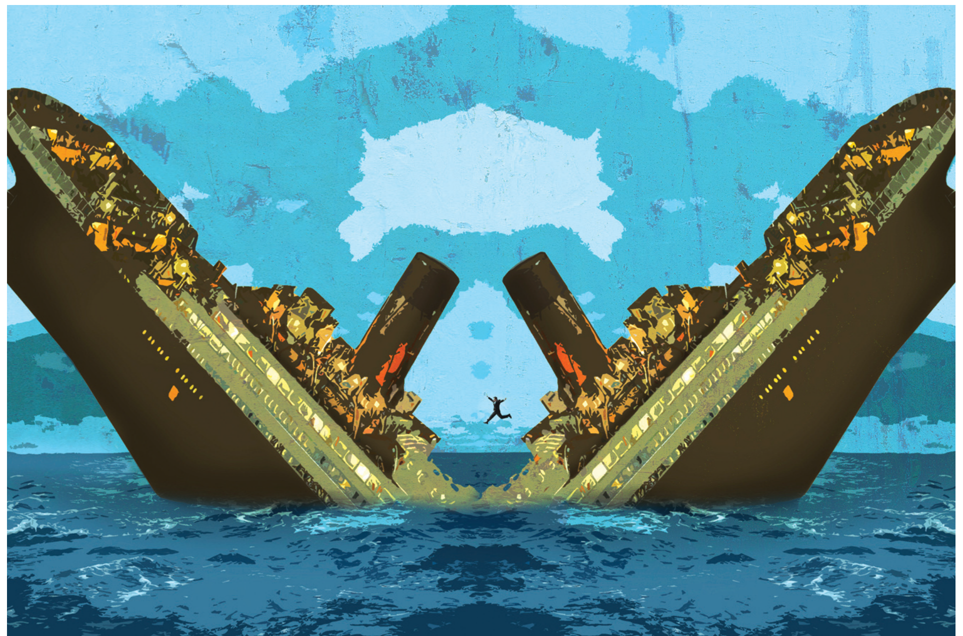
An ALM Publication
CORPORATE COUNSEL
LEGALMANAGER
09 : 2012

CAUTION: LIBOR LITIGATION AHEAD

There's going to be trouble; how will you deal with it?

BY MICHAEL T. GASS AND STUART M. GLASS

AS NEW TWISTS AND TURNS OF THE LIBOR scandal continue to unfold, it is clear that issues surrounding the alleged manipulation of this important financial benchmark will not be resolved quickly or quietly. Banks alleged to have manipulated the London Interbank Offered Rate will face government investigation and large regulatory fines, public excoriation by the press and politicians, and management shake-ups. Central banks and regulators—many at the heart of the 2008 global financial crisis—can expect criticism for their failure, yet again, to protect investors from the misdeeds of large financial institutions. Shareholders of the LIBOR banks will bring class and derivative litigation over harm to their shares and institutions.



Will this scenario translate into successful civil claims by holders or issuers of instruments tied to LIBOR? While the potentially huge sums at stake virtually guarantee a wave of litigation, there are inherent challenges that will make significant financial recoveries difficult.

LIBOR is a crucial element in the global economy, used worldwide to set interest rates for more than $350 trillion of futures, options, swaps, and other derivative financial instruments and as a reference rate for roughly $10 trillion in consumer lending products. Despite being the world's most important interest-rate benchmark, LIBOR is not supervised by any government agency or official. LIBOR quotes interest rates for 10 currencies and 15 different loan periods—ranging from overnight to 12 months—thus producing 150 separate rates each business day. Each day between 11 and 11:10 A.M. London time, each of the roughly 12–18 banks on the currency contributor panel (a reference panel of banks that reflects the balance of the market for a given currency) electronically communicates to Thomson Reuters the interest rate (for each of the 15 loan periods) at which it believes it could borrow funds from other banks at that time.

Significantly, the responses are subjective. That is, they are not based upon actual transactions, but on what the contributing bank believes to be its borrowing rate. Once submitted, rates are ranked, the highest and lowest 25 percent of the rates are excluded, and the remaining 50 percent are averaged. The resulting figures for each currency and final payment date are published by Thomson Reuters at 11:30 A.M. as that day's LIBOR.

Regulators allege that for at least four years, contributing banks at times attempted to manipulate LIBOR by submitting interest rates that varied from the rates at which they actually believed they could borrow. The attempted manipulations ran in both directions: A LIBOR contributing bank wanting to signal that it was healthy would submit an artificially low rate, while a bank on the receiving end of LIBOR–based interest payments would submit an artificially high rate.

This scenario understandably excites interest among potential plaintiffs in the investment community who claim they were harmed by either artificially high or low LIBOR, as well as the class action bar, which will be highly motivated by the prospect of large damage claims and defendants with deep pockets.

Plaintiffs will benefit from regulators' investigative work and the resulting settlement agreements, which typically contain detailed descriptions of the misconduct, providing a map for civil plaintiffs. For example, the U.S. Department of Justice's settlement with Barclays Bank PLC (the first bank to settle in the LIBOR investigation) expressly states that Barclays "admits, accepts, and acknowledges responsibility for the conduct" set forth in the detailed, 23-page factual recitation, making it nearly impossible to dispute the facts in civil litigation.

Despite these advantages, the road to recovery for civil claimants is not simple or clear. Unlike regulators, civil plaintiffs must identify legal theories under which they can collect damages for wrongdoing by participating LIBOR banks, and then must prove each element of that claim, including connecting the alleged misconduct to quantifiable damages actually incurred.

Legal claims arising out of alleged market manipulation typically are based upon a preexisting relationship between the parties, such as contractual, fiduciary, and buyer-seller relationships. But the LIBOR banks did not have such a relationship with the vast majority of the investment community who might claim harm from LIBOR manipulation. Therefore, identifying how LIBOR banks breached a legal duty to such plaintiffs may be difficult. Similarly, claims such as common-law fraud, negligent misrepresentation, and unjust enrichment also require some direct dealings between plaintiffs and the LIBOR banks. Statutes prohibiting unfair and deceptive trade practices vary by state, may not provide a private right of action or damages, and may not apply to conduct occurring outside of a particular applicable state.

The situation is somewhat analogous to the subprime mortgage crisis, in which holders stuck with worthless securities that had been (improperly) rated AAA by the rating agencies had no legal recourse against those agencies.

The proverbial $64,000 question—although a few zeros may need to be added—is whether there was provable collusion among the LIBOR banks in manipulating LIBOR. If so, plaintiffs may have claims under antitrust laws and/or the Racketeering Influenced and Corrupt Practices Act. Yet, even these claims face serious challenges.

Since the allegations do not involve manipulation by the LIBOR banks of the price of a good or service they sold to the plaintiffs, or otherwise interfering with competition in the traditional antitrust sense, there are substantial arguments that plaintiffs cannot meet the narrow requirements of an antitrust claim, most notably antitrust standing. It is also not clear whether RICO's arm reaches foreign enterprises, and whether plaintiffs have standing, because of the absence of a direct relationship between the alleged injuries and the alleged RICO violations.

Plaintiffs will also have to prove that the alleged wrongdoing actually affected LIBOR, and by how much. This requires establishing that a LIBOR bank submitted a false rate, identifying the magnitude of the variance, and tracing the impact through the daily rate-setting process to determine the ultimate impact on the posted LIBOR rates, if any. Since the top and bottom quartiles of submitted rates were excluded, and the remaining rates were averaged, proving an impact will be tough. It is the apparent inability of any single LIBOR bank to materially affect the rate that fuels suspicion about collusion among the banks. If systematic collusion were established, the impact on LIBOR would be easier to prove.

If plaintiffs can establish that the LIBOR banks meaningfully affected LIBOR, they still have to prove specific damages. This will not be straightforward. Virtually all of the securities and instruments pegged to LIBOR have variable interest rates that adjust periodically. The impact of each LIBOR rate affecting a given security would need to be factored in to determine the overall impact. The complexity is compounded by the fact that LIBOR was allegedly manipulated in both directions, raising the possibility of offsetting effects that could reduce or eliminate damages. Other complicating variables include how long individual plaintiffs held such instruments, when they sold them, and whether impacts on LIBOR had a countervailing impact on price.

Civil litigation against the LIBOR banks by individuals, groups, and classes of investors will abound, and a wide range of legal theories will be advanced to justify both defendants' and plaintiffs' positions. Parties on both sides of these cases will need to:

- Understand that the litigation will be challenging and hard fought.
- Focus on whether potential legal theories impose a legal duty on the defendant LIBOR banks and provide a corresponding right to recover for plaintiff investors.
- Carefully assess any evidence that the LIBOR banks acted in concert.
- Evaluate the connection between the banks' misconduct and actual impact on LIBOR.
- Determine whether and how LIBOR manipulation translates into quantifiable, recoverable damages.

At the end of the day, only one thing is certain—it's going to be a long and bumpy ride.

Michael T. Gass is the chair of the securities litigation group at Choate, Hall & Stewart in Boston. Stuart M. Glass is a partner in the firm's securities litigation group. They can be reached at mgass@choate.com and sglass@choate.com.

Reprinted with permission from the September 2012 edition of CORPORATE COUNSEL © 2012 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints@alm.com. # 016-09-12-05