

BREAKINGVIEWS

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ISDA suit could go to Supreme Court

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FRONT STORY COMMODITIES TRADING

CFTC staffers under attack for comments

Lack of evidence and cost benefit analyses cited

A lawsuit over the implementation of position limits for commodities trading threatens to unravel the entire regulatory process that has taken flight in the US since the credit crisis began in 2008.

The International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association filed a joint lawsuit earlier this month against the Commodity Futures Trading Commission in two federal courts – the US District Court for the District of Columbia, which is the lower Federal Court, and the US Court of Appeals, which is the higher court. The trade groups claim the CFTC had not provided enough support to have adopted a position limit rule.

The CFTC has been directed under Dodd-Frank to establish position limits applicable to futures, options, and swaps. The ruling, which was approved in a 3–2 vote by the CFTC on October 18, impacts on physical commodities and 28 derivatives on products ranging from oil to corn, but trade groups such as ISDA and SIFMA say the ruling has more far-reaching implications.

“The individual focus is on energy, metals and agriculture, but what they are putting in place here is a framework for position limits potentially across different areas as they bring swaps into the CFTC’s jurisdiction,” said Robert Pickel, CEO of the International Swaps and Derivatives Association.

“While we continue to have substantive concerns, we are also mostly concerned, at least in the lawsuit, about the process,” he said. ISDA does not question the authority of the Commission to establish position limits, just their appropriate level of support.

The case has some merit. To date, the CFTC has not provided evidence that such position limits will actually prevent speculation. Several market participants have weighed in on the issue, saying that not only their company’s growth but overall economic growth will be stymied by having the position limits.

The CFTC’s cost-benefit analyses in determining the effect of new regulations have also been weak or non-existent. Even the CFTC’s own inspector general questioned their quality. ISDA believes the limited analysis runs counter to the CFTC’s independent statutory obligation.

“Their cost-benefit analyses claimed by the CFTC across all their regulations are bogus,” added Jeremy Weinstein, energy and commodity derivatives attorney with the law offices of Jeremy Weinstein, noting that some CFTC Notices of Proposed Rules omitted hundreds of millions of dollars in costs to Main Street.

The position limit case could also hold up since there has been some precedent already in this area. The DC courts similarly cited a poor cost benefit analysis from the Securities and Exchange Commission earlier this summer as reason to throw out one of its rulings.

Placing blame

The CFTC itself is partly to blame for some of the legal rumbblings. When the CFTC approved the position limit ruling in October, CFTC Commissioner Scott O'Malia, who dissented against the vote, said: "... the Commission uses 'Congress did not give the Commission a choice' as a rationale in adopting burdensome and unmanageable rules of questionable effectiveness. This statement, in all of its iterations in this rule, is nothing more than hyperbole used tactfully to support a politically-driven overstatement as to the threat of 'excessive speculation' in our commodity markets."

According to language in the Commodity Exchange Act (CEA), the Commission does not have to establish limits if it finds that such limits will not effectively curb excessive speculation.

CFTC commissioner Michael Dunn, who gave his consent to the ruling though is personally against the idea, also said that if the limits were put on, producers might receive inaccurate market signals when making production decisions. (See "[CFTC narrowly passes position limit rule](#)", IFR 1906).

While other CFTC and SEC rulings may also seem ripe for a legal battle, market participants say the tangible evidence with the position limit ruling seems the most logical for a fight, or even a win.

Normally in a case like this, one would not petition the Court of Appeals right away, but since the CEA, which regulates commodity futures trading in the US, technically has its original jurisdiction in the Court of Appeals, said the derivatives attorney, ISDA filed with that court as a precautionary measure.

"They [ISDA and SIFMA] feel they should follow both routes to be safe," said the attorney.

No matter who wins, the case is bound to be appealed. If the DC lower court rules in favour of the associations, the CFTC is likely to appeal immediately to the Court of Appeals. Derivatives lawyers, though, say the case has all the makings to go to the Supreme Court.

"I wouldn't be surprised if it moved from the Appeals Court to the Supreme Court," said the derivatives attorney. "It's an oddity. It's a federal-federal issue and a jurisdictional issue," he said.

Weinstein agreed, saying: "I think the Supreme Court will consolidate [the lawsuits]. It's the first of many to come." The case, nevertheless, is not likely to come without challenges, particularly amid a revamped CFTC.

"The CFTC was a very narrow agency – an important agency – but it was a backwater agency. It had maybe eight rule-makings a year. Now, they're basically federalising the entire economy. No one has ever encountered that added scope," said Weinstein.

ISDA is hoping at a minimum that the courts will force CFTC to justify the rule or even vacate the rule entirely. But all may not go smoothly.

"I imagine this case will hit stumbling blocks since no one quite knows how you are supposed to challenge these guys," said Weinstein.