

ABA BUSINESS LAW SECTION  
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Civil Litigation Developments: Class Actions Alleging Manipulation

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The methods of “manipulation are limited only by the ingenuity of man.”<sup>2</sup> In 1974, the Commodity Exchange Act (CEA) was radically amended because of perceived widespread manipulative and other abuses. The Commodity Exchange Authority was replaced by the Commodity Futures Trading Commission (CFTC), the regulatory agency instrumental in combating market manipulators.<sup>3</sup> The CFTC, however, does not pursue litigation to compensate individuals and organizations harmed by market manipulators’ uneconomic trading practices. The class action device has developed as the best tool to cast a wide net and provide a remedy at law for the majority of the victims of market manipulation. Below is a summary of some of the most recent and ongoing class action litigation in this regard.

**1. *In re: Amaranth Natural Gas Commodities Litigation***<sup>4</sup>

Greenwich, Connecticut-based Amaranth, once valued at \$9.3 billion, collapsed after losing more than \$6 billion in poorly made bets in the natural gas sector over the course of a few days in September 2006. Plaintiffs first sued Amaranth in July 2007, alleging that the hedge

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<sup>2</sup> *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir.1971).

<sup>3</sup> See Markham, Jerry W., *Commodities Regulation: Fraud, Manipulation & Other Claims* § 16:1 (2005).

<sup>4</sup> The author’s firm, Louis F. Burke P.C., is co-lead counsel for plaintiffs along with two other firms.

fund exploited its influence in order to drive up prices on natural gas futures in violation of sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act (CEA). Plaintiffs alleged that at one point Amaranth held as many as 100,000 natural gas futures contracts, which represented 5 percent of the natural gas used in the U.S. in one year. Amaranth argued that merely buying and selling large contracts was not market manipulation.<sup>5</sup>

In a rare twist, the court recently granted plaintiffs' motion seeking a prejudgment attachment of \$72.4 million against a master fund entity (Amaranth LLC) associated with Amaranth.<sup>6</sup> The Amaranth master fund had sought to distribute the \$72.4 million to its feeder fund investors (including offshore entities) and also to its former employees as deferred compensation. Plaintiffs argued that if the money were distributed, plaintiffs would likely be unable to collect any final judgment won in the case since the potential judgment would far exceed the approximately \$110 million that the Amaranth master fund would have had left after the proposed \$72.4 million distribution. Plaintiffs further argued that they were likely to prevail at trial on their claims given, among other things, the fact that Amaranth's head trader Brian Hunter has been found liable for market manipulation by the Federal Energy Regulatory Commission in a proceeding that was premised on some of the same trading that underlies the Amaranth class action. The Amaranth master fund argued that plaintiffs should not be granted attachment because they were unlikely to prevail on their CEA Section 2(a)(1) agency claims against the Amaranth master fund because (defendant argued) Amaranth's trading advisor entity was not its agent. Under the court's ruling, Amaranth LLC will be prohibited from distributing the \$72.4 million in question during the pendency of the class action.

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<sup>5</sup> See *In re Amaranth Natural Gas Commodities Litigation*, No. 07-Civ.-6377(SAS), (S.D.N.Y. filed July 12, 2007).

<sup>6</sup> See *In re Amaranth Natural Gas Commodities Litigation*, 711 F.Supp.2d 301 (S.D.N.Y. 2010).

On September 28, 2010, Judge Shira A. Scheindlin issued an opinion certifying a class consisting of persons who purchased New York Mercantile Exchange natural gas futures contracts, which had certain expiration dates and fulfilled other criteria, between Feb. 16, 2006, and Sept. 28, 2006.<sup>7</sup> The certified class includes more than 1,000 potential claimants.

Amaranth claimed that the proposed class was impractical because it would be too difficult for the court to ascertain whether potential members had net short or long positions, as required by the class definition, but the judge ruled that would not be a problem. “Although plaintiffs’ proposed class is more complex than others previously certified by courts in commodities actions, it is not so complex as to prevent certification,” Scheindlin wrote. “Although it will require some complex math, whether a proposed class member held a net long or short position on a particular contract can be determined objectively through mechanical calculation.”

While Amaranth argued that the proposed class representatives failed to provide evidence of injury and therefore lack standing, the judge noted that plaintiffs are not required to prove they suffered an injury at the class certification stage. For the purposes of certification, Scheindlin ruled that plaintiffs adduced sufficient evidence that they suffered a net loss. The judge also ruled that the class is sufficiently numerous to warrant certification, and that the class members will all make similar legal arguments about their claims.

Defendants have indicated that a Rule 23(f) appeal filing is likely. The parties continue to conduct discovery on the merits.

## **2. *Hershey v. Energy Transfer Partners***

On June 23, 2010 the Fifth Circuit issued an opinion in *Hershey v. Energy Transfer*

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<sup>7</sup> *In re Amaranth Natural Gas Commodities Litigation*, 269 F.R.D. 366 (S.D.N.Y. 2010).

*Partners, L.P.*<sup>8</sup> upholding the dismissal of a class action lawsuit against Energy Transfer Partners (ETP) that had alleged market manipulation based on investigations by FERC and the CFTC. Plaintiffs, who had purchased and lost money on NYMEX natural gas futures contracts, brought a private right of action against ETP under the CEA alleging market manipulation based on the FERC and CFTC investigations into ETP trading at the Houston Ship Channel (HSC). A federal district court dismissed the case in favor of ETP, and the Fifth Circuit upheld.

The court ruled that in order to prevail on a private right of action under the CEA, the plaintiff must prove specific intent to manipulate, *i.e.*, that the defendant acted with the purpose or conscious object of influencing prices. The court also stated that the plaintiff must show that the defendant specifically intended to manipulate the commodity underlying the NYMEX natural gas futures contract, which is natural gas delivered at the Henry Hub. The court held that plaintiffs' attempt to tie ETP's manipulation of HSC prices to the price of Henry Hub natural gas and NYMEX futures prices by arguing that manipulation of gas prices at HSC would result in the artificial suppression of the prices of NYMEX futures was without merit. The court explained that under a specific intent standard, ETP must have specifically intended to impact the NYMEX natural gas futures market; mere knowledge is not enough to state a claim under the CEA.

**3. *Anderson v. Dairy Farmers of America, Inc.***

Plaintiffs brought this action against defendant Dairy Farmers of America, Inc. (DFA), alleging that DFA violated Section 9 of the CEA by manipulating prices for cheese and Class III

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<sup>8</sup> 610 F.3d 239 (5th Cir. 2010).

milk futures on the Chicago Mercantile Exchange (“CME”).<sup>9</sup> DFA argued that its purchases of cheese were part of legitimate supply and demand as a matter of law, and as a result, DFA asserted that no artificial prices for cheese or class III milk existed. In particular, DFA argued that federal courts and the CFTC have “held that market participants may legally purchase more of a commodity than needed to fill customer orders or at apparently higher than necessary prices.” The court rejected DFA’s argument citing to *In re Henner* in which the CFTC held that “[w]henver a buyer on the Exchange intentionally pays more than he has to for the purpose of causing the quoted price to be higher than it would otherwise have been ..., the resultant price is an artificial price not determined by the free forces of supply and demand on the exchange.”<sup>10</sup>

The court found that the plaintiffs alleged and adduced evidence that DFA purchased cheese on the Cheese Spot Call to prop up Class III milk futures prices to enable DFA to liquidate its long Class III milk futures position at a profit, and plaintiffs alleged that those actions did not constitute legitimate forces of supply and demand. Because plaintiffs’ factual allegations and the record demonstrated a genuine dispute of fact as to plaintiffs’ CEA manipulation claims, the court denied DFA’s motion for summary judgment.

#### **4. *In re Western States Wholesale Natural Gas Antitrust Litigation***

These cases are part of a consolidated Multidistrict Litigation arising out of the energy crisis of 2000-2001. Plaintiffs alleged that defendants conspired to engage in anti-competitive activities with the intent to manipulate and artificially increase the price of natural gas for consumers. Specifically, plaintiffs alleged that defendants, directly and through their affiliates,

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<sup>9</sup> See *Anderson v. Dairy Farmers of America, Inc.*, No. 08-4726, 2010 WL 3893601 (D. Minn. Sept. 30, 2010).

<sup>10</sup> *In re Henner*, 30 Agric.Dec. 1151, 1198 (1971).

conspired to manipulate the natural gas market by knowingly delivering false reports concerning trade information to trade indices, engaging in wash trades, and churning, which conduct violated various state and federal laws, including antitrust laws. The United States District Court for the District of Nevada granted defendant providers' motions to dismiss.<sup>11</sup> Plaintiff consumers appealed. The Court of Appeals for the Ninth Circuit reversed and remanded.<sup>12</sup>

Back before the District Court defendants moved for judgment on the pleadings, arguing that plaintiffs' federal and state antitrust claims and their state unfair competition claims are barred by the doctrine of implied antitrust immunity. Defendants relied upon the test set forth in *Credit Suisse Securities (USA) LLC v. Billing*<sup>13</sup> to argue that applying antitrust laws to defendants' alleged conduct would be incompatible with the CEA because evidence of unlawful activity would overlap with evidence of lawful activity, such cases would involve complex legal line drawing which should be done by an expert agency and not by non-expert judges and juries, and the CEA provides for limited remedies for violations of the Act which should not be circumvented through antitrust actions.

Plaintiffs responded that the CEA does not expressly provide for antitrust immunity, and the CEA contains a savings clause which preserves antitrust claims. According to plaintiffs, the legislative history demonstrates Congress intended the antitrust laws to apply. As to the *Credit Suisse* test, plaintiffs argue the test was developed under the securities laws and does not extend to the CEA. Plaintiffs also argued that even if *Credit Suisse* applied, there is no incompatibility between the CEA and antitrust laws because the CEA always bars collusive intentional price

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<sup>11</sup> *In re Western States Wholesale Natural Gas Antitrust Litigation*, 408 F.Supp.2d 1055 (D. Nev. 2005).

<sup>12</sup> *In re Western States Wholesale Natural Gas Antitrust Litigation*, 243 Fed.Appx. 328 (9<sup>th</sup> Cir. 2007).

<sup>13</sup> 551 U.S. 264, 127 S.Ct. 2383, 168 L.Ed.2d 145 (2007).

manipulation, as Plaintiffs alleged. Plaintiffs also argued that *Credit Suisse* does not apply to state law antitrust or unfair competition claims. The District Court held that natural gas providers were not entitled to “implied antitrust immunity” from consumers’ antitrust and unfair competition claims. The Court therefore denied defendants’ motion for judgment on the pleadings.<sup>14</sup>

**5. *Kohen v. Pacific Inv. Management Co. LLC***<sup>15</sup>

This is a class action brought by plaintiffs on behalf of purchasers of the June 2005 Ten-Year Treasury note futures contract (“June Contract”). Plaintiffs alleged that defendants manipulated and aided and abetted the manipulation of prices of the June Contract and the cheapest-to-deliver (“CTD”) Treasury note underlying the June Contract in violation of §§ 9(a), 22(a) and 22(a)(1) of the CEA.<sup>16</sup>

A federal appeals court rejected Pacific Investment Management Co.’s attempt to block some investors from suing the world’s largest bond fund manager for trying to corner a market for U.S. Treasury note futures. More than 1,000 investors who said they lost more than \$600 million because of Pimco’s actions had been certified as a class by a lower court in 2007. A panel of the U.S. Seventh Circuit Court of Appeals in Chicago, in an opinion by Judge Richard Posner, declined to reverse the ruling.

The lawsuit accused Pimco of boosting its percentage stake in futures contracts on some 10-year Treasury notes to 42 percent from 12 percent over a two-week span in the spring of

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<sup>14</sup> *In re Western States Wholesale Natural Gas Antitrust Litigation* 661 F.Supp.2d 1172 (D. Nev. 2009).

<sup>15</sup> The author’s firm, Louis F. Burke P.C., is co-counsel for plaintiffs in this case.

<sup>16</sup> *Kohen v. Pacific Inv. Management Co. LLC*, 1:05-cv-04681(RAG) (N.D. Ill. filed Aug. 16, 2005).

2005. Investors who bet the notes' price would fall complained that Pimco's actions instead drove the price higher, forcing them to pay a "monopoly price" to cover their short positions.

Pimco argued that class-action status should not have been granted because the class included some investors who did not lose money, and because of potential conflicts of interest among class members who might have suffered differing losses over different periods. The appeals court disagreed. "Although some of the class members probably were net gainers from the alleged manipulation, there is no reason at this stage to believe that many were," Posner wrote. He added that it was premature to deny class-action status "because of a potential conflict of interest that may not become actual."<sup>17</sup>

#### **6. *In Re: Platinum and Palladium Commodities Litigation***<sup>18</sup>

Plaintiffs filed the first of several putative class action complaints following the CFTC's announcement of a settlement with certain defendants relating to attempted manipulation of settlement prices of palladium and platinum futures contracts in late 2007 and early 2008.<sup>19</sup> Plaintiffs subsequently filed a consolidated amended complaint in the Platinum/Palladium Futures Action (the now-filed "Futures Complaint") and in the Platinum/Palladium Physical Action (the now-filed "Physical Complaint").<sup>20</sup>

The Futures Complaint purports to assert on behalf of a putative class of buyers of platinum and palladium futures contracts traded on the New York Mercantile Exchange

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<sup>17</sup> See *Kohen v. Pacific Investment Management Co. LLC*, 571 F.3d 672, 678 (7<sup>th</sup> Cir. 2009); see also Jonathan Stempel, *Pimco Fails to Block Suit Squeeze*, Reuters, July 7, 2009, available at <http://uk.reuters.com/article/idUKN0733371120090707>.

<sup>18</sup> The author's firm, Louis F. Burke P.C., filed a complaint in this action.

<sup>19</sup> See *In the Matter of Moore Capital Management, LP, Moore Capital Advisors, LLC and Moore Advisors, Ltd.*, CFTC Docket No. 10-09 (April 29, 2010).

<sup>20</sup> See *In re: Platinum and Palladium Commodities Litigation*, No. 10-Civ.3617(WHP) (S.D.N.Y. filed April 30, 2010)

(“NYMEX”): (1) a manipulation claim under the CEA; and (2) secondary liability claims of aiding and abetting and control person under the CEA. The Futures Complaint rests on the multi-step theory that defendants actually manipulated settlement prices of platinum and palladium futures by creating artificial prices through frequent, large open market purchases of platinum and palladium futures contracts during the two-minute settlement period at the end of certain NYMEX trading days. In turn, the allegedly artificial settlement prices are said to have sent a false “price beacon signal” to the market that caused all other market participants to buy or sell futures contracts at artificially inflated futures contract prices at all times on all days throughout the “Class Period.”

The Physical Complaint extends the Futures Complaint’s theory even further by alleging that higher futures contract prices caused artificial prices in the markets for physical platinum and palladium. The Physical plaintiffs claim that the price manipulation in the physical market was the product of an agreement in restraint of trade that supposedly violates both the antitrust laws and the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et. seq.* (“RICO”) statute. The Physical plaintiffs allege that they suffered damages from: (1) the defendants’ purported violations of the Sherman and Clayton Acts through an illegal agreement among themselves to fix prices in a market for physical platinum and palladium, and (2) defendants’ purported civil RICO violations through a pattern of racketeering activity that included mail fraud, wire fraud, money laundering and interstate transport of stolen property.

Defendants countered that plaintiffs fail to make out the elements of the claims that are asserted and, significantly, fail to allege any improper economic benefit derived from the trading at issue. At bottom, defendants argue, plaintiffs seek to transform arms-length transactions

executed in the open market at prevailing market prices, into the grist for a grandiose and wholly unsubstantiated set of private CEA, antitrust and RICO violations.

**7. In Re: Commodity Exchange, Inc., Silver Futures and Options Trading Litigation<sup>21</sup>**

JP Morgan Chase & Co. and HSBC Securities Inc. face charges of manipulating the market for silver futures and options in violation of federal commodities and racketeering laws, according to a group of lawsuits filed in the U.S. District Court for the Southern District of New York.<sup>22</sup> The suits – which allege violations of the Commodity Exchange Act and the Racketeering Influenced and Corrupt Organizations (RICO) Act – allege that the two banks colluded to manipulate the market for silver futures starting in the first half of 2008 by amassing huge short positions in silver futures contracts they had no intent to fill, but did so to force silver prices down to their benefit.

According to the complaint, JP Morgan amassed a sizeable short position in silver futures and options in part through its March 2008 acquisition of investment bank Bear Stearns. By August 2008, JP Morgan and London-based HSBC controlled more than 85 percent of the commercial net short position in silver futures contracts. The suit alleges that, starting in early 2008, the two banks began manipulating the silver futures market by accumulating unusually large “short” positions and then secretly coordinating enormous sales of silver futures contracts on the Commodity Exchange, which is known as “COMEX” and is part of the New York Mercantile Exchange. JP Morgan and HSBC used a variety of methods to coordinate their manipulation of the market for silver futures contracts, signaling when to flood the COMEX market with short positions, which caused the price of silver futures and options contracts to

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<sup>21</sup> The author’s firm, Louis F. Burke P.C., has filed a complaint in this action.

<sup>22</sup> See e.g. *Blackbriar Holdings, LLC v. JP Morgan Chase & Co. et al*, No. 10-cv-08254-RPP (S.D.N.Y. filed Nov. 1, 2010).

crash. The suit describes two “crash” events that were set in motion by JP Morgan and HSBC, one in March 2008, and the other in February 2010, after defendants had amassed large short positions. In the wake of both events, the suit alleges, COMEX silver futures prices collapsed.

The complaint also contains allegations that in September 2008, the CFTC launched an investigation that would eventually consider allegations made by a London-based independent metals trader named Andrew Maguire that the silver futures market was being manipulated. The complaint alleges that Maguire disclosed to the CFTC on Feb. 3, 2010 that he received a signal from the two banks of their intent to drive down the prices of silver futures two days later, on Feb. 5, 2010. Maguire’s information was correct and the price of silver dropped dramatically between Feb. 3, 2010 and Feb. 5, 2010.

In addition, the lawsuit states that both JP Morgan and HSBC still maintain highly concentrated holdings in short positions in silver futures and options, giving both banks the ability to continue manipulating the price of silver.

Plaintiffs’ attorneys have asked the court to certify the case as a class action and enjoin JP Morgan and HSBC from continuing their alleged conspiracy and manipulation of the silver futures and options contracts market.

### **CONCLUSION**

Proving manipulation under current law is so onerous as to be almost impossible. Under current law, plaintiffs are required to prove “specific intent” to create an artificial price—a price not responsive to the forces of supply and demand. Plaintiffs also have to prove that the alleged violator had sufficient market control to be able to manipulate, and that the conduct actually caused the artificial prices. It is a very tough standard. Specific intent to manipulate is not always equivalent to intent to deceive—it requires something more, and it’s also very difficult to

prove the existence of an “artificial price.” All in all, it makes for a very difficult legal burden, not to mention that it leaves a lot of wiggle room for mischief that is clearly prohibited by the Act.<sup>23</sup>

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<sup>23</sup> See Bart Chilton, Commissioner, Commodity Futures Trading Commission, Address at the Argus Media Summit (Oct. 21, 2009), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerBartChilton/opachilton-28.html>.