IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC. and SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, Plaintiffs, v. UNITED STATES COMMODITY FUTURES TRADING COMMISSION, Defendant.	Civil Action No. 11-CV-2146 (RLW)

PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

COME NOW PLAINTIFFS International Swaps and Derivatives Association, Inc. and Securities Industry and Financial Markets Association and hereby respectfully move this Court to enter summary judgment for Plaintiffs on all claims.

This motion is supported by the Memorandum of Points and Authorities filed concurrently herewith.

Dated: March 23, 2012

Respectfully submitted,

/s/ Miguel A. Estrada

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PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT

Dated: March 23, 2012

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OTHER AUTHORITY

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, Plaintiffs respectfully move for an order of summary judgment vacating a rule promulgated by the Commodity Futures Trading Commission ("CFTC" or "Commission"), which imposes position limits on derivatives contracts related to twenty-eight different physical commodity futures contracts. *See* Position Limits for Futures and Swaps; Final Rule and Interim Final Rule, 76 Fed. Reg. 71,626 (Nov. 18, 2011) ("Position Limits Rule" or "Rule").

INTRODUCTION

This case challenges an unlawful regulation that imposes onerous new restrictions on trading in the commodity derivatives markets—including limits on the size of the positions market participants may hold in various contracts linked to commodities. The Commission promulgated the Rule in violation of the Commodity Exchange Act, 7 U.S.C. §§ 1, *et seq*. ("CEA"), and the most elementary requirements of the Administrative Procedure Act, 5 U.S.C. §§ 500, *et seq*. ("APA")—even though a majority of its five Commissioners concluded that the Rule is unnecessary and risks harm to investors, markets, and consumers, at a time when the Nation is struggling to recover from the worst economic collapse since the Great Depression.

Three Commissioners disregarded these many defects and risks and adopted the Rule, claiming that the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act"), compelled them to do so—however deleterious the consequences may be. Relying on that same reasoning, they concluded that they were excused from performing the duties the law requires of rulemaking agencies. For example, the CEA, which governs the Commission's rulemaking authority, expressly directs the Commission to analyze the consequences, including the costs and benefits, of potential position limits before adopting them. 7 U.S.C. § 19(a). The Act also authorizes the Commission to impose position limits only after finding that those limits are "necessary" to combat the negative

effects (if any) of excessive speculation. *Id.* § 6a(a)(1). Far from reversing that requirement, the Dodd-Frank Act incorporated it into its new provisions, and provided that the Commission can "establish limits on the amounts of positions" only "as appropriate." *Id*. § 6a(a)(2). Yet, in adopting the new position limits, the Commission made no finding that they were necessary; it made no finding that they were appropriate; and it conducted no meaningful cost-benefit analysis. The Commission disregarded vital evidence in the administrative record. And it failed to articulate a reasoned basis for its decision to adopt the Rule as a whole, to regulate the particular commodity contracts it did, to set its position limits at the particular levels it chose, and to adopt numerous discrete provisions related to the application of the limits.

The Commission's view that this Rule, apart from all others, was exempt from the core tenets of administrative law tainted the rulemaking process and led it to adopt a regulation that is replete with error. Spurned by a majority of the Commissioners themselves, and irreconcilable with the commands of the CEA and APA, the Position Limits Rule should be vacated.

STATEMENT OF FACTS

A. The Commodity Exchange Act And The Commission's "Position Limits" Authority

Commodity derivatives markets are crucial to the U.S. economy. They enable producers and consumers to hedge against price fluctuations in everything from coffee to copper to crude oil and ultimately reduce the cost of goods for consumers. As Congress has observed, transactions involving commodity derivatives "provid[e] a means for managing and assuming price risks, discovering prices, [and] disseminating pricing information." 7 U.S.C. § 5(a).

The Commission regulates commodity derivatives markets pursuant to the CEA. First enacted in 1936 (as an amendment of the Grain Futures Act of 1922), the CEA authorizes the Commission to establish a comprehensive scheme of regulation for futures and options contracts in agricultural, metallurgical, energy, and other commodities, and the private exchanges on

which they are traded.[1] A futures contract is a standardized contract, developed by exchanges such as the Chicago Mercantile Exchange ("CME"), for the purchase or sale of a set quantity of a specified commodity (*e.g.*, natural gas) at a particular date and location.[2] Depending on the contract's terms, it can be satisfied either by physical delivery of the commodity to the buyer or by a cash transfer equal to the difference between the price set forth in the contract and the market price at the time the contract expires. An options contract is similar but confers the right (not the obligation) to buy or sell.

The CEA permits the Commission to establish "position limits"—a maximum number of contracts, net long or short, that an investor or group of investors may own during a given period. The CEA authorizes the Commission to "fix such limits on the amounts of trading which may be done or positions which may be held by any person" in contracts traded on commodity markets "as the Commission finds are necessary to diminish, eliminate, or prevent" an "undue and unnecessary burden on interstate commerce" caused by "[e]xcessive speculation." 7 U.S.C. § 6a(a)(1).

A separate provision of the CEA requires the Commission to evaluate the costs and benefits of any new rule. It provides that when a rule is promulgated, "[t]he costs and benefits of the proposed [rule] shall be evaluated in light of—(A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations." 7 U.S.C. § 19(a). This provision reflects Congress's understanding that Commission regulations, including position

[1] Commodity exchanges are commonly referred to as "contract markets," "Designated Contract Markets," or "DCMs."

[2] *See*, *e.g.*, http://www.cmegroup.com/trading/agricultural/grain-and-oilseed/oats_contract_specifications.html.

limits, that are inadequately tailored to the problem they purport to address can be detrimental to the markets.

The Commission first began establishing position limits shortly after the passage of the CEA in 1936. *See* 3 Fed. Reg. 3,145 (Dec. 24, 1938). Each time it established a new position limit with respect to a given commodity, the Commission made the statutorily required finding that a position limit was "necessary to diminish, eliminate, or prevent" an undue burden caused by excessive speculation.[3] In 1981, the Commission promulgated a rule that generally required private exchanges to set position limits for all commodities that were not subject to Commission-set limits. *See* 46 Fed. Reg. 50,938 (Oct. 16, 1981). In the 1990s, however, the Commission liberalized its approach, introducing a regime in which most commodities were not subject to position limits outside of the spot month but rather were governed by flexible "accountability levels" administered by exchanges, whereby investors with large positions were required to disclose information to the exchanges about their positions upon request. 17 C.F.R. §§ 38 app. B (Core Principle 5), 150.5(e)(3). The Commission ultimately codified "core principles" instructing exchanges to set position limits only where "necessary." *Id.* § 38 app. B (Core Principle 5). This framework was consistent with provisions of the CEA requiring exchanges to set limits or accountability rules "where necessary and appropriate." 7 U.S.C. § 7(d)(5).

At the time the Position Limits Rule at issue here was promulgated, the Commission's regulations imposed position limits on only nine agricultural commodity futures and options contracts—with the remainder of position limits or accountability levels set by exchanges. 17 C.F.R. §§ 150.2, 150.5. The preexisting position limits were subject to various exemptions for

[3] 3 Fed. Reg. 3,145 (Dec. 24, 1938); 5 Fed. Reg. 3,198 (Aug. 28, 1940); 16 Fed. Reg. 8,106 (Aug. 16, 1951); 18 Fed. Reg. 443 (Jan. 22, 1953); 18 Fed. Reg. 444 (Jan. 22, 1953); 18 Fed. Reg. 445 (Jan. 22, 1953); 21 Fed. Reg. 5,575 (July 25, 1956).

"bona fide hedging"—generally, circumstances in which a position is held to offset economic risk from trading of the underlying commodity. *See id.* §§ 1.3(z), 150.3(a). The limits were also subject to "aggregation" rules, which dictate when positions in multiple accounts must be combined for purposes of applying the limits. *See id.* § 150.4.

B. The Dodd-Frank Act And The Proposed Rule

In 2010, Congress enacted the Dodd-Frank Act, which amended the CEA to authorize the Commission to set position limits not only for futures and options contracts, but also for instruments called "swaps." 7 U.S.C. § 6a(a)(1). Although not yet fully defined by regulation, swaps are derivative instruments (most of which are transacted over-the-counter) that involve exchanges of payments based on changes in the prices of specified underlying commodities. Unlike futures and options contracts, swaps are not standardized by exchanges but rather are negotiated between the parties to the contract. Swaps vary widely in their specifications, can involve multiple commodities, and may include complex settlement and timing provisions.

The Dodd-Frank Act also amended the CEA to provide that "the Commission shall by rule, regulation, or order establish limits on the amount of positions, *as appropriate*, other than bona fide hedge positions, that may be held by any person with respect to" futures and options contracts traded on exchanges. 7 U.S.C. § 6a(a)(2) (emphasis added). The Dodd-Frank Act included a similar provision with respect to swaps. *Id.* § 6a(a)(5). Each of these two provisions (by cross-reference to another) requires the Commission to exercise "its discretion" in setting position limits "as appropriate," so that, "to the maximum extent practicable," they accomplish certain statutory objectives, among them "ensur[ing] sufficient market liquidity for bona fide hedgers" and "ensur[ing] that the price discovery function of the underlying market is not

disrupted." *Id.* § 6a(a)(3)(B). Congress thus contemplated that inappropriately strict position limits could impede important functions of the market.

On January 26, 2011, the Commission issued a notice of proposed rulemaking ("Notice") to set new position limits. 76 Fed. Reg. 4,752 (Jan. 26, 2011). The Notice proposed position limits on contracts tied to 19 physical commodities beyond the nine agricultural commodities that were previously subject to the Commission's limits. *See id.* at 4,768–69. It also proposed to extend all position limits to swaps for the first time and to make the hedging exemptions and aggregation rules more restrictive. *See id.* at 4,752, 4,760–62. The Notice acknowledged that the "basic statutory mandate . . . to establish position limits to prevent 'undue burdens' associated with 'excessive speculation' has remained unchanged" and stated that the Dodd-Frank Act "reaffirm[ed] the Commission's authority to establish position limits *as it finds necessary in its discretion* to address excessive speculation." *Id.* at 4,754–55 (emphasis added). Despite recognizing the Commission's obligation to make a necessity finding, the Notice did not provide any evidence that position limits were necessary to curb excessive speculation, aside from citing a 1926 study by the Federal Trade Commission concluding that a "very large trader by himself may cause important fluctuations in the market." *Id.* at 4,754 n.14.

During the rulemaking, it became apparent that a majority of Commissioners were unlikely to conclude that new position limits were necessary to curb excessive speculation. In fact, a majority concluded that the new limits would be ineffective and even harmful. At an open meeting shortly before the Notice issued, Commissioner Dunn observed that preexisting position limits appeared not to work, because "[p]rice volatility exists in markets that have position limits and in markets that do not have position limits." Tr. of Open Meeting on the Ninth Series of

Proposed Rulemakings Under the Dodd-Frank Act (Jan. 13, 2011), at 8.[4] He noted that "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." *Id.* at 9. "With such a lack of concrete economic evidence," he said, "my fear is at best position limits are a cure for a disease that does not exist, or at worst it's a placebo for one that does." *Id.* Nonetheless, he announced that he was "voting for the proposed rules on position limits in order to gather more information." *Id.* "If there is evidence that position limits will lower the price we pay for gas, milk and steak while simultaneously ensuring the integrity of our markets in the price discovery process, we need to see it. Only after these questions have been answered will I be able to determine whether or not position limits are appropriate." *Id.* at 10. Concerns similar to Commissioner Dunn's were also voiced by two other Commissioners who voted against the rulemaking.

During the comment period, members of the public "cited over 52 studies by institutional, academic, and industry professionals" relating to the need for and efficacy of position limits. 76 Fed. Reg. at 71,663 n.372. "Thirty-eight of the studies were focused on the impact of speculative activity in futures markets, *i.e.*, how the behavior of non-commercial traders affected price levels." *Id.* at 71,663. These studies demonstrated "virtually unanimous academic agreement that commodity price changes have been driven by fundamental market conditions, not by speculation." CME Group Comment, at 4 (Mar. 28, 2011). They included reports by the Government Accountability Office, the Organization for Economic Cooperation and Development ("OECD"), the European Commission, and the Commission itself (as part of an interagency task force). *Id.* The OECD study, for example, found that "[t]here is no

[4] *Available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission4_011311-transcri.pdf.

statistically significant relationship indicating that changes in index and swap fund positions [in agricultural and energy commodities] have increased market volatility."[5] The GAO paper—which conducted a "review of studies analyzing the impact that index traders and other futures speculators have had on commodity prices"—reported that there is "limited statistical evidence of a causal relationship between speculation in the futures markets and changes in commodity prices."[6]

Other studies cited by commenters reached similar conclusions. For example, a 2009 study by Professor Celso Brunetti of Johns Hopkins University and Bahattin Buyuksahin of the International Energy Agency analyzed data collected by the Commission itself and found "that speculative activity does not affect prices" and "actually reduces volatility." Brunetti & Buyuksahin, *Is Speculation Destabilizing?*, Working Paper Series, at 4 (2009). A 2009 study conducted by an economist at the Divisions of Research & Statistics and Monetary Affairs of the U.S. Federal Reserve found "no evidence that speculative activity in futures markets for industrial metals caused higher spot prices in recent years." Korniotis, *Does Speculation Affect Spot Price Levels?*, Federal Reserve Board (2009). Likewise, the International Organization of Securities Commissions ("IOSCO")—an organization to which the Commission belongs (*see* 76 Fed. Reg. at 71,658)—concluded in 2009 that "[r]eports by international organizations, central banks and regulators . . . suggest that economic fundamentals, rather than speculative activity, are a plausible explanation for recent price changes in commodities." IOSCO, Task Force on Commodity Futures Markets Final Report, at 3 (2009). One study that IOSCO examined, produced by the IMF, found that there was no "evidence of systematic causality between positions and prices in either direction" and that "the direction of financial flows was often

[5] *Available at* http://www.oecd.org/dataoecd/16/59/45534528.pdf (p.1).

[6] *Available at* http://www.gao.gov/new.items/d09285r.pdf (p.5).

inconsistent with the direction of price movements." *Id.* at 8 & n.12 (quotation marks omitted). "For example, while crude oil prices rose sharply in May and June 2008, net speculative positions *declined*." *Id.* (emphasis added; quotation marks omitted).

Studies in the record also showed that position limits were ineffective at reducing price volatility. One study examined speculative activity before and after a 2005 decision by the Chicago Board to raise (i.e., relax) position limits. *See* Irwin *et al.*, Working Paper, *The Performance of Chicago Board of Trade Corn, Soybean, and Wheat Futures Contracts After Recent Changes in Speculative Limits*, at 1 (2007). The study found "no large change in measures of volatility after the change in speculative limits," and so concluded that "there is little to suggest that the change in speculative limits has had a meaningful overall impact on price volatility to date." *Id.* at 16. Commenters also cited a "wealth of empirical evidence supporting the view that the proposed hard position limits . . . would actually be *counterproductive* by decreasing liquidity . . . which, in turn, would likely increase both price volatility and the cost of hedging." CME Group Comment, at 2. A 2011 study found that "[b]inding position limits . . . inhibit the freedom of hedgers, thereby reducing the overall endogenous hedging demand and volume of trade (i.e., liquidity)," and in so doing "augment market power of speculators (along with other agents) instead of diminishing it." Ebrahim, Working Paper, *Can Position Limits Restrain "Rogue" Trading?*, at 9 (2011) (cited at 76 Fed. Reg. at 71,664 n.378). "Instead of curtailing price swings," the study concluded, position limits "could exacerbate them." *Id.* at 27.

Numerous commenters echoed the view that position limits are unnecessary and would impose tremendous costs on market participants and the U.S. economy. Electric power companies told the Commission that its proposed "approach likely will make the U.S. derivatives markets less efficient and more expensive for commercial entities seeking to manage the risks

they incur in their businesses." Edison Electric Institute et al. Comment, at 2 (Mar. 28, 2011). Commodity exchanges anticipated that "[t]he imposition of unnecessary constraints on legitimate speculative trading will only deprive the market of essential liquidity with resulting harm to the U.S. futures markets and their participants." Commodity Markets Council Comment, at 2 (Mar. 28, 2011). For their part, Plaintiffs explained that the proposed rules would impose "significant financial and regulatory burdens . . . on market participants" and result in a "loss of liquidity, increase in volatility in commodity markets and increased hedging costs." ISDA-SIFMA Comment, at 6 (Mar. 28, 2011).

In addition to these broad challenges to the Commission's proposal, each important element of the proposed rule—for example, the choice of commodities to regulate, the specific formulas adopted, the aggregation rules, and the hedging exemptions—was vigorously contested by commenters, who proposed alternative regulatory approaches. *See*, *e.g.*, *infra* at 34–45.

C. Adoption Of The Final Rule

The Commission nevertheless elected to adopt the Position Limits Rule on October 18, 2011, by a 3-2 vote. 76 Fed. Reg. at 71,699. In the hearing in which the Rule was approved, Commissioner Dunn—who provided the crucial third vote for the Rule—made clear that the comment period had failed to resolve the misgivings he had expressed at the outset of the rulemaking. The Commission staff, he found, had not mustered "any reliable economic analysis to support either the contention that excessive speculation is affecting the market we regulate or that position limits will prevent the excessive speculation." Tr. of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act (Oct. 18, 2011) ("Oct. 18 Tr."), at 13.[7] "[P]osition limits may harm the very markets we're intending to protect," he warned, predicting that

[7] *Available at* http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_26_PosLimits/dfsubmission7_101811-trans.

"position limits and the rules that go along with them may make it actually more difficult to hedge the risks that [producers] take on in order to provide the public with milk, bread, and gas." *Id.* at 12, 14. Commissioner Dunn said that he was voting for the Rule *only* because he interpreted the Dodd-Frank Act amendments to *require* the Commission to impose position limits. *Id.* at 11.

During the hearing, the Commission's staff admitted that it had failed to conduct any inquiry into whether excessive speculation was a real problem with respect to any of the derivatives that the Rule regulates. The Acting Director of the Commission's Division of Market Oversight, for example, could not answer "yes" to the question whether he "actually believe[d] that position limits will control the price of a commodity or stabilize market volatility." Oct. 18 Tr. 167. When a Commissioner asked him what the "working definition of 'excessive speculation'" was, he replied that "we don't particularly have a working definition, but Congress directed us to implement these." *Id.* at 189. The Commission's General Counsel echoed that admission, testifying that "[t]he Commission does not have a definition of excessive speculation." *Id.* at 189–90. The Commissioner asked whether it was true that the staff "did not link-up what excessive speculation was and the price movement they had in order to set these limits." *Id.* at 190. The General Counsel replied: "Pursuant to the Congressional direction, yes." *Id.* Faced with no evidence (or even definition) of excessive speculation, Commissioner Chilton was forced to explain his vote in favor of the Rule by paraphrasing Justice Stewart's famous adage: "[Prior questioning] got me thinking on what's excessive speculation, and it reminded me of Potter Stewart on pornography. 'I know it when I see it.'" *Id.* at 203.

Consistent with the view of Commissioner Dunn and the Commission's staff that the record lacked "any reliable economic analysis" demonstrating excessive speculation or the need

for position limits, the rule release stated that the Commission was *not* required to find that excessive speculation was a problem or that position limits were necessary in order to impose them on markets—an abrupt departure not only from the Notice, but from 75 years of Commission practice. 76 Fed. Reg. at 71,628. Rather, the release claimed, "Congress mandated the imposition of position limits" in the Dodd-Frank Act, and "the Commission does not have the discretion to alter an express mandate from Congress." *Id.* at 71,663–64. On this reasoning, the Commission deemed the plethora of studies finding no correlation between commodity prices and speculation *irrelevant* to its decision: "[S]tudies suggesting that there is insufficient evidence of excessive speculation in commodity markets fail to address that the Commission must impose position limits, and do not address issues that are material to this rulemaking." *Id.* at 71,664. The Commission also disregarded studies showing that position limits are ineffective, reasoning that "they do not address or provide analysis of how the Commission should specifically implement position limits." *Id.*; *see also id.* at 71,629 n.32 ("[S]tudies and reports addressing the issue of whether position limits are effective or necessary to address excessive speculation . . . do not present facts or analyses that are material to the Commission's determinations in finalizing the Proposed Rules.").

Commissioners O'Malia and Sommers each issued pointed dissents. Commissioner O'Malia wrote that the Commission "fail[ed] to comply with Congressional intent" and "misse[d] an opportunity to determine and define the type and extent" of harmful speculation "so that it can respond with rules that are reasonable and appropriate." 76 Fed. Reg. at 71,700. Commissioner Sommers lamented that the Commission "ha[s] chosen to go way beyond what is in the statute and ha[s] created a very complicated regulation that has the potential to irreparably harm these vital markets." *Id.* She was "most concerned that rules designed to 'rein in

speculators' have the real potential to inflict the greatest harm on bona fide hedgers—that is, the producers, processers, manufacturers, handlers and users of physical commodities." *Id.* at 71,699. "This rule," she said, "will make hedging more difficult, more costly, and less efficient, all of which, ironically, can result in increased food and energy costs for consumers." *Id.*

The final Position Limits Rule was published in the Federal Register on November 18, 2011, with the first of its key provisions set to take effect 60 days after the CFTC and SEC jointly further define the term "swap" in a separate rulemaking. *See* Further Definition of "Swap," etc., 76 Fed. Reg. 29,818 (May 23, 2011). The Rule identifies twenty-eight "Core Referenced Futures Contracts"—standardized futures contracts traded on commodity exchanges, such as "Chicago Board of Trade Corn." 17 C.F.R. § 151.2; 76 Fed. Reg. at 71,629 & n.33. The Rule then sets forth limits for all "Referenced Contracts," 17 C.F.R. §§ 151.1, 151.4(a), (b), a term that is defined as a Core Referenced Futures Contract or "a futures contract, options contract, swap or swaption . . . [d]irectly or indirectly linked" to either the price of a Core Referenced Futures Contract or to the price of the commodity underlying a Core Referenced Futures Contract for delivery at the same location as the commodity underlying the relevant Core Referenced Futures Contract. *Id.* § 151.1; 76 Fed. Reg. at 71,630. The Rule imposes both "spot-month" and "non-spot-month" limits.

Spot-Month Position Limits

The Rule's spot-month limits restrict investors from holding more than the specific number of Referenced Contracts for delivery in a given spot month.[8] The limits are based on the formula set forth in the Notice: "one-quarter of the estimated spot-month deliverable supply." 17

[8] The Rule defines "spot month" differently for different Referenced Contracts, relying on certain dates set forth in the Core Referenced Futures Contracts. *See* 17 C.F.R. § 151.3.

C.F.R. § 151.4(a)(1), (2)(i).[9] With the exception of natural gas contracts, the Commission elected not to permit parties to hold or control an amount of cash-settled contracts greater than or equal to five times the limit for physical-delivery contracts, as proposed in the Notice. Rather, the spot-month position limits formula of 25% of deliverable supply applies separately to physical-delivery contracts and cash-settled contracts. An investor may not net the two types of contracts to stay within the position limits, even though having an offsetting position is economically equivalent to having no position. *See* 76 Fed. Reg. at 71,632–33.

The Commission established the limits for cash-settled contracts on an "interim final rule basis" and invited further comments on whether "the interim final rule best maximizes the four objectives" set forth in Section 6a(a)(3)(B) and whether the Commission "should set a different ratio for different commodities." 76 Fed. Reg. at 71,635, 71,638. Despite the "interim" label, those limits will be binding on the compliance date.

The Commission issued a list of initial spot-month limits for each of the twenty-eight Core Referenced Futures Contracts. *See* 76 Fed. Reg. at 71,695–96. These initial limits are based on the contract markets' estimates of deliverable supply. *See* 17 C.F.R. § 151.4(d)(1); 76 Fed. Reg. at 71,631–32. They will take effect 60 days after the term "swap" is further defined by the CFTC and SEC. 17 C.F.R. § 151.4(d)(1). The initial limits will expire on January 1 of the second calendar year after they take effect. *Id.* § 151.4(d)(2)(i). The Commission will then establish new limits based on updated estimates of deliverable supply submitted by contract markets or based on the Commission's own updated estimates. *Id.* § 151.4(d)(2)(ii)-(iii).

[9] The Commission defines "deliverable supply" as "the quantity of the commodity meeting a derivative contract's delivery specifications that can reasonably be expected to be readily available to short traders and saleable by long traders at its market value in normal cash marketing channels at the derivative contract's delivery points during the specified delivery period, barring abnormal movement in interstate commerce." 76 Fed. Reg. at 71,633.

Non-Spot-Month Position Limits

The Rule also establishes non-spot-month position limits for Referenced Contracts. These limits apply to an investor's position, net long or short, in a commodity in all months combined, and in any single month. *See* 17 C.F.R. § 151.4(b). Different compliance timetables apply to "legacy Referenced Contracts" and "non-legacy Referenced Contracts."

Legacy Referenced Contracts are contracts that are subject to position limits under preexisting regulations set forth in part 150 of Title 17 (as well as swaps linked to those contracts). *See* 17 C.F.R. § 151.4(b)(3). The Position Limits Rule raised the preexisting limits for legacy Referenced Contracts. *See* 76 Fed. Reg. at 71,642. Because new part 151 will not take effect until 60 days after "swap" is further defined, the Position Limits Rule also amended part 150 to raise these preexisting limits with respect to futures contracts and options. The higher limits became effective on January 17, 2012. *See id.* at 71,684–85.[10]

Non-legacy Referenced Contracts are Referenced Contracts not previously subject to position limits by the Commission. The Position Limits Rule establishes a formula for the non-spot-month limits for these contracts: "10 percent of the first 25,000 contracts of average all-months-combined aggregated open interest with a marginal increase of 2.5 percent" of aggregated open interest thereafter. 17 C.F.R. § 151.4(b)(1).[11] The initial non-spot-month position limits for non-legacy Referenced Contracts will be published one month after the Commission obtains the data necessary for the calculation of "aggregated open interest." *Id.* § 151.4(d)(3)(i).

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[10] After "swap" is further defined, spot-month limits for Legacy Referenced Contracts will be equal to 25% of deliverable supply, just as for other Referenced Contracts.

[11] "Open interest" means the total number of contracts, long or short, that have been entered into and not yet liquidated by an offsetting transaction or fulfilled by delivery.

Aggregation Provisions And Hedging Exemptions

The final Rule also sets forth circumstances in which an investor must aggregate positions held in multiple accounts for the purpose of complying with the position limits. *See* 17 C.F.R. § 151.7. Subject to very limited exceptions, an investor must aggregate all accounts in which it holds directly or indirectly at least a 10% ownership interest. *See id.* § 151.7(c)(1). The Final Rule eliminated with little explanation the "owned non-financial entity" ("ONF") exemption that was included in the Rule as proposed. As a result, an investor that owns 10% of companies that are engaged in activities that are not financial in nature will be required to aggregate 100% of their positions in Referenced Contracts with its own holdings for purposes of determining compliance. This is the case even if the investor lacks the capacity to control trading in Referenced Contracts by the other companies or—for that matter—the ability to discover the companies' positions. *See* Notice, 76 Fed. Reg. at 4,762.

The Rule also curtailed the opportunity for bona fide hedging by enumerating an *exclusive* list of permissible hedges. *See* 17 C.F.R. § 151.5(a)(2). Under prior law, a party could request approval of a "non-enumerated" hedging transaction from the Commission, but the final Rule eliminated that option. *See* 76 Fed. Reg. at 71,648–49.

STANDARD OF REVIEW

Summary judgment is "an appropriate procedure for resolving a challenge to a federal agency's administrative decision" when, as here, "review is based on the administrative record." *Fund for Animals v. Babbitt*, 903 F. Supp. 96, 105 (D.D.C. 1995) (citing *Richards v. INS*, 554 F.2d 1173, 1177 (D.C. Cir. 1977)). In an agency challenge, summary judgment "serves as the mechanism for deciding, as a matter of law, whether the agency action is supported by the administrative record and otherwise consistent with the APA standard of review." *Air Transp. Ass'n of Am., Inc. v. Nat'l Mediation Bd.*, 719 F. Supp. 2d 26, 32 (D.D.C. 2010) (quotation

marks omitted). The function of the district court is to "review the administrative record to determine whether the agency's decision was arbitrary and capricious, and whether its findings are based on substantial evidence." *Forsyth Mem'l Hosp., Inc. v. Sebelius*, 639 F.3d 534, 537 (D.C. Cir. 2011).

Agency action is arbitrary and capricious when the agency "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 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). Courts focus their review "on whether the agency examined the relevant data, articulated a satisfactory explanation for its action, based its decision on the relevant factors, and committed no clear error of judgment." *Defenders of Wildlife v. Salazar*, 651 F.3d 112, 116 (D.C. Cir. 2011). Furthermore, a court may not "affirm an agency decision on a ground other than that relied upon by the agency." *Manin v. Nat'l Transp. Safety Bd.*, 627 F.3d 1239, 1243 (D.C. Cir. 2011). Therefore, the Commission may not proffer arguments in this Court that were different from those cited in favor of those provisions below to save the Rule from vacatur. *SEC v. Chenery Corp.*, 318 U.S. 80, 87–88 (1943).

ARGUMENT

The Commission promulgated the Position Limits Rule without heeding the most basic requirements of administrative decision-making: evaluating the record evidence, considering competing assessments of that evidence contained in comment letters, and weighing the evidence and arguments to reach a sensible policy result consistent with legislative requirements and objectives. The Commission shirked its statutory duties, repeatedly pinning its decisions on Congress. The consequence is a rule that a majority of Commissioners believed would harm the

U.S. economy and that the Commission could not bring itself to defend as advancing the public interest when it opposed the Plaintiffs' preliminary-injunction application.

The serious legal errors in the rulemaking require the Court to vacate the Rule. Under the APA, a court "shall" vacate agency action when it is found inconsistent with the Act. 5 U.S.C. § 706(2)(A); *NRDC v. EPA*, 489 F.3d 1250, 1262 (D.C. Cir. 2007) (Randolph, J., concurring). The D.C. Circuit has "not hesitated to vacate a rule when the agency has not responded to empirical data or to an argument inconsistent with its conclusion"—as the Commission has clearly failed to do here. *Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009). Indeed, when an agency has relied on alternative grounds to support a regulatory choice and at least one ground is deficient, the practice within this circuit is "ordinarily [to] vacate the [rule] unless [it is] certain that [the agency] would have adopted it even absent the flawed rationale." *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006).[12]

I. The Commission Violated The Commodity Exchange Act And Administrative Procedure Act By Imposing Position Limits Without First Finding That They Are Necessary And Appropriate

The Commission expressly declined to make the findings that have been required by the CEA for over 75 years. The Commission "disagree[d] that it must first determine that position limits are necessary before imposing them," and it declined even to determine that they were appropriate and effective. 76 Fed. Reg. at 71,628. The Commission's interpretation of the statute is erroneous, and the Rule must be vacated on that ground alone. But even assuming that

[12] The factors that have caused courts to remand without vacatur in certain cases are absent here: (1) The Rule has not gone into effect, *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 179 (D.C. Cir. 2009); (2) the regulatory "egg has [not] been scrambled" and vacatur will maintain "the status quo ante," *Milk Train, Inc. v. Veneman*, 310 F.3d 747, 756 (D.C. Cir. 2002) (quotation marks omitted); (3) vacatur will not forfeit funds that the government could not recoup later, *Heartland Reg'l Med. Ctr. v. Sebelius*, 566 F.3d 193, 198 (D.C. Cir. 2009); and (4) public health and safety are not threatened, *NRDC*, 489 F.3d at 1265–67 (Rogers, J., concurring in part and dissenting in part). Plaintiffs do not seek vacatur of the Rule's changes to Part 150 of Title 17 of the Code of Federal Regulations.

Congress required the establishment of *some* position limits, there is no conceivable argument—and the Commission has not made one—that Congress mandated the key choices that the Commission made in adopting the Rule: the specific formulas that the Commission derived to set the level of the limits, which commodities would be regulated, and the onerous aggregation rules and limited hedging exemptions. At minimum, the CEA required the Commission to conclude that those decisions were necessary and appropriate—and in fact, the Commission has *conceded* that with respect to the *levels* at which to set the position limits, it was required to make findings of necessity and appropriateness. *See* Opposition to Application for Preliminary Injunction, Dkt. 25, at 24 (Feb. 17, 2012) ("PI Opp."). Yet it failed to do so.

For that reason, and as explained below, the Commission violated the CEA and the APA as well, whose most basic command requires agencies to determine that their new regulations are necessary and appropriate and will be effective.

A. The Commission Misconstrued The Dodd-Frank Act To Compel The Imposition Of Position Limits Even If They Would Be Unnecessary And Inappropriate

Since 1936, the Commission's authority to establish position limits has been circumscribed by a basic statutory standard: It may establish position limits for a given commodity "as the Commission finds are *necessary* to diminish, eliminate, or prevent" "an undue and unnecessary burden on interstate commerce in such commodity" caused by "[e]xcessive speculation." 7 U.S.C. § 6a(a)(1) (emphasis added). By its plain text, this standard requires the Commission to determine (i) that harm to "excessive speculation" exists (ii) with respect to a specific commodity and (iii) that position limits are necessary to diminish, eliminate, or prevent it. For decades, the Commission has applied this standard in setting position limits for each new commodity that it has subjected to limits. *See supra* at 4 n.3.

In order to determine that position limits are necessary, the Commission was required to evaluate the existence, scope, and effect of excessive speculation in the underlying commodities markets, but it expressly declined to do so. 76 Fed. Reg. at 71,627–29. Moreover, the Commission specifically stated that it was ignoring "a number of studies and reports addressing the issue of whether position limits are effective or necessary to address excessive speculation." *Id.* at 71,629 n.32. In the Commission's view, because it lacked discretion to decline to impose position limits, "these studies [did] not present facts or analyses that [were] material." *Id.*

This failure was clear error requiring vacatur of the Rule. "When a statute requires an agency to make a finding as a prerequisite to action, it must do so." *Gerber v. Norton*, 294 F.3d 173, 185 (D.C. Cir. 2002). The Commission presented no evidence that excessive speculation is a problem in the relevant markets or that position limits are a necessary, appropriate, or effective way to combat excessive speculation. The Commission, moreover, could not have made such findings because three members of the Commission expressly concluded that position limits are not necessary to curb excessive speculation. *See supra* at 10–11.

The Commission has argued that the Dodd-Frank Act's amendments to the CEA implicitly repealed this threshold requirement and *compelled* the imposition of position limits, regardless of their necessity, effectiveness, or cost. That is mistaken. The Commission relies almost exclusively on the fact that Congress set a deadline of 180 days for the promulgation of "the limits required under" Section 6a(a)(2) of Title 7 of the U.S. Code.[13] PI Opp. 21; 7 U.S.C. § 6a(a)(2)(B), (C). There is no doubt that Congress intended the Commission to initiate a rulemaking and to impose position limits if they met the statutory standards. But Section 6a(a)(2) expressly incorporates "the standards set forth in [Section 6a(a)(1)]"—including the

[13] For ease of reference, we cite the section numbers of the U.S. Code throughout the brief rather than citing the corresponding numbers used in the CEA.

necessity standard—in directing the Commission to complete a rulemaking. Congress, moreover, added swaps to the coverage of Section 6a(a)(1), while leaving the necessity requirement in place.[14]

The Commission has also pointed to a provision of the Dodd-Frank Act that requires the Commission to submit a report to Congress about this rulemaking. PI Opp. 22–23; 15 U.S.C. § 8307(a). Nothing in that provision purports to alter the statutory standards of Section 6a. Nor does it say that the Commission must impose position limits, even if it concludes that they are unnecessary and ineffective; the reporting provision would be phrased precisely the same way whether Congress believed position limits to be mandatory or discretionary.

It is, in fact, the Commission's interpretation of Section 6a that is irreconcilable with other provisions of the CEA. The statute sets forth various "core principles" with which exchanges must comply. 7 U.S.C. § 7(d). One of those principles is that exchanges "shall adopt position limitations or position accountability for speculators, where necessary and appropriate." *Id*. § 7(d)(5). The Dodd-Frank Act added a similar requirement for swap execution facilities. *See id*. § 7b-3(f)(6)(A). Those provisions confirm Congress's command that position limits should be adopted only where necessary, since otherwise unwarranted burdens and costs would result with no corresponding benefit.

[14] As the Court previously observed, Section 6a(a)(5), which concerns position limits for swaps, opens with the phrase "[n]otwithstanding any other provision of this section." 7 U.S.C. § 6a(a)(5). This introductory clause does not negate the necessity requirement, and the Commission has not suggested that it does. Rather, as just noted, by adding swaps to Section 6a(a)(1), the Dodd-Frank Act subjected any swaps position limits to the necessity requirement. Furthermore, Section 6a(a)(5) addresses limits only on those swaps that are "economically equivalent" to the futures and options contracts for which the Commission has established position limits. If the limits for those futures and options contracts are unlawful because the Commission has failed to make the necessity finding, the limits on swaps under Section 6a(a)(5) would necessarily fail as well.

Indeed, the Commission's contrary interpretation is at war with itself. The Commission acknowledged in the rule release that it had the discretion to establish position limits for some commodity contracts and not others, even though the text of the statute does not distinguish between different commodities. *See*, *e.g.*, 76 Fed. Reg. at 71,665. The Commission's claim elsewhere that it had no discretion thus makes its interpretation of the Dodd-Frank Act "internally inconsistent" and therefore "unreasonable and impermissible" under the APA. *Air Line Pilots Ass'n v. FAA*, 3 F.3d 449, 453 (D.C. Cir. 1993).

Finding no support for its view in the text of the CEA, the Commission has resorted to a mistaken reading of legislative history to suggest that Congress intended something other than what is reflected in the plain text of the statute. According to the Commission, after 45 years of interpreting Section 6a(a)(1) to require a finding of necessity, it set forth a different interpretation of the statute in a 1981 rulemaking that required contract markets to establish position limits for most commodities (a requirement that was later rescinded). Congress was aware of this interpretation, the argument goes, when it amended the CEA in 1982, 2008, and 2010.

This argument is misguided on multiple levels. Most fundamentally, the preamble to the 1981 order simply does not say what the Commission attributes to it. The paragraph relied on by the Commission nowhere suggests that the Commission had interpreted Section 6a—contrary to decades of settled understanding—not to require a necessity finding. Rather, the paragraph states only that Congress has found that "excessive speculation is harmful to the market" and that "speculative limits are an effective prophylactic measure." 46 Fed. Reg. 50,938, 50,940 (Oct. 16, 1981). Absent a finding of excessive speculation, there is no basis for new limits. The 1981 statement certainly does not demonstrate the sort of "long, uniform administrative construction" that the Supreme Court has required to presume that Congress intended to ratify an agency's

interpretation. *Helvering v. Hallock*, 309 U.S. 106, 121 n.7 (1940); *see also Rowan Cos. v. United States*, 452 U.S. 247, 262 (1981) (administrative actions that lend "only the most ambiguous support" to interpretation are insufficient). In fact, it is far more plausible that Congress "ratified" the Commission's decades-long practice of making a necessity finding each time that it extended the limits to a new commodity. *See supra* at 4 n.3.

Nor is there any "evidence to suggest that Congress was even aware of the [agency's] interpretive position" in its amendments to the CEA in 1982, 2008, and 2010; therefore, those "re-enactment[s] [are] without significance." *Brown v. Gardner*, 513 U.S. 115, 121 (1994) (quotation marks omitted). In fact, the Senate Report for the 1982 act—which the Commission has claimed supports its position—made clear that "the Committee contemplates that, before establishing speculative limits, the Commission will consider *objective economic data* relevant to the *need* for restraints on the markets." S. Rep. No. 97-384, at 45 (1982) (emphases added).

In contrast to the vague inference that the Commission attempts to draw from the 1981 preamble, the regulations actually codified in the Code of Federal Regulations tell a different story. The Commission's "core principles" for private exchanges expressly provide that "position limits are not necessary for markets where the threat of excessive speculation or manipulation is nonexistent or very low," and "[t]hus, contract markets do not need to adopt speculative position limits for [those] futures markets." 17 C.F.R. § 38 app. B (Core Principle 5). If anything, under the Commission's reasoning, when Congress amended the CEA in 2008 and then in 2010 with the Dodd-Frank Act, it must have "ratified" the Commission's practice in the 1990s of not imposing position limits unless they were necessary.

Finally, even assuming, as the Commission contends, that it was not required to find position limits *necessary* before imposing them, the Commission was, at minimum, obligated to

find that such limits were "appropriate." The new provisions established by the Dodd-Frank Act each state that the Commission must establish limits only "as appropriate." 7 U.S.C. § 6a(a)(2), (a)(5). The Commission did not make any finding that position limits were appropriate and expressly ignored record evidence relevant to that proposition. *See supra* at 11–12.

B. The Commission's Concession That Limit *Levels* Must Be Necessary And Appropriate Is Fatal To The Position Limits Rule

The Commission has conceded in this Court that with respect to the *levels* at which it sets position limits, it must apply the necessary and appropriate standards. In attempting to give meaning to "the phrase 'as the Commission finds are necessary' in subsection 6a(a)(1) and the words 'as appropriate' in subsection 6a(a)(2)(A)," the Commission asserted that "it is far more plausible to interpret the two subsections as a direction to the Commission, when it imposes the required position limits, to set them at an appropriate level." PI Opp. 24. The Commission made a similar concession in the rule release. *See* 76 Fed. Reg. at 71,629 (explaining that phrase "as appropriate" "is most sensibly read as directing the Commission to exercise its discretion in determining the extent of the limits that Congress required the Commission to impose"). But the Commission never concluded that the levels at which it set the position limits were "necessary" under Section 6a(a)(1). Although it paid lip service to the "appropriate" requirement under Section 6a(a)(2)(A), it could not possibly have made that finding because it made no attempt to measure or even define "excessive speculation" and ignored 52 studies highly relevant to the levels at which the position limits should be set. Moreover, three Commissioners declared on the record that the levels were neither necessary nor appropriate.

The Commission's concession aside, even if the Dodd-Frank amendments to the CEA required the Commission to impose position limits, there is no plausible argument that the amendments dictated the specific levels at which the limits should be set or any of the other

discrete choices in the Rule, such as the aggregation standard. And the Commission may not justify these choices on judicial review by resorting to a ground not asserted below. *SEC v. Chenery Corp.*, 318 U.S. 80, 87–88 (1943). Because no necessity finding appears in the record, and because the Commission could not have reasonably made an "appropriateness" finding with respect to the levels at which it set the position limits, the Rule must be vacated.

II. The Commission Violated The Commodity Exchange Act By Failing To Conduct The Required Cost-Benefit Analysis

The Rule also must be vacated because the Commission failed to conduct a meaningful cost-benefit analysis under Section 19(a). The D.C. Circuit has vigorously enforced statutory cost-benefit requirements akin to this provision. In a string of recent unanimous decisions, the D.C. Circuit has repeatedly invalidated rules of the Securities Exchange Commission ("SEC")—a sister agency to the CFTC—for failures to assess rules' costs and benefits that are strikingly similar to the CFTC's shortcomings here. *See Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2009); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005). Last year's *Business Roundtable* case, for example, concerned an SEC rule that would have enabled certain large shareholders to use companies' proxy materials to put forward information about the shareholders' nominees for corporate boards of directors. Vacating the rule, the D.C. Circuit explained that it was the Commission's responsibility to "frame[] the costs and benefits of the rule," "adequately to quantify . . . costs or . . . explain why those costs could not be quantified," and to "support its predictive judgments." 647 F.3d at 1148–49. Yet, the SEC had "d[one] nothing to estimate and quantify the costs it expected companies to incur; nor did it claim estimating those costs was not possible." *Id.* at 1150. One key deficiency was that the SEC had not reliably estimated the frequency with which contested elections would occur under the new rule compared to existing

practices; "[w]ithout this crucial datum, the Commission has no way of knowing whether the rule will facilitate enough election contests to be of net benefit." *Id.* at 1153. The SEC's "failure to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation makes promulgation of the rule arbitrary and capricious and not in accordance with law." *Id.* at 1148 (quotation marks omitted).

Here, the Commission's cost-benefit analysis fell well short even of the analysis conducted by the SEC and deemed deficient by the D.C. Circuit. The Commission repeatedly conceded that it lacked data permitting it to reasonably estimate the costs of the Rule.[15] Where it did collect such data, the Commission conceded that the Rule would entail "significant costs," explaining that it is "expected to result in costs to market participants whose market participation and trading strategies will need to take into account and be limited by the position limits rule." 76 Fed. Reg. at 71,665, 71,677. The Commission, however, discounted these costs on the ground that "many of the costs that arise from the application of the final rules are a consequence of the congressional mandate that the Commission impose position limits." *Id*. at 71,665. But as discussed above, even if one assumed that Congress required *some* position limits, there is no plausible argument that Congress dictated, for example, the specific levels at which they were set or the draconian aggregation standard—precisely the choices that make the Rule so onerous.

On the other side of the ledger, the Commission had no way to evaluate the benefits of the Rule, because it did not—as the staff conceded—even have a "working definition" of

[15] *See*, *e.g.*, 76 Fed. Reg. at 71,670 ("At this time, the Commission's data set does not allow the Commission to estimate the specific number of traders that could potentially be impacted by the limits on cash-settled contracts . . . ."); *id.* at 71,672 ("[T]he Commission is unable to determine or estimate the number of entities that may need to alter their business strategies."); *id.* ("[T]he Commission cannot determine or estimate the number of entities that will be eligible for [the bona fide hedging] exemption. Accordingly, the Commission cannot determine or estimate the total costs industry-wide of filing for the exemption.").

"excessive speculation," or attempt to link price increases or volatility in the past with large positions, and it ignored all data in the record relevant to the question. Oct. 18 Tr. 189–91. Although the rule release briefly acknowledged that "'overly restrictive' limits can negatively impact market liquidity and price discovery" (76 Fed. Reg. at 71,664), the Commission could not possibly discern the tipping point at which the limits became "overly restrictive" because it failed to conduct any analysis of that issue or assess the 52 studies cited in the record that were relevant to it. And without measuring whether the preexisting regime had been effective, the Commission could not reasonably assess whether the new limits were justified. *See Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 178 (SEC's cost-benefit analysis was flawed because it failed to measure "baseline" level of price competition).

As a consequence, the Commission's conclusions about the Rule's benefits merely begged questions that the Commission was required to answer. For instance, the Commission found that the Rule "*should* protect the efficiency, competitiveness, and financial integrity of futures markets," but only "[*t*]*o the extent* that the position limit formulas achieve [their] objectives." 76 Fed. Reg. at 71,675 (emphases added). Having thus posited that assessing the Rule's effects on efficiency, competitiveness, and financial integrity required evaluating the Rule's success in achieving its objectives, the Commission failed to consider or demonstrate in any way "the extent to which" those objectives would be achieved. This empty "analysis"—which posed, rather than answered, a question—is even more egregiously inadequate than the analyses performed by the SEC that the D.C. Circuit has repeatedly deemed insufficient over the past decade. The Commission's analysis of each of the other Section 19(a) factors was equally

inconclusive and perfunctory.[16] The Commission was ultimately unable to assure the public that the Rule provided any meaningful benefits at all—just as it has been unable to tell this Court that the Rule advances the public interest in opposing Plaintiffs' preliminary-injunction application.

It is clear, moreover, that a majority of the Commissioners believed that the Rule would impose significant costs on the public that were not outweighed by the Rule's purported benefits. Commissioner Dunn, who cast the deciding vote in favor of the Rule based solely on an erroneous view of the law, said that it was "important to let the public know what may happen once we implement position limits": "Position limits may actually lead to higher prices for commodities that we consume on a daily basis" and "may harm the very markets we're intending to protect." Oct. 18 Tr. 11, 13, 14. For "farmers, producers, and manufacturers," he explained, "position limits and the rules that go along with them may make it actually more difficult to hedge the risks that they take on in order to provide the public with milk, bread, and gas." *Id.* at 12. Commissioner Sommers likewise foresaw "increased food and energy costs for consumers," and Commissioner O'Malia predicted that "our action could negatively affect the liquidity and price discovery function of our markets." 76 Fed. Reg. at 71,699, 71,706.

[16] *See* 76 Fed. Reg. at 71,675 ("[T]o the extent that the position limits described herein protect prices from market manipulation and excessive speculation, the final rules should protect the price discovery function of futures markets."); *id.* ("To the extent that these position limits prevent any market participant from holding large positions that could cause unwarranted price fluctuations in a particular market, facilitate manipulation, or disrupt the price discovery process, such limits serve to prevent market participants from holding positions that present risks to the overall market and the particular market participant as well."); *id.* at 71,679 ("To the extent that the aggregation policy under the final rules prevent any market participant from holding large positions that could cause unwarranted price fluctuations in a particular market, facilitate manipulation, or disrupt the price discovery process, the aggregation standards finalized herein operate to help ensure the efficiency, competitiveness and financial integrity of futures markets.").

The Commissioners' views are amply supported by the record. Commenters predicted that the Rule would increase volatility of energy prices, make beneficial hedging more difficult, and ultimately increase the price of consumer products. An organization representing energy companies that use commodity markets every day to manage commercial risk warned the Commission that the Rule "is not supported by empirical evidence and will impose a significant compliance burden on traders." Coalition of Physical Energy Companies Comment, at 13 (Mar. 28, 2011). The Colorado Public Employees Retirement Association told the Commission that the Rule may have an "adverse impact" on its "ability to implement [its] commodities mandates and thereby on [its] ability to provide diversification and inflation protection to [its] members." Colorado Public Employees Retirement Association Comment, at 1 (Mar. 28, 2011).

Given the Commission's inability to assess the benefits of the Rule, unreasonable discounting of the costs it imposed, and ultimate view that the Rule represented a net negative for the public interest, the Rule is fatally flawed and must be vacated under Section 19(a).

Even apart from that critical substantive deficiency, the Commission's discussion of costs and benefits in the Notice—which took up less than a page in the Federal Register—failed to give members of the public a reasonable opportunity to evaluate and critique the Commission's scant justifications for the Rule. *See* Notice, 76 Fed. Reg. at 4,764. That itself was legal error requiring vacatur. The Commission's one-page notice of its cost-benefit analysis fell far short of ensuring that "the most critical factual material that is used to support the agency's position on review . . . [has] been made public in the proceeding and exposed to refutation." *Chamber of Commerce v. SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006) (quotation marks omitted).

III. The Commission Violated The Administrative Procedure Act By Disregarding Critical Record Evidence And Exercising Its Authority Arbitrarily And Capriciously

A. The Position Limits Rule, As A Whole, Is Defective Under The Administrative Procedure Act

Even assuming that Congress required the imposition of *some* position limits and that the Commission was free to disregard the statutory standards of necessity and appropriateness in setting the specific levels for those limits, the Commission, at minimum, was subject to the basic APA requirements for reasoned decision-making in the numerous choices that it made in the Rule: not only the levels at which to set the limits, but also which commodities to regulate, the aggregation rules it set forth, and the various bona fide hedging exemptions it established. The Commission's rule release acknowledged this discretion repeatedly. *See*, *e.g.*, 76 Fed. Reg. at 71,659 (stating that the Commission "has been granted discretion to determine the specific levels" of the limits); *id.* at 71,672 (observing that only "to a certain extent" do the Rule's costs result from the supposed "Congressionally-imposed mandate").

Those well-settled standards under the APA require an agency to "examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quotation marks omitted). A court must overturn an agency rulemaking as arbitrary and capricious where the agency has failed to respond to relevant and specific comments that are sufficiently central to its decision. *See La. Fed. Land Bank Ass'n v. Farm Credit Admin.*, 336 F.3d 1075, 1080 (D.C. Cir. 2003); *Int'l Fabricare Inst. v. EPA*, 972 F.2d 384, 389 (D.C. Cir. 1992); *Am. Mining Cong. v. EPA*, 907 F.2d 1179, 1190–91 (D.C. Cir. 1990). As part and parcel of the requirement of reasoned decision-making, an agency is required to "respond to substantial problems raised by commenters."

Business Roundtable, 647 F.3d at 1148–49. An agency's "fail[ure] adequately to consider relevant evidence . . . falls afoul of [the] requirement that an agency engage in reasoned decision-making by supporting its conclusions with 'substantial evidence' in the record." *Tenneco Gas v. FERC*, 969 F.2d 1187, 1214 (D.C. Cir. 1992) (per curiam) (quotation marks omitted).

In addition, the APA requires that an "agency . . . cogently explain why it has exercised its discretion in a given manner." *State Farm*, 463 U.S. at 48. That explanation must be sufficient to enable a court to conclude that the agency's action "was the product of reasoned decisionmaking." *Id*. at 52; *see also Portland Cement Ass'n v. EPA*, 665 F.3d 177, 187 (D.C. Cir. 2011) (per curiam). "It is the court's function to assure that the agency has given reasoned consideration to the facts it has latitude to find, the conclusions drawn therefrom and the judgments it makes based on the record evidence." *Wheaton Van Lines, Inc. v. ICC*, 671 F.2d 520, 527 (D.C. Cir. 1982).[17]

Here, the Commission failed to comply with its obligation to engage in reasoned decision-making. It expressly ignored highly material data and arguments proffered by commenters, all the while claiming that the numerous choices it made were based on its consideration of their effectiveness. *See* 76 Fed. Reg. at 71,629 n.32, 71,664. In this Court, the Commission has conceded that it did not take into account studies and evidence addressing "whether position limits are an effective regulatory tool," and that it "dismissed objections regarding the effectiveness and need for position limits"—even though throughout the rule release and its brief in this Court, the Commission repeatedly justified the choices it made on the

[17] These standards apply with no less force when an agency is under a deadline to promulgate a rule. *See*, *e.g.*, *Am. Mining Cong.*, 907 F.2d at 1191 ("That an agency has only a brief span of time in which to comply" with a rulemaking deadline "cannot excuse its obligation to engage in reasoned decisionmaking under the APA."); *Ill. Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997) (per curiam).

ground that, in its experience, particular limits or provisions were "effective." PI Opp. 4, 10; *see also* 76 Fed. Reg. at 71,663 ("[T]he Commission disagrees with comments asserting that the Commission must first determine that excessive speculation exists or prove that position limits are an effective regulatory tool."). The Commission admitted in the rulemaking and its brief that it believed that the 52 studies cited in the record addressing the effectiveness and need for position limits did "not present facts or analyses that are material to the Commission's determinations in finalizing the Proposed Rules." 76 Fed. Reg. at 71,629 n.32; *see*, *e.g.*, PI Opp. 13.

Such evidence was critical to every one of the key choices that the Commission made. Had the Commission found that position limits were not needed to curb excessive speculation—indeed, that excessive speculation did not even exist—it surely would at least have set *very high* limits, and it would not have elected to expand limits to 19 new commodities and to related swaps. Likewise, had the Commission found that excessive speculation was not a real problem in the markets, it would never have imposed an aggregation rule that mandates the aggregation of the *entire position* of another company in which one holds as little as a 10% interest. The Commission's failure to consider critical record evidence similarly infected every other important component of the Rule.

The Commission has appeared to suggest that it is sufficient under the APA that it merely "considered" the comments citing the studies—even though it then expressly deemed them immaterial. PI Opp. 10, 27, 38. It is black letter administrative law, however, that merely "considering" relevant evidence in the sense of acknowledging it, without giving it due weight, is unreasonable—a principle that the D.C. Circuit has vigorously enforced. In the *Business Roundtable* case, for example, the court noted that although the SEC had "acknowledged the

numerous studies submitted by commenters" casting doubt on the agency's empirical conclusions, the Commission "discounted those studies" on specious grounds. 647 F.3d at 1149–51. Meanwhile, other studies were given undue weight. *Id.* Here, the Commission's error is far worse—it provided no meaningful discussion of any study at all. And even while ignoring studies and data showing that position limits were ineffective, it repeatedly justified its decisions by claiming that the (substantially less onerous) preexisting position-limits regime was "effective" or had "worked well."[18]

The Commission's errors, however, go deeper than ignoring record evidence. The Commission's staff admitted at the hearing approving the Rule that it declined even to attempt to measure excessive speculation, and, indeed, lacked even a "working definition" of the term. Oct. 18 Tr. 189. In this Court, the Commission has repeatedly avowed that it adopted limits that "worked well" in the past, but it was impossible for the Commission to reach that conclusion without any metric with which to measure excessive speculation. As one comment letter aptly characterized the Commission's overall approach, "[i]nstead of reasoned analysis based on objective facts, the Proposed Rule *assumes* that excessive speculation exists (or could exist) and

[18] In its opposition to Plaintiffs' application for a preliminary injunction, the Commission cited various decisions that it claimed supported its perfunctory acknowledgment of the studies in the record, but in each of those cases, the agency performed a far more intensive analysis of data than what the Commission did here. For example, in *Cablevision Systems Corp. v. FCC*, 597 F.3d 1306 (D.C. Cir. 2010), the FCC identified a specific problem of monopoly power potentially resulting from certain contracts, analyzed the market to determine the level of risk, "used [an] example as a case study to reverse engineer what market conditions make [anticompetitive conduct] profitable," and then "extrapolated from these data to predict how" vertically integrated cable companies would affect competition without the rule at issue. *Id.* at 1307–10; *see also Sw. Airlines Co. v. TSA*, 650 F.3d 752, 754–57 (D.C. Cir. 2011) ("[T]he agency commissioned a report from . . . a reputable airline consultant" and "explained why [an industry-commissioned] report was inferior to the . . . report on which the agency relied."); *Vonage Holdings Corp. v. FCC*, 489 F.3d 1232, 1243 (D.C. Cir. 2007) ("[W]e are reluctant to fault the Commission for considering the only available data, however imperfect.").

then establishes a pervasive and burdensome regulatory regime to remedy this assumed problem." Edison Electric Institute et al. Comment, at 2 (emphasis added). Judicial review exists precisely to prevent such arbitrary administrative decision-making.

B. Key Provisions Of The Position Limits Rule Independently Fail To Meet The Requirements Of The Administrative Procedure Act

Beyond these basic failures to base the Rule on record evidence, the Commission, in numerous areas at the core of the Rule, failed to exercise reasoned discretion and draw a sensible connection between the record evidence and the particular choice made.

1. Selection Of Contracts Subject To Position Limits

The Commission concedes that it had discretion in selecting which contracts to subject to position limits, but the Commission failed to set forth reasonable grounds for selecting the contracts that it did. Indeed, the Commission more than *tripled* the types of commodities covered by Commission-set position limits without finding that any of those limits would be effective in preventing excessive speculation. When the Commission first proposed the expanded limits in the Notice, commenters responded that the Commission had failed to set forth "a reasoned explanation as to why the Commission has chosen to establish position limits for the 28 specific core referenced futures contracts." Edison Electric Institute et al. Comment, at 5. In the rule release, the Commission, rather than tying its selection to commodities most susceptible to excessive speculation, explained that its choice was based on those contracts with "high levels of open interest." 76 Fed. Reg. at 71,665. That was an irrational decision: If anything, it is more likely that deep markets are *less* susceptible to manipulation than markets with relatively few participants.

That, in fact, is precisely the judgment embodied in preexisting Commission regulations, which permit exchanges to adopt more flexible accountability levels rather than position limits

for contracts "with *large open-interest*, high daily trading volumes and liquid cash markets." 17 C.F.R. § 38 app. B (Core Principle 5) (emphasis added). The Commission's explanation for the contracts it selected was thus entirely arbitrary. It is a bedrock principle of administrative law, after all, that "[r]easoned decision making . . . necessarily requires the agency to acknowledge and provide an adequate explanation for its departure from established precedent, and an agency that neglects to do so acts arbitrarily and capriciously." *Jicarilla Apache Nation v. U.S. Dep't of Interior*, 613 F.3d 1112, 1119 (D.C. Cir. 2010) (quotation marks omitted; alterations in original).

2. Spot-Month Position Limit Formula

The Rule establishes a spot-month position limit equal to 25% of "deliverable supply." 17 C.F.R. § 151.4(a). The Commission's only explanation for this level was that the Commission had previously required exchanges to use the 25% formula for spot-month limits and that "based on its experience, the formula has appeared to work effectively as a prophylactic tool to reduce the threat of corners and squeezes and promote convergence without compromising market liquidity." 76 Fed. Reg. at 71,634. The Commission's analysis has multiple fatal flaws.

First, without any evidence that excessive speculation as a problem—indeed, without even a "working definition" of excessive speculation—the Commission could not possibly have determined that this formula had "worked well" in the past. The Commission made no attempt to estimate whether the preexisting limits had curtailed excessive speculation or imposed costs on the economy. That would not have been difficult to do. A study in the record, after all, conducted precisely the sort of analysis that the Commission should have undertaken, comparing price volatility before and after an increase in exchange-set position limits—and found no effect. *See supra* at 9. The Commission also could have compared the degree of harmful speculation in a commodity subject to preexisting position limits with that of a commodity not subject to such

limits. Instead of conducting these sorts of analyses, the Commission embraced the logical fallacy that the mere (alleged) fact that excessive speculation has not occurred under the preexisting position-limit regime means that the regime was effective. For all the Commission knows, excessive speculation would not have occurred even if there had been no position limits, or significantly higher ones.

In addition, even if the 25% formula had "worked well" for futures and options contracts, spot-month limits (or limits of any kind) had never before been imposed on the much larger swaps market. *See* 76 Fed. Reg. at 71,634 ("Currently, with the exception of significant price discovery contracts, traders' swaps positions are not subject to position limit restrictions."). The Commission therefore could not possibly have invoked its experience to conclude that position limits in this market—which is for most of the relevant commodities several times larger than futures and options markets—"worked well" in the past. It is a clear transgression of the most basic APA requirements for an agency to "fail[] to explain how its knowledge or experience supports [its] understanding." *McDonnell Douglas Corp. v. U.S. Dep't of Air Force*, 375 F.3d 1182, 1191 (D.C. Cir. 2004). Moreover, given that the Commission extended position limits to the swaps market for the first time, the Commission lacked any basis to assume that the limits previously applied to futures and options contracts remain appropriate even for those contracts now.

The Commission unreasonably rejected commenters' proposals for different spot-month limits. *See*, *e.g.*, Futures Industry Association ("FIA") Comment, at 9–10 (Mar. 25, 2011). For example, the Commission rejected Plaintiffs' proposal for a broader measure of "deliverable supply" with no explanation whatsoever—even though the Commission had expressly solicited comments on different definitions of deliverable supply in the Notice. *See* 76 Fed. Reg. at 4,758;

ISDA-SIFMA Comment, at 22 n.43. The Commission merely noted the comment and moved on, *see* 76 Fed. Reg. at 71,633 & n.71, calling upon its "experience overseeing the position limits" to assert that limits are "based most appropriately on" current deliverable supply, *id.* at 71,633 (quotation marks omitted). *See also id.* at 71,669. Such an "*ipse dixit* conclusion, coupled with [a] failure to respond to contrary arguments resting on solid data, epitomizes arbitrary and capricious decisionmaking." *Ill. Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555, 564 (D.C. Cir. 1997); *see also Business Roundtable*, 647 F.3d at 1155 (rejecting SEC's analysis of costs as "ipse dixit, without any evidentiary support and unresponsive to [a] contrary claim"). The APA's requirement for public notice and comment would be meaningless if agencies were required only to acknowledge significant comments and dismiss them without response.

Finally, despite the fact that the Notice had proposed permitting higher limits for cash-settled contracts (including swaps)—up to 125% of deliverable supply—the Commission rejected that proposal without adequate explanation. *See* 76 Fed. Reg. at 71,634–37. In the first place, this surprise change from the Notice violated the distinct APA command that an agency "give interested persons an opportunity to participate in the rule making." 5 U.S.C. § 553(c). Although the final rule may of course differ from the rule set forth in the Notice, the public must be able to "anticipate[] the agency's final course in light of the initial notice." *Crawford v. FCC*, 417 F.3d 1289, 1295 (D.C. Cir. 2005) (quotation marks omitted).

The 25% formula for cash-settled contracts is also unsupported by the record evidence. Even though the Commission's rationale for the 25% formula was that "the formula has appeared to work effectively as a prophylactic tool to reduce the threat of corners and squeezes," and even though it conceded cash-settled contracts are not subject to such tactics, the Commission required them to be subject to the same low position-limit formula. Numerous

commenters "questioned the application of proposed spot-month position limits to cash-settled contracts" and "suggested that cash-settled contracts, if subject to any spot-month position limits at all, should be subject to relatively less restrictive limits that are not based on estimated deliverable supply." 76 Fed. Reg. at 71,634; *see*, *e.g.*, ISDA-SIFMA Comment, at 6–7.

The Commission's only answer to these concerns was that unless the limit was the same for cash-settled contracts as it was for physical-delivery contracts, the Rule would "permit larger positions in lookalike cash-settled contracts that may provide an incentive to manipulate and undermine price discovery in the underlying physical-delivery futures contract." 76 Fed. Reg. at 71,635. The Commission did not explain how this alleged manipulation would work nor provide any evidence that such manipulation has ever occurred—even though swaps were not subject to position limits before, and one would expect to have seen evidence of the deleterious effects of large positions if it existed. This is not reasoned decision-making based on record evidence.

3. Non-Spot-Month Position Limit Formula

The Commission's decision-making with respect to non-spot-month limits was equally flawed. As with spot-month limits, the Commission asserted that the non-spot-month limits formula—10% of open interest for the first 25,000 contracts and 2.5% thereafter—was justified merely because it allegedly was "consistent with the Commission's historical approach to setting non-spot-month speculative position limits." 76 Fed. Reg. at 71,639. But the Commission could not possibly know whether that "historical approach" was effective, because it took no steps to examine whether it prevented excessive speculation and ignored studies showing that it did not.

The Commission itself acknowledged numerous comments pointing out that the Commission had provided no sensible explanation for selecting this formula. Commenters objected that the "proposed formulaic approach to non-spot-month position limits seems arbitrary" and argued that "position limits outside the spot month should be eliminated or be

increased substantially because threats of manipulation and excessive speculation are primarily of concern in the physical-delivery spot month contract." 76 Fed. Reg. at 71,639 n.124. Commenters recommended that the Commission "impose federal accountability levels rather than hard limits," as it had permitted exchanges to do in the past, and objected that the Notice had "not explain[ed] why the Commission's prior guidance does not provide a basis today for an exemption from hard speculative position limits for these same markets." FIA Comment, at 11. They also suggested alternative formulas. *See*, *e.g.*, *id.* at 12.

The Commission offered no explanation for the restrictive formula it proposed other than another blanket appeal to its "experience." That analysis rings especially hollow with respect to non-spot-month limits because such limits were *not* previously imposed for the majority of contracts subject to the new limits. The rule release hid in a footnote that the experience to which the Commission referred for the formula was "the level of the *legacy* all-months position limits since 1999." 76 Fed. Reg. at 71,639 n.131 (emphasis added). But the 19 commodities not previously subject to Commission-set limits were generally subject to more flexible accountability levels by the exchanges—that is, they were not subject to position limits at all. And swaps were never subject to position limits or accountability levels, so the Commission's appeals to its experience were unfounded in extending limits to this much larger market.

The Commission has done no better before this Court in defending the non-spot-month position limits. In opposing Plaintiffs' preliminary-injunction application, the Commission's sole explanation for the formula it selected was that "comments [were] pointing in all directions" and it was facing a deadline. PI Opp. 30. But as the D.C. Circuit explained in faulting another agency for shrinking from a statutorily-required cost-benefit analysis because commenters' estimates were in conflict, an "agency's job is to exercise its expertise to make tough choices

about which of the competing [cost] estimates is most plausible, and to hazard a guess as to which is correct." *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1221 (D.C. Cir. 2004). The mere fact that the Commission's task might have been difficult and involved uncertainty did not excuse its obligation to squarely address the comments in the record and provide a reasoned explanation about why the formula it adopted was appropriate.

4. Extension Of Same Limits To Swaps

The Commission elected to subject swaps to the same position limit formulas that have been historically applied to futures and options contracts, even though the term "swap" has not yet even been fully *defined*, and the Commission conceded it lacks sufficient data on swaps to evaluate the necessity for position limits or their economic costs. *See*, *e.g.*, 76 Fed. Reg. at 71,671 n.432 ("[A]bsent complete data on swaps positions, the Commission cannot accurately estimate a trader's position for the purposes of compliance with spot-month limits for cash-settled contracts."). Before this Court, the Commission has blamed Congress for the lack of any factual basis for its decision, citing the statutory requirement that limits for swaps were to be developed concurrently with limits for futures and options and must be tailored to achieve the same goals. PI Opp. 33–34. But nothing in the text suggests that a single position-limit formula must apply to futures, options, and swaps, and the rule release cited no evidence showing that swaps should be subject to the same restrictive limits as futures and options.

5. Aggregation Rules

The core requirement of the Rule's aggregation provisions is that an investor generally must aggregate the positions of any entities in which it owns as little as a 10% interest. 17 C.F.R. § 151.7(b). The investor is not permitted to pro-rate its share—it must aggregate the *full* position held by the entity even if it owns as little as a 10% stake. *See* 76 Fed. Reg. at 71,651

n.245. The Rule requires aggregation absent any proof that the investor exercises control over the entity or has knowledge of the entity's positions.

Given the lack of any record evidence showing that such a draconian aggregation standard is necessary to combat excessive speculation, the requirement is arbitrary and capricious. Indeed, it violated the plain terms of Section 6a(a)(1), which authorizes the Commission to aggregate only positions "directly or indirectly *controlled*" by the investor. 7 U.S.C. § 6a(a)(1) (emphasis added). Yet the Rule's aggregation standard does not turn on control, and there is no reason to believe that an investor holding a 10% or 15% stake in another entity has the power to control it. *See* 76 Fed. Reg. at 71,651 & n.244.

As with the limit formulas, the rule release supplied no testable basis for the aggregation standard but claimed only that the "10 percent ownership standard . . . has worked effectively to date." *Id.* at 71,651 n.245; *see also id.* at 71,652 (asserting, without analysis, that the aggregation provisions are needed to reduce "the risk of market manipulation or disruption"); *id.* at 71,678 (same). Again, the Commission conducted no analysis to determine whether the 10% aggregation rule "worked effectively" in the past and did not even specify what it would mean for it to have "worked effectively," and it could not in any event have known from experience whether it worked well for swaps. Although the Commission stated that the purpose of the 10% aggregation rule is to prevent "the sharing of transaction or position information that may facilitate coordinated trading" (*id.* at 71,654), the standard it established is vastly over-inclusive—forcing aggregation even where an investor has no knowledge of another entity's positions, let alone the ability to coordinate trading with that entity.

In contrast, as Commissioner O'Malia discussed in dissent, the aggregation requirement will impose significant costs on market participants—particularly given the inclusion of the

much larger swaps market for the first time. "The practical effect of th[e] [aggregation] requirement," he explained, "is that non-eligible entities, such as holding companies who do not meet any of the other limited specified exemptions will be forced to aggregate on a 100% basis the positions of any operating company in which it holds a ten percent or greater equity interest in order to determine compliance with position limits." 76 Fed. Reg. at 71,704. "[B]y requiring 100% aggregation based on a ten percent ownership interest, the Commission has determined that it would prefer to risk double-counting of positions over a rational disaggregation provision based on a concept of ownership that does not clearly attach to actual control of trading of the positions in question." *Id*.

The Notice had proposed to mitigate some of the harsh effects of the aggregation rule through the ONF exemption. *See supra* at 16. Under that exemption, an investor would have permitted the disaggregation of positions held by independently controlled and managed non-financial subsidiaries. *See* Notice, 76 Fed. Reg. at 4,774 (proposed § 151.7(f)). Plaintiffs and other commenters made clear that the ONF exemption alone was insufficient, because the same rationales supporting an exemption for owned *non-financial* entities also supported an exemption for owned *financial* entities over which the investor does not exercise control. *See* comments cited at 76 Fed. Reg. at 71,653 nn.266–67. Yet in the final Rule, the Commission abandoned even the modest ONF exemption, on the ground that it was reinstating a different, preexisting exemption for independently controlled accounts ("IAC exemption").

Not only did that change violate the APA's fair-notice requirement, but the Commission's justification was entirely illogical. The IAC exemption provides only that an investor need not aggregate independently controlled *client* accounts—for example, an investment bank need not aggregate all positions traded by bank employees on behalf of clients.

See 76 Fed. Reg. at 71,651–52, 71,653–54. The IAC exemption covers completely different conduct than the ONF exemption, so its reinstatement provides no logical reason to discard the ONF exemption, and was not a logical response to commenters' arguments that the exemption should be broadened to include *non*-financial entities over which a firm has no control. In Commissioner O'Malia's words, the Commission "fail[ed] to articulate a basis for its decision to drop outright from consideration the ONF exemption." 76 Fed. Reg. at 71,705. He appropriately worried that "baseless decisionmaking of this kind creates a risk that a court will strike down our action as arbitrary and capricious." *Id.*

Moreover, "the Commission did not address" a proposal by a commenter that it adopt a "tiered" approach whereby "only an entity's pro rata share of the position that is actually controlled by it, or in which it has an ownership interest[,] will be aggregated." 76 Fed. Reg. at 71,704 (O'Malia, Comm'r, dissenting). The rule release's only response to that proposal was to reject it in a footnote with no analysis, and note that "the Commission may reconsider whether to adopt [the] recommendation" at some unspecified future date. *Id.* at 71,651 n.245.

Finally, the Commission failed to exempt investors from the aggregation rules when compliance with those rules might require them to violate state or foreign law preventing information-sharing between certain entities. Although the Commission established an exemption for when sharing would violate federal law (such as the antitrust statutes), commenters pointed out that the problem was broader than that. *See* FIA Comment, at 24 (urging Commission to take into account "other regulatory, fiduciary and contractual requirements that prohibit common control of accounts managed by financial entities"); ISDA-SIFMA Comment, at 16 (citing "fiduciary duties"). The Commission gave no explanation for failing to address the full scope of the problem. Indeed, as written, the Rule absurdly requires

investors to attempt to acquire information about other entities' positions to prevent coordination of speculative activity that, but for that information request, would not be possible.

6. Bona Fide Hedging Exemptions

The Commission failed to justify the circumscribed scope of the bona fide hedging exemptions. Most egregiously, the Commission eliminated the preexisting options for parties to ask the Commission to recognize a "non-enumerated" hedging transaction. The Commission justified this decision on the ground that parties could still seek "interpretive guidance" under 17 C.F.R. § 140.99 as to whether the proposed transaction fit within one of the enumerated hedges, or could petition to amend the regulations. But as Commissioner Sommers aptly stated in dissent, "[t]hese processes are cold comfort . . . [N]one of these processes is flexible or useful to the needs of hedgers in a complex global marketplace." 76 Fed. Reg. at 71,700. It was also an unexplained departure from "decades of precedent that provided flexibility in favor of specifying a specialized list of enumerated bona fide hedging transactions and positions." *Id.* The Commission's reversal of its prior position is a further reason to vacate the Rule.

7. International Regulatory Arbitrage

The Dodd-Frank Act requires the Commission to "strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade." 7 U.S.C. § 6a(a)(2)(C). Commenters warned that the Position Limits Rule "will undoubtedly lead to a significant migration of market participants to less-regulated overseas markets." Chamber of Commerce Comment, at 4 (Mar. 28, 2011). Plaintiffs told the Commission that the Rule would likely drive trading activity overseas, thus "reduc[ing] liquidity in the U.S. commodity markets, thereby increasing price volatility and hampering price formation in the U.S. commodity markets." ISDA-SIFMA Comment, at 24.

The Commission failed to seriously assess the threat that the burdensome Rule will force market participants to flee to foreign markets. *See* 76 Fed. Reg. at 71,658–59. The two studies cited in the rule release were each more than a decade old, at a time when ready access to foreign markets was not nearly as widespread as it is now and a less restrictive regime was in effect. *See id.* at 71,659. The Commission also briefly noted its participation in an international organization to develop regulatory principles—a fact that has no bearing on whether the adopted Rule would lead to a flight of investors from U.S. markets. *Id.* The Commission concluded by once again throwing up its hands, fretting that "it is difficult to attribute changes in the competitive position of U.S. exchanges to any one factor" and assuring the public that it "takes seriously the need to avoid disadvantaging U.S. futures exchanges." *Id*. But however difficult it may be to predict the effects of a rule on regulatory arbitrage—and there is no indication that it is, because the Commission did not even initiate an inquiry—the statute calls for the Commission to conduct such an inquiry *before* promulgating a new rule. It failed to do so.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that this motion for summary judgment be granted, and that the Court enter judgment declaring the Position Limits Rule to be invalid, enjoining its enforcement, and vacating the Rule.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 23rd day of March, 2012, I caused the foregoing Motion for Summary Judgment and accompanying memorandum to be filed and served via the Court's CM/ECF filing system.

/s/ Jason J. Mendro
Jason J. Mendro