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Tail Wagging the Dog: The Manipulation of Benchmark Rates – A Competitive Bone of Contention

Alexander K. PASCALL^{*}

The manipulation of financial benchmarks, such as the London Interbank Offered Rate (Libor), has resulted in swift enforcement by regulators across the globe and the imposition of a multitude of impressive fines. In 2013, the European Commission settled with eight financial institutions for EUR 1.7 billion for their role in an alleged cartel relating to interest rate derivatives pegged to Libor. This article seeks to analyse the manipulation of financial benchmarks under Article 101(1) TFEU from both an economic and legal perspective. It is hoped that this exercise will shed some much needed light on what remains a relatively obscure area in competition law. Following the analysis herein, it is argued that EU competition law, in its current guise, is not well placed to deal with the mischief at issue. In light of the specificities of Libor and the markets in which products indexed to Libor are traded, the manipulation should, instead, be left to market regulatory tools specifically designed for this purpose.

1 INTRODUCTION

I can resist anything except temptation
Oscar Wilde, Lady Windermere's Fan

As a newly qualified litigation associate in London, I had the pleasure of working under Philip Young and Len Murray of Cooke, Young & Keidan LLP on the dispute between Graiseley Properties and Barclays Bank.¹ The case was dubbed by the judiciary as the London Inter-Bank Offer Rate (*Libor*) ‘test case’. In a nutshell, our client had been sold two interest rate swap products tied to Libor and its subsequent claim included Barclays’ alleged manipulation of GBP Libor and the mis-selling of the two interest rate swap products. The case settled shortly before trial. This was perhaps fortunate for the parties involved but less fortunate for those of us keen to see how the High Court was going to deal with some of the difficult

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¹ *Graiseley Properties Ltd & Ors v. Barclays Bank plc* [2013] EWHC 67 (Comm).

legal issues at hand. The case furthered my interest in competition law which, in turn, led me to undertake a Master's degree in the subject for which this article (albeit in a longer guise) formed an integral part.

Following the European Commission's (*Commission*) eye-watering EUR 1.71 billion settlement with eight financial institutions in 2013, the issue of Libor manipulation and its implications for competition law remain very much *à l'ordre du jour*.² The regulatory activity has not just been limited to Libor but has extended to other benchmarks used, for example, in the currency exchange and crude oil trading markets.³

Notwithstanding this high profile settlement, the application of competition law to benchmark manipulation remains an overlooked and somewhat obscure subject in the EU. This stands in stark contrast to the recent developments in the US, where private actions alleging Libor manipulation have benefited from new wind in their sails following a US Supreme Court decision on 21 January 2015 allowing the appeal of a summary dismissal of an action in which antitrust infringements were alleged.⁴ Further, at the time of initial writing, Deutsche Bank was fined a record breaking USD 2.5 billion as part of its settlement with US and UK regulators for its involvement in Libor manipulation.⁵ Regulatory and private actions aside, some firms continue to demonstrate a robust appetite for litigation and have, thus far, refused to settle. Earlier last year, the Commission fined ICAP, an inter-dealer broker, EUR 14.9 million for its role in facilitating a Yen Libor cartel.⁶ In a bullish response to the fine, ICAP stated that it '*does not accept the EC's decision, which it believes is wrong both in fact and in law. [...] It is not a competition issue, and the EC has presented no evidence that ICAP facilitated a competition law violation*'.⁷ There may be something to this statement, particularly given that the Commission has subsequently chosen to abandon its oil benchmark and credit default swap probes.⁸

² European Commission, Press Release IP/13/1208, 4 Dec. 2013.

³ U.S. Commodities and Futures Trading Commission, *Press Release PR7056-14*, <http://www.cftc.gov/PressRoom/PressReleases/pr7056-14> and Financial Times, *European Commission raids oil groups over price benchmarks*, <http://www.ft.com/intl/cms/s/0/fl574eb6-bca2-11e2-b344-00144feab7de.html#axzz3VabYFYoU>, (both accessed 25 Mar. 2016).

⁴ *Ellen Gelboim and Linda Zacher, et al. v. Bank of America Corporation, et al.*, No. 13-1174, US Supreme Court, 21 Jan. 2015.

⁵ The Guardian, *Deutsche Bank hit by record \$2.5bn Libor-rigging fine*, <http://www.theguardian.com/business/2015/apr/23/deutsche-bank-hit-by-record-25bn-libor-rigging-fine> (accessed 25 Mar. 2016).

⁶ The Financial Times, *European Commission slaps ICAP with 14.9m fine*, <http://www.ft.com/intl/fastft/272891/european-commission-slaps-icap-with-14.9m-fine> (accessed 27 Apr. 2015).

⁷ *Ibid.*

⁸ The Financial Times, *Europe drops antitrust probe into banks' CDS market activities*, <http://www.ft.com/intl/cms/s/0/30135458-9a84-11e5-be4f-0abd1978acaa.html#axzz3yXto2Mvh>, and Bloomberg, *Oil*

The importance of rigorously and objectively considering the application of competition law to the Libor misconduct cannot be overstated given Libor's expansive use and the potentially enormous financial implications that such wide use entails. To this end, this article seeks to analyse the manipulation of benchmarks, particularly Libor, under Article 101(1) TFEU from both a legal and economic perspective. Before doing so, section 2 will first set out Libor's history, how it is calculated and how it was subsequently manipulated. A brief review of interest rate derivatives and the Over-the-Counter market will also be undertaken. Section 3 will consider the approach the US judiciary has taken in applying competition law to benchmark manipulation. It will then examine the manipulation of Libor under EU competition law from both a legal and economic perspective. Section 4 will review the controversial developments in the EU's jurisprudence relating to information exchanges in a bid to understand how these sit with Libor manipulation, as well as their application to the current day to day functioning of the financial marketplace more generally. The final section will touch upon some of the suggested reforms to Libor, before setting out some concluding remarks on the suitability and consequences of applying competition law to the conduct in question.

As an overarching point, it should be made clear from the outset that the manipulation of any benchmark intended to be set in a bona fide and independent manner is unacceptable and a matter for concern. Fortunately, there is a vast body of financial regulatory legislation that targets this sort of behaviour. The various regulatory authorities have, quite rightly, imposed significant fines for breaches of these rules. That being said, following the analysis herein, it is submitted that EU competition law should not extend to cover benchmark manipulation. The latter should, instead, be governed by the regulatory instruments specifically designed for this purpose.

2 LIBOR, DERIVATIVES AND THE OVER-THE-COUNTER DERIVATIVES MARKET

It may be helpful to set out briefly how financial benchmarks were initially conceived, how they are set and why they are used. An understanding of the financial instruments referenced to Libor and the markets in which these instruments are traded is imperative before seeking to analyse benchmark manipulation from a competition law perspective.

Traders Spared as EU Commission Drops Price-Rigging Probe, <http://www.bloomberg.com/news/articles/2015-12-07/oil-traders-spared-as-eu-commission-drops-price-rigging-probe> (both accessed 25 Mar. 2016).

2.1 STOIC BEGINNINGS

For much of the general public, Libor was, until recently, an unknown concept. This all changed when it was unwittingly thrust into the limelight during the fallout of the 2007–2008 global financial crisis. Although the term is now relatively widespread, its usage and *raison d'être* remain a source of contention and confusion for many.

Libor has been accredited as the brainchild of Greek banker Minos Zombanakis when he, in 1969, arranged a USD 80 million syndicated loan to the Shah of Iran based on the reported funding costs of a group of reference banks.⁹ In a nutshell, Libor is ‘a measure of the rate at which large banks can borrow from one another on an unsecured basis’.¹⁰ It is important to stress that the word *can* from the preceding quote is indicative of the hypothetical, rather than the *real* or *actual*, cost of borrowing in the inter-bank market.

The British Bankers’ Association (BBA) was (previously) responsible for publishing the daily Libor rate at 11:30 GMT. Every morning, the fifteen or so relevant Libor panel banks would individually submit their rates to the BBA. Banks would submit a specific rate for each maturity term linked to Libor (e.g., one day, three months, six months etc.) and for various currencies. The BBA required that ‘an individual BBA Libor Contributor Panel Bank will contribute the rate at which it could borrow funds, were it to do so by asking for and then accepting inter-bank offers in reasonable market size just prior to [11:00 a.m. London time]’.¹¹ This definition clearly does not allow for the consideration of factors unrelated to the costs of borrowing unsecured funds in the submitted rate.¹² Thomson Reuters would then process the various submissions on behalf of the BBA in order to ascertain the value of Libor for that day.¹³ In a world of derivatives and quantitative finance, this calculation was remarkably simple. Thomson Reuters would discard the four highest and the four lowest submissions and calculate an average of the remaining submissions. These figures would then be announced to the public by the BBA as Libor for every currency and tenor on that day.¹⁴ The BBA would simultaneously

⁹ K. Ridley & H. Jones, Reuters, *A Greek Banker Spills on the Early Days of the LIBOR and His First Deal with the Shah of Iran*, <http://www.businessinsider.com/history-of-the-libor-rate-2012-8?IR=T> (accessed 25 Mar. 2016).

¹⁰ D. Duffie & J. Stein, *Reforming LIBOR and Other Financial-Market Benchmarks*, Working Paper No. 3170, Stanford Business, 19 Sep. 2014, p. 1.

¹¹ United States of America before the Commodity Futures Trading Commission (CFTC) in the matter of: Barclays PLC, Barclays Bank PLC and Barclays Capital Inc., CFTC Docket No. 12-25, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions, 27 Jun. 2012, p. 6.

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ *Ibid.*

also make public the submissions of the respective panel banks.¹⁵ The daily Libor rate would be relied on globally; some USD 350 trillion of notional swaps and USD 10 trillion of loans are referenced to it.¹⁶

2.2 THE NEED FOR FINANCIAL BENCHMARKS

Now that the basic mechanics of Libor have been briefly explained, it may be worthwhile examining how and why it is actually used. In essence, Libor is a benchmark. Benchmarks, in all their various forms, require little explanation in that they provide us with the means to gauge performance in respect of certain criteria. The ‘best’ restaurants are benchmarked as to how many Michelin stars they have; law firms are put into various bands in order to help potential clients and competitors better understand the firms’ respective positions in a market or practice area. The financial markets are no different in that they rely extensively on the use of benchmarks.

DUFFIE and STEIN provide a pertinent example of how a benchmark could work in a financial context.¹⁷ The example given is that of a forward contract for gold, whereby a buyer agrees to pay the difference between an agreed forward price and the spot price (the ‘benchmark’ price of gold on that day) at maturity. Difficulties will clearly arise at maturity if the parties do not have access to a benchmark price of gold. One party will be advocating for a high spot price of gold and vice versa. Concluding such a contract will be troublesome without access to a spot price set in an objective and independent manner.

Libor’s purpose is that of a reference rate and a benchmark rate – it benchmarks the relative performance of banks and it is used as an underlying reference rate to establish the terms of financial contracts.¹⁸ Its wide usage stems from its construction in that it should represent the terms on which the largest and most financially sound institutions can obtain funds.¹⁹ Libor forms the basis, from an interest rate perspective, of the terms of financial contracts between parties other than financial institutions. These parties are, in theory, less creditworthy than banks and the applicable interest rates are therefore expressed as ‘*Libor + x*’, where ‘*x*’ is the premium charged for the particular borrower based on its credit risk.²⁰ Libor’s popularity stems from the fact that reference rates allow for the

¹⁵ *Ibid.*

¹⁶ *Ibid.*, p. 5.

¹⁷ Duffie *supra* note 10, p. 4.

¹⁸ D. Hou & D. Skeie, *LIBOR: Origins, Economics, Crisis, Scandal, and Reform*, Federal Reserve Bank of New York Staff Reports, Staff Report No. 677, March 2014, p. 2.

¹⁹ *Ibid.*, p. 3.

²⁰ *Ibid.*

standardization of financial contracts.²¹ Put simply, it is easier to compare and contrast different contracts if they are all based on the same benchmark.

2.3 INTEREST RATE DERIVATIVES AND THE OVER-THE-COUNTER MARKET

Libor's importance and wide use pertains to interest rate derivatives such as interest rate swaps. These financial instruments have become immensely popular over the past two decades.²² Derivatives are financial contracts '*whose value is linked to the price of an underlying commodity, asset, rate, index or the occurrence or magnitude of an event*'.²³ The term *derivative* is indicative of how its value is *derived* from the price of one of the aforementioned indices, commodities, rates etc.²⁴ Over-the-Counter (OTC) interest rate derivatives include financial instruments such as interest rate swaps, caps, floors, and collars.²⁵ The term 'OTC' refers to the market in which these derivatives are traded. OTC derivatives are key tools for risk-management and they are used extensively for this purpose by financial institutions and corporations.²⁶ A simple example of this sort of risk-management involves hedging against interest rate fluctuations. If a bank holds a large amount of fixed rate loans and anticipates a rise in interest rates, it can transform its fixed rate payments into floating rate payments using a fixed-for-floating interest rate swap (see example of 'vanilla' swap below).²⁷ Interest rate swaps make up the vast majority of all OTC contracts.²⁸

In broad terms, a derivative is a formal agreement between two parties specifying the exchange of cash payments based on changes in price of a specified underlying item.²⁹ The most common swap is the 'plain vanilla' interest rate swap – it works as follows:³⁰

Party A agrees to pay Party B a predetermined fixed rate of interest on a notional amount, on specific dates, over a specific period of time. In return, Party B agrees to make payments based on a floating rate of interest to Party A on the same notional amount, on

²¹ *Ibid.*

²² R. Conroy & K. Eades, *Valuation of 'Plain Vanilla' Interest Rate Swaps*, 1 (Darden Graduate School of Business Administration, University of Virginia, 1997).

²³ R. Dodd, *The Structure of OTC Derivatives Markets*, 9(1–4) Derivative Study Center, The Financier 1 (2002).

²⁴ *Ibid.*

²⁵ A. Kuprianov, *Over-the-Counter Interest Rate Derivatives* 238 (Federal Reserve Bank of Richmond, Richmond, Virginia 1998).

²⁶ A. Steinherr, *Derivatives, The Wild Beast of Finance* 168 (John Wiley & Sons Ltd 2000).

²⁷ *Ibid.*, p. 155.

²⁸ Bank for International Settlements, <http://www.bis.org/statistics/dt21a21b.pdf> (accessed 25 Mar. 2016).

²⁹ *Ibid.*

³⁰ Example inspired by Investopedia, *An Introduction to Swaps*, <http://www.investopedia.com/articles/optioninvestor/07/swaps.asp>, (accessed 25 Mar. 2016).

the same specified dates and over the same period of time. The specified payment dates are called settlement dates and the time between them are known as settlement periods. By way of example, on 31 December 2013 Party A and Party B enter into a five-year swap with the following terms:

- Party A pays Party B an amount equal to 6% per annum on a notional principal of EUR 10 million.
- Party B pays Party A an amount equal to one year Libor + 1% per annum on a notional principle of EUR 10 million.

One year later on the settlement date, Party A will have an obligation to pay Party B (EUR 10 million)*6% = EUR 600,000. For illustrative purposes, imagine that Libor was 5.33% on 31 December 2014. Party B would therefore have an obligation to pay Party A (EUR 10 million)*(5.33% + 1%) = EUR 633,000. In order to avoid unnecessary payments, the amounts payable are usually offset against each other. Party B would therefore pay Party A EUR 33,000 and Party A's obligation to pay Party B would be extinguished.

Derivatives are primarily traded in two kinds of markets: exchanges and OTC markets.³¹ The former have evolved from traditional physical trading pits to automated electronic platforms that match bids (i.e., the price point at which someone is willing to buy) and offers (i.e., the price point at which someone is willing to sell) to execute trades.³² OTC contracts are different in that their terms are negotiated as between counterparties rather than traded on an exchange.³³ Their popularity stems from their bespoke nature in that they can create a *perfect* hedge.³⁴ Perfect hedging entails the elimination of disparities, such as the term (start/end dates), between the underlying asset and the derivative contract (the hedge).³⁵ The OTC market can basically be divided into two categories: the *customer market* and the *inter-dealer market*.³⁶ Bilateral trading between dealers (usually large banks) and their customers (e.g., hedge funds) takes place in the former.³⁷ The latter is the platform for trades between dealers.³⁸

In the customer market, dealers provide information on bid/ask quotes to potential customers and will subsequently execute trades on behalf of the latter.³⁹ The provision of bid/ask information is done over the phone, by instant messaging

³¹ R. Dodd, *supra* note 23, p. 1.

³² *Ibid.*

³³ R. Heckinger, *Understanding Derivatives: Markets and Infrastructure – Over-the-Counter (OTC) Derivatives*, 27 (Federal Reserve Bank of Chicago 2014).

³⁴ *Ibid.*

³⁵ *Ibid.*

³⁶ R. Dodd, *Markets: Exchange or Over-the-Counter*, Finance & Development, International Monetary Fund, April 2012.

³⁷ *Ibid.*

³⁸ *Ibid.*

³⁹ *Ibid.*

or by using electronic bulletin boards.⁴⁰ The same is done in the inter-dealer market, but often through the use of brokers who act as bid/ask information intermediaries between a certain dealer and the other dealers in the inter-dealer market.⁴¹ Advances in technology and recent reforms have bolstered the use of electronic bulletin boards, with the result that modern OTC markets function more like exchanges.⁴²

Banks will often execute trades for customers in the customer market and then seek to offset this risk by subsequently trading in the inter-dealer market.⁴³ A particularity of the OTC market, in comparison to more conventional markets, is that banks also act as *market makers*.⁴⁴ This means that they act as both buyers and sellers of a particular product.⁴⁵ One can draw similarities here with currency exchange bureaus that list the prices at which they are willing to buy or sell a particular currency. Further, much like an exchange bureau, market makers earn their money through charging an execution fee and the profit gleaned from their bid/ask spread.⁴⁶ In order to manage the risk of their bid/ask spread, market makers will often hedge their positions by entering into swap agreements.⁴⁷

2.4 THE MANIPULATION OF FINANCIAL BENCHMARKS

Returning to our example of the forward contract for gold, a positive perception of the need for a spot price benchmark may well be tarnished if it became apparent that one of the parties to the forward contract also had a hand in setting the benchmark rate. In such a scenario, the temptation to manipulate the underlying rate in order to extract maximum profit at maturity may well prove too great. Although the example given is hypothetical, it is this sort of behaviour that led the Financial Conduct Authority (FCA) to issue Barclays with a fine of GBP 26 million for '*failing to adequately manage conflicts of interest between itself and its customers*'.⁴⁸

⁴⁰ *Ibid.*

⁴¹ *Ibid.*

⁴² Heckinger, *supra* note 33, p. 30.

⁴³ *Ibid.*, p. 29.

⁴⁴ *Ibid.*

⁴⁵ Fxkeys, *Market Maker Brokers: Is It Bad or Illegal to Be a Market Maker?*, <http://www.fxkeys.com/market-maker-brokers/> (accessed 25 Mar. 2016).

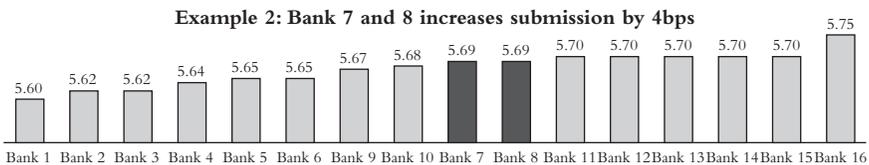
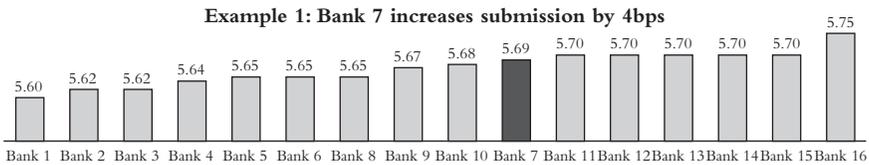
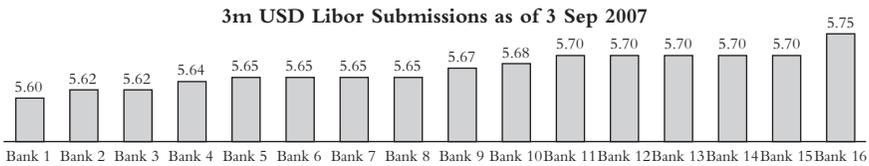
⁴⁶ *Ibid.*

⁴⁷ The OTC Investor, *Understanding Market Makers*, <http://www.theotcinvestor.com/understanding-market-makers-089/> (accessed 25 Mar. 2016).

⁴⁸ The Financial Conduct Authority, *Barclays fined £26m for failings surrounding the London Gold Fixing and former Barclays trader banned and fined for inappropriate conduct*, <https://fca.org.uk/news/barclays-fined-26m-for-failings-surrounding-the-london-gold-fixing> (accessed 25 Mar. 2016).

Turning to Libor, its manipulation is by no means an exact science in that it is calculated by way of an arithmetic mean following submissions by various panel banks. Unlike ‘traditional’ price-fixing, it is not a question of manipulating Libor to a specific (higher) figure. Instead, the manipulation sought either to systematically lowball Libor or attempted to marginally nudge it either up or down.

The following graphs illustrate how the latter could have happened in practice:⁴⁹



In the first example above, bank 7’s higher submission of four basis points (*bps*) would have resulted in an increased Libor rate by 0.5 bps. In the second example, Libor would have been 1 bps higher than if no manipulation by banks 7 and 8 would have occurred. Going back to our interest rate swap example, Party A (a panel bank in this instance) would have a vested interest in a high Libor rate on the settlement date. If, like bank 7, Party A submitted a rate 4 bps higher than it otherwise would have, Libor would have been 5.335% rather than 5.33%. As a result, Party B would have had to pay EUR 633,500 and Party A would have

⁴⁹ Fideres Partners, Seminar: *The Technical Aspects of Alleged LIBOR Manipulation*, 45 (The Zetter Hotel London, 6 June 2013).

made an additional EUR 500 under the contract. This may seem like a small gain but in reality the gains were vast given the huge notional amounts in play.⁵⁰ In the financial markets, a mere shift of 1 bps could result in profits (or losses) of up to USD 4 million.⁵¹

The then FSA's decision to fine Barclays some GBP 59.5 million for its role in Libor manipulation is indicative that it was in the OTC market (rather than the inter-bank market) in which the FSA focused its attention.⁵² The market for these derivatives is substantial, with a notional amount of outstanding OTC contracts amounting to some USD 554 trillion.⁵³ Taking the example given in the FSA's notice, swaps traders working at Barclays would be divided by currency and maturity – one trader would work on interest rate derivative contracts in GBP for maturities of, say, one month, six months and one year.⁵⁴ Pursuant to the FSA's decision, Barclays' traders knew, on any particular day, what their exposure was should the underlying rate move by 1 bps.⁵⁵ It is plain to see the rationale or temptation to bump Libor in one direction or another as this would have a direct impact on the level of profit or loss generated by a particular trade.

2.5 REGULATORY ACTION

In 2014, the FCA fined Lloyds Bank and the Bank of Scotland GBP 105 million each for their role in the manipulation of Libor, in particular, for failing to '*observe proper standards of market conduct*'⁵⁶ and for not taking '*reasonable care to organise and control [their] affairs responsibly*'.⁵⁷

As mentioned earlier, in 2013 the Commission settled with eight financial institutions for EUR 1.71 billion for their participation in alleged illegal cartels in markets for financial derivatives.⁵⁸ In conjunction with the Commission's press release, Commissioner Almunia announced that '*what is shocking about the LIBOR and EURIBOR scandals is not only the manipulation of benchmarks, which is being tackled by financial regulators worldwide, but also the collusion between banks who are supposed to be competing with each other*'.⁵⁹

⁵⁰ *Ibid.*, p. 49.

⁵¹ FSA, Final Notice to UBS AG, Reference-186958, 19 Dec. 2012, p. 21.

⁵² FSA, Final Notice, Barclays Bank Plc, 122702, 27 Jun. 2012.

⁵³ BIS, *OTC derivative market activity in the first half of 2011*, Monetary and Economic Department, November 2011.

⁵⁴ *Ibid.*, para. 46.

⁵⁵ *Ibid.*, para. 48.

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*

⁵⁸ Commission, *supra* note 2.

⁵⁹ *Ibid.*

From the press release, one can extract the following key points as regards the Commission's position: (i) the parties' behaviour amounted to an illegal cartel in the financial derivatives markets; (ii) the illegal cartel sought to distort the normal course of pricing components for derivatives i.e., the underlying benchmark; (iii) banks that were supposed to be competing with each other were not and were, instead, colluding; and (iv) the Commission has taken a *by object* approach to the conduct.

The first three of these points will be examined in the upcoming section. The final point relating to the Commission's *by object* characterization of the conduct *viz.* the exchange of information as between employees at different banks, will be dealt with in section 4.

3 BENCHMARK MANIPULATION: A COMPETITION LAW ISSUE?

The manipulation of Libor can be neatly divided into three categories. The first involved the systematic lowballing of panel bank submissions in order to portray a (false) image of financial solidity during the financial crisis (*Type 1*). This, in turn, led to the unravelling of what came to be known as the "Libor scandal".⁶⁰ Type 1 manipulation was made infamous by a senior Barclays' treasury manager instructing his USD Libor submitters to submit (lower) rates so that Barclays would not be '*sticking its head above the parapet*'.⁶¹ The second involved collusion as between those tasked with submitting Libor and swaps traders within the same bank (*Type 2*). Type 2 manipulation involved traders requesting that their submitters submit a rate in a bid to nudge Libor up or down depending on the traders' positions. These requests would often be by way of instant messages such as '*your annoying colleague again . . . Would love to get a high 1m Also if poss a low 3m . . . if poss . . . thanks (February 3, 2006, Trader in London to Submitter)*'.⁶² The third mirrored Type 2 manipulation only that it took place as between individuals at different banks⁶³ (*Type 3*).

Type 1 and Type 2 manipulation primarily concern the actual process of setting the rate. We saw earlier how each panel bank submits a rate based on its subjective interpretation of the cost of funds in the inter-bank market. Problems clearly arise when factors, unrelated to the costs of borrowing in the inter-bank market, influence those hypothetical submissions. Type 3 manipulation goes one step further in that it involves the exchange of information as between employees

⁶⁰ HOU *supra* note 18, p. 6.

⁶¹ CFTC, *supra* note 11, p. 20.

⁶² *Ibid.*

⁶³ FCA, Final Notice, Lloyds Bank plc and Bank of Scotland plc, 28 Jul. 2014, p. 12.

at various competing banks in a bid to nudge Libor in one direction or another in order to boost traders' profits (or reduce losses).

It has been argued that the way in which commercially sensitive and 'fresh' information is pooled and shared to arrive at an average rate amounts to an information exchange arrangement among competitors.⁶⁴ However, it is submitted that Libor manipulation has certain distinct characteristics which, pursuant to the following chapters, take it outside the scope of a conventional Article 101 infringement.

3.1 US DEVELOPMENTS

Before looking at the manipulation of Libor from an EU law perspective, one can gain valuable insight by first examining how the US judiciary has grappled with the onerous task of applying competition law and theory to the nebulous world of benchmark manipulation.

In 2011, the Judicial Panel on Multidistrict Litigation motioned to consolidate numerous actions relating to Libor on the basis that they all shared common questions of fact.⁶⁵ In particular, the respective claimants alleged that the defendant banks manipulated Libor by '*deliberately and intentionally understating their respective borrowing costs to the BBA*' and thereby paid lower interest rates to their customers.⁶⁶ The case came before Judge Naomi Buchwald sitting in the Southern District Court of New York⁶⁷ (*US Libor Litigation*).

In order to successfully bring a damages claim under US federal antitrust law, private claimants must demonstrate that they have standing under section 4 of the Clayton Antitrust Act, one element of which is establishing antitrust injury.⁶⁸ In essence, claimants must demonstrate that: (i) they suffered damage as a result of the conduct; (ii) the conduct breached antitrust laws; and (iii) it was this breach that caused the alleged harm to the claimants.⁶⁹

Interestingly, Judge Buchwald held that the process of setting Libor was never intended to be competitive.⁷⁰ Instead, '*it was a cooperative endeavor wherein otherwise competing banks agreed to submit estimates of their borrowing costs to the BBA each day to*

⁶⁴ A. Andreangeli, *Of lending rates, information exchange agreements and competition – the Libor scandal and Article 101 TFEU*, (Competition Law in Edinburgh Blog 2012).

⁶⁵ *United States Judicial Panel on Multidistrict Litigation*, 802 F.Supp.2d 1380 (J.P.M.L. 2011), p. 1.

⁶⁶ *Ibid.*

⁶⁷ *In re LIBOR-Based Financial Instruments Antitrust Litigation*, 935 F. Supp.2d (S.D.N.Y. 2013).

⁶⁸ R. Wolfram, *In re LIBOR: More Light, Please! – Questions and Observations as the Decisions Dismissing Antitrust Claims for Lack of Antitrust Injury Now Faces Appellate Review*, 28 Jan. 2015, p. 6.

⁶⁹ *Ibid.*, p. 7.

⁷⁰ *In re LIBOR*, *supra* note 67, p. 31.

facilitate the BBA's calculation of an interest rate index'.⁷¹ As such, even if the claimants could successfully demonstrate that the defendants had undermined this cooperative process, the claimants' injury would flow from the defendants' misrepresentation and not from harm to competition.⁷² Further, as regards antitrust injury in the market of financial instruments tied to Libor (i.e., the OTC market), Judge Buchwald held that it was not sufficient that the claimants had paid higher prices for these instruments because of the defendants' collusion – that collusion must have been anti-competitive, involving a failure of the defendants to compete where they otherwise would have.⁷³ Similarly, the Court found that there was no harm to competition in the inter-bank market, in that Libor was simply intended to convey information pertaining to interest rates in that market and was not intended to convey the interest rate of any *actual* inter-bank loans. Again, the defendants' conduct could fall within the ambits of misrepresentation and/or fraud but would not amount to a failure to compete.⁷⁴ Finally, the Court found that the conspiracy to manipulate Libor could not be equated to a conspiracy to fix prices. The basis for this conclusion was that unlike a price fixing scenario, where there is an agreement not to compete on price, each bank could have independently and rationally submitted false rates given that the Libor process is not competitive. A misreporting bank would not have been concerned about being forced out of business by competition from other banks and, additionally, their collusion would not have allowed them to do anything that they could not have otherwise done.⁷⁵ As a result, the Court granted the defendants' motion to dismiss claimants' antitrust claims holding that the '*process by which banks submit LIBOR quotes to the BBA is not itself competitive, and [the] plaintiffs have not alleged that [the] defendants' conduct had an anticompetitive effect in any market in which defendants compete*'.⁷⁶

In stark contrast to the above, District Judge Schofield took a different view in a consolidated case relating to the conspiracy to manipulate benchmarks in the foreign exchange markets⁷⁷ (*US FX Litigation*). Unlike in the US Libor Litigation, the Court held that the claimants had standing to plead antitrust injury given that the defendants, who were horizontal competitors, engaged in price-fixing, which caused the claimants to pay supra-competitive prices.⁷⁸ In FX markets, the rate or 'fix' is calculated by an arithmetic mean of *actual* FX transactions that take place in

⁷¹ *Ibid.*

⁷² *Ibid.*

⁷³ *Ibid.*, p. 33.

⁷⁴ *Ibid.*, p. 34.

⁷⁵ *Ibid.*, p. 37.

⁷⁶ *Ibid.*, pp. 157–158.

⁷⁷ *In re Foreign Exchange Benchmark Rates Antitrust Litigation*, No. 1-13-CV-07789 (S.D.N.Y. 2015).

⁷⁸ *Ibid.*, p. 21.

the 30 seconds either side of 16:00 London time.⁷⁹ Judge Schofield drew a distinction between Libor and FX in that the rate in the latter is based on actual, rather than hypothetical, transactions.⁸⁰ The defendants sought, unsuccessfully, to rely on the findings of the Court in the US Libor Litigation. Judge Schofield stressed that the Court's dismissal of antitrust injury in the US Libor Litigation was 'explicitly' based on its finding that Libor was a cooperative, rather than a competitive, endeavour.⁸¹ Further, Judge Schofield rejected the argument run in the US Libor Litigation to the effect that there could be no antitrust injury in that the same result could have been accomplished through unilateral, rather than collusive, conduct.⁸² Following the decision, JP Morgan and UBS, two out of the twelve defendants, agreed to settle with the claimants.⁸³ It will be interesting to follow what implications (if any) the decision in the US FX Litigation will have for the US Libor Litigation appeal.

3.2 EU LAW QUALIFICATION

Having looked at how the US judiciary has dealt with the manipulation of Libor, we now turn to examine the conduct from an EU law perspective.

In order to find a breach of Article 101(1) one must establish: (i) an agreement, decision or concerted practice between undertakings; (ii) that may affect trade between Member States; (iii) which has as its object or effect the prevention, restriction or distortion of competition within the internal market; and (iv) which does not fulfil the conditions under 101(3). Further, the most relevant sub-paragraph for these purposes appears to be Article 101(1)(a), whereby any agreement to directly or indirectly fix purchase or selling prices or any other trading conditions is held to be incompatible with the internal market.

As to the first limb of Article 101, there is nothing to contest the view that the financial institutions in question are undertakings. Further, there is little to contest the view that the conduct in question could fall within the scope of a concerted practice – the term is specifically designed to catch looser forms of collusion.⁸⁴ The question is whether the manipulation of Libor sought to prevent, restrict or distort competition. Before seeking to qualify the conduct from a legal

⁷⁹ *Ibid.*, p. 4.

⁸⁰ *Ibid.*, p. 22.

⁸¹ *Ibid.*

⁸² *Ibid.*

⁸³ Nasdaq, *Settlement Announced With UBS in In Re Foreign Exchange Benchmark Rates Antitrust Litigation*, <http://globenewswire.com/news-release/2015/03/13/715169/10124715/en/Settlement-Announced-With-UBS-in-In-Re-Foreign-Exchange-Benchmark-Rates-Antitrust-Litigation.html> (accessed 25 Mar. 2016).

⁸⁴ A. Jones & B. Sufirin, *EU Competition Law*, 5th ed., 164 (Oxford University Press, 2014).

perspective, it may be worthwhile looking at the economic rationale for the detrimental effect of collusive practices and whether the same theory applies to the manipulation in question.

3.3 CARTELS FROM AN ECONOMIC PERSPECTIVE

Collusion can take various forms. Most commonly it involves some kind of agreement on prices, output or the delineation of geographical markets. The central idea behind collusive practices is that they allow firms to exercise market power they would otherwise not have.⁸⁵ As a result, firms are able to artificially restrict competition and increase prices, thereby reducing welfare.⁸⁶ From an economic perspective, collusion can be defined as a situation where prices are set close to monopoly prices.⁸⁷ As a demonstrative example, imagine two identical coffee stalls in the main square of a small town.⁸⁸ Both sellers agree to charge EUR 2 per cup and will therefore each absorb roughly 50% of market demand. In a Bertrand model of competition, if one seller were to lower his price to EUR 1.9 per cup, he will likely gain the entire market.⁸⁹ In this scenario, the seller will make more profits than if he sold at a collusive price of EUR 2.⁹⁰ The incentive to collude stems from the Prisoner's Dilemma, which in turn illustrates the incentive to *cheat* on the cartel.⁹¹ Following an agreement between the two to maintain a collusive price, one party could cheat on this agreement (by lowering price) in order to absorb the entire market demand. Accordingly, economic doctrine has advanced two inherent elements of collusion that must be present in order to avoid the cheating mentioned above. The first is the ability to detect deviation (i.e., the reduction of the unit price of the coffee). The second is the ability to punish the deviating firm.⁹² Punishment is an important element in that it must be severe enough to overcome any temptation on the part of the co-cartelists to cheat on the cartel. Taking the example above, the most obvious would be the threat of a substantial reduction in the price of coffee which would, ultimately, result in a price war, thereby reducing the profit margins of both parties significantly.⁹³ This is far from ideal for either party, hence the rationale to

⁸⁵ M. Motta, *Competition Policy: Theory and Practice* 137 (Cambridge University Press, 12 Jan. 2004).

⁸⁶ *Ibid.*

⁸⁷ K. Kuhn, *Fighting Collusion by Regulating Communication between Firms*, 16(32) *University of Michigan and Institut d'Analisi Economica, Economic Policy* 172 (April 2001).

⁸⁸ Motta *supra* note 85, p. 139.

⁸⁹ S. Bishop & M. Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, 38 (Sweet & Maxwell, 2010).

⁹⁰ *Ibid.*

⁹¹ Bishop *supra* note 89, p. 168.

⁹² *Ibid.*

⁹³ *Ibid.*

maintain the collusive price. In summary, in order for collusion to occur and to be sustained, mechanisms for detection and punishment must be present.⁹⁴

Any form of agreement between the two coffee sellers to fix prices at EUR 2 would amount to price-fixing. The effect on consumer welfare is evident in that consumers would have to bear the burden of paying for coffee at a supra-competitive level. Pursuant to the Court's decision in *Dyestuffs*, 'it is contrary for a producer to co-operate with his competitors, in any way whatsoever, in order to determine a co-ordinated course of action relating to a price increase'.⁹⁵ In line with EU case law, agreements and/or concerted practices between competitors to fix prices are seen as restrictive *by object*.⁹⁶ Once it has been established that an agreement has as its *object* the prevention, restriction or distortion of competition, there is no need to demonstrate, or take account of, its concrete effects on competition.⁹⁷ A breach is established unless the defending party can satisfy the (onerous) requirements under Article 101(3).

This *by object* approach is appropriate where the negative effects on competition are unequivocally established. It would be nonsensical and unduly onerous to require the Commission to undertake a comprehensive economic analysis in every case. The manipulation of Libor is, however, more nebulous and it is submitted that it is not a case of a price-fixing cartel in the conventional sense.

3.3[a] *Type 1 and Type 2 Manipulation*

As per section 2.1, Libor rate submissions were intended to reflect the costs of borrowing funds in a certain inter-bank market just prior to 11:00. In order to manage public perceptions during the financial crisis, senior management at banks required their submitters to knowingly submit false, misleading and inaccurate rates that affected Libor.⁹⁸ There is little to indicate that such behaviour would fall foul of Article 101(1) in that there appears to be no agreement and/or concerted practice *as between* undertakings. Rather, this was a unilateral act by an undertaking to submit rates in order to portray a (false) image of solidity. It is submitted that such conduct poses few concerns from an Article 101 perspective.

The same argument can be made as regards Type 2 manipulation. In this instance, traders within the same bank sought to bolster their positions by

⁹⁴ *Ibid.*

⁹⁵ Joined cases 48, 49, and 51-57/69, *ICI v. Commission (Dyestuffs)* [1972] ECR 619, paras 115-118.

⁹⁶ Joined cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services v. Commission*, [1998] ECR II-3141.

⁹⁷ Joined cases 56 and 58/64, *Etablissements Consten SARL and Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, para. 342.

⁹⁸ CFTC, *supra* note 11, p. 4.

requesting that their submitters submit a favourable rate. Again, the element of a concerted practice as between undertakings is absent thereby precluding a putative infringement of Article 101.

3.3[b] *Type 3 Manipulation*

Type 3 manipulation is more relevant from a cartel perspective in that it involves conduct as between undertakings. In a traditional cartel, such as a price-fixing cartel, it is plain to see where the interests of the co-cartelists lie. By agreeing not to compete on price, the parties to the cartel are able to avoid competition and charge supra-competitive prices. Such conduct is obviously detrimental to consumer welfare and strictly prohibited under EU competition law. As we saw earlier, economic doctrine has established that in order to maintain an effective cartel, the parties must establish a system to detect and punish deviation. The latter element is of paramount importance given the inherent propensity of cartel members to cheat in a bid to steal market share. In a price-fixing scenario, this would mean having access to information regarding prices and the ability to substantially undercut the co-cartelists in the event that one of them decides to cheat on the cartel. The application of the same economic doctrine to the alleged cartel relating to Libor reveals some significant differences.

First, and on the (refuted) assumption that benchmark manipulation is akin to price-fixing, there is no real ability for the cartelists to monitor the submission of rates. Rather, requests were made as between employees at different banks that may or may not have been acted upon. It is unlikely that a submitter would heed a request from a trader at a different bank if he had been given a clear and opposite instruction from within his own institution. As regards causality, notwithstanding the presumption under EU law that concertation presupposes conduct on the market, it would be difficult to establish the causal link between an initial single request, the effect of that request (if any) on the submitted rate and the subsequent anti-competitive effect (if any) of the manipulated rate in the market.⁹⁹ Further, the *ex post* publication of individual rates by the BBA would be of little use as a monitoring device given that rates varied on a daily basis. Further, there would be little way of consistently knowing what a particular bank's honest (rather than manipulated) rate would have been on that day. This also begs the question of how to quantify what the 'honest' rate should have been given its largely subjective and hypothetical nature.

⁹⁹ Case C-199/92 P, *Huls AG v. Commission (Polypropylene)* [1999] ECR I-4287, para. 165.

Second, there is no real method to punish deviation in the event that this can be monitored effectively in the first place. Unlike a traditional price-fixing scenario, the alleged cartelists would have no ability to undercut on submissions. The most obvious reason for this is that Libor, unlike prices, can generate substantial benefits by a marginal move either upwards or downwards. Simply seeking to undercut the co-cartelist(s) by submitting low rates would be manifestly of no use, in that it is likely that the ‘punishing’ submission would simply fall within the lower quartile and be disregarded from that day’s calculation. Further, it is likely that such behaviour would be seen and questioned by both market regulators and participants and would, therefore, not be a viable strategy in any event.

A further disparity that Type 3 manipulation brings to the surface from a cartel perspective is that of so-called rogue traders. It is well established in case law that undertakings are responsible for the actions of their employees.¹⁰⁰ If the analogy of a rogue trader is applied to a classic bid-rigging cartel, there is a clear alignment of interests as between the rogue employee and his employer. The employee may be acting outside his remit and under the radar of management, but his participation in a successful cartel will, inevitably, result in a financial gain to his employer and possibly also himself. The disastrous consequences of rogue traders in the financial context have been well documented. In some instances, the losses engendered by their risky and highly leveraged portfolios have been so vast as to result in the bankruptcy of their employers.¹⁰¹ In the case of Type 3 manipulation, a rogue swaps trader would be seeking to maximize gains (or limit losses) on a particular settlement date. In this instance, the trader would be acting in the best interests of his own trading book or desk. His conduct may, however, not be in the best interests of his employer who may have a much larger position, unbeknownst to the trader (or to which he is indifferent), in the opposite direction. Importantly, there is potentially an obvious disconnect between the interests of the employee and his employer. This irreconcilability of interests is not present in more traditional cartels.

3.3[c] *Relevant Market Power*

Successful cartels allow cartelists to enjoy market power they would otherwise not have.¹⁰² In a price-fixing scenario, this would entail fixing prices at

¹⁰⁰ Case C-68/12, *Protimonopolný úrad Slovenskej republiky v. Slovenská sporiteľňa a.s.* [2013] ECLI:EU:C:2013:71, 7 Feb. 2013, para. 25.

¹⁰¹ Nick Leeson, <http://www.nickleeson.com/> (accessed 25 Mar. 2016).

¹⁰² Jones, *supra* note 84, p. 659.

supra-competitive levels, with price being a key indicator of competition.¹⁰³ Taking the inter-bank market as the relevant market, it is difficult to see how Type 3 manipulation would bolster a panel bank's market power. It is questionable whether panel banks are competing at all in this market. To this end, Judge Buchwald's characterization of the inter-bank market as cooperative rather than competitive is compelling. The paucity of actual transactions in the inter-bank market only serves to strengthen the argument for its cooperative rather than competitive nature.¹⁰⁴ One former trader closely involved in the Libor setting process commented that '*there is no reporting of transactions, no one really knows what's going on in the market*'¹⁰⁵ and '*you have this vast overhang of financial instruments that hang their own fixes off a rate that doesn't actually exist*'.¹⁰⁶ It is submitted that the behaviour in question has adequately been characterized as regulatory misconduct, contractual misrepresentation and/or fraud in light of the clear guidelines on how Libor should be set. The nature of the inter-bank market appears to favour the application of market regulatory instruments given that the application of, *inter alia*, traditional cartel behavioural patterns under competition law leaves much to be desired.

Many of the same arguments could be made when taking the OTC derivatives market as the relevant market. From a competition perspective, one could characterize the OTC market as a sort of 'downstream' market from the inter-bank market. In comparison to the inter-bank market, the OTC market appears to be more relevant given the vast amount of transactions that take place in both the OTC customer and inter-dealer markets. However, there are (again) difficulties in applying traditional economic doctrine to this unconventional market. For example, in a conventional market, elements affecting the elasticity of demand are crucial to the assessment of market power.¹⁰⁷ When looking at cross-price elasticity (i.e., the ratio of demand for one product to the change in price of another) an increase in price of a product should result in customers switching to a substitutable product.¹⁰⁸ In our coffee stall example, an increase in price by one seller would result in customers switching to the other market participant. It is difficult to see how Type 3 manipulation could have such an effect. Given the specificities of derivatives and the OTC market, a counterparty

¹⁰³ Bishop, *supra* note 89, p. 52.

¹⁰⁴ Hou, *supra* note 18, p. 11.

¹⁰⁵ The Economist, *The Rotten Heart of Finance: A scandal over key interest rates is about to go global*, 7 Jul. 2013.

¹⁰⁶ *Ibid.*

¹⁰⁷ Bishop, *supra* note 89, p. 56.

¹⁰⁸ *Ibid.*, p. 58.

would already be tied into the derivative contract prior to the settlement date. This would negate any opportunity of switching to a competitor. Further, those in the market for a derivative (e.g., an interest rate swap) are looking to hedge their exposure to future fluctuations in interest rates. As such, the 'price point' of Libor on the trade execution date is of little relevance. Conversely, what matters is that the derivative contract provides an adequate hedge to the customer's underlying liabilities.

A further interesting issue is whether the various tenures and currencies of Libor would have an effect on market definition. Does market definition extend beyond the bifurcated analysis of inter-bank versus OTC? Could it be said that three-month USD Libor is a separate and distinct market from ten-month SEK Libor? The situation is far from clear. What is clear, on the other hand, is that Libor manipulation throws up some novel particularities that render the application of traditional competition theory far from straight forward.

4 INFORMATION EXCHANGES IN THE FINANCIAL CONTEXT

The exchange of information between competitors is a vexed area and has been the subject of much legal debate and judicial controversy. An open market, in which information flows freely, clearly has its benefits. However, the EU judiciary and the Commission are very much aware that such exchanges can be a double-edged sword. Financial markets are characterized by the vast amounts of information that flow between competing traders, brokers and dealers. The majority of this exchange of information is legitimate and forms part of normal day-to-day business conduct. That is not to say that some exchanges of information clearly fall outside the realm of accepted business practice. The manipulation of Libor is a classic example of the latter. However, from a competition law perspective, recent developments in case law pose difficulties when applied to the specificities of the financial markets. Traditionally, exchanges of information were seen as a contingent part of a cartel, usually to facilitate the monitoring of deviation. However, as set out below, there has been a shift towards a view that the mere exchange of information itself can be problematic. The question for our purposes is therefore threefold: (i) whether the exchange of information, in and of itself, in a bid to manipulate Libor should constitute an infringement; (ii) whether the Commission's characterization of the conduct as a *by object* infringement is appropriate; and (iii) how does one reconcile the jurisprudential developments with accepted modes of doing business in the financial markets.

4.1 THE PROS AND CONS OF INFORMATION EXCHANGE

From a competition perspective, increased market transparency is generally viewed as something to be encouraged.¹⁰⁹ Perfect information on both the demand and supply side is innate to perfect competition.¹¹⁰ Market knowledge allows market participants to develop efficient commercial strategies.¹¹¹ Further, market knowledge also benefits consumers, given that it allows them to choose between competing products in order to determine which product best suits their needs.¹¹²

Information exchanges can generate substantial efficiency benefits.¹¹³ For example, uncertainty about demand may result in firms under producing.¹¹⁴ Further, if a firm is unaware that its competitors have lower production costs it may not seek to rectify this productive inefficiency.¹¹⁵ However, the exchange of information as between firms is generally only beneficial if firms continue to compete.¹¹⁶ The dilemma is that an exchange of information will often facilitate collusion.¹¹⁷ Therefore, a delicate balance has to be struck between allowing exchanges of information that are pro-competitive and prohibiting those that are of a collusive nature. An overly restrictive approach by enforcement officials is bound to chill efficiency and negate the pro-competitive advantages engendered by information exchange.¹¹⁸

4.2 DEVELOPMENTS IN EU CASE LAW ON INFORMATION EXCHANGE

The case law surrounding the exchange of information is a contentious area in which those advocating the need for rigorous economic analysis clash with the advocates of a form based approach. The answer to the question of whether to celebrate or condemn information exchanges comes easily to both economists and lawyers; it depends.¹¹⁹ As such, a brief examination of the jurisprudential developments in this area may be helpful in assessing if and how the law should be applied to Libor manipulation.

¹⁰⁹ OECD, *Information Exchanges between Competitors under Competition Law*, 23 (Policy Roundtables, 2010).

¹¹⁰ *Ibid.*

¹¹¹ *Ibid.*

¹¹² *Ibid.*

¹¹³ X. Vires, *Information Sharing: Economics and Antitrust*, Conference on the Pros and Cons of Information Sharing, Swedish Competition Authority, November 2006, p. 87.

¹¹⁴ F. Wagner-von Papp, *Information Exchange Agreements*, in *Handbook on EU Competition Law 3* (I. Lianos & D. Geradin eds, Edward Elgar Publishing, October 2013).

¹¹⁵ *Ibid.*

¹¹⁶ *Ibid.*, p. 4.

¹¹⁷ *Ibid.*

¹¹⁸ *Ibid.*

¹¹⁹ Wagner-von Papp, *supra* note 114, p. 4.

In *Asnef-Equifax*, concerning the compilation of a register on the solvency of customers between financial institutions, the CJEU held that exchanges of information ‘are incompatible with the rules on competition if they reduce or remove the degree of uncertainty as to the operation of the market in question with the result that competition between undertakings is restricted’.¹²⁰ Further, ‘the compatibility of an information exchange system [...] cannot be assessed in the abstract [and] depends on the economic conditions on the relevant markets and on the specific characteristics of the system concerned’.¹²¹ In this instance, the register was not held to constitute an infringement.

One of the main issues in information exchange cases is whether to characterize the exchange of information as a *by object* or *by effect* infringement. In a straightforward exchange of information to fix prices, a *by object* approach is appropriate given the inherent negative consequences of such conduct. However, the purpose of exchanging information is not limited to fixing prices. Given this ambiguity, economic theory advocates that information exchanges are assessed on a *by effect* rather than a *by object* basis.¹²² Pursuant to the Commission’s Guidelines, ‘Restrictions of competition by object are those that by their very nature have the potential to restrict competition within the meaning of Article 101(1). It is not necessary to examine the actual or potential effects of an agreement on the market once its anti-competitive object has been established’.¹²³ The Guidelines clearly advocate that a putative effect on competition is enough to categories conducted as a *by object* infringement.

Clarification on the scope of the *by object* concept was sought by the referring Dutch Court in the case of *T-Mobile*.¹²⁴ The case concerned five telecommunications operators in the Netherlands who met a single time to discuss a reduction in standard dealer remunerations for post-paid subscriptions. During this one-off meeting, confidential information also came up for discussion although it is unclear what this exactly related to. The CJEU held that a putative negative impact on competition was enough to characterize a practice as anti-competitive by object.¹²⁵ As such, ‘the concerted practice must simply be capable in an individual case, having regard to the specific legal and economic context, of resulting in the

¹²⁰ Case C-238/05, *Asnef-Equifax, Servicios de Información sobre Solvencia y Crédito, SL, Administración del Estado v. Asociación de Usuarios de Servicios Bancarios (Ausbanc)*, [2006] ECR I-11125, para. 51.

¹²¹ *Ibid.*, para. 54.

¹²² RBB Economics, Brief 31: *Catch-22: The role of economics in the assessment of information exchanges under Article 81*, September 2008, p. 1.

¹²³ European Commission, Communication: *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*, O.J.E.U., 2011/C 11/01, 14 Jan. 2011, para. 24.

¹²⁴ Case C-8/08, *T-Mobile Netherland BV v. Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-4529, 4 Jun. 2009.

¹²⁵ *Ibid.*, para. 31.

prevention, restriction or distortion of competition within the common market'.¹²⁶ This paragraph appears to be a non sequitur. On the one hand, the Court appears to say that a potential impact on competition is sufficient and, on the other, that regard must be had to the specific legal and economic context. A *by object* infringement is presumed where the exchange 'is capable of removing uncertainties between participants as regards the timing, extent and details of the modifications to be adopted by the undertaking concerned'.¹²⁷ What is surprising in this decision is that the Court focused on the issue of exchange of information, rather than analysing the conduct as a price-fixing cartel.¹²⁸ This is particularly odd given that the term 'information exchange' was not mentioned in any of the preliminary questions.¹²⁹ The result is that the decision only adds to the confusion surrounding information exchanges, rather than providing clear guidance on when conduct is a *by object* restriction.¹³⁰

Recently, in *Bananas*, the CJEU handed down judgment on the appeal of the decision dismissing the claimants' action for annulment of a Commission decision imposing substantial fines for the claimants' involvement in 'a concerted practice by which they coordinated quotation prices for bananas'.¹³¹ The Commission characterized this bilateral conduct as a *by object* infringement.¹³² On appeal, the Court sought to bring clarity to the muddy waters of where to draw the line between a *by object* and *by effect* infringement in the case of information exchange between competitors. The Court reiterated its case law in *T-Mobile* to the effect that 'the exchange of information between competitors is liable to be incompatible with the competition rules if it reduces or removes the degree of uncertainty as to the operation of the market in question, with the result that competition between undertakings is restricted'.¹³³ Further, 'a concerted practice may have an anticompetitive object even though there is no direct connection between that practice and consumer prices'.¹³⁴ Moreover, 'it must be presumed that the undertakings taking part in the concerted action and remaining active on the market take account of the information exchanged with their competitors in determining their conduct on that market'.¹³⁵ On these grounds the appeal was dismissed.

Strikingly, recent case law appears to indicate that the mere provision of information can, in and of itself, amount to a concerted practice the *object* of

¹²⁶ *Ibid.*

¹²⁷ *Ibid.*, para. 41.

¹²⁸ B. Meyring, *T-Mobile: Further Confusion on Information Exchanges between Competitors*, 1(1) J. Eur. Competition L. & Prac. 31 (Oxford, 2010).

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*

¹³¹ Case C-286/13 P, *Dole Food Company, Inc (and ors.) v. European Commission* (not yet reported), 19 Mar. 2015, para. 27.

¹³² *Ibid.*, para. 21.

¹³³ *Ibid.*, para. 121.

¹³⁴ *Ibid.*, para. 123.

¹³⁵ *Ibid.*, para. 127.

which is the restriction of competition.¹³⁶ This is the case, even where there is no agreement to fix prices or where there is no direct connection to prices.

4.3 TYPE 3 MANIPULATION

We saw earlier that the Commission appears to have focused its Libor investigation primarily on the exchange of information as between competing banks. The inference is taken from its official announcement in that '*the cartel aimed at distorting the normal course of pricing components for these derivatives. Traders of different banks discussed their bank's submissions for the calculation of the EURIBOR as well as their trading and pricing strategies*'.¹³⁷ The exchange of information as between traders also formed the focal point in the Commission's recent decision in a separate and distinct infringement relating to Swiss Franc bid-ask spreads.¹³⁸

It is common ground that employees at competing banks exchanged information with each other. Further, it appears that these exchanges took place on a relatively frequent basis which is an aggravating factor pursuant to the Guidelines. It is also fair to characterize the information exchanged as individualized, as opposed to aggregated, given that it was specific and could be said to reduce strategic uncertainty to some extent. If a trader at bank A asked a submitter at bank B for a 'high 3M Libor tomorrow' it would be evident to that submitter what fix that trader had on that date. That being said, the real strategic value of that information (if any), from a competitive perspective, is ambiguous.

4.3[a] *The Price Fallacy*

In a scenario where information pertaining to price is exchanged, there is clear strategic weight in that it will allow those privy to the information to set prices at supra-competitive levels. A key distinction with Libor is that it does not pertain to price or quantity. Setting the manipulation to one side, and on the assumption that the banks set the rate in an honest (albeit subjective) manner, Libor still remains an almost entirely fictional number.¹³⁹ The lack of inter-bank lending activity is a testament to its fictional nature. Further, Libor is set by way of arithmetic mean based on a number of submissions from various panel banks. There has been no

¹³⁶ R. Whish, *Trade Associations and Exchange of Information*, speech given at Centro de Libre Competencia Puc, 11 Apr. 2012.

¹³⁷ Commission, *supra* note 2.

¹³⁸ Commission Decision of 21 Oct. 2014, *Swiss Franc Interest Rate Derivatives (CHF Libor)*, Case AT.39924, para. 26.

¹³⁹ D. Corker, *Manipulating LIBOR...*, New Law Journal, Issue 7524, <http://www.newlawjournal.co.uk/nlj/content/manipulating-libor%E2%80%A6> (accessed 27 Apr. 2015).

suggestion that *all* panel banks sought to manipulate the rate so as to arrive at predetermined and specific rates.¹⁴⁰ Unlike price-fixing, where the exchange of information would result in a specific price increase, the exchange of information in this instance could, at best, result in a minor influence on the final rate. That is not to say that a minor 1 bps change in Libor could not have significant consequences, but it is important to draw the distinction nonetheless. Although the Commission's characterization of Libor as a 'pricing component' may infer similarities to the common understanding of the word 'price', to characterize them as the same would be a step too far. It is important to bear in mind that Libor does not '*sell or supply anything*'.¹⁴¹ Nor do banks (or traders) generate profits from Libor in the same way as a supplier of coffee generates profits from an artificially elevated retail price.

4.3[b] *The Reduction of Uncertainty*

The exchange of information can be incompatible with the competition rules if it reduces or removes a degree of uncertainty as to future conduct. Pursuant to *Bananas*, there is a presumption in law that account is taken of the exchanged information in determining future market conduct. It would be difficult to refute that the exchange of information relating to Libor does not reduce uncertainty to some degree – a trader or submitter privy to that information now knows something that he would otherwise not have known. The real question is what the strategic value of that information is. The issue is whether, in disclosing to competitors information pertaining to Libor, a firm is subsequently influencing the conduct of its competitors on a certain market. In the case of Type 1 and Type 2 manipulation, there is little to say that this would or could have an effect on the conduct of the other banks given its unilateral nature.

As regards Type 3 manipulation, the criterion of reducing uncertainty to some degree appears to be satisfied. However, the information exchange in this instance pertains to the submission of a rate in order to (hopefully) lessen payment obligations or to increase the amount of incoming funds flowing from a contractually predetermined settlement date. That settlement date was determined in advance upon ratification of the derivative swap contract. The conduct at issue (wrongly) seeks to manipulate obligations pertaining to that predetermined payment date. This is clearly a cause for concern. However, it is submitted that this cannot be equated to a situation in which information on future prices and/or quantities is exchanged with a view to affect pricing or output levels on some

¹⁴⁰ *Ibid.*

¹⁴¹ *Ibid.*

future date. There is an argument to be made that, from a competition perspective, the reduction in uncertainty on Libor positions via the medium of information exchange does not influence or alter conduct in the relevant market. To this end, it is submitted that Type 3 manipulation is more akin to a distortion of predetermined contractual obligations than to a distortion of competition.

4.3[c] *The Market Specific Legal and Economic Context*

Given the inherent differences of Type 3 manipulation to more traditional competition infringements, the conduct should be analysed in the economic context of the market to which it applies. Again, the relevant market could, therefore, either be defined as the inter-bank market or the OTC derivatives market. As regards the former, there is little to show that banks were seeking to compete at all in this market. We saw earlier how: (i) rate setting appears to be a cooperative rather than a competitive endeavour; (ii) the rate was largely fictional given the lack of actual unsecured inter-bank loans and (iii) the same result could have been achieved through unilateral misrepresentation.¹⁴²

Turning to the OTC market, the Commission appears to have focused on the purported detrimental effect on competition engendered by the exchange of information as between employees at different banks. However, those looking to trade in the OTC derivatives market are either seeking to hedge against interest rate exposure or seeking to speculate on interest rate movements. As such, the Libor fix on the execution date is of minimal importance. Given the temporal disparity between execution and settlement, there is little to indicate that competition in the OTC market would be distorted by Type 3 manipulation. This analysis appears to be in line with Judge Buchwald's decision, where she found that the manipulation did not appear to affect competition between panel banks in the derivatives market.¹⁴³

4.4 THE 'BY OBJECT' APPROACH

A *by object* approach is suitable for infringements which are so obviously detrimental to competition that they require no further (economic) explanation. An exchange of information on future pricing strategy would, understandably, fall into that category. The Commission's overextension of a *by object* approach to cases,

¹⁴² P. Huizing, *Parallel Enforcement of Rate Rigging: Lessons to Be Learned from LIBOR*, J. Antitrust Enforcement 11 (Oxford University Press, 2014).

¹⁴³ *Ibid.*

like benchmark manipulation, that are not, *prima facie*, *by object* infringements is an issue of contention and concern.

Commissioner Verstaager's designation as the European Commissioner for Competition practically dovetailed with the ECJ's landmark decision in *Cartes Bancaires* in which the application of a *by object* approach was analysed.¹⁴⁴ *Cartes Bancaires* (CB) is a grouping of French banks established to achieve the interoperability of payments and withdrawals by bank cards. Following two Statements of Objections, the Commission adopted a decision in which it considered that CB had infringed Article 101(1) *by object*. This decision was upheld by the General Court in 2007. CB appealed this decision arguing that the notion of a restriction of competition *by object* must be interpreted restrictively.¹⁴⁵ Further, it argued that the concept can only apply 'to agreements which, inherently, pursue an objective the very nature of which is so serious or harmful that the negative impact of the agreements on the functioning of competition is clear beyond doubt, there being no need therefore to assess their potential effects'.¹⁴⁶ In a seminal judgment overturning the decision at first instance, the CJEU stressed that certain forms of collusive behaviour, like price-fixing cartels, are so likely to have negative effects, that it would be redundant to show actual effects on the market.¹⁴⁷ Where this is not the case, it is necessary to demonstrate that competition has in fact been prevented, restricted or distorted to an appreciable extent.¹⁴⁸

It is submitted that a *by object* approach to benchmark manipulation is not appropriate given the inherent differences as between modern financial markets and more conventional markets. As such, pursuant to *Cartes Bancaires*, a thorough analysis of 'the real conditions of the functioning and structure of the markets'¹⁴⁹ should be undertaken in order to ascertain whether competition has in fact been prevented, restricted or distorted to an appreciable extent. It is submitted that this is questionable given the cooperative nature of setting Libor, its hypothetical nature and the lack of any real competition in the inter-bank market. Much the same could be said for the OTC market in light of the arguments set out previously.

It may be tempting, from a policy perspective, to seek to extend the application of a *by object* approach to conduct undertaken in novel and complex markets. One can perhaps understand the rationale in that it alleviates the need to perform the labour intensive task of formulating and proving a convincing theory

¹⁴⁴ Case C-67/13 P, *Groupement des Cartes Bancaires v. Commission* (not yet reported), 11 Sep. 2014.

¹⁴⁵ *Ibid.*, para. 25.

¹⁴⁶ *Ibid.*

¹⁴⁷ *Ibid.*, para. 51.

¹⁴⁸ *Ibid.*, para. 51.

¹⁴⁹ *Ibid.* para. 78.

of harm.¹⁵⁰ However, it must be borne in mind that ‘*genuine restrictions by object are agreements where the theory of harm is obvious and where competitive harm is a foregone conclusion*’.¹⁵¹ As regards Type 3 manipulation, this is manifestly not the case. That is not to say that Libor manipulation did not cause any harm. On the contrary, it quite clearly could have. Certain end-customers, with products tied to the rate, may have ended up paying more than they should have under the life of their contracts. Nevertheless, this detriment to consumer welfare can be adequately dealt with by, for example, contractual claims for misrepresentation. Seeking to draw the link between a loss in consumer welfare due to the putative anti-competitive effects of Libor manipulation is tenuous and unnecessary.

An overextension of the *by object* approach would entail undue speculation and the inappropriate reversal of the burden of proof.¹⁵² As such, the EU judicature should remain vigilant, as it did in *Cartes Bancaires*, to ensure that the *by object* approach is not stretched beyond its intended purpose.

5 CONCLUSION

The manipulation of Libor sparked considerable academic debate as to the sustainability of Libor given the potentially permanent decline in unsecured inter-bank activity.¹⁵³ Suggestions ranged from abandoning Libor altogether to implementing a system whereby Libor would be calculated pursuant to actual transactions.¹⁵⁴ The latter would entail that any future attempted manipulation would no longer be costless.

On 1 February 2014, the ICE Benchmark Administration replaced the BBA to become the new independent administrator for Libor.¹⁵⁵ On 22 July 2014, the Financial Stability Board (*FSB*) proposed wide-ranging reforms to major interest rate benchmarks.¹⁵⁶ The FSB proposals suggest that the overarching objective should be to transition to benchmark rates which are ‘*anchored in actual transactions*’.¹⁵⁷ As such, reference rates should be based exclusively on actual transactions where possible.¹⁵⁸

¹⁵⁰ H. Zenger & M. Walker, *Theories of Harm in European Competition Law: A Progress Report*, in *Ten Years of Effects-Based Approach in EU Competition Law 19* (J. Bourgeois & D. Waelbroeck eds, Bruylant, 2012).

¹⁵¹ *Ibid.*

¹⁵² *Ibid.*, p. 20.

¹⁵³ Hou, *supra* note 18, p. 11.

¹⁵⁴ *Ibid.*, pp. 12–13.

¹⁵⁵ ICE Benchmark Administration, *Position Paper on the evolution of ICE Libor*, 20 Oct. 2014.

¹⁵⁶ Financial Stability Board, *Reforming Major Interest Rate Benchmarks*, 22 Jul. 2014.

¹⁵⁷ *Ibid.*, p. 12.

¹⁵⁸ *Ibid.*

A detailed analysis of the proposed reforms is beyond the scope of this paper and the implications (if any) of the changes from an EU competition law perspective are unclear. From a regulatory perspective, any increased transparency or *reality* in setting Libor is to be commended. The transition to transaction based benchmarks may, however, be more pertinent to US antitrust law given the distinction drawn by Judge Schofield in the US FX Litigation as between benchmarks based on actual, rather than hypothetical, transactions.

Regulatory enforcement against benchmark manipulation has been widespread and swift, with financial regulators around the globe imposing impressive fines for the mischief at issue. The concurrency of multiple investigations, prosecutions and punishments is not, however, without its issues.¹⁵⁹ As regards benchmark manipulation, there is a clear risk of over-punishment in that sanctions for fraud, financial misconduct and antitrust infringements are treated by the various regulatory authorities as distinct offences despite relating to the same conduct.¹⁶⁰ This approach is artificial, unduly onerous and questionable as regards the *ne bis in idem* principle.¹⁶¹ These concerns are exacerbated by the fact that some areas of law are clearly better suited to deal with the vexed manipulation than others.

On 12 June 2014, a Regulation on Market Abuse (applicable in July 2016) and a Directive on Criminal Sanctions for Market Abuse (to be transposed within two years) were published. The Regulation deals specifically with what it terms ‘*market manipulation*’.¹⁶² This includes ‘*transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark*’.¹⁶³ In addition, the Directive requires that Member States treat as a criminal offence any ‘*transmitting [of] false or misleading information or providing false or misleading inputs or any other behaviour which manipulates the calculation of a benchmark*’.¹⁶⁴ These new regulatory instruments are welcome in that they appear to target directly the sort of manipulation dealt with in this article. That being said, their recent adoption is perhaps indicative of the underlying difficulty in rigorously applying competition law to these markets and practices. Had competition law been objectively suitable and capable of dealing with benchmark manipulation it would have made little sense to create new legislative instruments covering the same offence. The adoption of these instruments is perhaps telling of the inherent shortcomings of

¹⁵⁹ Huizing, *supra* note 142.

¹⁶⁰ *Ibid.*, p. 17.

¹⁶¹ *Ibid.*, p. 21.

¹⁶² Regulation 596/2014 of 16 Apr. 2014, on market abuse (market abuse regulation), [2014] O.J. L173/1.

¹⁶³ *Ibid.*, Art. 12(d).

¹⁶⁴ Directive 2014/57 of 16 Apr. 2014 on criminal sanctions for market abuse (market abuse directive), [2014] O.J. L173/179, Art. 5(d).

competition law when applied to the ever more sophisticated financial market place. Seeking to stretch law to cover circumstances for which it was not designed is bound to lead to questionable decisions, legal uncertainty and unsatisfactory precedents. Moreover, particular regard to the law should be had in the context of leniency proceedings, as in the case of Libor, given the putative desire of the confessor to paint a subjective and macabre image of the conduct in a bid to prejudice its competitors and alleged co-cartelists.¹⁶⁵

The real worry for the banking sector is how to ensure compliance going forward. It may well be that long established and legitimate ways of conducting business are found to infringe competition law, particularly given the jurisprudential developments relating to information exchanges. Given the paucity of case law on the application of competition law to financial market conduct, this may well be a real compliance headache for the financial sector. It is submitted that unless the temptation to unduly extend *by object* infringements in competition law is curtailed, there is a strong possibility that current and accepted modes of doing business in financial markets will have to be revisited.

¹⁶⁵ I. Forrester, *A Bush in Need of Pruning: The Luxuriant Growth of Light Judicial Review*, European Competition Law Annual 2009: Evaluation of Evidence and its Judicial Review in Competition Cases, European University Institute, Hart Publishing, January 2009, p. 10.

[A] Aim of the Journal

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