IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION and SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION,

Plaintiffs,

v.

COMMODITY FUTURES TRADING COMMISSION,

Defendant.

No. 11-cv-2146 (RLW)

DEFENDANT COMMODITY FUTURES TRADING COMMISSION'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF ITS CROSS-MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

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A. Introduction

Plaintiffs, two trade associations who represent members of the financial industry, seek to invalidate the Commission's rule regarding Position Limits for Futures and Swaps, 76 Fed. Reg. 71626, 71684-71699 (Nov. 18, 2011) (to be codified at 17 C.F.R. Part 151) ("Rule"). But Plaintiffs ignore that Congress mandated that the Commission promulgate the Rule. Congress included this mandate as part of the reforms it enacted in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) ("Dodd-Frank"). The Rule addresses Congress' longstanding concern that excessive speculation in derivatives has led to spikes in the price for oil, natural gas, and other physical commodities. *See, e.g., The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat*, Staff Report, Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, U.S. Senate, S. Prt. No. 109-65 (June 27, 2006) ("*Oil and Gas Rep.*") at 3 ("[L]arge speculative buying or selling of futures contracts can distort the market signals regarding supply and demand in the physical market or lead to excessive price volatility, either of which can cause a cascade of consequences detrimental to the overall economy."). Thus, as directed by Congress, the Commission issued the Rule, which imposes limits on the number of physical commodity futures contracts, options, and economically equivalent swaps that any speculator may hold.

Commodity futures contracts, options, and swaps are derivatives. That is, their prices are derived from the price of an underlying commodity. Although the commodity underlying a derivative may be a tangible (*e.g.*, an agricultural product, an energy product, or a metal), or intangible (*e.g.*, an interest rate, or the value of a foreign currency), the Rule only applies to the former. Those who purchase or sell derivatives do so either to hedge or speculate. Hedging reduces risk from fluctuation in the price of the underlying commodity. Thus, for example, producers or users of a physical commodity (oil, corn, silver, etc.) could use derivatives to hedge their exposure to fluctuations in the price of that commodity by purchasing or selling derivatives contracts in an amount related to the amount of the underlying commodity that they expect to produce or use. Those who purchase or sell derivatives to speculate seek to profit from the price fluctuation of the underlying commodities. The use of derivatives contracts for hedging is limited – generally, a producer or user can only hedge the amount of the commodity it intends to produce or use. But there is no natural limit to the amount of derivatives that a speculator may purchase, even where the underlying commodity is a physical product whose supply is limited.

Derivatives contracts have certain designated expiration dates. As the expiration date of a particular physical-delivery contract for a particular commodity approaches, each holder of that contract must close out its obligation under that contract, or be prepared to make or take delivery of the underlying commodity. When this happens, the price of the derivative should converge with the price of that commodity. But if a speculator holds or controls too many derivative contracts for a physical commodity, price discovery may be distorted. For example, convergence may not happen smoothly because that speculator may block other derivative holders from closing out their contracts. This can occur when the speculator controls contracts representing a sufficiently large proportion of the finite supply of the underlying physical commodity. Like a firm with market power, such a speculator may be able to time its trading and manipulate the price of the derivative contract, thereby destabilizing the price of both the derivative contract and the underlying commodity.

It is essential that the market for commodity derivatives operates smoothly and fairly. As

Congress recognized, transactions in that market "are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities." 7 U.S.C. § 5(a). The Commodity Exchange Act, 7 U.S.C. §§ 1-27 ("CEA"), serves this national public interest by, among other things, "deter[ring] and prevent[ing] price manipulation or any other disruptions to market integrity; [] ensur[ing] the financial integrity of all transactions subject to" the Act, and "avoid[ing] . . . systemic risk[.]" 7 U.S.C. § 5(b). To that end, the Commission and its predecessors have, since the 1930s, been authorized to set position limits – limits on the number of commodity derivatives that any speculator may hold.

1. The History of Position Limits

This Rule is by no means the first regulation imposing position limits. The history of speculative limits closely parallels the history of turbulence in the commodity markets, *i.e.*, periods of time when the price of the derivatives for a physical commodity and the underlying physical commodity itself were particularly volatile. Congress enacted the Grain Futures Act of 1922, the first federal regulation of the futures market, in the wake of what were, at the time, described as violent fluctuations in the price of various grains. "[S]udden or unreasonable fluctuations in the prices" of certain commodity futures transactions "frequently occur as a result of [] speculation, manipulation or control . . . ." Grain Futures Act of 1922, ch. 369 at § 3, 342 Stat. 998, 999 (1922), codified at 7 U.S.C. § 5 (1925-26). Further, "such fluctuations in prices are an obstruction to and a burden upon" interstate commerce. *Id.*

But speculators in grains were able to evade the restrictions of that Act, which did not include position limits. Thus, in 1936, against the backdrop of hearings and reports by the

Federal Trade Commission and the Grain Futures Administration that very large speculative traders holding enormous positions were responsible for dramatic price fluctuations in the grain markets, Congress passed the CEA, which permitted the Commission's predecessor, the Commodity Exchange Commission ("CEC"), to impose position limits. Congress authorized the CEC to "fix such limits on the amount of trading . . . which may be done by any person as the [CEC] finds is necessary to diminish, eliminate, or prevent such burden." 7 U.S.C. § 6a(1) (1940). These limits applied then, and now, only to speculators. 7 U.S.C. § 6a(1) (1940); 7 U.S.C. § 6a(c). Two years later, the CEC imposed its first position limits. 3 Fed. Reg. 3145 (Dec. 24, 1938).

In 1974, in response to the expansion of the derivatives market, Congress created the Commission, and it also extended the reach of the CEA so that it encompassed not just specified agricultural commodities, but futures contracts for virtually all commodities.[1] The Commission invoked its expanded jurisdiction in 1981. There had recently been a rapid increase in the price of silver, followed by an equally rapid decrease, at a time when a few speculative traders controlled an extraordinarily large number of futures contracts for that commodity. In response, the Commission required contract markets to "close the existing regulatory gap" and impose position limits for *all* futures contracts. 46 Fed. Reg. 50938, 50939 (Oct. 16, 1981). The Commission explained:

> [7 U.S.C. § 6a(1) (1976)] represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure . . . The prevention of large and/or abrupt price movements which are attributable to extraordinarily large speculative positions is a Congressionally endorsed regulatory objective of the Commission.

[1] Concerned that speculators had caused severe and unwarranted fluctuations in the price of onions, Congress in 1958 banned outright the trading of onion futures contracts, a ban that is still in effect. *See* 7 U.S.C. § 13-1.

> Further, it is the Commission's view that this objective is enhanced by speculative position limits since it appears that the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, *i.e.*, the capacity of the market is not unlimited.

Id. at 50940. The Commission dismissed objections regarding the effectiveness and need for position limits, objections similar to those resolved by Congress when it enacted the CEA: "the observations concerning the general desirability of limits are contrary to Congressional findings in Section 3 and 4a of the Act [7 U.S.C. §§ 5, 6a] and considerable years of Federal and contract market regulatory experience." *Id*. The Commission also dismissed objections to its authority to require the exchanges to impose limits "on an omnibus basis." *Id*. at 50939. The Commission construed its statutory authority as authorizing the adoption of "a reasonable means of achieving one of the primary statutory purposes underlying the Act, that is, to prevent disruptions in the marketplace which are a result of large speculative positions." *Id*. at 50939. The Commission concluded that "speculative limits are appropriate for all contract markets irrespective of the characteristics of the underlying cash market"; such characteristics would be considered, the Commission explained, "in reviewing the levels proposed by the exchanges." *Id*. at 50941.

Futures industry groups immediately sought to upend the Commission's prophylactic approach by proposing changes to the Commission's statutory authority over position limits. One proposed amendment would have required the Commission, before ordering an exchange to review or revise limits, to make specific findings after a hearing on the record that position limits were *necessary* to prevent manipulation, corners, or squeezes. S. Rep. 97-384, at 44, 79. Another proposal would have modified the CEA by removing the very language on which the Commission had relied in requiring the exchanges to establish speculative limits on all futures contracts as a prophylactic measure – the language that expressed Congress' finding regarding the harmful effects of excessive speculation but that industry claimed had no economic basis. *Id.*

at 44.

Congress rejected each of these proposals, choosing instead to "strengthen the Commission's" position limits authority, S. Rep. No. 97-384, at 44, and to reaffirm that "speculative limits [are]. . . important regulatory tools for preventing unreasonable fluctuations or unwarranted changes in commodity prices that may arise even in the absence of manipulation." S. Rep. 97-384, at 45.

In doing so, Congress made clear that it was well aware of the Commission's prophylactic approach to the setting of position limits. The Senate Report noted that "[d]uring 1981, the Commission promulgated a final rule requiring exchanges, by February 14, 1982, to submit speculative position limits proposals for Commission approval *for all futures contracts traded as of that date*." S. Rep. 97-384, at 44 (emphasis added). As Commission Chair Philip McBride Johnson explained:

> In the aftermath of the silver crisis, the Commission began serious consideration of a number of regulatory changes designed to prevent a recurrence in silver or other commodities. The advisability of permanent speculative limits *in all commodities* was among the most important to be taken up. [A Commission report] concludes that "reasonable limits in place *before* the buildup of large (silver futures) occurred, would have helped prevent the accumulation of such large positions and the resultant dislocations created when the holders of these positions stood for delivery." [The report] goes on to observe that "it seems clear from the silver crisis that the orderly imposition of speculative limits *before a crisis develops* is one of the more promising means of solving such difficulties in the future." With this in mind, the Commission adopted [the] 1981 rule which ensures that *each* futures and options contract traded on [an exchange] will be subject to speculative position limits.

Futures Trading Act of 1982: Hearings on S. 2109 before the S. Subcomm. on Agricultural Research, 97th Cong. 44 (1982) (emphases added).

Acting against this backdrop, Congress clarified the Commission's authority to set position limits by rule or regulation, as well as by order. 7 U.S.C. § 6a(a). Further manifesting its approval of the Commission's prophylactic approach, Congress provided for the first time that violations of exchange-set limits would constitute violations of the CEA. 7 U.S.C. § 6a(e); 7 U.S.C. § 6a(5) (1986).

For a period of time beginning in the 1990s until the passage of Dodd-Frank, the Commission took a different approach to *some* position limits for *some* commodities, allowing exchanges to substitute trader reporting obligations for fixed limits. But the Commission retained federal speculative limits on certain agricultural contracts and required exchanges to set position limits on all physical-delivery (and most cash-settled), physical-commodity contracts during the spot month, the period of time closest to delivery, when futures and physical commodity prices converge and the potential for market disruption is greatest. 17 C.F.R. § 150.2 (and App. B to Part 38); 7 U.S.C. § 7(d)(5).

In 2008, in response to high prices and volatility in the energy markets and evidence that a large trader of energy contracts had exploited the absence of Commission regulatory authority over the swaps market, Congress provided the Commission authority to set and police position limits on energy contracts, including certain swaps. Pub. L. 110-246, 122 Stat. 1651 (2008) (Title XIII); *see Excessive Speculation in the Natural Gas Market*, Staff Report, Permanent Subcommittee on Investigations, U.S. Senate (June 25, 2007) ("*Excessive Speculation*"). The Commission then commenced a rulemaking, during which it reiterated that 7 U.S.C. § 6a(a) "made it clear that unchecked speculative positions, even without intent to manipulate the market, can cause price disturbances" and thus authorized it to impose limits "prophylactically," "render[ing] unnecessary a specific finding that an undue burden on interstate commerce had actually occurred." 75 Fed. Reg. 4144, 4146 (Jan. 26, 2010); *see id*. at 4146 n.13 ("Requiring a specific demonstration of the need for position limits is contrary to [7 U.S.C. § 6a(a)] . . . .”).[2]

2. The Dodd-Frank Act and Congress’ Mandate

In July 2010, in response to the financial crisis, including volatility in the price for oil, gas, and other commodities, and problems arising from the largely unregulated swaps market, Congress enacted Dodd-Frank. It strengthened 7 U.S.C. § 6a(a) by requiring that the Commission impose speculative limits on futures contracts for all physical commodities (*id*. § 6a(a)(2)(A)), that it do so promptly (*id*. § 6a(a)(2)(B)), and that it apply the limits to economically equivalent swaps (*i.e.*, those that derive their price from the futures contracts) (*id*. § 6a(a)(5)). Congress required the Commission to set the limits at appropriate levels in its discretion, so as to effectuate, to the extent possible, four specific criteria. *Id*. § 6a(a)(3)(B). Finally, Congress decided that it would review the mandate it had imposed upon the Commission within a short time after the new limits took effect. Thus, it required the Commission to provide it with a study regarding the effects of the limits within 12 months of their imposition, and it further provided that it would hold hearings within 30 legislative days after submission of the study. 15 U.S.C. § 8307(a).

Congress had no intention of requiring the Commission, as a precondition to imposing the mandatory limits, to find that excessive speculation existed, or was about to occur. Congress had already determined that limits were necessary. During hearings prior to the passage of Dodd-Frank, Senator Levin, chair of the Senate Permanent Subcommittee on Investigations (which had conducted hearings and issued the reports on excessive speculation in energy and

[2] The Commission did not complete this rulemaking because it was overtaken by the Dodd-Frank Act and the rulemaking that resulted in the rule at issue in this case.

other commodity markets),[3] urged passage to ensure "a cop on the beat in all commodity markets where U.S. commodities are traded . . . that can enforce the law to prevent excessive speculation and market manipulation." 156 Cong. Record S. 4064 (daily ed. May 20, 2010). And in the House of Representatives, Representative Collin Peterson, Chairman of the House Committee on Agriculture and author of an amendment strengthening the position limits provision, reminded his colleagues that his committee's own:

> in-depth review of derivative markets began when we experienced significant price volatility in energy futures markets due to excessive speculation – first with natural gas and then with crude oil. We all remember when we had $147 oil . . . .This conference report [now] includes the tools we authorized and the direction to the CFTC to mitigate outrageous price spikes we saw 2 years ago.

156 Cong. Rec. H5245 (daily ed. June 30, 2010).

Numerous references in the legislative history also attest to the importance to Congress of applying regulatory tools, including position limits, to the largely unregulated, invisible swaps market. Congress viewed the nearly $600 trillion swaps market as a "major contributor to the financial crisis" because excessive risk taking, hidden leverage, and under collateralization in that market created a systemic risk of harm to the entire financial system. S. Rep. 111-176, at 29 (2010). As Senator Cantwell and others explained, it was imperative that the CFTC have the ability to regulate swaps through "position limits," "exchange trading," and "public transparency" to avoid a recurrence of the instability that rippled through the entire financial system in 2008. *See e.g.* 156 Cong. Rec. S 2676-78, S 2698-99, S 3606-07, S 3966, S 5919 (daily ed. April 27, May 12, 19, July 15, 2010 (statements of Sens. Cantwell, Feinstein,

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[3] *See Excessive Speculation*, at 8 ("Excessive speculation that occurred on electronic exchanges in 2006 contributed to the overall distortion of energy prices in the natural gas market, to the detriment of American consumers, businesses, industry and utilities."); *Oil & Gas Rep.*, at 2 ("[T]here is substantial evidence that the large amount of speculation in the current [crude oil futures] market has significantly increased prices" of crude oil).

Lincoln)).

As enacted, Dodd-Frank amends 7 U.S.C. § 6a(a) to direct that:

> In accordance with the standards set forth in [7 U.S.C. § 6a(a)(1)] . . ., with respect to physical commodities . . . the Commission *shall* by rule . . . 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 contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.

7 U.S.C. § 6a(a)(2)(A) (emphasis added). Congress specified that "the limits *required* under subparagraph (A)" be imposed expeditiously – within 180 days for exempt commodities (*i.e.*, energy and metals) and within 270 days for agricultural commodities (grains, dairy, etc.). *Id*. at § 6a(a)(2)(B) (emphasis added). Congress directed the Commission, when setting the limits it required, to impose them "as appropriate" on positions held during the spot month, each other month, and all months. *Id.* at § 6a(a)(3)(A). And Congress directed that, when setting the required limits, the Commission do so "to the maximum extent practicable, in its discretion," to (1) diminish, eliminate or prevent excessive speculation; (2) deter and prevent manipulation; (3) ensure sufficient liquidity for bona fide hedgers; and (4) ensure that the price discovery function of the underlying market is not disrupted. *Id.* at § 6a(a)(3)(B). Reflecting a significant concern of Dodd-Frank, Congress extended its position limits mandate to those swaps that are "economically equivalent" to commodity futures and options contracts for physical commodities. *Id*. § 6a(a)(5). Congress also required the Commission to establish limits "on the aggregate number or amount of positions in contracts based upon the same underlying commodity." *Id*. § 6a(a)(6). Finally, Congress directed the Commission to "conduct a study of the effects (if any) of the position limits imposed pursuant to [7 U.S.C. §6a] on excessive speculation and on the movement of transactions from exchanges in the United States to trading venues outside the United States," and to submit a report to Congress on the study "[w]ithin 12 months after the

imposition of position limits pursuant to [7 U.S.C. § 6a].” 15 U.S.C. § 8307(a).

3. The Rule

a. Pursuant to Congress’ mandate, the Commission issued its notice of proposed rulemaking in January 2011. 76 Fed. Reg. 4752 (Jan. 26, 2011). In response, the Commission received more than 15,000 comments from, among others, industry, trade organizations, academics, and the general public. Many commenters generally supported the Rule. 76 Fed. Reg. 71626 (Nov. 18, 2011). The Commission also received, and carefully considered, dozens of studies; some were supportive of position limits, some were opposed, and many expressed no view on position limits. *Id*. at 71663-64.

As in previous Commission rulemakings, commenters offered varying opinions as to whether position limits are an effective regulatory tool and whether speculation causes price spikes or market disruptions. *Id*. at 71663-64. The studies received by the Commission discussed whether excessive speculation exists or whether speculation has a negative impact on derivatives markets. Thirty-eight of those studies did not even discuss position limits; given Congress’ mandate to impose limits, the Commission concluded that such studies had failed to address the issues that were material to the rulemaking. *Id*. at 71663-64 and n.373. The other fourteen studies mentioned position limits, but did so only as a part of a broader discussion of the role of speculation. None addressed the crucial question: how the Commission should specifically implement the required limits to advance the objectives set forth in subsection 6a(a)(3)(B). *Id.* at 71664-65.

Even the studies and comments that questioned whether speculation affects prices were often equivocal.[4] Some of the studies that mentioned position limits concluded that speculative position limits were an important regulatory tool to control excessive speculation.[5] Another study concluded that, "despite rhetoric that imposing stricter limits would harm market liquidity, there is no evidence to support such claims, especially in light of the fact that the market was functioning very well prior to 2000, when speculative limits were tighter."[6]

On October 26, 2011, the Commission met and adopted the Rule by a three-to-two vote.[7] One member of the majority, Commissioner Dunn, initially expressed concern that the Rule

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[4] *Compare* Technical Comm., IOSCO, *Task Force on Commodity Futures Markets: Final Report* at 3 (2009) ("economic fundamentals, rather than speculative activity, are a plausible explanation for recent price changes in commodities") *with id.* at 8 ("short term expectations can be influenced by sentiment and investor behavior, which can amplify short-term price fluctuations, as in other asset markets"). Another study opining that speculative activity in general may reduce volatility nevertheless conceded that the authors could not rule out the possibility that a single trader might implement strategies that move prices and increase volatility. Brunetti & Buyuksahin, *Is Speculation Destabilizing?* at 4, 22-23 (2009); *see also* Irwin, *et al.*, *The Performance of Chicago Board of Trade Corn, Soybean, and Wheat Futures Contracts after Recent Changes in Speculative Limits*, at 1, 6 (2007) (concluding that there was "no *large* change in" price volatility after speculative limits were increased, but cautioning that "[w]ith limited observations available for the period following the change in speculative limits …, conclusions about the impact on volatility are tentative. Additional observations will be required across varying scenarios of supply, demand, and price level, to have full confidence in the conclusions.") (emphasis added); Parsons, John: Economia, Vol. 10, *Black Gold and Fools Gold: Speculation in the Oil Futures Market* at 108 (2010) (position limits will not prevent asset bubbles from forming, but they are "necessary to insure the integrity of the market").

[5] *See, e.g.*, Greenberger, Michael, *The Relationship of Unregulated Excessive Speculation to Oil Market Price Volatility*, at 11 (2010) ("[t]he damage price volatility causes the economy by needlessly inflating energy and food prices worldwide far outweighs the concerns about the precise application of what for over 70 years has been the historic regulatory technique for controlling excessive speculation in risk-shifting derivative markets"); De Schutter, O., United Nations Special Rapporteur on the Right to Food: Briefing Note 02, *Food Commodities Speculation and Food Price Crises* at 8 (2010) ("strict position limits should be placed on individual holdings, such that they are not manipulative").

[6] Medlock, *et al.*, Rice University, James A. Baker III Institute for Public Policy: *Who Is In the Oil Futures Market and How Has It Changed?* at 8 (2009).

[7] Transcript of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act (Oct. 18, 2011) ("Oct. 18 Tr.").

could raise prices, or make it more difficult for producers to hedge risk. Oct. 18 Tr. at 11-13. Nevertheless, he recognized that "Congress has tasked the CFTC with preventing excessive speculation by imposing position limits. This is the law. The law is clear and I will follow the law." *Id.* at 11. Later during the same meeting, Commissioner Dunn engaged in a colloquy with the Commission's chairman and its rulemaking staff, a colloquy that Commissioner Dunn hoped would make him "comfortable" with respect to his final vote. *Id.* at 148. He asked whether the Commission would take prompt corrective action if it determined that the Rule had caused any market disruption, and whether the Commission would act to make sure that those with legitimate hedging interests would be protected. *Id.* at 148-49. He sought assurance that the Rule would combat manipulation, and would not result in price setting. *Id.* at 150-51. And he provided the staff with a description of a transaction entered into by a Kansas grain elevator operator, and asked whether the transaction would be exempt under the Rule's bona fide hedging exemption. *Id.* at 152-53. The answers that he received satisfied his concerns, and he voted in favor of the Rule and its preamble. *Id.* at 205. Although he had an opportunity to submit a statement to accompany the preamble that might have qualified his vote, he did not do so.

Commissioners Sommers and O'Malia dissented. The Commission issued the Rule on November 18, 2011. 76 Fed. Reg. 71626.

b. The biggest change effected by the Rule is that, as required by Congress, for the first time, federal position limits apply to swaps. Otherwise, the Rule substantially parallels the pre-existing position limits regime of the Commission and the exchanges. In particular, the Rule imposes limits on speculative positions both for the spot month and non-spot months on 28 physical commodity derivative contracts. *Id.* at 71668-69. As the Commission noted, "[a]ll of the 28 Core Referenced Futures Contracts have some form of spot-month position limits currently in place." *Id.* at 71669. Similarly, the Rule's formulas for calculating both spot-month and non-spot-month limits are the same formulas that the Commission and the exchanges have used to set limits. *Id*. at 71632-33, 71639, 71669. The Rule contains a statutory-based exemption for transactions that constitute bona fide hedging. *See* 7 U.S.C. § 6a(c). As required, the Rule also incorporates account aggregation standards, which determine when certain traders are sufficiently interconnected so that their positions must be combined to assess whether they exceed the position limits. 7 U.S.C. § 6a(a)(6). The Rule's aggregation standards are consistent with the Commission's current aggregation policy. *Compare* 76 Fed. Reg. at 71692-93 *with* 17 C.F.R. § 150.4.

The Rule provides for phased implementation. The spot-month limits, and the non-spot-month limits for commodities already subject to Commission-imposed limits (pursuant to 17 C.F.R. Part 150), will become effective 60 days after the Commission and SEC jointly publish in the Federal Register a rule further defining the term "swap." 76 Fed. Reg. at 71632.[8] Non-spot-month limits on other commodities will take effect only after that rule takes effect and the Commission has received one year of open interest data (*i.e.*, data regarding open contracts). *Id*. The Rule exempts positions that have been established in good faith prior to its effective date. *Id*. at 71655-56.

STANDARD OF REVIEW

In a case involving review of final agency action under the Administrative Procedure Act (APA), summary judgment serves as the mechanism for deciding as a matter of law whether the administrative record supports the agency action, and whether that action is otherwise consistent

[8] Neither agency has scheduled a meeting to consider that rule. Until they issue a rule defining swaps, market participants must continue to comply with the Commission's current position limits regime.

with the APA's deferential standard of review. *Genesis Health Ventures, Inc. v. Sebelius*, 798 F. Supp. 2d 170, 179 n. 19 (D.D.C. 2011). Courts must "presume[] the validity of agency action." *WorldCom Inc. v. FCC*, 238 F.3d 449, 457 (D.C. Cir. 2001) (quotation marks omitted). The scope of review of agency action is "narrow." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513-14 (2009). "[A] court is not to substitute its judgment for that of the agency" and must uphold agency action if "the agency's path may reasonably be discerned[.]" *Id.* (internal quotation marks omitted). When a court evaluates regulations that, like the Rule, are "essentially legislative and rooted in inferences from complex scientific and factual data," the court's "task is not to second-guess an agency decision that falls within a zone of reasonableness." *Nat'l Mar. Safety Ass'n. v. OSHA*, 649 F.3d 743, 751-52 (D.C. Cir. 2011) (internal quotation marks omitted).[9]

SUMMARY OF ARGUMENT

Plaintiffs seek not only to invalidate the Rule but to dismantle the speculative position limits regime that Congress has erected over the past 75 years. Plaintiffs are trying to use the APA to overturn a congressional mandate, and to impose on the Commission requirements that Congress chose not to impose first in 1982, when Congress ratified the Commission's prophylactic approach to position limits over vigorous industry opposition, and then again in 2010, when Congress directed the Commission to impose position limits on physical commodity derivatives. This Court should reject Plaintiffs' gambit.

In promulgating the Rule, the Commission followed a congressional mandate – a

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[9] Plaintiffs mistakenly contend that this Court must vacate the Rule in the event it agrees with any of Plaintiffs' arguments. Mem. at 18 & n.12. In fact, even if this Court were to find the Rule flawed, it has the discretion to remand the Rule to the Commission without vacatur as the D.C. Circuit did in *Chamber of Commerce v. SEC*, 412 F.3d 133, 145 (D.C. Cir. 2005), (remanding, but not vacating, after finding, *inter alia*, flaws in the rule's cost-benefit analysis).

culmination of years of congressional review of the role of speculation in physical commodity markets – to impose the speculative limits and to do so expeditiously. By imposing tight deadlines on the Commission as part of the response to the financial crisis, Congress made clear its view of the importance of having federal position limits in place to prevent speculative traders from amassing extraordinarily large positions in physical commodity futures and options and economically equivalent swaps.

Plaintiffs contend that, for each position limit for each contract, the Commission must first make evidentiary-type findings about the role of speculation and the need for that limit. But this ignores the language, structure, and history of the position limits regime that Congress established. Congress determined that extraordinarily large speculative positions in the derivatives markets for physical commodities can cause unwarranted volatility in the price of the underlying commodity. Thus, it directed the Commission to impose speculative limits to prevent the establishment of such positions while at the same time ensuring that there is sufficient liquidity for bona fide hedgers. If the Dodd-Frank Congress had wanted the Commission to study the role of speculation in the derivatives markets *before* imposing limits, it would not have used the language that it did, nor would it have demanded the limits within tight deadlines.

Plaintiffs' challenge to the Rule's cost-benefit consideration similarly ignores that the Dodd-Frank mandate reflects Congress' judgment as to the benefits of position limits. The Commission properly conducted its cost-benefit consideration within that framework, concluding that the relatively unrestrictive limits that the Rule sets would affect only a small number of large, speculative traders. For those traders, the Commission estimated the costs of developing or adapting the systems needed for complying with the Rule and explained why it could not quantify the costs to those traders of adjusting their trading strategies. The Commission also noted numerous ways in which it had mitigated costs.

Plaintiffs' argument that it was imperative for the Commission to set the limits at the least restrictive level ignores the wide discretion Congress conferred on the Commission to achieve multiple objectives and invites the Court to apply an exacting standard that finds no support in the APA. In conducting the cost-benefit analysis, the Commission acknowledged the limitations on the data available, especially with respect to the swaps market, and indicated a willingness to revisit the limit levels upon collecting more data.

In considering the costs and benefits of the Rule in light of the five criteria set out in 7 U.S.C. § 19(a), the Commission may not have guaranteed that its Rule would produce particular results, but that was not its obligation, and there is plainly an element of prediction in extending the reach of the speculative limits to new markets, as Congress required. Given the broad discretion granted to the Commission to weigh all of the section 19(a) factors, and in light of Congress' demand that the Commission impose the limits expeditiously and report back promptly on their effects, if any, the Commission's cost-benefit consideration is entitled to substantial deference and should be upheld as sufficient.

Plaintiffs' attack on the limit formulas themselves fares no better. The Rule draws on the Commission's long history of experience with speculative limits, which its predecessor first imposed in the late 1930s under authority provided by Congress in the CEA. In particular, based on the Commission's view that the limit formulas that both it and the exchanges had long applied had a solid track record, the Commission largely adopted them for the new, required federal limits. The choices the Commission made reflect a conscious decision to act cautiously and incrementally in effectuating Congress' mandate to extend speculative limits, including to the previously unregulated swaps market. In reviewing these choices, this Court must accord deference to the Commission's exercise of its judgment based on its experience and expertise and Congress' demand for expeditious action. Because the discretionary decisions the Commission made were reasonable, and because the threshold decision to require federal limits was made by Congress, this Court should grant summary judgment for defendant.

ARGUMENT

I. THE RULE IS CONSISTENT WITH THE CEA AND CONGRESS' MANDATE.

Plaintiffs' argument that the Rule is contrary to statutory authority, Plaintiffs' Memorandum in Support of their Motion for Summary Judgment ("Mem.") at 18-25, rests on two fundamental errors: first, Plaintiffs misinterpret 7 U.S.C. § 6a(a)(1), and second, they ignore the impact of 7 U.S.C. §§ 6a(a)(2)-(7), which were added to the CEA by Dodd-Frank.

A. Subsection 6a(a)(1), in substantially its current form, has been part of the CEA since 1936. *See* 7 U.S.C. § 6a(1) (1940). This provision gives the Commission the general authority to promulgate position limits to "prevent" the burdens on commerce of excessive speculation causing undue price fluctuations. Plaintiffs contend that subsection 6a(a)(1), which authorizes the Commission to impose position limits "as [it] finds are necessary," limits the Commission so that it may impose position limits only if it first finds, with respect to a specific commodity, that excessive speculation already exists, and that position limits are necessary to put a halt to that speculation. Mem. at 19.

But that is not what the phrase "as the Commission finds are necessary" means.[10] Many regulatory statutes contain language authorizing agencies to promulgate regulations or take other

[10] The Commission's interpretation of section 6a(a)(1) is also entitled to deference. *Chevron USA, Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 843 (1984) (where the statute is silent or ambiguous as to the precise question at issue, courts must defer to the agency interpretation if it is a permissible construction of the statute).

action as they "find" "necessary" (or "appropriate") to effectuate either the statute's goals in general, or its specific provisions. Such phrases have been interpreted as affording deference to the agency to make a judgment, and as requiring only that any action the agency takes in the exercise of that judgment be rationally related to the purpose of the statute or its specific provisions. That is, "as necessary" does not impose substantive requirements. *See, e.g.*, *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973) ("Where the empowering provision of a statute states simply that the agency may make … such rules and regulations as may be necessary to carry out the provisions of this Act, we have held that the validity of a regulation promulgated thereunder will be sustained so long as it is reasonably related to the purpose of the enabling legislation") (internal quotation marks omitted); *Checkosky v. SEC*, 23 F.3d 452, 455 (D.C. Cir. 1994) (SEC's authority to promulgate rules "necessary" to carry out its functions required only that the rule be reasonably related to the purposes of the securities laws).[11]

Since 1981, the Commission has interpreted its authority under 7 U.S.C. § 6a to allow it to impose limits without making the sorts of findings that Plaintiffs would now require.[12] *See* Mem. at 22-23. That year, in the wake of great disruption in the silver market, the Commission

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[11] *Gerber v. Norton*, 294 F.3d 173 (D.C. Cir. 2002), *see* Mem. at 20, is irrelevant to this case. Before permitting a residential development in the habitat of an endangered species, the Endangered Species Act specifically required the Fish and Wildlife Service ("FWS") to find that the developer would act to minimize the effects of the development on the species. The FWS's failure to make such a finding bears no relationship to the Commission's actions in this case.

[12] Plaintiffs contend that, in the past, the Commission has only imposed limits when it found such limits immediately necessary. *See* Mem. at 4 & n.3 (citing orders), 19. Although the orders cited by Plaintiffs state the conclusion that specific position limits were necessary, none states that a finding was required. In any event, all of those orders long predate the 1981 rulemaking, in which the Commission adopted a prophylactic approach, requiring the imposition of speculative limits on all futures contracts without any findings about harm from excessive speculation in any of those markets.

issued a rule that required exchanges to establish position limits for *all* futures contracts for which there were not already limits. The exchanges were required to do so without regard to whether there was excessive speculation as to any of those contracts, whether speculation had caused price volatility, or whether position limits would be necessary to combat price volatility. 46 Fed. Reg. at 50940; 17 C.F.R. § 1.61(a)(1); *supra* at 4-6. In the preamble to the 1981 rule, the Commission unequivocally construed its statutory authority to impose limits as arising from "an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure." 46 Fed. Reg. at 50940.[13]

Over industry opposition, Congress ratified the Commission's construction the following year. It did so in three ways. First, Congress specifically rejected an industry proposal to strip out from section 6a the congressional findings about excessive speculation on which the Commission expressly relied in justifying its prophylactic approach. S. Rep. 97-384, at 44, 79. Second, Congress specifically rejected an industry proposal to require the Commission to hold a hearing on the record and make specific, evidentiary-type findings about the need for position limits to prevent manipulation, corners, or squeezes. *Id.* Finally, and most importantly, Congress gave the Commission authority to enforce violations of the exchange-set limits as violations of the CEA. *See* 7 U.S.C. § 6a(5) (1982). As the Supreme Court has explained, when

[13] Plaintiffs contend that the Commission did not specifically state that it could impose position limits without a finding of necessity. Mem. at 22-23. But even a cursory reading of the preamble to the 1981 rule makes clear that, in requiring position limits for all commodities, the Commission did not first find, as Plaintiffs would require, that there had already been excessive speculation with respect to each commodity, or that limits were necessary to rein in that speculation. Indeed, the Commission concluded that "speculative limits are appropriate for all contract markets irrespective of the characteristics of the underlying cash market" and even regardless of "the existence of historical trading data." 46 Fed.Reg. at 50941. Moreover, the Commission's prophylactic approach is also inherent in the rule itself, which requires exchanges to adopt limits "[f]or the purpose of *preventing* excessive speculation in any . . . [commodity futures contract]." 17 C.F.R. § 1.61(a)(1) (1982), 46 Fed. Reg. at 50945.

"Congress has not just kept its silence by refusing to overturn the administrative construction, but has ratified it with positive legislation, we cannot but deem that construction virtually conclusive." *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 846 (1986) (internal quotation marks omitted).[14] Had Congress disagreed with the Commission's interpretation, it would not have authorized the Commission to enforce those limits, and it would not have rejected industry efforts to change the language of (what is now) subsection 6a(a)(1) to require the Commission to make predicate findings. *See Forest Grove Sch. Dist. v. T.A.*, 129 S. Ct. 2484, 2492 (2009) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.") (internal quotation marks omitted); *Sherley v. Sebelius,* 644 F.3d 388, 396-97 (D.C. Cir. 2011) (same).[15]

B. Dodd-Frank amended section 6a(a) by adding subsections 6a(a)(2)-(7), which make the imposition of speculative limits on physical commodity derivative contracts mandatory. Subsection 6a(a)(2) is titled "Establishment of Limitations," and subsection 6a(a)(2)(A) states that "with respect to physical commodities, . . . the Commission *shall* by rule, regulation, or

[14] In the face of this overwhelming evidence of congressional ratification, Plaintiffs cling to one sentence of the Committee Report, which states that the Committee "contemplates" that the Commission would "consider objective economic data" when imposing limits. Mem. at 23 (quoting S. Rep. No. 97-384, at 45). That Congress expected the Commission to consider data in formulating its limits is a far cry from requiring the Commission to make particularized findings about excessive speculation and the need for position limits before imposing them. Indeed, the Commission does not contend that it may ignore objective data that are relevant to setting specific limits under the Dodd-Frank mandate, and the Commission did consider such data in exercising its discretion to set limits at appropriate levels. *See, e.g.*, 76 Fed. Reg. at 71635-37.

[15] Because *Forest Grove* and *Sherley* make clear that Congress is presumed to be aware of an agency's interpretation of a statute, those cases render irrelevant Plaintiffs' contention that, for 30 years, Congress was unaware that the Commission was imposing position limits as a prophylactic measure without making predicate necessity findings. *See* Mem. at 23. In any event, that contention is wrong as a factual matter. *See* p. 6, *supra*.

order establish limits on the amount of positions, as appropriate, . . . that may be held by any person . . . ." (Emphasis added.) Subsection 6a(a)(2)(B) sets forth deadlines for "the limits *required* under [§ 6a(a)(2)(A)]" (emphasis added) – 180 days for energy and metals, 270 days for agricultural commodities. Subsection 6a(a)(3), titled "Specific Limitations," provides that "[i]n establishing the limits *required* in [§ 6a(a)(2)(A)], the Commission, as appropriate, *shall* set limits" for the spot month and non-spot month. § 6a(a)(3)(A) (emphasis added). Subsection 6a(a)(3)(B) explains what the words "as appropriate" in subsection 6a(a)(3) (and subsections 6a(a)(2)(A) and 6a(a)(5)(A)) mean – the Commission shall, "to the maximum extent practicable, in its discretion," set the limits at levels that "diminish, eliminate or prevent excessive speculation as described in this section"; "deter and prevent manipulation"; "ensure liquidity for hedgers"; and "ensure that the price discovery function of underlying market is not disrupted."[16] Subsection 6a(a)(5) provides that "[n]otwithstanding any other provision of this section, the Commission *shall* establish limits" (emphasis added) on swaps that are economically equivalent to the commodities as to which the Commission must impose limits.[17] Subsection 6a(a)(6) provides that the Commission "*shall*" establish aggregate limits across contract markets and foreign boards of trade, and subsection 6a(a)(7) provides that the Commission "*may*" grant exemptions from any limits it establishes. (Emphasis added.) Finally, Section 719 of Dodd-Frank (codified at 15 U.S.C. § 8307) provides that the Commission "*shall* conduct a study of the effects (if any) of the position limits imposed" pursuant to subsection 6a(a), that "[w]ithin 12

[16] Subsection 6a(a)(4) provides guidance as to whether a swap performs a significant price discovery function.

[17] Subsection 6a(a)(5) begins with the phrase "[n]otwithstanding any other provision of this section" because the mandate to set position limits in subsection 6a(a)(2) applies only to futures contracts and options in physical commodities, not to swaps.

months after the imposition of position limits," the Commission "*shall*" submit a report of the results of that study to Congress, and that, within 30 days of the receipt of that report, Congress "*shall*" hold hearings regarding the findings of that report.

If, as Plaintiffs insist, the Dodd-Frank Congress had wanted the Commission to determine the need for each position limit before implementing it, Congress would not have written the statute that it did. There is only one plausible reading of the Dodd-Frank amendments: Congress unconditionally required the Commission to impose limits and to do so expeditiously. Congress conveyed that intent by stating four times that the limits are "required" and by setting two deadlines by which the limits "shall be established." If Congress wanted speculative limits only if the Commission decided on a contract-by-contract basis whether they were necessary, it would not have "required" limits for entire categories of commodities on short deadlines. [18] Nor would Congress have directed the Commission to issue a report to Congress within 12 months of the imposition of the limits on their effects, if any. Congress plainly wanted the Commission to act quickly and conduct an analysis of the limits' impact *after* they are established.[19]

Although no confirmation of the mandate beyond the language and structure of the Dodd-Frank amendments is needed, the legislative history provides it. Statements of representatives, including sponsors of the pertinent position limits provisions, confirm their understanding that Congress had mandated that the Commission impose position limits without making any of Plaintiffs' necessity findings. *See supra* at 8-10. Congress' intent is further evinced in its

[18] Under plaintiffs' reading, the Dodd-Frank amendments essentially do no work at all.

[19] Contrary to plaintiffs' contention, Section 719 would indeed be worded differently (if it would exist at all) had the Dodd-Frank Congress simply confirmed the Commission's discretion to impose position limits. In that context, Congress would have used conditional language (e.g., *If* the Commission imposes position limits pursuant to the other provisions of this title, *then* it shall conduct a study . . .).

progressive strengthening of the position limit provision during consideration of the legislation.[20] *See, e.g.*, *Russello v. United States*, 464 U.S. 16, 23-24 (1983) ("The evolution of these statutory provisions supplies further evidence [of Congressional intent]").

Plaintiffs seek to nullify the entire Dodd-Frank position limits framework by contending that subsection 6a(a)(2) incorporated a finding of "necessity" because it provides that limits shall be established "[i]n accordance with the standards in" subsection 6a(a)(1). Mem. at 20-21. There are two critical flaws in this argument. First, plaintiffs' argument runs headlong into Congress' ratification of the Commission's prophylactic approach to imposing limits, under which findings of necessity are not required. *See* Part I.A, *supra*. The "standards" in subsection 6a(a)(1) thus do not require any finding of necessity.

Second, the "standards" referred to in subsection 6a(a)(2) do not encompass a finding of necessity. Subsection 6a(a)(1) directs the Commission to apply aggregation standards to "positions held and trading done by any persons directly or indirectly controlled by such person," to consider setting different limits "for different commodities, markets, futures, or delivery months, or for different number of days remaining until the last day of trading in a contract," and to consider exempting or setting different limit levels for "transactions normally known to the trade as 'spreads' or 'straddles' or 'arbitrage.'" These standards are consistent with the first relevant dictionary definition of "standard": "something set up and established by authority as a rule for the measure of quantity, weight, extent, value, or quality." *Merriam-Webster's*

[20] As initially introduced in the House, the bill did not mandate the imposition of position limits and did not require a study of their effectiveness. H.R. 4173, 111th Cong., at 558 (as introduced in House, Dec. 2, 2009). But the bill was then amended in the House, and later in conference, to add the mandate by including what are now subsections 6a(a)(2) through (5), by strengthening the wording (referring to the limits to be established in 180 or 270 days as "required"), and by the addition of the separate provision requiring the study. H.R. Rep. No. 111-517, at 285, 354-56 (2010) (Conf. Rep.).

Collegiate Dictionary 1216 (11th ed. 2011). A finding of necessity is not. Because the Commission promulgated the Rule "in accordance with the standards set forth in" subsection 6a(a)(1), Plaintiffs' argument—which would render the Dodd-Frank mandate a dead letter—is unavailing.

Plaintiffs are also mistaken that the Commission's interpretation is inconsistent with other provisions of the CEA authorizing imposition of position limits or position accountability by exchanges and swap execution facilities. *See* Mem. at 21, 23 (citing 7 U.S.C. §§ 7(d)(5); 7b-3(f)(6)(A); 17 C.F.R. § 38 App. B). There is no inconsistency. The language and structure of subsection 6a(a), which requires the imposition of speculative limits, is different from subsections 7(d)(5) and 7b-3(f)(6). Those latter provisions do not refer to limits as "required," do not contain deadlines, and refer also to "position accountability." Moreover, the phrase "as is necessary and appropriate" comes after "shall adopt" and before "position limits or position accountability," and thereby modifies the directive "shall," whereas the phrase "as appropriate" in the Dodd-Frank mandate in subsections 6a(a)(2) and 6a(a)(5) comes after the reference to "the amount of positions." Thus, for the intangible commodities as to which the Dodd-Frank mandate does not apply, the exchanges and swap execution facilities retain discretion whether to impose limits, position accountability, or no constraints at all.

Finally, Plaintiffs' contention that the Commission failed to find that it had set position limits at an appropriate level (because it did not make a specific necessity finding with respect to each limit) is demonstrably incorrect.[21] Mem. at 24-25. As explained above, subsection

[21] Plaintiffs contend that the Commission has previously conceded it must make a necessity finding before setting particular position levels. Mem. at 24, citing Commission Opp. to Plaintiffs' Motion for a PI at 24. But Plaintiffs are able to find this concession only in a quote taken out of context. What the Commission actually stated was "even under *Plaintiffs*' approach of considering these two subsections [*i.e.*, subsections 6a(a)(1) and 6a(a)(2)] in isolation, it is far

6a(a)(3)(B) sets forth four factors for the Commission to consider in determining whether it has set limits at an appropriate level. The Commission discussed these factors throughout the Rule's preamble in setting the limit levels. *See, e.g.,* 76 Fed. Reg. at 71633-43, 71665-75. Indeed, Plaintiffs do not identify any of the factors that the Commission failed to consider.

II. THE COMMMISSION'S CONSIDERATION OF COSTS AND BENEFITS WAS SUFFICIENT.

Plaintiffs' argument that the Commission failed to provide a "meaningful cost-benefit analysis" in support of the Rule, *see* Mem. at 25, founders on its one-size-fits-all approach to cost-benefit analysis. Plaintiffs would have this Court require the Commission to conduct the same sort of cost-benefit analysis that the D.C. Circuit required in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011), where the SEC sought to amend its proxy rules. But one-size-fits-all is not the law in this circuit. To the contrary, an agency's cost-benefit analysis must take account of specific instructions that the agency has received from Congress with respect both to cost-benefit analysis generally and with respect to the requirements for a particular rulemaking. Regardless of the analysis, an agency may not countermand Congress' will. The nature of a "meaningful cost-benefit analysis" also depends upon the nature of the rule that the analysis supports. Here, the Rule is a prophylactic measure of prospective application, regulates an aspect of the economy – the swaps market – that heretofore has been, for the most part, unregulated, and was adopted under a congressional command to act expeditiously. In such a

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." The Commission has never (at least since 1981) required a finding of necessity before imposing position limits or setting limit levels, and no plausible argument can be made that such a finding is now required under section 6a(a)(2) with respect to limit levels. As the Commission stated in the Rule, "the contention that the Commission is required to demonstrate that … position limit levels … are necessary is contrary not only to the language of, and congressional objectives underlying amended section [6](a), but also to the regulatory history of position limits and to the choices that Congress made in the Dodd-Frank Act in light of that history." 76 Fed.Reg. at 71629.

circumstance, it is neither required nor possible to conduct the sort of precise evaluation of costs and benefits that Plaintiffs demand.

A. Certain principles govern the Commission's consideration of the Rule's costs and benefits. First, Congress directed the Commission to "consider" the costs and benefits of its actions and gave the Commission guidance as to how to conduct that analysis:

> The costs and benefits of the proposed Commission action 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)(2). This five-factor analysis is unique to the Commission and plainly contemplates the exercise of broad discretion in weighing the various and disparate considerations. *See Serafinn v. Local 722*, 597 F.3d 908, 913 (7th Cir. 2010) ("When multi-factor balancing tests and complex fact-determinations govern, the district court's discretion is greater.").

Second, agencies are not "empowered to weigh the costs and benefits of regulation at every turn; agencies surely do not have inherent authority to second-guess Congress' calculations." *Public Citizen v. FTC*, 869 F.2d 1541, 1557 (D.C. Cir. 1989); *see Shays v. FEC*, 414 F.3d 76, 114 (D.C. Cir. 2005) (agency may not create an exception to a statutory requirement merely because it concludes that the benefits of the requirement are exceeded by the costs). Regardless of the nature of the comments and studies received during the rulemaking, the Commission could not second-guess Congress by refusing to impose position limits.

Third, when a cost-benefit analysis involves predictive calculations, which "are a murky science in the best of circumstances. . .," judges "do not sit as . . . referees on a professional economic journal, but as . . . generalist judges obliged to defer to a reasonable judgment by an agency acting pursuant to congressionally delegated authority." *Cablevision Sys. Corp. v. FCC*, 597 F.3d 1306, 1314 (D.C. Cir. 2010) (internal quotation marks omitted). That is the situation here because Congress required the Rule to regulate the "dark market" for swaps.[22] Given the limited amount of available data, the Commission was obliged to rely on its experience and expertise. *See Southwest Airlines Co. v. TSA*, 650 F.3d 752, 756 (D.C. Cir. 2011) (court "will not second-guess [agency's] determination of this obscure calculation in a data-poor environment in which [a]ny decision . . . would have required considerable guesswork") (internal quotation marks omitted; brackets and ellipsis in original); *see also California v. Watt*, 712 F.2d 584, 600 (D.C. Cir. 1983) ("Where existing methodology or research in a new area of regulation is deficient, the agency necessarily enjoys broad discretion to attempt to formulate a solution to the best of its ability on the basis of available information") (internal quotation marks omitted).

Finally, that the Commission was operating under congressionally mandated tight deadlines must also be taken into account in assessing the reasonableness of the analysis. As the D.C. Circuit explained in a comparable context:

> Congress did not want the Secretary to spend years developing a five-year leasing program. Indeed, the Secretary was required to submit the first proposed program to Congress, the Attorney General, and the Governors of the affected states within nine months of the effective date of the 1978 amendments. Thus, the final decision as to how much analysis is necessary in view of the available data must be the agency's subject to judicial review only for obviously incorrect results or methodology.

Watt, 712 F.2d at 600 (internal quotation marks and footnotes omitted).

B. The Commission's 18-page cost-benefit consideration, 76 Fed. Reg. at 71662-80, is more than sufficient to justify the discretionary aspects of the Rule. *See* Mem. at 26. The

[22] *See, e.g.*, *Unregulated Markets: How Regulatory Reform Will Shine a Light in the Financial Sector*, *Hearing Before the Joint Economic Committee*, 111th Cong. 2, 6 (2009) (statements of Rep. Maloney and former CFTC chair Brooksley Born referring to a "dark market").

Commission took a step-by-step approach, considered all the criteria set forth in the CEA, and generated an analysis that was hardly "empty." *See* Mem. at 27.

First, the Commission responded to those commenters who, like Plaintiffs, suggested that the Commission had not made findings sufficient to support a conclusion that position limits are necessary. As the Commission explained, Congress mandated that it impose limits to restrict excessive speculation before such speculation could cause an undue burden on interstate commerce.[23] The Commission further explained that it carefully considered the studies it received and determined that none provided analysis as to *how* it should impose the limits mandated by Congress.[24] 76 Fed. Reg. at 71662-65. While Plaintiffs argue that the Commission failed to give "due weight" to studies concluding that extraordinarily large positions do not cause unwarranted price fluctuations, the Commission reasonably determined that studies that reached conclusions fundamentally at odds with Congress' determination that they do cause such harm were not useful in deciding how to set the limit levels to prevent such harm.

The Commission then separately considered the costs and benefits of the three principal elements of the Rule – position limits, exemptions, and aggregation – estimating costs where it could and providing an explanation for not estimating costs where it could not. With respect to position limits, the Commission predicted that the Rule would impose costs resulting from monitoring position limits, changing trading strategy, and reporting. For those firms that already monitor positions, those monitoring costs should not exceed $12,300 per firm. The Commission

[23] Although Plaintiffs suggest that position limits may result in increased prices to consumers, Mem. at 28-29, Congress believed the reverse – that it was excessive speculation, not limits thereon, that increased prices to consumers. *See supra* at 1, 7.

[24] When the Commission was presented with data relevant to its task of setting the limit levels, as it was with one commenter's data on conditional limits on contracts in the natural gas market, the Commission evaluated the data and explained why it disagreed with the commenter's assertions. 76 Fed.Reg. at 71635.

estimated that there might be as many as 100 firms that trade only in swaps, and that if any such firm had never monitored its positions in the past (which the Commission thought unlikely in light of other business reasons for doing so), the monitoring start-up cost would range from $5000 to $100,000, and annual operating costs would range from $1000 to $20,000. 76 Fed. Reg. 71665-68.

With respect to changes in trading strategy, the Commission explained that no market participant provided any data showing the magnitude of such costs, and that such costs, if they exist, are highly individualized. 76 Fed. Reg. at 71668. The Commission further explained that it could not independently estimate those costs because such an estimate "would necessarily be based on the underlying business models and strategies of the various market participants." *Id*. at 71672. The Commission predicted that costs on the whole would be "minimal for most market participants" because the formulas it chose for the limits would result in levels that are "sufficiently high" such that only a small percentage of traders – the largest speculative traders – would be affected. *Id*. at 71668 & n.413 (estimating that from 1.2% to 8% of reportable traders would be affected by spot-month limits for certain specified core-referenced contracts). The Commission also noted several ways in which it had sought to mitigate costs that would inexorably flow from Congress' mandate, including adopting a broad exemption from the limits for pre-existing swap positions, *id*. at 71667, adopting formulas for the limits that had long been applied by the Commission and the exchanges to promote continuity and facilitate an orderly transition to the new regime, *id*. at 71669, and permitting the netting of futures and swaps positions for purposes of complying with the non-spot-month limits, *id*. at 71672.

The Commission next proceeded to evaluate the costs and benefits of the speculative limits, in light of the five criteria listed in 7 U.S.C. § 19(a)(2). In conducting this evaluation, the

Commission devoted much of its discussion to the first factor – protection of market participants and the public – which is quite broad. The Commission explained that the determinations it had already made in setting the limit levels – namely, that the levels that it established for the spot month and non-spot month would serve the four objectives Congress specified in 7 U.S.C. § 6a(a)(3)(B) (preventing excessive speculation, deterring manipulation, ensuring sufficient liquidity for bona fide hedgers, and protecting the price discovery process) – supported the conclusion that the limits would protect market participants and the public. The Commission went on to note the similarly substantial correspondence between the subsection 6a(a)(3)(B) determinations and the cost-benefit considerations of protecting the efficiency, competitiveness, and financial integrity of the futures markets, protecting the price discovery function, and promoting sound risk management practices. The Commission concluded that the Rule would advance the section 19(a)(2) criteria.

With respect to the bona fide hedging exemption, the Commission explained that Dodd-Frank "provided a definition of bona fide hedging that is more narrow than the Commission's existing definition," 76 Fed. Reg. at 71675, requiring the trading position to "represent a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel." 7 U.S.C. § 6a(c)(2). Thus, swap dealers would no longer be able to obtain an exemption to manage the risk of their swap portfolios. The Commission recognized that "there may be significant costs (or foregone benefits) associated with the implementation of the new statutory definition," in that traders might have to adjust their trading strategies. 76 Fed. Reg. at 71677. The Commission could not quantify those costs, for the same reasons it could not quantify such costs in connection with the position limit levels: commenters did not provide any data on this score, and the Commission does not have access to the business strategies of market participants. *Id.* The Commission noted several ways in which it had sought to mitigate the costs flowing from the statute's narrower definition, including by expanding (from the proposed rule) the list of qualifying, enumerated hedging transactions, and by permitting netting of positions taken in the futures market to hedge the risk from positions established in the swaps market. *Id*. at 71678. The Commission also noted that it had sought to mitigate costs by reducing the frequency of reporting from daily to monthly, resulting in costs of approximately $29.8 million across approximately 200 entities. *Id*. at 71677. After considering the costs and benefits, the Commission evaluated them in light of the Section 19(a) factors and concluded that the requirements related to bona fide hedging would protect market participants and the public, would not negatively affect the competitiveness or efficiency of the futures markets, and would not disrupt the price discovery process. *Id*. at 71677-78.

As for the Rule's aggregation provisions, the Commission explained that it decided to largely retain its preexisting policy. *Id*. at 71678. The Commission noted that there nevertheless would still be significant changes stemming from Congress' mandate to apply position limits to swaps. The Commission recognized that the necessary extension of the aggregation policy to swaps "may force a trader to adjust its business model or trading strategies to avoid exceeding the limits." *Id.* at 71679; *see also id.* at 71679 n.497 (noting that this cost "is directly attributable to the congressional mandate that the Commission impose limits on economically equivalent swaps"). Here again, the Commission was unable to quantify those costs given the individualized and proprietary nature of a firm's trading strategy and business model. The Commission was able to quantify the cost of the aggregation provisions' reporting requirements, estimating that they would affect approximately 90 entities and cost $5.9 million. *Id*. at 71679. The Commission explained that these costs were necessary to ensure compliance with the policy.

The Commission then evaluated the costs and benefits in light of the Section 19(a) factors and concluded, based on its experience with the similar, current aggregation rules, that the aggregation provisions would protect market participants and the public. *Id.* The Commission further explained that a robust aggregation policy can prevent traders from evading the speculative limits through ownership or control of multiple accounts and holding large positions "that could cause unwarranted price fluctuations in a particular market, facilitate manipulation, or disrupt the price discovery process." *Id.* Thus, the policy would "help ensure the efficiency, competitiveness and financial integrity of the futures markets," protect price discovery, and promote sound risk management. *Id*. at 71679-80.

C. Because the Commission fulfilled its obligation under the CEA to consider the costs and benefits of the Rule, there is no merit to any of the challenges Plaintiffs raise. First, this case is nothing like *Business Roundtable*. *See* Mem. at 26-27. Unlike here, the proxy access rule at issue in *Business Roundtable* was discretionary; it was not a rule that was mandated by Congress, nor was it a rule that was subject to a time deadline. Although the Commission, like the SEC, has a statutory obligation to consider the costs and benefits of certain actions that the Commission takes under the CEA, the Commission could not, based on that consideration, issue a rule that is in any way at odds with Congress' mandate.[25]

In addition to all of these categorical distinctions, *Business Roundtable* is not helpful to Plaintiffs because the court specifically found that the SEC did not quantify certain costs when data were "readily available," did not address pertinent comments, and made internally

[25] For example, the D.C. Circuit faulted the SEC for relying on studies supporting the Rule that the court deemed "unpersuasive" when numerous studies "reached the opposite result." *Business Roundtable*, 647 F.3d at 1150. Here, in light of the mandate, the Commission could not give weight to studies concluding that excessive speculation does not exist or does not cause harm.

contradictory assumptions. 647 F.3d at 1150-54. Because the Commission's careful consideration of costs and benefits does not suffer from any of these flaws and implemented a congressional mandate, *Business Roundtable* is inapposite.[26]

Plaintiffs contend that the Commission conceded that it lacked data permitting it to estimate the costs of the Rule. In fact, as described above, the Commission provided estimates regarding a number of costs imposed by the Rule, and reasonably explained why other costs could not be estimated. Plaintiffs base their argument on the Commission's concession that it was difficult to estimate the specific number of traders who would be affected by the Rule. Mem. at 26 n.15. But this is not a flaw in the analysis, it is merely a recognition of the problem that Dodd-Frank seeks to combat – the previously opaque market for swaps. *See* S. Rep. 111-176, at 29-35 (2010). In such a situation, where data do not exist, the Commission need only "so state and go on to identify the considerations it found persuasive." *Jifry v. FAA*, 370 F.3d 1174, 1180 (D.C. Cir. 2004); *Watt*, 712 F.2d at 600 (agency has "broad discretion" to act "on the basis of available information" when "research in a new area of regulation is deficient").

Plaintiffs also complain that the Commission did not quantify the "significant costs" that could result if the Rule's provisions cause some traders to modify their trading strategy. *See* Mem. at 26. Here, where the Commission reasonably explained why it is impossible to quantify a potential cost, *see* p. 32-33, *supra*, it cannot be faulted for not doing so. Moreover, the Commission explained that it set the limits at levels that it estimated would only affect a small percentage of speculative traders, 76 Fed. Reg. at 71668, 71672, and took steps to mitigate any costs associated with the statutory narrowing of the bona fide hedging definition by permitting

[26] Nor are Plaintiffs helped by *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2009), or by *Chamber of Commerce, supra, see* Mem. at 25, because, among other reasons, neither of those cases involved a rule mandated by Congress.

the netting of risk-reducing positions in futures and swaps. *See* p. 32, *supra*.

Plaintiffs' complaint that the Commission failed to evaluate the benefits of the Rule, *see* Mem. at 26-27, and that it cannot assess such benefits until it first defines "excessive speculation," misses a fundamental point. Congress specifically directed the Commission to impose position limits. It did so because it wanted the Commission to act to "diminish, eliminate, or prevent excessive speculation *as described in this section.*" 7 U.S.C. § 6a(a)(3)(B)(i) (emphasis added). Section 6a(a)(1) describes excessive speculation as that which "caus[es] sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, [which] is an undue and unnecessary burden on interstate commerce in such commodity." And the Commission has long understood what Congress meant: "the historical and current reason for imposing position limits on individual contracts is to prevent unreasonable fluctuations or unwarranted changes in the price of a commodity which may occur by allowing one trader or a group of traders acting in concert to hold extraordinarily large futures positions." 46 Fed. Reg. at 50939; *see also* 76 Fed. Reg. at 71629 n.30. Thus, the benefit derived from the Rule is the prevention of the sort of excessive speculation that has long concerned Congress. The Commission cannot second-guess that concern.[27] *See Public Citizen*, 869 F.2d at 1557.

Nor is the Commission required to calculate the exact "tipping point" at which position limits might become overly restrictive. *See* Mem. at 27. Such a precise calculation is not possible nor is it required. Congress required the Commission to seek to advance four objectives to the maximum extent practicable in its discretion, when deciding on limit levels: prevent excessive speculation, deter manipulation, ensure sufficient liquidity for bona fide hedgers, and

[27] Plaintiffs note that a member of the majority, Commissioner Dunn, expressed some initial concerns regarding the Rule, *see* Mem. at 28, but his concerns were addressed, and he voted in favor of the Rule, recognizing that he had a statutory obligation to implement Congress' mandate. His initial remarks provide no basis for invalidating the rule. *See supra* at 13.

protect price discovery. The Commission explained that the formulas that it and the exchanges had applied had been effective in serving those objectives with respect to futures and options contracts, and it reasonably predicted, based on the limited data it had on the size of the swaps market, that those formulas would work effectively there as well. *E.g.*, 76 Fed. Reg. at 71669-70. The Commission also explained that these limits were relatively unrestrictive. *Id.* at 71672. The Commission was under no obligation to experiment with even less restrictive limits at the possible expense of Congress' objectives of preventing excessive speculation and deterring manipulation, especially when the Commission had no evidence that the limit levels it adopted would impair liquidity or price discovery. This Court should reject Plaintiffs' attempt to import into the judicial review process an exacting level of scrutiny that the APA does not permit and that few rules could survive. Plaintiffs' insistence that the Court apply such a standard is especially incongruous in the face of Congress' demand for expeditious action and its decision to exercise close oversight of the Commission's action.

Plaintiffs also attack the Commission's cost-benefit consideration by focusing on the phrase, "to the extent that," which appears in several places in the analysis. *See* Mem. at 27-28. Plaintiffs wrongly suggest that the use of the phrase indicates that, when it considered the factors set forth in 7 U.S.C. § 19(a)(2), the Commission failed to make certain determinations. In fact, as explained above, the Commission carefully considered all the section 19(a)(2) factors. The Commission repeatedly used the phrase "to the extent that," not to cover any failings in its analysis, but to reflect the uncertainty that is inherent where, as here, a rule will regulate transactions that have not been previously regulated. Plaintiffs also complain that the Commission was unable to "assure" the public as to the Rule's benefits. Mem. at 28. But no such assurance is required with respect to a rule of future application. *See Cablevision Sys.*

Corp. v. FCC, 597 F.3d at 1314 (predictive assessments are "murky science").[28]

III. THE RULE REFLECTS REASONED DECISION-MAKING AND IS ENTITLED TO DEFERENCE.

Plaintiffs contend that the Commission failed to exercise reasoned discretion with respect to various decisions it made in the course of the rulemaking. Mem. at 30-45. In fact, with respect to each issue raised by Plaintiffs, the Commission addressed the comments it received, applied its experience, and provided a rationale in the preamble supporting the policy choices it made. Because the APA requires no more, Plaintiffs' challenges are meritless.

A. Spot-Month Limits – Relying on available data, the Commission initially elected to use the 25% of deliverable supply formula (except for cash-settled natural gas contracts) for the spot month. 76 Fed. Reg. at 71633-34, 71669. The Commission made this choice because all of the futures contracts – and an important swap – that were subject to the Rule already had spot-month limits, 76 Fed. Reg. at 71634 & n.88, 71669, and these limits are largely set at 25% of deliverable supply. *Id.* at 71633-34. Thus, this formula is the industry standard, provides clarity to market participants, and has appeared to work effectively in achieving Congress' subsection 6a(a)(3)(B) objectives. *Id*. at 71669. Further, the Commission examined data to confirm that its formula would not have a detrimental impact on liquidity or price discovery. *Id*. at 71668-71. [29]

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[28] Plaintiffs are also mistaken in contending that the Commission erred by failing to include in its Notice of Proposed Rulemaking a sufficiently detailed analysis of costs and benefits of the proposed rule. *See* Mem. at 29. In fact, pursuant to 5 U.S.C. § 553(b), a notice of proposed rulemaking need only include "(1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved." There is nothing in *Chamber of Commerce v. SEC*, 443 F.3d 890 (D.C. Cir. 2006), to the contrary. That case merely holds that an agency may not issue a rule, and rely on extra-record materials without providing the public with any opportunity to comment.

[29] Plaintiffs suggest that the Commission can impose limits only if it first conducts a study showing that, with respect to a particular commodity, there would be harm in the absence of

Plaintiffs urge a more expansive definition of "deliverable supply" than the one adopted by the Commission. Mem. at 36-37. But the Commission determined that its longstanding definition of that term provided a reliable estimate of the amount of the commodity readily available to traders, which is the relevant benchmark for deterring manipulation. 76 Fed. Reg. at 71633, 71669. The Commission further explained that retaining its existing definition would facilitate an orderly transition to the new Federal limits. *Id.* at 71633 & n.73, 71669. Either justification was more than sufficient under the APA.

Finally, Plaintiffs contend that the Commission had "conceded cash-settled contracts are not subject" to the threat of corners and squeezes, and they challenge the decision to impose the same spot-month limits on cash-settled contracts that it imposed on physical-delivery contracts.[30] Mem. at 37-38. The Commission has made no such concession; corners and squeezes are not the only forms of market manipulation. Without parity in spot-month limits between cash-settled and physical-delivery contracts, traders would be able to build large positions in look-alike cash settled contracts, thus creating an incentive to manipulate and undermine price discovery in the physical delivery contract, to which the cash-settled contract is linked by price. *See* 76 Fed. Reg. at 71635; *id*. at 71670.[31] In addition, Congress found signs that even large, liquid contracts, like

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limits. See Mem. at 35-36. But the CEA authorizes, and Congress requires, the Commission to impose limits as a prophylactic measure, not just when a study shows that harmful speculation is already occurring. *See supra* at 18-26, 36.

[30] The Commission specifically sought comment as to whether it should adopt the same limit for cash-settled contracts that it proposed for physical delivery contracts. 76 Fed. Reg. at 4758. Thus, Plaintiffs are wrong to argue, Mem. at 37, that they did not have adequate notice with respect to the limit the Commission ultimately set. *See CSX Transp. Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1081 (D.C. Cir. 2009) (agency satisfies APA notice requirement if it requests comments on a particular issue).

[31] In fact, manipulating the price of a physical delivery contract in the spot month to benefit a larger position in the cash-settled contract is a well-known manipulative tactic known as

cash-settled natural gas contracts, were subject to excessive speculation and distortion. *Excessive Speculation*, *supra*, at 1-4, 6-7. After reviewing the operation and size of cash-settled derivatives markets for the relevant commodities, the Commission reasonably concluded that applying the same limit (except for natural gas) would ensure sufficient liquidity for bona fide hedgers and protect price discovery.[32] 76 Fed. Reg. at 71635-36.

B. Non-Spot-Month Limits – Nor is there any merit to Plaintiffs' challenge to the Commission's non-spot-month formula. Mem. at 38-40.[33] The Commission applied the formula it first adopted in 1999, setting the limit at 10% of the first 25,000 contracts and 2.5% of the contracts thereafter. *See* 76 Fed. Reg. at 71639 & n.131. This formula is highly permissive. 76 Fed. Reg. at 71639; 75 Fed. Reg. at 4147. It ensures that there are at least a minimum number of distinct market participants, thereby lessening the risk of market manipulation or disruption. 76 Fed. Reg. at 71678-79. Plaintiffs contend that the Commission's experience with this formula is "hollow" because it did not, in the past, apply to all of the contracts to which it will now apply. Mem. at 39. But the Commission concluded, 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. 76 Fed. Reg. at 71639. Further, the Commission examined the data and confirmed that the non-spot-month limits would impact only

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"banging the close" or "marking the close" that the Commission regularly combats. *See* http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/glossary_b.

[32] After a review of market data, the Commission concluded that cash-settled natural gas contract markets are large and a significant source of liquidity for bona fide hedgers. Accordingly, the Commission retained exchange-set spot-month limits of 125% of deliverable supply limit for cash-settled natural gas contracts because this level was appropriate to maximize the subsection 6a(a)(3) factors. 76 Fed. Reg. at 71636.

[33] Plaintiffs contend that the Commission should have permitted position accountability outside the spot month. Mem. at 38-39. This ignores that Congress mandated that the Commission impose position limits in the non-spot month. 7 U.S.C. § 6a(a)(3); 76 Fed. Reg. at 71640.

115 traders across all 28 contracts subject to these limits. *Id*. at 71672.[34] Thus, the Commission had an ample basis for choosing its non-spot-month limits, and this choice of adhering to a formula with a solid track record, especially in the face of a demand for expeditious action, merits deference. *Vonage Holdings Corp. v. FCC*, 489 F.3d 1232, 1242 (D.C. Cir. 2007) (Commission line drawing must be upheld unless "patently unreasonable" or "dictate of unbridled whim"); *WorldCom Inc. v. FCC*, 238 at 461-62.

C. Extension of Same Limits to Swaps – Congress required the Commission to impose limits on swaps that were economically equivalent to physical commodity futures and options, and its decision to impose the same limits on those swaps that it imposed on the futures and options was reasonable. *See* Mem. at 40. Plaintiffs argue that the Commission should not have set such limits because it lacked experience with respect to swaps. Mem. at 36. But this ignores Congress' mandate, as well as the fact that, before it changed course with Dodd-Frank, Congress had permitted swaps to be largely free from regulation.[35] Thus, the Commission surveyed the markets for cash-settled contracts, of which swaps are a subpart, and concluded based on available data that, with the exception of natural gas, these markets were not larger than the

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[34] Plaintiffs argue the Commission shirked its responsibility to evaluate the impact of non-spot-limits on swaps, Mem. at 39-40, but Plaintiffs are mistaken. Based on available data, the Commission concluded that its non-spot-month limits would not affect most swaps traders. 76 Fed. Reg. at 71672. Moreover, the Commission explained that it understood that swap dealers "would constitute a large percentage of those anticipated to be near or above" the limits and that the Commission's decision to permit netting of futures and swaps positions "would reduce their exposure" to the limits. *Id*.

[35] Congress changed course after it determined that large speculative traders exploited the absence of regulation of physical commodity swaps by shifting positions from futures to equivalent swaps. *Excessive Speculation*, supra, at 3-4. Further, Plaintiffs' claim that swaps "were never subject to position limits or accountability levels," Mem. at 39, is incorrect. Beginning in 2008, exchanges were directed to adopt position limits or accountability for significant price discovery contracts, including swaps. *See* 76 Fed. Reg. at 71634 & n.88; 17 C.F.R. Part 36, App. B, Core Principle IV.

market for physical delivery futures contracts. 76 Fed.Reg. at 71635-36. Thus, to advance the same statutory objectives as for economically equivalent futures, *see* 7 U.S.C. § 6a(a)(5)(B)(i), the Commission reasonably concluded in light of the available data that limits at the same level would provide ample liquidity while serving to deter excessive speculation and market manipulation.[36] 76 Fed. Reg. at 71635-36.

This Court should defer to the Commission's choice because Congress did not intend that a quest for perfection should obstruct expeditious action. "[A]ll agencies should always strive to develop the most effective and sound regulations, [but] that quest must give ground in favor of expedition where Congress directs the [agency] to establish standards promptly." *Sierra Club v. Jackson*, 2011 WL 181097 at *7 (D.D.C. Jan. 20, 2011) (internal quotation marks omitted). Recognizing the unavailability of useful swaps data, Congress also directed the Commission to study the effect of its position limits *after* their imposition. 15 U.S.C. § 8307(a). This shows that "Congress was aware that perfect regulatory standards could not be developed in so short a period of time. But so too must it have appreciated that whatever levels were promulgated initially by the Administrator could be amended should later studies demonstrate that a different level is more appropriate. . . ." *N.Y. v. Gorsuch*, 554 F. Supp. 1060, 1064 (S.D.N.Y. 1983).[37]

D. Selection of Contracts to Regulate – Plaintiffs contend that the Commission acted arbitrarily in its selection of commodities to which the Rule applied. Mem. at 34-35. Congress

[36] The Commission adopted limits for cash-settled contracts on an interim final basis, and it invited comment on the appropriateness of those levels. 76 Fed. Reg. at 71638. The Commission is currently considering those comments.

[37] Plaintiffs cite *American Mining Congress v. EPA* and contend that it suggests Dodd-Frank's deadlines are irrelevant to the Commission's defense of the Rule. Mem. at 31 (citing 907 F.2d 1179, 1191 (D.C. Cir. 1990)). But the case says nothing of the sort. *American Mining* concerned a court order, not a congressional directive. 907 F.2d at 1191. When Congress imposes a deadline, the court will review an agency's analysis "only for obviously incorrect results or methodology." *Watt*, 712 F.2d at 600.

mandated limits on speculative positions taken with respect to all physical commodity derivatives. 7 U.S.C. § 6a(a)(2). Lacking sufficient resources simultaneously to administer limits for all such instruments, the Commission chose to focus on those that were most important to interstate commerce. 76 Fed. Reg. at 71629; *id*. at 71665. Given the mandate, this was a reasonable first step. *Nat'l Mining Ass'n v. MSHA*, 116 F.3d 520, 549 (D.C. Cir. 1997).

Plaintiffs argue that the Commission's choice should have been tied to a specific commodity-by-commodity assessment of speculation. Mem. at 34-35. But Congress concluded that *all* physical commodity derivatives – which are characterized by limited supply – are vulnerable to excessive speculation. It was thus entirely reasonable for the Commission to begin implementing the mandate on contracts that are most important to the health of the economy, particularly because Congress had determined that such contracts are subject to excessive speculation and manipulation. *Supra* at pp. 1-7.

E. Aggregation – A central feature of any position limits regime is determining which positions to attribute to a particular trader. The CEA requires the Commission to attribute to a person all positions that person holds or trades, as well as positions held or traded by anyone such person directly or indirectly controls. 7 U.S.C. § 6a(a)(1). In 1979, the Commission codified its long-standing aggregation policy and required aggregation of positions in which a "person has a financial interest of 10 percent or more."[38] 44 Fed. Reg. 33839, 33843 (June 13, 1979). This standard is currently in force, it applies to Plaintiffs' members, and it has never been

[38] Other agencies rely on a similar ownership threshold to trigger obligations on behalf of owners. For example, the SEC requires filing of detailed forms when a trader acquires more than a five percent ownership of a class of stock. *See* 17 C.F.R. § 240.13d-1(a). The FCC attributes influence based on control of five percent of a company's voting shares. *Time Warner v. FCC*, 240 F.3d 1126, 1141 (D.C. Cir. 2001). Similarly, the rules of appellate procedure require all entities to report certain entities who hold a beneficial ownership of ten percent or more in them. *See* Fed. R. App. P. 26.1(a).

challenged. *See* 17 C.F.R. § 150.4(b). The Rule reasonably applies this same standard to the new position limits regime, *see* 76 Fed. Reg. at 71678.

Plaintiffs contend that the Commission should have developed a new aggregation formula that incorporated pro rata attribution. Mem. at 43. The Commission explained that it was not prepared to accept pro-rata aggregation because it was adhering to its longstanding prior approach, which had worked well. 76 Fed. Reg. at 71651 n.245. This was a reasonable decision for the Commission to make, particularly when facing tight deadlines.

Plaintiffs also challenge the Commission's decision not to enact an aggregation exemption for owned-non-financial entities ("ONF"), *see* Mem. at 42, but the Commission provided a reasoned explanation for not adopting it. The Commission initially proposed the ONF exemption as part of a substantial overhaul of its aggregation policy. 76 Fed. Reg. at 4762. Commenters – including Plaintiffs – reacted negatively to this proposed overhaul. *See* 76 Fed. Reg. 71651-52. In light of those comments and negative reaction to other proposed changes to its aggregation policy, the Commission ultimately decided largely to retain its current aggregation policy, which was effective. 76 Fed. Reg. at 71654. The Commission certainly was not required to enact a regulation merely because it was included in the initial proposal. *See Long Island Care at Home Ltd. v. Coke*, 551 U.S. 158, 174-75 (2007).[39]

Finally, Plaintiffs contend the Commission acted unreasonably when it did not provide an exemption from its aggregation rules where compliance might result in a violation of state or foreign law. Mem. at 43-44. But the Commission concluded that the current aggregation policy,

[39] Plaintiffs also contend that they were deprived of notice that the Commission might retain the status quo instead of adopting an overhaul of its aggregation policy. Mem. at 42-43. The Commission sought comment on "all aspects of its aggregation requirements," including the ONF exemption. 76 Fed. Reg. at 4762-63. For that reason, and because inherent in a proposal is the possibility that it will not be adopted, Plaintiffs had notice that the final Rule might not include the ONF exemption. *CSX Transp. Inc.*, 584 F.3d at 1081.

which does not include such exemptions, worked well. Moreover, if the Rule conflicted with state law, it would preempt any such law that makes it impossible to comply. *See Fidelity Fed. S & L Ass'n. v. de la Cuesta*, 458 U.S. 141, 153-54 (1982). In addition, persons who are concerned that compliance with the Rule *might* result in a violation of state or foreign law may seek an exemption pursuant to the Commission's exemptive authority. 7 U.S.C. § 6a(a)(7).

F. Bona Fide Hedging – Plaintiffs mistakenly contend that, when the Rule takes effect, market participants will no longer be able to avoid position limits through "non-enumerated" hedging transactions. Mem. at 44. But the Commission explained that it continues to encourage market participants "engaging in other risk reducing practices . . . not specifically enumerated [in section 151.5(a)(2)] . . . [to seek] relief regarding the applicability from the staff under § 140.99 or the Commission under section 4a(a)(7) of the CEA." 76 Fed. Reg. at 71646. The procedure for seeking such relief is clearly set forth in section 151.5(a)(5). Plaintiffs complain that this procedure is inadequate, but do not explain why. This failure to demonstrate prejudice is fatal to Plaintiffs' claim. *PDK Labs, Inc. v. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004).

G. International Regulatory Arbitrage – Finally, Plaintiffs contend that the Commission did not adequately consider the possibility that, after the Rule takes effect, traders may migrate to foreign venues that have no limits. The Commission addressed that concern, as Congress required. 7 U.S.C. § 6a(a)(2)(C). The Commission noted its efforts to forge an international consensus in favor of imposing position limits, which would reduce the likelihood of such a migration. 76 Fed. Reg. at 71658-59. Further, two studies in the record concluded that differences in regulatory regimes "did not appear to be a factor in the competitive positions of the world's leading exchanges." *Id*. at 71659. Plaintiffs complain that the studies were not recent enough, Mem. at 45, but agencies have broad discretion to rely on the research they deem most helpful. *S. UT Wilderness Alliance v. Norton*, 326 F. Supp. 2d 102, 112-13 (D.D.C. 2004). Congress was well aware of the possibility that the Rule might cause transactions to migrate overseas – indeed, it instructed the Commission, *after* the Rule takes effect, to study this issue and report the results promptly to Congress. 15 U.S.C. § 8307(a). Given this legislative directive and oversight, the mandate to impose limits expeditiously, and the other explanations in the record, Plaintiffs' unsubstantiated concerns provide no basis for invalidating the Rule.

CONCLUSION

For the reasons set forth above, this Court should grant the Commission's Cross-Motion for Summary Judgment, deny Plaintiffs' Motion for Summary Judgment, and dismiss Plaintiffs' complaint.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on April 13, 2012, I filed Defendant's Cross-Motion for Summary Judgment, and its Memorandum of Points and Authorities in Support of Its Cross-Motion for Summary Judgment and In Opposition to Plaintiffs' Motion for Summary Judgment using this Court's CM/ECF electronic filing system. Also on April 13, I served these documents on the following counsel for Plaintiffs:

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