ORAL ARGUMENT NOT YET SCHEDULED

CASE NO. 18-1213

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TWIN RIVERS PAPER COMPANY, LLC, *et al.,*

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Petition for Review of Final Rule of the
United States Securities and Exchange Commission

OPENING BRIEF OF PETITIONERS

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rules 26.1 and 28(a)(1), Petitioners state as follows:

A. <u>Parties and *Amici*:</u>

The parties in this case are Petitioners Twin Rivers Paper Company LLC ("Twin Rivers"), Consumer Action, American Forest & Paper Association ("AF&PA"), The Coalition for Paper Options ("CPO"), and Printing Industries Alliance ("PIA"), and Respondent United States Securities and Exchange Commission ("SEC" or "Commission"). No entity or individual has sought to file as an intervenor in this matter. No entity or individual has filed a notice of intent to participate as *amicus curiae*.

Petitioner Twin Rivers manufactures specialty paper for packaging, technical, label, and publishing markets as well as dimensional lumber. Twin Rivers' publishing market includes paper products for religious, pharmaceutical, reference, catalogue, financial and commercial printing. Petitioner Consumer Action focuses on consumer education that empowers low- and moderate-income and limited-English-speaking consumers to succeed in today's marketplace and prosper financially. Consumer Action hears from consumers across the country, including seniors (about a third of seniors own mutual funds), minority Americans, disabled Americans, and those living in rural areas, who struggle with digital

literacy and depend on access to paper materials for the information they need. Petitioners AF&PA, CPO, and PIA are trade associations representing the forest product industry, consumer organizations, labor unions, rural advocates, print communication industry organizations and the printing industry.

Petitioner Twin Rivers is a privately-held company headquartered in Madawaska, Maine. Twin Rivers is not a publicly-held company and has no parent company. No publicly-held company has a ten percent (10%) or greater ownership in Twin Rivers. Consumer Action is a non-profit association that operates as a tax-exempt organization under the provisions of § 501(c)(3) of the Internal Revenue Code. It has no parent company and no publicly held company has a ten percent (10%) or greater ownership in Consumer Action. AF&PA, CPO, and PIA have no parent corporation or publicly-held company with a ten percent (10%) or greater ownership interest.

B. <u>Rulings Under Review:</u>

Under review in this case is the SEC's Rule 30e-3, which will allow investment funds to satisfy their obligations to transmit shareholder reports by making these reports accessible at a website address rather than by delivery of paper reports. The rule was adopted at an open meeting on June 5, 2018. The final rule was published in the Federal Register on June 22, 2018. *Optional Internet*

Availability of Investment Company Shareholder Reports, 83 Fed. Reg. 29,158 (June 22, 2018).

C. Related Cases:

Petitioners are aware of no cases related to this Petition.

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GLOSSARY

Adopting Release, or Final Rule	*Optional Internet Availability of Investment Company Shareholder Reports,* 83 Fed. Reg. 29,158 (June 22, 2018)
AF&PA	American Forest & Paper Association
APA	Administrative Procedure Act, 5 U.S.C. §§ 551-559, 701-706 (and selected other sections in Title 5 of the U.S. Code)
Commission, or SEC	United States Securities and Exchange Commission
CPO	The Coalition for Paper Options
Dodd-Frank Act (2010)	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 911, 124 Stat. 1376, 1822 (codified at 15 U.S.C. § 78pp)
FINRA	Financial Industry Regulatory Authority
IAC	Investor Advisory Committee
IAC Report	*Recommendations of the Investor Advisory Committee Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure Document for Delivery of Investment Company Shareholder Reports* (Dec. 7, 2017)
Investment Company Act U.S.C. of 1940, or '40 Act	Investment Company Act of 1940, 15 §§ 80a-1, *et seq.*
IRS	Internal Revenue Service
PIA	Printing Industries Alliance

Proposing Release, Proposed Rule, or Proposal	*Investment Company Reporting Modernization*, 80 Fed. Reg. 33,590 (June 12, 2015)
Rule 30e-3	*Optional Internet Availability of Investment Company Shareholder Reports,* 83 Fed. Reg. 29,158 (June 22, 2018)
Rule 498	17 CFR 230.498 under the Securities Act of 1933, 15 U.S.C. §§ 77a, *et seq.*
Securities Act of 1933, or Securities Act	Securities Act of 1933, 15 U.S.C. §§ 77a, *et seq.*
Securities Exchange Act of 1934, or Exchange Act	Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.*

JURISDICTIONAL STATEMENT

This case is before the Court on a petition to review a final rule of the Securities and Exchange Commission. *Optional Internet Availability of Investment Company Shareholder Reports*, 83 Fed. Reg. 29,158 (June 22, 2018). The rule was adopted pursuant to the Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq*. The final rule also adopts amendments to rule 498 under the Securities Act of 1933, 15 U.S.C. § 77a, *et seq*.

This Court has jurisdiction pursuant to Section 43(a) of the Investment Company Act of 1940, 15 U.S.C. § 80a-42(a), Section 25(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y(b), Section 9(a) of the Securities Act of 1933, 15 U.S.C. § 77i(a), and Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706.

The rule was published in the Federal Register on June 22, 2018. Petitioners filed their petition for review on August 3, 2018. The petition challenges final agency rules that dispose of all parties' claims, and the matter is properly before this Court.

STATEMENT OF ISSUES

1. The SEC has a statutory obligation to protect investors under the Securities Exchange Act of 1934 (15 U.S.C. § 78c(f)) ("Exchange Act"), the Securities Act of 1933 (15 U.S.C. § 77b(b)) ("Securities Act"), and the Investment

Company Act of 1940 (15 U.S.C. § 80a-2(c)). The SEC acknowledged the significance of concerns that had been raised with respect to the rule's "potential adverse effects on investor readership of shareholder reports generally and on certain demographic groups in particular," when the Commission initially decided *against* finalizing rule 30e-3 in November 2016. *Investment Company Reporting Modernization: Final Rule*, 81 Fed. Reg. 81,870, 81,961 (Nov. 18, 2016); *see* 83 Fed. Reg. at 29,165 n.98 (summarizing concerns and explaining the November 2016 decision to defer finalizing rule 30e-3). Commenters vigorously reinforced these concerns during the comment period. In the final rule, the Commission disregarded these concerns and ignored the recommendations of its statutorily established Investor Advisory Committee ("IAC") that further exploration of alternatives was needed, along with additional public comment, to ensure that the Commission's action respected investor preferences and would increase, rather than reduce, the likelihood that investors would see and use important disclosure documents. *Recommendations of the Investor Advisory Committee Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure Document for Delivery of Investment Company Shareholder Reports*, at 2 (Dec. 7, 2017) ("IAC Report");[1] *see* 83 Fed. Reg. at 29,164-65 (discussing report findings

[1] *Available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-promotion-of-electronic-delivery-and-development.pdf.

and recommendations). Were the Commission's actions arbitrary and capricious and contrary to the SEC's responsibility to protect investors?

2. Established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 911, 124 Stat. 1376, 1822 (2010) (codified at 15 U.S.C. § 78pp), the SEC's IAC is charged with providing advice to the Commission on "initiatives to protect investor interest; and initiatives to promote investor confidence and the integrity of the securities marketplace." 15 U.S.C. § 78pp(a)(2)(iii)-(iv). Upon receiving an IAC report, the SEC is required to: (1) review the findings and recommendations, (2) "promptly issue a public statement assessing the finding or recommendation," and (3) disclose the action, if any, the Commission will take in response. 15 U.S.C. § 78pp(g). The Commission has issued no such public statement, no assessment of the IAC's recommendations, and no disclosure of any responsive action. Nor did the Commission address the IAC's recommendations to consider a layered approach to investor disclosures, test the effectiveness of new disclosure requirements, and solicit supplemental comment in the final rule or elsewhere, despite referencing the IAC Report and describing some of its recommendations in the final rule. Were these failures to act arbitrary and capricious and in violation of the SEC's duties?

3. The SEC has a statutory duty to determine as best it can the economic implications of a regulatory change, and a "unique obligation to consider the effect

of a new rule upon 'efficiency, competition, and capital formation.'" *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011), *quoting* 15 U.S.C. §§ 78c(f), 78w(a)(2), and 80a-2(c), *citing Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); *see also* 15 U.S.C. § 77b(b); 83 Fed. Reg. at 29,183 (acknowledging these statutory duties). The Commission is also required to consider the impact that any new rule would have on competition and may not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act. 15 U.S.C. § 78w(a)(2). The Commission's cost benefit analysis in the Proposing Release was strongly criticized by commenters for failings this Court has found unacceptable in previous SEC rulemakings. That analysis was largely carried over to the final rule, with additional benefits claimed. Was reliance on this analysis arbitrary and capricious and a violation of the SEC's duty to consider efficiency, competition, and capital formation?

4. A final rule issued by a federal agency may differ from the relevant proposed rule "only insofar as the latter is a logical outgrowth of the former." *Environmental Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005) (citations and quotations omitted). In order to protect investors, the Commission's Proposing Release required funds to mail a stand-alone Initial Statement that advised of the upcoming change to electronic delivery and was accompanied by a

postage-prepaid, pre-addressed reply form that would allow investors to indicate their choice to continue receiving paper reports. 80 Fed. Reg. at 33,629. The final rule reversed course and eliminated both of these safeguards entirely. Did the Commission violate the Administrative Procedures Act by failing to adopt a final rule that is a logical outgrowth of the proposed rule?

STATUTES AND REGULATIONS

The text of relevant statutes and regulations is set forth in the Addendum to this brief.

STATEMENT OF THE CASE

This case concerns a final SEC rule ("rule 30e-3") that was published in the Federal Register on June 22, 2018. 83 Fed. Reg. 29,158. Rule 30e-3 allows investment funds to satisfy their obligations to transmit shareholder reports to investors by making these reports available at a website address rather than by the previously standard method, delivery of paper reports. While funds already had the ability to provide shareholder reports via electronic delivery to those who "opted-in" to this choice, and many investors had elected this choice, rule 30e-3 now allows funds to abandon paper reports on a wholesale basis, except to the extent an investor understands and heeds notice of the coming change and successfully navigates fund-prescribed measures to "opt-out" of default electronic delivery. In finalizing the rule, the SEC eliminated obligations on investment

funds that the proposal had included to protect investors who wanted to preserve their ability to continue receiving paper reports, including a stand-alone notice of the impending change accompanied by a prepaid reply card an investor could use to continue receiving paper reports. Petitioners challenge rule 30e-3 as contrary to the Administrative Procedure Act, the Exchange Act, the Securities Act, and the Investment Company Act of 1940. The final rule also amends the SEC's rule 498 to conform to the changes instituted by rule 30e-3, and Petitioners challenge those amendments for the same reasons as the challenge to rule 30e-3. A copy of the Adopting Release is reprinted in the Addendum to this brief.

STATEMENT OF THE FACTS

In June 2015, the SEC proposed a suite of rules under the title *Investment Company Reporting Modernization*, 80 Fed. Reg. 33,590 (June 12, 2015) (the "Proposing Release"). One part of the Proposing Release – rule 30e-3 – contemplated a change in the default mechanism for investment funds to use in delivering shareholder reports, from paper to electronic. In its Proposing Release, the Commission recognized "concerns associated with how some investors may be affected" by this change. *Id*. at 33,627. Citing the results of SEC-conducted investor testing, the Proposing Release noted "that a significant minority of investors prefer to receive paper reports and that some demographic groups of investors may be less likely to use the Internet. Some of these investors might not

fully understand the actions they would need to take under the proposed rule to continue to receive their reports in paper." *Id.* The Proposing Release recognized a further concern, based on the difference between use of the Internet for some purposes but not others: "In addition, there is a risk that even some investors that prefer to use the Internet might be less likely to review reports electronically than they would in paper." *Id.*

The Proposing Release drew strong criticism from commenters emphasizing the rule's harmful impacts on investment report readership generally and on certain demographic groups in particular, such as the elderly, the disabled, racial and ethnic minorities, and those in rural communities with limited broadband Internet access. 83 Fed. Reg. at 29,162 nn.48-53. Concerns regarding harm to these groups focused on the proposal's reliance on "implied consent," which allowed investment funds to assume an investor agreed to the switch to electronic delivery if he or she did not follow fund-specified procedures to preserve the right to continue receiving paper reports. *Id.* at 29,162-63. Commenters noted that reduced investor readership implicates not only investor protections, but also competition and capital formation. *Id.* at 29,162, nn.48-53. Other adverse comments challenged the credibility of the proposal's cost benefit analysis, and in particular the cost savings it asserted funds – and investors – would realize by the default to electronic delivery of shareholder reports. 81 Fed. Reg. at 81,961 and

nn.1179-80. Accepting that these comments raised issues meriting further consideration, the SEC finalized the rest of the changes in the Proposing Release without adopting rule 30e-3 in November 2016. *Id.* at 81,961.

Aware of the concerns raised by commenters, the SEC's statutorily constituted IAC began considering the proposed rule 30e-3 in July 2016.[2] Congress established the IAC to provide advice to the SEC on, among other concerns, "initiatives to protect investor interest" and "promote investor confidence and the integrity of the securities marketplace." 15 U.S.C. § 78pp(a)(2)(iii), (iv). After several meetings in 2016 and 2017, the IAC issued its final report and recommendations to the SEC on rule 30e-3 in December 2017. *Recommendations of the Investor Advisory Committee Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure Document for Delivery of Investment Company Shareholder Reports* (Dec. 7, 2017) ("IAC Report"), cited and discussed in part at 83 Fed. Reg. at 29,164-65. The report recommended that the SEC consider recent survey data published by the Financial Industry Regulatory Authority ("FINRA") showing nearly half of investors (49%) still preferred to receive paper shareholder reports, compared to 33% who favored electronic reports. IAC Report at 1. The report further recommended that, before finalizing the rule, the SEC should provide a supplemental comment cycle and

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[2] *See* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac071416-minutes.

conduct investor testing to ascertain whether the proposed approach "delivers the expected benefits of reducing costs for funds and distributors without sacrificing disclosure quality." *Id*. at 2.

Section 78pp(g) of the Exchange Act requires the SEC to respond to the recommendations of the IAC promptly and publicly and to consider alternatives that it proposes, but the SEC has not responded to the IAC's recommendations and proposed alternatives. The Adopting Release generally identifies several of the recommendations of the IAC, but makes no attempt to address them, despite affirming the Commission's duty to issue a prompt public statement assessing the IAC's findings and recommendations and advising the action, if any, the Commission intends to take in response. 83 Fed. Reg. at 29,164-65 and n.90.

On June 5, 2018, the Commission adopted its final rule 30e-3, rebranding it with the name *Optional Internet Availability of Investment Company Shareholder Reports* (the "Adopting Release"). The new rule, according to the Federal Register publication, "will provide certain registered investment companies with an optional method to satisfy their obligations to transmit shareholder reports by making such reports and other materials accessible at a website address specified in a notice to investors." 83 Fed. Reg. at 29,158. Buried within the Adopting Release, however, was the SEC's acknowledgement that, far from being precluded from making these materials available electronically up to that point, funds had for years conducted

"campaigns" to persuade investors to switch to electronic delivery, using a variety of mechanisms falling into six different categories of inducements, including financial incentives. *Id*. at 29,182. These extensive recruitment efforts had achieved considerable success: one commenter reported data showing that "electronic delivery is used for a significant portion of shareholder reports" already—as high as 43% for 2015, with higher estimates projected for the future. Broadridge Comment Letter I, *cited at* 83 Fed. Reg. at 29,184 and n.348.

Notwithstanding the fact that these numbers contradicted the impression investment companies lacked effective means to make shareholder reports available to investors interested in electronic delivery, *id*. at 29,165, and despite the Commission's expressed belief that these trends would continue to grow as a result of funds' efforts to increase awareness of the availability of electronic options, *id.* at 29,182, the final rule reversed the default from paper to electronic delivery, shifting the burden of taking action away from the funds and placing it on investors who want to continue receiving paper report delivery.

Although the Commission referenced the importance of protecting investors who want to receive paper reports, the rule solidified reliance on the controversial implied consent approach, requiring those wishing to avoid being automatically switched to electronic report delivery to follow a fund-designated process using a toll-free number to override the default. *Id*. at 29,162, 29,175 and n.234.

Apparently realistic about the problems many encounter with toll-free numbers, the Adopting Release encouraged funds to adopt methods to reduce these obstacles, by "limiting the need for investors to speak with multiple representatives or navigate through multiple telephone menus," or similar measures, none of which was made an enforceable requirement. *Id.* at 29,171. The Adopting Release abandoned proposed requirements for a stand-alone, mailed notice of the coming change and a postage-prepaid reply card that would have allowed investors simply to check a box to preserve their election of paper reports; these changes were justified as cost-savings measures for investment funds, but eliminated a means of notification and choice in the medium most familiar to those relying on paper reports. *Id.* at 29,170-72 and n.173, 29,189.

In place of the protections it eliminated, the Commission adopted an extended transition period, during which funds would send investors as many as six notices over a two-year timeframe to advise them of the coming switch to electronic reports; the Adopting Release retained a requirement from the proposal for a toll-free number for investors to use if they wished to continue receiving paper reports. 83 Fed. Reg. at 29,159. Notably, however, these notices can be combined with other materials and information sent to investors, no longer transmitted as an independent, mailed notice of the upcoming change. *Id.* at 29,160. As a second new measure described as a protection for investors, the

Adopting Release indicated the Commission's interest in receiving comments – *after* the rule was finalized and in full effect – offering suggestions for "ways in which fund disclosure, including shareholder reports, may be improved." *Id.* at 29,159.

The Commission's analysis of costs, benefits, and effects on efficiency, competition, and capital formation were the focus of many critical comments during the comment period. The Commission stated its intention to "improve investors' experience while reducing expenses associated with printing and mailing shareholder reports that are borne by investment companies and ultimately their investors." 83 Fed. Reg. at 29,158, 29,163, 29,183-85. The Commission, however, was unable to estimate how much, if any, of the cost savings inuring to the benefit of the funds would actually be passed on to investors. *Id.* at 29,186. Nor could the Commission determine whether the rule would actually increase investor access and review, *id.* at 29,185-88, or quantify the effects of the rule on competition and capital formation, *id.* at 29,185-86.

At the same time, the Commission "acknowledge[d] that there may be some investors who would prefer to receive paper copies but may not notify their fund of that preference. To this end, several commenters pointed out that internet access and use among Americans was not universal." *Id.* at 29,193. Such investors "might experience a reduction in their ability to access shareholder reports and

portfolio investment information if they do not elect to receive paper reports." *Id.* "Further, some commenters have asserted that some investors with internet access may be less likely to review their shareholder reports made available online than shareholder reports delivered in paper form." *Id.* at 29,193 and n.453. The Commission recognized the implications of this decreased readership: "[t]o the extent that a reduction in the review of shareholder reports by such investors [who want to receive paper reports] decreases how informed they are about funds, it could potentially decrease their ability to efficiently allocate capital across funds and other investments." *Id.* at 29,193. In addition, "[a] decrease in the ability of investors to access and review information about different funds could also decrease the competition among funds for investor capital." *Id.*

STANDARD OF REVIEW

The Administrative Procedure Act ("APA") provides that this Court "shall hold unlawful and set aside agency action . . . found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). The Supreme Court has held that agency action is arbitrary and capricious if it "entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or it is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut.*

Auto. Ins. Co., 463 U.S. 29, 43 (1983). Further, "an agency's proposed rule and its final rule may differ only insofar as the latter is a 'logical outgrowth' of the former." *Environmental Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005) (citations and quotations omitted).

The Exchange Act, Securities Act, and Investment Company Act all require the SEC, when engaged in rulemaking, to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. §§ 78c(f), 77b(b), 80a-2(c). This Court has interpreted this as a "unique obligation" imposed on the Commission. *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011). Applying these principles, this Court has found that the Commission has a "statutory obligation to determine as best it can the economic implications of the rule it has proposed," *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005), and struck down SEC rules that failed "adequately to assess the economic effects of a new rule," *Business Roundtable*, 647 F.3d at 1148-49, or give adequate consideration to suggested alternatives, *Chamber of Commerce*, 412 F.3d at 144. The Commission also may not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act. 15 U.S.C. § 78w(a)(2). *American Petroleum Institute v. SEC*, 953 F.Supp.2d 5 (D.D.C. 2013).

SUMMARY OF ARGUMENT

The 30e-3 rule reverses the longstanding practice of providing shareholder reports to investors in paper form, delivered by mail. Although investors already had the option of receiving shareholder reports electronically if they preferred, and a significant percentage had exercised that option, the Commission's rule switched the default to electronic delivery. The rule forces a new burden on investors who want to continue receiving paper reports, and the Commission concedes some may not understand or successfully carry out the procedures to continue receiving reports in that format, thereby experiencing decreased access to shareholder reports. This decreased readership, in turn, has negative implications for investor ability to efficiently allocate capital across funds and competition among funds. This cascade of adverse consequences on investors, competition, and capital formation cannot be justified by a rule that offers at best speculative, marginal benefits for investors, given that those preferring to receive electronic reports already have the ability to ensure that outcome.

Rule 30e-3 violates the Administrative Procedure Act and the Commission's statutory duties, including its obligation to consider effects on investors as well as on efficiency, competition, and capital formation, and the statutory bar on adopting rules that would impose an unnecessary or inappropriate burden on competition. The Commission improperly disregarded its statutory duties to consider and

respond to the recommendations of the IAC and failed to take into account alternatives put forward by that committee, including the need for supplemental comment.

The Commission further failed adequately to assess the costs and benefits of the rule. It suffers from internal contradictions; omits quantification of measurable costs it treats as qualitative or ignores entirely; applies different methodologies in evaluating costs and benefits; and does not meet the statutory requirement that no rule may be adopted that would impose a burden on competition not necessary or appropriate in furtherance of the securities laws. Lastly, because the final rule completely eliminated the requirement that funds must mail a stand-alone Initial Statement that advised of the upcoming change to electronic delivery, accompanied by a postage-prepaid, pre-addressed reply form, the final rule is not a logical outgrowth of the proposed rule. The rule should be vacated.

STANDING

Petitioners participated in the rulemaking process and were among the numerous entities and individuals that submitted comments on the proposed rule to the SEC. The SEC acknowledged the adverse impacts that the final rule would have on Petitioners and their members. 83 Fed. Reg. at 29,160. Petitioners and/or their members will be directly and adversely impacted by the final rule, and the

Court may remedy these harms by vacating the final rule and/or enjoining the SEC from enforcing its requirements.

Petitioner Consumer Action is a non-profit organization whose members comprise consumers across the country, including seniors (about a third of seniors own mutual funds), minority Americans, disabled Americans, and those living in rural areas, who struggle with digital literacy, do not have Internet access, and/or depend on access to paper materials for the information they need. The final rule will cause Consumer Action's members to suffer harm with respect to their ability not only to access but also to understand critical shareholder information. *See* Declaration of Consumer Action in the Addendum for more information.

Petitioners Twin Rivers Paper Company, LLC, AF&PA, PIA, and CPO are companies and associations directly involved or whose members are directly involved in the paper, printing, and mail delivery industries. They or their members will be harmed by the rule's adverse impacts on the paper, print and mail delivery industries, which the SEC has acknowledged.

As detailed above and in the Declarations in the Addendum, Petitioners satisfy the necessary elements of injury, causation, and redressability. *See Treasure State Resource Industry Ass'n v. EPA*, 805 F.3d 300, 307 (D.C. Cir. 2015). Furthermore, the interests that each Petitioner seeks to protect are "arguably within the zone of interests to be protected or regulated by the" relevant

statutes in question, *Honeywell Intern. Inc. v. EPA*, 374 F.3d 1363, 1370 (D.C. Cir. 2004), and are certainly not "so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that Congress intended to permit the suit." *Clarke v. Sec. Indus. Ass'n.*, 479 U.S. 388, 399 (1987).

With respect to the organizational Petitioners (Consumer Action, AF&PA, PIA, and CPO), in addition to their members' standing to bring this suit in their own right, the interests that the organizational Petitioners seek to protect are germane to their various purposes (*i.e.*, preserving access to important paper-based information and services for Americans who prefer them or depend on them; empowering underrepresented consumers nationwide to assert their rights in the marketplace; and advancing the U.S. paper and printing industries). Further, neither the claims asserted nor the relief requested requires that an individual member of any of the organizational Petitioners participate in the lawsuit. The requirements of associational standing are therefore satisfied. *See Sierra Club v. EPA*, 292 F.3d 895, 898 (D.C. Cir. 2002).

ARGUMENT

I. The Commission Arbitrarily and Impermissibly Elevated the Interests of Investment Funds in the Final Rule 30e-3 to the Detriment of Investor Protection.

The SEC's responsibilities in promulgating new rules identify protection of investors as a preeminent concern. *See* 15 U.S.C. §§ 78c(f), 77b(b), 80a-2(c). The Commission was aware at the time it finalized other rules that had been proposed with rule 30e-3 that, unlike the others, the contemplated switch from paper to electronic delivery of shareholder reports raised serious concerns regarding "potential adverse effects on investor readership of shareholder reports generally and on certain demographic groups in particular." *Investment Company Reporting Modernization: Final Rule*, 81 Fed. Reg. 81,870, 81,961 (Nov. 18, 2016). Despite these concerns, which were amply supported by comments in the record, and notwithstanding the lack of investor need for the rule, the Commission prioritized cost savings to investment funds in seeking to justify the change, eroding investor protections even further in finalizing the rule. The Commission's decision to promote cost savings for investment funds to the detriment of investor protection was arbitrary and capricious and contrary to law.

A. The Rule was Unnecessary, Since Investors Who Preferred Electronic Reports Could Freely Receive Them and Were Already Doing So at Levels Aligned with Preferences Reflected in the SEC's Own Survey.

As the Adopting Release acknowledges, "under existing Commission guidance, funds can transmit shareholder reports or other documents electronically in lieu of paper delivery if they satisfy certain conditions relating to investor notice, access, and evidence of delivery. The Commission's guidance indicates that one way evidence of delivery can be demonstrated as to an investor is if an investor has agreed to electronic transmission on an affirmative 'opt-in' basis." 83 Fed. Reg. at 29,184.

Many investors have exercised this option and satisfied this condition; the Adopting Release characterizes the proportion of shareholders already receiving electronic reports as "significant," citing numbers in the 40-plus percent range, with estimates of higher percentages for the future. *Id.* at n.348. The Commission believes that trends favoring electronic delivery may continue naturally, even without regulatory intervention: "We recognize, consistent with the comments we have received, that electronic delivery of reports to some investors under existing Commission guidance may continue to reduce printing and mailing costs in the future, regardless of whether rule 30e-3 is adopted." *Id.* at 29,184.

The evidence of existing rates of electronic delivery compares favorably to studies of investor preference. The Commission's own survey data show that 44.3

percent of investors expressed a preference for electronic delivery of financial information with or without an option for a print version, compared with 33.3 percent who preferred printed reports delivered by mail, and 16.5 percent who preferred a printed, mailed summary, adding up to 49.8 percent who want some form of printed, mailed report. 80 Fed. Reg. at 33,627 n.293. More recent FINRA data indicate that 27 percent of investors preferred electronic delivery of financial information by email and six percent by Internet access, for a combined total of 33 percent, while 49 percent preferred paper delivery and 14 percent preferred to receive financial information through an in-person meeting with a broker/adviser. 83 Fed. Reg. at 29,161 n.44. With electronic preference rates in the 33 to 44 percent range, and current electronic delivery exceeding that level in the 40-plus range, and generally trending upward, no misalignment supports the need for a rule providing a default reversal in favor of electronic reports. Indeed, instead of further aligning investor preferences with respect to method of delivery, the final rule has a net effect of misaligning investor preferences (*i.e.*, the number of investors who would choose paper delivery and will no longer receive reports this way is greater than the number of investors who prefer electronic delivery and will now gain this option). *See infra* pp. 35-37.

B. The Final Rule's Reliance on Implied Consent, Despite Well-Documented Objections from Commenters, Disproportionately Harms Vulnerable Investors

The Proposing Release contemplated that the switch from paper to electronic delivery of shareholder reports would be accomplished through reliance on implied consent, that is, the presumption that investors agreed to discontinue receiving paper reports unless they took affirmative steps to counteract that result. In the Proposing Release, the Commission acknowledged "that a significant minority of investors prefer to receive paper reports and that some demographic groups of investors may be less likely to use the Internet." 80 Fed. Reg. at 33,627. Further, the Commission noted that "there is a risk that even some investors that prefer to use the Internet might be less likely to review reports electronically than they would in paper," and with respect to implied consent, "[s]ome of these investors might not fully understand the actions they would need to take under the proposal to continue to receive their reports in paper." *Id.*

Commenters strongly reinforced these concerns, citing harm to seniors, the disabled, minorities, and rural investors without widespread Internet access. 83 Fed. Reg. at 29,162 and nn.48-53. Among other points, commenters provided data showing 25-30 percent of Americans do not have a computer with broadband access in their homes, and that 41 percent of seniors aged 65 and above do not use the Internet (while 34 percent of this age group own mutual funds). *Id.*

The Commission acknowledged the adverse implications of these issues for "investor readership generally and on certain demographic groups in particular" in deciding in November 2016 to finalize other rules that had been proposed with rule 30e-3 while holding back rule 30e-3 for further consideration. 81 Fed. Reg. at 81,961 & nn.1179-80. In proceeding with the final rule despite these concerns, the Commission relied on figures showing that high percentages of U.S. households have a computer or some form of Internet access (83 Fed. Reg. at 29,165 n.97), but ignored comments and practical knowledge that merely owning or having access to a computer or smartphone does not equate to functional capability and a deliberate choice to research funds and review shareholder reports and other complex financial disclosure documents online. Nor do high household Internet access rates explain away recent data showing that 43 to 55 percent of investors still want to receive paper shareholder reports. *Id.* at 29,165 n.96.

Other objections to the Commission's reliance on implied consent emphasized that the Internal Revenue Service ("IRS") prohibits financial organizations from using implied consent to enroll investors in electronic delivery of tax documents, and that the Commission likewise has historically been a proponent of requiring express consent. *See id.* at 29,162 n.56 (*citing Use of Electronic Media for Delivery Purposes, Investment Company Act*, 60 Fed. Reg. 53,458 (Oct. 13, 1995) (providing Commission views on the use of electronic

media to deliver information to investors, and stating that consent should be "informed" and expressly provided in order to utilize electronic media as a means of delivery). This recognition by the IRS and the Commission itself that implied consent is unsuitable for complex tax-related or financial matters underscores the inappropriateness of rule 30e-3's reliance on this method.

C. The Commission's Final Rule Exacerbated Harm to Investors by Eroding Proposed Protections in the Interest of Saving Costs for Investment Funds.

The Proposing Release recognized the importance of protecting investors and, in particular, preserving their right to continue receiving paper reports. Because of these considerations, the Proposing Release "incorporate[d] a set of protections intended to avoid investor confusion and protect the ability of investors to choose their preferred means of communication." 80 Fed. Reg. at 33,626. The key protections for investors who preferred paper reports were a mailed Initial Statement that would have advised of the upcoming change to electronic delivery, accompanied by a postage-prepaid, pre-addressed reply form that would allow investors to indicate their choice to continue receiving paper reports. *Id*. at 33,629.

The Commission's final rule eliminated both of these protections, in the interests of saving costs for investment funds. Instead of these measures, the final rule provides for a two-year transition period, during which time funds are required to send notifications of the forthcoming change. Notably, however, these notices

may be mixed in with other shareholder materials, as opposed to a free-standing document, increasing the odds that investors will not appreciate the impending change in how they receive shareholder reports. 83 Fed. Reg. at 29,160. Investors who wish to preserve their ability to receive paper reports will now have the burden of contacting the fund, through use of a toll-free number. This change not only diminishes investor protection, but is not a "logical outgrowth" of the proposed rule, since the Adopting Release argued for the importance of these protections rather than providing notice they could well be eviscerated. *See infra* pp. 42-44.

Further illustrating the diminution of investor protections in the Adopting Release, the Commission revealed its awareness of the problems that investors may be expected to encounter in seeking to counteract the impending electronic default. The Adopting Release went so far as to provide specific points in "encourag[ing]" investment funds to reduce obstacles to effective use of toll-free numbers, including "limiting the need for investors to speak with multiple representatives or navigate through multiple telephone menus." *Id.* at 29,171. Yet, none of these measures was made an enforceable requirement, and the Commission fully recognized in its cost benefit analysis that the diluted investor protections could result in reduced investor awareness and consequently the

numbers of investors who successfully communicated their wish to preserve delivery via paper reports. *Id.* at 29,191.

The Commission's second new, asserted protection, a Request for Comment seeking suggestions from investors on how to improve fund disclosure reports, including shareholder reports, *id.* at 29,159, was meaningless, coming *after* promulgation of the rule, and with no guarantee that any such comments would be seriously considered or acted upon. Courts have found such after-the-fact comment opportunities devoid of value and unavailing in sustaining a rule. *See, e.g.*, *U.S. Steel Corp. v. EPA*, 595 F.2d 207, 214-15 (5th Cir. 1979) (explaining that such comments are "no substitute for the right of interested persons to make their views known to the agency in time to influence the rule making process in a meaningful way" and that the court "doubt[ed] that persons would bother to submit their views or that the Secretary would seriously consider their suggestions after the regulations are a *fait accompli*"). Indeed, in response to this newly minted comment opportunity, dissenting Commissioner Robert J. Jackson, Jr., said: "I am puzzled, though, that we are requesting those insights after, not before, we are adopting a final rule. We ordinarily request information from market participants first and regulate later, and the many questions raised by the rule show why that is

the better course…." Statement of Commissioner Robert J. Jackson, Jr., on Investment Company Disclosure (June 8, 2018).[3]

D. Contrary to the Commission's Statutory Obligation to Protect Investors, the Rule Serves the Interest of Cost Savings to Funds, With Little or No Expected Cost Savings Expected for Investors.

The SEC has a statutory obligation to protect investors under the Exchange Act, the Securities Act, and the Investment Company Act. 15 U.S.C. §§78c(f), 77b(b), 80a-2(c). In recognition of this obligation, the Adopting Release states that the Commission's goals in adopting rule 30e-3 are to "improve investors' experience while reducing expenses associated with printing and mailing shareholder reports that are borne by investment companies and ultimately their investors." 83 Fed. Reg. at 29,201. The weight of evidence, however, clearly demonstrates that the rule will not improve investor experience for the large proportion of investors who rely on reading reports on paper, and will instead impose new burdens and costs on them, such as the cost of time spent seeking to retain the right to receive paper reports and the cost of printing reports on home printers, neither of which was included in the Adopting Release's cost benefit analysis. *See infra* pp. 31-34.

By the Commission's own admission, rule 30e-3 will increase risks that some investors "might not fully understand the actions they would need to take

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[3] *Available at* https://www.sec.gov/news/public-statement/statement-jackson-060618.

under the proposed rule to continue to receive their reports in paper" and "that even some investors that prefer to use the Internet might be less likely to review reports electronically than they would in paper." 80 Fed. Reg. at 33,627. As the Commission recognized in the Adopting Release, "[a]mong investors in funds that elect to rely on the rule [which the Commission elsewhere estimates at 90%], investors with a preference for paper delivery that fail to express it may be less likely to review that information in the reports because it is not presented in their preferred format." 83 Fed. Reg. at 29,188; *accord*, *id.* at 29,193. Even for investors who prefer electronic reports, the Commission is unable to identify tangible benefits, instead speculating that having centralized access to reports that are already available electronically "may result" in better informed investor decisions. *Id.* at 29,185-86.

Nor is the Commission able to determine whether investors will realize any benefits from the cost savings that investment funds are expected to reap from elimination of most paper reports. Reasoning that "printing and mailing expenses associated with shareholder reports are typically passed on to fund investors through fund expense ratios," the Commission assumes that, by the same token, rule 30e-3 "will reduce the printing and mailing costs shared by investors." *Id.* at 29,183. However, in comments the Commission never addresses or rebuts, the Consumer Federation of America provided strong evidence that contradicts this

assumption. Calculating, based on the Proposing Release's cost projections, a net savings of $73 million per year, spread across 11,957 funds, the average savings per fund would be $6,100 per year. "That is a negligible cost reduction that is highly unlikely to be passed on to shareholders and that wouldn't have a noticeable impact on investor costs if it were," in view of the fact that these funds operate on behalf of 90 million shareholders. *Comments of Consumer Federation of America*, at 4 (July 29, 2015), 83 Fed. Reg. at 29,163 n.71. Without responding to these comments, the Adopting Release nonetheless concedes it is unable to estimate the degree to which investment fund cost savings will be passed through to investors. *Id.* at 29,186.

II. The Commission's Disregard of its Obligations with Respect to Investor Advisory Committee Recommendations was Arbitrary and Capricious and Contrary to Law.

A. The Commission Failed to Discharge its Responsibilities under 15 U.S.C. §78pp(g).

In enacting the Dodd-Frank Act, Congress established the Investor Advisory Committee and charged it to provide advice to the Commission on "initiatives to protect investor interest" and "promote investor confidence and the integrity of the securities marketplace." 15 U.S.C. § 78pp(a)(2)(iii), (iv). The IAC is empowered to issue reports to the SEC, which is then required to: (1) review the findings and recommendations, (2) "promptly issue a public statement assessing the finding or

recommendation," and (3) disclose the action, if any, the Commission will take in response. 15 U.S.C. § 78pp(g).

In December 2017, the IAC issued a report on rule 30e-3, recommending that instead of proceeding as proposed, the Commission consider a layered approach to investor disclosures, test the effectiveness of new disclosure requirements, and solicit supplemental comment. *See* IAC Report; *see also* 83 Fed. Reg. at 29,164-65 (discussing report findings and recommendations in part). Although the Adopting Release references the IAC Report and summarizes some of its recommendations, suggesting the Commission has at least reviewed the report, the Commission has totally failed to issue a statement (prompt or otherwise) assessing the findings or recommendations; nor has it disclosed any action it will take in response. This failure to fulfill clear statutory obligations, and the Commission's finalizing the rule regardless of the IAC's recommendations to the contrary, is arbitrary and capricious, and otherwise not in accordance with law.

B. The Commission Improperly Ignored Serious, Credible Alternatives Proposed by the IAC.

The Commission's disregard of reasonable alternatives proposed by the IAC further invalidates the final rule. While the Commission is "not required to discuss every alternative … conceivable by the mind of man," and particularly not those "unworthy of consideration," this Court has made it clear that failure to address serious, credible alternatives, such as those raised by dissenting SEC

Commissioners, constitutes arbitrary and capricious agency action. *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005), *quoting and distinguishing Motor Vehicle Mfrs Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 51, (1983). Here, instead of a worthy alternative offered by dissenting Commissioners, one recommended by the statutorily constituted IAC (consideration of a layered approach to investor disclosures) was summarily ignored. The Commission's failure to address the IAC's recommended alternatives was no less arbitrary and capricious than its untenable, similarly dismissive actions in *Chamber of Commerce*.

III. The Commission's Cost Benefit Analysis Justifying the Rule was Flawed in Fundamental Respects and Cannot Support the Rule.

This Court has repeatedly held the Commission accountable for failing "adequately to assess the economic effects of a new rule" and to fulfill its "unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation' and 'apprise itself – and hence the public and the Congress – of the economic consequences of a proposed regulation.'" *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (*quoting* 15 U.S.C. §§ 78c(f), 782(a)(2), 80a-2(c)). In previous decisions, this Court has invalidated SEC rules for "inconsistently and opportunistically fram[ing] the costs and benefits of the rule," failing "adequately to quantify the certain costs or to explain why those costs could not be quantified," "neglect[ing] to support its predictive judgments,"

"contradict[ing] itself," and "fail[ing] to respond to substantial problems raised by commenters." *Business Roundtable*, 647 F.3d at 1148-49. Many of the same fundamental flaws permeate the Commission's analysis here and render it arbitrary and capricious.

A. The Analysis Omits Quantification of Measurable Costs it Treats as Qualitative or Ignores.

The Adopting Release fails to quantify measurable costs the Commission could reasonably calculate. As one example, the final rule will impose costs on both investors and funds in implementation of the toll-free call requirement that could be quantified. Despite the Commission's detailed description of this requirement and its important role in ensuring that investors who want to continue receiving paper shareholder reports can do so (83 Fed. Reg. at 29,170-71), the cost benefit analysis provides no reference at all to the costs involved. Yet, such costs are not difficult to estimate.

To illustrate, the Commission predicts that five percent of shareholders in funds relying on the rule will make such calls (*id*. at 29,199 n.529, *referencing* 80 Fed. Reg. at 33,678-79 n.816), and that 90 percent of funds will rely on rule 30e-3 (83 Fed. Reg. at 29,199). Multiplying these numbers produces an estimate that 4.5 percent of all investors will make such calls. Elsewhere, the Commission estimates that 95.8 million individuals are investors in registered investment companies. *Id*. at 29,184. Multiplying 95.8 million investors by 4.5 percent results

in a projection that 4.3 million investors will call the toll-free numbers set up by the investment funds. The Commission could readily find estimates for the time generally involved in trying to reach an operator and conduct business in toll-free calls, but, assuming hypothetically that each call required one-fifth of an hour, approximately 860,000 hours of calls would take place, combining the time spent by both investors and the funds' call centers. Again, the Commission could use documented figures for the cost of investor and call receptionist time, but hypothetically assigning a cost of $20 per hour for investor time and $15 per hour for receptionist time, the total cost would amount to $30 million in one-time costs the Commission failed to include in its cost benefit analysis. (860,000 hours x ($20 + $15=$35) = $30 million.) This hypothetical calculation may be significantly too low, since the Commission's survey and FINRA data reflected far higher numbers of investors who want to continue paper delivery than the five percent the Commission estimates would be willing to make toll-free calls to ensure continuation of that right, but the Commission's failure to make even a colorable effort to quantify these costs is a serious flaw in the cost benefit analysis.

The Adopting Release similarly fails to include in its analysis costs that will be incurred by investors who, deprived of paper reports, will find it necessary to print out shareholder reports at home. The Commission cited precedent from a previous release that would support an expectation that ten percent of investors

will print reports at home, at a unit cost of $0.70 to $1.25 per report. *Id.* at 29,194 n.461. Using the ten percent prediction for investors who will print reports at home and the Commission's estimate of 95.8 million investors, a calculated 9.58 million investors will print reports at home. Doubling that number to account for the fact that there are two reports per year produces a total of 19.16 million reports printed at home annually. Multiplying that total by the *lower* per report cost estimate, $0.70 per report, results in an annual $13.4 million cost that investors will bear, which was not included in the rule's cost estimate. Like the cost estimate for the toll-free call requirement that the Commission failed to include, this is likely to be a conservative estimate of costs to investors. In any event, both examples illustrate the Commission's failure to quantify predictable costs or to explain why they cannot be quantified.

B. The Commission's Methodology is Rife with Internal Contradictions and Does Not Support the Adopting Release's Conclusions.

The Commission assumes that 90 percent of funds would conclude the benefits of the rule to the fund outweigh its costs and will implement the rule (*i.e.*, will utilize rule 30e-3 to provide reports electronically). *Id.* at 29,196. However, the Commission also assumes that 90 percent of funds are already posting shareholder reports on their websites in compliance with rule 498, which allows mutual funds to send investors summary prospectuses if the funds make full

shareholder reports available at a website. *Id.* The Adopting Release makes no attempt to estimate how many funds, in addition to those essentially meeting the requirements of rule 30e-3 already because of compliance with rule 498,[4] would rely on the new rule, or whether the same 90 percent would comply with both.

The Commission assumes, however, that funds will act rationally and "only rely on the rule if the benefits to that fund exceed the costs." *Id.* at 29,183. Assuming that this is true and that funds act rationally, the difference between these two groups (*i.e.*, the percentage of funds utilizing rule 30e-3 that are not already using rule 498) will be little to none because those funds already relying on rule 498 will have already incurred the costs of implementing electronic reports, meaning they will have few costs compared to funds that would experience some level of cost to implement the change. Since the Commission believes 90 percent of funds have elected to rely on rule 498, the Adopting Release's claim of potentially increased readership by those investors preferring electronic reports, and concomitant benefits of the rule to investors, appears to be almost entirely without basis and an overstatement of the potential benefits to investors.

Indeed, to the contrary, the relevant data shows that there will be a net increase in the number of investors (those who want paper delivery) receiving their

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[4] The only information not already required to be disclosed on the websites of funds complying with rule 498 that would be added to comply with rule 30e-3 is the "first- and third-quarter portfolio holdings information" that can readily be found on the SEC's EDGAR website. 83 Fed. Reg. at 29,185.

reports in a manner that they do not prefer, and a net decrease in readership. As just described, the percentage of investors preferring electronic reports who do not already receive their reports in this manner will be little to none.

Despite the Commission's claim that it cannot estimate the number of investors who want paper reports but will fail to request delivery in that form (83 Fed. Reg. at 29,183 n.332), the Commission estimates that: (1) five percent of investors in funds relying on rule 30e-3 will successfully request paper delivery (83 Fed. Reg. 29,199 n.529), and (2) as much as ten percent of investors will continue to receive paper reports because their funds will not rely on rule 30e-3 (*i.e.*, these funds will not be among the 90 percent that implement rule 30e-3). *Id.* at 29,196. This results in an estimated total of 15 percent of investors who will still receive reports via paper delivery. The FINRA data cited by the IAC and in the Adopting Release estimates that approximately 49 percent of all investors prefer paper delivery. 83 Fed. Reg. at 29,161 n.44. The Commission's own survey data likewise show that 49.8 percent of investors prefer some form of printed, mailed report.

Therefore, approximately 34 percent (49 percent minus 15 percent) of investors will lose access to their preferred means of delivery, seriously contradicting the Commission's claims of potentially increased readership and further demonstrating the Commission's failure to conduct an adequate cost-

benefit analysis. *See also Chamber of Commerce*, 412 F.3d at 144 (explaining that even if the Commission faced uncertainty in assessing relevant costs and benefits, "it does not excuse the Commission from its statutory obligation 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").

The net decrease in readership is further supported by data submitted by Broadridge concerning the negative impacts on proxy readership and voting that resulted from the Commission's conversion of requirements in that rule, from mailed proxy materials to a post card notice advising of online availability of proxy materials. *Internet Availability of Proxy Materials; Final Rule*, 72 Fed. Reg. 4,148 (Jan. 29, 2007). *See* Broadridge Comments, at 11-12 (Aug. 11, 2015). According to Broadridge's analysis, the data are "conclusive: viewing levels and voting levels were dramatically reduced by the notice [and] access method[.]" *Id.* Following adoption of the rule, viewing levels of proxy information fell from 80 percent to "less than one-half of one percent," and voting response rates fell "by over 80 [percent]" compared to previous levels (*i.e.*, compared to paper delivery). *Id.* It is reasonable to assume similar decreases will occur with respect to readership percentages of shareholder reports on account of the final rule. The Commission acknowledged that both competition among funds for investor capital and the

efficiency of capital allocation would vary with increased or decreased use of shareholder reports by investors, 83 Fed. Reg. at 29,188, and that decreases in readership could harm competition and efficiency of capital allocation among funds, *id*. at 29,193. Taking into account all these data points, it is evident that rule 30e-3 will harm not only investors but also competition and capital formation.

Other contradictions appear in the Commission's baseline assumptions, from which marginal costs and benefits are calculated. For example, the Adopting Release claims to "lack information to estimate the percentage of funds that solely or predominantly rely on electronic delivery under existing Commission guidance." *Id*. at 29,184. On the same page, however, the Adopting Release sets forth estimates provided by commenters of 43 percent of investors currently receiving electronic reports, and provides no reason to doubt these figures or decline to rely on them in the analysis. *Id.* This is important, since the Commission could have used these numbers in its baseline cost calculations, combining them with estimates from one commenter that mailed reports had already declined from 81 percent in 2010 to 57 percent in 2015, with emailed reports rising commensurately from 19 percent to 43 percent under existing SEC guidance. *See* Broadridge Comments, at 6 (Aug. 11, 2015). Had the Commission translated those cost declines into its baseline cost estimates to account for this trend (which the Commission acknowledged on the same page), instead of

assuming flat costs of $256.2 million per year, its calculation of cost savings would likely have decreased by about seven percent in the first year and even further every succeeding year.

C. The Cost Benefit Analysis Applies Different Methodologies to Costs and Benefits.

For purposes of estimating gross cost savings from rule 30e-3 (*i.e.*, benefits), the Commission uses a simple methodology, multiplying its estimate of current aggregate annual total printing and mailing costs – $256.2 million – by the percentage of funds expected to rely on rule 30e-3, that is, 90 percent. This produces an expected $230.6 million in estimated annual gross savings or benefits of the rule. 83 Fed. Reg. at 29,187.

On the cost side, using these numbers, the Commission estimates that funds relying on rule 30e-3 will spend $5.7 million to mail reports to investors who request paper reports. *Id.* at 29,199 n.530. Comparing this cost to the aggregate annual current costs noted above ($256.2 million), the SEC is assuming 2.2 percent of all investors in funds will request paper reports ($5.7 million/$256.2 million). In determining the $5.7 million cost figure, however, the Commission uses a different approach from its benefits calculation. The methodology used to derive the $5.7 million figure is based on a footnote in the Proposing Release, which assumes that *five* percent of investors will request paper reports, which would cost $10,000 in printing and mailing costs per fund, or $500 per fund (five percent x

$10,000). *Id*. at 29,199 n.529 (referencing 80 Fed. Reg. at 33,678-79 n.816). This five percent estimate of investors that are expected to request paper reports, when multiplied by the 90 percent of funds that the Commission assumes will rely on rule 30e-3, produces a 4.5 percent total that is more than double the 2.2 percentage relied upon in the benefits calculation. While the difference may seem small, given the numbers involved, it is not. Moreover, the $10,000 cost input from the Proposing Release was doubled in the Adopting Release for the purpose of estimating benefits, 83 Fed. Reg. at. 29,185 n.353, but was not doubled in the Adopting Release for the purposes of estimating costs. *Id*. at 29,199 nn. 529-30. Not only is this a methodological inconsistency, but if the same approach were applied on the cost side as to the benefits calculation, the final cost estimate would more than double.

D. The Commission's Cost Benefit Analysis Does Not Meet the Statutory Requirement that No Rule May be Adopted that Would Impose a Burden on Competition Not Necessary or Appropriate in Furtherance of the Securities Laws.

Section 23(a)(2) of the Exchange Act, 15 U.S.C. § 78w(a)(2), bars the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the securities laws. As discussed above, the Commission was unable to quantify or even determine a clear benefit from the rule to investors. *Id*. at 29,185-86.

On the other side of the coin, the Commission "acknowledge[d] that there may be some investors who would prefer to receive paper copies but may not notify their funds of that preference" and evidence in the record that "internet access and use among Americans [is] not universal." *Id.* at 29,193. Further, such investors "might experience a reduction in their ability to access shareholder reports and portfolio investment information if they do not elect to receive paper reports." *Id.* Even "some investors with internet access may be less likely to review their shareholder reports made available online than shareholder reports delivered in paper form," *id.* at 29,193 and n.453, and "[t]o the extent that a reduction in the review of shareholder reports by such investors decreases how informed they are about funds, it could potentially decrease their ability to efficiently allocate capital across funds and other investments," *id.* at 29,193. Moreover, "a decrease in the ability of investors to access and review information about different funds could also decrease the competition among funds for investor capital." *Id.* Although the Commission did its utmost to avoid the inevitable conclusion of this train of logic with unrelenting reliance on what "may" or "could" happen, it seems clear that changing the default form of shareholder report delivery away from paper will result in some degree of competitive harm.

The evidence that this burden on competition is neither necessary nor appropriate is equally strong. The Commission admits that investors who prefer

electronic reports can receive them under existing guidance. *Id.* at 29,184. Indeed, the Adopting Release characterizes the proportion that have exercised this option as "significant," with estimates in the 40-plus percent range currently, and those numbers compare favorably with the percentages of investors who expressed a preference for electronic reports in the Commission's and other surveys. *Id.* at 29,184 n.348; 80 Fed. Reg. at 33,627 n.293; and 83 Fed. Reg. at 29,161 n.44. And, as the Commission further recognizes, trends toward increased electronic reporting are expected to continue, regardless of whether the Commission adopted rule 30e-3 or not. *Id.* at 29,184.

In light of all the evidence in the record, it is inescapable that this rule, which burdens competition, is neither necessary nor appropriate and should be vacated as unsupportable under 15 U.S.C. §78w(a)(2). At the very least, as the IAC recommended and as at least one court has found in similar circumstances, "a fuller analysis was warranted" of the proportions of burden on competition and justifications for the rule. *API v. SEC*, 953 F.Supp.2d at 23. Construing similar "necessary" and "appropriate" language, the Supreme Court has held that "[n]o rule is 'appropriate' if it does significantly more harm than good." *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015). The final rule is therefore arbitrary and capricious, and not in accordance with law.

IV. The Final Rule is Not a Logical Outgrowth of the Proposed Rule.

As this Court has explained on numerous occasions, "an agency's proposed rule and its final rule may differ only insofar as the latter is a 'logical outgrowth' of the former." *Environmental Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005), *citing Shell Oil Co. v. EPA*, 950 F.3d 741, 750-51 (D.C. Cir. 1991); *Northeast Md. Waste Disposal Auth. v. EPA*, 358 F.3d 936, 947 (D.C. Cir. 2004); *City of Waukesha v. EPA*, 320 F.3d 228, 245 (D.C. Cir. 2003). Thus, there is no logical outgrowth (and an agency therefore violates the APA) when an agency adopts a final rule that enacts opposing positions or proposals compared to those set forth in its proposed rule. *Environmental Integrity Project v. EPA,* 425 F.3d at 996 (noting that agencies cannot "pull a surprise switcheroo" in rulemaking). *See also Alina Health Services v. Sebelius*, 746 F.3d 1102, 1108 (D.C. Cir. 2014) (*citing Environmental Integrity Project* and similarly holding that the final rule was not a logical outgrowth of the proposed rule where the agency's position in the final rule was opposite to that in the proposed rule); *Public Citizen, Inc. v. Mineta*, 427 F. Supp. 2d 7, 15-17 (D.D.C. 2006) (same).

Here, the Commission has similarly attempted to "pull a switcheroo," and the final rule is not a logical outgrowth of the proposed rule. The Proposing Release "incorporate[d] a set of protections intended to avoid investor confusion and protect the ability of investors to choose their preferred means of

communication." 80 Fed. Reg. at 33,626. The key protections for investors who preferred paper reports were a mailed Initial Statement that would have advised of the upcoming change to electronic delivery, accompanied by a postage-prepaid, pre-addressed reply form that would allow investors to indicate their desire to continue receiving paper reports. *Id.* at 33,629. Explaining further, the Commission noted:

> We believe it is important to limit the information in the Notice and the other materials sent along with the Notice in order to ensure that shareholders are made aware of the availability of a shareholder report and so that the availability of the report does not become obscured. Therefore, the rule as proposed would limit the information contained in the Notice to the information required by the rule. The Notice also could not be incorporated into or combined with another document, nor could it be sent along with other shareholder communications (with the exception of the fund's current summary prospectus, prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials under rule 14a–16 under the Exchange Act).

Id. at 33,630.

However, to the surprise of investors and others, the Commission completely reversed course in the final rule and eliminated both of these safeguards entirely. In lieu of these measures, the Adopting Release provides that notifications of the forthcoming change can be combined with other documents and sent along with other shareholder information, rather than in the form of a free-standing document designed to avoid the risk of the information's "becom[ing] obscured." 83 Fed. Reg. at 29,160. The required postage-prepaid reply card is

also no more. Instead, investors who wish to preserve their ability to receive paper reports will now have the burden of contacting the fund, following fund-prescribed procedures, and navigating a toll-free number process that the Commission recognizes may be tortuous. *Id.* at 29,171. Therefore, with respect to the most substantive "protections intended to avoid investor confusion and protect the ability of investors to choose their preferred means of communication," the Commission has adopted an approach that is the complete opposite of that set forth in the Proposing Release. The final rule is not a logical outgrowth of the proposed rule in this regard, and the Commission has therefore violated the APA. The final rule should be vacated.

CONCLUSION

The SEC has a statutory obligation to protect investors, which it failed to uphold in finalizing rule 30e-3. The record amply demonstrates the likelihood of significant, adverse impacts on investors who want to continue receiving shareholder reports in paper form. These negative effects are intensified by the Commission's reliance on implied consent, an approach that disproportionately increases the risk of harm to certain vulnerable demographic groups. In addition to causing harm to investors, decreased investor readership has adverse consequences on competition and capital formation.

This burden on investors, competition, and capital formation is neither necessary nor justified. Investors who prefer electronic access to shareholder reports can freely secure them without the rule. The Commission acknowledges that its existing guidance allows for electronic delivery and that a high percentage of investors already have exercised this choice, at levels commensurate with the Commission's own preference surveys.

The Commission ignored its statutory duty to respond promptly and publicly to the recommendations of its Investment Advisory Committee. The Commission also disregarded credible alternatives the IAC proposed.

The Commission's final rule eroded protections included in the Proposing Release and failed adequately to respond to comments in the record. The rule's cost benefit analysis is flawed in multiple respects and unsustainable under this Court's precedent.

For all these reasons, as detailed in the foregoing brief, the Court should hold the Commission's action in promulgating rule 30e-3 arbitrary and capricious, and contrary to law, and should vacate it.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 10,512 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

Date: November 6, 2018

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