IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

INVESTMENT COMPANY INSTITUTE and CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,

Plaintiffs,

v.

UNITED STATES COMMODITY FUTURES TRADING COMMISSION,

Defendant.

Civil Action No. 1:12-cv-00612 (BAH)

PLAINTIFFS' MEMORANDUM IN RESPONSE TO DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT, IN RESPONSE TO DEFENDANT'S MOTION TO DISMISS IN PART, AND IN FURTHER SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

The requirements of the Administrative Procedure Act ("APA") and Commodity Exchange Act ("CEA") that govern this case are clear, familiar, and straightforward: The Commission was required to consider the "important aspect[s] of the problem" underlying the Rule at issue. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) ("*State Farm*"). It had to address "significant" points raised by commenters, *Int'l Fabricare Inst. v. EPA*, 972 F.2d 384, 389 (D.C. Cir. 1992) (per curiam), including "reasonable" alternative regulatory "options," "and to explain any decision to reject such options." *Int'l Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 818 (D.C. Cir. 1983). The Commission was obligated to explain why the rationale it proffered in 2003 no longer justified exemption from CFTC regulation, *see Dillmon v. NTSB*, 588 F.3d 1085, 1089-90 (D.C. Cir. 2009), and "evaluat[e]" the costs and benefits of its action, including their effects on "efficiency" and "competitiveness," 7 U.S.C. § 19(a). Mere "ipse dixit" is insufficient to sustain agency action, *Ill. Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555, 564 (D.C. Cir. 1997) (per curiam), and the D.C. Circuit has made clear that determining the benefits of increased regulation requires assessing the existing "baseline" of regulatory protections and identifying what added benefits will come from the new requirements. *See Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010). Moreover, in this litigation itself, the Commission may not defend its action on a basis not put forward in the Rule Release, *see SEC v. Chenery Corp.*, 318 U.S. 80, 87-88 (1943), and if multiple rationales were given in the Release and one is flawed, this Court must vacate the Rule unless the Release identified the flawed rationale as an alternative ground and the other grounds are sufficient to support the Rule. *See Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006).

In their opening brief, Plaintiffs showed that the Commission violated the requirements of the APA and CEA by deploying a superficial, conclusory analysis that gave insufficient attention to the Commission's action in 2003, provided no meaningful discussion of the existing regulatory structure for investment companies, and—by the agency's own admission—declined to consider some of the costs registration would impose because, due to an ongoing rulemaking, the agency does not know what those costs are.

The Commission's response brief is to a large degree an attempt to avoid the analysis that the APA and CEA require. Rather than engage in pointed, specific discussion of the reasons it gave for its action and why they are supposedly correct, the Commission discourses at length on the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)—which required hundreds of new financial regulations, but not the Rule at issue here—and on the financial crisis of 2008, which the Commission concedes in a footnote had nothing to do with registered investment companies. Similarly, the Commission's brief avoids any meaningful discussion of the regulatory protections provided by the Investment Company Act of 1940 ("ICA") and the Securities and Exchange Commission ("SEC"). Like the relevant portions of the Rule Release, the brief does not cite a single SEC rule or ICA provision—and instead resorts to a misleading depiction of the SEC's role. It will surprise this Court to hear the Commission's claim, for example, that while the CFTC focuses on "protect[ing] market users and the public from fraud, manipulation, and abusive practices," the SEC evidently does not. CFTC Br. 5 (internal quotation marks omitted).

The Commission's attempt to change the subject is perhaps understandable, as the explanations provided in the Rule Release give it so little to work with now. But a summary judgment brief is not the time for an agency to cite evidence and arguments that were never put forward in the adopting release. And Dodd-Frank and the 2008 financial crisis are not a wand the Commission may wave to dispel its obligations under the APA, CEA, and a series of highly relevant D.C. Circuit decisions. On the contrary, the inadequacy of the Commission's *post hoc* justifications, together with the gulf between what the Commission argues now, and what it said in the rulemaking, provides powerful confirmation that this ill-considered Rule must be vacated.

ARGUMENT

I. The Commission's Justifications For The Rule Are Irrelevant And Inadequate.

The Commission stakes its defense of the Rule on the financial crisis of 2008 and enactment of the Dodd-Frank Act. Indeed, the Commission accuses Plaintiffs of "virtually ignoring" this history, even as it concedes that Plaintiffs acknowledged the significance of these events during the rulemaking. *See* CFTC Br. 22-23. But neither the financial crisis nor Dodd-Frank excused the Commission from its obligation to justify, in the Rule Release, the specific regulation of investment companies contained in its Rule. And on that—the relevant—issue, the Commission has surprisingly little to say.

A. The Dodd-Frank Act Neither Requires The Rule, Nor Suspends The Commission's Obligations Under The Administrative Procedure Act And The Cost-Benefit Provision Of The Commodity Exchange Act.

For all its repeated invocations of the Dodd-Frank Act, the Commission never confronts this telling fact: Dodd-Frank required the issuance of hundreds of rules, but did not require the amendments at issue here. To be sure, Congress amended the statutory definition of "commodity pool operator" ("CPO") to include entities that engage in swap transactions—but it preserved the Commission's authority to exclude entities from that definition. *See* Pub. L. No. 111-203, § 721. And none of the statute's provisions indicate that the Commission should subject investment companies to the regulatory burdens imposed by this Rule.

If anything, Dodd-Frank suggests that Congress viewed such increased regulation of investment companies as unnecessary. Congress singled out particular segments of the financial industry for additional regulation; for instance, it imposed new requirements—including a variety of disclosure and reporting obligations—on advisers of so-called "private funds." Pub. L. No. 111-203, § 406. No such requirements were added for investment companies. The Commission therefore has it backwards when it tries to justify its Rule on the ground that some of the obligations it imposes on investment companies mirror obligations imposed on private funds pursuant to Dodd-Frank. *See* CFTC Br. 40-41.

The Commission nonetheless insists that Dodd-Frank changed the regulatory zeitgeist, and urges this Court to base its decision on broad policy pronouncements such as that a former federal "policy of deregulation . . . failed" and a new pro-regulatory "philosophy" now reigns. *See* CFTC Br. 1, 25. But a purported pro-regulatory "philosophy" does not suspend the APA or immunize all new regulations that an agency adopts, any more than a de-regulatory "philosophy" would justify all de-regulatory measures. *See State Farm*, 463 U.S. at 41. In either case, the agency must "cogently explain why it has exercised its discretion in a given manner." *Id.* at 48.

Nor is there any merit to the suggestion by *amicus* Better Markets that Dodd-Frank somehow alleviates the Commission's obligation to consider the costs and benefits of its Rule. *See* Better Markets *Amicus* Br. 25. Dodd-Frank left in place the cost-benefit provision applicable to the CFTC, as well as the analogous provisions applicable to the SEC. Congress is presumed to have been aware of the recent D.C. Circuit decisions holding that such cost-benefit provisions require an agency to "determine as best it can the economic implications of the rule it has proposed," *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005), and that an agency adopting new regulations must assess the "baseline" of benefits provided under existing regulations, *Am. Equity*, 613 F.3d at 178. Yet Congress nowhere indicated that it disapproved of these decisions, or wished to impose a lower standard. On the contrary: Dodd-Frank *prohibited* the SEC from re-adopting the rule that the D.C. Circuit invalidated in *American Equity.* Pub. L. No. 111-203, § 989J. And it is the regulatory error identified in *American Equity* that the CFTC's error in this case most resembles.

The Commission therefore could not simply invoke the financial crisis and conclude that any subsequent regulation is justified; its Release had to explain why the financial crisis justifies the Rule adopted here. Its brief provides a wide-ranging history of the past five years, but buries in a footnote its tacit agreement with "Plaintiffs' observation that the CFTC has not attributed the financial crisis specifically to" investment companies. CFTC Br. 24 n.10; *see also* 77 Fed. Reg. 11,252, 11,344 (Feb. 24, 2012) (Sommers, Comm'r, dissenting). The brief then seeks to divert the Court's attention to the "bigger picture" of the "commodity derivatives markets." CFTC Br. 24 n.10. But the absence of a demonstrated link between investment companies and the financial crisis necessitated more than a footnote in the Commission's brief—it required a fact-specific illustration in the Rule Release of the risks investment companies supposedly pose. Similarly, while the Commission suggests its regulation is necessary to address *systemic* risk, it never explained how investment companies purportedly contribute to that risk, or even showed that investment companies account for a sufficient portion of the commodities markets that their holdings could have system-wide effects.

B. The Commission's Newfound Reliance On Dodd-Frank And The Financial Crisis Is A Profound And Impermissible Shift From Its Original Justification For The Rule.

In shifting focus to the "bigger picture," the Commission disregards the rationale set forth in the Rule Release and ignores the actual provisions and effect of its Rule, which is specifically addressed to investment companies rather than the derivatives markets generally.

1. The Commission attempts to support its focus on Dodd-Frank and the financial crisis by pointing to scattered statements in the Rule Release, particularly in the introduction. *See* 77 Fed. Reg. at 11,252-53. But the Rule Release amended multiple regulations, many of which are not challenged here. The introduction generally does not distinguish among those amendments, and does not explain why the financial crisis justifies regulation of investment companies *in particular*. By contrast, in the portions of the Rule Release discussing the amendments to Section 4.5, the focus is on asserted needs to regulate these specific "entities" that have little or nothing to do with the broader financial crisis. The Release begins its response to the public's "Comments Regarding Proposed Amendments to Section 4.5" by explaining that the Commission proposed to restore the registration requirement because "it became aware that certain registered investment companies were offering interests in de facto commodity pools" and "it believed registered investment companies should not engage in such activity without Commission oversight and that such oversight was necessary to ensure *consistent treatment* of CPOs regardless of their status with respect to other regulators." Full stop. 77 Fed. Reg. at 11,254 (emphasis added). The Release then turned to the public's "General Comments on Proposed Amendments to § 4.5," in particular those opposed to reviving the registration requirement. Here, the Commission identified "two significant benefits":

> First, registration allows the Commission to ensure that all entities operating collective investment vehicles participating in the derivatives markets meet minimum standards of fitness and competency. Second, registration provides the Commission and members of the public with a clear means of addressing wrongful conduct by individuals and entities participating in the derivatives markets.

Id. at 11,254.

And on the next page of the Release the Commission responded to "those commenters who argued against the adoption of any change to § 4.5" (which imposes the registration requirement) by stating its "belief" that "collective investment vehicles that engage in more than a de minimis amount of derivatives trading should be required to register with the Commission" because "Congress empowered the Commission to oversee the derivatives market" and "the Commission is in the best position to oversee entities engaged in more than a limited amount of non-hedging derivatives trading." 77 Fed. Reg. at 11,255. Then, responding to commenters who said registration would impose a "significant burden" without "meaningful benefit," the Commission for the second time in as many pages cited its "belie[f]"—"*as discussed throughout this release*"—"that entities that are offering services substantially identical to those of a registered CPO should be subject to substantially identical regulatory obligations." *Id.* (emphasis added). This "consistent treatment" rationale makes its third appearance at the top of the very next page, *id.* at 11,256, yet it is essentially ignored in the Commission's brief. The entire discussion in this key section of the Release justifying the registration requirement is focused on the supposed benefits of regulating investment companies, not—like the Commission's brief—on the "bigger picture" of the derivatives market in the wake of Dodd-Frank and the financial crisis.

The Commission's determination to conjure new rationales to replace the justifications provided in the Rule Release becomes particularly apparent when the Commission is confronted with the response it gave to commenters who opposed the inclusion of swaps when calculating the Rule's trading threshold. In the Rule Release, the Commission said it was including swaps because, given the inclusion of swaps within the statutory definition of a CPO, "[i]f swaps were excluded, any swaps activities undertaken by a registered investment company would result in that entity being required to register." 77 Fed. Reg. at 11,258. The Commission now seeks to characterize the statement as a "limited, technical reminder, perhaps inelegantly phrased," which was provided "in response to 'a comment asking for additional clarification.'" CFTC Br. 34-35 (quoting 77 Fed. Reg. at 11,258). But the Rule Release in fact states that it "received a comment asking for additional clarification *regarding its decision to include swaps* within the threshold," and cites in a footnote *eleven* separate comment letters on the issue. 77 Fed. Reg. at 11,258 & n.70 (emphasis added). These comments did not request a limited, technical clarification; they challenged the Commission to provide a reasoned justification for its decision to include swaps when calculating the trading threshold. S*ee*, *e.g.*, ICI, Comment (Apr. 12, 2011), at 3. If the "dark" market for over-the-counter swaps played the prominent role in the Commission's thinking that the Commission now claims, it would have said so when asked to explain its "decision to include swaps within the threshold"—the Commission would have responded, as it does now, that "inclusion of swaps in the threshold follows logically, if not inexorably, from . . . Dodd-Frank's concern about the unregulated nature of the swaps market." CFTC Br. 19. But the Rule Release did not say that, because the purportedly "inexorable" command of Dodd-Frank is simply rhetoric the Commission seizes upon now to defend a regulation that was put forward on other—flawed—grounds.[1]

2. Similarly, the Commission fails to acknowledge, much less defend, the many passages of the Rule Release that justify the Rule on the basis of supposed consistent treatment of regulated entities. In the notice of proposed rulemaking ("NPRM"), this was the *only* benefit identified in the cost-benefit analysis that was specific to Section 4.5. *See* 76 Fed. Reg. 7,976, 7,988 (Feb. 11, 2011). As shown above, the final Rule Release identifies this rationale repeatedly at key junctures and discusses it "throughout [the] release." 77 Fed. Reg. at 11,255; *see id.* at 11,254-56, 11,275, 11,278, 11,280. Yet the Commission now disavows it.

[1] The importance that the Release attached to this flawed rationale is confirmed by the Commission's use of the same rationale in another portion of the Rule Release. Plaintiffs do not challenge that aspect of the Rule, but the Commission's use of virtually identically-phrased reasoning is instructive. *See* 77 Fed. Reg. at 11,263.

According to the Commission, "Plaintiffs misquote the Commission" when they "deride the Final Rule as 'wholly irrational' because, in their words, it seeks to 'ensure uniform treatment of regulated entities,' but without requiring pensions, trusts, and banks to register, while subjecting RIC/CPOs to dual regulation inapplicable to other CPOs." CFTC Br. 30. Those portions of the Rule Release, the Commission claims, were merely "discussing the problem of in-name-only RICs," that is, entities registered as investment companies that (the Commission now asserts) escape regulation by the SEC. *Id.*

This retort by the Commission merely highlights another flaw in its defense of the Rule, without curing the deficiency in the Release it intends to address. The additional flaw is that the purported "problem of in-name-only RICs," which is mentioned repeatedly in the brief, was not put forward as a justification for the Rule in the Release. The Release expressed concern that a grand total of three investment companies were known to be "offering interests in de facto commodity pools while claiming exclusion under [Section] 4.5." 77 Fed. Reg. at 11,254. But it did not state that these entities were escaping *all* regulation; its stated concern was that they were free of regulation *by the CFTC*. The Commission now suggests in its brief that it *also* was concerned about the use of foreign subsidiaries to circumvent regulation by the SEC, but the portion of the Release the Commission cites for this addresses whether a "Controlled Foreign Corporation" should be "entitled to exclusion simply because its parent company is a registered investment company that may be entitled to exclusion under [Section] 4.5," *id.* at 11,260—it did not purport to explain the Commission's reasons for requiring investment company advisers to register as CPOs in the first place. (Moreover, these entities *are* regulated by the SEC. *See infra* 27.) Nor does the Rule Release anywhere discuss the claim that investment companies have used foreign subsidiaries to avoid SEC regulation. The Commission cites comment letters that it reads as raising this concern, as well as a letter from two Senators. *See* CFTC Br. 30. But while some of these letters were mentioned in the Rule Release, *they were never cited to show that SEC regulation is inadequate or was being circumvented through use of foreign subsidiaries*.

The Commission resorts to this new rationale for the Rule because the "consistent treatment" rationale—which is deployed "throughout" the Release, 77 Fed. Reg. at 11,255—is transparently irrational. The Rule in no way promotes "consistent treatment" of regulated entities; it subjects investment companies to dual regulation not faced by other entities registered as CPOs, and, among all the entities granted exclusions under Section 4.5, it subjects only investment companies and their advisers to a registration requirement. *See* MSJ Br. 31. In so doing, the Rule breaks with a nearly 30-year history of uniform treatment of "otherwise regulated" entities (including banks, trust companies, pension plans, and insurance companies) under Section 4.5. *Id.* To say that the Rule promotes "consistent treatment" of regulated entities thus reflects a profound misunderstanding of its implications, and is part and parcel of the Release's larger failure to thoroughly consider the existing SEC regulatory regime before imposing new requirements.[2]

* * *

Ultimately, the Commission's attempts to substitute new rationales in its brief for the flawed reasoning of the Rule Release create three problems for its defense of the Rule. First, "an agency's action must be upheld, if at all, on the basis articulated by the agency itself," not "counsel's *post hoc* rationalizations for agency action." *State Farm*, 463 U.S. at 50; *see also Chenery*,

[2] The Commission offers one tepid defense of this rationale: "[d]ifferent regulation," it states, "follows naturally from *different* business activities." CFTC Br. 31. In fact, however, differences in treatment arise under the Rule precisely when investment companies and other entities eligible for exclusion under Section 4.5 engage in the same business activities—trading in futures, options, or swaps—but only investment companies have to register as CPOs. Moreover, the Commission never undertook to explain *why* any differences between these entities justify different treatment, and in fact repeatedly sought to justify this regulation on the ground that it would promote consistent treatment regardless of registration status.

318 U.S. at 87-88. The brief the Commission has filed here is exceptional for the degree to which it attempts to plow new ground that is not addressed in the Release. Second, when an agency adopting a rule "has relied on multiple rationales (and has not done so in the alternative), and we conclude that at least one of the rationales is deficient, we will ordinarily vacate the order unless we are certain that [the agency] would have adopted it even absent the flawed rationale." *Nat'l Fuel Gas Supply*, 468 F.3d at 839. The Rule Release failed in multiple respects to provide the reasoned explanation required by the APA and CEA. None of those flawed rationales is stated in the alternative; each, therefore, requires vacatur.

Third, as shown below, the Commission's new-found arguments are not only impermissible, they are inaccurate.

C. The Commission's New Contentions Cannot Salvage This Rule From The Critical Flaws In The Rulemaking Analysis.

The Commission concluded in the Rule Release that "the benefits provided by these rules are supplementary to, and not duplicative or redundant of, benefits provided by the federal securities laws." 77 Fed. Reg. at 11,276. Yet the Commission totally failed to undertake the analysis of existing regulation required to support this conclusion. The Commission thus did "not adequately address the probability the Rule will be of no net benefit as applied to investment companies." *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1155 (D.C. Cir. 2011). It is precisely this shortcoming that has led the Commission to shift strategies in this Court.

The Commission's brief does not contest that investment companies are already among the "most regulated types of companies in the United States." Clifford E. Kirsch, 1 *Mutual Funds and Exchange Traded Funds Regulation* § 1:4.1 (3d ed. 2011). Nor does the Commission contest that the effect of the Rule is to subject entities and activities *already* subject to extensive regulation by the SEC and FINRA to the oversight of two additional regulators—the CFTC and the NFA. Yet, the relevant portions of the Rule Release did not cite or discuss a single SEC regulation—a point the Commission does not dispute. *See* CFTC Br. 48-49. Indeed, the Commission's brief *also* does not cite or discuss a single SEC regulation of investment companies.

1. The Commission seeks to excuse the Release's failure to discuss the SEC regulatory regime by asserting that the CFTC and SEC are "regulating different activity in different markets." CFTC Br. 58. By this, the Commission appears to suggest that the CFTC concentrates exclusively on commodities and derivatives, while the SEC focuses on the securities markets, with scant concern for investment companies' investments in derivatives. That is profoundly false, as demonstrated by SEC statements and guidance on derivatives dating back to the 1970s. *See* SEC, *Registered Investment Company Use of Senior Securities—Select Bibliography*, http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm (compiling sources). The SEC's engagement is reflected most recently in its "Concept Release," an analysis of investment companies' use of derivatives that takes up nearly 20 fine-print pages in the Federal Register and was issued just months before the CFTC's Rule Release. *Use of Derivatives by Investment Companies Under the Investment Company Act of 1940*, 76 Fed. Reg. 55,237 (Sept. 7, 2011). As the Concept Release explains: "The activities of [mutual] funds, *including their use of derivatives*, are regulated *extensively* under the Investment Company Act [("ICA")], [SEC] rules, and [SEC] guidance." *Id.* (emphasis added). Accordingly, a "fund that invests in derivatives must take into consideration various provisions of the [ICA] and [SEC] rules under the Act," including provisions "governing diversification, concentration, investing in certain types of securities-related issuers, valuation, and accounting and financial statement reporting," and "applicable disclosure provisions." *Id.* at 55,238-39.

The Concept Release reflects a regulator actively and thoughtfully engaged in a single subject: the most effective means of overseeing investment companies' use of derivatives. And while, as the CFTC notes, the Concept Release seeks public comment on ways that the SEC's regulation of derivatives might be improved—a query made periodically by any effective regulator—the Concept Release also reports the conclusion of an American Bar Association report that the SEC's "basic framework" for addressing the leverage-related risk of derivatives "has worked very well," and that another key feature of the SEC's regulation of investment companies' use of derivatives "provides an appropriate framework." *Id.* at 55,245, 55,253 (citing Cmte. on Fed. Regulation of Securities, ABA, *Report of the Task Force on Investment Company Use of Derivatives and Leverage* (July 6, 2010) ("ABA Rpt."), at 16, *available at* http://apps.americanbar.org/buslaw/blt/content/ibl/2010/08/0002.pdf).

To support its claim that there is no relevant overlap between its regulatory programs and the SEC's, the Commission plucks a quotation from each of the agencies' websites, which it claims demonstrates that the agencies have different "missions." *See* CFTC Br. 5. The notion that agencies' relative responsibilities can properly be delineated by citing snippets of mission statements is absurd. If the SEC's programs could simply be dismissed as regulating "different activity in different markets," then there would be little need to "harmonize" the CFTC's regulations; the regulators could simply direct investment companies to comply with SEC regulations when engaged in securities market "activities," and with CFTC regulations when engaged in commodity market "activities." And if SEC regulation of investment companies were truly "irrelevant," then there would have been no reason for the Commission to have recognized for nearly thirty years that the "otherwise regulated" nature of investment companies justifies treating them differently from other entities that meet the statutory definition of a CPO. *See* 50 Fed. Reg.

15,858 (Apr. 23, 1985). Section 4.5 continues to permit a retinue of other "otherwise regulated" entities to claim a blanket exemption from CPO registration. None of this is consistent with the Commission's suggestion that the "otherwise regulated" status of investment companies and their advisers is irrelevant to its analysis.

To be sure, the CFTC focuses on commodities and derivatives—but the SEC regulates investment companies comprehensively, *including their use of derivatives*. Thus, for example, although the Commission's brief (but not its Rule Release) emphasizes the impact of the "leverage" that results from use of derivatives, CFTC Br. 8, the SEC's regulation of investment companies' use of derivatives *already* includes limitations on the creation of risk through leverage. *See*, *e.g.*, Morgan Lewis, Comment (Apr. 12, 2011); ICI Comment, at 34. Indeed, the NFA in its *amicus* brief describes the "protection of investors from the potential adverse effects of leverage" as a "core purpose" of the ICA. NFA *Amicus* Br. 11. The SEC has provided guidance interpreting Section 18 of the ICA, 15 U.S.C. § 80a-18, to require funds investing in derivatives either to enter into offsetting transactions or to segregate fund assets in amounts that would cover the fund's liabilities under the instruments—measures that reduce the investment company's potential exposure to, and therefore the risk from, derivative instruments. *See* Fidelity Comment, at 4 n.12 (citing Securities Trading Practices of Registered Investment Companies, 44 Fed. Reg. 25,128, 25,132 (Apr. 27, 1979); Dreyfus Strategic Investing & Dreyfus Strategic Asset Management, L.P., SEC No-Action Letter (pub. avail. July 2, 1996)).

The Commission's emphasis on leverage in its brief suggests that, under the *American Equity* decision, these features of the SEC regulatory regime should have been at the very heart of the discussion in the Rule Release. Likewise, basic precepts of notice and comment dictate that the Commission should have responded to the many commenters who pointed to these and other features of SEC regulation. *Int'l Fabricare*, 972 F.2d at 389. But the SEC requirements were not even mentioned, and under the *Chenery* doctrine, the Commission cannot defend its Rule by commencing a discussion of them now.

Investment companies are also subject to a unique requirement of independent board oversight, which provides an important layer of protection for investors. *See* 15 U.S.C. §§ 80a-10(a), 80a-2(a)(19); *see also*, *e.g.*, SIFMA, Comment (Apr. 12, 2011), at 3. A fund's independent directors serve as "'watchdogs" who furnish an independent check upon the management of the fund. MFDF, Comment (Apr. 12, 2011), at 2; *see also Burks v. Lasker*, 441 U.S. 471, 480-84 (1979) (same). The board's general oversight includes the "particular responsibility to ask questions concerning why and how the fund uses futures and other derivatives instruments, the risks of using such instruments, and the effectiveness of internal controls designed to monitor risk and assure compliance with investment guidelines regarding the use of such instruments." Custody of Investment Company Assets With Futures Commission Merchants and Commodity Clearing Organizations, 61 Fed. Reg. 66,207, 66,209 (Dec. 11, 1996); *see also* MFDF Comment, at 3. Directors' responsibilities also include overseeing leverage risks: Directors seek to ensure "that the relevant operations of the investment manager, including its risk management systems, are adequate to accommodate the actual and proposed uses of derivatives" and that "the investment manager has the capacity to measure and monitor a fund's risk exposures generally, and from the use of derivatives in particular." ABA Rpt. at 45; *see also* Independent Directors Council, *Board Oversight of Derivatives* 2 (2008), *available at* http://www.idc.org/pdf/ppr_08_derivatives.pdf.

The Commission failed even to mention this unique aspect of investment companies. Its *amici* recognize its significance, however: The NFA states that "if a registered investment company is presently investing more than a *de minimus* amount in derivatives, its board of directors—in the exercise of its fiduciary duty—may well have already ensured that the investment adviser and/or investment company has compliance personnel who are qualified in derivatives transactions and regulations." NFA *Amicus* Br. 20.

Still other requirements applicable to investment companies can further affect investments in derivatives. Dechert, Comment (Apr. 12, 2011), at 11. Among other things, investment companies' investments in derivatives are subject to prohibitions on affiliated transactions (15 U.S.C. § 80a-17), requirements regarding portfolio concentration (*id.* §§ 80a-8(b)(1)(E) and 80a-13(a)(3)), and restrictions on counterparty credit exposure (*id.* § 80a-12(d)(3) and 17 C.F.R. § 270.12d3-1).

The SEC's reporting and disclosure requirements also apply broadly to investment companies' activities, including their investments in derivatives. *See*, *e.g.*, Items 4(a), 9(b), and 16(b) of Form N-1A; 17 C.F.R. § 210.12-13. Indeed, the SEC has emphasized to the investment company industry "the importance of specifying derivatives disclosure in share-holder communications." Dechert Comment, at 17 n.35 (citing Letter from Barry D. Miller, Associate Director, Office of Legal and Disclosure, to Karrie McMillan, General Counsel, Investment Company Institute (July 30, 2010)). On Form N-1A, an investment company must disclose the types of instruments in which it invests or will invest, including derivatives, and must detail risks presented by transactions in derivatives instruments. And in their annual and semi-annual reports to shareholders, as part of their financial statements, investment companies must provide a list of all open derivatives positions on a contract-by-contract basis. *See* 17 C.F.R. § 210.12-13. These disclosures are publicly available. Yet the Commission nowhere assessed the impact of these requirements on the need for (and purported benefits of) the Rule.

Ultimately, even the CFTC's own fellow regulator of the commodities markets seems to recognize that, in light of the extensive SEC regulatory framework, there are few—if any—benefits to be expected from registration as a CPO. "[I]nvestment advisers to registered investment companies," the NFA states, "should already have many, if not all, of the regulatory requirements mandated by NFA in place." NFA *Amicus* Br. 20. The NFA believes this rebuts the claim that "investment advisers will incur substantial additional operating costs," *id.*, although the Commission itself has recognized that these costs will be substantial. But the NFA's statement unwittingly reveals how few benefits the registration requirement is likely to produce given existing regulatory requirements—and how profoundly the CFTC failed in its statutory obligations by failing even to *consider* this issue when adopting the Rule and purporting to perform the cost-benefit analysis required by Section 15(a) of the CEA.

2. The purported benefits the Commission attributes to the Rule are similarly unsupported by the rulemaking record. For instance, the Commission concluded that registration would provide authority to address wrongdoing by investment companies, but the SEC already fills that role. *See* MSJ Br. 28. The SEC has extensive authority to investigate, subpoena, and bring enforcement actions against investment companies and their advisers; FINRA may suspend and bar broker-dealers from the industry for misconduct when distributing investment company shares. *Id.* at 4, 6. This aspect of the Rule Release goes undefended in the Commission's brief.

The Commission asserted that regulation of investment companies would allow it to enforce a "minimum standard of fitness and competency," but the Rule Release nowhere assessed the efficacy of existing regulations that serve this role. Thus, in one of the few instances where it elaborated on this boilerplate assertion, the Commission claimed that "fitness" and "competency" would increase because investment companies would be held to a "high financial standard" by measures that include "periodic account statements, disclosure of risk, audited financial statements, and other measures designed to provide transparency to investors." 77 Fed. Reg. at 11,280. But the SEC and FINRA already provide precisely these kinds of protections. The Commission belatedly asserts that qualifications tests administered by NFA will enhance "competency" because NFA tests cover topics not already covered by FINRA. *See* CFTC Br. 28. Once again, this unelaborated assertion comes too late; if true, it should have been made and supported in the Rule Release, particularly because NFA itself gives reason to question this purported benefit. Investment companies engaged in more than de minimis use of derivatives, NFA states, "may well have already . . . compliance personnel who are qualified in derivatives transactions and regulations." NFA *Amicus* Br. 20. The ABA Report cited extensively in the SEC Concept Release suggests the same, stating that investment companies' independent directors bear an obligation to ensure "that the [investment] manager has the requisite skills to use derivatives and brings them to bear." ABA Rpt. at 46. The CFTC, for its part, does not explain why its own regulations include an exemption from NFA testing for many persons subject to testing by FINRA, if NFA qualifications testing is materially better. *See* 17 C.F.R. § 3.12(h)(1)(ii). The Commission disputes the relevance of this exemption, observing that one person at every CPO must be qualified by the NFA, *see* CFTC Br. 63, but that does not explain why the Commission relies on FINRA testing to exclude so many *other* persons from qualifications testing. In any event, the Commission does not even attempt to demonstrate that the matters tested only by NFA are significant, or that investors will meaningfully benefit because, due to the Rule, a single person at each investment company's adviser would now be NFA-qualified. Such speculative musing should have been vetted by the Commission in the rulemaking process, not introduced now in its briefs.

3. Perhaps aware of the shortcomings of its approach, the Commission strives mightily to avoid the implication of a series of recent D.C. Circuit decisions invalidating regulations promulgated by the SEC. *See Bus. Roundtable*, 647 F.3d 1144; *Am. Equity*, 613 F.3d 166; *Chamber of Commerce*, 412 F.3d 133. The Commission goes so far as to attack the most recent of these precedents, which is binding on this Court. *See* CFTC Br. 52 n.27. *Amicus* Better Markets echoes this line of attack, suggesting that a requirement of cost-benefit analysis should not be imposed in the context of financial regulation because costs and benefits can be difficult to quantify. *See* Better Markets *Amicus* Br. 13, 16. This contrasts with the assessment of the CFTC's own Inspector General, who has criticized the agency's approach to cost-benefit analysis, observing that the agency's difficulty "seems odd for an agency that regularly engages in economic analysis." Office of Inspector General, CFTC, *A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act*, at ii (June 13, 2011).

The Commission claims the D.C. Circuit's cases are irrelevant because they "concern a unique obligation on the part of the SEC arising under the securities laws." CFTC Br. 52 (internal quotation marks omitted). The Commission emphasizes that *its* governing statute requires only that it "consider" enumerated factors as part of its cost-benefit analysis. *Id.* But this is no distinction at all: The cost-benefit provisions applicable to the SEC *likewise* require the agency to "consider" a list of factors in connection with its cost-benefit analysis. 15 U.S.C. §§ 78c(f), 77b(b), 80a-2(c). As the Commission acknowledges, the statutory term "consider" requires the Commission to "take into account" the costs and benefits of its rule. CFTC Br. 52. The Commission can hardly satisfy that obligation without knowing what those costs and benefits will be.

The Commission's cramped reading of the word "consider" is particularly baffling given the statute's direction that the "costs and benefits of the proposed Commission action shall be *evaluated*." 7 U.S.C. § 19(a) (emphasis added). The Commission seeks to read the word "evaluat[e]" out of the statute, asserting that "[t]he drafters likely used 'evaluate' rather than repeating 'consider' so as to avoid the awkward phrasing that would result from requiring the Commission to 'consider . . . considerations.'" CFTC Br. 53 n.29 (ellipsis in original). The suggestion that Congress selected the operative verb of the statute solely to "avoid . . . awkward phrasing" underscores the Commission's cavalier attitude towards its cost-benefit obligations. The Commission is not free to edit Congress's enactments on the theory that Congress meant something different, but chose words for their elegance rather than their meaning.

These cases make clear that the Commission's Rule cannot stand. Indeed, this case is virtually indistinguishable from *American Equity*, 613 F.3d at 168, 178, which the Commission seeks to distinguish on the now-familiar ground that the SEC and CFTC regulate different activity in different markets. The SEC unsuccessfully advanced the same distinction in *American Equity*. The court found that the SEC had failed to consider the overlap, in the context of fixed index annuities, between regulation of two different markets—its own regulation of securities, and state regulation of insurance. *See id.* The SEC sought to distinguish state regulation on this basis, concluding that a state's "insurance laws . . . cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws." 74 Fed. Reg. 3,138, 3,148 (Jan. 16, 2009). Its brief contended that state insurance laws serve a different purpose from federal securities laws, as they are directed primarily to "the solvency of the issuing insurance company." Final Br. of the SEC at 65-66, *Am. Equity Inv. Life Ins. Co. v. SEC*, No. 09-1021 (D.C. Cir. Apr. 6, 2009). Even though state insurance regulators have no role in regulating securities, the D.C. Circuit rejected this distinction, concluding that the SEC's analysis was "incomplete because it fails to determine whether, under the existing regime, sufficient protections existed." *Am. Equity*, 613 F.3d at 179. Similarly here, the CFTC engaged in an "incomplete" analysis because it did not analyze whether "sufficient protections existed," *id.*; whether those protections are characterized as "securities"- or "commodities"-based is irrelevant. The Commission's failure to consider or even cite a single feature of the existing SEC regulation of investment companies' use of derivatives is simply an indefensible oversight in the wake of *American Equity*. (As noted above, Dodd-Frank indicates Congress's *approval* of the court's conclusion in *American Equity*—the Act prohibited the SEC from re-adopting its rule. Pub. L. No. 111-203, § 989J.)

This case also bears a significant resemblance to *Business Roundtable*. In both cases, the agency failed to consider the unique structure of investment companies (including the requirement of independent board oversight) when promulgating its regulation, and therefore failed to "adequately address the probability the rule will be of no net benefit as applied to investment companies." 647 F.3d at 1155. There is no merit to the Commission's attempt to distinguish *Business Roundtable* based on its "special responsibility to oversee trading activity in its jurisdictional markets." CFTC Br. 58-59. As discussed above, the securities laws regulate investment companies' use of derivatives, and have for decades. Moreover, the SEC in *Business Roundtable* made a similar claim, asserting that it had a "mandate from Congress" to "actively overse[e] the development of the proxy process." 74 Fed. Reg. 29,024, 29,025 (Jun. 18, 2009). But the SEC (like the CFTC here) *also* had an obligation to comply with the cost-benefit provisions applicable to its rulemaking, as well as the requirement of reasoned decision-making imposed by the APA. The Court found that the SEC had not complied with those separate obligations because it "failed adequately to address whether the regulatory requirements of the ICA reduce the need for, and hence the benefit to be had from" the Rule, and did "not adequately address the probability the Rule will be of no net benefit as applied to investment companies." *Bus. Roundtable*, 647 F.3d at 1155. Here, too, the Commission's authority to regulate the commodity markets does not excuse its statutory duty to comply with the APA and the CEA.

The Commission may be of the view that SEC regulation of investment companies is inadequate, although it did not say so in the Rule Release. Even so, it was under a clear statutory duty to explain in its Rule Release why—in light of existing requirements—additional regulation is necessary. It did not even attempt to do so.

D. The Portions Of The Rule Release Cherry-Picked In The Commission's Brief Do Not Support Its Rule.

To marshal record support for its "bigger picture" defense of the Rule, the Commission identifies a list of "separate and compelling reasons," cherry-picked from the Rule Release, that it puts forward as its current justification for the Rule. CFTC Br. 21. As shown at pages 6-11 above, these were *not* the principal reasons given in the key portions of the Rule Release explaining the registration requirement—the Commission relied primarily on the now-discarded claim that "consistency" required registration, and on the unsubstantiated benefits of more "oversight" for one of the most heavily regulated types of entities in the financial markets. In any event, each of these proffered reasons fails to provide the justification that the Commission supposes.

1. ***To eliminate informational "blind spots."*** The Commission suggests the Rule is justified to provide information that it otherwise would not have, even as it acknowledges that registration is not "simply a means to obtain financial data." CFTC Br. 29. For the reasons discussed below, *see infra* 43-44, the CFTC has not remotely established the existence of "blind spots" that additional disclosure requirements would remedy. But in any event, registration as a CPO will

subject investment companies to an entire regulatory apparatus that largely parallels the regulatory apparatus already in place under the ICA. *See* MSJ Br. 7. Requirements that flow from registration (many of which have parallels in the SEC's regulation of investment companies and their advisers) include, among other things, recordkeeping obligations, restrictions on segregation of assets, investor disclosures, marketing restrictions, a requirement to register with the NFA, and, under NFA rules, qualifications testing of associated persons. These collective burdens cannot be justified to eliminate informational blind spots.[3]

2. ***To enable the CFTC to carry out the "more robust mandate" of Dodd-Frank.*** The Commission cites its assertion in the Rule Release that the Rule is needed to carry out its mandate under Dodd-Frank to "manage systemic risk and ensure safe trading practices by entities involved" in the derivatives markets. CFTC Br. 21 (quoting 77 Fed. Reg. at 11,275). The Commission has never demonstrated that investment companies contribute to systemic risk. In any event, the passage cited by the Commission comes from a discussion of the need for information: The Commission is stating that it lacks "reliable information" to execute Dodd-Frank. 77 Fed. Reg. at 11,275. Thus, the CFTC's invocation of Dodd-Frank is essentially a rehash of its professed need to obtain information, which is inadequate for the reasons just discussed.

[3] Indeed, as noted in Plaintiff's opening brief, the CFTC Chairman has publicly stated that gaining enforcement authority was the main value of the registration requirement, and that existing SEC requirements collected sufficient information for CFTC purposes. In response to a question about the registration requirement, the Chairman stated that it was "really just to have . . . the statutory authority to pursue [wrong-doing]. It's really to give us—the registration gives us a bit of a regulatory or enforcement hook. And the forms and the data, as I say, that which they file with the SEC generally works for us." Webcast: Sixth Annual Capital Markets Summit (Mar. 28, 2012) (pt. 2 at 25:25) (Statement of Comm'r Gensler), *available at* http://www.uschamber.com/webcasts/6th-annualcapital-markets-summit. The Commission incorrectly suggests that the Chairman's remarks came "in the context of a discussion concerning those required to file Form PF." CFTC Br. 41 n.19. In fact, however, Chairman Gensler was responding to a question specifically about the Commission's amendments to Section 4.5.

Moreover, the CFTC misunderstands the "mandate" of Dodd-Frank. Congress created *the FSOC* to "monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States," Pub. L. No. 111-203, § 112(a)(2)(c), and authorized *the FSOC* to "require the submission of periodic and other reports from any nonbank financial company" to assess potential "threat[s] to the financial stability of the United States," *id.* §§ 112(d)(3)(A), 154(b)(1)(B)(i). Dodd-Frank required the FSOC, before requesting reports from regulated companies, to coordinate with relevant agencies and, "whenever possible, rely on information available" from those agencies. *Id.* §§ 112(d)(3)(B), 154(b)(1)(B)(ii). This hardly justifies *new* regulation by the CFTC solely to have "information available" if the FSOC decides to request it, and certainly not when the SEC already regulates and obtains information from the investment companies and advisers at issue here.

3. ***To better understand who is operating in derivatives markets, as well as the "inter-connectedness of market participants."*** The Commission cites its unelaborated assertion that "[t]he information the Commission gains from the registration of entities allows the Commission to better understand the participants in the derivatives markets and the interconnectedness of all market participants." 77 Fed. Reg. at 11,280. The Commission undertook no assessment of the extent to which this type of information was already available through SEC-mandated disclosure and reporting, *see supra* 16, as well as through reporting requirements (some only recently promulgated by the CFTC) that apply generally to all participants in the derivatives markets. *See* 17 C.F.R. pts. 15-21; 77 Fed. Reg. 2,136 (Jan. 13, 2012); 77 Fed. Reg. 1,182 (Jan. 9, 2012). To the extent this information is *not* already available, this amounts to yet another assertion that the Rule will help fill supposed informational "blind spots." But the Commission cannot justify all

the burdens that accompany registration through an asserted need for information that can be satisfied by other, less burdensome means.

4. ***To enable the CFTC to carry out its duties as a member of the FSOC.*** The Commission cites its assertion in the introduction to the Rule Release that "the Commission is among those agencies that could be asked to provide information necessary for the FSOC to perform its statutorily mandated duties." 77 Fed. Reg. at 11,252. This is the same—inadequate—information-gathering rationale. And, as noted above, the relevant agency to provide information on registered investment companies is the SEC, which is also a member of the FSOC.

5. ***To respond to the amendment in Dodd-Frank of the definition of a CPO.*** The Commission next cites the portion of the Rule Release in which it concluded that Congress's amendment of the definition of a CPO necessitated including swaps within the trading threshold. *See* CFTC Br. 21 (citing 77 Fed. Reg. at 11,258). That passage in the Rule Release is nonsensical, as demonstrated in Plaintiffs' Motion for Summary Judgment. *See* MSJ Br. 40-41. Moreover, the Commission's reliance on this passage conflicts with its claim elsewhere that this "limited, technical reminder" played no part in its decision. *See* CFTC Br. 35.

In any event, the Commission nowhere explains how the amended definition of CPO could justify this regulation. "Congress was aware of the existing exclusions and exemptions for CPOs when it passed Dodd-Frank and did not direct the Commission to narrow their scope or require reporting for systemic risk purposes." 77 Fed. Reg. at 11,344 (Sommers, Comm'r, dissenting). There is also "no evidence to suggest that inadequate regulation of commodity pools was a contributing cause of the crisis, or that subjecting entities to a dual registration scheme will somehow prevent a similar crisis in the future." *Id.*

6. ***To address information indicating that some investment companies are de facto unregulated.*** The Commission here combines two distinct concepts—"de facto" commodity pools and what its brief calls investment companies "in name only." The first of these was actually identified as a basis for the Rule in the Rule Release, but does not provide adequate justification for the Rule. The second was *not* discussed, and also does not justify the Rule.

The Commission cites portions of the Rule Release expressing concern that some investment companies were "offering interests in de facto commodity pools while claiming exclusion under [Section] 4.5." 77 Fed. Reg. at 11,254. The Commission, however, never demonstrated that such entities exist in significant numbers; to the contrary, it relied on a submission by the NFA indicating only that *three entities* were engaged in such behavior. *See* 76 Fed. Reg. at 7,983; *see also* NFA *Amicus* Br. 7 ("several" entities). And while the Commission states repeatedly that the Rule is directed at this narrow universe of "de facto" commodity pools, the trading threshold adopted in the Rule will result in sweeping regulation of investment companies that engage in anything more than a "de minimis" amount of trading in the derivatives markets. *See* CFTC Br. 21, 29, 32; *see also* 77 Fed. Reg. at 11,258. The Commission has not explained why, if the regulation is aimed at "de facto" commodity pools, it is necessary to sweep up entities engaged in anything more than de minimis derivatives trading. Commenters suggested ways in which the regulation could be more narrowly tailored to "de facto" commodity pools. *See*, *e.g.*, ICI Comment, at 20. The Commission was required to explain why it rejected those alternatives, *see Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533, 543 (D.C. Cir. 1999), but failed to do so.

The Commission now suggests it was also concerned about use of foreign subsidiaries to circumvent SEC regulation, through what its brief calls "in name only" investment companies. This rationale was not identified in the Rule Release. *See supra* 9-10. Moreover, the Commission did not attempt to establish that these "in name only" investment companies exist *at all*, let alone in significant numbers. In fact, the entities now discussed by the CFTC are subject to the full panoply of regulations under the ICA. The parent of a controlled foreign corporation remains a registered and regulated investment company, and the controlled foreign corporation is itself subject to key requirements of the ICA, including disclosure requirements and limitations on leverage. *See* ICI, Comment (July 28, 2011), at 3-4 ("ICI Roundtable Comment"); Invesco, Comment (Apr. 12, 2011), at 6; SIFMA Comment, at 17. Indeed, the ICA specifically "prohibits a registered investment company from using a subsidiary to engage in any activity that the investment company could not engage in directly." ICI Roundtable Comment, at 3 (citing 15 U.S.C. § 80a-47(a)).

Even supposing that so-called "in name only" investment companies did need to be addressed, that would not justify regulating all other investment companies that use derivatives. Commenters suggested measures that would target such subsidiaries—including a requirement that an investment company make its subsidiary's books and records available for inspection by the CFTC and NFA, *see* ICI Comment, at 24—and the NFA submitted a comment approving such an approach. *See* NFA, Comment (Apr. 12, 2011), at 12. The Release was required to explain why, if the Rule was directed at this subset of investment companies, the Commission rejected alternatives that would target them directly. *Rio Grande Pipeline Co.*, 178 F.3d at 543. Once again, it failed to do so.

7. ***To ensure that all CPO operators meet minimum standards of competency.*** Finally, the Commission cites its vague assertion that registration would help ensure that investment companies meet "minimum standards of fitness and competency." 77 Fed. Reg. at 11,254, 11,277. Yet, as already explained, the Commission nowhere undertook the analysis necessary to

determine that existing regulations do *not* achieve this goal, and in the course of explaining what the Commission means by such "fitness" it refers to requirements imposed on investment companies already, such as "periodic account statements," "disclosure of risk," and "audited financial statements." *Id.* at 11,280. *See supra* 18.

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The Commission's Rule must stand on the reasons given at the time it was adopted, not those cobbled together in the agency's brief. And the reasons offered now fail in any event: Dodd-Frank required many rules, but not this one; investment companies' use of derivatives is already regulated; and the Commission's interest in collecting information cannot justify subjecting investment companies to the full-blown, dual regulatory regimes of the CFTC and NFA.

II. The Commission Offers No Explanation For Its Failure To Address Its Prior Rulemaking.

The Commission in 2003 concluded that eliminating the very trading and marketing thresholds imposed by this rulemaking was justified by the "otherwise regulated" nature of investment companies, and that eliminating the thresholds would "allow greater flexibility and innovation," 68 Fed. Reg. 12,622, 12,625 (Mar. 17, 2003) ("2003 Proposing Release"); "encourage and facilitate participation in the commodity markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity," *id.*; and "increase the available range of risk management alternatives" by permitting investment companies to take advantage of a wider range of trading strategies," enhancing "efficiency and competition." 68 Fed. Reg. 47,221, 47,230 (Aug. 8, 2003) ("2003 Adopting Release"). And, conversely, the Commission concluded that there "should be no decrease in the protection of market participants and the public" because the amendments merely relaxed the Commission's regulatory requirements "in order to be consistent with existing requirements under the federal securities laws and the SEC's rules." *Id.*

The Commission's brief does not seriously dispute that the Rule Release failed to cite or discuss these conclusions. The Commission also does not explain how its failure to discuss these issues in the Rule Release can be squared with the requirement that, when an agency changes course from a prior policy, it must provide a "reasoned explanation . . . for disregarding facts and circumstances that underlay . . . the prior policy." *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1811 (2009); *see also Dillman v. NTSB*, 588 F.3d 1085, 1089-90 (D.C. Cir. 2009). "While the agency is entitled to change its view," "it is obligated to explain its reasons for doing so." *State Farm*, 463 U.S. at 56. Bringing more liquidity to the commodities markets, for instance, was a central benefit and rationale for the 2003 amendment, and therefore losing liquidity and its attendant benefits is a principal cost of the rulemaking. Yet the word "liquidity" does not even appear in the Commission's analysis in the Rule Release. (This omission is also an impermissible failure to consider "an important aspect of the problem." *Owner-Operator Indep. Drivers Ass'n v. FMCSA*, 494 F.3d 188, 205-06 (D.C. Cir. 2007) (internal quotation marks omitted).) Likewise, effects on "efficiency" and "competiveness" are issues the Commission is required by law to "evaluat[e]," 7 U.S.C. § 19(a), and were areas the Commission "expected to benefit" from the 2003 change "by removing barriers to participation in the commodity interest markets." 2003 Adopting Release at 47,230. By the Commission's reasoning just years ago, then, these were benefits that would be lost by re-imposing a registration requirement, and the Commission was required by the APA and CEA to explain whether and how that assessment in 2003 was mistaken or was outweighed by other, specific determinations. But the Commission's "explanation of [its] decision does not address these concerns." *Donovan*, 722 F.2d at 825.

The Commission is correct that an agency is entitled to "change its view of what is in the public interest." CFTC Br. 22. The two cases the Commission cites for this principle, however, make clear that an agency must provide an "explanation for its change of position," *Am. Farm Bureau Fed'n v. EPA*, 559 F.3d 512, 522 (D.C. Cir. 2009), and both cases reverse agency action for failure to satisfy this requirement, *see id.*; *State Farm*, 463 U.S. at 57. Moreover, the CFTC here did not even *address* its prior rulemaking. *Donovan*, 722 F.2d at 825. It thus "crossed the line from the tolerably terse to the intolerably mute." *Williams Gas Processing-Gulf Coast Co. v. FERC*, 475 F.3d 319, 329 (D.C. Cir. 2006) (internal quotation marks and alterations omitted); *see also Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1044-45 (D.C. Cir. 2002).

The Commission's brief discusses the financial crisis at length, as well as Dodd-Frank and what the Commission sees as a new regulatory "philosophy." But this generalized, belated discussion cannot substitute for the Commission's obligation, under the APA, to address the rationale for its 2003 amendment in its Rule Release. The Commission claims that a single, unelaborated reference to "[c]hanged circumstances" in the Release provides a sufficient basis to infer the central argument in its brief, *i.e.,* that the financial crisis and Dodd-Frank tip the scales against the benefits identified in the 2003 rulemaking. CFTC Br. 26 (alteration in original). But the Commission's obligation to provide a reasoned explanation for its change in position could not be satisfied simply by gesturing vaguely at changed circumstances.

With respect to the financial crisis, the Commission argues that it was justified in ignoring its 2003 rulemaking because "a major contributor to the financial crisis was the unregulated over-the-counter ('OTC') derivatives market." CFTC Br. 24. Yet the Commission acknowledges in practically the same breath that "the CFTC has not attributed the financial crisis specifically to RICs." *Id.* at 24 n.10. And, the Commission does not suggest that the financial crisis somehow undermined its 2003 conclusions about the benefits for liquidity and the statutorily-required factors of efficiency and competitiveness.

Similarly, with respect to Dodd-Frank, the Commission does not point to any provision of the Act requiring departure from its 2003 regulation. The Commission states that the "premises underlying the 2003 amendment were vitiated" by the provision of the Act that amended the definition of a CPO, CFTC Br. 25, a suggestion that notably does not appear anywhere in the Rule Release (and that does not explain why the 2003 amendments were left in place for other otherwise-regulated entities). Certainly no specific provision of Dodd-Frank had this effect. *See supra* 3-5. On the contrary, at least one provision of Dodd-Frank specifically requires the Commission to consider the benefits of liquidity when promulgating certain regulations—a benefit that the Commission identified in 2003 but ignored now. *See* Pub. L. No. 111-203, § 737.

Painting with a broad brush, the Commission argues that it was justified in rethinking all aspects of its regulatory apparatus because Dodd-Frank made a "major change to the regulation of derivatives." CFTC Br. 25 (internal quotation marks and emphasis omitted). But the need for the Commission to rethink its regulations does not eliminate the requirement that the Commission articulate a reasoned justification for the conclusions that it reaches at the end of that review, and for its decision to depart from conclusions that it reached in its prior rulemakings.

The Commission sought to minimize the significance of its prior regulation by stating that the pre-2003 version of Section 4.5 was significantly different from the version imposed here, but in doing so the Commission misstated the state of the law before 2003, as it has belatedly acknowledged. *See* CFTC Erratum at 1. Specifically, the Commission stated that the current section 4.5 differs from the pre-2003 version because it includes *only* non-bona fide hedging within the calculation of the trading threshold. *See* CFTC Br. 35. This, however, is incorrect;

the same was true before 2003. *See* 17 C.F.R. § 4.5 (2002).[4] The Commission's lapse is yet more evidence that it failed to give reasoned consideration to the 2003 policy before reversing it.

The Commission also points to the addition of the net notional test, and it is true that the net notional test did not exist before 2003. But the same is true of the inclusion of swaps, which will render the Rule's registration thresholds *more* restrictive than they were before 2003. And, in any event, the significance of the 2003 regulation is its determination that significant benefits—and few costs—would flow from the wholesale elimination of the registration threshold. The Commission had to explain its rationale for reversing that determination, and failed to do so.

III. The Commission Cannot Justify Its Failure To Properly Determine The Costs And Benefits Of Its Rule.

A. The Rule Was Adopted In A Manner That Made It Impossible For The Commission To Meaningfully Determine Its Costs.

The Commission acknowledged in the Rule Release that "significant burdens may arise from the modification to [Section] 4.5." 77 Fed. Reg. at 11,278. These burdens include compliance costs for investment companies and their advisers, including an NFA audit, "on average, every two to three years." *Id.* at 11,277. They include negative effects on investors, such as the confusion arising from overlapping regulation. *See* MSJ Br. 34-35. And they include the very things identified as benefits in 2003, which are mandated considerations under the CEA's cost-benefit provision: Just as increased participation by investment companies in the commodity markets could be expected to provide liquidity and promote efficiency and competitiveness (as

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[4] The Commission's 1985 rulemaking, which first excluded investment companies and other "otherwise regulated" entities from the definition of a CPO, included both bona fide hedging and non-bona fide hedging transactions within the trading threshold. *See* 49 Fed. Reg. 4,778 (Feb. 8, 1984). In 1993, however, the Commission modified "the five percent margin/premium limitation to exclude margins on bona fide hedging positions from computation of the five percent." 57 Fed. Reg. 47,821, 47,821 (Oct. 20, 1992) (Proposing Release); *see also* 58 Fed. Reg. 6,371 (Jan. 28, 1993) (Adopting Release).

well as risk management, by permitting a greater variety of risk-management transactions), so reinstating registration thresholds should be expected to have the opposite effects. The Commission downplays these costs in its brief, suggesting that the costs of the Rule amount to paying "fees and a modest amount of time submitting forms." CFTC Br. 55. But the Commission cannot so easily walk away from costs the Release acknowledged to be "significant."

At the same time, the rulemaking imposed these costs in a manner that made it impossible to properly determine the extent of the costs. The Commission provides no adequate justification for this approach in its brief.

1. Aside from its meritless justiciability argument, which is addressed below, the Commission offers no defense of its decision to adopt the registration requirement and to opine on its costs and benefits without even knowing the contours of the requirements that would result from the harmonization rulemaking. The Rule Release described the harmonization rulemaking as effectively creating the "compliance framework for registered investment companies subject to the Commission's jurisdiction." 77 Fed. Reg. at 11,259. Because it required investment company advisers to register with the CFTC and subject themselves to this "compliance framework" without knowing what the framework will entail, the Commission could not possibly determine the costs and benefits associated with the Rule's registration requirement.[5]

Indeed, the Commission effectively acknowledged as much in the Rule Release, when it stated that it could not complete the burden analysis required by the Paperwork Reduction Act ("PRA") until the harmonization rulemaking was complete. The Commission was clear that the cost of the Rule would include the very burdens it was required to assess under the PRA, stating

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[5] The NFA asserts that the Commission employed a "similar harmonization process" in a prior rulemaking. *See* NFA *Amicus* Br. 10. In fact, the Commission in that rulemaking harmonized its regulations with securities laws in a *single* rulemaking. *See* 76 Fed. Reg. 28,641 (May 18, 2011).

that "entities that will be required to register" would be subject to "the information collection costs addressed by the Commission under the PRA." 77 Fed. Reg. at 11,277. Because the Commission admitted that it could not calculate those "information collection costs" at the time of the rulemaking, and thus postponed its PRA analysis, its analysis of costs and benefits was necessarily incomplete. The Commission misleadingly implies that Plaintiffs requested this multi-stage approach, CFTC Br. 48, but in fact Plaintiffs requested that the entire Rule be *re-proposed* to include a detailed proposal for harmonization, in order to permit notice and comment on registration and harmonization together. *See* ICI Comment, at 10-11.

The Commission compounded its error by, elsewhere in the Rule Release, congratulating itself on cost savings that it attributed to the as-yet incomplete harmonization rulemaking. It characterized its "efforts to harmonize its compliance requirements with those of the SEC" as a "cost-mitigation measure[ ]" under the Rule. 77 Fed. Reg. at 11,276. In its brief, the Commission similarly urges the Court to uphold the Rule in part because it "took appropriate steps to mitigate costs attendant to the Final Rule," chief among those being "a new rulemaking dedicated entirely to reducing costs." CFTC Br. 56 (emphasis omitted). The Commission effectively assumes away the possibility that its Rule will subject investment companies to conflicting regulatory decrees, and does so entirely on the basis of a rulemaking that is not concluded and that may not succeed. This is an unsustainable approach toward cost-benefit analysis.

2. The Commission also could not meaningfully calculate the costs of its Rule because it included swaps within the Rule's registration thresholds even though key regulations regarding swaps—including the very definition of the term—have yet to be finalized. *See* MSJ Br. 36. The Commission now responds that this makes no difference because the pending regulations merely provide "interpretive guidance" and "narrow the definition by *excluding*" certain transac-

tions that otherwise would fall within the definition of swap. CFTC Br. 61. Yet if these matters were truly insignificant, the Commission presumably would not have tied the Rule's effective date to the definition of "swap." *See* 77 Fed. Reg. at 11,252. Moreover, the Commission did not draw these distinctions in its Rule Release; it now cites as support a portion of the release that contains only the unadorned conclusion that the "Commission does not believe that the adoption of these regulations should be postponed until after other regulations are finalized and believes that the costs and benefits are sufficiently clear." *Id.* at 11,276. That bare statement was insufficient to justify the Commission's approach, and to respond to commenters who questioned how the Commission could assess the Rule's costs and benefits while these matters remained undecided. *See* Institutional Investors, Comment (Apr. 12, 2011), at 5; Invesco Comment, at 5.

In any event, the Commission does not explain why the distinctions drawn in its brief should have any significance. The definition of a swap could be significantly more or less broad depending on whether certain transactions are excluded from its scope. *See* ICI Comment, at 10 (stating that, given uncertainty, it "is simply not possible for funds to calculate in any meaningful way how they would fare under the proposed 5 percent trading restriction" (emphasis omitted)). Forthcoming regulations will set margin requirements for swap transactions—a matter that is of obvious significance for this Rule, which imposes a trading threshold that depends upon the "initial *margin* and premiums" for swap transactions. 77 Fed. Reg. at 11,283 (emphasis added).[6]

[6] The Commission asserts that the upcoming determination of margin levels for uncleared swaps is irrelevant because it "will have only prospective application" and thus will not affect "existing contracts." CFTC Br. 61 n.36. Yet the instant Rule will apply to future contracts as well, and the Commission does not explain how it could determine the effect of the Rule on those contracts without knowing how margin levels will be set for swap transactions. The Commission also argues that margin levels will not affect the operation of the net notional test. *Id.* But the Commission was required to assess the costs and benefits of both the five percent threshold and the net notional test; even if the Commission could determine the likely effects of one, that would not absolve it of responsibility to meaningfully assess the other.

3. The Commission also could not determine the scope of its Rule because, although it acknowledged that "current data and information does not allow the Commission to evaluate the difference in market impact at various threshold levels," 77 Fed. Reg. at 11,278, the Commission failed to take steps suggested by commenters to obtain the necessary data. The Commission now responds that *Plaintiffs* should have provided the data. *See* CFTC Br. 62. That is a remarkable abdication of the Commission's responsibility under the APA and CEA to inform itself adequately about the Rule's costs and benefits before adopting it. In any event, Plaintiffs *did* provide the Commission with significant data, which indicated that the Rule was not adequately tailored to the Commission's stated rationale. *See* ICI Comment, at 19-20.

At the Roundtable held in connection with the rulemaking, commenters suggested how the Commission might collect additional data, including by requiring entities claiming exclusion under Section 4.5 to provide additional information without subjecting them to the full panoply of CPO regulations. *See* Roundtable Tr. 82-83 (July 6, 2011). The Commission might, in light of the data collected under such a rule, reassess whether and how Rule 4.5 should be amended. *See* ICI Roundtable Comment, at 7. The response of the Commission staff to this suggestion was that "it's an interesting idea" but "[e]ven though my training . . . would say you get the data first, *I'm not seeing it in this current political and budgetary environment*." Roundtable Tr. 84 (emphasis added). The meaning of this statement is plain on its face, and is hardly capable of being taken "out of context," as the Commission suggests. CFTC Br. 62 n.37. The Commission did not address this suggested alternative in its Rule Release, failing once again to discharge a basic APA obligation.

B. The Commission's Cart-Before-The-Horse Approach Does Not Insulate Its Admittedly Incomplete Analysis From Judicial Review.

In requiring investment companies to register and subject themselves to a new "compliance framework," even as it launched an as-yet unfinished revision of that framework, the Commission proceeded in an unorthodox, arbitrary and capricious manner that admittedly prevented it from analyzing the Rule's burdens under the Paperwork Reduction Act, and that necessarily prevented it from performing the required cost-benefit analysis as well.

With some chutzpah, the Commission's brief contrives to make a virtue of this defect: It argues that Plaintiffs' claims are premature because they concern costs that *still* cannot be determined and remain "contingent" on future regulatory action. CFTC Br. 48. The Commission's determination to blind itself to the costs of its Rule, however, cannot insulate that Rule from judicial review. The Commission does not (and could not) claim that plaintiffs' challenge to the Rule's registration requirement is not yet ripe. The Commission in fact concedes that "the provisions challenged by Plaintiffs are final . . . with respect to registration under Rule 4.5." *Id.* at 16-17. The requirement that investment companies register if they meet the trading and marketing thresholds is unquestionably set out as a final agency action in the challenged Rule, not subject to modification in further agency proceedings. *See* 77 Fed. Reg. at 11,252. It is this registration requirement that is the subject of Plaintiffs' challenge.

This case is thus ripe under the test set out by the D.C. Circuit, which looks to both the "fitness of the issues for judicial determination" and the "hardship to the parties of withholding court consideration." *La. Pub. Serv. Comm'n v. FERC*, 522 F.3d 378, 397 (D.C. Cir. 2008). Under the first of these factors, this case is clearly ripe because the agency "[h]as conclusively resolved" the question whether to impose a registration requirement, and because nothing about the requirement is "contingent on subsequent proceedings or events." *Id.* at 398. The case thus presents a "concrete legal dispute [as to which] no further factual development is essential to clarify the issues," and there is "no doubt whatsoever that the challenged agency practice," *i.e.*, the registration requirement, "has 'crystalized' sufficiently for purposes of judicial review." *Rio Grande Pipeline Co.*, 178 F.3d at 540 (alteration omitted). Moreover—although an independent showing of hardship is not required to establish ripeness, *id.*—postponing consideration of the registration requirement until the conclusion of harmonization would place Plaintiffs in an untenable position. The compliance date for registration is not linked to the harmonization rule-making, *see* 77 Fed. Reg. at 11,252, and therefore if review of the registration requirement were postponed until harmonization is completed, Plaintiffs could be required to comply with the registration requirement—and subjected to CFTC and NFA oversight—while simultaneously being denied an opportunity to challenge that requirement in court.[7]

While admitting that the Rule is final "with respect to registration," the Commission says it is not "final as to other areas." CFTC Br. 17. By this it means to say that the *costs and consequences* of the Rule have yet to be fully determined, because of its declared intent to harmonize its "recordkeeping, reporting, and disclosure requirements" with those of the SEC. 77 Fed. Reg. at 11,252. But the consequences of registration are hardly *irrelevant* simply because their precise contours remain to be determined. To the contrary, the Commission seeks to invoke those same consequences as supposed benefits of its Rule. *See* CFTC Br. 27; 77 Fed. Reg. at 11,280.

[7] The cases cited by the Commission provide no support for its approach. These cases hold, for instance, that a challenge to an administrative "plan" is premature when the plan does "not command anyone to do anything or to refrain from doing anything." *Ohio Forestry Ass'n v. Sierra Club*, 523 U.S. 726, 733 (1998). And, they hold that a challenge is premature when "none of the . . . rule's requirements" would go into effect until the conclusion of some further agency action. *CTIA-The Wireless Ass'n v. FCC*, 530 F.3d 984, 987 (D.C. Cir. 2008). On the other hand, these cases are clear that a challenge is not premature where the challenged order "alters the legal regime" under which the agency and regulated entities operate, *Bennett v. Spear*, 520 U.S. 154, 169 (1997), or when plaintiffs challenge provisions that are not "undergoing further agency review," *Shoreham-Wading River Cent. Sch. Dist. v. NRC*, 931 F.2d 102, 105 (D.C. Cir. 1991). The Commission, by requiring registration of investment advisers, has undoubtedly altered the legal regime, and that decision is not undergoing further agency review.

The Commission's heads-I-win, tails-you-lose approach is merely an attempt to evade the critical point: It set the registration requirement in stone even as the full consequences of that requirement—both its benefits and its costs—remained undetermined. Having done so, the Commission deprived itself of the ability to "apprise itself—and hence the public and the Congress—of the economic consequences of [the] proposed regulation" prior to its finalization. *Chamber of Commerce*, 412 F.3d at 144; *see also Bus. Roundtable*, 647 F.3d at 1148; *Am. Equity*, 613 F.3d at 177. The Commission thus did not "fram[e] the costs and benefits of the" registration requirement—a requirement that the Commission acknowledges is undoubtedly imposed by the Rule—and failed "adequately to quantify the certain costs" of the registration requirement "or to explain why those costs could not be quantified." *Bus. Roundtable*, 647 F.3d at 1148-49. It is no answer to say that a challenge to the *consequences* of the registration requirement would be premature; Plaintiffs are challenging the registration requirement itself.

IV. The Commission's Belated Attempts To Justify Specific Aspects Of Its Rule Are Untimely and Insufficient.

The Commission also fails—in its brief, as well as in its Rule Release—to provide a reasoned explanation to justify specific aspects of its rulemaking.

1. ***Inclusion Of Swaps Within The Registration Thresholds.*** The Commission in the Rule Release gave an illogical and inadequate explanation for its decision to include swaps within the Rule's registration thresholds, suggesting that it would not be possible to fashion language that would exclude swaps from the determination of whether an investment company met the definition of a CPO. *See* 77 Fed. Reg. at 11,258. As already explained, the Commission's brief did not defend the rationale put forth in the Rule Release, effectively conceding the irrationality of a key aspect of the explanation offered for the Rule. *See supra* 7-8.

The Commission now offers a new explanation for including swaps within the registration thresholds: "[A] key purpose of the Final Rule is to help implement Dodd-Frank's policy of greater transparency in the heretofore largely unregulated swaps markets." CFTC Br. 34. This was decidedly *not* the explanation offered at the time of the Rule, and the Commission cannot justify the Rule on the basis of this post hoc rationale. *See Chenery*, 318 U.S. at 87-88. Nor does this belated rationale provide the support the Commission is seeking. The inclusion of swaps within the Rule's registration thresholds means that entities engaged in a certain level of swaps transactions will be subject to the full panoply of CFTC regulation, which extends well beyond information collection. The Commission nowhere explains how the need for "transparency" could justify the entirety of the Rule.

2. ***Adoption of Specific Trading Threshold.*** The Commission also failed to provide a reasoned explanation for setting the non-bona fide hedging trading threshold at five percent. *See* MSJ Br. 43. The Commission in 2003 explained that the five percent threshold had come to limit the activities of investment companies "to a much greater extent" than originally intended, due to changes for margin levels. *See* 2003 Proposing Release at 12,625. And, here, the Commission acknowledged that "margin levels are significantly higher" than five percent and that "levels for swap margining may be as well." 77 Fed. Reg. at 11,256. Yet the Commission again adopted a five percent threshold. And it did so even while maintaining that such a threshold would sweep in anything more than a "de minimis" level of trading, despite the Commission's stated desire to target the Rule at "de facto" commodity pools.

To justify its decision, the Commission now cites the fact that it adopted a five percent threshold in 1985, and that it adopted a five percent threshold in a separate rulemaking, for different entities, in 2003. *See* CFTC Br. 32. Yet the Commission itself explained in 2003 that the threshold set in 1985 had become more restrictive over time. And the very 2003 rulemaking that the Commission cites decided to eliminate the five-percent threshold for investment companies altogether. The fact that the Commission in that rulemaking imposed a five percent threshold for a *different* set of entities is hardly a justification for imposing that threshold for investment companies. *See* MSJ Br. 44. Indeed, it is totally arbitrary for the Commission to rely on these prior rulemakings to support the imposition of a five percent threshold, while ignoring the conclusion reached in the very same rulemaking that any registration threshold would be counterproductive.

Nor is there any merit to the Commission's suggestion that, simply because the five percent threshold is a "percentage term[ ]," its selection will be upheld unless it represents an "unbridled whim." CFTC Br. 31 (quoting *Vonage Holdings Corp. v. FCC*, 489 F.3d 1232, 1242 (D.C. Cir. 2007)). The case cited by the Commission makes clear that the numerical threshold selected by the agency must "reflec[t] its informed discretion." *Vonage Holdings*, 489 F.3d at 1242. Here, the agency provides no justification for selecting the number "five" other than that it had selected that number before. This is not the reasoned decision-making required by the APA.

3. ***Definition Of Bona Fide Hedging.*** The Commission in the Rule Release also gave an illogical explanation for its definition of bona fide hedging, which limits the definition to transactions designed to offset exposure in the *physical* commodity markets. *See* MSJ Br. 42. The Commission "recognize[d] the importance of the use of derivatives for risk management purposes." 77 Fed. Reg. at 11,257. Yet it failed to provide a reasoned explanation for excluding risk-management transactions offset by exposure in markets other than the physical commodity markets, and for therefore indiscriminately sweeping those transactions within the trading threshold.

The Commission opens its defense of the bona fide hedging test with a clear error, repeating its inaccurate claim—since corrected—that, pre-2003, bona fide hedging transactions were not excluded from the trading threshold. CFTC Br. 35. According to the Commission, this purported change in the law made it "necessary to draw a bright line" in its definition of bona fide hedging because "bona fide hedging is now an exclusion that, if open to subjectivity, could be abused and thus defeat the purpose of the 5-percent threshold." *Id.* That statement of the law is wrong, and plainly cannot support the hedging definition.

The need for a "bright line" also does not explain why the Commission could not have adopted a test for bona fide hedging that would include offsetting transactions in other markets. The Commission implies that such a test would lack "objective criteria." CFTC Br. 36. Yet the Commission takes a broader approach to defining bona fide hedging in other contexts without evident difficulty, and Commenters proposed a number of possible definitions of a risk management transaction. *See* SIFMA Comment, at 10; ICI Comment, at 21-22. The Commission failed to explain how its approach is the only possible "bright line" in light of these alternatives.

The Commission also argues that a broader definition could not be adopted because "there is no industry consensus on how a 'risk management' exception should be defined." CFTC Br. 36. That makes no sense. The fact that there are multiple possible alternatives is not a reason to reject *all* the alternatives, rather, it is reason for confidence that viable alternatives exist and to thoroughly examine them. The Commission had an obligation to explain why it adopted its definition, and why it viewed those alternatives as unsatisfactory.

Finally, the Commission vaguely suggests that a broader definition would somehow be more risky, obliquely citing recent events involving J.P. Morgan Chase & Co. *See* CFTC Br. 36. J.P. Morgan is not an investment company, and those post-rulemaking events have no relevance to the issue at hand. In any event, as Commissioner Sommers explained in dissent, the Commission has never explained why transactions offset by exposure in the physical commodities markets should be considered less risky than transactions offset by exposure in other markets. "Both are hedges, and there is no explanation as to why the Commission believes that bona fide hedges are less risky." 77 Fed. Reg. at 11,344.

4. ***Requirement That Investment Company Advisers File Form CPO-PQR.*** The Commission also did not provide an adequate explanation for requiring investment company advisers to file form CPO-PQR. *See* MSJ Br. 39-40. The Commission points to its "detailed explanations for requesting this data," CFTC Br. 38 (citing 76 Fed. Reg. at 7,980-82), but the cited passages of the NPRM explain the Commission's reason for requesting this data from *all* CPOs; they provide no justification for requesting this data from investment companies in particular.

The Commission does not contest that much of the information required by form CPO-PQR (particularly that required by Schedule A) is already disclosed by investment companies. *See* CFTC Br. 39-40. Indeed, its *amici* candidly acknowledge as much. *See* NFA *Amicus* Br. 20 n.12 (noting that "the Investment Company Act requires similar disclosures for entities that are subject to its jurisdiction"). Yet the Commission provides no explanation whatsoever for requiring investment companies to disclose the information again. The Commission also misstates the record when it says that "ICI failed to identify a single overlapping question in Schedule B." CFTC Br. 43. In fact, ICI concluded that the information requested by Schedule B was "comparable to that required by the corresponding provisions of Form N-SAR." ICI Comment, at viii column 2. The Commission did not respond to this conclusion in the Rule Release, and did not explain why investment companies should nonetheless be required to provide this information.

Nor does the Commission explain why its rationale for requiring Form CPO-PQR applies to investment companies *at all*. The Commission sought to justify Form CPO-PQR because "[t]he sources of risk delineated in Dodd-Frank Act with respect to private funds are also presented by commodity pools," 77 Fed. Reg. at 11,253, but the Commission nowhere evaluated whether those same risks are posed by investment companies. Indeed, the Commission now admits that it "has not attributed the financial crisis specifically to RICs." CFTC Br. 24 n.10. There is, in short, no justification in the rulemaking record for requiring investment companies to submit the extensive information required by Form CPO-PQR.

V. The Commission Did Not Provide An Adequate Opportunity For Notice And Comment.

The Commission did not provide an adequate opportunity for notice and comment, and therefore ran afoul of the separate requirement of the APA that an agency "give interested persons an opportunity to participate in the rulemaking." 5 U.S.C. § 553(c); *see also Nat'l Mining Ass'n v. Mine Safety & Health Admin.*, 116 F.3d 520, 531-32 (D.C. Cir. 1997) (per curiam). The Commission fell short in at least two specific respects.

First, the Commission did not give adequate notice of its cost-benefit analysis in the notice of proposed rulemaking, which contained less than one full sentence of analysis specifically addressed to investment companies. The Commission claims in its brief that this amounts to merely a difference in "length." CFTC Br. 63. Yet the difference is also one of substance: The sentence fragment of analysis in the NPRM stated only that failure to amend Section 4.5 would "result in disparate treatment of similarly situated collective investment schemes." 76 Fed. Reg. at 7,988. The cost-benefit analysis contained in the Rule Release also addressed this issue of consistent treatment (although the Commission now attempts to disavow that rationale). But the cost-benefit analysis also addressed several other issues, including the Commission's conclusions under the specific statutory factors listed in Section 15(a) of the CEA. *See* 77 Fed. Reg. at 11,280. Because the NPRM was silent on these issues, their discussion in the Rule Release cannot possibly be justified as merely "confirming" the Commission's "prior assessments." *Cham-*

ber of Commerce v. SEC, 443 F.3d 890, 900-05 (D.C. Cir. 2006). Commenters had no meaningful opportunity to comment on the substance of this analysis—which undoubtedly helps explain why the analysis is so flawed.

Second, the Commission did not give commenters notice of the seven-factor test set out in the Rule Release, which it announced would guide application of the marketing threshold. *See* 77 Fed. Reg. at 11,259. The Commission suggests that notice and comment was not required because the factors are merely a statement of "policy," and that they were a logical outgrowth from the NPRM. CFTC Br. 37-38. However, this list of factors represented a significant elaboration of the standard articulated in the rule proposal, and included factors such as the use "of a controlled foreign corporation" that have no logical connection to the concept of "marketing" contained in the Rule as it was proposed. 77 Fed. Reg. at 11,259. The Commission cannot justify the imposition of these substantive requirements merely on the ground that they are not found in the text of its Rule. *See Syncor Int'l Corp. v. Shalala*, 127 F.3d 90, 96 (D.C. Cir. 1997).

The Commission implies that Plaintiffs have somehow perpetrated an ambush—asking for clarification of the marketing threshold and then complaining when clarification was provided. *See* CFTC Br. 37. In asking for clarification, however, Plaintiffs specifically noted that it is "critical that the public has an opportunity to comment on any test that the CFTC determines to propose." ICI Comment, at 27; *see also* Janus Capital Management, Comment (Apr. 12, 2011), at 3. That opportunity for comment was never provided.

CONCLUSION

For the foregoing reasons, the Rule's amendments to Sections 4.5 and 4.27 must be vacated. The court should grant plaintiffs' motion for summary judgment, deny defendant's cross-motion for summary judgment, and deny defendant's motion to dismiss.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 2nd day of July, 2012, I caused the foregoing Motion for Summary Judgment to be filed and served via the Court's CM/ECF filing system.

/s/ Eugene Scalia

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