Market Manipulation in Energy-Related Markets

By Shaun Ledgerwood and Jeremy Verlinda[30]

Introduction

A market manipulation occurs when an economically rational actor deliberately uses a false or fraudulent act to cause demand or supply to deviate from their economic fundamentals in order to benefit from that deviation. The act can take the form of an output restriction (an uneconomic act of withholding), output expansion (through intentionally uneconomic purchases or sales) or can be purely information-based. Such deviations can result in unjustifiable transfers of wealth and inefficient long-term investments. Market manipulation also undermines trust in the prices that guide the economy and can reduce economic efficiency even after the manipulative behavior has stopped.

This article reviews two recent energy-related manipulation cases where the plaintiffs claimed antitrust harms but received very different outcomes following Motions to Dismiss. The district court in the first case, involving the alleged manipulation of a benchmark for North Sea Brent Crude Oil in possible violation of the Commodity Exchange Act, Sherman Act Sections 1 and 2, and various state laws ("*Brent*"),[31] recently granted defendants' motions to dismiss each of the plaintiffs' complaints.[32] The second complaint, filed by Merced Irrigation District[33] alleging manipulation of four western power indices ("*Merced*"), saw dismissal of the alleged Sherman 1 claims, but the alleged Sherman 2 claims were allowed to proceed.[34] The rulings in these two cases contribute to a nascent but growing case law on the reach of the antitrust laws with regard to market manipulation.

Brent – Summary and Current Status

In *Brent*, two separate sets of plaintiffs have alleged that Brent crude oil producers, traders, and affiliates conspired to manipulate exchange prices for Brent crude oil and its futures and derivatives contracts. Plaintiffs allege that Defendants manipulated the Platts Dated Brent benchmark, which summarizes daily over-the-counter physical trades of Brent crude oil, by submitting fraudulent information

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[31] In re: North Sea Brent Crude Oil Futures Litigation ("Brent"), No. 1:13-md-02475 (S.D.N.Y. 2017), Amended Consolidated Class Action Complaint.

[32] *Brent*, "Opinion and Order on Motions to Dismiss" (2017).

[33] Merced Irrigation District is an electric utility that serves 8,500 retail customers in the San Joaquin Valley of Northern California. See http://www.mid.org/about/default.html.

[34] Merced Irrigation Dist. v. Barclays Bank PLC, No. 15-cv-04878 (S.D.N.Y. 2015) ("Merced Complaint").

about those trades to Platts during the benchmarking period and engaging in "spoof orders" and "wash sales".[35] Following a similar procedural history for *Libor*,[36] *Aluminum*,[37] and other recent manipulation cases, Defendants filed motions to dismiss based principally on issues of antitrust standing.[38]

The court noted that (a) Plaintiffs do not participate directly in the physical Brent crude oil market; (b) Plaintiffs only allege that the manipulation occurred in the physical Brent crude oil market; (c) Plaintiffs participated mainly in the NYMEX and ICE Brent futures and derivatives markets; and, critically, (d) all of the Brent futures traded on NYMEX and ICE are pegged to the "ICE Brent Index", which does not incorporate the Platts Dated Brent in its calculation.[39] Consequently, although Plaintiffs alleged a market that encompassed both physical trades and the NYMEX/ICE futures and derivatives, the court concluded that Plaintiffs do not have antitrust standing because they participate neither in the direct market where the alleged manipulation occurred nor in a market that is "inextricably intertwined" with the physical market where the alleged manipulation occurred.[40]

The court's decision in *Brent* mirrors the decisions in *Aluminum* and the *Forex* end-user class actions.[41] Plaintiffs in those cases were found to lack antitrust standing on grounds that they did not participate in the market where the benchmark was manipulated.[42] However, this ruling differs factually from several other

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[35] "Spoofing" refers to the placement of bids or offers into the market with the intent to cancel the bid or offer before execution. See *Antidisruptive Practices Authority*, Commodity Exchange Act Release No. 3038-AD96 (May 20, 2013). "Wash sales" (or, more generally, "wash trades") are purchases and sales that match each other in price, volume and time of execution such that they involve no change in beneficial ownership. The CFTC prohibition against wash trades resides in 7 U.S.C. § 6c(a) (2006).

[36] In re Libor-Based Financial Instruments Antitrust Litigation, No 1:11-md-2262-NRB (S.D.N.Y. 2012).

[37] In re Aluminum Warehousing Antitrust Litigation, Nos 1:14-cv-03116, 1:14-cv-03121, and 1:14-cv-03122 (S.D.N.Y.).

[38] Defendants also submitted motions to dismiss based on extraterritoriality claims. See *Brent* Opinion and Order on Motion to Dismiss (June 18, 2017), at 7-8. The district court has ruled that the Commodity Exchange Act claims are dismissed on grounds that they are impermissibly extraterritorial. See *Brent* Opinion and Order on Motion to Dismiss at 16.

[39] The court acknowledged that some derivatives traded on NYMEX and ICE Futures Europe incorporated Platts Dated Brent. However, because plaintiffs did not allege to buy or sell such derivatives contracts, the court found no antitrust standing in this space either. See *Brent* Opinion and Order on Motion to Dismiss at 22-23.

[40] Judge Carter dismissed Plaintiffs' combined market definition as a legal claim, not a factual one. See *Brent* Opinion and Order, at 20.

In *Aluminum*, the appellate court wrote in its opinion that "[I]n Blue Shield of Virginia v. McCready, 457 U.S. 465, 102 S.Ct. 2540, 73 L.Ed.2d 149 (1982), the Supreme Court 'carved a narrow exception to the market participant requirement for parties whose injuries are `inextricably intertwined' with the injuries of market participants' " (In re Aluminum Warehousing Antitrust Litigation, 833 F.3d 151, 157 (2d Cir. 2016) at 158, citing Am. Ad Mgmt., Inc., 190 F.3d at 1057 n.5). The court's decision in *Brent* relies on this interpretation of *McCready*.

[41] See Nypl v. JP Morgan Chase & Co.. No. 15 Civ. 9300 (LGS) (S.D.N.Y. 2017).

[42] In *Aluminum*, Plaintiffs were purchasers of physical aluminum, while Defendants allegedly manipulated warehouse storage costs for non-physically traded aluminum. The appellate court writes

antitrust-based manipulation cases where Plaintiffs have (ultimately) been found to have antitrust standing because they participate in the same market that is allegedly manipulated—see *Libor*, *Silver Fixing*,[43] and the *Forex* exchange class.[44]

Merced – Summary and Current Status

Merced Irrigation District ("MID") brought antitrust claims against Barclays Bank, PLC and four traders (collectively, "Barclays") for the alleged manipulation of price indices at four western power trading hubs over the period November 1, 2006 through December 31, 2008.[45] The lawsuit ties to an enforcement action brought by the Federal Energy Regulatory Commission ("FERC") under its anti-manipulation Rule 1c,[46] which assessed $487.9 million in disgorgement and civil penalties against the accused.[47] Barclays was found to have used uneconomic purchases and sales of power to bias index prices up or down, in benefit to much larger financial derivatives positions it held that were long or short to those indexed prices.[48]

MID's complaint sought class certification based on three antitrust claims: (1) a Section 1 claim, based on the allegation that the contracts that Barclays used to bias the relevant indices created an unreasonable restraint of trade; (2) a Section 2 claim, that Barclays acquired, maintained and exercised the monopoly power needed to profitably increase or decrease the index prices at issue; and (3) attempted monopolization under Section 2 (as an alternative to Count 2).[49] Ruling on a subsequent Motion to Dismiss, the *Merced* court dismissed the Section 1 claim, finding that the contracts allegedly used to bias the indices did not constitute agreements to restrain trade.[50] However, the Section 2 claims survived due to facts alleging direct evidence of Barclays' unilateral exercise of market power "to distort

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"…Consumers and Commercials [Plaintiffs at issue in the appellate decision] allege…that the injuries Consumers and Commercials suffered by paying a higher Midwest Premium were "inextricably intertwined" with that scheme. This gets McCready backwards. Even assuming a plausible allegation that the defendants conspired to corrupt the primary aluminum market, the purported injuries of Consumers and Commercials were not "the very means" by which the defendants achieved that illegal end; insofar as anyone's injury could be "the very means," it would be the injury suffered by participants in the market for LME-warehouse storage…Injury to Consumers and Commercials remains collateral damage." In re Aluminum Warehousing Antitrust Litigation, 833 F.3d 151, 157 (2d Cir. 2016) at 162-163.

[43] See In re London Silver Fixing, Ltd. Antitrust Litig. ("Silver Fixing"), ___ F. Suppl. 3d ___, No. 14-MD-2573, 2016 WL 5794777 (SDNY 2016) at 10-11.

[44] See Forex, No. 13 Civ. 7789, 2016 WL 5108131, (S.D.N.Y. 2016).

[45] Merced Complaint, ¶ 1.

[46] 18 C.F.R. § 1c (2010).

[47] Barclays Bank PLC, 144 FERC ¶ 61,041 (2013), ¶ 8. The case is now under de novo review in the Eastern District of California. FERC v. Barclays Bank PLC, 2:13-cv-02093-TLN (E.D. Cal. 2013).

[48] Merced Complaint, ¶ 2.

[49] Merced Complaint, ¶¶ 126-144. MID also claimed relief under the California Business & Professions Code and the theory of unjust enrichment. *Id.*, ¶¶145-152.

[50] Merced Irrigation Dist. v. Barclays Bank PLC, No. 15-cv-04878 (S.D.N.Y. 2016) ("Merced Order on Motion to Dismiss"), pp. 31-32.

ordinary forces of supply and demand[…] through uneconomical physical trading positions[.]"[51] The case is presently awaiting a ruling on class certification.

Remaining Questions & Unresolved Issues

Antitrust law increasingly is used as the legal basis for bringing civil claims against manipulative acts,[52] particularly if no anti-manipulation laws were in place at the times the behavior occurred or when the existing manipulation laws fail to provide a cause of action. However, because none of the claims filed to date have been fully litigated, it remains unclear as to whether the transient market distortions typical of manipulative acts give rise to an actionable antitrust injury, with or without the presence of collusive behavior. This uncertainty raises several economic questions that help to determine the applicability of antitrust law to remedy injuries arising from market manipulation.

For example, does the ability to profitably manipulate a price index to benefit financial positions traded in a separate, related market but valued from that price constitute a market power abuse? Would more remote sources of recoupment tied to the index that would increase the profitability of the manipulative scheme increase the actor's alleged market power? How should intentionally uneconomic behavior be viewed under antitrust law when it is used to manipulate prices? What is the relevance of the actor's intent to this calculus? If manipulative acts executed unilaterally do not raise a viable claim under Section 2, should otherwise identical manipulative conduct with an identical effect give rise to a claim under Section 1?

At the present time, neither *Brent* nor *Merced* answers these questions, although they and other manipulation cases yet may, pending full trial. Concerning Section 1 claims, the appellate court in *Gelboim*[53] vacated Judge Buchwald's original decisions in *Libor*, concluding that allegations of horizontal price fixing of benchmarks may constitute per se antitrust violations, preserving the potential for antitrust injury in market manipulation cases alleging conspiracy. Since *Libor* and most other cases focus on conspiracies to manipulate benchmark prices, they are unlikely to illuminate questions around Section 2 monopolization.

Merced, however, may lead to guidance on unilateral market manipulation and the antitrust laws. The *Merced* court's dismissal of MID's Section 1 claim may reflect that parties transacting standardized contracts multilaterally on exchanges

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[51] *Id.*, p. 40. MID's claim under the California Business & Professions Code also survived, but its claim of unjust enrichment was dismissed. *Id.*, pp. 45, 48.

[52] See, for example, *In re Libor-Based Financial Instruments Antitrust Litigation*, No 1:11-md-2262-NRB (S.D.N.Y. 2012) (alleged manipulation of Libor); *In re Foreign Exch. Benchmark Rates Antitrust Litig.*, 13-cv-07789-LGS (S.D.N.Y. 2014) (alleged FOREX manipulation); *Alaska Elec. Pension Fund v. Bank of Am.*, No. 14-cv-07126 (S.D.N.Y. 2014) (alleged manipulation of ISDAfix); and *In re Zinc Antitrust Litig.*, No. 14-cv-3728 (S.D.N.Y. 2016) (order dismissing Clayton Act claims but allowing the remaining Sherman 2 to proceed against an alleged zinc warehousing manipulation).

[53] Gelboim v. Bank of Am. Corp. ("Gelboim"), 823 F.3d 759, 770 (2d Cir. 2016), cert. denied, 137 S.Ct. 814 (2017). The court remanded to the district court the question of further antitrust standing based on whether Plaintiffs are "efficient enforcers" of the antitrust laws.

trade will typically have no communication with their direct counterparties.[54] However, in addressing whether manipulative acts could give rise to an antitrust injury, the court reasoned that "Merced has pled an antitrust injury causally linked to Barclays' practices: it is a purchaser of electricity on the daily markets in which it alleges it paid higher supra-competitive prices or received lower sub-competitive prices as a result of Barclays' rate-manipulation."[55] Finding that "[t]his is an injury 'of the type the antitrust laws were intended to prevent'",[56] the court allowed MID's Section 2 claims to survive, possibly opening the door for antitrust to take a broader role in civil claims brought against unilaterally-executed manipulative behavior.

[54] This is especially true when the party's sales or purchases are intentionally-uneconomic, for the counterparty then benefits from the exchange by (respectively) paying or receiving a favorable price.

[55] Merced Order on Motion to Dismiss, pp 13-14.

[56] *Id.*, p. 14, citing *Brunswick Corp. v. Pueblo Bowl-0-Mat, Inc.*, 429 U.S. 477, 488 (1977).