Some of the U.S. Securities and Exchange Commission’s Dodd-Frank rules may face legal challenges after a federal appeals court ruling rejected an agency regulation on shareholder rights, analysts said.

The SEC rule written last year was meant to open company boards to candidates pushed by major shareholders. The U.S. Court of Appeals in Washington yesterday agreed with business groups that the rule shouldn’t be implemented because the regulator didn’t properly explore the costs of the change.

The requirement that the SEC do a full cost-benefit analysis on its rulemaking has been a trouble spot for the agency, which has lost several similar cases in the same court. Today’s defeat comes as the SEC works on more than 100 rules it was assigned by the Dodd-Frank overhaul enacted a year ago.

“The whole implementation of Dodd-Frank is at risk,” said Hal Scott, director of the Committee on Capital Markets Regulation, a research group that has been critical of the regulatory overhaul. “This is a problem that we should have been aware of from the beginning. That’s why this rush to rulemaking was flawed.”

Among federal regulators, the SEC faces the largest share of Dodd-Frank rule-writing. About 70 of the rules have been proposed so far, SEC Chairman Mary Schapiro told lawmakers at a hearing July 21. The law requires the agency to study each rule’s effect on “efficiency, competition and capital formation.”

Three-Judge Panel

The SEC declined to comment on whether Dodd-Frank rules are legally vulnerable. On yesterday’s ruling, Kevin Callahan, an SEC spokesman, said the commission is “reviewing the decision and considering our options.”

In the so-called proxy access rule struck down by the court yesterday, the three-judge panel sided with the U.S. Chamber of Commerce and the Business Roundtable, finding that the agency failed to study how much the rule would cost companies to fight investors’ bids to oust board members.

“The commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters,” U.S. Circuit Judge Douglas Ginsburg wrote.
“The court has sent a clear signal that the agency must continue to improve its efforts in that area,” said Eugene Scalia, a lawyer at Gibson, Dunn & Crutcher LLP in Washington who represented the business groups. “The decision is notable for the number of different errors it finds in the commission’s analysis and the degree for which those errors go to the very core of the commission’s argument.”

**Fourth Victory**

Yesterday’s finding was Scalia’s fourth victory since 2005 challenging the cost-benefit reviews of SEC rules. The Court of Appeals in Washington rejected other SEC rules that defined indexed annuities as securities and that required 75 percent of a mutual fund’s directors to be independent. Scalia said the latest finding gives guidance to the SEC to consider “the rationales for its other rulemakings, including those under Dodd-Frank.”

“This is sort of a wake-up call for Dodd-Frank,” said Jeff Morgan, president and chief executive officer of the National Investor Relations Institute in Vienna, Virginia. “It puts a light on the SEC and their process for how they make decisions.”

Morgan, whose group represents investor-relations officials at 3,500 public companies, offered advice to the SEC: “You really need to make sure you spend the time.”

**‘Agency of Lawyers’**

Scott, the director of the capital markets group who is also a professor at Harvard Law School, said that the SEC is “an agency of lawyers” where economists struggle for recognition. Its failure to review the full economic weight of its rules “is largely, in my mind, a cultural problem in the agency.”

President Barack Obama this month issued an executive order for independent agencies to look at the costs of new and existing rules to avoid regulations that are “excessively burdensome.”

In a June report examining whether the SEC had properly estimated the costs and benefits of new rules, Inspector General H. David Kotz said the agency had set up teams of officials with “sufficient expertise to conduct a comprehensive and thoughtful review.” Kotz said two rules had “potential deficiencies” and that there was a lack of quantitative analysis in a rule that would establish municipal advisers’ registration with the commission.

“This is a very difficult time for the commission,” said Jeffrey W. Rubin, chairman of the American Bar Association’s committee on federal regulation of securities. “Maybe it’ll add some degree of caution in its rulemaking.”