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VIA FACSIMILE AND HAND DELIVERY

Giovanni P. Prezioso, Esq.
General Counsel
U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: *Investment Company Governance Rule, 69 Fed. Reg. 46,378 (Aug. 2, 2004); File No.* S7-03-04

Dear Mr. Prezioso:

I am writing on behalf of the Chamber of Commerce of the United States regarding the Court of Appeals's June 21 decision remanding the Commission's mutual fund "governance" rule, and regarding the meeting the Commission has scheduled for next Wednesday, June 29, concerning the remanded rule and the Court's order. In particular, we wish to express our concern that if, as has been reported, the purpose of June 29 meeting is to vote on re-adoption of the two provisions deemed to be "defective" by the Court, proceeding in such a hasty manner would constitute a profound departure from the requirements of the administrative process, and from the Court's order in this case.

As you know, the Court held that in adopting the rule's independent chair and 75 percent independent director requirements, the Commission failed to satisfy its obligations under the Investment Company Act ("ICA") and the Administrative Procedure Act ("APA"). Specifically, the Court held that the Commission improperly failed to consider the costs of the requirements, and the effect of those costs on efficiency and competition; and, the Court ruled, the Commission had neglected to consider a significant alternative to the independent chair requirement. Op. at 15-19. Accordingly, the Court "remanded to the Commission to address the deficiencies with

the 75% independent director condition and the independent chairman condition identified [in its decision]." *Id.* at 19 (emphasis added).

The Chamber trusts that the Commission will now engage in a thorough, rigorous, and deliberate process to comply with the Court's order, and will more carefully examine the matters identified in the Court's decision. As noted, the Commission has noticed an Open Meeting for next Wednesday, June 29, to "consider the matters remanded to the Commission by the [Court]." *See* http://www.sec.gov/news/openmeetings/ ssacmtg062905.htm (last visited June 23, 2005). The purpose of this meeting is not clear. It may be merely to publicly affirm, as we believe is self-evident, that funds have no obligation to undertake further compliance efforts with the "deficient" rule until further rulemaking proceedings are completed. Perhaps the Commission's purpose is also to establish a timetable for seeking, receiving, and responding to information and comments from the public.

There has been reports, however, that the purpose of the June 29 meeting is to re-adopt the challenged requirements, on the basis of a purported consideration of the matters identified by the Court. We are doubtful that could be the case, given the procedures the government ordinarily follows when a rule is remanded, and given other legal and practical considerations discussed below. If, however, it is the Commission's current intention to vote whether to re-adopt the challenged provisions on June 29, we strongly urge reconsideration of that course of action.

It is well established that when a court remands a rule, the agency has no less a duty to comply with its rulemaking obligations than it had during the initial rulemaking process. *See Checkosky v. SEC*, 139 F.3d 221, 225-26 (D.C. Cir. 1998) (holding that the Commission violated the APA on remand). Thus, as an initial matter, the Commission must respect the fundamental predicate of rulemaking that it approach the matter with an open mind, without a predetermined commitment to one outcome or another. The Commission may not "prematurely and arbitrarily rubber stamp[] the previously approved standard." *CPC Int'l, Inc. v. Train*, 540 F.2d 1329, 1332 (8th Cir. 1976) (emphasis added); *see also Checkosky v. SEC*, 23 F.3d 452, 465-66 (D.C. Cir. 1994) (requiring "the Commission [on remand] to face squarely and forthrightly the legal and practical consequences" of its action).

In the case of this particular remand, the first step for the Commission will be to gather the evidence needed to judge the costs identified in the Court's opinion, as to both the independent chair and the 75 percent independence requirements. As you know, the Court's decision noted the Commission's statutory obligation under the ICA to "'consider . . . whether [its] action will promote efficiency, competition, and capital formation.'" Op. at 13 (quoting 15 U.S.C. § 80a-2(c)). "The Commission violated its obligation . . ., and therefore the APA, in failing adequately to consider the costs imposed upon funds by the two challenged conditions," the Court said. Op. at 17. And yet, while responsibly assessing those costs is the first task at

hand, the Commission confessed in its Adopting Release that the existing rulemaking record provides "no reliable basis for determining how funds would choose to satisfy the [condition]." As a consequence, the Commission said, "it is difficult to determine the costs associated with electing independent directors." 69 Fed. Reg. at 46,387 (emphases added); *see* Op. at 15.

On remand, a period of public comment is the customary and appropriate manner for addressing such acknowledged deficiencies in the evidence before an agency. That was the process followed by the agencies in the two cases cited by the Court in its decision remanding this rule. Op. at 19. In *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027 (D.C. Cir. 2002), the agency took several months to permit public comment and develop a new rule in light of the deficiencies identified in the D.C. Circuit's decision. *See* 67 Fed. Reg. 65,751 (Oct. 28, 2002). Similarly, in *Allied-Signal, Inc. v. NRC*, 988 F.2d 146 (D.C. Cir. 1993), further notice and comment was sought over a period of months before the agency undertook to finalize new regulatory provisions. *See* 58 Fed. Reg. 50,859 (Sept. 29, 1993).

Importantly, since the Commission finalized this rule last summer, valuable sources of evidence have developed regarding the costs funds would incur under the provisions at issue. As you know, a number of funds already have taken steps to comply with the challenged provisions of the rule, bringing the complement of independent directors to 75 percent and installing an independent chair. Which of the three approaches identified by the Commission in its Adopting Release have these funds taken to satisfy the 75 percent independence requirement? If the actual number of independent directors is being increased, is that accompanied by an increase in the fees paid for independent directors? And similarly, as to the hiring of staff to support the independent chair and other independent chairs and directors, have funds determined—as the Commission expected they would—that the hiring of staff is necessary? If so, what costs are being incurred for those staff? And if not, is that because the costs of staff are prohibitively high and independent chairs and directors—who are less familiar with the fund—feel compelled to forego support they otherwise would seek?

We respectfully request that 60 days' public comment be allowed for the Commission to collect information of this nature and thereby discharge its legal duties responsibly and with appropriate information. We believe it is plainly insufficient for the Commission by itself to seek out data to address the matters it had "no reliable basis" to address during the rulemaking. Data collected in this way would not be part of the rulemaking record, and would not satisfy the APA's requirement that an agency make the opportunity to comment available to the public as a whole, rather than to individual interests or entities chosen by the agency. To proceed in that non-public and selective manner would also raise concerns about the integrity of the data and, indeed, of the process itself. Thus, for example, in another recent rulemaking cited by the Court of Appeals as authority for the Commission's duty in this case to "determine as best it can the economic implications of the rule," the agency expressly sought data from the public on the rule's cost in the wake of the Court's decision. Op. at 15-16 (citing *Public Citizen v. Federal*

Motor Carrier Safety Admin., 374 F.3d 1209, 1221 (D.C. Cir. 2004); 70 Fed. Reg. 3339 (Jan. 24, 2005).

Simply, the Court of Appeals has instructed the Commission to "do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure." Slip Op. at 16-17 (emphasis added). For the Commission to "do what it can" to apprise itself includes seeking public comment. And, as the Court made clear, the Commission must apprise not only itself, but also "the public and Congress," before any decision is made whether to re-adopt the "deficient" requirements. *Id.*

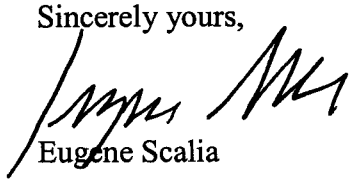
The Commission's responsibilities under the remand order will not end with gathering and assessing data on the costs of the two provisions. Rather, that is a preliminary step toward determining what effects those costs will have on efficiency and competition. As the Commission has noted previously, such questions can be "difficult" to resolve. The question of competition, for example, is a matter not merely of the performance of individual funds, but of the ability of funds to compete—when burdened with these new costs—with other investment vehicles available to the public. Put differently, effects on competition cannot appropriately be considered without defining and considering the relevant market as a whole.

Once these costs and their competitive effects are understood, the Commission will be in a position to take up the ultimate question: Whether the challenged provisions should be retained, or whether some other course is appropriate. The new evidence and analysis must be taken into account, and consideration must be given to whether alternatives that were rejected before—including but not limited to the alternative identified in the Court's order—are more appropriate now in light of this fuller understanding of the provisions' broader effects.

Plainly, the tasks identified above cannot be accomplished in the five business days between the Court's decision and the June 29 meeting. For the Commission to attempt to re-adopt the two provisions in that manner would be inconsistent both with the requirements of the Administrative Procedure Act outlined above, and with the respect for the rule of law historically associated with the Commission. If the Commission is committed to the administrative process; to soliciting and considering the views of the public; and to faithfully discharging the Court's order, it will seek further information and reconsider the proper regulatory approach in light of it. By contrast, for the agency to rush to judgment a day before the departure of the Chairman would cause the public, and the Court of Appeals, to conclude that the Commission's decision was pre-ordained. Such a course would subject the Commission to yet further legal proceedings in which it is unlikely to prevail.

Thank you for your attention to this important matter.

Sincerely yours,



Eugene Scalia

cc: Hon. William H. Donaldson, Chairman, Securities and Exchange Commission
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Cynthia A. Glassman, Commissioner
Hon. Harvey J. Goldschmid, Commissioner
Mr. Jonathan G. Katz, Secretary
Mr. John W. Avery, Special Counsel