

October 1, 2012

## Court Vacates Position Limit Rules

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### **U.S. District Court for the District of Columbia Vacates the CFTC's New Position Limit Rules Under Part 151 of the CFTC's Regulations**

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#### **SUMMARY**

On October 18, 2011, the Commodity Futures Trading Commission ("CFTC") adopted interim and final rules on positions limits applicable to options, futures contracts and swaps (including swaptions) related to 28 agricultural, metal and energy commodity contracts under Part 151 of its regulations (the "Position Limit Rules") as well as amended existing position limits applicable to options and futures contracts under Part 150 of its regulations.<sup>1</sup> The Position Limit Rules would have expanded the existing position limits regime to, among other things, apply to swaps, limit available hedging exemptions and impose stricter aggregation requirements. On December 2, 2011, the International Swaps and Derivatives Association ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") filed a challenge to the Position Limit Rules in the U.S. District Court for the District of Columbia (the "Court"). Initial position limits under the Position Limit Rules were due to take effect on October 12, 2012. On September 28, 2012, the Court vacated the Position Limit Rules, remanding them to the CFTC.

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#### **DECISION TO VACATE AND REMAND POSITION LIMIT RULES**

The Position Limit Rules were adopted by a divided 3-2 vote during an open meeting of the CFTC. Commissioner Michael Dunn was one of the three votes in the majority and at the open meeting both indicated that he believed the CFTC was required to impose position limits and explained that "no one has presented this agency any reliable economic analysis to support either the contention that excessive speculation is affecting the market we regulate or that position limits will prevent the excessive speculation."<sup>2</sup> The belief that the CFTC had no discretion in adopting the Position Limit Rules was supported by CFTC Chairman Gary Gensler (who also voted with the majority), reflected in the text of the release adopting the Position Limit Rules, and central to the Court's decision.

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The complaint filed by ISDA and SIFMA challenged the Position Limit Rules on a number of grounds, the first of which was that the statutory grant of authority under which the CFTC acted when promulgating the Position Limit Rules unambiguously required a finding by the CFTC that the position limits were “necessary” to diminish, eliminate or prevent certain burdens on interstate commerce identified in Section 4a(a)(1) of the Commodity Exchange Act (“CEA”) and that the statutory grant of authority also required the CFTC to find that the established limits were “appropriate”. In response, the CFTC argued that Congress unambiguously mandated that the CFTC impose position limits without requiring the CFTC to find that such limits were necessary or appropriate. After reviewing the language of the statutory grant of authority and the parties’ arguments, the Court concluded that the relevant provisions were ambiguous as to whether imposition of position limits had to be predicated on a finding by the CFTC that such position limits were “necessary” or “appropriate”. Accordingly, the Court vacated the rulemaking and remanded it to the CFTC to determine in the first place whether the CFTC was compelled to impose position limits under the statute, or rather, was only required to impose position limits if it found them “necessary” or “appropriate”. The decision expressly did not address whether the CFTC may, in the exercise of its discretion, construe the statute to compel imposition of position limits without a finding that they are “necessary” or “appropriate”; and the Court did not reach the plaintiffs’ other challenges, which included that the promulgation of the Position Limit Rules: (1) violated the CEA by omitting adequate cost-benefit analysis, (2) violated the Administrative Procedure Act (“APA”) as arbitrary and capricious, and (3) violated the APA by failing to provide interested persons a sufficient opportunity to participate in the rulemaking. In limiting its holding, the Court expressly declined to opine on the validity of the new aggregation requirements under the Position Limit Rules, which the CFTC had proposed to further amend following the adoption of the Position Limit Rules.<sup>3</sup>

Because the Position Limit Rules were vacated and remanded to the CFTC for proceedings consistent with the Court’s opinion, compliance with the terms of the Position Limit Rules will not be required on October 12, 2012. However, the current position limit regime under Part 150 will continue to be in effect. As indicated above, position limits under Part 150 were amended by the CFTC’s action of Oct. 18, 2011; this amendment (that went into effect January 17, 2012) increased position limits applicable to nine agricultural contracts under Part 150 and is unaffected by the vacatur of the Position Limit Rules.

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### ENDNOTES

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<sup>1</sup> CFTC, “Position Limits for Futures and Swaps,” 76 Fed. Reg. 71626 (November 18, 2011). For additional information on these rules, see our Memorandum to Clients, dated November 7, 2011, “CFTC Issues Final Rules to Impose Position Limits on Physical Commodity Futures, Options, Swaps and Swaptions.”

<sup>2</sup> *Int’l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission*, Civil Action No. 11-cv-2146, Mem. Op. 5-6 (D.C., Sept. 28, 2012).

ENDNOTES (CONTINUED)

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- <sup>3</sup> See CFTC, “Aggregation, Position Limits for Futures and Swaps,” 77 Fed. Reg. 31767 (May 30, 2012). For additional information on these rules, see our Memorandum to Clients, dated May 21, 2012, “CFTC Proposes Aggregation Exemptions.”

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## CONTACTS

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### New York

Whitney A. Chatterjee	+1-212-558-4883	<a href="mailto:chatterjee@sullcrom.com">chatterjee@sullcrom.com</a>
David J. Gilbert	+1-212-558-4680	<a href="mailto:gilbergd@sullcrom.com">gilbergd@sullcrom.com</a>
Marion Leydier	+1-212-558-7925	<a href="mailto:leydiern@sullcrom.com">leydiern@sullcrom.com</a>
Kenneth M. Raisler	+1-212-558-4675	<a href="mailto:raislerk@sullcrom.com">raislerk@sullcrom.com</a>
Robert W. Reeder III	+1-212-558-3755	<a href="mailto:reederr@sullcrom.com">reederr@sullcrom.com</a>
Andrew S. Rowen	+1-212-558-3896	<a href="mailto:rowena@sullcrom.com">rowena@sullcrom.com</a>
Rebecca J. Simmons	+1-212-558-3175	<a href="mailto:simmonsr@sullcrom.com">simmonsr@sullcrom.com</a>
Saul P. Sarrett	+1 212 558 4816	<a href="mailto:sarretts@sullcrom.com">sarretts@sullcrom.com</a>
Ilya Beylin	+1-212-558-1674	<a href="mailto:beylini@sullcrom.com">beylini@sullcrom.com</a>
Christine Trent Parker	+1-212-558-3631	<a href="mailto:parkerct@sullcrom.com">parkerct@sullcrom.com</a>

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### Washington, D.C.

Eric J. Kadel, Jr.	+1-202-956-7640	<a href="mailto:kadelej@sullcrom.com">kadelej@sullcrom.com</a>
Robert S. Risoleo	+1-202-956-7510	<a href="mailto:risoleor@sullcrom.com">risoleor@sullcrom.com</a>
Dennis C. Sullivan	+1-202-956-7554	<a href="mailto:sullivan@sullcrom.com">sullivan@sullcrom.com</a>

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