

Can SEC's Consolidated Audit Trail Survive Post-Chevron?

By **Daniel Hawke** (October 11, 2024)

At 2:40 p.m. on May 6, 2010, the "flash crash" occurred. Within minutes, the Dow Jones Industrial Average plummeted almost 9%, causing some securities to trade at pennies on the dollar and triggering losses of over \$1 trillion before rebounding. The flash crash was the largest and fastest market decline in U.S. history, shaking investor and public confidence and putting pressure on regulators to determine and explain what happened.



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Two weeks later, Mary L. Schapiro, then-chair of the U.S. Securities and Exchange Commission, opened a public meeting to discuss whether to propose a rule for a single consolidated audit trail, or CAT, for orders and securities transactions across the U.S. equity markets.

In her opening statement, Schapiro noted that the

SEC's efforts to reconstruct the trading on that day are substantially more challenging and time consuming than we would have liked because no standardized, automated system exists to collect data across the various trading venues, products and market participants. On May 6, more than 19 billion shares of stock were traded across multiple markets — each with its own individual, and in some cases incomplete, data collection approach.[1]

She concluded that "[a]s a result, there is an intense need for regulators to have efficient access to a far more robust and effective cross-market order and execution tracking system." Other commissioners echoed these sentiments, and some also expressed concern over the cost of such a system.

The SEC was operating in the twilight. While it appeared that the U.S. Commodity Futures Trading Commission had access to near-real-time data in the markets it regulates, the SEC did not. It was reduced to making phone calls to exchanges and market centers to request the data it needed. Often, that data took days or even weeks to arrive.

Against this backdrop, a working group was formed, and market oversight experts at the SEC conceived the CAT — a system to consolidate all order and execution activity into a single repository, complete with trade-level detail, to modernize reporting, market oversight and surveillance.

On July 11, 2012, the commission proposed a new rule requiring a consolidated audit trail to monitor and analyze trading activity.[2] The CAT would position the commission to receive comprehensive market data in near-real-time, improving its ability to regulate the markets, enforce the securities laws, and quickly and efficiently respond to market contingencies, like the flash crash, as they arise.

More than 12 years later, the CAT is mired in appellate litigation over the SEC's authority to impose its cost on the industry, among other things. A petition filed in October 2023, by the American Securities Association and Citadel Securities in the U.S. Court of Appeals for the Eleventh Circuit[3] challenges the SEC's authority under the Securities Exchange Act to require that the industry spend the billions of dollars to fully develop, implement and maintain the CAT.

ASA's petition in *American Securities Association v. SEC* was fully briefed in May 2024, a few weeks before the U.S. Supreme Court's landmark decision in *Loper Bright Enterprises v. Raimondo* in June.[4] *Loper Bright* is an analogous case that involved a group of fishermen who sued the National Marine Fisheries Service after the agency required them to pay for federal observers to be on their boats.

The fishermen argued that the Magnuson-Stevens Act did not authorize the NMFS to require industry-funded observers. The NMFS argued that the act gave it the authority to require observers to collect data, and to impose other measures to conserve and manage fisheries. While the Supreme Court did not resolve the funding question, it held that courts should not defer to the NMFS' interpretation of the statute in addressing who would bear the cost of the observers.

The timing of *Loper Bright* for the petitioners challenging the CAT was felicitous.

The Eleventh Circuit Review of the CAT

In September 2023, roughly 11 years after issuing its proposing release, the SEC issued its final order approving the CAT funding plan. A few weeks later, ASA filed its petition in the Eleventh Circuit challenging the SEC's authority to promulgate the CAT. At the core of the petition is a fundamental question: Does the SEC have the legal authority to mandate the CAT under the Exchange Act?

Proponents of the CAT asserted that the SEC has clear and unambiguous authority under the Exchange Act to take necessary actions to protect investors and ensure market integrity.[5] They asserted that the CAT fits "comfortably within the Commission's clear authority to ensure that the SROs' regulatory capabilities keep pace with changing markets and to require joint SRO action in regulating the national market system." [6]

Conversely, opponents characterized the CAT as an "unprecedented government surveillance system," assert that the CAT imposes a "transaction tax on every share traded in the U.S. securities markets," and described it as a "Big Brother regime without any approval, direction, or appropriation from Congress." [7] They contend that the SEC has overstepped its bounds and that the requirement for near-real-time reporting imposes an unreasonable and excessively costly regulatory burden on firms. [8]

The petitioners further asserted that the SEC lacks the authority to mandate both the funding plan for the CAT and the CAT itself, and that its promulgation of the CAT required an express delegation from Congress under the major questions doctrine because the agency's action was politically and economically significant. [9]

Supreme Court's Elimination of Chevron Deference Now in the Mix

On June 28, the Supreme Court issued its landmark decision in *Loper Bright*, in which it struck down *Chevron* deference — a doctrine that had long compelled federal judges to defer to reasonable agency interpretations of ambiguous statutes. Now, federal judges must independently review and weigh competing interpretations by private litigants, fundamentally altering the balance of power and substantially leveling the playing field between agencies and those whom they regulate.

On July 2, just two business days after the *Loper Bright* decision, the petitioners in the Eleventh Circuit case supplemented their brief asserting that *Loper Bright* refutes the SEC's

position that the "political and economic significance" of an agency action is insufficient to trigger the major questions doctrine.[10] The petitioners asserted that because the SEC does not, and cannot, deny that the CAT is consequential, a delegation of authority from Congress is required that is not present here.

Petitioners also asserted that "Loper forecloses the SEC's assertion that this Court 'should defer to' its interpretation of [the Exchange Act]" because "courts 'must exercise their independent judgment in deciding whether an agency has acted within its statutory authority,' which requires 'deploying [their] full interpretive toolkit' to determine the 'best meaning' of the statute." [11]

The SEC responded that "Loper Bright is irrelevant because the Commission did not rely on or ask for Chevron deference." [12] The commission, however, asserted in a footnote that "[b]ecause the creation of CAT plainly falls within the Commission's authority, the Court need not address whether the Commission's interpretation is entitled to deference. But were it to reach that issue, it should 'defer to the [Commission's] interpretation' because it is 'reasonable.'" [13]

With the matter fully briefed, the Eleventh Circuit is now positioned to review the SEC's authority over the CAT. [14]

While the SEC contends that it is not asking for Chevron deference, the Loper Bright decision potentially affects the SEC's legal position if the court rejects the commission's argument that its authority to promulgate the CAT is clear. If the court concludes that its authority is unclear, the commission will face greater scrutiny than it would have pre-Loper Bright on its arguments that its interpretation of the Exchange Act is reasonable and that Congress delegated the SEC the necessary statutory authority to require the industry to adopt the CAT and bear its cost.

Without the availability of Chevron deference, the playing field has been substantially leveled, and the Eleventh Circuit is now free to consider and weigh the petitioners' competing interpretation irrespective of whether the SEC's interpretation is reasonable.

Accordingly, as the CAT litigation unfolds in the Eleventh Circuit, the implications of the Loper Bright decision loom large. The outcome could complicate government agencies' ability to impose reporting requirements on the industries they regulate — reporting requirements that provide the agencies with the information they need to satisfy their statutory mandates, accomplish their missions, and, in the case of the SEC, conduct appropriate market oversight, surveillance, enforcement and investor protection functions.

Back to the Flash Crash

Regulators are often criticized for not doing enough after a financial or market crisis to address the root causes of the problem and anticipate future crises. They are also criticized if they overreact — regulatory reaction may lead to overreach, with burdens and costs on industry that can stifle competition, cause inefficiency, and increase expenses.

Here, in addition to other rulemaking, the SEC responded to the flash crash by revealing its lack of timely access to market data and its inability to quickly reconstruct the markets when the flash crash occurred.

Given the commission's long-standing mission to protect investors and maintain fair, orderly and efficient markets, as well as its broad authority under the Exchange Act, the

commission's views of its need for the CAT do not appear to be unreasonable. Nor does the elimination of Chevron deference mean that the court cannot give substantial weight to the commission's interpretation of the Exchange Act or defer to its expertise, provided that it conducts an independent evaluation of, and weighs, the petitioners' competing interpretation and arguments "to determine the best reading of the statute." [15]

Nevertheless, the Eleventh Circuit will consider whether Congress conferred such broad authority on the SEC under the Exchange Act that the commission had the authority to promulgate new reporting requirements and require the industry to absorb their cost. If the answer is no, it raises the question of whether it should have taken an act of Congress for the commission to obtain the data it needs to regulate markets where trillions of dollars in investor assets are at risk. The future of the CAT, the SEC's authority to develop and maintain a national market system, and billions of dollars in expense to the industry hang in the balance.

By eliminating Chevron deference, Loper Bright is a game-changer, timely intersecting with the pending high-stakes legal battle over the CAT in the Eleventh Circuit. Whether the CAT becomes a cornerstone of market oversight or a cautionary tale of costly regulatory overreach remains to be seen. What is clear is that Loper Bright could not have come at a worse time for the SEC as it seeks to defend the CAT against a petition in the Eleventh Circuit without the availability of Chevron deference.

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Disclosure: Hawke led the Division of Enforcement's investigation of the flash crash.

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[1] <https://www.sec.gov/news/speech/2010/spch052610mls-audit.htm>.

[2] SEC.gov | SEC Approves New Rule Requiring Consolidated Audit Trail to Monitor and Analyze Trading Activity.

[3] American Securities Association, et al v. U.S. Securities and Exchange Commission, No. 23-13396, 11th Cir. (Oct. 17, 2023) ("ASA Action").

[4] Loper Bright Enterprises v. Raimondo Relentless, Inc. v. Department of Commerce, 603 U.S. ___, 144 S. Ct. 2244 (Slip Op. June 28, 2024) ("Loper Bright").

[5] ASA Action, Appellee's Brief filed by Respondent U.S. Securities and Exchange Commission, Docket No. 96, at 5.

[6] Id.

[7] ASA Action, Appellant's Brief filed by American Securities Association and Citadel

Securities LLC, Docket No. 49 at 1-2.

[8] Id. at 3.

[9] Id. at 23-27.

[10] ASA Action, Supplemental Authority filed by Petitioners Citadel Securities LLC and American Securities Association. Docket Entry 110.

[11] Id.

[12] ASA Action, Response to Supplemental Authority filed by Respondent U.S. Securities and Exchange Commission. Docket Entry 111.

[13] ASA Action, Brief for Respondent Securities and Exchange Commission, Docket Entry 96 at 48, n.6.

[14] Oral argument is scheduled for January 2025. Citadel has filed a motion for a stay which has been fully briefed but the 11th Circuit has not yet ruled as of the publication date of this article.

[15] Loper Bright, Slip. Op. at 23.