The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 26558**

October 8, 2012

# Oral Argument in Lawsuit Challenging Amendments to Rule 4.5

[26558]

October 8, 2012

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VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 12-12 RE: ORAL ARGUMENT IN LAWSUIT CHALLENGING AMENDMENTS TO RULE 4.5

On October 5, 2012, Judge Beryl Howell of the United States District Court for the District of Columbia held oral argument in the lawsuit brought by ICI and the U.S. Chamber of Commerce against the Commodity Futures Trading Commission (CFTC) regarding the CFTC's amendments to Rules 4.5 and 4.27 under the Commodity Exchange Act (CEA). [1] Eugene Scalia, of Gibson, Dunn & Crutcher, represented ICI and the Chamber in the oral argument. Jonathan Marcus represented the CFTC. A brief summary, prepared by Gibson, Dunn & Crutcher, is provided below.

Judge Howell heard lengthy arguments from both sides and asked a number of questions, which revealed that she had carefully studied the parties' briefs in advance of the argument. Her level of preparation and participation in the argument suggested that she will give all of the arguments full and fair consideration as she decides how to rule. In total, she heard from both sides—beginning with Mr. Scalia, then Mr. Marcus, and then a rebuttal from Mr. Scalia—for between an hour and a half and two hours.

Judge Howell indicated early in the argument that she was familiar with the recent decision by Judge Robert Wilkins who, on September 28, issued an opinion invalidating the CFTC's

position limits rule. [2] As Judge Howell noted, this decision could have implications for our lawsuit because Rule 4.5 cross-references a definition of "bona fide hedging" included in the now-invalidated position limits rule. The parties offered to submit supplemental briefing on the implications of the invalidation of the position limits rule for the definition of "bona fide hedging" used in Rule 4.5. The CFTC's brief is due to the court on October 15, and ICI's brief is due on October 22.

During Mr. Scalia's argument, Judge Howell asked questions about the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and in particular the CFTC's argument that Rule 4.5 is justified by the Dodd-Frank Act and the financial crisis. She also asked a number of questions about the CFTC's concern with increased participation by investment companies in the commodity derivatives markets. Mr. Scalia emphasized, among other things, that the CFTC had not claimed in the adopting release amending Rule 4.5 that it was doing so as a response to the Dodd-Frank Act, and that it is not permitted to defend the rulemaking on new grounds once the case reaches court. Moreover, Mr. Scalia noted, the CFTC has never alleged that the financial crisis was caused by investment companies, let alone by any participation by investment companies in the derivatives markets.

Judge Howell indicated during Mr. Scalia's argument that she wanted to hear from the CFTC about whether it believed that investment companies had played a role in the financial crisis. Mr. Marcus, representing the CFTC, responded that investments in swaps generally had contributed to the crisis, and argued that the CFTC was entitled, even absent past or anticipated future problems, to "prophylactic[ally]" regulate investment companies' use of derivatives. Mr. Marcus also responded to questions about whether the CFTC had properly conducted a cost-benefit analysis given that the contours of the regulatory regime are still being considered in the harmonization rulemaking. The bifurcated nature of the rulemaking was proper, he claimed, because the CFTC had determined that the registration requirement's benefits would outweigh its costs, and any challenge to requirements that would be imposed only after harmonization was, in his view, not yet presented given the ongoing rulemaking. At this point, Mr. Marcus argued that even the district court could not "evaluate" the requirements that would be imposed.

In his rebuttal argument, Mr. Scalia focused, among other things, on Mr. Marcus' argument that the CFTC could not properly determine the costs of the rule given the bifurcated structure of the rulemaking. He noted that, while the CFTC claimed that the district court could not "evaluate" the relevant costs given the harmonization rulemaking, the CEA uses precisely that word in imposing the cost-benefit obligation on the CFTC: the CFTC is required to "evaluate" costs and benefits, and yet, Mr. Scalia noted, they admittedly could not have done so. Mr. Scalia closed by reiterating our request that Judge Howell vacate the CFTC's rulemaking, and do so prior to its effective date.

Sarah A. Bessin
Senior Counsel

**endnotes**

[1] Investment Company Institute, et al. v. United States Commodity Futures Trading Commission, Case No. 1:12-cv-00612 (D.D.C. April 17, 2012), available at http://www.ici.org/pdf/12_commod_inv_complaint.pdf. For a description of the complaint in

the lawsuit, see ICI Memorandum No. 26050 (April 17, 2012), for a description of our motion for summary judgment, see ICI Memorandum No. 26172 (May 21, 2012), for a description of the CFTC's initial response to the lawsuit, see ICI Memorandum No. 26246 (June 19, 2012), for a description of our reply brief, see ICI Memorandum No. 26284 (July 3, 2012), and for a description of the CFTC's reply brief, see ICI Memorandum No. 26313 (July 19, 2012). More information relating to the lawsuit may be found on ICI's website at http://www.ici.org/cftc_challenge.

[2] International Swaps and Derivatives Association, et al. v. United States Commodity Futures Trading Commission, Case No. 11-cv-2146 (D.D.C. September 28, 2012).

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