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The CFTC's Implementation of Financial Market Reform: Progress and Legal Challenges

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Summary

In the wake of the crisis in the financial markets that engulfed the economy in 2008, in July 2010 Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank Act") to provide the federal government with an array of new authorities to prevent the build-up of systemic risks within financial markets and the potential that any single institution again would be considered "too big to fail." Subtitle A of Title VII of the Dodd-Frank Act ("Title VII") amended the Commodity Exchange Act ("CEA") to establish a comprehensive new framework for the regulation of swaps, including registration requirements, capital requirements, and business conduct standards for swap dealers and major swap participants; mandatory clearing and transparent trading requirements for standardized swaps; comprehensive reporting requirements for all swaps; and enhanced enforcement authorities for the Commodity Futures Trading Commission ("CFTC" or "Commission").[2] The Dodd-Frank Act generally directed the Commission to issue implementing regulations within one year of enactment of the legislation. Although the CFTC did not meet the one-year deadline, it nonetheless proposed and issued a significant number of implementing regulations—more than sixty final rules and orders in total—in the span of a few years following the Dodd-Frank Act's passage. Beginning in late 2012 and throughout 2013 many of the agency's new rules for the swaps markets became effective. Further, in July 2013 the Commission issued guidance as to the cross-border application of these rules, which became generally effective in December 2013.[3]

The vast majority of these regulations have gone into effect domestically without legal challenge. The few judicial decisions that have been issued have brought mixed results for both the CFTC and those challenging these regulations. In the one case that has been decided by the U.S. Court of Ap-

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peals for the District of Columbia Circuit ("D.C. Circuit"), *Investment Company Institute v. CFTC* ("*ICI*"), the court upheld the Commission's rulemaking to eliminate a broad exemption for registered investment companies ("RICs") from the definition of a commodity pool operator ("CPO").[4] The court's opinion rejected arguments that the agency had not adequately considered the costs and benefits of the rule, distinguishing the case from prior D.C. Circuit decisions that had invalidated Securities and Exchange Commission ("SEC") rulemakings on the basis of inadequate considerations of economic consequences. In *ICI*, the court of appeals applied the traditional standard of review to CFTC rulemakings rather than a heightened standard that a number of commenters had asserted might be applied based on the D.C. Circuit's decisions in the SEC cases.

Of the two district court decisions on challenges to CFTC rules, one vacated the CFTC's rule and the other dismissed the challenge for lack of standing. In *International Swaps and Derivatives Assoc.* ("*ISDA*") *v. CFTC*, the U.S. District Court for the District of Columbia invalidated the CFTC rule imposing position limits on futures and swaps in 28 commodities, holding that that the Commission had improperly construed the CEA, as amended by the Dodd-Frank Act, to unambiguously impose a mandate for the Commission to impose position limits for those commodities.[5] In *Bloomberg v. CFTC*, the D.C. District court dismissed a challenge to one of the provisions in the rulemaking establishing core principles for derivatives clearing organizations ("DCOs") on the grounds that the plaintiff had failed to demonstrate standing.[6] These two district court decisions also applied traditional standards of review and well-established legal principles to the rules and claims before the court.

On December 4, 2013, three financial industry trade organizations—the Securities Industry and Financial Markets Association ("SIFMA"), the International Swaps and Derivatives Association ("ISDA"), and the Institute of International Bankers ("IIB") (collectively "the trade associations") filed suit seeking to invalidate the CFTC's cross-border guidance and "enjoin[] the CFTC from giving extraterritorial effect to its swaps regulations, until a valid rulemaking regarding extraterritorial application has been completed."[7] Despite the pendency of this lawsuit, on December 21, 2013, the terms of the CFTC's guidance became applicable to cross-border activities.

This article will briefly outline the regulation of derivatives in the Dodd-Frank Act and summarize the CFTC's issuance of regulations to implement the Act. The article will then review the line of D.C. Circuit decisions invalidating SEC rules on the basis that the SEC had inadequately considered economic consequences of those rules. It will then examine the three judicial decisions on challenges to CFTC rulemakings, which indicate that a traditional standard of review is in fact being applied to CFTC rulemakings, including the agency's consideration of costs and benefits. In light of the significant number of CFTC rulemakings and requirements that have become effective within the past year-and-a-half, forecasts that the D.C. Circuit Court of Appeals would readily overturn these CFTC rulemakings for ideological reasons through the guise of judicial review of agency considerations of costs and benefits have not been accurate. To be accorded deference and withstand judicial review, however, the Commission nonetheless will need to ensure that its actions fully comport with the requirements of its governing statutes, such as the Dodd-Frank Act, the CEA, and the Administrative Procedure Act ("APA"). Potential challenges to the Commission's actions should be evaluated under these standards as well.

The Dodd-Frank Act

The financial crisis of 2008 prompted national and international calls for reform of the laws and regulations governing financial markets.[8] In April 2009, the leaders of the G-20 nations pledged to "take action to build a stronger, more globally consistent, supervisory and regulatory framework for the future financial sector."[9]

In June 2009, President Obama called for a "sweeping overhaul of the financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression."[10] Concurrently, the Treasury Department issued a "White Paper" entitled "Framework for Regulatory Reform," containing the Administration's specific legislative proposals.[11] With respect to the regulation of the derivatives markets, the Treasury Department stated:

> **We propose to bring the markets for all OTC derivatives and asset-backed securities into a coherent and coordinated regulatory framework that requires transparency and improves market discipline. Our proposal would require record keeping and reporting requirements on all OTC derivatives. We also propose to strengthen the prudential regulation of all dealers in**

> **the OTC derivative markets and to reduce systemic risk in these markets by requiring all standardized OTC derivative transactions to be executed in regulated and transparent venues and cleared through regulated central counterparties.[12]**

In August, 2009, the Treasury Department transmitted specific legislative language to Congress to codify its proposals for reform of the financial markets.[13] The House of Representatives passed its version of financial reform in December 2009[14], and the Senate passed its version in May 2010.[15] The President signed the legislation—the Dodd-Frank Act—on July 21, 2010.

The final legislation embodied the Administration's basic policy objectives with respect to the regulation of derivatives. The Conference Report on the final bill explained that the new regulatory framework provided for "mandatory clearing of swaps that are eligible for clearing as determined by clearinghouses and the regulators"; "mandatory trading on an exchanges or [swap] execution facility" for cleared swaps that are accepted for trading; "[p]ublic trade reporting of all cleared and uncleared [swaps]"; capital, margin, and business conduct standards for registered swap dealers and major swap participants; position limits for swaps; and prohibitions against market manipulation.[16] The Act established a general one-year deadline for the CFTC to issue implementing regulations.[17]

CFTC Implementing Regulations

Although the CFTC did not meet the general one-year deadline, it nonetheless issued a significant number of regulations in a relatively short period of time in relation to typical timeframes for agency rulemakings—more than 60 final implementing regulations, orders and guidance documents in approximately three-and-a-half years following the Act's passage.[18] In August 2012, the CFTC and SEC jointly issued the statutorily-required rulemaking to further define the terms "swap," "security-based swap," and "security-based swap agreement." Under a previously issued CFTC Order, the effective date of this definitional rule triggered the compliance dates for a number of previously-issued CFTC regulations referencing the term "swap," including the definition of "swap dealer" and "major swap participant."[19] Hence, beginning in October 2012, entities meeting that definition of "swap dealer" and "major swap participant" were required to register as such. For swap dealers, this meant that many swap dealers would have to submit registration applications and thereby formally be considered swap dealers by December 31, 2012.

Registration as a swap dealer triggers a number of regulatory requirements. Upon registration swap dealers are required to comply with the business conduct standards promulgated by the Commission; initially the Commission extended the compliance date for certain of these standards relating to documentation and portfolio reconciliation until the second and third quarters of 2013.[20] The swap data reporting requirements also began to be phased-in beginning in the fourth quarter of 2012, as entities meeting the definition of swap dealers as of October 31, 2012 (and who therefore would be required to submit a registration application by December 31), were required to report credit and interest rate swaps in which they were a counterparty by December 31, 2012.[21] Reporting for other classes of swaps and counterparties was phased-in throughout 2013.[22]

Mandatory clearing of swaps began in March 2013, when swap dealers, major swap participants and private funds active in the swaps market were required to submit certain North American-based index credit default swaps and interest rate swaps for clearing.[23] The same clearing requirement applied to other financial entities beginning in June 2013, and to all other entities (subject to any applicable exemptions from the clearing requirement), including third party investment managers and ERISA pension plans, beginning in September 2013.

With respect to the trading mandate, swap execution facilities (SEFs) were required to submit applications for registration by October 2, 2013.[24] A swap subject to the mandatory clearing requirement is required to be traded on a SEF or designated contract market (DCM) following a determination by the Commission that the class of swaps has been "made available to trade" ("MAT").[25] In late 2013, five SEFs submitted MAT determinations to the CFTC, covering various classes of interest rate and index credit default swaps.[26] Following the Commission's 90-day review period, in January 2014 the Commission announced the certifications of the first group of interest rate and index CDS that had been submitted. Accordingly, the trade execution mandate for certain interest rate and index CDS began to apply in February, 2014.[27]

In July 2013, the Commission issued "Interpretive Guidance" as to the cross-border application of the swaps provisions of Title VII. The Interpretive Guidance set forth guidance as to how the Commission would apply the swap dealer and MSP registration requirements, business conduct standards, the clearing requirement, the trade execution requirement, and swap data reporting requirements to cross-border activities of both U.S. and non-U.S. persons, including the affiliates and branches of such persons. Concurrently, to facilitate the application of the Commission's regulations to cross-border activities, Commission provided temporary conditional relief from the cross-border application of certain of the swaps provisions until December 21, 2013.[28]

On December 20, 2013, the Commission issued Comparability Determinations for six non-U.S. jurisdictions (Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland), finding that certain regulatory requirements in these jurisdictions were comparable to and as comprehensive as the corresponding "entity-level" requirements for swap dealers under the CEA and the Commission's regulations.[29] The Commission also issued comparability determinations for certain transaction-level requirements in the EU and Japan. As outlined in the cross-border guidance, following a comparability determination a non-U.S. entity may comply with the comparable and comprehensive entity- or transaction-level requirements in its home jurisdiction as a substitute for complying with the otherwise applicable Commission requirements.[30]

Judicial Review of Agency Rulemakings

The vast majority of these rules have become effective without legal challenge. Although several lawsuits have been filed challenging particular Commission rulemakings, and the trade associations have filed suit to enjoin the application of these rules extraterritorially, to date only one rule has been vacated.[31] The opinions in these cases indicate that the courts are applying the traditional standards of review for agency rulemakings to the Commission's rulemakings under Dodd-Frank. Although at first glance this may seem an unremarkable statement, based on a string of previous decisions by the D.C. Circuit that vacated SEC rules on the grounds of inadequate consideration of economic consequences, a number of commenters stated that the CFTC's rules might not pass muster under the standards articulated in these SEC cases. This section will first review the previous D.C. Circuit cases that overturned SEC rulemakings on the basis of inadequate consideration of the economic consequences of those rules, including various comments regarding the potential implications of these decisions for judicial review of CFTC rulemakings under Dodd-Frank Act. It will then review the judicial decisions of CFTC actions that indicate that to date a heightened standard in fact has not been applied to the CFTC's actions under the Dodd-Frank Act.

In July 2011, the D.C. Circuit issued its decision in *Business Roundtable v. SEC*, invalidating the SEC's "proxy access" rule, which provided a shareholder or group of shareholders with a certain minimum of shares in a company subject to the SEC's proxy rules the right to nominate candidates to the boards of directors of the company and have such nominations included in the company's proxy materials.[32] In *Business Roundtable,* the D.C. Circuit sharply criticized the SEC's consideration of the economic consequences of the rule under the statutory mandate in the Securities and Exchange Act to consider the effect of the rule upon "efficiency, competition, and capital formation."[33] The court found that the SEC had "failed once again" to "adequately to assess the economic effects of a new rule."[34] It stated the Commission "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters."[35] The court then vacated the SEC's rule.

Prior to *Business Roundtable*, the D.C. Circuit had invalidated several other SEC rulemakings on the basis of flawed cost-benefit considerations. In *American Equity Investment Life Insurance Company v. SEC*, the D.C. Circuit invalidated the SEC's rule 151A providing that fixed index annuities ("FIAs") were not annuities within the meaning of the Securities Act of 1933.[36] Writing for a unanimous panel, Judge Sentelle found that although the SEC's interpretation of the statute was reasonable in concluding that an FIA is not an "annuity contract" within the meaning of the 1933 Act, its "consideration of the effect of Rule 151A on efficiency, competition, and capital formation was arbitrary and capricious."[37] Specifically, the court found that the SEC failed to consider the benefits of the rule with respect to competition and efficiency in relation to the existing "baseline" of state regulation, and that the benefit of additional "clarity," by itself, is insufficient rationale to support the regulation. "The SEC cannot justify the adoption of a particular rule based solely on the assertion that the existence of a rule provides greater clarity to an area that remained unclear in the absence of any rule."[38]

In another case, *Chamber of Commerce v. SEC* ("*Chamber I*"), the D.C. Circuit invalidated an SEC rule prohibiting an investment company from engaging in certain transactions unless the company's board had no fewer than 75% independent directors and an independent chairman.[39] Although here too the court held that the SEC had not exceeded its authority in adopting these conditions, it again found that the SEC's reasoning regarding whether the conditions will promote efficiency, competition, and capital formation was arbitrary and capricious. The court stated that the SEC had not sufficiently considered the costs of the independent director or chairman conditions, and did not sufficiently consider alternatives to the regulation.

Within days of the court's decision in *Chamber I*, the SEC re-issued the rule, with additional consideration of costs and alternatives. The SEC explained that the expedited consideration was necessary to ensure that the rule could become effective on the previously announced compliance schedule and to enable the Commission to vote on the re-issuance of the rule prior to the expiration of the Chairman's term. In re-issuing the rule, the Commission considered publicly available data regarding mutual fund directors' compensation and set forth more fully its reasons for rejecting the alternatives. However, in order to issue the rule in this expedited manner, the Commission did not provide any opportunity for notice and comment on the reissuance of the rule or the use of the publicly available data. In *Chamber of Commerce v. SEC* ("*Chamber II*"), the D.C. Circuit again invalidated the rule, this time on the grounds that the SEC had violated the APA by failing to provide an opportunity for notice on comment on "extra-record data" that was of "primary, rather than supplementary evidence."[40] The court found that the need for the agency to act prior to the expiration of the Chairman's term and the resulting delay that could result during the change in membership "is hardly atypical and does not satisfy the narrow exception" from the APA's notice-and-comment requirement."[41]

The line of D.C. Circuit cases invalidating SEC rulemakings, culminating with the issuance of the *Business Roundtable* decision in the midst of the Dodd-Frank rulemakings, led to a number of questions as to whether the CFTC's Dodd-Frank rulemakings would be vulnerable to the same types of challenges with respect to the adequacy of the CFTC's consideration of costs and benefits. Section 15(a) of the CEA states that before promulgating a regulation under the Act or issuing an order the Commission "shall consider the costs and benefits of the action of the Commission." It provides that the costs and benefits of the action shall be evaluated in light of five factors: "(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."[42]

In light of the CFTC's and SEC's similar mandates to consider the economic consequences of new rules, commenters and observers speculated as to whether the CFTC would be any more successful than the SEC in surviving judicial review. One article published shortly after the *Business Roundtable* decision reported that the decision could "create a wave of similar litigation targeting SEC and [CFTC] rules."[43] Another observer predicted "lots of challenges coming down the pike."[44] Some believed that in its review of the SEC's consideration of costs and benefits of its rulemakings the D.C. Circuit had adopted an impermissibly higher standard of review for SEC rules. In one analysis, the language in the *Business Roundtable* decision stating that the SEC had failed to consider the net benefit of the rule in effect imposed upon the SEC a legal standard that went beyond the statutory requirement that the agency consider the effect of the rule on efficiency, competition, and capital formation. Contending that the SEC's statutory mandate "does not explicitly require the SEC to specify the costs of any proposed rule, to engage in rigorous analysis, or even to engage in cost-benefit analysis," this analysis concluded "the level of review invoked by the D.C. Circuit in *Business Roundtable* and its earlier decisions is dramatically inconsistent with the standard enacted by Congress."[45] Others argued the decisions, rather than suffering from ideological motivations of judges on the D.C. Circuit, or improper application of the law, simply reflected flawed rulemaking activity by the SEC.[46]

Regardless of the merits of these opposing views with respect to the D.C. Circuit's review of the SEC's consideration of costs and benefits in SEC rulemakings, the recent decision of the D.C. Circuit in the one CFTC rulemaking that has been brought before the court demonstrates a straightforward application of the traditional standard of review of agency rulemakings under its governing statutes, including its application to the CFTC's consideration of costs and benefits under CEA section 15(a). In the two challenges to CFTC rulemakings that were decided by the U.S. District Court for the District of Columbia, the courts did not reach the issue of the adequacy of the agency's consideration of costs and benefits.

In the case decided by the D.C. Circuit, appellant ICI had challenged the CFTC's rulemaking that rescinded the broad exclusion under Regulation 4.5 from status as a CPO for registered investment companies (e.g., mutual funds) regulated by the SEC under the Investment Company Act of 1940. In a 2003 rulemaking, the Commission had "'effectively excluded RICs from the CPO definition,' freeing registered investment companies from most CFTC CPO regulations."[47] In its 2012 rulemaking, the Commission essentially returned the scope of the RIC exclusion to its pre-2003 status, only excluding from the CPO definition those RICs with minimal commodity interests, specifically those for which the aggregate initial margin and premiums for non-bona fide hedging positions does not exceed five percent of the portfolio's liquidation value.[48] The Commission's 2012 rulemaking also required swaps entered into by a RIC to be included within the trading threshold calculations, reinstated the prohibition on marketing as a condition for the exclusion, and imposed a requirement for the regular filing of reports under CFTC Regulation 4.27. Explaining that the "sources of risk delineated in the Dodd-Frank Act with respect to private funds are also presented by commodity pools," the Commission justified the rule on the basis that it was necessary to both require registration of previously exempt pools and to impose various reporting requirements.[49] According to the Commission, registration would "allow[] the Commission to ensure that all entities operating collective investment vehicles participating in the derivatives markets meet minimum standards of fitness and competency," and provide the Commission and the public with "a clear means of addressing wrongful conduct by individuals and entities participating in the derivatives markets."[50] The appellants challenged both the Commission's justification for the rule and the adequacy of its consideration of costs and benefits.

In its decision upholding the rule, the court of appeals provided the CFTC with the standard degree of deference according on judicial review to the agency's policy determinations and expert judgments, and declined to interpret the statute so as to require any exacting or quantitative requirements for the CFTC's consideration of costs and benefits under CEA section 15(a).

First, the court noted "an agency changing course 'need not demonstrate to a court's satisfaction that the reasons for the new policy are better than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better.'"[51] The court concluded that the CFTC's stated rationale for the rule "clears this low bar."[52]

With respect to the challenges to the Commission's consideration of costs and benefits, the court again noted the deferential standard of review role for the court: to "'determine whether the [agency] decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.'"[53] The court stated the Commission had in fact considered the need for CFTC regulation in addition to SEC regulation, and noted the CFTC's efforts to harmonize its reporting and disclosure requirements with those of the SEC. It also specifically distinguished the D.C. Circuit's prior decisions involving the SEC. "These explanations suffice to justify the marginal benefit of CFTC regulation of registered investment companies in the derivatives markets, and distinguish this case from *Business Roundtable* and *American Equity*."[54]

The court employed a similar deferential standard of review for the CFTC's obligation to consider costs and benefits under CEA section 15(a). The court held that the Commission did not err in failing to quantify the benefit of preventing future financial crises, holding that "the law does not require agencies to measure the immeasurable."[55] Rather, the court found that the agency's qualitative discussion of the "unquantifiable" benefits fulfilled its statutory mandate to consider and evaluate the potential costs and benefits of the rule.[56] More broadly, the court held that CEA section 15(a) does not impose on the CFTC an obligation to engage in "rigorous, quantitative economic analysis."[57] The court also limited the CFTC's obligation to gather additional market data, finding that data limitations are present "in practically any regulatory endeavor," and therefore the agency's decision to proceed without seeking additional data was neither arbitrary nor capricious.[58]

The court also used the APA's basic "arbitrary and capricious" standard to evaluate the rule itself. With respect to the appellant's challenge to the inclusion of swaps within the registration threshold, the court cited the Commission's statement in the rule that "'[t]he Dodd-Frank Act amended the statutory definition of the terms 'commodity pool operator' and 'commodity pool' to include those entities that trade swaps,'" thereby demonstrating "that swaps were a central concern of the statute."[59] Citing the Commission's stated goals of bringing transparency to and policing the swaps markets, the court found the inclusion of swaps within the threshold was "not arbitrary or capricious."[60]

Again explicitly employing a deferential standard of review, the court declined to disturb the Commission's definition of bona fide hedging for purposes of this rule. The Commission had justified its decision not to adopt the broader alternative "risk management" standard on the grounds that transactions offset by physical transactions were inherently less risky than other types of risk management transactions, and that the broader standards would be too difficult to limit and enforce. Citing "the deference appropriate to such expert determination," the court rejected the appellant's challenge to this aspect of the Commission's determination.[61]

The court similarly deferred to the agency's judgment with respect to the five-percent threshold. The court elucidated the deferential standard of "reasonableness" for this type of agency line-drawing:

> **It is true that an agency may not pluck a number out of thin air when it promulgates rules in which percentage terms play a critical role. When a line has to be drawn, however, [CFTC] is authorized to make a rational legislative-type judgment. If the figure selected by the agency reflects its informed discretion, and is neither patently unreasonable nor a dictate of unbridled whim, then the agency's decision adequately satisfies the standard of review.[62]**

In the two other CFTC rulemakings that were challenged in district court, neither court reached the issue of the adequacy of the CFTC's cost benefit considerations. In one case, *ISDA v. CFTC*, the district court vacated the rule on the grounds that the CFTC had improperly construed the statutory requirements with respect to the imposition of position limits. In the other case, *Bloomberg v. CFTC*, the court denied the plaintiff's motion for a preliminary injunction to preclude the application of the CFTC's rule regarding minimum margin requirements for derivative clearing organizations ("DCOs"), on the grounds that the plaintiffs had not demonstrated standing to bring the motion. Although in one case the CFTC's rule was vacated, and in the other it was not, in both *ISDA* and *Bloomberg* the district courts applied the traditional standard of review to the challenges to those rules.

In *ISDA v. CFTC*, the plaintiffs challenged the CFTC's rulemaking imposing position limits on futures contracts and economically equivalent swaps for 28 agricultural, energy and other physical commodities. The plaintiffs argued that the CFTC had failed to meet what it considered the unambiguous requirement of CEA section 4a(a)(1) that the Commission determine that position limits were necessary to "diminish, eliminate, or prevent" the undue burdens on interstate commerce that may result from excessive speculation in any commodity.[63] Plaintiffs contended that the statutory language requires the Commission to make a finding for each specific limit to be imposed upon a specific commodity that such limit was both necessary and appropriate to prevent excessive speculation in that commodity. The Commission, on the other hand, argued that the statute unambiguously required it to impose such limits within the expeditious timeframes specified in the statute without any prerequisite finding that excessive speculation exists or is likely to exist, has caused any undue burden on interstate commerce, or that position limits are necessary to prevent sudden or unreasonable fluctuations in prices. In the final rule the Commission stated it "must set position limits prophylactically, according to Congress' mandate in section 4a(a)(2), and, in establishing the limits Congress has required, exercise its discretion to set a limit that, to the maximum extent practicable, will, among other things, "diminish, eliminate, or prevent excessive speculation.'"[64] The Commission summed up its position, "Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously."[65] The district court observed "although each party believes the statute is clear and unambiguous, their respective "plain readings" compel different results."[66]

The district court was not persuaded by either party's arguments. First, it found that CEA section 4a(a)(1) contained an unambiguous mandate to make a necessity finding prior to imposing any position limits. However, it then found that the Dodd-Frank Act amendments directing the Commission to establish position limits for futures and swaps ambiguous as to whether Congress intended to require the Commission to establish position limits without regard to any necessity finding, or whether Congress directed the Commission to establish position limits in accordance with the requirements in section 4a(a)(1), including the requirement to make a necessity finding. "This Court is left with no clear indication of Congress' intent when it directed the Commission to set position limits in Section 6a(a)(2) 'in accordance with the standards set forth in paragraph (1) of this subsection . . . .'"[67]

Finding the statutory language ambiguous, the court determined that the CFTC's interpretation was not entitled to any deference.[68] The court held that where an agency erroneously interprets the statute to be unambiguous, the appropriate course is for the court to "remand the rule to the agency so that it can fill in the gaps and resolve the ambiguities."[69] In vacating the rule the court found it unnecessary to address the plaintiff's other arguments.[70]

In *Bloomberg v CFTC*, the plaintiff challenged the provisions in the CFTC's final rule establishing core principles for DCOs that specified the minimum liquidation times a DCO must use in determining margin requirements for swaps and futures. The challenged provision provides a DCO must use a minimum liquidation time of: (A) one day for futures and options; (B) one day for swaps on agricultural commodities, energy commodities, and metals; and (C) five days for all other swaps; or (D) "[s]uch longer liquidation time as is appropriate based on the specific characteristics of a particular product or portfolio."[71] The plaintiff alleged that the Commission had provided only a "superficial discussion of the Rule's costs and benefits," that the Commission had provided insufficient notice of the rule's provisions, and that the rule itself was arbitrary, capricious and not otherwise in accordance with the law."

The plaintiff also filed a motion for a preliminary injunction, claiming that further implementation of the rule would cause it irreparable harm. The plaintiff's essential claim was that as a result of this rule a futures exchange could offer a "swap future" which would be economically equivalent to a swap, and as a futures contract be subject to only a one-day minimum liquidation time, whereas the economically equivalent swap would be subject to a five-day minimum liquidation time if traded on a SEF. The plaintiff alleged that absent relief this disparate and "arbitrary [and] capricious" treatment of economically equivalent financial instruments would cause irreparable harm to plaintiff as the operator of a SEF since trading would migrate to the less costly forum for trading economically equivalent instruments.[72]

The court held that the plaintiff lacked standing. Finding that the plaintiff had not demonstrated that any DCO had actually adopted a lesser liquidation time for swap futures than for swaps, or was imminently about to do so, the court found that plaintiff had not sustained any injury and therefore lacked standing to bring a claim. "As the D.C. Circuit has clearly stated, "'[s]peculative and unsupported assumptions regarding the future actions of third-party market participants are insufficient to establish Article III standing.'"[73] The court therefore dismissed the plaintiff's challenge.

Conclusion

The vast majority of the CFTC's rules to implement the Dodd-Frank Act have become effective within the past eighteen months and have not been challenged in court. Although the judicial record in reviewing CFTC rulemakings is not extensive, the three cases in which the courts have issued written opinions are consistent in applying traditional standards and principles of deference, standing, and statutory interpretation to CFTC rulemakings to implement the Dodd-Frank Act, including the agency's consideration of costs and benefits. In light of the significant number of CFTC rulemakings and requirements that have become effective over these recent months, speculation that the D.C. Circuit Court of Appeals would be a fertile ground to overturn these CFTC rulemakings on ideological grounds through the guise of judicial review of agency considerations of costs and benefits has not proven to be accurate. To the extent that the Commission has appropriately interpreted its statutory mandate or authority, and provided a well-reasoned rationale for its actions in implementing that mandate or exercising its authority, these cases indicate that, at least in the D.C. Circuit, a reviewing court is likely to accord the agency the appropriate degree of deference upon review. However, to the extent that the Commission fails to follow the statutory mandates in the CEA, as amended by the Dodd-Frank Act, or abide by the procedural requirements of the APA, such actions will not be accorded deference and be vulnerable to challenge upon judicial review.

In their lawsuit seeking to invalidate the Commission's cross-border guidance, the trade associations have alleged that the interpretive guidance is actually a rulemaking, and in promulgating the guidance the Commission "failed to conduct the cost-benefit analysis required by law or to comply with other essential prerequisites of rulemaking under the APA and the CEA."[74] The trade associations also have raised corollary claims that the Commission both failed to provide the public with an opportunity to comment on the costs and benefits of the Commission's action and failed to respond to comments offered in the individual rulemakings regarding the consideration of costs and benefits with respect to application of the rules to activities outside the United States.[75] In its response, the Commission contends that the interpretive guidance is in fact non-binding guidance rather than a rulemaking and unreviewable, it properly considered the costs and benefits of its regulations to implement the Dodd-Frank Act, its interpretation of section 2(I) is reasonable, and that the relief sought by the plaintiffs is beyond the court's authority and unjustified.[76] The issues before the court in the trade associations' lawsuit, therefore, are the types of procedural and statutory interpretation issues the courts are well-equipped to adjudicate, including in the context of the Dodd-Frank Act.

ENDNOTES

1. Pub. L. No. 111-203, 124 Stat. 1376 (2010).
2. Subtitle B of Title VII provided the Securities and Exchange Commission with parallel authority over security-based swaps.
3. Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).
4. *Investment Company Institute v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013). Petitions for review of CFTC's Dodd-Frank rulemakings must initially be filed in the district court. *International Swaps and Derivatives Assoc., Inc. v. CFTC*, No. 11-1469, Order No. CFTR-FR71626 (Jan. 20, 2012). In the *ICI* case, the district court had upheld the CFTC's rulemaking. *Investment Company Institute v. CFTC*, 891 F. Supp. 2d 162 (D.D.C. 2013).
5. *ISDA v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012).
6. *Bloomberg L.P. v. CFTC*, 2013 U.S. Dist. LEXIS 80275 (D.D.C. 2013).
7. *SIFMA v. CFTC*, Civil Action No. 13-CV-1916 (D.D.C. filed Dec. 4, 2013).
8. The Financial Crisis Inquiry Commission concluded "widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets," and that "the existence of millions of derivatives contracts of all types between systemically important financial institutions—unseen and unknown in this unregulated market—added to uncertainty and escalated panic, helping to precipitate government assistance to those institutions." The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, at pp. xviii, xxv (PublicAffairs, Jan. 2011).
9. The Global Plan for Recovery and Reform (April 2, 2009), http://www.treasury.gov/resource-center/international/g7-g20/Pages/g20.aspx .
10. Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009), http://www.whitehouse.gov/the-press-office/remarks-president-regulatory-reform.
11. U.S. Department of Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation (June 2009). The White Paper presented a variety of legislative proposals to meet four broad objectives: (1) promote robust supervision and regulation of financial firms; (2) establish comprehensive supervision of financial markets; (3) protect consumers and investors from financial abuse; and (4) provide the government with the tools it needs to manage financial crises. It also proposed to raise international regulatory standards and improve international cooperation.
12. *Id.* at 43. Meeting in Pittsburgh in September, the G-20 leaders set forth similar objectives, with a goal for implementation by the end of 2012: "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements." Leaders' Statement, The Pittsburgh Summit (September 24-25, 2009), http://www.treasury.gov/resource-center/international/g7-g20/Pages/g20.aspx.
13. U.S. Department of Treasury, Administration's Regulatory Reform Agenda Reaches New Milestone: Final Piece of Legislative Language Delivered to Capitol Hill, http://www.treasury.gov/press-center/press-releases/Pages/tg261.aspx. The Administration transmitted its legislative language in several installments. Financial market reform constituted Title VII of the overall legislative package and was entitled, "Over-the-Counter Derivatives Markets Act of 2009." As proposed, Title VII was 69 pages in length; as enacted it was over 300 pages.
14. H.R. 4173, 111th Cong. (as passed by House of Representatives, December 11, 2009).
15. H.R. 4173, 111th Cong. (as passed by Senate, May 20, 2010).
16. Joint Explanatory Statement of the Committee of Conference, Dodd-Frank Wall Street Reform and Consumer Protection Act, Conference Report to Accompany H.R. 4173, H.R. Rep. No. 111-517, at 869 (111th Cong., 2d Sess.).
17. Dodd-Frank Act, § 712(e).
18. See, e.g., A New Marketplace, Keynote Address of Chairman Gary Gensler at the 5th Annual Financial Regulatory Reform Symposium at George Washington University (October 31, 2013), http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-150.
19. Second Amendment to July 14, 2011 Order for Swap Regulation, 77 Fed. Reg. 41,260 (July 13, 2012).
20. Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date, 78 Fed. Reg. 17 (Jan. 2, 2013).
21. CFTC Staff, "Q & A – On Start of Swap Data Reporting" (Oct. 9, 2012), http://www.cftc.gov/

ucm/groups/public/@newsroom/documents/file/startreporting_qa_final.pdf; see CFTC Letter No. 12-32, Time-Limited No-Action Relief for Swap Dealers from Certain Swap Data Reporting Requirements in Part 43, Part 45 and Part 46 of the Commission's Regulations (Nov. 19, 2012).

22. See CFTC Letter No. 13-10, Time-Limited No-Action Relief for Swap Counterparties that are not Swap Dealers or Major Swap Participants, from Certain Swap Data Reporting Requirements of Parts 43, 45 and 46 of the Commission's Regulations (April 9, 2013).

23. 17 C.F.R. § 50.25 (2013); Release PR6529-13, CFTC Announces that Mandatory Clearing Begins Today (March 11, 2013).

24. Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg, 33,476 (June 4, 2013).

25. Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act ("MAT Rule"), 78 Fed. Reg. 33,606 (June 4, 2013). A MAT determination submitted by a SEF or DCM will become effective absent a finding by the Commission that the determination is "inconsistent or appears to be inconsistent with the Act or the Commission's regulations." 17 C.F.R. §§37.12, 40.5 (2013).

26. The SEFs submitting MATT determinations were Bloomberg, Javelin, MarketAxess, trueEX, and Tradeweb. See http://sirt.cftc.gov/sirt/sirt.aspx?Topic= SwapsMadeAvailableToTradeDetermination (last visited Dec. 19, 2013).

27. *See* The Commodity Futures Trading Commission Staff Announces Trade Execution Mandate for Certain Interest Rate Swaps, Javelin SEF, LLC's Available-to-Trade Determinations are Deemed Certified, January 16, 2014; The Commodity Futures Trading Commission's Division of Market Oversight Announces Trade Execution Mandate for Additional Interest Rate Swaps, trueEX, LLC's Available-to-Trade Determinations Are Deemed Certified, January 23, 2014; The Commodity Futures Trading Commission's Division of Market Oversight Announces Trade Execution Mandate for Certain Credit Default Swaps and Additional Interest Rate Swaps, TW SEF LLC Available-to-Trade Determinations Are Deemed Certified, January 28, 2014; The Commodity Futures Trading Commission's Division of Market Oversight Announces Trade Execution Mandate for Certain Credit Default Swaps, Market Access SEF Corporation's Available-to-Trade Determinations Are Self-Certified, January 30, 2014.

28. Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 43,785 (July 22, 2013).

29. Under the cross-border guidance, entity-level requirements include requirements regarding capital adequacy, chief compliance officer, risk management, swap data recordkeeping, and swap data reporting. Transaction-level requirements include requirements relating to required clearing and swap processing, margin and segregation for uncleared swaps, trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, daily trading records, and external business conduct standards.

30. *See* CFTC Approves Comparability Determinations for Six Jurisdictions for Substituted Compliance Purposes, December 20, 2013. The Commission also has provided time-limited no action relief from transaction-level requirements with respect to swaps between a non-U.S. swap dealer and a non-U.S. person when the swap is arranged, negotiated, or executed by personnel or agents of the non-U.S. swap dealer in the U.S. CFTC Letter No. 14-01, Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers, January 3, 2014. In February 2014 the Commission provided no-action relief from the SEF registration requirement and the trade execution mandate for persons executing swaps subject to the mandate on qualifying multilateral trading facilities in the EU, provided those facilities demonstrated to the Commission that they were subject to regulatory requirements in their home jurisdiction that were essentially comparable to and as comprehensive as the requirements for SEFs under the Commission's regulations. CFTC Letter No. 14-16, Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Member States, February 12, 2014. On April 9, 2014, the CFTC staff issued CFTC Letter No. 14-46, which generally tracked the conditional relief provided in Letter No. 14-16, but clarified, amended, and superseded the relief provided in that letter.

31. The Depository Trust & Clearing Corporation ("DTCC") and the DTCC Data Repository also have filed a lawsuit against the CFTC alleging that the CFTC violated the APA and failed to consider costs and benefits under the CEA when it withdrew certain "Frequently Asked Questions" about swap data reporting and approved rules submitted by CME and ICE Clear Credit regarding the reporting of swaps to the CME and ICE swap data repositories. Amended

Complaint, DTCC v CFTC, No. 1:13-cv-00624-ABJ (D.D.C. June 10, 2013).

32. *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).
33. 15 U.S.C.A. §§ 78c(f), 78w(a)(2), 80a-2(c) (2012).
34. *Business Roundtable*, 647 F.3d at 1148.
35. *Id.* at 1148-9.
36. *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166 (D.C. Cir. 2009).
37. *Id.* at 177.
38. *Id.* at 177-8.
39. *Chamber of Commerce v. SEC* ("*Chamber I*"), 412 F.3d 133 (D.C. Cir. 2005).
40. *Chamber of Commerce v. SEC* ("*Chamber II*"), 443 F.3d 890 (D.C. Cir. 2006).
41. *Id.* at 908.
42. 7 U.S.C.A. § 19(a) (2010).
43. Peter Madigan, *CFTC and SEC Facing Legal Anxiety Over Cost-Benefit Analysis*, Risk magazine, Oct. 3, 2011.
44. Ben Protess, *Court Ruling Offers Path to Challenge Dodd-Frank*, New York Times, Aug. 17, 2011.
45. James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 Tex. L. Rev. 1811, 1813, 1824 (2012).
46. Eugene Scalia, *Why Dodd-Frank Rules Keep Losing in Court*, Wall St. Journal, Oct. 3, 2012.
47. *ICI v. CFTC,* 720 F.3d at 372, quoting *Investment Company Institute v. CFTC*, 891 F. Supp. 2d 162, 172 (D.D.C. 2013).
48. Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11,252, 11,253 (Feb. 24, 2012) ("CPO/CTA Compliance Rule"). The 2012 rule also provides that to claim the exclusion the aggregate net notional value of non-bona fide hedging positions may not exceed the liquidation value of the pool. 17 C.F.R. § 4.5(c)(iii) (2013).
49. CPO/CTA Compliance Rule, at 11,253.
50. *Id.* at 11,254-5.
51. *ICI v. CFTC*, at 376, quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515, 129 S. Ct. 1800, 173 L. Ed. 2d 738 (2009).
52. *Id.* at 377. Noting that the agency's decision "followed a congressional shift evidenced in the Dodd-Frank Act—legislation expressly relied upon by the Commission," the court stated that "[s]uch reasoned decisionmaking is an acceptable way to change CFTC's past rules . . . ." *Id.* (citation omitted).
53. *Id.*, quoting *Center for Auto Safety v. Peck*, 751 F.2d 1336, 1342, 243 U.S. App. D.C. 117 (D.C. Cir. 1985).
54. *Id.* at 379.
55. *Id.*
56. *Id.*
57. *Id*., quoting *American Financial Services Ass'n v. FTC*, 767 F.2d 957, 986, 247 U.S. App. D.C. 167 (D.C. Cir. 1985).
58. *Id.* at 379-380.
59. *Id.* at 380, quoting CPO/CTA Compliance Rule, at 11,258.
60. *Id.*
61. *Id.*
62. *ICI v. CFTC*, at 381.
63. CEA § 4a(a)(1) provides:
    For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person . . . under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity, as the Commission finds are necessary to diminish, eliminate, or prevent such burden.
64. Position Limits for Futures and Swaps ("Position Limits Rule"), 76 Fed. Reg. 71,626, 71,627 (Nov. 18, 2011).
65. *Id*. at 71,628. CEA § 4a(a)(2)(A) states:
    In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to 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.
    Section 4a(a)(2)(B) directs the Commission to establish the limits "required under subsection (A) within 180 days after enactment for exempt commodities and within 270 days for agricultural commodities. Section 4a(a)(2)(C) states that in establishing the limits "required under subsection (A)," the Commission shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits imposed by the Commission will not cause price discovery

to shift to trading on the foreign board of trade.

66. *ISDA v. CFTC*, 887 F. Supp. 2d at 268.
67. *Id.* at 275.
68. "'[D]eference to an agency's interpretation of a statute is not appropriate when the agency wrongly believes that interpretation is compelled by Congress.'" *Id.* at 280-1, quoting *Peter Pan Bus Lines, Inc. v. Fed. Motor Carrier Safety Admin.*, 471 F.3d 1350, 1352, 1354 (D.C. Cir. 2006).
69. *Id.* at 282.
70. On November 5, 2013, the Commission voted to issue a revised proposed rule to impose position limits for the sane 28 physical commodity swaps and futures as in the vacated rule. In issuing the propose rule, the Commission stated it was "undertak[ing] the task assigned by the court: using its experience and expertise to resolve the ambiguity the district court perceived in section 4a(a) of the Act." Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,682 (proposed Dec. 12, 2013). The Commission's analysis concluded that "Congress mandated limits and did not intend for the Commission to make a necessity finding as a prerequisite to the imposition of limits." *Id.*
71. 17 C.F.R. 39.13(g)(2)(ii) (2013).
72. *Bloomberg L.P. v. CFTC*, slip. op. at 56, 70-1.
73. *Id.*, at 79, quoting *Crete Carrier Corp. v. EPA*, 363 F.3d 490, 494, (D.C. Cir. 2004).
74. *SIFMA v. CFTC*, Pl's Complaint 2.
75. The trade associations also have raised several substantive objections to the Commission's actions. These include that the Commission has "attempt[ed] to regulate activities well beyond" those that have the requisite "direct and significant" connection with activities in, or effect on, commerce of the United States. *Id.* at 55.
76. *SIFMA v. CFTC*, Def.'s Cross Mot. for Summ. J., Opp'n to Pl's Mot. for Summ. J., and Mot. to Dismiss in Part.