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Nos. 19-1042(L), 19-1043, 19-1046, 19-1049, 19-1053, 19-1054

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

New York Stock Exchange LLC, et al.,
Petitioners,
v.
Securities and Exchange Commission,
Respondent.

On Petition for Review of a Rule
of the Securities and Exchange Commission

BRIEF AMICUS CURIAE, BY CONSENT, OF BETTER MARKETS, INC. IN SUPPORT OF RESPONDENT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure ("FRAP"), Better Markets, Inc. ("Better Markets") states that it has no parent corporation and there is no publicly held corporation that owns any stock in Better Markets.

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

I. PARTIES AND AMICI

All parties to this case are listed in the Brief for Petitioner. Except for Investors Exchange LLC, all *amici* who have noticed an appearance in this Court are listed in the Brief for Respondent.

II. RULINGS UNDER REVIEW

Reference to the ruling under review appears in the Brief for Respondent.

III. RELATED CASES

Reference to consolidated cases pending before this Court appear in the Brief for Respondent.

Dated: August 1, 2019

/s/ Stephen W. Hall
Stephen W. Hall
Counsel for Better Markets

CERTIFICATION OF CONSENT FROM ALL PARTIES AND THE NEED FOR SEPARATE BRIEFING

In accordance with FRAP 29(a)(2) and D.C. Circuit Rule 29(b), undersigned counsel for Better Markets certifies to this Court that counsel for all parties have consented to the filing of this brief.[1]

Pursuant to D.C. Circuit Rule 29(d), undersigned counsel for Better Markets certifies that this separate brief is necessary. Unlike other amici, Better Markets has no commercial or financial interest whatsoever in the outcome of this case. Instead, its sole objective is to advance the public interest. Accordingly, it has a unique perspective; rather than approaching the issues presented from the viewpoint of a financial market participant with commercial or business interests, Better Markets approaches it from the perspective of an organization seeking regulatory outcomes that promote market transparency, market integrity, and, ultimately, the protection of all investors. This separate amicus brief, focused primarily on achieving the right outcome from a broader public interest perspective, is therefore necessary and appropriate.

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[1] In accordance with FRAP 29(a)(4)(E), Better Markets certifies that (i) no counsel for any party authored this brief in whole or in part; (ii) no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and (iii) no person—other than Better Markets, its members (of which there are none), or its counsel—contributed money that was intended to fund preparing or submitting this brief.

Dated: August 1, 2019

/s/ Stephen W. Hall

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GLOSSARY

FRAP Federal Rule of Appellate Procedure

HFT High-Frequency Traders

NBBO National Best Bid and Offer

Pilot Rule 610T of Regulation NMS, Transaction Fee Pilot for NMS Stocks

Release Transaction Fee Pilot for NMS Stocks, 84 Fed. Reg. 5202, 5209 (Feb. 20, 2019)

STATEMENT OF IDENTITY AND INTEREST OF BETTER MARKETS

Better Markets, Inc. ("Better Markets") is a nonprofit, nonpartisan organization that promotes the public interest in the financial markets through comment letters on proposed rules, litigation, independent research, and public advocacy. It fights for regulatory reforms that create a more stable financial system and more fair and transparent financial markets. It also advocates for reforms that protect individual investors from fraud, abuse, and conflicts of interest, and it seeks to ensure that investors who are victimized by brokers, financial advisers, or banks have meaningful remedies. *See generally* Better Markets, http://www.bettermarkets.com (including archive of comment letters, briefs, and other materials). It has no commercial or financial interest whatsoever in the outcome of this case, as its sole objective is to advance the public interest.

Better Markets' advocacy has focused significantly on issues surrounding the transparency and integrity of the equity markets. For example, it has advocated for enhanced oversight of Alternative Trading Systems, *see* Better Markets Comment Letter to the SEC on Regulation of NMS Stock Alternative Trading Systems, Release No. 34-76474, 80 Fed. Reg. 80998 (Dec. 28, 2015), *available at* https://www.sec.gov/comments/s7-23-15/s72315-23.pdf; prompt and robust implementation of the "Consolidated Audit Trail," a critically important market surveillance tool currently in the development stages, *see* Better Markets Comment

Letter to the SEC on National Market System Plan Governing the Consolidated Audit Trail, Release No. 34- 77724; File No. 4-698 (Apr. 27, 2016), *available at* https://www.sec.gov/comments/4-698/4698-17.pdf; stronger order-routing disclosure requirements to increase transparency in markets and reduce conflicts of interests, *see* Better Markets Comment Letter to the SEC on Disclosure of Order Handling Information, Release No. 34-78309; File No. S7-14-16, 81 Fed. Reg. 49432 (July 27, 2016), *available at* https://www.sec.gov/comments/s7-14-16/s71416-17.pdf; and greater access to market data, *see* Better Markets Comment Letter to Chairman Jay Clayton on Roundtable on Market Data and Market Access, File. No. 4-729 (Oct. 25, 2018), *available at* https://www.sec.gov/comments/4-729/4729-4875182-177428.pdf.

In addition, Better Markets submitted extensive comments on the Transaction Fee Pilot for NMS Stocks ("Pilot") at issue in this case. *See* Better Markets Comment Letter to the SEC on Transaction Fee Pilot Proposal, *available at* https://bettermarkets.com/sites/default/files/CL%20SEC%20Transaction%20Fee%20Pilot%205-24-18%20-%20Final.pdf. Its comment letter was cited by the SEC in the final release nearly 20 times, on a broad range of issues presented by the Pilot. *See, e.g.,* Transaction Fee Pilot for NMS Stocks, 84 Fed. Reg. 5202, 5209 (Feb. 20, 2019) ("Release").

Better Markets has a strong interest in supporting the Pilot. The Pilot is

necessary to enable the SEC to better understand the impact that exchange rebates and fees are having on order routing, execution quality, and overall market quality. Indeed, it is the only way that the SEC can gather the data necessary to inform its regulatory approach to a market practice that, while entrenched and profitable for the Petitioners and other exchanges, is widely viewed as a threat to investors and the public interest. Thus, the Pilot aligns with Better Markets' interest in promoting market transparency, market integrity, and investor protection.

In addition, Better Markets has in interest in defeating the Petitioners' legal theory, which if accepted by this Court, will have far-reaching and deleterious consequences not only for the SEC but for other regulatory agencies as well. The Petitioners' attack on the Pilot is predicated largely on the claim that the SEC failed to adequately assess, predict, or quantify the impact that the Pilot might have on markets and market participants. But the standard to which the Petitioners seek to hold the SEC is an impossible one to satisfy: As the SEC made abundantly clear in the Release, given the paucity of available data, the complexity of today's markets, and a myriad of other factors, it was impossible for the SEC to foretell the future impact of the Pilot with the precision that the Petitioners seek. More to the point, and as argued below, the law does not impose such an exacting standard on the SEC. Were the Petitioners' misinterpretation of the law to be adopted in this case, the SEC and other agencies will face nearly impossible hurdles when seeking to regulate

complex commercial activities and markets in the public interest. Thus, refuting the Petitioners' erroneous legal arguments aligns with Better Markets' interest in preserving the SEC's ability to adopt rules and regulations that protect investors, promote market integrity, and serve the overall public interest.

SUMMARY OF ARGUMENT

Evoking images of the Wizard of Oz, the Petitioners insist that the SEC must not be allowed to look behind the curtain of complexity and secrecy that surrounds today's enormously convoluted equity markets, all for fear that their established and profitable pricing and trading practices will be exposed as unfair and abusive and then curtailed or abolished. But Congress specifically charged the SEC above all with protecting investors and market integrity, and the Pilot is a vital step toward discharging those duties. By peeling back the curtain on exchange pricing practices, the SEC will be better able to understand the predominant fee and rebate system that creates intense conflicts of interest, compromises brokers' duty of best execution, and facilitates the predatory behavior of high-frequency traders who feed on retail trading volume lured by the rebate system. The results of the Pilot will lay the foundation for a well-informed, long-term regulatory solution to these abuses, one that is carefully calibrated to maximize investor protection and market integrity while minimizing market disruption. And the Pilot achieves this goal through measures that are strictly limited in time and scope.

There is a compelling need for the Pilot because the current system of fees and rebates creates distortions and conflicts of interest that result in real harm to investors and the markets, while benefitting exchanges and other market participants. To design the best possible solution to address these harms, the SEC must have more detailed and comprehensive data. The Pilot is a rational, thoroughly-considered, appropriately-tailored, and amply-explained approach that will yield the necessary information.

And contrary to the Petitioners' claims, the SEC's economic analysis in support of the Pilot satisfied all applicable legal requirements. The agency exhaustively considered whether the Pilot would promote efficiency, competition, and capital formation, as required under the securities laws, 15 U.S.C. § 78c(f) and it went further, exploring the potential costs and benefits of the Pilot. Given the lack of available data and the extraordinarily complex nature of the equity markets, the SEC was unable to forecast *some* of the ways in which the Pilot might affect the markets. But it did the best it possibly could, and the law does not require the SEC to eliminate all uncertainty regarding the impact of a rule or "to measure the immeasurable." *See Nat'l Ass'n of Mfrs. v. SEC,* 748 F. 3d 359, 369 (D.C. Cir. 2014).

Accepting the Petitioners' argument poses multiple threats. Most immediately, and ironically, it would prevent the SEC from gathering the very data

it needs to remove the uncertainties about market impact on which the Petitioners base their attack, thus preventing the SEC from fashioning an optimal solution. This is an unacceptable Catch-22. More broadly, requiring an agency to forecast the economic impact of every facet of a rule would paralyze agencies confronted with complex and technical regulatory challenges, contrary to the public interest. The law does not impose such unreasonable burdens on regulators.

ARGUMENT

I. THE CURRENT FEE AND REBATE SYSTEM IS HARMING INVESTORS AND UNDERMINING MARKET INTERGRITY, AND THE PILOT IS A NECESSARY AND APPROPRIATE RESPONSE.

The U.S. securities markets have grown enormously complex over the last several decades, resulting in a wide variety of venues to which orders to buy and sell securities may be routed for execution. Orders can be sent to national and regional stock exchanges, alternative trading systems such as dark pools and electronic communications networks, and individual market makers.

The current system of trading fees and rebates exerts a powerful influence on where orders are routed in this complex web. Moreover, the complexity of the current system is largely due to the practices of exchanges such as Petitioners. One study determined that for a single trade, there were 1,023 different "pricing paths" the trade could take across different exchanges, with an astonishing 3,762 separate pricing variables. *See* RBC, Comment Letter on Proposed Transaction Fee Pilot for

NMS Stocks (Oct. 16, 2018), *available at* https://www.sec.gov/comments/s7-05-18/s70518-4527261-176048.pdf. As even the current CEO of Petitioner NYSE's parent company has explained, this complexity is not the natural state of the market, but instead exists primarily to allow the exchanges to offer services from which they reap handsome profits:

> [The maker-taker system] has made the markets more complex, as many exchange operators have opened multiple exchanges and use a wide variety of order types so that they can offer customized rebate structures aimed at different segments of the market, he said. If maker-taker were eliminated, NYSE, for instance, could theoretically go from operating five different exchanges down to just one, Sprecher said. He added that NYSE has as many as 80 different order types, most of which exist to make sure that somebody gets the right rebate.

John McCrank, *NYSE Owner Says Outlawing Exchange Rebates Would Simplify Market*, REUTERS (Feb. 12, 2014), *available at* https://www.reuters.com/article/intercontinentalexchange-rebates/nyse-owner-ays-outlawing-exchange-rebates-would-simplify-market-idUSL2N0LH14D20140212.

This market structure poses a threat to investors on two levels. First, investors rely on their brokers to route orders in their best interest, but the lure of exchange rebates can compromise a broker's duty to seek the best possible trade execution for its clients. Second, the system of exchange fees and rebates also fosters a predatory environment in which high-frequency traders ("HFTs") can take advantage of retail investors. In effect, exchanges use the current fee and rebate system to increase the pool of investors on which HFT can prey, inflicting additional harms on investors.

A. <u>The Current Market Structure Creates Conflicts of Interest for Brokers Who Owe a Fiduciary Duty of Best Execution.</u>

One of the primary consequences of the current market structure is the conflict it creates with the fiduciary duty that brokers owe their clients to obtain the best reasonably available execution for their clients' orders. The execution quality of any particular order varies depending on where it is routed and ultimately where it is filled. Investors, particularly ordinary retail investors, typically rely on the expertise of their brokers, and the duty of brokers to seek best execution, to determine how best to route their orders. Accordingly, in most situations, the execution quality an investor will receive for a particular order is determined by their broker's routing decisions and the broker's exercise of the discretion entrusted to them by their clients. *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) ("a general fiduciary duty…arises when brokers have discretionary authority over their customers' accounts.").

In accordance with this fiduciary duty, a broker must make a reasonable effort to seek best execution on behalf of its client. Fidelity to this duty is especially important for ordinary retail investors, who entrust brokers with their hard-earned savings and lack the resources to monitor the complex and distant operations of large Wall Street brokerage firms. In turn, this duty is critical to the proper functioning of the markets. As one commentator put it, because of the amount of trust and, importantly, money, clients place in brokers, "fiduciary obligations protect the

invaluable integrity of the market." Brian J. Wanamaker, *Class Actions and Rule 10b-5: A Critique of Newton v. Merrill Lynch,* 80 WASH. U. L. Q. 997, 1020 (2002).

The maker-taker model obviously creates powerful financial incentives for brokers to route orders to particular exchanges, which plainly present conflicts of interest for brokers who have a fiduciary duty to seek best execution and to route orders *solely* for the benefit of clients. As the CEO of Petitioner NYSE's parent company, Jeffrey Sprecher stated, "the maker-taker system puts brokers in an awkward position, as they have to shop for rebates in order to compete, and that can get in the way of the brokers' obligation of finding the best price for their end customers." McCrank, *supra.* And the conflict of interest is intense, as these financial order routing incentives are highly profitable for brokerage firms, *See, e.g.*, TD Ameritrade Holding Corp., Annual Report (Form 10-K), at 37 (Nov. 16, 2018) (reporting over $1 billion in revenue from order routing between 2016 and 2018).

Whether or not an investor's order receives best execution is not a trivial matter, particularly for ordinary retail investors with relatively limited resources. Anything less than best execution means a loss of real money for these investors—fewer savings available to meet basic needs, to fund a college education, to plan for retirement, or to achieve other life goals.

Investors suffer the most obvious and direct harm from violations of the duty to seek best execution when a broker routes an order to a venue with a price for the

security that is worse than the price available on another venue. This is an especially prevalent concern for "marketable" orders, i.e. orders for a security at a price that can be executed at the current publicly quoted price. That publicly quoted price may not actually be the best available price, due to a number of factors such as delays between the time a particular trade occurs and the time that trade is incorporated into public pricing data. Routing marketable orders to the venue that offers brokers the highest payment for the order does nothing to ensure that clients will receive the most favorable price for the security. And, indeed, it has been demonstrated that this practice is costly for investors, with one study estimating that the annual drain on investor funds resulting from brokers' routing marketable orders to the venues that pay the most for those orders is $5 *billion*. Katya Malinova & Andreas Park, *Subsidizing Liquidity: The Impact of Make/Take Fees on Market Quality*, 70 J. FIN. 509, 535 (2015) (citing industry study).

For non-marketable orders, i.e. orders that cannot be filled at the prevailing public market price, other execution quality factors come into play. A broker seeking best execution for a non-marketable order should make reasonable efforts to seek a venue that would maximize the likelihood of the order getting filled at the best price *and* as quickly as possible. Routing non-marketable orders to venues that pay brokers the most for those orders increases the likelihood of worse execution and real harm to investors.

For example, a broker seeking to maximize revenue from routing orders would send a non-marketable order to a maker-taker venue that offers the highest rebate for adding liquidity. However, that venue is also likely to have a high "take" fee for orders that remove liquidity (maker-taker venues charge higher "take" fees than they pay in "make" rebates and pocket the difference). Consequently, other brokers will be less likely to route orders that might remove liquidity, i.e. that might execute against the client's resting order, to that venue.[2] The end result is that the order is less likely to be filled, or if filled will be filled more slowly, all to the detriment of the client. This is not mere speculation: Academic studies have confirmed that non-marketable orders routed by brokers seeking to maximize revenue are less likely to be filled, and when they are filled, are filled more slowly. Robert Battalio, Shane A. Corwin & Robert Jennings, *Can Brokers Have it All? On the Relation between Make-Take Fees and Limit Order Execution Quality*, 71 J. FIN. 2193, 2222 (2016).

B. **The Current System of Fees and Rebates Also Fosters an Environment in Which HFTs Prey on Investors.**

Fees and rebates not only create conflicts of interest between brokers and their clients, but also facilitate another form of investor predation at the hands of HFTs.

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[2] While most exchanges have a maker-taker model, there are so-called "inverted exchanges" that give rebates to orders that *take* liquidity and charge a fee to orders that make liquidity. Brokers looking to maximize order routing revenue (or decrease order routing costs) will likely route executable orders to inverted exchanges.

By attracting and increasing order volume, exchanges enhance the value of the data they can sell to HFTs, which in turn use that information to gain advantage over other traders, including millions of everyday investors.

Understanding this additional form of harm entails an understanding of the dramatic changes in market practices and conditions that have evolved over several decades. The growth in market complexity and fragmentation has been accompanied by the dominance of electronic trading, and in particular HFTs. Trading no longer occurs on trading floors of exchanges, but electronically in data centers in New Jersey, directed by computer algorithms. The conversion of almost all trading to electronic trading has in turn given rise to the prominence of HFTs, which now account for most of the trading volume in U.S. equity markets. Gaia Balp & Giovanni Strampelli, *Preserving Capital Markets Efficiency in the High-Frequency Trading Era*, 2018 U. ILL. J.L. TECH. & POL'Y 349, 352. There are a variety of HFT trading strategies, but they primarily rely on the ability to act on superior information. This requires extraordinary speed—obtaining the most current market information and acting on that information before it becomes stale within microseconds.

The current system for disseminating information to market participants has its roots in 1975, when Congress mandated that the SEC create a "national market system" for trading equity securities. *See* 15 U.S.C. § 78k-1(a). Before this, market

fragmentation frequently resulted in the same security trading at different prices on different exchanges. *City of Providence, Rhode Island v. Bats Glob. Markets, Inc.*, 878 F.3d 36, 41 (2d Cir. 2017). The SEC promulgated a series of regulations implementing Congress's mandate, culminating with Regulation NMS in 2005. Regulation NMS requires, among other things, that investors receive the best available price for orders. 17 C.F.R. § 242.611. In order to accomplish this, exchanges are required to contribute to a consolidated, publicly available data feed that informs the public of the national best bid and offer ("NBBO") for a given security. 17 C.F.R. § 242.603(b). Exchanges and brokers must accept the NBBO, which is supposed to be the most competitive publicly available price. Moreover, exchanges must essentially provide the information that feeds into the NBBO at cost. *In re Application of Sec. Indus. & Fin. Markets Ass'n for Review of Action Taken by NYSE Arca, Inc., & Nasdaq Stock Mkt. LLC*, Release No. 84432 at 5 (Oct. 16, 2018).

However, the information that exchanges must provide to the consolidated data feed constitutes only a small portion of the information that exchanges control. Specifically, information about the depth of demand and supply for any particular security, *i.e.* existing orders to buy (or bids to sell) a security at a price lower (or higher) than the NBBO, is valuable, especially for HFTs. Exchanges are not required to provide this information to the public at cost, but instead are free to sell this information at a price the market will bear so long as the price is "fair and

reasonable" and "not unfairly discriminatory." *Id.* at 1. These proprietary data feeds provide the purchasers with more valuable information than the public consolidated data feed can supply; moreover, because the data in the proprietary feed need not be consolidated, it can be transmitted to purchasers before the consolidated feed is made public. To further satisfy HFTs' need for speed, exchanges also sell "co-location" services, *i.e.* they rent space to HFTs that is in close physical proximity to the exchange's systems. Purchasers of co-location services thus receive information faster, and can execute trades faster, than traders who do not purchase those services.

Exchanges have increasingly relied on the sale of proprietary data feeds and co-location services for revenue. The relative value of a particular exchange's proprietary data feed and co-location services depends on the value of the information the exchange possesses, and *the value of that information depends on the number of orders that are routed to the exchange*—the more orders routed to the exchange, the more valuable that exchange's information becomes and the higher the fees it can charge. SHAWN M. O'DONOGHUE, KELLEY SCHOOL OF BUSINESS RESEARCH PAPER, THE EFFECT OF MAKER-TAKER FEES ON INVESTOR ORDER CHOICE AND EXECUTION QUALITY IN U.S. STOCK MARKETS at 2 (2015), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2607302. The maker-taker model at issue here has evolved as the predominant pricing model as exchanges compete for the order flow that, in addition to providing them with access fees, also

makes their information that much more valuable to certain traders, specifically HFTs.

HFTs are often on the other side of the trades that, from retail investors' perspective, receive inferior execution. HFTs use their access to superior information, purchased from exchanges, as well as their physical proximity to exchange systems, to pick off and front-run retail investors' orders. Accordingly, the current market structure benefits a few market participants, primarily HFTs, exchanges, and to a lesser extent brokers, all at the expense of longer-term, retail investors.

Plainly, the current system of fees and rebates is inflicting wide-spread and multi-faceted harm on retail investors, and the Pilot is an important and appropriate data-gathering measure that will enable the SEC to develop an appropriately tailored regulatory solution.

II. THE SEC FULFILLED ITS DUTY TO CONSIDER THE IMPACT OF THE PILOT, AND THE INESCAPABLE UNCERTAINTIES SURROUNDING THE RULE DO NOT INVALIDATE THE AGENCY'S ANALYSIS.

The essence of Petitioners' attack on the Pilot is that the SEC was unable to predict all of the economic consequences it would have on issuers, investors, or exchanges. This line of argument has become a standard weapon routinely deployed by members of the financial services industry in attempts to nullify SEC rules that

threaten their established and profitable business models and market practices. BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC at 15-32 (2012), *available at* https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf. But the law does not require a federal agency to foretell the future or to make definitive determinations as a pre-condition for taking action in furtherance of its mandate to protect the public interest. Rather, it requires merely that the SEC "consider" certain factors and economic consequences of its rules.

In this case, the SEC amply fulfilled that duty, as it thoroughly explored to the best of its ability the anticipated effects of the Pilot, including its potential impact on efficiency, competition, and capital formation and its costs and benefits. Because of the complexities inherent in the prevailing market structures and trading practices at issue, and because of the lack of data currently available to the SEC, the agency was simply unable in some instances to determine the likely impact of the Pilot. But under the law, these uncertainties do not invalidate the Pilot; rather, they confirm the wisdom and importance of the Pilot as a means of better understanding market practices widely viewed as predatory and anti-competitive. What matters is that the SEC substantiated and explained its reasoned decision that the Pilot overall will serve the purposes underlying the securities laws by enabling it to gather the data necessary to fully evaluate and address the problems created by the opaque system

of fees and rebates prevailing in our markets.

A. **The SEC's Duty to Consider Economic Factors Is Limited, and It Does not Supersede the Agency's Duty to Protect Investors and the Public Interest.**

Section 3(f) of the Exchange Act, invoked by the Petitioners, requires the SEC, after first considering "the public interest" and the "protection of investors," "to *consider* . . . whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f) (emphasis added). In a similar vein, Section 23(a)(2) requires the SEC to "*consider* among other matters the impact any such rule or regulation would have on competition," and to refrain from adopting a rule if it "would impose a burden on competition *not necessary or appropriate in furtherance of the purposes of [the statute]*." 15 U.S.C. § 78w(a)(2) (emphasis added).

This duty to consider three discrete economic factors is limited in two important respects. First, the SEC's duty under Section 3(f) is a far cry from the obligation to conduct a formal or quantitative cost-benefit analysis. Whether or not an agency must conduct cost-benefit or economic impact analysis, and the exact nature of that exercise, is determined principally by what Congress has actually said in the agency's organic statute, and it is not to be inferred lightly or without a clear indication from Congress. *Am. Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-512 & n. 30 (1981) ("Congress uses specific language when intending that an agency engage in cost-benefit analysis."). In recent decisions, the D.C. Circuit has

repeatedly reaffirmed this principle and applied it in rejecting industry challenges to agencies' economic analysis. For example, in *Lindeen v. Sec. & Exh. Comm'n*, 825 F. 3d 646, 658 (D.C. Cir. 2016), this Court observed that "[w]e do not require the Commission to 'conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.'" (internal citations omitted).

Section 3(f) is also limited because it only requires that the SEC "consider" the potential impact of a rule on efficiency, competition, and capital formation. On its face, and despite Petitioners' repeated assertions, *see, e.g.,* Pet'rs' Br. at 34, Section 3(f) does not require that the SEC definitively "determine" the degree to which a rule will impact the three factors. Moreover, the duty to consider specific factors reflects a deliberate decision by Congress to afford the agency broad discretion in how it conducts its analysis. In fact, long before Congress added the applicable statutory provisions to the Exchange Act in 1975 and 1996, the Supreme Court held that when statutorily mandated "considerations" are not "mechanical or self-defining standards," they "in turn imply wide areas of judgment and therefore of discretion." *Sec'y of Agriculture v. Cent. Roig Refining Co.*, 338 U.S. 604, 611-12 (1950) ("Congress did not think it was feasible to bind the Secretary as to the part his 'consideration' of these three factors should play in his final judgment—what weight each should be given, or whether in a particular situation all three factors must play a quantitative share in his computation.").

Courts afford agencies special deference in this area, as "[economic] analyses epitomize the types of decisions that are most appropriately entrusted to the expertise of an agency." *Office of Commc'n of United Church of Christ v. FCC*, 707 F.2d 1413, 1440 (D.C. Cir. 1983). Similarly, judicial deference is elevated where an agency is grappling with highly complex and technical issues, as in this case. *See Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) ("broad deference is all the more warranted when, as here, the regulation concerns 'a complex and highly technical regulatory program.'"); *Dana-Farber Cancer Inst. v. Hargan*, 878 F.3d 336, 340–41 (D.C. Cir. 2017) (courts give substantial deference "particularly where the regulations involve 'a complex and highly technical regulatory program'").

Moreover, it is clear from the legislative history that Congress did not intend economic considerations to supersede the SEC's paramount duty to protect investors and the public interest. When enacting the provision requiring the SEC in Section 3(f) to "consider" "efficiency, competition, and capital formation," it disavowed any intention to subordinate the SEC's primary duty to protect investors:

> The new section…makes clear that matters relating to efficiency, competition, and capital formation are only part of the public interest determination, which also includes, among other things, consideration of the protection of investors**.** *For 62 years, the foremost mission of the Commission has been investor protection, and this section does not alter the Commission's mission.*

H.R. REP. NO. 104-622, at 39 (1996).

Nor did Congress intend to impose through Section 3(f) a rigorous economic analysis requirement. Indicative of this intent is that Congress actually considered, but rejected, a much more prescriptive obligation, explicitly declining to impose this "mechanical or self-describing" process on the SEC in favor of a more limited duty to "consider" the enumerated factors and preserving a wide degree of discretion to determine how consideration of those factors should play in the rulemaking process.[3] *See Cent. Roig Refining Co.*, 338 U.S. at 611-12.

Similarly, in 1975 when Congress added Section 23(a)(2) to the Exchange Act requiring the SEC to consider the anticompetitive effects of its rules, it intended this consideration to be flexible and entitled to deference without imposing a duty to necessarily minimize the anti-competitive effects of a rule:

> This explicit obligation to balance…the competitive implications of self-regulatory and Commission action *should not be viewed as requiring the Commission to justify that such actions be the least anti-competitive manner of achieving a regulatory objective.* Rather, the Commission's obligation is to weigh competitive impact in reaching regulatory conclusions. The manner in which it does so is to be subjected to judicial scrutiny upon review in the same fashion as are other Commission determinations, *with no less deference to the Commission's expertise than is the case in other matters subject to its jurisdiction.*

[3] That provision would have required the SEC to analyze the costs of the regulation on the U.S. economy in general and the securities markets in particular and estimate the impact on economic and market behavior. S. REP. NO. 104-293, at 28-29 (1996).

S. REP. No. 94-75, at 13 (1975) (emphasis added). Moreover, "[c]ompetition was simply not to 'become paramount to the great purposes of the Act.'" *Bradford Nat'l Clearing Corp. v. SEC*, 590 F.2d 1085, 1105 (D.C. Cir. 1978).

B. **The SEC is Not Required to Predict the Impact of Every Facet of its Rules.**

This Court's decisions construing the SEC's economic analysis obligation consistently recognize that the SEC may be genuinely unable to quantify or forecast the impact of its rules. A core principle embedded in decisions analyzing the SEC's economic analysis obligation—even those in which the Court has faulted the SEC for failing to conduct a sufficient analysis[4]—is that there are limits on what agencies can be expected to accomplish when it comes to economic analysis. As the Court observed, the SEC's duty is to "determine *as best it can* the economic implications of [a] rule." *Chamber*, 412 F. 3d at 143 (emphasis added). This is consistent with the general principle articulated by this Court that in "circumstances involving agency predictions of uncertain future events, complete factual support in the record for the Commission's judgment or prediction is not possible or required" since "a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency." *Rural Cellular Ass'n v.*

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[4] *See, e.g. Chamber of Commerce v. Sec. & Exch. Comm'n.*, 412 F.3d 133, 143 (D.C. Cir. 2005) (remanding SEC rule designed to address mutual fund conflicts of interest through enhanced corporate governance requirements).

F.C.C., 588 F.3d 1095, 1105 (D.C. Cir. 2009) (internal citations and quotation marks omitted).

For example, in *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm'n*, 720 F. 3d 370, 379 (D.C. Cir. 2013), the Court upheld the economic analysis supporting a registration requirement for certain derivatives traders. The Court rejected the claim that the agency should have precisely quantified the benefits the rule would provide in terms of preventing another financial crisis, observing that "the law does not require agencies to measure the immeasurable." *Id.* The Court also accepted the agency's qualitative consideration of costs and benefits, given the limited data available to the CFTC and the resulting uncertainties. *Id.* at 379-80. And in an observation directly relevant to this case, the Court noted that since the derivatives rule under attack was in part designed to help close that very data gap, the challengers were attempting to place the agency in an untenable position:

> In essence, the appellants are challenging the very method for obtaining the data they want on the ground that CFTC has not yet obtained the data they want. But neither the APA nor the [Commodity Exchange Act] imposes such a catch-22 on CFTC.

Id. at 380.

And in *Lindeen v. Sec. & Exh. Comm'n*, 825 F. 3d 646 (D.C. Cir. 2016), the Court upheld the SEC's "Reg A+" establishing an expansive new exemption from registration for certain securities offerings, rejecting an argument that the SEC failed to adduce evidence regarding the prospective costs of state-law compliance and state

law preemption. The Court noted that the SEC simply "did not have the data necessary to quantify precisely" those factors and reiterating the principle that "[w]e do not require the Commission to 'measure the immeasurable.'" *Id.* at 658; *see also Nat'l Ass'n of Mfrs.*, 748 F.3d at 369 (D.C. Cir. 2014) ("we find it difficult to see what the Commission could have done better" since the agency "lacked data about the rule's effects").

C. **The SEC Considered All of the Requisite Economic Factors.**

In this case, the SEC complied with all of the requirements surrounding not only reasoned decision-making but also economic analysis. It thoroughly considered the potential impact of the Pilot on efficiency, competition, and capital formation, *see, e.g.,* Release at 5280-91; it considered a wide array of potential costs and benefits of the Pilot, *see, e.g.,* Release at 5259-5280; it quantified where it could, *see, e.g.*, Release at 5267 (estimating dollar amounts of compliance costs); it made exhaustive and well-supported qualitative judgments about the likely impact of the Pilot where it could, *see, e.g.,* Release at 5287 ("The Commission does not expect the Pilot to have a substantial permanent impact on capital formation because the Pilot is limited in duration . . . ."); and it addressed a host of comments expressing a wide variety of views about the Pilot, some strongly critical and some strongly supportive, *see, e.g.,* Release at 5280-5291.

In addition, on a number of issues the Commission asserted that it simply could not make a predictive judgment about the impact of the Pilot, either because it lacked data or simply could not determine *ex ante* the impact of the rule due to market complexities and predictive difficulties. *See, e.g.,* Release at 5281 ("the Commission is unable to determine the overall effect of the Pilot on price efficiency and the price discovery process"). These assessments, which are presumptively trustworthy, *U.S. Postal Serv. v. Gregory*, 534 U.S. 1, 10 (2001) ("a presumption of regularity attaches to the actions of Government agencies"), are also buttressed by the record. As the SEC explained:

> [D]etermining whether a causal relationship between exchanges' transaction fee-and-rebate pricing models and broker-dealers' behavior is complicated because, for example, such pricing models and order routing decisions could be jointly determined and order routing decisions could influence fees just as fees could influence order routing decisions. Currently available data do not permit researchers to isolate these factors and thus identify the existence or direction of such a causal relationship, which in turn impedes researchers' ability to determine the extent to which conflicts may exist and any potential negative impacts may manifest.

Release at 5244.[5] The very point of the Pilot is to gather data that will enable the SEC to better understand the impact of fees and rebates on order routing, execution

[5] Given that Exchanges are largely responsible for the daunting complexity of the trading systems in place today, *see supra* Part I, accepting their argument would essentially reward them for creating the very conditions making it difficult for the SEC to predict the impact of new measures to control fees and rebates. The Court should reject this transparently self-serving strategy.

quality, and overall market quality. In light of that goal, it would be astonishing if the SEC already had sufficient data to predict the impact of every aspect of the Pilot. Moreover, as the SEC observed repeatedly in the Release, the practices to be studied in the Pilot have been the subject of intense debate for years. *See, e.g.,* Release at 5214 ("there is strong disagreement about the impact of exchange fee-and-rebate pricing models but a lack of data to study the issue").

Accordingly, this case epitomizes the type of rulemaking where the agency has done all it can to consider the economic impact of its rule, and any inability to reach certain conclusions arise from insuperable obstacles beyond its control. No more was required. *BellSouth Corp. v. F.C.C.*, 162 F.3d 1215, 1221 (D.C. Cir. 1999) ("When, as in this case, an agency is obliged to make policy judgments where no factual certainties exist or where facts alone do not provide the answer, our role is more limited; we require only that the agency so state and go on to identify the considerations it found persuasive.")

D. Accepting the Exchanges' Argument Would Create a New and Dangerous Obstacle to Evidence-Based Rulemaking.

On the facts of this case, the Petitioners' argument, if accepted, would significantly impair agency rulemaking by preventing regulators from taking reasonable action to protect the public absent an arbitrary and unobtainable degree of certainty about the possible future impact of its approach. The danger is

especially acute where, as here, the agency action is specifically limited in time and scope and specifically designed to gather the data necessary to develop the best possible long-term course of action. A necessary corollary to the rule affording agencies significant latitude in making policy judgments in the face of uncertainty, *see BellSouth Corp*. 162 F.3d at 1221, is that agencies should have significant latitude when attempting, as here, to reduce that uncertainty. In short, accepting the Petitioners' argument would not only imperil agencies' ability to take action to regulate in the public interest, no matter how necessary or urgent, where there is uncertainty regarding future effects, but also imperil agencies' ability to even attempt to resolve those uncertainties.

The result would be perverse: Instead of taking advantage of opportunities, such as establishing programs like the Pilot, to develop the best possible evidence to choose the best possible remedies, agencies would be forced to make policy choices based on suboptimal information. Here the SEC is faced with a situation that is common for agencies making difficult decisions. Evidence indicates that the current regulatory structure is flawed, undermining market integrity and harming the investors the SEC is charged with protecting. However, that evidence is, for a variety of reasons, limited and subject to intense dispute. The SEC can now achieve much greater clarity through empirical evidence gathered via the Pilot, enabling it to fashion the best possible regulatory solution. The Petitioners would instead force

the SEC—and other agencies facing similar circumstances—to either (1) ignore the evidence of harm caused by the current regulatory structure and simply maintain the status quo, or (2) adopt a final rule to address the harm based on limited and disputed evidence, even where the agency has an opportunity to develop a more robust dataset on which to act. The Court should reject the Petitioners' attempt to force such unacceptable choices on the SEC and to more broadly thwart regulators' ability to protect the public interest.

CONCLUSION

For all of the foregoing reasons, and those set forth in the SEC's brief, this Court should uphold the Pilot.

Respectfully submitted,

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Dated: August 1, 2019

CERTIFICATE OF COMPLIANCE

In accordance with FRAP 29(a)(4)(G) and FRAP 32(g), I hereby certify the following:

This document complies with the type-volume limit of FRAP 29(a)(5) because, excluding the parts of the document exempted by FRAP 32(f), this document contains 6,498 words.

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/s/Stephen W. Hall
Stephen W. Hall

Dated: August 1, 2019

CERTIFICATE OF SERVICE

I hereby certify that on August 1, 2019, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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Stephen W. Hall

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