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Libor Litigation Must Overcome Significant Obstacles

Law360, New York (May 15, 2013, 5:10 PM ET) -- Libor litigation will not go away quickly or quietly. When U.S. District Judge Naomi Reice Buchwald dismissed a consolidated, multidistrict batch of antitrust and racketeering suits in Manhattan earlier this spring, she suggested that plaintiffs seeking to recover from the banking giants at the heart of the interest rate-fixing scandal might have better luck with securities fraud claims.

But those plaintiffs will need to be lucky indeed. Two recent developments — Charles Schwab's filing of securities claims in California state court, and the dismissal of a federal securities suit against Barclays — show that obstacles to recovery are inherent and, perhaps, insurmountable.

The Scandal: A Refresher

The London Interbank Offered Rate (Libor) has been an important fixture in global financial markets, particularly those involving derivatives, for more than two decades. It has served as the most widely accepted benchmark for setting interest rates for more than $350 trillion of futures, options, swaps and other derivative financial instruments annually. Libor for a wide range of currencies and maturities was established through the British Bankers' Association based upon contributing banks' self-reported borrowing costs in the London interbank lending market. Significantly, the reported borrowing costs were not based upon actual transactions, but rather upon each contributing bank's estimation of its then-current borrowing costs.

Regulators allege that for years, contributing banks systematically 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. Some of this misconduct involved alleged collusion between traders at peer banks.

Three Libor panel banks have settled with regulatory authorities thus far (there were 18 on the U.S. dollar currency panel at the relevant times). Since June 2012, Barclays, UBS and the Royal Bank of Scotland have paid a collective $2.5 billion in criminal and civil penalties to authorities in the U.S. and overseas. As part of its settlement agreement, each disclosed and admitted to conduct set forth in detailed factual recitations. More settlements will undoubtedly follow; JP Morgan Chase and Citigroup have already acknowledged that they are being probed by regulators.

The First Wave of Private Litigation

Bolstered by evidence disclosed in the settlement agreements and motivated by the prospect of recovery against deep-pocketed defendants, dozens of plaintiffs — individuals, groups and classes — have filed Libor-related suits. An August 2011 order consolidated federal Libor litigation before Judge Naomi Reice Buchwald of the Southern District of New York. On March 29, 2013, Judge Buchwald issued a 161-page opinion decimating the bulk of those claims.

Antitrust theories, Judge Buchwald decided, were a nonstarter. Even if a plaintiff could prove that the banks colluded to fix the interest rates, and alleged resulting harm, that alone would not be enough — the plaintiff must also allege that the harm resulted from an anti-competitive aspect of the defendants' conduct. Because the Libor-setting process itself was intended to be collaborative, rather than competitive, there was no competitive market to subvert, and therefore plaintiffs could not show the requisite antitrust injury.

Nor could plaintiffs avail themselves of the RICO anti-racketeering statute. Under a provision of the Private Securities Litigation Reform Act of 1995, RICO cannot be used in cases that could have been brought as securities actions — as these could have been, according to Judge Buchwald. Moreover, RICO applies only to domestic enterprises, and the focal point of the alleged Libor manipulation was in London.

On May 3, 2013, Judge Buchwald granted the plaintiffs leave to attempt to amend their complaints to sufficiently allege antitrust injury, but expressed extreme skepticism that the promised new allegations "would change the outcome reached in our memorandum and order." Thus — barring a contrary decision on reconsideration or a reversal by the Second Circuit on appeal — Libor plaintiffs will not be able to recover the treble damages and attorney's fees produced by a successful antitrust or racketeering claim.

Schwab and Securities Fraud: New Theories, Inherent Obstacles

Judge Buchwald did not slam the door entirely shut, however. She permitted a subset of commodities manipulation claims based on Eurodollar futures contracts to proceed under the Commodity Exchange Act. She declined to exercise supplemental jurisdiction over certain state law claims. And, perhaps most significantly, she implied that securities fraud would have been a viable cause of action under certain circumstances:

If the offering materials described how Libor was calculated by reference to the "proper" procedures rather than the manipulation that allegedly was occurring, they would contain a material misrepresentation. If they did not describe how Libor was calculated, they would still be omitting that

Libor was being manipulated, surely a material omission.

To be sure, not all — or even many — putative Libor plaintiffs could avail themselves of this theory. It only applies to securities — floating-rate bonds pegged to Libor, for example — and not swaps or other derivative instruments. The securities would have to have been purchased directly from a Libor-manipulating bank. And only those plaintiffs who bought securities in sufficient quantity to justify the expense of litigating would be in a position to pursue these claims. But Schwab fits the bill, and others assuredly do, too.

Schwab — one of the plaintiffs in the Buchwald litigation — alleges in its new case that the defendants (all Libor panel banks) conspired to suppress the benchmark borrowing rate, enabling them to pay unduly low returns on Libor-pegged securities that they issued. Based on the banks' alleged misrepresentations regarding how Libor was set, Schwab asserts, among other claims, common-law fraud liability and violations of Sections 11, 12 and 15 of the Securities Act of 1933.

Despite Judge Buchwald's implicit endorsement of the securities fraud theory, Schwab and future plaintiffs who assert similar claims, will have a difficult time actually recovering. Issues of timeliness, causation and damages are inherent obstacles that private plaintiffs will be hard-pressed to overcome.

- Timeliness: The one- and three-year statutes of limitations governing applicable securities and common law fraud claims will be a substantial obstacle, particularly since the conduct at issue was the subject of widespread publicity before that period. Indeed, Judge Buchwald held that the multidistrict plaintiffs were "clearly on inquiry notice" of their injury with the publication of a Wall Street Journal article about Libor manipulation on May 29, 2008.

Anticipating this problem, Schwab alleges in its new complaint that the "fraudulent and surreptitious nature of the defendants' misconduct" should itself toll the statute and preserve their claims. Despite the swirling rumors and front-page newspaper headlines, Schwab asserts, it was justified in relying on the defendants' official assurances that Libor was legitimate. Thus, it was only on notice of its injury once UBS disclosed that it was under government investigation in March 2011. The statute, Schwab argues, was further tolled by Schwab's status as a class member in the multidistrict proceedings.

It remains to be seen whether Schwab's tolling argument will hold water. Interestingly, if the case is removed to California federal court because of the Securities Act claims, it will presumably end up back before Judge Buchwald in New York — and her May 29, 2008 notice date — pursuant to the multidistrict consolidation order.

- Causation and damages: Even if plaintiffs like Schwab are able to prove that the Libor-setting process was compromised; that the manipulating banks misrepresented their conduct; that the plaintiffs reasonably relied on those misrepresentations; and that their suit was timely filed, they will still be faced with the daunting task of proving causation and specific damages.

To do so 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. While impact will be easier to show as more banks settle and admit to misconduct, further calculations will be necessary. 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.

Barclays: "Fundamental Deficiencies Under the Securities Laws"

On May 13, 2013, Judge Buchwald's colleague in the Southern District of New York, Judge Shira Scheindlin, dismissed a securities class action against Barclays PLC (a Libor panel bank). The complaint alleged that plaintiffs purchased American Depository Receipts (ADRs) from Barclays during the period in which it has admitted to manipulating Libor, and that the ADRs tumbled in value when Barclays disclosed its regulatory settlements in June 2012.

Judge Scheindlin held that the alleged misrepresentations — in sum, representing Barclays as a "model corporate citizen" — were largely "mere puffery" and not actionable under Rule 10(b)(5). Even if there had been material misrepresentations before 2009, they were too attenuated from the 2012 disclosure to establish loss causation, she held.

The Barclays suit was brought on a different — indeed, a weaker — fact pattern than the one contemplated by Judge Buchwald and pursued by the Schwab plaintiffs. The ADRs were shares of the bank; they were not directly pegged to Libor. Nor did the alleged misrepresentations specifically concern Libor. But the decision is nonetheless another example of the difficulties securities plaintiffs — like all private plaintiffs — face in trying to recover for banks' misconduct.

In the end, as Judge Buchwald wrote, accountability will come chiefly from regulators: "The broad public interests behind the statutes invoked here, such as integrity of the markets and competition, are being addressed by ongoing governmental enforcement."

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