdicated its responsibilities. *See Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 328 (5th Cir. 2001); *St. James Hospital v. Heckler*, 760 F.2d 1460, 1467 & n.5 (7th Cir. 1985).

c) In estimating how frequently funds would incur the costs associated with replacing independent directors, the Commission relied on data that is at least five years old. 70 Fed. Reg. at 39,393 n.33 (survey conducted in 2000). That data cannot account for the great changes in the mutual fund industry in the intervening years, including the "governance" requirements adopted in 2001, enactment of the Sarbanes-Oxley Act, and the Commission's increased resolve to initiate enforcement actions against independent directors and others. Those changes have created strictures and incentives that are likely to cause directors to serve shorter terms than they had prior to 2000. By failing to consider that boards will likely need to replace independent directors with greater frequency than in the past, the Commission failed to develop reliable cost estimates.

d) The Commission estimated that funds would pay an average of $300 per hour for legal counsel. That improbable figure was drawn from a rulemaking conducted almost two years ago (70 Fed. Reg. at 39,393 n.36), and necessarily fails to account for increases in rates in the interim. *See* Danilo DiPietro, *Picking Up Steam*, AM. LAWYER (Dec. 1, 2004) (noting a 6.2 percent increase in billing rates in the first half of 2004 alone).

In sum, the Commission's cost estimates are unsubstantiated and unreliable.

Fifth, the Commission failed to engage in serious analysis of the challenged provisions' likely effects on efficiency, competition, and capital formation, as required by Section 2(c) of the ICA, 15 U.S.C. § 80a-2(c). Slip Op. at 13. For example, the Commission acknowledged that costs are likely to be greater for smaller funds, but altogether failed to address the effect of this on new entrants in the marketplace and the ability of smaller funds to survive—both matters of central importance to "competition" and "capital formation." *See, e.g.*, 70 Fed. Reg. at 39,393, 39,395 (costs for boards that oversee a large number of funds are less than for boards that oversee only one fund). In fact, "publicly-available evidence" indicates that smaller funds are having difficulty attracting qualified candidates to serve as independent directors, an issue never considered by the Commission. *See* Exh. B(5) (Amanda Gerut, *Small Fund Boards Struggle to Comply with 75% Provision*, BOARDIQ, July 12, 2005). The Commission also engaged in no meaningful analysis of how the new costs will affect investor returns and, in turn, how that would influence investors to seek investment alternatives to mutual funds.

Finally, the Commission gave short shrift to the disclosure alternative identified by the Court. The Commission could not adequately have appraised the disclosure alternative without assessing it in light of the following factors, which where never addressed: (i) the separate protections provided by the 75 percent independence requirement; (ii) the other protections

already provided by the exemptive rules; (iii) the narrow nature of many of the exempted transactions at issue; and (iv) the public's interest in investing in management-chaired funds. Importantly, the hundreds of thousands of dollars in costs discussed above that will be the minimum under the new rule, will be incurred by a fund that chooses to rely on any <u>one</u> of the ten exemptive rules amended—the rule permitting a fund to purchase a joint insured bond, for instance. *Id.* at 39,390; 69 Fed. Reg. at 46,379 n.9 (Rule 17g-1). The Commission gave no explanation why to make that once-a-year decision, a fund must permanently alter the composition of its board and incur all the foregoing costs, rather than relying on the disclosure alternative and the other pre-existing exemptive rule requirements to protect investor interests. In addition to ignoring such considerations, the Commission also ignored the two dissenting Commissioners, whose views on the disclosure alternative were never solicited or considered on remand. 70 Fed. Reg. at 39,407-39,408.

For all of these reasons, the Chamber is substantially likely to succeed on the merits and, at minimum, has presented serious legal concerns—shared by half the current Commission—that warrant a stay by the Court.

III. A STAY WILL SERVE THE PUBLIC INTEREST AND WILL NOT HARM OTHER PARTIES

If the challenged provisions of the rule are stayed, the public interest will be served and no harm will occur to other parties. It is in the public's interest for the Court to determine the lawfulness of the challenged provisions before the Commission forcibly reconstitutes the governing bodies of thousands of companies that account for several trillion dollars in assets. Moreover, the private investors that the Commission purports to protect through the disputed provisions will, in the interim, be protected by a variety of other (lawful) provisions of federal

and state law. Finally, while this litigation is pending, independent directors—and not management directors—will constitute a majority of the boards of most funds.

This Court has already found these two challenged provisions to have been unlawfully adopted once. Given the extraordinary manner in which the Commission proceeded on remand, a stay is appropriate to ensure a more orderly process and to avoid the Commission's dubious action becoming a *fait accompli* before meaningful review can occur.

CONCLUSION

For the foregoing reasons, the Chamber of Commerce respectfully moves this Court to stay the independent chair and 75 percent independent director requirements pending review by this Court.

Dated: July 26, 2005

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ADDENDUM

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, Petitioner, v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Respondent.	**ON PETITION FOR REVIEW** No. 05-1240

PETITIONER'S PROVISIONAL CERTIFICATE AS TO PARTIES

Pursuant to Circuit Rules 18(a)(4)and 28(a)(1)(A), Petitioner Chamber of Commerce of the United States of America states as follows:

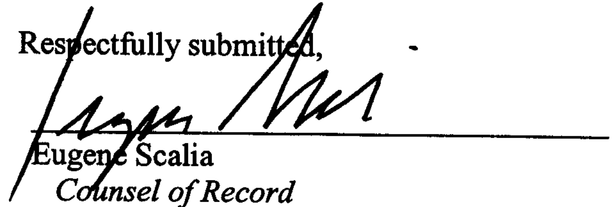
The parties in this case are the Chamber of Commerce of the United States of America (Petitioner) and the United States Securities and Exchange Commission (Respondent). There currently are no intervenors or amici.

The Chamber of Commerce is the nation's largest federation of business companies and associations. With substantial membership in each of the fifty states, the Chamber has an underlying membership of more than three million businesses, chambers of commerce, and business and professional organizations of every size and in every industry sector. One of the Chamber's associational purposes is to protect its members from costly and unlawful federal regulation. Chamber members and their subsidiaries include mutual fund advisers that will be injured by the Commission's challenged rule. Moreover, the Chamber invests in mutual funds, and thus will itself be injured by the Commission's challenged rule.

The Chamber is a non-stock corporation and thus has no parent organization, and no publicly-held corporation holds a 10 percent or greater stake in the Chamber.

Dated: July 26, 2005

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have caused to be served a true and correct copy of the Motion for Stay, or, Alternatively, for Expedited Briefing by Petitioner Chamber of Commerce of the United States of America and Petitioner's Provisional Certificate as to Parties via hand delivery this 26th day of July, 2005, upon the following:

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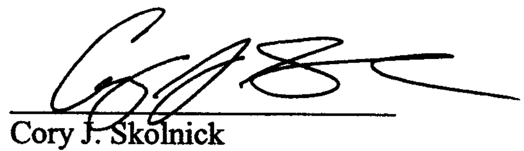

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