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LIBOR Manipulation

The implications for all financial institutions

Executive Summary

Since the publication of our most recent newsletter in January (accessible here: LIBOR Manipulation bulletin-January 2013) markets have awaited with bated breath the results of further regulatory investigations into LIBOR manipulation by rate-setting banks. As at the date of publication of this bulletin, the wait continues, but here we summarise recent developments in the UK and US Courts and discuss the very important issue of time-bars on civil claims.

Developments in the English Courts - Graiseley Properties Limited and Others v Barclays Bank Plc[1] ("Graiseley") and Deutsche Bank AG v Unitech Limited[2] ("Unitech")

Our January 2013 bulletin made fleeting reference to the (then) pending *Unitech* hearing. This was heard in late February 2013 before Mr Justice Cooke.

The factual matrix was slightly different to that in *Graiseley*. Here, Deutsche Bank ("**DB**") was pursuing Unitech Global Limited ("**UGL**"), an Indian property firm, for the sum of approximately $11m. This was the breakage fee payable in relation to a credit contingent swap that was entered into in October 2007 between Deutsche Bank and UGL ("**Swap**"). Deutsche Bank was also pursuing Unitech, which was acting as guarantor for UGL. Deutsche Bank had terminated the Swap following UGL's failure to pay the sum of c$5.5m in March 2011.

Unitech's original Defence included arguments that:

- payment under the guarantee was unlawful because Unitech was under investigation by the Enforcement Division of the Indian tax authority at the time (i.e. had Unitech made the payment, it would have been unlawful under Indian law);
- that DB misrepresented the mechanism and risks of the Swap, which it argued was not suitable for UGL;
- that DB was negligent and/or breached the duties it owed to UGL.

Unitech also included a Counterclaim seeking that the Swap be rescinded and all amounts paid by UGL to DB be refunded, or, in the alternative, that damages be provided in lieu of rescission.

The hearing before Mr Justice Cooke was to determine whether Unitech and UGL should be granted permission to amend their Defence and Counterclaim so as to include allegations that DB made implied representations as to the legitimacy of the LIBOR rate, which were false. It should be noted that, unlike Barclays, DB has yet to be fined by any international regulator in relation to the attempted manipulation of LIBOR (although it has been reported that various regulators have DB in their sights[3]).

[1] [2012] EWHC 3093
[2] Deutsche Bank AG v Unitech Limited, High Court of Justice, Queen's Bench Division
[3] http://www.reuters.com/article/2013/02/08/us-libor-banks-idUSBRE91708B20130208

Mr Justice Cooke rejected Unitech and UGL's arguments, and refused them permission to amend their Defence and Counterclaim. He placed considerable weight on the absence of any allegation that there was an express representation in relation to LIBOR (unlike in Graiseley, where permission to amend was granted by Mr Justice Flaux), and neither was any specific loss said to have been suffered by UGL or Unitech as a result of any such misrepresentation (it was simply argued that the Swap would not have been entered into). Mr Justice Cooke also felt the suggestion of a collateral implied warranty as to the legitimacy of LIBOR would be deemed to have no reasonable prospect of success owing (partly) to the entire agreement provisions contained in the Swap confirmation. However, Mr Justice Cooke granted Unitech permission to appeal against his decision not to allow them to amend their Defence and Counterclaim.

Turning to *Graiseley*, we suggested in our January 2013 bulletin that "*it would not be a surprise to see numerous further interlocutory skirmishes*" in this matter, and this has proven to be the case. At the November 2012 Case Management Conference, Barclays' application for various confidentiality orders in relation to its disclosure in the forthcoming proceedings was dismissed. However, as the individuals in question and the FSA (as was) did not have the opportunity to make representations to the court at that time, Mr Justice Flaux granted them a period in which to do so. The individuals involved duly made an application, seeking for their identities to remain confidential. This was on the basis that, *inter alia*, disclosure of their identities could interfere with the ongoing criminal proceedings in the UK and the US, that there was no compelling public interest in identifying the individuals, and that the restrictions sought by Barclays were proportionate. Mr Justice Flaux rejected this, on the basis that the individuals had failed to persuade him that there was not a sufficient reason to depart from the starting point that all hearings ought to be in public.

A further hearing took place in late April 2013 during which Barclays was granted permission to appeal Mr Justice Flaux's decision to allow the Claimants to amend their Particulars of Claim, following Mr Justice Cooke's refusal to grant permission for LIBOR-related amendments to be made in *Unitech*. Given the similar issues arising in both cases, the appeals are expected to be heard together in July 2013. As a consequence, the Graiseley trial, which was originally scheduled to take place in October 2013, has been moved back until April 2014, pending the outcome of the appeal. It will be fascinating to see how the contrasting fact patterns are dealt with at the hearing next month, and whether an overarching test or approach will emerge.

Recent developments in US LIBOR litigation

As widely covered in the media, District Judge Naomi Buchwald dismissed most of the anti-trust claims hitherto filed in *In re LIBOR-Based Financial Instruments Anti-trust Litigation* on 29 March 2013. In summary, the decision to dismiss the claims was largely based on the fact that the plaintiffs could not establish that the manipulation of LIBOR rates constituted anti-competitive behaviour. The judge found that any losses suffered by the plaintiffs could not give rise to claims under anti-trust laws because the mechanism for setting LIBOR rates was inherently collaborative as opposed to competitive and even if, as a result of manipulation, "*LIBOR no longer painted an accurate picture of the interbank lending market, the injury plaintiffs suffered derived from misrepresentation, not from harm to competition*". Furthermore, "*the injury plaintiffs suffered from defendants' alleged conspiracy to suppress LIBOR is the same as the injury they would have suffered had each defendant decided independently to misrepresent its borrowing costs to the BBA*". Claims under the Racketeer Influenced and Corrupt Organizations Act ("**RICO**") were also dismissed by District Judge Buchwald, primarily based on issues of standing and jurisdiction. On the other hand, commodities claims brought by those involved in Eurodollar futures contracts were allowed to move forward.

District Judge Buchwald's decision has been seen by some to indicate that claims relating to LIBOR manipulation are better formulated as claims for misrepresentation and fraud.

The Freddie Mac Lawsuit

In actions separate to the *In re LIBOR* claims, Freddie Mac has brought LIBOR manipulation-related claims against a number of banks, alleging losses on interest-rate swaps and interest payments on Mortgage Backed Securities (*The Federal Home Loan Mortgage Corporation v Bank of America Corporation et al*). It is reported that Fannie Mae may be bringing a similar action in due course.

The claim is summarised in Paragraph 79 of the Complaint:

"*Freddie Mac engaged in numerous financial transactions with Panel Bank Defendants and others involving products that incorporated USD LIBOR. For example, Freddie Mac engaged in thousands of pay-fixed swaps and held billions of dollars of MBSs that paid monthly coupons tied directly to USD LIBOR. Freddie Mac reasonably relied on the honesty*

of the affected benchmark rates in undertaking these transactions. As a direct and proximate result of Defendants' unlawful conduct as described in this Complaint, and as will become clearer when information known only to Defendants is disclosed in discovery, Freddie Mac has been injured in its business and property and has suffered damages in an amount presently undetermined."

Whereas the *In re LIBOR* claims primarily focused on anti-trust infringements, the Freddie Mac Complaint sets out further claims in relation to allegations of fraud, breach of contract and tortious interference with contract.

The fraud claims essentially allege that the Defendants knowingly and intentionally, or with reckless disregard for the truth, made ongoing representations as to the nature and accuracy of LIBOR (e.g. "*…Defendants touted LIBOR as a "simple, transparent benchmark … [that is] a reliable indicator of the state of the money markets, and one of the most reliable barometers of risk in the global economy…*"). In particular, the Complaint continues "*beginning in August 2007 and continuing through at least May 2010, each Panel Bank Defendant falsely represented on a daily basis the following:*

- *Its USD LIBOR submissions were consistent with the published definition of LIBOR.*
- *It based its USD LIBOR submissions on its honest perception of its cost of funds in the London interbank market without reference to rates submitted by other Panel Bank Defendants.*
- *Its USD LIBOR submissions represented the actual rates at which it honestly believed another bank would offer it funds in the London interbank market.*

The Panel Bank Defendants made these representations knowing that they were false, or with reckless disregard for their truth, intending for Freddie Mac and others to rely on them, to influence the USD LIBOR fixing to their benefit, and to conceal their ongoing fraud and collusion."

The claims for breach of contract are set out separately against each relevant Defendant bank with whom Freddie Mac had entered into ISDA Master Agreements and series of Confirmations. Freddie Mac alleges that these banks breached and defaulted on the Master Agreements through their fraudulent and collusive conduct, through failing to disclose such conduct, through the intentional misrepresentation and manipulation of LIBOR, and through underpayments resulting from the artificially suppressed levels of USD LIBOR. More specifically, Freddie Mac alleges that the Defendant banks were in breach of their obligations arising from their representations in their respective Master Agreements "*that the execution, delivery, and performance of the … Master Agreement[s] did not violate or conflict with any law applicable to … [them]*" and that that "*[a]ll applicable information that is furnished in writing by or on behalf of [a party] to the other party [is] true, accurate and complete in every material respect*". It is further averred that the Master Agreements provided that where a party "*makes or repeats a representation that proves to be incorrect or misleading in any material respect when made or repeated*", it would be in default, and as a result Freddie Mac, as the non-defaulting party under the various agreements, would be entitled to its contractual redresses.

The final head of claim is tortious interference with contract. Freddie Mac alleges that the Defendants intentionally interfered with its contracts with counterparties other than the Defendants, causing it to suffer damages in the form of, *inter alia*, lower interest rate payments on MBSs (Mortgage Backed Securities) and losses on pay-fixed swaps and other financial contracts tied to USD LIBOR.

Apart from the addition of different alternative heads of claim, a further key difference in this claim as compared to the *In Re LIBOR* consolidated action is that the British Bankers' Association itself is being sued for having participated in the scheme to manipulate the rates in order to protect its own profits generated from its role in overseeing the LIBOR setting process.

Finally, the Complaint seeks to head off any defence relating to limitation periods by stating that it did not discover any malfeasance by the Defendant panel banks prior to the LIBOR manipulation admissions by Barclays Bank in June 2012. Although Freddie Mac admits being aware of regulatory investigations into LIBOR prior to that date, it submits that it did not know that "*USD LIBOR fixings were false, made intentionally and knowingly, with intent to mislead, and/or pursuant to an agreement among Defendants*", particularly as the Defendants had continuously held out the accuracy and honesty of the LIBOR setting process.

The Charles Schwab Lawsuit 2.0

Subsequent to Judge Buchwald's ruling in March, one of the plaintiffs in the original consolidated proceedings, Charles Schwab, filed a new complaint in the Superior Court of the State of California County of San Francisco, this time formulating its claim, *inter alia*, under common law fraud, breach of contract, California trade practices

statutes, and federal securities law. The Defendants comprise 20 of the banks that were members of the USD-LIBOR panel during the relevant period.

Charles Schwab alleges that artificially suppressed LIBOR rates caused them losses in the form of lower interest rate payments on their investments. Interestingly, they claim losses on both floating-rate and fixed rate instruments. In relation to the latter, it was averred that artificially low LIBOR rates affected the spread and therefore the interest payable on short term fixed rate instruments.

Practical Considerations on Limitation Periods for claims in English Courts

An interesting consideration that emerges from the recent judgments in the US is that some LIBOR claims risk being disallowed because they are time-barred. Is this a concern also for potential claimants in the UK? We suggest that this may well be the case.

There are two key questions that potential claimants ought to ask about limitation:

- When does the statute begin to run for my claim(s)?
- Are there any exceptions to the general rule?

When does the statute begin to run for my claim(s)?

An action in contract or tort needs to be brought within 6 years from the date of the breach of contract (whether or not the damage has been suffered) or, in the case of a tort claim, from the date when the damage was suffered. At the time when parties entered into contracts with banks which reference LIBOR, they would not have known of the fact that, due to the alleged manipulation of submissions made, LIBOR was unreliable. The question has arisen as to the point in time from which the limitation period will run where there has been deliberate concealment of the conduct which gave rise to claims being made.

It is therefore essential that financial institutions that may have suffered losses due to LIBOR manipulation engage in a careful internal due diligence process. This will be necessary to establish not only the quantum of loss suffered but also (and more crucial at the outset of any claim) whether the claim is time-barred.

When was the relevant contract entered into? When did the financial institution know or ought to have known that LIBOR had been, or was being, manipulated? These are crucial questions and the circumstances that start the clock for the purposes of the statute of limitation have to be considered carefully. One view is that the starting point for any limitation clock is 27 June 2012, which was the date of the much-publicised announcement that Barclays Bank had been fined for its participation in the LIBOR manipulation by the United States Commodity Futures Trading Commission, the United States Department of Justice and the then Financial Services Authority.

However, District Judge Naomi Buchwald in the judgment discussed above[4] took time to analyse the issue. She asked "*at what point the circumstances were such that they would suggest to [a person] of ordinary intelligence the probability that she has been defrauded*".[5] Her conclusion in the case before her was that, prior to Barclays being fined, there was sufficient publicly available information[6] relating to LIBOR manipulation having taken place from, at least, August 2007. In her view, this would (and should) have suggested to a person of ordinary intelligence the probability that he had been defrauded. The same analysis may apply in claims in England.

Although the judgement of Judge Buchwald analysed the statute of limitation under two specific US statutory instruments and the relevant federal case law, it is instructive that she gave substantial weight to the fact since "*by May 29, 2008, seven articles published in prominent national news sources, along with one report referenced in*

[4] In re LIBOR-Based Financial Instruments Anti-trust Litigation

[5] In re LIBOR-Based Financial Instruments Anti-trust Litigation, Memorandum and Order 11 MD 2262 (NRB), page 56 of 161

[6] District Judge Buchwald cited the following publications: Citigroup strategists Scott Peng, Chintan Gandhi and Alexander Tyo, "Special Topic: Is LIBOR Broken", 10 April 2008, Citigroup; Carrick Mollenkamp, "Bankers Cast Doubt on Key Rate amid Crisis", Wall Street Journal, 16 April 2008; Carrick Mollenkamp & Laurence Norman, "British Bankers Group Steps up Review of Widely Used Libor", Wall Street Journal, 17 April 2008; Carrick Mollenkamp, "Libor Surges After Scrutiny Does, Too", Wall Street Journal, 18 April 2008; Gillian Tett & Michael Mackenzie, "Doubts over Libor Widen", Financial Times, 21 April 2008; "European, U.S. Bankers Work on Libor Problems", Reuters, 16 May 2008; Gavin Finch & Elliott Gotkine, "Libor Banks Misstated Rates, Bond at Barclays Says", Bloomberg.com, 29 May 29 2008; and Carrick Mollenkamp & Mark Whitehouse, "Study Casts Doubt on Key Rate", Wall Street Journal, 29 May 2008.

several of those articles, suggested that LIBOR had been at artificial levels since August 2007',[7] which, she concluded, had put the claimants on notice of their claims. As a consequence, some of those claims were barred.

Exceptions

The limitation rules are not straightforward and there are some exceptions that can assist claimants in postponing the commencement of the limitation periods. However, claimants should be alerted that there are some instances in which defendants can argue for the statutory limitation to be shortened. Some examples are discussed briefly below.

(i) In favour of the claimant

If the defendant (i.e. the manipulating bank) has deliberately concealed the facts that give rise to a claim, then section 32 of the Limitation Act 1980 can be invoked. This provides that a limitation period does not to begin to run until the claimant has discovered the fraud, concealment or mistake, or could with reasonable diligence have discovered it, in any of the following circumstances:

- where an action is based on the fraud of the defendant; or
- where any fact relevant to the claimant's right of action has been deliberately concealed by the defendant.

There is another exception under section 32 of the Limitation Act 1980 – where an action is for relief from the consequences of mistake. This exception has the same effect of delaying the commencement of the limitation period until the mistake is either discovered or could have been discovered by a person exercising reasonable diligence. The law on mistake is, however, interpreted quite restrictively and the fraud/concealment grounds look more promising.

(ii) In favour of the defendant

Potential claimants ought to be aware that shorter foreign limitation periods might be applied to a claim in an English court. For instance, English courts might have jurisdiction pursuant to the underlying contract, even though the contract itself is subject to foreign law. In that case the Foreign Limitation Periods Act 1984 will be relevant. The effect of this Act is that the English court will apply the limitation periods provided for by the law governing the contract rather than the rules under English law.

In conclusion, our general advice to potential claimants is to investigate any potential claims as quickly as possible since the limitation clock has already started ticking.

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[7] In re LIBOR-Based Financial Instruments Anti-trust Litigation, Memorandum and Order 11 MD 2262 (NRB), page 60 of 161

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