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' REPLY MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

Dated: April 23, 2012

Miguel A. Estrada, SBN 456289
Counsel of Record
Eugene Scalia, SBN 447524
Jason J. Mendro, SBN 482040
John F. Bash, SBN 988874
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036
Telephone: (202) 955-8500
Facsimile: (202) 467-0539

Counsel for Plaintiffs

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INTRODUCTION

The Commission's summary judgment brief, like the rulemaking it defends, is a sustained avoidance of the most basic tasks of reasoned decision-making under the Administrative Procedure Act: to take the measure of a problem before regulating it, and then to tailor the regulation appropriately to address the problem. The Commodity Exchange Act's cost-benefit requirements place a heightened duty on the Commission to perform these tasks and to evaluate specific considerations, such as maintaining liquidity and preserving the price discovery function of the markets—lest consumers and markets be adversely affected by the agency's decisions. Yet in the rulemaking in issue here the Commission declined to explore whether there was a genuine threat, its nature and extent, and in what particular markets the threat was concentrated. The agency could not, therefore, intelligently craft a rule to respond to the (supposed) problem.

The Commission spends most of its brief suggesting that it did not need to take these basic steps of reasoned decision-making because Congress pre-ordained the outcome. The Commission's "Congress-made-me-do-it" defense is wrong as a matter of statutory interpretation, and ultimately fails as a matter of logic and common sense—as the latter part of the Commission's brief reflects. For even if Congress pre-ordained a rule (and it did not), it plainly left it to the Commission to craft the rule's specifics. And accordingly, after dozens of pages of arguing that Congress freed it from any duty of inquiry, the Commission's brief does an about-face and claims repeatedly that the rulemaking reasonably examined the "effectiveness" of the Commission's existing requirements and deemed them worthy of applying on a far broader scale to a range of different financial instruments. But the Commission could not know that those requirements are effective without measuring the problem they supposedly were effective *against*. The Commission declined to perform that task because the rulemaking record failed to show that excessive speculation was a problem, as a majority of the Commissioners recognized.

The law does not require adopting a rule that a majority of the Commission's members concluded was both unnecessary, and was likely to raise prices for consumers of everyday goods. Rather, the law forbids it. The Position Limits rule should be vacated.[1]

ARGUMENT

I. The Commission's Interpretation Of The CEA Is Indefensible

With each new filing, the Commission offers a different variation on its interpretation of the CEA. The Court should not credit the Commission's implausible arguments.

1. As Plaintiffs explained, there is only one way to read Section 6a(a)(1): The Commission must find position limits "necessary" to combat "excessive speculation" causing an "undue burden on interstate commerce" before imposing them. *See* Mem. Supp. Mot. Summ. J., Dkt. 31, at 19–24 (Mar. 23, 2012) ("Mot.").[2] Contrary to the Commission's argument, that does not mean that the Commission may not impose position limits prophylactically, so long as it makes an informed determination that there is a reasonable likelihood that excessive speculation will pose a problem in a particular market, and that position limits are likely to curtail it without imposing undue costs. What the plain language of Section 6a(a)(1) does not permit is the establishment of position limits—whether prophylactic or remedial—without any necessity finding at all.

In its brief, the Commission tries out a new, yet equally tortured, interpretation of that provision: It contends that the key phrase "'as necessary' does not impose substantive

[1] The Commission suggests that this Court could remand the Rule without vacating it. Mem. Supp. Cross-Motion Summ. J. & Opp., Dkt. 38, at 15 n.9 (Apr. 13, 2012). But it offers no substantive rebuttal to Plaintiffs' argument that the unusual remedy of remand without vacatur is not appropriate in this case in light of the factors identified by the D.C. Circuit: The Rule has not yet taken effect, so vacatur will not upset the status quo, and the Rule obviously does not implicate government funds or the public health and safety. *See* Mem. Supp. Mot. Summ. J., Dkt. 31, at 18 n.12 (Mar. 23, 2012).

[2] As in Plaintiffs' opening brief, section numbers correspond to the U.S. Code numbering. *See* Mot. 20 n.13.

requirements" *at all*. Mem. Supp. Cross-Motion Summ. J. & Opp., Dkt. 38, at 19 (Apr. 13, 2012) ("Opp."). The Commission claims that provisions of agency statutes that on their face require a finding of necessity have no force beyond the basic APA requirement of rational decision-making. *Id.*[3]

This counter-textual argument has no basis in the basic interpretive principles laid down by the Supreme Court and the D.C. Circuit, which instruct courts to give effect to the plain meaning of statutory language. *See*, *e.g.*, *Jimenez v. Quarterman*, 555 U.S. 113, 118 (2009). The Commission's reliance on *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356 (1973), is misplaced. In *Mourning*, the Supreme Court explained that a statutory provision authorizing an agency to promulgate "such rules and regulations as may be necessary to carry out the provisions of the Act" supports any regulation "reasonably related to the purposes of the enabling legislation." *Id.* at 369 (internal quotation marks omitted). As a judge of this court has explained, however, "courts have consistently read this language" from *Mourning* merely "to describe a heightened level of deference that is due the agency's interpretation of an ambiguous statute under *Chevron* step two." *Colo. River Indian Tribes v. Nat'l Indian Gaming Comm'n*, 383 F. Supp. 2d 123, 144 (D.D.C. 2005). Its holding, moreover, is limited to the broad grant of rulemaking authority at issue in the case. *See Ragsdale v. Wolverine World Wide, Inc.*, 535 U.S. 81, 92 (2002). It has no bearing on a provision like Section 6a(a)(1), which authorizes the Commission to take an action only upon making a finding that the action is necessary to fulfill a

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[3] The Commission again claims that its interpretation is entitled to *Chevron* deference, Opp. 18 n.10, without so much as addressing cases that hold that "'deference to an agency's interpretation of a statute is not appropriate when the agency wrongly believes that interpretation is compelled by Congress.'" *Peter Pan Bus Lines, Inc. v. Fed. Motor Carrier Safety Admin.*, 471 F.3d 1350, 1354 (D.C. Cir. 2006) (quoting *PDK Labs., Inc. v. DEA*, 362 F.3d 786, 798 (D.C. Cir. 2004)). Here, the central plank of the Commission's argument is that Congress has mandated position limits. It has never suggested, either during the rulemaking or before this Court, that it exercised discretion in interpreting Section 6a.

specific objective, "rather than more generally to act as is 'necessary to carry out the purposes' or 'provisions' of a statute, as discussed in *Mourning*." *AFL-CIO v. Chao*, 409 F.3d 377, 384 (D.C. Cir. 2005). For such a targeted provision, "the court's deference to the [agency] is . . . limited by the particular language" of the statute. *Id.*

The Commission also cites the separate opinion of one D.C. Circuit judge, while portraying the decision as a precedential holding of a panel. *See* Opp. 19 (citing Judge Silberman's separate opinion in *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994)). But that case concerned an agency's authority to promulgate rules of discipline for professionals practicing before it, and Judge Silberman "relied on the line of cases which held that administrative agencies have the power, under their general rulemaking authority, to prescribe standards of practice for attorneys practicing before them and to discipline those who fail to conform." *Checkosky*, 23 F.3d at 456 (opinion of Silberman, J.). That principle has no application here.

The Commission's strange interpretation of Section 6a(a)(1) is evidently an attempt to recant its previous concession that the necessity requirement would apply at least to the *levels* at which it sets position limits. The Commission claims that it never made such a concession, and that Plaintiffs took a quotation out of context. Opp. 25 n.21. That is false. In its preliminary injunction briefing, the Commission argued that even if Plaintiffs were correct that position limits were not required to be imposed by the Dodd-Frank amendments, the language of Section 6a(a)(1) requires a necessity finding only with respect to the levels at which limits are set. *See* Opp. to App. Prelim. Inj., Dkt. 25, at 24 (Feb. 17, 2012). The Commission offered no other interpretation of the necessity language in that brief.

2. The Commission concedes that over the last 75 years, each time it or its predecessor agency has promulgated new position limits, the order has "state[d] the conclusion that specific

position limits were necessary." Opp. 19. n.12. But, the Commission says, that does not mean that the Commission believed that such "a finding was required." *Id.* This argument strains credulity. Agencies do not make findings for no reason, and they certainly do not do so time after time over the course of decades. There is no reasonable way to read the regulatory history other than that the Commission understood what the plain text of the CEA says: that a finding of necessity is required to impose new position limits.

Nevertheless, the Commission claims that nearly 50 years after the CEA's enactment, in 1981, it interpreted Section 6a(a)(1) for the first time not to require a finding of necessity and that Congress subsequently ratified that interpretation. Opp. 20. The Commission's own application of the CEA in the 1990s, however, refutes that contention. As the Commission's brief concedes, "beginning in the 1990s [and] until the passage of Dodd-Frank, the Commission took a different approach" by eliminating position limits on a number of contracts. *Id.* at 17. Indeed, the Commission wrote into regulations that "position limits are not necessary for markets where the threat of excessive speculation or manipulation is nonexistent or very low." 17 C.F.R. § 38 app. B (Core Principle 5). The Commission fails to explain how this could possibly comport with its supposed 1981 view that Congress, in Section 6a(a)(1), had *already* determined that excessive speculation exists in all markets and that position limits were always effective to combat it. Indeed, if the Commission took its own congressional ratification argument seriously, it would have to concede that Congress ratified the 1990s regime in subsequent amendments to the CEA in the 2000s, including in the Dodd-Frank Act.

In any event, the Commission's 1981 order does not remotely reflect a determination that the Commission was excused from the half-century-old requirement of finding that limits are necessary. The only language the Commission quotes states that Congress, in Section 6a(a)(1), made a "'finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure.'" *Id.* (quoting 46 Fed. Reg. 50,938, 50,940 (Oct. 16, 1981)). Neither of those propositions means that excessive speculation exists or is even likely to arise with respect to any given commodity contract, or that position limits are always effective, regardless of the circumstances. Although the Commission accurately states that the 1981 rulemaking did not expressly include a finding of necessity, Opp. 20 n.13, that omission from a *preamble* to a regulation is legally insufficient to establish that Congress ratified the Commission's interpretation in subsequent legislation, as the Supreme Court has made clear. *See Rowan Cos. v. United States*, 452 U.S. 247, 262 (1981); *Helvering v. Hallock*, 309 U.S. 106, 121 n.7 (1940). It is well-settled that congressional ratification may be implied only where the "agency interpretation has been officially published and consistently followed." *Autolog Corp. v. Regan*, 731 F.2d 25, 32 (D.C. Cir. 1984). The cases the Commission cites are fully consistent with that principle. In one of the cases, for example, the Court relied on two unanimous Supreme Court decisions construing a statute, "the reasoning of [which] applie[d] equally to th[e] case" before it. *Forest Grove Sch. Dist. v. T.A.*, 129 S. Ct. 2484, 2490–91 (2009). In another, there was "abundant evidence that Congress both contemplated and authorized" the regulatory action, including a statutory provision "explicitly affirm[ing] the CFTC's authority." *CFTC v. Schor*, 478 U.S. 833, 846–47 (1986).

The Commission's reliance on the legislative history of a 1982 statute also is misguided. That history shows that Congress rejected requests to remove language about excessive speculation and to require trial-type hearings before imposing limits, and that it gave the Commission the authority to enforce exchange-set limits established in the 1981 order. Opp. 20–21. But the first two points have nothing to do with the necessity standard of Section 6a(a)(1), and the fact that Congress authorized the Commission to enforce exchange-set limits does not suggest that Congress was aware of the purported legal theory under which the Commission had required exchanges to establish limits. More importantly, the very legislative report it relies on states in no uncertain terms 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). That puts to rest any notion that Congress ratified the unspoken interpretation that the Commission purportedly adopted in 1981 (and proceeded to disregard throughout the 1990s).

3. Even while reading Section 6a(a)(1)'s necessity requirement out of the statute, the Commission avows fidelity to the statute's text in claiming that the Dodd-Frank amendments required it to impose position limits. Opp. 21–23. The Commission's reading has two fatal flaws: (i) It contradicts the plain text of Section 6a(a)(1), which is incorporated by reference into Section 6a(a)(2), and which Congress not only left intact in the Dodd-Frank Act, but amended to include swaps; and (ii) it ignores the fact that the key statutory "mandates" are each modified by the phrase "as appropriate." 7 U.S.C. § 6a(a)(2)(A), (a)(3), (a)(5)(A).[4]

With respect to the first problem, the Commission argues that the "standards" referred to in the opening clause of Section 6a(a)(2) do not include *the* central standard in Section 6a(a)(1)—the necessity requirement—relying on the dictionary definition of "standard" to refer to weights and measures. Opp. 24–25. As Plaintiffs have previously explained, however, in ordinary legal parlance, a "standard" is "a rule or principle that is used as a basis for judgment."

[4] The Commission continues to rely on the requirement that it submit a report to Congress about any position limits. Opp. 23 n.19. There is simply nothing in that provision that overcomes the standard of Section 6a or implies that the Commission was under an unwavering obligation to impose position limits regardless of their necessity or appropriateness.

Random House Webster's Unabridged Dictionary 1857 (2d ed. 2001). The necessity requirement is the primary "standard" set forth in Section 6a(a)(1).

With respect to the second problem, the Commission's only argument is that the words "as appropriate" are entirely superfluous: They merely replicate the regulatory objectives set out in Section 6a(a)(3). Opp. 22. But "[i]t is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (internal quotation marks omitted). Indeed, here the redundancy would occur in the *same* sentence of Section 6a(a)(3). That is an indefensible reading of the statute.

Both the Commission and *amici* focus on the word "required" in Sections 6a(a)(2) and 6a(a)(3). *See* Opp. 23 ; Br. of *Amici Curiae*, Dkt. 37-1, at 4 (Apr. 13, 2012) ("Senators Br."). But the phrase "the limits required under [Section 6a(a)(2)(A)]" refers to limits established that are "[i]n accordance with the standards set forth in [Section 6a(a)(1)]" and that are otherwise "appropriate." 7 U.S.C. § 6a(a)(2)(A). Those "standards" include the "necessary" determination. Moreover, it is clear that the word "required" cannot bear the weight the Commission and *amici* place on it because Section 6a(a)(5) does not state that the limits for *swaps* are "required." *See id.* § 6a(a)(5).

Instead of seriously addressing these flaws with its interpretation of the Dodd-Frank amendments, the Commission retreats to reliance on floor statements of three members of Congress. Opp. 8–10. Courts give little weight to such isolated statements. *See Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 457 (2002) ("We see no reason to give greater weight to the views of two Senators than to the collective votes of both Houses, which are memorialized in the unambiguous statutory text."); *Pub. Citizen, Inc. v. Rubber Mfrs. Ass'n*, 533 F.3d 810, 819 (D.C.

Cir. 2008) ("We ordinarily do not give controlling weight to such colloquies."). It is telling that the Commission has been unable to locate support for its view in more useful forms of legislative history, such as conference reports. Moreover, the statements it cites do not even address the necessity finding or suggest that position limits are mandatory (much less that Congress intended to override the necessity requirement for the levels at which to set position limits). For example, Senator Levin said only that the amendments would enable the Commission to "enforce the law to prevent excessive speculation and market manipulation." 156 Cong. Rec. S4064 (daily ed. May 20, 2010). Representative Peterson explained that the law provided "direction to the CFTC to mitigate outrageous price spikes we saw 2 years ago." 156 Cong. Rec. H5245 (daily ed. June 30, 2010). That is fully consistent with the traditional authority of the Commission to combat *actual* excessive speculation through position limits and its new authority to regulate the swaps market.

The Commission also repeatedly cites, for the first time in this litigation, *subcommittee staff reports*, which are submitted to members of Congress by aides and therefore do not purport to reflect the views of any committee or individual member of Congress. *See* Opp. 1, 7, 9 n.3, 39, 40 n.35. More importantly, those reports—from 2006 and 2007, three years before the passage of the Dodd-Frank Act—do not address the meaning of Section 6a or the Dodd-Frank amendments to it. To the extent that they supply relevant empirical analysis, the Commission was obligated to consider them alongside numerous studies in the record that it ignored.

For their part, *amici* attempt to cobble together a legislative-history narrative in which Congress intended for the Commission to ignore the statutory necessity standard but somehow neglected to write that into Section 6a when revising adjacent language in the very same subsection. *See* Senators Br. 4.[5] They give the misleading impression that in the week between when the bill was introduced and when it passed the House, Congress made a relevant decision to change the word "may" to the word "shall," and added the word "required." *See* Senators Br. 17–18. The revised provision, however, was what became Section 6a(a)(6)—a provision requiring aggregation of positions across exchanges that is not at issue in this case and that in any event does not use the key phrase "as appropriate" or expressly incorporate the necessity standard of Section 6a(a)(1). *Compare* H.R. 4173, 111th Cong. § 3113(a)(5) (Dec. 2, 2009), *with* H.R. 4173, 111th Cong. § 3113(a)(5) (Dec. 11, 2009). The Dodd-Frank sections at issue in this case—Sections 6a(a)(2), 6a(a)(3), and 6a(a)(5)—were added *in toto* to the next iteration of the bill, complete with the words "as appropriate" and the reference to the standards of Section 6a(a)(1). *See* H.R. 4173, 111th Cong. § 3113(a)(5) (Dec. 11, 2009). That "evolution" does not add anything to a plain-language reading of the statute; there was no change to the provisions at issue here indicating a shift from "permissive" to "mandatory."[6]

Finally, the Commission claims that under Plaintiffs' interpretation, "the Dodd-Frank amendments essentially do no work at all." Opp. 23 n.18. That is wrong. Plaintiffs agree that, besides adding swaps to the Commission's regulatory ambit and making a host of other changes, the amendments instruct the Commission to consider new position limits and to impose them if the statutory requirements are met. Members of Congress were undoubtedly concerned that the

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[5] As a type of "[p]ost-enactment legislative history," which "is not a legitimate tool of statutory interpretation," the Senators' views—which may or may not have been shared by the 41 other Senators whose votes were necessary for passage of the Dodd-Frank Act—are not entitled to any deference. *Bruesewtiz v. Wyeth LLC*, 131 S. Ct. 1068, 1081 (2011).

[6] Nor does the repetition of the word "required" in a subsequent version of the bill indicate any evolution toward mandatory limits. As explained above, that phrase refers only to position limits that meet the statutory standard. And the argument that the introduced version of the bill did not include deadlines, *see* Senators Br. 20, ignores the fact that the provisions in which the deadlines appear were not yet in the bill.

recent financial crisis may have been exacerbated by excessive speculation and wanted the Commission to get to work on the issue expeditiously. But Congress did not jettison the statutory standards that have long governed the Commission's rulemaking in this area.

II. The Commission's Strained Defense Of Its Cost-Benefit Analysis Betrays The Serious Shortcomings Of The Rule

The Commission had a duty under 7 U.S.C. § 19(a) to seriously assess the costs and benefits of the Rule, but it ignored the major costs of the Rule and reached no definitive conclusions about whether the Rule would achieve any of its purported benefits—because a majority of Commissioners believed that it would not. The Commission virtually concedes that the Rule cannot survive the standards set forth in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011), and other recent decisions in which the D.C. Circuit has concluded that the SEC failed to conduct an adequate cost-benefit analysis. Opp. 26. It pleads only that the principles applied in those cases should not extend to this case because "one-size-fits-all is not the law in this circuit." *Id.*[7] The Commission claims that here, the congressional "mandate" barred it from considering studies showing that excessive speculation is not a problem and that position limits are ineffective. In fact, even if such a mandate had existed it would not have excused the Commission from its statutory duty to assess the costs and benefits of the rule. *See* SEC Office of Inspector General, *Follow-up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings* 3–9 (2012) (explaining that cost-benefit analysis must still be performed as to all aspects of Dodd-Frank mandated rules).[8] And, the Commission never

[7] The cost-benefit provision at issue in *Business Roundtable* entailed similar considerations as Section 19(a) of the CEA. *Compare Business Roundtable*, 647 F.3d at 1148 (enforcing provisions requiring SEC "to consider the effect of a new rule upon 'efficiency, competition, and capital formation'"), *with* 7 U.S.C. § 19(a)(2)(B) (requiring evaluation of "considerations of efficiency, competiveness, and financial integrity of futures markets").

[8] *Available at* http://www.sec-oig.gov/Reports/AuditsInspections/2012/Rpt%20499_FollowUpReviewofD-F_CostBenefitAnalyses_508.pdf.

explains why such studies are irrelevant to the key choices in the Rule, such as the level of the limits. In reality, the Commission could not and did not perform any semblance of an appropriate cost-benefit analysis because it chose to ignore key issues and voluminous record evidence that conflicted with its preordained outcome.

1. In defense of its cost-benefit analysis, the Commission correctly notes that "when a cost-benefit analysis involves predictive calculations . . . judges 'do not sit as . . . referees on a professional economic journal.'" Opp. 27 (quoting *Cablevision Sys. Corp. v. FCC*, 597 F.3d 1306, 1314 (D.C. Cir. 2010)). No one is asking this Court to assess the Commission's "predictive" economic "calculations"—because it did not make any. The rule release repeatedly punted on the critical cost-benefit questions by claiming that the Rule would be cost-effective "to the extent" that it fulfilled congressional objectives, without assessing "the extent to which" those objectives would indeed be achieved. *See* Mot. 27–28 & n.16. That failure to reach any conclusions on the costs and benefits of the Rule violated the plain text of Section 19(a), which provides that the "costs and benefits of the proposed Commission action shall be *evaluated* in light of" the statutory factors—a term that connotes a determination of value or worth. 7 U.S.C. § 19(a)(2) (emphasis added); *see* Random House Webster's Unabridged Dictionary, *supra*, at 670 (evaluate: "1. to determine or set the value or amount of . . . . 2. to judge or determine the significance, worth, or quality of . . . ."). The Commission was required to employ its expertise to place an estimated value on both the costs and benefits of the Rule; it did neither.

The defects in the Rule, in fact, are even worse than a failure to exercise agency expertise: The majority of Commissioners foresaw that the Rule would "make it actually more difficult to hedge the risks that they take on in order to provide the public with milk, bread, and gas." Tr. of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act (Oct. 18,

2011) ("Oct. 18 Tr."), at 12. It was therefore not only Plaintiffs who "suggest[ed] that position limits may result in increased prices to consumers," Opp. 29 n.23, flunking any reasonable cost-benefit assessment; it was the Commission itself. Giving judicial approval to such a rule would encourage agencies to *shirk* their responsibility to employ their expertise, not to exercise it.

To persuade this Court to sustain its paltry cost-benefit analysis, the Commission makes novel contentions that contradict the well-settled tenets of administrative law. According to the Commission, for example, its duty to assess the costs and benefits of the Rule should be relaxed because the swaps market was not previously subject to position limits. Opp. 28, 34. The Commission therefore urges the Court to defer to its "experience and expertise." *Id.* at 28. But by its own admission, the Commission *lacks* any "experience" in establishing position limits for the swaps market. For that reason, the Commission was, if anything, under a *greater* obligation to collect data on the costs and benefits of new regulation.

In any event, the D.C. Circuit has squarely rejected the Commission's argument. In *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006), FERC attempted to justify its failure to find any evidence of anticompetitive abuse between pipelines and their non-marketing affiliates by arguing that the rules prohibiting such abuse did not previously apply to non-marketing affiliates, and therefore FERC would not have been apprised of abusive behavior. *See id.* at 844. The court vacated the rule. "If abuse arising from the relationship between pipelines and non-marketing affiliates were . . . rampant," it explained, "FERC likely would have been inundated with complaints and evidence." *Id.* (emphasis omitted). That is also true here: If excessive speculation were really a problem in the swaps market, the Commission should have been able to find support for that proposition in record evidence open to public scrutiny.

The Commission suggests that it would be impossible to assess whether position limits would be cost-effective in the swaps market because of the lack of sufficient data. Opp. 33–34. The flaw in the Commission's analysis, however, is that it did not even identify what data would be relevant to the inquiry. Its staff conceded that it lacked a "working definition" of "excessive speculation," Oct. 18 Tr. 189, and the rule release nowhere identified what sort of "excessive speculation" the Commission believed that the limits would curtail. The Commission attempts to paper over this central problem with the rulemaking with the tautological assertion that "excessive speculation" means "unwarranted" price volatility. Opp. 35. But what is "unwarranted" is no more self-evident than what is "excessive"; in either case, the role of the Commission is to "giv[e] some definitional content" to those general statutory standards. *Pearson v. Shalala*, 164 F.3d 650, 660 (D.C. Cir. 1999). Moreover, although the Commission complains that commenters did not volunteer data on the swaps market, it nowhere explains why, as an expert agency, it could not have attempted to collect and analyze data itself.

Those threshold flaws aside, the Commission's factual assertion that the record lacked data relevant to whether to establish position limits on the swaps market is false. For example, one of the studies that it deemed irrelevant, conducted through the Organization of Economic Cooperation and Development (OECD), concluded, after an exhaustive analysis of data, that "[t]here is no statistically significant relationship indicating that changes in index and *swap* fund positions have increased market volatility." Scott H. Irwin and Dwight R. Sanders, *The Impact of Index & Swap Funds on Commodity Futures Markets: Preliminary Results* 1 (OECD Food, Agriculture & Fisheries Working Papers No. 27, 2010) (cited at 76 Fed. Reg. 71,626, 71,663 n.373 (Nov. 18, 2011)) (emphasis added).[9] In fact, the study found that "there is some evidence that increases in index trader positions are followed by *lower* market volatility." *Id.* (emphasis

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[9] *Available at* www.oecd.org/dataoecd/16/59/45534528.pdf.

added). The data that the report relied on was readily available in this rulemaking: the "two related data sets [were] compiled by the *U.S. Commodity Futures Trading Commission*." *Id.* at 11 (emphasis added).

The Commission's appeal to cases in which an agency "adequately considered the submissions of dueling experts," *Sw. Airlines Co. v. TSA*, 650 F.3d 752, 756 (D.C. Cir. 2011), or developed a concrete formula for the key regulatory standard and applied that formula with mathematical rigor, *see California v. Watt*, 712 F.2d 584, 601–06 (D.C. Cir. 1983), thus rings hollow. Opp. 28. Unlike in those cases, Plaintiffs do not merely "attempt to prove that the [Commission's] decision is not supported by evidence in the record by citing evidence which conflicts with [its] conclusion," 712 F.2d at 606; rather, here the Commission entirely *ignored* key evidence and reached no definitive conclusions. Simply, to read the Commission's cases on this point is only to see how the Commission's diligence paled compared to those other agencies'.

The Commission also claims that it was subject to a less demanding standard for cost-benefit analysis because it was "under congressionally mandated tight deadlines." Opp. 28; *see also id.* at 33 (distinguishing *Business Roundtable* on this basis). That is an incorrect statement of the law (and in any case it is irrelevant because the Commission concedes that it had adequate time to develop the position limits on the 28 commodities covered by the Rule, *see id.* at 41–42). The fact "[t]hat 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." *Am. Mining Cong. v. EPA*, 907 F.2d 1179, 1191 (D.C. Cir. 1990). Indeed, the Commission overlooks that in the only case it relies on for this proposition, the D.C. Circuit had originally remanded the rulemaking to the Commission for failure to conduct an adequate cost-benefit analysis, despite the presence of the congressionally imposed deadlines. *See Watt*, 712 F.2d at 589, 599–600. And on the second appeal (the only one cited by the Commission), there was no claim that the agency had failed to conduct the cost-benefit analysis required by statute; the only relevant objections were technical challenges to the agency's "factual findings and methodological assumptions." *Id.* at 600. The D.C. Circuit explained that because the challenge was limited to these issues at the "frontiers of scientific knowledge" that had been resolved in the course of a proper cost-benefit analysis, the agency was entitled to deference. *Id.* (internal quotation marks omitted).

2. The Commission concedes that it ignored studies in the record showing that position limits were burdensome to the economy and unnecessary. Opp. 29. That evidence was indisputably "relevant to its task of setting the limit levels," *id.* at 29 n.24, as well as the question of what exemptions and other rules to establish. The Commission never addresses this fundamental flaw in its analysis.

Rather, the Commission's defense of its cost-benefit analysis only underscores its shortcomings. The only costs that it even attempts to quantify are those "resulting from monitoring position limits, changing trading strategy, and reporting"—not the enormous costs from prohibiting a range of beneficial economic activity. Opp. 29. For those costs, the best the Commission can muster are the obvious points that such costs are "highly individualized" and that any estimate—which it did not even attempt to develop—"'would necessarily be based on the underlying business models and strategies of the various market participants.'" *Id.* at 30 (quoting 76 Fed. Reg. at 71,672). Those obstacles, however, are present with respect to virtually any regulation of sophisticated economic activity. Thus, in *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005), the D.C. Circuit vacated an SEC regulation of mutual funds for failure to adequately assess its economic costs, despite the SEC's protest that it had no "'reliable basis for determining how funds would choose to satisfy the [rule] and therefore it [was] difficult to determine the costs associated with [it].'" *Id.* at 143 (quoting rule release; second alteration in original). Such difficulties, the court held, "do[] not excuse the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed." *Id.*

The Commission provides no convincing support for its assertion that these costs would be low. It claims, for example that only a small "percentage of *traders*" would be affected. Opp. 30 (emphasis added). But it concedes that the affected entities are the largest traders in the industry, *id.*, and yet the rule release made no attempt to estimate what percentage of the market they represent or the impact on the economy of imposing limits on them.[10] The Commission also asserts that the Rule includes cost-mitigation measures, *id.*, but the measures it identifies are either marginal (a one-time exemption for preexisting positions), unreasonably incomplete (netting of positions for *non*-spot-month limits only), or illusory (supposedly adopting formulas that "had long been applied by the Commission and the exchanges," which ignores the prior accountability-level regime and the lack of any prior limits on the large swaps market).[11]

Remarkably, the Commission claims that its cost-benefit analysis found that "the levels that it established for the spot month and non-spot month would serve the four objectives

[10] The Commission also ignored the considerable costs that the Rule will place on the 159 CFTC-registered Futures Commission Merchants ("FCMs"), many of which are relatively small, who act as intermediaries between customers and exchanges. FCMs have historically had a regulatory obligation to monitor compliance of their customers with exchanges' and the CFTC's legacy position limits applicable to futures. The Commission did not give any consideration at all to the large costs to be incurred by FCMs to design, develop, and implement position tracking and aggregating systems in order to monitor their customers' compliance with the Rule.

[11] The Commission's cost-benefit analysis with respect to aggregation and bona fide hedging exemptions is similarly flawed. The Commission again appeals, for example, to the "individualized" nature of sophisticated economic instruments. Opp. 32.

Congress specified in 7 U.S.C. § 6a(a)(3)(B)"—without a *single citation* of the rule release to support that assertion. Opp. 31. In fact, the Commission repeatedly concluded that the Rule would achieve its purported benefits only "*to the extent* that the position limits described herein protect prices from market manipulation and excessive speculation." 76 Fed. Reg. at 71,675 (emphasis added); *see also* Mot. 28 n.16. The Commission could not have found otherwise because three Commissioners were not convinced that the Rule would achieve those objectives. The Commission's revisionist position that this language merely reflects predictive uncertainty, Opp. 36, is thus not credible. This Court should not permit the Commission to rehabilitate its flawed cost-benefit analysis by setting forth arguments that did not achieve a majority vote at the time of the rulemaking.

In sum, a majority of Commissioners believed this rule was unnecessary and harmful, but the Commission wagered it could ignore those gaping defects by tossing aside volumes of record evidence and claiming that Congress hard-wired the Rule. Proceeding in that manner was mistaken for many reasons, not the least being that ignoring the record and facts left the agency incapable of satisfying its statutory responsibility to appraise the Rule's benefits and costs.[12]

III. The Rule Cannot Stand In Light Of The Commission's Substantial APA Violations

1. The Commission presents *no* serious rebuttal to Plaintiffs' core APA objection that 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

[12] The Commission touts the rule release's "18-page cost-benefit analysis," but does not acknowledge that it originally thought it could get away with a one-page analysis in the Notice that failed to give members of the public any indication of the Commission's view of the costs and benefits of the Rule or the data it was relying on. Opp. 28–29. An agency may not rely, "without affording comment, on data critical to support a rule solely because the existing record contains a deficiency that extra-record data might cure." *Chamber of Commerce v. SEC*, 443 F.3d 890, 903 (D.C. Cir. 2006).

effectiveness." Mot. 30–34. Its brief almost entirely disregards this failure and devotes its APA discussion solely to the discrete errors that Plaintiffs have identified. *See* Opp. 37–45.

The Commission briefly claims that it did in fact "address[] the comments it received, appl[y] its experience, and provide[] a rationale in the preamble," Opp. 37—going so far as to assert that it "carefully considered[] dozens of studies," *id.* at 11. That is simply incorrect: The rule release declared that the key "studies and reports do 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 also id.* at 71,664. The Commission does concede in a footnote that in the rulemaking it did not "give weight to studies concluding that excessive speculation does not exist or does not cause harm." Opp. 33 n.25.[13] But without taking account of those studies, it could not answer the concededly "crucial question [of] how the Commission should specifically implement the required limits." *Id.* at 11. There is simply no doubt that the Commission ignored highly material evidence in the record during the rulemaking. The Commission's failure to address this serious APA violation in its brief only underscores that the Rule is unsupportable.[14]

2. The Commission's defense of the discrete provisions of the Rule identified by Plaintiffs also lacks merit.

Spot-month Limits. The Commission seeks to justify its spot-month formula of 25% as an "industry standard"—a claim that is misleading not only because that level has not previously applied to the much larger swaps market or cash-settled futures and options, but also because it

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[13] It also ignored studies showing that position limits are ineffective. *See* Mot. 9–10.

[14] The Commission belatedly attempts to smuggle an evaluation of the record evidence in through the back door, observing in the factual background section of its brief that some of the studies in the record were "equivocal" and others found that position limits were helpful. Opp. 11–12 & nn.4–6. Whether that is true, however, is irrelevant: It is not this Court's job to evaluate studies in the record that the Commission ignored, and it cannot uphold the Rule based on evidence not relied on below. *See Safe Food & Fertilizer v. EPA*, 365 F.3d 46, 50 (D.C. Cir. 2004).

was an "industry standard" only insofar as the Commission itself previously mandated that exchanges adopt that formula, not because the "industry" independently concluded that it was necessary or effective. *See* 17 C.F.R. § 150.5(c)(1) (2011).

The Commission also trots out the same *ipse dixit* conclusions that plagued the rule release. In justifying the rejection of Plaintiffs' definition of "deliverable supply," for example, the Commission states that it "determined that its longstanding definition of that term provided a reliable estimate of the amount of the commodity readily available to traders." Opp. 38 (citing 76 Fed. Reg. at 71,633, 71669). That is certainly the *conclusion* it reached, but it provided no analysis whatsoever of *why* its definition was preferable to Plaintiffs'. Similarly, the Commission defends its decision to subject cash-settled contracts (including swaps) to the same low limits as physical-delivery contracts, despite the fact that the former are not susceptible to corners and squeezes, on the ground that cash-settled contracts are vulnerable to another form of "market manipulation" called "banging the close" or "marking the close" (terms that appear nowhere in the rule release). Opp. 38–39 & n.31. It is true that the rule release speculated that if the cash-settled limits were higher, it would "permit larger position[s] 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 (emphasis added). But it did not identify a *single instance* where this ever occurred, despite the fact that swaps were never subject to position limits before, and not all cash-settled contracts were subject to the 25% formula.

Non-spot-month Limits. The Commission concedes that it had not previously applied the non-spot-month formula to all of the contracts subject to the Position Limits Rule (including, of course, the swaps market), but states only that it found, "based on its experience with the formula for the contracts to which it has applied, that the formula has helped prevent excessive speculation and manipulation while protecting liquidity and price discovery." Opp. 39. As Plaintiffs have explained, however, the Commission has not defined "excessive speculation," measured whether it was occurring with respect to any given commodity or set of contracts, analyzed whether a higher limit would accomplish the same objectives, or identified what precisely in its experience led it to conclude that the formula had been effective. The Commission's brief makes no attempt to rebut any of these points.

The Commission's footnoted defense of its analysis of the impact of non-spot-month limits on swaps is inadequate. *See* Opp. 40 n.34. Again, the Commission's argument relies entirely on the *number* of affected traders, regardless of the size of those traders' presence in the market. But it is the scope of trading, not the number of traders, that enables producers and consumers to access deep, liquid markets to hedge against risk and obtain accurate information about prices. And the Commission concedes that the Rule will have a disproportionate impact on swaps but makes no effort to explain why the same formula appropriate for certain physical-delivery contracts is appropriate for those very different instruments. *See id.*

Extension of Limits to Swaps. Besides repeating its incorrect statutory argument that it was required to impose position limits on swaps, the Commission offers no reasoned defense of its decision to do so. The Commission suggests that swaps have been subject to position limits or accountability levels since 2008 (even though elsewhere in its brief it asserts that "[t]he biggest change effected by the Rule is that . . . for the first time, federal position limits apply to swaps"). Opp. 13, 40 n.35. The Commission exploits an ambiguity in its own regulations. Although certain *exchange-traded* cash-settled contracts, which may have been termed "swaps" by the exchanges, were subject to the prior accountability-level regime (e.g., "NYMEX Henry

Hub Natural Gas Last Day Financial Swap"), *see* 76 Fed. Reg. at 71,634 n.88, the rule release repeatedly conceded that the Commission previously lacked authority to regulate "swaps" that are not traded on commodity exchanges. *See*, *e.g.*, *id.* at 71,627 ("Congress extended the Commission's reach to the heretofore unregulated swaps market.").[15]

Selection of Contracts to Regulate. The Commission attempts to justify its choice to subject only certain commodities to position limits—which directly contradicts its current interpretation of the congressional "mandate" to apply position limits to all commodities derivatives—as a "reasonable first step" in light of its limited resources. Opp. 41–42. That is not the explanation it gave below; nothing in the cited pages of the rule release suggests that the Commission intended to extend position limits to other contracts at a later date. *See* 76 Fed. Reg. at 71,629, 71,665. Under the *Chenery* principle, this Court must reject that made-for-litigation rationale. *See Manin v. Nat'l Transp. Safety Bd.*, 627 F.3d 1239, 1243 (D.C. Cir. 2011). The Commission has likely concocted this new explanation because it has no answer to the logical flaw in its decision to regulate the contracts with the *largest* open interest: As Plaintiffs explained in their opening memorandum (in a point that the Commission declines to address), this rationale makes no sense because, as the Commission's own regulations establish, contracts "with large open-interest, high daily trading volumes and liquid cash markets" are *less* likely to be subject to manipulation. 17 C.F.R. § 38 app. B (Core Principle 5). *See* Mot. 34–35; Tr. of Preliminary Injunction Hr'g at 31 (Feb. 27, 2012) (the Court describing the Commission's contention that it must establish position limits for all non-exempt contracts as "astonishing").

Aggregation. The Commission offers a similarly hollow analysis in its defense of the

[15] In fact, as the Commission's own *amici* note, in 2000 Congress "amended the CEA to prohibit the CFTC from exercising any authority over any swap transactions," which "remained the law" until the Dodd-Frank Act. Senators Br. 11.

draconian 10% aggregation standard. Opp. 42–44. As in the rule release, the Commission claims that this standard has "worked well" in the past, *id.* at 43, but cites no evidence to support that conclusion, and does not identify the standard it used to determine what has "worked well." It provides no explanation for why a pro rata aggregation standard, which was suggested by numerous commenters and vigorously supported by dissenting Commissioner O'Malia, would not achieve the objective of preventing excessive speculation while avoiding "the potential costs to industry associated with the implementation of 100% aggregation." 76 Fed. Reg. at 71,704. Those costs will explode under the Rule, as companies must now somehow monitor the positions held in the much larger and more diverse swaps market by companies in which they hold ownership stakes—positions that, in many circumstances, are not readily discernible. The Commission did not even acknowledge this significant practical problem in the rulemaking, let alone explain how the onerous 10% threshold could possibly be justified in light of the potential divestments and corporate reorganizations that it will trigger.

Nor does the Commission provide any coherent reason for withdrawing the owned non-financial entity ("ONF") exemption to the aggregation requirement. It asserts that Plaintiffs and other commenters "reacted negatively" to the proposal. Opp. 43. That was true only because the ONF exemption was not *broad enough*, as it unreasonably excluded owned financial companies. Moreover, in removing the ONF exemption, the Commission contended that because it had retained the independent account controller ("IAC") exemption, along with other exemptions that were in the original proposal, further disaggregation exemptions were not "warranted." 76 Fed. Reg. at 71,654. As discussed in Plaintiffs' opening memorandum, however, the ONF and IAC exemptions cover different activity, so there was no reasonable basis for the Commission to withdraw the ONF exemption on the ground that it was abandoning its ill-considered proposal to withdraw the IAC exemption. The Commission's brief ventures no explanation for this arbitrary course of decision-making, stating only that it "ultimately decided largely to retain its current aggregation policy, which was effective." *Id.* at 43.[16]

Finally, the Commission offers the same broken-record defense of its decision not to exempt parties from the aggregation requirement where the necessary information-sharing would violate state or foreign law: The current policy "worked well." Opp. 43–44. There is no evidence in the record that it has "worked well," and even if there were, there would be no basis to assume it would function effectively now that the aggregation requirement applies to a much broader range of entities in light of the expansion to swaps. With no analysis, the Commission asserts that the aggregation rule would preempt state law (a legal conclusion found nowhere in the rule release). But it is not at all clear that a court would hold that the aggregation rule preempts a state law barring a company from obtaining information from an owned entity. It might well conclude that the company is required to divest its stake where compliance with the aggregation rule would put it in violation of state law.[17]

Bona Fide Hedging. The Commission suggests that it preserved the non-enumerated hedge exemption from its prior regulations. Opp. 44. The rule release, however, clearly explained that the Commission was eliminating that exemption (which was previously set forth at 17 C.F.R. § 1.3(z)(3)). 76 Fed. Reg. at 71,648–49. As Commissioner Sommers observed in

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[16] While the Commission cites the Supreme Court's decision in *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158 (2007), for the self-evident proposition that agencies are not required to adopt their proposals, that case makes clear that an agency's withdrawal of its proposal is subject to the APA's requirement of a reasonable explanation. *See id.* at 175.

[17] The Commission also says that a party could seek an exemption from the aggregation rule to avoid a violation of state or foreign law. Opp. 44. That is true of virtually any regulatory requirement, but it does not excuse arbitrary administrative decision-making. The Commission gives no explanation why it has not given a blanket exemption to all parties in circumstances that would violate the law of another sovereign.

dissent, "the Commission is eliminating a valuable source of flexibility that has been a part of regulation 1.3(z) for decades—that is, the ability to recognize nonenumerated hedge transactions and positions." *Id.* at 71,700. The Commission's brief points to 17 C.F.R. § 150.5(a)(5), but that provision does not include the preexisting flexible procedure for seeking approval of non-enumerated hedges. As Commissioner Sommers explained, the new provision is "cold comfort" in part because it requires the Commission to "formally propose [an] amendment pursuant to APA notice and comment" in order "to amend the list of enumerated transactions"—a time-consuming process that the Commission is unlikely to invoke for every party that requests a non-enumerated exemption. *Id.*

International Regulatory Arbitrage. The Commission claims that the rulemaking adequately addressed the potentially enormous problem of traders fleeing to overseas markets. Opp. 44. The rule release, the Commission says, "noted its efforts to forge an international consensus in favor of imposing position limits" and cited two outdated studies that concluded that regulatory arbitrage was not a problem (neither of which, of course, addressed the *new* limits imposed by the Rule). *Id.* The Commission appears to believe that it has unbridled discretion "to rely on the research [it] deems most helpful," *id.* at 44–45, even if that research bears little relevance to the issue at hand in light of the vastly changed global economy over the last decade. The D.C. Circuit has held otherwise. *See Business Roundtable*, 647 F.3d at 1151 (vacating rule where SEC "relied exclusively and heavily upon two relatively unpersuasive studies").

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that their 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.

Respectfully submitted,

Dated: April 23, 2012

/s/ Miguel A. Estrada

Miguel A. Estrada, SBN 456289
Counsel of Record
Eugene Scalia, SBN 447524
Jason J. Mendro, SBN 482040
John F. Bash, SBN 988874
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
Telephone: 202.955.8500
Facsimile: 202.467.0539

Counsel for Plaintiffs

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 23rd day of April, 2012, I caused the foregoing Reply Memorandum in Support of Plaintiffs' Motion for Summary Judgment to be filed and served via the Court's CM/ECF filing system and to be served by hand on the following:

Jonathan L. Marcus
Lawrence DeMille-Wagman
Mary T. Connelly
U.S. Commodity Futures Trading Commission
Office of the General Counsel
1155 21st Street, NW
Washington, DC 20004
(202) 418-5649

/s/ Jason J. Mendro
Jason J. Mendro