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A Question of First Principles

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I. THE LIBOR CASE

The U.S. Dollar London Interbank Offered Rate ("U.S. LIBOR") is determined based upon a daily survey which asks 16 major banks ("the LIBOR Banks") at "what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?" and then calculates U.S. LIBOR by taking these sixteen numbers, eliminating the bottom four and top four, and averaging the remaining eight numbers.

The U.S. LIBOR rate is traded via fixed income futures, options, swaps, and other derivative products on U.S. commodities exchanges and governs the amount of money paid in interest in numerous financial securities, including many created and sold by the LIBOR Banks. In *In Re Libor-Based Financial Instruments Antitrust Litigation*, the Exchange-Traded Plaintiffs, representing those who transacted in Eurodollar futures contracts and options on U.S. exchanges, and the Over-The-Counter Plaintiffs, representing those purchasers of financial instruments tied to U.S. LIBOR purchased from the LIBOR Banks (collectively "Plaintiffs"), sued the LIBOR Banks, alleging, *inter alia*, that the LIBOR Banks colluded to manipulate the U.S. LIBOR rate and that this violates Section 1 of the Sherman Act, 15 U.S.C. § 1.

Defendants' motions to dismiss the antitrust claims of the Plaintiffs in the LIBOR multi-district litigation includes an argument that advocates for a limitation on the coverage of Section 1 of the Sherman Act based on the assertionthat LIBOR is not a traditional good traded in commerce. Defendants argue that the Sherman Act does not cover manipulation of U.S. LIBOR as this manipulation cannot constitute a restraint of trade[2] because "LIBOR is just an index and not is itself a marketplace transaction." Specifically, Defendants argue:

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[2] Section 1 of the Sherman Act states that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." 15 USCS § 1.

> Plaintiffs' USD LIBOR submissions do not compete with one another. USD LIBOR is not itself a product that is bought, sold, or traded. No Defendant is concerned it will lose USD LIBOR business to another Defendant if its USD LIBOR submissions are too high or too low. Defendants have no customers for USD LIBOR and Plaintiffs have no USD LIBOR suppliers. Defendants earn no profits from making USD LIBOR submissions to the BBA. Simply put, the mere submission of rates to the BBA is not an activity that involves buying, selling, or any competition at all.

Defendants reinforce this novel argument in their reply brief, stating that it is "axiomatic that to be a 'restraint of trade or commerce' prohibited by section 1, competition in some market must be restrained [and here] there is not a 'market' for reporting USD LIBOR; in submitting their rate reports, Defendants are not buying or selling anything."

II. DEFINING "TRADE" UNDER THE SHERMAN ACT

From Plaintiffs' perspective, Defendants' arguments bear the usual indicia of an attempt to make new law—an absence of case citations supporting the core of an argument accompanied by rhetorical devices designed to indicate that the assertion they advocate is so simple and basic that common sense, as opposed to case law or other legal citations, is sufficient for them to prevail. From Defendants' perspective, their argument's lack of legal citations is a function of the novelty of Plaintiffs' claims and not the novelty of their defense— according to Defendants, no court has ever had to rule on a claim precisely like this one because no plaintiff has ever brought an antitrust claim based on manipulation of an index that lies outside the marketplace and that is not attached to an underlying commodity.

Regardless of who is right—whether this is a novel defense, a novel claim, or both—what is relatively certain is that there is something here that merits comment, discussion, and study. This is especially true because a decision on this issue could have significantly wider import. For instance, there are a large and increasing number of other commodities that are similar to LIBOR in that they arguably are not based on a tangible product. For example, the new and growing market in weather derivatives, which include futures and options on futures traded on the Chicago Mercantile Exchange that reflect monthly and seasonal average temperatures of certain cities, is similar to LIBOR in that the financial instrument is arguably not based on a tradable physical commodity. Instead, the financial instrument is based on the weather—and nobody can buy, sell, or trade the weather.

There are also examples outside of the world of derivatives that do not involve the purchase or sale of a product. For instance, in the market for gambling, which is enormous, there is generally no physical commodity that changes hands. No one buys or sells anything when gambling. Instead, the gambling market consists of the payment of money for a chance to receive larger sums of money. While counter-arguments can, of course, be developed as to why weather derivatives, gambling, and other markets are different from LIBOR, there is a good chance that a court's decision on LIBOR would impact a future court's decision on how to approach the application of the Sherman Act to many non-traditional areas of the economy.

If Defendants' restrictive interpretation of what constitutes "trade" were to prevail, this could mean that weather derivatives, gambling, and other current economic activities detached from direct goods for money exchanges in the market could be outside the purview of the antitrust laws, making those markets highly susceptible to manipulation or monopolization. Moreover, the inelastic definition of "trade" advocated by Defendants, if adopted, could result in additional categories of commercial activities being outside the protective umbrella of the Sherman Act as commerce continues to innovate and the reach of the Sherman Act remains static.

On the other hand, if Plaintiffs prevail, this would potentially allow the Sherman Act to apply to areas that are at least one stepremoved from direct commercial transactions in the marketplace. This flexible approach to a definition of trade could arguably result in an application of the Sherman Act somewhat outside of its role in preventing abuse of dominance in conventional markets.

III. THE SCOPE OF THE SHERMAN ACT

Resolving this issue requires going back to first principles of the Sherman Act. It has been long established that the purpose of the Sherman Act is "[t]he prevention of restraints to free competition in business and commercial transactions which tended to restrict production, raise prices or otherwise control the market to the detriment of purchasers or consumers of goods and services."[3]

In this light, Defendants' position may have some appeal at first glance. It is superficially plausible that manipulation of LIBOR does not constitute a "restraint of trade" because LIBOR does not fit into the layperson's everyday conception of a tangible commodity that is bought or sold like oil, milk, cars, or any other product. However, a deeper look at court decisions defining the concept of "trade" under the Sherman Act, and of what constitutes a commodity in actual practice, indicates that the "common sense" definition of trade and commodities advocated by Defendants is too restrictive. First, the limited available case law seems to confirm that, contrary to Defendants' argument, the definition of "trade" as used in the Sherman Act is broad, flexible, and encompasses changes in commerce over time. Second, it seems that in both law and regulatory practice outside of the antitrust context U.S. LIBOR is currently considered a commodity.[4]

Since the Sherman Act was passed, courts have only infrequently been forced to grapple with what constitutes "trade." When they have, however, they have generally pointed towards a broad definition that would likely encompass a commercial, but intangible, commodity like LIBOR. First, there is affirmative case law holding that the intangibility of a product—in fact that it is not a physical good that one can touch—is not an obstacle to it being covered by the Sherman Act. As the Second Circuit has explained, the "Supreme Court did not intend the

[3] *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 493 (1940).

[4] Plaintiffs, in their opposition brief, take a different tack in opposing Defendants argument. They point out that this is a case of *per se* unlawful price-fixing because Defendants' collusion "caused them to pay more, receive less, or both on LIBOR-based financial instruments" and, under the Supreme Court's decision in *Socony-Vacuum*, the "machinery employed by a combination for price-fixing is immaterial." Pl. Br. at 30. Plaintiffs also attack Defendants' assertion that they do not "compete" with respect to the setting of LIBOR by reminding the Court that Defendants conceded they compete with respect to the sale of LIBOR-based financial instruments and that the "Sherman Act does not impose the requirement that antitrust conspiracies involve 'products' or items that are 'sold.'" Pl. Br. at 33-34.

application of the antitrust laws to be limited to 'goods' qua 'item of goods.'"[5] Instead, it meant the term "goods" in the "broader sense," as the Supreme Court has "refused to exempt banks from the antitrust laws simply because they 'deal[] in the intangibles of credit and services rather than in the manufacture or sale of tangible commodities.'"[6] This principle has broader application in that it can be read as freeing the Sherman Act from being tied to physical goods. This would remove "intangibility" as an obstacle to LIBOR or other innovations in commerce like weather derivatives that are not tied to tangible goods being governed by antitrust law.

Second, while most case law defining the term "trade" is not recent, and does not discuss everything about the word, it does make clear that "trade" includes the exchange of any "commodity." There is "is little if any conflict as to the usual and ordinary meaning of the word 'trade.' It is defined in *Webster's International Dictionary* as: 'The act or business of exchanging commodities by barter or by buying and selling for money; commerce; traffic; barter.'"[7] In *May v. Sloan,*[8] it is said: "The word 'trade,' in its broadest signification, includes not only the business of exchanging commodities by barter, but the business of buying and selling for money, or commerce and traffic generally.'"[9]

There is also considerable regulatory activity concerning whether LIBOR is covered by the Commodity Exchange Act and its government enforcer and regulator, the Commodity Futures Trading Commission ("CFTC"). This regulatory activity consistently takes the position that LIBOR itself is a commodity. First, and most directly related to the LIBOR case, in its settlement with Barclays regarding the LIBOR manipulation, the CFTC identifies LIBOR as a commodity.[10] The CFTC's description also is fully in harmony with applicable law and regulations. Under Section 1(a)(13) of the Commodity Exchange Act ("CEA"), LIBOR fits neatly into the definition of an "excluded commodity"[11] which includes:

> (a) an interest rate, exchange rate, currency, security, security index or macroeconomic index or measure; (b) any other rate, differential, index or measure of economic or commercial risk, return or value that is not based in substantial part on the value of a narrow group of commodities not described in (a) above, or is based solely on one or more commodities without a cash market; (c) any economic or commercial index based on values or levels that are not within the control of any party to the transaction; and (d) an occurrence, extent of

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[5] *Finnegan v. Campeau Corp.*, 915 F.2d 824, 827-828 (2d Cir. 1990).

[6] *Id.*, quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 368, 10 L. Ed. 2d 915, 83 S. Ct. 1715 (1963).

[7] *Bluejacket v. Ewert*, 265 F. 823, 827 (8th Cir. 1920).

[8] *May v. Sloan (May v. Rice)*, 101 U.S. 237, 25 L. Ed. 797

[9] *Id.* at 828. *See also Catalano, Inc. v. Target Sales, Inc.,* 446 U.S. 643, 647, 64 L. Ed. 2d 580, 100 S. Ct. 1925 (1980) (fixing price of ***commodity*** illegal under Sherman Act) (emphasis added); *United States v. Socony-Vacuum Oil Co*., 310 U.S. 150, 223, 84 L. Ed. 1129, 60 S. Ct. 811 (1940) (same).

[10] *See, e.g.*, *In the Matter of: Barclays PLC, Barclays Bank PLC and Barclays Capital Inc.,* Respondents, CFTC Docket No. 12-25, 2012 WL 2500330, *3 (June 27, 2012) ("Accordingly, during the financial crisis period, Barclays, through its submissions, knowingly delivered, or caused to be delivered, false, misleading or knowingly inaccurate reports that affected or tended to affect LIBOR, ***a commodity in interstate commerce***.") (emphasis added).

[11] An "excluded commodity" means that the CEA does not apply if the transaction is, *inter alia*, (1) entered into between Eligible Contract Participants and is not conducted on a Trading Facility or (2) between Eligible Contract Participants, trading on a principal to principal basis, and the transaction is conducted on an Electronic Trading Facility."

> an occurrence or contingency beyond the control of the parties and associated with a financial, commercial or economic consequence.

Certain academic articles are also in accord.[12]

IV. A COMMON SENSE SOLUTION

What this article advocates for is use of the established regulations and law in the Commodity Exchange Act sphere to help determine the scope of "trade" under the Sherman Act. Use of the regulatory schema governing commodities to help define the boundaries of "trade" in the Sherman Act makes perfect sense. As of 1974, the "majority of futures trading took place in the agricultural industry," but "the futures industry has become increasingly varied over time and today encompasses a vast array of highly complex financial futures contracts."[13]

The CFTC, guided by its mission "to protect market users and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives that are subject to the Commodity Exchange Act, and to foster open, competitive, and financially sound markets,"[14] has extended its protection to all of these new derivatives. The Sherman Act, whose purpose is the similarly broad "prevention of restraints to free competition in business and commercial transactions,"[15] should not be less expansive. It would make no sense for a commodity to be traded on an exchange, protected by the Commodity Exchange Act and the CFTC, and yet be outside of the purview of the similarly expansive Sherman Act. This is especially true when almost every definition of the word "trade," whether legal or common usage, includes the exchange of commodities. Therefore, at a minimum, the Sherman Act's definition of trade should include all commodities that fit within the CFTC's definition of a commodity.

V. CONCLUSION

If this reasoning is adopted, which this article contends it should be, LIBOR should fall within the purview of the Sherman Act, as it is a commodity and therefore part of "trade." Consequently, assuming the other requirements of the Sherman Act are satisfied, any manipulation of U.S. LIBOR should constitute a restraint of trade in violation of Section 1 of the Sherman Act.

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[12] *See, e.g.*, Mark D. Young & William L. Stein, *Swap Transactions Under the Commodity Exchange Act: Is Congressional Action Needed?*, 76 GEO. L.J. 1917, 1932 (1988) ("the legislative history of the CEA's expansive 'commodity' definition contains convincing evidence that Congress intended intangible rates, like the CPI and LIBOR, to be treated as commodities").

[13] http://www.cftc.gov/About/MissionResponsibilities/index.htm (last visited, November 5, 2012).

[14] *Id.*

[15] *Apex Hosiery Co.*, 310 U.S. at 493.