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TAX AND FINANCIAL SERVICES CLIENT ALERT

LEGAL CHALLENGE TO CFTC POSITION LIMITS RULE

On September 28, 2012, the U.S. District Court for the District of Columbia struck down the Commodity Futures Trading Commission's (CFTC) final rule on position limits, which was enacted as part of the agency's implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[1] The rule applied position limits to swaps and other derivatives, limited available hedging exemptions, and imposed stricter aggregation requirements.

This recent Court decision, coupled with pending legal challenges as well as the increasing threat of additional legal challenges to Dodd-Frank rulemakings, has raised questions within the financial services industry and among regulators regarding the scope of the CFTC's, among other agencies, authority and the timing for Dodd-Frank rulemaking implementation. We believe the Court decision may further delay the Dodd-Frank rulemaking process and encourage additional legal challenges to the Dodd-Frank Act as well as potentially compel lawmakers to revisit the Dodd-Frank Act in whole or in part.

Background: Position Limits Final Rule

The position limits final rule was adopted by a 3 – 2 vote by the CFTC in October 2011. When they voted on the rule, some CFTC Commissioners expressed concerns regarding the need for a position limits rule and its potential impact. Ultimately, the Commission adopted the rule because it concluded that "Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously."[2]

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).
[2] 76 Fed. Reg. at 71,628 (Nov. 18, 2011).

CFTC Commissioner Michael Dunn, now senior policy advisor at Patton Boggs, voted in the majority with Chairman Gary Gensler and Commissioner Bart Chilton only because he believed Congress had required the CFTC to impose position limits.[3] In fact, in public discussions regarding the proposed rule Commissioner Dunn noted, "to date CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the market we regulate or that position limits will prevent excessive speculation."[4] Similarly, in a recent media interview, Chairman Gensler reiterated his belief that "it was a clear message from Congress intent" that the CFTC impose position limits.[5]

The position limits final rule modified CFTC's Part 150, regarding existing aggregation standards. Further, the rule codified, in Part 151, aggregation requirements for contract positions in accounts (i) for which the person "directly or indirectly holds positions or controls trading" and (ii) held by the person and one or more other persons "acting pursuant to an expressed or implied agreement or understanding […] as if the positions were held by, or trading of the positions were done by, a single individual."[6] Part 151 set limits on the amount of positions that a particular trader could hold in "28 physical commodity futures and option contracts and physical commodity swaps that are economically equivalent to such contracts."[7]

Challenge to Position Limits Final Rule

On December 2, 2011, the International Swaps and Derivatives Association (ISDA) and Securities Industry and Financial Markets Association (SIFMA), filed a complaint against the CFTC in the U.S. District Court for the District of Columbia. In its complaint, ISDA and SIFMA claimed that the statutory authority granted to the CFTC by the Dodd-Frank Act, required the agency to find that the position limits rule was "necessary" and "appropriate" to diminish, eliminate, or prevent certain burdens on interstate commerce.

After reviewing the statutory authority language, the Court concluded that the statutory provisions were ambiguous as to whether a position limits rule had to be predicated on a finding by the CFTC that such position limits were "necessary" or "appropriate." The Court's emphasis on the statute's use of the word "may" in granting the CFTC the authority to set limits was central in its analysis. As a result, the Court vacated the rule and remanded it to the CFTC for the agency to exercise its own judgment on whether the statute compels it to impose a position limits rule or whether a "necessary" and "appropriate" finding is required to impose such rule. The Court's decision is important because it highlights the importance of statutory construction and impliedly sends a message to the Congress that, if it desires to have an agency act in a certain way, it must clearly and unambiguously state its intent. In addition, while the decision is narrow in that it addresses the Position Limit only, it may provide a roadmap to litigants on how to frame a challenge to an agency's decision and avoid having a court give deference to the regulatory agency.[8]

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[3] Int'l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission, Civil Action No. 11-cv-2146, Mem. Op. 6 (D.C., Sept. 28, 2012).
[4] Transcript of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act, at 13 (Oct. 18, 2011).
[5] Reuters, Remarks by Chairman Gensler (transcript), *CFTC's Gensler Mulls Next Step for Position Limits* (Oct. 2, 2012), *available at* http://www.reuters.com/video/2012/10/02/cftcs-gensler-mulls-next-step-for-positi?videoId=238128856&videoChannel=1.
[6] 76 Fed. Reg. at 71,692 (Nov. 18, 2011).
[7] *Id.; see also* CFTC, Q & A - Position Limits for Futures and Swaps, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_qa_final.pdf (listing the 28 core referenced futures contracts: nine "legacy" agricultural contracts: (1) CBOT Corn (C); (2) CBOT Oats (O); (3) CBOT Soybeans (S); (4) CBOT Soybean Meal (SM); (5) CBOT Soybean Oil (BO); (6) CBOT Wheat (W); (7) ICE Futures U.S. Cotton No.2 (CT); (8) KCBT Hard Winter Wheat (KW); and (9) MGEX Hard Red Spring Wheat (MWE); ten non-"legacy" agricultural contracts: (1) CME Class III Milk (DA); (2) CME Feeder Cattle (FC); (3) CME Lean Hog (LH); (4) CME Live Cattle (LC); (5) CBOT Rough Rice (RR); (6) ICE Futures U.S. Cocoa (CC); (7) ICE Futures U.S. Coffee C (KC); (8) ICE Futures U.S. FCOJ-A(OJ); (9) ICE Futures U.S. Sugar No. 11 (SB); and (10) ICE Futures U.S. Sugar No. 16 (SF); four energy contracts: (1) NYMEX Henry Hub Natural Gas (NG); (2) NYMEX Light Sweet Crude Oil (CL); (3) NYMEX New York Harbor Gasoline Blendstock (RB); and (4) NYMEX New York Harbor Heating Oil (HO); five metal contracts: (1) COMEX Copper (HG); (2) COMEX Gold (GC); (3) COMEX Silver (SI), (4) NYMEX Palladium (PA); and (5) NYMEX Platinum (PL)).
[8] Int'l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission, Civil Action No. 11-cv-2146, Mem. Op. 36 (D.C., Sept. 28, 2012) (*quoting* Arizona v. Thompson, 281 F.3d 248, 253 (D.C. Cir. 2002) (stating, "[d]eference to an agency's statutory interpretation is only appropriate when the agency has exercised its own judgment, not when it believes that interpretation is compelled by Congress").

The Court did not opine as to whether the CFTC may use its discretion to construe the statute as compelling imposition of position limits without a "necessary" or "appropriate" finding. Further, the Court did not address the validity of the aggregation requirements under CFTC Part 150, or the plaintiffs' claims regarding inadequate cost-benefit analysis, arbitrary and capricious conduct, and failure to provide interested persons a sufficient opportunity to participate in the rulemaking.[9]

Legal Challenges to Agency Rulemakings

This is not the first legal challenge to the implementation of regulatory agency rulemakings. In 2010, the U.S. Chamber of Commerce and Business Roundtable filed a lawsuit to overturn the Securities and Exchange Commission's (SEC) "proxy access" rule, which required publicly traded corporations and investment firms to disseminate information about board nominations made by shareholders. The Court in that case found that the SEC acted in an "arbitrary and capricious" manner, failing to conduct a proper cost-benefit analysis.

Recently, the Attorneys General of Michigan, Oklahoma, and South Carolina challenged the Dodd-Frank Act provision that empowers the Secretary of the Department of Treasury to order the liquidation of failing financial institutions.[10]

These Court decisions, combined with the very real threat of continued legal challenges, will increase the pressure and burdens that rule-making agencies face when implementing Dodd-Frank Act provisions. As a result, the timeline for implementation of the Dodd-Frank Act may be prolonged, as regulatory agencies seek to avoid promulgating rules that will not withstand judicial scrutiny.[11]

The Court's decision on the CFTC's position limits rule may also impact Congress' ability to pass legislation clarifying or altering the provisions of the Dodd-Frank Act, as legislators, regulators, and the industry may see the need for legislative action to cure ambiguities in the Dodd-Frank Act. Since the Dodd-Frank Act passed, thirty-five pieces of legislation have been introduced in the House and twelve in the Senate in the 112th Congress, and six pieces of legislation were introduced in the House in the 111th Congress. Only five of these bills have passed the House, and none have been signed into law. The results of ensuing elections will undoubtedly have an impact on the future implementation of the Dodd-Frank Act and the next Congress will face difficult questions regarding potential modifications to the Dodd-Frank Act, and these will not be easy to undertake in a divided Congress.

Looking Forward: The Road Ahead

The Court's decision vacates CFTC's Part 151 but it does not vacate the amendments to CFTC Part 150, which increase certain pre-existing speculative position limits as noted above.[12] As a result, the current rules governing speculative position limits (i.e., Part 150), will remain in effect for now.[13]

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[9] The Court noted that the CFTC is "reviewing and possibly revising its aggregation policies." For this reason, the Court stated that its decision "would merely maintain the status quo and cause far less disruption than vacating the regime after it has gone into effect." *See* Int'l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission, Civil Action No. 11-cv-2146, Mem. Op. 36 (D.C., Sept. 28, 2012).

[10] This case is ongoing (Case No. 1:12-cv-01032).

[11] As an example, as a result of the claim against the SEC's proxy access rule, the SEC announced an updated regulatory timeline, which noted that new disclosure requirements may not take effect until the 2013 proxy season.

[12] The Court noted that the Commission is revisiting seven aggregation positions of the final rule. For this reason, the Court did not determine whether the aggregation standards in the final rule were arbitrary and capricious or violate the cost-benefit analysis. However, the Court noted that, "[b]ecause the entire rule will be vacated, the Commission can on remand, if it so chooses, modify and finalize any aggregation rules as part of any new regime it may promulgate." Int'l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission, Civil Action No. 11-cv-2146, Mem. Op. 32-33 (D.C., Sept. 28, 2012).

[13] Further information regarding the provisions that remain in effect is available by contacting Micah Green at msgreen@pattonboggs.com.

The CFTC may, with a 3 – 2 vote, choose to appeal the Court's decision and file a stay of the Court's decision so that the agency can attempt to re-write the rule. In a speech at the G-20 AMIS Roundtable on October 2, 2012, Commissioner Chilton stated that "the Agency should immediately appeal the Court decision and seek a stay in order to allow us to go forward." Experts speculate that such appeal would likely be unsuccessful. He also suggested drafting a revised rule to satisfy the objections raised by the Court, and provide an expedited time frame "with a short comment period, perhaps 15 days." Additionally, legislators who have pushed for position limits, such as Bernie Sanders (I-VT) and Maria Cantwell (D-WA), may try to amend the law to make position limits mandatory, by attaching an amendment to must-pass legislation that Republican leaders in the House would not want to lose. However, the Republican-controlled House can be expected to block such attempts at amending the law.