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CONSPIRACY ALLEGATIONS IN THE STOCK LOAN MARKET: WHY PLAINTIFFS SHOULD BE SEEKING A REMEDY IN CONGRESS AND NOT IN COURT

DANIELLE P. KATZ[*]

ABSTRACT

This Article first provides a comprehensive analysis of conspiracy allegations in over-the-counter markets, focusing on the stock loan market as an exemplar.

Multiple conspiracy claims, implicating antitrust law, have been brought regarding over the counter markets since the financial crisis of 2008. The biggest banks in the country have been the center of novel complaints, new regulations, and innovative legislation in the recent years. But, despite regulation and legislation, Sherman Act litigation alleging conspiracy has endured as plaintiffs claim that big banks are conspiring to fix markets when, in fact, they are exercising economies of scale to provide unique, tailored products to sophisticated consumers who seek an edge in the market. This Article uses Iowa Public Employees' Retirement System v. Bank of America, a recently filed complaint in the Southern District of New York, as an analytical tool to demonstrate why arguments regarding antitrust conspiracy in unique, large-scale financial transactions fail to make plausible antitrust claims and, instead, are the by-products of market conditions and sophisticated bargaining.

This Article ultimately concludes that the plaintiffs alleging conspiracy in the stock lending market and over-the-counter markets, in general, do not have a judicial remedy available to them. Instead, as sophisticated, large clients, their remedy is legislative and regulatory (assuming that a remedy is warranted).

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INTRODUCTION

To paraphrase Tolstoy, the stock market is divided in two parts: one where there is light and happiness, and one where there is dejection and darkness.[1] Here, the electronic market is considered to be one of light and happiness, and stock lending in over-the-counter ("OTC") markets is a two-trillion dollar dark pool[2] and the subject of constant and unwarranted litigation.[3] In 2017, a complaint alleging conspiracy in the stock loan market was brought against some of the largest banks in the country, collectively referred to as the Prime Broker Defendants. The Prime Broker Defendants include Bank of America, Credit Suisse, Goldman Sachs, J.P. Morgan Chase, Morgan Stanley, UBS, EquiLend, as well as their affiliates and subsidiaries.[4] This complaint was filed shortly after a similar suit alleging conspiracy in the credit default swap market was settled against an almost identical defendant group.[5]

Given that these two complaints were filed so closely together and with such similar allegations, this Article analyzes why plaintiffs are predisposed to sue OTC market participants using antitrust theories and why OTC markets do not implicate antitrust concerns.

The first Part of this Article seeks to explain the structure of the stock lending market and further seeks to distinguish the stock lending market from traditional electronic markets or exchanges.[6] The stock lending market is unique in that it is restricted to high capital transactions and does not record its transactions in the same electronic manner as stock markets.[7] The stock lending market requires brokers, in this case the Prime Broker Defendants, to perform each transaction and to assume the risk of failed transactions and the potential to have to repay an unlimited amount of money.[8] The stock lending market is distinctive as the majority of the transaction takes place post-trade, meaning after the transaction on the stock market or exchange is complete.[9] This makes stock lending transactions a classic candidate for litigation as

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[1] LEO TOLSTOY, WAR AND PEACE 508 (Oxford World Classics, rev. ed. 2010).

[2] Terry Flanagan, *Securities Lending: A $2 Trillion 'Dark Pool'*, MARKETS MEDIA (April 17, 2015), http://marketsmedia.com/securities-lending-a-2-trillion-dark-pool/.

[3] OTC markets have been the subject of at least three major claims in the past 5 years. The focus of the claims have been the credit default swap market, the interest rate swap market and the finally, the focus of this Article, the stock loan market. As this Article argues, litigation surrounding OTC markets is unwarranted as plaintiffs' complaints usually take issue with the form of the market itself, something that should be dealt with through legislative channels and not judicial ones.

[4] *See infra* note 56.

[5] *See* In re Credit Default Swaps Antitrust Litig., No. 13md2467 (DLC), 2016 U.S. Dist. LEXIS 123784, at *1–56 (S.D.N.Y. Apr. 25, 2016).

[6] *See infra* Part I.

[7] *See infra* Part I.A.

[8] *See infra* Part I.B.

[9] SEC. & EXCH. COMM'N, TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE 131 (2009).

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the transactions are not as transparent as, for instance, those performed on the New York Stock Exchange.

The second Part of this Article summarizes the recently filed complaint *IPERS v. Bank of America*.[10] The Plaintiffs in IPERS are retirement systems and associations, as well as direct market participants who collectively allege that the Prime Broker Defendants blocked the creation and widespread adoption of various electronic platforms used to facilitate stock lending transactions.[11] Additionally, the Plaintiffs claim that the Prime Broker Defendants disincentivized their clients from using the electronic platforms in order to retain control of the market.[12] Finally, the Plaintiffs focus heavily on the creation of EquiLend by the Prime Broker Defendants and their subsequent use of the company. Formed in 2001, EquiLend's purpose is to "optimize efficiency in the securities finance industry by developing a standardized and centralized global platform for trading and post-trade services."[13] The Plaintiffs allege that the Prime Broker Defendants conspired to restrain trade by creating EquiLend and used the company to further their goals of restraining trade in the stock loan market, thereby violating Section 1 of the Sherman Act.[14] The Complaint lays out specific instances of conduct by the individual Prime Broker Defendants and further discusses their past allegations of antitrust conspiracy.[15]

The third Part of this Article argues that the conduct engaged in by the Prime Broker Defendants does not rise to the level of an antitrust violation.[16] Upon analysis of both the Prime Broker Defendants' horizontal and vertical conduct, they neither formed an agreement nor acted in restraint of trade. Furthermore, this Part argues that due to the lack of conspiracy alleged by the Plaintiffs, and therefore a lack of injury, the Plaintiffs lack standing to bring an antitrust claim.[17] In response to the Plaintiffs' persistent claims that EquiLend was formed to further anticompetitive conspiratorial goals of the Prime Broker Defendants, this Part stresses the fact that EquiLend was formed in 2001, long before the relevant time period of this litigation.

Finally, this Article ultimately concludes the Plaintiffs chose the incorrect forum in which to seek a remedy. The Plaintiffs are ultimately taking issue with the organization of OTC markets. Although the Plaintiffs claim to take issue with the Prime Broker Defendants' conduct within the market as well, this Article aims to show that the Prime Broker Defendants acted within the boundaries of the market and pertinent regulations. In order to prevent frivolous claims from being brought in the future, OTC markets should be protected from litigation through legislation and the Plaintiffs should seek a legislative remedy for their concern with the structure of the OTC market.

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[10] Iowa Pub. Emps. Ret. Sys. v. Bank of Am. Corp., No. 1:17-cv-06221 (S.D.N.Y. Aug. 16, 2017).

[11] *See infra* Part II.A.

[12] *See infra* Part II.A.

[13] *About*, EQUILEND, http://www.equilend.com/about/ (last accessed December 10, 2017).

[14] *See infra* Parts II and III.

[15] *See infra* Part II.B.

[16] *See infra* Part III.

[17] *See infra* Part III.A.

I. THE STOCK LENDING MARKET

This Article focuses on OTC markets, specifically the stock lending market.[18] Before turning to the issues raised by the stock lending market and the allegations made in the IPERS complaint,[19] it is important to understand the structure of the market[20] and the nature of stock lending transactions.[21] This Part begins by orienting the reader to the nature of OTC markets by contrasting them with exchanges.[22] After discussing OTC markets, this Part discusses a specific type of transaction, the short sale, which is sometimes conducted on exchanges, but other times conducted on OTC market when the needs of the marketplace require a specialized setting.[23]

A. Over-the-Counter Markets v. Exchanges

"The phrase 'over the counter' [is] used to refer to stocks [or securities] that trade via a dealer network as opposed to on a centralized exchange."[24] An OTC market always includes three parties: the buyer, the seller, and the broker.[25] Unlike an exchange, where the broker is always one entity, an OTC market operates with varying intermediaries.[26] Thus, the buyer and seller in any transaction are dependent on specific brokers and cannot go to a single entity to effectuate a transaction.[27] Put simply, OTC markets are customer service businesses based on interpersonal connections while exchanges are impersonal and institutional.[28]

In markets where the transactions are on a scale inconceivable to the public and where few actors interact, the decentralized structure of OTC markets provides

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[18] It is also referred to as the Stock Loan Market. Stock lending happens outside of an exchange, such as the New York Stock Exchange, and "is a practice where an institution with a portfolio of investment securities temporarily lends out, on a collateralized basis, some of its portfolio securities that would otherwise be sitting idle." TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 2.

[19] *See infra* Part II.

[20] *See infra* Part I.A.

[21] *See infra* Part I.B.

[22] *See infra* Part I.A.

[23] *See infra* Part I.B.

[24] THE INVESTOPEDIA GUIDE TO WALL SPEAK 217 (Jack Guinan, ed., 2009) [hereinafter "INVESTOPEDIA"].

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] Exchanges are not without their benefits. Exchanges for example, provide transparency and efficiency due to their centralization. Everyone knows where to go and what the rules of the exchange are. The market is open. But OTC markets have their own benefits. Personal relationships mean that brokers can assess risks and place transactions based on client preferences. *See generally* Randall Dodd, *Markets: Exchange or Over-the-Counter*, INT'L MONETARY FUND, http://www.imf.org/external/pubs/ft/fandd/basics/markets.htm. (last updated Dec. 18, 2018).

participants with a freedom of choice unavailable in a traditional exchange system.[29] In short, OTC markets are social networks that are focused on the needs of small and high-risk markets that are ill-suited to the standardization that exchanges require.[30] OTC markets provide necessary customization for sophisticated customers effectuating niche transactions.[31]

Although OTC markets are well-suited to certain types of transactions, national exchanges serve an important purpose in the financial system as well. Exchanges are centralized, allowing them to be more efficient, easily accessible for investors and generally lower-risk due to their amount of regulatory oversight. Since OTC markets are controlled by private actors who can manage their own risk tolerances, individual actors can over-estimate their risk tolerance and cause greater fluctuations for market participants. The stereotypical OTC market, for example, is full of companies that do not meet the rigorous listing requirements to trade on national exchanges, as well as companies with poor credit records, thereby causing investors to enter with a 'greater risk, greater reward' mentality.[32] However, traditional OTC markets have their drawbacks: the market's opacity may lead to predatory practices, and unreliable data meaning that price spikes can be based solely on speculation, and not on actual demand.[33]

B. Short Sales and Their Risks to Brokers

A short sale is a two-step transaction predicated on a bet that a stock[34] will decline in value.[35] Put simply, a short sale is a bet against a stock's success in the market.[36] In order to "short" a stock, an actor must use a broker.[37] The broker finds the shares of

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[29] *Id.*

[30] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 176.

[31] *Id.* at 48.

[32] INVESTOPEDIA, *supra* note 24, at 217.

[33] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 176. Of course, the analogy is not without its distinguishing features. In the commonly-known OTC stock market, unlike the stock lending market, unsophisticated market participants were guided by sophisticated brokers. The stock lending market, on the other hand, deals with few, if any, unsophisticated market participants. The brokers act more as intermediaries than experts, and fill a role that looks less like an advisor and more like a racetrack teller.

[34] For the sake of simplicity, this Article will discuss shorting in terms of stocks, though it applies to any commodity.

[35] David C. Worley, *The Regulation of Short Sales: The Long and Short of It*, 55 BROOK. L. REV. 1255, 1257 (1990) ("Rule 3b-3 defines the term 'short sale' as (1) any sale of a security which the seller does not own, or (2) any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.").

[36] Rodolphe B. Elineau, *Regulating Short Selling in Europe After the Crisis*, 8 INT'L L. & MGMT. REV. 61, 63–64 (2012).

[37] Katherine McGavin, *Short Selling in a Financial Crisis: The Regulation of Short Sales in the United Kingdom and the United States*, 30 NW. J. INT'L L. & BUS. 201, 204 (2010).

stock the actor wants to short from its client's portfolios.[38] After the actor provides collateral,[39] the broker then provides the stock taken from its client's portfolios[40] to the actor who sells the stock.[41] A specified time period then passes.[42] When the period elapses, the actor must replace the shares of stock to the broker, who will return the stock to its client.[43] If, when the actor must return the stock, its price has gone down, the shares of stock can be replaced for less money than they were purchased for, yielding a profit for the actor.[44] If however, the stock's price has risen, the actor must still buy the same number of shares of the stock back to return to the broker.[45] The actor, therefore, loses money because it costs more to replace the same shares of the stock.[46] If the actor cannot buy the shares of the stock, then the broker would use the collateral, make up the difference (taking a loss on the transaction), and replace the stock in its client's portfolio.[47] Although short selling is inherently risky, finance academics strongly agree that short selling is necessary as it improves market efficiency and provides additional liquidity.[48]

Just as the window washers at the top of the Chrysler Building make more money than those washing the windows on the street, the brokers who facilitate short sales ensure they are compensated according to the level of risk they assume.[49] Stocks have unlimited potential to grow.[50] Therefore, because the market is essentially inversed in a short sale, there is unlimited potential for the actor to lose money.[51] That loss must be insured, and the brokers provide their word, and more importantly their money, to insure the actor's default.[52] If, when the actor must replace the stock, the stock has risen in value such that the actor is unable to buy the shares back, the broker will use

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[38] Naked Shorts, which are no longer permitted, are when you short stocks that you already own. After the market crash in 2008, the SEC prohibited naked shorts to prevent the use of insider trading information. James Chen, *Naked Shorting*, INVESTOPEDIA https://www.investopedia.com/terms/n/nakedshorting.asp (last updated Mar. 18, 2019).

[39] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 2.

[40] *Id.*

[41] STATE ST. GLOB. ADVISORS, UNDERSTANDING THE SECURITIES LENDING PROCESS (2016), https://us.spdrs.com/library-content/public/Understanding_the_Securities_Lending_Process.pdf.

[42] *Id.*

[43] *Id.*

[44] Elineau, *supra* note 36, at 63.

[45] *Id.*

[46] *Id.*

[47] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 7.

[48] *Id.* at 14.

[49] UNDERSTANDING THE SECURITIES LENDING PROCESS, *supra* note 41.

[50] Worley, *supra* note 35, at 1283.

[51] *Id.*

[52] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 18.

the actor's collateral to do so.[53] If the collateral does not cover difference, the broker assumes liability for the difference in order to successfully replace the stock to its client.[54] The higher the risk, the bigger the incentive must be for banks to participate, but only insofar as they have the capital and risk tolerance to cover losses.[55] After all, the window washer washing the higher windows makes more money than the ground-level window washer because of the risks involved in the height: the injuries resulting from the fall are exponentially greater, so every hour of service must be compensated to account for the risk that it will lead to catastrophe. Thus, the Prime Broker Defendants here are simply conforming to the societal practice of charging an increased amount of money to engage in risky behavior.

II. Summary of IPERS Complaint and Previous Related Allegations

This Part summarizes the allegations Plaintiffs made in their complaint. After discussing the factual allegations, this Part focuses on the historical conspiracy allegations.

A. Summary of Complaint

On August 16, 2017, Iowa Public Employee's Retirement System ("IPERS") and various other retirement associations (collectively, the "Plaintiffs") brought a class action complaint against some of the biggest and most influential banks in America.[56] Collectively referred to as the "Prime Broker Defendants"[57]— Bank of America, Credit Suisse, Goldman Sachs, JP Morgan, Morgan Stanley, UBS, and EquiLend— are defending against claims of conspiracy arising in the OTC stock lending market.[58] Currently, there is no central marketplace for stock loan transactions, as there is for the sales of the stocks themselves.[59] The Plaintiffs hedge an educated guess that, if left

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[53] *Id.*

[54] *Id.* at 198.

[55] Marc C. Faulkner, An Introduction to Securities Lending 24–25 (4th ed. 2007), file:///C:/Users/wasil/Downloads/An_Introduction_to_Securities_Lending_4th_Ed%20(1).pdf.

[56] *See generally* Complaint, Iowa Pub. Emps. Ret. Sys. v. Bank of Am. Corp., No. 17 Civ. 6221 (S.D.N.Y. Aug. 16, 2017), *amended by* Amended Complaint, Iowa Pub. Emps. Ret. Sys. v. Bank of Am. Corp., No. 1:17-cv-06221 (S.D.N.Y. Nov. 17, 2017) [hereinafter Amended Complaint].

[57] Amended Complaint, *supra* note 56, at 16–28. For the purposes of brevity, all Prime Broker Defendants include their parents, subsidiaries and affiliates and are outlined in further detail. Since writing this Article, claims against some of the Prime Broker Defendants have been dropped but the case continues to press on.

[58] *Id.* at 138 (including claim for unjust enrichment, in which Plaintiffs "seek restitution of the monies of which they were unfairly and improperly deprived"). *See id.* at 129–30. As the Plaintiffs' claim of unjust enrichment rests on the showing of an antitrust claim, they will unlikely prevail. Furthermore, should the court find a sufficient foundation in the antitrust claim for a claim of unjust enrichment, if successful the damages awarded would be duplicative. Although the Plaintiffs can plead two mutually exclusive claims at the pleading stage, they ultimately will not be able to recover on both. This is yet another example of how claims stemming from conduct in OTC markets consume judicial resources. A detailed discussion of the unjust enrichment claim is beyond the scope of this Article.

[59] *Id.* at 2.

to evolution, the stock loan market would gravitate towards electronic trading, causing it to become more efficient and transparent.[60] Plaintiffs argue that the nature of the market allows the Prime Broker Defendants to exploit its inefficiencies and benefit at the expense of the borrowers and lenders participating in the market.[61]

In the mid-2000's, a start-up company called Quadriserv, Inc. built an electronic platform to allow buyers and sellers to interact directly in the stock loan market.[62] After announcing that Quadriserv had reached an agreement with the world's largest clearing house for them to act as the intermediary for stock loan transactions,[63] the Prime Broker Dealers proposed that the platform be exclusive to dealers and prohibit lenders and borrowers of securities.[64] After the capital exposure of Quadriserv had been effectively maxed out, another electronic stock lending platform, SL-x, emerged in its wake.[65] SL-x proposed to replace the current OTC system "with an electronic system where broker-dealers could communicate bids and offers much more efficiently."[66]

However, the Prime Broker Defendants treated SL-x similarly to the way they treated Quadriserv. The Prime Broker Defendants refused to transact business on SL-x's platform.[67] Instead, they "agreed that any such market innovations, if they were to occur at all, would need to be done through EquiLend."[68]

After SL-x exhausted its financial resources, EquiLend bought its patents and intellectual property rights but never attempted to commercialize the technology.[69] To increase the level of control over stock loan transactions, in 2011 the Prime Broker Defendants, acting through EquiLend, created a competing business–DataLend–that the Plaintiffs allege would work to suppress other electronic platforms.[70] The Plaintiffs then allege that the Prime Broker Defendants developed 'Project Gateway' and that "[t]he goal of Project Gateway was to erect an iron-clad 'gate' through which all stock loan transactions *must* pass on their way to central clearing . . . . Project Gateway made certain that this would be a 'gate' that the Prime Broker Defendants would collectively control."[71] During this time, AQS was working on an agreement with the clearinghouse for use of its product, however, the deal was never completed.[72] Shortly

[60] *Id.* at 4.

[61] *Id.* at 40.

[62] *Id.* at 44.

[63] *Id.* at 52.

[64] *Id.* at 70.

[65] *Id.* at 58.

[66] *Id.* at 58–59.

[67] *Id.* at 75.

[68] *Id*.

[69] *Id.* at 90.

[70] *Id.* at 85.

[71] *Id.* at 97–98.

[72] *Id.* at 99.

after the deal fell through, EquiLend purchased AQS and, in doing so, retained their control of the stock lending market.[73]

This is not the first time these allegations have been made, both towards the Prime Broker Defendants and in similar markets. The next Part of this Article analyzes the past allegations of conspiracy against the Prime Broker Defendants and their associated outcomes.

B. *History of Conspiracy Allegations*

The IPERS complaint includes five past allegations of conspiracy involving various Prime Broker Defendants.[74] The five instances of conspiracy include three instances involving markets[75] and two involving transactions.[76] In addition to the allegations discussed in the IPERS complaint, there is an additional allegation of conspiracy currently pending in the Southern District of New York ("S.D.N.Y.").[77] This conspiracy allegation focuses on a similar group of defendants and their conduct with regard to Interest Rate Swaps, another OTC market.[78] This Part focuses on the allegations involving specific transactions. The most relevant to the claims brought by the Plaintiffs are the conspiracy allegations regarding Credit Default Swaps and Interest Rate Swaps.[79]

ISDAfix, a widely used financial benchmark, has been at the center of numerous antitrust and anti-manipulation violations.[80] The Prime Broker Defendants have collectively paid approximately $342 million dollars "to settle private antitrust and common laws claims concerning these banks' collusive manipulation of the ISDAfix benchmark."[81]

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73 *Id.* at 100.

74 *Id.* at 120–28.

75 *See generally id.* at 120–26. These allegations for market conspiracy were for conduct in the municipal bond derivatives industry, the LIBOR Market, and the Foreign Exchange Market. The allegations involving these markets resulted in settlements and/or the admission of possible anticompetitive conduct.

76 *Id.* at 126–28.

77 *In re* Int. Rate Swaps Antitrust Litig., 261 F. Supp. 3d 430, 501 (S.D.N.Y. 2017).

78 Amended Complaint, *supra* 56, at 14–23. (alleging conspiracy against Bank of America, Barclays Bank PLC, BNP Paribas, S.A., Citigroup, Inc., Credit Suisse Group AG, Deutsche Bank AG, The Goldman Sachs Group, Inc., HSBC Bank PLC, J.P. Morgan Chase & Co., Morgan Stanley, Royal Bank of Scotland PLC, UBS AG, ICAP Capital Markets LLC, and Tradeweb Markets LLC, collectively referred to in the complaint as the 'Dealer Defendants').

79 *See id.* at 126–28. A comparison of the allegations of conspiracy in the stock lending market, the credit default swap market and the interest rate swap market are eerily similar. Using a different over the counter market as the basis for the IPERS complaint, the Plaintiffs allege that the Prime Broker Defendants acted almost identically in each market. The similarity of alleged conduct in these markets strengthens the argument that it is the structure of the OTC market itself, not the participants conduct in it, that create impending vulnerability to litigation. Furthermore, all three claims of conspiracy in OTC markets were filed by the same group of attorneys.

80 *Id.* at 126.

81 *Id.*

In the Credit Default Swaps ("CDS") litigation,[82] "Defendants Bank of America, Credit Suisse, Goldman Sachs, JP Morgan, Morgan Stanley, and UBS, [along with others], were accused of participating in a remarkably similar conspiracy to the one alleged here."[83] There, the Prime Broker Defendants were allegedly conspiring to keep control of the OTC market with respect to credit default swaps, as opposed to stock lending.[84] The Plaintiffs in the CDS case claim that the Defendants were working together to block electronic market platforms and the overall natural evolution of the market.[85] However, that case ultimately settled for $1.86 billion dollars and the Defendants were not found liable for a conspiracy.[86]

The pending Interest Rate Swap litigation in the S.D.NY. analyzes the current process of trading interest rate swaps on an OTC market[87] and alleges that electronic trading platforms will increase efficiency, transparency, and competition in the market.[88] Defendants Bank of America, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley, and various others are having claims brought against them for their conduct in the interest rate swap market.[89] The complaint includes similar legal allegations as both the IPERS complaint as well as the credit default swap complaint and tailors the factual allegations to interest rate swaps.[90]

III. ANALYSIS OF PLAINTIFF'S CLAIMS

Here, the Plaintiffs allege the Prime Broker Defendants conspired to restrain trade in violation of Section 1 of the Sherman Act by agreeing to an illegal boycott. A violation of Section 1 of the Sherman Act requires (1) a contract, combination or conspiracy; (2) affecting interstate commerce; (3) which imposes an unreasonable restraint of trade.[91] Here, Plaintiffs' claims are not sufficient to demonstrate the requisite acts by the Prime Broker Defendants.

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[82] *In re* Credit Default Swaps Antitrust Litig., No. 13md2476, 2014 WL 4379112, at *1–4 (S.D.N.Y. Sept. 4, 2014).

[83] Amended Complaint, *supra* note 56, at 127.

[84] *Id.* at 127–28.

[85] *Id.*

[86] *Id.* at 128.

[87] *See id.* at 127–28; *see also In re* Credit Default Swaps Antitrust Litig., No. 13md2476, 2014 WL 4379112, at *1–4 (S.D.N.Y. Sept. 4, 2014).

[88] Amended Complaint, *supra* note 56, at 3; *See In re* Credit Default Swaps Antitrust Litig., 261 F. Supp. 3d 430, 448, 454 (S.D.N.Y. 2017).

[89] *See generally* Amended Complaint, *supra* 56.

[90] *See generally id.* at 28–101; *see In re* Credit Default Swaps Antitrust Litig., 261 F. Supp. 3d at 442–45.

[91] Willman v. Heartland Hosp. E., 836 F. Supp. 1522, 1526 (W.D. Mo. 1993) (quoting White & White, Inc. v. Am. Hosp. Supply Corp., 723 F.2d 495, 504 (6th Cir. 1983)).

A. Plaintiffs Lack Standing to Bring an Antitrust Claim

1. No Injury

The Plaintiffs here allege a per se antitrust violation. Due to their claim of a Section 1 violation, if the Plaintiffs can plead enough facts to successfully demonstrate a conspiracy between the Prime Broker Defendants, that in and of itself is a sufficient indication of injury sufficient for standing to bring the claim. However, the Plaintiffs have failed to properly allege that the Prime Broker Defendants engaged in conspiracy. The Plaintiffs have filled their complaint with actions performed by the Prime Broker Defendants that amount to nothing more than parallel conduct – not something considered to be a violation of federal antitrust laws. It is not unusual for similarly situated companies to act in a similar fashion in order to increase the success of their business. The Plaintiffs generally allege the Prime Broker Defendants conspired to engage in conduct to prevent the evolution of the OTC market. However, considering all of the Prime Broker Defendants have similar interests in the market and comparable resources, acting in parallel to one another does not an antitrust claim make. Since the Plaintiffs here have not pled enough facts to demonstrate a conspiracy between the Prime Broker Defendants, the additional two elements of a Section 1 Sherman Act violation become moot.

Even if the court should find more than ordinary parallel conduct by the Prime Broker Defendants, each Defendant's actions alone could be considered "rational and competitive business strategy unilaterally prompted by common perceptions of the market."[92] All of the Prime Broker Defendants remain independently successful because of their foresight and ability to strategically be proactive in their business models. It is not unrealistic that the country's largest banks have the same access to information, the same level of brilliant minds creating business strategies, and the same foresight to act as necessary to protect their interests in the stock loan market.[93]

In order to have standing to bring an antitrust claim, "a private antitrust plaintiff must establish three quite independent requirements: (1) that it suffered an injury; (2) that its injury was caused by an antitrust violation; and (3) that the injury qualifies as an 'antitrust injury.'"[94] The standard for establishing an injury in an antitrust litigation is less than an individual would need to show under Article III of the Constitution.[95]

The courts are split when interpreting how to determine whether an injury was caused by an antitrust violation. The Supreme Court in *Zenith Radio Corp. v. Hazeltine*

[92] Bell Atl. Corp. v. Twombly, 550 U.S. 544, 554 (2007).

[93] Additionally, with all of the lateral hiring between the Prime Broker Defendants, it is further not surprising that they all would eventually gain access to the same information and unilaterally act to ensure they don't cannibalize their profits.

[94] HERBERT HOVENKAMP, PRINCIPLES OF ANTITRUST 537 (2017) [hereinafter, "HOVENKAMP, PRINCIPLES"].

[95] *Id.* at 538. As is the case of the indirect purchaser rule which allows indirect purchasers of goods and services to bring antitrust actions. When compared to standing under the Constitution and the requirement that the claimant be the person directly injured, antitrust allows for a less strict standard.

Research Inc.[96] required that a violation be a 'material cause' of the plaintiff's injury.[97] "Other courts have assessed a stronger requirement that the violation be shown to be a 'substantial factor' in the plaintiff's loss–apparently meaning that the violation must be the most important cause, or at least among the most important."[98] However, it is unanimously determined that an antitrust injury is one that is "a natural result of diminished competition in the market . . . ."[99]

Antitrust litigation is one of the areas of law in which private parties have the power to bring legal actions.[100] However, the ability of private parties to bring claims forces companies to live in constant fear of prosecution and in turn, has the undesirable effect of decreasing efficiency.[101] In order to strike a balance between protecting private parties' claims and ensuring that industry efficiency and innovation continue, plaintiffs must meet a heightened requirement to have antitrust standing, which the Plaintiffs here have failed to reach. The Prime Broker Defendants' alleged violation was neither the material cause, nor a substantial factor in the Plaintiffs' injury. The Plaintiffs' injury here, an alleged financial injury, is a product of the organization of the stock lending market, not the Prime Broker Defendants' conduct within it.

Here, the Plaintiffs have failed to establish the first requirement of antitrust standing, the injury itself. However, should an injury be found, the Plaintiffs further lack standing due to their failure to directly link the Prime Broker Defendants' actions to their injury. A broker-dealer must be the legal borrowing entity in every stock loan transaction and none of the allegedly boycotted firms had the potential to displace brokers as intermediaries in stock loans.[102] Here, however, absent from Plaintiff's complaint is an allegation that it would or could have traded anonymously on AQS in contravention of market standard had the option been available. [103] As a result, any

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[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.* at 543.

[100] *Cf.* Bill Baer, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Remarks as Prepared for Delivery to European Competition F. 2014: Pub. and Priv. Antitrust Enf't in the U.S. 2 (Feb. 11, 2014) ("Since the 19th Century, the United States has relied on a combination of federal, state and private enforcers to combat anticompetitive conduct. The idea has always been that these three enforcers should play different, yet complementary, roles. Federal and state competition law enforcers have similar missions: both protect the public from the harms flowing from anticompetitive conduct. But federal enforcement seeks to protect the interests of all consumers across the nation, while state enforcers understandably focus their efforts on the consumers in their respective states. Similarly, private enforcers act on behalf of the specific concerns of their clients, usually seeking damages for any antitrust harms that have been inflicted.").

[101] John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, not Increasing Efficiency*, 84 NOTRE DAME L. REV.191, 192 (2008) ("When conduct presents a conflict between protecting consumers and promoting the efficiency of the economy (e.g., a merger that raises prices but reduces costs), no court in recent years has chosen efficiency over consumer protection.").

[102] Clapper v. Amnesty Int'l USA, 568 U.S. 398, 409 (2013).

[103] *See generally,* Amended Complaint, *supra* note 56.

alleged injury is not "fairly traceable" to Defendants' conduct as required to confer Article III standing."[104]

2. Plaintiffs Do Not Meet the Efficient Enforcer Test

In addition to requiring a viable injury, the court must determine whether a physical and economic nexus exists between the violation and the harm to the plaintiffs.[105] In order to do so, the court considers "(1) 'the directness or indirectness of the asserted injury'; (2) 'the existence of an identifiable class of persons whose self-interest would normally motivate them to vindicate the public interest in antitrust enforcement'; (3) the speculative nature of the alleged injury; and (4) the difficulty of identifying damages and apportioning them among direct and indirect victims so as to avoid duplicative recoveries."[106] These four factors, also "referred to as the 'efficient enforcer' factors—may 'indicate that a party who states an antitrust injury is nevertheless not a proper antitrust plaintiff.'"[107] The weight given to the factors varies from case to case and is within the discretion of the judge to determine.[108]

Generally, consumers and competitors of the violator are presumptively granted standing.[109] Here, however, although IPERS is a consumer in the stock lending market, standing should be denied. First and foremost, the Plaintiffs here have suffered no injury. The Plaintiffs brought their claims under Section 1 of the Sherman Act in which they allege a per se violation through conspiracy by the Prime Broker Defendants.[110] The Plaintiffs here satisfy the second requirement of standing as they are the appropriate plaintiffs. The retirement associations have a fiduciary relationship with those to whom they provide retirement benefits.[111] Furthermore, the Plaintiffs experience a direct injury and can be considered the more efficient enforcer of the injury than the individual investors.[112]

Additionally, Plaintiff Torus Capital, LLC is a direct market participant and therefore the most appropriate plaintiff to bring a cause of action against the Prime Broker Defendants. The third requirement for standing, the speculative nature of the alleged injury, becomes moot as, again, the Plaintiffs have failed to establish an injury.[113] Even if the court reaches the third prong of a standing analysis, the Plaintiffs'

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[104] *Id.*

[105] Paycom Billing Servs., Inc. v. Mastercard Int'l, Inc., 467 F.3d 283, 290–91 (2d Cir. 2006).

[106] *Id.* at 290–91.

[107] *Id.* at 290.

[108] *Id.* at 291.

[109] HOVENKAMP, *supra* note 94, at 544.

[110] *See supra* Part 3.A.1.

[111] *In re* Credit Default Swaps Antitrust Litig., No. 13md2476 (DLC), 2016 WL 2731524, at *16 (S.D.N.Y. April 26, 2016).

[112] HOVENKAMP, *supra* note 94, at 541. "The 'direct injury' test originated in *Loeb v. Eastman Kodak Co.* [There,] [t]he court denied standing to a stockholder in a corporation allegedly victimized by antitrust violations."

[113] *See supra* Part 3.A.1.

injury is purely speculative because Plaintiffs could not plead monetary damages flowing from any alleged conspiracy, or even prove that an electronic market would likely create a more efficient market with a smaller spread; it is possible, for example, that a transparent market would expose risk-averse buyers to greater risks, driving spreads higher. Finally, should the court find sufficient injury to allow standing, the fourth requirement will prove to be a barrier for the Plaintiffs.

Here, damages would have to be appropriately apportioned between the direct victims, the retirement associations, and the indirect victims, the pension holders.[114] Furthermore, if appropriate apportionment was possible, there still remains the issue of determining the actual amount of damage—an almost impossible task.

Even if the OTC market was electronically regulated, there is no way to know how exactly the profits of the Prime Broker Defendants would change, and additionally, how much of that money would be passed onto consumers. Electronic regulation of the market does not guarantee a decrease in profits for the Prime Broker Defendants, it only guarantees an electronically regulated, and slightly more transparent market. Neither of those factors alone, give certainty to the Plaintiff's claims that they would be in a better financial position because of it and therefore deserve speculative damages.

B. Plaintiffs Fail to Plead Facts Supporting a Section 1 Violation

1. Pleading Standard

The Federal Rules of Civil Procedure require a complaint to provide a "short and plain statement of the claim showing that the pleader is entitled to relief . . . ."[115] The purpose of the short and plain statement requirement is "to give the defendant fair notice of what the claim is" against them and "the grounds upon which it rests."[116] Under *Bell Atlantic Corp. v. Twombly*[117] and *Ashcroft v. Iqbal*,[118] a complaint "must include 'enough facts to state a claim to relief that is plausible on its face.'"[119] For a claim has "'facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'"[120]

"A plaintiff's job at the pleading stage, in order to overcome a motion to dismiss, is to allege enough facts to support the inference that a conspiracy actually existed."[121] Conspiracy can be shown by circumstantial facts, but those facts must be more than

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[114] In addition to the difficulty of apportioning damages between the retirement associations and the pension holders, it will also prove difficult to properly apportion the damages to those within the group of injured pension holders. The uncertainty of fixed rates make the allocation of damages more of a guessing game than a realistic venture.

[115] Keiler v. Harlequin Enters. Ltd., 751 F.3d 64, 70 (2d Cir. 2014).

[116] *Id.*

[117] 550 U.S. 544, 570 (2007).

[118] 556 U.S. 662, 678 (2009).

[119] Wilson v. Dantas, 746 F.3d 530, 535 (2d Cir. 2014) (quoting *Bell Atl. Corp.*, 550 U.S. at 570).

[120] *See id.* (quoting *Ashcroft*, 556 U.S. at 678).

[121] Mayor & City Council of Balt., Md. v. Citigroup, Inc., 709 F.3d 129, 136 (2d Cir. 2013).

speculation or threadbare recitals of the legal elements of the claim.[122] If a complaint pleads parallel acts between actors, courts require plaintiffs to prove what are known as "plus factors" to establish a plausible conspiracy.[123] The "plus factors" include "a common motive to conspire, evidence that shows that the parallel acts were against the apparent individual economic self-interest of the alleged conspirators, and evidence of a high level of interfirm communications."[124]

2. Vertical and Horizontal Restraint

When analyzing a claim of conspiracy, both the vertical and horizontal restraint on trade are considered.[125] The vertical restraint considers conspiracy between parent companies and their subsidiaries, whereas horizontal restraint looks at conspiracy between two or more independent companies.[126] Historically, the court has "recognized two exceptions to the application of Section 1 of the Sherman Act that allowed many distribution restraints to escape antitrust scrutiny."[127] First, in *United States v. Colgate*, the Court made clear that the Sherman Act does not restrict companies from unilaterally deciding to refuse to do business with anyone.[128] Furthermore, *United States v. General Electric Co.*[129] held that a patent holder can lawfully fix the price at which a license holder of the patent may sell the product under a bona fide consignment. More recently, the Court decided the standard under which vertical agreements should be judged. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the Court held that vertical restraints are no longer per se illegal and that they are to be judged by the rule of reason.[130]

The rule of reason "is in contrast to antitrust's 'per se' rule, in which power generally need not be proven and anticompetitive effects are largely inferred from the conduct itself."[131] Claims reviewed under a rule of reason standard require the plaintiff to plead four elements: "(1) the existence of a conspiracy; (2) the intention on the part of the co-conspirators to harm or restrain competition; (3) actual injury to competition; and (4) that the plaintiffs suffered 'antitrust injury' as a result" of the conspiracy.[132] In

[122] *See id.*

[123] *Id.*; *see also* Apex Oil Co. v. DiMauro, 822 F.2d 246, 253 (2d Cir. 1987).

[124] *Citigroup, Inc.*, 709 F.3d at 136 (citations omitted).

[125] *See* LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK, 317–19 (2d ed. 2006).

[126] *See id.* at 185–86.

[127] *Id.* at 374.

[128] United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[129] United States v. Gen. Elec. Co., 272 U.S. 476, 489 (1926).

[130] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 882 (2007).

[131] Herbert J. Hovenkamp, *The Rule of Reason*, n.2 U. PA. SCHOLARLY REPOSITORY, No. 7-17. [hereinafter "Hovenkamp, *Rule of Reason*"].

[132] Bay Area Surgical Mgmt. LLC v. Aetna Life Ins. Co., 166 F. Supp. 3d 988, 994 (N.D. Ca. 2015) (quoting Brantley v. NBC Universal, Inc., 675 F.3d 1192, 1197 (9th Cir.2012)).

addition to these four elements, plaintiffs must also prove that defendants held enough market power to have made their alleged anticompetitive conduct unreasonable."[133]

The rule of reason is designed to allow the markets to be competitive and fluid by raising the bar for conspiracy claims. In essence, the rule of reason allows for some conduct that is competitive but might look conspiratorial to the skeptical or threatened Plaintiff's eye, to be considered in a more nuanced, in-depth analysis by courts. For example, the rule of reason takes anticompetitive conduct that is not categorically analyzed through a per-se lens and allows …conduct that might seem conspiratorial to the person being edged out of the market, may merely be the parallel action of competitors who, realizing the market is changing, are taking prudent steps to ensure that their business evolves to compete with modern expectations. Thus, the rule of reason instills a flexibility into antitrust law, allowing markets to grow and evolve on their own. Without the rule of reason, the strictures of antitrust law would stifle the markets and deaden competitive growth by incentivizing the status quo.

In the case here, twenty-seven defendants make up the Prime Broker Defendants. In *Copperweld*, "the Supreme Court established that a parent corporation and its wholly owned subsidiary are legally incapable of conspiring with each other under Section 1 of the Sherman Act."[134] Furthermore, the Fourth Circuit has held, "that two subsidiaries wholly owned by the same parent corporation are legally incapable of conspiring with one another for purposes of Section 1 of the Sherman Act."[135]

After applying the limitations of conspiracy as set forth by the courts, the Plaintiffs are left with only seven Prime Broker Defendants 'units'.[136] Although the possibility of conspiracy among Prime Broker Defendants and other named defendants, which are not wholly owned subsidiaries, still remains, the magnitude of the alleged conspiracy considerably lessens in scope when twenty named defendants are no longer considered to be direct participants in the conspiracy.

Furthermore, the Prime Broker Defendants are not engaging in conspiracy, but simply parallel action. "Even 'conscious parallelism,' a common reaction of 'firms in a concentrated market [that] recogniz[e] their shared economic interests and their interdependence with respect to price and output decisions' is 'not in itself unlawful.'"[137] Additionally, "[w]hile parallel pricing suggests interdependence of behavior, parallel failure to move into new markets ordinarily does not."[138]

In order to prove horizontal conspiracy, the Plaintiffs must establish that the Prime Broker Defendants had specific intent and "at least one overt act in furtherance of the

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[133] Hovenkamp, *supra* note 131, at 83.

[134] Adv. Health-Care Servs., Inc. v. Radford Cmty. Hosp., 910 F.2d 139, 145–46 (4th Cir. 1990) (quoting Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 768 (1984)).

[135] *Id.* at 146 (collecting cases reaching similar conclusions).

[136] The Plaintiffs acknowledge the relationships between the parents and subsidiaries when they group the Prime Broker Defendants by entity in their complaint for purposes of ease of explanation. However, they should be grouped in the same manner for the purposes of bringing the cause of action as well.

[137] Bell Atl. Corp. v. Twombly, 550 U.S. 544, 553–54 (2007) (quoting Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 227 (1993)).

[138] Hovenkamp, *supra* note 131, at 88.

conspiracy."[139] Specific intent is the essence of the offense of conspiracy and was absent from the Plaintiffs' claim. The Plaintiffs simply stated the actions taken by the Prime Broker Defendants but have not proved the reasons for their actions as a whole.[140] Furthermore, although intent can be inferred from the degree of coordinated action, the Plaintiffs here have failed to allege the coordinated action itself. Where the Plaintiffs discuss specific instances of individual Prime Broker Defendants acting in possible violation of antitrust laws, they have failed to show that the intent to act was shared by all named defendants, and that the conduct of the Prime Broker Defendants was more than simply parallel conduct.[141]

3. IPERS Arguments

Here, the Plaintiffs did not plead facts sufficient to link the Prime Broker Defendants to the 'dark pool' conspiracy of the stock loan market. The Plaintiffs meticulously described conduct of each independent Defendant but failed to connect their actions in a conspiracy. The complaint filed by the Plaintiffs stresses the formation of EquiLend as a response to the evolution in OTC markets, specifically the stock lending market, and the need for the Prime Broker Defendants to prevent the market from entering an electronic age.[142] The Plaintiffs further argue that the Prime Broker Defendants used EquiLend to further their conspiratorial goals of retaining control in the stock loan market.[143] However, the Plaintiffs gloss over the fact that EquiLend was formed in 2001 – before the relevant period of their claim and even before the financial crisis of 2008. Each Prime Broker Defendant undoubtedly possesses some foresight, but Plaintiffs' complaint would turn that foresight into clairvoyance, claiming that the Prime Broker Defendants formed EquiLend in 2001 just to protect their interests in the stock lending market in 2017.

The Plaintiffs here also fail to mention that the evolution of stock lending and the introduction of electronic platforms to facilitate stock lending transactions, have been a conversation amongst industry leaders since at least 2009.[144] In fact, in 2009 the majority of stock loan transactions were conducted on electronic platforms.[145] The stock lending market has already evolved into what the Plaintiffs desire, and it happened without the threats of litigation. It is again simply the Prime Broker Defendants' connection with the existing electronic platforms that the Plaintiffs take issue with. Unfortunately for the Plaintiffs, the courtroom is not the appropriate venue to bring those concerns.

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[139] United States v. Washington, 715 F.3d 975, 980 (6th Cir. 2013).

[140] Amended Complaint, *supra* note 56, at 107–08.

[141] *See generally* HERBERT HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW, 373–78 (1985).

[142] *See generally* Amended Complaint, *supra* note 56, at 107.

[143] *Id.* at 131.

[144] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 136.

[145] *Id.*

CONCLUSION

The nature of the stock lending market makes it vulnerable to litigation. The absence of real time information available to buyers and sellers, as well as the need for broker involvement in every transaction, encourages plaintiffs to come forward with claims of conspiracy should their transaction go any way but seamlessly. The constant threat of lawsuits hampers the efficiency of market participants and inevitably fosters a culture in which no progress can be made. If the Prime Broker Defendants, among other market participants, must meticulously assess the risks of potential litigation for every transaction they conduct, in addition to the financial risks, the stock lending market will generate lengthy and inefficient transactions.

In order to ensure an efficient market, while at the same time comply with SEC regulations that prohibit naked stock lending, Congress should protect the stock lending market.[146] The overall takeaway from the Plaintiffs' complaint analyzed by this Article is the issue with the structure of the market itself, not the Prime Broker Defendants' conduct within it. The Plaintiffs here took issue with the lack of transparency within the stock lending market and insist that an electronic platform, run independently of the Prime Broker Defendants, is the ultimate solution. The Plaintiffs bringing the IPERS claim obtained what they sought, an electronic platform on which to facilitate stock loan transactions. Plaintiffs true issue is with the Prime Broker Defendants involvement in running that platform.

For years before this complaint was filed, the financial industry generally agreed that further automation of the stock lending market would be beneficial.[147] Realizing this, the market and its participants responded to the needs of the Plaintiffs, and the industry in general, on their own and without the need for litigation. It is not for the courts to decide the method by which the market organizes itself, only if the participants within the market are acting in accordance with the law and regulations. The remedy sought by the Plaintiffs—a change in the organizational structure of OTC markets—is legislative, not judicial, and certainly not a matter of antitrust law.

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[146] This should apply to other OTC markets with the same susceptibility to litigation, such as the credit default swap market.

[147] TRANSCRIPT OF SECURITIES LENDING AND SHORT SALE ROUNDTABLE, *supra* note 9, at 132.