Securities Regulation Daily Wrap Up, DERIVATIVES—S.D.N.Y.: Post-Dodd Frank claims survive dismissal in interest rate swap antitrust case, (Jul. 31, 2017)

Securities Regulation Daily Wrap Up

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Claims of unlawful collusion by investment banks in regard to interest rate swaps (IRS) electronic markets were dismissed only in part, with those claims following the Dodd-Frank Act's mandates regarding electronic platforms for IRS trading surviving. The plaintiffs, investors and companies that developed trading platforms, adequately alleged a boycott, antitrust standing to bring suit, and that their claims were not precluded by Dodd-Frank (*In re Interest Rate Swaps Antitrust Litigation*, July 28, 2017, Engelmayer, P.).

This litigation involves two groups of plaintiffs: (1) a putative class of investors who bought and sold IRS between January 2008 and December 2016 who were allegedly subject to unfair pricing due to collusive actions; and (2) Javelin Capital Markets, LLC (Javelin) and Tera Group, Inc. (Tera), two companies that separately developed trading platforms that IRS dealers allegedly conspired to boycott. The defendants are 13 corporate entities and their affiliates, 11 investment banks that function as IRS dealers, one IRS broker, and one provider of IRS electronic trading services. The initial complaint was filed November 2015 and consolidated with multiple other cases in 2016 by the U.S. Judicial Panel on Multidistrict Litigation. The present motion to dismiss is based on the second amended complaint filed in December 2016.

Electronic platform. The plaintiffs allege that the defendants colluded to prevent the establishment of an electronic platform that would allow all-to-all, anonymous IRS trading. IRS trading consists of two parties trading interest-based cash flows on a specific amount of money over a fixed period of time, with the buyer typically using a fixed rate and the seller typically using a floating rate. IRS trading was standardized by 2000 and historically commenced over the counter by telephone, which was advantageous to dealers as they received information about the buyer, including their identity, prior to quoting pricing.

Dealers began using electronic platforms in the 1990s to access better and more transparent pricing for dealers, but such platforms were not open to buyers. Dealer-to-dealer trades also utilized clearinghouses, which allowed for anonymity in exchange trading, although this was also denied to buy-side trades. The plaintiffs allege these disadvantages to buy-side trades were the result of collusion among the dealer defendants. This included the defendants collectively buying a controlling stake in an existing electronic platform in order to prevent implementation of all-to-all trading and the use of trade associations to coordinate dealer actions, including the use of intimidation in order to prevent development of all-to-all trading which would have lowered the defendant profits in the IRS marketplace.

In 2010, the Dodd-Frank Act created a comprehensive new regulatory framework for swaps with the goal of increasing accountability and transparency, which included enabling IRS to be traded via anonymous all-to-all trading platforms. After Dodd-Frank, three companies, including Javelin and Tera, developed trading platforms for all-to-all anonymous trading of IRS. The plaintiffs allege that the defendants conspired to boycott these platforms and instructed their clearinghouse affiliates to refuse to clear trades executed through them. The plaintiffs claim there was clearly coordinated joint opposition to the platforms, including intimidation of would-be users. The result of these efforts are that the defendants control 70 percent or more of the IRS market and no structural changes, as intended by Dodd-Frank, have taken place, causing the failure of alternative platforms and higher prices for investors.

Conspiracy to boycott. The plaintiffs' claims can be separated as pre-Dodd-Frank (2007-2012) and post-Dodd-Frank (2013-2016) due to changes in the structure and nature of the IRS market in 2013 as a result of the legislation. During the pre-Dodd-Frank time period, dealers took no actions to support the emergence of all-to-all exchange-based IRS trading as a matter of self-interest in preserving their profits but there was no inference of collusion from the parallel actions pleaded.

The parallel behavior of the defendants implicated narrower business practices that were pleaded generally and collectively and not via specifics, according to the court. In addition, the infrastructure necessary for such platforms did not exist prior to 2013. As such, prior to the Dodd-Frank Act making the infrastructure a looming reality, there was no urgency for collective action to block all-to-all exchange trading. Nor were the plaintiffs successful in pleading any specific actions, including the buying of a controlling stake in an existing electronic platform, constituted direct evidence of a conspiracy as the pleadings were at best inferential and not explicit and there was no demonstration that the defendants' actions as pleaded were unlawful. As such, the motion to dismiss claims from this time period was granted by the court.

For the post-Dodd-Frank time period, however, the motion to dismiss was denied as the plaintiffs successfully pleaded that the defendants engaged in a group boycott, according to the court. The plaintiffs provided a detailed list of parallel conduct by the defendants, with circumstantial evidence and the Second Circuit's "plus" factors indicating agreement and coordinated action amongst them. These were not isolated acts but a showing of refusal to do business with the new exchange platforms. None of the practices or acts were inherently irrational, self-destructive or illegal in isolation, but when engaged in by multiple dealers and viewed in context allowed for a plausible inference of communication and coordination among dealers with the goal of destroying the new platforms. The Second Circuit's designated "plus" factors gave further support to that inference in that there was a common motive to conspire, there was a high degree of interfirm communication and, to a lesser extent, the defendants' actions were against self-interest.

Statute of limitations. The defendants argued that the plaintiffs' claims prior to November 2011 were time-barred. While those claims were dismissed as noted above, the court still addressed the statute of limitations argument and determined such claims were, in fact, time-barred. There was no showing of fraudulent concealment and there was ample opportunity, given the facts on the ground, for the plaintiffs to have suspected the probability of wrongdoing in sufficient time to have filed suit prior to the expiration of the statute of limitations.

Antitrust standing. The defendants argued that because Javelin and Tera have antitrust standing, they were more efficient enforcers of the antitrust laws than the investor plaintiffs. As alleged, the investor plaintiffs were harmed by the inability to obtain the superior prices on a higher-priced all-to-all exchange, and the existence of a superior victim in Javelin and Tera did not require dismissal of the investors for lack of standing. Rather, effective enforcement of antitrust law is enhanced by collaboration of both plaintiffs. The investor plaintiffs conceded at oral argument that while their claims could apply to all buy-side trades, it was intended to be limited to plain vanilla swaps, a limitation the court promised to enforce.

Implied preclusion. Dodd-Frank includes a so-called antitrust savings clause which explicitly states that it does not modify antitrust statutes unless it specifically says so. In analyzing a similar boycott claim in *In re CDS* (S.D.N.Y. 2014), Judge Cote noted that Dodd-Frank did not explicitly mention the Sherman Act and where it modified the Clayton Act, none of those provisions were relevant in such a case. Thus, Dodd-Frank did not displace operation of the antitrust laws in such a boycott case. After independent review, the court adopted this analysis. As such, the antitrust savings clause preserved rather than precluded the plaintiffs' claims.

The case is No. 16-MD-2704 (PAE).

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