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ANTITRUST

Securities Regulation and the Antitrust Laws: Navigating the Law Enforcement Schemes

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Many otherwise skilled and able lawyers believe that the securities and antitrust laws are wholly separate professional disciplines. It is true that advising clients on shelf registrations or Rule 144A offerings is a different skill set than advising clients on matters such as vertical integration or franchise terminations. Nonetheless, these complex regulatory arrangements can and do overlap, as recent and ongoing jurisprudence in the Second Circuit makes clear.

The Law of Implied Immunity. "Antitrust is as deeply imbedded in the American scene as baseball, bourbon whiskey, and aspirin. It is the principal—to some extent the only—structure of our economy."[1] As such, it is a basic axiom of our system of commerce that violations of the antitrust laws—e.g., price fixing—are serious offenses, with criminal and civil ramifications. And this is true in heavily regulated industries such as the securities industry, as well—except where it is not.

Under the doctrine of implied immunity, conduct impermissible under the antitrust laws may be nonactionable if the regulatory prerogative(s) of the Securities and Exchange Commission have been (are or could be) put at issue. Implied immunity from the antitrust laws is generally disfavored, however, with courts invoking the doctrine "[o]nly when there is plain repugnancy between the antitrust and regulatory provisions."[2] The mere overlap of the two is not enough, by itself; at the same time, the "repugnancy" at issue can be actual as well as potential.[3] As set forth by the Second Circuit,

"There are two narrowly-defined situations in which 'repeal' of the Sherman Act will be inferred: first, when an agency, acting pursuant to a specific Congressional directive, actively regulates the particular conduct challenged . . . and second, when the regulatory scheme is

[1] This sentiment was espoused by Abe Fortas (prior to his elevation to the Supreme Court). *See* C. Stewart & P. Tozzi, "Enforcement in the Millennium—Back to the Future," *BNA Mergers & Acquisitions Law Report* Vol. 4, p. 222 (Feb. 26, 2001).

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[2] *Finnegan v. Campeau Corp.*, 915 F.2d 824, 828 (2d Cir. 1990).

[3] *Strobel v. New York Mercantile Exchange*, 768 F.2d 22, 27 (2d Cir. 1985).

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so pervasive that Congress must be assumed to have forsworn the paradigm of competition.''[4]

Implied Immunity in the Second Circuit. Building upon U. S. Supreme Court precedent,[5] the Second Circuit has frequently been called to pass on when and where the implied immunity doctrine is applicable in various situations involving (possibly) conflicting laws. In *Strobel v. New York Mercantile Exchange*,[6] for example, the court ruled in 1985 that there was no implied immunity where the plaintiff sued under both the Commodity Exchange Act and the antitrust laws. Rejecting the defendants' arguments that antitrust treble damages could not be awarded, the court ruled there was no conflict between the two sets of laws since ''price manipulation is an evil that is always forbidden under every circumstance by both [sets of laws].''[7] In so emphasizing the ''always'' and ''every,'' the court contrasted the Commodity Exchange Act with the securities laws, in which the latter allows ''a little price manipulation in order to further some other statutory goal.''[8]

And in *Finnegan v. Campeau Corp.*,[9] the court subsequently ruled in favor of implied immunity. There, a direct conflict was found between the Williams Act (which permits interested parties in takeover battles to submit joint bids) and the antitrust laws (which would clearly bar such conduct). The court thus ''presumed'' that Congress did not allow collective action under the Williams Act, on the one hand, while taking away that right on the other ''by authorizing suit against such joint bidders under the antitrust laws.''[10]

The Initial Public Offering Litigations. A particular focus of the plaintiffs' securities bar of late has been on the manner in and by which underwriters/broker-dealers have been bringing to the capital markets initial public offerings of companies; the collapse of the Internet and technology ''bubbles'' has provided those zealous advocates a great deal of material with which to work. This has led to renewed interest in the implied immunity doctrine, in particular within the courts of the Second Circuit.

In August 1998, a purported class of retail investors filed suit in the Southern District of New York (*Friedman v. Salomon/Smith Barney, Inc.*)[11] against many (but certainly not all) underwriters/broker-dealers, charging that certain conduct of those firms was designed to prevent the quick resale of the I.P.O. stock (which is known as flipping). The gravamen of the antitrust claim was that the anti-flipping conduct was a price-fixing conspiracy against retail investors, to the advantage of institutional investors (which did not suffer from the alleged anti-competitive action). Assigned to Judge Buchwald, defendants moved to dismiss the complaint (as later amended), a motion that Judge Buchwald granted (in effect, twice—also denying plaintiffs' motion for reconsideration).

On December 20, 2002, the Second Circuit strongly affirmed Judge Buchwald's ruling, forcefully upholding the applicability of the implied immunity doctrine to that case. The securities law provision at issue was Section 9(a)(b) of the Securities Exchange Act of 1934, which specifically empowers the SEC to establish ''such rules and regulations'' with respect to the ''pegging, fixing, or stabilizing the price'' of any security. The plaintiffs took the position that the SEC's non-action vis-à-vis ''such rules and regulations'' meant that there was no conflict with the antitrust laws. The Second Circuit (and Judge Buchwald), however, did not agree.

Initially, the court pointed to numerous SEC studies and analyses of price stabilization practices in the IPO aftermarket over 60-plus years, noting that each time the SEC has declined to regulate price stabilization in that area. The court then took issue with the plaintiffs' use of *Strobel* because, unlike in that case, securities regulation and the antitrust laws are not in perfect sync—the SEC's mandate is to consider competition as only one of many factors in making regulatory determinations (e.g., investor protection, etc.[12]); furthermore, by the fact that Section 9(a)(b) permits certain forms of price stabilization (if authorized by the SEC), the securities laws are in obvious conflict with the antitrust laws, or could be. Finally, the court noted that the plaintiffs misread the Section 9(a)(b) and turned its meaning 180 degrees from its real meaning—viz.—the statute permits price stabilization practices not barred by the SEC, *not* that the statute bars all price stabilization practices not specifically permitted by the SEC.

The Second Circuit's decision has two immediate benefits: first, it is clearly correct; and second, it is likely to have a significant impact on important litigation now

[4] *Northeastern Telephone Co. v. AT&T*, 651 F.2d 76, 82 (2d Cir. 1981).

[5] *See Silver v. NYSE*, 373 U.S. 341, 357 (1963) (no implied immunity because the SEC—at that time—did not have power to ''review particular instances of enforcement of [NYSE] rules'' relating to competition; subsequently, Congress amended the Securities Exchange Act of 1934 to require the SEC to take competition, among other factors, into decision-making relating to rules and regulations); *Gordon v. NYSE*, 422 U.S. 659, 688-89 (1975) (implied immunity because SEC had jurisdiction over NYSE's system—then extant—of fixed commission rates); *U.S. v. NASD*, 422 U.S. 694, 729-30 (1975) (implied immunity because the Investment Company Act of 1940 empowered the SEC with respect to restricting sales and distribution of mutual funds).

[6] 768 F.2d 22 (2d Cir. 1985).

[7] *Id.* at 28.

[8] *Id.* Under both the Securities Act of 1933 (15 U.S.C. § 77b(b)) and the Securities Exchange Act of 1934 (15 U.S.C. § 78c(f)), the SEC is specifically charged to consider the ''public interest,'' in addition to ''the protection of investors, whether the action will promote efficiency, competition, and capital formation.''

[9] 915 F.2d 824 (2d Cir. 1990).

[10] *Id.* at 830.

[11] *Friedman v. Salomon/Smith Barney, Inc.*, 2000 WL 1804719 (S.D.N.Y. Dec. 8, 2000) and 2001 WL 64774 (S.D.N.Y. Jan. 23, 2001).

[12] *See supra* note 8.

Note to Readers

The editors of BNA's *Securities Regulation & Law Report* invite the submission for publication of articles of interest to practitioners.

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pending before Judge Pauley in the Southern District of New York: *In re Initial Public Offering Antitrust Litigation*.[13] That proceeding has consolidated nine antitrust actions against underwriters; the antitrust gravamen is that the IPO process and its aftermarket (i.e., the defendants' ''allocation and commission practices'') were illegally manipulated to the detriment of all those who purchased securities brought to the public between 1997 and 2000. It is the bookend of more than 1,000 class actions that have been consolidated before Judge Scheindlin: *In re Initial Public Offering Securities Litigation*.[14] The same illegal manipulation(s) are at issue, the only difference is that the alleged legal violations arise from the federal securities laws.

On the same day that the Second Circuit affirmed Judge Buchwald, the SEC (at Judge Pauley's request) submitted a memorandum amicus curiae on the applicability of the implied immunity doctrine to that case. As the SEC's memorandum makes clear, it is not even a close case.[15] The SEC, under both the Securities Act of 1933 and the Securities Exchange Act of 1934, explicitly and comprehensively regulates the offering process and firms' conduct therein. Moreover, the NASD has additional regulatory authority over, among other things, underwriter communication and compensation.[16] Furthermore, both the SEC and NASD are currently reviewing the IPO process, with an obvious eye to overhauling existing rules and regulations in this very area. That injured investors have sufficient remedies under the securities laws in the consolidated proceedings before Judge Scheindlin did not even require a footnote.

Judge Pauley heard oral argument on defendants' motions to dismiss based upon implied immunity on January 16th, and the matter is currently sub judice. Predicting the outcome of any pending litigation is always chancy. But given the Second Circuit's decision in *Friedman* (in addition to an even more recent decision to be discussed next), the logic and weight of precedent to find immunity will be very compelling.

Even the Government Sometimes Gets It Wrong. And the Second Circuit has not yet exhausted this subject. On January 9, 2003, the court upheld the dismissal of a class action against five stock exchanges, which charged that they had colluded on the spreads for equity option trades—allegedly the exchanges agreed not to list options already listed on other exchanges: *In re Stock Exchange Options Trading Antitrust Litigation*.[17]

The SEC regulates option trading on various exchanges under SEC Rule 19c-5. Notwithstanding, the SEC urged before the district court (and the Justice Department did likewise to the Second Circuit) that antitrust immunity was not necessary because the Commission had made a policy decision that the allocation of options among exchanges should be governed by free competition in the marketplace, rather than by regulation. The Second Circuit (as did the district court) rejected that position, however. Because the SEC had once regulated the process and because it could do so again in the future, the court ruled the mere fact that the SEC had chosen not to do so at present was not dispositive—an actual conflict was not required, a potential conflict was sufficient:

> ''The appropriateness of an implied repeal does not turn on whether the antitrust laws conflict with the current view of the regulatory agency; rather it turns on whether the antitrust laws conflict with an overall regulatory scheme that empowers the agency to allow conduct that the antitrust laws would prohibit.''

Conclusion. The foregoing flurry of recent judicial activity in spelling out the ins and outs of implied immunity should help provide significant guidance for potential plaintiffs and defendants (and their lawyers) as to where the lines intersect between the antitrust laws and securities regulation. Hopefully, it will also save defendants from litigating antitrust actions where their conduct is clearly overseen by the SEC and the securities laws, as well as to ensure that those in the securities industry understand that this is a narrow exception from the general rules of the competitive market by which American business is governed.

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[13] 01 Civ. 2014 (WHP) (S.D.N.Y.). The decision is likely to play an important role in another case as well. At the same time the Second Circuit has been addressing the implied immunity doctrine in the context of the IPO process, a panel recently revived a similar antitrust class action against a number of investment banks/broker-dealers: *In re Public Offering Fee Antitrust Litigation*, Nos. 01-7585, 01-9072 (2d Cir. Dec. 13, 2002). The district court had dismissed the action on the ground that the basis of the claim—IPO purchasers paid higher prices for securities because of a price-fixing conspiracy among the defendants as to their underwriting fees—was not actionable under the antitrust laws, reasoning that the fees at issue did not (and could not) affect the prices of securities (the court took judicial notice that the impact of underwriter fees is borne by the issuer alone). The Second Circuit's reversal was based upon the lower court's unjustified use of judicial notice on a Rule 12 motion, where the plaintiffs' factual allegations must be credited. That the SEC (and NASD) comprehensively regulate underwriter compensation, etc. in the IPO process does not appear to have been part of the court's consideration. Presumably, the implied immunity doctrine will be invoked in due course, and this antitrust action will likely not be sustained under Second Circuit precedent.

[14] 21 MC 92 (SAS) (S.D.N.Y.). For a greater explication of the proceedings before Judge Scheindlin, see C. Stewart, ''Underwriters' Liability: A Brief Precis,'' *Current Developments & Strategies in Securities Litigation* (Association of the Bar, City of New York April 2002).

[15] Interestingly, the Justice Department has submitted an *amicus curiae* brief to Judge Pauley, as well. The DOJ's position, however, is that this is not a case for implied immunity. That the government can be (and has been) wrong on this point of law is underscored by the Second Circuit's rejection of the position espoused by both the DOJ and the SEC in the *Stock Exchange Options Trading* case (*see infra* note 17 and accompanying text).

[16] *See*, *e.g.*, NASD Rule 2710.

[17] 01-7371, 01-7580 (2d Cir. Jan. 9, 2003), *aff'g*, 171 F. Supp. 2d 174 (S.D.N.Y. 2001).