



INTERNATIONAL CRIMINAL LAW AND ENFORCEMENT

Expert Analysis

Foreign Price-Fixing Probes Spur U.S. Inquiries

In our last column, we discussed the ability of the Securities and Exchange Commission (SEC) to compel production of foreign documents in instances when such production may violate foreign law.¹ More commonly these days, however, domestic and foreign regulators seem to be eyeing the same targets for the same offenses under the same theories. In this column, we describe parallel investigations by U.S. and EU regulators into the manipulation of various markets. These investigations, combined with regulatory developments in the United States, likely portend an increase in the number and scope of U.S. investigations into price-rigging in all markets. In particular, corporations involved in any market with prices set by benchmarks should be mindful of the ways such benchmarks can be prone to manipulation.

Increase in Investigations

On May 14, 2013, European Union antitrust regulators commenced a series of raids on a number of corporations involved in the oil industry. Firms raided included massive energy companies such as BP, Royal Dutch Shell and Statoil. Also raided was the Platts unit of McGraw Hill Financial Inc., a price reporting agency that publishes oil prices. The focus of the probe is suspected manipulation by energy companies of the \$2.5 trillion physical oil market accomplished by providing false data to Platts.² Traders voluntarily report data to Platts, and this data is used to determine prices. Investigators suspect that traders selectively reported trades to manipulate the pricing benchmark.

The EU raids occurred only months after various banks paid \$2.5 billion to resolve investigations into alleged manipulation of the London Interbank Offered Rate, or LIBOR. The media raised concerns over potential inaccuracies in the LIBOR benchmark as early as 2008, prompting an investigation by the Commodity Futures Trading Commission (CFTC) which was



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followed by investigations in numerous countries.³ The \$2.5 billion in settlements involved U.S., U.K. and Swiss regulators, but criminal investigations apparently remain active in multiple countries. In the United States, UBS Securities Japan Co., Ltd. and two of its traders were criminally charged with colluding with other banks to manipulate LIBOR.⁴ The UBS affiliate pleaded guilty to the charges and agreed to pay a \$100 million fine, while its parent company, UBS AG, entered into a non-prosecution agreement covering itself and other subsidiaries and imposing a \$400 million penalty.⁵ One trader faces parallel criminal charges in the U.K. and is expected to plead guilty.⁶

On July 1, 2013, EU antitrust regulators announced a preliminary conclusion that 13 banks colluded to prevent credit default swaps from trading on exchanges.⁷ In this sense, the alleged scheme involved collusion that may have prevented credit default swaps from even trading on a regulated index. These swaps are typically traded over the counter, where it is harder for customers to gather trade data and thus harder to learn a true market price.

The CME Group Inc. and Deutsche Borse AG sought licenses from the International Swaps and Derivatives Association (ISDA) and data service provider Markit in an effort to bring credit default swap trading onto exchanges. The banks allegedly pressured ISDA and Markit not to license CME Group or Deutsche Borse to protect the banks' more opaque (and profitable) over-the-counter market. The EU regulators' announcement of the preliminary conclusion is the first step toward imposing fines.⁸

Most recently, on July 16, 2013, the Federal Energy Regulatory Commission (FERC) announced an order assessing civil penalties against Barclays Bank PLC and four of its traders in the amount of \$453 million based on alleged manipulation of the California electric energy market.⁹ Barclays has announced that it will contest the fine.¹⁰ As in the EU Platts and LIBOR investigations, the alleged means of manipulation in the FERC investigation is a market benchmark. Barclays traders are alleged to have placed trades to manipulate an index price, thus benefiting the bank's other trades.¹¹

U.S. media outlets also reported last month that the Federal Trade Commission (FTC) has opened a preliminary inquiry that parallels the EU antitrust investigation into manipulation of the Platts benchmark. Apparently, the FTC and Justice Department Antitrust Division agreed that the FTC would handle the investigation.¹² As set forth below, recent regulatory developments in the United States have resulted in a more prominent enforcement role for the FTC, as well as increased and overlapping authority and coordination between multiple federal regulatory and criminal enforcement agencies.

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Regulatory Developments

U.S. regulators and their EU counterparts are increasingly examining how pricing benchmarks can be used to manipulate markets. Any such investigation revealed or commenced in one jurisdiction invariably leads to parallel investigations in other jurisdictions. In short, regulators here and elsewhere may be inspiring one another to undertake broad investigations into manipulation of markets. Recent policy developments in the United States provide domestic regulators with the means to wage

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market manipulation investigations of potentially unprecedented number and scope.

In the energy sector, the Energy Independence and Security Act of 2007 (EISA) put the FTC in charge of petroleum manipulation regulation, resulting in three agencies—the FTC, CFTC and SEC—having varying degrees of regulatory jurisdiction over petroleum markets.¹³ The broadly worded authority arguably empowers the FTC to prosecute even anti-competitive practices typically pursued by the Justice Department's Antitrust Division, although the EISA specifically states that it does not "modify, impair, or supersede the operation of any of the antitrust laws." EISA authorizes the FTC to seek fines of up to \$1 million per violation, with each day a violation continues considered a separate violation.¹⁴

The Dodd-Frank Act amended the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 (Exchange Act) to increase regulation of swaps and security-based swaps.¹⁵ In particular, the CEA amendment prohibits "unlawful manipulation," which includes "a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce."¹⁶ The Exchange Act amendment broadens liability for use of manipulative or deceptive devices to cover "any transaction" involving a security-based swap.¹⁷ The amendment was crafted in part to reflect the fact that fraud involving swaps can occur not just upon the offer of the security, but in ongoing payments and deliveries during the tenor of the swap. The amount of such payments can be altered by manipulating the value of the asset underlying the swap.

Overlapping jurisdiction, even today, can sometimes inhibit regulatory action.¹⁸ Increasingly, however, federal agencies are cooperating with each other rather than engaging in turf battles. In April 2011, the FTC and CFTC entered into a memorandum of understanding (FTC-CFTC MOU) to share non-public information between the two agencies for law enforcement purposes.¹⁹ This follows the memorandum of understanding entered into by the SEC and CFTC back in April 2008.²⁰ The FERC and the CFTC entered into a memorandum of understanding back in 2005, although it was aimed more at avoiding duplication of information requests rather than sharing information for enforcement purposes.²¹

The more recent FTC-CFTC MOU, however, specifically states that a focus of the understanding is prevention of manipulation of energy markets. Although the FTC and CFTC to some extent have overlapping jurisdiction, to the extent they do not, producing documents to one agency as part of an investigation into one market could now lead to those documents being used by the other agency to commence an investigation into a different market. Thus, these memoranda of understanding coupled with enhanced and at times parallel enforcement powers have essentially turned federal regulatory agencies into an

interconnected web where a document production to one agency could make its way to three other agencies.

Moreover, on April 21, 2011, Attorney General Eric Holder announced the formation of a "Financial Fraud Enforcement Taskforce Working Group" composed of representatives from the Justice Department, the FTC, the CFTC, the SEC, the Department of the Treasury, the Department of Agriculture, the Department of Energy, the Federal Reserve Board and the National Association of Attorneys General.²² The group is part of the Justice Department's Financial Fraud Taskforce, suggesting that it may have bite to go with its bark.

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In sum, regulatory developments in the United States have empowered multiple federal agencies with new statutory tools. Overlapping jurisdiction and increased coordination among these agencies should permit them to move beyond traditional investigations into manipulation in connection with offers or sales of specific securities, and undertake an increasing number of investigations into broad, market-based manipulations.

Any corporation engaged in a market that involves a voluntarily reported benchmark should be mindful of heightened scrutiny. For example, in May 2013 U.S. media outlets reported that the CFTC is investigating manipulation of a benchmark used for pricing swaps—the ISDAfix swaps rate. Similar to the benchmarks in the LIBOR and Platts investigations, this rate is reported by London-based corporation ICAP Plc based on manual submissions of trade data by its brokers based in New Jersey.²³ Delays in reporting by brokers could manipulate the benchmark. Once again, the voluntary reporting provides opportunities for manipulation. Apparently, the CFTC is reviewing one million emails and IMs as part of the investigation, and under its memoranda of understanding with the FERC, the SEC and the FTC, those materials could wind up in the hands of four separate federal agencies.

Conclusion

In sum, all signs point to a potentially significant increase in investigations into manipulation of U.S. markets. Such investigations are most likely in any market that relies on benchmarks compiled from voluntarily reported data to set market prices. As investigations in both the EU and the United States have shown, the ability to influence benchmarks provides the means for the broadest form of market manipu-

lation, and benchmarks composed of voluntarily reported data are most prone to abuse.

The deep pocket multinationals operating in this environment may be inviting targets to regulators. Any corporation that relies on or reports benchmarks should review its policies and oversight of involved employees and departments.

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1. Nicholas M. De Feis and Philip C. Patterson, "In Seeking Documents Abroad, Does the SEC's Reach Exceed Its Grasp?," NYLJ, April 24, 2013, available at <http://www.newyorklawjournal.com/PubArticle-NY.jsp?id=1202597179910&return=20130619163248>.

2. See Justin Scheck and Christian Berthelsen, "EU Inspects Four Firms in Oil Probe," WSJ, May 14, 2013, available at <http://online.wsj.com/article/SB10001424127887323716304578483012667760962.html>.

3. Liam Vaughan and Gavin Finch, "LIBOR Lies Revealed in Rigging of \$300 Trillion Benchmark," Bloomberg, Jan. 28, 2013, available at <http://www.bloomberg.com/news/2013-01-28/LIBOR-lies-revealed-in-rigging-of-300-trillion-benchmark.html>.

4. See *United States v. Hayes*, 12 MJ 3229 (S.D.N.Y.); *United States v. UBS Securities Japan*, 12 CR 00268 (D. Conn.).

5. See Justice Department Press Release, "UBS Securities Japan Co. Ltd. to Plead Guilty to Felony Wire Fraud for Long-running Manipulation of LIBOR Benchmark Interest Rates," Dec. 19, 2012, available at <http://www.justice.gov/opa/pr/2012/December/12-ag-1522.html>.

6. See Lindsay Fortado, "Ex-UBS, Citigroup Trader Hayes to Enter Plea at Next Hearing," Bloomberg, July 4, 2013, available at <http://www.bloomberg.com/news/2013-07-04/ex-ubs-citigroup-trader-hayes-to-enter-plea-at-next-hearing.html>.

7. See European Commission Press Release, "Antitrust: Commission sends statement of objections to 13 investment banks, ISDA and Market in credit default swaps investigation," July 1, 2013, available at http://europa.eu/rapid/press-release_IP-13-630_en.htm.

8. The announcement followed the filing of lawsuits in the United States in May 2013 by U.S. and foreign pension funds based on the same allegations, and the Justice Department reportedly began investigating the same allegations as far back as 2009. See Katy Burne, "Pensions Sue Banks Over Credit-Default Swaps," WSJ, July 12, 2013, available at <http://online.wsj.com/article/SB10001424127887324879504578601810668515312.html>.

9. See FERC Press Release, "FERC Orders \$453 Million in Penalties for Western Power Market Manipulation," July 16, 2013, available at <https://www.ferc.gov/media/news-releases/2013/2013-3/07-16-13.asp#UegMd6zjZKs>.

10. See Tenille Tracy, "Barclays to Dispute Electricity-Manipulation Charges," WSJ, July 17, 2013, available at <http://online.wsj.com/article/SB10001424127887323993804578611653162164128.html>.

11. J.P. Morgan Chase is also reportedly in settlement talks with FERC to resolve allegations of manipulation of the California energy market, although the investigation of J.P. Morgan Chase apparently involves allegations of traders profiting by improperly generating "make-whole" payments that energy providers receive to cover operational costs. See Dan Fitzpatrick, Rebecca Smith & Ryan Tracy, "J.P. Morgan Staring at Record Fine Over Energy," WSJ, July 17, 2013, available at <http://online.wsj.com/article/SB10001424127887323993804578611940638603204.html>.

12. See Sara Forden, "U.S. FTC Said to Open Probe of Oil Price-Fixing After EU," Bloomberg, June 25, 2013, available at <http://www.bloomberg.com/news/2013-06-24/u-s-ftc-said-to-open-probe-of-oil-price-fixing-after-eu.html>.

13. Pub. L. No. 110-140, 121 Stat. 1723 (Dec. 19, 2007), codified at 42 U.S.C. §§17301-17305.

14. 42 U.S.C. §17304.

15. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, §§753 and 761(a)(2).

16. See CEA Section 6(c)(1)(A), codified at 7 U.S.C. §9(1)(A).

17. See Exchange Act Section 9(j), codified at 15 U.S.C. §78i(j).

18. One example that bucks the trend of inter-agency cooperation is the March 14, 2013, opinion of the U.S. Court of Appeals for the D.C. Circuit vacating a \$30 million penalty imposed by the FERC against a trader accused of manipulating the natural gas futures market on the ground that the CFTC has exclusive jurisdiction over commodity futures markets. See *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).

19. Available at <http://www.ftc.gov/os/2011/04/110412ftccftc-mou.pdf>.

20. Available at <http://www.sec.gov/news/press/2008/2008-40-mou.pdf>.

21. See FERC-CFTC MOU, available at <http://www.ferc.gov/legal/majord-reg/mou/mou-33.pdf>.

22. See Justice Department Press Release, "Attorney General Holder Announces Formation of Oil and Gas Price Fraud Working Group to Focus on Energy Markets," April 21, 2011, available at <http://www.justice.gov/opa/pr/2011/April/11-ag-500.html>.

23. Matthew Leising, "CFTC Said Preparing ISDAfix Probe Talks in Weeks: Credit Markets," Bloomberg, May 21, 2013, available at <http://www.bloomberg.com/news/2013-05-20/cftc-said-to-review-1-million-emails-in-isdafix-investigation.html>.