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Gold, Silver, Platinum & Palladium

The State of Play in Precious Metals Litigation

"It occurs to me that such massive speculation in COMEX silver futures may not be in keeping with the spirit and intent of commodity law and may suggest something is wrong with the price discovery process, since real producers and consumers of silver don't appear to be represented."

– Keith Neumeyer, CEO, First Majestic Silver Corp. (NYSE:AG) (June 2015 letter to the CFTC)[i]

Introduction

Pundits have long argued that gold and silver markets were being manipulated.

Among the earlier cases litigated was the contention that banks and other parties conspired to artificially suppress the price of gold. In a case filed in 2000, gold investor Reginald Howe sued the Bank for International Settlements, U.S. government, Secretary of Treasury, Chairman of the Federal Reserve, President of the New York Fed, and five banks, alleging such a conspiracy — an "unholy alliance of high public officials" and the "large bullion banks" (*Howe v. Bank for International Settlements et al*; 00-cv-12485). The case was dismissed in 2002, with the Court opining that: (1) the individuals whose actions were being questioned enjoyed the protections of sovereign immunity; (2) the plaintiff lacked standing to raise antitrust claims; and (3) the plaintiff was unable to demonstrate reliance or causation.

A separate case was filed in 2002, this time by a retail dealer of gold coins, accusing multinational gold miner and producer Barrick Gold of conspiring with JPMorgan to manipulate gold prices, usually downward (*Blanchard & Co Inc, et al v. Barrick Gold Corp, et al* (2:02-cv-03721). The case was ultimately dismissed in April 2006 following the plaintiff's November 2005 voluntary motion for dismissal, with no settlement payments being made. Blanchard, rather, paid Barrick an undisclosed amount to settle the libel case Barrick brought against Blanchard in 2003 in the Ontario Superior Court of Justice.

More recently, supervisory authorities have been monitoring trading practices in the silver markets that Neumeyer is focused on in the citation above, and similar practices in the gold, platinum and palladium markets.[ii] Much of the initial inquiry was into the so-called *slam-downs* of prices, particularly in the gold and silver markets. The CFTC opened an investigation into the silver markets back in 2008, but it was closed five years later, despite the vocal admonitions of Bart Chilton, then a CFTC Commissioner:

> "I believe that there have been repeated attempts to influence prices in the silver markets. There have been fraudulent efforts to persuade and deviously control that price….I believe violations to the Commodity Exchange Act (CEA) have taken place in silver markets and that any such violation of the law in this regard should be prosecuted."[iii]

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The supervisory emphasis later shifted to the setting of daily benchmark price levels which are often used for contractual reference. The daily precious metals "fixings" are being investigated, alongside the settings of other benchmark rates in the areas of interest rates (e.g., LIBOR and ISDAFIX), other commodities (e.g., Brent crude oil), and foreign exchange rates.[iv]

In January 2014, German financial regulator BaFin reportedly complained that "possible manipulation of currency rates and prices for precious metals is worse than the Libor-rigging scandal, which has already led to fines of about $6 billion."[v] In November 2014, as part of its investigation into foreign exchange trading, Swiss regulator FINMA found improper conduct in precious metals trading at UBS, such as:

> "(i) sharing information on order books with third parties (e.g. stop loss orders), (ii) sharing so-called 'flow information' with third parties on large current or imminent orders, (iii) sharing client names with third parties, (iv) front running and (v) triggering stop loss orders. A substantial element of the conspicuous conduct in PM trading was the repeated front running (especially in the back book) of silver fix orders of one client. Owing to the frequency and obviousness of front running in the back book, the desk supervisors saw themselves forced – after some time of passive inactivity – to prohibit front running in the back book, but did not sanction the traders who engaged in it."[vi]

This paper explores the various types of investigations that are ongoing. We begin with the bellwether benchmark fixing actions, before turning to spoofing, slam-downs, and other modes of alleged manipulation.

Benchmark Fixings

The most prominent of the metals cases allege collusion and manipulation of the daily benchmark prices in gold, silver, platinum and palladium markets, known as the London Fixings. During daily fixings, banks' representatives would consult via conference calls to determine benchmark spot prices for the precious metals. (The process has since been changed to minimize the chances for collusion among the participating banks.) Those benchmark prices would then be referenced in various contracts used by producers, end-users and investors, as well as by derivative contracts tied to the benchmark prices.

Three separate class actions were filed in 2014, alleging antitrust violations and Commodity Exchange Act claims, with the Gold and Silver cases being argued before Judge Valerie Caproni and the Platinum/Palladium case being heard by Judge Gregory H. Woods.

- Gold: *In Re Commodity Exchange Inc. Gold Futures Options Trading Litigation* (1:14-md-02548)
    - Before Judge Caproni. Remaining defendants: Bank of Nova Scotia; Barclays; HSBC; Société Générale; UBS; London Gold Market Fixing Ltd.
- Silver: *In Re London Silver Fixing Ltd. Antitrust Litigation* (1:14-md-02573)
    - Before Judge Caproni. Remaining defendants: Bank of America; Bank of Novia Scotia; Barclays; BNP Paribas; HSBC; Standard Chartered; UBS
- Platinum and Palladium: *In Re Platinum And Palladium Antitrust Litigation* (1:14-cv-09391)
    - Before Judge Woods. Remaining defendants: BASF Metals; Goldman Sachs; HSBC; ICBC Standard Bank; London Platinum and Palladium Fixing Company Ltd.

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The three class actions make similar arguments.

The plaintiffs allege that the defendant banks colluded during the fixings to set prices that benefited the panel banks at the expense of their customers and any incidental parties relying on contracts tied to the benchmark prices.

Chatroom Exchange (Example 1)

UBS Trader: "im gonna sell a lil more we need to grow our mafia a lil get a third position involved"

Deutsche Bank Trader: "ok calling barx"

Deutsche Bank Trader: "he said he will wait for 35 he is disciplined good man"

Source: Third Amended Complaint (Silver)

The core arguments are that the defendants shared confidential customer order information in online chat rooms and would then, armed with the knowledge of one another's customer orders, coordinate their trading to push prices in the pre-conceived direction, while positioning themselves to profit from the anticipated price movements associated with their coordinated trading.

In addition to statistical analyses, the complaints cite to the outcomes of regulatory investigations (and associated fines levied) such as the May 2014 fine of £26 million, imposed by the FCA on Barclays, "for failing to adequately manage conflicts of interest between itself and its customers as well as systems and controls failings, in relation to the Gold Fixing."[vii]

The statistical analyses provided in the class action complaints concentrate largely on trading patterns in and around the fixings (e.g., "The data reveals that the price spikes occur far more often around the Fixing than during any other part of the day."[viii]).

Chatroom Exchange (Example 2)

UBS Trader: "trying to coordinate moves together here"

UBS Trader: "ok we both bid at 60"

* * *

UBS Trader: "we gotta do it the same time next time . . ."

UBS Trader: "if we are correct and do it together, we screw other people harder"

Source: Third Amended Complaint (Silver)

All three complaints argue that prices tended to be manipulated downward during the fixings (e.g., (1) "Multiple economic analyses reveal artificial downward spikes around the time of the [platinum and palladium] fixing[s],"[ix] (2) "Silver prices drop during the silver fix at an abnormally high frequency,"[x] and (3) "To a statistically significant degree, prices around the PM [gold] fixing trended lower than previously prevailing prices."[xi])

Interestingly, plaintiffs in the silver action describe a price pattern that they argue is common across all the precious metals fixings, but that is only statistically significant in the silver fixing. They note:

> "This pattern persists through the A.M. Platinum/Palladium and Gold Fixings, which, although they are associated with a price decrease in Figure 2, do not cause a statistically significant break from the prior returns displayed in Figure 3. However, in the 10 minutes leading up to the start of the Silver Fix, the unadjusted returns breakout [sic] from their observed range, with multiple five-minute intervals showing negative returns. The Silver Fix is the only part of the day where there is such a concentration of negative returns."[xii]

In October 2016, in its rulings on motions to dismiss the gold and silver cases, the Court narrowed the time period of claims. In December 2016, the Court later approved negotiated settlements in the gold and silver cases with the first defendant to settle: Deutsche Bank. (Deutsche Bank is not a named defendant in the platinum/palladium case.) As part of those settlements — $60 million in the gold case and $38 million in the silver case — Deutsche Bank agreed to subsequently cooperate with plaintiffs' counsel.

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Two months after Judge Caproni's October 2016 rulings in the gold and silver cases, plaintiffs in both cases presented documents to the Court that included new evidence (such as electronic chat room transcripts) garnered from Deutsche Bank's cooperation. Plaintiffs filed their most recent amended complaints, bolstered by the new evidence, in June 2017.

Gold and silver defendants filed their motions to dismiss the third amended complaint on September 11, 2017. UBS, which was not a fixing panel member, but is a co-defendant, concurrently filed its motion to dismiss.

The platinum and palladium case is ongoing, although some claims were tossed in a March 2017 ruling. A third amended complaint was filed in May 2017. The defendants subsequently filed their motion to dismiss in July 2017.

Chatroom Exchange (Example 3)

UBS Trader: "if you want to accelerate it . . ."

UBS Trader: "go short 20k silver"

UBS Trader: "stay on the offer in 1s"

UBS Trader: "doesn't require much ammo"

Deutsche Bank Trader B: "ack"

UBS Trader: "avalanche can be triggered by a pebble if u get the timing right"

Source: Third Amended Complaint (Silver)

"Slam-downs"

The CFTC issued a report in May 2008 in which it noted that it had "received numerous letters, e-mails and phone calls from silver investors" during the last 20 to 25 years, alleging that prices were being "manipulated downward."[xiii] Despite the objection of then-Commissioner Bart Chilton, the CFTC would later close this investigation, after five years, without bringing any charges and without notifying aggrieved investors as to the findings or their motivation for closing the file.

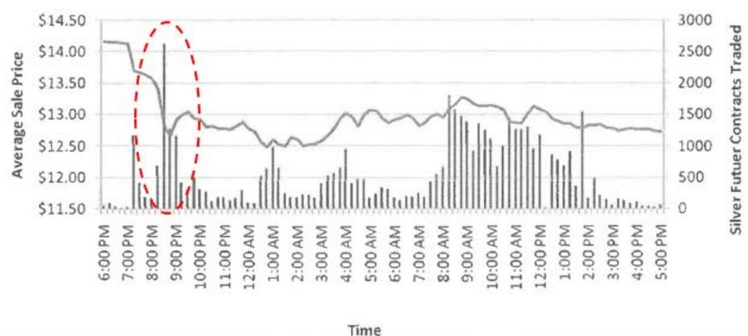
A class action was filed in 2010, alleging that JPMorgan Chase and other parties manipulated and suppressed silver futures and option prices. (*In Re: Commodity Exchange, Inc., Silver Futures and Options Trading Litigation*; 1:11-md-02213) JPMorgan is the largest player in the silver market, which, according to the plaintiffs, allowed it to exert a disproportionate influence on the market. The complaint explains: "This short position and JPMorgan's existing COMEX short silver positions gave JP Morgan substantial market power in COMEX silver futures contracts."

The complaint included examples of large price drops in silver futures, occurring over brief periods of time, in conjunction with spikes in trading volume.

In the example shown here from the complaint, on August 14, 2008 silver futures fell more than 11% in the roughly 90-minute window from around 7:15 PM until 8:45 PM.[xiv]

The case was dismissed in December 2012, with the Court finding that the plaintiffs had failed to plead their claims, with sufficient particularity, as to motive, impact, and the linkage of the alleged misconduct to the Defendants.

Silver Futures Electronic Sales Averages (August 15, 2008)



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The Court found the plaintiffs' allegation "that large *unspecified* and 'uneconomic' trades were taking place on the COMEX during the more than two-and-a-half year Class Period" to be "*too general* to plead the existence of artificial prices," despite the Court's recognition that the plaintiffs had in fact "specified uneconomic trades explicitly alleged to have been made by JPMorgan *at specific times of day on specific days* on the COMEX…."[xv] (emphasis added)

The core elements of Judge Robert Patterson's ruling are as follows:[xvi]

- Re: Intent to Influence Market Prices: "The Complaint here does not include factual allegations sufficient to support the reasonable inference that Defendants acted with the purpose or conscious object of causing artificial to exist silver futures prices or an artificial price trend on the COMEX market."
- Re: Existence of Artificial Prices: "Plaintiffs have failed to plead factual allegations sufficient to show that artificial prices existed in the COMEX silver futures market during the Class Period."
- Re: Causation of Artificial Prices: "Complaint fails … to plead factual allegations sufficient to allow the Court to draw 'the reasonable inference' that Defendants are liable for the misconduct alleged."

Spoofing

Spoofing is a trading practice according to which a trader submits orders which she intends to cancel before actually executing; rather, her motivation is to create artificial supply/demand so as to move market prices in a certain direction. After the passage of Dodd-Frank in 2010, spoofing was explicitly prohibited, in the amended Commodities Exchange Act: "A section 4c(a)(5)(C) violation occurs when the trader bids or offers with the intent to cancel a bid or offer before execution."[xvii]

In June 2017, David Liew, a former Deutsche Bank[xviii] precious metals trader, pleaded guilty to conspiring to commit "wire fraud affecting a financial institution" and "spoofing" in gold, silver, platinum and palladium futures markets.[xix]

According to the DOJ plea agreement, as well as a CFTC order,[xx] not only did Liew spoof futures markets on his own and with the help of his colleagues at Deutsche Bank, but he also at times coordinated his trading with a trader at another bank in order to trigger customers' *stop-loss* orders. Liew's manipulative trading is said to have spanned from approximately December 2009 until February 2012.

Settlement Price Manipulation

JPMorgan: Three direct actions have been filed against JPMorgan Chase. The three cases, filed by the same law firm, all sit before Judge Paul A. Engelmayer. The cases have not been consolidated, although Judge Engelmayer has issued combined rulings for the matters.

Plaintiffs in these ongoing cases accuse JPMorgan of manipulating certain silver contracts in order to move the market prices of *other* silver contracts. The complaints also allege that JPMorgan traders pressured COMEX employees, who were responsible for the end-of-day contract settlement prices, to set the settlement prices at levels beneficial to JPMorgan.[xxi]

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The plaintiffs were commodities traders, essentially trading for their own accounts. They posit that they were squeezed out of the marketplace — forced to liquidate their positions — due to JPMorgan's alleged manipulation. With silver futures and options contracts being leveraged instruments, traded using margin accounts, traders experiencing large enough losses are often forced to liquidate their positions or hurriedly replenish their trading margins — but this latter option is not always accessible. Across the three actions, the plaintiffs argue for damages totaling roughly $38 million, with antitrust claims potentially tripling some of the damages claimed.

According to all three complaints, JPMorgan had amassed a large long position in long-dated silver futures calendar spreads, by buying medium-term contracts and selling longer-term contracts. The longer-term contracts were priced higher than the medium-term contracts, a condition known in futures trading parlance as *contango*, which is typical of silver futures markets. JPMorgan would profit if the medium-term contracts appreciated relative to the long-term contracts: that is, if the futures spread *tightened*. Plaintiffs had the opposite positions, and allege that JPMorgan manipulated the market by placing uneconomic bids and offers to artificially tighten the calendar spread, thereby squeezing out competitors (such as the plaintiffs) in an already thin market for longer-dated calendar spreads, and consolidating its monopoly power. According to the complaints, once the plaintiffs could no longer maintain their positions, JPMorgan was able to profitably assume their positions (directly, in the case of Shak's positions, via a transfer negotiated by Shak's Futures Commission Merchant).

The cases were originally dismissed in 2016, as the Court found that "plaintiffs here have not made concrete allegations plausibly suggesting uneconomic behavior intended to acquire or maintain monopoly power, or satisfactorily distinguished JP Morgan's conduct from that of a rational, hard-nosed market actor."[xxii] However, the 2nd Circuit vacated the dismissals in February 2017, finding that "willingness to forsake short-term profits to achieve an anticompetitive end is indicative of anticompetitive behavior."[xxiii] Fact discovery is due to be completed by December 8, 2017.

Moore Capital: In 2010, the CFTC fined Moore Capital $25 million for its alleged attempts to manipulate platinum and palladium futures and options prices; Moore neither admitted to nor denied the allegations.[xxiv]

According to the CFTC order, from at least November 2007 through May 2008: "The Former [Moore Capital] PM engaged in a trading practice known as 'banging the close.' Specifically, the Former PM caused to be entered market-on-close ('MOC') buy orders that were executed in the last ten seconds of the closing period for both contracts in an attempt to exert upward pressure on the settlement prices of the futures contracts."[xxv] This is somewhat similar to attempts to influence foreign exchange benchmark prices and ISDAfix rates by concentrating trading activity within a brief trading window during which prices are set.

In 2011, the CFTC would later fine the former Moore trader, Christopher Pia, $1 million and permanently ban him from trading CFTC-regulated products;[xxvi] and the following year, the CFTC fined and permanently banned Joseph Welsh III, the broker at MF Global who had accepted and executed Pia's manipulative orders.[xxvii]

According to the CFTC:

> "…Welsh's trading in both futures contracts on the close on behalf of Pia frequently accounted for a significant portion of the volume. Welsh's trading strategy took advantage of these key characteristics of the palladium and platinum futures markets … to attempt to manipulate the daily settlement prices. ... During the Relevant Period, Pia or his execution clerks entered orders to Welsh with instructions to exert upward pressure on the prices of NYMEX palladium and platinum futures contracts."[xxviii]

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Conclusion

The various forms of alleged misconduct examined here are mostly not new. But on the back of a financial crisis and associated anti-bank sentiment, plaintiffs might find themselves benefiting from a more sympathetic bench.

Importantly, the claims made — with the possible exception of *slam-downs* — are also not unique to precious metals markets. In fact, the probes have generally coincided with, intentionally or otherwise, investigations of practices by the same banks in the FX markets: the FX and commodities traders at the center of these probes often sat on the same trading desks or near one another, and often fell under the same management or risk supervisory umbrellas.

With large penalties and settlements in the FX and LIBOR cases ($13 billion and $10 billion, respectively, as of November 2017), these precious metal cases have been reinvigorated by the associated investigations into banking conduct and by the broader focus on potential misconduct in the trading of similar instruments in the time window pertinent to their daily price settings.

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[i] http://www.gata.org/files/FirstMajesticLetterCFTC-06-01-2015.pdf
[ii] The trading of precious metals and related contracts is generally governed by the Commodities Exchange Act ("CEA"), rather than the Securities Act of 1933 and the Securities Exchange Act of 1934.
[iii] http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerBartChilton/chiltonstatement102610
[iv] Settlements and penalties for FX and interest rate benchmarks have climbed over $13 billion and $10 billion, respectively, as of November 2017.
[v] https://www.bloomberg.com/news/articles/2014-01-16/metals-currency-rigging-worse-than-libor-bafin-s-koenig-says
[vi] https://www.finma.ch/en/~/media/finma/dokumente/dokumentencenter/8news/20141112-ubs-fx-bericht.pdf?la=en
[vii] Remarkably, the failures alluded to in the FCA settlement had spanned the years from 2004 to 2013. The FCA also fined and banned from the industry a Barclays gold trader, Daniel Plunkett, who had taken advantage of a customer. Per the FCA's Final Notice: "The Authority has concluded that Mr Plunkett breached Statements of Principle 1 and 3 of the Authority's Statements of Principle and Code of Practice for Approved Persons by placing orders during the 3.00 p.m. Gold Fixing on 28 June 2012 with the intention of increasing the likelihood that the price of gold would fix below a certain level. In doing so, Mr Plunkett preferred his own interests to those of a customer in respect of whom he was managing a product that was referenced to that specific Gold Fixing." www.fca.org.uk/news/barclays-fined-26m-for-failings-surrounding-the-london-gold-fixing; https://www.fca.org.uk/publication/final-notices/daniel-james-plunkett.pdf
[viii] *In Re Platinum And Palladium Antitrust Litigation,* Third Amended Complaint
[ix] *In Re Platinum And Palladium Antitrust Litigation,* Third Amended Complaint
[x] *In re London Silver Fixing Ltd Antitrust Litigation,* Third Amended Complaint
[xi] Per the Third Amended Complaint (Gold)
[xii] Per the Third Amended Complaint (Silver)
[xiii] http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/silverfuturesmarketreport0508.pdf
[xiv] *In Re: Commodity Exchange, Inc., Silver Futures And Options Trading Litigation,* amended complaint
[xv] *In Re: Commodity Exchange, Inc., Silver Futures And Options Trading Litigation,* Opinion & Order (December 21, 2012)
[xvi] *In Re: Commodity Exchange, Inc., Silver Futures And Options Trading Litigation,* Opinion & Order (December 21, 2012)
[xvii] http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dtpinterpretiveorder_qa.pdf
[xviii] Deutsche Bank is referred to as Bank A by the DOJ and Financial Institution I by the CFTC, but has been identified by people familiar with the matter, according to multiple news reports, such as: https://www.bloomberg.com/news/articles/2017-06-02/trader-pleading-guilty-in-metals-probe-tied-to-deutsche-bank
[xix] https://www.justice.gov/criminal-fraud/file/972986/download
[xx] http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfdavidlieworder060217.pdf
[xxi] *Shak v. JPMorgan Chase & Co. et al* (1:15-cv-00992); *Wacker v. JPMorgan Chase & Co. et al* (1:15-cv-00994); *Grumet v. JPMorgan Chase & Co. et al* (1:15-cv-00995)
[xxii] Opinion & Order (1/12/2016) - *Shak v. JPMorgan Chase & Co. et al* (1:15-cv-00992); *Wacker v. JPMorgan Chase & Co. et al* (1:15-cv-00994); *Grumet v. JPMorgan Chase & Co. et al* (1:15-cv-00995)
[xxiii] Summary Order (United States Court of Appeals for the Second Circuit) - *Thomas Wacker, et al. v. JP Morgan Chase & Co., et al.* (16-2482)
[xxiv] http://www.cftc.gov/PressRoom/PressReleases/pr5815-10
[xxv] http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfmooreorder04292010.pdf
[xxvi] http://www.cftc.gov/PressRoom/PressReleases/pr6079-11
[xxvii] http://www.cftc.gov/PressRoom/PressReleases/pr7188-15
[xxviii] http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfwelshorder061715.pdf

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