With Friends Like These: Rule-Making Comment Submissions to the Securities and Exchange Commission

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ABSTRACT

Structure and process theorists (McCubbins, Noll, and Weingast, among others), argue that the Administrative Procedures Act establishes a privileged position for the dominant organized interests of an industry in their dealings with regulatory agencies. We examined whether this was indeed the case with respect to the APA-required notice and comment period for rule making at the Securities and Exchange Commission (SEC). Based on an analysis of the commission's own statements regarding comment submissions in 1998, there is little to no evidence that interests that are more institutionally privileged are any more effective in changing the SEC's mind once the agency has proposed a rule.

REGULATION AND IRON TRIANGLES

Although some scholars have argued to the contrary (Pertshuk 1982; Kelman 1982; Seligman 1995), many political scientists and economists have long argued that regulatory agencies exist to benefit and serve the regulated industry. Specifically, interest groups have the power, motivation, and ability to influence the regulatory process to benefit the particular industry rather than the public. Theodore Lowi, in his self-styled polemic The End of Liberalism (1969), argued that these interest groups corrupt the democratic process, preventing just and fair public policy.

More specifically, many policy scholars have posited the existence of an iron triangle (McCool 1990; Meier 1985; Mazmanian and Sabatier 1980; McConnell 1966). An iron triangle represents a symbiotic relationship between a regulated industry, the key congressional committees or subcommittees, and the agency in charge of the regulated industry. Through a convergence of interests, membership, and access, the iron triangle dominates the policy-making process and prevents any change that hurts or impairs the interests of the regulated group. As two scholars point


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out, “policy subsystems tend to reduce or eliminate conflict by concentrating economic and political power in the hands of a few individuals who tend to have overlapping interests” (Fritschler and Hoefler 1996, 5). Bernstein (1955) described the powerful collection of political and personal incentives that inexorably lead to such agency capture.

Many economists have argued that the participation of interest groups in the regulatory process leads to increased consumer cost and harm to the public and that agency capture is endemic to regulation (Stigler 1971; Tullock 1967; Kreuger 1974). Kolko (1965) makes a compelling case that the very existence of an agency is often rooted in demands by the industry for self-beneficial regulations. Indeed, Dahl (1989) suggested that interest group influence in democracy itself is economically stifling—presumably a direct result of regulatory capture.

As an alternative to the iron triangle depiction, Heclo and others have suggested that modern American policy is established among “issue networks,” rooted in exchanges of technical information and expertise, in which no one actor necessarily dominates policy decisions (Heclo 1978; Heinz et al. 1993). However, even after a decade of deregulation, particularly in the airline and trucking industries, Peltzman, Levine, and Noll (1989) continued to argue for capture theory’s vitality, albeit with some modification.

Most bureaucratic control literature also views the preferences of the dominant organized interests as the driving force behind bureaucratic policy making. Either because Congress explicitly works on behalf of those interests (Weingast 1981 and 1984; Weingast and Moran 1983; Moran and Weingast 1982; Calvert, Moran, and Weingast 1987) or because Congress uniquely empowers those interests in bureaucratic decision procedures (McCubbins, Noll, and Weingast 1987 and 1989; McCubbins and Schwartz 1984), bureaucratic policy choices have been portrayed as very responsive to the needs and demands of the dominant interests of the regulated industry.

Researchers in this field have demonstrated bureaucratic fealty to congressional committee preferences (Calvert, Moran, and Weingast 1987) and have highlighted and explicated the nature of the advantages Congress confers on like-minded (usually dominant) organized interests in their interaction with agencies. However, interest group influence over specific regulatory decisions generally has not been documented in a careful manner, taking into account the institutional structure that shapes the bureaucratic policy-making process. We propose to do just that, in the case of the rule-making process of the Securities and Exchange Commission (SEC)."
Kerwin (1999, 188) succinctly stated the most straightforward hypothesis:

A strong case can be made that [business and trade associations'] superior resources and experience lead to a degree of influence in rulemaking that others cannot match.

Because the SEC is an independent regulatory commission, engages in low salience and highly technical decision making, has a very narrow industry clientele, and has practically no citizen advocacy clientele, the commission represents the classic profile for the agency capture thesis (Quirk 1981). If SEC rule making is not dominated by the most powerful interests in the securities industry, then federal agencies in general may be less susceptible to capture than has been realized.

RULES AND OPINIONS

The structure and process wing of the bureaucratic control literature argues that Congress, through the Administrative Procedures Act (APA), guarantees bureaucratic policy decisions consistent with the preferences of the dominant organized interests (McCubbins, Noll, and Weingast 1987 and 1989; Banks and Weingast 1992; Lupia and McCubbins 1994a and 1994b; D. Epstein and O’Halloran 1994; Bawn 1997). For example, the APA requires agencies to first announce proposed rules, to be published in the Federal Register, before promulgating a final rule. This notice requirement guarantees that organized interests have adequate warning about impending agency decisions and substantial information about the agency’s policy inclinations. The APA also requires that agencies delay implementation of their proposed rules for a lengthy time period, while they receive written comments from interested parties. This institutional mechanism provides an advantage to politically powerful groups (who normally possess substantial information advantages), by establishing a window of opportunity to mobilize an opposition campaign for unfavorable rules. Finally, through the judicial review mechanisms of the APA, the comment period and requirements for the final rules provide a tool for politically powerful groups (who normally possess substantial legal resources) to impose significant costs on agencies that attempt to disagree with them.

Furlong’s prior research (1997 and 1998) has demonstrated that submission of comments during rule making is the most commonly used tactic by organized interests in the regulatory arena. That research also shows that rule-making comment submissions are perceived by both administrative and organized interest personnel as the most effective tactic employed by groups.

\(^3\)See 5 U.S.C.A. sec. 553.
INTEREST GROUPS AND AMICUS PARTICIPATION

The influence of interest groups in Congress is often, if not always, mediated by the indirect contacts between lobbyists and legislators, extralegal considerations of campaign contributions, and constituency mobilization. At the other end of the spectrum, organized interest influence in the courts is maximally constrained to legal argumentation in written form. Interest group interaction with bureaucracies probably lies between the extreme poles of strictly legal and formal interaction with courts and mostly extralegal and informal interaction with legislators. In fact, the formality of interest group interaction with agencies ranges itself from the relatively informal contacts prior to rule proposal to the relatively formal contacts during the comment period after a rule proposal.

Law and courts scholars have examined the influence of interest groups in the courts—an arena where organized interest interaction is institutionally constrained to formal argumentation, usually in written submissions. Beginning with Krislov (1963), judicial scholars have explored the potential impact organized interests may have on court decisions through the filing of amicus curiae briefs. Caldeira and Wright (1990) documented the large number and diverse character of amici before the Supreme Court, concluding that the information and argumentation base in Supreme Court cases is quite pluralistic. Lee Epstein (1994) showed that such pluralism exists for state supreme courts, as well.

Although often not a direct party to the litigation, many scholars have posited that interest groups can alter the agenda and the outcome of a matter before the courts through the filing of such briefs, both at the national and the state level (Caldeira and Wright 1988 and 1990; Songer and Kuersten 1994; Spriggs and Wahlbeck 1997). For example, Caldeira and Wright (1990) demonstrated how interest groups can help set the agenda for the Supreme Court through the filing of amicus curiae briefs urging the Court to decline or take a particular case for review. Songer and Kuersten (1994) show that amici participation is quite successful in promoting particular interest group agendas at the state supreme court level. Spriggs and Wahlbeck (1997) noted how supreme court justices incorporate novel amici arguments into their opinions.

INTEREST GROUPS AND COMMENT SUBMISSIONS

In analyzing the influence of organized interests on SEC rules, our approach loosely follows the textual analysis of Spriggs and Wahlbeck (1997), in which they study interest group influence on court decisions. They looked at the legal arguments proposed in amici briefs, to see whether the Supreme Court adopted the

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Arguments proposed therein. Their evidence suggests that, while the Court does indeed adopt some of the arguments proposed in briefs, they are less likely to do so if those arguments were not already proposed by one of the direct parties in the case. That is, amici may influence the Court by buttressing already established lines of reasoning, but lone amici arguments are much less likely to be endorsed by the Court majority. While it goes beyond the scope of their project, one might infer from the Spriggs and Wahlbeck results that numbers matter and relative uniformity of opinion among organized interests enhances the likelihood of success.

Many scholars have suggested the very same dynamics with respect to comment submissions and bureaucratic rule making, hypothesizing that consensus among commenters and repetition of a particular comment would increase an agency’s probability of agreement (Magat, Krupnick, and Harrington 1986; Furlong 1997; Golden 1998). However, Golden’s analysis did not support the hypotheses, while the remaining studies have mostly supported both propositions.

The notice and comment requirements of the APA allow affected parties to argue, submit their views, and in general offer data and other information about the potential impact of the proposed rule. This allows those most in opposition to the rule an opportunity to protest or even alter or amend the proposed rule. It is the effect of comments on rules that we examine in this article. Analogizing from the amicus participation in court proceedings, we examine the effect of the comments on the rules promulgated by the SEC.

As has been noted in previous literature, the ability to distinguish an effect of an organized interest on an agency rule is perhaps even greater than in the case of amici and court opinions, because of the nature of the rule-making process. Under the APA, agencies must publicly propose a rule prior to comment submissions. They are then required to make appropriate adjustments to their rules, in light of the comments, and to summarize their reactions to comments in a written document (typically referred to as the rule preamble) published along with the final rule in the Federal Register. Thus change (in direct response to comments) is publicly acknowledged and measurable (Golden 1998).

DATA AND DESIGN

In keeping with the previous research on organized interest influence on federal agencies (Golden 1998) and the Supreme Court (Caldeira and Wright 1988 and 1990; Spriggs and Wahlbeck 1997),
and in order to establish some preliminary bounds on the scope of the project, we restricted our attention to the rules promulgated by the SEC in a single year—1998. This collection of rules allows us to follow the convention proposed by Golden (1998), in that each rule had been both proposed and finalized under the same (Clinton) administration. It also allows us to follow Golden’s convention of examining all, and not just OMB-designated significant rules.

Throughout the year, the commission was fully staffed with three Democratic and two Republican commissioners, and the agency promulgated a total of twenty-one final rules. The rules generated over six thousand comment letters, though the vast majority of those comments were submitted in reference to two particular rules (for these two rules, the SEC established a website to facilitate comments by individual investors, with dramatic results). Individuals submitted a large percentage of the comments, and the commission distinguished between comments by individuals and comments by organizations, perhaps implicitly discounting comments by individuals. ¹

Our research design departs from the designs used in court amici studies because rule making is institutionally distinct from court opinion writing in that there are no appellants. For example, Songer’s study uses the appellant as the unit of analysis, and employs both a logit analysis and matched pairs analysis of appellant success, which they hypothesized would increase with increasing support by amici filers. A parallel approach might be to use the final rule as the unit of analysis, characterizing it as a victory or a defeat for an organized interest, and hypothesize that the chances of victory increase with the number and weight of comments advocating such an outcome. However, rules, unlike court decisions, are not all-or-nothing victories for one side in a struggle. Therefore, characterizing at a summary level whether a final rule is consistent with the weight and direction of the comments is likely to be problematic.

Another possible design, paralleling the Spriggs and Wahlbeck approach, would avoid this difficulty by identifying the specific arguments and requests in each comment, to determine whether the commission eventually adopted each individual commenter position. It would be reasonable to hypothesize that a larger number of commenters all advocating the same argument or request would be more successful before the commission. Our research along these lines is ongoing.

Rather than examine the comment letters themselves, as has been done recently (Golden 1998), we chose to look to the internal evidence of group influence—the specific references to comments

¹SEC Release 33-7513, Final Rule and Rule Amendment Summary, for example, specifically notes that 226 of the 256 comment letters (88 percent) were submitted by individual investors. In that rule and the other rules we examined, not a single mention of comments specifically cites an individual investor.
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contained in the preamble to the final rule itself. Final rules contain the actual language of the rule, but the APA mandates that any agency promulgating a final rule includes in their rule preamble a summary and response to the comments received by the agency. This opinion typically constitutes the bulk of the document when an agency promulgates a final rule. While we cannot demonstrate that these internal references are a representative sample of the overall comments, it is worth pointing out that the internal references are likely to identify, in summary form, every credible argument and alternative considered by the agency. Indeed, failure to adequately acknowledge or respond to a comment is grounds for judicial appeal, and ultimately remand or even reversal. Kerwin (1990) found that the Federal Energy Regulatory Commission was dramatically affected by lawsuits, at least with respect to licensing decisions. Preamble description of comments is, then, a useful vehicle for exploring the influence of organized interests in the rule-making activity of the agency. Magat, Krupnick, and Harrington (1986) made this same argument about the representativeness of rule preambles, with respect to the EPA, and even conducted a cursory comparison of rule preambles to the actual comments, concluding that “the major points made in the original comments appear to be well represented in the Federal Register” (p. 145, n. 6).

We identified each specific reference to comments in the twenty-one final rules that were promulgated by the SEC in 1998. All told, there were 1190 such references. We excluded nonsubstantive references to comments,\^ such as “we received thirty comments,” or “two commenters addressed the issue,” and focused exclusively on specific references that potentially had a bearing on the elements of the final rule. Such references ranged from relatively generic claims of opposition or support (“most commenters supported the 13(b) exception, as proposed”), to suggested lines of reasoning (“XX felt that the 13(b) exception would likely enhance the security and reliability of the alternative trading system”), to specific proposals for change (“two commenters felt the 13(b) exception should be clarified to indicate that it applied to third market traders”).

In each instance, we identified the nature of the referent as either a self regulatory organization (SRO),\(^\text{5}\) government organization,\(^\text{6}\) trade association, or regulated party.\(^\text{7}\) Even though trade association members are regulated parties, comments from these umbrella or professional organizations probably command greater attention from the commission (Magat, Krupnick, and Harrington 1986).

When a comment raised a specific line of reasoning, or

\(^\text{We also excluded nineteen substantive references in which the SEC responded by initiating a new rule-making proceeding. In such cases, we were unable to establish a legitimate coding regime for the SEC’s response to the comment because the agency’s initial response in such cases is, at best, provisional.}\)

\(^\text{Self regulatory organizations are specifically empowered by the SEC and the Securities Exchange Act of 1934 to police enforce, and even write their own trading rules for members. All significant exchanges in the United States, such as the New York Stock Exchange or the Chicago Board Options Exchange, are covered under this category.}\)

\(^\text{Including other federal agencies, and representatives of state or local governments or government agencies.}\)

\(^\text{It is worth noting that of the 633 references that explicitly identified a commenter, not a single one referred to an individual investor.}\)
requested that the SEC make a specific change to its proposed rule, we also identified the degree of apparent agreement between the SEC and the commenter on the issue. Finally, we attempted to identify the number or weight of the commenters for each specific reference by the commission. That is, when the specific commenters were identified, we recorded the number of commenters. When proportions of commenters were identified (such as "two of the three commenters who addressed the issue felt that the current regulations were adequate"), we recorded that information, as well. When more general references were used by the commission (such as "many commenters," or "a few commenters"), we recorded the nature of the language used.

As exhibit 1 illustrates, the nature of the internal references to comments is spread pretty evenly between general acknowledgments of support or opposition, specific arguments bearing on the proposed rule, and specific requests or proposals for changes to the proposed rule.

Exhibit 2 indicates that, while about half of all internal references to comments did not permit identification of the commenter, many explicitly identified commenters could be considered to be repeat players (Galanter 1974).

### Exhibit 1

**Nature of SEC References to Comments in Final Rule Summary**

<table>
<thead>
<tr>
<th>Type of Reference</th>
<th>Number of References</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citation of general support/opposition</td>
<td>275 (23.1%)</td>
</tr>
<tr>
<td>Description of specific line of reasoning</td>
<td>484 (40.7%)</td>
</tr>
<tr>
<td>Notation of specific rule change request/proposal</td>
<td>431 (36.2%)</td>
</tr>
<tr>
<td>Total</td>
<td>1190 (100%)</td>
</tr>
</tbody>
</table>

### Exhibit 2

**Identity of Commenter Referred to in SEC Final Rule Summary**

<table>
<thead>
<tr>
<th>Type of Referent</th>
<th>Number of References</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self regulatory organization</td>
<td>177 (14.9%)</td>
</tr>
<tr>
<td>Government agency</td>
<td>30 (2.5%)</td>
</tr>
<tr>
<td>Trade association</td>
<td>161 (13.5%)</td>
</tr>
<tr>
<td>Regulated industry participants</td>
<td>189 (15.9%)</td>
</tr>
<tr>
<td>Mixed groupings</td>
<td>76 (6.4%)</td>
</tr>
<tr>
<td>Generic reference to &quot;commenter(s)&quot;</td>
<td>557 (46.8%)</td>
</tr>
<tr>
<td>Total</td>
<td>1190 (100%)</td>
</tr>
</tbody>
</table>

*To test the reliability of the data, we double coded a random sample of two hundred references. In cases that involved a commission response, we achieved 94.2 percent agreement with our coders on whether the SEC agreed or disagreed with the referenced commenter (Kappa = .881, p < .001). This was the most subjective of our measurements, and relia-ability on all other measures was even higher.*

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Owing to their special status as mini- or sub- regulators, SROs have persistent and regular contact with the agency, both in adjudication and rule-making settings. As such, they should clearly be considered advantaged or inside players. Of course, SROs can and do disagree with one another (see, e.g., Khademian 1992), as they did on occasion for the rules we examined. Nevertheless, as a category, SROs have a special status within the SEC framework, which plausibly translates into greater influence than other commenters. Indeed, the special status of SROs within the SEC regime is probably the epitome of the institutional advantage portrayed by structure and process theorists.

Government entities are also often characterized as inside players, especially when their interaction with the decision-making body is regular and institutionalized. In our data, government agencies ranged from clear insiders, such as the Commodity Futures Trading Commission (CFTC) to agencies unlikely to have regular interaction with the SEC, such as the Council of the City of New Orleans. No state governments or state agencies were referenced in the preambles we studied. The overlapping jurisdictions and regular interaction between the SEC and the other federal agency commenters clearly indicate that they should be considered inside or repeat players in each other’s policy domain. However, as a category, government agencies are not uniformly repeat players before the SEC.

The voices of broad trade associations, such as the Securities Industry Association, are frequently heard by the SEC, and they plausibly carry significant weight with the commission. However, including trade associations in a single insider category along with SROs and federal agencies is not necessarily justified. Trade associations do indeed appear before the commission frequently, and they might be considered repeat players according to Galanter’s definition. On the other hand, trade associations do not share the same degree of institutionalized relationship with the commission as do SROs. We explored two possible groupings of referents, alternately including or excluding trade associations from an insider category.

When the SEC cites a specific argument, it is not necessarily one that supports the agency’s own position. As exhibit 3 shows, the SEC agrees more than it disagrees with specifically cited arguments, but in a substantial proportion of cases the SEC specifically mentions an argument in its final rule summary in order to disagree with and refute the argument.

The same can be said for SEC references to specific requests for changes from the proposed rule. Exhibit 3 also indicates that

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when the SEC specifically mentions a requested change to its proposed rule, it does so in order to reject that proposal and provide reasons for the rejection in over 40 percent of all cases.

HYPOTHESES AND ANALYSIS

We identify two broad generalizations arising from the literature. First, both prior research on agency rule-making comments and the amicus literature that examines Supreme Court opinions and arguments suggest that when arguments or proposals by different parties reinforce one another, the deliberating body will be more likely to adopt the position. That is, numbers matter. Second, the structure and process literature suggests that institutionally advantaged players will be more successful before regulatory agencies than will nonadvantaged players. There are different ways to characterize who is advantaged before the SEC, and the following analyses flesh out several alternative operationalizations.

Hypothesis 1: When the SEC encounters a specific request or argument by a larger number or proportion of commenters, it will be more likely to respond favorably to the request.

As Golden (1998, 261) put it, “[W]hen there is conflict rather than consensus among the commenters, the agency tends to hear most clearly the voices that support the agency’s position. . . . This finding applies not just when there is conflict between citizen’s groups and business but when the conflict is among business commenters.” We identified three alternative means of assessing the number of commenters behind a particular suggestion.

Test 1a: Raw numbers explicitly identified by the commission. In 761 instances of discussion of an argument or proposal contained in comments, the SEC explicitly identified the number of commenters behind the suggestion. Plausibly, the larger the number of commenters behind a particular suggestion, the more favorable the response from the SEC. Exhibit 4 presents a logit regression that
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Exhibit 4
Logit Regression of SEC Reaction to Cited Comment
Dependent: Favorable/Unfavorable (n=761)

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>b</th>
<th>se</th>
<th>Prob (1-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>.111</td>
<td>.114</td>
<td>.166</td>
</tr>
<tr>
<td>Number of commenters taking the position (ranging from 1 to 88)</td>
<td>.004</td>
<td>.042</td>
<td>.465</td>
</tr>
<tr>
<td>F^2</td>
<td></td>
<td>0.01</td>
<td>.929</td>
</tr>
</tbody>
</table>

tests this hypothesis. The regression features the SEC’s reaction to a cited comment (0-unfavorable, 1-favorable) as the dependent variable, with the actual number of commenters behind each suggestion as an independent variable.

Exhibit 4 demonstrates that the coefficient for number of commenters is positive, as hypothesized. If the number of commenters in support of a position grows, the SEC’s response is predicted to become more favorable. However, the estimated effect is neither statistically nor substantively significant. A t-test for the independent variable is very small (0.09), indicating that a positive coefficient could have been rooted in mere chance while the true relationship between the variables remains nil.  

Substantively, the logit coefficients may be used to generate predicted SEC responses for values of the independent variable(s). In this case, if the number of commenters behind a particular suggestion were to increase from 1 to 10 (about 2 standard deviations in our data), the predicted probability of a favorable SEC reaction would rise only from 52.1 to 53.8 percent—a minuscule change in favorability that cannot be distinguished from the null relationship.

For example, when the SEC considered extensive new rules for alternative trading systems, many SROs submitted written comments. When the SEC cited seven or more commenters, it often meant strong SRO support for a position. Nevertheless, the commission agreed with the commenters in exactly 50 percent of such situations—just as the model would predict.

Test 1b: Comparable qualitative language used by the commission. Often, the commission used language (generally, majority, some, and so on) which we thought could be rank ordered to allow comparisons of SEC response across varying levels of perceived support. Exhibit 5 presents a cross tabulation for the 282 instances

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^Our dataset represents the population of comment references for a particular set of rules, rather than a random sample from that population. For this reason, significance tests in this and other analyses should not be interpreted in the classical sense. Assuming that stochastic factors influence such things as comment submissions, staff interpretations of comments, the variety of drafting decisions during writing of the rule preambles, and our own coding of the text, our dataset might be viewed as a sample from a much larger population of possible comment references (for a fuller discussion, see Kmenta 1986, 4). Presumably, the comment references in this collection of SEC preambles would vary randomly over hypothetical repetitions of the 1998 rulemaking season. The statistical analysis of the 1998 rule preambles provides an assessment of the degree to which these results are generalizable to similar situations.

in which the SEC did not explicitly identify the commenters, but provided a qualitative assessment of the level of support for a position.

A visual inspection of exhibit 5 appears to show some relationship between SEC qualitative assessments of commenter support and the agency's own reaction. In the above sample, the SEC reacted favorably about 60 percent of the time. However, the percentage of SEC support is appreciably greater for the two categories that seem to indicate the greatest level of support (generally/almost all and most/majority). In these situations, the SEC is significantly more likely to adopt the position of the commenters, doing so in 80 percent of such situations. By contrast, if only a few commenters are proposing a particular approach, the commission is less likely to adopt the position of the commenters, doing so in 57 percent of such situations.

As a statistical matter, a \( \chi^2 \) test for independence is positive, demonstrating that SEC reaction is not randomly distributed among different commenter contexts. That is, the number or proportion of commenters behind a specific suggestion is significantly related to whether the SEC adopted the position of the commenters. However, the relationship between the variables is not monotonic. The gamma coefficient is the counterpart to a Pearson correlation coefficient, for categorical data, and indicates the degree of directional relationship between the variables, ranging from -1 (perfectly negative relationship) to +1 (perfectly positive relationship). The gamma statistic in exhibit 5 is .053 with a standard error of .089, which cannot be distinguished from zero at an acceptable level of certainty. The lack of a clearly positive relationship between the variables is easily seen in that the SEC responded unusually favorably to comments that were submitted by only a single commenter.
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(68 percent favorable). It is possible that when the SEC makes note of a comment by a single commenter, it does so for qualitatively distinct reasons—to provide at least some support to a position it already preferred.

For example, the SEC considered amendments to the Advisor’s Act, to allow alternative fee arrangements for certain sophisticated clients.\textsuperscript{11} Although many commenters were opposed to the SEC’s proposal to increase client net worth requirements, the commission persisted. In fact, the commissioners cited a lone commenter’s argument about how inflation had eroded the threshold over the years as a support for its position—the very same argument the SEC had itself used in the proposing release.\textsuperscript{12}

Test 1c: Percentage of commenters explicitly calculated by the commission. On rare occasions (thirty-four instances), the commission explicitly identified the percentage of commenters in favor of a position (usually a specific proposal among a set of proposals). Plausibly, the larger the percentage of total commenters behind a particular suggestion, the more favorable the response from the SEC. Exhibit 6 presents a logit regression, examining the relationship between the percentage support and the SEC reaction. The regression features the SEC’s reaction to a cited comment (0-unfavorable, 1-favorable) as the dependent variable, with the percentage of total commenters supporting each suggestion as an independent variable.

As exhibit 6 shows, the coefficient for number of commenters is positive, as hypothesized. If the number of commenters in support of a position grows, the SEC’s response is predicted to become more favorable. However, the estimated effect is not statistically significant. A t-test for the independent variable is small (1.33), indicating that a positive coefficient could have been rooted in mere chance, while the true relationship between the variables remains nil.

Exhibit 6
Logit Regression of SEC Reaction to Cited Comment Dependent: Favorable/Unfavorable (n=34)

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>b</th>
<th>se</th>
<th>Prob (1-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-1.75</td>
<td>.780</td>
<td>.025</td>
</tr>
<tr>
<td>Percent of commenters taking the position (ranging from 4 to 100)</td>
<td>.020</td>
<td>.015</td>
<td>.171</td>
</tr>
<tr>
<td>p^2</td>
<td>1.97</td>
<td></td>
<td>.161</td>
</tr>
</tbody>
</table>

\textsuperscript{11}SEC Release IA-1731 (rule adopted as 17 CFR 275).

\textsuperscript{12}SEC Release IA-1682 (published at 62 FR 61882, November 19, 1997).

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However, the estimated impact suggested by the logit regression is substantively large. The logit coefficients may be used to generate predicted SEC responses for values of the independent variable(s). In this case, if the percentage of commenters favoring a particular suggestion were to increase from 15 to 80 percent (about two standard deviations in our data), the predicted probability of a favorable SEC reaction would rise from 19.0 to 46.3 percent—a sizeable increase in favorability.

For example, the SEC considered loosening its volume-reporting requirements for passive investors—those who may own large blocs of shares in a company but do not seek to use their voting rights to influence the management control of the company. One of the five commenters who favored a greater loosening of the restrictions suggested that volume-reporting requirements be eliminated altogether, for passive investors. The SEC would not go that far, and the text indicates that a greater proportion of commenters had pointed out an independent value in the volume-reporting requirements. Five of the seven commenters who addressed the issue of proxy voting thought that certain proxy activities should be construed as oriented toward influencing the ownership of a company. The SEC agreed. Overall, however, there are precious few examples to clearly illustrate the phenomenon, with the result that the effect cannot be distinguished from the null relationship because of a large standard error.

Hypothesis 2: When the SEC encounters a specific argument, request, or proposal by a more advantaged commenter, it will be more likely to respond favorably to the request.

Magat, Krupnick, and Harrington (1986) suggested, but did not test, the hypothesis that firms represented by trade associations receive more-favorable regulatory decisions, and by extension, a greater weakening of standards during the rule-making process. Exhibit 7 lays out the SEC response versus the type of commenter(s).

As exhibit 7 demonstrates, our results seem to contradict the supposition of Magat, Krupnick, and Harrington. When the SEC specifically identifies a more advantaged commenter, it more often does so in order to disagree. Aside from the federal agencies (with whom the SEC agreed in practically every instance it mentioned them), commenters one would expect to be more advantaged before the commission were more often rebuffed than the generic category of commenters. For example, the commission agreed with SROs 55.4 percent of the time. This is lower, not higher, than the 57.7 percent agreement for all other commenters.

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Exhibit 7
Testing Whether SEC Responds More Favorably to Insiders

<table>
<thead>
<tr>
<th>Type of Commenter</th>
<th>SEC Reaction to Cited Comment (row percentages in parentheses)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>favorable</td>
</tr>
<tr>
<td>SRO</td>
<td>87 (55.4%)</td>
</tr>
<tr>
<td>Federal agency</td>
<td>10 (90.9%)</td>
</tr>
<tr>
<td>Trade association</td>
<td>74 (49.0%)</td>
</tr>
<tr>
<td>Specific company</td>
<td>81 (51.3%)</td>
</tr>
<tr>
<td>Mixed/unspecified</td>
<td>263 (62.3%)</td>
</tr>
</tbody>
</table>

Significance Tests

<table>
<thead>
<tr>
<th>Possible Groupings for 2x2 Test</th>
<th>p^2</th>
<th>prob</th>
<th>Gamma</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRO, federal agency advantaged, others disadvantaged</td>
<td>0.02</td>
<td>.895</td>
<td>.01 (.09)</td>
</tr>
<tr>
<td>SRO, federal agency, trade association advantaged. others disadvantaged</td>
<td>2.74</td>
<td>.098</td>
<td>-.12 (.07)</td>
</tr>
<tr>
<td>All identified commenters advantaged, others disadvantaged</td>
<td>8.25</td>
<td>.004</td>
<td>-.19 (.07)**</td>
</tr>
</tbody>
</table>

The final grouping and significance tests help to illustrate the conundrum. Exhibit 7 presents three $p^2$ tests of independence between identity of commenter and SEC response, to correspond to three plausible groupings of advantaged versus disadvantaged commenters. The first two tests are not significant, which should be read to imply that the identity of commenters is statistically independent from the SEC response. The final test is positive, indicating a significant relationship between identity and response. However, the gamma statistic (-.19 with a standard error of .07) indicates that the relationship is negative and significant—precisely opposite Magat’s hypothesis. Thus the SEC responds less favorably to commenters who are arguably insiders. Ultimately, there is no support, and perhaps even contradictory evidence, for the hypothesis that institutionally advantaged commenters receive more favorable treatment by the SEC.

CONCLUSIONS

Among scholars, lawyers, politicians, and even the public, the SEC enjoys a good reputation and has established a culture of bureaucratic expertise (Khademian 1992; Seligman 1995; Ratner 1998). Research in other policy arenas suggests that these are the conditions that lead to bureaucratic autonomy and impartiality (Eisner 1991). This implies that the SEC is less susceptible to industry influence and more responsive to the needs of the investing public. On the other hand, if ever a bureaucracy was created to serve the
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dominant organized interests of an industry, it is the SEC. The structure and process of SEC regulation and rule making could be expected to produce policies more favorable to the preferences of the dominant securities exchanges in the United States (McCubbins, Noll, and Weingast 1987 and 1989). In examining the details of SEC rules, our results reinforce the former conclusion. There is practically no evidence that the strength of the institutional relationship between the commission and a commenter is related to the degree of acquiescence by the commission during the notice and comment phase.

Our results point to a potential hole in the structure and process hypothesis of congressional dominance. There seems to be little or no evidence that the APA requirements make dominant interests unusually effective in changing the commission’s rule components, once those rules have been proposed. It must be acknowledged that our evidence is based entirely on the SEC’s own statements about its rule changes. If the commission’s summary of rule changes are systematically misleading, then the truth may be something very different from our portrayal. A direct examination of the comments will help address this issue, but we reiterate that there is good reason to believe that the SEC account is reasonably accurate. The SEC itself has the most expert judgment about summarizing the comments it received and its own reaction, and when federal judges disagree with this account, a remand is often swiftly handed down.

We should note that our results apply only to a particular phase of regulatory decision making—adjustments to proposed rules prior to final promulgation. It may be that the notice and comment phase of the commission’s decision-making process provides a misleading view of the overall character of interest-commission relations. For example, if an agency’s proposed rule perfectly or nearly perfectly anticipates the arguments and policy preferences of the powerful interests in the industry, then the commission might quibble with insiders over (many) minor issues, while remaining a captured agency. This suggestion would be consistent with Magat, Krupnick, and Harrington’s (1986) finding that interaction before rule making is substantial and effective, at least at the EPA. After all, Chubb (1983) found traditional subsystem domination alive and well in energy policy. The limited scope of this article does not allow us to address such a broad question, but our findings do at least rule out the possibility that the most powerful interests dominate the argumentation process during the notice and comment period itself.
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Errata

In the article by David C. Nixon, Robert M. Howard, and Jeff R. Davis, "With Friends Like These: Rule-Making Comment Submissions to the Securities and Exchange Commission," on pages 59-76 of Volume 12, Number 1, January, 2002, the symbol $P^2$ appeared in exhibits 4, 5, and 6. It should have been the symbol $\chi^2$.

The Cover: As in most American statehouses, the rotunda of the Illinois capitol is directly below the dome, the ceremonial heart of the building. The rotunda cuts through all floors of the building and joins corridors bisecting the four wings, a communications crossroads and a splendid site for the statue of Abraham Lincoln on a granite pedestal.


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