

## E-ALERT | Dodd-Frank Act

October 2, 2012

### FEDERAL DISTRICT COURT VACATES AND REMANDS CFTC POSITION LIMITS RULE

On September 28, 2012, the District Court of the District of Columbia vacated a rule setting position limits on derivatives tied to 28 physical commodities (the “Position Limits Rule”) issued by the Commodity Futures Trading Commission (“CFTC”) and remanded the Position Limits Rule to the CFTC for further proceedings. The Court’s decision was the result of a challenge to the Position Limits Rule brought by the Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association (together, the “Petitioners”), claiming that the CFTC had misinterpreted its statutory authority under the Commodity Exchange Act (“CEA”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Title VII of the Dodd-Frank Act set forth a comprehensive regulatory framework for derivatives and amended the CFTC’s authority to impose position limits, i.e., caps on the number of derivative contracts to purchase or sell a commodity that an individual trader or groups of traders may own during a specified period. The decision comes at a critical time as the Position Limits Rule was set to become effective on October 12, 2012. The decision to vacate the CFTC Position Limits Rule maintains the status quo with respect to existing exchange-set limits that were to be replaced on October 12 with the new Position Limits Rule.

#### THE LEGISLATIVE BACKGROUND OF THE POSITION LIMITS RULE

Title VII of the Dodd-Frank Act amends language in §4a of the CEA empowering the CFTC to impose position limits for the purpose of “diminishing, eliminating or preventing” sudden and unreasonable fluctuations in commodity prices. Acting pursuant to its perceived statutory mandate, on October 18, 2011, the CFTC adopted the Position Limits Rule by a vote of 3 to 2. The Position Limits Rule imposed limits on speculative positions in 28 core physical commodity contracts and their “economically equivalent” futures, options, and swaps (to which the CFTC refers collectively as “Referenced Contracts”). Position limits on Referenced Contracts were scheduled to take effect in two phases:

- First, spot-month position limits would become effective on October 12, 2012, i.e., 60 days after the CFTC adopted a final definition of the term “swap.”
- Second, the non-spot-month position limits, i.e., limits applied to positions in all contract months combined or in a single contract month, would become effective in two phases. For the nine “legacy” agricultural Referenced Contracts that were subject to CFTC-administered limits, the new non-spot-month limits would have gone into effect on October 12, 2012. For all other Referenced Contracts (that were not subject to CFTC-administered limits), the limits would be made effective by a CFTC order after the CFTC had received one year of open interest data on physical commodity cleared and uncleared swaps under the swaps large trader reporting rule.

Further, on May 18, 2012, the CFTC proposed rules that would modify the aggregation provisions for the Position Limits Rule (the “Aggregation Rules”). The Aggregation Rules were issued in response to certain industry groups arguing that requiring aggregation based on ownership absent control of trading decisions would impose substantial burdens on market participants and could harm market liquidity. The Aggregation Rules have yet to be finalized.

After first failing to convince the CFTC to stay the Position Limits Rule, the Petitioners challenged the Position Limits Rule in the D.C. District Court, alleging that the CFTC (1) had failed to determine the Position Limits Rule to be necessary and appropriate under the CEA; (2) had violated the CEA by insufficiently evaluating the costs and benefits of the Position Limits Rule; (3) had violated the Administrative Procedure Act (“APA”) by acting arbitrarily and capriciously in promulgating the Position Limits Rule; (4) had violated the APA by acting arbitrarily and capriciously in establishing specific position limits and adopting related requirements; and (5) had violated the APA by failing to provide interested persons sufficient opportunity to participate meaningfully in rulemaking.

## THE COURT’S DECISION

The Court’s decision, written by Judge Robert L. Wilkins, focused primarily on the first of the Petitioners’ claims, i.e., whether the CFTC had failed to determine the Position Limits Rule to be necessary and appropriate under the CEA. The decision considered two competing interpretations of CEA §4a, one advanced by the Petitioners and the other by the CFTC. While Petitioners argued that the CEA §4a required the CFTC to determine whether position limits were necessary before imposing such limits, the CFTC contended that through the Dodd-Frank Act, Congress had mandated the CFTC to impose position limits and had removed the CFTC’s discretion not to impose position limits.

The Court rejected the CFTC’s assertion that the clear and unambiguous language of §4a required the CFTC to impose position limits without discretion and without first making a finding that such limits were necessary. Interpreting CEA §4a as a whole, the Court found that there were at least two plausible readings of the statute – first, the CFTC’s interpretation that it was mandated to set position limits with no discretion; and second, the Petitioners’ interpretation that CEA §4a required the CFTC to gather evidence and then impose position limits only if it was necessary and appropriate to do so. Because both interpretations were plausible, the Court concluded that the CEA §4a was ambiguous on whether the CFTC was required to find that position limits were necessary before imposing limits and that the CFTC had mistakenly construed §4a as providing a clear and unambiguous mandate to set position limits. As a result, the Court vacated the Position Limits Rule and remanded it to the CFTC for the agency to resolve the ambiguities present in CEA §4a.

The decision expressly declined to consider the Petitioners’ other claims concerning the CFTC’s alleged violations of the APA and failure to adequately consider the costs and benefits in promulgating the Position Limits Rule. The Court also observed that the CFTC was in the process of revisiting the Aggregation Rules, which would ultimately form part of the new regime on position limits. The Court therefore decided not to “interfere” with the ongoing rulemaking process on the Aggregation Rules. The Court further determined that vacatur was appropriate in this case to preserve the status quo with respect to position limits while the agency resolves the statutory ambiguities on remand.

## CONCLUSION: NEXT STEPS FOR MARKET PARTICIPANTS

While it is not yet clear whether the CFTC will appeal the decision, it now appears that the Position Limits Rule will not come into effect on October 12, 2012. As a result, the new spot-month position limits on Referenced Contracts will not apply to market participants. Existing exchange-set and

Federal position limits in place pursuant to the CFTC's current position limits rules found in Part 150 will likely continue to be in effect until and after October 12th. Before imposing a new position limits rule, the CFTC must reconsider the nature of its mandate in light of the ambiguities in CEA §4a before deciding whether, and under what conditions, it can impose position limits.

While the decision acknowledges that §4a might be interpreted to require a finding of necessity before position limits can be imposed, it does not require the CFTC to adopt this interpretation. Market participants should monitor the CFTC's reconsideration of §4a and evaluate submitting a comment on any proposed new position limits rules.

The decision is available [here](#).

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If you have any questions concerning the material discussed in this client alert, please contact the following members of our antitrust group:

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