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ANTITRUST & YOUR CITY
A Primer

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I. INTRODUCTION

Why should we care about Price-Fixing and Bid-Rigging?

Interest rate and bid-rigging may seem remote but have a very real impact on public entities. Public entities, such as municipalities, cities and towns seek to raise money from a variety of sources, often tied to interest rates or other benchmarks to fund public projects. Over the last few years, hundreds of municipalities, cities and towns were deprived of money on interest rate swaps due to manipulation, and their bonds only achieved suppressed rates of return due to bid rigging. Banks and other financial institutions were artificially setting the interests rates that public entities were depending on. Brokers hired to pursue a competitive bidding process for the bond awards arranged predetermined bids, which caused public entities to loose in these agreements. In doing so, schools, cities, hospitals libraries and nursing homes – from virtually every state, city and town in the United States were deprived of sorely needed funds.

So how is this process supposed to work?

The public is best served by competition in trade. When markets involve independent businesses, the quality of products and services increase, innovation flourishes, and prices are driven to decrease – but the competitive process only works when competitors set prices honestly and independently. When competitors collude by price-fixing, bid-rigging, or other anticompetitive activity, prices are inflated and the consumer, in this case, the public entity, is cheated.

In 1890, the Sherman Antitrust Act was enacted to remedy these kinds of collusive schemes, prohibiting any agreement among competitors to fix prices, rig bids, or engage in other anticompetitive activity. The Sherman Antitrust Act (the "Sherman Act"), 15 U.S.C. §§ 1–7 (1890). The Supreme Court of the United States explained:

> The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself.
>
> *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993).

Basic Overview of Collusive Schemes

Price-fixing and bid-rigging schemes are per se violations of the Sherman Antitrust Act. Per se violations are characterized as having a "'pernicious effect on competition' or 'lack[ing] . . . any redeeming virtue,'" *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58 (1977), and require no further inquiry into the actual effect on the market or the intentions of those individuals who engaged in the practice. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1556

(1984) (a per se violation forecloses analysis of the purpose or market effect of a restraint).

Antitrust laws treat concerted behavior more strictly than unilateral behavior because concerted activity by would-be competitors is inherently full of anticompetitive risk. When two or more independent entities join forces, they begin to act for their common benefit which results in a detriment to consumers. This is why horizontal price-fixing agreements, agreements among sellers to establish prices on certain goods or services, are per se violations of the Sherman Act. *See generally United States v. Socony-Vacuum Oil Co*., 310 U.S. 150, 210-28 (1940).

By way of examples, Part II will discuss the financial manipulation of Euroyen TIBOR and Yen-LIBOR and Part III will discuss the municipal derivative investigation. Finally, Part IV will discuss the impact of anticompetitive conduct on public entities.

A. Price-Fixing

Price-fixing is an agreement among competitors to raise, fix, or otherwise maintain the price at which their goods or services are sold. To allege a price-fixing claim: there must be (i) a plurality of participants;[1] (ii) an agreement;[2] (iii) the restraint must fail the appropriate "reasonableness" test;[3] (iv) the plaintiff must be an efficient enforcer of antitrust laws.[4]

B. Bid-Rigging

Bid-rigging is an agreement among competitors predetermining who will be the winning bidder for a purchaser soliciting a bid to purchase goods or

[1] *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984) (explaining why concerted activity is judged more sternly than unilateral activity).

[2] *Monsanto Co. v. Spray-Rite Serv. Corp*., 465 U.S. 752, 764 (1984) ("Circumstances must reveal a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement.")

[3] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007). (The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1 (15 U.S.C.S. § 1) of the Sherman Act. Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. Appropriate factors to take into account include specific information about the relevant business and the restraint's history, nature, and effect...) (internal citations and quotations omitted).

[4] *Daniel v. Am. Bd. of Emergency Med.*, 428 F.3d 408, 443 (2d Cir. 2005) ("[F]actors generally considered relevant to standing are (1) "the directness or indirectness of the asserted injury"; (2) "the existence of an identifiable class of persons whose self-interest would normally motivate them to vindicate the public interest in antitrust enforcement"; (3) the speculativeness of the alleged injury; and (4) the difficulty of identifying damages and apportioning them among direct and indirect victims so as to avoid duplicative recoveries.") (quoting *Associated Gen. Contractors of California v, California State Council of Carpenters*, 459 U.S. at 540-45).

services. Four basic schemes involved in most bid-rigging conspiracies are: [5]

1. Bid Suppression: One or more competitors agree to refrain from bidding or withdraw a previously submitted bid, so that the designated winning competitor's bid will be accepted.

2. Complementary Bidding: Co-conspirators submit token bids which are intentionally high or which intentionally fail to meet all of the bid requirements in order to lose a contract.

3. Bid Rotation: In bid rotation, all co-conspirators submit bids, but by agreement, take turns being the low bidder on a series of contracts.

4. Customer or Market Allocation: Co-conspirators agree to divide up customers or geographic areas. The result is that the coconspirators will not bid or will submit only complementary bids when a solicitation for bids is made by a customer or in an area not assigned to them. This scheme is most commonly found in the service sector and may involve quoted prices for services as opposed to bids.

When one of these schemes is successful, the purchaser, in this case, a public entity, who depends on competition between the bidders to generate the lowest competitive price, receives instead a "lowest bid" that is higher than the competitive market would have produced.

II. EUROYEN TIBOR & YEN-LIBOR: Price-fixing

A. Overview

Euroyen TIBOR and Yen-LIBOR are intended to reflect the rate of interest charged on short-term loans of unsecured funds denominated in Japanese yen between banks in the Euroyen market. In addition to pricing loans in the Euroyen market, Euroyen TIBOR and Yen-LIBOR are used to price, settle, and benchmark many financial instruments, including Euroyen TIBOR futures contracts.

The Japanese Bankers Association (the "JBA") calculates and publishes Euroyen TIBOR based on rate submissions received from JBA Euroyen TIBOR contributor banks. Until 2014, the British Bankers Association (the "BBA") calculated and published Yen-LIBOR based on rate submissions received from BBA Yen-LIBOR contributor banks. For Euroyen TIBOR, the contributor banks are required to submit rates they deem to be prevailing rates in the Euroyen

[5] Department of Justice, "Price Fixing, Bid Rigging, and Market Allocation Schemes: What They Are and What to Look For, *available at* http://www.justice.gov/atr/public/guidelines/disaster_primer.htm

assuming transactions between prime banks unaffected by their own positions. For Yen-LIBOR, the contributor banks are required to submit rates reflecting what they could borrow funds in the Euroyen market if they were to ask for and then accept inter-bank offers in a reasonable market size. JBA Euroyen TIBOR or BBA Yen-LIBOR contributor banks are not allowed to report rates that are reflective of factors unrelated to prevailing costs of borrowing unsecured funds in the Euroyen market.

B. *Laydon v. Mizuho Bank, Ltd*, Docket No. 12-cv-03419 (GBD)

In *Laydon v. Mizuho Bank, Ltd. et al.*, No. 12-cv-03419, Defendants served as JBA Euroyen TIBOR and/or BBA Yen-LIBOR reference banks during the Class Period. In that capacity, they were directly responsible for the setting of JBA Euroyen TIBOR and BBA Yen-LIBOR during the Class Period, and thereby controlled pricing for Euroyen derivatives, including Euroyen TIBOR futures contracts. Although Defendants were responsible for setting these rates, Defendants were also engaging in for-profit trading of Euroyen TIBOR futures and other Euroyen derivatives contracts, which were benchmarked, traded and/or price-settled to Euroyen TIBOR and/or Yen-LIBOR. Defendants not only used proprietary knowledge gleaned from their role as a contributor panel bank, to make investment decisions, they also manipulated the rates to artificial levels. The following examples of this misconduct are memorialized in the Department of Justice Statement of Facts:[6]

- Between January 2005 to at least June 2010, Defendant UBS made deliberately false submissions of Euroyen TIBOR and Yen-LIBOR to the JBA and BBA, respectively, to move these rates in an artificial direction that financially benefitted UBS's Euroyen derivative trading positions and, on certain occasions, the Euroyen derivatives trading positions of other Contributor Bank Defendants.

- Commencing in 2006 through 2010, RBS made false Yen interest rate submissions to benefit its Euroyen derivatives and Euroyen money market trading positions. At times, RBS aided and abetted other Contributor Bank Defendants' manipulative acts in settling the Yen interest rate. This misconduct involved more than a dozen RBS derivatives and money market traders, one manager, and multiple offices around the world, including London, Singapore and Tokyo. During this period, RBS's Yen

[6] *See* United States ("U.S.") Department of Justice ("DOJ"), Criminal Division, Fraud Section Non-Prosecution Agreement ("DPA") and Appendix A Statement of Facts ("SOF") with UBS AG; *see also* U.S. DOJ, Criminal Division, Fraud Section, and Antitrust Division DPA and Attachment A SOF with The Royal Bank of Scotland plc; *see also* U.S. DOJ, Criminal Division, Fraud Section and Antitrust Division Plea Agreement and SOF with RBS Securities Japan Limited; *see also* U.S. DOJ, Criminal Division, Fraud Section and Antitrust Division DPA and Attachment A SOF with Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.. The UBS, RBS and Barclays Settlements are also memorialized in "CFTC Orders" and "FSA Final Notices" which include additional factual allegations consistent with the admissions contained in the DOJ "Statement of Facts" regarding unlawful acts by Defendants UBS, RBS, and Barclays.

trading desk was responsible for generating nearly $200 million in revenues from Yen interest rate derivatives trading.

- From 2006 through approximately June 2007, and in June 2009, Barclays' interest rate derivatives traders made at least twenty-six internal requests to Barclays' submitters to manipulate Yen interest rates in a direction that would benefit Barclays' Euroyen related positions. Barclays' swaps traders made requests of interest rate derivatives traders at other Contributor Bank Defendants for favorable submissions from those banks and received requests from traders at other contributor banks for artificial Yen interest submissions from Barclays' rate submitters, so as to coordinate their manipulative and anticompetitive conduct.

C. Government Settlements and Guilty Pleas

The Contributor Banks' unlawful conduct relating to Euroyen TIBOR and Yen-LIBOR resulted in agreements with government regulators resulting in the collective payment – to date – of over $4.5 billion in fines and penalties (among other relief) by Defendants UBS, RBS, Rabobank ($1 billion fine expected to be announced in early November) and Barclays PLC, Barclays Bank PLC, and Barclays Capital Inc. (collectively, "Barclays"). The settlements resolve DOJ, U.S. Commodity Futures Trading Commission ("CFTC"), and Britain Financial Services Authority ("FSA") criminal and/or civil charges relating to restraints of trade and manipulation of Euroyen TIBOR, Yen-LIBOR, Euroyen TIBOR futures and other Euroyen derivatives contracts.

Defendant UBS Securities Japan Co., Ltd. ("UBS Securities Japan"), a wholly owned subsidiary of Defendant UBS AG, agreed to waive indictment and plead guilty to a one-count criminal information filed in the District of Connecticut by the Criminal Division, Fraud Section, of the DOJ charging UBS Securities Japan with wire fraud, in violation of 18 U.S.C. § 1343 and 2. UBS Securities Japan agreed to cooperate with the DOJ's investigation of false reporting of Euroyen TIBOR and Yen-LIBOR (among other unlawful conduct) and agreed to a pay a fine of $100 million.

Defendant RBS Securities Japan Limited ("RBS Japan"), a wholly owned subsidiary of Defendant RBS, agreed to waive indictment and plead guilty to a one-count criminal information filed in the District of Connecticut by the Criminal Division, Fraud Section, of the DOJ charging RBS Japan with wire fraud. RBS Japan agreed to cooperate with the DOJ's investigation of false reporting of Yen-LIBOR (among other unlawful conduct) and agreed to pay a fine of $50 million.

III. MUNICIPAL BONDS DERIVATIVE LITIGATION: Bid-rigging

A. Overview

Municipal derivatives are specialized investment vehicles used by issuers of municipal bonds, generally, for one of two purposes: (1) investment of unused bond proceeds; and (2) hedging of interest rate exposure on underlying bonds. The most common type of municipal derivative used for reinvestment purposes is a Guaranteed Investment Contract ("GIC"). The most common type of municipal derivative used for hedging is an Interest Rate Swap.

Between at least 1998 and 2003, a large number of bond offerings undertaken by various state and local municipalities and authorities were victims of a widespread scheme orchestrated by banks and brokerage firms to rig the bidding process used to select the financing firms to issue these bonds.

B. DOJ Investigation of Fraud Involving GICs

The DOJ identified and investigated an antitrust conspiracy among major Wall Street banks to rig bids in the market for municipal derivatives associated with bond issuances, which led to nearly one dozen individual indictments. In addition, Bank of America ("BofA") agreed to cooperate with the DOJ and recently announced it agreed to settle the government's charges by entering into a settlement agreement whereby the Cooperating Bank would pay $137 million to various government agencies including the DOJ, the Securities and Exchange Commission ("SEC"), and a group of twenty state Attorneys' General.

In the DOJ's ongoing criminal investigation, more than two dozen financial institutions, insurance companies, and brokers were targeted, including JPMorgan, Bear Stearns, Société Générale, GE/Trinity, Smith Barney, and others. The complaints have named more than three dozen companies and brokers. The IRS, SEC, and State attorneys general are also investigating aspects of derivatives bid-rigging and more than a dozen individuals have been notified by the SEC that they face civil suits. To date, a total of 17 individuals have been convicted or pleaded guilty. For example, JP Morgan settled with the SEC, but two former managers now face trial. Defendant Bank of America ("BofA") entered the DOJ amnesty program in February 2007. In February 2010, one of CDR's former bidding agents, Daniel Naeh, pleaded guilty to bid-rigging and fraud conspiracies. In March 2010, two more bidding agents, Matthew Rothman and Douglas Goldberg, pleaded guilty to bid-rigging and fraud conspiracies.

C. How Bid-Rigging for Municipal GICs Worked

In February 2014, former BofA executive, Phillip D. Murphy, pleaded guilty for his participation in this conspiracy and scheme to defraud related to bidding

contracts for the investment of municipal bond proceeds and other municipal finance contracts. Murphy won investment agreements through the broker's manipulation of the bidding process in obtaining losing bids from other providers. In exchange for this information, Murphy submitted intentionally losing bids for certain investment agreements and other contracts when requested, and, on occasion, agreed to pay or arranged for kickbacks to be paid to CDR and other co-conspirator brokers. Murphy and his co-conspirators misrepresented to municipal issuers that the bidding process was competitive and in compliance with U.S. Treasury regulations. This caused the municipal issuers to award investment agreements and other municipal finance contracts to providers that otherwise would not have been awarded the contracts if the issuers had true and accurate information regarding the bidding process.

The DOJ investigation and public evidence suggests that the financial impact of the bid-rigging conspiracy was nationwide. This conduct undermined the public's trust and took advantage of taxpayer money and cash-strapped municipalities. Brent Snyder, Deputy Assistant Attorney General said, "By manipulating what is intended to be a competitive bidding process, the conspirators defrauded municipalities, public entities and taxpayers across the country,"

IV. ANTICOMPETITIVE ACTIVITY: The Impact on a City Near You

In both the Euroyen TIBOR and Yen-LIBOR and the Municipal Derivatives investigations, virtually every major bank and finance company on Wall Street was involved in large schemes that skimmed billions of dollars from cities and small towns across the United States.

These cities and towns were harmed by the manipulation of Euroyen TIBOR and Yen-LIBOR because the use of LIBOR is ubiquitous. The anticompetitive conduct was pervasive impacting tens of trillions of consumer loans, and hundreds of trillions in interest rate contracts (swaps) with municipalities throughout the United States. Many state and local governments invest cash in complex financial instruments, including interest-rate swaps tied to various LIBOR rates, which were used to hedge against rate hikes and add certainty to budgets. By artificially driving LIBOR down, the banks cheated the state and local governments out of enormous investment returns at a time when their budgets were already badly damaged from the recession.

In the municipal derivatives litigation, the banks secretly colluded to rig the public bids on municipal bonds to lower the interest rates that towns earn on these investments. In doing so, the banks systematically stole from schools, hospitals libraries and nursing homes – from virtually every state, district and territory in the United States. The banks were lying and cheating cities and towns by shaving

fractions of a percent off their winning bids and thereby stealing incredible sums over the life of a multimillion-dollar bond deal. Lowering a bid by just one-100th of a percent, could cheat a town out of tens of thousands of dollars it would otherwise have earned on bond deposits. Antitrust compliance can and should be a contract term in every vendor and advisor contract and municipalities should seek trusted counsel if they believe they are being deprived of the benefits of robust competition.