Oral History of Judge Douglas H. Ginsburg
Ninth Interview
March 21, 2014

This interview is being conducted on behalf of the Oral History Project of the Historical Society of the District of Columbia Circuit. The interviewer is Daniel Marcus, Esquire, and the interviewee is Judge Douglas H. Ginsburg. The interview took place on Friday, March 21, 2014. This is the ninth interview.

DANIEL MARCUS: This is Daniel Marcus interviewing Judge Ginsburg on March 21st, 2014. Today, Judge Ginsburg, we're going to discuss the last of our regulatory administrative law cases, one of your recent opinions a few years ago in the *Business Roundtable* case. This was a decision that I think had a great impact on regulatory agencies and regulatory agency lawyers, because of a number of things.

This case involved a rule by the SEC on proxy statements with respect to the election of directors. And the SEC had promulgated a rule requiring companies to include in proxy materials shareholder nominees for directors, subject to certain limitations. And I think the reason the decision startled a lot of people in the Washington regulatory world was this is not a big-ticket really expensive rule compared to a rule requiring reduction of emissions, one of the EPA or OSHA rules that had a huge multi-million, multi-hundred of millions of dollars impact on the economy. And second, the SEC was not subject by statute to a rigorous cost-benefit analysis requirement; the statute just required it to consider economic factors. And third, this seemed like a sort of innocuous good corporate governance rule. It was a shareholder democracy kind of rule.

And so why don't you start if you would by summarizing your approach to the case and to what extent this was sort of a straight arbitrary and capricious analysis or whether it was tied mostly to the statutory economic factor requirement.

JUDGE GINSBURG: Well, the SEC is uniquely subject to a requirement that was added to the securities laws in 1996 or 98, requiring that when it promulgated a rule—before doing so, I should say—it analyze the effect of the rule on four, I believe, dimensions, that included the effect on capital formation, the effect on the efficiency of capital markets, and two other considerations. And the SEC literally ignored that statutory requirement from its inception until a case brought to this court in about 2005 in which the Chamber of Commerce, I believe, objected to a rule on the ground that it had not been accompanied by the required analysis. And so the court, in a panel on which I sat, necessarily remanded the rule to the SEC to do the required

analysis. And the issue was one that was a high priority for then Chairman Donaldson of the Commission. And the remand—

DANIEL MARCUS: This is in the Chamber of Commerce case.

JUDGE GINSBURG: In the Chamber of Commerce case. The remand to the agency occurred a scant two weeks before the previously announced date for his departure. So a meeting of the SEC was held and a few paragraphs were appended to the old rule that had been done up by the economist at the direction of the chairman, and the rule was re-promulgated and came to the court with what was obviously a not only hasty but totally inadequate and superficial so-called analysis of a few pages, and we again remanded to the agency.

There was another instance I believe, if not two more, before the *Business Roundtable* case came to us. So there were three or four cases—I think three—preceding this one in which the agency had been called to account for either ignoring or deficiently taking account of its statutory obligation. In the case of the *Business Roundtable*, the rule in question as you said required that companies give access to their proxy machinery to shareholders who qualified by having a certain minimum percentage of the shares, I think it might have been three percent, which they had held for a minimum period, which I think again was three years. And they had tightened up, between the initial proposal and the final rule they had tightened up and narrowed the scope of the rule by increasing the holding period and the percentage of shares to be held. And this time the agency did an extensive economic analysis directed at the four requirements of the statute. As a practical matter it was their first serious outing along these lines. I should say, it was quite lengthy, but it was also full of problems. There were internal contradictions, there were some unexplained assumptions, some objections that had been raised in the comments on the notice of proposed rulemaking but not answered in the final rule, and in many instances certainly not answered adequately.

The rule also applied not only to industrial corporations but to mutual funds. Or more strictly I guess to the investment advisory firms that provide services to mutual funds. And there an additional consideration had been raised by the parties, namely that a group of mutual funds almost universally has the same board of directors for all of the funds in the family, it's a so-called unitary board. And the election of a dissident—or let's say independent—director at the instance of the shareholders to one of those funds would mean that they now would not have the same board for each fund because one or more of them would have one or more directors who would not appear on the other boards. So instead of having one joint meeting of all of the 30 or 50 or whatever mutual funds, they would have to have a separate meeting for every different board configuration. And the agency had not dealt with the cost of that; instead

they said, to give you an idea of how ludicrous some of their reasoning was, they said, "Well, if unitary boards are such a good thing then people won't vote to have these disparate directors."

So it was really a botched job all around. Not to say they didn't try. I mean, there's a lot of wording, there are several columns, several pages, in the *Federal Register* of the so-called economic analysis, but it was deficient in quite a number of ways. It bears no resemblance, to the economic analysis you would get from the EPA accompanying a major rule. The difference is not that the major rule involves hundreds of millions of dollars and this one does not, it's that they've been doing this for a long time and they know what they're doing, and this was new to the SEC.

The SEC has historically been an entirely lawyer-driven agency. They've had economists for a long time, and they've had some very excellent chief economists over the years. Ken Lane, who now teaches at Buffalo, and another one whose name escapes me now that I have worked with when I was in the government, were high-level people that were brought in to run the economic shop. But the economic shop had virtually no—or very little apparent influence within the Commission, and it was therefore really not adapted to do what this statute required.

DANIEL MARCUS: Of course the statute didn't require a cost-benefit balancing and judgment by the Commission.

JUDGE GINSBURG: Well, that's true. Let me come back to that in a moment.

No, I'll stay with it. The statute says, "Consider the following four factors." One of them is the effect of the rule on capital formation, and let's say another one is on the efficiency of other capital markets or of the national economy. And having considered those, suppose the agency comes to the conclusion that if it imposes a certain identifiable cost—maybe it doesn't monetize it in dollars and cents, but it characterizes it—it will have the following effects: some delay in the issuance of new shares, or increased administrative costs with regard to the conduct of proxy voting. And they clearly did deal with that at some length. And then having considered those four things, made no effort to consider the net effect—or the cumulative effect of the four, which could be purely additive because each one incurs a cost. Or it could be a matter of netting out the gains on some dimensions against the losses on others. They didn't do that, they just considered those four things. Having considered those four things and ignored the implications of them brings them into the world of the arbitrary and capricious standard under the APA.

DANIEL MARCUS: So if they had considered the arguments that had been made with respect to the costs adequately and dealt with them the Commission could then

have said, "Well gee, these costs are significant in some respects, but in our judgment the benefits to shareholders from having a greater access to proxy statements and a better chance to nominate and elect directors is so great for shareholder democracy, that's a value that we think is important, that Congress thinks is important, and we think it justifies these costs." If they had done an adequate analysis of the costs that would have been okay then, is that right?

JUDGE GINSBURG: Sure. And with regard to some of the issues where they didn't really do an analysis of the cost at all, because some of them were more difficult issues—so for instance, based on an experience with the Safeway supermarket company the commenters had objected that under the new proposed proxy rules a union could get seats on the board through its pension fund, and would inherently represent a conflict of interest with true shareholder representatives, because they would be representing both employees and shareholders, people who are both.

And the experience that Safeway had with this attempt to get on their board apparently—I don't remember even whether it succeeded—crystallized this issue, which really had not been anticipated by anybody before the very clever people at the union came up with this, and the SEC dealt with it in a really dismissive way and didn't really take it—I mean, it would be very difficult to quantify, but they didn't try to deal with it in any meaningful way at all. So anyway, the net result was a bunch of lawyers' arguments about the economics, not arguments that economists would typically advance. So we remanded it. I mean, there's nothing that prohibits them—at least we didn't come up with anything—from having a proxy access rule.

Now, that was in August of was it 2011?

DANIEL MARCUS: 2011, yeah. July of 2011.

JUDGE GINSBURG: Okay. And in the spring of 2012 a House oversight committee scheduled a hearing for April 17th to examine the SEC with respect to what they'd done in reaction to this opinion, and Chairman Shapiro was due to testify. On Monday April 16th the Commission released a very long—well, 15- or 20-page single-spaced memorandum jointly authored by the Office of the General Counsel and another entity within the SEC laying out detailed instructions for how cost-benefit analysis—or, more accurately, how the four considerations in the statute would henceforth be taken care of, and a press release announcing that they were going to be approximately doubling the number of PhD economists, or at least hiring another sixteen I think economists, something like that, in the near future in order to implement this.

The hearing went forward the next day and of course the committee welcomed this as an interesting development. I presume the SEC followed through since that's what they said they would do, although they may have had some budgetary limitations. And I have absolutely no doubt that they will pull up their socks and do the kind of job that the EPA or even the OSHA would do because those agencies have experience dealing with these things. For those agencies the cost-benefit analysis is imposed really by the Executive Order, and they're accountable for that to OMB rather than to the courts. But because the Congress here laid down a marker for the SEC, they are accountable to the courts for adhering to it.

DANIEL MARCUS: I think that is correct. So if I understand your explanation of the opinion correctly, it was basically an application of the arbitrary and capricious standard to the Commission's performance of its statutory responsibility to analyze the cost with respect to these several factors, including capital formation and so on, and the sin was not doing an adequate job, both in responding to comments and in the body of its own analysis, of explaining why it reached the conclusions it did with respect to its consideration of these factors. Is that a fair summary?

JUDGE GINSBURG: I think so. In many a case that comes to us there is a challenge to an agency's decision on the ground that it departs from or exceeds their statutory mandate, and in addition a complaint that the agency acted arbitrarily and capriciously. So the agency could prevail on the first point that they did not exceed their authority, and yet lose on the arbitrary and capricious point if their analysis doesn't stand up. You know, their bottom line is something they're authorized to do if they present a reasonable case for doing it, if they didn't exceed their authorization, so there you have an APA case. In other instances the agency gets stopped at the threshold because it exceeded its authority and we don't have to go any further than that.

Here these two issues were more tangled than in most instances. I was frankly taken aback when it was first pointed out to me after the opinion issued that there was some ambiguity as to whether this was a cost-benefit analysis requirement now applicable to the SEC sort of at large, unmoored in the four considerations in the statute, which really had not occurred to me. But I could see how people could read it that way.

DANIEL MARCUS: I think that's an interesting point, because I think you're right, that the strong reaction to the decision in the regulatory community was probably in large part by people who had heard about the decision but hadn't read it. Because I think that some people thought that this meant that the court was using the arbitrary and capricious standard as a basis for imposing cost-benefit analysis even where it wasn't required by the statute.

JUDGE GINSBURG: Right.

DANIEL MARCUS: Although I guess one of the things, it is sort of hard to see on some of these issues, like you point out the issue about the problem of a union pension fund electing members of the board and the inherent conflicts. Now, the SEC apparently didn't deal with that issue at all, or didn't deal with it very satisfactorily.

JUDGE GINSBURG: They mentioned it and dealt with it summarily.

DANIEL MARCUS: Yeah. It's sort of hard to see what they could have said about it, except to say, "Well, yes, this could create problems on boards and conflict issues and so on, but that's something that can happen as a result of proxy contests and shareholder groups who have interests that may not always coincide with the corporation." How could the SEC deal with something like that?

JUDGE GINSBURG: Well, first we say that that's their problem. And they might say, "Well, that's a state law problem," because all these directors are fiduciaries, and all these companies are incorporated under state law. They might have said for one reason or another there was something peculiar about that instance, that it wasn't likely to recur. They might have looked at the ownership of shares by union-affiliated health and welfare funds in the employers that fund them and decided that this was a very unusual situation not likely to recur—I don't know if it's true—but if it was one that was likely to occur then I think they would have to deal with the implications of it. Well, let me put it another way. Consideration of these factors in the statute isn't the same as a cost-benefit analysis.

DANIEL MARCUS: That's correct, yes.

JUDGE GINSBURG: And even with cost-benefit analysis there are going to be some things on one side or both sides of a ledger that can't be monetized. And, I mean, we did this at OMB all the time. The fewer of those things there are, the more confident one can be about the decision having a net benefit. So if you have on the one side there will be opportunities for recreational fishing by creating this waterway, but the cost on the other side will be taking land out of some productive use in order to flood the area. When we started down that path monetizing the value of recreational fishing had never been done. Now it's routine. Because it turns out by looking at the amount that people will pay to avoid a stop or a longer flight—these are fishing destinations, you have to fly somewhere, okay. So you can determine how much people who are going to fishing destinations value their time by how much more they're willing to pay for a shorter flight, which is to say a non-stop flight, than for a one stop and therefore longer duration trip. Now you know the value to them, minimum value to them, of the recreational fishing. All right. So you don't have to just put a total unknown on the ledger, you say it's at least this amount. Well, over time, that's 30 years, economists have gotten pretty good at that.

DANIEL MARCUS: Can economists monetize the value of opportunities for shareholders to contest a management—

JUDGE GINSBURG: Probably not. Probably not at this stage, and maybe never. A similar requirement of analyzing the economic effects of a rule or a standard is administered by the Financial Services Authority in the United Kingdom, and they actually do a macro-economic analysis. They talk about the effect on the economy of changes in capital market rules, and they've been doing it for a while and they are very good at it. And even—I mean, there was no suggestion of that in what came out of the SEC.

DANIEL MARCUS: No. And the SEC doesn't need to do that really, as I understand this decision. It's that they need to do a non-arbitrary and non-capricious job of considering the economic costs that they're required to consider under the statute.

JUDGE GINSBURG: But when they've done what looks like that kind of a job—

DANIEL MARCUS: Then they're okay.

JUDGE GINSBURG: Well, then they will be met with an objection I'm sure eventually from someone seeking review of the rule, saying they haven't looked at the macro-economic effects on the economy. And look, there's nothing impractical about this, the FSA's been doing it for years. But no one's brought that challenge. No one challenged their failure to abide by the statute of the late 90s until the mid-2000s.

DANIEL MARCUS: Right. Well, I think this was a wakeup call to agencies, and I think there's some others besides the SEC who have similar statutory provisions requiring them to consider various factors but not requiring a particular cost-benefit conclusion.

JUDGE GINSBURG: Well, in this instance, though, the factors by themselves almost inherently require considering the monetary cost. Whereas if the Fish and Wildlife Service has to consider the effects on species, endangered species, then they're not going to monetize that.

DANIEL MARCUS: Right. Well, I think this opinion has probably had a salutary effect on scaring independent agencies particularly into hiring a few more economists and doing a better job of considering costs.

JUDGE GINSBURG: When I was at OMB Milt Russell was the head of the policy office at EPA, and he was a PhD economist. He came from Resources for the Future, spent a few years at EPA, then went to the federal labs in Tennessee, I've forgotten what that's called. And he said, "OMB review under the Executive Order was the best thing that ever happened to me and my office, because we used to be irrelevant, and now people who are proposing to do something run it by my office because they know we'll

raise the same questions OMB will raise, so why not anticipate them and deal with it?"

DANIEL MARCUS: Of course Congress if it wanted to could make independent agencies subject to OMB OIRA review. It's something Congress is very unlikely to do because it views the independent agencies as its babies, not the Executive Branch's babies.

JUDGE GINSBURG: I understand that the President has asked or encouraged the so-called independent agencies to submit their proposed rules to OMB for an opinion.

DANIEL MARCUS: I wonder if any of them have done it.

JUDGE GINSBURG: I don't know what's happening, if anything, on that score. But then in a different vein Christopher DeMuth has proposed that OMB's review of the agency's proposed rule be made part of the administrative record and subject to judicial review—or at least available, I should say, so that judicial review for arbitrary and capriciousness can be informed by the questions raised by OMB and the way in which the agency responded to them.

DANIEL MARCUS: I think challengers to rules would welcome that.

JUDGE GINSBURG: Challengers would?

DANIEL MARCUS: Yes.

JUDGE GINSBURG: Sure. Sure they would.

DANIEL MARCUS: Sure, because I'm sure some agencies, obviously they'd make an effort to respond to OMB's objections, and they have to if they know what's good for them, Executive Branch agencies, but they probably don't always do a perfect job.

JUDGE GINSBURG: Well, it would probably move a lot of comments from writing to oral communication, with OMB not sending a pass-back letter raising objections but rather—continuing to press them on the phone and in meetings--a lot of which occurs anyway—because things get sorted out and settled and clarified and you don't have to exchange lots of writing in order to do that, it'd be very inefficient. But at the end of the process, if there's an unresolved disagreement OMB can return the rule as not approved.

DANIEL MARCUS: Correct. Okay, one of the themes I noticed in the opinion was the point that the way the rule was structured with the three percent minimum and so on suggested that it was—and comments I think raised this issue—that it raised this problem that you adverted to with the union pension funds

of—as you put it in the opinion—of being a rule designed—I'm overstating it now—designed to permit special interest groups to have an opportunity to nominate their own people for directorships. To what extent—

JUDGE GINSBURG: Within the universe of shareholders.

DANIEL MARCUS: Of shareholders, correct. To what extent, if any, was your suspicion about the SEC's performance in this case driven by the special interests issue?

JUDGE GINSBURG: Well, it was really more about the way in which they blew it off. I mean, I don't think—I'm not aware of other special interests within shareholders lurking about waiting for a proxy access rule in order to introduce a conflictual situation into the boardroom. That kind of thing arises when hedge funds obtain representation on a board and may have different—well, they certainly have different ideas about what management should be doing, but they are unquestionably interested in profit maximization, as opposed to wage maximization.

DANIEL MARCUS: And that's true I guess of the big individual shareholder who is buying up shares and maybe looking to get a seat on the board, or even make a tender offer or something for the company, who often initiates a proxy contest.

JUDGE GINSBURG: Yes, although it's become more and more difficult. I mean, it used to be easier to do that. The Williams Act inhibits it for one thing, because you have to give notice when you hit five percent of the shares.

DANIEL MARCUS: I see.

JUDGE GINSBURG: And then state legislation with poison pills and so on allowing various takeover defenses has greatly inhibited the market for corporate control, and it's only in the last several years that hedge funds have revitalized it to some degree.

DANIEL MARCUS: I see.

JUDGE GINSBURG: These maverick takeover artists, the Carl Icahns of the world, have made that a live issue again. Absent that, managements are not very well supervised and small shareholders are not in a position to supervise. And the rule of Wall Street for institutional investors is not to complain but to sell. If you don't like management you sell.

DANIEL MARCUS: Yeah. Okay, well, I don't have any further questions on this so we'll end the interview at this point unless you have anything you want to add.

JUDGE GINSBURG: I don't think so. I would welcome DeMuth's proposal of having the OMB record subject to judicial review. I think it's worth considering. I'm interested in that but I haven't come to a conclusion on that.