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NOTE

LIBOR INTEGRITY AND HOLISTIC DOMESTIC ENFORCEMENT

Milson C. Yu†

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Introduction

From the Great Depression to the Great Recession, financial market crises have often been accompanied by complex phenomena¹ that authorities fail to account for due, in certain instances, to the ostensible simplicity of such phenomena. Take, for example, the interest rate, a fundamental yet simplistic concept in finance. Private banks employ interest rates to account for and assess borrower risk of default.² By controlling the supply of money, central banks attempt to influence interest rates to counter inflation or spur economic growth.³

Simplicity notwithstanding, certain critical interest rates, such as the lesser-known "reference" or "benchmark" rates, should not be overlooked. At essence, these rates serve to convey information about some aspect of the financial markets. The most prominent of the numerous reference rates⁴ is the London Interbank Offered Rate (Libor), a benchmark estimate of the cost of short-term borrowing for large banks situated in London.⁵ Though Libor is currently undergo-

¹ See Joe Nocera, A Wall Street Invention that Let the Crisis Mutate, N.Y. Times, Apr. 17, 2010, at B1 (noting the "introduction of [the] synthetic [collateralized debt obligation]" as a vehicle for Wall Street and market participants to conduct innovative financial transactions such as "short[ing] the subprime market" and "mak[ing] an infinite number of bets on the [subprime loans] that already existed"). Financial innovation plays a disproportionate role in such market phenomena. See, e.g., Goldman Sachs and Abacus 2007-AC1: A Look Beyond the Numbers, Knowledge@Wharton (Apr. 28, 2010), http://knowledge.wharton.upenn.edu/article.cfm?articleid=2481 (describing the complex Abacus 2007-AC1 instrument, a synthetic collateralized debt obligation created by Goldman Sachs); see also World Econ. Forum, Rethinking Financial Innovation: Reducing Negative Outcomes While Retaining the Benefits 24–31 (2012), available at http://www3.weforum.org/docs/WEF_FS_RethinkingFinancialInnovation_Report_2012.pdf (discussing financial innovation's role in the financial crisis of 2008).

² See Gary Gorton & Andrew Winton, Financial Intermediation, in 1A Handbook of the Economics of Finance: Corporate Finance 431, 464 (George M. Constantinides et al. eds., 2003) ("If banks compete actively for loans, the rate they charge initially will reflect average credit quality").

³ See Sarwat Jahan, Inflation Targeting: Holding the Line, INT'L MONETARY FUND, http://www.imf.org/external/pubs/ft/fandd/basics/target.htm (last updated Mar. 28, 2012); see also A. James Meigs & William Wolman, Central Banks and the Money Supply, Fed. Res. Bank St. Louis, Aug. 1971, at 18, 18–19 (explaining how monetarist economists believe money supply can control inflation); Andreas Schabert, Money Supply and the Implementation of Interest Rate Targets 13–18 (European Cent. Bank, Working Paper No. 483, 2005), available at http://www.ecb.int/pub/pdf/scpwps/ecbwp483.pdf (examining the relationship between money supply and interest rates).

⁴ See The Wheatley Review, The Wheatley Review of LIBOR: Final Report 54–55 (2012), available at http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf (detailing many other lesser-known benchmark rates and defining the term "benchmark rate").

⁵ See John C. Hull, Options, Futures, and Other Derivatives 76 (8th ed. 2011); see also infra Part I.A.2 (noting that Libor is designed fundamentally to portray accurately the borrowing costs for major banks and depository institutions in the financial markets). Cost of short-term borrowing for an entity often serves as a proxy for the general credit condition and financial health of that entity.

ing reform,⁶ traditionally leading London banks which are members of the British Bankers' Association (BBA) calculate it daily using estimates of these banks' borrowing rates.⁷ Because Libor is such a convenient measure of baseline borrowing cost in the marketplace, it is used, or "indexed," by trillions of dollars' worth of financial instruments, including many derivatives. 10

Libor provides a paradigmatic example of an overlooked, but enormously influential, innovative financial phenomenon. Derived from humble beginnings, 11 Libor was quickly formalized by the BBA and gained widespread acceptance in modern markets. Legal intervention was virtually nonexistent. Unfortunately, this financial cornerstone, whose integrity was and is still central to the continued systemic stability of global markets, fell prey to scandal. In early- to mid-2008, whispers of Libor's inaccuracy erupted into outright doubt after a *Wall Street Journal* article catalyzed markets by reporting that "[m]ajor banks [we]re contributing to the erratic behavior of a crucial global lending benchmark" by "reporting significantly lower borrow-

⁶ See infra note 15.

⁷ The BBA, a trade association of the world's largest banks, used to independently calculated Libor. However, the BBA ceded Libor-setting authority following the manipulation scandal involving Barclays and other member banks. *See infra* Part I.B; *see also infra* Part I.A.1 (providing a detailed description of how Libor is set).

⁸ For example, a bank wishing to raise short-term debt financing may offer to the public medium-term notes with annual interest at the current Libor rate plus two percent. In this manner, the notes reference Libor as the floating rate.

⁹ See Carrick Mollenkamp et al., Libor's Rise May Sock Many Borrowers, Wall St. J., Apr. 19–20, 2008, at B1; Julia Werdigier, British Banker Group to Strengthen Libor Oversight, N.Y. Times, May 31, 2008, at C2. Approximately seventy-five percent of major U.S. cities employ debt instruments indexed to Libor. Nathaniel Popper, Rate Scandal Stirs Scramble for Damages, Deal B%κ (July 10, 2012, 9:28 PM), http://dealbook.nytimes.com/2012/07/10/liborrate-rigging-scandal-sets-off-legal-fights-for-restitution/. Just before the financial crisis, approximately ninety percent of all subprime mortgages issued in Ohio were indexed to Libor. Mark Schweitzer & Guhan Venkatu, Adjustable-Rate Mortgages and the Libor Surprise, Fed. Reserve Bank Cleveland (Jan. 21, 2009), http://www.clevelandfed.org/research/commentary/2009/012109.cfm.

Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions at 6, *In re* Barclays PLC, CFTC Docket No. 12-25 (filed June 27, 2012) [hereinafter Settlement Order] ("LIBOR also affects businesses seeking credit, consumers obtaining mortgages or personal loans, and market participants transacting in numerous other financial contracts in the U.S. and abroad that are based on the benchmark interest rates."). To be clear, a derivative instrument is a financial contract whose value in the marketplace stems formulaically from some other instrument—another derivative, an asset of value, a commodity, a security regulated by the SEC, and countless others. *See* Melanie L. Fein, Securities Activities of Banks § 14.01[A] (4th ed. Supp. 2013).

¹¹ See infra Part I.A.1.

ing costs for . . . Libor." 12 After similar articles were published, 13 the BBA, followed closely by regulators, engaged in its own investigation of potential manipulation. 14

Given Libor's worldwide significance, the United States should have a certain threshold level of oversight over the rate to prevent future rate rigging. Though private litigants can engage in full-hearted litigation, agency action is essential for holistic enforcement against rate rigging. What is not certain, however, is the *extent* to which U.S. authorities, namely the Commodity Futures Trading Commission (CFTC), may enforce U.S. antifraud and antimanipulation laws against overseas banks for submitting false rates to the London

Carrick Mollenkamp & Mark Whitehouse, Study Casts Doubt on Key Rate, WALL St. J., May 29, 2008, at A1; see David M. Ellis, FTI Consulting, LIBOR Manipulation: A Brief OVERVIEW OF THE DEBATE 1 (2011), available at http://www.fticonsulting.com/global2/media/collateral/united-states/libor-manipulation.pdf ("[I]f LIBOR rates are being distorted or manipulated in any way, the ramifications extend to nearly every corner of the global money markets and to participants in many sectors of the global economy "); Carrick Mollenkamp, Bankers Cast Doubt on Key Rate Amid Crisis, Wall St. J., Apr. 16, 2008, at A1 (noting that "[o]ne of the most important barometers of the world's financial health could be sending false signals" due to manipulation); James Surowiecki, Bankers Gone Wild, New YORKER, July 30, 2012, at 25, 25; Ben Protess & Mark Scott, After Barclays Scandal, Regulators Say Rates Remain Flawed, DEALB%K (July 17, 2012, 2:32 PM), http://dealbook.nytimes.com/ 2012/07/17/after-barclays-scandal-regulators-say-rates-remain-flawed/ ("[Barclays] was accused of reporting false rates [to the BBA] that both bolstered its profits and projected an overly rosy image of its health during the financial crisis."). For a comprehensive discussion of the Barclays manipulation scandal as well as ensuing enforcement actions and regulatory reform, see infra Part I.B.

¹³ See, e.g., Carrick Mollenkamp & Laurence Norman, Under Watch, Libor Rises, Wall St. J., May 30, 2008, at C2. Queries into whether Libor was being manipulated were not limited to the newspapers; academics also engaged in similar analyses. See, e.g., Rosa M. Abrantes-Metz et al., Libor Manipulation?, 36 J. Banking & Fin. 136, 140–49 (2012).

¹⁴ See Class Action Complaint for Violation of the Fed. Antitrust Laws at 12–14, Green Pond Rd. Assocs., LLC v. Bank of Am. Corp., No. 12-CV-5822 (S.D.N.Y. filed July 30, 2012).

U.K. authorities, namely the Financial Services Authority, are set to wrest control of Libor calculation out of the BBA's hands. Mark Scott, British Bankers Group May Give Up Control over Libor, DealB%k (Sept. 25, 2012, 1:11 PM), http://dealbook.nytimes.com/ 2012/09/25/british-bankers-group-seen-losing-control-over-libor/. The European Union has also engaged in broad investigations of the rate-rigging scandal, the results of which may lead to "stricter curbs for financial benchmarks." John O'Donnell, EU Prepares for Clampdown on Libor-Style Indexes, Reuters, Sept. 5, 2012, available at http://www.reuters. com/article/2012/09/05/us-eu-libor-law-idUSBRE8840H920120905; see Jennifer Ryan, Central Bankers Meet in Basel as King Leads Libor Talks, Bloomberg (Sept. 10, 2012, 6:29 AM), http://www.bloomberg.com/news/2012-09-08/king-to-lead-central-bankers-seeking-solu tion-to-libor-damage.html ("[T]he European Union has also pledged tougher supervision of Libor, Euribor and other market indices. It's weighing options such as forcing banks to provide real transaction data rather than estimates and increasing the number of lenders involved in the rate setting."). In addition, "Bank of England Governor Mervyn King has . . . called for 'radical reforms' of Libor." O'Donnell, supra. Central bankers from around the world have joined other Libor investigations after an inquiry into Libor rigging. Ryan, supra. Speed in regulation is critical at this juncture; as CFTC Chairman Gary Gensler pointed out, Libor is "still vulnerable to manipulation" because when banks do not lend to each other, "the lack of real transactions underpinning [Libor leaves] it open to tampering." Scott, supra.

organization responsible for calculating Libor. While legislators and regulators on both sides of the Atlantic—including the U.K. Financial Services Authority (FSA) and the U.S. Federal Reserve—engaged in their own investigatory proceedings following the scandal, ¹⁶ various private parties, many situated in the United States, hurled lawsuits against Libor-setting banks. ¹⁷ And the investigation continues: many banks currently not implicated are expected to be caught in the scandal. ¹⁸

The CFTC, in addition to spearheading global regulatory investigative efforts, also engaged in its own investigation against Barclays, one of the first Libor-setting banks embroiled in the scandal, for attempted manipulation and fraud.¹⁹ Ultimately, Barclays offered to settle, and the CFTC accepted, culminating in what would become the largest settlement order the agency has ever agreed to.²⁰ In closing the settlement offer, Barclays agreed to admit that executives had

17 For example, the city of Baltimore filed one of the first private suits against Barclays, claiming that the rate rigging caused many of the city's Libor-indexed investments to sour due to the low rates Barclays attempted to set. See In re Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB, 2012 WL 1522306 (S.D.N.Y. filed Apr. 30, 2012). Various Barclays shareholders filed another class action suit last year, alleging damages stemming from Libor manipulation, among other things; the case is still pending in the Southern District of New York. Gusinsky v. Barclays PLC, No. 12-CV-5329, 2012 WL 2775017 (S.D.N.Y. filed July 10, 2012). This is the first class action suit brought by private litigants since the enforcement actions by the FSA and CFTC.

18 For example, Royal Bank of Scotland said it would "probably face financial penalties connected to . . . rate-rigging" as it joins the ranks of implicated Libor-setting banks. Mark Scott, *R.B.S. Expects Fine over Libor Investigation*, DealB%κ (Nov. 2, 2012, 5:13 AM), http://dealbook.nytimes.com/2012/11/02/r-b-s-expects-libor-fine-amid-third-quarter-loss/.

 19 See Ben Protess, Libor Case Energizes a Wall Street Watchdog, Deal-B%k (Aug. 12, 2012, 8:57 PM), http://dealbook.nytimes.com/2012/08/12/libor-case-energizes-gensler-and-the-c-f-t-c/.

²⁰ Settlement Order, *supra* note 10; *see* Press Release, U.S. Commodity Futures Trading Comm'n, CFTC Orders Barclays to Pay \$200 Million Penalty for Attempted Manipulation of and False Reporting Concerning LIBOR and Euribor Benchmark Interest Rates (June 27, 2012), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6289-12; *infra* Part I.B.2.

Barclays recently settled an enforcement action brought by the CFTC for \$200 million. Settlement Order, *supra* note 10, at 1. Barclays and the Royal Bank of Scotland also face potentially crippling lawsuits with "billions of pounds of claims." Alistair Osborne, *Banks Face Crippling Libor Litigation Costs*, Telegraph (June 28, 2012, 7:34 PM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9363260/Banks-face-crippling-Libor-litigation-costs.html; *see also* David Keohane, *Some More Big Scary Libor Risk Numbers to Digest*, FTALPHAVILLE (July 12, 2012, 1:59 PM), http://ftalphaville.ft.com/2012/07/12/1081181/some-more-big-scary-libor-risk-numbers-to-digest/ (detailing a study from Morgan Stanley analysts covering the potential costs of the Libor manipulation to Barclays and other banks). Costs to other stakeholders such as municipalities are difficult to measure because of the inherent ambiguity in determining damages in a Libor-manipulation suit. *See* Popper, *supra* note 9 ("The efforts to calculate potential losses are complicated by the fact that Libor is used to determine the cost of thousands of financial products around the globe each day. If Libor was artificially pushed down on a particular day, it would help people involved in some types of contracts and hurt people involved in others.").

tried to manipulate Libor.²¹ Had the bank chosen to litigate rather than settle, however, the CFTC would have faced formidable legal obstacles.

First, the CFTC might not have withstood jurisdictional challenges. After all, Libor is not specifically defined in the Commodity Exchange Act (CEA), the CFTC's operative statute;²² additionally, Barclays and other Libor-setting banks are situated primarily in London,²³ where Libor's calculation and dissemination actually occurs. Further, Libor-setting banks report to U.K. organizations and authorities in calculating Libor.²⁴ Second, even assuming that the CFTC could overcome these jurisdictional challenges, the agency might not have a legitimate cause of action under the CEA sufficient to surpass a motion to dismiss. As I describe later, it is unclear just how broadly the CEA covers rate rigging, both on an extraterritorial basis and on substantive grounds.²⁵ Moreover, the traditional extraterritoriality tests for subject-matter jurisdiction under the CEA are in a state of flux after the Supreme Court's recent pronouncement in Morrison v. National Australia Bank Ltd., 26 which abrogated the traditional tests in the securities realm and established that extraterritoriality is a question of jurisdiction and substantive statutory reach otherwise known as substantive statutory merit.²⁷ The conclusion, then, is quite clear: contemporary statutory and regulatory regimes are inadequate to effectively capture reference rates and holistically enforce against their manipulation.²⁸

Ultimately, Barclays is just the tip of the iceberg. To ensure preparedness against future manipulations of and fraud in connection with reference rates, the CFTC must establish a holistic enforcement regime and avoid piecemeal litigation in enforcing against rate rigging. In so doing, the Commission must consider a trio of issues: subject-matter jurisdiction, substantive statutory merit, and the claim itself. Part I of this Note begins this discussion by first describing Libor—its history and modern calculation—and then examining the Barclays case. Part II initiates a descriptive survey of the limits—both jurisdictional and substantive—of CFTC enforcement authority and capability in the Libor rate-rigging context and concludes with an ar-

²¹ Jean Eaglesham et al., Traders' Messages Providing Grist to Regulators for Investigation, WALL ST. J., July 6, 2012, at C1.

²² See *infra* Part II.A for a discussion of the difficulties associated with fitting Libor into the CEA's framework.

²³ See Appendix A: Statement of Facts at 4, In re Barclays, CFTC Docket No. 12-25 (filed June 27, 2012) [hereinafter Statement of Facts].

²⁴ See Press Release, supra note 20.

²⁵ See infra Part II.A.1-2.

²⁶ 130 S. Ct. 2869 (2010).

²⁷ See infra Part II.B.

²⁸ See infra Part II.C.

gument for a holistic approach to enforcement. Current case law and statutory frameworks do not clearly permit the CFTC to reach rate rigging extraterritorially as a matter of substantive merit and subject-matter jurisdiction. In addition, once these two hurdles have been surpassed, the CFTC must still face off against the difficulties inherent in proving a Libor fraud or manipulation case, complicated by Libor's defiance against classification within existing case precedent. Part III outlines a two-part plan to engage the CFTC in active oversight and enforcement of Libor. The plan addresses the jurisdictional and substantive merit questions by reintroducing the conduct and effects tests²⁹ for extraterritorial commodities law and the substantive case question by advocating for the insertion of Libor as a commodity in the CEA followed by reference-rate rulemaking.

I Ubiquitous, Scandalous Libor

A. History and Anatomy of Libor

1. Inception

Libor dates back to 1969, when the London branch of Manufacturer's Hanover Bank organized an \$80 million syndicated loan³⁰ for the Shah of Iran pegged to an interbank offered interest rate based in London.³¹ The boom of the global loan market and the creation of the Eurodollar in the 1960s paved the way for Libor's broad use as a benchmark rate for various instruments to reference.³² As growth in syndicated loans exploded due in part to new regulations that capped the amount of credit risk any individual bank could carry at a given time, a group of "big reference banks within each syndicate" began reporting their funding rate—at weighted average—which changed on a set periodic basis to reflect market conditions.³³ The headmaster of this reporting, Minos Zombanakis, called this new rate the London Interbank Offer Rate, or Libor.³⁴

²⁹ See infra notes 146, 148 and accompanying text.

The term "syndicated loan" describes a standard loan or credit line provided not by one lender but by a group of lenders, and which is structured and executed by one or several financial institutions—mainly banks. Standard & Poor's, A Guide to the Loan Market 7 (2011), available at https://www.lcdcomps.com/d/pdf/LoanMarketGuide.pdf. Syndicated loans are still prevalent today and frequently employ Libor as the reference interest rate. *Id.*

³¹ Kirstin Ridley & Huw Jones, *Libor's Troubled History Features the Shah, Greece and Scandal*, Huffington Post (Aug. 8, 2012, 5:01 AM), http://www.huffingtonpost.com/2012/08/08/libor-history_n_1754745.html.

³² Id

³³ Id. (internal quotation marks omitted).

³⁴ Id

Calculation of this initial rate roughly employed the same formula used today, whereby all members of the syndicate submitted their funding costs and the highest and lowest rates were discarded to prevent skew.³⁵ Incentive to manipulate early Libor was low for two reasons: first, since banks were *lending* money at these rates rather than borrowing, "there was no incentive to low-ball rates"; second, banks were subject to ejection from the syndicate if they submitted an unreasonable rate.³⁶ As the credit markets surged in growth and new derivative instruments blossomed, the BBA intervened in 1986 to consolidate, formalize, and make transparent the rate-setting process for the global credit markets, creating the modern Libor. Through a snowball effect, "Libor became a benchmark for trillions of dollars worth of derivatives," with traders all over the world "watching and dissecting what rates people had been putting in each day, looking for a major change in behaviour."³⁷

2. Methodology

As noted in the previous section, Libor gained prominence after its adoption by the BBA as a benchmark rate representing interbank borrowing costs. The following section details how rate setting occurred *prior* to the relinquishment of control over Libor by the BBA following the rate-rigging scandal. Though the BBA no longer plays a role in Libor setting, the new process—which as of this writing is still in development—will likely look very similar to the discarded one.³⁸

In a speech given late last year, FSA head of conduct Martin Wheatley outlined the basic points around which the reform effort centered. Libor Reform: Main Points in Martin Wheatley's Review, Telegraph (Sept. 28, 2012, 7:07 AM), http://www.telegraph.co.uk/finance/libor-scandal/9572778/Libor-reform-Main-points-in-Martin-Wheatleys-review.html. Among other things, Wheatley emphasized the need for greater governmental administration in the setting of Libor, noted the delicate task of finding a new administrator to replace the BBA, and argued for increased external oversight of the rate-setting process. Id. Nowhere among the proposals was any indication that there would be significant alteration of the calculation method itself. Reform efforts have also failed to review the quality of submissions. In rough market conditions, where banks are simply refusing to lend to each

³⁵ Id.; see infra Part I.A.2.

³⁶ Ridley & Jones, *supra* note 31.

³⁷ Id.

³⁸ See Brooke Masters, Libor Reform to Become Law Next Year, Fin. Times (Sept. 28, 2012, 7:16 PM), http://www.ft.com/intl/cms/s/0/99fcf516-0984-11e2-a5a9-00144feabdc0.html# axzz2AEEI21FX; Harry Wilson, Libor Reform Is "First Step" to City Overhaul, Telegraph (Sept. 28, 2012, 5:25 PM), http://www.telegraph.co.uk/finance/libor-scandal/9574676/Libor-reform-is-first-step-to-City-overhaul.html. Indeed, many commentators view current reform proposals to be insufficient because they address only the issue of manipulation, not the deeper problem the Libor structure imposes. See, e.g., Karen Brettell, Libor Reform May Add Volatility, Increase Some Funding Costs, Reuters, Sept. 28 2012, available at http://www.reuters.com/article/2012/09/28/us-markets-money-idUSBRE88R1C720120928; Tim Worstall, The Libor Reform that Doesn't Reform Libor Enough, Forbes (Sept. 30, 2012, 11:34 AM), http://www.forbes.com/sites/timworstall/2012/09/30/the-libor-reform-that-doesnt-reform-libor-enough/.

The BBA, with its over 200 member banks, defines Libor as "[t]he rate at which an individual contributor panel bank could borrow funds [on an unsecured basis], were it to do so by asking for and then accepting interbank offers in reasonable market size, just prior to 11.00am London time." Included in over \$10 trillion of loans and \$350 trillion of swap derivatives, Libor is set each day for ten currencies, with fifteen maturities quoted for each. All rates are submitted between 11:00 AM and 11:10 AM London time and disseminated to the public by 12:00 PM London time each day.

The BBA's Libor-setting capacity comprises a number of Contributor Panels, one for each currency quoted, for a total of ten Panels; each Panel consists of BBA-approved banks that trade in the London market.⁴⁴ For example, the Panel for U.S. dollar Libor in 2010 con-

other, should Libor submissions still be based on actual market transactions or on modeled predictions? *See* Worstall, *supra*. Reform legislation is now making its way through the British Parliament, with "evolution rather than revolution" in mind. Huw Jones, *UK Faces Balancing Act with Libor Reform Proposals*, Reuters, Sept. 26, 2012, *available at* http://www.reuters.com/article/2012/09/26/us-britain-fsa-libor-idUSBRE88P0EV20120926.

This Note will not delve into the details of reforming Libor's rate-setting structure, as it is beyond the scope of domestic regulatory jurisdiction to enforce against rigging of the structure in place—whatever that may ultimately be. For a comprehensive outline of reform targets, see generally The Wheatley Review, *supra* note 4, *passim*.

- 39 Definitions, BBALIBOR, http://www.bbalibor.com/bbalibor-explained/definitions (last visited Apr. 10, 2013); see Statement of Facts, supra note 23, at 1. In soliciting quotes, the BBA poses the following question to each Contributor Panel bank: "At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?" The Basics, BBALIBOR, http://www.bbalibor.com/bbalibor-explained/the-basics (last visited Apr. 10, 2013). However, current reform efforts in the United Kingdom have trended toward requiring Libor submissions to be based on real transactions. The Wheatley Review, supra note 4, at 35–36.
- 40 Connan Snider & Thomas Youle, Diagnosing the LIBOR: Strategic Manipulation and Member Portfolio Positions 2 (Dec. 2009) (unpublished manuscript), available at http://www.econ.umn.edu/~bajari/undergradiosp10/LiborManipulation.pdf. Compare this \$350 trillion figure to the total "volume" of interest rate derivatives (the most popular form of swap derivative by a wide margin) outstanding in the second half of 2009: \$450 trillion. See Statement of Facts, supra note 23, at 1.
- The ten currencies are the Australian dollar, the Canadian dollar, the Danish krone, the euro, the New Zealand dollar, the U.K. pound sterling, the Swedish krona, the Swiss franc, the U.S. dollar, and the Japanese yen. Of these ten, the most highly watched are the pound, the U.S. dollar, the euro, and the yen. British Bankers' Ass'n, Understanding the Construction and Operation of BBA LIBOR—Strengthening for the Future § 3.4 (2008).
 - 42 The Basics, supra note 39.
 - 43 Id
- ⁴⁴ See id.; Statement of Facts, supra note 23, at 1–2; see also Panels, BBALIBOR, http://www.bbalibor.com/panels (last visited Apr. 10, 2013) (providing lists of contributor banks for each Panel). The BBA principally selects the banks to participate in each Panel, and the Foreign Exchange and Money Markets Committee reviews the panel selection biannually. See BBA Libor Panels, BBALIBOR (June 10, 2010), http://www.bbalibor.com/news-releases/bba-libor-panels1. The BBA follows three guiding principles in selecting banks for currency Panels: (1) scale of market activity, (2) credit rating, and (3) perceived expertise in the currency concerned. The Basics, supra note 39.

sisted of sixteen banks, including Barclays (which was also a member of the yen and sterling Panels).⁴⁵ After Panel banks make submissions, the BBA ranks them for each currency and maturity, excludes the highest and lowest quartiles, and averages the resulting rates to arrive at that day's Libor "fix," or rate.⁴⁶ The BBA uses this methodology to prevent bias in the final estimate from outlier submissions. According to the BBA, the basis for each submission must be supported by employees responsible for cash management without influence from other bank divisions such as derivatives trading desks, and it should not be derived in any manner from the pricing of any derivative instrument.⁴⁷

Though Libor was initially used as an indicator of the lowest borrowing cost a Panel bank⁴⁸ could achieve, its use has expanded beyond this strict interpretation. Now, market participants and others use Libor as a floating rate of payment in standard derivative and loan documentation as well as certain retail products such as mortgages and college loans.⁴⁹ Libor's prominence in derivatives markets⁵⁰ gives way to clear moral hazard issues because those banks contributing to each day's fix have derivatives and securities positions that may result in profits or losses depending on Libor's movements over time.⁵¹ Further, given that Libor's fixes are attributed to Panel bank factors such as liquidity access and credit risk, perceptions of Libor movements—

⁴⁵ Statement of Facts, *supra* note 23, at 3.

⁴⁶ *Id.* at 1–2.

⁴⁷ *Id.* at 2–3.

The Panel banks supposedly act as proxies for creditworthy, well-capitalized, and liquid banks. See, e.g., British Bankers' Ass'n, supra note 41, at 1 ("LIBOR panel banks . . . are invariably those with the best credit ratings"); Int'l Monetary Fund, Financial Stress and Deleveraging: Macrofinancial Implications and Policy 74 (2008), available at http://www.imf.org/external/pubs/ft/gfsr/2008/02/pdf/text.pdf ("LIBOR . . . rates remain worthwhile as measures of a typical creditworthy bank's marginal cost of unsecured term funds in the wholesale money market").

⁴⁹ The Basics, supra note 39.

⁵⁰ Reference rates, though incredibly useful for ease of exposure hedging and market liquidity, can gather inertia such that alternative rates, which may be more accurate or precise, are ignored for the sake of familiarity. *See* The Wheatley Review, *supra* note 4, at 45–46.

⁵¹ Indeed, this is the exact scenario that Barclays admitted to in its settlement order with the CFTC. See Press Release, supra note 20. Also, structural market characteristics buttress the moral hazard concerns. The Eurodollar futures contract, which is priced to Libor, began trading on the Chicago Mercantile Exchange in 1997, notwithstanding industry concerns that many of the Libor-setting banks would have positions in these Eurodollar contracts. Larry Doyle, Libor Scandal Update: More Evidence from Mid-1990s, Business Insider (Nov. 21, 2012, 10:00 AM), http://www.businessinsider.com/libor-scandal-update-more-evidence-from-mid-1990s-2012-11 ("If [U.S. regulators] approved a Chicago Mercantile Exchange plan to [price Eurodollars to Libor], they would put at risk the integrity of a key interest rate in the global financial system."); see Carrick Mollenkamp et al., Special Report: How Gaming Libor Became Business as Usual, Reuters, Nov. 20, 2012, available at http://www.reuters.com/article/2012/11/20/us-libor-fixing-origins-idUSBRE8AJ0MH20121120.

even if incorrect or untethered to economic foundation—can easily chip away at the integrity of the rate.⁵²

During the period leading up to and after the recent financial crisis, "numerous sources in the financial markets" called into question Libor's integrity due to perceived problems with large-bank balance-sheet liquidity.53 Though the BBA, denying that cracks in Libor's foundation existed, undertook an extensive study⁵⁴ examining the concerns raised, both public news sources as well as trader circles ruminated on Libor's accuracy, leading to the "breakdown of longstanding correlations."55 After the financial crisis, Libor received a massive blow because London banks simply were not and are still not lending to each other.⁵⁶ Without such transactions, these banks have no real numbers to base their Libor submissions on, and so they must estimate hypothetical numbers as if the interbank market were thriving. While this development carries significant implications for Libor's reform, it also brings to bear a particular line of argument against accusations of rate rigging: that any abnormal rate submissions are not products of attempted manipulation or fraud but of interbank credit conditions.57

B. The Rate-Rigging Scandal

After the *Wall Street Journal* spurred investigations into the rigging of various reference rates (including Libor),⁵⁸ numerous Libor-setting banks came forward to deal with the charges levied against them.⁵⁹

⁵² For example, in mid-2008, the market expressed distrust for current Libor fixes because it believed the Panel banks had an incentive not to report their actual borrowing costs due to financial weaknesses on their books. Adam Bradbery, *Libor Revamp Is Urged by Money-Market Group*, WALL ST. J., July 11, 2008, at C2.

⁵³ Justin T. Wong, Note, *LIBOR Left in Limbo; A Call for More Reform*, 13 N.C. Banking Inst. 365, 369 (2009).

⁵⁴ See generally British Bankers' Ass'n, supra note 41, passim (discussing the stability and integrity of Libor-fixing methodology).

⁵⁵ See generally Wong, supra note 53, at 369–72 (citing British Bankers' Ass'n, supra note 41, §§ 2.3–.4, 11.1) (examining the "indicators" circulated by market participants questioning the validity of Libor during this time period).

⁵⁶ See, e.g., infra note 107.

⁵⁷ See infra Part II.A (fleshing out this argument).

See supra notes 12–14 and accompanying text.

UBS was the first bank to admit to Libor manipulation. Lindsay Fortado et al., *UBS Turning Whistleblower in Libor Probe Pressures Rivals*, Bloomberg (Feb. 21, 2012, 5:43 AM), http://www.bloomberg.com/news/2012-02-21/ubs-turning-whistleblower-in-libor-probe-pressures-rivals.html. UBS AG, ICAP plc, Lloyds Banking Group plc, Deutsche Bank AG, and some American banks also were, or are still being, subject to regulatory investigations and probes. *See* Howard Mustoe, *Barclays Tumbles as Libor Fine Sparks Lawsuit Speculation*, Bloomberg (June 28, 2012, 7:59 AM), http://www.bloomberg.com/news/2012-06-28/bar clays-tumbles-as-libor-fine-sparks-lawsuit-speculation.html; Hugh Son, *BofA Says Libor Probe Draws U.S. Subpoenas on Submissions*, BloombergBusinessweek (Aug. 3, 2012), http://www.businessweek.com/news/2012-08-02/bofa-says-libor-probe-draws-u-dot-s-dot-subpoenas-on-submissions.

Private parties also filed countless lawsuits against the various banks, each hoping to catch a piece of the restitution pie. Though there are too many to name individually, the major cases were consolidated by their respective claims, including an antitrust consolidation (including over-the-counter plaintiffs, bondholder plaintiffs, and others)⁶⁰ as well as other class actions.⁶¹ Private parties in the United Kingdom have reportedly also been readying actions against certain U.K. banks.⁶² To demonstrate how Libor manipulation and rigging occurs, I use Barclays's case because of the comparatively large amount of available information on it. It is important to remember, however, that future reference-rate manipulation cases may be starkly different from Barclays's case, both in depth of inculpatory evidence available and in type of manipulation or fraud involved.

1. Barclays's Misdeeds

At core, regulators alleged that Barclays engaged in three discrete wrongdoings. The first involved intrabank conflict of interest: namely, that the bank's internal derivatives trading desk—occupied by swaps traders—unlawfully influenced the bank's London money markets desk—responsible for submitting quotes to the BBA—by encouraging the money-markets desk to make submissions that would benefit the bank's derivatives positions. Swaps traders made such requests from roughly 2005 to 2009, and submitters accommodated such requests "on numerous occasions." The undue influence typically occurred in this fashion:

[O]n December 19, 2006, a swaps trader located in New York . . . sent an e-mail to [a London submitter] with the subject line, "3m Libor," asking, "Can you . . . [please] continue to go in for 3m[onth] Libor at 5.365[%] or lower, we [have positions that require lower three-month Libor]." . . . [The submitter] replied, "Will do my best sir." . . . On December 19, 20, and 21, 2006, Barclays's 3-month Dollar LIBOR submissions were 5.37%, 5.37%, and 5.375%, respectively. . . . At approximately 1:03 p.m. [on December 21], [the submitter] created an electronic calendar entry stating, "SET 3 MONTH US\$ LIBOR LOW!!!!!!" that was scheduled to begin on

 $^{^{60}}$ $\,$ In re Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed Apr. 30, 2012).

For a list of all outstanding private litigation involving the Libor manipulation, see Presentation by Brian P. Murray, Murray Frank LLP, LIBOR Manipulation Litigation: Latest Trends & Developments; Pursuing and Defending Individual and Class Action Libor-Related Actions 46–57 (Oct. 23, 2012), available at http://media.straffordpub.com/products/libor-manipulation-litigation-latest-trends-and-developments-2012-10-23/presentation.pdf.

⁶² See id. at 59.

⁶³ See Settlement Order, supra note 10, at 6-11.

⁶⁴ Statement of Facts, *supra* note 23, at 5–6.

December 22, 2006 . . . and continue until January 1, 2007 On December 22, 2006 and the subsequent trading days . . . , Barclays's 3-month Dollar LIBOR submissions were 5.36%, 5.365%, 5.35%, and 5.36% ⁶⁵

It became clear to markets (and later to regulators) that these traders were attempting to manipulate Barclays's U.S. dollar and yen Libor submissions to have a "favorable effect" on "trading positions," which would boost trader compensation—often tied to profits of the trading books.66

The second major finding concerns attempted *interbank* collusion to improperly influence Libor fixes: from roughly 2005 to at least 2008, swaps traders at various Panel banks attempted to convince each others' submitters to submit favorable Libor quotes-mostly for the U.S. dollar and yen—to the BBA.⁶⁷ The motive was simple: since each Libor fix depends on the submissions of a number of Panel banks, with half of the quotes cut anyway, more collusion meant more substantial results.68

The third and final finding arguably produces the greatest systemic concern: according to certain internal communications that surfaced during the CFTC's investigation, Barclays's management, in the periods immediately preceding the crisis, attempted to make the bank's risk profile appear rosier than it actually was by encouraging submitters to lower their Libor submissions to suppress Libor.⁶⁹ Cer-

Id. at 7. The trader in the example had derivatives positions (tied to Libor) that would presumably earn money when three-month Libor for U.S. dollars decreased below 5.635%, leading the trader to tell the submitter in London to submit low quotes for that specific Libor maturity. And the submitter complied. This sort of submission does not mean that three-month Libor for U.S. dollars will be 5.635%; but Barclays's submission could certainly reduce that number, producing an inaccurate borrowing cost rate. Other requests would note that it was "very important that the [Libor fix] comes as high as possible" or that submitters should "go for LOW 6[-month] [Libor fix] today." Id. at 7-8.

⁶⁶ Id. at 9. The reason swaps traders cared so much about what a particular Libor fixed at on any given trading day was the massive size of positions the traders held in derivatives indexed to Libor. Typically, when a trader enters into a position (e.g., buying interest rate swaps coupled with some other derivatives), that trader, taking into account market conditions and other positions held, makes a bet on information, since usually one can only guess where Libor will be in the next few days, weeks, or months in a tight range. However, even small adverse movements in Libor—proving the trader's information inaccurate—can have a "significant impact on the profitability of a trader's trading portfolio." Id. For example, one Barclays trader, in some electronic messages to submitters, stated, "[F] or every [0.0025%] tomorrows [sic] [Libor] fix is below 4.0525[%,] we lose 154,687.50 usd [United States dollars]" Id. (first, third, and sixth alterations in original). Thus, it pays to move Libor in one's favor.

See id. at 10–13 (providing some examples of these interbank communications and requests).

⁶⁸ In early 2007, one Barclays trader wrote to a trader at another Panel bank, stating: "[T]his is the way you pull off deals like this[;] . . . the trick is you must not do this alone." Id. at 13 (internal quotation marks omitted).

Id. at 16–18.

tain midlevel employees, concerned about the integrity of the rates submitted, spoke quietly to British regulators, though none mentioned management's directives.⁷⁰

The fear attending this final revelation stems from the implications of management's motive to obscure the entire bank's financial condition. From mid- to late-2007, Barclays, like many of its peers, began suffering from liquidity problems due to decreased liquidity supply in the money markets—where large banks go to refresh their short-term capital necessary to conduct daily operations.⁷¹ Also like its peers, Barclays began receiving negative press questioning Barclays's financial condition because of its high Libor submissions; high Libor generally meant higher borrowing costs, which in turn indicated that lenders attributed a higher risk of default to Barclays and thus demanded higher interest to cover this risk.⁷² Barclays's management believed that its peers were in similarly negative liquidity positions but were already reducing Libor quotes to fight the negative publicity.⁷³ Thus, management "improperly . . . [took] concerns about negative publicity into account"; they were interested in using the bank's submissions themselves, not the resulting Libor fixes, to bolster the public's view of Barclays's financial condition.⁷⁴ In defense of their actions, some managers at Barclays alleged that officials at the Bank of England indirectly instructed the bank to report lower numbers market doubt of major allay to creditworthiness.75

2. The Commodity Futures Trading Commission's Response

Based on the three chief discoveries outlined above, the CFTC—with aid from the U.S. Department of Justice and other government

⁷⁰ *Id.* at 18–21.

⁷¹ See id. at 17-18.

⁷² See The Wheatley Review, supra note 4, at 79–80 ("[A]lthough a bank's daily LIBOR submission does not necessarily reflect increased counterparty risk, it may be interpreted by external observers as an indication of . . . creditworthiness During periods of market stress there is . . . an incentive to lower submissions in order that perception of that bank's relative creditworthiness is not negatively affected.").

⁷³ See Settlement Order, supra note 10, at 19–20; The Wheatley Review, supra note 4, at 79–80. Recall that Libor submissions are public information. Assuming truthful reporting, a lower Libor submission means that the submitting bank has lower borrowing costs and thus has relatively better credit and liquidity positions in the market (i.e., the bank is healthier). The BBA in 2008 noted that "contributor banks may be exhibiting herd behavior in their submitted rates to avoid speculation and rumour mongering [regarding their financial health]." See Statement of Facts, supra note 23, at 19 (internal quotation marks omitted).

⁵⁴ Statement of Facts, supra note 23, at 18, 22.

⁷⁵ See id. at 21-22.

authorities⁷⁶—brought an enforcement action under several provisions of the CEA⁷⁷ broadly alleging that Barclays attempted to manipulate Libor and Euribor fixes to benefit their derivatives trading positions and bolster public perception of their financial health.⁷⁸

The Commission's first allegation was a violation of section 9(a)(2) of the CEA, which prohibits any fraudulent communication knowingly made "concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce."⁷⁹ By knowingly using impermissible factors⁸⁰ in its calculation of Libor quote submissions, the Commission argued, Barclays conveyed "false, misleading or knowingly inaccurate information" which "tends to affect the prices of commodities in interstate commerce."⁸¹

The next allegation concerned violations of sections 6(c), 6(d), and 9(a)(2), which together prohibit attempted manipulation in the commodities and futures markets. Section 9(a)(2), in relevant part, deems unlawful any attempt to manipulate the *price* of a commodity or futures contract in interstate commerce.⁸² Sections 6(c) and 6(d) are more procedural in nature, providing the Commission with the authority to "serve a complaint" and impose, among other things, "civil

Other agencies that aided the CFTC in its investigation include the U.S. Securities and Exchange Commission, the FSA in London, the U.S. Justice Department, and the Washington Field Office of the FBI. Press Release, *supra* note 20. The FSA, in its own regulatory action, issued a Final Notice fining Barclays £59.5 million. *See* Barclays Bank Plc, Final Notice, Reference No. 122702 (Fin. Servs. Auth. June 27, 2012). The Justice Department's Fraud Division also entered into a nonprosecution agreement with Barclays under which the bank agreed to pay \$160 million in fines as well as implement various compliance and internal control measures. Press Release, U.S. Dep't of Justice, Barclays Bank PLC Admits Misconduct Related to Submissions for the London Interbank Offered Rate and the Euro Interbank Offered Rate and Agrees to Pay \$160 Million Penalty (June 27, 2012), *available at* http://www.justice.gov/opa/pr/2012/June/12-crm-815.html.

The CEA regulates the trading of futures and certain derivatives activity in the United States and establishes the statutory framework through which the CFTC derives its enforcement and regulatory authority. Pub. L. 107-8, ch. 545, 49 Stat. 1491 (1936) (codified as amended in scattered sections of 7 U.S.C.).

⁷⁸ Settlement Order, *supra* note 10, at 2–4. After accepting the settlement offer, pursuant to sections 6(c) and 6(d) of the CEA, the CFTC entered an official order documenting the investigation and ensuing settlement in which the agency established several violations of the CEA—consented to by Barclays. *See id.* at 1.

⁷⁹ 7 U.S.C. § 13(a) (2) (2006). Several cases interpret this section, though predominantly in the natural gas and energy market context. *See, e.g.*, United States v. Brooks, 681 F.3d 678, 703–05 (5th Cir. 2012) (false reporting of natural gas trades); United States v. Valencia, 394 F.3d 352, 354–57 (5th Cir. 2004) (manipulation of natural gas markets); CFTC v. Johnson, 408 F. Supp. 2d 259, 266–67 (S.D. Tex. 2005) (injunction against engaging in trading in energy markets).

These factors include management's wish to portray a stronger financial outlook to the public as well as the derivatives positions on Barclays's swaps books. *See* Settlement Order, *supra* note 10, at 26.

⁸¹ Id.

^{82 7} U.S.C. § 13(a)(2).

monetary penalties and cease and desist orders" so long as the Commission "has reason to believe that any person . . . has manipulated or attempted to manipulate the *market price* of any commodity [or future] . . . or has violated any of the provisions of [the CEA]."83 As applied, the CFTC insists that Barclays intended to supply a "price" that "did not reflect the legitimate forces of supply and demand."84 A major hurdle in this allegation is whether Libor itself can be considered the "price" of a commodity or derivative instrument,85 discussed in depth in the next Part.86

The penultimate count captures the interbank activity: the CFTC charged Barclays swaps traders with aiding and abetting manipulation activities conducted by similarly situated traders at other Panel banks in violation of section 13(a) of the CEA.⁸⁷ And finally, to pursue the bank itself rather than the individual swaps traders, the CFTC invoked section 2(a)(1)(B) of the CEA and attendant Regulation 1.2, which provide for respondeat superior liability.⁸⁸

As mentioned, Barclays preempted any pending CFTC litigation by settling. Such a swift and uncontroversial resolution to these otherwise contentious events is certainly a blessing, though it would be myopic to expect repeat performances in the future. The next Part examines the difficulty of labeling Libor rigging under any of the CEA's enforcement provisions in the context of the Barclays fiasco and advocates for a "holistic enforcement" regime for the CFTC.

II IMPEDIMENTS TO DOMESTIC ENFORCEMENT

The detrimental effects of and urgency surrounding attempted manipulation of and fraud concerning Libor are evident from the

⁸³ See Settlement Order, supra note 10, at 26 (quoting 7 U.S.C. § 9 (emphasis added) (CEA section 6(c)) and 7 U.S.C. § 13b (CEA section 6(d))).

⁸⁴ Id. at 27 (quoting Ind. Farm Bureau Coop. Ass'n, [1982–1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶¶ 21,796, 27,283 (Dec. 17, 1982)); see also United States v. U.S. Gypsum Co., 438 U.S. 442, 445 (1978) (indicating that it would not be necessary to prove that the accused knew his attempted manipulation would succeed, as long as the accused "consciously desire[d] that result, whatever the likelihood of that result happening from his conduct" (quoting Wayne R. LaFave & Austin W. Scott, Jr., Criminal Law 196 (1972))).

⁸⁵ In financial vernacular, the term "price" is frequently used to describe the particular rate or rates a counterparty might pay in a given swap or other derivative transaction. For example, in the common interest-rate swap, each counterparty pays either a fixed or floating rate to the other and receives the opposite in return. Determination of these rates is also called "pricing" the swap. *See* Andrew M. Chisholm, Derivatives Demystified 59–60, 62–63 (2010).

⁸⁶ See infra Part II.A.1.

⁸⁷ 7 U.S.C. § 13c(a); Settlement Order, *supra* note 10, at 27.

⁸⁸ 7 U.S.C. § 2(a)(1)(B); 17 C.F.R. § 1.2 (2012); Settlement Order, *supra* note 10, at 28.

Barclays scandal and from the numerous other allegations suggesting the involvement of a host of other banks. To set the stage for the discussion of how the Commission *should* involve itself going forward, this Part describes how Libor manipulation may be anchored substantively and jurisdictionally in the CEA⁸⁹ and addresses the impediments facing the Commission in both regards. This Part also crafts a normative argument for why an ad hoc approach is inadequate to suppress future problems.

A. Substantive Routes: Antimanipulation and Antifraud

1. Attempted Manipulation

The CEA, a remedial statute, ferrets out manipulation and fraud, "distinguishable on the basis of how they affect other [market participants]." The statute never defines manipulation; instead, a gargantuan body of case law and commentary has coalesced around this gap in the context of futures markets. Not surprisingly, the most probable avenues for finding statutory manipulation of Libor were set forth by the Commission in its settlement order against Barclays. Together, those provisions permit the Commission to go after "persons" who exercise the requisite market power to *attempt* to manipulate "commodity prices" to effect artificial prices. The "price" of a commodity is the price at which one may buy some unit of the commodity immediately. He saturday of the commodity immediately.

The Barclays investigation partially unveiled the scope of the CFTC's enforcement in the face of manipulation in the marketplace. *See* Protess, *supra* note 19 (pointing out that the once "toothless agency" has now been "thrust . . . into the spotlight," with "Wall Street . . . taking the [C]ommission more seriously" (internal quotation marks omitted)).

^{90 3} Philip McBride Johnson & Thomas Lee Hazen, Derivatives Regulation 1232 (4th ed. 2004). The driver of this distinction lies in the fact that for every derivative, there are two parties holding opposite positions. One party's gain is exactly inversely proportional to the other party's loss. Thus, "the gain . . . of a market manipulation is shared by the manipulator with all other persons on the same side of the market." Id. (emphasis added). For example, a trader who manipulates the futures market for grain invariably will cause the futures price for grain—which is the same for everyone in that market—to move up or down, whichever way benefits that trader. If the grain trader causes the market price to shift up, then all other traders holding the manipulator's position will benefit unwittingly. Id. The fraudster, however, receives benefits from targeting individual market participants, not the market itself, and thus keeps all of the "fruits of the fraud." Id.

⁹¹ Entire volumes could be filled to recount the various decisions and commentaries on the definition of manipulation and how it should be applied. Confusion notwithstanding, the Supreme Court has still refused to certify this issue as of the date of this writing. *Id.* at 1239 (noting that the closest the Court came to a definitional standard was in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran,* 456 U.S. 353 (1982), in which the Court found an implied right of action for manipulation under the Act but failed to define the term itself).

 $^{^{92}}$ See supra Part I.B.1–2 (recounting the CFTC's three claims of manipulation under the CEA against Barclays).

⁹³ See 3 Johnson & Hazen, supra note 90, at 1237, 1239.

⁹⁴ Chisholm, *supra* note 85, at 1.

Courts typically ask, as an initial matter, whether manipulation *actually* or *could have* produced "artificial" prices. This prong presents the most difficult obstacle because price artificiality is inherently an intensely complex question of economic analysis. Gourts, many of which have fairly opposing views on determining price artificiality, will surely probe this point in litigation because price artificiality is viewed as "the *sine qua non* of manipulation. See traditional method, as employed in financial engineering, largely relies on prices and conditions in similar or underlying markets to determine prices of the instruments in question. For example, courts may compare the prices at issue with those from a past time period with similar market conditions or with those of the underlying assets. Additionally, as plaintiffs in private Libor litigation have done, prices in question may be compared to rates, spreads, or prices of related instruments with comparable historical movements.

These methods, however, are problematic. First, the Commission would have to somehow compare Libor to another similar reference rate or underlying spread, which would be exceedingly difficult and circular given the fact that all reference interest rates or underlying rates are in theory *perceived* estimates, meaning that their "true" value is almost impossible to discern (or nonexistent). For example, Libor fluctuates depending on the submitting banks' financial health and condition, which in turn is largely dependent on the market's *perception* of these banks' health. Some parties, including the city of Baltimore in its antitrust action against Barclays and other banks, have

⁹⁵ In re Soybean Futures Litig., 892 F. Supp. 1025, 1045 (N.D. Ill. 1995).

⁹⁶ See Craig Pirrong, Commodity Market Manipulation Law: A (Very) Critical Analysis and a Proposed Alternative, 51 Wash. & Lee L. Rev. 945, 965 (1994).

⁹⁷ Ind. Farm Bureau Coop. Ass'n, [1982–1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (Dec. 17, 1982) (discussing extensively the weaknesses of the various measures of price artificiality).

⁹⁸ See, e.g., Gen. Foods Corp. v. Brannan, 170 F.2d 220, 223 (7th Cir. 1948) (finding against the government in a futures manipulation case, partly because the government failed to produce expert testimony establishing that the price of rye futures was artificial due to manipulation).

⁹⁹ Pirrong, *supra* note 96, at 960.

¹⁰⁰ E.g., Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476, 482–84 (7th Cir. 1953) (comparing the "spread relationship" of different egg futures contracts over an extended period of time).

¹⁰¹ E.g., Cargill, Inc. v. Hardin, 452 F.2d 1154, 1156–58 (8th Cir. 1971) (comparing wheat futures contracts); see also United States v. Reliant Energy Servs., Inc., 420 F. Supp. 2d 1043, 1058 (N.D. Cal. 2006) (noting that "[f]undamentally, markets are information processing systems" and that a "market price is only as real as the data that inform the process of price discovery").

Amended Consolidated Class Action Complaint at 17–41, *In re* Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed Apr. 30, 2012) (comparing the Eurodollar spread with Libor in a time series to argue manipulation because the typical static comparability between the two rates was skewed during the time the alleged manipulation took place).

argued that other financial instruments that closely track Libor may serve as proxy benchmarks.¹⁰³ The contention assumes that historical empirical correlation implies a predictive relationship between the Eurodollar bid rate and Libor, which is quite reasonable.¹⁰⁴ The issue, however, is that opposing banks can easily argue that the relationship suffers from foresight bias; while the Eurodollar rate can be a good predictor of what Libor will be in the future based on past data points, the fact that future Libor does not actually comport with the prediction does not imply it is "inaccurate," only that some factor has created a skew.¹⁰⁵ Indeed, a number of reasons can explain such a shift, including a change in regional credit conditions or adverse news from a certain global sector.

In addition, the Commission faces the powerful argument that if, for a given Libor fix, an accused bank did not have real lending numbers, that bank must rely on estimates, the formulation of which is not regulated. Thus, if, say, Barclays submitted abnormal numbers for a certain fix, allegedly to benefit itself at the expense of accuracy, the bank can argue that its lack of transactions pushed it to submit "bona fide" estimates, which are low because of the models used. 106 In this scenario, determination of a "true" Libor price, or even just of fraud, is even more difficult because the entire submission is based on historical data and hypothetical modeling. And this is no imagined scenario: following the recent crisis, the London interbank lending market has all but disappeared.¹⁰⁷ Without the benefit of precedent in this area or real transaction data (if other London banks were engaging in interbank lending), the Commission will have a challenging time proving that any submission is "false" or "artificial" if no or few real transactions even exist for comparison. Argumentation would turn to

Class Action Complaint for Violation of the Federal Antitrust Laws at 12–14, Baltimore v. Bank of Am. Corp., No. 11-CIV-5450 (S.D.N.Y. filed Aug. 5, 2011). Other private litigants have used similar rates such as the credit default swap spread on Libor-setting banks. *See*, *e.g.*, Class Action Complaint at 18–21, Berkshire Bank v. Bank of Am. Corp., No. 12-CV-5723, 2012 WL 3024769 (S.D.N.Y. filed July 25, 2012).

¹⁰⁴ See generally Connan Snider & Thomas Youle, Does the LIBOR Reflect Banks' Borrowing Costs? 7–9 (Apr. 2, 2010) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1569603 (affirming the relationship between Libor and the Eurodollar rate).

Abrantes-Metz et al., *supra* note 13, at 149 (noting that empirical comparisons of Libor to benchmark rates cannot conclusively establish "the presence of a conspiracy or a manipulation of the Libor rate").

¹⁰⁶ Of course, in the investigation of Barclays, incriminating e-mails surfaced that would push against this argument. *See supra* text accompanying note 65. Had such e-mails never arisen, however, the argument posed would hold much more ground.

John Glover, Libor, Set by Fewer Banks, Losing Status as a Benchmark, Bloomberg (Oct. 8, 2012, 4:58 AM), http://www.bloomberg.com/news/2012-10-08/libor-now-set-by-six-banks-losing-status-as-a-benchmark.html ("Unsecured lending between banks—the activity Libor is designed to reflect—has dried up as institutions increasingly demand collateral before money changes hands or go to central banks for funds.").

the estimation methodology employed, which could become messy very quickly. Further, if the Commission compared allegedly manipulated Libor fixes to a benchmark like the Eurodollar rate, defendant banks could argue that they had no positions in the Eurodollar, obviating any conflict of interest, and that, because of other market conditions, the Eurodollar rate no longer correlates well with Libor. ¹⁰⁸ In any case, suffice it to say that the determination of what counts as "artificial" or "real" in the reference-rate context is intellectually arduous, fact sensitive, and theoretically incomplete. ¹⁰⁹

As if price artificiality were not already taxing enough, its complexity is compounded in Libor's case by a more fundamental problem: reference interest rates traditionally do not have set "prices" and do not always act as "prices"; rather, rates like Libor are used as prices for certain financial instruments and transactions but not for others.¹¹⁰ For example, Libor may act as the price for a swap contract but not when it is used in a bank financing or student loan.¹¹¹ Such a situation poses the question of whether the CFTC can bring a case of manipulation only with respect to the former instrument, which used Libor as the price, and not the latter, which did not. This sort of asymmetry would not be beneficial in the Commission's efforts to enforce holistically against Libor manipulation because for cases in which Libor is the price of an instrument, the Commission only has a claim with regards to that instrument, resulting in erratic enforcement targeting.¹¹² Although courts have historically interpreted "price" quite broadly, 113 the pervasiveness of Libor coupled with its novelty in litigation and enforcement can militate against exclusive reliance on case precedents in potential CFTC litigation. For exam-

¹⁰⁸ See Snider & Youle, supra note 104, at 7-9.

¹⁰⁹ 3 JOHNSON & HAZEN, *supra* note 90, at 1262–63.

As the Libor-setting banks themselves noted (quite accurately), "[t]here are no buyers or sellers, no market, no profit, and no competition of any kind associated with the mere reporting of rates or setting of [Libor]." Memorandum of Law in Support of Defendants' Motion to Dismiss Plaintiffs' Antitrust Claims at 3, *In re* Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed June 29, 2012).

For a list of Libor uses, see The Wheatley Review, *supra* note 4, at 44–45.

To elaborate, consider a typical commodity. It has one price for all items of that commodity in any class of contract. All of the oil in one contract class only has one price, which fluctuates according to various factors like regional supply and demand. Libor is here and there: it is used as an interest rate for loans, a payment rate for some swaps, a benchmark rate for corporate projects, and the list goes on. Given this fact, the Commission cannot realistically enforce against Libor manipulation by arguing that some subset of instruments that employs Libor as the "price" were manipulated. That would be a case against manipulation of those instruments, not Libor, because of the manner in which the CEA is written. See supra Part I.B.2 (describing the various causes of action used by the CFTC in the Barclays settlement order).

¹¹³ See, e.g., CFTC v. Parnon Energy Inc., 875 F. Supp. 2d 233, 240–42 (S.D.N.Y. 2012) (interpreting the spreads between oil futures contracts of different months to be "prices" under the CEA).

ple, price artificiality may be determined by looking to what the price would have been in the context of natural market forces such as supply and demand. Such an analysis is incredibly open ended with Libor because the rate is affected first by a consortium of bank borrowing costs, which are supported by global credit conditions, which in turn are undergirded by such myriad factors as regional lending conditions and interest rate levels. The level of necessary abstraction is phenomenally high.

In sum, under the CEA's traditional¹¹⁵ framework, it is incredibly difficult to prove that a bank manipulated or even attempted to manipulate Libor because (a) Libor does not have an inherent price, (b) Libor *is* the "price" only for certain financial instruments and transactions, and (c) Libor fixes are wholly dependent upon market perception of borrowing costs and thus proof of manipulation would have to compare Libor to a "true" level of borrowing cost or some other relative benchmark.¹¹⁶

2. Fraud

Given the difficulties in configuring a manipulation case, rate rigging could very likely be characterized as fraud or fraud-based manipulation. The standard fraud provision in the CEA is section 4b, which generally prohibits "cheat[ing] or defraud[ing] or attempt[s of either]" by "any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce or for future delivery . . . , or swap." Congress has also inserted, via Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), a new broader antifraud measure in the CEA by way of section 6(c)(1), the consequences of which are discussed later. Under both the old and new provisions, Libor manipulation might be described as fraud because the relevant Panel banks lied about their cost of borrowing; however, the substantive elements of fraud here are difficult to match against the facts of rate rigging.

The rate-rigging scandal was incredibly broad; though one could argue that the swaps traders at Barclays intended for rate rigging to benefit certain of their outstanding swaps positions, the Commission

¹¹⁴ Id. at 246-47.

¹¹⁵ I use "traditional" here because recent amendments to the CEA have expanded the CFTC's enforcement authority under the auspices of antimanipulation and antifraud. *See infra* Part III.B.2 (describing Rules 180.1 and 180.2).

¹¹⁶ If market participants could determine the "true" cost of borrowing, they would not need to have a panel of banks submit their borrowing costs to produce an estimate. Further, although Libor may not be used as a proxy for borrowing cost in certain contexts, such as in floating-rate swap contracts, plaintiffs would still have to prove that Libor was "incorrect" in those contexts by comparing it to another relative benchmark.

^{117 7} U.S.C. § 6b (2006).

¹¹⁸ See infra Part III.B.2.

would realistically only be able to enforce against those traders, which would be erratic enforcement. Also, the swaps traders' positions and the rate-rigging effects have several degrees of separation between them, so causation is again a formidable issue. Specific intent poses certain problems as well because, without special inculpatory evidence, the Commission would face difficulty proving that any bank intended to manipulate a reference rate. The CEA's fraud definition also poses a definitional ambiguity. The statute prohibits fraud or cheating in connection with *a commodity, futures contract, or swap.* But recall that Libor is *not* a commodity or affixed to any specific commodity, derivative, or transaction.

The Commission may find relief, however, in the fact that section 4b itself does not expressly require a transaction in connection with the fraud before a claim can be brought,121 and section 40, which prohibits fraud for certain regulated entities under the CEA, does not include language requiring any specific transactions. 122 In fashioning rate-rigging cases, then, the Commission could plausibly argue that, although the distortion of submissions in the course of setting rates might not have benefitted any specific transaction, submission of inaccurate or biased Libor numbers nevertheless constitutes actionable fraud, although the CFTC would still labor to demonstrate that the fraud was perpetrated "in connection with" some transaction or instrument.¹²³ A final issue is that fraud requires a "material misrepresentation or omission."124 The obvious argument, then, is that any accused bank will contend that its Libor submission did not materially affect Libor fixes. As this Note will show, a mixture of fraud and manipulation allegations, brought under new Commission rules, provides the answer to how the Commission should build its substantive claim for rate rigging. 125

¹¹⁹ But see Supplemental Consent Order Setting Judgment for Restitution and Civil Monetary Penalty Against Defendants, CFTC v. Jade Invs. Grp. LLC, No. 11-CV-128 (W.D. Wis. filed Nov. 17, 2011) (finding liability against the firm itself for the actions of its individual traders and employees). Of course, the CFTC here could also employ respondeat superior, but reliance upon this measure is insufficient to establish holistic enforcement necessary for effective deterrence.

¹²⁰ ³ Johnson & Hazen, *supra* note 90, at 1361 (noting that fraud must be "perpetrated in connection with a commodities-related transaction" in order to prosecuted by the Commission (citing FDIC v. UMIC, Inc., 136 F.3d 1375 (10th Cir. 1998)).

¹²¹ *Id.* at 1420–21.

¹²² See 7 U.S.C. § 6o.

¹²³ See CFTC v. AVCO Fin. Corp., 28 F. Supp. 2d 104, 116–17 (S.D.N.Y. 1998).

^{124 3} JOHNSON & HAZEN, *supra* note 90, at 1423.

¹²⁵ See infra Part III.B.2.

B. Foundations for Commission Jurisdiction and Reach

1. Choice of Forum

To enforce against violations of the CEA involving rate rigging, the Commission has three routes under the CEA: it may initiate administrative adjudicatory proceedings,¹²⁶ bring a civil action in federal court,¹²⁷ or collaborate with prosecutors—federal, state, or local—to prosecute violations criminally.¹²⁸ Should the Commission choose to go first to federal court, as authorized by section 6c of the CEA,¹²⁹ it may seek injunctive relief,¹³⁰ a judicial award of a civil penalty of the greater of three times the defendant's monetary gain or \$100,000 per violation of the CEA,¹³¹ or disgorgement of profits by court order.¹³²

Stepping back, it is worth noting that the question posed here regards the reach of the Commission's enforcement ability under the CEA; thus, at first glance, *how* the Commission chooses to go about enforcement procedurally is of little concern. Indeed, should the Commission decide after investigation that a foreign bank has fraudulently manipulated Libor or some other benchmark rate, the choice of initial forum—administrative adjudication or enforcement in federal court—only matters insofar as the Commission prefers one over the other.¹³³ For example, choice of forum may implicate preferences as to trial procedure¹³⁴ or level of deference to findings of fact and law on appeal.¹³⁵ The value of precedent also may encourage the Commission to lean toward one route over the other.¹³⁶

^{126 7} U.S.C. § 9.

¹²⁷ Id. § 13a-1; see, e.g., CFTC v. Kimberlynn Creek Ranch, Inc., 276 F.3d 187 (4th Cir. 2002); CFTC v. Vartuli, 228 F.3d 94 (2d Cir. 2000); CFTC v. Clothier, 788 F. Supp. 490 (D. Kan. 1992).

¹²⁸ 7 U.S.C. § 13.

¹²⁹ *Id.* § 13a-1.

¹³⁰ Id.

¹³¹ *Id.* § 13a-1(d)(1).

¹³² See Vartuli, 228 F.3d at 98.

¹³³ ² Johnson & Hazen, *supra* note 90, at 1078 ("When as a result of an investigation the Commission determines that the law has been violated, it can proceed either administratively or by going to court.").

 $^{^{134}}$ For a description of trial procedure in CFTC administrative adjudications, see generally id. at 1096-120.

¹³⁵ Chevron deference would extend to the Commission's adjudications. See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 (1984). With respect to findings of fact, a reviewing court must treat the Commission's findings as conclusive so long as they are supported by the weight of the evidence. 7 U.S.C. § 9; see Wilson v. U.S. Commodity Futures Trading Comm'n, 332 F.3d 555, 559 (8th Cir. 2003); Maloley v. R.J. O'Brien & Assocs., 819 F.2d 1435, 1440 (8th Cir. 1987). In reviewing findings of law in a specialized area, under which Libor would presumably fall, the court should only look for a rational basis for the Commission's conclusions. See Wilson, 322 F.3d at 559.

¹³⁶ The SEC, for example, has traditionally favored litigating section 10(b) antifraud enforcement actions in the Second Circuit because of the wealth of advantageous precedent accrued there.

Another implication of a different nature in this decision of forum is the future effect of rulemaking related to Libor or other reference rates, to be further discussed in the next Part.¹³⁷ Continual agency adjudication of cases involving fraudulent Libor manipulation under traditional antimanipulation and antifraud precedent may be irrational when the Commission could simply promulgate rules addressing fraudulent manipulation of Libor and similar reference rates directly because of the fact-preclusive benefits of rulemaking going forward.¹³⁸

2. Extraterritorial Jurisdiction

The CEA is premised on the impact of commodities and derivatives trading on interstate commerce;¹³⁹ thus, conventional interpretive logic has held that at least some foreign activity that touches upon domestic financial markets is within the CFTC's purview.¹⁴⁰ When considering the Commission's subject-matter jurisdiction to police activities of foreign persons and entities that are either in the United States or that have an effect on U.S. markets under the CEA, one must look to the conduct and effects tests,¹⁴¹ which the CFTC adopted from judicial precedent involving the SEC's extraterritorial reach under the federal securities laws.¹⁴²

Under the securities laws, courts employ both tests to determine whether they have jurisdiction to adjudicate antifraud cases that involve foreign defendants or transactions. Of course, should a court decide that such jurisdiction does not lie in any given transnational

¹³⁷ See infra Part III.B (discussing rulemaking as an option to curing jurisdictional issues).

¹³⁸ See United States v. Mead Corp., 533 U.S. 218, 226–27 (2001).

^{139 7} U.S.C. § 1a(13) (defining interstate commerce); see Bd. of Trade v. Olsen, 262 U.S. 1, 32–42 (1923) (upholding the Grain Futures Act of 1922, the CEA's predecessor, on interstate commerce grounds). On this theme, then, it is safe to conclude that from the Act's jurisdictional standpoint, Libor is not excluded on constitutional grounds.

¹⁴⁰ See Jerry W. Markham, Regulation of International Transactions Under the Commodity Exchange Act, 48 FORDHAM L. REV. 129, 132–33 (1979); Richard B. Earls, Note, Extraterritorial Application of Fraud Provisions of the Commodity Exchange Act, 41 Wash. & Lee L. Rev. 1215, 1217–18 (1984); Marcel A. Sager, Comment, Tamari v. Bache & Co. (Lebanon) S.A.L.: The Extraterritorial Application of the Antifraud Provisions of the Commodity Exchange Act, 11 Brook. J. Int'l. L. 615, 615–16 (1985); see also Philip McBride Johnson & Michael S. Sackheim, Long-Arm Powers for the CFTC, Int'l. Fin. L. Rev., Aug. 1986, at 13, 13 ("[T]he CFTC has become increasingly visible as a potential international policeman of the activities of foreign as well as domestic participants in US markets.").

^{141 2} JOHNSON & HAZEN, supra note 90, at 983.

¹⁴² See Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1044 (2d Cir. 1983); Mormels v. Girofinance, S.A., 544 F. Supp. 815, 817 n.8 (S.D.N.Y. 1982); Thomas Lee Hazen, The Law of Securities Regulation 730–31 (rev. 5th ed. 2006); 2 Johnson & Hazen, supra note 90, at 985. Case law employing the two tests in actions brought under the CEA, however, has generally called for much lower thresholds of "effect" for satisfaction of either test. See CFTC v. Muller, 570 F.2d 1296, 1299 (5th Cir. 1978).

¹⁴³ See HAZEN, supra note 142, at 730–31 (discussing the conduct and effect tests).

case, it must dismiss the case. In the context of Libor and London banks, the effects test—directing courts to focus on the domestic effect of conduct that occurred overseas—is more appropriate for judicial application.¹⁴⁴ However, in the Barclays case, because the swaps traders who solicited the faulty submissions were based in New York City,¹⁴⁵ the conduct test may have some play as well.

The effects test requires courts to consider whether the activity abroad caused a "substantial effect" within the United States, with "substantial" being predicated on a number of factors. 146 Though the securities laws do not speak directly to extraterritorial reach, Congress has tacitly endorsed the effects test because it has "accepted, over a long period of time, broad judicial authority to define substantive standards of . . . liability."¹⁴⁷ The conduct test, on the other hand, bids courts to consider whether the fraudulent or manipulative conduct takes place in the United States, notwithstanding where the negative effects occur. 148 Because rate rigging's effects are much broader in scope than the conduct that caused the rate rigging itself, naturally the effects test seems more appropriate. However, insofar as conduct can be established as occurring in the United States, the conduct test may be used to establish jurisdiction. In any case, the ultimate analysis for securing jurisdiction under the CEA is the same, no matter which of the two routes one takes.¹⁴⁹

In fashioning the original effects test for extraterritorial application of the federal securities laws, the U.S. Court of Appeals for the

¹⁴⁴ See Schoenbaum v. Firstbrook, 405 F.2d 200, 208–09 (2d Cir.) (creating the effects test), aff'd in part, rev'd in part en banc, 405 F.2d 215 (2d Cir. 1968). The effects test was created on the logic that one state's jurisdiction should apply over one who fires a gun from outside its borders and causes injury to the state's citizens within its borders. See Strassheim v. Daily, 221 U.S. 280, 285 (1911).

¹⁴⁵ Jennifer Ablan & Matthew Goldstein, *LIBOR Scandal Claims New York-Based Barclays Executive and Trader*, Business Insider (Sept. 4, 2012, 5:57 PM), http://www.businessinsider.com/libor-barclays-executive-trader-new-york-2012-9.

¹⁴⁶ See Earls, supra note 140, at 1219–20. A number of cases have produced factors to be weighed in evaluating substantiality of effect. See, e.g., Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991); Consol. Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 261–62 (2d Cir.), amended by 890 F.2d 569 (2d Cir. 1989); Des Brisay v. Goldfield Corp., 549 F.2d 133, 135–36 (9th Cir. 1977); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989–90 (2d Cir. 1975), abrogated by Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010); Schoenbaum, 405 F.2d at 208–09.

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 163 (2008) (citing Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 899 (2007)).

¹⁴⁸ See Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 665 (7th Cir. 1998), abrogated by Morrison, 130 S. Ct. 2869; IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975), abrogated by Morrison, 130 S. Ct. 2869.

¹⁴⁹ The conduct test as adopted by CEA-oriented case law has its own subtleties and wrinkles, though because the proposal laid out in Part III focuses more on the effects test, these nuances will not be explored in detail here. For a comprehensive discussion of conduct-test case precedent, see generally Earls, *supra* note 140.

Second Circuit in Schoenbaum v. Firstbrook¹⁵⁰ referred to international law principles articulated in section 18 of the Restatement (Second) of the Foreign Relations Law of the United States.¹⁵¹ Courts have applied that test in a far-reaching manner in the years since. In Bersch v. Drexel Firestone, Inc., the Second Circuit found section 10(b) liability for foreign defendants under the effects test even though the actual domestic consequences of the defendants' actions were quite minimal. 152 The litigation involved foreign and domestic plaintiff-investors, each of whom had purchased securities of a Canadian corporation, alleging that defendant corporation made several material misrepresentations in its prospectus—or marketing document that plaintiffs relied upon in contemplating whether to purchase. 153 Even though defendants had prepared their prospectus in Canada, only sending several copies into the United States, 154 the court found jurisdiction under the effects test because of domestic reliance on the prospectuses.155

A mere glance at cases involving extraterritorial violations of the CEA's antimanipulation provisions reveals the resemblance to their securities-law cousins. Even so, the first case to arise, Tamari v. Bache & Co. (Lebanon) S.A.L., 156 demonstrates the expansiveness of commodities-law jurisdiction as compared to securities law jurisdiction. Tamari involved a case brought by Lebanese citizens against a Lebanese investment firm for fraudulently managing plaintiffs' commodity futures accounts.¹⁵⁷ The parties' only contacts in the United States were defendants' use of the Chicago Mercantile Exchange to place futures orders, 158 which had little to no detrimental domestic effects and certainly no "substantial" effects required by the Second Circuit in its securities antifraud jurisprudence. 159 The Tamari court, undeterred, found that defendants' mere use of domestic exchanges created sufficient domestic "effects" to confer jurisdiction. 160 In so holding, the court reasoned that any sort of fraud or manipulation on domestic exchanges, no matter the perpetrator's location, weakened

 $^{^{150}}$ $\,$ 405 F.2d 200 (2d Cir. 1968), aff'd in part, rev'd in part en banc, 405 F.2d 215 (2d Cir. 1968).

 $^{^{151}}$ Restatement (Second) of Foreign Relations Law of the United States § 18 (1965).

^{152 519} F.2d 974, 988-90 (2d Cir. 1975), abrogated by Morrison, 130 S. Ct. 2869.

¹⁵³ See id. at 987-93.

¹⁵⁴ Id. at 987.

¹⁵⁵ *Id.* at 991. In so holding, however, the Second Circuit imposed a caveat by stating that adverse effects of a general nature are insufficient to perfect jurisdiction under the effects test. *Id.* at 988 (requiring a "substantial effect" on U.S. interests).

^{156 547} F. Supp. 309 (N.D. Ill. 1982).

¹⁵⁷ *Id.* at 310.

¹⁵⁸ Id.

¹⁵⁹ See supra note 146 and accompanying text.

¹⁶⁰ Tamari, 547 F. Supp. at 312–13.

the integrity of U.S. derivatives markets.¹⁶¹ The reverse of this logic is useful in the Libor context. Whereas the *Tamari* scenario involved fraudulent activity by foreign investors on domestic exchange markets, Libor manipulation entails manipulative effects posed on virtually *all* U.S. derivatives markets with the causative *activity* based overseas. In both cases, the focus, or part of it, is on the integrity of domestic markets, even though the operative activity takes place in different geographic areas. Later actions brought under the CEA have relied heavily upon *Tamari*'s expansive reasoning to establish extraterritorial reach.¹⁶²

The most recent judicial proclamation on the issue of transnational reach—resting in the securities antifraud realm—is Morrison v. National Australia Bank Ltd., which concerns Australian investor-plaintiffs suing a Florida-based company under the antifraud provisions of the federal securities laws. 163 In Morrison, National Australia Bank (NAB), purchaser-parent of HomeSide, a Florida-based mortgage servicer, cooperated with HomeSide executives in manipulating Home-Side's financials to inflate the value of their mortgage reservicing rights.¹⁶⁴ After several write-downs totaling \$2.2 billion on Home-Side's financial statements in 2001, Australian NAB shareholders filed suit in U.S. federal court.¹⁶⁵ On appeal to the Second Circuit, the court found subject-matter jurisdiction lacking under the conduct test, noting that the fraud stemmed primarily from NAB's lack of oversight, and thus the Australian shareholder-plaintiffs lacked sufficient contacts to U.S. markets to warrant protection under the federal securities laws. 166 The Supreme Court affirmed, finding that because section 10(b) does not extend to transactions related to securities listed on foreign exchanges, the securities laws do not apply since they focus not on the forum of fraud but on transactions of securities in domestic settings. 167 However, in so holding, the Court abandoned the conduct and effects tests traditionally employed to determine statutory reach and instead opted for a bright-line rule: absent a clear con-

¹⁶¹ Id. at 313.

¹⁶² See, e.g., Cresswell v. Prudential-Bache Sec., Inc., 580 F. Supp. 55, 58 (S.D.N.Y. 1984) (finding subject-matter jurisdiction over foreign defendants on the basis of transactions executed on U.S. exchanges).

^{163 130} S. Ct. 2869, 2875 (2010).

¹⁶⁴ *Id.* at 2875–76.

¹⁶⁵ Id.

Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167, 175–76 (2d Cir. 2008), aff'd, 130 S. Ct. 2869 (2010). The court gave a nod to Judge Henry Friendly's policy rationale in formulating the conduct test, stating: "[The] United States should not be seen as a safe haven for securities cheaters; those who operate from American soil should not be given greater protection from American securities laws because they carry a foreign passport or victimize foreign shareholders." *Id.* at 175.

¹⁶⁷ Morrison, 130 S. Ct. at 2878, 2884.

gressional expression of a statute's extraterritorial application, a statute lacks extraterritorial reach. In addition, the Court clarified that the question of extraterritorial reach of section $10(b)^{169}$ concerns substantive statutory scope; that is, while subject-matter jurisdiction pertains to the a "tribunal's power to hear a case," 170 statutory scope refers to whether section 10(b) may be applied extraterritorially in granting a cause of action against foreign defendants. Thus, a shift from jurisdiction to substantive statutory reach "require[s] a new Rule 12(b)(6) label for the same Rule 12(b)(1) conclusion"—dismissal.

Following Morrison, there has yet to be a commodities case brought under the auspices of extraterritoriality, so the reach of section 10(b) precedent, which historically has been mirrored in the commodities arena, is unclear. Moreover, in the context of Libor, even a conduct-test approach or the bright-line transactional approach in *Morrison* has only tangential influence because the negative conduct occurs before any effects appear within U.S. borders, though in Barclays's case, the negative conduct stemming from London offices derived from requests by New York office swaps traders. Finally, Congress compounded interpretive issues by inserting an extraterritoriality provision, section 929P(b), for the securities (but not commodities) laws into Dodd-Frank just weeks after the Supreme Court handed down the *Morrison* decision in 2010.¹⁷³ In a nutshell, this provision amends the Securities Exchange Act of 1934¹⁷⁴ (Exchange Act) by conferring exclusive jurisdiction to U.S. district courts over extraterritorial securities fraud, effectively overruling at least part of the Morrison holding.¹⁷⁵ But confusion abounds. The statutory language only

¹⁶⁸ Id. at 2884.

^{169 15} U.S.C. § 78j(b) (2006).

Union Pac. R.R. v. Bhd. of Locomotive Eng'rs & Trainmen Gen. Comm. of Adjustment, Cent. Region, 130 S. Ct. 584, 596 (2009) (internal quotation marks omitted).

¹⁷¹ Genevieve Beyea, Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws, 72 Оню St. L.J. 537, 546–47 (2011). A "merits issue" concerns the substantive limits or reach of a particular statute. Morrison, 130 S. Ct. at 2877 ("But to ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. . . . It presents an issue quite separate from the question whether the allegations the plaintiff makes entitle him to relief." (citations omitted)).

¹⁷² Morrison, 130 S. Ct. at 2877.

 ¹⁷³ Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),
 Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864–65 (2010) (codified at 15 U.S.C.
 §§ 77v(a), 78aa (Supp. IV 2010)).

 $^{^{174}}$ Pub. L. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78pp (Supp. IV 2010)).

 $^{^{175}}$ $\,$ Dodd-Frank inserted its amendments at section 27(b) of the Exchange Act, reading in relevant part:

⁽b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving—

appears to affirm *Morrison*'s second holding, which confers subject-matter jurisdiction on district courts over some extraterritorial antifraud cases, and thus remains silent on the contested holding, which forbids section 10(b) to reach certain extraterritorial matters on the merits. That is to say, plaintiffs' claim in *Morrison* failed because the Court did not read section 10(b) as a substantive cause of action to reach defendants based on the failure of their activity to satisfy the conducts test; jurisdiction in the traditional sense is not implicated.

It remains unclear how and to what extent *Morrison*, section 929P(b), and what remains of the conduct and effects tests impact domestic enforcement of the CEA against Libor rigging. Congress, with its keen interest in deterring future Libor manipulations, ¹⁷⁶ would seem to prefer some sort of extension of section 929P(b) to aid in commodities antimanipulation. Many have argued in private Libor litigation that the CEA is included in *Morrison*'s "transactional" test in that the Act only extends to *domestic* commodities and their transactions. ¹⁷⁷ Such a reading completely abrogates the conduct and effects tests for CEA actions, imputes congressional intent to *restrict* extraterritorial CEA application, and implies that Libor is not a commodity under the CEA because it cannot be used to achieve extraterritorial application of the Act. In sum, before a court can ever reach the merits of a CFTC Libor case, it must determine whether the CEA may be applied extraterritorially to reach Libor and its fixers.

C. The Merits of Holistic Enforcement

The preceding analysis demonstrated the perplexing nature of Libor and the unstable state of the CFTC's extraterritorial jurisdiction. Before introducing remedial options, however, I will explain why change is necessary. Recall that in Barclays's case, the CFTC had fairly strong evidence that the bank had violated U.S. commodities laws.¹⁷⁸ The Commission also has not had difficulty getting other Panel banks to settle Libor charges. In addition, the CFTC may be

⁽¹⁾ conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

⁽²⁾ conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Pub. L. No. 111-203, § 929P(b)(2), 124 Stat. 1376, 1865 (2010) (codified at 15 U.S.C. § 78aa (Supp. IV 2010)).

¹⁷⁶ See Ben Protess, Geithner Faces Senate on Rate-Rigging Scandal, DealB%k (July 26, 2012, 12:29 PM), http://dealbook.nytimes.com/2012/07/26/geithner-faces-senate-on-rate-rigging-scandal/.

¹⁷⁷ Reply Memorandum of Law in Further Support of Defendants' Motion to Dismiss the Exchange-Based Plaintiffs' Claims at 6–7, *In re* Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed Sept. 27, 2012).

¹⁷⁸ See supra Part I.B.2.

able to use the imperfect manipulation and fraud provisions in the CEA to at least catch some rate riggers. For example, while the CFTC may not be able to capture *all* rate rigging because Libor is currently neither expressly enumerated as a commodity under the CEA nor as a per se price for those derivatives and transactions that reference Libor, the CFTC can at least drum up a legitimate fraud or manipulation case against certain banks whose rate-rigging activities are directly linked to instruments or transactions with discrete U.S. impact (satisfying the effects test and presumably *Morrison* as well) and which are caused, at least in part, by communications from U.S.-based swaps traders (satisfying the conduct test). The point is, why all the fuss?

While the CEA and the rules thereunder provide for certain relief, they are distinctly insufficient for realization of holistic enforcement. Merely targeting individual rate riggers in a piecemeal fashion shares the same problematic characteristics that plagued pre-Dodd-Frank enforcement and regulation of the intricate and complex derivatives markets: they are both post hoc and ad hoc. For example, proving intent and price artificiality in fraud or manipulation cases is inherently fact-bound, meaning that any enforcement approach must be ad hoc to adapt to different fact settings. At essence, holistic enforcement accomplishes two broad goals. First, such a scheme would provide the CFTC with clearly defined authority under the CEA to react quickly to market phenomena that have been taken advantage of, such as Libor, and that cause problems on their own. For example, as I propose in the next Part, including within the CEA's definition of commodity the term "reference rate" or "Libor" gives the CFTC broad authority to bring enforcement actions against any rate rigging, wherever it should occur or stem from. Second, the CFTC would be able to engage in fact-preclusive rulemaking to clarify its substantive enforcement ability.

The law often struggles to keep pace with the new transactions, products, and entities that are generated almost on a daily basis because of the law's need to balance parochialism with market freedom. For example, an entire "shadow banking" system had been slowly growing up until the financial crisis, whose systemic implications regulators failed to catch until it was too late. 179 Libor is no different. In this day and age, many financial machinations do not fit into the neat buckets that the CEA traditionally holds. Congress recognized this fact in providing an incredibly broad definition of "swaps" in Dodd-

¹⁷⁹ Zoltan Pozsar et al., *Shadow Banking* 1–2 (Fed. Reserve Bank of N.Y., Staff Report No. 458, 2012) (describing shadow banking as the unregulated system that financial institutions, primarily banks, use to intermediate capital in lieu of the traditional capital intermediation process).

Frank,¹⁸⁰ permitting the CFTC and SEC to capture as many of these innovative instruments as possible within their new Dodd-Frank regulations.

Like swaps, Libor represents a pervasive phenomenon—the reference or index rate—of the modern financial age that defies traditional categorization. Libor is used as a benchmark rate of interbank borrowing but also as the "price" for trillions of financial products; it is employed transnationally and in many different contexts—ranging from local bank loans to complex, structured transactions between financial institutions and multinational corporations. 181 As such, with the current statutory framework for antimanipulation and antifraud in the CEA, the CFTC has no choice but to enforce against Libor and similar reference rates in a piecemeal fashion, creating ad hoc, post hoc oversight and enforcement. For example, if a bank is caught rate rigging to benefit derivatives positions and maintain stronger financial health, the CFTC can prosecute the former but not the latter. And if it surfaces later that other banks were involved, the CFTC can prosecute them as well. In each instance, the Commission is constrained by antiquated law.

Such an incrementalist approach is simply insufficient to achieve widespread deterrence and enforcement, and it surely does not serve to maintain the integrity of evolving financial markets, whose pervasive instrumentalities, like Libor and swaps, must be structurally sound to retain their beneficial effects (i.e., efficient risk allocation for swaps and accurate benchmarking for Libor). Indeed, U.K. regulators have also come to a similar conclusion, advocating for amendments to their financial laws to explicitly include Libor manipulation as criminal conduct such that "the scope of the [new] provision for benchmark[] [rates] is consistent with the scope of market manipulation of financial instruments." Without a fundamental change in the law to accommodate these nebulous innovative phenomena, the CFTC simply has no other choice. With these justifications in mind, the next Part relays a holistic reconciliation process for domestic oversight over Libor.

III TOWARD HOLISTIC ENFORCEMENT

While holistic enforcement and a shift from incrementalism are both well and good, the task of extraterritorially enforcing Libor is daunting to say the least. The CFTC must not only surpass the substantive and jurisdictional hurdles detailed in the previous Part but

¹⁸⁰ Dodd-Frank Act, § 721.

¹⁸¹ See supra Part I.A.

THE WHEATLEY REVIEW, *supra* note 4, at 18–19.

also carefully tread a precedential path to be prepared to combat future fraudulent manipulations of Libor and its cousin reference rates. At present, the Commission's armada is ill defined at best. Should U.S. authorities fail to deliver any significant threat against Libor fixers, the stage is all but set for repeat performances because "[t]he methods and techniques of manipulation are limited only by the ingenuity of man." 183

The present Part proposes a two-part option that can pave the way for greater CFTC presence in policing Libor and similar reference interest rates. The first part preserves the pre-*Morrison* conduct and effects test for actions brought under the commodities laws against foreign defendants who attempt to manipulate or defraud using reference rates. I argue that the conduct and effects tests, not the bright-line test set forth in *Morrison*, should govern whether the CEA substantively reaches extraterritorial manipulations to provide the CFTC with a cause of action.¹⁸⁴

The second part of the option rounds out the *Morrison* issue and buttresses the substantive case against rate rigging by proposing that (a) Congress amend the CEA to enshrine in its "commodity" definition Libor and other similar reference rates and (b) the Commission promulgate rules interpreting manipulation and fraud in the reference-rate context. In regards to *Morrison*'s bright-line rule, if Libor is made a statutory commodity, then the CFTC can satisfy the *Morrison* test by establishing that Congress intended for the CEA to reach reference-rate manipulation that causes detrimental effects in the United States (i.e., satisfaction of the effects test), especially given Congress's implicit intent to convey extraterritorial jurisdiction to the SEC via section 929P(b) and Congress's interest in curbing rate rigging. 185

As for the substantive rate-rigging case, a statutory amendment would grant the Commission ex ante rulemaking authority to enact regulations regarding Libor policing, permitting the Commission to refine its enforcement powers over fraud and manipulation as enunciated in the CEA to better capture Libor and related reference interest rates. Though the CEA's commodity definition is already broad, express statutory amendment or even ex ante interpretation by rulemak-

Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971). U.K. regulators have come to a similar conclusion, noting that a credible reference rate is "subject to credible oversight" and that "a credible governance and regulation structure should have sufficient independence and *powers* to ensure that attempted manipulation . . . does not occur." The Wheatley Review, *supra* note 4, at 56 (emphasis added).

¹⁸⁴ But see Reply Memorandum of Law in Further Support of Defendants' Motion to Dismiss the Exchange-Based Plaintiffs' Claims, supra note 177, at 4–6 (arguing exactly the opposite—that the CEA is covered by Morrison and thus must abide by its new transactional test to determine substantive statutory scope).

¹⁸⁵ See Protess, supra note 176 (noting that "Congress [has] intensified its focus on the interest-rate rigging scandal"); see infra Part III.A.

ing would be preferable to arguing in actual litigation that Libor is a commodity, as many private litigants have already done.¹⁸⁶

A. Clarifying the Commodity Futures Trading Commission's Extraterritorial Jurisdiction

The last Part's discussion of jurisdiction left off with the question of whether Morrison and section 929P(b) can be reconciled with preserving conduct- and effects-test jurisdiction for CFTC claims against foreign rate-riggers. As the Morrison Court stated, the question of section 10(b)'s reach is one of substantive merit, not subject-matter jurisdiction, 187 and the lack of statutory endorsement of extraterritorial application belies congressional intent to preclude such application. 188 However, not all of the Justices agreed with such a reading of the Exchange Act, which houses section 10(b). In his concurrence, Justice John Paul Stevens questioned the merit of complete elimination of the conduct and effects tests along with their decades of established Second Circuit jurisprudence. 189 He noted the irrationality of clearly demarcating when extraterritorial jurisdiction applies and when it does not, advocating for the flexible standard in place prior to Morrison. 190 To demonstrate, Justice Stevens posed a hypothetical situation in which a U.S. investor purchases common shares listed on a foreign exchange of a corporation whose New York subsidiary engages in fraud.¹⁹¹ Under the new transactional test outlined by the majority in Morrison, the investor has relief in section 10(b) because there was no purchase or sale of a security domestically even though "there is both substantial wrongful conduct . . . in the United States and a substantial injurious effect on United States markets and citizens."192

In further advocating against the majority's bright-line rule, Justice Stevens pointed out that, though a presumption against extraterritoriality underlies the Supreme Court's jurisprudence, ¹⁹³ the Court must "give effect to 'all available evidence about the meaning' of a provision when considering its extraterritorial application," overcoming

¹⁸⁶ See, e.g., Amended Consolidated Class Action Complaint, supra note 102, at 96 ("LIBOR acts just as any other commodity").

¹⁸⁷ Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2877 (2010).

¹⁸⁸ *Id.* at 2892 (Stevens, J., concurring).

¹⁸⁹ Id. at 2891.

¹⁹⁰ Id. at 2891-92.

¹⁹¹ Id. at 2895.

¹⁹² Id.

¹⁹³ See, e.g., EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 258 (1991) ("Congress' awareness of the need to make a clear statement that a statute applies overseas is amply demonstrated by the numerous occasions on which it has expressly legislated the extraterritorial application of a statute.").

the presumption when no clear statutory directive exists.¹⁹⁴ He further argued that the presumption carries little weight in consideration of section 10(b)'s extraterritorial applicability because the presumption is a "tool for managing international conflict" and a "tiebreaker"; courts still retain authority to faithfully interpret statutes.¹⁹⁵ Because the Second Circuit's effects test adheres to the Exchange Act's purpose of capturing overseas fraudulent activity with detrimental effects in the United States, it comports with Congress's understanding of the Act.¹⁹⁶

The logic in Justice Stevens's arguments should carry special weight under the CEA. Fundamentally, much of the reasoning in *Morrison* does not fit the situation created by Libor, in part due to Libor's defiance of traditional categorization.¹⁹⁷ Though securities are offered on a cross-border basis and companies can list on exchanges of multiple countries, derivatives transcend borders by affecting markets as a whole.¹⁹⁸ This characteristic stems from the fact that derivatives markets exist to permit market participants to transfer risk or profit from proprietary information on risk fluctuations.¹⁹⁹ Take the futures market as an example. The trading of futures contracts does not affect any one company or investor per se, yet it can affect the prices of *all* futures contracts of its kind in the given market as well as the underlying market for the commodity upon which the futures contracts are written.²⁰⁰

Moreover, it is well established in the financial literature that the price of one type of derivative—say, an interest-rate swap—can be directly influenced by the prices of other derivatives because many prominent pricing models employed by market participants use the

 $^{^{194}}$ $^{\,}$ Morrison, 130 S. Ct. at 2891 (Stevens, J., concurring) (quoting Sale v. Haitian Ctrs. Council, Inc., 509 U.S. 155, 177 (1993)).

¹⁹⁵ Id. at 2892.

¹⁹⁶ Id. at 2888–91; see Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1336 (2d Cir. 1972), abrogated by Morrison, 130 S. Ct. 2869; Hannah L. Buxbaum, Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict, 46 Colum. J. Transnat'l L. 14, 19 (2007). Domestic effects as a proxy for necessity of extraterritorial reach has been prevalently employed in other contexts as well. See Cont'l Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 705 (1962); Envtl. Def. Fund, Inc. v. Massey, 986 F.2d 528, 531 (D.C. Cir. 1993) (noting that the presumption against extraterritoriality loses strength "when the [relevant] conduct . . . occurs within the United States" and failure to extend extraterritoriality "will result in adverse effects within the United States"); Restatement (Second) of Foreign Relations Law of the United States § 38 (1965).

¹⁹⁷ See supra Part II.C.

¹⁹⁸ See generally Deutsche Börse Grp., The Global Derivatives Market: An Introduction passim (2008) (describing the global nature and function of derivatives).

199 Id

Additionally, the commodities markets, and thus their attendant derivatives markets, are substantially subject to the whims of global supply and demand. See Gary L. Seevers, Report of the Commodity Futures Trading Commission Advisory Committee on the Economic Role of Contract Markets 24–27 (1976).

prices of simpler derivatives to value more complex derivatives.²⁰¹ For example, the standard interest-rate swap entails one party paying a fixed rate and receiving from its counterparty a floating rate.²⁰² To determine what the rates (the price) should be, the swap itself can be broken down into several futures contracts, which are much easier to value due to their simplistic term structures. Evidently, then, derivatives and commodities markets possess much greater fluidity and interconnectedness, a phenomenon recognized early on by the *Tamari* court in its finding that the integrity of domestic exchange markets are worthy of protection from extraterritorial deceit and fraud even where limited domestic contacts exist.²⁰³ A bright-line purchase or sale transactional test simply does not comport with the underlying economics of commodities and derivatives markets.²⁰⁴

In July 2010, Congress—in its sweeping reform of financial markets—passed section 929P(b) of Dodd-Frank to rebut *Morrison*'s holding and presumption against extraterritoriality for section 10(b) antifraud cases brought by the SEC or the Justice Department.²⁰⁵ Notwithstanding the language confusion in section 929P(b),²⁰⁶ it appears that Congress intended to restore the conduct and effects tests for

 $^{^{201}}$ See generally Hull, supra note 5, at 75 (describing interest rates and how they are a factor in the valuation of all derivatives).

²⁰² See supra notes 66, 85 and accompanying text (describing interest rate swaps).

Tamari v. Bache & Co. (Lebanon) S.A.L., 547 F. Supp. 309, 313 (N.D. Ill. 1982) ("[W]here the challenged transactions involve trading on domestic exchanges, harm can be presumed, because the fraud alleged implicates the integrity of the American market."). Other courts have also pondered the question of how much deference courts should extend to the international scope of commodities transactions. *See, e.g.*, Mormels v. Girofinance, S.A., 544 F. Supp. 815, 817 (S.D.N.Y. 1982).

Plaintiffs in private Libor litigation argued, to similar effect, that Morrison's application to Libor claims under the CEA generates the inquiry of "where the underlying [derivatives] contracts were actually traded." The Exchange-Based Plaintiffs' Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Exchange-Based Amended Consolidated Class Action Complaint at 33, In re Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed Aug. 28, 2012) (citing CFTC v. Garofalo, No. 10 Civ. 2417, Rec. Doc. 83, at *12 (N.D. Ill. Dec. 21, 2010)). Because the Libor-based contracts being traded by the various banks' swaps traders, including those at Barclays, were ultimately executed on U.S. exchanges, plaintiffs argue that Morrison's transactional test is satisfied. Id. Such an argument on its face is perfectly sufficient for this case, however, it fails in the holistic enforcement regard because one can imagine a variety of plausible scenarios in which Libor manipulation was not in fact tethered to any specific transaction or transactions. Additionally, if the manipulation in these hypotheticals only partially implicated contracts traded on U.S. exchanges, courts would have to engage in line drawing to determine what threshold percentage of such transactions would have to be executed in the United States before sufficient contacts rest domestically. Such line drawing is the antithesis of a holistic approach to enforcement against Libor rigging.

Pub. L. No. 111-203, § 929P(b)(2), 124 Stat. 1376, 1862 (2010) (codified at 15 U.S.C. § 78aa (Supp IV. 2010)); see 156 Cong. Rec. H5237 (daily ed. June 30, 2010) (statement of Rep. Paul Kanjorski) (clearly noting the intention of section 929P(b)).

Though the Supreme Court in *Morrison* addressed the lack of substantive statutory merit to hear the extraterritorial case, the language in Dodd-Frank grants the SEC and Justice Department subject-matter jurisdiction. Read literally, the Dodd-Frank language is

agency antifraud actions under the federal securities laws on both subject-matter jurisdiction and substantive statutory scope grounds. Indeed, the SEC has taken this view and has initiated rulemaking congruent with restored conduct and effect tests.²⁰⁷ Justice Stevens would also likely advocate for this reading given his arguments that the conduct and effects tests should not be affected by the presumption against extraterritoriality endorsed by Morrison's majority. Assuming that the Court confirms this reading of section 929P(b),²⁰⁸ later courts in commodities actions brought by the CFTC should read Dodd-Frank's restoration of extraterritoriality purposively as warranting the same treatment in such actions by interpreting Morrison as not applying to the CEA given the differences between the securities and derivatives markets. At a minimum, section 929P(b) comports with the historical and economic understanding that derivatives markets transcend national borders in a more fluid manner than securities markets, as exemplified in the previous paragraph.

Finally, at its core, *Morrison* instructs courts to observe the focus of congressional intent when deciding whether a statute may be used to reach extraterritorially.²⁰⁹ Thus, the *Morrison* Court noted that because section 10(b) of the Exchange Act focused on purchases and sales of securities in the United States, the "transactional test" forecloses section 10(b) from reaching overseas to an Australian bank when the securities sales occurred overseas as well.²¹⁰ The Court further distinguished "interstate commerce" from "foreign commerce," remarking that mention of the former does not imply inclusion of the latter to defeat the presumption against extraterritorial application.²¹¹ But as I noted before, the derivatives markets are uniquely fluid in global scope; thus, manipulation and fraud of such markets can vary in effect, from regional to international, more so than in the companion securities markets. Indeed, Dodd-Frank itself is partially premised on the need for *international* standardization of derivatives market re-

superfluous since subject-matter jurisdiction is presumably already conferred upon the SEC to bring these sorts of actions.

 $^{^{207}}$ See, e.g., Study on Extraterritorial Private Rights of Action, 75 Fed. Reg. 66,822 (Oct. 29, 2010).

²⁰⁸ Indeed, many commentators have already endorsed the SEC's interpretation of section 929P(b) and have placed their bets with the agency in the event of litigation over the provisions. *See, e.g.*, Richard W. Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. Bus. L. Rev. 195, 206–08 (2011) (discussing the SEC's interpretation of section 929P(b) and arguments the agency could make in support of its interpretation).

²⁰⁹ See Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2873 (2010) ("It is a 'long-standing principle of American law "that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."" (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991))).

²¹⁰ See id. at 2874.

²¹¹ See id. at 2873-74.

form, and in investigating Libor, authorities forthrightly affirmed the need for international cooperation. It follows, then, that certain subject areas covered by the CEA that have substantial U.S. effects should permit the statute to have extraterritorial reach; to hold otherwise would be to strip the CEA of any power whatsoever given the transnational nature of derivatives markets. In today's continuously evolving global markets, strict *Morrison*-type limitations on extraterritorial application of the CEA would be nothing less than arbitrary. Instead, if a derivatives-related manipulation or fraudulent scheme such as rate rigging produces *substantial effects* in the United States, *Morrison*'s bright-line wall should fall away to permit extraterritorial access for the CFTC.

B. Libor's Place in the Commodity Exchange Act

Aside from the post-Morrison restoration of the conduct and effects tests, two issues remain: first, the CFTC may still face substantive statutory scope issues because defendants can still use Morrison to argue that, notwithstanding any restoration of the effects test for CEA actions, the CEA still does not reach reference-rate manipulation; second, the CFTC must contend with the difficulty in establishing a prima facie case in Libor litigation. Approaches to the second issue can take many forms. For example, some private claimants have gone the antitrust route.²¹³ Others, figuring that Libor is embedded in many securities, have sued directly under the federal securities laws.²¹⁴ Litigants have also argued that, given the broad definition of "commodity," Libor and similar reference rates are already captured in the definition.²¹⁵ But these more treacherous avenues can all be scrapped in favor of a much more unassuming, foundational option: Congress should explicitly make Libor—or any reference rate for that matter a commodity.²¹⁶

²¹² See Am. Bankers Ass'n, Dodd-Frank and Community Banks: Your Guide to 12 Critical Issues 2 (2012), http://www.aba.com/aba/documents/dfa/dfguide.pdf (noting that that one of the intentions behind the Dodd-Frank Act was "to harmonize U.S. regulations with international standards, and even exceed them").

²¹³ See Amended Consolidated Class Action Complaint, supra note 102, ¶¶ 1–8. The CFTC actually does possess some antitrust authority that it may exercise in conjunction with administering the CEA. Essentially, the CFTC is tasked with weighing antitrust concerns with its own regulatory needs. See 2 Johnson & Hazen, supra note 90, at 1223 (citing Senate Agric. & Forestry Comm., Report on H.R. 13,113, S. Rep. No. 93-1131, at 22–23, 90 (2d Sess. 1974)). However, much of this inquiry pertains to rulemaking decisions, not enforcement, since the latter would presumably run parallel with, not against, antitrust concerns.

 $^{^{214}}$ – See Class Action Complaint $\P\P$ 147–56, Gusinsky v. Barclays PLC, No. 12-CV-5329, 2012 WL 2775017 (S.D.N.Y. filed July 10, 2012).

²¹⁵ See Amended Consolidated Class Action Complaint, supra note 102, passim.

²¹⁶ U.K. regulators, as mentioned earlier, have advocated for a similar result, requesting that Libor manipulation be codified as a *specific prosecutable offense* in their financial laws

1. Classification of Reference Rates as Commodities

While the Commission has the authority to prevent manipulation and fraud in the marketplace, it also has express plenary authority over all enumerated commodities in the CEA.²¹⁷ In enacting the CEA, Congress defined "commodity" in section 1a(9) as follows:

wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils, . . . cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in. 218

The phrase "contracts for future delivery are presently or in the future dealt in" expands the commodity definition to include all items and assets that underlie traded *futures* contracts.²¹⁹ The piecemeal format of the definition does not imply a form-based approach to determining what is and is not a commodity; the Commission has consistently taken the position that determination of commodity status considers economic reality.²²⁰ On its face, because certain futures contracts are traded on interest rates, the CFTC could conceivably take a product-based approach in capturing Libor; indeed, private litigants have taken the approach that defendant banks manipulated the Eurodollar futures price and its underlying commodity: Libor.²²¹ Again, however, such an approach falters for the CFTC not due to lack of statutory blessing but because the approach fails to produce holistic results. In the Barclays case, for example, interest rate futures were at best only partially implicated. Should a bank manipulate reference

to ensure that they *holistically* capture rate rigging. *See* The Wheatley Review, *supra* note 4, at 18–19. Indeed, U.K. regulators expressly reject the notion of simply expanding regulators' enforcement powers and prefer explicitly making Libor manipulation an offense. *See id.* at 18.

²¹⁷ See 2 Johnson & Hazen, supra note 90, at 976–77; David J. Gilberg, Regulation of New Financial Instruments Under the Federal Securities and Commodities Laws, 39 Vand. L. Rev. 1599, 1601–03 (1986).

²¹⁸ 7 U.S.C. § 1a(9) (2006).

²¹⁹ It could be argued that Libor might fall within this leg of the definition since many swaps, which theoretically can be decomposed into multiple futures contracts, employ Libor as the rate at which payments are exchanged. Though this interpretation would most likely fail in the judicial context, it nevertheless serves to illustrate the potential flexibility of the commodity definition in the face of evolving financial markets.

²²⁰ 1 JOHNSON & HAZEN, *supra* note 90, at 9.

²²¹ See, e.g., The Exchange-Based Plaintiffs' Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Exchange-Based Amended Consolidated Class Action Complaint at 5–8, *In re* Libor-Based Fin. Instruments Antitrust Litig., No. 1:11-md-2262-NRB (S.D.N.Y. filed Aug. 28, 2012) (arguing that Barclays intentionally manipulated Libor levels to gain favorable prices in some of its swaps traders' Eurodollar contracts).

rates but not have positions in any relevant futures contract or derivative instrument, this route would falter.

The commodity definition further excludes certain items, including any:

interest rate, . . . other rate, . . . index . . . not based in substantial part on the value of a narrow group of commodities . . . or based solely on 1 or more commodities that have no cash market . . . , [or] any economic . . . index based on prices, rates, values, or levels that are not within the control of any party to the relevant contract, agreement, or transaction. 222

The CEA, by amendment from the Commodity Futures Modernization Act (CFMA), 223 also exempts commodities that are not "excluded commodit[ies] or . . . agricultural commodit[ies]." Though excluded commodities, which notably include "interest rates," are not covered by many of the CEA's and CFTC's regulatory provisions, they—along with exempt commodities—remain subject to the CFTC's general antimanipulation and antifraud authority. 225

Several arguments militate against Libor being a commodity. First, one can differentiate an "interest rate," contained in the excluded commodity definition, from an "index rate": Libor serves many more purposes than simply being an interest rate. It is employed as a benchmark for all sorts of financial instruments and is an indicium of bank borrowing costs, which has implications for alternative uses. Though "price" is interpreted fairly broadly by courts,²²⁶ a court may hesitate in finding all uses of Libor to be prices, even if the court agrees that Libor is an excluded commodity. Further, a court may not even get that far, finding that Libor is simply too nebulous or has too many uses in the markets to be considered an interest rate. Finally, even if a court found the other way, the CFTC would still face challenges in bringing future enforcement cases on this one piece of precedent alone and in promulgating rules under the excluded commodity provision to bolster its enforcement power. Further, banks have argued in private Libor litigation that Libor is a "hypothetical" number subject to much discretion.²²⁷

²²² 7 U.S.C. § 1a(19).

²²³ Commodity Futures Modernization Act, Pub. L. No. 106-554, 114 Stat. 2763 (2000) (codified in scattered sections of titles 7, 11, 12, and 15 U.S.C.).

²²⁴ 7 U.S.C. § 1a(20).

 $^{^{225}}$ Jerry W. Markham, Commodities Regulation: Fraud, Manipulation & Other Claims ch. 27 (2012).

²²⁶ See, e.g., Memorandum and Order at 11, 17–22, CFTC v. Parnon Energy Inc., No. 11 Civ. 3543 (WHP) (S.D.N.Y. Apr. 26, 2012) (finding that the spread in a calendar spread trade involving sweet light crude futures can be a "price" for manipulation purposes).

²²⁷ See The Exchange-Based Plaintiffs' Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Exchange-Based Amended Consolidated Class Action Complaint, supra note 221, at 8 (citing Defendant's Brief at 27 n.25).

The foregoing arguments notwithstanding, congressional endorsement of Libor and other reference rates as statutory commodities would almost be formalistic given how closely reference rates already resemble commodities. First, recall that excluded commodities, which include interest rates, are simply excluded by the CFMA from certain of the CFTC's and CEA's rules and provisions, yet the CFTC retains antifraud and antimanipulation authority over them. Second, Libor reflects all of the essentials present in what one might depict as a "true" commodity. Libor is tied to endless amounts of derivative instruments around the world and makes transparent what baseline costs of borrowing are in the financial markets on a daily basis.²²⁸ As with other commodities, the cost of borrowing fluctuates depending on a plethora of factors, including the state of the global economy, the idiosyncrasies attendant to each currency fix, the risk and volatility of the various markets (money, security, and derivative) shown through the different maturities, and others.²²⁹ In other words, in this light, Libor begins to look like any other commodity that neutrally responds to the ebb and flow of global markets.

Further, the results of the calculation are broadly disseminated and incorporated into market transactions around the globe. Information consumption of this kind cycles through the markets and, eventually, the information makes its way back into bank borrowing costs by affecting market perceptions of what borrowing costs should be. Finally, market participants interact heavily using Libor as a method of communicating views on risk and market conditions (i.e., price information). In this vein, Libor acts as the "price" for any instrument that employs Libor or some other reference rate because the price of an instrument includes not only the stated payment rates but also their underlying components.²³⁰ Thus, for those instruments and contracts that employ a price tethered or related in some way to bank borrowing cost or some other market benchmark, the CFTC could contend that the relevant reference rate benchmark is included in that price. Indeed, the CFTC has taken the position in the past that Libor rates are commodities under the CEA.²³¹

²²⁸ See Mollenkamp & Whitehouse, supra note 12 ("\$90 trillion in dollar-denominated mortgage loans, corporate debt and financial contracts rise and fall according to Libor's movements.").

Standard & Poor's, *supra* note 30, at 13 (noting that risk of lending money depends on "the issuer's financial condition, industry segment, and conditions in that industry and economic variables and intangibles").

²³⁰ See Memorandum and Order, supra note 226, at 17–21 (noting that in determining an artificial price, "one must look to the broadest possible range of relevant cash market transactions" (internal quotation marks omitted)).

²³¹ Settlement Order, *supra* note 10, at 4, 11, 25–27 ("[T]he daily BBA LIBOR for U.S. Dollar, Sterling, and Yen [are] . . . all commodities in interstate commerce"); *see In re* DiPlacido, Comm. Fut. L. Rep. (CCH) ¶ 30970, 2008 WL 4831204, at *31 (Nov. 5, 2008)

2. A Full Trip: Realization of Holistic Enforcement

Once Congress amends the CEA to include "reference rate" in the commodity definition, the CFTC can effectively circumvent the *Morrison* merits question to prepare a substantive case against *any* rate manipulation or fraud. 232

With satisfaction of the effects test and characterization of Libor as a commodity, the CFTC should survive a motion to dismiss brought under Morrison because under Justice Stevens's reasoning in his concurrence, the Tamari rationale, the definitional and economic transnationalism of derivatives markets, and implied congressional vision of harmonized global derivatives regulation (through its enactment of section 929P(b) and Dodd-Frank), the CEA can be said to extraterritorially reach foreign reference rates and their fixers. Inclusion of Libor as a commodity in the CEA is crucial here because although the CFTC could potentially successfully argue that Morrison should not apply in rate-rigging litigation, inclusion solidifies the argument by specifically pointing to the very thing that caused the substantial effects (shown through the restored effects test) on domestic interests.

To circumvent these complications, the Commission, once statutorily vested with oversight over Libor, can and should promulgate rules and regulations to help it prove a Libor-based fraudulent manipulation claim. Congress has taken the first step already in its enactment of Dodd-Frank, which includes a new broad prohibition against fraud and market manipulation, modeled after section 10(b) of the Exchange Act: section 6(c)(1) of the CEA.²³³ Section 6(c)(1) prohibits any "manipulative or deceptive device or contrivance" in the derivatives markets,²³⁴ which expands the CFTC's authority to enforce against manipulation and fraud in two ways: first, the CFTC now is not limited to proving price artificiality in manipulation cases; second, the scienter standard for both fraud and manipulation has been reduced from intentional acts to recklessness.

Acting upon this new authority, the Commission promulgated Rule 180.1, which models Rule 10b-5 from the securities laws.²³⁵ Rule 180.1 elaborates upon section 6(c)(1) to broadly capture intentional

⁽holding that an artificial price includes the calculation of an average of prices over a given time period).

²³² In *Morrison*, the plaintiffs lacked a cause of action because their transaction did not fall within the scope of the Securities Act because of the lack of a "purchase or sale" of a security within domestic borders. Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2883–85 (2010).

²³³ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,400 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

²³⁴ *Id.* at 41,401.

²³⁵ See id. at 41,400.

or reckless fraud-based manipulations in connection with a derivative or commodity.²³⁶ With the new rule and its "flexibl[e]" and "remedial" interpretation,²³⁷ the CFTC will not have to prove any actual effect, such as abstruse price artificiality, in manipulation cases so long as it shows fraud.²³⁸ In addition, the CFTC promulgated Rule 180.2, which preserves the traditional price manipulation analysis borne of case law.²³⁹ Fundamentally, Rule 180.2 expands the traditional analysis by capturing *indirect* manipulations.²⁴⁰ Together, the two new rules appear to have a fairly firm grasp on reference-rate manipulation: general reference-rate manipulation is arguably "in connection with" the various indexed instruments and contracts and would indirectly affect market prices around the world.²⁴¹

Though it is a step in the right direction, Rule 180.1 falls short of holistic enforcement in a critical way. The CFTC has commented that the Rule can only apply to "manipulative or deceptive conduct *in connection with* the purchase, sale, . . . or termination of any swap, or contract of sale of any commodity . . . , or contract for future delivery."242 The CFTC specifically pronounced that it would follow SEC precedent in formulating the transaction or instrument requirement, posing an example from *SEC v. Zandford:* "If . . . a broker embezzles cash from a client's account . . . , then the fraud would *not* include the requisite connection to a purchase or sale of securities. Likewise, if the broker . . . was stealing the client's assets, that breach . . . would not involve a deceptive device or fraud."243 Thus, before the Rules

²³⁶ See id.

²³⁷ See id. at 41,401.

²³⁸ See id. ("A market or price effect may well be indicia of the use or employment of a manipulative or deceptive device or contrivance; nonetheless, a violation of final Rule 180.1 may exist in the absence of any market or price effect.").

Prohibition on Price Manipulation, 17 C.F.R. § 180.2 (2012) ("It shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.").

²⁴⁰ Id.

²⁴¹ Rosa M. Abrantes-Metz, *Has the Libor-Alleged Conspiracy and Manipulation Inspired the New CFTC Regulations?*, Global Econ. Group (Mar. 7, 2012), http://www.globaleconomicsgroup.com/financial-regulation/has-the-libor-alleged-conspiracy-and-manipulation-inspired-the-new-cftc-regulations/.

Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,405 (July 14, 2011) (emphasis added).

²⁴³ 535 U.S. 81³, 825 n.4 (2002) (emphasis added) (citation omitted); *see* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 85 (2006) (holding that section 10b-5 requires a nexus between fraud and a securities transaction). Although the Supreme Court has construed the antimanipulation and antifraud provisions of the CEA broadly, *see* CFTC v. Schor, 478 U.S. 833, 836 (1986), virtually all judicial interpretations of such provisions have required a similar nexus between fraudulent or manipulative activity and a commodities or derivatives transaction or contract, *see*, *e.g.*, R&W Technical Servs. Ltd. v. U.S. Commodity Futures Trading Comm'n, 205 F.3d 165, 171–74 (5th Cir. 2000).

can be used against reference-rate manipulation, the CFTC must find some transaction or contract to tie the manipulation to, which could result in erratic enforcement. However, the CFTC stated that it will interpret this language broadly—meaning the connection may be tenuous and the transaction or transactions may be unspecified.²⁴⁴

In light of this obstacle, the Commission should promulgate rules beyond 180.1 and 180.2.245 First, with respect to definitions, the Commission might further define the new "reference rate" commodity (similar to its additional definitions of "swap" in Dodd-Frank).²⁴⁶ In this endeavor, the Commission can look to how U.K. regulators have classified reference, or benchmark, rates to retain parallel regimes with European authorities. The Wheatley Report, for example, has advocated for a broader definitional standard to capture any rate "vulnerable to similar conflicts of interest and weak governance issues that have been identified with LIBOR."247 On the issue of scienter, because the requisite threshold is now recklessness, the Commission might clarify in rulemaking that at least a presumption of recklessness can be met if certain internal controls required by U.K. authorities for Libor-setting banks are not met by insiders, if those controls produced red flags that management failed to heed and investigate, or if submission estimation procedures have been corrupted. Such a presumption would capture cases in which the facts were not as blatant as in the Barclays scenario.

The Commission should particularly focus on apprehending attempted indirect manipulation of reference rate levels *as commodities*, not as prices of instruments "in connection with" the manipulation. With the abrogation of a specific intent standard, any fraud-based attempt to suppress or increase reference-rate fixes would fall under the indirect manipulation standard of Rule 180.2 as well as the fraud standard in Rule 180.1. Because Rule 180.1 does not require a showing of negative effect, such as price artificiality, the CFTC may argue that the fraud artificially altered the normal "course" of a reference rate's fixes *without* proving that the price was actually artificial.

The implications here are enormous. Typically, as I mentioned earlier, price artificiality can only be proved by comparing the alleg-

²⁴⁴ See Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,406–07.

The Commission might further clarify just how strong the "connection" must be between the fraud or manipulation and a transaction, as many industry members have already requested. *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,400.

²⁴⁶ See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 Fed. Reg. 29,818, 29,821–25 (May 23, 2011).

²⁴⁷ See The Wheatley Review, supra note 4, at 54, 61–62.

edly manipulated price to a "true" price, an intensely difficult endeavor considering the hefty economic analysis required as well as the immense subtlety in proving that any deviation of the price in question from some other benchmark price was caused by fraud (as opposed to neutral market conditions or bona fide estimates) or if such a comparison is even relevant (i.e., whether the deviation from the benchmark even implies price artificiality). With the two new rules, the CFTC can argue both on price artificiality grounds—Rule 180.2—for an indirect manipulation claim *and* on a more nebulous fraudbased manipulation basis—Rule 180.1—akin to a section 10b-5 argument of general deception in the marketplace—without proving price artificiality.

To bolster the Rule 180.1 claim, the Commission should also clarify reference-rate fraud (beyond outright fraud like that in Barclays's case) because, practically speaking, any reference-rate manipulation will most likely result from fraud. There are multiple ways to do this. For example, now that traditional price artificiality has been discarded, the Commission might adopt certain reference-rate benchmarks, such as the Eurodollar rate and credit default swap spread for Libor.²⁴⁹ Plaintiffs in private Libor litigation rely heavily on comparative empirical analysis to prove price artificiality, using such benchmarks as the Eurodollar rate.²⁵⁰ The argument goes that if Libor, which historically tracks the Eurodollar rate closely, deviates from the Eurodollar rate, Libor must be off because the Eurodollar rate is the result of neutral market fluctuations whereas Libor can be manipulated more easily. Empirical comparisons suffer from certain biases,²⁵¹ and deviations or irregularities "may indeed exist in the absence of anticompetitive [or manipulative] behavior."252 For example, a time-series regression comparing Libor fixes with comparable credit spreads on Libor-setting banks "cannot establish the presence of a conspiracy or a manipulation" because "there are many reasons why significant discrepancies . . . exist between CDS [credit default

²⁴⁸ See supra Part II.A.I.

Many studies and analyses have already compared Libor to other benchmarks such as the credit default swap spread for Libor-setting banks, Treasury rates, and Eurodollar contract rates, all of which traditionally correlate closely with Libor, to "prove" that Libor is being artificially skewed (i.e., not tracking actual market conditions). *See, e.g.*, Abrantes-Metz et al., *supra* note 13, at 141–50 (extending the original *Wall Street Journal* comparison of Libor to the noted benchmarks to "present statistical evidence of patterns that appear to be inconsistent with those expected to occur under conditions of [normal] market competition"); Mollenkamp & Whitehouse, *supra* note 12.

²⁵⁰ See Amended Consolidated Class Action Complaint, supra note 102, at 18-43.

See supra Part II.A.1.

²⁵² Abrantes-Metz et al., supra note 13, at 149.

swap] spreads and short-term borrowing costs,"²⁵³ but it does observe "certain patterns [that] 'flag' such a possibility."²⁵⁴

However, empirical results may be useful if the proxy instrument is more relevant; for example, should U.K. regulators publish a regular statistical bulletin using relevant data points such as the volume and value of interbank funding transactions, such information could provide a picture of actual conditions of the interbank market and serve as a comparison benchmark to elucidate deviations.²⁵⁵ The CFTC might adopt this approach in rulemaking to formalize its use in future litigation. Should the CFTC demonstrate material deviation from those benchmarks of Libor or another rate, such as commercial paper rates,²⁵⁶ then it has established a presumption of fraud-based manipulation, rebuttable by defendant banks, which must show that some other factor or factors caused the deviation, not fraud-based manipulation.²⁵⁷ Further, the CFTC might look to the *procedure* through which submitting banks determine and disseminate their rates. Finally, if it comes out in discovery that an accused bank failed to adhere to such internal controls, this failure would be indicative of possible inaccurate submissions.²⁵⁸

Holistic enforcement is also fulfilled if reference rates are made and then manipulated "in connection with" commodities under Rule 180.1.²⁵⁹ To see why, consider a Libor-setting bank that wishes to portray itself as financially healthy and creditworthy.²⁶⁰ Assume also that during this time, the interbank market is thin. Among other things, the bank, in estimating its borrowing costs, uses more conservative inputs to arrive at a lower rate, which it submits publicly. Up to this point, the bank has not technically employed any "deceptive device,"

²⁵³ *Id.* at 147 (noting, for example, that the discrepancies can be due to differences in time horizons, segmentation effects on liquidity premia, and other uncontrolled factors).

 $^{^{254}}$ Id. at 147–49 (presenting correlations between individual banks' Libor quotes and their credit default swap spreads).

²⁵⁵ See The Wheatley Review, supra note 4, at 40.

²⁵⁶ See Abrantes-Metz et al., supra note 13, at 150.

The argument underlying this treatment is not entirely new. See In re Cox, CFTC Docket No. 75-16, 1987 WL 106879, at *12 (July 15, 1987) (recognizing that there can be many causes of an artificial price and holding that manipulation can be argued when defendants' acts are a proximate cause of the artificial price); see also CFTC v. Parnon Energy Inc., 875 F. Supp. 2d 233, 248 (S.D.N.Y. 2012) (remarking that, for an attempted manipulation claim, "[i]t is enough . . . that respondents' action contributed to the price [movement]" (quoting In re Kosuga, 19 Agric. Dec. 603, 624 (U.S.D.A. 1960))).

The procedures could mirror the code of conduct and submission procedures advocated by the *Wheatley Report*. See The Wheatley Review, supra note 4, at 30–33.

²⁵⁹ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices, 17 C.F.R. § 180.1 (2012).

²⁶⁰ See Abrantes-Metz et al., supra note 13, at 137 (noting that banks have an incentive to submit inaccurate published rates not to influence the Libor fix but to "signal that... borrowing costs are... no higher than those of... peers" and "signal... pricing intentions [to peer banks]").

it has not been reckless, and it did not attempt to manipulate Libor "in connection with" any transactions or derivatives, even indirectly. Yet this is precisely one of the scenarios authorities hope to eliminate because it destabilizes the integrity of an important financial benchmark, not because the bank will inequitably profit from such a move. The issue here is compounded by the fact that the bank's decision to use conservative inputs is not entirely fraudulent; rather, on a sliding scale from outright fraud to questionable conduct, such a decision falls somewhere in the middle. And here, the CFTC cannot avail itself of the aforementioned clarifying regulations that compare referencerate levels to other benchmarks for evidence of manipulation because the bank will simply argue that, in estimating its Libor submission, it followed protocol by using inherently subjective model inputs. However, the CFTC can solve these issues by clarifying that the reference rate is the commodity whose level is being manipulated. Now, all the CFTC must show is that the bank in the example set forth inaccurate submissions based on impermissibly conservative inputs in connection with a commodity—the reference rate itself. The deception is in the model, and the inputs can be compared to market benchmarks.

Conclusion

Libor rate rigging is a dangerous externality of the increasing interconnectedness of global markets. Its effects have transcended national boundaries and permeated through the domestic socioeconomic stratum. And it is, unfortunately, not a singular threat: Libor and its companion reference rates have revealed the subtle holes in the CFTC's current enforcement toolbox. This Note encourages clarification of the domestic defenses available to financial regulators to combat the rate rigging of benchmark reference rates in the global financial markets. Much attention in the last few years has been focused on the credit crisis, and rightly so. But with the passage of Dodd-Frank and the quelling of the initial panic, regulators and legislators need to look beyond the obvious issues meriting market reform and delve into deeper, more pervasive structural problems that may undermine the integrity of the financial system at any time.

This Note advocated for a holistic, statutory-cum-functional enforcement approach, in lieu of a piecemeal judicial approach, to resolve deficiencies and ambiguities currently present in the statutory and regulatory provisions governing the CFTC's ability to handle foreign fraudulent manipulations of broad-based benchmark reference rates such as Libor. The two-part option sponsored in this Note works not only to address the Libor issue at hand but also to capture future manipulations or even innocent distortions of index rates or other nebulous financial phenomena that have transnational effects. By

clarifying judicial treatment of extraterritorial application of commodities law jurisdiction and by solidifying Libor in the CEA or rules thereunder, whatever future financial phenomena are to come, whether in the benchmark reference-rate realm or not, domestic watchdogs will be much better prepared to police against improper behavior.