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NEW YORK COURT HOLDS THAT MARKET MAKERS TRADING WITH EACH OTHER IN DECENTRALIZED FINANCIAL MARKETS CAN BE PROSECUTED CRIMINALLY FOR ANTITRUST VIOLATIONS

On May 4, 2018, a federal district court in New York permitted criminal charges to go forward against three former currency traders accused of colluding to rig prices of currency pairs in violation of Section 1 of the Sherman Antitrust Act. In *United States v. Usher*, the court held that, among other things, the U.S. Department of Justice ("DOJ"), Antitrust Division, had pleaded a "hard core" horizontal cartel arrangement—a *per se* violation of the antitrust laws—between market-makers in the decentralized, over-the-counter spot market for foreign currency exchange ("FX"), a two-sided market in which dealers regularly act as both buyers *and* sellers, including to each other.

The ruling represents the first judicial test of the Antitrust Division's legal theories in its recent, high-profile pursuit of cartel conduct in the financial industry, most notably in the LIBOR and FX cases. And while the allegations in *Usher* were particularly suggestive of collusion—many relevant conversations allegedly took place in chat rooms with names like "The Cartel" and "The Mafia"—the decision may nonetheless encourage federal prosecutors to rely more heavily on the criminal antitrust laws (instead of the federal wire fraud statute) when charging individual employees involved in corporate-level conduct.

At a minimum, *Usher* makes plain that episodic "buy-sell" transactions between nominal competitors do not convert their relationship into the sort of "vertical" arrangement that can escape liability on the basis of its efficiency-enhancing effects. Rather, *Usher* affirms that participants in the financial markets must take concrete steps to police the conduct of their employees, particularly in the sorts of complex, decentralized markets which depend on at least some degree of communication—and trading—between competing market-makers.

Attorney Advertising: Prior results do not guarantee a similar outcome

Sherman Act Section 1: An Overview

Section 1 of the Sherman Antitrust Act of 1890[1] is the principal federal statute used to prosecute cartel conduct between competitors, "the supreme evil of antitrust."[2] Section 1 prohibits concerted activity between two or more parties that restrains trade in or affecting U.S. commerce. Since any agreement restrains trade, including in ways that produce market benefits (for example, a joint venture that speeds up production and lowers prices for consumers), courts interpret Section 1 to prohibit only *unreasonable* restraints, and have developed two principal standards for assessing the reasonableness of a challenged restraint.

Most restraints—including "vertical" restraints between entities at different levels of a distribution chain—are examined under the so-called "Rule of Reason," which requires a fact-finder to balance a restraint's alleged anti-competitive effects against its proffered pro-competitive justifications.[3] For example, an electronics manufacturer's territorial restrictions on where its downstream distributors can sell its products may pass muster under Section 1 because the restriction encourages regional competition *between* electronics brands. By contrast, a narrow class of "hard core" restraints between "horizontal" competitors are deemed so antithetical to the ideals of free competition that they are deemed *per se* violations of Section 1, inherently lacking in—and thus eliminating the need to assess—any plausible pro-competitive justification. *Per se* restraints include collusion between competitors to fix prices, rig bids, or allocate customers or markets.[4]

The distinction between horizontal and vertical classifications carries great weight. Though Section 1, by its terms, gives rise to both civil and criminal liability, the DOJ Antitrust Division—the federal law enforcement agency responsible for prosecuting alleged violations of Section 1—pursues criminal charges only for horizontal, *per se* violations. Indeed, the Antitrust Division's criminal enforcement unit aggressively pursues criminal cartel cases against both corporate actors and individual employees, securing more than USD 6 billion in corporate criminal penalties and charging more than 200 individuals in the last five years.[5] By contrast, the Antitrust Division pursues only civil charges as to vertical restraints analyzed under the Rule of Reason. The Antitrust Division defends this policy distinction as an important means of providing "transparency and predictability in cartel enforcement," and of using the clear threat of criminal penalties—subject to the well-defined boundaries of the narrow categories of *per se* conduct—as a "critical foundation for effective deterrence" of hard core restraints.[6]

This means whether a challenged restraint is viewed as horizontal or vertical "can make a huge difference in the outcome of an investigation"; in other words, that

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1 15 U.S.C. § 1.
2 *See Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004).
3 *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885-86 (2007).
4 *See United States v. Topco Assocs., Inc.*, 405 U.S. 596, 607-08 (1972).
5 *See* Dep't of Justice, Antitrust Div., *Total Criminal Fines & Penalties*, https://www.justice.gov/atr/total-criminal-fines (last visited May 10, 2018) (reporting number of companies charged with criminal antitrust violations)*; see also* Dep't of Justice, Antitrust Div., *Corporations & Individuals Charged*, https://www.justice.gov/atr/total-defendants-charged (last visited May 10, 2018) (individuals).
6 *See* Thomas O. Barnett, Ass't Att'y Gen., Dep't of Justice, Antitrust Div., Address at Fordham Competition Law Inst.'s Annual Conf. on Int'l Antitrust Law & Policy, Criminal Enforcement of Antitrust Laws: The U.S. Model (Sept. 14, 2006), https://www.justice.gov/atr/speech/criminal-enforcement-antitrust-laws-us-model (announcing Antitrust Division enforcement priorities) (hereinafter "Barnett Speech").

"classification is everything."[7] When it comes to antitrust cases against individuals, how a restraint is classified can mean the difference between prison and freedom. It is perhaps no surprise, then, that DOJ's commitment to a bright-line enforcement approach can encourage defense counsel representing companies or individuals charged with *per se* restraints to challenge, where possible, the government's "horizontal" classification of the conduct.

The *Usher* Opinion

The *Usher* case tested the distinction between horizontal and vertical restraints in the financial markets. *Usher* concerns a January 2017 indictment (the "Indictment") in which the Antitrust Division charged three former currency traders with a criminal violation of Sherman Act Section 1 in connection with an alleged conspiracy to manipulate the FX spot market, a global market in which participants buy and sell currency pairs for immediate delivery, and one of the most actively-traded financial markets in the world. The FX spot market is a decentralized, over-the-counter market: currency pairs are not traded on an exchange, but rather are dependent upon financial institutions acting as "dealers," or market-makers, that buy and sell currency from customers in the market, including other dealers. In addition to acting as a source of market liquidity, FX spot market dealers may trade in the market for their own, proprietary accounts.

Since 2015, six major FX dealer banks have pleaded guilty and paid nearly USD 2.6 billion in penalties to resolve antitrust and fraud crimes charged by DOJ in connection with a conspiracy to fix prices for, and rig bids and offers of, currency pairs exchanged in the FX spot market.[8] Other law enforcement agencies in the U.S. and around the world have resolved similar allegations of FX spot market manipulation. FX dealer banks admitted their employee-traders held "near daily conversations" with traders employed by competing FX dealers in which they coordinated their trading to benefit their respective positions in USD-Euro currency pairs.[9]

The traders charged in *Usher* worked in the United Kingdom for affiliates of four FX spot market dealer banks that pleaded guilty to conspiring to rig prices for Euro-USD currency pairs (the "Defendants"). The allegations in the Indictment tracked those of the FX dealers' corporate-level guilty pleas: the Indictment charged that from at least December 2007 to January 2013, Defendants conspired—including in the "Cartel" and "Mafia" chat rooms—to "suppress and eliminate competition for the purchase and sale of" USD-Euro currency pairs in the U.S. market, by coordinating their bidding to (1) move or stabilize prices; (2) "refrain[] from trading" in ways that could move the market "against each other's interests"; and (3) influence two key benchmarks of the EUR/USD exchange rate. Consistent with DOJ policy, the Antitrust Division asserted only a *per se*, horizontal theory of criminal liability.

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7 1 Julian O. von Kalinowski et al., Antitrust Laws and Trade Regulation, § 11.01[1] n.4 (2nd ed. 2018).

8 *See* Press Release, Dep't of Justice, Antitrust Div., Five Major Banks Agree to Parent-Level Guilty Pleas (May 20, 2015), https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas; *see also* Press Release, Dep't of Justice, Antitrust Div., Sixth Major Bank to Plead Guilty in Ongoing Foreign Currency Exchange Investigation Agrees to Pay $90 Million Criminal Fine (Jan. 26, 2018), https://www.justice.gov/opa/pr/bnp-paribas-usa-inc-pleads-guilty-antitrust-conspiracy (guilty plea in connection with conspiracy to rig prices of Central and Eastern European, Middle Eastern and African currency pairs).

9 *See, e.g.*, Plea Agreement, *United States v. Citicorp*, No. 3:15-cr-00078, at ¶4(h) (D. Conn. May 20, 2015).

The *Usher* Defendants moved to dismiss the indictment in November 2017, arguing (among other things) the Indictment did not allege a *per se* violation of the Sherman Act because it failed to plead that the Defendants were horizontal competitors in the FX spot market. Defendants said allegations they competed with one another "on the same side of" the FX spot market were a "necessary condition" to alleging a horizontal relationship between them. But as market-makers in "a hectic, modernized bazaar," Defendants argued they did not compete on the *same side* of the FX spot market because they "were not always buyers, or always sellers," in that market. Instead Defendants said they were "constantly shifting from one side of the market to the other," sometimes buying, sometimes selling, and that indeed, "were regularly potential counterparties of one another," either when trading for their own proprietary accounts or when relying on one another as sources of liquidity for purposes of "executing orders for non-bank customers."

The Defendants thus characterized their relationships to one another as "*not consistently horizontal, but instead often vertical*": they were regularly "on different sides of the market" from one another, "continually making euro-dollar sales with each other, just as they did with other market participants." In this way, Defendants argued their relationships to one another was similar to that of a vertical wholesaler and retailer, making *per se* treatment inappropriate. Indeed, the Defendants said the "nature of the FX market"—which they characterized as "enormous, sophisticated, and decentralized"—compelled traders to communicate with one another to "quote more informed and realistic prices" and "improve their access to the currency necessary to execute customer orders." Thus, even if their relationship was consistently horizontal, Defendants said their challenged behavior amounted to "procompetitive information sharing" that the courts have not yet developed the expertise to assess on a *per se* basis.[10]

DOJ opposed dismissal, arguing the horizontal (or vertical) nature of an alleged conspiracy is determined by a firm's "location or role . . . *within the market structure*," rather than "the buy/sell orientation of a particular entity at a particular moment." Pointing to the electronic platforms on which FX spot market participants exchanged bids and offers for currency pairs, DOJ characterized the market as "a continuous, bilateral auction," in which FX traders are "in constant competition with one another to both *buy and sell* currency profitably throughout the trading day," rapidly switching from buyer to seller (and vice versa) and sometimes occupying both roles simultaneously. In DOJ's view, these dynamics created "one, continuous market place in a single market level," which DOJ characterized as an "interbank market" between "banks, and the traders who represent them." Thus, DOJ said it was irrelevant to the characterization of the challenged restraint that Defendants may have sometimes traded with one another. DOJ asserted that Defendants' alleged crime was to "influence [the FX] auction and the resulting price," through price-fixing and bid-rigging, which DOJ characterized as "quintessential illegal restraint[s] of trade," suitable for

10 *See* Memorandum of Law in Support of Defendants' Motion to Dismiss, *United States v. Usher*, No. 1:17-cr-00019, at 8-17 (S.D.N.Y. Nov. 17, 2017).

prosecution on a *per se* basis without any assessment of the Defendants' claimed procompetitive benefits of their conduct.[11]

The district court denied Defendants' motion to dismiss. Among other things, the court said Defendants' vertical characterization of their conduct was "unpersuasive[]," and that the Indictment "clearly state[d]" a horizontal restraint of trade because it described "an agreement among competitors in the *same level* of the market." The Defendants were "traders working for dealers in the FX spot market," said the court, and were therefore "in competition with one another" in that market, "whether or not they were buying or selling at any given moment." The *Usher* court agreed with DOJ that the "nature of the [alleged] restraint" was horizontal, because Defendants were accused of rigging the market price of EUR-USD currency pairs, "the very product over which they compete[d]" with one another to buy and sell. The court held the Indictment alleged a horizontal, *per se* violation of the Sherman Act, and therefore the judge did not consider Defendants' arguments about the procompetitive justifications for their conduct.[12] Trial in the *Usher* case is now set for October 2018.

Implications

While *Usher* does not mark a substantive shift in the law of *per se* horizontal restraints, it is nevertheless notable for its possible impact on both DOJ Antitrust Division enforcement priorities and on the compliance initiatives of participants in complex financial markets.

First, the *Usher* opinion represents the first test of the *per se* standard as applied to DOJ's recent pursuit of criminal charges for cartel conduct in a decentralized, over-the-counter financial market comprised of constant buyers and sellers. Guilty pleas by banks and individual employees in the FX and LIBOR investigations necessarily did *not* test the sufficiency of DOJ's theory of antitrust violation in those markets. Nor did the follow-on civil suits connected to those investigations: for example, in reinstating Section 1 civil claims for alleged LIBOR manipulation in 2016, the Court of Appeals for the Second Circuit focused on the role of defendant banks competing with one another only "as *sellers*" of LIBOR-linked financial products (not as buyers and sellers, or as trading counterparties to one another).[13] In that regard, *Usher* further aligns Section 1 case law with DOJ's enforcement approach of using "the clear guidance of the *per se* rule" to provide "predictable boundaries for business" regarding the contours of the antitrust laws and related penalties. A contrary decision in *Usher* would have occasioned a strong response from DOJ, likely in the forms of both a strenuous appeal and condemnations from senior Antitrust Division officials for muddying the waters of the *per se* standard. This was the case last year when a Utah federal court rejected *per se* liability for a horizontal customer allocation arrangement in the market for "heir location services," citing the unusual nature of the industry and the possible efficiencies gained by the challenged allocation arrangement.[14]

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[11] *See* Memorandum in Opposition to Motion to Dismiss, *United States v. Usher*, No. 1:17-cr-00019, at 8-12 (S.D.N.Y. Dec. 8, 2017).

[12] Decision & Order, *United States v. Usher,* No. 1:17-cr-00019, at 7 (S.D.N.Y. May 4, 2018). The court also held that Defendants' conduct in London had a sufficient impact on U.S. interstate and import commerce to merit prosecution under the antitrust laws. *Id.* at 8-11.

[13] *See Gelboim v. Bank of America Corp.*, 823 F.3d 759, 771 (2d. Cir. 2016) (emphasis added).

[14] Andrew Finch, Acting Ass't Att'y General, Dep't of Justice, Antitrust Div., Remarks at Global Antitrust Enforcement Symposium (Sep. 12, 2017), https://www.justice.gov/opa/speech/acting-assistant-attorney-general-andrew-finch-delivers-remarks-global-antitrust (criticizing

Second, and relatedly, the *Usher* decision could embolden federal prosecutors to charge misconduct between competitors in the financial markets as criminal Section 1 violations rather than as charges of the criminal wire fraud statute (the charge levied against most individual traders pursued in LIBOR and FX) or market manipulation. The Antitrust Division believes that a core advantage of pursuing criminal charges only for *per se* cartel violations is that doing so "reduc[es] the complexity of proof" for prosecutors, because "proving the existence of the agreement establishes the violation."[15] In contrast, the criminal wire fraud statute requires prosecutors to establish challenging elements, such as that the representations at issue were both false and material – elements about which a federal judge in New York recently expressed concerns in connection with pending wire fraud charges against two traders accused of LIBOR manipulation.[16] Criminal charges for Section 1 violations present fewer such challenges. Indeed, just days after the *Usher* decision rejected Defendants' challenges, the Antitrust Division filed a new, one-count indictment accusing another former currency trader of conspiring to rig foreign exchange rates in violation of Sherman Act Section 1, the Division's first such charges since indicting the *Usher* Defendants last year.[17]

Third, *Usher* underscores the antitrust risks faced by participants in financial markets, particularly complex, over-the-counter markets such as those for certain derivatives. When announcing the guilty plea of an FX trader in 2017, the head of the Antitrust Division's criminal prosecution unit emphasized the Division's continued resolve to target collusion in the financial markets, which he characterized as "*no different than*" collusion in markets for more "traditional products and services that the Antitrust Division routinely prosecutes."[18] But that is not quite right: unlike the markets for most consumer goods, the efficient operation of financial markets—including many of those covered by the Commodity Exchange Act ("CEA")[19] —frequently depends on *some* degree of interaction between nominal competitors, for example, as trading counterparties or resources of price discovery.

Of course, the specific allegations in *Usher*—*e.g.*, traders coordinating with each other in a chat room called "The Cartel"—are an unsurprising target for antitrust scrutiny. But in a broader sense, *Usher* affirms the need for participants in the financial markets to remain vigilant about compliance and conduct in those markets: participants risk exposure to criminal antitrust penalties—including corporate guilty pleas and prison sentences for individuals—if their regular trading

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district court's decision in *United States v. Kemp & Assocs., Inc.*, No. 2:16-cr-403 (D. Utah Jun. 21, 2017)). The Antitrust Division is presently appealing the *Kemp* decision. *See* Opening Brief for the United States of America, *United States v. Kemp & Assocs, Inc.*, No. 17-4148 (10th Cir. Jan. 03, 2018).

15 Barnett Speech, *supra* note 6, at 2.

16 *See* Thoughts on the Proof Necessary for Government to Establish Wire Fraud as Charged in This Case, *United States v. Connolly*, No. 16-cr-370, at 7 (S.D.N.Y. Mar. 28, 2018), ECF No. 203 (expressing "qualms about the Government's understanding of the reach of the wire fraud statute"). In *Connolly*, for example, the court has questioned whether allegedly false LIBOR submissions could possibly have been intended to induce counterparties to trade with defendants, since the false submissions were allegedly intended to "ensur[e] the success of trades already on the books." *Id.* at 13.

17 *See* Indictment, *United States v. Aiyer*, No. 18-cr-00333-JGK (S.D.N.Y. May 10, 2018) (accusing trader of conspiring to rig rates on several Eastern European and Middle Eastern currencies).

18 *See* Press Release, Dep't of Justice, Antitrust Div., Second Foreign Currency Exchange Dealer Pleads Guilty to Antitrust Conspiracy (Jan. 12, 2017), https://www.justice.gov/opa/pr/second-foreign-currency-exchange-dealer-pleads-guilty-antitrust-conspiracy (emphasis added).

19 7 U.S.C. § 1 *et. seq.*

conduct crosses the line into concerted activity that restrains trade. Likewise, the Antitrust Division's broader cartel investigation into the FX spot market, which led to the *Usher* Indictment, underscores the continuing convergence of antitrust law with separate laws targeting conduct that manipulates (or attempts to manipulate) price in regulated markets, such as the commodity derivatives markets regulated by the CEA.[20]

There are several concrete steps market participants can take to manage the risks of criminal antitrust violations in their day-to-day trading operations: *first*, develop clear compliance guidelines distinguishing ordinary trading conduct from inappropriate coordination of trading patterns with competing market makers; *second*, regularly educate (and remind) traders and managers of those guidelines on the boundaries between communication and collusion; *third*, limit traders' access to unrestricted chat rooms, where competitors can exchange pricing information; *fourth*, conduct routine compliance monitoring of traders' emails and phone calls, to assess whether the trading desks are adhering to this guidance.

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[20] The FX spot markets at issue in *Usher* are exempted from coverage of the CEA through the so-called Treasury Amendment. *See* 7 U.S.C. § 2(c)(1)(A) (exempting from CEA coverage "agreement[s], contract[s], or transaction[s] in foreign currency"). But the Commodity Futures Trading Commission nonetheless settled market manipulation allegations with several FX dealer banks, apparently on the theory that FX benchmarks were commodities in interstate commerce subject to its anti-manipulation provisions. *See*, *e.g.*, Order, *In re Citibank, N.A.*, CFTC No. 15-03, at 9 (Nov. 11, 2014). And a federal judge in the Southern District of New York permitted a putative class of private plaintiffs to pursue CEA claims for the same conduct, on the theory that the FX dealers' alleged manipulation of the exempted over-the-counter FX spot markets was the "means of manipulating" prices of exchange-traded FX futures contracts covered by the CEA. *See In re Foreign Exch. Benchmark Rates Antitrust Litig.*, No. 13-civ-7789, 2016 WL 5108131, at *18 (S.D.N.Y. Sep. 20, 2016).

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