



# SECURITIES REGULATION & LAW



## REPORT

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### ANTITRUST

## A Dangerous Intersection of the Securities and Antitrust Laws

By C. EVAN STEWART

Someone once sagely remarked that you only have to hit .300 to go to the Hall of Fame. And while I have always preferred to have a higher batting average, a recent decision by the Second Circuit will likely drop my lifetime stats for prognostication down a bit.

Nearly three years ago, I published an article in this distinguished publication wherein I sought to address the law of implied immunity;<sup>1</sup> that article purported to explain what happens when and where the antitrust laws and securities regulation (as per the U.S. Securities and Exchange Commission) intersect (i.e., when are antitrust concerns trumped by investor protection issues, if the two legal constructs are in conflict). And after tracking recent Second Circuit jurisprudence upholding the applicability of the implied immunity doctrine—particularly with respect to the securities industry,<sup>2</sup> I boldly (or foolishly) predicted what would

happen in litigation then pending before Judge William Pauley in the Southern District of New York.

**IPO Antitrust Litigation: the District Court.** Judge Pauley was faced with nine consolidated antitrust actions brought on against various securities underwriters; the gravamen of each of the cases was that the initial public offering (IPO) process and its aftermarket had been illegally manipulated to the detriment of investors who had purchased securities brought to the capital markets between 1997 and 2000. These antitrust claims were the

<sup>1</sup> See “Securities Regulation and the Antitrust Laws: Navigating the Law Enforcement Schemes,” 35 Sec. Reg. & L. Rep. (BNA) 196 (Feb. 3, 2003).

<sup>2</sup> See, e.g., *In re Stock Exchange Options Trading Antitrust Litigation*, 317 F.3d 134 (2d Cir. 2003) (implied immunity because the SEC had once regulated options listing on exchanges and because it could do so again in the future); *Friedman v.*

*Salomon/Smith Barney*, 313 F.3d 796 (2d Cir. 2002) (implied immunity because the SEC had statutory authority with respect to the “pegging, fixing, or stabilizing the price” of any security, notwithstanding that the SEC had declined to regulate price stabilization in that area); see also *Finnegan v. Campeau Corp.*, 915 F.2d 824 (2d Cir. 1990) (implied immunity where there was a direct conflict between the Williams Act and the antitrust laws); *Strobel v. New York Mercantile Exchange*, 768 F.2d 22 (2d Cir. 1985) (no implied immunity because price manipulation was forbidden under both the Commodity Exchange Act and the antitrust laws); see generally *Gordon v. NYSE*, 422 U.S. 659, 688-89 (1975) (implied immunity because the 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); *Silver v. NYSE*, 373 U.S. 341, 357, 358 n.12 (1963) (no implied immunity because the SEC—at that time—did not have the power to “review particular instances of enforcement of [NYSE] rules” relating to competition; subsequently, Congress amended the Securities Exchange Act of 1934 to take competition, among other factors, into decision-making in relation to rules and regulations).

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exact mirror image of more than 1,000 securities class actions charging illegal/fraudulent manipulation(s) in the IPO process under the federal securities laws, cases which had been consolidated before Judge Shira Scheindlin.<sup>3</sup>

Besides the fact that the exact same conduct was being prosecuted under the securities laws (and thus injured investors already had sufficient remedies thereunder), also put before Judge Pauley was the position of the Securities and Exchange Commission. The SEC opined that this was not a close case—the Commission called for the application of the implied immunity doctrine. Under both the Securities Act of 1933 and the Securities Exchange Act of 1934, the Commission told Judge Pauley that it explicitly regulates the IPO offering process, the underwriters' conduct therein, and the "various normally anticompetitive price stabilization techniques" used in that market;<sup>4</sup> in addition, the NASD has further regulatory authority over, among things, underwriter communications and compensation (classic antitrust concerns).<sup>5</sup> And the Commission further informed the court that it was in the midst of studying the whole IPO process, a review which ultimately led to a comprehensive report in 2005 overhauling existing rules and regulation in that area.<sup>6</sup>

Defendants moved to dismiss the consolidated complaints, and Judge Pauley granted the motion. Based upon the record before him, Judge Pauley was persuaded that:

- the SEC expressly regulates the underwriting syndicate process;<sup>7</sup>
- the SEC expressly regulates the "road show" process;<sup>8</sup>
- the SEC expressly allows for underwriter communications (through the rules of the various self-regulatory organizations (SROs));<sup>9</sup> and
- the SEC, both previously and currently, had considered (and was considering) rules specifically addressing the alleged misconduct at issue.<sup>10</sup>

<sup>3</sup> See *In re Initial Public Offering Securities Litigation*, 241 F. Supp. 2d 281 (S.D.N.Y. 2003).

<sup>4</sup> *In re Initial Public Offering Antitrust Litigation*, 287 F. Supp. 2d 497, 506 (S.D.N.Y. 2003). The Justice Department had also filed an amicus, taking a directly contrary view (as it had in *Stock Exchange Options Trading*).

<sup>5</sup> See, e.g., NASD Rule 2710.

<sup>6</sup> See *Commission Guidance Regarding Prohibited Conduct in Connection with IPO Allocations*, Final Rule, Securities Act Release No. 8565, Exchange Act Release No. 51,500 (April 7, 2005); 70 Fed. Reg. 19,672 (April 13, 2005). The Commission's first significant review of the underwriting process (which, by definition, incorporates/tolerates some "price manipulation in order to further some other statutory goals") was issued in 1940. See *Statement of the Commission on the Problem of Regulating the "Pegging, Fixing, and Stabilizing" of Security Prices Under Sections 9(a)(2), 9(a)(6), and 15(c)(1) of the Securities Exchange Act*, Exchange Act Release No. 2446 (March 18, 1940), 11 Fed. Reg. 10,971 (Sept. 27, 1946). See also *Trading Practices Rules Concerning Securities Offering*, Proposed Rules, Securities Act Release No., 7282, Exchange Act Release No. 37,094 (April 11, 1996), 61 Fed. Reg. 17,108 (April 18, 1996).

<sup>7</sup> *In re Initial Public Offering Antitrust Litigation*, 287 F. Supp. 2d 497, 506-8 (S.D.N.Y. 2003).

<sup>8</sup> *Id.* at 508-9.

<sup>9</sup> *Id.* at 509-10.

<sup>10</sup> *Id.* at 510-21. See *supra* note 6.

In light of the foregoing, Judge Pauley held that implied immunity was called for because "the SEC, both directly and through its *pervasive oversight* of the NASD and other SROs, either expressly permits the conduct alleged or has the power to regulate the conduct[,] such that a failure to find implied immunity would 'conflict with an overall regulatory scheme that empowers the [SEC] to allow conduct that the antitrust laws would prohibit.'" <sup>11</sup>

I thought that with this ruling Judge Pauley was following Second Circuit precedent (and I said so at the time—indeed, before the time!).<sup>12</sup> On September 28, 2005, however, the Second Circuit disagreed, reversing and saying that Judge Pauley's decision "goes too far."<sup>13</sup>

**IPO Antitrust Litigation: the Second Circuit.** The Second Circuit panel, per Judge Richard Wesley, wrote that implied immunity arises only in two narrow areas: (1) where "pervasive regulation" overrides antitrust enforcement; or (2) where there are "potential specific conflicts" between the antitrust laws and the other regulatory scheme.<sup>14</sup> As to the former, the panel referenced this as a "vague ground," upon which (in its view) few cases have been found to uphold the propriety of implied immunity. Consequently, Judge Wesley turned to (and principally dealt with) the second basis for immunity, on which, he wrote, "[a]ll of [the Second Circuit's] cases finding immunity have focused."<sup>15</sup>

Because there was an obvious and clear conflict between the law enforcement schemes with respect to IPO practices (potential or actual, or both), the court wrote that such conflict "is simply the essential starting point"; the more important inquiry is "whether there is any evidence of an implicit congressional intent to repeal the antitrust laws."<sup>16</sup> To determine the latter, four "insights" from prior precedents had to be addressed:

<sup>11</sup> *Id.* at 523 (quoting *In re Stock Exchange Options Trading Antitrust Litigation*, 317 F.3d 134, 149 (2d Cir. 2003)) (emphasis added).

<sup>12</sup> See *supra* notes 1 & 2.

<sup>13</sup> *Billing v. Credit Suisse First Boston Ltd.*, 426 F.3d 130, 137 (2d Cir. 2005).

<sup>14</sup> The Second Circuit had previously characterized these grounds as follows: "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 so pervasive that Congress must be assumed to have forsworn the paradigm of composition." *Northeastern Telephone Co. v. AT & T*, 651 F. 2d 76, 82 (2d Cir. 1981).

<sup>15</sup> 426 F.3d at 161. The court later returned to analyze the "pervasive" argument advanced by the defendants, but found it of little moment. *Id.* at 170-71. Nonetheless, as Judge Wesley (correctly) noted, the SEC's exercise of regulatory authority in *U.S. v. NASD* (*supra* note 2) (a case which is not at all dissimilar to the IPO litigation) was considered by the U.S. Supreme Court to be "sufficiently pervasive" for there to be implied immunity. *Id.* at 155-56. And he also noted (correctly) that the Second Circuit's decision in *Stock Exchange Options Trading Antitrust Litigation* (*supra* note 2) was similarly grounded in the "pervasive" nature of the SEC's oversight. *Id.* at 159-60 & n.40. And finally, he quoted Judge Pauley (quoting the Second Circuit) on the "pervasive" nature of regulatory oversight in this area, and acknowledged that Judge Pauley had "masterfully demonstrate[d]" the SEC's jurisdiction over the practices in question. *Id.* at 168 (see also *supra* note 11).

<sup>16</sup> 426 F.3d at 162.

(i) legislative history vis-à-vis antitrust repeal; (ii) the regulatory structure and power given to an agency; (iii) where applying the antitrust laws would “rob [the agency] of some grant of discretion”; and (iv) where there is “regulatory history permitting, at some point, the challenged anticompetitive conduct.”

The Second Circuit panel then ruled that not one of these (or any other) factors favored immunity. First off, it determined that there was no legislative history that Congress ever contemplated immunizing the underwriting process from the antitrust laws. Next, it observed that no party (nor the SEC) was arguing that the SEC could *compel* anticompetitive conduct activity prohibited by the antitrust laws (here alleged tie-ins linked to IPO allocations). Third, it determined that neither the securities laws nor the SEC would be hurt (or “render[ed] nugatory”) by having the antitrust laws applied to the activity at issue. And finally, it found that, in every case upholding implied immunity, the courts had “done so in the wake of SEC authorization—whether past or present—of the specific anticompetitive behavior”—a fact the court said was not present in the instant case.<sup>17</sup>

In light of the foregoing determinations, the Second Circuit panel concluded as follows:

The claim of implied immunity in this case is, in many ways, unlike any we have seen. Tie-in agreements are recognized as means of dangerous manipulation, and there is no indication that Congress contemplated repealing the antitrust laws to protect them. Thus, defendants insist that the SEC could exercise powers—powers the agency refuses to recognize—to immunize conduct that neither Congress nor the agency has ever contemplated permitting.

There may be reasons why Congress might choose to immunize such conduct. The SEC and defendants have vigilantly reminded us that the securities markets *in toto* might be better entrusted to an expert agency than to the federal courts. While we might agree, we do not have the responsibility for making national policy. Congress knows how to immunize regulated conduct from the antitrust laws. To date, it has not done so here either expressly or impliedly. Construing the statutes as written, we find no repeal.<sup>18</sup>

**Where Do We Go From Here?** Now that the Second Circuit has ruled, where does the law of implied immunity stand (at least in the Second Circuit)? Certainly, it stands in a different place than prior to the court’s decision. The precedential link from the Supreme Court (*Gordon v. NYSE* and *U.S. v. NASD*) to the earlier decisions of the Second Circuit (*Finnegan v. Campeau Corp.*, *Friedman v. Salomon/Smith Barney*, and *In re Stock Exchange Options Trading Antitrust Litigation*) all pointed in one direction,<sup>19</sup> and that was the conclusion reached by Judge Pauley.

Many of the factors that were present in those prior cases were also present in this case; for example:

■ As the Second Circuit explicitly acknowledged, Judge Pauley had “masterfully demonstrate[d] that the SEC has unquestionable jurisdiction over the tie-in

agreements underlying [the antitrust] plaintiff’s complaints.”<sup>20</sup>

■ The SEC’s “pervasive” oversight over this part of the securities industry was in fact (as noted by Judge Pauley) quite similar (and more) to prior cases finding implied immunity.<sup>21</sup>

■ It is indisputable that Congress has long known of the non-competitive nature of the IPO process, as well as the SEC’s ongoing pervasive regulation of the various components thereof (and various proposed and actual “reforms” vis-à-vis that process dating back to the 1940s).<sup>22</sup>

■ The issue of restraints in secondary markets proved no barrier to the Second Circuit’s finding of implied immunity in prior cases.<sup>23</sup>

■ Courts have regularly expressed concern for securities firms facing the possibility of being whipsawed by the antitrust laws and the securities laws, but for antitrust immunity.<sup>24</sup> (As a result of the Second Circuit’s ruling here, of course, this liability whipsaw is a given.<sup>25</sup>)

■ Finally, from the 9th Circuit’s 1981 decision in *Phonetele* by then Judge Anthony Kennedy, the “special aspects of the regulated industry” and the fact that said industry “had a reasonable basis to conclude that its actions . . . [had been] recognized as legitimate by the regulatory authority,” would tend to be further support for a finding of immunity.<sup>26</sup>

So why did the Second Circuit turn away from prior precedent (the Supreme Court’s and its own)? It would appear, drawing heavily from an academic treatise critical of the doctrine of implied immunity,<sup>27</sup> that the real nub for Judge Wesley was the fourth factor he cited—a distinction between past precedent, where conduct found to be immunized was not actionable under the securities laws by dint of regulation, and here, where conduct allegedly wrongful under the antitrust laws is also being prosecuted under the securities laws before Judge Scheindlin. Or stated differently: that the SEC has “pervasive” oversight over the conduct at issue, but does not currently explicitly authorize it (the flip side of *In re Stock Exchange Options Trading*), is what (appears) to make this case “in many ways, unlike [what the Second Circuit has ever] seen.”<sup>28</sup>

Of course, the Second Circuit is free to recast prior precedent to achieve a result it deems right. That it did,

<sup>20</sup> 426 F.3d at 168.

<sup>21</sup> See *supra* notes 15 & 11 (and accompanying text).

<sup>22</sup> 426 F.3d at 137-43. See also *supra* note 6.

<sup>23</sup> 426 F.3d at 153-54, 155-56, 158 (e.g., *U.S. v. NASD; Friedman*).

<sup>24</sup> 426 F.3d at 152, 153 n.31, 156, 163 & n.43 (e.g., *Gordon v. NYSE; U.S. v. NASD; Friedman*).

<sup>25</sup> As we know from the cases based upon the securities laws consolidated before Judge Scheindlin. See *supra* note 3.

<sup>26</sup> *Phonetele, Inc. v. Am. Tel. & Tel. Co.*, 664 F.2d 716, 727, 737-38 (9th Cir. 1981). The Kennedy factors cut here for immunity, given that the prior precedent involving the securities industry all pointed in one direction, and given the SEC’s “pervasive” oversight over the IPO process. Judge Kennedy’s opinion, however (which ultimately found no immunity in a different regulated industry), was (surprisingly) an important authority for the Second Circuit here, being cited a total of twelve times.

<sup>27</sup> P.E. Areeda & H. Hovenkamp, *Antitrust Law* (2d ed. 2000) is cited seven times in the court’s opinion.

<sup>28</sup> 426 F.3d at 172; see also *id.* at 168-71.

<sup>17</sup> The court cited the Justice Department’s “undisputed” representation that “the Commission has never authorized tying and laddering . . . [or] even considered doing so.” 426 F.3d at 169-70. See also *id.* at 141-43.

<sup>18</sup> *Id.* at 172.

<sup>19</sup> See *supra* note 2.

while struggling with that precedent—its own and the Supreme Court’s, however, seems evident.<sup>29</sup> Perhaps the nub, as I have described it, is the only thing that makes this case different from all the others; but perhaps not. Until the Second Circuit takes up another implied immunity case, the securities industry going forward must recognize that a Pandora’s Box of a liability

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<sup>29</sup> The court’s re-jiggering of prior precedent on the “pervasive” oversight issue seems apparent. *See supra* notes 15, 11 & 21 (and accompanying text). In order to clarify various distinctions being drawn, moreover, the court found it desirable to clarify what the word “permit” means. 426 F.3d at 162 n.41 (because within that word “lurks the danger of assuming away the entire immunity analysis”). And a review of the decision shows a rather significant reliance upon “cf.” citations. *See id.* at 148, 151, 152, 161 (thrice), 163, 164 n.45, 165, 169, 171.

whipsaw between antitrust plaintiffs and securities plaintiffs (on top of “pervasive” regulation by the SEC, NASD, NYSE, etc.) has been opened.<sup>30</sup> Just how far it has been opened, we will all have to wait and see.

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<sup>30</sup> One interesting factoid in these implied immunity cases is how the courts pick and choose governmental agencies’ views about immunity. Here, Judge Pauley relied upon the SEC and found the Justice Department’s views unavailing. The Second Circuit, however, did just the opposite. In my prior article (*see supra* note 1), this “pick and choose” approach was highlighted. Not that the flip side of this approach is all that great either. *See In re Enron Corp. Securities, Derivatives & ERISA Litigation*, 235 F. Supp. 2d 549 (S.D. Tex. 2002) (Judge Harmon gave “considerable weight” and “deference” to the SEC’s proposal for primary liability of a secondary actor under § 10(b)).