U.S. COMMODITY FUTURES TRADING COMMISSION

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

KOCH SUPPLY & TRADING, LP, Plaintiff, v. JAMES W. GIDDENS, Trustee for the SIPA Liquidation of MF Global Inc., Defendant.	No. 1:12-cv-05596-NRB

REPLY BRIEF OF THE COMMODITY FUTURES TRADING COMMISSION IN SUPPORT OF THE TRUSTEE'S MOTION FOR SUMMARY JUDGMENT

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The rule at issue is simple: as required by the Bankruptcy Code, every public customer shares equally in the loss when there is a shortfall in a given customer estate, no matter what form of collateral the customer used to margin its futures positions. *See* 11 U.S.C. §§ 761(10), 766(h); 17 C.F.R. § 190.08(a). If the customer used a letter of credit, the "full proceeds" of the letter become customer property subject to pro rata distribution. 17 C.F.R. § 190.08(a)(1)(i)(E). "Full proceeds" means nothing more complicated than the full amount secured by the letter. This is both the ordinary meaning of those words and the meaning specified by the CFTC in the Federal Register release accompanying the rule. *Bankruptcy*, 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983). The rule is necessary to prevent large traders from seizing unfair advantage in bankruptcy; to give all participants assurance that they will be treated equitably; and to prevent the deterioration of the collateral base upon which the safe functioning of these markets depends. Plaintiff KS&T does not argue that this reasoning is arbitrary or capricious, which is the applicable standard. *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 843-44 (1984). The CFTC has interpreted the rule consistently since it was proposed in 1981, including when new facts presented themselves here and in *ConocoPhillips Co. v. Giddens*, No. 12-cv-6014-KBF (S.D.N.Y.). Indeed, the Commission's most recent interpretation, which confirms that equitable treatment of customers does not depend on any given letter of credit's expiration date, is required for such equity and consistency.[1]

Objecting to the burdens of the Commission's longstanding, reasonable approach, Plaintiff KS&T has devised an alternate interpretation that would conveniently absolve it of any liability and thereby shift additional bankruptcy loss onto other customers. But Plaintiff's theory rests on a number of unreasonable premises: For example, Plaintiff argues (1) that KS&T has no

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[1] Ordinarily, a customer who posted a letter of credit as margin would also have a claim against the estate, just like any other customer, based on the full amount deemed customer property. Here, KS&T's claim was denied as untimely, and KS&T's complaint does not challenge that denial. The Commission expresses no view on the issue.

liability here because the $20 million in dispute is not "property" (Doc. 43 at 19-20);[2] (2) that the CFTC has misunderstood the words it used in Rule 190.08(a)(1)(i)(E) since it proposed them in 1981 (Doc. 36-1 at 15 n.14; Doc. 43 at 17-18); and (3) that a market participant trying to understand those words would naturally interpret them by reference to an isolated provision of the Uniform Commercial Code – but never by reference to the accompanying Federal Register release (Doc. 43 at 19). Indeed, Plaintiff urges the Court to ignore the Federal Register release altogether (Doc. 36-1 at 15 n.14; Doc. 43 at 17-18), except in one narrow sense conceived, again, to absolve KS&T of any liability – Plaintiff argues that certain phrases and partial sentences in the release that include the word "draw" decide the expiration issue in its favor (Doc. 43 at 22). But, KS&T also insists that the Court ignore all context for those phrases and partial sentences, because, Plaintiff admits, the release "does not address" the issue. (*Id*. at 9.) The Commission submits that none of this is persuasive, let alone "compelled," as would be required to disturb the CFTC's authoritative view. *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994).

In light of the "controlling" deference owed to an agency's interpretation of its own rules, *Auer v. Robbins*, 519 U.S. 452, 461 (1997), Plaintiff urges the Court alternatively to hold that Congress unwittingly voided Rule 190.08(a)(1)(i)(E) in the Legal Certainty for Bank Products Act of 2000 ("Legal Certainty Act"). However, KS&T misreads the statute, and the theory has so little to commend it that Plaintiff's opening brief confined it to a partial footnote. (Doc. 36-1 at 15 n.14.) KS&T's final theory – that the CFTC has exceeded its authority to preempt state law – did not merit even that mention. With good reason: it would require the Court to (1) ignore the specific provisions in KS&T's contract with MF Global in which it agreed that federal law would apply (Doc. 35-6, ¶¶ 2, 29.A.); and (2) hold that transactions in which a customer provides

[2] References to "Doc. _" are to bankruptcy-court docket entries in *Koch Supply & Trading v. Giddens*, Adv. Pro. No. 12-01754 (MG) (Bankr. S.D.N.Y.). Page references in those citations are to the ECF-stamped numbers rather than to the document's internal numbering.

letters of credit in consideration for commodity futures contracts are not "transactions involving" commodity futures, which are subject to the CFTC's exclusive jurisdiction (Doc. 43 at 22-23). Neither is supportable. As discussed below, the Trustee is entitled to summary judgment.

I. KS&T's Interpretation of 190.08(a)(1)(i)(E) is Not "Compelled," But Wrong.

1. "Full proceeds" cannot mean what KS&T urges – the amount needed to cover customer margin obligations – because such payments would not typically be "customer property." (Doc. 40 at 14.) KS&T's states in its opposition that its letter served as "initial margin" (Doc. 43 at 15), which is a term defined in CFTC regulations to mean property held by the FCM to cover "future exposures," *i.e.*, potential losses, "arising from changes in the market value" of the customer's positions. 17 C.F.R. § 1.3(bbb)-(ccc). That is, when a futures position loses value, the clearinghouse will make a "variation margin call" to the FCM. *The Bankruptcy Reform Act: Hearings Before the Subcomm. on Improvement in Judicial Machinery of the S. Comm. on the Judiciary*, 94th Cong. 59 (1977) (statement of CFTC Chairman William T. Bagley) ("Bagley Test.").[3] The FCM must respond with a variation margin payment. *See* 17 C.F.R. § 1.3(fff). When such payments pertain to customer accounts, the FCM's first recourse is to the customer's posted collateral. Bagley Test. 59. Unlike some forms of margin payment that constitute "deposits" to which a customer retains rights, variation payments are "losses." *Id*. 56. "Once paid out . . . they are gone." *Id*. In a liquidation, because no customer has a claim to those funds, they are outside the definition of "customer property." 11 U.S.C. § 761(10)(B).

[3] The specialized commodity-broker liquidation provisions of the Bankruptcy Code were "derived largely from the testimony of Chairman Bagley." H.R. Rep. 95-595, at 271 (1977), *reprinted in*1978 U.S.C.C.A.N. 5963. The Chairman's descriptions of the mechanics of the futures markets and the unique problems associated with commodity broker bankruptcies are exceptionally clear and may be useful to the Court. This testimony is available at http://archive.org/details/bankruptcyreform00unit (last visited Jan. 7, 2013).

Customers do retain rights to certain "margin" *deposits*, but such deposits made post-petition nevertheless are outside the scope of "customer property" (and therefore outside the scope of Rule 190.08) because they are not subject to pro rata distribution. 17 C.F.R. § 190.01(n) (restricting "customer property" to assets to be distributed pro rata). In a liquidation, the trustee of an FCM is empowered to continue making variation payments from customer initial margin. *Id*. § 190.02(g)(1). When a customer's initial margin drops below a specified level, Part 190 directs the trustee to make a margin call to that customer. *Id*. To protect customers who wish to supply additional margin to maintain open positions post-petition, Part 190 provides that such deposits must *not* be subject to pro rata distribution as "customer property." *Id*. §§ 190.02(g)(3), 190.07(c)(1)(ii)-(d)(1); *see also* 48 Fed. Reg. at 8726 ("This should facilitate the payment of margin because such payments will not be diluted in a pro rata distribution."). Instead, those margin deposits, from whatever source, must be credited entirely to the account of the customer on whose behalf they are made. *Id*. Thus, by definition, they are not "customer property," 17 C.F.R. § 190.01(n), and the "proceeds" referenced in Rule 190.08(a)(1)(i)(E) as a component thereof cannot, as KS&T asserts, be *limited* to those amounts.

2. While KS&T suggests that the UCC definition of "proceeds" is somehow implicit in the "plain language" of Rule 190.08(a)(1)(i)(E) (Doc. 43 at 7, 19), the UCC's very inclusion of such a statutory definition suggests that the ordinary meaning of that term, which applies here, was *not* intended in the UCC. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) ("When terms used in a statute are *undefined*, we give them their ordinary meaning." (emphasis added)). Part 190 contains no such definition, nor any cross-reference to the UCC, and the term's ordinary meaning therefore applies. *Id*. Although KS&T takes apparent issue with the particular dictionary the CFTC cited in its opening brief (Doc. 43 at 20), the ordinary meaning of

the word "proceeds" is not controversial, and authorities are broadly in agreement with the CFTC that it means the "value" of an item "when converted into money," *Black's Law Dictionary* 1325 (9th ed. 2009), or "upon selling, *exchanging*, collecting or *otherwise disposing* of collateral," *id*. (emphases added); *see also* XII *Oxford English Dictionary* 544 (2d ed. 1989) ("That which . . . is derived, or results from something"); *Webster's Third New Int'l Dictionary* 1807 (1986) ("what is produced by or derived from something . . . by way of total revenue: the total amount brought in"). And, while KS&T correctly points out that Part 190 distinguishes "value" from "proceeds" (Doc. 43 at 20 n.10), the distinction favors the Trustee – "value" is used where the trustee is to make a calculation, *see, e.g.*, 17 C.F.R. § 190.06(e)(2), while "proceeds" is used where, as here, the trustee is to collect money, *see*, *e.g.*, *id*. § 190.08(a)(1)(ii)(I).[4]

3. Thus unable to offer even a plausible interpretation of the rule text, KS&T resorts to a series of groundless attacks, not only on the Trustee, but also on the CFTC's own motivation. For example, Plaintiff asserts without any basis that the Commission's views on the expiration issue are unreliable because they "came in direct response to a recent finding" (Doc. 43 at 9) by Judge Forrest that the 1983 Federal Register release "does not address how a Trustee should treat expired letters of credit." *ConocoPhillips Co. v. Giddens*, 2012 WL 4757866, at *6 n.11 (S.D.N.Y. Oct. 4, 2012). But the causal connection posited by KS&T is, factually, false: Judge Forrest's observation was hardly a "finding" – it was a statement of self-evident fact, and it provoked no "response" from the CFTC.

Even so, there is nothing improper about an agency interpreting its regulations in response to new facts not previously subject to specific guidance. *Smiley v. Citibank (S.D.), N.A*, 517 U.S. 735, 744 n.3 (1996) (stating that it would be "absurd" to ignore such guidance).

[4] KS&T suggests that such "proceeds" are not "property" and, therefore, not covered by Rule 190.08(a)(1) (Doc. 43 at 19), but "[m]oney, of course, is a form of property." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 338 (1979).

Indeed, Congress authorized the CFTC to "raise and appear and be heard on *any issue*" in a commodity broker liquidation. 11 U.S.C. § 762(b) (emphasis added). To disregard the CFTC's views simply because they pertain to novel issues would defeat the statute's purpose. In the same vein, KS&T misstates the law in asserting that notice and comment are a precondition to judicial deference to an agency interpretation. (Doc. 43 at 21.) The APA provides that there is no such requirement, 5 U.S.C. § 553(b)(3)(A), and courts consistently defer to interpretations set forth in briefs. *Talk Am., Inc. v. Mich. Bell Tel. Co.*, 131 S. Ct. 2254, 2261 (2011); *Auer v. Robbins*, 519 U.S. 452, 462 (1997); *Union Carbide Corp. v. Comm'r*, 697 F.3d 104, 109 (2d Cir. 2012); *Gen. Signal Corp. v. Comm'r*, 142 F.3d 546, 548 (2d Cir. 1998).

4. There is similarly no basis for KS&T's assertion that the views expressed "do[] not reflect the CFTC's fair and considered judgment." (Doc. 43 at 21.) Counsel's representations are sufficient to establish that they do. *Talk Am.*, 131 S. Ct. at 2257 n.1. There are exceptions, *see Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2166 (2012), but none applies here. This is not, for example, "a 'post hoc rationalization' . . . to defend past agency action." *Id*. The Trustee is an officer of the bankruptcy court, *In re Lehal Realty Assocs.*, 101 F.3d 272, 277 (2d Cir. 1996), not the CFTC. Nor has the Commission offered a "convenient litigating position," which is an exception also applicable to agency defenses of their own actions. *Christopher*, 132 S. Ct. at 2166; *see Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 206, 213 (1988). The CFTC was not even an original litigant here, and its only interest is to ensure that the law is applied correctly so that KS&T may not shift additional bankruptcy loss unfairly onto a subset of MF Global's customers. In that context, it is inappropriate for KS&T to accuse the government of complicity in a "scheme" by the Trustee "to leverage monies." (Doc. 43 at 8.) It

is sufficient to respond that the CFTC's only purposes are the public interest purposes set forth in Section 3 of the CEA. 7 U.S.C. § 5(b).

Lastly, the CFTC's interpretation does not "contradict[]" the 1983 release. (Doc. 43 at 22.) KS&T admits that the release "does not address how a Trustee should treat expired letters of credit," *ConocoPhillips*, 2012 WL 4757866, at *6 n.11 (Doc. 43 at 9) – conceding, in effect, as the CFTC has noted, that Plaintiff's case is based largely on misleading excerpts of partial sentences taken out of context from the release (Doc. 40 at 15). In fact, the CFTC's current interpretation is *required* for consistency with the 1983 release inasmuch as the rule was expressly premised, for stated policy reasons, on the need to treat letter-of-credit customers "no differently" from others in a liquidation. 48 Fed. Reg. at 8718-19.

Accordingly, there is no basis to disregard the Commission's authoritative view.

II. Section 27a Is Irrelevant.

As a fallback, KS&T urges the Court to construe the Legal Certainty Act as an implied repeal of Rule 190.08(a)(1)(i)(E). But the rule is consistent with Section 27a, which KS&T simply misreads: The statute states the CFTC may not "exercise regulatory authority under the [CEA] with respect to, an identified banking product." 7 U.S.C. § 27a. To "exercise regulatory authority . . . with respect to [a] product" is to establish and enforce rules of general applicability for that product; to exercise the CFTC's "regulatory authority under the [CEA]" is to regulate the product as if it were a future or swap. *See, e.g.*, *id*. §§ 6(b), 6a, 6r, 6s (examples of such regulatory authority). Section 27a does not purport to void *futures* regulations that apply only incidentally to other instruments, and only to the extent that a market participant chooses to use that instrument in a futures transaction. This is confirmed by the statute's legislative history, structure, and purpose, and the CFTC's interpretation is entitled to *Chevron* deference.

1. The Legal Certainty Act was Congress's response to a 1998 CFTC release indicating that the Commission "might seek to exercise regulatory authority" over financial products transacted by banks, *Derivatives & the Legal Origin of the 2008 Credit Crisis*, 30 Banking & Fin. Svcs. Policy Rep. 13, 18 (2011) (citing *Over-the-Counter Derivatives*, 63 Fed. Reg. 26114 (May 12, 1998)), including "swaps" and some "hybrid instruments," such as letters of credit with "commodity futures or option characteristics." 63 Fed. Reg. at 26116, 26120-21; 12 C.F.R. § 204.2 (a)(1) & (b)(1)(v). The release contemplated that the CFTC might exercise regulatory authority with respect to those products by requiring registration, minimum capital, internal controls, disclosures to customers, personnel supervision, recordkeeping, and financial reporting – much like the regime applicable to futures. 63 Fed. Reg. at 26124-27. Other regulators "question[ed] the scope of the CFTC's jurisdiction in this area,"[5] and Congress reacted swiftly by imposing a six-month "restraint period" in which the CFTC was barred from moving forward. Omnibus Consol. & Emergency Appropriations Act of 1999, Pub. L. 105-277, § 760, 112 Stat. 2681 (Oct. 21, 1998). Soon after, Congress passed the Legal Certainty Act, including Section 27a, to restrict the CFTC from moving to "exercise regulatory authority . . . with respect to" those products, as the 1998 release described.

2. The bill's Senate sponsor, Senator Lugar, explained that "this legislation provides certainty that products offered by banking institutions will not be regulated *as futures contracts*." 146 Cong. Rec. S11918, S11925 (Dec. 15, 2000) (emphasis added). Senator Harkin, then ranking member of the Senate committee with primary oversight of the CFTC (Senate Agriculture – Senator Lugar was Chairman), underscored that Section 27a did not roll back existing regulations, but simply "clarifie[d] what [wa]s already the current state of the law," in

[5] *See* Joint Statement by Treasury Sec'y R. Rubin, Fed. Reserve Bd. Chairman A. Greenspan, and SEC Chairman A. Levitt (May 7, 1998), *available at* http://www.treasury.gov/press-center/press-releases/Pages/rr2426.aspx.

which "[t]he [CFTC] d[id] not regulate traditional banking products[,] [including] . . . letters of credit." 146 Cong. Rec. S11896, S11896 (Dec. 15, 2000). Senator Gramm, then Chairman of the Senate Banking Committee, agreed, stating that the law would provide "certainty" that such products could "*continue* to be offered . . . without being subject to CFTC regulation." 146 Cong. Rec. S11855, S11867 (Dec. 15, 2000) (emphasis added); *see also* H. Rep. 106-711(II), 2000 WL 1279130, at *54 (Sept. 6, 2000) (defining "legal uncertainty" as the "risk that the CFTC or a court might determine that a particular" product "is an illegal off-exchange futures contract"). Rule 190.08(a)(1)(i)(E) predated Section 27a by 17 years, does not impose general requirements on bank products or regulate them as futures, and was, therefore, unaffected.

3. KS&T states that the CFTC – and, by extension, the bill's congressional sponsors and supporters – are confusing "regulatory authority" with "regulatory jurisdiction," which KS&T asserts is "narrowe[r]." (Doc. 43 at 26.) But KS&T cites no basis for that assertion, and the most natural interpretation is simply that the CFTC's "jurisdiction" over various products is set forth in CEA Section 2(a)(1)(A), 7 U.S.C. § 2(a)(1)(A) ("exclusive jurisdiction . . . with respect to . . . swaps or contracts of sale of a commodity for future delivery"), while its regulatory "authority" with respect to those products is delineated in other CEA sections, *see, e.g., id.* §§ 6(b) (authority to "adopt rules and regulations proscribing fraud and requiring minimum financial standards, the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of customers' funds, and registration"), 6a (authority to establish transaction "limits"), 6d (authority to regulate treatment of customer margin). Rule 190.08(a)(1)(i)(E) is not such a regulation "with respect to [a] . . . product." 7 U.S.C. § 27a(a).

4. In that context, Section 27a(a) cannot be understood correctly without reference to paragraphs (b) and (c) of the same section. *Comm'r v. Engle*, 464 U.S. 206, 223 (1984). In

Dodd-Frank, Congress granted the CFTC new regulatory authority over "swaps," *see, e.g.*, 7 U.S.C. §§ 2(h) (clearing), 6r (reporting and recordkeeping), 6s (registration and regulation of swap dealers and major swap participants), which product it defined broadly, *see id*. § 1a(47), so that without a separate exclusion, certain bank products might be subject to CFTC regulation. Congress therefore revised Section 27a, structuring it in a way that confirms its purpose to establish the proper regulator for products near the dividing line between swaps and traditional banking instruments: While paragraph (a) contains the "identified banking products" exclusion, paragraphs (b) and (c) establish exceptions to that exclusion for products structured "for the purpose of evading *the provisions of* the" CEA. *Id*. § 27a(b)-(c) (emphasis added). Where there is such evasion, the product may be, in effect, deemed a swap, subject to comprehensive regulation as a product by the CFTC. *Id*. Congress's reference to the collective "provisions of" the CEA underscores its intent to mark the perimeter around commodity derivatives regulation.[6] The statute, in other words, gives "legal certainty" to banks and their customers that their transactions will not be inadvertently drawn into the CFTC's regulatory regime, but there is no indication in the statue or legislative history that traders may be permitted to use particular types of collateral to access CFTC-regulated markets unfettered by CFTC regulations, like Rule 190.08(a)(1)(i)(E), that pertain *only* to the collateral's use in futures transactions.

5. KS&T's reading would also lead to absurd and potentially harmful results. For example, it is clear that the CFTC could altogether *bar* market participants from using letters of credit to margin futures trades. 7 U.S.C. § 12a(7)(D) (empowering the CFTC to set "margin

[6] Similarly, revised Section 27a is situated in Dodd-Frank Section 725, the main Dodd-Frank section establishing requirements for derivatives clearinghouses. P.L. 111-203, § 725, 124 Stat. 1376, 1685 (July 21, 2010). Those requirements are extensive, pertaining, *inter alia*, to participant and product eligibility, risk management, settlement procedures, rules for customer defaults, reporting, and recordkeeping. Banking regulators impose their own such requirements, and the placement of revised Section 27a among those provisions underscores Congress's intent to carve out "identified banking products" from dual regulation as futures or swaps. *Dobrova v. Holder*, 607 F.3d 297, 301 (2d Cir. 2010) (explaining that "the placement and purpose of th[e] words in the statutory scheme" is part of their "plain meaning" (internal quotation marks omitted)).

requirements" to protect the integrity of clearing organizations); *id*. § 12a(5) (plenary rulemaking authority); 17 C.F.R. § 39.13(g)(10) (stating that a clearinghouse "shall not accept letters of credit as initial margin for swaps"). But the Commission has declined to do so, recognizing that certain market participants find the practice useful. *But see Deriv. Clearing Org. Gen. Provisions & Core Principles*, 76 Fed. Reg. 69334, 69393 (Nov. 8, 2011) ("The Commission will monitor developments in this area and may revisit this issue in the future."). Instead, the Commission identified a specific risk – that using these instruments as collateral could unfairly harm other customers in the event of a bankruptcy – and imposed a condition, which market participants accept by their own actions. *See Almeida-Sanchez v. U.S.*, 413 U.S. 266, 271 (1973) ("The businessman in a regulated industry in effect consents to the restrictions placed upon him."). On KS&T's theory, the CFTC may *ban* the use of letters of credit as margin, but may not *permit* the practice, subject only to reasonable conditions designed to protect customers. There is no indication that Congress intended that anomalous result, and KS&T's interpretation should, accordingly, be rejected. *See United States v. Wilson*, 503 U.S. 329, 334 (1992).

6. KS&T's interpretation may also place in peril other important market regulations that Congress plainly did not intend to undermine. For example, CEA Section 4d establishes that an FCM must segregate customers' property deposited as margin – the requirement at the center of the MF Global controversy. *See* 7 U.S.C. § 6d(a)(2). A critical aspect of this protection is Section 4d(b), which renders it "unlawful" for any "depository" receiving customer property "for deposit in a separate account" to "hold, dispose of, or use such money, securities, or property as belonging . . . to any person other than the customers." *Id*. § 6d(b). Like the Part 190 Rules, Section 4d(b) is a condition one must accept in order to participate in transactions involving commodity futures. In so conditioning participation in the CFTC's jurisdictional markets, the

statute places a restriction on an identified banking product – a deposit account, *see* Gramm-Leach-Bliley Act § 206, Pub. L. No. 106–102, 113 Stat. 1338 (Nov. 12, 1999) – but, like Rule 190.08(a)(1)(i)(E), it applies only incidentally to the banking product to the extent the product is involved in a commodity transaction. Section 4d(b) does not regulate deposit accounts generally, but does regulate the use an FCM – or even a bank – may make of a deposit account holding property segregated for the benefit of futures customers. Contrary to KS&T's argument, Congress did not abrogate such critical protections, *sub silentio*, in Section 27a.[7]

7. To the extent KS&T has identified an ambiguity in Section 27a, the CFTC's interpretation is entitled to *Chevron* deference. *See* 467 U.S. at 842-43. *Chevron* applies where, as here, it is "apparent from the agency's generally conferred authority and other statutory circumstances that Congress would expect the agency to be able to speak with the force of law," *United States v. Mead*, 533 U.S. 218, 229 (2001), and the agency's "interpretive method" is sound, *Barnhart v. Walton*, 535 U.S. 212, 222 (2002). Here, Congress has granted the CFTC broad authority to determine what constitutes "customer property," 7 U.S.C. § 24(a), plenary power to establish regulations "as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of" the CEA, *id*. § 12a(5), which necessarily requires judgments as to the limits of the CEA's reach, as well as the unusual authority in FCM liquidations to "raise and appear and be heard on any issue," 11 U.S.C. § 762(b). The CFTC's interpretation of Section 27a is a direct exercise of each of these powers, is thorough, and relies on proper sources. *See Union Carbide*, 697 F.3d at 109 ("'Agencies are

[7] In this respect, Rule 190.08(a)(1)(i)(E) is no different from rules by which the CFTC regulates the use of securities as margin for futures transactions even though regulatory authority over securities as such rests with the SEC. *See, e.g.*, 17 C.F.R. §§ 1.25-1.28 (permissible investment of customer margin funds in securities). Similarly, much "customer property" subject to Part 190 consists of instruments not within the CFTC's "regulatory authority," including securities, but which are nevertheless subject to the CEA and CFTC regulations to the extent they are part of a futures transaction. *See* 11 U.S.C. § 761(10); 17 C.F.R. § 190.08(a)(i).

charged with implementing legislation that is often unclear and the product of an often-messy legislative process. Trying to make sense of the statute with the aid of reliable legislative history is rational and prudent.'" (quoting Hon. R. Katzmann, C.J., *Madison Lecture: Statutes*, 87 N.Y.U. L. Rev. 637 (2012)).[8]

KS&T is incorrect to assert, and cites no cases holding, that interpretations expressed in legal briefs are categorically ineligible for *Chevron* deference. *See Jones v. Am. Postal Workers Union*, 192 F.3d 417, 427 (4th Cir. 1999) (applying *Chevron* deference to an interpretation in a brief); *Tax Analysts v. IRS*, 117 F.3d 607, 613 (D.C. Cir. 1997) (same). Such a limitation would make particularly little sense here, because Congress has specifically provided that the CFTC should appear and be heard concerning these laws. 11 U.S.C. § 762(b). Because the Commission's interpretation is authorized, thorough, and methodologically sound, deference is required. *See Barnhart*, 535 U.S. at 222; *see also Skidmore v. Swift & Co.*, 323 U.S. 134, 144 (1944) (requiring deference to an agency interpretation with the "power to persuade").

III. State Law Does Not Control Conditions on the Use of Margin in Futures Markets.

1. With respect to preemption, no court has ever invalidated a CFTC regulation on the basis of a conflict with state law. That is because CEA Section 2(a)(1)(A) broadly and directly

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[8] In a footnote, KS&T disputes that Rule 190.08(a)(1)(i)(E) was promulgated pursuant to the Commission's plenary power under 7 U.S.C. § 12a(5), in addition to Section 24(a) (Doc. 43 at 20 n.11), but the CFTC specifically stated that it was, 48 Fed. Reg. at 8739, reflecting an interpretation of Section 12a(5) that is itself entitled to *Chevron* deference. *See CFTC v. Schor*, 478 U.S. 833, 835, 845 (1986) (stating that the CFTC is due "substantial deference" concerning "whether a particular regulation is 'reasonably necessary to effectuate any of the provisions? or to accomplish any of the purposes' of" the CEA). Section 12a(5) is a "broad grant of power," *id*. at 843, to which Congress *added* in adopting Section 24(a). KS&T does not argue that Rule 190.08(a)(1)(i)E) exceeds the plain language of Section 12a(5), and there is no basis to read Section 24(a) as *contracting* the "broad grant of power," *Schor*, 478 U.S. at 843, in 7 U.S.C. § 12a(5). To construe Section 24(a) as a limitation on Section 12a(5) would also contradict *CFTC v. Schor*, in which the Supreme Court upheld certain CFTC procedures established pursuant to a specific grant of authority under 7 U.S.C. § 14, as well as the Commission's plenary power under Section 12a(5). *Schor*, 478 U.S. at 836, 843. While Plaintiffs cite *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012), in that case, the Supreme Court rejected a contention that one provision "permit[ted] precisely what" the other "proscribe[d]," *id*. at 2070. No such issue exists here. *RadLAX* also did not involve an agency's interpretation of its organic statute; nor did it suggest that a grant of expanded authority could somehow reduce an agency's preexisting authority. *See id.* at 2072. In any event, Section 24(a) is plainly sufficient authority for Rule 190.08(a)(1)(i)(E).

"preempts the application of state law," *Leist v. Simplot*, 638 F.2d 283, 322 (2d Cir. 1980) (Friendly, J.), by granting the CFTC "exclusive" jurisdiction over "transactions involving" commodity futures, 7 U.S.C. § 2(a)(1)(A). Plaintiff, however, breezes past the statute into a lengthy academic discussion on preemption's various forms (Doc. 43 at 21-26), none of which discussion is relevant, because Section 2(a)(1)(A) controls. *Chamber of Commerce v. Whiting*, 131 S. Ct. 1968, 1977 (2011) ("When a federal law contains an express preemption clause, we focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' pre-emptive intent." (quotation marks omitted)). Rule 190.08(a)(1)(i)(E) is squarely within the CFTC's "exclusive" authority over "transactions involving" commodity futures, because, on its face, the rule applies *only* to transactions involving commodity futures:

> The full proceeds of a letter of credit *if such letter of credit was received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract*;

17 C.F.R. § 190.08(a)(1)(i)(E) (emphasis added).

2. KS&T relies on a *presumption* against preemption (Doc. 43 at 27), but no such presumption applies where, as here, Congress has spoken directly to the issue. *New York v. FERC*, 535 U.S. 1, 18 (2002); *City of New York v. Permanent Mission of India*, 618 F.3d 172, 188-189 (2d Cir. 2010). Thus, KS&T is mistaken to rely on *Wyeth v. Levine*, 555 U.S. 555 (2009), where the Court found no preemption because "Congress ha[d] not authorized the FDA to pre-empt state law." *Id*. at 576; *see also id*. at 575 ("Congress has not enacted such a provision for prescription drugs."); *id*. at 578 (citing "Congress' decision not to pre-empt common-law tort suits"). The Court reviewed the statute as well as the legislative history for any indication that the FDA was so authorized, but found "silence on this issue," which was "powerful evidence that Congress did not intend" preemption. *Id*. at 574-75 & n.7. Here,

Congress was not silent, stating unequivocally that the CFTC's jurisdiction over transactions involving futures is "exclusive," 7 U.S.C. § 2(a)(1)(A), so that, in the event of any conflict, "Federal law would govern." H.R. Rep. 93-1383, *reprinted in* 1974 U.S.C.C.A.N. 5894, 5897.

3. In any event, state law provides KS&T with no defense, because Illinois would enforce KS&T's contractual submission to federal law. (Doc. 40 at 19.) In a footnote, KS&T objects that it did not intend to accept the CFTC's interpretation of Rule 190.08, which it believes is "invalid." (Doc. 24 at 24 n.13.) But KS&T "confuses the question of the substantive" with the question of which law controls. *See Smiley*, 517 U.S. at 744. By contract and by operation of the CEA, federal law controls here. The Court must determine the regulation's meaning, under the standard of deference due an agency's interpretation of its own rule, but that is a separate question.

CONCLUSION

For the foregoing reasons, the CFTC supports the Trustee's motion for summary judgment.

Respectfully submitted,

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Dated: January 7, 2013

CERTIFICATE OF SERVICE

I hereby certify that on January 7, 2013, I caused the foregoing document to be served via the Court's CM/ECF system.

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