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District Court Rejects CFTC Rule on Position Limits, for Now

By **Craig Enochs**, **Dan Nossa**, **Kevin Page**, and **Joseph Guajardo**

On September 28, 2012, in the case of *International Swaps and Derivatives Association v. U.S. Commodity Futures Trading Commission*, the District Court for the District of Columbia (the "Court") ruled that the Commodity Exchange Act ("CEA"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was ambiguous as to whether the CFTC was required to set position limits without first determining that the limits were necessary and appropriate.¹

On October 18, 2011, the CFTC adopted the Position Limits Rule, which would cap the maximum number of contracts a trader can own during a given period and would require traders to aggregate positions held in multiple accounts. The rule would impact derivatives tied to 28 physical commodities. In promulgating the final rule, the CFTC viewed Section 6a of the Commodity Exchange Act of 1936 as an unambiguous congressional mandate that required the Commission to issue and implement the new rule.

According to the CFTC, the Dodd-Frank amendments eliminated its discretion on the issue of position limits and altogether dispensed with its longstanding obligation to make necessity findings in its rulemakings. The International Swaps and Derivatives Association ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") brought suit to challenge the CFTC's rulemaking process by arguing that the CFTC's obligation to impose position limits under Dodd-Frank does not arise *until* it finds that the limits are necessary and appropriate. The two industry associations claimed that the CFTC misinterpreted its authority under the CEA by issuing the new rule in the absence of a necessity determination. The associations also raised claims asserting that the CFTC failed to evaluate the costs and benefits of the rule and that it violated the Administrative Procedure Act, but the Court declined to rule on those broader claims.²

In reaching the "necessary" and "appropriate" issue, the Court noted the wide disparity between the interpretations of the parties:

"[a]lthough both sides forcefully argue that the statute is clear and unambiguous, their respective interpretations lead to two very different results: one which mandates the Commission to set position limits without regard to whether they are necessary or appropriate, and one which requires the Commission to find such limits are necessary and appropriate before imposing them."³

The CFTC argued that Congress restricted its discretionary authority in Section 6a(a)(2) of the CEA, which states that "the Commission *shall* by rule, regulation, or order establish limits on the amount of

positions, as appropriate."⁴ Furthermore, the CFTC argued, Congress referred to the limits as "required" and imposed time limits and reporting requirements on the agency.⁵

While the Court agreed that "Congress used traditionally mandatory language throughout the Dodd-Frank amendments to Section 6a," those provisions could not be easily reconciled with other portions of the CEA which appear to leave the agency discretion on whether or not to impose limits.⁶ Most notably, the first clause of Section 6a(a)(2) instructs the CFTC to set position limits "[i]n accordance with standards set forth in paragraph (1) of this subsection."⁷ Section 6a(a)(1) states that:

"...the Commission shall, from time to time...proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person...as the Commission finds are necessary to diminish, eliminate, or prevent such burden [on interstate commerce]."⁸

The Court noted that the use of the terms "from time to time" and "as the Commission finds are necessary" in 6a(a)(1) left considerable discretion to the CFTC to impose position limits and "clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits."⁹ The Court found that this express reference to the discretionary standard cast doubt on the "mandate" the CFTC claimed to exist in Section 6a(a)(2). The CFTC argued that the term "standards" in Section 6a(a)(2) referred instead to the aggregation standards of Section 6a(a)(1) and not the necessity standard. The Court dismissed this argument, finding that it was "not based on any reasoned interpretation in which the CFTC engaged at the agency level."

Ultimately, the Court declined to endorse either view, instead holding that "the Dodd-Frank amendments [to the CEA] do not constitute a clear and unambiguous mandate to set position limits."¹⁰ Since the CFTC "fundamentally misunderstood and failed to recognize the ambiguities in the statute, "its interpretation of the CEA was erroneous and therefore entitled to no deference."¹¹ The Court stopped short of finding that a determination of necessity would be required before the agency could issue rules on position limits. Instead, it narrowly held that the Dodd-Frank amendments were ambiguous and that the agency needed to "bring its experience and expertise to bear...to resolve the ambiguities in the statute" rather than "rest simply on its parsing of the statutory language."¹²

The Court vacated the Position Limits Rule and remanded the matter back to the CFTC for reconsideration. The Court held that vacating the rule was appropriate in this case since the rule has not yet gone into effect and "according to both parties is a significant and unprecedented change in the operation of the commodity derivatives market."¹³ The Court believed that maintaining the status quo in the interim would be far less disruptive than later vacating the rule after it took effect.¹⁴

The Position Limits Rule was scheduled to take effect on October 12, 2012. In light of this holding, implementation is unlikely as of the planned effective date and it remains unclear how and when the CFTC will address the Court's concerns with the rule.

We will continue to monitor the status of the Position Limits Rule in order to provide relevant updates. If you have any questions, please contact **Craig Enochs** at 713.752.4315 or cenochs@jw.com, **Dan Nossa** at 713.752.4327 or dnoosa@jw.com, or **Kevin Page** at 713.752.4227 or kpage@jw.com.

¹ *International Swaps and Derivatives Association v. U.S. Commodity Futures Trading Commission*, 11-02146, U.S. District Court, District of Columbia (Washington).

² Opinion at 9, 39.

³ Opinion at 10.

⁴Opinion at 12 (emphasis added).

⁵Opinion at 33.

⁶Opinion at 33.

⁷Opinion at 25.

⁸Opinion at 15.

⁹Opinion at 15.

¹⁰Opinion at 36.

¹¹Opinion at 42.

¹²Opinion at 38.

¹³Opinion at 43.

¹⁴Opinion at 43.

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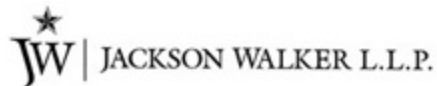
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