Securities Regulation Daily Wrap Up, TOP STORY—D.C. Cir.: 'Joint' credit risk retention rule row must first go to district court, (Mar. 18, 2016)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The D.C. Circuit held that an industry-led challenge to Dodd-Frank Act credit risk retention rules jointly adopted by the SEC and the Fed must be brought in the federal district court because the Exchange Act's jurisdictional provision does not mention the law authorizing these rules in its list of rulemaking disputes that can be brought directly in a federal appeals court. But the panel kept the case alive by invoking a federal procedural rule that allows it to transfer the case to the D.C. District Court (*Loan Syndications and Trading Association v. SEC*, March 18, 2016, Brown, J.).

The Loan Syndications and Trading Association (LSTA) petitioned the appellate court for review of the joint credit risk retention rules, arguing that regulators should not have applied Dodd-Frank Act Section 941's mandate to some collateralized loan obligations. The D.C. Circuit's opinion dealt exclusively with the jurisdictional issues raised and not the substantive questions about the agencies' decision to include CLOs in the final rules. Also, those watching the Supreme Court nomination process might note that Chief Judge Merrick Garland, President Obama's nominee, joined the unanimous panel opinion, which follows circuit precedent and mulls the jurisdictional impact of the "joint" character of the disputed rules.

Wrong court. Writing for the panel, Judge Janice Rogers Brown, partially inspired by the simplicity of the maxim Occam's Razor, set out a few organizing principles for appellate review of agency rules such as the credit risk retention rule contained in Exchange Act Regulation RR and in identical rules issued by federal banking regulators. Generally, these disputes are first shunted to federal district courts via federal question jurisdiction. Direct access to federal appeals courts is permitted only when congress permits, typically because there is no need for a trial judge to duplicate the agency's rulemaking record via new fact-finding and the cases are likely to be appealed.

But the panel noted that ambiguity in direct-review laws favors appellate review, yet only if Congress has not already closed this path. As an example, the panel cited the legislative history of the original Exchange Act text, which allowed review of orders (not rules) to better protect rulemakings from judicial review. In any event, the panel reiterated that it cannot impose its policy views over congressional intent in a nod to the Supreme Court's *Lorion* opinion.

The Exchange Act framework has been altered twice to allow direct appellate review of 10 types of disputes. Congress first specified Exchange Act provisions for direct appellate review in 1975 and added one more direct appeal option in 1990. All of these directly appealable cases deal with the national market system and related regulations.

The panel found that Exchange Act Section 15G, the securities law provision implementing Dodd-Frank Act Section 941's risk retention mandate, was not among the provisions listed in Exchange Act Section 25(b)(1)'s list of laws eligible for direct appellate review. The exclusion of Section 15G would apply to the other party in the *LSTA* case, the Fed, because the Exchange Act mentions the several federal banking regulators.

The D.C. Circuit has been down this road before in another Dodd-Frank Act case that disputed the SEC's resource extraction issuers rule. That case had to go to the district court first and, after litigation in several federal courts, the SEC re-proposed the rule. The *LSTA* panel copiously cited the D.C. Circuit's *API opinion*, in which Judge Brown participated yet did not author. But unlike the LSTA, the petitioner in *API* simultaneously filed suit in the appellate court and the district court, eliminating the need for the case to be transferred to the lower court.

Joint rulemaking. The panel also rejected LSTA's alternative grounds for direct appellate review, which the industry group said could be found in the various additional statutory authorities cited by the SEC and the Fed in adopting their respective, identical rules. In this respect, the panel said the challenge here was "unique" because most cases focus on rules adopted by just one agency. The panel noted that the government admitted at oral argument that no single federal agency could have issued what would become the joint the credit risk retention rules on its own.

Ultimately, the case came down to what authority the several federal agencies tasked with implementing the credit risk retention rules relied on. The court said the answer was simple: the rule itself said the agencies issued it pursuant to Exchange Act Section 15G. Because Section 15G is not among the provisions that Congress made eligible for direct federal appellate review, the court had to decline jurisdiction and instead, by invoking a procedural rule, send the case to the D.C. District Court.

The panel also declined to invoke its discretionary power to exercise pendant appellate jurisdiction. The opinion explained that Congress chose a particular path for this case and the panel's own ideas about fairness and efficiency cannot displace that legislative choice.

Open market CLOs. The LSTA sought to appeal directly to the D.C. Circuit in the hope that the court would upend the joint rules' inclusion of requirements for open market CLOs. The final rules define "open market CLO," establish the requirements for CLO-eligible loan tranches, and impose disclosure requirements on open market CLOs.

On the substantive issue, amicus Better Markets, Inc. argued that the CLOs addressed by the credit risk retention rules were one of several causes of the 2008 financial crisis that led to the Great Recession. According to Better Markets, the SEC and the Fed reasonably chose not to include an exemption for the types of CLOs LSTA wants to preserve for its members. The consumer group also said federal regulators conducted as much economic analysis of the rules as was legally required.

By contrast, the U.S. Chamber of Commerce said in its amicus brief the courts should scrap the joint rules on credit risk retention because the agencies failed to exempt open market CLOs, and they botched the economic analysis. The Chamber said CLOs provide important financing to companies with heavy debts via the leveraged loan market. Contrary to public perception, said the Chamber, these investment vehicles are stable, transparent, and weathered the 2008 financial crisis. According to one economic analysis cited by the Chamber, the final rules could result in a 60 percent to 90 percent reduction in the CLO market, with $170-$250 billion less credit available to companies, and annual replacement financing costs of between $2.5 and $3.8 billion.

The D.C. Circuit panel sympathized with all sides' concerns about the fast-approaching December 24, 2016 compliance date. But the panel still chided the LSTA because it "could and should have" (but did not) bring its petition in the district court. The panel chose transfer over dismissal because the litigation would only drag on if the petition was formally dismissed.

The case is No. 14-1240.

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Companies: Loan Syndications and Trading Association; Better Markets, Inc.; Chamber of Commerce of the United States of America

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