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Comment, An Approach for Reconciling Antitrust Law and Securities Law: The Antitrust Immunity of the Securities Industry Reconsidered

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COMMENT

AN APPROACH FOR RECONCILING ANTITRUST LAW AND SECURITIES LAW: THE ANTITRUST IMMUNITY OF THE SECURITIES INDUSTRY RECONSIDERED*

Probably the most current and most critical problem facing the securities industry is the extent to which that industry—particularly the stock exchanges—should be subjected to the rules of competition as enforced under the antitrust laws.[1] The Department of Justice is concerned particularly with three rules of the New York Stock Exchange which, when viewed in light of that Exchange's dominant position in the securities industry, give it near monopoly power. These rules result in fixed minimum commission rates, arbitrarily restricted membership, and restricted off-floor trading. This inquiry will focus on these interrelated rules in an effort to determine: (1) the proper body for policing and regulating anticompetitive practices

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1 This article is based on the premise that there is a national policy favoring competition as articulated in the antitrust statutes and the case law developing them. This body of law has proven to be flexible, making exceptions to general rules where economic factors or congressional mandate so necessitated. This flexibility is embodied in the "rule of reason" which interprets the language of sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1-2 (1964), to apply to only those restraints of trade which are *unreasonable*. This implies that some restraints of trade may be found to be reasonable, and thus not illegal under the statute. The rule of reason is in contrast to the per se rule, which treats certain types of agreements and practices as inherently unreasonable and, consequently, subject to no justification or affirmative defense. Per se offenses include price fixing, collective refusals to deal (boycotts), tying arrangements and market allocations. *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911).

in the securities industry and (2) the proper approach which that body should employ in performing its task of evaluation. Prior to a detailed discussion of these issues, however, one must have a comprehensive understanding of both the structure of the securities industry and the regulatory scheme which Congress has developed for that industry.

THE ECONOMIC STRUCTURE OF THE SECURITIES INDUSTRY AND THE ANTITRUST PROBLEMS CREATED BY THAT STRUCTURE

The Securities Markets and Their Functions

For all practical purposes, the securities industry[2] is composed of the 3,669[3] broker-dealers who are members of the National Association of Securities Dealers.[4] Competition exists among these individual broker-dealers, primarily on the bases of efficiency and services offered.[5] In addition to this individual competition among broker-dealers, a second level of competition exists in the securities industries—competition among the various securities exchanges.[6] The methods of competition on the second level tend to be based less on economic principles than on what would be called restraints

[2] A broad definition of the securities industry would include salesmen of mutual funds and some small, local brokers, and perhaps even large institutions which deal largely in the third and fourth markets. However, since current problems are primarily concerned with competition for brokerage services, the narrower definition is preferable for the purposes of this study. SECURITIES AND EXCHANGE COMMISSION, REPORT OF THE SPECIAL STUDY OF THE SECURITIES MARKETS, H.R. DOC. No. 95, 88th Cong., 1st Sess., pt. 1, at 72 (1963) [hereinafter cited as SPECIAL STUDY].

[3] THE NEW YORK STOCK EXCHANGE, ECONOMIC EFFECTS OF NEGOTIATED COMMISSION RATES ON THE BROKERAGE INDUSTRY, THE MARKET FOR CORPORATE SECURITIES, AND THE INVESTING PUBLIC 93 (SEC File No. 4-144, 1968) [hereinafter cited as NYSE 1968 ECONOMIC BRIEF]. The number has fallen from a high of 4,771 in 1962. *Id.*

[4] Technically, membership in the NASD is not required for one wishing to engage in the brokerage business; however, NASD rules, pursuant to the requirements of the Securities Exchange Act of 1934, 15 U.S.C. § 78 (1964), make it economically infeasible for nonmembers to function as broker-dealers. *See* 15 U.S.C. §§ 78o to 78o-3 (1964), especially 15 U.S.C. § 78o-3(i) (preventing nonmembers from participating at a profit in securities distributions). *See also* Green, *Legal Test Looms for NASD Regulation Covering Securities Distribution to Public*, Wall Street Journal, April 28, 1970, at 2, col. 3. (Note: all references to the Wall Street Journal are to the Midwest Edition.)

[5] UNITED STATES DEPARTMENT OF JUSTICE, MEMORANDUM ON THE FIXED MINIMUM COMMISSION RATE STRUCTURE 97 (SEC File No. 4-144, 1969) [hereinafter cited as JUSTICE DEPARTMENT BRIEF].

[6] SPECIAL STUDY, *supra* note 2, pt. 2, at 946.

of trade in the context of most other industries.[7] These restraints take the form of forcing as much trading as possible onto a particular exchange and of limiting access to the individual exchanges, membership to which is a crucial factor in determining the competitive position of any broker-dealer.

A third level of competition which cuts across all broker-dealers and all exchanges is competition between the different securities markets.[8] These markets can be grouped into three categories:[9] (1) the organized exchanges, including the New York Stock Exchange (NYSE), the American Stock Exchange (Amex), and the regional exchanges; (2) the over-the-counter market (OTC), dealing in stocks not listed on exchanges; (3) the third and fourth markets, in which nonmember firms deal in listed securities (the "third market") or in which institutional investors deal directly with each other (the "fourth market").[10] These securities markets are distinguished by the securities traded on them and by the availability of access to them.

Although each registered stock exchange may be considered to be a separate securities market, two exchanges in New York City (NYSE and Amex) together handle over 90% of exchange transactions.[11] Regional exchanges, only seven of which are "national" in character,[12] are located outside of New York City. To trade on any

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[7] *See, e.g.*, Silver v. NYSE, 373 U.S. 341, 348 (1963). *See also* Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 Sw. L.J. 536, 546 (1966).

There are, however, valid methods of competition based on efficiency: narrower margins for specialists, more services for members, mechanized securities transfer systems, greater freedom of access to membership, and so forth. *See* FURTHER PREPARED TESTIMONY ON BEHALF OF THE MIDWEST STOCK EXCHANGE 31-39 (SEC File No. 4-144, 1969) [hereinafter cited as MSE PREPARED TESTIMONY, 1-7-69 (or 9-18-68, depending on date of testimony)].

[8] One must be careful not to confuse the market for brokerage services with the various markets for securities (securities markets). Securities markets do not *necessarily* represent a given place; rather, they represent a level of trading activity where buy and sell orders are congregated.

[9] This classification is taken from the prepared statement of Professor Henry C. Wallich, an economist from Yale University, before the SEC hearings on commission rates, Oct. 31, 1968, SEC File No. 4-144, at 17 [hereinafter cited as Wallich Prepared Statement].

[10] Very little is known about the "fourth market," but industry speculation indicates that it is growing in volume. It is an attempt on the part of institutional traders to avoid the use of brokers altogether by finding their own matches for buy and sell transactions.

[11] This is on a share volume as well as a dollar basis. *See* note 21 *infra*.

[12] SPECIAL STUDY, *supra* note 2, pt. 2, at 948. The seven significant regional

one of the national securities exchanges, a broker-dealer must be a member of that exchange. The rules of eligibility are, however, largely under the control of the exchanges themselves.[13] A particular broker-dealer may be a member of no exchange, a "sole member" of one exchange, or a "dual member" of both a regional and one or both of the New York exchanges. A particular security may be traded on one or more exchanges.[14]

Stocks traded "over-the-counter" are usually not traded in sufficient volume to sustain a continuous auction market which characterizes an organized stock exchange. Instead, individual dealers make a market[15] in a particular security. A broker-dealer need not be a member of any organized exchange to become a market-maker in an OTC issue, but exchange members frequently make markets for unlisted securities and thus participate in the OTC market.[16]

Until quite recently, almost all trading on the OTC market was in securities not listed on a securities exchange. An important modern trend has been the increase in the over-the-counter trading in listed stocks.[17] If securities are traded by broker-dealers who are

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exchanges are the Boston, Cincinnati, Detroit, Midwest, Pacific Coast, Philadelphia-Baltimore-Washington and Pittsburgh exchanges. Seven other minor exchanges remain registered with the Securities and Exchange Commission. In the late 1920's there were over 100 regional exchanges. *Id.*

13 This results from the rules of the various exchanges, not from the dictates of the 1934 Act, although the Act authorizes any rule "not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located." 15 U.S.C. §§ 78f(a) (2), (c) (1964).

> Two hundred and thirty-eight firms are members of either or both New York exchanges as well as one or more regional exchanges, while 449 are sole members of regional exchanges.

SPECIAL STUDY, *supra* note 2, pt. 2, at 928.

14 When a security is listed on more than one exchange, it is "dually traded." In 1968, 450 of 503 issues listed on the Midwest Stock Exchange (MSE) were dually traded. These dually-traded issues accounted for 89% of share volume and 94% of dollar volume on the MSE. Moreover, with only 11% of 1968 MSE share volume attributable to exclusively-listed securities, 60% of that was from trading in only four active stocks. MSE EXHIBIT 10 (SEC File No. 4-144, 1969); MSE PREPARED TESTIMONY, 1-7-69, at 11. These figures have changed very little since the beginning of the decade. *See* SPECIAL STUDY, *supra* note 2, pt. 2, at 930.

15 A broker-dealer makes a market in a security when he stands ready to buy *and* sell limited quantities of it.

16 THE NEW YORK STOCK EXCHANGE, THE LANGUAGE OF INVESTING 25 (1968). *See also* SPECIAL STUDY, *supra* note 2, pt. 1, at 13. In 1961, trading over-the-counter represeuted 60% in dollar volume and 125% in share volume of securities traded ou all registered exchanges. *Id.*

17 *See* note 25 *infra.*

not members of the exchange on which that security is listed, those securities are being traded in the "third market," off the floor of the exchanges. Such trading has the effect of widening access to trading in listed stocks, since nonmembers can participate in trades diverted from the exchanges. The rules of the NYSE are designed to discourage this diversion of transactions by prohibiting Exchange members from trading away from the Exchange floor.

The recent growth of third market trading reflects the partial success of non-NYSE members in circumventing that Exchange's anticompetitive trading rules. The growth of the third market may also be attributed to the failure of any of the traditional markets to facilitate trading in large blocks of listed stocks at economical commission charges.[18] Until recently, the NYSE has maintained a fixed rate of commission for all transactions, regardless of size or economies of execution. Although it may be argued that the growth of the third market is due to the unsuitability of the auction-market mechanism for trading large blocks of securities,[19] the failure of the exchanges to hold the large block transactions is attributable more to their pricing practices than to the auction-market mechanism itself. Block transactions still account for a large part of trading on the stock exchanges.[20]

The relative importance of the various markets, in terms of dollar value of stocks traded and share volume, is instructive, for such information reveals three important trends which suggest that the securities industry is not as competitive as it should be.[21] First,

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[18] *See* note 43 *infra.*

[19] Wallich Prepared Statement, *supra* note 9, at 18.

[20] *See* note 50 *infra.*

[21] Source: *Midwest Stock Exchange Exhibit A* 1-2 (SEC File No. 4-144, 1969). Figures are approximate.

			Share and Dollar Volumes of Major Securities Exchanges Presented as a Percentage of Total Share and Dollar Volumes of All Registered Exchanges				
Year	Total for All Exchanges		NYSE	AMEX	MSE	PCSE	Other
1950	Share	900,000,000 shs.	76.3%	13.5%	2.1%	3.1%	5.0%
	Dollar	$22,260,000,000	85.9%	6.8%	2.3%	2.2%	2.8%
1960	Share	1,418,000,000 shs.	68.4%	22.2%	2.2%	3.1%	4.1%
	Dollar	$45,750,000,000	83.8%	9.3%	2.7%	1.9%	2.3%
1965	Share	2,580,000,000 shs.	69.9%	22.5%	2.7%	2.3%	2.6%
	Dollar	$88,166,000,000	82.1%	9.6%	3.5%	2.4%	2.4%
1966	Share	3,138,800,000 shs.	69.2%	22.9%	2.7%	2.7%	2.5%
	Dollar	$121,152,375,000	80.1%	11.5%	3.2%	2.9%	2.3%
1967	Share	4,545,000,000 shs.	64.1%	28.6%	2.4%	2.5%	2.4%
	Dollar	$161,300,000,000	77.5%	14.3%	3.1%	2.8%	2.3%

NYSE = New York Stock Exchange
AMEX = American Stock Exchange
MSE = Midwest Stock Exchange
PCSE = Pacific Coast Stock Exchange

the New York Stock Exchange is dominant in securities transactions.[22] Second, the percentage of all trading conducted on regional exchanges has been declining while the dependency of the regional exchanges on multiple trading has been increasing.[23] The declining use of regional exchanges as exclusive markets and the declining percentage volume on these exchanges suggest the increasingly narrow functions of regional exchanges and the resulting pressure upon sole members of the regonal exchanges, who do not have direct access to the New York exchanges.[24] The third major trend is the rapid diversion of trading from the exchange floors to the third and fourth markets.[25] As noted, this is largely attributable to the inability of the NYSE to satisfy the demands of institutional investors[26] for executing large block transactions at competitive commission rates.

The Operation of the New York Stock Exchange and Its Impact on the Securities Markets

The most crucial anticompetitive aspects of the securities in-

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22 Its share of all exchange trading has been declining slightly, but this is due to the rapid increase in volume on the Amex, not a resurgence of regional exchanges. Despite the slight decline in the NYSE's share of trading activity, it is not uncommon for the NYSE to be referred to as a monopoly. *See, e.g.*, Johnson, *supra* note 7, at 536.

23 *See* note 14 *supra*. Multiple trading is trading in a given security on more than one exchange.

24 *See* note 21 *supra*. These developments should dispel the common belief that regional exchanges deal primarily in smaller, regionally-distributed securities.

25 New York Stock Exchange, The Economics of Minimum Commission Rates 26 (1969) [hereinafter cited as NYSE 1969 Economic Brief]. Although the NYSE terms the third market insubstautial, its rate of growth is substantial indeed. For NYSE stocks alone, this market has grown from an estimated dollar volume of $84 million in 1941 to an estimated $2 billion twenty years later, a relatively greater expansion than that of the NYSE. Special Study, *supra* note 2, pt. 2, at 870. In 1966, trading over-the-couuter in NYSE-listed stocks was 2.6% of the total NYSE volume. This figure grew to 2.9% in 1967 and 3.8% in 1968. In 1961, there were off-board markets for 270 NYSE-listed stocks, with off-board trading in 43 of these issues reaching 10% of NYSE volume in the same issues. *Id.* at 902. Recent developments in the NYSE community indicate that NYSE members are more concerned with this trend than their official position would lead one to believe. *Compare* Rustin, *Big Board Study Shows Brokerage Firms Make Their Money on Institutional Trades*, Wall Street Journal, July 31, 1969, at 4, col. 1 *with* NYSE 1968 Economic Brief, *supra* note 3, at 5. (Recall that block transactions, or institutional trades, account for the bulk of third market trading.)

26 Institutional investors include mutual funds, pension trusts, insurance companies, and the like.

dustry stem from the operations of the NYSE. Because of its preeminence, the behavior of the NYSE dictates the pattern of behavior for the entire securities industry. Economists generally accept the concept that a large centralized securities market is economically the most efficient mechanism for allocating capital in a private enterprise economy.[27] There is also general agreement that the NYSE is an efficient market in the sense that it accurately values stocks through the free play of supply and demand.[28] However, the NYSE dominates the industry largely because its members have taken advantage of the absence of effective regulation, and not merely because of the natural efficiencies of the central market.[29]

Traditionally treated as a private club, the NYSE has been free to adopt rules tending to solidify its domination over securities trading.[30] Three rules are the core of this tendency. First, a minimum commission rate schedule is enforced. All transactions on the Exchange floor are subject to a fixed minimum commission in accordance with a detailed rate schedule incorporated in the NYSE Constitution. No deviation from this schedule is officially permitted, and the rate which a floor broker must charge another member of the Exchange is lower than that required to be collected when executing a trade for a non-member.[31] Second, off-floor trading in listed securities is prohibited by Rule 394. This insures that members will transact all trades in listed securities on registered exchanges.[32] Third, membership is restricted to a total of only 1,366 seats, owned by members or member firms. The NYSE exercises tight control over this membership through its rules of eligibility.[33]

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27 *See, e.g.,* Wallich Prepared Statement, *supra* note 9, at 18.

28 *Id.* at 21.

29 Silver v. NYSE, 373 U.S. 341, 351 (1963). *See also* Robbins, *Securities Industry at the Crossroads*, COMMERCIAL AND FINANCIAL CHRONICLE, Nov. 21, 1968, at 4-5 [hereinafter cited as Robbins, *Securities at the Crossroads*].

30 The 1934 Act gives the SEC some review over exchange rules and the administration of those rules.

The NYSE was organized in 1792 with the avowed purpose of "setting minimum commission rates and . . . establishing . . . a preference for members of the Exchange in their dealings with other members . . . ." SPECIAL STUDY, *supra* note 2, pt. 2, at 295.

31 NYSE CONST. art. XV, in 2 CCH NYSE GUIDE ¶ 1701-12 (1968).

32 NYSE Rule 394, in 2 CCH NYSE GUIDE ¶ 2394 (1966). Sole NYSE members must transact all trades in NYSE-listed securities on the NYSE.

33 NYSE CONST. art. IX, in 2 CCH NYSE GUIDE ¶ 1401-15 (1969), and NYSE Rules 301-21, in 2 CCH NYSE GUIDE ¶ 2301-21 (1969). *See* Johnson, *supra* note 7, at 545. The SEC must approve most exchange rules. The use of this power of review by the SEC is dealt with in the next section. *See generally* section 19(b)

In operation, the NYSE minimum commission rate schedule has become a maximum rate schedule.[34] Since the NYSE is the largest, deepest,[35] and most liquid[36] of all the markets, an ever-increasing percentage of all securities holders has been attracted to trading in NYSE-listed stocks. Once an order is drawn to this exclusive market, direct rate competition is officially precluded by the Exchange's rules.[37] The NYSE schedule has been adopted by the regional exchanges; it also serves as the rule for OTC transactions, but not for block trading on the third market. The stabilization of commission rates at the minimum NYSE level indicates two important concepts: First, brokerage firms consider competition for brokerage business to be based at least partly on price; consequently, any one firm refrains from charging higher commission rates, since that firm anticipates that its customers would shift their orders to a competing brokerage firm that still charges the original rates.[38] Second, pricing for brokerage services is based on oligopolistic decision-making. Thus, each decision-maker (on the exchange level),

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of the 1934 Act, 15 U.S.C. § 78s(b) (1964).

The rules controlling what types of firms may become members of the NYSE have recently been revised to allow publicly-held firms to hold seats on the Exchange, but the new rules are drawn so as to prevent institutional investors from acquiring direct access to the Exchange floor at the favorable member commission rates. Substantial Exchange control over members' management will continue. *See* Rustin, *Big Board Slates Vote on Members' Public Ownership*, Wall Street Journal, Sept. 15, 1969, at 3, col. 1. There appears to be no statutory justification for arbitrarily limiting membership. *See* note 77 *infra.*

34 In 1970, some brokerage firms have been charging commissions higher than the NYSE minimum rate for small transactions. Rustin, *Many Brokerage Firms Raise Minimum Fees for Trading Stocks*, Wall Street Journal, Feb. 13, 1970, at 1, col. 4. *See* notes 37 & 42 *infra.*

35 "Depth" connotes the ability to absorb a considerable volume of demand and supply in a particular security (but in many isolated transactions rather than large block transactions). NYSE 1968 ECONOMIC BRIEF, *supra* note 2, at 12, 14.

36 "Liquidity" means that an investor can readily convert his stock into cash at a price close to the previous sale. This normally requires the existence of a continuous market, which is absent from the OTC market.

37 As seen in note 34 *supra,* in late 1969 and early 1970, some NYSE brokerage firms have raised their minimum commission charge for small transactions. While there were some demonstrable effects from this novel price competition in the market for brokerage services, the need for such competition will be eliminated if the NYSE's proposed across-the-board increase in the minimum commission rate for small transactions is put into operation. *See* Rustin, *Many Broker Firms Raise Minimum Fees for Trading Stock,* Wall Street Journal, Feb. 13, 1970, at 1, col. 4; Wall Street Journal, Feb. 16, 1970, at 3, col. 1.

38 This condition would obtain regardless of the price-elasticity of aggregate demand for brokerage services. Some shifting of accounts has accompanied the recent increase in minimum rates by some brokerage firms. Rustin, *supra* note 37.

in setting the minimum commission rates, is constrained by the predictable response of its competitors. Consequently, there is no incentive for a regional exchange, for example, to lower its commission rates, since it expects that if such a move is successful in attracting commission business away from the NYSE, the NYSE will lower its rates. The obvious result would be that nothing would be gained and everyone would be making less profit.[39]

The recent introduction of volume discounts for customers trading in large blocks of stock illustrates both of these concepts. To win a larger share of institutional trading, three regional exchanges adopted volume discounts.[40] In December, 1968, the NYSE introduced an "interim" rate schedule providing for volume discounts.[41] Although the NYSE may also have been under other pressures, this move may have indicated that NYSE members were feeling the pinch of price competition in the market for brokerage services. In any event, it removed the price advantage which regional exchanges had been enjoying in the competition for institutional orders.[42] Before

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[39] *See* MSE PREPARED TESTIMONY, 9-18-68, at 6. The commission rate (price of brokerage services) will stabilize at a level where the marginal members of the industry can make a satisfactory profit, meaning that the more efficient firms, with their lower costs, will be making an exorbitant profit over the long run. Thus, the more efficient firms have no great incentive to drive the marginal members out of business. Although this analysis has been referring to competition among exchanges, it is also applicable to the rate-fixing decisions of any one exchange.

An argument has been made that the customers gained by the temporary advantage flowing from a rate reduction may tend to remain with their new broker eveu after the customer's old broker responds to competition by meeting the lower rates. If this is true, it may be expected that a regional exchange may "test the market" in the near future by lowering its minimum rates to a level below those of the NYSE. *See, e.g.*, Tobin, SEC File No. 4-144, Hearings Transcript, at 4408.

Service competition does exist, since there is no prohibition against charging or not charging for other services rendered. SPECIAL STUDY, *supra* note 2, pt. 2, at 321. There is incentive for a member broker to maintain his services at the same or higher level than his competitors, for he cannot lower the price which he charges his customers, and failure to compete in the service area would put him at a disadvantage vis-a-vis his competitor member firms.

[40] SPECIAL STUDY, *supra* note 2, pt. 2, at 299-300, *cited in* Johnson, *supra* note 7, at 540.

[41] JUSTICE DEPARTMENT BRIEF 5; 2 CCH NYSE GUIDE ¶ 1702 (1968).

[42] On February 13, 1970, the NYSE presented its proposed revision of the commission rate structure for SEC comment. The new structure calls for large increases in commission rates for small transaction and significant volume discounts in the form of lower commission rates as the size of the transactions (number of shares) increases. Wall Street Journal, Feb. 16, 1970, at 3, col. 1. The Exchange has received SEC approval for an interim increase in the minimum fee for transactions of less than 1,000 shares while the new schedule is being studied. Wall

the volume discounts were put into operation, different Exchange customers—although they required and received different services—were charged identical commission rates, regardless of the size of the transaction. While the volume discounts provided some relief for institutional investors, they did not create price competition among Exchange members. Commission rates continued to be unrelated to the cost of execution or to the cost of providing services for the customers.[43]

Prior to 1941, Rule 394 not only forbade NYSE members

Street Journal, March 17, 1970, at 5, col. 2. This move came in the wake of growing financial troubles for mauy NYSE firms. *See, e.g.*, Robards, *Fears Fulfilled as Big Broker Fails,* N. Y. Times, March 15, 1970, § 3, at 1, col. 5. (Note: all references to the New York Times are to the City Edition.)

[43] The new rate structure and the more generous "nonmember access" included in the proposed rules chauges presented by the NYSE in 1970 may make the power exercised by the NYSE more tolerable, but they do not make that power more controllable. Still at issue and unchecked is the Exchange's power to make such rules and impose them on all its members, its power to exclude qualified competitors from membership, and its power to engage in the *practice* of fixing minimum commission rates.

The proposed 1970 rate changes are based on the assumption, generated by an independent consultant's analysis of cost information, that the larger, institutional investors have been subsidizing the public investors under the prevailing rate structure. Yet the Exchange has refused to consider the adoption of a rate structure which would take into account the different services provided for the different types of customers. Thus, the possibility of separating charges for transacting trades from charges for other services (such as research, advice, and safe-keeping) performed by broker-dealers was ignored by the Exchange. Several students of the industry have observed that certain services (and costs) are imposed on smaller investors whether they desire them or use them. An allocation of costs along service lines might result in a rate structure that would not be so harsh for the public investor. On the other hand, the result of the 1970 proposed rate structure may have the effect of driving small investors into mutual funds and other institutional concerns in order to take advantage of the economies offered in the rate structure for the institutional investor. *See* Robards, *Brokerage Fees Ready to Soar,* N.Y. Times, Feb. 15, 1970, § 3, at 1, col. 3; Wall Street Jourual, Nov. 11, 1969, at 6, col. 3. It can be argued that this would not be a bad result.

The crisis atmosphere surrounding the Exchange's proposals for rate increases is the result of the poor profit picture of the industry during 1969. Yet, many have pointed out that 1969 was atypical for the industry and therefore a poor year on which to base cost analyses. Greer, *Rationale for Commission Hikes,* Chicago Suu-Times, Feb. 15, 1970, at 77, col. 5. Furthermore, 1969 was a bad year for Americau business in general. Only the NYSE is in the position to raise prices to offset the declining profits accompanying the cyclical downtrend. With most over-the-counter brokers in the black and many NYSE members showing profits (although lower than peak levels), there seems to be little justification for the Exchange to attempt to insure that every year's profits for its members will be higher thau the previous year's. *See* Hammer, *Over-the-Counter Brokers Stay in the Black,* N.Y. Times, Feb. 22, 1970, § 3, at 1, col. 1.

from trading in listed stocks over-the-counter, but it also prevented dual members from executing transactions in dually-listed stocks on any exchange other than the NYSE. The application of the rule to trading on regional exchanges was struck down by the SEC,[44] but it is still in force for the third market. This rule has the effect of compelling NYSE members to execute institutional trades on one of the organized exchanges at fixed rates rather than in the third market, which offers negotiated rates.

Membership restriction operates to exclude sole regional broker-dealers, broker-dealers who belong to no exchange, and institutional investors from access to the NYSE. To trade on the NYSE stock market, one must place his order with one of the select members of the NYSE, and he must pay the NYSE commission charge. Therefore, when a broker-dealer who is not a member of the NYSE receives a customer's order to buy or sell a security listed solely on the NYSE, he can make no profit on the transaction, since he must execute that transaction through a NYSE member who will charge him the nonmember commission rate.

> [He] is forced either to refuse business in listed securities, or accept the business and sustain a loss equal to overhead costs. On the other hand, business channeled through a non-member broker is important to the member broker; and, thus, the member seeks to make it attractive to the non-member to channel business to him.[45]

The enforcement of these rules has affected the development of the regional exchanges, the OTC market, and the third market.

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[44] Rules of the New York Stock Exchange, 10 S.E.C. 270 (1941).

[45] Johnson, *supra* note 7, at 538. Theoretically, the non-NYSE firm could charge a higher rate, but the discussion in note 39 *supra* describes the competitive conditions that make this impractical. Of course, when a sole regional broker-dealer receives an order in a dually-listed stock, he may collect commissions and retain them, since he can execute the transaction without going through the NYSE. (The policy—and the common law duty—of regional exchange members is to take orders in dually-listed stocks to the NYSE if a better price is obtainable for their customer there. MSE PREPARED TESTIMONY, *supra* note 7, at 17.) It is only in this type of transaction that the sole regional member avoids the "difficult middle ground between the major exchanges and the over-the-counter markets . . . ." SPECIAL STUDY, *supra* note 2, pt. 2, at 937.

The NYSE's proposal for a revised commission rate structure partially ameliorates the competitive disadvantage which exclusion from NYSE membership imposes on a brokerage firm. It does this by providing discounts of 20-25% of the ordinary commission charge for "qualified" nonmember broker-dealers. Brokerage subsidiaries of financial institutions would not be "qualified" for such discounts. Wall Street Journal, Feb. 16, 1970, at 3, col. 1.

First, the rapid growth of the third market can be attributed to the exclusion of institutional investors from the benefits of rate competition. Many institutional investors have turned to the third market because it satisfies needs not met by the NYSE. The institutional investor not only can negotiate for the commission rate to be charged, but also can execute transactions more rapidly on the third market.[46] Non-member brokers also prefer this market for transacting trades for small "public" customers because they can negotiate a commission rate equal to the NYSE rate without having to pass that commission to a NYSE member. The cost is the same for the customer, although it is possible that the execution price suffers.[47]

Another diversion of institutional trading from the NYSE has resulted from the admission of some institutional investors to membership on some regional exchanges.[48] The more liberal rules of these regional exchanges enable large mutual funds to acquire direct access to the trading floor, normally through wholly-owned subsidiary broker-dealers which obtain seats on the regional exchanges. This results in a significant savings for the mutual fund investors trading in dually-listed stocks, since commission expense is avoided.[49] Thus, an unnatural fractionalization of the NYSE central market results from the NYSE's exclusion of institutions from memberships.

In the face of these developments, it is understandable that the NYSE members consider regional exchanges and the third market as direct competitive threats to their share of the market for brokerage

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[46] It has been noted that an auction market is considered by some to be inappropriate for executing block transactions. Wallich Prepared Statement, *supra* note 9, at 18. "In good part, however, . . . [the third and fourth markets] exist because of the relatively high commissions set by the exchanges. This clearly detracts from the efficiency of the auction market." *Id.* at 19. Therefore, a system of commission rates which encourages investors to execute block transactions away from the central marketplace fosters a distortion in natural demand and supply conditions in a given security. About 10% of institutional transactions are estimated to go through the third market. SPECIAL STUDY, *supra* note 2, pt. 2, at 895.

[47] Johnson, *supra* note 7, at 542-43.

[48] Wall Street Journal, June 10, 1969, at 8, col. 2. *See also* Laing, *Midwest Board's Governors Vote To Allow Institutional Members; Action Opposed,* Wall Street Journal, Jan. 2, 1970, at 4, col. 2.

[49] Wall Street Journal, July 18, 1969, at 3, col. 1. For a discussion of the impact of such rule changes on shareholders of mutual funds see note 43 *supra* and note 54 *infra. See also* Robards, *Big Board to Let Brokers Go Public,* N.Y. Times, July 18, 1969, at 1, col. 5. The largest mutual fund in the country, Investors Mutual, Inc., is already deriving significant commissions savings for its shareholders. 5 L. Loss, SECURITIES REGULATION 3135 (1969) [hereinafter cited as Loss with volumes 1-3 published in 1962 and volumes 3-6 published in 1969)].

services, especially in institutional trading, which has been estimated to constitute anywhere from 40% to 67% of trading on the NYSE.[50] The members of the NYSE have devised methods, both announced and unannounced, to respond to this growing competition. One announced response has been the grudging adoption of volume discounts for large transactions, effective in December, 1968. This move had been resisted by the Exchange community.[51] Before this change was adopted, however, many NYSE members successfully circumvented the Exchange rules against commission-splitting and rate-cutting by developing intricate, circuitous rebate practices. Denominated as give-ups or directed splits, these practices are manifestations of hard-nosed price competition for this important share of the brokerage services market.[52] Each of these practices is a subterfuge for commission rates lower than required by the NYSE official schedule.

> [I]n each case a customer placing commission business with an NYSE member has paid the entire commission to the member, who has retained it in its entirety, and the customer has then received reciprocity in the form of other commission business or special services.[53]

Mutual funds are especially amenable to this type of arrangement.

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[50] *See* Rustin, *supra* note 25; SPECIAL STUDY, *supra* note 2, pt. 2, at 989. "[T]he financial institutions . . . now account for nearly half of the trading volume of the New York Stock Exchange and some $700- to 800 million of the brokerage industry commission revenues of $1.8 billion (annually)." Rolo, *When Wall Street Catches the Flu, 26 Million Americans Ache*, N.Y. Times, Aug. 31, 1969, § 6, at 20 [hereinafter cited as Rolo]. *See also* Robards, *Institutional Trading Now Tops Small Investors on Big Board*, N.Y. Times, April 21, 1970, at 59, col. 6.

[51] *See* Rustin, *supra* note 25. This generality is of course more true for some firms than for others. The volume discount has been estimated to lower NYSE commission revenues by $150 million annually. Address by Mr. Donald Baker, Chief of the Evaluation Section of the Antitrust Division of the Department of Justice, *Competition in the Securities Markets*, Investment Banker Ass'n Seminar, in Glen Cove, Long Island, New York, July 9, 1969, at 7 [hereinafter cited as Baker, *Competition In the Securities Markets*].

Most firms catering primarily to institutional customers also oppose the increases in volume discounts contained in the 1970 rate changes proposed by the NYSE. Similarly, most firms with substantial public business have embraced the proposal for raising the minimum commission charges for small transactions, thereby favoring elimination of the price competition that has recently materialized with respect to small transactions. *See* Rustin, *Big Board Member Firms Oppose Lowering Large-Trade Fees, Basing Rates on Costs*, Wall Street Journal, Jan. 27, 1970, at 4, col. 2; Rustin, *Many Broker Firms Raise Minimum Fees For Trading Stocks*, Wall Street Journal, Feb. 13, 1970, at 1, col. 4. *See* note 37 *supra*.

[52] 5 Loss 3173.

[53] SPECIAL STUDY, *supra* note 2, pt. 2, at 316.

It enables them to direct a member firm to transact a given percentage of a trade with another brokerage firm which may have a close relationship with the mutual fund, *e.g.*, as sponsor or advisor or simply as a vigorous retailer of the mutual fund's shares.[54] The recipient of the directed split may be a sole member of a regional exchange. Thus, the customer directing the split may determine the market on which the transaction will be executed.[55] As if to demonstrate the relationship between these customer-directed give-ups and rate competition, the December, 1968, rules changes which initiated volume discounts on the NYSE, simultaneously banned customer-directed give-ups.[56] Reciprocal practices are popular because all parties with sufficient bargaining power to participate in them benefit: regional exchanges receive some business that might not have

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[54] 5 Loss 3173.

> The reciprocal give-up procedures tend to create a conflict of interest between the interest of mutual fund shareholders desiring lower commission charges and the interest of mutual fund advisors and underwriters attempting to stimulate the sale of additional shares by directing a split in commission charges.

Johnson, *supra* note 7, at 540.

[55] The prevalence of these practices is striking. The SPECIAL STUDY found that two-thirds of sole regional exchange members have such reciprocal arrangements with members of a New York Exchange. Sixty-one percent of the regional exchange members participating in such agreements reported receiving at least 20% of their income from this source. SPECIAL STUDY, *supra* note 2, pt. 2, at 302-03. It has been reported that in 1968 these practices resulted in Big Board firms giving out $19.9 million in regional business in return for $34.4 million in New York exchange business. Wall Street Journal, June 10, 1969, at 8, col. 2. At times brokers retain as little as 10-15% of the NYSE schedule commissiou rate. JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 72 (*citing* testimony of Hearney, Transcript at 232 (SEC File No. 4-144)).

[56] The 1970 proposed changes continue to exclude systematically institutional investors from direct access to NYSE trading, despite improved non-member access for most broker-dealers.

These customer-directed reciprocal practices should be distinguished from so-called "regular way" reciprocity, in which NYSE members and sole regional members channel commission business back and forth on a fixed reciprocal relationship. MSE PREPARED TESTIMONY, 1-7-69, *supra* note 7, at 37.

Although regional exchanges deny any dependence on customer-directed give-ups, they are willing to agree that an end of "regular way" reciprocity, withont some other channel of access to the NYSE, would seriously test the viability of sole regional members, if not the regional exchanges themselves. 5 CCH FED. SEC. L. REP. ¶ 77,719 (1969).

The NYSE has requested the SEC to adopt a rule that would eliminate all reciprocal practices between members of the NYSE and members of regional exchanges, and the regional exchanges have bitterly opposed such a rule. *See* Wetherill, *Regional Stock Exchanges*, 2 REV. OF SEC. REG. 929 (1969); Wall Street Journal, June 10, 1969, at 8, col. 3. Reciprocity is generally considered to impair competition in a market economy.

gone there otherwise;[57] the NYSE participant is always favored in the reciprocity ratio;[58] and the institutional investor gets the benefits of a lower commission rate because of competition.[59] Nevertheless, these rates may not be as low as could be obtained if the three restrictive NYSE rules were not in existence.

Current Issues To Be Resolved

Viewed separately, each of these NYSE rules narrows the range of competition among securities markets and broker-dealers; in combination, however, the rules insure the near monopoly position of the NYSE among securities markets. With membership restricted, the prohibition against trading in the third market can be effective in keeping most transactions in the hands of Exchange members, with rates fixed free of the threat of competition.[60]

These rules are currently being scrutinized by the Securities and Exchange Commission and the Department of Justice. An SEC-proposed rule (10b-10) banning customer-directed give-up practices led to hearings on those practices, beginning on July 1, 1968.[61] The Department of Justice entered the hearings to request that the SEC eliminate the entire practice of fixing minimum rates on the NYSE.[62] While the hearings have been in progress, pressures both

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57 5 Loss 3173.

58 Special Study, *supra* note 2, pt. 2, at 302.

59 5 Loss 3173.

60 This combination of rules has been described as a "patchwork of regulations" that is indicative of an effort "to enforce an 'artificial price' in a market with many sellers." Justice Department Brief, *supra* note 5, at 151, *citing* Baumel, Ex. 1, at 4-5 (SEC File No. 4-144). It was neither the competitive effort to serve customers better nor competition from non-member brokers that prompted NYSE members to develop the intricate, circuitous reciprocal practices that lowered the effective cost of trading for institutional investors. Rather, it was the countervailing power of the institutional investors and the threat of potential competition represented by mutual fund-controlled seats on regional exchanges and increased third market participation on the part of these important institutional investors. In the securities industry, the small, public investor has no such countervailing power. Thus, the commission rates for odd-lot purchases (purchases of quantities of shares not in multiples of 100) have been set by agreement by the two (recently merged) NYSE odd-lot firms accounting for 99% of NYSE odd-lot transactions, without any Exchange or SEC intervention until 1964. *See* Nerenberg, *Application of the Antitrust Laws to the Securities Field*, 16 W. Res. L. Rev. 131, 153 (1964).

61 As of the time of printing of this article, the hearings were still in progress.

62 *See* Comments of the United States Department of Justice, Securities Exchange Act Release No. 8239, CCH Selected Comments on SEC Proposed Rule on Give-ups and NYSE Proposal on Commission Rates 16 (May, 1968) [hereinafter cited as CCH Selected Comments]. *See also* Justice Department Brief,

inside and outside the industry have resulted in proposals to modify the commission rate structure, improve access to the Exchange, and allow public ownership of member firms.[63]

While it is beyond the scope of this article to conduct a detailed analysis of the economic arguments concerning the validity of the crucial NYSE rules, a review of the opposing positions is necessary for an understanding of what is at stake when a reconciliation approach is chosen.

Rule Against Trading in the Third Market[64]

When the SEC struck down the applicability of Rule 394 to regional exchanges in the *Multiple Trading Case*,[65] the Exchange community maintained that the Commission's decision would spell the doom of the strong central market of the NYSE. Similar protests are now being raised regarding proposals to permit third market trading by Exchange members. Those supporting such third market trading argue that it would be appropriate to extend the theory of the *Multiple Trading Case* of 1941 to the application of Rule 394 to third market trading.[66] They also point to the common law duty of broker-dealers to obtain the best price possible[67] when executing a customer's transactions, noting that the *Special Study* implied that Rule 394 prevents the best execution in at least some cases.[68]

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supra note 5. It may well be that the SEC welcomed the Justice Department's intervention in the hearings, since it would strengthen the Commission's position in urging reform.

63 The public ownership question bears directly on the membership issue, since it goes a long way toward determining what kinds of firms are eligible for membership.

64 The rule was modified in 1966 after considerable member dissatisfaction with its operation following the increased number of listings in the wake of the 1964 Amendments to the 1933 Act, 15 U.S.C. § 77a-aa (1964). Probably because of antitrust considerations, the Exchange requested the SEC to approve its proposed amended rule 394(b), which the Commission found to be "necessary and in the public interest." The Commission, however, supplemented the parameters within which off-floor trading in listed stocks must occur with its Rule 19b-1, creating minimum capital requirements and reporting guidelines for non-member market-makers. "All in all, the strictures surrounding this reform are so great that activity under Rule 394(b) averaged less than one trade a day during the first two months of its life." 5 Loss 3169-70.

65 Rules of the New York Stock Exchange (*Multiple Trading Case*) 10 S.E.C. 270 (1941).

66 *See, e.g.*, Nerenberg, *supra* note 60, at 152. The theory of the *Multiple Trading Case* is discussed following note 150 *infra*.

67 Edison Elec. Illuminating Co., 1 S.E.C. 909, 913 (1936), *cited in* Nerenberg, *supra* note 60, at 152.

68 5 Loss 3167-68, *citing* SPECIAL STUDY, *supra* note 2, pt. 2, at 958.

As in 1941, Rule 394 is justified by the Exchange as necessary to prevent erosion of the primary market. Opponents of the rule contend that the policy of the 1934 Act allows greater competition among markets than does Rule 394.[69] The *Special Study* suggested a balancing analysis for solving this controversy and concluded that any potential impairment in the depth of the primary market due to the abolition of Rule 394 would be outweighed by the public interest in the preservation of competition among markets.[70]

Membership Restriction

The NYSE argues that it is obligated to restrict membership to assure integrity and ability in broker-dealers. The rebuttal to this argument takes no exception to the concept that the objective of protecting investors, which is at the heart of the 1934 Act, calls for limiting membership to reputable, qualified firms. Those objecting to present membership rules do take issue, however, with the need to limit membership so drastically. They argue that the restriction of membership numbers has no relevance to the question of integrity or ability to operate proficiently in the securities business. Proponents of this side of the argument go so far as to call for open access to the NYSE for all qualified broker-dealers.[71] They see no danger to investors as long as the SEC imposes minimum standards to guarantee character, capital and ability.[72]

If all registered broker-dealers were given access to the NYSE, mutual fund-owned broker-dealers would be included. With institutional trading accounting for about 50% of NYSE volume, there would be a severe shift of commission business away from the present NYSE broker-dealers now employed by the institutional investors.

[69] One of the aims of the scheme of regulation embodied in the Securities Exchange Act was to endeavor to create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets and to allow each type of market to develop in accordance with its natural genius consistently with the public interest.

S. REP. No. 1739, 74th Cong., 2d Sess. 3 (1936), *cited in* Nerenberg, *supra* note 60, at 152.

[70] SPECIAL STUDY, *supra* note 2, pt. 2, at 957. *See* note 69 *supra*. Incidentally, the SPECIAL STUDY concluded that the existence of the third market does not in fact seriously impair the depth of the primary exchange market, since third market transactions are not suited to the exchange mechanism because of their size. SPECIAL STUDY, *supra* note 2, pt. 2, at 902-06.

[71] Chicago Daily News, July 31, 1969, at 51, col. 5; Wall Street Journal, Aug. 1, 1969, at 2, col. 2.

[72] Johnson, *supra* note 7, at 572. The Exchange's argument that limited floor space demands restricting membership to 1,366 members is attacked as anachronistic. JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 149-51.

The Exchange contends that opening the doors in this manner would severely impair the depth and liquidity of the central marketplace, since present NYSE members who depend on this institutional business would be forced out of business.[73] Others suggest that the natural efficiencies of the NYSE central market would forestall any undue tendency toward fractionalization.

The responsibility and authority of the SEC to intervene with respect to membership rules is also at issue. Section 6(b) of the 1934 Act[74] requires registered exchanges to have minimum standards for membership, which must be approved by the SEC. It has never been clearly established that the SEC has powers emanating from section 19(b)(1)[75] to amend NYSE admissions rules in order to establish freer access.[76] On the one hand, while the 1934 Act does not specifically authorize the Exchange's refusal to admit qualified broker-dealers, it may be argued that SEC approval of the Exchange's rules limiting admission impliedly grants such an authorization. On the other hand, antitrust arguments can be made that the practice of arbitrarily restricting membership in the NYSE should be enjoined as a concerted refusal to deal which is a restraint of trade illegal under section 1 of the Sherman Antitrust Act.[77]

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[73] Fear of such a result may be indicated by recent apparent support by the Investment Company Institute for an NYSE plan that would increase volume discounts as a substitute for direct Exchange membership. Wall Street Journal, Sept. 16, 1969, at 3, col. 2. There is debate among financial institutions as to whether these fears are justified. Robards, *Membership Issue Stirs Institutions*, N.Y. Times, Apr. 19, 1970, § 3, at 1, col. 1.

[74] 15 U.S.C. § 78f(b) (1964).

[75] 15 U.S.C. § 78s(b)(1) (1964).

[76] Theoretically, the exchange could go ahead and adopt its rule with the SEC's only recourse being a proceeding to make the exchange justify its action. As a practical matter, however, the exchange doesn't adopt a rule without first answering the SEC's questions.

Wall Street Journal, June 26, 1969, at 2, col. 4.

[77] 15 U.S.C. § 1 (1964). *See, e.g.*, Silver v. NYSE, 373 U.S. 341, 347 (1963); Associated Press v. United States, 326 U.S. 1 (1945); Bale v. Glasgow Bd. of Trade, Inc., 339 F.2d 281 (6th Cir. 1964); cases cited in JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 148. "[T]he antitrust laws require fair and non-discriminatory rules governing membership." *Id.* at 149.

The new public ownership rules originally would have (1) prevented a member from selling more than 49% of its voting stock for three years after the rule takes effect, (2) required a member corporation or its parent to be primarily engaged in business as a broker or dealer in securities, and (3) prevented any member firm from having as a customer a non member who beneficially owns a 5% or larger interest in the member. Wall Street Journal, Nov. 18, 1969, at 3, col. 2. *See also* Wall Street Journal, Dec. 24, 1969, at 3, col. 5. The SEC has suggested that the anticompetitive thrust of the first and third restrictions is unjustified, and the NYSE

Fixed Commission Rate Schedule

This "patchwork of regulations"[78] is viewed by the Department of Justice and many economists as a general scheme to impose rates higher than would be obtained if market forces were given freedom to operate. The Department of Justice has urged the SEC to decide that any fixed rate system is illegal and contrary to the purposes of the 1934 Act or, at least, that it is not necessary to make the Exchange Act work.[79] It takes the position that "not only are the antitrust laws applicable [to this practice], but the objectives of the Exchange Act also are inconsistent with the present rate structure."[80] The Department recommends the gradual elimination of fixed rates with the eventual imposition of negotiated rates, beginning with larger transactions and encompassing all trades within five years.

While agreeing that a revised rate structure is necessary,[81] the position of the NYSE is that the SEC is powerless to eliminate fixed rates, since such were mandated by the 1934 Act.[82] Moreover, the Exchange contends that the results of a negotiated commission rate system would be disastrous. It fears the fractionalization of the

has amended its proposal to remove all but the second restriction. Wall Street Journal, Feb. 27, 1970, at 3, col. 1; Wall Street Journal, March 6, 1970, at 10, col. 1.

To be sure, the recent proposals to allow public ownership of NYSE members are in response to member firms' needs for additional long-term capital. By simultaneously proposing a commission schedule more closely tied to costs, the Exchange hopes to satisfy the capital needs of members while at the same time diminishing the incentive for institutions to seek membership. The thrust of the recent rule change proposals is to preserve for member firms the lucrative commission business represented by mutual fund transactions. Wall Street Journal, July 18, 1969, at 3, col. 1. Therefore, it cannot be said that the reformed rules on public ownership were motivated by a concern for greater competitiou on the part of Exchange members. And inasmuch as the new rules were initiated by the Exchange, it cannot be said that the SEC has adopted a policy of reforming Exchange rules to enhance competition.

78 *See* note 60 *supra.* It is clear that enforcement of the fixed minimum commission rate schedule of the NYSE would be impossible without Rule 394 on third market trading and the limitations on membership in accordance with Article 9 of the NYSE Constitutiou. JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 157-58, referring to an SEC staff study's conclusiou.

79 JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 11, 13.

80 *Id.* at 14.

81 NYSE 1969 ECONOMIC BRIEF, *supra* note 25, at 5.

82 Memorandum of New York Stock Exchange in Reply to Supplemental Memorandum of Antitrust Division, SEC File No. 4-144, at 13 (May 1, 1969) [hereinafter cited as NYSE 1969 Legal Memo], referring to section 19(b)(9) of the 1934 Act, 15 U.S.C. § 78s(b)(9) (1964). *See* text accompanying notes 115-27 *infra.*

centralized securities markets and the establishment of destructive price competition, which would result in the closings of many small, but efficient, brokerage firms as well as a reduction in customer services and innovation.[83] Without the preferential commission rate system, the argument continues, there would be no incentive for membership in the NYSE.[84] Despite the Exchange's proposed revamping of the fixed rate schedule, the SEC has not yet spoken on the challenge to the minimum rate system.[85]

A SURVEY OF THE REGULATORY SCHEME FOR REGISTERED SECURITIES EXCHANGES

There is general agreement that the securities markets do a commendable job of channeling capital into industry and allocating that capital among different industries. Yet, the securities industry has a record marked with scandal[86] and resistance to innovation and progress.[87] In short, its self-regulatory performance has never been commensurate with its responsibility as an industry at the very heart of our economy.

Congress recognized the power and importance of the securities markets when it passed the Securities Exchange Act of 1934. Section 2 of that Act speaks of the necessity for regulation:

> [T]ransactions in securities . . . are affected with a national

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83 NYSE 1969 ECONOMIC BRIEF, *supra* note 25, at 5, 23.

84 *Id.* at 12. The preferential commission rate referred to is the one allowing members to provide floor brokerage and clearing services for other members at a commission rate lower than that charged for providing the same services to nonmembers. The preference for members is retained in the Exchange's 1970 proposed rate changes.

The fears expressed by the NYSE concerning negotiated commission rates are familiar to one who has reviewed the arguments in support of illegal price-fixing arrangements in other industries. *See, e.g.,* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 170-77 (1940). Mr. Justice Douglas stated: "But such defense is typical of the protestations usually made in price-fixing cases. Ruinous competition, financial disaster, evils of price cutting and the like appear throughout our history as ostensible justifications for price-fixing." *Id.* at 220-21.

85 Wall Street Journal, March 11, 1970, at 3, col. 1.

86 *See* text accompanying notes 141-47 *infra.*

87 For years we've been running our business in 19th century style and getting away with it," says a critic within the brokerage industry. "Now we're being brutally shoved into the 21st century—and it hurts." Gilbert Kaplan, publisher of a magazine for professional money managers, The Institutional Investor, renders an equally harsh verdict: "It's a disgrace that an industry which is in the business of assessing other industries and company managements should be so poorly managed itself.

Rolo, *supra* note 50, at 18. *See also, The Vanishing Stock Market,* NEWSWEEK, Feb. 23, 1970, at 71.

public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . .[88]

It is the purpose of this section to define the scope and limits of the Securities Exchange Act of 1934 as it pertains to matters of competition within the securities industry. It will be seen that Congress, in devising a system that includes both exchange self-regulation and exchange supervision through a governmental agency, left significant gaps in its regulatory scheme.

The Absence of Public Utility-Type Regulation

Noting the right of self-regulation embodied in its regulatory scheme, the NYSE argues[89] that government regulation of exchanges is as broad as that for public utility industries and that therefore the securities industry should be similarly dealt with in antitrust matters.[90] The type of "regulation and control" provided for in the 1934 Act apparently falls short of public utility-type regulation.[91] What is or what is not a public utility is largely determined by the nature and extent of governmental regulation over a particular industry. Extensive public regulation of an industry usually takes place when competition cannot be relied on to protect the public interest and private ownership is desirable.[92] Therefore, if Congress did mean to treat the securities industry as a public utility, pervasive regulatory controls to protect consumers (investors) must be found, since treatment as a public utility is tantamount to recognition of the ineffectiveness of competition to perform this function. And if Congress did not mean to treat the securities industry as a public utility, then it must be concluded that Congress intended to rely primarily on the

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88 15 U.S.C. § 78b (1964).

89 NYSE 1969 Legal Memo, *supra* note 82, at 12-13.

90 Yet, the Exehange appears to be unwilling to carry this argument too far, for it rejects the kind of governmental intervention that public utility regulation entails. Public utilities encounter *governmental participation* in decisions on prices (commission rates) and entry into the industry (membership). Self-regulation cannot be deemed a substitute for the kind of governmental participation involved in public regulation. *See* note 98 *infra*.

91 *See* C. PHILLIPS, JR., ECONOMICS OF REGULATION 3-4 (1965). BLACK'S LAW DICTIONARY 1395 (4th ed. 1951) defines "Public Utility" as: "A business or service which is engaged in regularly supplying the public with some commodity or service which is of public consequence and need. . . ." There is growing expectation that the NYSE has arrived at a status in which public utility treatment is appropriate. *See, e.g.*, Rolo, *supra* note 50, at 21.

92 C. PHILLIPS, JR., *supra* note 91, at 6.

forces of competition to protect the interests of investors in those areas where the Act is silent. If the latter is found to be the case, the antitrust laws must have been intended to serve their traditional roles as protectors of the public interest in the operation of the securities industry.[93]

The legislative history of the 1934 Act indicates congressional disappointment with the ability of competition in the securities industry to protect the public interest. The House Committee Report indicates, however, that Congress did not consider this to be a problem inherent in the industry. The Report indicates that Congress felt that competition had never been given a chance to operate in the industry because of the stultifying impact of overbroad self-regulation on normal competition.[94] Rather than treating competition as unworkable in the securities industry, Congress was concerned with *unsupervised* competition in an industry that had been proven vulnerable to fraudulent and unfair practices. Consequently, Congress felt it necessary to put checks into the system where before the industry had been free to "regulate" itself. Those checks were intended to end the era of unsupervised self-regulation.[95]

The Incomplete Regulatory Scheme

The Scope and Standard of Exchange Self-Regulation

Since Congress was disappointed with the performance of self-

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[93] This is the approach generally followed by the Supreme Court in determining the existence of exceptions to the antitrust laws. *See, e.g.*, Silver v. NYSE, 373 U.S. 341 (1963). Even if the antitrust immunity created by the Act is held to be on a par with the immunity granted public utilities, that in no way would assure antitrust immunity for the particular rules and practices of the NYSE: "There is nothing novel about applying the antitrust laws to an industry which is otherwise subject to governmental regulation or control." Nerenberg, *supra* note 60, at 132.

[94] The fundamental fact behind the necessity for this bill is that the leaders of private business, whether because of inertia, pressure of vested interests, lack of organization, or otherwise, have not since the war been able to act to protect themselves by compelling a continuous and orderly program of change in methods and standards of doing business to match the degree to which the economic system has itself been constantly changing . . . . [E]nlightened self-interest in private leadership is not sufficiently powerful to effect the necessary changes alone . . . . [P]rivate leadership seeking to make changes [to protect the public] must be given Government help and protection.

H.R. REP. No. 1383, 73d Cong., 2d Sess. 3 (1934), *cited in* Silver v. NYSE, 373 U.S. 341, 351 (1963).

[95] Nerenberg, *supra* note 60, at 133. Thus, one authority concludes that "federal regulation of the securities field was designed to curb existing abuses." *Id.* Another views the dominating concern of Congress as being to protect investors from fraud and unfair practices. 2 Loss 1165-67. There was also concern about maintaining a viable central market.

regulation in the securities industry, it used the 1934 Act to place self-regulation under governmental supervision. Professor Loss concludes that self-regulation was adopted not as a substitute for legislation and direct supervision, but as a supplement to such forces. Its sphere of influence was considered to be placed primarily on industry ethics, with unethical practices being defined as those which are seriously damaging to the mechanics of the free and open market.[96] A watchdog commission was contemplated, with self-regulation being retained "on grounds of practicality and the potential ineffectiveness of direct governmental regulation on a wide scale."[97]

However, the scope of self-regulatory activity was limited. In imposing statutory limits on self-regulation, Congress revealed no express intention that the scope of self-regulation extend to matters of competition among broker-dealers.[98] As one authority has written:

> Although the Act sanctions the exchange type of organization, it makes no attempt to legalize every type of activity which could be fostered through joint action. Indeed, certain powers are given the SEC to interfere directly and indirectly into matters of exchange policy when it becomes necessary to carry out the statutory duties imposed by the Exchange Act.[99]

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[96] 2 Loss 1361, *citing* S. REP. No. 1455, 75th Cong., 3d Sess., at 3; H.R. REP. No 2307, 75th Cong., 3d Sess., at 4 (1938). Note that Loss is referring to the "free and open" market for *securities*, not the market for *brokerage services*.

The SPECIAL STUDY notes three reasons for public supervision of self-regulation, but it does not give reference to the legislative history to indicate that the reasons it suggests were actually the ones that motivated Congress. Those three reasons cited by the SPECIAL STUDY are: (1) to assure that the self-regulatory agency assumes its assigned responsibility; (2) to assure that any impairment in competition is only as great as required by the purpose of regulation and that such impairment is adequately compensated for by effective regulation; (3) to provide the public oversight attendant to the public utility role performed by the agency sought to be regulated. SPECIAL STUDY, *supra* note 2, pt. 4, at 502.

[97] Nerenberg, *supra* note 60, at 133. The inference here again refers to the area of industry ethics.

[98] 2 Loss 1175-76. The last part of this paper will demonstrate that courts narrowly construe the ambit of congressionally-authorized self-regulation. Thus, explicit language is required to lift the antitrust laws from application to self-regulatory activity. And, unless Congress simultaneously provides for effective administrative review of that self-regulatory activity that *is* explicitly authorized, it has exceeded its powers of delegation. Total self-regulation is a euphemism for no regulation at all. *See, e.g.*, Carter v. Carter Coal Co., 298 U.S. 238 (1936); Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

[99] Johnson, *supra* note 7, at 555. A question of great importance is whether these "duties" involve the enforcement of the policies expressed in the antitrust laws. This question is deferred to the next section.

For example, exchange rules must be found by the SEC not to be "inconsistent with just and equitable principles of trade."[100]

This statutory scheme can be interpreted as giving the SEC a great deal of discretion in deciding where self-regulation ends and direct governmental supervision begins.[101] A Commission member who served shortly after passage of the 1934 Act expressed strong reservations against relying on the self-regulatory concept. Commissioner William O. Douglas described the role of the SEC as a residual one with government keeping "the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used."[102]

Without this introduction of SEC supervision, exchange self-regulation would still be subject to the abuses which prompted Congress to act, and it certainly would offer no antitrust immunity for the exchanges. Unsupervised self-regulation apparently will not perform the antitrust function.[103]

There are some authorized "built-in anticompetitive effects" in the self-regulatory system, but those anticompetitive effects are authorized by the 1934 Act ouly to the extent necessary to accomplish the policies of the Act. This narrow construction of the scope of self-regulation follows from the conclusion that the very types of collective activity authorized by the 1934 Act would be violative of the antitrust laws[104] if found in an unsupervised industry. Therefore, unless Congress explicitly authorizes such collective activity for the accomplishment of some policy within its power to effectuate, that collective activity should fall under antitrust law. Thus, the scope of self-regulation should be interpreted to allow only the kinds of cooperative behavior necessary to accomplish Congress' purposes.

Congressional concern was with activities of the exchange members who had previously participated in fraudulent practices and un-

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100 1934 Act § 6(b), 15 U.S.C. § 78f(b) (1964). Loss observes that this broad phrase was chosen as a standard "because of its long history in exchange rules and in court cases in which those rules have been brought in question." 2 Loss 1364 n.11.

101 2 Loss 1180.

102 W. DOUGLAS, DEMOCRACY AND FINANCE 64-65 (Allen ed. 1940), *cited in* 2 Loss 1180-81 and in Silver v. NYSE, 373 U.S. 341, 352 (1963).

103 Nerenberg, *supra* note 60, at 157. *See* note 98 *supra*.

104 Antitrust law traditionally disapproves of self-regulation which is not pursuant to express legislative authorization. FTC Advisory Opinion, Digest No. 59, *cited in* J. Rahl, Materials on Antitrust Law (unpublished work in Northwestern U. Law School Library) 6-100 (1969).

ethical dealings rather than with the activities of the exchanges as entities in themselves. This leads to the conclusion that self-regulation was relied on to supplement government supervision of the *markets for securities*, but that self-regulation was not expected to have a significant role in the supervision of the *market for brokerage services*. It is competition within this latter market with which this article is concerned. In the area of markets for securities, direct SEC supervision was established for the first time by the 1934 Act. Yet no such supervision was established over the market for brokerage services.

The Role of the SEC

The scope and standard of SEC regulations over exchanges

The 1934 Act calls for the registration with the SEC of all exchanges, brokers, and dealers.[105] The SEC is required to register all exchanges which have satisfactory rules covering a minimum range of activities[106] if the rules are found to be "just and adequate to insure fair dealing and to protect investors."[107] Once an exchange is registered, the Exchange Act authorizes it to adopt—and the SEC to approve—any rules "not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the state in which it is located."[108] Section 6(a)(4)[109] requires registered exchanges to submit all proposed rules changes to the SEC.

There is debate as to whether the SEC's standard of review for exchange rules incorporates antitrust considerations. It may be argued that to the extent that competition is necessary to protect investors the SEC would take that factor into consideration in passing on the rules of exchanges. While such a reading is not inconsistent with the statute, the Act itself nonetheless lacks an explicit antitrust standard. In marked contrast, competitive standards are incorporated into statutes governing other regulated industries, including transportation, natural gas pipeline, and banking.[110] All that can

105 Sections 5 & 15 of the 1934 Act, 15 U.S.C. § 78e (1964) (requiring registration of exchanges); 15 U.S.C. § 78o (1964) (requiring registration of brokers and dealers).

106 15 U.S.C. § 78f(b) (1964). Rules must cover expulsion, suspension, and disciplining of members.

107 1934 Act § 6(d); 15 U.S.C. § 78f(d) (1964).

108 1934 Act § 6(c); 15 U.S.C. § 78f(c) (1964).

109 15 U.S.C. § 78f(a)(4) (1964).

110 *See, e.g.*, California v. Federal Power Comm'n, 369 U.S. 482, 485 (1962).

be concluded from the language of the Securities Exchange Act, therefore, is that (1) it would not be inappropriate for the SEC to consider the competitive impact of exchange rules when those rules are presented for Commission consideration, but (2) there is no statutory duty, in the absence of a legislative standard, for the Commission to do so.[111]

With only an implied duty to consider the competitive impact of exchange rules, the question arises as to whether SEC approval might act to insulate an exchange rule from attack under the antitrust laws.[112] Two factors lead to the conclusion that the SEC is not charged with review of antitrust considerations. The first has already been noted: the absence of a clear statutory duty to apply an antitrust standard. The second will be discussed shortly: the SEC's history of inattention to matters of competition in those areas where discretionary powers exist. Each of these factors results in a regulatory system that is not pervasive, *i.e.*, which contains gaps for the application of other laws to the activities of the securities industry. Perhaps the best example of the non-pervasiveness of the regulatory scheme is the fact that the SEC takes a passive, rather than active, role in the rule-making process.

> The SEC does not give affirmative sanction to rules filed by national exchanges. Its grant of registration to an exchange goes no further than indicating that the rules filed meet the minimum standards required of exchanges by the statute so as to insure that its members will comply with the provisions of the law and shall not conduct themselves in a manner inconsistent with just and equitable principles of trade.[113]

This passivity is not absolutely required, but it is allowed. As

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[111] Therefore, the SEC may evaluate competitive considerations as it did in the *Multiple Trading Case* and more recently when it amended the NYSE proposal for rules on public ownership, or it may overlook such considerations as it evidently has done on past rate changes and past membership rules enacted by the NYSE.

[112] *See* California v. Federal Power Comm'n, 369 U.S. 482, 485-86 (1962). The last part of this paper will also demonstrate that eveu when administrative agencies have *explicit* statutory duties to consider the competitive impact of the activities it authorizes, it may be unable to create antitrust immunity for the companies engaging in those events. *See, e.g.*, the discussion of the bauk merger cases in text accompanying notes 287-317 *infra,* construing 12 U.S.C. § 1828(c) (Supp. IV, 1969). It would follow that the SEC, with only implied duties in this area, should have no greater power of immunization

[113] Silver v. NYSE, 196 F. Supp. 209, 221 (S.D.N.Y. 1961), *rev'd on other grounds*, 302 F.2d 714 (2d Cir. 1962), *rev'd on other grounds*, 373 U.S. 341 (1963). In note 100 *supra*, we indicated the source of the phrase "just and equitable principles of trade." There is no clear inclusion of antitrust principles in this phrase.

the discussion of section 19(b) of the 1934 Act will show, the SEC has more power over exchange rules than it has exercised; yet, as long as that power is discretionary—no matter how vigorously it may be applied from time to time—there is a gap in the regulatory system that opens the door for unsupervised self-regulation.

Although the SEC may have the *power* to compel exchange rules to preserve competition wherever that competition is consistent with the goals of the 1934 Act, it does not have the *duty* to do so. This interpretation is consistent with the kind of regulatory system Congress adopted: one that calls for supervision rather than direct SEC participation in the industry's decision-making process.[114]

Analysis of section 19(b)

One of the rarely-used powers held by the SEC is contained in section 19, which is entitled "Powers with respect to exchanges and securities." Exercise of these powers is discretionary, with action taken when deemed "necessary or appropriate for the protection of investors."[115] Section 19(b) "authorizes the Commission by rule or order to 'alter or supplement' the rules and practices of any exchange, after written request to the exchange and opportunity for hearing upon the exchange's refusal."[116] This authority extends to the fixing of reasonable rates of commission, interest, listing, and other charges.[117]

Controversy has focused on SEC power to review rules fixing rates of commission contained in section 19(b)(9). The Justice Department argues that the language of this section authorizes the SEC to eliminate the practice of fixing rates,[118] while the NYSE maintains that the authority to alter rules fixing rates is limited to

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114 Johnson, *supra* note 7, at 555. *See* note 112 *supra*.

115 1934 Act § 19(a); 15 U.S.C. § 78s(a) (1964). Even in areas in which courts have applied the substantial evidence test to SEC actions, the conrts have recognized the element of discretion in the regulatory scheme. *See, e.g.*, Wright v. SEC, 112 F.2d 89, 95-96 (2d Cir. 1940), 134 F.2d 733 (2d Cir. 1943), *cited in* 2 Loss 1174.

116 2 Loss 1179.

117 15 U.S.C. § 78s(b)(9) (1964). Commission authority also extends to rules concerning: (1) financial responsibility of members; (2) registration limitations; (3) listing; (4) hours of trading; (5) soliciting practices; (6) fictitious or numbered accounts; (7) timing of transactions; (8) reporting of transactions; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters. 15 U.S.C. § 78s(b) (1964).

118 JUSTICE DEPARTMENT BRIEF, *supra* note 5, at 15.

altering the *rates* that are fixed, not the *practice* of fixing them.[119] The Exchange goes so far as to argue that the system of fixing minimum rates is mandated by the statutory language of the 1934 Act.[120] The Exchange supports this argument with its interpretation of section 3(a)(3)[121] of the 1934 Act. That section defines a member of a national securities exchange as a person who is permitted to effect transactions on the exchange "with the payment of a commission or fee which is less than that charged the general public . . . ."[122]

[119] NYSE 1969 Legal Memo, *supra* note 82, at 3. The Exchange takes the position that regulation of rates in the securities industry is analagous to rate regulation in the traditionally regulated industries such as transportation and electricity. The next section will show that this is an oversimplification and that the analogy does not fit. In fact, the legislative committee specifically rejected the administrative agency rate-fixing approach. Nerenberg, *supra* note 60, at 151. The real issue in the securities field is not the reasonableness of the *rates* (to which the argument of administrative expertise is applicable for support of the doctrine of primary jurisdiction, with review only by the substantial evidence test), but the reasonableness of the *practice* of fixing rates.

[120] NYSE 1969 Legal Memo, *supra* note 82, at 5.

[121] 15 U.S.C. § 78c(a)(3) (1964).

[122] *Id.* In response to this argument, one might contend that the restrictive membership rules of the NYSE have operated to change the definition of "general public" from "investors" (which Congress probably meant) to "those broker-dealers not privileged with admission to the NYSE club." *See* text accompanying note 45 *supra* for the restrictive membership rules.

The Exchange also argues that the absence of discussion of the minimum fixed rate system in the legislative hearings on the 1934 Act is indicative of congressional approval of such a system. This was not one of the abuses at which the Act was directed, the argument continues. A response to this argument would be to suggest that Congress was not so short-sighted. The purpose of emphasizing earlier the limited types of abuses which prompted Congress to act in 1934 was to note the absence of congressional intent to rely on self regulation to assure competition among exchanges. While limited *types* of abuses prompted Congress to enaet the 1934 legislation, the language of section 19(b) was made sufficiently broad to enable the SEC to prevent future abuses, even if they be different from those encountered in the past. Indeed, those future abuses may include the continued application of anachronistic rules if the effect of those rules changes from one of protecting investors to one of injuring them (or a certain class of them) because of changing economic conditions.

The high point of SEC performance in the area of encouraging competition in the securities exchanges came in the *Multiple Trading Case* in 1941. *See* the discussion of this case in note 150 *infra.* There the Commission did exercise its 19(b) powers to amend the present Rule 394 of the NYSE to remove its impact on regional exchanges. In this case the Commissioners felt a responsibility to incorporate an antitrust standard into its own standard for action under section 19(b). This case illustrates that the power is in the Commission, but the rarity of application of the approach applied in the *Multiple Trading Case* illustrates a gap in the regulatory system. The growth of the importance of institutional investors and of the third market has changed the economic impact of Rule 394. It follows that the SEC's attitude toward the rule should change also, simply by applying the same approach that

A rebuttal to these arguments implying the power to fix rates emphasizes the need for explicit congressional language for the creation of such power:

> [T]he existence of so important and pervasive a structure of commission rates ought to rest on sounder legal foundation. . . . [I]n the absence of further regulatory control by the Commission, it would appear that the present rate structure may be susceptible to antitrust enforcement.[123]

Another argument which is put forth as justifying the NYSE's power to fix minimum rates with resultant antitrust immunity is that the SEC and Congress have acquiesced in the practice.[124] Yet, inasmuch as Congress explicitly rejected the administrative rate-making approach used in the public utilities,[125] something more than acquiescence should be required to authorize what would clearly be an illegal practice in the absence of congressional authorization.[126]

Even if the SEC does not have power sufficiently pervasive to warrant interpreting Commission approval as tantamount to antitrust exemption, there can be little doubt that the agency does have the authority under section 19(b) to impose new rate schedules on the exchange—including "everything suggested by either the Exchange or the Department of Justice, not to mention the SEC's own proposed Rule 10b-10."[127]

To better understand the power the SEC does possess and what that means in terms of antitrust considerations when the SEC does act, it is helpful to look at the SEC's powers over the National Association of Securities Dealers (NASD).

Comparison with SEC regulation of the NASD.

The 1934 Act was amended in 1938 by the Maloney Act,[128] which extended SEC supervision to the over-the-counter markets by requiring registration of securities dealers associations, whose rules, in turn, became subject to SEC review and oversight. The measure

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was used in the *Multiple Trading Case.*

123 Nerenberg, *supra* note 60, at 151.

124 NYSE 1969 Legal Memo, *supra* note 82, at 14. *See also* Johnson, *supra* note 7, at 565. Support for this argument is found in Kaplan v. Lehman Bros., 250 F. Supp. 562 (N.D. Ill. 1966).

125 Nerenberg, *supra* note 60, at 151. An early draft of the bill with such a proposal was rejected.

126 *See* note 122 *supra.*

127 5 Loss 3180.

128 "The Maloney Act," 15 U.S.C. §§ 78o-3(a) to (n) (1964), known as § 15A of the 1934 Act.

vastly increased the SEC's direct involvement in policing the securities industry.

The language which Congress used in defining the Commission's powers over dealer associations[129] and the rules of such associations is more explicit than that used in the original 1934 Act, and the bounds of self-regulation are much more precisely spelled out. Significantly, membership may not be restricted except for certain specified objective reasons incorporated into the statute,[130] and the association is forbidden to implement rules which are intended "to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges."[131] Moreover, the Commission is empowered to abrogate, alter, or supplement the rules of the NASD.[132]

Senator Maloney himself described the NASD scheme as "not so much self-regulation as 'cooperative regulation.'"[133] The critical difference between the Maloney Act and the 1934 Act—a difference that makes equating the degree of immunity accompanying each of the acts totally inappropriate—is the flexibility that each gives to the rule-making authority of the entity being regulated. Membership

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129 The National Association of Securities Dealers (NASD) is the only association registered with the SEC; therefore, we may refer to it from time to time as though the Maloney Act were directed specifically at this association.

130 1934 Act §§ 15A(b)(3), (4), 15 U.S.C. §§ 78o-3(b)(3), (4) (1964).

131 1934 Act § 15A(b) (8), 15 U.S.C. § 78o-3(b) (8) (1964).

132 1934 Act § 15A(k), 15 U.S.C. § 78o-3(k) (1964). This power over the NASD's rules is, of course, subject to congressionally established standards. One standard requires that the NASD's rules be consistent with the requirements of the Maloney Act.

> The Commission may . . . *abrogate* any rule of a registered association if, after appropriate notice and opportunity for hearing, it concludes 'that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purpose of' the Exchange Act.

2 Loss 1364, *citing* provisions of § 15A(k)(1), 15 U.S.C. § 78o-3(k)(1) (1964) (emphasis added). The power to *alter* or *supplement* NASD rules after request, notice, and opportunity for hearing may be exercised if it is deemed

> necessary or appropriate in the public interest or for the protection of investors or to effectuate the purpose of section 15A; but this authority, unlike the power to abrogate rules, applies only to association rules having to do with (1) denial of membership, barring from association with a member, and the qualifications and disciplining of members and their associates, (2) the method of adopting or amending rules, (3) the method of choosing officers and directors, and (4) affiliation between registered associations.

2 Loss 1364 & 5 Loss 3449, *summarizing* § 15A(k) (2), 15 U.S.C. § 78o-3(k) (2) (1964). Note the contrast with powers over exchange rules delineated in § 19(b). (Reviewed following note 117 *supra*.)

133 2 Loss 1362, *citing* 83 CONG. REC. 4451 (1938).

in an approved securities dealers association "must be open to any over-the-counter broker or dealer except those who may be restricted on such a specified and appropriate basis as the *Commission* may approve."[134] Furthermore, the Maloney amendment demands that all those affected by an approved association's rules be represented in the rule-making process of the association. NASD rules must provide for "safeguard[s] against unreasonable profits or unreasonable rates of commissions or other charges . . . and . . . [removing] impediments to . . . the mechanism of a free and open market . . . ."[135] To repeat, the NASD is prohibited from adopting rules leading to the fixing of prices, commissions, or other charges. In short, the regulatory scheme is much more pervasive than that under which the exchanges are supervised.

The SEC is required by the Maloney Act to alter, supplement, or abrogate NASD rules that are in conflict with this pervasive regulatory scheme. Parties who feel they are being injured because of NASD noncompliance with the limitations imposed on that organization by the Maloney Act have remedies within the regulatory scheme. If the SEC should refuse to abrogate a NASD rule that violates the limits of the NASD's powers as defined by the Maloney Act, an injured party may seek judicial review of the SEC's refusal. This judicial review is an integral part of the pervasive regulatory scheme.

The non-pervasiveness of SEC supervision over exchanges is highlighted by two basic differences between the 1934 Act and the 1938 Maloney Act. First, exchanges are not limited by the 1934 Act from making non-competitive rules concerning commissions, membership, and unrepresentative control of the internal management of the exchanges; the NASD is foreclosed from making these kinds of noncompetitive rules. Second, because of the freedom of the SEC to approve such noncompetitive rules if adopted by an exchange, a person injured by such a rule has no avenue of protection built into the 1934 Act; but a person injured by such a noncompetitive rule, if adopted by the NASD, has a remedy built into the Maloney Act.[136]

Thus, a grant of antitrust immunity to an organization comply-

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[134] 2 Loss 1363 (emphasis added).

[135] 1934 Act § 15A(b)(8), 15 U.S.C. § 78o-3(b)(8) (1964).

[136] *See* Administrative Procedure Act §§ 10(a),(b), 5 U.S.C. §§ 702, 703 (1964). *See also* 15 U.S.C. §§ 78o-3(g), 78y(a) (1964).

ing with the standards of the Maloney Act results in practically no danger of public injury from collusion or other anticompetitive activities. While NASD members are authorized to engage in certain group activities that would be subject to antitrust prosecution in the absence of immunity to the antitrust laws, the immunity that is offered is extremely limited.[137] It authorizes only those activities which Congress deemed would result in a public benefit that outweighs any public injury which might result from those activities. To make sure that its purpose of allowing only a narrow immunity to the antitrust laws would not be judicially or administratively broadened, Congress built in express denials of authority to enter into that type of anticompetitive behavior that it evidently deemed no direct public benefit could counterbalance.[138] Indications are that Congress is satisfied with the distinction between the NASD and the securities exchanges as far as antitrust immunity is concerned.[139]

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137 "If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provisions of this section shall prevail." Maloney Act § 15A(n), 15 U.S.C. § 78o-3(n) (1964).

138 It is ironic that these explicitly proscribed activities and rules are precisely the activities and rules that the NYSE argues are authorized for exchanges by the 1934 Act. It argues by negative implication that if Congress explicitly denied the NASD the power to adopt these kinds of rules (fixing commissions, restricting membership, internal anticompetitive rules), then its failure explicitly to deny exchanges the power to make such rules indicates an acquiescence to the exchanges' adoption of such rules. The answer to this argument is to turn it around: The NASD is explicitly made exempt from the antitrust laws, but the exchanges are not; therefore, the antitrust laws were relied on to prevent the exchanges from adopting the kinds of rules that are presently being challenged. Congress felt it necessary to circumscribe explicitly the NASD's rule-making authority because of the antitrust exemption (which was necessary to accomplish the desired activities which the Maloney Act fostered). There was no similar need to circumscribe explicitly exchange rule-making authority, since that authority was to be kept in check by the antitrust laws—and that is why there is no express antitrust exemption built into the 1934 Act.

139 There has been no visible inclination to enlarge the antitrust immunity of the exchanges. This fact is all the more significant, since it is despite efforts of the Commission to accomplish this result. *See* Letter of SEC Chairman Cohen to Congressman Celler of the House Committee on Interstate and Foreign Commerce, Sept. 22, 1965, *cited in* 5 Loss 3470. The Commission has appealed to Congress for clarifying legislation to establish that the SEC is the forum for "achieving a rcasonable accomodation between the policies of the securities laws and the antitrust laws." 5 Loss 3171, *citing* 111 CONG. REC. 19,021 (1965). The SEC apparently would like the type of authority granted the ICC in the Reed-Bulwinkle Act of 1948, 49 U.S.C. § 5b (1964), empowering that agency to grant antitrust immunity with respect to certain rate agreements approved by it—subject to the standard that any so-approved agrcement is considered to be in furtherance of national transportation policy as declared by the ICC itself. 5 Loss 3171-72.

Summary: Limited but sufficient power.

Although the SEC cannot extend antitrust immunity to rules which it approves, the Commission does have the power to alter exchange rules so that they will not unnecessarily conflict with the antitrust laws. Even if the Exchange is correct in stating that it is authorized to fix the rate structure, then it must submit that rate structure to the SEC; and the SEC has the power and authority to modify it under section 19(b). If the Exchange is incorrect in implying the authority to fix commission rates as the analysis in the preceding section concluded, then the SEC has the power and authority to condemn that practice, to promulgate rules against it, and to punish violators of such rules.

Gaps in the Regulatory System: Performance of Self-Regulation and the Quality of SEC Review

Two considerations militate against either exchange self-regulation or SEC action being a source of immunity to antitrust attack. First is the absence of a self-contained, pervasive regulatory scheme with enforceable remedies for those who might be injured by its operation, as just discussed. Second is the poor performance of exchange self-regulation and SEC supervision in matters of competition. This insensitivity to the competitive impact of exchange rules and practices not only creates a gap of its own in the regulatory scheme, but also compounds the problem presented by the first gap of non-pervasiveness.

Exchange Self-Regulation

In 1940, Commissioner Douglas expressed doubts that self-regulation by the securities industry would protect the public's interest, warning: "For a business so vested with the public interest, this traditional method has become archaic."[140] Unfortunately, there have since been few developments indicating an attitude of greater responsibility on the part of the exchanges or the broker-

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Congress' failure to act on these proposals should be interpreted as an argument *against* the NYSE's suggestion of implying that the SEC already has such immunizing authority. It might be possible to interpret congressional silence as indicating that the SEC already has this power. However, since the efforts described above came after the *Silver* opinion, it would appear that such an interpretatiou cannot be justified. *See* Wall Street Journal, Apr. 29, 1970, at 9, col. 1.

[140] W. DOUGLAS, *supra* note 102, at 65.

dealer industry in general. Even the rules which have proven to be anticompetitive have not been enforced evenly by the Exchange.[141]

The primary criticism against the exchange community is that it seems to act only when goaded by outside pressure, and then not always constructively. For instance: (1) the NYSE internal reorganization in the early 1940's came only after the famed Whitney scandal,[142] and even that reorganization did not directly affect the causes that led to the Whitney problem;[143] (2) the Amex imposed greater restrictions on its members only after an SEC study of fraudulent activities by the Re brothers, specialists on the Amex;[144] and (3) recent industry suggestions for changes such as volume discounts, public ownership of member firms, and improved back office procedures have come only after customer outcry and SEC pressure.[145] This reticence toward reform, with progress only in response to scandals or government pressure, causes a loss of confidence in the

141 The prevalent give-up practices that have been used to escape NYSE restrictions on competing for institutional investor business were described by the Exchange itself as "an intricate maze." CCH SELECTED COMMENTS, *supra* note 62, at 14.

142 2 Loss 1181. The scandal resulted from the discovery that an Exchange member had been operating for three years while being insolvent. The firm of Richard Whitney & Co. was subsequently expelled from the Exchange and its president was imprisoned.

143 The criticisms that had been raised by Commissioner Douglas and others (and which the *Whitney* case dramatized) were directed toward the self-regulatory process itself. The reorganization effected by the Exchange only provided for broader representation on the Exchange's Board of Governors. 2 Loss 1181-82. Therefore, the SEC felt it necessary to go to Congress to request the power to *enforce* exchange rules after an exchange had been registered. At that time the SEC could not directly discipline an exchange member for violating exchange rules. Despite the exposure of yet another scandal during the congressional hearings on the proposed 1941 amendments (In the Matter of Disciplinary Proceedings of the New York Curb Exchange, Report of Investigations (1941), *summarized in* 10 SEC ANN. REP. 36-37 (1944)), the Exchange argued that there should be no interference with the 1934 Act's mandate for self-regulation. 2 Loss 1177.

144 SPECIAL STUDY, *supra* note 2, pt. 4, App. XII-A, at 52-53.

145 The events leading to the adoption of the interim commission rate structure offer justification for one's skepticism of the NYSE's interest in serving the public efficiently and economically. First, in 1961, Congress became concerned and added § 19(d), 15 U.S.C. § 78s(d) (1964), to the 1934 Act, enabling the SEC to conduct the SPECIAL STUDY. The American Exchange immediately appointed a blue-ribbon committee to study the need for reform. Although the committee recommended some changes, before they could be enacted the interim report of the SPECIAL STUDY was published in January, 1962. Focusing entirely on the Amex, this report devastated the last rays of confidence in self-regulation. *See* SPECIAL STUDY, *supra* note 2, pt. 4, at 751-814, *cited in* 5 Loss 3146. The final report

ability of self-regulation to serve the public interest.[146] As one student of the industry has summarized:

> A more open approach by the NYSE would have the advantage of engaging the expertise and experience of that body in exploring the feasibility of competitive rates. Moreover, such an approach would demonstrate that the Exchange's entrenched position is motivated by the public interest, not by a desire to solidify its lucrative monopoly on the commission business.[147]

Laxness of SEC Supervision and Control in Matters of Competition

The SEC has not been particularly helpful in controlling these abuses of self-regulation. This is partly true because the SEC lacked clear congressional authorization to police the exchanges in

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of the SPECIAL STUDY criticized the conduct of self-regulation on the New York Stock Exchange as well. *Id.* at 570-71.

Yet, the NYSE continued to fight reform. At first, the Exchange favored the retention of give-ups; but after the Justice Department intervened, the Exchange offered what amounted to a compromise plan for eliminating give-ups if the Commission would force the regional exchanges to do the same. This was apparently an attempt to take the pressure off the minimum commission rate structure itself by eliminating the cause that had brought to the nation's attention the inappropriateness of the rate structure. Protection from antitrust attack was also a motivating factor. The result of these negotiations was the interim rate schedule put into effect December 5, 1968. This interim schedule was offered *despite* the NYSE's economic study that fixed rates were necessary. 5 Loss 3182-83; Note, *The NYSE Minimum Commission Rate Structure: Antitrust on Wall Street*, 55 VA. L. REV. 661, 689-90 (1969) [hereinafter cited as Note, 55 VA. L. REV. 661 (1969)].

> Eventually, these pressures—a more aggressive Commission, the anti-trust threat, the diversion of business from the NYSE—combined to produce a new proposal by the NYSE which, for the first time, gave serious attention to the need of some basic revisions in the commission rate schedule.

Robbins, *Securities Industry at the Crossroads, supra* note 29, at 6. The 1970 rate changes proposed by the NYSE concentrate on increasing Commission revenue instead of on lowering costs. *See* Wall Street Journal, Feb. 16, 1970, at 3, col. 1.

Another example of the Exchange community's disregard for the best interests of investors is its apparent reluctance to initiate the modernization of exchange and back office procedures. Although recently the exchanges and their members have made significant efforts in this direction, Wall Street Journal, July 9, 1969, at 9, col. 2, *id.*, June 20, 1969, at 4, col. 2, such efforts appear to have been more in response to outside pressure than to internal motivation. "[P]rogress with respect to exchanges' trading mechanisms has not been impressive." SPECIAL STUDY, *supra* note 2, pt. 2, at 357. Conversations with economists, SEC staff, and Antitrust Division attorneys showed a unanimous consensus that the securities industry has behaved like a slumbering giant in respect to innovation and mechanization. Such a situation can be explained only by the presence of a virtual monopoly situation.

146 Another example of abdication of self-regulatory responsibilities is found in NYSE odd-lot practice. *See* SPECIAL STUDY, *supra* note 2, pt. 2, at 172-73. *See* note 60 *supra*.

147 Note, 55 VA. L. REV. 661, 690 (1969).

these critical areas. Principally, however, the explanation rests more with an unwillingness or inability[148] to exercise what power has been available.[149]

One exception to the SEC's neglect of competitive factors was the Commission's action in the *Multiple Trading Case*.[150] But even this was only in response to the cries of the regional exchanges, and not an example of SEC initiative. The case involved old Rule 394 of the NYSE, which prohibited its members from executing trades in NYSE-listed securities on any other exchange or market. The Rule was criticised by the Commission under the authority of section 19(b) as violative of a basic purpose of the 1934 Act. That purpose was described as

> a purpose which is closely related to the public policy regarding unreasonable restraints and the maintenance of fair competition as declared by Congress in the Sherman Act, the Clayton Act, and the Federal Trade Commission Act.[151]

The Commission's action in the *Multiple Trading Case* is easily overbalanced by its inaction in other areas of anticompetitive activities. The *Special Study* leveled severe criticism against the SEC for

> its relative inattentiveness in the past to the exchanges' commission rate structures . . . . During a period of some thirty years of SEC interest in exchange commissions . . . the most tangible progress has been the development by the New York Stock Exchange of some statistics dealing with costs and profits, which had been used principally to justify rate increases.[152]

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148 Part of the problem undoubtedly results from the limited staff and funds allocated to the SEC. The Commission does a commendable job in its supervision of registration and reporting requirements of issuers of securities as well as enforcing various antifraud sections of the securities laws. This leaves too few people and dollars for adequate attention to matters of competition. Yet, a more critical attitude, similar to that being evidenced now in regard to proposed rules changes on public ownership and the commission rate structure, goes a long way toward creating the consciousness of supervision in the decision-making process of the exchanges.

149 For example, the Commission did not exercise its rule-making authority under the bookkeeping, reporting and inspection provisions of § 17(a), 15 U.S.C. § 78q(a) (1964), until Rule 17a-8 was adopted in 1964, requiring the submission of proposed changes in exchange rules at least three weeks before any action is taken by the exchange with respect to a proposed rule. 5 Loss 3126-27, 3151-52.

150 Rules of the New York Stock Exchange, 10 S.E.C. 270 (1941).

151 *Id.* at 287.

152 S. Robbins, The Securities Markets: Operations and Issues 69-70 (1946), *cited in* 5 Loss at 3185-86. Writing elsewhere, Robbins notes:

> The history of the commission rate provides a good illustration of the lethargy, until recent years, on the part of the Commission towards its regulatory responsibilities and the seeming concern of the NYSE, the major self-regulatory agency, at least until recently, with the welfare of its members rather than the

Professor Loss describes SEC review of exchange rules as having a history of laxness. For example, only informal hearings were held in section 19(b) review proceedings, and the 1958 commission rate increases had been in effect eleven months before the SEC won NYSE compliance with a suggested modification for small transactions.[153] Moreover, prior to the Justice Department's intervention in the commission rate controversy, three years of rate negotiations between the SEC and the Exchange had been unproductive.[154]

Some commentators have contended that the Commission's declaration in the *Multiple Trading Case* is sufficient to end any doubts over the Commission's concern for competition in its decision-making process.[155] Unfortunately, this dictum in the Commission's opinion is not sufficient to establish the presence of an antitrust standard in the 1934 Act. It will be seen in the next section that the courts agree with this position. Not only was the Commission's language dictum, but it was guided by no precise statutory standard. The inference of the Commission's statement is that antitrust policy may sometimes coincide with the policy of the 1934 Act, and that sometimes it will not. The Commission offers no indication of when the two schemes coincide or how it would answer the question in a future case. A question of major importance for this undertaking is whether the Commission should be left to its discretion to decide when the two statutory schemes merge. The absence of a clearer standard in the 1934 Act is a sufficient reason for a negative answer to this question. It should be noted that it was the guidelines of the Securities Exchange Act that the Commissioners relied on in the *Multiple Trading Case*, not the antitrust laws themselves. Thus, even this SEC opinion does not indicate that the Commission

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interests of the public.
Robbins, *supra* note 29, at 5.

[153] 5 Loss 3150. Of course, this was prior to the adoption of Rule 17a-8 in 1964, requiring rules changes to be submitted to the SEC at least three weeks before formal exchange action is taken.

[154] *See* 5 Loss 3176-80; Note, 55 VA. L. REV. 661, 667 (1969), *citing* Wall Street Journal, May 31, 1968, at 3, col. 1.

[155] Nerenberg notes that the *Multiple Trading Case* was the only opportunity the SEC has had "to weigh the anticompetitive effects of exchange rules." Nerenberg, *supra* note 60, at 135. While it may be correct to say that only once *has* the SEC looked to the anticompetitive effects of an exchange rule in deciding whether or not to approve it, it is nonetheless true that every time an exchange rule is presented to the SEC for approval the SEC has an *opportunity* (or "occasion" as Nerenberg puts it) to weigh the anticompetitive effects of the exchange rule. *See* note 111 *supra*.

considers itself bound by the antitrust laws—as if that would be sufficent to resolve the question.

Summary

There is nothing built into the regulatory scheme of the 1934 Act which *directly performs the antitrust function* of guarding against anticompetitive behavior in the market for brokerage services. Self-regulation cannot be considered a substitute for the antitrust laws, since the sphere of influence given to exchanges was limited to industry ethics. The SEC has neither exclusive antitrust authority nor sufficient inclination to exercise the authority it does have. Since there is residual power in the courts to hear antitrust actions, this power must be relied on to fill the gaps left by Congress in the regulatory scheme and by the SEC in its failure to exercise its discretionary powers.

Although the SEC supervision may perform a screening function to help prevent antitrust violations, absent a standard of competition directed by Congress, the SEC is unable to confer antitrust immunity by approving exchange rules or by any other action. The problem, however, is that the SEC does have discretionary power in areas pertinent to antitrust matters. To some extent, therefore, antitrust regulation of the securities industry is more strict than for completely nonsupervised industries. In the securities industry there are two schemes of regulation, whereas nonregulated industries have only one—antitrust laws. The subject of the next section is to suggest an approach for reconciling these two statutory schemes when they come into conflict.

Developing a Judicial Approach for Reconciling Antitrust Law and Securities Law

The discussion up to now has attempted to demonstrate that antitrust law has a significant role to play in the securities industry, that the industry enjoys only a limited protection from the antitrust laws, and that the federal courts rather than the SEC should be the final forum for measuring the need for antitrust immunity in a particular instance. In this section an analysis of how the courts have performed the task of reconciling regulatory statutes with the antitrust laws and the national policy favoring competition[156] will lead

[156] *See* note 1 *supra.*

to an understanding of how the judiciary should approach the task of reconciling antitrust law and securities law. The end result will be an appreciation of the desirability of having the courts available to perform this function, rather than having to rely on the SEC—with its record of, at best, inconsistent performance—to do the reconciling.

Judicial Supervision of Competition in the Securities Industry

The Supreme Court's decision in *Silver v. New York Stock Exchange*[157] is the most complete comment by that Court on the reconciliation problem in the securities industry. This was a private action brought under sections 1 and 2 of the Sherman Act,[158] alleging a concerted refusal to deal[159] and an attempt to monopolize the brokerage business in NYSE-listed stocks by the NYSE and its members. The Exchange, pursuant to its rules, had ordered its members to sever all wire and stock ticker services with the plaintiff, thus seriously impairing his ability to compete and causing heavy loss of business.[160] The Exchange action came without notice or the opportunity for hearing or explanation. The district court, finding for the plaintiff, described the Exchange's action as a collective refusal to deal and thus a per se violation of the Sherman Act.[161] The Court of Appeals for the Second Circuit reversed, finding that the Exchange was exempt from the Sherman Act "because it is exercising a power which it is required to exercise by the Securities Exchange Act."[162] The Supreme Court, through Mr. Justice Goldberg, affirmed the district court decision but rejected the approach of each of the lower courts.

Mr. Justice Goldberg described the fundamental issue to be

> whether the Securities Exchange Act has created a duty of exchange self-regulation so pervasive as to constitute an implied repealer of our antitrust laws, thereby exempting the Exchange from liability in this and similar cases.[163]

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157 373 U.S. 341 (1963).

158 15 U.S.C. §§ 1-2 (1964).

159 A "concerted refusal to deal" is a group boycott arranged by agreement. Ordinarily, it constitutes a per se violation of § 1 of the Shermau Act, 15 U.S.C. § 1 (1964).

160 Silver v. NYSE, 196 F. Supp. 209, 213 (S.D.N.Y. 1961).

161 *Id.* at 209.

162 Silver v. NYSE, 302 F.2d 714, 721 (2d Cir. 1962). The power referred to is the control of members' dealings with non-members, pursuant to § 6(a)(1) of the 1934 Act, 15 U.S.C. 78f(a)(1) (1964). Silver was not a member of the Exchange.

163 373 U.S. at 347.

The Court concluded that in a nonregulated industry, the stipulated facts would have clearly constituted a per se violation of sections 1 and 2 of the Sherman Act.[164] It concluded, however, that the district court had erred in treating the securities industry as a nonregulated industry.

The Court's first step in resolving the "fundamental issue" was delineating the purpose and scope of the legislative policy of self-regulation. After recognizing the need for regulation as well as the need for some limit on the strict rules of competition, the Court concluded that, "the pattern of governmental entry was by no means one of total displacement of the exchanges' traditional process of self-regulation."[165] Adopting the understanding of the self-regulatory mechanism that Mr. Justice Douglas had set out when he was a member of the SEC, the Court concluded that a "federally mandated duty of self-policing by exchanges" had been established.[166] In adopting the Douglas view, the Court rejected the notion that every rule within the delegated realm of self-regulation and every application of an exchange rule was immune from antitrust attack.[167]

Although the Court found the Exchange rule involved was authorized by the 1934 Act, this was not considered decisive. The validity of the rule or the Exchange's power (or duty) to enact such a rule was not at issue; rather, it was the particular application of the rule to Silver that was being presented for review. The Court concluded, therefore, that the court of appeals had ended its inquiry too soon when it held the rule valid as within the scope of authorized exchange self-regulation and therefore beyond the reach of the antitrust laws.[168]

Having established that neither antitrust law nor securities law completely supercedes the other, the Court undertook a methodical reconciliation of the statutory schemes. The first step was to determine if the 1934 Act contained an express exemption from the antitrust laws. None was found.[169] Step two was to determine if there were any grounds for implying an exemption from the antitrust

164 *Id.* at 348.
165 *Id.* at 352.
166 *Id.* (*quoting* the passage of Mr. Justice Douglas found in the text accompanying note 102 *supra*).
167 *Id.* at 352.
168 *Id.* at 357.
169 *Id.*

laws. After noting that repeal by implication is frowned upon, the Court announced the "guiding principle" for reconciling the two statutory schemes: "Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary."[170] This guiding principle essential to the reconciliation must be applied in a case-by-case approach. In *Silver*, the Supreme Court decided a heavy-handed application of the Exchange rule was not necessary to effectuate the 1934 Act. Consequently, there was no need to imply an antitrust exemption, and the plaintiff's claim was upheld on the merits. Indeed, the Court held that the application of antitrust law to this type of action is essential to prevent abuses of the self-regulatory mechanism. Without a provision for SEC review of disciplinary actions, "[t]here is nothing built into the regulatory scheme which performs the antitrust function" of assuring that self-regulation will not be used for purposes other than what Congress thought justified.[171] "Some form of review of exchange self-policing, whether by administrative agency or by the courts, is therefore not at all incompatible with the fulfillment of the aims of the Securities Exchange Act."[172]

The circumstances of *Silver* obviated any question of primary jurisdiction (*i.e.*, what would be the effect of Commission approval of an exchange rule being challenged on antitrust grounds), since the SEC has no statutory authorization "to review particular instances of *enforcement* of exchange rules."[173] Moreover, the absence of Commission jurisdiction in this matter allowed the Court to avoid "any problem of conflict or coextensiveness of coverage with the agency's regulatory power."[174] Significantly, however, the Supreme Court conducted its own analysis of the merits of the rule's existence in the first place. After examining the alleged justification of the rule, it concluded that the rule was "just and adequate to insure fair dealing and to protect investors."[175] The Court's analysis of the

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170 *Id., citing* United States v. Borden, 308 U.S. 188, 198 (1939).

171 373 U.S. at 358.

172 *Id.* at 359.

173 *Id.* at 357 (emphasis added).

174 *Id.* at 358.

175 *Id.* at 355, *quoting* the language of § 6(d) of the 1934 Act, 15 U.S.C. § 78f (d) (1964):

> Transactions with non-members under the circumstances mentioned can only be described as "inconsistent with just and equitable principles of trade," and rules regulating such dealing are indeed "just and adequate to insure fair deal-

challenged rule went into considerable detail,[176] going much beyond a perfunctory affirmance of SEC approval of the rule when it first went into effect. The Court apparently was making its own conclusion on the propriety of SEC approval of the rule in light of the directive of section 6(d) of the 1934 Act. It would appear, therefore, that if an Exchange rule itself were litigated under the Sherman Act, the Supreme Court would not feel bound by the substantial evidence test[177] in deciding: (1) whether the Exchange was justified in enacting it in the first place or (2) whether the SEC had acted properly in approving the Exchange rule.[178]

The NYSE reads *Silver* as holding that whenever

> exchange self-regulation is subject to supervision by the SEC, it is immune from antitrust attack; and that it is only when self-regulatory conduct by an exchange is not subject to SEC review under the Act that such conduct may be judged by antitrust criteria . . . .[179]

The Exchange claims that the court in *Silver* "indicated that repeal of the antitrust laws should be implied since SEC supervision takes the place of antitrust regulation."[180]

Two recent lower court cases, *Kaplan v. Lehman Brothers*[181] and *Thill Securities Corp. v. New York Stock Exchange*,[182] lend support to the NYSE interpretation of *Silver*. In *Kaplan*, plaintiff alleged that the NYSE rate structure, fixing prices for broker services,

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ing and to protect investors."
373 U.S. at 355.

176 373 U.S. at 353-55.

177 The "substantial evidence test" is a common standard for judicial review of administrative agency decisions on matters within the delegated responsibilities of the agency, but which involve questions of fact or mixed questions of law and fact. It is the standard of review when the doctrine of primary jurisdiction is invoked. *See* note 240 *infra*. Stated simply, the substantial evidence test involves a judicial determination of whether the record in the agency's determination of the question, taken as a whole, contains such relevant evidence that a reasonable mind would accept it as adequate to support the agency's conclusion. Therefore, when a court applies the substantial evidence test, it does not make its own findings of fact from the record; consequently, it is a relatively superficial review of the agency's decision. *See, e.g.*, Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951).

178 *See* the discussion of the doctrine of primary jurisdiction in reconciliation problems later in this paper.

179 NYSE 1969 Legal Memo, *supra* note 82, at 7.

180 *Id.* at 8.

181 250 F. Supp. 562 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967).

182 — F. Supp. — (E.D. Wis. 1969).

constituted a per se violation of the Sherman Act. The court dismissed on a motion for summary judgment. However, the case should be interpreted as holding only that "[a]ction taken by the Exchange and its members, pursuant to its statutory authority to make rules, is not per se illegal under the Sherman Act."[183] In *Kaplan*, the court adhered formalistically to the substantive holding of *Silver*, while apparently ignoring the *Silver* approach.[184] Despite acknowledging that its conclusion represented only the beginning of the inquiry in *Silver*, the *Kaplan* court noted: "It is the final conclusion here." It held that the review provided within the regulatory scheme was sufficient to meet the demands of *Silver*; thus there was no need to determine whether the practice of fixing rates was necessary to make the regulatory scheme work.[185] In fact, the court accepted the Exchange's argument that the practice of fixing rates was mandated by section 19(b) of the 1934 Act.[186]

Similarly, in granting a summary judgment for the NYSE, the court in *Thill* found that since the rules being challenged[187] pertained to a legitimate subject of self-regulation,[188] and since the Rule was subject to review and amendment by the SEC (which was actively exercising its review powers), there was no reason "for this court to undertake an inquiry into the reasonableness of the prohibition or to apply the antitrust laws to the challenged practice."[189]

The Commission's power to approve or disapprove exchange rules does not, on the basis of *Silver*, make the Commission the exclusive forum for reconciling antitrust law and securities law. The

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183 250 F. Supp. 564, *citing* Silver v. NYSE, 373 U.S. 341, 347 (1963).

184 Judge Hoffman seemed impressed with the absence of the "due process" problem found in *Silver*. *See* note 210 *infra*. Emphasis was placed on the equality of application of fixed rates to all customers and the absence of opportunity for discrimination against individual customers. The fact that *Kaplan* was brought under a per se theory should not have deterred Judge Hoffman from conducting a rule of reason analysis. *See* the discussion of United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953), *infra* note 201, which was brought under a per se theory, only to have Judge Medina apply a complex rule of reason analysis.

185 250 F. Supp. at 566.

186 *Id.* at 565.

187 The rules, which prevented commission splitting with non-members and limited membership on the Exchange, resulted in an alleged commission-fixing system that allegedly injures the class of plaintiffs: non-member over-the-counter dealers.

188 That "legitimate subject of self-regulation" was fixing minimum commission rates.

189 — F. Supp. — (E.D. Wis. 1969).

significance of the availability of Commission review in the *Silver* case goes to the question of the exhaustion of administrative remedies, rather than to questions of primary or exclusive jurisdiction. This is clear from the context of the Court's contrast between exchange powers subject to Commission review and those powers over which the SEC has no jurisdiction.[190] Even if the Commission had approved exchange rules fixing rates of commission, there is no language in the *Silver* opinion that would bar the Court from holding, as the Antitrust Division has argued, that the fixed rate structure is unnecessary for the success of the regulatory scheme. The Court's refusal to imply an exemption from the antitrust laws has already been noted.[191] As to the power of the Commission to immunize approved rules from antitrust attack, the Court simply has made no direct statement.

The Court did state: "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented."[192] However, this statement apparently was made with reference to a comprehensive review mechanism such as that provided for in the Maloney Act.[193] The reference to a comprehensive review mechanism is found in footnote 12 of the *Silver* opinion.[194] The provi-

[190] 373 U.S. at 358, *citing* 2 Loss 1178.

[191] *See* text accompanying note 170 *supra*. The *Silver* holding refuses to imply an exemption.

[192] 373 U.S. at 360, referring to footnote 12 of the opinion. Similarly, Judge Reynolds in the *Thill* case read footnote 12 in *Silver* as intimating that a "different result [in *Thill*] might be reached where the particular Exchange conduct was [not] subject to SEC regulation . . . ." Thill Sec. Corp. v. NYSE, —— F. Supp. —— (E.D. Wis. 1969).

[193] For a detailed discussion of the review machinery provided by the Maloney Act see note 196 *infra* and accompanying text. There is difficulty in extrapolating from the *Silver* opinion a view as to how the Court would decide the question of the immunizing effect of SEC approval of exchange rules. The problem is that *Silver* dealt with disciplinary procedures rather than rule-making procedures. The text accompanying notes 105-14 *supra* pointed out the non-pervasive nature of the Commission's power of review of exchange rule-making procedures. The Commission's inattention to matters of competition has also been reviewed. With these facts in mind, it seems there is good reason to extend the *Silver* result to the rule-making procedures. For the same reasons, it is incorrect to analogize SEC review powers over the exchange's rule-making processes with SEC review powers over disciplinary proceedings under the Maloney Act (as discussed by the Court in its footnote 12).

[194] Silver v. NYSE, 373 U.S. 341, 358 n. 12 (1963), states:

> Were there Commission jurisdiction and ensuing judicial review for scrutiny of a particular exchange ruling, as there is under the 1938 Maloney Act amendments to the Exchange Act, to examine disciplinary action by a registered

sions referred to require that an association's rules provide for a

> fair and orderly procedure for the disciplining of members and their associates as well as the denial of membership or the barring of any person from being an associate, with a statement of specific charges, a hearing of record, and specific findings.[195]

These safeguards were not incorporated in the portions of the 1934 Act dealing with securities exchanges.[196] All in all, the thoroughness of the review machinery built into the Maloney Act is considerably more comprehensive than the machinery for Commission review of exchange rules.[197] It is inconceivable that the Court would consider the Commission mechanism for review of exchange rules as equivalent to the NASD review machinery.

This interpretation is reinforced by the language immediately following the Court's reference to a "vehicle" for review of exchange self-regulation. There the Court conveys an awareness of the uncertainty that might confront the Exchange in evaluating its rules in the light of the antitrust laws. Admitting that this ruling makes it necessary for the Exchange to walk a fine line between permissible

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> securities association (i.e., by the NASD), sections 15A(g), 15A(h), 25(a), 15 U.S.C. section 78o-3(g), 78o-3(h), 78y(a) . . . [*see* note 136 *supra* and accompanying text], a different case would arise concerning exemption from operation of laws designed to prevent anti-competitive activity, an issue we do not decide today.

195 5 Loss 3470.

196 As seen earlier, the supervisory role of the SEC is more clearly defined in the Maloney Act. Section 15A(g), referred to in footnote 12 of the *Silver* decision, has been interpreted as providing that

> any final decision of the Board of Governors [of NASD], whether by way of disciplinary action against a member or an associate or whether by way of denial of admission or the barring of any person from being associated is in turn reviewable by the Commission either on its own motion or upon application filed by an aggrieved person within thirty days or such longer period as the Commission may determine; and with a member there is an automatic stay pending review.

5 Loss 3478. The SEC is empowered to review the case de novo, except that the Commission cannot find a violation when the Board of Governors has found none, nor can it impose a more severe penalty than the Board has directed. 2 Loss 1374-75. Recall § 15A(b) (3) requires an association to admit all those not disqualified under the *statutory* standards.

As a matter of record, the SEC has proved to be quite independent of the Board of Governors of the NASD in its role as reviewer of disciplinary activities. Every denial of NASD membership that has been appealed to the SEC has been reversed by the Commission.

197 For example, one who is denied membership to the NYSE, because of the Exchange's administration of its SEC-approved rules, has no *right of review* before the SEC to challenge this denial. In matters relating to the NASD, there are absolute statutory standards for membership. With the NYSE, however, the statutory standards are more discretionary. Thus, the opportunity for discrimination or arbitrariness is much greater—and yet no SEC review is provided.

and impermissible self-regulation, the Court assures the Exchange that

> [u]nder the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act.[198]

If the Court had considered the present provision for Commission review of exchange rules to be the type of review procedure that would create "a different type of case" from the one presented in *Silver*, this dictum pertaining to rule of reason analysis would not have been appropriate. The problem that the Court anticipated for the exchange would not arise if Commission approval were viewed as assuring antitrust immunity. The view that SEC approval of exchange rules falls short of the review procedures envisioned as necessary to create a presumption of antitrust immunity is also consistent with the Court's conclusion, following its rule of reason language, that the statutory scheme of the Securities Exchange Act is not sufficiently pervasive to grant total exemption from the antitrust laws. Mr. Justice Goldberg added that "[i]t is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim."[199] This language would seem inappropriate if SEC approval were considered to be dispositive of the question of antitrust immunity. Once again, the implication is that this is a decision to be weighed by the court hearing the antitrust claim. This conclusion is based not only on the language of the opinion noted above, but also on the fact that the Court itself proceeded to answer the question of whether this particular act was justified by the scope and purposes of the Securities Exchange Act.[200]

The rule of reason approach reconciling securities law and antitrust law in *Silver* is similar to that applied in an earlier district court

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198 373 U.S. at 360, *citing* Board of Trade v. United States, 246 U.S. 231, 238 (1918).

199 373 U.S. at 361.

200 *Id.* The absence of *any* review procedure in the 1934 Act with respect to the circumstances of the *Silver* case makes this an easier case than that which would be presented if an SEC-approved rule were challenged as a violation of the antitrust laws and not justified by the purposes of this regulatory act. But this analysis of the *Silver* opinion supports the conclusion that the approach used in *Silver* should—and would—be applied in the harder types of cases. Note especially the Court's language referring to a rule of reason analysis. *See* text accompanying and immediately following note 198 *supra*.

opinion, *United States v. Morgan.*[201] Although the *Morgan* case involved the application of the antitrust laws to NASD members rather than the NYSE, it considered a rule of reason analysis appropriate for resolving questions of reconciliation between antitrust law and securities law. Like *Kaplan* and *Thill*, the *Morgan* complaint was based on a per se theory. The court, however, refused to recognize the applicability of the per se rule to the securities industry. Instead, it conducted its own evaluation of whether the challenged practice was justified by the purposes of securities law. Its conclusion was identical with that of the SEC in the *Public Service of Indiana* case,[202] which involved similar factual circumstances. The view that the SEC had taken in that case was that this practice of maintaining fixed offering prices of securities was not per se unlawful, "but, like many other contracts, these may be entered into and performed under circumstances that amount to an unlawful suppression of competition."[203] The Court was careful to point out, however, that it did not consider itself bound by the opinion of the SEC in this or similar matters. The Commission's views were, however, to be considered:

> These views are not binding upon me, or upon any other court or judge; but they are persuasive and helpful, especially as they are those of public officials of ripe experience in dealing with this very subject matter from day to day. Moreover, the very commissioners who expressed these views had been in close cooperation with the members of the Congress who formulated the terms of some of the statutory provisions under consideration. After all, these antitrust problems are largely factual and their true resolution depends in the last analysis upon an intimate familiarity with the characteristic features of the particular industry in which these problems arise.[204]

[201] 118 F. Supp. 621 (S.D.N.Y. 1953). The complaint struck out at many of the practices of underwriting groups, and it was aimed directly at a group of seventeen leading investment banking firms who had utilized the practices of resale price maintenance that had become commonplace in the industry for distributions of securities issues.

[202] National Ass'n of Sec. Dealers, Inc., SEC Securities and Exchange Act Release No. 3700 (June 13, 1945), *quoted,* 118 F. Supp. at 699.

[203] 118 F. Supp. at 699. The price maintenance rules were authorized by § 15A(i), 15 U.S.C. § 78o-3(i) (1964), and were necessary to enable the NASD machinery to perform the function of price-stabilization—which was one of the objectives of the Act. The rules made possible economic sanctions with which effective discipline could be rendered. Apparently Congress deemed it necessary to authorize an antitrust exemption with respect to these practices, § 15A(n) of the 1934 Act, 15 U.S.C. § 78o-3(n) (1964), to guarantee honesty in the underwriting and distribution of shares. 2 Loss 1369-70; 6 Loss 3778. The limitations of this antitrust exemption were noted at notes 134 & 135 *supra.*

[204] 118 F. Supp. at 699.

Therefore, the Commission's opinion is to be given some weight[205] in the court's evaluation of the necessity argument, but the weight is less than that afforded agency opinions in review under the substantial evidence test.[206]

In *Silver*, the Court had suggested the Exchange adopt rules providing fair notice and hearing in disciplinary proceedings to keep its self-regulatory procedures from straying too far beyond the purposes of the 1934 Act. The Court reminded the Exchange of its vulnerability to antitrust attack if its acts of self-regulation fell too far outside the scope of that statute.[207] Arguably, the Court might be viewed as substituting itself for the SEC by performing the Commission's function, under section 19(b), of reviewing Exchange rules and suggesting amendments when the dictates of the 1934 Act require. This is not a displacement of SEC power in this area; rather, it is merely filling a void created by the Commission's failure to exercise its power. This illustrates an earlier suggestion that the Commission's function in antitrust enforcement is a screening function—to prevent unjustified anticompetitive acts of self-regulation. Those violations that escape the screening process are nonetheless subject to judicial censure.

In footnote 16 of the opinion, after granting that the SEC has the power to make a rule concerning fair hearing procedures for nonmembers, the Court noted:

> Absent Commission adoption of a rule requiring fair procedure, and in light of both the utility of such a rule as an antitrust matter and its compatibility with securities-regulation principles . . . no incompatibility with the Commission's power inheres in announcement by an antitrust court of this rule.[208]

The Court further noted that even if the Commission had forced a rule covering this situation on the Exchange, the rule would have had to embody procedural safeguards required by the antitrust laws "in cases like this."[209] Evidently, if the Commission had enacted, or caused the Exchange to enact, a rule that did not contain these pro-

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205 *See* note 177 *supra* and accompanying text.

206 *See* note 177 *supra*. Inasmuch as the substantial evidence test is ordinarily applied when the doctrine of primary jurisdiction is invoked, *see* note 240 *infra*, one may conclude that that doctrine is not applicable in antitrust questions affecting the securities industry.

207 373 U.S. at 362.

208 *Id.* at 364 n.16.

209 *Id.* "Cases like this" may be interpreted as cases involving concerted refusals to deal.

cedural safeguards, the Court would not have hesitated to decide the *Silver* case in the same manner as it did; that is, the Court would have in effect re-written the Commission-approved rule. The language of this footnote provides another illustration of the limited impact of Commission approval of a rule *as far as antitrust matters are concerned.* The Court would make its own determination as to whether the rule was necessary to accomplish the purposes of the Securities Exchange Act; and without procedural safeguards, the answer would again be in the negative:

> The point is not that the antitrust laws impose the requirement of notice and a hearing but rather that, in acting without according these safeguards in response to their request, the Exchange has plainly exceeded the scope of its authority under the Securities Exchange Act to engage in self-regulation and therefore has not even reached the threshold of justification under that statute for what would otherwise be an antitrust violation.[210]

Against this background of rule of reason analysis, both *Kaplan* and *Thill* can be criticized. Both rejected the rule of reason approach suggested in *Silver* and *Morgan.*[211] Both failed to receive evidence on whether the rule was necessary to make the 1934 Act work. Both declined to inquire as to whether the type of review provided for in the 1934 Act and exercised by the SEC was equivalent to the kind of review which would assure that the antitrust function was being performed within the regulatory framework.[212]

When the Court of Appeals for the Seventh Circuit reviewed *Kaplan,* it also stopped its inquiry too soon.[213] Its one page opinion apparently holds that the practice of fixing minimum commission

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210 *Id.* at 364-65.

211 *See* note 184 *supra.*

212 The *Thill* opinion does give a cursory treatment to the effectiveness of SEC review over Exchange rules affecting the commission rate structure (— F. Supp. at —), but the question of the necessity of the rule to make the Exchange Act work was not treated. Nor did the court reach the problem of providing an effective remedy for those alleging injury due to Exchange rules. As Chief Justice Warren pointed out in his dissent to the Supreme Court's denial of certiorari in Kaplan v. Lehman Bros., 389 U.S. 954, 956-57 (1967), no court has yet dealt with the significance of the claim that

> if and when the SEC exercises its discretion to review rates, it is not required to hold a hearing, and because the matter is committed to the SEC's discretion, there is no effective judicial remedy to require it to initiate a rate proceeding.

Id. Therefore, simply because the SEC is now holding hearings on the matter, the review machinery cannot be said to be performing the functions that concerned the Supreme Court at footnote 12 of the *Silver* opinion.

213 371 F.2d 409 (7th Cir. 1967).

rates is necessary to make the Securities Act work. Yet, the district court in its summary judgment made no finding on that crucial issue. The court of appeals did not even accept as binding the district court's opinion that Congress required that rates be fixed by the exchanges.[214] Chief Justice Warren, in a castigating dissent from the Supreme Court's denial of certiorari in *Kaplan,* considered the question involved in this case as one not previously decided by the High Court.[215] He lamented the failure of either of the lower courts to decide the "clear question presented of whether there is anything 'built into the regulatory scheme which performs the antitrust function . . . .' "[216] Terming the seventh circuit's approach "blunderbuss,"[217] he noted the distinction between a question of the reasonableness of the rates fixed and the reasonableness of the practice of fixing rates, observing that the latter problem was one for which the courts *were* suited.[218] He noted that the delicate balancing process of applying the rule of reason was never applied in *Kaplan.* Summarizing the plaintiff's complaint, the Chief Justice pointed out several alleged flaws in the commission rate review machinery and its application[219] which, if proved, would result in the absence of any machinery in the regulatory scheme for enforcing competitive standards.[220] Thus, Chief Justice Warren felt that the Court should be ready to perform that function or at least to remand to the district

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214 *Id.* at 411. It is conceivable that, even if the statute were explicit in authorizing fixed rates, a court—under the *Silver* approach—could find that the review procedure provided in the statute was not sufficient for performing the antitrust function of protecting consumers (investors) from abuses of monopoly power—even if such power were necessary to accomplish the legitimate purposes of the regulatory scheme.

215 Kaplan v. Lehman Bros., 389 U.S. 954 (1967).

216 *Id.* at 956, *citing* Silver v. NYSE, 373 U.S. 341, 358 (1963).

217 389 U.S. at 957.

218 Judge Hoffman had stated that the courts are ill-equipped to judge whether the level of the rates is reasonable, but he did not answer the question of whether the *practice* of fixing rates is unreasonable.

219 *See* text accompanying notes 140-47 *supra* for a detailing of these flaws.

220 389 U.S. at 956-57. The flaws listed by the Chief Justice were:

> [T]he regulatory scheme fails specifically to enjoin the SEC, in determining what rates are reasonable, to "enforce the competitive standard," *United States v. Philadelphia National Bank,* 374 U.S. 321, 351 (1963), and furthermore neither the SEC nor the Exchange has ever articulated any standard of reasonableness. Petitioners also claim that the underlying data used by the SEC in reviewing each of the five rate increases . . . have been very limited in scope and content. Finally, they claim that if and when the SEC exercises its discretion to review rates, it is not required to hold a hearing, and, because the matter is committed to the SEC's discretion, there is no effective judicial remedy to require it to initiate a rate proceeding.

Id.

court for a determination of whether that function was being performed by the regulatory scheme.

Although it is a limited holding (self-regulatory action taken without affording fair procedure is not immune from the antitrust laws),[221] and although it leaves a number of unanswered questions, *Silver* provides a framework through which the reconciliation problem may be resolved. The NYSE exaggerates when it contends that *Silver* "implicitly forecloses application of the antitrust laws to Exchange activity subject to the SEC oversight."[222] Not only is this conclusion contrary to the express language of the opinion, but also it is inconsistent with the Exchange's own position that the Commission is not authorized to review the *practice* of fixing minimum rates.[223] If the practice is not subject to SEC supervision, then *Silver* would not protect the Exchange even under its own interpretation of that opinion. It is clear from the *Silver* opinion that the Court does not interpret section 19(b) as giving affirmative sanction to exchange rules.[224]

Summary: A Problem of Approach

The failure of any of the courts in *Kaplan* or *Thill* to apply the approach announced in *Silver* is disappointing. Hopefully, the Supreme Court will soon have a case that provides the opportunity to decide the "other case" that was left open in the *Silver* opinion at footnote 12.[225]

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221 Nerenberg, *supra* note 60, at 140.

222 NYSE 1969 Legal Memo, *supra* note 82, at 3.

223 *Id.*

224 *See* 5 Loss 3152.

225 The *Kaplan* case, the only case on this question to reach the Supreme Court since *Silver* was decided, did not raise "that other question" because it was brought on a per se theory. The Supreme Court's denial of certiorari in *Kaplan* should not be interpreted as a disposition of the question left open by *Silver*; therefore, the questiou is yet to be decided.

Two other cases involving a per se approach have met with a fate similar to *Kaplan*. Cowen v. NYSE, 371 F.2d 661 (2d Cir. 1967), *aff'g* 256 F. Supp. 462 (N.D.N.Y. 1966); Baum v. Investors Diversified Serv., 286 F. Supp. 914 (N.D. Ill. 1968.)

One case pending which may provide an opportunity for the courts to decide the unanswered question is Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968). The case, having survived a preliminary motion for dismissal, involves a class action for all those who have bought or sold odd-lots through the New York Stock Exchange. The complaint charges:

[T]he two major odd-lot dealers . . . with the benign indulgence of the Exchange, have "established, increased and maintained" the odd-lot differential

The Supreme Court in *Silver* proposed a rule of reason approach for deciding cases involving antitrust actions which challenge accepted practices in the securities industry. Thus, the defendant has an affirmative defense if it can demonstrate that the challenged practice is necessary for the operation of the regulatory scheme. It has not been decided that the mere availability of Commission review nor favorable Commission action will necessarily result in immunity from antitrust attack. The nature and quality of the review available must be analyzed by a court following the *Silver* rule of reason approach. Another factor that must be weighed in this approach is the extent to which judicial review is provided for in the regulatory framework for those claiming injury from SEC-approved Exchange rules. It is submitted that these two factors—the nature and quality of Commission review of exchange rules and the unavailability of judicial review for non-members injured by exchange rules that have been approved by the SEC—warrant judicial acceptance of antitrust attacks on such rules. It is further submitted that the standard for evaluating these cases should be that set forth in *Silver*: Anticompetitive activities of stock exchange members are subject to the antitrust laws unless the activities are necessary to achieve a legitimate goal of the Securities Exchange Act, and even then, only to the minimum extent necessary.

Both the *Morgan* and the *Silver* opinions contain language to the effect that this "necessity question" should ultimately be decided by the courts. These opinions suggest that, in approaching the necessity question, the court may give some weight to accepted industry practices, especially if affirmative Commission approval of that practice has been obtained. Still, the court must independently judge the wisdom of the Commission's approval, since there is no clear-cut antitrust standard built into the 1934 Act. Courts may conclude, as did Judge Medina in *Morgan*, that "the eggs cannot be unscrambled"[226] without severe dislocation and defeat of the primary purpose of the Exchange Act. But, if economic evidence is convincing that the practice under attack is anticompetitive and at the same time unnecessary for the accomplishment of the objectives of the 1934 Act, then the court *may* strike down the practice. Such a result is all the more likely absent *effective* Commission *and* judicial review

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in violation of the Sherman Act, as well as §§ 6(b) and 6(d) of the Exchange Act.
5 Loss 3167.

[226] 118 F. Supp. at 688.

procedures within the regulatory act. Three key features of the *Silver* opinion portend this result: the Court's performance of an independent evaluation of the merits of the rule being challenged in *Silver*; the case-by-case approach to reconciliation illustrated in the Court's application of its "guiding principle;" and the actual reversal of the court of appeals' decision in *Silver*.

The next section will discuss some of the questions left unanswered by the *Silver* case. For now it is important to recognize the limits of the *Silver* opinion: (1) It does not deal with the question of primary jurisdiction, and (2) when a question of primary jurisdiction is presented, the presence of coextensiveness of the Commission's regulatory power with judicial determination of antitrust questions is not necessarily determinative. Cases involving other regulated industries have presented the problems of coextensiveness and primary jurisdiction, and it is to them that we must look for an indication of how such problems should be resolved in the context of the securities industries.

The Judicial Approach to Antitrust Problems in Other Regulated Industries and Its Application to the Securities Industry

Silver left unresolved several questions concerning the reconciliation of antitrust and securities law: (1) the effect of SEC approval of an exchange rule; (2) the manner in which the courts will balance the competing interests of (a) the national policy for competition and (b) regulatory schemes; and (3) the means by which the problem of coextensiveness of Commission and judicial jurisdiction over exchange rules will be resolved.[227] A review of the approach followed by the Court in reconciling antitrust law with statutory schemes governing other regulated and semi-regulated industries may help predict how the questions will—and should—be resolved by a court.

It will be seen that the essence of the Court's approach involves determining the existence and scope of any antitrust exemption provided in a regulatory scheme. The more pervasive the regnlatory scheme (in terms of governmental participation in and sanction of concerted behavior), the broader the exemption. The broader the exemption, the greater the range of statutorily protected activity. A rule of reason analysis is conducted to determine whether the attacked activity, although per se illegal in a non-regulated industry,

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[227] *See* text following note 224 *supra*.

falls within the exempted range of behavior. Thus, an affirmative defense is always available.

Throughout this following survey, an attempt will be made to fit the *Silver* approach into the mold of decisions in other regulated industries. To analogize effectively from this line of decisions, it is important to compare the characteristics of the securities industry and its regulatory scheme with those of the other regulated industries that have been subjected to the antitrust laws.

Exemptions Doctrines and the Application of the Rule of Reason

Previously,[228] it was noted that Congress has occasionally felt it necessary to exempt certain industries from the antitrust laws. These exemptions, however, are carefully tailored to the need for accomplishing the specific objectives of the regulatory act.[229] Thus, the problem of reconciling antitrust law with regulatory statutes is largely one of statutory interpretation to determine the extent of each exemption.[230] The guiding principle for judicial treatment of this problem has been that

> [t]he basic policy expressed by the antitrust laws should continue to be an important consideration in policy formulation in the regulated industries insofar as it does not conflict with other goals of higher priority.[231]

The approach followed in the *Silver* case was, therefore, a standard one. A capsule account of this standard approach will seem familiar after the description of the *Silver* case. First the court looks to see if there is an express statutory exemption from the antitrust laws. Failing to find this, the court evaluates whether there are grounds for implying a general exemption to those laws. The next step, if necessary, is an inquiry to determine if there is reason to imply a limited exemption from the antitrust laws with respect to a particular industry practice.[232] The tests applied along each step of this analysis are different, and it is not surprising that the extent of exemption varies widely among the regulated industries.

Where an *express exemption* exists, the regulatory agency su-

228 *See* notes 91-94 *supra* and accompanying text.

229 *See* REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 261 (1955) [hereinafter cited as ATTORNEY GENERAL'S REPORT].

230 *Id.*

231 Johnson, *supra* note 7, at 547.

232 *See* text accompanying notes 169-70 *supra.*

pervising the industry is obliged to guarantee the public the benefits of competition and protection from collusive action adverse to the public interest.[233] Such exemptions, however, are rare,[234] and none is found for the securities exchanges.[235]

The "pervasiveness test" for *implying a general exemption* to the antitrust laws is seldom, if ever, satisfied.[236] Before a general exemption to the antitrust laws will be implied, the court must find that the regulatory scheme is so pervasive that it leaves no scope of operation for the antitrust laws. The Supreme Court in *Silver* found that no such general exemption could be implied from the 1934 statute, citing *United States v. Borden.*[237] *Borden* provides that repeals by implication are not favored. A general exemption will be implied only when Congress has explicitly provided for the antitrust function to be performed within the regulatory system.[238] The history of bank merger litigation, discussed later, demonstrates that language which may appear to be sufficiently explicit to establish a general exemption only creates an exhaustion of remedies[239] problem, as opposed to a primary jurisdiction[240] problem, for the party bring-

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233 *See* ATTORNEY GENERAL'S REPORT, *supra* note 229, at 261 n.2, 262 n.3.

234 Express exemptions are found, *e.g.*, at: 7 U.S.C. § 282 (1964) (Capper-Volstead exemption for agricultural cooperatives); 15 U.S.C. § 62 (1964) (Webb-Pomerene exemption for producers export trade associations); 15 U.S.C. § 1012 (1964) (McCarran-Ferguson exemption for state regulation of insurance indnstry); 15 U.S.C. § 17 (1964) (exempting labor, agricultural and horticultural associations); 15 U.S.C. § 45(a) (1964) (exempting state supervision of resale price maintenance). Note, 55 VA. L. REV. at 669 n.66. *See also* 49 U.S.C. § 5(11) (1964) (Interstate Commerce Act), and § 15A(n) of the 1934 Act, 15 U.S.C. § 78o-3(n) (1964).

235 373 U.S. at 357.

236 *See* Note, 55 VA. L. REV. at 671 n.76.

237 308 U.S. 188, 198 (1939). *See* text accompanying note 170 *supra.*

238 *See* Johnson, *supra* note 7, at 546-53.

239 The doctrine of exhaustion of administrative remedies can be explained as a judicial principle that relief will not be available in the courts until the complainant has exhausted the administrative remedies available for the settlement of his claim. The doctrine of exhaustion is normally invoked when three conditions simultaneously obtain: (1) there is an administrative remedy available on the initiative of the complaining party; (2) that remedy is available more or less immediately; and (3) that remedy will substantially protect the rights or claim being asserted.

240 The doctrine of primary jurisdiction is discussed *infra* at text accompanying note 319 of this section. For now, it can be defined as a judicial doctrine that refers questions which the court determines to be within the special competence of an administrative agency (either because of the agency's expertise gained from administering a regulatory scheme or because the matter to be determined has been delegated to the administrative agency as an essential part of a pervasive regulatory

ing an antitrust action.

Limited exemptions may be implied when the court recognizes the likelihood of frustrating the policy goals of the regulatory scheme if competition is enforced in a particular situation. Frustration may take the form of rendering meaningless procedural provisions of the regulatory statute or rendering unattainable substantive results sought by enactment of the statute.[241] The search for such a limited exemption with regard to the specific facts of the *Silver* case was unsuccessful.[242] Even limited exemptions which have been implied by an administrative agency have been subject to judicial review to determine "whether the Commission has been guided by proper considerations in bringing its . . . experience . . . to bear . . . in [determining] the public interest."[243]

A segment of the *Attorney General's Committee to Study the Antitrust Laws*[244] was of the opinion that no implied exemption should rest on a substantial evidence test. This group believed

> that in the absence of express antitrust exemption, Congress did not intend that administrative agencies should, in all cases, be the sole forum for determination of antitrust questions stemming from conduct subject to their jurisdiction. This is especially so . . . since it is by no means clear that the courts will closely scrutinize agency determinations of the weight given to factors in evaluating 'public interest.' . . . Even where [agency] approval occurs, it is clearly a proper subject for judicial scrutiny to determine whether or not the agency has accorded whatever Congressionally-intended weight to promotion of competition that the particular statute requires.[245]

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scheme that requires consistent administration) to the agency. When the doctrine is invoked, the court requires the complaining party to seek relief within the administrative agency, and on review of the agency's decision, the court applies the substantial evidence test, note 177 *supra.* It is a question of administrative authority and expertise, as opposed to the doctrine of exhaustion of remedies, which is a question of procedure. *See* text accompanying note 190 *supra.*

241 *See* Johnson, *supra* note 7, at 546-53.

242 373 U.S. at 357-58.

243 *See* FCC v. RCA Communications, Inc., 346 U.S. 86, 91 (1953), *cited in* ATTORNEY GENERAL'S REPORT, *supra* note 229, at 284.

244 *See* note 229 *supra.*

245 ATTORNEY GENERAL'S REPORT, *supra* note 229, at 283-84. A minority of the committee advocated that "the inroads of protectionism in domestic trade should be kept to a minimum." *Id.* at 288. They pointed out that most regulatory schemes arose during the depression when Congress was in desperation over the plight of the economy. (Securities legislation is no exception to this point.) Truck transportation, insurance, and petroleum are listed as illustrations of industries surviving under the guise of regulation, which is really collusive control of prices. The

In short, this approach calls for the courts to do the balancing between regulatory need and the policy favoring competition.

It is submitted that the Supreme Court has followed this approach consistently, and the *Silver* case was no exception to this approach. The following review of cases involving the reconciliation process will demonstrate the Court's adherence to this approach.

It was noted earlier that a rule of reason analysis is conducted to determine whether a particular practice falls within the area of activity exempted by regulatory statute from antitrust liability. Several early cases found particular exchange activities to be exempted from the antitrust laws,[246] and Nerenberg[247] has written that the *Chicago Board of Trade* case[248] sets forth "the controlling principles" for judicial reconciliation of securities law and antitrust law. Contrary to Nerenberg's inference, that case is not a source of optimism for the securities industry. Rather than holding that the securities industry has been accorded a general immunity from antitrust laws, *Board of Trade* falls squarely in the mold of *Silver* and *Morgan* with their rule of reason analyses. The use of this rule of reason approach to evaluate the internal rules of the Board of Trade

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minority urged congressional re-examination of regulatory schemes and narrow judicial interpretation of present statutes, there being no justification for much of the present protection. *Id.* at 288-93. The relevance of these remarks for the securities industry should not be lost.

246 *See* Moore v. New York Cotton Exch., 270 U.S. 593 (1926); Board of Trade v. United States, 246 U.S. 231 (1917); Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236 (1905) (withholding quotations); Anderson v. United States, 171 U.S. 604 (1898) (prohibiting members from dealing with members of rival exchanges); Hopkins v. United States, 171 U.S. 578 (1898); Chamber of Commerce v. FTC, 13 F.2d 673 (8th Cir. 1926) (enforcing minimum commission rates for brokerage service). The foregoing cases are cited in Nerenberg, *supra* note 60, at 136 n.27, with the caveat: "Some of the foregoing cases may be of doubtful authority today."

247 Nerenberg, *supra* note 60, at 136.

248 Board of Trade v. United States, 246 U.S. 231 (1917). The Board of Trade, being a commodity exchange, is in many ways similar to a securities exchange, *e.g.*, in the area of self-regulation. The case saw the Supreme Court uphold a rule of the Chicago Board of Trade which forbade members from trading in commodities while the Board was closed, except at the price established on the Board's auction market as of closing time. After ascertaining "all relevant facts" on the circumstances surrounding the rule's adoption and application, the Court concluded that the rule did not restrict competition; rather it regulated the form in which competition might occur. Its *purpose* was clearly to improve competition. There was no intent to regulate or fix prices, merely an effort to control the process of price making. Prices would continue to be determined by the market.

does not suggest that the antitrust laws are inapplicable to the Board of Trade or similar types of institutions. On the contrary, the Court treated this case like all others brought under the antitrust laws since the establishment of the rule of reason in the *Standard Oil* decision.[249]

Mr. Justice Brandeis' language in *Board of Trade* throws light on how the Court applies the rule of reason to regulated industries:

> The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, all are relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.[250]

Other factors, such as the degree of market control of the body regulating the process of competition, may also be important in evaluating the need for the rule. In the *Board of Trade* case, market control was not a factor. Prices continued to be set by the market. The disputed rule was an effort to improve the market mechanism, and the public was protected from manipulation away from the auction market. In fact, the rule fostered the concentration of trading on the central market.

This case is important for the securities industry because it illustrates the Court's ability to take into consideration industry conditions and competitive factors as it analyzes the legality of a restrictive rule. There is no reason to think that the Court could not handle the current questions concerning commission rates, membership, or third market restriction. The opportunity to introduce economic evidence sustaining the necessity of the rule in order to satisfy the objectives of the 1934 Act is clearly available to the NYSE as an affirmative defense. *Silver* so indicated.[251]

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249 Standard Oil v. United States, 221 U.S. 1 (1911).

250 246 U.S. at 238.

251 *See* text accompanying note 199 *supra.* Another example of the Court's ability to analyze difficult economic material to determine the actual effect on competition is found in Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). For reasons not pertinent here, this case is of doubtful validity today. Nonetheless, the *approach* applied by the Court is still valid. That approach consists of looking to the purpose of the combination, and in the *Appalachian Coals* case, Chief Justice Hughes found that the purpose was not to accomplish market control or price control.

Admittedly, the *Appalachian Coals* case did not involve a regulated industry, but the insistence on competition is even higher in non-regulated industries. The case is preseuted only to show the Court's ability and willingness to interpret economic

The advantage of the rule of reason approach over a per se approach[252] cannot be overestimated by those opposing any application of the antitrust laws to the securities industry. What may be per se unreasonable in a nonregulated industry may be proven to be legal and necessary under the rule of reason approach applied to regulated industries.[253] *Silver's* declaration of the rule of reason approach for evaluating Exchange rules thus permits the Exchange to justify its rules. Protection from the per se rule should not be lightly regarded, and in this sense the securities industry does indeed possess a preferred position for antitrust purposes. The Supreme Court has proved itself capable of distinguishing between legitimate and contrived fears of destructive competition, for example. If its arguments are valid, the Exchange need have no fear of the chaos that might follow from a misdirected decision. The caution of the judiciary in dealing with the securities industry has been amply illustrated in *Morgan*[254] and *Silver*.[255]

The Doctrine of Primary Jurisdiction in Reconciling Antitrust Law and Regulatory Statutes

One of the problems left unsettled by the *Silver* case was how much weight should be given to the fact that the SEC has approved an Exchange rule being challenged under the antitrust laws. The earlier analysis of the *Silver* opinion concluded that the Court should do the final balancing between the need for the rule to effectuate the 1934 Act and the impairment to competition resulting from the rule. This conclusion was based on the Court's failure to find in the 1934

data and balance the need of a particular rule or practice with the resulting injury to competition. This is due to the flexibility embodied in the rule of reason, and that flexibility extends to the regulated industries as well as the non-regulated sector.

252 *See* note 1 *supra*.

253 The inflexibility of the per se approach is illustrated in the *Socony-Vacuum* price-fixing case, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940). There the Court discarded arguments of destructive competition, conservation of petroleum reserves, and maintenance of a viable petroleum industry for defense purposes in striking down a mammoth price-fixing combination affecting the entire petroleum supply in the United States. This time the *purpose* of the agreement was discerned to be market control and fixing of prices at a higher-than-market level, and the Court enunciated once and for all that such a purpose irreparably taints the agreement so that it is per se unreasonable under the Sherman Act.

254 118 F. Supp. at 688.

255 373 U.S. at 366.

Act a self-regulatory scheme so pervasive as to make a court's finding of an antitrust violation within the industry being regulated inherently disruptive to the self-regulatory function. The Court refused to invoke the doctrine of primary jurisdiction.[256] The question remains whether it would do so when the SEC has approved the exchange rule under attack.

The doctrine of primary jurisdiction will be invoked when the court decides that the issue before it should be decided by an administrative agency. Either of two factors will prompt such a decision: (1) the court determines that the question to be decided falls within the special expertise of the administrative agency because of its familiarity with the industry, or (2) the court determines that the question to be decided has been delegated to the agency as an essential part of a pervasive regulatory scheme that requires consistent administration. It is submitted that neither of these factors is present when the issue is the necessity for competition in the securities industry.

This conclusion is based on the non-pervasiveness of the regulatory scheme[257] and the fact that the doctrine of primary jurisdiction is only rarely invoked in cases involving the reconciliation of antitrust law with a regulatory statute.[258] Since the Court itself defines the boundaries of agency expertise, the Supreme Court has guarded the judiciary's role in fostering the national policy favoring competition by retaining for itself the ultimate balancing between the need for an anticompetitive rule and the potential injury to the public as a result of that rule.

Yet, while the Court reserves the task of reconciliation to itself, the decisions of the administrative agency which has approved the anticompetitive rule may aid the Court in its decisions.[259] The weight accorded the decisions of the various regulatory commissions has varied in the past. By examining this line of cases we can attempt to determine where the securities industry fits into the spectrum of regulatory pervasiveness. This will give us better insight into (1) which SEC decisions will be given primary jurisdiction treatment, (2) how SEC opinions will be weighted when that doc-

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[256] *See* note 240 *supra.*

[257] *See* text accompanying notes 87-155 *supra.*

[258] *See* text accompanying notes 236 & 248 *supra,* where it is pointed out that regulatory schemes are seldom so pervasive as to permit the application of the doctrine of primary jurisdiction to questions concerning antitrust matter.

[259] *See* quotation of Judge Medina at note 204 *supra.*

trine is not invoked, and therefore (3) how the current issues facing the securities industry should be approached if they come before the Court.

Far East Conference v. United States[260] is a classic disposition of the primary jurisdiction issue. Asked by the Justice Department to condemn a dual rate system that prevented a shipper from doing business with smaller carriers, the Court held that the Federal Maritime Board should have been asked to review the practice before the parties resorted to the courts.

> Uniformity and consistency in the regulation of business entrusted to a particular agency are secured, and the limited functions of review by the judiciary are more rationally exercised, by preliminary resort for ascertaining and interpreting the circumstances underlying legal issues to agencies that are better equipped than courts by specialization, insight gained through experience and by more flexible procedure.[261]

The question of primary jurisdiction is, therefore, entwined with the question of the scope of regulation built into the statute. In *Far East* the Court reasoned that "[t]he allegations [of antitrust illegality] either constitute direct and basic charges of violation of . . . [the Shipping Act] or are so interrelated with such charges as to be in effect a component part of them . . . ."[262] But under a regulatory statute where the regulatory agency is given less discretion or responsibility in the area of competition, it might well be argued that the primary jurisdiction theory has less significance and might be bypassed. And even in *Far East*, the Court noted that a later "similar suit . . . if appropriate, was not barred [by agency review]."[263]

It is at the time of such subsequent review that the question of weight becomes dominant. An important factor in determining the weight of the agency's finding on a particular matter is the availability of a remedy for those claiming to be injured by collusive action authorized or approved by the agency. The *Air Transport Association* case[264] suggests that even where "the allegations of the complaint reveal that" the regulatory act "covers the dominant facts alleged . . . as constituting a violation of the Antitrust Act," anti-

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260 342 U.S. 570 (1952).
261 *Id.* at 574-75.
262 *Id.* at 574. *See* ATTORNEY GENERAL'S REPORT, *supra* note 229.
263 342 U.S. at 577.
264 S.S.W., Inc. v. Air Transp. Ass'n, 191 F.2d 658, 662 (D.C. Cir. 1951).

trust recovery may merely be postponed rather than forever barred when the regulatory statute affords no remedy comparable to that embodied in the antitrust statutes.[265] The absence of formal hearing procedures and opportunity for public comment in SEC approval of NYSE rules, the limited provisions for judicial review under section 25 of the 1934 Act,[266] and the absence of any provision for injunctive relief or treble damages, which are available under the Clayton Act,[267] combine to suggest that the relief available under the 1934 Act is inadequate to provide just remedies for those injured by anticompetitive activities.

The question of remedies aside, courts may be less willing to postpone or bar antitrust action where the regulatory statute involved does not provide "for detailed and comprehensive economic regulations."[268] *United States v. Borden*, which deals with the Agricultural Marketing Agreement Act,[269] held that the statute empowered the Secretary of Agriculture to review only isolated issues rather than affirmatively approving a comprehensive economic plan; such a limited procedure, therefore, was not meant to "substitute for the provisions of the Sherman Act."[270] The language of the Capper-Volstead Act that was deemed not to constitute a substitute for the provisions of the Sherman Act is worth noting. The gist of that language is that the Secretary of Agriculture is authorized to determine, subject to judicial review, whether any such cooperative association monopolizes or restrains interstate trade to such an extent that the price of any agricultural product is unduly enhanced, and, if so, to issue a cease and desist order. One searches in vain for such explicit guidelines in the Securities Exchange Act. If the Court saw fit to review the *Borden* case, it seems futile to argue that the self-regulatory mechanism established by the 1934 Act was intended as a substitute for the Sherman Act. There is no provision for an affirmative approval of a comprehensive economic plan included in the 1934 Act. The *Silver* case supports such a conclusion.[271]

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[265] *See* ATTORNEY GENERAL'S REPORT, *supra* note 229, at 280.

[266] 15 U.S.C. § 78y (1964). *See generally* 2 Loss 1919-35; 6 Loss 4055-71.

[267] Sections 4 and 14 of the Clayton Act, 15 U.S.C. §§ 5, 15, 26 (1964).

[268] United States v. Borden, 308 U.S. 188 (1939), *cited in* ATTORNEY GENERAL'S REPORT, *supra* note 229, at 281-82.

[269] 50 Stat. 246, *as amended* by §§ 1 and 2 of the Capper-Volstead Act, 7 U.S.C. §§ 291-92 (1964).

[270] 308 U.S. at 206. *See* ATTORNEY GENERAL'S REPORT, *supra* note 229, at 282.

[271] 383 U.S. at 357.

In *United States v. RCA*[272] an exchange of television stations was held to have violated the Sherman Act. The Court rejected the contention that the FCC had primary jurisdiction to decide the question of antitrust violation, even though the FCC was vested with the power to approve the transaction. The Court held that "[t]he Commission lacked the statutory power to resolve antitrust questions since its approval was based on a broad standard of 'public interest, convenience, and necessity' rather than on antitrust criteria."[273] The Court in *Silver* likewise implied that the standard of Commission review provided in the 1934 Act was too general to perform the antitrust function.[274]

An example of the type of language that is necessary to instill the antitrust standard into the regulatory act was found in *Pan American World Airways v. United States*.[275] The Court held that the Federal Aviation Act gave the Civil Aeronautics Board authority to consider unfair methods of competition in air transportation in approving mergers and that part of the Clayton Act gave the CAB the authority to enforce the Clayton Act as it applied to air carriers. That section of the Clayton Act does not refer to the SEC. Despite all of this, the Court in the *Pan American* case went on to say that the CAB does not "have jurisdiction over every antitrust violation by air carriers."[276]

As one commentator has put it:

> From the language in these cases it would appear that both criteria—explicit statutory authority to consider antitrust variables and juridical review of the exercise of that authority—are essential for an implied exemption based upon the 'pervasiveness' of agency regulation.[277]

The language of footnote 12 of the *Silver* opinion agrees with this analysis. Earlier, it was found that there was no antitrust standard in the 1934 Act, no pervasive regulatory scheme, and no satisfactory "juridical review of the exercise of [SEC] authority" for non-mem-

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272 358 U.S. 334 (1959).

273 *See* Note, 55 VA. L. REV. at 671-72.

274 373 U.S. at 358, *citing* the *RCA* case. The *Silver* court stated:

> Moreover, the Commission's lack of jurisdiction over particular applications of exchange rules means that the question of antitrust exemption does not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power.

Id.

275 371 U.S. 296 (1963).

276 *Id.* at 311-12, *cited in* Note, 55 VA. L. REV. at 672.

277 Note, 55 VA. L. REV. at 673.

bers. Without an implied exemption to the antitrust laws, the doctrine of primary jurisdiction is not applicable.

Of course, other administrative law principles apply to the securities field, such as exhaustion of administrative remedies, ripeness of a justiciable question, and standing to raise a claim. But when judicial review of the agency's findings on competitive effects finally comes, the inapplicability of the doctrine of primary jurisdiction is still significant because the standard of judicial review will be much more comprehensive than under the substantial evidence test customarily applied in judicial review of administrative action peculiarly within the agency's expertise.[278]

Judicial Retention of Antitrust Questions as a Limitation on Commission Power

The narrow interpretation of the power of the SEC to establish antitrust immunity for Exchange rules is based on the absence of an antitrust standard in the 1934 Act and the poor record of the SEC in maintaining a high level of competition within the securities industry. Prior analysis of the Supreme Court's decision in *Silver* has emphasized the Court's inclination toward a narrow construction of Commission power in this area. This section is intended to demonstrate that such a narrow interpretation of SEC power in matters pertaining to competition is consistent with a long-standing judicial policy of narrowly construing regulatory statutes, even when such statutes have created a more pervasive scheme of governmental control of industry practices than it did for the securities industry. It will be seen that when Congress has delegated to an administrative agency some power to authorize a curtailment in the level of competition that would be expected to prevail in the absence of the regulatory scheme, the Supreme Court has consistently restricted the limits of that power.

The limits of even an express exemption that accompanies the

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[278] *See* note 177 *supra.* The more dependent the resolution of a question on the expertise of the administrative agency, the more likely are the courts to invoke the doctrine of primary jurisdiction and the substantial evidence test. It may be argued that SEC expertise is more essential in approving exchange rules thau it is in approving, say, disciplinary actions of an exchange or mergers within the securities industry. The more the courts rely ou the expertise of the SEC, the greater the weight accorded to the SEC's approval of the rule, and, consequently, the closer the standard of review comes to being the substantial evidence test. But the courts decide whether particular questions fall within the special expertise of the SEC.

inclusion of the antitrust standard in a regulatory act are pointed out in *Georgia v. Pennsylvania Railroad Co.*[279] The complaint alleged a conspiracy to fix arbitrary and noncompetitive rates on traffic through Georgia by using the ICC rate-setting procedures as a subterfuge. The Supreme Court held unanimously that the action for damages did not lie, but the action for an injunction was upheld (5-4). The Court reached this decision despite the language of section 16 of the Clayton Act,[280] which provides that injunctions should not be issued against a carrier subject to the provisions of the Interstate Commerce Act "in respect of any matter subject to the regulation, supervision, or other jurisdiction of the Interstate Commerce Commission."[281] The Court simply found that the injunctive relief sought was "not a matter subject to the jurisdiction of the Commission. . . . [Georgia] merely asks that the alleged rate-fixing combination and conspiracy among the defendant carriers be enjoined . . . [and] that is a matter over which the Commission has no jurisdiction."[282]

Some language of the Court involving the vulnerability of commission-approved rates to antitrust attack is especially pertinent to a consideration of the status of the NYSE's commission rate structure.

> The fact that the rates which have been fixed may or may not be held unlawful by the Commission is immaterial to the issue before us. The *Keogh* case indicates that even a combination to fix reasonable and non-discriminatory rates may be illegal. 260 U.S. p. 161. The reason is that the Interstate Commerce Act does not provide remedies for the correction of all the abuses of rate-making which might constitute violations of the anti-trust laws. Thus a 'zone of reasonableness exists between maxima and minima within which a carrier is ordinarily free to adjust its charges for itself . . . . Within that zone the Commission lacks the power to grant relief even though the rates are raised to the maxima by a conspiracy among carriers who employ unlawful tactics . . . .'[283]

The decision in *Kaplan* is contrary to this language. In *Georgia v. Pennsylvania Railroad*, the Court cast aside the question of the reasonableness of the rates. The antitrust question was how those rates

[279] 324 U.S. 439 (1945).

[280] 15 U.S.C. § 21(a) (1964).

[281] L. JAFFE & N. NATHANSON, ADMINISTRATIVE LAW 670 (1968).

[282] *Id., citing* Georgia v. Pennsylvania R.R., 324 U.S. 439, 455 (1945). As suggested in note 278 *supra*, the Court is defining the ambit of the agency's expertise.

[283] 324 U.S. at 460-61.

were established. It was the practice of rate fixing, not the particular rates fixed, that concerned the Court. The ICC's power over rates is broader and more explicit than is the SEC's, yet the Court found the ICC to be incapable of creating antitrust immunity for unnecessary rate agreements. Arguably, then, a court should be able to find that the practice of exchange members agreeing on a minimum rate structure is an unreasonable practice. Other rules (such as artificial membership barriers or restrictions on members' tradings) established by the self-regulatory mechanism are likewise subject to antitrust attack as unreasonable under the approach applied in *Georgia v. Pennsylvania Railroad.*

The problem with the securities industry is its unique regulatory scheme, which the NYSE considers an advantage in these issues. But the stronger the NYSE's argument for limiting the SEC's power over the self-regulation mechanism, the less power the SEC will have for immunizing Exchange rules from antitrust attack. More than in most regulated industries, the decisions being made in the securities industry are being made by the actual parties sought to be regulated. Moreover, the SEC is given no statutory standard for evaluating competitive impact, nor for weighing that against the public interest. In the context of its limited powers of regulation, then, SEC approval of rules cannot be said to perform the antitrust function. The peculiar market position of the major exchanges and their self-control over membership, coupled with the performance of the industry as measured by traditional standards, suggest that in the absence of firmer SEC authority[284] over rates and rules—so that the Commission rather than the Exchange is the policy-making body—the SEC should have no authority to exempt industry members from the antitrust laws. Only to the extent that the courts agree with the Commission as to the necessity of a particular rule or practice to the purposes of the 1934 Act should they grant an exemption.[285]

[284] Authority here is unfirm because of both a lack of a clear statutory duty to perform the antitrust function and a failnre of the SEC to exercise the powers that it does possess to introduce a competitive standard into exchange decision-making. SEC activity since 1968 indicates that the Commission is exercising greater initiative in the area of competition than ever before. Whether this trend will continue is not certain.

[285] Recall the language of Judge Medina at note 204 *supra.* The Attorney General's Committee supports this view. In commenting on the weight to be given by the courts to the agency's decision in an antitrust review, the Committee suggested that the courts adopt the position of the dissent in McClean Trucking Co. v. United States, 321 U.S. 67 (1944). Working the language of that dissent

The resiliency of the antitrust laws within the framework of regulatory statutes has been demonstrated by recent developments in the field of bank mergers. These cases are highly significant for the securities industry, since they illustrate how service industries with characteristics similar to the securities industry have been treated with respect to specific antitrust questions. The issues dealt with in these banking cases provide special insight into how the Court may weigh some of the particular economic arguments mentioned earlier as they pertain to issues in an antitrust action.[286]

The bank merger story begins with *United States v. Philadelphia National Bank*,[287] decided in the same year as *Silver*. This case involved the applicability of section 1 of the Sherman Act and section 7 of the Clayton Act to the banking industry, which is subject to an even higher degree of government regulation than the securities industry. Although the particular action involved a merger, there is no compelling reason why the analysis employed by the Supreme Court in the *Philadelphia National Bank* case would not be appropriate for other restraints of trade covered by the same sections of the antitrust laws.[288] The proposed merger of two large Philadelphia banks fell under the Bank Merger Act of 1960,[289] which required approval of bank mergers by the Comptroller of the Currency, who, in turn, was required to receive reports from the Board of Governors of the Federal Reserve System and/or the Federal Deposit Insurance Corporation *and* the Attorney General on the probable effects of the proposed merger on competition. Despite the recommendations by these agencies that this merger would produce substantial anticompetitive effects, the banks were authorized by the

into its own phraseology, the Committee wrote, ATTORNEY GENERAL'S REPORT, *supra* note 229, at 270:

> Ultimately, however, the agency's interpretation of Congressional design is clearly a proper subject for judicial review. True, the "wisdom and experience of . . . [the agency]," not of the courts, must determine whether the proposed consolidation is "consistent with the public interest." (McClean, 87-88.) Equally true, however, it is the Court's "responsibility to say whether the Commission has been guided by proper consideration in bringing the deposit of its experience . . . to bear . . . in [determining the public interest]." (FCC v. RCA, at 91.) Where Congress has been silent, the basic policy of our antitrust laws requires the Court's conclusion that competition, at least where all other considerations involved are equal, is in the "public interest."

It seems fair to say that the Supreme Court's decision in *Silver* (and all the cases discussed that were handed down since *McClean*) was in line with the views of the Attorney General's Committee.

286 *See* text accompanying notes 60-85 *supra*.

287 374 U.S. 321 (1963).

288 *See* note 278 *supra*.

289 12 U.S.C. § 1823(c) (Supp. IV, 1964).

Comptroller to proceed. The government immediately challenged the merger.

The Court approached the case by first deciding that the companies involved fell within the ambit of section 7 of the Clayton Act.[290] The next step, the traditional relevant market analysis, identified the relevant product market as commercial banking and the relevant geographical market as the Philadelphia area.[291] The Court did not explicitly describe the weight given to the findings of the three bank regulatory bodies in reaching its decision that "[t]he area in which banks have their offices . . . [is] an area of effective competition."[292] However, in the *Houston Bank* case,[293] the Court explained that the weight given to administrative findings in antitrust actions was somewhat less than presumptive.[294]

Having established the relevant product and geographic markets, the Court examined whether the effect of this merger may be substantially to lessen competition in the relevant market. It held that the size of the resulting institution was inherently anticompetitive for the area's commercial banking business.[295] The possibility of entry of competitive banks was held to be too dependent upon gov-

290 374 U.S. at 342. This was despite the fact that the banks were not subject to the jurisdiction of the Federal Trade Commission.

291 *Id.* at 356. Thus the whole cluster of services comprising "commercial banking" was held to be an identifiable line of commerce in Clayton Act terms, but only the four-county Philadelphia area was relevant geographically. The area of effective competition was determined on the basis of the area in which the seller operates and "to which the purchaser can practicably turn for supplies. *Id.* at 357-59, *citing* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 337 (1961).

The lessons of this market analysis should not be lost on the securities industry. While the full line of brokerage services may be designated the relevant line of commerce for Clayton Act purposes, the degree of specialization prevalent in the industry may lead to a narrower definition of the relevant product market. As for geographical markets, localities may be treated as isolated markets in the brokerage industry, or the factor of ease of communication may justify a broader definition of the relevant market. Such market definitions are important for judging the competitive effects of mergers under section 7 of the Clayton Act, the test being whether the merger may tend substantially to lessen competition in any line of commerce in any section of the country. 15 U.S.C. § 18 (1964). While a market analysis is not required for Sherman Act conspiracies, it throws light on how a court may measure competition in the securities industry.

292 374 U.S. at 361.

293 United States v. First City Nat'l Bank, 386 U.S. 361 (1967).

294 *Id.* at 367. *See* text accompanying note 305 *infra* for the Court's language.

295 374 U.S. at 365.

ernmental grace and too remote due to simple economic barriers to breaking into the market.[296]

Next the Court rejected the banks' argument that the high degree of governmental control in the banking industry constituted reason for exemption from treatment under traditional antitrust concepts, such as economic concentration and relevant market.

> [W]e reject the position that commercial banking, because it is subject to a high degree of governmental regulation, or because it deals in the intangibles of credit and services rather than in the manufacture or sale of tangible commodities, is somehow immune from the anticompetitive effects of undue concentration. Competition among banks exists on every level—price, variety of credit arrangements, convenience of location, attractiveness of physical surroundings . . . . There is no reason to think that concentration is less inimical to the free play of competition on banking than in other service industries. On the contrary, it is in all probability more inimical.[297]

It seems that the same argument would be at least equally valid for price-fixing, a more blatant anticompetitive act. Furthermore, the applicability of these words to the securities industry—a service industry which is subject to even less direct regulation than banking—seems obvious. Competition in regulated industries is to be retained wherever possible.

The next consideration of the Court was to treat the banks' affirmative justifications for the merger. Rejecting the rather vague suggestion that ruinous competition would result from the application of section 7 to mergers with substantial anticompetitive effects, the Court held that traditional antitrust concepts were capable of dealing with special economic situations, without requiring a total abdication of the national policy favoring competition.

> Section 7 does not mandate cutthroat competition in the banking industry, and does not exclude defenses based on dangers to liquidity or solvency, if to avert them a merger is necessary. It does require, however, that the forces of competition be allowed to operate within the broad framework of governmental regulation of the industry. The fact that banking is a highly regulated industry critical to the Nation's welfare makes the play of competition not less important but more so . . . .[298]

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[296] *Id.* at 367.

[297] *Id.* at 370-71.

[298] *Id.* at 371-72. Footnote 46 in the opinion mentions the possibility of enlarging the contours of the failing company defense as an affirmative defense in bank merger cases, because of the "greater public impact of a bank failure com-

The only alternative which the Court saw to competition in the banking industry was tighter government regulations. This observation as well as the entire attitude of the Court in *Philadelphia National Bank* is easily translatable to the economic structure of the securities industry. The economic analysis of the industry presented earlier plus the review of the limited regulatory scheme controlling it combine to make such a translation most appropriate. The *Philadelphia National Bank* case also stands as another example of the ability and willingness of the Supreme Court to consider economic arguments concerning cost factors and the potential for ruinous competition.

Congress, hoping to overrule the *Philadelphia National Bank* case, passed the Bank Merger Act Amendment of 1966.[299] The strategy was to build into the regulatory scheme an antitrust standard sufficiently explicit to prevent the Supreme Court in the future from overruling determinations of the Comptroller of the Currency concerning bank mergers. The 1966 Act requires the Comptroller (or other appropriate supervisory agency) to apply the Clayton Act standard of effect on competition in evaluating proposed bank mergers or acquisitions. If, however, an initial appraisal finds that the merger would substantially lessen competition in a relevant market, a balancing test is to be applied. The anticompetitive effect is to be weighed against the extent to which the public interest will be served by the merger. "[U]nless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served," the merger shall be disapproved.[300] By building into the statute, as nearly as possible, the precise approach followed by the Supreme Court in the *Philadelphia National Bank* case, Congress thought that it would preclude the Court from holding in the future that the antitrust standard was not built into the regulatory scheme.

Supreme Court interpretation of this amendment has determined that no real change in the substantive law was created by this amendment. The Court has sustained the procedural innovations included in the 1966 Act, but it has held that although pre-1966 judicial standards have been built into the post-1966 regulatory statute, no change has been effected in the status of judicial review of

pared with ordinary business failures." Such treatment illustrates the flexibility of antitrust doctrines.

299 Public Law 89-356, 12 U.S.C. 1828(c)(5)(B) (Supp. V, 1969).

300 *Id.*

Comptroller-approved mergers. Simply because the Comptroller is supposed to apply the same standards that the Court applies does not mean that the Court should refuse to examine the Comptroller's application of the standards of competition. In fact, the Court has clearly established that a hearing de novo by the appropriate court is called for whenever the government timely challenges a merger, even though that merger may have been approved by a supervisory agency.

This grudging interpretation of the 1966 amendment was first set forth in *United States v. First City National Bank* and *United States v. Provident National Bank.*[301] In a joint opinion written by Mr. Justice Douglas, the Court reviewed two mergers which had been approved by the Comptroller over the adverse reports of the other interested agencies (including the Justice Department). Commenting on the changes wrought by the amendment, Mr. Justice Douglas wrote:

> [C]ongress intended that a defense or justification be available once it had been determined that a transaction would have anticompetitive effects, as judged by the standards normally applied in antitrust actions . . . . [T]he offsetting community "convenience and needs," as specified in 12 U.S.C. section 1828(c)(5)(B), must be pleaded and proved by the defenders of the merger.[302]

Review de novo was provided by the act itself. The language of section 1828(c)(7)(B) of title 12 demands that judicial review of mergers approved under the 1966 amendments shall be on the basis of identical standards as those which the act requires the Comptroller to apply in his evaluation of the merger. This section is to guide the Court when section 7 is the basis for the government's attack on the merger. Despite this express language, the Supreme Court held that "Section 7 of the Clayton Act condemns mergers where 'the effect of such acquisition may be substantially to lessen competition.' The Bank Merger Act of 1966 did not change that standard . . . ."[303]

The Court's action in this case supports the earlier conclusion that the traditional rule of reason approach is flexible enough and broad enough to recognize any valid justification for a restraint of trade. Consistent with this approach, the Court interpreted the public interest standard of the 1966 amendment as an affirmative de-

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301 386 U.S. 361 (1967) (decided concurrently).
302 *Id.* at 364.
303 *Id.* at 365.

fense. However, the banks carry the burden of proving that the merger falls within the 1966-created exception to the Clayton Act. Relying on the legislative history of the Act, the Court found that Congress intended the usual Clayton Act standards to be applied, with the amendment merely establishing a chance to justify the initially-apparent anticompetitive effect.

This seems to be the precise approach applied by the Court in *Silver.* Instead of the Bank Merger Act Amendment of 1966, the Court treated the self-regulatory process "mandated" by Congress as containing the foundation of the presentation of an affirmative defense for the NYSE. The burden, however, remained with the Exchange to justify its action as necessary within the objectives of the 1934 Act. The Exchange failed to meet this burden. Similarly, a future attack on an exchange rule, evaluated under the rule of reason analysis, could be defeated if the Exchange could sustain the burden of proving the rule necessary to accomplish the goals of the 1934 Act.

Just as the Supreme Court was required to apply the same standards as the Comptroller in bank merger review, it would take it upon itself to apply the same standard as built into the Securities Exchange Act in reviewing SEC-approved action. Although the *Houston Bank* case was not a hearing on the merits, the Court expressed the appropriateness of its finding contrary to the Comptroller in a hearing de novo.[304] So just as the Court can apply identical standards as the Comptroller and achieve a different result, it could similarly apply the "protection of investors" standard of the 1934 Act and reach a different conclusion on the merits than the SEC. If the antitrust standard was not built pervasively into the Bank Merger Act, it certainly cannot be suggested that it is adequately built into the Securities Exchange Act to justify an antitrust exemption.

On the question of jurisdiction and the standard for review of the agency's decision, the Court in the *Houston Bank* case found that no change had been created in the weight given to agency findings in antitrust matters. Indeed, in antitrust matters, the policy before and after the 1966 amendment has been to accord no special weight to agency findings.

> Prior to the 1966 Act administrative approval of bank mergers was necessary. Yet in an antitrust action later brought to enjoin them we never stopped to consider what weight, if any, the agency's determination should have in the antitrust case. See

[304] *Id.* at 366.

> *United States v. Philadelphia National Bank* . . . . Traditionally in antitrust actions involving regulated industries, the courts have never given presumptive weight to a prior agency decision, for the simple reason that *Congress put such suits on a different axis than was familiar to administrative procedure. United States v. Radio Corporation of America,* 358 U.S. 334; *United States v. El Paso Natural Gas Co.,* 376 U.S. 651; *United States v. Philadelphia National Bank* . . . .[305]

This reasoning forthrightly rejects the substantial evidence test. Douglas wrote that a "grant of administrative power to give immunity unless the agency's decision is arbitrary, capricious, or unsupported by substantial evidence, would be a long step in" the direction of implying an exemption from the antitrust laws.[306] That was one giant step the Court refused to take. The Court also viewed the absence of a formal hearing procedure in the approval process for bank mergers as an additional reason for judicial review. Then, in a statement reminiscent of Judge Medina's view of the value of SEC opinions in antitrust matters,[307] the Court added:

> The courts may find the Comptroller's reasons persuasive or well nigh conclusive. But it is the court's judgment, not the Comptroller's that finally determines whether the merger is legal.[308]

One can already see the citation to this next quotation if the Exchange ever presents to the Supreme Court the argument that SEC approval of an exchange rule exempts that rule from antitrust attack:

> The "rule of reason," long prevalent in the antitrust field (*see, e.g., Chicago Board of Trade v. United States,* 246 U.S. 231), has been administered by the courts. A determination of the effect on competition within the meaning of section 7 of the Clayton Act is a familiar judicial task. The area of "the convenience and needs of the community to be served" . . . is related, though perhaps remotely, to the failing-company doctrine, long known to the courts in antitrust merger cases . . . . The appraisal of competitive factors is grist for the antitrust mill. *See, e.g., United States v. Philadelphia National Bank* . . . . The courts are not left as large planning agencies. The effect on competition is the standard; and it is a familiar one. If the anticompetitive effect is adverse, then it is to be excused only if "the convenience and needs of the community to be served" *clearly*

305 *Id.* at 367 (emphasis added).
306 *Id.* at 368.
307 *See* text accompanying note 204 *supra.*
308 386 U.S. at 369-70.

> outweigh it. We see no problems in bringing these standards into the area of judicial competence. There are no constitutional problems here not present in the "rule of reason" cases.[309]

The Court would merely have to substitute the "protection of investors" standard for the "convenience of the community" standard to apply the same approach to the securities industry. This is what was done in *Silver.* As far as the rule of reason approach is concerned, there is no distinction between merger cases and other alleged restraints of trade that might alter the applicability of the Court's pronouncement in the *Houston Bank* case to the securities industry. The most liberal interpretation of the 1934 Act does not leave support for the proposition that the antitrust standard is more apparent in that act than in the Bank Merger Act.

As if to demonstrate its independence from the findings of regulatory agencies, the Supreme Court's decision in *United States v. Third National Bank in Nashville*[310] categorically reversed on the merits the findings of the Comptroller. The *Nashville Bank* case was another bank merger case coming under the Bank Merger Act of 1966. The district court had upheld the Comptroller's approval of the merger prior to the decision in the *Houston Bank* case. The Comptroller's approval had been based on the "convenience and needs of the community" factor, which he held to outweigh the Federal Reserve Board's and the Attorney General's criticisms of the merger on the grounds of its anticompetitive effect.

The Supreme Court embarked immediately upon a relevant product and geographical market analysis. Thus, it was answering the Clayton Act test first. Then, noting its designation of the "convenience and needs" test as a potential affirmative defense in the *Houston Bank* case, the Court disregarded the district court's acquiescence to the Comptroller's findings on the basis of that test. The Court emphasized that the district court had not performed its *duty* of conducting a hearing de novo into the validity of a bank merger approved by the relevant bank regulatory agency.[311] It criti-

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309 *Id.* (emphasis added) (footnote omitted).

310 390 U.S. 171 (1968).

311 The Securities Exchange Act is not so explicit in requiring a hearing de novo, but the Court's reliance on the de novo provision in the Bank Merger Act Amendment of 1966 is not crucial to its approach, since this is referred to as an additional factor—over and above the rule of reason standard built into the Clayton Act by judicial decisions—in warranting judicial review de novo. *See* United States v. First City Nat'l Bank, 386 U.S. 361, 368 (1967).

cized the lower court for treating the "convenience and needs" test as "a legislative or administrative determination . . . [on which] the Comptroller's findings should not be disturbed unless they are unsupported by substantial evidence."[312] The Supreme Court saw no statutory language amending the traditional definitions of relevant markets.[313] Therefore, the Court held that the district court employed an erroneous standard in applying section 7 of the Clayton Act.

The Court then illustrated what it considered the proper approach for evaluating bank mergers. First, the Clayton Act test was applied to see if the merger would tend substantially to lessen competition in the relevant market.[314] Once this anticompetitive effect had been ascertained by the Court, the next step was to see if such effect would be "clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. . . . The public interest was the ultimate test imposed."[315] The burden of proving the convenience and needs defense is a heavy one; it cannot be inferred or implied.[316] Although cases may arise, as when one of the merging banks is about to fail, in which the public interest will be best served by a lessening of competition, the Court is competent (and willing) to recognize those cases when they are presented.[317] No reason appears why the same approach should not be applied to the securities industry.[318]

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312 390 U.S. at 181.
313 *Id.* at 182 n.15.
314 *Id.* at 182-83.
315 *Id.* at 184.
316 *Id.* at 192.
317 *Id.* at 187.
318 Another recent example of the inapplicability of the primary jurisdiction argument in antitrust actions against companies falling under other regulatory statutes is found in the litigation involving the attempted acquisition by El Paso Natural Gas Company of Pacific Pipeline Corporation. Litigation of this case, which began in 1956, is still in progress. The acquisition technically fell outside of matters explicitly requiring approval of the Federal Power Commission, *see* § 7(c) of the Natural Gas Act, 15 U.S.C. § 717(c) (1964), since it was a stock acquisition rather than an acquisition of assets. After the Justice Department filed suit to stop the acquisition, El Paso requested FPC approval. The district court refused El Paso's request to stay its proceedings in the Clayton Act action until the FPC ruled on the proposed acquisition, holding that the FPC had "no jurisdiction to decide the Clayton Act issues." United States v. El Paso Natural Gas Co., 1957 Trade Cas. ¶ 68,872. The Supreme Court denied certiorari to a petition for review of the district court's order. 355 U.S. 950 (1958). Nonetheless, after considerable haggling

No matter how broad the scope or pervasiveness of a regulatory scheme, the Supreme Court has reserved for itself the duty of deciding the antitrust questions within the flexible framework of the rule of reason. The most that Congress can do by way of creating exemptions to the antitrust laws (without amending them) is to create affirmative defenses which courts will recognize if those attempting to assert them sustain the burden of proof.

It may be concluded, then, that those SEC decisions which are guided by the general standard of "just and adequate to insure fair dealing and to protect investors" will be reviewed on their merits by the courts. The doctrine of primary jurisdiction will not apply whenever the courts determine that the Commission decision under review called for a consideration of its competitive impact. On the other hand, there is sound precedent to the effect that a court will give substantial consideration to the opinions of the SEC to avail itself of that agency's expertise, when relevant to the court's decision.[319]

Insofar as the current issues confronting the securities industry are concerned, this judicial attitude can be expected to result in judicial evaluation of exchange rules under the rule of reason, as earlier described. SEC approval of these rules will not be consid-

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between the Justice Department and the FPC, Judge Ritter continued the antitrust suit until the final decision of the FPC could be handed down. J. Rahl, Materials on Antitrust Law (unpublished work in Northwestern U. Law Library) 9-111 (1969).

The FPC Hearing Examiner, in the face of substantial opposition, approved the merger aud dismissed the Clayton Act issue by interpreting section 7 of the Clayton Act as exempting from the antitrust laws any merger approved by the FPC. The Examiner included a detailed appraisal of the economic impact expected from the merger in conducting his public benefit test. He specifically included an analysis of the potential competition of Northwest in the California market, concluding that certain detailed advantages from the merger would "far outweigh" the relatively unimportant effects on competition. 22 F.P.C. 1116, 1123. The FPC approved the Examiner's findings. California appealed. The court of appeals affirmed, 196 F.2d 348 (D.C. Cir. 1961), but the Supreme Court reversed (5-2), holding that the FPC should have deferred its finding until the Clayton Act issue had been settled by the district court. California v. FPC, 369 U.S. 482 (1962). Then, after the district court found for defendant on remand, the Supreme Court reversed, invoking a potential competition doctrine—thereby completely discarding the findings of the FPC on this specific matter. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964). The Supreme Court ordered divestiture and retained jurisdiction of this issue rather than entrusting the FPC to approve the divestiture plans. J. Rahl at 9-123.

319 *See* note 318 *supra,* as well as the language of the Supreme Court quoted at notes 308 & 309 *supra.*

ered to result in antitrust immunity, but will be given some weight by the court as supporting the need for the rule. The fact of SEC approval, by itself, will not automatically defeat a prima facie antitrust case. Whether the analysis supporting the Commission's approval of the rule will be weighty enough to defeat such a claim is not certain, since this depends on a balancing of the public injury resulting from the rule against the alleged necessity for it. The cases presented in this section leave no doubt as to who is the keeper of the scales. The arguments on either side have been framed. It remains for the Supreme Court to accept a case, with the issues properly framed, for the balancing to be performed. The approach which should be applied, however, should now be clear.[320]

CONCLUSION: THE RECOMMENDED APPROACH AND ITS CONSEQUENCES

The approach recommended for reconciling antitrust and securities law is not particularly novel, but its application to the securities industry has not yet been confirmed. The holding of the Supreme Court in *Silver v. New York Stock Exchange* indicated the Court's disposition to treat the problem of reconciling antitrust law and securities law as it has treated problems of reconciling the antitrust laws with other regulatory statutes. The propriety of this approach has been demonstrated, and, in the absence of additional legislation, it is submitted that this approach is a necessity.

The initial feature of this approach is to place primary responsibility for the resolution of the problem in the hands of the courts. This comment has demonstrated the importance of eventually turning to a judicial forum to determine how much suppression of competition is necessary to achieve the goals of the regulatory statutes. This is especially appropriate for the securities industry, given (1) the limited nature of the regulatory scheme,[321] (2) the uncertainty of the ability and determination of the SEC to give due

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320 The question may arise whether the Justice Department, having intervened in the SEC hearings on the commission rate problem, should be barred from filing a claim in court seeking an injunction if it has lost at the hearings. The experiences of the bank merger litigation and the *El Paso* case, note 318 *supra,* suggest that agency decisions on matters of competition are not res judicata for the Court. Therefore, it would seem that the courts would remain open for the Justice Department's claim (or a private action). Another factor suggesting this result is the irregular hearings requirements regarding approval of exchange rules.

321 *See* text accompanying notes 96, 113 & 114 *supra.*

weight to competitive factors in performing its supervisory task,[322] and (3) the absence of an adequate antitrust remedy within the regulatory scheme for those who might be injured by anticompetitive practices.[323]

Once a court accepts jurisdiction in a case challenging the activities or rules of an exchange or its members, its first step should be to determine if there has been a violation of the antitrust laws—notwithstanding any protection that might be afforded by the 1934 Act. This decision should be made on the basis of the court's defining the relevant product market and the relevant geographical market in Clayton Act section 7 cases, and determining whether there has been a restraint of trade in Sherman Act section 1 cases. Traditional antitrust concepts guide this inquiry, aided by SEC findings and opinions.[324]

If the court concludes that there has been a prima facie violation of the Sherman Act, the Clayton Act, or the Federal Trade Commission Act (or any of their amendments), the next step is to determine if there is reason to imply an exemption from the antitrust laws for this particular activity. The mandate of self-regulation does permit an affirmative defense if it can be shown that the particular collective behavior under scrutiny is necessary for the accomplishment of the purposes and goals of the 1934 Act. The guiding principle for determining the scope of antitrust exemption called for by the 1934 Act was stated in *Silver*: "Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary."[325] The task of the court, therefore, is to determine if a particular activity or rule is necessary to make the 1934 Act work.

To answer this question the court should evaluate the purpose and effect of the activity. Even if the purpose is justified by the 1934 Act, such as protecting investors by assuring a strong central market, the court must still ascertain whether the desirable goal can be attained by some other means.[326] In short, the court is asking: "Is this restraint of trade unreasonable?" This calls for an economic analysis and expert testimony by those who are in a position to help

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322 *See* text accompanying notes 149-54 *supra*.
323 *See* notes 192-200 *supra* and accompanying text.
324 *See* notes 290-94 *supra* and accompanying text.
325 373 U.S. at 357.
326 *See* text accompanying note 104 *supra*.

the court appraise the economic data. The SEC may enter the case as amicus curiae, as did the FPC in the *El Paso* litigation.[327] But even if the rule or activity under attack has the support of the SEC, it is the courts that must do the balancing, and this calls for a determination of whether the SEC has given appropriate consideration to the competitive factors involved. The record of SEC inattention to issues involving competition indicates that the court is in a more objective position to accord the proper weight to the public policy favoring competition.

The arguments suggesting a broad antitrust exemption because of the congressionally-mandated system of self-regulation have been found not to reach problems of competition (especially among exchanges) since they lead to a situation in which essentially uncontrolled self-regulation would prevail.[328] Even *Silver* held that no express exemption was contained in the 1934 Act, and the type of immunity the NYSE seeks to establish can only be obtained by express language from Congress.[329]

The burden of proving the affirmative defense made available by the 1934 Act is a very difficult burden to sustain, as demonstrated by the cases reviewed here. Given the extreme importance of the securities industry and the incomplete regulatory system governing its operations, the only justification for allowing a suppression of competition is that such behavior is necessary to insure fair dealing or for investor protection. This is a decision that the courts should retain, giving some—but never presumptive—weight to SEC opinion.

The line of cases establishing judicial jurisdiction for antitrust cases involving regulated industries is impressive in both its consistency and its soundness of logic. The concept of a broad, overriding competitive scheme with niches cut out only where courts interpret particular congressional policy and goals to require exemption from the antitrust laws is logical because of the concept of regulation itself. It was seen that regulation occurs for one of two rea-

327 *See* note 318 *supra*.

328 *See* text accompanying notes 87-155 *supra*.

329 Indeed, on balance, it appears that the economic justifications for the present restrictive practices of the New York Stock Exchange are largely unpersuasive. The fears of the Exchange appear to be exaggerated, and the predicted detrimental results stemming from competition seem avoidable. Although this article is only concerned with approach, a rough weighing of the opposing arguments results in a decision for more competition.

sons: either competition cannot be expected to protect consumers, or competitive pressures are likely to result in public injury.

These are two distinct situations that have resulted in two distinct types of regulation. In the first case, regulatory machinery is designed as a supplement to natural competition, not a substitute for what competition exists. This type of regulation is found in the banking and agricultural industries, for example, and it is also the type of scheme embodied in the Maloney Act. The second type of regulation is found in the pervasive statutes governing the transportation industries and public utilities. The natural monopoly situation present in these industries compels direct government participation in rate-making and service-allocation decisions. The first type of regulation is more supervisory or policing in nature; the second type is more participatory. This distinction is significant for purposes of construing statutory langnage when a court attempts to determine the extent of antitrust immunity required to accomplish Congress' purposes. The second type, or "participatory regulation," requires broader antitrust exemptions than the first type, or "supervisory regulation." A participatory-type regulated industry may fix prices because the government agency is involved in the process. A supervisory-type regnlated industry may adopt rules for disciplining members if they do not meet group norms of honesty and fair dealing because direct government regulation may not be feasible. But it may not fix prices, since the government agency is not directly involved in this process. There is no provision for that kind of involvement in the act of Congress. While the court retains jurisdiction over antitrust matters in both types of regnlatory schemes, the niche that is cut out of the national policy favoring competition is much broader for participatory-type regulated industries than for supervisory-type regulated industries.

It was noted that even the most direct of Congress' attempts to bestow upon a supervisory agency the power to make decisions on antitrust questions have been construed by the Supreme Court to be merely a broadening of *supervision* rather than a deepening of governmental *participation* in the industry's decision-making process. Agency decisions in this field have been treated with no special deference by the Supreme Court. The *regulatory* agencies, with their more pervasive role in the decision-making process of the industries that they regulate, have been treated with more deference, since a greater exemption from the antitrust laws is necessary for the accomplishment of the broader purposes of the regulatory acts under which they operate. In transportation industries, for example, rate-fixing is necessary. In banking, on the other hand, it is not. Again, the varying comprehensiveness of the statutes Congress has passed is responsible for this distinction.

The controversy as to which of these categories applies to the securities industry has been noted. The position taken here has been that the regulatory scheme of the 1934 Act is clearly supervisory in nature. This may be appropriate for the economic circumstances, or it may be a mistake. But it is the way the law is written. If the economics of the industry justify treating the industry as a natural monopoly, Congress must increase the degree of SEC entry into the decision-making process, extending its control to cover rates and entry and services on a level equal to that of other regulatory agencies. That is the only way additional antitrust exemption can be justified. For, as this analysis has shown, the only instances of antitrust exemption have been in cases where the antitrust function of protecting the public against collusion was provided for somewhere within the regulatory scheme. When one looks at the securities industry and its performance, it becomes apparent that this industry, protected by the mere acceptance of status quo, has been free from the rigors of competition. While the 1934 Act may be unique, there is nothing in the legislative history or post-1934 congressional attitude to suggest that this industry, so vital to our economy and so amenable in the past to abusing the public, should be the only one in the entire economy in which the antitrust function is not to be performed either by competition or by pervasive regulation. It would be the only industry in which traditional antitrust remedies would not be available for those injured.

There is no middle ground. The securities industry must either accept the responsibilities of competition or turn to Congress to request a pervasive regulatory scheme. Because of the economic questions involved and the policy implications surrounding such a decision, it is altogether appropriate that Congress, not the SEC, be the forum for the making of this decision. It may be true that future SEC rules will bring about better *results*, and new exchange rules—adopted by agreement—may reduce the injury caused by anticompetitive activity; but this will not by itself remove the potential for new types of unjustified anticompetitive practices. The power to make rules which have good results is also the power to make rules which have bad results. Because the real rule-making power has been retained by the exchanges, despite the presence of the SEC, it must be concluded that the ultimate safeguard against unjustified exchange practices is the threat of prosecution or civil liability for the violation of the antitrust laws.

Until a decision is made by Congress, the courts must continue to interpret the present law. A rule of reason analysis must be applied. The NYSE will be hard pressed to justify the three rules discussed here by simply relying on the limited objectives of the 1934 Act.