IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, and INSTITUTE OF INTERNATIONAL BANKERS, Plaintiffs, v. UNITED STATES COMMODITY FUTURES TRADING COMMISSION, Defendant.	Civil Action No. 13-CV-1916 (ESH)

PLAINTIFFS' (CORRECTED) MOTION FOR SUMMARY JUDGMENT

COME NOW PLAINTIFFS Securities Industry and Financial Markets Association, International Swaps and Derivatives Association, and Institute of International Bankers and hereby respectfully move this Court to enter summary judgment for Plaintiffs on all claims. Defendant CFTC consents to this correction of Plaintiffs' earlier filing of its Motion for Summary Judgment.

This motion is supported by the (Corrected) Memorandum of Points and Authorities filed concurrently herewith.

Dated: December 27, 2013

Corrected: January 23, 2014

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INTRODUCTION

This is a case about a federal agency that attempted to evade the requirements for rulemaking by claiming that a new directive is a "general statement of policy" rather than a rule. The Commodity Futures Trading Commission ("CFTC") was required by the Commodity Exchange Act ("CEA") to perform a cost-benefit analysis that took account of the consequences of applying its new "swaps" regulations extraterritorially. This extraterritorial, or "cross-border," application of the swaps rules was a quintessential "important aspect of the problem" that the Commission had to address under the Administrative Procedure Act ("APA"), because swaps markets are global: To the extent the CFTC's swaps requirements apply to transactions or entities abroad, that has immense implications for U.S.-based companies, foreign companies who deal with them, and market participants' willingness to continue to conduct U.S.-related business.

Yet, the Commission never performed the statutorily-required cost-benefit analysis. Instead, it studiously avoided doing so. First, the Commission issued numerous separate swaps rules ("Title VII Rules"), in which it repeatedly declined to address how the Rules' requirements would apply extraterritorially, thereby neglecting its duty to address an "important aspect of the problem," and ignoring significant comments in the record that asked that the issue be resolved and the attendant costs addressed. Then, when it finally did address the Title VII Rules' extraterritorial application, the Commission did so in an extraordinary 78-page document—hereinafter referred to as the Cross-Border Rule—that has all the trappings not merely of a rule but of an immensely important rule, but which the Commission characterized as a "general statement of policy" so that it could, yet again, omit a statutorily-required cost-benefit analysis.

In proceeding in this manner—which contrasts sharply with how the Securities and Exchange Commission ("SEC") approached these same issues—the CFTC improperly evaded its obligations under the APA and the CEA. The CFTC also vastly exceeded the boundaries that Congress has placed on its cross-border authority, imposing costly and arbitrary requirements on activities that do not come close to the "direct and significant" impact on U.S. commerce necessary for extraterritorial application of the CFTC's rules. 7 U.S.C. § 2(i).

The Commission's unlawfully promulgated Cross-Border Rule should be vacated, and the Commission should be enjoined from implementing that Rule in any manner. In addition, and to effectuate the Court's vacatur of the Cross-Border Rule, the Court should declare that the Title VII Rules have no extraterritorial application, and should enjoin the Commission from enforcing the Title VII Rules extraterritorially until it promulgates a valid cross-border rule; alternatively, any extraterritorial aspects of the Title VII Rules should be vacated.

STATEMENT OF FACTS

A. The Global Swaps Market

Derivatives "provid[e] a means for managing and assuming price risks, discovering prices, [and] disseminating pricing information." 7 U.S.C. § 5(a). A "swap" is one type of derivative, which involves the exchange of payments between parties to transfer the risk of future change in the value or level of one or more underlying assets or prices over a set period of time. *See* 7 U.S.C. § 1a(47); 77 Fed. Reg. 48208 (Aug. 13, 2012). The market for swaps is global, totaling almost $700 trillion in notional value. *See* Bank of International Settlements, *OTC derivatives statistics at end-June 2013*, 2 (Nov. 2013), *available at* http://www.bis.org/publ/otc_hy1311.pdf. U.S. companies frequently enter into swap transactions with foreign companies that are separately regulated in foreign jurisdictions. *See, e.g.,* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg.

41214, 41215-16 (July 12, 2012). And foreign companies regularly enter into swaps with other foreign companies, sometimes using U.S.-based traders to facilitate the execution of their trades.

B. The Commission Promulgates The Title VII Rules In Violation Of The APA And The CEA

In 2010, Congress enacted Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), establishing a new statutory framework for the regulation of swaps. Pub. L. No. 111-203, tit. VII, §§ 711-74, 124 Stat. 1376, 1641-1802 (2010). Dodd-Frank authorizes, or in some cases requires, the CFTC to promulgate rules to implement Title VII. *See, e.g.*, 7 U.S.C. § 7a-1(c)(2). The CEA and the APA, in turn, impose requirements on CFTC rulemakings. For example, in promulgating a "regulation" under the CEA, the CFTC must evaluate "[t]he costs and benefits of the proposed [regulation]" in light of several enumerated factors. 7 U.S.C. § 19(a). In addition, the CFTC must comply with the APA's notice-and-comment requirements when issuing any substantive rule. 5 U.S.C. § 553(c).

1. The Title VII Rules

Starting in November 2010, the CFTC proposed and finalized the series of swaps rules at issue in this case. These "Title VII Rules" can be grouped into four categories:

(1) Registration Requirements. These Rules detail who must register with the CFTC and when and how they must register. The Entity Definition Rule defines which entities are the "swap dealers" or "major swaps participants" that must register and comply with a host of Dodd-Frank regulations, such as those relating to "margin, capital and business conduct."[1] The Swap Entity Registration Rule sets forth the registration process for these entities.[2]

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[1] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 Fed. Reg. 30596, 30597, 30612 (May 23, 2012).

[2] Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613, 2614 (Jan. 19, 2012).

(2) Entity-Level Requirements. These Title VII Rules detail the obligations of swap market participants. The Risk Management Rule requires registered swap dealers and major swap participants to develop and implement a comprehensive risk management program.[3] The Chief Compliance Officer Rule requires registered swap dealers and major swap participants to designate a chief compliance officer with specified qualifications, responsibilities, and authority.[4] The Entity-Level Requirements also address the data to be reported to Swap Data Repositories ("SDRs"), the manner of reporting, the counterparty required to report, and other requirements for swap data recordkeeping and reporting. The SDR Reporting Rule relates to reporting requirements for swaps transacted after promulgation of the rule,[5] and the Historical SDR Reporting Rule relates to reporting of swap data for transactions that occurred prior to the enactment of Dodd-Frank and during the transition to the Title VII SDR reporting regime.[6] The Large Trader Reporting Rule requires regular reports from swap dealers that hold significant positions in swaps that are linked to a prescribed group of commodity futures contracts.[7]

(3) Transaction-Level Requirements. These Title VII Rules impose obligations relating to specific transactions between various swap market participants. The Portfolio Reconciliation and Documentation Rule requires swap dealers and major swap participants to engage in regular compression and reconciliation of their swap portfolios, and to enter into

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3 Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128, 20205-11 (Apr. 3, 2012).

4 Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128, 20200-01 (Apr. 3, 2012).

5 Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012).

6 Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35200 (June 12, 2012).

7 Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43851 (July 22, 2011).

specialized agreements with other market participants.[8] The Real-Time Reporting Rule details requirements for the immediate public dissemination of swap data after a transaction is executed.[9] The Daily Trading Records Rule requires the daily maintenance of certain specified trading records.[10] The Straight Through Processing Rule sets documentation standards, conflict-of-interest standards, and requirements for prompt processing, submission, and acceptance in the clearing of swaps.[11] The Clearing Determination Rule requires certain interest rate swaps and credit default swaps to be cleared at a "derivatives clearing organization."[12] The Trade Execution Rule concerns the process by which trading platforms and the Commission determine which swaps are subject to Dodd-Frank's mandatory execution requirements.[13]

(4) The SEF Registration Rule. This Rule creates a framework for the registration and operation of swap trading systems and platforms, called Swap Execution Facilities ("SEFs").[14]

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8 Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904 (Sept. 11, 2012).

9 Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012).

10 Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128, 20133 (Apr. 3, 2012).

11 Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278 (Apr. 9, 2012).

12 Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74284 (Dec. 13, 2012).

13 Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 Fed. Reg. 33606 (June 4, 2013).

14 Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476 (June 4, 2013).

2. The Title VII Rulemaking Process

Congress recognized the international character of the swaps market when it enacted Dodd-Frank, and carefully limited the CFTC's authority to regulate swaps outside the United States. Under 7 U.S.C. § 2(i) (hereinafter "Section 2(i)"), Title VII's provisions "shall not apply to activities outside the United States" except where (1) "those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States"; or (2) those activities "contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of" Title VII. 7 U.S.C. § 2(i). The extraterritorial reach of this regulatory authority must be construed narrowly. *See Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2883 (2010).

During the comment periods for the Title VII Rules, market participants raised numerous concerns relating to the Rules' application outside the United States. These were fundamental issues. The territorial scope of the rules directly affected, among other things, which entities were required to register with the CFTC, and which specific swaps had to be "cleared" and reported according to CFTC requirements. Commenters proposed that the CFTC limit the Registration Requirements to certain foreign entities and entities engaged in cross-border transactions.[15] Commenters also requested that the CFTC define the cross-border application of the Entity-Level Requirements and cautioned against extending those requirements to a broad swath of foreign entities.[16] Commenters expressed similar concerns regarding the extraterritorial

[15] Comments from IIB on 75 Fed. Reg. 71379 at 2 (Jan. 10, 2011) (Swap Entity Registration Rule); Comments from Société Générale on 75 Fed. Reg. 71397 at 7 (Dec. 2, 2010) (same); Comments from Barclays Bank PLC et al. on 75 Fed. Reg. 71397 at 2 n.4 (Feb. 17, 2011); Comments from SIFMA on 75 Fed. Reg. 80174 (Feb. 3, 2011) (Entity Definition Rule); Comments from Bank of America Corp. et al. on 75 Fed. Reg. 80174 (Feb. 22, 2011) (same).

[16] Comments from SIFMA and ISDA on 75 Fed. Reg. 76573 at 27-29 (Feb. 7, 2011) (SDR Reporting Rule); Comments from Global Foreign Exchange Division on 75 Fed. Reg. 76573 at 3 (Feb. 7, 2011) (SDR Reporting Rule); Comments from Société Générale on 75 Fed. Reg.

application of the Transaction-Level Requirements[17] and requested "clarity with regards to extraterritorial[] application" of the SEF Registration Rule.[18]

The CFTC effectively ignored all of these comments. In adopting the vast majority of the Title VII Rules, the CFTC left the issue unaddressed, saying *nothing* about the Rules' cross-border application. In the few instances where the CFTC mentioned cross-border application at all, it simply said that it would not address these crucial questions regarding who and what was covered by the applicable Rule. For example, even though the CFTC had solicited comments on the extraterritorial application of the Swap Entity Registration Rule, in adopting the Rule the CFTC declared that defining its cross-border scope was "beyond the scope of this rulemaking." 77 Fed. Reg. at 2619-20. Similarly, although the Commission indicated that the Entity Definition Rule would cover at least some foreign entities (77 Fed. Reg. at 30692-93), the CFTC refused to address the scope of that coverage, explaining that it "intend[ed] to separately address issues related to the application of these definitions to non-U.S. persons in the context of the application of Title VII to non-U.S. persons" (*id.* at 30605, 30684 n.1078, 30688 n.1119).

C. The Commission Promulgates The Cross-Border Rule Without Even Purporting To Comply With The Rulemaking Requirements Of The APA And CEA

The CFTC finally undertook to address the cross-border scope of its Title VII Rules in July 2012, issuing for comment a document that it characterized as "guidance." *See* 77 Fed. Reg.

71397 (Jan. 21, 2011) (Risk Management Rule); Comments from Barclays Bank PLC et al. on 75 Fed. Reg. 70881 et al. (Feb. 17, 2011) (Chief Compliance Officer Rule); Comments from ISDA on 76 Fed. Reg. 22833 at 6 (June 9, 2011) (Historical SDR Reporting Rule); Historical SDR Reporting Rule, 77 Fed. Reg. at 35204 (Historical SDR Reporting Rule).

[17] Comments from Barclays Bank PLC et al. on 75 Fed. Reg. 76193, 75 Fed. Reg. 76666, 76 Fed. Reg. 6715, et al. (Feb. 17, 2011) (Real-Time Reporting Rule, Daily Trading Records Rule, and Portfolio Reconciliation and Documentation Rule); Comments from Bank of Tokyo-Mitsubishi UJF, Ltd. et al. on 75 Fed. Reg. 76193, 75 Fed. Reg. 76666, 76 Fed. Reg. 6715, et al. (May 6, 2011) (same); Real-Time Reporting Rule, 77 Fed. Reg. at 1189-90.

[18] Comments from ISDA on 76 Fed. Reg. 25274 at 3 (June 2, 2011); Comments from Cleary Gottlieb on 76 Fed. Reg. 1214 at 21-22 (Apr. 5, 2011).

at 41238. The proposal set forth the CFTC's interpretation of the scope of its cross-border authority under Section 2(i); introduced the new term "U.S. person" to describe entities that automatically must comply with all Registration, Entity-Level, and Transaction-Level Requirements; defined when a "non-U.S. person" must register with the CFTC under the Registration Requirements; detailed how Entity-Level and Transaction-Level Requirements would apply to cross-border swaps; and articulated a regime of "substituted compliance," under which certain requirements of the Title VII Rules could be satisfied by complying with foreign law. In January 2013, the CFTC requested further comment on certain provisions of the proposal. Further Proposed Guidance Regarding Compliance With Certain Swaps Regulations, 78 Fed. Reg. 909 (Jan. 7, 2013).

During both comment periods on the proposed Cross-Border Rule, commenters explained that the proposal was in the nature of a binding rule, not mere "guidance," and must be promulgated consistently with the rulemaking requirements of the APA and the CEA.[19] Specifically, commenters requested that the CFTC conduct a cost-benefit analysis, as required by the CEA,[20] explained that the Cross-Border Rule would impose significant costs,[21] and raised concerns about particular features of the rule discussed below, *see infra* 34-41.

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[19] Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 6-7 (Aug. 27, 2012); Comments from ISDA on 77 Fed. Reg. 41110 & 77 Fed. Reg. 41214 at 3 (Aug. 10, 2012); Comments from ISDA on 78 Fed. Reg. 909 at 2 (Feb. 6, 2013); Comments from JP Morgan on 77 Fed. Reg. 41214 & 77 Fed. Reg. 41110 at 4 (Feb. 22, 2011).

[20] Comments from JP Morgan on 77 Fed. Reg. 41214 & 77 Fed. Reg. 41110 at 4 (Feb. 22, 2011); Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 7-8 (Aug. 27, 2012); Comments from ISDA on 77 Fed. Reg. 41110 & 77 Fed. Reg. 41214 at 3 (Aug. 10, 2012).

[21] Comments from SIFMA on 77 Fed. Reg. 41214 at A-22 (Aug. 27, 2012); Comments from Sullivan & Cromwell on 77 Fed. Reg. 41214 at 6, 12-13 (Aug. 13, 2012); Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 2-3 (Aug. 27, 2012); Comments from JP Morgan on 77 Fed. Reg. 41214 & 77 Fed. Reg. 41110 at 4 (Feb. 22, 2011).

In July 2013, by a 3-1 vote, the Commissioners adopted the final Cross-Border Rule, which spans 78 pages in the Federal Register, including more than 650 footnotes and highly detailed and prescriptive "appendices," and which establishes even more comprehensive regulatory mandates for swaps trading around the world—even more comprehensive than in the proposed Rule. *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292, 45370 (July 26, 2013). The CFTC continued to characterize the rule as mere "[g]uidance." *Id.* at 45297. In dissent, Commissioner O'Malia said this was done to avoid the rulemaking requirements of the APA and the CEA, particularly the Commission's obligation under the CEA to "analyz[e] the costs and benefits of its actions," 78 Fed. Reg. at 45372-73, App. 3, which at least one Commissioner had repeatedly decried as improperly "paralyz[ing]" the agency's rulemaking.[22] The Commission also ignored a host of other rulemaking requirements in adopting the Rule, including those of the Regulatory Flexibility Act (5 U.S.C. § 601), the Paperwork Reduction Act (44 U.S.C. § 3504), and the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. No. 104-121, 110 Stat. 847 tit. II (1996) (as amended by Pub. L. No. 110-28, 121 Stat. 113 (2007)).

Despite the CFTC's claim that the Cross-Border Rule is a non-binding general statement of policy, the Rule contains numerous binding requirements and safe-harbors, stating when certain requirements "will" and "shall" apply. *See infra* 25. The Rule's "appendices" are in fact a series of detailed matrices intended to crystallize the Rule's requirements by setting forth which Title VII regulations "apply" or "do not apply" for various combinations of swap counterparties. *E.g.,* 78 Fed. Reg. at 45368. The Rule also sets forth an intricate regime for

[22] *See* Bart Chilton, Speech Before Americans for Financial Reform (May 9, 2012), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-65; Bart Chilton, Speech, Cadwalader Energy and Commodities Conference (Oct. 6, 2011), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-54.

accepting "substituted compliance" with foreign laws in limited circumstances, *id.* at 45342-46, and other regulatory safe-harbors, *e.g.*, *id.* at 45325 n.323.

The same week it adopted the Cross-Border Rule, the Commission confirmed the Rule's mandatory nature by issuing an "Exemptive Order" that provided certain entities "temporary conditional relief" until they could "transition" into compliance with the Rule. Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 43785, 43786-87 (July 22, 2013). This Exemptive Order referred to the Cross-Border Rule as if it was, in fact, binding. *See, e.g.*, *id.* at 43789 ("[A]ny foreign branch of a U.S. bank that is [a swap dealer] or [major swap participant] that was not required to clear under the January Order may delay complying with such clearing requirement until [October 9, 2013]."); *id.* & n.43. In the months since, the CFTC has continued to treat the Cross-Border Rule as binding. It has cited the Rule in subsequent rules, to explain when "the Commission's clearing requirement will not apply." Clearing Requirement Determination under Section 2(i) of the CEA, 77 Fed. Reg. 47170, 47213 & n.188 (Aug. 7, 2012). The CFTC and the Federal Register websites refer to the Rule as a "Rule,"[23] and the Federal Register itself lists the Rule as purporting to modify pre-existing rules. *See* 78 Fed. Reg. at 45292 ("17 CFR Chapter 1"). The CFTC Chairman has warned market participants that they should "come into compliance" with the Rule, and has described how he intends to enforce "one set of rules" for both foreign and U.S. companies.[24]

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[23] http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2013-17958; https://www.federalregister.gov/articles/2013/07/26/2013-17958/interpretive-guidance-and-policy-statement-regarding-compliance-with-certain-swap-regulations.

[24] Gary Gensler, Speech, CME Global Financial Leadership Conference (Nov. 19, 2013), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-153; Gary Gensler, Speech, SEFCON IV (11/18/13), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-152; *id.* (U.S. and foreign swap dealers "have to follow the same rules" when trading in the same U.S. office building).

The Commission gave further effect to the Cross-Border Rule on December 20, 2013, when it issued eight "comparability determinations" ("Determinations") regarding the extent to which compliance with the requirements of six foreign regulatory authorities suffices to satisfy the CFTC's requirements. Each of these Determinations declares that the Cross-Border Rule "*established* a recognition program" that allows market participants to comply with foreign requirements in lieu of the CFTC's rules, if the CFTC determines that the foreign requirements are "comparable." *See, e.g.*, CFTC, *Comparability Determination for the European Union: Certain Transaction-Level Requirements*, at 6, (Dec. 20, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/eutranreq.pdf (emphasis added). Each Determination further states that "market participants are responsible for determining whether substituted compliance is available *pursuant to* the" Cross-Border Rule and that, when substituted compliance is not available, market participants, "to the extent applicable under the [Cross-Border Rule], may be required to comply with the CEA and Commission regulations." *See, e.g.*, *id.* at 14, 16 n.35 (emphasis added).

The CFTC's staff has similarly treated the Cross-Border Rule as binding. On November 14, 2013, staff from the Division of Swap Dealer and Intermediary Oversight issued an "advisory" elaborating one of the Cross-Border Rule's requirements, apparently without notifying the entire Commission. Division of Swap Dealer and Intermediary Oversight Advisory, "Applicability of Transaction-Level Requirements to Activity in the United States," CFTC Letter No. 13-69 (Nov. 14, 2013) ("DSIO Advisory"), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf; Zachary Warmbrodt, POLITICO PRO (Nov. 18, 2013). The DSIO Advisory announced that Transaction-Level Requirements apply to CFTC-registered swap dealers that are "regularly using personnel

or agents located in the U[nited] S[tates] to arrange, negotiate, or execute a swap with a non-U.S. person." DSIO Advisory at 2. The DSIO Advisory characterized the Cross-Border Rule as a binding rule, stating that the Rule "intended substituted compliance *to be available*, or Transaction-Level Requirements *to not apply*, where the activities of the non-U.S. [swap dealer] take place outside the United States." *Id.* at 2 (emphases added).

One day later, staff in the Division of Market Oversight cited the Cross-Border Rule—specifically, its definition of "U.S. person"—as determinative of the cross-border application of the SEF Registration Rule. Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities, at 1 n.5, 2 (Nov. 15, 2013) (the "DMO Guidance"). The DMO Guidance stated that a non-U.S. trading platform that provides non-"U.S. persons" a venue for swaps execution could be required to register with the CFTC simply because one of the non-U.S. persons uses an agent located in the United States to assist in trade execution on the platform. *Id.*

CFTC staff have also issued "no-action letters" responding to regulated entities' requests for relief from certain Cross-Border Rule requirements. *E.g.*, No-Action Relief: Certain Transaction-Level Requirements for Non-U.S. Swap Dealers, CFTC Letter No. 13-71 (Nov. 26, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-71.pdf. One no-action letter explicitly applies the Cross-Border Rule's definition of "U.S. person." *See id.* at 1 n.2. Another sets forth temporary alternatives for complying with the Cross-Border Rule. *See* Time-Limited No-Action Relief Regarding Regulation 23.502 for Swap Dealers and Major Swap Participants in Connection with Uncleared Swaps Subject to Risk Mitigation Techniques under EMIR, CFTC Letter No. 13-50 (Aug. 23, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-50.pdf.

The SEC—which also has responsibility for regulating swaps under Dodd-Frank, and has an obligation similar to the CFTC's to conduct cost-benefit analyses in rulemakings (*see* 15 U.S.C. §§ 78c(f), 80a-2(c))—has proceeded very differently than the CFTC in addressing the cross-border scope of its swaps rules. It issued a proposed cross-border rule that includes an economic analysis of more than 85 pages. *See* Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30968, 31118-31204 (May 23, 2013). The SEC also re-opened the comment period for all affected final rules, so it could consider the costs and benefits of its proposed approach as a whole. *See* 78 Fed. Reg. at 30973. Explaining the difference between their approach and the CFTC's, SEC staff have said that "providing fairly significant guidance about how the rules would apply in a cross-border context . . . is beyond the scope of what we can do by interpretation" rather than rulemaking. Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later: Hearing Before the S. Comm. on Agric., Nutrition and Forestry, 112 Cong. 9 (2012).

D. The Cross-Border Rule Regulates Entities And Swap Activities Throughout The World Without Regard To The Impact On U.S. Commerce, And Rests Upon Arbitrary And Capricious Reasoning And Distinctions

The Cross-Border Rule sets out a complicated regime for the regulation of foreign swaps transactions and foreign swap market participants. Many of these requirements were opposed by commenters during the comment period, remained unchanged in the final Rule, and impose costly and arbitrary burdens on the swaps markets, including the following that are discussed in detail at pages 33-42 below:

- Rather than regulate cross-border "activities," as Section 2(i) requires, the Rule predicates much of its binding requirements on the *status* of the *entity*—such as whether one entity is "guaranteed" by another. *See* 78 Fed. Reg. at 45368-70, Apps. C-F.

- The Rule requires every "non-U.S. person" to aggregate its relevant dealing swaps with those of non-registered foreign affiliates "under common control," for purposes of determining whether registration is required pursuant to the Registration Requirements (*See* 78 Fed. Reg. at 45323), even where the activities of the "non-U.S. person" do not have a "direct and significant" connection with, or effect on, U.S. commerce.
- The Rule imposes Transaction-Level Requirements on certain transactions between two *foreign* entities, when one is a "guaranteed affiliate" or a foreign branch of a "U.S. person" (*see* 78 Fed. Reg. 45369-70, App. D, App. F), even though the presumption against extraterritoriality generally prohibits the regulation of conduct outside the United States (*see EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244 (1991)).
- The Rule applies Transaction-Level Requirements to swaps between a foreign "affiliate conduit" of a "U.S. person" and another foreign entity (78 Fed. Reg. at 45358-59 & n.588), even though these transactions often have no discernible relationship with U.S. commerce.
- The Rule does not allow "substituted compliance" for swaps involving one or more U.S. counterparties. 77 Fed. Reg. at 41230.
- The Rule imposes Transaction-Level Requirements on swaps between two foreign entities simply because the foreign entities use U.S.-based branches or U.S.-based personnel to "arrange, negotiate, or execute" their swaps (78 Fed. Reg. at 45350 n.513; DSIO Advisory at 2), even though most such transactions are regulated by foreign regulators and normally impose no risk on U.S. commerce.

STANDARD OF REVIEW

"Summary judgment is an appropriate procedure for resolving a challenge to a federal agency's administrative decision when review is based upon the administrative record." *Fund*

for Animals v. Babbitt, 903 F. Supp. 96, 105 (D.D.C. 1995) (citing *Richards v. INS*, 554 F.2d 1173, 1177 (D.C. Cir. 1977)). The Court should grant Plaintiffs' motion for summary judgment and "hold unlawful and set aside agency action, findings, and conclusions" if it determines that those actions were—as relevant here—"arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right" (including Section 2(i)'s prohibition on extraterritorial application of Dodd-Frank's swaps rules), or taken "without observance of procedure required by law" (including the CEA's cost-benefit requirement and the APA's notice-and-comment requirements). 5 U.S.C. § 706(2); *see, e.g.*, *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1023 (D.C. Cir. 2000).

SUMMARY OF ARGUMENT

In adopting the Title VII Rules and Cross-Border Rule, the CFTC failed to address a critical aspect of its swap regulatory regime through proper notice and comment rulemaking: The extent to which the CFTC's swaps requirements would apply to foreign entities and transactions. Several basic regulatory failures resulted. In its Title VII rulemakings, the Commission failed to specify which entities and transactions the rules would cover, and wrongly brushed aside comments that proposed answers to those questions. The Commission also failed to evaluate the costs and benefits of the Rules in light of (and to the extent of) their extraterritorial application, and failed to consider whether the Rules' terms should be modified to reduce costs on foreign activities, foreign entities, and U.S. firms operating abroad.

When it finally addressed this "important aspect of the problem" in connection with its Cross-Border Rule, the Commission compounded its error by circumventing federal rulemaking requirements. The Cross-Border Rule is a substantive rule: It lays down the requirements for foreign entities and U.S. entities operating abroad in connection with the Title VII Rules, setting

forth detailed definitions and a highly complex coverage scheme. And although the Cross-Border Rule plainly is intended to be treated as a rule by the Commission and its staff, the CFTC characterized it as a "general statement of policy" in an effort to circumvent Congress's requirements for rulemaking. The Commission then proceeded to give short shrift to rulemaking comments, and to omit altogether the cost-benefit analysis that is required by law.

The Commission's failure to adhere to legally-prescribed procedures led to numerous substantive errors. The cross-border requirements exceed the agency's authority under Section 2(i) and impose costly, burdensome, and unnecessary requirements on foreign activities, foreign entities, and U.S. entities operating abroad, to the detriment of markets and market participants.

The Cross-Border Rule should be vacated. In addition, this Court should declare that the Title VII Rules have no cross-border effect until the CFTC promulgates a valid cross-border rule and should enjoin the CFTC from applying the Title VII Rules to foreign activities and entities in the manner set forth in the Cross-Border Rule; or, in the alternative, the Court should partially vacate the Title VII Rules to the extent that they have cross-border effect.

ARGUMENT

A. In Adopting The Title VII Rules, The Commission Violated The APA And The CEA By "Fail[ing] To Consider An Important Aspect Of The Problem," Not Responding To Public Comments Regarding The Rule's Cross-Border Application, And Refusing To Conduct An Adequate Cost-Benefit Analysis

It is a well-established "canon of construction" that where U.S. law "gives no clear indication of an extraterritorial application, it has none." *See Morrison*, 130 S. Ct. at 2877-78; *accord Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437, 454-55 (2007). The Title VII Rules are silent on their own cross-border application (*see supra* 7) and the Commission concedes that Section 2(i) does not, of its own force, require the Commission to regulate to the full extent authorized by Section 2(i) (78 Fed. Reg. at 45297). Thus, neither the Title VII Rules nor Section

2(i) specifies the extent to which (if at all) the Title VII Rules apply extraterritorially, and accordingly, under the presumption against extraterritoriality, the Rules do not apply outside the United States. *See Morrison*, 130 S. Ct. at 2877-78. This Court should therefore declare that the Title VII Rules have no extraterritorial effect until the CFTC promulgates a valid cross-border rule and enjoin the CFTC from applying those Rules abroad.

If, however, the Court concludes that the Title VII Rules do have cross-border application, then it should hold that the Rules were improperly promulgated under the APA and CEA and vacate any extraterritorial aspects of the Rules. A core issue in regulating a market that includes participants and activities the world over is the extent to which the regulations will apply to foreign entities and activities, and to U.S. entities abroad. Congress addressed this issue by limiting the CFTC's "cross-border" authority. To the extent the CFTC asserts that the Title VII Rules have cross-border application, it also should have addressed this issue in tailoring the Rules: it was an "important aspect of the problem," commenters repeatedly raised it, and determining the costs and benefits of the Rules as required by statute—and tailoring them accordingly—necessarily required determining where and to whom the Rules would apply. In neglecting these matters, the CFTC violated the APA and the CEA.

1. The Commission "Failed To Consider An Important Aspect Of The Problem" And Did Not Adequately Respond To Comments Regarding The Extraterritorial Application Of The Title VII Rules

An agency action is arbitrary and capricious if it "fail[s] to consider an important aspect of the problem" being regulated. *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). Determining which entities and activities are covered by a regulation is necessarily an important part of crafting the rule. *See Mountain States Tel. & Tel. Co. v. FCC*, 939 F.2d 1035, 1037 (D.C. Cir. 1991) (vacating broad FCC orders as arbitrary and capricious because the agency failed to "adequately justify the scope of the rule");

see also Cablevision Sys. Corp. v. FCC, 649 F.3d 695, 719-20 (D.C. Cir. 2011); *Chamber of Commerce v. FEC*, 69 F.3d 600, 606 (D.C. Cir. 1999). In the case of a global market such as the swaps market, which foreign entities and cross-border activities will be regulated is undeniably "an important aspect of the problem." *Cablevision*, 649 F.3d at 715. But in finalizing its Title VII Rules, the CFTC either ignored the issue of extraterritoriality altogether,[25] explicitly refused to address it (as with the Swap Entity Registration Rule), or stated that extraterritoriality would be addressed in a future agency release (as with the Entity Definition and Clearing Determination Rules), when in fact these cross-border issues never have been addressed in a proper rulemaking. To the extent the Commission claims that the Title VII Rules have cross-border application, this failure to address extraterritoriality is arbitrary and capricious, particularly in light of the CFTC's own repeated statements regarding the global nature of the swaps market. *See supra* 2.

By ignoring extraterritoriality when adopting the Title VII Rules, the Commission also violated the APA's requirement to afford "interested persons an opportunity to participate in the rule making." 5 U.S.C. § 553(c). Notice and comment is "designed (1) to ensure that agency regulations are tested via exposure to diverse public comment [and] (2) to ensure fairness to affected parties . . . ." *Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin.*, 407 F.3d 1250, 1259 (D.C. Cir. 2005). Accordingly, when an agency issues a rule, the APA requires it to respond to all "relevant" and "significant" public comments. *HBO v. FCC*, 567 F.2d 9, 35 & n.58 (D.C. Cir. 1977). The agency's response must enable a court "to see what major issues of policy were ventilated and why the agency reacted to them as it did." *Pub.*

[25] The Commission ignored extraterritoriality in the SEF Registration Rule, the Portfolio Reconciliation and Documentation Rule, the Real-Time Reporting Rule, the Daily Trading Records Rule, the Trade Execution Rule, the Straight Through Processing Rule, the Chief Compliance Officer Rule, the Risk Management Rule, the SDR Reporting Rule, the Historical SDR Reporting Rule, and the Large Trader Reporting Rule.

Citizen, Inc. v. FAA, 988 F.2d 186, 197 (D.C. Cir. 1993) (citation and alterations omitted). Thus, for example, in *Louisiana Federal Land Bank*, plaintiffs challenged a rule that eliminated long-standing geographic restrictions on farm lending. *La. Fed. Land Bank Ass'n, FLCA v. Farm Credit Admin.*, 336 F.3d 1075, 1078 (D.C. Cir. 2003). During the comment period, commenters had argued that eliminating the geographical restrictions would violate the authorizing statute and harm customers. *Id.* at 1080. In promulgating the final rule, the agency "said almost nothing about the comments." *Id.* The D.C. Circuit held that the agency "should have responded to the plaintiffs' comment" because the geographical issue was "not a trivial part of what the plaintiffs had argued was unlawful." *Id.* at 1080-81.

In adopting the Title VII Rules, the CFTC similarly failed to respond to comments regarding the Rules' cross-border application. *See supra* 7. For example, commenting upon the Entity Definition Rule, market participants argued that the CFTC's extraterritorial jurisdiction under Title VII should "be narrowly construed" (Comments from SIFMA on 75 Fed. Reg. 80174 at 5 (Feb. 3, 2011)) and urged the Commission to "avoid a framework that is duplicative, inefficient . . . and would result in unrealistic extraterritorial supervisory responsibilities for the [SEC and CFTC] and potential fragmentation of the derivatives markets" (Comments from IIB on 75 Fed. Reg. 80174 at 7 (Jan. 10, 2011)). Similarly, commenters sought "clarification of the extent of the extra-territorial reach of Title VII" in the Risk Management Rule (Comments from Société Générale on 75 Fed. Reg. 71397 at 2 (Jan. 21, 2011)), stated that "jurisdictional boundaries should be defined" for the Real-Time Reporting Rule (77 Fed. Reg. at 1190), and asked for "clarity with regards to extraterritorial[] application of the" SEF Registration Rule (Comments from ISDA on 76 Fed. Reg. 25274 at 3 (June 2, 2011)).

In total, commenters submitted comments asking for clarification of the cross-border application of the SEF Registration Rule, the Portfolio Reconciliation and Documentation Rule, the Real-Time Reporting Rule, the Daily Trading Records Rule, the Chief Compliance Officer Rule, the Risk Management Rule, the SDR Reporting Rule, the Historical SDR Reporting Rule, the Swap Entity Registration Rule, and the Entity Definition Rule. *See supra* 6-7 & nn.15-18. Yet, for most of those Rules, the CFTC did not even mention commenters' concerns regarding cross-border scope; in the few cases it did mention those comments, it did so only to state that it would not address the issue—that those concerns were "beyond the scope of this rulemaking" (Swap Entity Registration Rule, 77 Fed. Reg. at 2619-20), or that the Commission "intend[ed] to issue separate releases addressing" those issues (Entity Definition Rule, 77 Fed. Reg. at 30684 n.1078; *see also id.* at 30605, 30688 n.1119); *see also supra* 7. The Commission thus acknowledged the relevance and significance of extraterritoriality when it *requested* comments on the issue, such as in the proposed Swap Entity Registration Rule (75 Fed. Reg. 71379, 71382), but then failed to adequately address the comments received. This violated the APA.

2. The Commission Failed To Consider The Costs And Benefits And Terms Of The Title VII Rules In Light Of (And To The Extent Of) Their Extraterritorial Application

When the CFTC issues a regulation, it must "evaluate[]" the "costs and benefits" of that rule. 7 U.S.C. § 19(a)(2). The CFTC must include in its cost-benefit analysis: "(A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations." *Id.* § 19(a)(2)); *Inv. Co. Inst. v. CFTC*, 720 F.3d 370, 377 (D.C. Cir. 2013). These requirements compel the Commission to determine "as best it can the economic implications of the rule" it has proposed. *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C.

Cir. 2011). The D.C. Circuit has repeatedly invalidated regulations of the SEC that failed to satisfy a similar statutory requirement. *See id.* at 1148-51; *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133, 142-144 (D.C. Cir. 2005).

In adopting the Title VII Rules, the CFTC refused to define their cross-border scope. Thus, while each of the Title VII Rules contained a cost-benefit analysis, at no point did these analyses discuss the Rules' costs, benefits, and terms in light of any application to non-U.S. transactions and entities. The Commission was therefore in no position to judge, for example, whether the obligations and costs it was imposing were necessary in the case of entities and transactions that already are amply regulated under the laws of other nations. *See Am. Equity*, 613 F.3d at 178-79 (vacating SEC rule because it regulated a product without first assessing protections already provided by state law).

The Commission's determination in its Cross-Border Rule that it should allow regulated entities to "substitute[]" compliance with foreign law for compliance with many of the Title VII Rules merely underscores the gravity of the CFTC's error in the Title VII rulemakings. *See* 78 Fed. Reg. at 45342-45, 45368-69, Apps. C-D. To the extent the Title VII Rules have cross-border application, the Commission was required to consider that in adopting the Title VII Rules themselves. This is particularly the case given the CFTC's legal position that the Cross-Border Rule has no force and effect, and therefore under the CFTC's own view, the Title VII Rules cover many circumstances that the Cross-Border Rule determined they should not.

The statutorily-required cost-benefit considerations ignored by the Commission in the Title VII rulemakings are legion. For example, the Commission never considered the harms to "market participants and the public" of applying the Title VII Rules extraterritorially, which

include increased prices for end-user counterparties and consumers because some foreign entities will withdraw from the market, or restructure and recapitalize. *See, e.g.*, Swap Entity Registration Rule, 77 Fed. Reg. at 2624-25; Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 2 (Aug. 27, 2012). Similarly, the CFTC ignored "considerations of the efficiency, competitiveness, and financial integrity of futures markets," because it never addressed the fact that applying these regulations extraterritorially would impose expensive, inefficient, and duplicative requirements on foreign entities already regulated by their home government (leading to increased transaction costs that would in turn be passed on to end-users and consumers); would decrease the competitiveness of certain foreign entities in relation to other foreign entities; and would increase market risk and decrease market liquidity by causing fragmentation of the international market. *See, e.g.*, Swap Entity Registration Rule, 77 Fed. Reg. at 2624-25; Comments from SIFMA on 75 Fed. Reg. 80174 at 7, 14 (Feb. 3, 2011); Comments from Barclays Bank PLC et al. on 75 Fed. Reg. 70881 et al. at 17 (Feb. 17, 2011); Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 2 (Aug. 27, 2012). Nor did the CFTC address "other public interest considerations" implicated by applying the Title VII Rules extraterritorially (7 U.S.C. § 19(a)(2)(E)), such as considerations of international comity. *See, e.g.*, Comments from IIB on 75 Fed. Reg. 71379 at 2 (Jan. 10, 2011); Comments from SIFMA on 75 Fed. Reg. 80174 (Feb. 3, 2011).

* * *

In adopting the Title VII Rules, the Commission neglected all of the foregoing issues—issues that the Commission could have, but did not, satisfactorily address through a proper "cross-border" rulemaking.

B. The Cross-Border Rule Is A Substantive Rule Adopted In Violation Of The APA And The CEA

1. The Cross-Border Rule Is A Substantive Rule That Was Subject To The Full Range Of Rulemaking Requirements

The APA requires notice-and-comment rulemaking for all "substantive rules." *Chrysler Corp. v. Brown*, 441 U.S. 281, 301 (1979); *see* 5 U.S.C. § 553(b). The only rules not subject to this requirement are "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." *Id.* § 553(b)(3)(A). In addition, the CEA requirement to "evaluate[]" costs and benefits applies to *all* CFTC "regulation[s]" (7 U.S.C. § 19(a)(1)), a term that is "interchangeable and synonymous" with "rule." *Nat'l Treasury Emps. Union v. Weise*, 100 F.3d 157, 160 (D.C. Cir. 1996).[26]

The CFTC seemed to believe that it could evade the rulemaking requirements of the APA and CEA by claiming that the Rule is a non-binding "statement of . . . general policy." *See, e.g.*, 78 Fed. Reg. at 45297. Even if that were true, a cost-benefit analysis under the CEA would still be required. The CEA's cost-benefit requirement applies to *all* CFTC "regulations." 7 U.S.C. § 19(a)(1). A general statement of policy is a "regulation" (*see Chrysler*, 441 U.S. at 301), albeit a type of regulation that is exempt from APA notice and comment requirements. Therefore, a cost-benefit analysis would be required even if the Cross-Border Rule were mere "guidance."[27]

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[26] The *only* exceptions to the CEA's cost-benefit mandate are for certain CFTC "order[s]," "emergency action[s]," and "finding[s] of fact," none of which are relevant here. 7 U.S.C. § 19(a)(3).

[27] The CFTC has never claimed that the Cross-Border Rule is an interpretative rule, and it is not. An interpretative rule "derive[s] a proposition from an existing document whose meaning compels or logically justifies" its requirements. *Catholic Health Initiatives v. Sebelius*, 617 F.3d 490, 494 (D.C. Cir. 2010) (internal quotation omitted). The Cross-Border Rule does not derive its intricate regulatory regime from the Title VII Rules (which are silent on the issue of cross-border application, *see supra* 7), or from Section 2(i)'s narrow authorization. Moreover, because the CFTC has never suggested that the Cross-Border Rule is an interpretative rule, it may not attempt to defend the Rule on that basis now. *See SEC v.*

But in fact the Cross-Border Rule plainly is not a general statement of policy. A "general statement of policy" is a non-binding announcement of "the agency's tentative intentions for the future." *Pac. Gas & Elec. Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974). An agency cannot avoid the requirements for rulemaking through the expedient of styling a rule as "guidance." Rather, courts will look behind the agency's labels—including disclaimers that the document is non-binding—to assess whether the claim to be a "general statement of policy" is a "charade, intended to keep the proceduralizing courts at bay." *Appalachian Power*, 208 F.3d at 1021 n.13, 1023 (internal quotation omitted).

An agency pronouncement is a substantive rule if "affected private parties are reasonably led to believe that failure to conform will bring adverse consequences," or if "the language of the [document] is such that private parties can rely on it as a norm or safe harbor by which to shape their actions." *Gen. Elec. Co. v. EPA*, 290 F.3d 377, 383 (D.C. Cir. 2002). The pronouncement will be treated by the courts as a substantive rule if it binds the public or if it serves to bind the agency itself in the discharge of its responsibilities (*id.* at 382-83), for example by "focus[ing] the [agency's] attention on the [rule's] criteria," "narrow[ing] [its] field of vision, [or] minimizing the influence of other factors and encouraging decisive reliance upon [the rule's] factors," *Pickus v. U.S. Bd. of Parole*, 507 F.2d 1107, 1113 (D.C. Cir. 1974). Therefore, the CFTC must comply with all rulemaking procedures when it issues a release that either (1) "appears on its face to be binding" or (2) "is applied by the agency in a way that indicates it is binding" (*Gen. Elec.*, 290 F. 3d at 382-83 (quotations and citations omitted)). The Cross-Border Rule is a substantive rule in both respects.

Chenery Corp., 318 U.S. 80, 87–88 (1943). In any event, the CEA's cost-benefit requirement applies to interpretative rules.

First, the Cross-Border Rule is binding on its face. The Rule spans 78 pages in the Federal Register (including 650 footnotes) and is accompanied by detailed matrices in the "appendices" that function as a distinct distillation of when the Rule's requirements "apply" or "do not apply." *See* 78 Fed. Reg. at 45368-70. Repeatedly, the document sets forth the agency's reasoning on specific issues and then, in a different type font, concludes with highly detailed and specific language that plainly is intended to be consulted by regulators and the regulated as if it were the text of a rule. *See, e.g., id.* at 45316-17, 45326, 45359. The Rule uses mandatory terms such as "must" and "will." *E.g.*, *id.* at 45309-15 (describing the elements the CFTC "will" consider in determining whether an entity is a "U.S. person"); *id.* at 45344 ("Once a comparability determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction . . ."); *id.* at 45352 n.529 ("Where one of the parties to the swap is a conduit affiliate, . . . the part 43 real-time reporting requirements must be satisfied."). Similarly, the Rule contains a detailed, eight-part definition of a "U.S.-person" (*id.* at 45316-17) that "cannot help but focus the [CFTC staff's] attention" in applying the Title VII Rules. *Pickus*, 507 F.2d at 1113. This definition—like the "detailed tables" in the appendices (*id.* at 1110) and other provisions—undoubtedly "narrow[s] [the staff's] field of vision, minimizing the influence of other factors and encouraging decisive reliance upon [the Rule's] factors." *Id.* The Rule creates safe-harbors from certain mandates (78 Fed. Reg. at 45325 n.323), and establishes a new and complicated regime of "substituted compliance" (*id.* at 45342-46).

Indeed, the entire architecture of the CFTC's cross-border regime makes clear that the Commission regards the Cross-Border Rule as a substantive rule—and a particularly important one at that. Time and again when adopting the Title VII Rules, the Commission ignored the Rules' application to foreign entities or transactions, occasionally providing assurances that this

critical feature of the regulatory structure would be addressed at a later point. The Cross-Border Rule is that point; it is in the Cross-Border Rule, for instance, that the Commission establishes that parties and transactions that it believes are otherwise covered by the Title VII Rules may, under certain circumstances, dispense with compliance with aspects of the Title VII Rules and "substitute[] compliance" with foreign law instead. *Id.* at 45342. The Rule "establishes" a "program," the December 20 Determinations declared, "pursuant to" which the entities identified in the Rule are entitled to "substituted compliance." *Supra* 11; *see Gen. Elec.*, 290 F.3d at 382-85 (safe harbor is indicative of a rule). And it is only by proffering the exemptions in the Cross-Border Rule that the Commission addressed—albeit incompletely—the patently inappropriate burdens and costs of requiring entities and transactions already comprehensively regulated under foreign law to satisfy analogous requirements of U.S. law.

Given the Cross-Border Rule's mandatory text and detailed regulatory regime, there can be no doubt that far from being a "general" "statement" about the agency's "policy," the Rule has "present-day binding effect," such that affected parties reasonably "can rely on [the Cross-Border Rule] as a norm or safe harbor by which to shape their actions" and expect that "failure to conform will bring adverse consequences." *Gen. Elec.*, 290 F.3d at 382-83.

Second, the CFTC and its staff have "regularly applied" the Cross-Border Rule as binding. *Gen. Elec.*, 290 F.3d at 383. In the same week that the CFTC adopted the Rule, it issued an Exemptive Order to give market participants time to "adjust their operational and compliance systems" to the Rule. 78 Fed. Reg. at 43786. This Exemptive Order confirmed that the CFTC understood that market participants would have to come into compliance with the Cross-Border Rule, both to avoid "adverse consequences" and to "shape their actions" according to the "norm or safe harbor" announced in the Cross-Border Rule. *Gen. Elec.*, 290 F.3d at 382-

83. CFTC rules proposed or finalized after the Cross-Border Rule issued have also treated that Rule as binding, by referring to or incorporating the Rule to explain their own extraterritorial scope. *See, e.g.*, Clearing Determination Rule, 77 Fed. Reg. at 74326 & n.216.

The CFTC staff has issued "no-action" letters with regard to certain aspects of the Rule, premised on the assumption that, without this relief, failure to comply with the Rule would expose market participants to enforcement action. *See, e.g.*, CFTC Letter No. 13-71. Similarly, the CFTC staff has issued "advisories" in the belief that the Rule is a binding indication of what requirements do and "[do] not apply" to foreign entities. DSIO Advisory at 2; *accord* DMO Guidance at 2. Both the CFTC's website and the Federal Register website label the Cross-Border Rule as a "Rule." *See supra* 10 & n.23. And the CFTC's Determinations warn that when substituted compliance is unavailable, market participants "may be required to comply with" the CFTC's regulations "to the extent applicable under" the Cross-Border Rule. *See supra* 11.

The staff's treatment of the Rule as binding is understandable given not only the terms of the Rule, but the circumstances of its adoption as well. The Rule was the product in part of prolonged discussions between Chairman Gensler and international regulators. *See* The European Commission and the CFTC Reach a Common Path Forward on Derivatives, http://www.cftc.gov/PressRoom/PressReleases/pr6640-13 (Jul. 11, 2013) (last visited Dec. 27, 2013). CFTC staff would hardly feel at liberty to depart from terms that were intended to implement a much-ballyhooed international agreement—and the Chairman's agreement with fellow regulators would mean little if the Rule were not binding. Nor would staff feel free to cast aside detailed regulatory language that has been approved after notice and comment by a vote of the Commissioners who head the agency. The Chairman has directly warned regulated parties that they must "come into compliance" with the Rule, noting, for example, that the Rule

and the DSIO Advisory dictate that both domestic and foreign entities using personnel in the United States "*have to follow* the same rules." *See supra* 10 n.24 (emphasis added). There is thus no doubt that "affected private parties are reasonably led to believe that failure to conform [to the Rule] will bring adverse consequences." *Gen. Elec.*, 290 F.3d at 383.

The CFTC's self-serving disclaimer that the Rule "is a statement of the [CFTC's] general policy regarding cross-border swap activities" does not change the foregoing analysis. *See, e.g.*, 78 Fed. Reg. at 45297. In *Appalachian Power*, the EPA relied on a virtually identical disclaimer, claiming that "[t]he policies set forth in this paper are intended solely as guidance, do not represent final Agency action, and cannot be relied upon to create any rights enforceable by any party." 208 F.3d at 1023 (internal quotation omitted). The D.C. Circuit dismissed this as a legally irrelevant "charade, intended to keep the proceduralizing courts at bay," concluding instead that "[t]hrough the Guidance, EPA has given the States their 'marching orders' and EPA expects the States to fall in line." *Id.* (internal quotation omitted); *see also Gen. Elec.*, 290 F.3d at 382-85 (vacating EPA pronouncement because its mandatory language and use by the EPA were intended to cause regulated parties to "shape their actions" to satisfy the pronouncement and treat it as a "norm or safe harbor"); *accord Natural Res. Def. Council v. EPA*, 643 F.3d 311, 319-21 (D.C. Cir. 2011); *Cmty. Nutrition Inst. v. Young*, 818 F.2d 943, 946-49 (D.C. Cir. 1987).

Because the Cross-Border Rule is binding on its face and has been regularly applied as binding, it is a rule subject to the rulemaking requirements of the APA and the CEA.

2. The Commission Violated The CEA Because It Failed To Conduct Any Cost-Benefit Analysis Of The Cross-Border Rule

Because the Cross-Border Rule is a "regulation" (*see supra* 23), the CEA required the CFTC to "consider [its] costs and benefits" before adopting it (7 U.S.C. § 19(a)(1)). The Commission did not do so. Its failure in this regard was complete and total; unlike other rules

vacated by the D.C. Circuit for deficient cost-benefit analyses (*see supra* 21), the CFTC did not purport to perform the statutorily-required cost-benefit analysis *at all.*

The CFTC's failure to conduct *any* cost-benefit analysis before adopting the Cross-Border Rule caused it to overlook what Commissioner O'Malia correctly described as the "significant costs for market participants" that the Rule imposes. 78 Fed. Reg. at 45373, App. 3. Commenters consistently called the proposed Cross-Border Rule's costs to the Commission's attention, and "urge[d] the Commission to conduct a full cost benefit analysis." Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214, at 8 (Aug. 27, 2011); *see, e.g.,* Comments from JP Morgan, *supra* 8 n.21, at 4. (At least one Commissioner, meanwhile, repeatedly decried what he called the "paralyzing" effect of statutorily-required cost-benefit analyses, *supra* 9 & n.22.) Commenters also raised numerous concerns regarding the costs of particular requirements in the Cross-Border Rule, discussed below. *See infra* 37, 39, 40.

The Cross-Border Rule mentions only some of these costs, and then only in passing and not as part of a full cost-benefit analysis. The CFTC failed to "evaluate" such costs as the increased prices for end-users and consumers, the likelihood of duplication or conflict with foreign regulations, violations of principles of international comity, decreased competition, decreased market liquidity, and increased market risk. The twelve-page Exemptive Order at least contains one page of cost-benefit analysis, *see* 78 Fed. Reg. at 43792-93; the Cross-Border Rule contains none. By contrast, the SEC conducted a preliminary economic analysis for its own cross-border rule proposal, including a baseline quantification of the security-based swaps marketplace, the potential effects of the proposed regulations on efficiency and competition, and extensive analysis of the anticipated costs and benefits of each proposed rule. *See* 78 Fed. Reg. at 31118-204.

The CFTC's complete failure to conduct a cost-benefit analysis of the Cross-Border Rule violated the CEA, and the Rule must be vacated. *See, e.g.*, *Bus. Roundtable*, 647 F.3d at 1156; *Am. Equity*, 613 F.3d at 179.

3. In Adopting The Cross-Border Rule, The Commission Violated the CEA And The APA By Arbitrarily Extending Onerous Swaps Regulations To Activities That Lack A "Direct And Significant" Connection With, Or Effect On, U.S. Commerce, And By Neglecting Bedrock Rulemaking Requirements

In the Cross-Border Rule, the CFTC violated several important statutory limitations on its authority, adopting requirements that unduly burden foreign and domestic corporations and establish powerful incentives for foreign businesses to cease doing business with U.S. firms, in order to avoid the burdens of the Commission's sweeping regulatory regime. The Cross-Border Rule therefore must be vacated not only because that is how courts address rules masquerading as "policy statements," but also because relief is needed from the Commission's violations of the congressional limits on its authority.

First, as further explained below, the CFTC exceeded the bounds of its authority under Section 2(i) and the related presumption against extraterritoriality. Section 2(i) prohibits the CFTC from applying its Title VII swap regime "to activities outside the United States unless"—as relevant here—"those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States." 7 U.S.C. § 2(i). This circumscribed authority is reinforced by the long-standing presumption against extraterritorial application of U.S. law. *Morrison*, 130 S. Ct. at 2877. Any ambiguity in Section 2(i) thus must be construed narrowly, "to avoid unreasonable interference with the sovereign authority of other nations." *Hoffman-La Roche Ltd. v. Empagran*, 542 U.S. 155, 164 (2004); *accord Microsoft Corp.*, 550 U.S. at 455-56 (when a statute expressly allows some extraterritorial application, the presumption still "remains instructive in determining the extent of the statutory exception"). And yet, even though Section

2(i) is an explicit prohibition on cross-border regulation with narrow exceptions, the CFTC has wielded it as a far-ranging grant of "new and broad authority." 78 Fed. Reg. at 45299.

While no court has construed Section 2(i) to date, courts' interpretation of comparable statutory provisions is instructive. In *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607 (1992), the Supreme Court narrowly interpreted the phrase "direct effect in the United States" in the Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(2), explaining that the term "direct" means that the effect must "follow[] as an *immediate* consequence of the defendant's activity." *Id.* at 618 (emphasis added) (internal quotations and alteration omitted); *see also Webster's Third New Int'l Dictionary of the English Language* 640 (1976 ed.) (defining "direct" as "immediate . . . marked by absence of an intervening agency, instrumentality, or influence."). Applying *Weltover*'s interpretation of "direct," the D.C. Circuit has said that a "direct" consequence is one that is "unavoidable," such that breaching or terminating a contract has a "direct effect" on U.S. commerce only when the contract *requires* performance in the United States. *I.T. Consultants, Inc. v. Islamic Republic of Pakistan*, 351 F.3d 1184, 1188-91 (D.C. Cir. 2003) (Roberts, J.).

Similarly, the Foreign Trade Antitrust Improvements Act ("FTAIA") applies to "conduct" that has a "direct, substantial, and reasonably foreseeable effect" on certain categories of commerce. 15 U.S.C. § 6a. In *United States v. LSL Biotechnologies*, 379 F.3d 672, 680-83 (9th Cir. 2004), the Ninth Circuit considered whether an agreement between a U.S. corporation and a foreign corporation to ban the sale of modified tomatoes in the United States had such a "direct effect" on U.S. commerce. Following *Weltover*'s interpretation of "direct," the court concluded that "speculative" effects that depend on "uncertain intervening developments" are not "direct." *Id.* at 680-83. Applying this standard, courts have held that competitive harm to a U.S. company's foreign subsidiary—which in turn causes the U.S. parent to lose revenues—is

"indirect and derivative" and therefore insufficiently "direct" under the FTAIA. *See Info. Res., Inc. v. Dun & Bradstreet Corp.*, 127 F. Supp. 2d 411, 417 (S.D.N.Y. 2001).[28]

Second, the CFTC violated several requirements of the APA, as set forth in detail below. It violated notice-and-comment procedures by failing to respond to all "relevant" and "significant" public comments (*HBO*, 567 F.2d at 35 & n.58); failing to consider all "important aspect[s] of the problem" being regulated (*State Farm*, 463 U.S. at 43); and adopting a final rule that was not a "logical outgrowth" of the proposed rule (*Envtl. Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005)). The CFTC also acted arbitrarily and capriciously in violation of the APA by failing to "articulate a satisfactory explanation for its action, including [establishing] a rational connection between the facts found and the choice made" (*State Farm*, 463 U.S. at 43 (internal quotes omitted)), failing to avoid "internally inconsistent and inadequate[]" explanations (*Gen. Chem. Corp. v. United States*, 817 F.2d 844, 846 (D.C. Cir. 1987)), and not "treat[ing] similar cases in a similar manner" (*Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996)).

Third, the CFTC violated the CEA's mandate to "evaluate[]" the costs and benefits of the choices it makes in crafting a "regulation." 7 U.S.C. § 19(a); *see supra* 28-30.

Regulation Of "Entities" Instead Of "Activities"

Although Section 2(i) permits the Commission to regulate only overseas "activities" that "have a direct and significant connection with activities in or effect on commerce of the United

[28] Although the Seventh Circuit declined to adopt the Ninth Circuit's interpretation of the FTAIA, it did so because it saw significance in the fact that FTAIA—unlike the FSIA provision at issue in *Weltover*—contains a "requirement of 'substantiality' or 'foreseeability.'" *See Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845, 857 (7th Cir. 2012) (en banc) (citation omitted). The Seventh Circuit's rationale does not apply to Section 2(i), because the CEA—like the FSIA—contains no "foreseeability" requirement. *Id.* In any event, the Seventh Circuit's departure from the Supreme Court's interpretation of the term "direct" was mistaken.

States" (7 U.S.C. § 2(i)), the Cross-Border Rule impermissibly imposes many requirements based on the *status* of the trading *entity*. For example, the Rule provides that application of the Title VII Rules depends on whether the counterparties are "non-U.S. persons," "foreign branches," "guaranteed affiliates," "conduit affiliates," etc. *See* 78 Fed. Reg. at 45368-71, Apps. C-F.

The CFTC attempted to justify this assertion of regulatory authority by claiming that Section 2(i) permits regulation of "persons" whose activities have the requisite "direct and significant" connection with or effect on U.S. commerce. *Id.* at 45301. This was an exceptionally broad assertion, for the Commission also interpreted Congress's use of the plural "activities" as requiring an assessment of whether activities, when "viewed as a class or in the aggregate," have the requisite "direct and significant" connection with or effect on U.S. commerce. 78 Fed. Reg. at 45300 & n.75. But if Congress had intended to authorize the CFTC to regulate foreign entities that affect U.S. commerce, it would have provided that authorization. Indeed, Congress authorized the SEC to regulate a narrow category of certain "*persons* [who] transact[] a business in security-based swaps without the jurisdiction of the United States" (15 U.S.C. § 78dd(c) (emphasis added)), but provided no such authorization to the CFTC. Instead, Congress authorized the CFTC to regulate only certain foreign *activities* that have a "direct and significant" connection with or effect on U.S. commerce—any regulation must be tethered to that narrow statutory authorization. *See Morrison*, 130 S. Ct. at 2883; *Microsoft Corp.*, 550 U.S. at 454-56; *Arabian Am. Oil Co.*, 499 U.S. at 274-75. Even if the Commission's interpretation were correct, moreover, it could not justify the instances where the final Rule regulates entities on a transaction-by-transaction basis. *See, e.g.,* 78 Fed. Reg. at 45350 n.513.

The Rule's erroneous focus on entities, rather than "activities," is exemplified by its pervasive regulation of "U.S. persons." As the Supreme Court made clear in *Arabian American Oil Company*, the presumption against extraterritoriality restricts application of U.S. law beyond the borders of the United States, including to corporations whose home is the United States. *See* 499 U.S. at 246-48. The Cross-Border Rule turns this rule on its head by presuming that "U.S. persons" must comply with U.S. law wherever in the world they go, and then proceeding to impose *all* of the Title VII Rules' requirements on any transactions those persons engage in, with anyone, anywhere in the world. *See* 78 Fed. Reg. at 45369-70, Apps. D-F. This assertion of regulatory authority over any "U.S. person"—without any determination that its non-U.S. activities, individually *or* in the aggregate, have a "direct and significant connection with activities in, or effect on, commerce of the United States"—violates Section 2(i) and the presumption against extraterritoriality.

Aggregation Requirements On Certain Foreign Affiliates

During the comment period, the CFTC proposed that, for purposes of determining whether a swap dealer has exceeded the *de minimis* threshold triggering numerous Title VII requirements, a "non-U.S. person" would have to aggregate its swap dealing transactions with the swap dealing transactions of all its corporate affiliates that are "under common control," subject to limited exceptions. 78 Fed. Reg. at 911. Among other problems identified with this were, first, that forcing *all* foreign affiliates "under common control" to aggregate their relevant swaps would erroneously "equat[e] . . . shared corporate parenthood with an implied coordinated swap dealing strategy." Comments from SIFMA et al. on 78 Fed. Reg. 909 at B-11 (Feb. 6, 2013). Yet if there is no coordinated swaps strategy, there is no possibility that the parent is acting to evade the entity registration requirements, which is the purpose of the aggregation rule in the first place. *Id*. Second, commenters argued that transactions between a foreign affiliate

and another foreign entity should not count towards the *de minimis* threshold because they lack a sufficient nexus to U.S. commerce. Comments from ISDA on 78 Fed. Reg. 909 at 4 (Feb. 6, 2013).

In retaining an aggregation requirement in the final Rule, the Commission never addressed SIFMA's objection that when a parent company does not coordinate its swap strategy with its foreign subsidiaries, there is no legitimate reason to aggregate the parent's swaps with the subsidiaries'. The CFTC therefore failed to respond to "significant" public comments (*HBO*, 567 F.2d at 35 & n.58), and failed to provide a "satisfactory explanation" for its decision (*State Farm*, 463 U.S. at 43). The Commission also violated the CEA by not "evaluat[ing]" the substantial costs of imposing the Title VII Rules on foreign affiliates in circumstances with a negligible relationship to U.S. commerce. 7 U.S.C. § 19(a).

The final Rule's registration requirements for foreign affiliates also exceed the CFTC's extraterritorial authority under Section 2(i). As a threshold matter, the requirement is in part entity-based—rather than activity-based—and violates Section 2(i) for that reason. *See supra* 32-34. Furthermore, the Rule requires aggregation of foreign affiliate swaps even when any U.S. relationship is remote: specifically, a foreign affiliate's swaps with a guaranteed or conduit affiliate, with certain exceptions; and a guaranteed or conduit affiliate's swaps with any foreign entity. 78 Fed. Reg. at 45326. If a U.S. parent company had only these types of foreign affiliates "under common control," then one of the affiliates could be forced to register as a swap dealer or major swap participant even if it engaged in less than the *de minimis* threshold of swaps trading, and even if all of its trading was with other foreign entities. In other words, even though the Commission may have deemed the swaps of each affiliate too insignificant to regulate on their own, the aggregation requirement could force one or more of the affiliates to register—

which, in turn, would trigger new Entity-Level and Transaction-Level Requirements on those affiliates' trades with certain foreign entities.[29] The SEC has declined to take a similar approach, instead stating that forcing foreign entities to register in this way would only impose costs without "materially increas[ing] the programmatic benefits of the dealer registration requirements." 78 Fed. Reg. at 31146.

Guaranteed Affiliates And Foreign Branches Of U.S. Persons

The Cross-Border Rule violates Section 2(i) by imposing Transaction-Level Requirements on certain transactions because they involve foreign branches of "U.S. persons," or involve foreign-based affiliates of "U.S. persons" and the U.S. company provides a financial "guarantee" of the foreign affiliate's obligations (so-called "guaranteed affiliates").

Under the Rule, when two foreign affiliates guaranteed by "U.S. persons" execute a swap, they must comply with various Transaction-Level Requirements. *E.g.,* 78 Fed. Reg. at 45369, App. D. Yet the only possible tie such a transaction has to U.S. commerce is through each affiliate's guarantee. That guarantee does not have a "*direct* and *significant* connection with activities in, or effect on, commerce of the United States." 7 U.S.C. § 2(i) (emphases added). On the contrary, there will not be any impact on U.S. commerce unless the guaranteed affiliate defaults—which will not occur in most circumstances—and the U.S. entity assumes its obligation. Because default is far from "unavoidable" (*I.T. Consultants,* 351 F.3d at 1190-91), and "depends on . . . uncertain intervening developments" (*LSL Biotechs.*, 379 F.3d at 681), the transaction has no "*direct*" effect on, or connection with, U.S. commerce.

[29] *Compare* 78 Fed. Reg. at 45368, App. C (most Entity-Level Requirements apply only to registered swap dealers); *with id.*at 45370, App. F (no Transaction-Level Requirements apply to swaps between an unregistered foreign entity that is not a guaranteed or conduit affiliate and another foreign entity, whether or not it is a guaranteed or conduit affiliate).

The Rule's imposition of Transaction-Level Requirements on transactions involving foreign branches of "U.S. persons" also violates Section 2(i). The CFTC treats the foreign branch of a "U.S. person" as a "U.S. person" (78 Fed. Reg. at 45315) and—based on the erroneous assumption that it may regulate a "U.S. person" anywhere in the world—imposes Transaction-Level Requirements on nearly all transactions by that foreign branch, *id.* at 45369-70, Apps. D, F. This assumption that U.S. law automatically applies to the activities of U.S. persons abroad, without regard to the "effect on" or "connection with" U.S. commerce, is flatly inconsistent with Section 2(i) and the presumption against extraterritoriality. *See supra* 34.

The CFTC further violated the CEA by failing to mention, let alone "evaluate[]," the substantial costs of imposing the Title VII Rules on guaranteed affiliates and foreign branches of U.S. persons. 7 U.S.C. § 19(a). For example, commenters pointed out that imposing Title VII's requirements on foreign affiliates or branches of U.S. entities would induce those entities to separately capitalize, imposing on customers the costs of increased capitalization and re-documentation of existing relationships. Comments from JP Morgan on 77 Fed. Reg. 41213 at 4 (Aug. 27, 2012). The CFTC ignored those comments and never considered these costs.

Affiliate Conduits

Under the Commission's proposed Cross-Border Rule, Transaction-Level Requirements would apply to all swaps between a foreign swap dealer (or major swap participant, or "MSP") and a so-called "affiliate conduit" of a U.S. person. 77 Fed. Reg. at 41228-29. An affiliate conduit is a "non-U.S. person"—normally a subsidiary of a U.S. parent company—that generally acts as a centralized "treasury" to consolidate expertise, net exposures, and manage the company's risk globally. 78 Fed. Reg. at 45358. An affiliate conduit typically enters into internal swaps directly with its affiliates, nets the exposures of those swaps, and then enters into

a reduced number of external swaps directly with third parties to hedge the risk of the U.S. parent company and its affiliates on a global basis. *Id.* This arrangement is a common best practice allowing companies to manage risk efficiently while reducing risk to the total market.

The proposed Rule intended to impose requirements not only on the affiliate conduit's transactions with other affiliates—the internal swaps—but also on its transactions with unrelated foreign entities—the external swaps. 77 Fed. Reg. at 41229. Commenters explained that this proposal was irrational because swap transactions between two foreign entities do not necessarily introduce new risk into U.S. financial markets; indeed, because affiliate conduits typically act as hedging centers, they often reduce risk in and re-allocate risk *away from* U.S. markets.[30]

The CFTC failed to correct the error these comments identified, and assumed instead that the risk of *all* of the affiliate conduit's swaps "in fact" resides with its U.S. affiliate. 78 Fed. Reg. at 45358. The Commission therefore retained this part of the affiliate conduit requirement in its proposed form, then claimed—without support—that "it is irrelevant whether the risk is wholly or partly transferred back to the U.S. affiliate(s); the jurisdictional nexus is met by reason of the trading relationship between the conduit and the affiliated U.S. persons." 78 Fed. Reg. at 45359 n.588. This rationale again loses sight of the fact that the CFTC's cross-border authority is limited to activities with a "direct and significant" relationship with U.S. commerce—jurisdiction over one set of activities of an entity (in this case, the internal swaps) does not confer authority over all of the entity's other activities (here, the external swaps) without regard to *those* activities' U.S. relationship. In fact, the external swaps' relationship to the United States is not "direct" because it hinges on whether the affiliate conduit transfers risk *back* to a U.S. affiliate—

[30] Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 4 (Aug. 27, 2012); *accord* Comments from SIFMA on 77 Fed. Reg. 41214 at A-22 (Aug. 27, 2012); Comments from Sullivan & Cromwell on 77 Fed. Reg. 41214 at 6-8 (Aug. 13, 2012).

a possibility that is "speculative" (*LSL Biotechs.*, 379 F.3d at 681-82), "depends on . . . uncertain intervening developments" (*id.* at 681), and is wholly "[]avoidable" (*I.T. Consultants*, 351 F.3d at 1190), since the conduit could decide to reallocate the risk of the external swaps among non-U.S. affiliates only.

The Commission's treatment of affiliate conduits also violated the APA and the CEA's cost-benefit requirement. Nowhere did the Commission respond to the commenters' argument that end-users typically use affiliate conduit trades "as an internal allocation of risk [that is, to *reduce* risk to U.S. markets]—not as speculative trades that create risk." Comments from Coalition for Derivatives End-Users on 77 Fed. Reg. 41214 at 4 (Aug. 27, 2012). In ignoring this objection, the CFTC violated the APA by failing to respond to "significant" public comments (*HBO*, 567 F.2d at 35 & n.58), and failing to provide a "satisfactory explanation" for its decision (*State Farm*, 463 U.S. at 43). And the Commission failed to mention, let alone "evaluate[]," the substantial costs of imposing the Title VII Rules on affiliate conduits (7 U.S.C. § 19(a)), such as commenters' concern that the Rule "could likely result in non-U.S. swap dealers no longer doing business with entities deemed to be non-U.S. affiliate conduits." Comments from SIFMA on 77 Fed. Reg. 41213 at A-22-23 (Aug. 27, 2012); *see Bus. Roundtable*, 647 F.3d at 1152.

Substituted Compliance

In the proposed Cross-Border Rule, the Commission provided that "substituted compliance"—that is, the ability to adhere to foreign law in lieu of U.S. requirements—would be available to foreign entities for swaps only with non-U.S. counterparties, not with U.S. counterparties. *See* 77 Fed. Reg. at 41230. In other words, a Japanese swap dealer transacting with a German affiliate guaranteed by a U.S. firm could potentially discharge its Title VII

obligations by complying with comparable Japanese law. But if that same Japanese swap dealer transacted directly with the U.S. firm, no substituted compliance would be available—the Japanese firm would have to comply with all applicable Title VII requirements as well as the requirements of Japanese law. Commenters responded by explaining that the Japanese swap dealer is *already subject* to requirements in its jurisdiction of Japan: failing to afford substituted compliance to the Japanese firm would thus produce duplicative and often conflicting regulation. *See* Comments from SIFMA on 77 Fed. Reg. 41214 at A-47 (Aug. 27, 2012). Because some foreign entities frequently trade with U.S. firms, they would "have to build [new] systems to comply with U.S. requirements" in those transactions. *Id.* At that point, it would be more cost-efficient for the foreign firm to use those U.S. compliance systems in all transactions, including transactions outside the CFTC's purview, rather than try to use one compliance system for some transactions, and another system for others. *Id.* As a result, the Title VII Rules would become the *de facto* standard for swaps around the globe. *Id.*

The final Cross-Border Rule adopted this aspect of the substituted compliance regime unchanged, without ever addressing the concern that it could make U.S. law the *de facto* global standard and thereby undermine international comity. *See* 78 Fed. Reg. at 45342-45. The CFTC thus failed to respond to "relevant" and "significant" public comments (*HBO*, 567 F.2d at 35 & n.58), and failed to provide a "satisfactory explanation" for its action (*State Farm*, 463 U.S. at 43), in violation of the APA. There is no "legitimate reason" (*Indep. Petroleum Ass'n*, 92 F.3d at 1258)—and the CFTC has given none—to offer substituted compliance to foreign entities in some transactions, but not in similarly situated transactions. Notably, the SEC declined to take this approach because of concern with creating competitive disadvantages for U.S. firms, and has

instead proposed to permit substituted compliance whenever a transaction between a foreign and a U.S. entity occurs abroad. 78 Fed. Reg. at 31093-94.

The CFTC also violated the CEA because it failed to mention, let alone "evaluate[]," the substantial costs of imposing the Title VII Rules on foreign companies that are already regulated by vigilant foreign regulators. 7 U.S.C. § 19(a); *see Am. Equity*, 613 F.3d at 178-79.

U.S. Branches And Personnel Of Foreign Entities

In the proposed Cross-Border Rule, the CFTC stated that it would "*not require* the application of . . . Transaction-Level Requirements to swaps between a non-U.S. swap dealer or non-U.S. [major swap participant] with a non-U.S. counterparty that is not guaranteed by a U.S. person." 77 Fed. Reg. at 41229 (emphasis added). In the final Cross-Border Rule, however, the Commission reversed course, imposing new requirements—without the availability of substituted compliance—on transactions between "a U.S. branch of a non-U.S. swap dealer or MSP" and another non-U.S. counterparty. 78 Fed. Reg. at 45350 n.513. Expounding upon this unexpected mandate, in November 2013 CFTC staff issued an "advisory" stating that the Cross-Border Rule extends Transaction-Level Requirements to swaps between two foreign entities whose sole connection to the United States is that one "regularly us[es] personnel or agents located in the U.S. to arrange, negotiate, or execute [the] swap." DSIO Advisory at 2. A subsequent no-action letter gave firms until January 2014 to comply. CFTC Letter No. 13-71.

This 180-degree change from the proposed to final rule is one that no commenter "[c]ould have anticipated" (*Ne. Md. Waste Disposal Auth. v. EPA*, 358 F.3d 936, 952 (D.C. Cir. 2004)), and violates the bedrock APA requirement that the terms of a final rule be the "logical outgrowth" of the proposal (*Envtl. Integrity Project*, 425 F.3d at 996). The unanticipated change denied the public the opportunity to explain that the position taken in the Rule—and elaborated

upon in the DSIO Advisory—would have significant harmful effects, including driving foreign entities to stop using U.S. branches or U.S. employees to execute trades, but would have no cognizable benefits, since in a transaction between two non-U.S. entities, any risk resides abroad.

The CFTC also failed to "articulate a satisfactory explanation" for this requirement. *State Farm*, 463 U.S. at 43. By the CFTC's own logic, the "strong supervisory interest" of foreign regulators, cited in the proposal, does not wane because one foreign entity happens to use a U.S. branch to facilitate a swap with another foreign entity. It was "internally inconsistent" (*Gen. Chem. Corp.*, 817 F.2d at 846) for the CFTC to honor a foreign jurisdiction's interest in some cases, but not others. In fact, for *every other transaction between non-U.S. counterparties*, the CFTC permits substituted compliance (or admits that Title VII does not apply). *See* 78 Fed. Reg. at 45369-70, Apps. D, F. Yet the CFTC did not address why substituted compliance is unavailable in the circumstances of a foreign entities' use of U.S.-based branches and personnel, nor did it offer any explanation—let alone a "satisfactory" one (*State Farm*, 463 U.S. at 43)—for why many Transaction-Level Requirements must apply.

Finally, the Commission violated the CEA's cost-benefit requirement because it failed to mention, let alone "evaluate[]," the substantial costs of imposing the Title VII Rules on foreign market participants simply because they rely upon U.S. branches or U.S. personnel to execute their swaps, especially where the risk entirely remains abroad. 7 U.S.C. § 19(a).

C. The Court Should Vacate The Cross-Border Rule And Enjoin The CFTC From Implementing It, And Should Declare That The Title VII Rules Have No Cross-Border Application And Prohibit Any Such Application

Because the CFTC adopted the Cross-Border Rule without even purporting to comply with the APA and the CEA, this Court should vacate the Rule. That is the remedy prescribed by statute (*see* 5 U.S.C. § 706(2) (the court "shall . . . set aside such agency action")), and invariably imposed by courts when agencies adopt a substantive rule under the guise of a "general

statement of policy." *See, e.g.*, *Nat. Res. Def. Council*, 643 F.3d at 323; *CropLife Am. v. EPA*, 329 F.3d 876, 884-85 (D.C. Cir. 2003); *Gen. Elec.*, 290 F.3d at 385; *Appalachian Power*, 208 F.3d at 1028; *Neb. Dept. of Health & Human Servs. v. U.S. Dept. of Health & Human Servs.*, 340 F. Supp. 2d 1, 25-26 (D.D.C. 2004). The CFTC's errors in adopting the Cross-Border Rule are clear, profound, and costly to market participants in the United States and the world over; for that reason too, the Rule must be vacated and the CFTC should be enjoined from implementing it.

Because the Cross-Border Rule is invalid and the plain text of the Title VII Rules does not address those Rules' extraterritorial application, the Court should declare that the Title VII Rules do not apply abroad and enjoin the Commission from applying them extraterritorially until valid cross-border rule is promulgated. Such a declaration will put to rest the Commission's claim that Section 2(i) itself "provides for the application of" the Title VII Rules extraterritorially, *see* 78 Fed. Reg. at 45297, and forestall the enforcement action "realistically threatened" by the expiration of "exemptive" and "no action" relief, and by Chairman Gensler's warnings to firms to "come into compliance," *supra* 10 & n.24. *See Haase v. Sessions*, 835 F.2d 902, 910-11 (D.C. Cir. 1987).

Alternatively, if the Court determines that the Title VII Rules have cross-border application, the Commission's adoption of those Rules was arbitrary and capricious because their cross-border application was not considered or addressed. An "important aspect of the problem" was therefore ignored; countless public comments were given short shrift; the statutory duty to conduct a cost-benefit analysis was not fulfilled. These failures ordinarily would require this Court to "set aside" the Title VII Rules too. 5 U.S.C. § 706(2); *see, e.g.*, *Bus. Roundtable*, 647 F.3d at 1156 (vacating rule for deficient cost-benefit analysis and failure to respond adequately to comments); *Am. Equity*, 613 F.3d at 179 (same). Plaintiffs, however, seek a narrower remedy:

partial vacatur of the Rules to the extent the CFTC claims they have extraterritorial application. *See, e.g.*, *Davis Cnty. Solid Waste Mgmt. v. EPA*, 108 F.3d 1454, 1460 (D.C. Cir. 1997).

Regardless of how the Court ultimately frames the remedy with regard to the Title VII Rules (injunction or vacatur), the Commission should—at the very minimum—be prohibited from: (1) employing or applying the "U.S. person" definition in the Cross-Border Rule, such as by treating a "foreign branch" as a "U.S. person"; (2) applying the Title VII Rules to swaps transactions in which both parties are organized or incorporated under the laws of a jurisdiction outside the United States, even if one party is a guaranteed or conduit affiliate of a "U.S. person"; (3) applying the "Transaction-Level Requirements" of the Title VII Rules to swaps with non-U.S. swap dealers or major swap participants, regardless of whether the counterparties use U.S. branches or U.S. personnel to execute their swaps; and (4) applying the SEF Registration Rule to non-U.S. multilateral trading platforms that limit the execution of swaps to counterparties organized or incorporated under the laws of a jurisdiction outside of the United States.

This relief as to the Title VII Rules is warranted by the Rules' terms and the underlying rulemakings, and also is essential to giving effect to a court order vacating the Cross-Border Rule. Absent such relief, the Commission might seek to continue to apply the Cross-Border Rule through the Title VII Rules, which would nullify the Court's order vacating the Cross-Border Rule and would perversely permit the Commission to give extraterritorial effect to the Title VII Rules even though those Rules do not purport to apply extraterritorially, and even though the Commission steadfastly refused to address extraterritoriality when adopting those Rules.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that this motion for summary judgment be granted, and that the Court enter the relief requested herein.

Dated: December 27, 2013

Corrected: January 23, 2014

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 23rd day of January, 2014, I caused the foregoing (Corrected) Motion for Summary Judgment and accompanying memorandum to be filed and served via the Court's CM/ECF filing system.

/s/ Eugene Scalia
Eugene Scalia

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, and INSTITUTE OF INTERNATIONAL BANKERS, Plaintiffs, v. UNITED STATES COMMODITY FUTURES TRADING COMMISSION, Defendant.	Civil Action No. 13-CV-1916 (ESH)

[PROPOSED] ORDER

Upon consideration of Plaintiffs' Motion for Summary Judgment, the response of the United States Commodity Futures Trading Commission thereto, Plaintiffs' reply, and all other arguments submitted to the Court in the parties' papers and at oral argument, it is hereby

ORDERED that Plaintiffs' motion for summary judgment is **GRANTED**; and that it is further

ORDERED that the final rule promulgated by the Commission on July 26, 2013, and set forth at 78 Fed. Reg. 45292 is **VACATED** and the Commission and its officers, employees, and agents are **ENJOINED** from implementing, applying, or taking any action whatsoever to enforce that rule, including through guidance or advisory (including the Nov. 14, 2013 DSIO Advisory and Nov. 15, 2013 DMO Guidance), until the Commission promulgates a cross-border rule that is consistent with the Administrative Procedure Act, the Commodity Exchange Act, and all other provisions of law; and that it is further

ORDERED that the following final rules promulgated by the Commission—Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43851 (July 22, 2011); Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012); Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012); Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613, 2614 (Jan. 19, 2012); Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128 (April 3, 2012); Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278 (April 9, 2012); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 Fed. Reg. 30596 (May 23, 2012); Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35200 (June 12, 2012); Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904 (Sep. 11, 2012); Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74284 (Dec. 13, 2012); Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 Fed. Reg. 33606 (June 4, 2013); and Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476 (June 4, 2013)—are **DECLARED** to not apply to activities outside the United States and the Commission and its officers, employees, and agents are **ENJOINED** from implementing,

applying, or taking any action whatsoever to apply or enforce these rules extraterritorially, including through guidance or advisory (including the Nov. 14, 2013 DSIO Advisory and Nov. 15, 2013 DMO Guidance) until the Commission promulgates a final rule defining such extraterritorial application in accordance with the Administrative Procedure Act, the Commodity Exchange Act, and all other provisions of law.

ENTERED this ___ day of _____, 2014.

_____
ELLEN S. HUVELLE
United States District Judge

cc:

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