

Court Ruling Offers Path to Challenge Dodd-Frank

New York Times DealBook

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August 17, 2011

A new front has opened in the behind-the-scenes battle over financial regulation.

Industry groups have been examining legal challenges to the Securities and Exchange Commission's new corporate whistle-blower program and a provision surrounding the extraction of oil and natural gas from foreign countries, people briefed on the talks said. The Commodity Futures Trading Commission's plan to curb speculative trading is also under fire.

The catalyst has been a federal appeals court decision in July striking down an S.E.C. rule that would have made it easier for shareholders to nominate company directors. The so-called proxy access rule stemmed from the Dodd-Frank act, the sweeping regulatory overhaul enacted in the wake of the financial crisis.

In recent weeks, lawyers and Wall Street trade groups have gathered in Washington to ponder the next big case. Lawyers branded one meeting, held by the United States Chamber of Commerce, as "Dodd-Frank Excesses," according to two people who were notified of the meeting.

Until now, Wall Street relied largely on an army of lobbyists to chisel away at 300 new rules flowing from the S.E.C. and the Commodity Futures Trading Commission, among other agencies. But while lobbying might yield the occasional loophole, judicial rulings can halt new rules altogether.

"I would hope the agencies are taking to heart the potential consequences for Dodd-Frank rules," said Eugene Scalia, the lawyer who won the proxy case on behalf of the Chamber of Commerce.

Hal S. Scott, a professor at Harvard Law School and a director of the Committee on Capital Markets Regulation, a research group that has been a critic of Dodd-Frank, said, "I do see lots of challenges coming down the pike."

Regulators, reluctant to give in to industry pressure, are rushing to safeguard their rules from legal action. The commodity commission, having already delayed several Dodd-Frank rules for six months, is now studying the proxy case and considering adjustments to some proposed regulations, according to a person close to the agency. Earlier this month, the agency dispatched several staff members to meet with S.E.C. officials about the recent court decision.

For its part, the S.E.C. is weighing an appeal of the proxy ruling. The S.E.C. is also adding economists, planning to hire eight over the next two years, after the appeals court rebuked the agency for not fully evaluating the proxy rule's economic effects.

The legal challenges are rooted in a 1996 law that requires the S.E.C. to promote "efficiency, competition and capital formation." The law enabled the financial industry to build lawsuits

around the economic costs of a rule, regardless of its merits.

In 2005, the Chamber of Commerce was the first business group to invoke the law, using it to successfully challenge certain S.E.C. rules for the mutual fund industry. The chamber later gained momentum with a string of similar victories in the United States Court of Appeals for the District of Columbia Circuit. Altogether, the appeals court has tossed out three financial regulations in the last six years, including the proxy rule.

Mr. Scalia, a partner at the law firm Gibson Dunn and the son of Supreme Court Justice Antonin Scalia, was on the winning end of each case.

Banks and corporations, rather than challenging the rules directly at the risk of alienating regulators, turn to seasoned litigators like Mr. Scalia and influential trade groups like the Chamber of Commerce to lead the fight. For more than 30 years, the chamber has had a separate litigation center, which operates as its own law firm in Washington.

“It is usually not in the interest of a single business to mount a claim,” said Brian G. Cartwright, the S.E.C.’s former general counsel who now works at the law firm Latham & Watkins. “You need some cut-out manager or organization that speaks for broad groups.”

The industry has shied from mounting a broader challenge to Dodd-Frank itself, finding it cheaper and easier to gradually chip away at the law’s fiercest provisions. Lawyers say a single lawsuit contesting the constitutionality of Dodd-Frank could take years — and millions of dollars — to wind through the courts, with little chance of succeeding.

“Dodd-Frank is not one thing but many,” said Margaret E. Tahyar, a partner at the law firm Davis Polk. “There is no reasonable constitutional or statutory challenge on the whole — only on the bits and pieces.”

By some measures, the proxy rule was an unlikely choice to challenge on economic grounds. The S.E.C. produced 60 pages on a cost-benefit analysis of the rule and spent 21,000 staff hours drafting it over two years, Mary L. Schapiro, the agency’s chairwoman, said in a recent letter to Congress.

That the proxy regulation still did not pass muster does not bode well for several other Dodd-Frank rules that received considerably less explication, sometimes only 25 pages, on their economic effects.

“The proxy case makes all the rules open target to challenge,” Mr. Scott of Harvard said.

Financial trade groups, according to several lawyers, are now considering suits against the S.E.C.’s corporate whistle-blower office, which opened last week. The chamber, at least, argues that the whistle-blower program allows tipsters to undermine internal compliance departments. Industry groups are also looking at claims against a few more obscure Dodd-Frank provisions. One S.E.C. regulation requires companies to disclose whether they manufacture goods using so-called

conflict minerals like gold from Congo.

Tiffany & Company argued in a letter to the S.E.C. that the proposed rules “would violate the First Amendment,” laying the groundwork for business groups to mount a constitutional challenge.

Some letters are even blunter, as groups invoke the proxy case as a cautionary tale.

Royal Dutch Shell wrote the S.E.C. this month about “our expected costs” stemming from a proposal about oil extraction. Shell filed the letter, it said, “in light of the recent decision by the U.S. Court of Appeals.”

The commodity commission has received a barrage of hostile letters, too, some foreshadowing legal action. In March, the Futures Industry Association urged the commission to scrap its plan for reining in speculative commodities trading, saying it “may be a gall in firm.”

Bart Chilton, a Democratic commissioner at the agency who has championed tough position limits on oil, corn and the like, sought feedback on the plan from the CME Group, the nation’s largest futures exchange. But at CME’s Chicago headquarters last fall, executives declined to discuss the proposal with Mr. Chilton, saying the Commodity Futures Trading Commission lacked the legal authority to impose trading limits.

With the industry firing such warning shots, regulators have spent months shielding their rules from litigation.

In May, the Commodity Futures Trading Commission’s general counsel and chief economist issued a memo spelling out guidelines for cost-benefit analyses. The memo and other efforts to slow down the Dodd-Frank rules later drew rare praise from the agency’s internal watchdog, which said the commission “has taken proactive steps to address concerns.”

Scott O’Malia, a Republican commissioner at the futures trading commission, also called for the agency to re-examine every cost-benefit analysis drawn up for Dodd-Frank. “The commission does not have the final word, as the S.E.C. has recently learned,” Mr. O’Malia warned this month.

Still, most regulators are hesitant to strike the panic button.

“We hear about potential lawsuits with some frequency,” Mr. Chilton said in an interview. “There’s an old saying in Washington that, if you’re not part of the solution, there’s plenty of money to be made being part of the problem.”