

MEMO# 27222

May 7, 2013

Oral Argument in Appeal of Lawsuit Challenging Amendments to Rule 4.5

[27222]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 14-13
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UNIT INVESTMENT TRUST MEMBERS No. 11-13
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 10-13 RE: ORAL ARGUMENT
IN APPEAL OF LAWSUIT CHALLENGING AMENDMENTS TO RULE 4.5

On May 6, 2013, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit (Circuit Court) held oral argument in the appeal of 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 Rule 4.5 under the Commodity Exchange Act. * The Circuit Court panel consisted of Chief Judge Garland and Judges Sentelle and Brown. 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. Please do not circulate this summary outside your organization.

Mr. Scalia opened the argument for ICI and the Chamber by pointing to a series of recent, unanimous decisions by the Circuit Court vacating Securities and Exchange Commission (SEC) rulemakings for failure to conduct an adequate cost-benefit analysis, and by explaining that the failures in this case are just as great. Specifically, Mr. Scalia pointed to

two significant problems with the Rule 4.5 rulemaking process: the CFTC's failure to consider the effect of the rulemaking on liquidity, and its failure to measure the purported benefits of the rulemaking against the "baseline" of existing SEC regulation. In response, Mr. Marcus argued for the CFTC that amended Rule 4.5 was a prudent response to the financial crisis and the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act that should satisfy the deferential standard of review that applies to agency rulemakings.

Chief Judge Garland was the most active member of the Circuit Court panel. He asked by far the most questions, including questions suggesting that the Rule 4.5 rulemaking release was not required to discuss liquidity at any length because the CFTC had not engaged in extensive analysis of the issue when it eliminated the trading and marketing thresholds under Rule 4.5 in 2003. He also asked questions suggesting that the CFTC might have satisfied its obligation to assess the baseline of existing regulation in a portion of the Rule 4.5 rulemaking release in which it quoted, out of context, a few remarks by the SEC concerning its regulation of investment companies' use of derivatives.

The other two members of the Circuit Court panel asked fewer questions and, as a result, it is more difficult to draw any conclusions about their likely positions. Judge Brown asked Mr. Marcus whether the CFTC believed it had any obligation to conduct a cost-benefit analysis, and appeared somewhat displeased when he responded that the CFTC did not have such an obligation, as cost-benefit analysis is commonly understood. Judge Sentelle, meanwhile, asked probing questions of both sides. Judge Sentelle asked Mr. Scalia what burdens are imposed by registration alone—putting aside measures that are subject to harmonization—and Mr. Scalia responded that registration imposes, among other things, the significant burden of being subject to two new regulatory masters. Judge Sentelle also asked a number of tough questions of Mr. Marcus, including whether an agency could ever conduct a cost-benefit analysis of a financial regulation without considering liquidity, whether the CFTC had claimed benefits from compliance rules that are still subject to harmonization, and whether the CFTC had claimed benefits that are already provided by the SEC. Judge Sentelle also questioned whether it would be possible for regulated entities to bring suit after the conclusion of the harmonization rulemaking. Mr. Marcus responded that suit could be brought to challenge only the details of compliance, and Mr. Scalia pointed out in his rebuttal that the CFTC did not concede that suit could be brought to challenge the registration obligation itself.

It is always difficult to predict the outcome of a case from oral argument, and that is particularly true in this instance. While there are no guarantees regarding timing, we expect that the Circuit Court will issue a decision before it returns in September from its upcoming summer recess.

Sarah A. Bessin
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endnotes

*More information relating to the lawsuit may be found on ICI's website at http://www.ici.org/cftc_challenge.

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